MARKETING OPPORTUNITIES AT THE INTERSECTION OF FORMAL AND INFORMAL ECONOMIES
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The informal economy is significant in dollar terms in all nations of the world, but particularly in developing countries. Here, informal economy is used in relation to legal activities generating income unregulated by societal institutions which are not officially included in national accounts for purposes of taxation or social security contributions. This article focuses on three formal Latin American economies, Brazil, Mexico and Costa Rica, and then offers suggestions to marketing managers on how they might make the bridge to the informal economy of those countries.

INTRODUCTION
What is equal to 1 trillion dollars in annual revenues in the U.S. (approximately 10 percent of the GDP) and employs over 12 percent of the workforce in Mexico? Surprising but true, the right answer to both questions is the informal economy. The informal economy is significant in dollar terms in all nations of the world. However, this is where the similarity ends. In the United States, as in many other industrialized nations, the main activities found in the informal economy are drug trafficking, pornography and illegal labor (Schlosser 2003). These activities would be part of the illicit economy, whereas the majority of activities taking place outside the formal economy in developing countries would be classified as the informal economy and would be made up mostly of small, family businesses, street merchants and service providers such as car washers, shoe shiners, cooks, maids, gardeners and security guards (Zidouni 2003). These entrepreneurs in the developing countries have generally not been able to find gainful employment in the formal economy; hence, they make their living selling legal products and services, which in no way can be considered illicit. Because they are not part of the formal economy, they pay no taxes, but neither do they have access to medical benefits, legal protection, subsidies, tax credits or retirement benefits. These individuals operating in the informal economy do have wealth, but it is not registered or transferable, so it cannot be used as collateral or to secure financing. Herman DeSoto in his book, The Mystery of Capital (2000), postulates that, in fact, the world’s poor in developing countries own the equivalent of the GDP of the United States!

If these consumers in the informal economy do have buying power, although it may be limited, how might foreign firms market to this untapped potential of the masses? This paper will focus primarily on three formal Latin American economies, Brazil, Mexico and Costa Rica and then offer suggestions to the marketing managers on how they might make the bridge to the informal economy of those countries.

THE INFORMAL ECONOMY AND ITS IMPORTANCE
Castells and Portes (1989 p.12) define the informal economy as “income generating unregulated by the institutions of society in a legal and social environment in which similar activities are regulated.” The concept of informal economy covers a residual category of economic activities, which, whether remunerated directly or indirectly, are not officially included in any national accounts for purposes of taxation, so-
cial security contributions, etc. (Kesteloot and Meert 1999). Portes (1994) stresses that the working process makes the difference, being licit in the formal economy and illicit in the informal economy. Some kinds of informal work may be illegal, but many simply fall outside state regulation. Illicit working processes are not backed by formal and enforceable rules, so informal production must depend on trust and the solidarity of social norms (Neel 2002).

In contrast, the formal economy can be defined as “all activities carried on in a regulated way whose output is socially recognized and therefore renumerated by the market (traded goods and services) or by the state (non-profit services)” (Kesteloot and Meert 1999 p. 233).

The informal economy exists both in industrialized countries, as well as in developing nations. It has emerged as a response to deficiencies in the formal economy or due to a lack of access by members of a society to necessary social institutions. For instance, in Hernando de Soto’s seminal work, *The Mystery of Capital* (2000), he points out that the poor in many emerging markets have assets, such as houses and land, but these resources are in “defective forms” since they do not come with recorded deeds. Without such legal representations, their assets are “dead capital” (DeSoto 2000) because they cannot be used to get loans to finance economic activity. The value of savings among the poor is, in fact, immense (forty-five times all the foreign aid received throughout the world since 1945), but it cannot be turned readily into capital like in the industrialized Western world (DeSoto, 2000).

