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Magazine Luiza: Expanding Horizons
The role of e-commerce in the post-IPO growth strategy

Introduction

In May 2011, Magazine Luiza successfully raised R$926 million from its initial public offering on the São Paulo stock exchange. Not bad for a company that started out in 1957 as a small family business and has gone on to become one of the three biggest retailers of household goods and electronics in Brazil, with sales of R$5.7 billion[1] in 2010.

The Donato family initially set up a gift shop 400 km north of São Paulo and named it after the matriarch, Luiza. In 1991 the founders' niece, also named Luiza Helena, became CEO and began a new wave of development, setting up a division to professionalize the company and to organize the shareholder structure.

The management philosophy had always been the same: think big and expand. Brazil's turbulent economic environment had felled many players