The informal economy is socially efficient in that it makes a real contribution to reducing poverty and helping to improve the living standards of the poor. Informal incomes (both monetary and in kind) help the majority of citizens in developing countries to escape formal poverty (Neef 2000). For instance, between 2001 and 2002 in Mexico, at least 600,000 Mexicans joined the informal economy due to a painfully slow formal economy. In fact, in 2002, the informal economy in Mexico included 46 percent of the active workforce (News, 2002). The International Employment Organization has stated that the problem of unemployment and underemployment has become more pronounced in Latin America in the last decade. Recent studies have shown that Mexican college graduates have a higher unemployment rate than do those who have not finished basic schooling. This is because the majority of college graduates work in the formal economy, whereas those with less education tend to be more involved in the informal economy (“Mexican College Graduates” 2001). In Brazil, an extensive, informal economy is expanding and absorbing a growing number of people that the formal sector fails to employ. The informal sector not only includes street vendors and service providers, but also middle-class workers such as artisans and self-employed businessmen. Additionally, established businesses are also using the informal sector as a means of avoiding taxes and increased regulations. The proportion of workers with formal labor contracts has declined considerably in the last five years, even in more organized sectors such as manufacturing (“Employment Trends” 2002). Toloken (2003) points out that in the tough economic times experienced in the packaging and plastics industries in Brazil in the last year, 55 percent of the flexible packaging people operating in the informal economy are totally in the black, while few in the formal economy have been able to turn a profit. In Jamaica in 2002, 30 percent of the total GDP was generated from the “gray”, or informal, economy, which is an increase from 2001 (“Employment and Earnings” 2003).

Latin America is by no means the only area where the informal economy has taken on increasing importance. In South Africa in 2003, the informal economy absorbed approximately one-quarter of the total labor force of 15 million people and is the fastest growing sector of employment (Mayrhofer and Hendriks 2003). Also, there is a long tradition of informal activities in the former Soviet countries. The economies in most countries in Southeast Europe and across the whole of the former Soviet Union
have suffered a long-lasting transformational recession with significant declines in real GDP, real consumption and real wages, while the informal economy has grown (Neef 2002). In these “economies of shortage,” informal economic activities have been important for the social provision of households, as well as for the functioning of the formal economy. The persistent malfunctioning of the planned economy called for forms of barter or payment “off the books” within and between enterprises in these countries and the state accepted the so-called “second economy.” This informal economy helped to prop up the formal system, making up for shortfalls in consumer goods and allowing the more wealthy to have access to some luxury goods. In fact, a study done by Kim (2003) found that from 1969 to 1990 an average of 23 percent of all Soviet household expenditures took place in the informal economy.

This phenomenon of the informal economy exists even in developed countries, but to a lesser extent. Tienda and Raijman (2000) demonstrate that even the U.S. Census does not pick up all informal economic activities transpiring in the U.S. economy. Because the U.S. Census fails to ask the right questions, as well as the reluctance of some respondents to divulge their work activities, the extent of informal immigrant labor in the United States is decidedly underestimated. In the households sampled by Tienda and Raijman (2000), 14 percent were involved in legal work activities in the informal economy in the U.S., which effectively reduced earnings poverty by nine percentage points. Thus, the importance of the informal economy is universal, but how may firms tap into this important sector of economic activity?

FORMAL MARKETS IN LATIN AMERICA

In our global economy, more opportunities for expansion exist in developing countries than in industrialized nations whose markets are more mature and reaching saturation in many product categories. For U.S. firms, our Latin American neighbors offer many marketing opportunities to savvy firms. Increasing privatization, better technology and improved infrastructure, along with decreasing trade barriers due to the signing of new trade agreements, have made Latin American countries even more attractive as export markets and locations for foreign direct investment (FDI). Marketing opportunities in three Latin American countries will be explored in more detail: Brazil, the largest country in South America, Costa Rica, the most important economy in Central America, and Mexico, the second largest U.S. export market and a NAFTA partner.

Brazil

Brazil represents about one-half of the South American population, territory and economy. It is the eleventh largest economy in the world with a gross domestic product (GDP) of over $457 billion. For 2003, U.S. exports to Brazil reached $10 billion and Brazilian exports to the U.S. totaled $16 billion, making the U.S. its largest trading partner. With over 170 million people, it is one of the top three locations for U.S. foreign direct investment and offers a substantial market opportunity for U.S. exporters. (Brazil Country Commercial Guide 2004). Most of the industrial economic activity, as well as the population, is centered around the states of Rio de Janeiro, Sao Paulo and Minas Gerais, where automobiles, steel, computers, aircraft and petrochemicals are among the important products, as well as sugarcane, coffee, soybeans and orange juice in the agricultural sector.

In the last decade, Brazil has undertaken a number of economic reforms. In 1994, Brazil initiated an economic stabilization program known as the Real Plan, which was highly successful in reducing runaway inflation; it also initiated one of the world’s largest privatization programs. The government has remained dedicated to fiscal responsibility, setting limits on government spending during Cardoso’s second term and initiating an inflation targeting program. In 2003 the Lula government advanced a
program of economic reform based on major changes in Brazil’s tax and pension systems. However, the high sales tax rates currently, which often amount to over 30 percent of the total price of the good when both state and federal taxes are considered, are generating a demand by formal companies to be supplied through informal channels to keep their costs down. Thus, this is yet one more factor leading to the growth of the informal economy.

Some of the challenges encountered in Brazil are that inflation still hovers between 10 and 12 percent and interest rates between 20 and 25 percent, making financing very difficult for Brazilian businesses, especially for small firms. Internal migration from the poor northeastern states to Rio de Janeiro and Sao Paulo has led to rapid urbanization with the accompanying problems of crime, drug abuse, lack of adequate housing and environmental degradation. Economic difficulties in neighboring Argentina and the continued slow down in the world economy have led to a slow down in Brazil’s GDP, which grew just over 1.5 percent in 2003. In 2003 the GDP/capita in Brazil was $7,800 in purchasing power parity terms, a very respectable sum for a developing country, but this figure masks the plight of millions of poor because Brazil has one of the most unequal distributions of wealth in the world. The Brazilian business environment is complex with hidden costs of doing business, high tariffs, a difficult customs system and an overburdened legal system. Most products reach Brazil by sea and thus must go through Brazil’s inefficient and costly seaports, where offloading costs are high and ship turnaround time is long. Nevertheless, many companies have found that the opportunities outweigh the risks.

While only 3.6 million of Brazil’s total population could be classified as “rich” (Rosenwald 2001), it has a middle class of 35 million consumers, ready and able to buy many consumer products. It has an excellent postal service and Brazilians, on the average, only receive about 10 percent as much direct mail as U.S. citizens do, so direct marketing is a good way to approach such a large country. E-commerce is on the increase and provides many additional marketing and business opportunities. Brazil is the ninth largest Internet market in the world and the largest in Latin America with the most advanced Internet and e-commerce industries. Today, approximately 20 million Brazilians are on-line on a regular basis and many are significant users of Amazon.com. There has been a large increase in credit-card penetration and usage with 35 million credit cards in circulation (Brazil Country Commercial Guide 2004). Consequently, online advertising is expected to grow 109 percent annually (Rosenwald 2001). Additionally, electronic bank account transfers are becoming increasingly safe and efficient.

Sales in Brazil are mainly price-driven, but quality is also an important factor. Generally U.S. products are perceived as high quality, but domestic production has been dramatically upgraded and many European products can be found in the market, particularly since the European Union (EU) negotiated a free trade agreement in 2001 with Mercosur, the South American common market to which Brazil belongs. To be successful in Brazil, firms must take into consideration the local culture and technical requirements and adapt their products accordingly. For example, a firm using catalogues to market in Brazil must prepay the customs duty before delivering direct to the customer’s door (Rosenwald 2001), so this customs duty must be reflected in the advertised price, which is no small feat in light of continually changing customs duties. Additionally, foreign firms need to be cognizant of the difficulty Brazilian firms have in obtaining financing and the role that plays in business activity. One important new initiative offered by the U.S. Ex-Im Bank is co-financing. Using the flexibility created by these changes, the Ex-Im Bank has established principles for co-financing transactions with other exporting entities when exports from each of the respective countries are involved.

In Brazil, as in the rest of Latin America, the culture is high context (Hall 1976). This means that the main purpose of communication is in-
interaction, whereas in a low context culture, like the United States, information exchange is the purpose of communication. In today’s technological world, information can be easily transmitted via e-mail and FAX, but the personal element must be introduced to be successful in a high context culture. This means that a firm’s representatives must visit Brazil and develop relationships there before they can expect any business to transpire. They must continue to cultivate this relationship through telephone calls and repeat visits, not just through electronic communication. Business partners, suppliers and other types of strategic alliances are often selected based on personal relationships, and not just on price or quality. It has been said that the U.S. manager is concentrating on the chessboard while the Latin American manager is concentrating on his opponent more than the actual game. The Latin American manager is looking for a level of trustworthiness in his U.S. counterpart before opening up the full potential of the business relationship.

Most firms targeting Brazil as a market for their products/services typically select the rich and middle class as their target markets, because these are seen as the consumers who have both the desire and ability to buy global consumer products. For example, C&A of the Netherlands in 2004 targeted high-income shoppers in Brazil with a new upscale lingerie line and increased its marketing budget in Brazil by 50 percent. MasterCard has launched a virtual credit card in Brazil which is geared toward online purchases, which are typically made by the more educated and well-to-do consumers. Procter and Gamble has recently begun cleaning up public parks in Brazil in an effort to promote its Ariel brand of cleaners and detergents; this initiative is targeting the middle class consumers who use the parks for vacations. Nestle’s, the Swiss foods firm, also targets the middle and upper classes in Brazil with its premium chocolates and food products and in 2003 launched its newly acquired energy bar line, Power Bar, to the “Yuppies” there.

Few firms target the huge mass market of the poor. Many of Brazil’s poor cannot find employment in the formal economy, so they create their own jobs in the informal economy, such as street vendors, shoe shiners, etc. Most foreign firms believe that they would have to modify their products too much to sell to this mass market and that its buying power would still be too limited to justify the time and expense expended by the firm. One notable exception is a large Dutch multinational focusing on consumer goods, Unilever, which has targeted the mass market in many developing areas of the world, including Brazil. In order to serve the needs of this segment, they have done such things as create a laundry detergent in bar form for people who still wash their clothes in a stream or river. Additionally, Unilever has even delivered products to remote villages using bicycles and oxen. However, the mass market, although typically large in developing countries, has not attracted much attention from foreign firms.

Mexico

Mexico is one of only four countries in the world, Brazil, China and India are the others, denoted as a Big Emerging Market (BEM) so it is only natural that it would be included in this discussion of Latin American markets. The U.S. - Mexico bilateral relationship is of paramount importance to both countries. Besides sharing a 2,000-mile border, the two countries cooperate on trade, finance, narcotics, immigration, labor, the environment and cultural relations. The North American Free Trade Agreement (NAFTA), signed in 1994 which created a free trade zone for Mexico, Canada and the United States, has been a boost for all three economies. The U.S. share of Mexico’s trade increased with NAFTA, accounting for nearly 78 percent of Mexico’s total trade in 2002 and Mexico’s exports to the U.S. have grown likewise. Mexico is the second most important trading partner of the U.S., after Canada, and is expected to move into the number one spot by 2010 (Mexico Country Commercial Guide 2004).
Mexico’s economy faced a recession and slight negative real growth in 2001, but has shown positive growth in 2002 and 2003. One of the challenges faced by the Mexican economy is its high dependence on the U.S. economy. It is said that when the U.S. economy sneezes, Mexico coughs. In order to reduce its dependence on the U.S. market and reap the benefits of trade, Mexico is vigorously pursuing free trade agreements with other countries. It currently has free trade agreements in place with the European Union, Chile, Costa Rica, Uruguay, Bolivia, Columbia, Venezuela, Nicaragua and Israel, as well as other countries in Central America and Scandinavia. It is also a member of the Asia Pacific Economic Cooperation Group (APEC) and was President of this group in 2002, giving further testimony to its commitment to free trade.

The general political climate in Mexico is calm and elections have steadily become more free and fair with the PAN (National Action Party) winning the national election in 2000 after seventy-one years of rule by the PRI (Institutional Revolutionary Party). Vicente Fox was elected president from the PAN party in 2000 but has had difficulty enacting all his desired reforms due to a Congress controlled by the PRI. Nonetheless, the Fox administration has continued to liberalize trade, has furthered the privatization of government enterprise which was initiated by President Salinas, and has facilitated consumer credits for home loans. Corruption has also significantly diminished at all levels of government during President Fox’s term of office. Additionally, the government has successfully pursued a conservative fiscal policy.

Mexico represents a large market with a growing middle class. Its population according to the 2000 census was 97.5 million. Ten percent of the population is defined as wealthy and accounts for 38 percent of the national income; this group has a high level of education, lives in luxury homes, travels internationally and owns multiple vehicles. The upper middle class also represents 10 percent of the population and is composed of university-educated people who own their own homes and cars.

The lower middle class comprises about 40 percent of the population; these Mexicans live in smaller houses or apartments and spend most of their income on basic goods. The remaining 40 percent live in poverty; these individuals live in marginal urban areas or rural areas and are often unemployed or underemployed and often involved in the informal economy.

Mexico has a very young population with 33 percent under 15 years old and 62 percent between 15 and 64 years old. This offers a wealth of employees to firms wishing to locate in Mexico and many consumers with purchasing power. For example, 96 percent of all homes have electric power, 87 percent have radios and televisions, 33 percent of all Mexican families have at least one car but only 10 percent own a computer (Mexico Country Commercial Guide 2004). Mexican consumer demand is increasingly aggressive with retail sales growing 16 percent in 2003 over the previous years, buoyed by lower inflation and lower interest rates than in previous years.

Mexico is a marketer’s dream in that most of the population capable of buying many consumer products live in the cities and 75 percent of the population can be reached by targeting only four cities: Mexico City, Guadalajara, Monterrey and Veracruz. Moreover, there is a wide range of broadcast and print media available in Mexico to help a firm achieve its advertising objectives. There are eight television networks with national coverage and more than 636 local or regional TV stations with cable television readily available. Mexico has more than 420 newspapers, 1600 magazines and billboard advertising is common. Additionally, the Internet market is the fastest growing segment within Mexico’s telecommunications sector. Nonetheless, Internet penetration is limited by a low PC penetration rate (only 10 percent own computers, as previously mentioned) and a lack of fixed-line capacity within the country. However, ciber cafes have sprung up all over the cities offering Internet access in such locations as retail stores, pharmacies, coffee shops, bars, convention centers and airports. All signs are
that e-commerce and Internet usage will continue to grow. In 2002 the Mexican government created a trust fund to begin providing more points of Internet access to its citizens. In 2003, 12.2 million Internet users were reported in Mexico.

Similar to Brazil, most foreign firms target the middle and upper classes with their products. However, in Mexico the wealth is much more evenly distributed than in Brazil, with the middle class occupying a larger percentage of the total population. One firm which has done well targeting not only the upper classes but also the masses is Walmart de Mexico, or Walmex as it is known. It has been listed on the Mexican Stock Exchange since 1977 and has grown into one of Mexico’s largest retail chains, having 643 outlets in 64 cities. Its sales in 2003 were 120,280 million pesos, which was a 9 percent increase over the previous year. By offering a good variety of products at affordable prices and locating its stores in poor neighborhoods, as well as in the middle and upper class areas, Walmart de Mexico has reached record sales and profits and is Walmart’s most profitable foreign operation.

Not unlike the situation in Brazil, financing is one of the main stumbling blocks for both consumers and businesses in Mexico. The banking system in Mexico is generally weak and undercapitalized with high interest rates. Thus, only about 36 percent of Mexican companies utilize or have access to bank financing, and of course bank financing is non-existent for those operating in the informal economy. To reduce the cost of capital for a Mexican wholesaler or distributor, a U. S. vendor could offer six months to pay the bill. To cover the cost of this extended time period to pay, the U. S. vendor could simply increase the amount invoiced by 4-5 percent, this would save the Mexican distributor about 10-11 percent with an annual interest rate for borrowing in Mexico of 30 percent. Both parties win and the relationship is well on its way to being solidified.

Costa Rica

Costa Rica was given the name “Rich Coast” by the Spaniards and it is today the richest country in Central America. Its stable democracy and wonderful climate have given it a competitive advantage in attracting not only tourists but also foreign direct investment. Its signing of the Central American Free Trade Agreement (CAFTA) in 2004 with the U. S. will boost trade, help open restricted sectors of the economy and, in general, improve the investment climate for U. S. firms.

In 2003 Costa Rica’s GDP grew by 2.8 percent, but its state-dominated economy is struggling to maintain growth due to natural population increase and immigration, mostly from Nicaragua, followed by Colombia and Argentina. The growing fiscal deficit continues to be one of the country’s most serious macroeconomic problems, with the country’s sovereign credit rating downgraded in April, 2003. (Costa Rica Country Commercial Guide 2004). However, Costa Rica’s people are one of its most important resources. The Ticos, as they are called, are well-educated, with a literacy rate of over 96 percent, similar to that of most industrialized countries. Because Costa Rica eliminated its army, it has been able to devote considerable resources to educating its people. Its young, skilled workforce has enabled it to attract high technology firms, such as Intel, to locate within its borders. The GDP per capita was $8,300 in PPP in 2002, with an average life expectancy rate of 76.43 years, equivalent to most industrialized countries.

The Ticos love U. S. products and services and welcome U. S. citizens. The U. S. is the most important trading partner for Costa Rica and Costa Rica ranked as the 29th market for U. S. exports in 2003. Costa Rica’s exports overall grew 4.8 percent in 2003, perhaps due to the positive impact of its bilateral trade agreements with Mexico, Chile, Trinidad and Tobogo, and Canada. Exports showing growth were industrial products, fish and seafood, and products exported from Costa Rica’s numerous Free
Trade Zones. However, tourism, agricultural products and electronics are its most important exports overall. Costa Rica has many excellent seaports on both the Atlantic and Pacific Oceans, but its highways and railroads need major investment and renovation, which has been impeded by the government’s interference in privatization initiatives in these areas. For example, in May 2001, Alterra Partners, a consortium led by the U. S. firm Bechtel, assumed management of Costa Rica’s principal airport under a twenty year $120 million contract, but now airport improvements have been halted due to a legal dispute with the Costa Rican government.

As a market, Costa Rica is ideal. It is affectionately referred to as “Latin America Lite” because the abundance of U. S. products and services gives the country the feeling of being in the U. S. The retail distribution sector closely follows U. S. practices. Potential customers are easy to reach because seventy-five percent (2.5 million people) of the consumers live in the Greater San Jose area known as the Central Valley. The Ticos are accustomed to large shopping centers and malls that include retail stores, kiosks, food courts, theaters and supermarkets. Franchise outlets and hypermarkets are proliferating rapidly due to increased pressure and competition from large retail stores. Customers are brand conscious and view U. S. goods and services as being of high quality. Costa Ricans are very savvy shoppers and are generally aware of what items cost in the U. S. While they are willing to pay slightly more for the perceived quality of a U. S. product, budgetary constraints will not allow them to pay much more. Although price is definitely a consideration when a purchase is being considered, customer service is also of paramount importance to the Ticos.

Advertising is well developed in Costa Rica with radio, TV, print and billboard advertising readily available. Costa Rican newspapers are one of the best advertising venues to promote the sale of products and services. Costa Rica’s basic telecommunication services are acceptable, but its Internet services are poor relative to its neighbors, with only 12 percent of its population being regular Internet users in 2003. Hence, e-marketing is probably not the best advertising option for Costa Rica.

Costa Rica, like Brazil, Mexico and the rest of Latin America, is a high context culture where personal relationships are all important. These relationships must be cultivated and nourished for a firm to prosper, whether they are targeting the formal or informal market.

DISCUSSION AND MANAGERIAL IMPLICATIONS

Making the Bridge

During the last decade and a half, the number of firms from industrialized countries trying to engage in business activities in developing nations has increased dramatically due to saturated markets in the developed world and untapped potential in the developing markets. However, many firms’ efforts have produced less than stellar results because they have attempted to use the same products, ways of doing business and marketing techniques in the developing markets as they have used in their home markets. For example, until recently, most firms marketing consumer goods and services did not recognize the poor and those primarily active in the informal economy as potential customers. This is not surprising in that most marketing techniques commonly used were created in the developed countries where the middle class represents the largest segment of the population. When these marketing strategies are transferred to the developing world, they continue to focus on the middle and upper classes; however, in that environment, the poor and those involved in the informal economy constitute the majority of the population. When these marketing strategies are transferred to the developing world, they continue to focus on the middle and upper classes; however, in that environment, the poor and those involved in the informal economy constitute the majority of the population in those countries. Only a few firms have begun to realize that tapping into the mass market in developing countries can be an exciting and financially rewarding source of revenue. As previously mentioned, Unilever is one such firm. However, Nestle, a Swiss multinational
of consumer goods, also has targeted the masses, even in rural areas, with some of their basic foods such as infant formula and noodles. When Nestle’s went into China to produce infant formula for the mass market there, it was having difficulty getting enough milk. To overcome this problem, Nestle’s built roads in the rural areas and established points where the Chinese farmers could bring their milk and be paid cash. This not only provided the needed milk, but it also engendered strong feelings of customer loyalty to Nestle’s. Milk production in China actually increased dramatically, because Nestle’s paid more than the government had previously and also paid on the spot in cash. These rural roads in China constructed by Nestle’s are still known as the “milk roads.” Nonetheless, few firms have been willing to tailor their products to the needs and wants of the poor in the developing world, even though those who have made the necessary changes in product and marketing techniques have reaped significant financial rewards.

The previous example was of a firm successfully customizing its product to market to the poor in the formal economy. However, in relation to consumer goods, formal and informal markets have had ongoing relationships for many decades in Latin American countries, as well as in others. The most typical approach to bridging the two economies is to have the formal companies import, or acquire goods in the formal market, and then act as the wholesaler who supplies informal parties, such as street vendors, with goods who then act as the retailers. Although this is not the only supply chain for the informal sector, it is by far the most important one. An example of this was seen in 1991 in Lima, Peru by a sales representative for a U.S. based toy manufacturer. His customer, the formal distributor of the firm, had his place of business in the “Mercado Central” of Lima, which is an old neighborhood with large street markets where food and non-food items are sold to the general public. At first glance, the distributor’s place of business looked just like any regular store. However, in the back was a closed room, which was hidden from the general public, where a lively crowd of street vendors was picking up merchandise to sell on the streets of Lima. Thus, goods were being transferred from the formal economy to the informal one.

This example highlights the first principle which must be adhered to by those attempting to market to consumers in the informal economy. A firm should attempt to enter the informal market only in countries where the firm has a strong knowledge base and a significant presence in the formal market. The most important piece of building this bridge into the informal market is the distributor used in that country for the firm’s formal marketing activities. The firm must have a very positive relationship with this individual, because this distributor will become the firm’s liaison to connecting with the informal economy of that country. This person must be chosen wisely. It was mentioned that Latin American countries are high context cultures where relationships come before business dealings. Nowhere is this more true than in the informal economy because, due to its very nature, there are no formal laws or regulations; the informal economy is held together by a network of relationships. The firm’s distributor in the formal market must be an individual not only trusted by the firm, but also trusted by those in the informal market with ties to that network. The distributor must be savvy enough to understand that certain strategies will be used in the formal market, while possibly different methods of marketing and doing business will be needed for the informal market.

Although the distributor in the formal market is the firm’s first connection to the informal market, the firm needs to hire a sales manager who will be devoted entirely to developing the informal market for the firm. This person should know the language and culture of the country and ideally have ties with the informal market. The firm must take a long-term perspective and realize that developing the informal market, even in a country where the firm has a strong presence in the formal market, is just like entering a brand new market in another country.
If a firm wants to target the informal market, it must look for ways to approach and engage that group, making itself accessible to those potential customers. While a firm might use street merchants initially to enter the informal market, if its goal is serious market penetration, it must set up shops or outlets in the neighborhoods where the poor live, such as in the favelas in Brazil. Until very recently, any type of business conducted within the favelas was exclusively within the parameters of the informal market. Now, however, Casas Bahias and Extra, two of Brazil’s largest retailers, have opened their doors inside the favelas, bringing the concepts of doing business within the formal economy to the informal market. Casas Bahias started operating as a one-man enterprise offering its own credit with weekly payment booklets to the poor. As mentioned earlier in relation to the formal market, a lack of financing pervades the Latin American business environment; this is true in relation to firms and consumers alike. This is, of course, even more true in the informal market, where formal financing is nonexistent. This access to credit for the masses on the part of Casas Bahias has enabled it to prosper and grow into the largest retailer in Brazil.

Another way to penetrate the informal market is by setting up a network of door-to-door sales representatives. This strategy works particularly well in the rural areas. The sales representative who brings along actual goods and/or catalogues, visits potential customers in their homes. Once the customer decides on a purchase, the sales representative provides a weekly payment booklet, returning to deliver the goods ordered and pick up the weekly payment. This system is widely used in Latin America, but particularly in Central America. The interface here of the formal and informal markets is that the sales representative acquires his goods from a distributor in the formal economy, who acts as a liaison, and then sells his products in the informal market. Avon has used this network of sales representatives in rural areas of developing countries to successfully penetrate the informal market and reach the masses. Not only will its sales representatives travel to rural areas of China and Brazil by canoe, but they will also accept countertrade (goods) as payment rather than cash. For example, a customer pays for a lipstick with a live chicken which the sales representative then takes to the nearest village and sells in the local market. This example not only shows how the lack of financing in the informal market is of paramount importance, but also that a firm must be creative in its approaches to informal markets. Covey (1990) advocates a “win-win” approach, in which it is neither your way or my way, but rather a better way. In the informal market, managers clearly need to adopt this mindset to find alternatives which allow the customers’ needs to be met and the firm to prosper.

Product and Branding

Many times the price that can be charged in the informal market necessitates product changes so that the firm can hit that price point and still make a profit. However, even if the same products could be sold in the informal market as in the formal market, it is advisable to create modified products for the informal market, which can be differentiated from those for sale in the formal market. Most societies in Latin America are highly class conscious. If a firm would begin actively marketing its formal market products in the informal market, it could harm its image in the formal market. Because a firm’s global brand image is its most valuable possession (Green and Smith 2002), the firm should develop a new brand name for its modified product in the informal market. In this way, the firm will not cannibalize its own sales in the formal market, nor will it hurt its brand image by selling the same products at lower prices and in different types of outlets than are typically used in the formal market.

Knowledge and Transfer

Once a firm has implemented strategies to successfully penetrate the informal market in one
country, it needs to make sure that the marketing know-how gained by the sales manager hired and the distributor being used is transferred into the experience asset base of the firm. This sharing of knowledge of the informal market channels is a very crucial step, because what is learned in one local market can be applied in other developing countries. The transferring of this know-how to other marketing professionals within the corporation can possibly create a competitive advantage for the firm to be used in the global arena.

CONCLUSION

Without question, entering a foreign market can be extremely challenging for a firm, especially if you are among the first to blaze a trail. In relatively untapped markets, such as many major Latin American countries, the challenges and risks may be substantial, but the demand for products and services is high. If after entering and learning about the formal markets in these countries a firm is able to build relationships; these relationships can serve as the bridge into the informal markets. If a firm can achieve this tie into the informal market, the potential for sales and profits escalates exponentially.

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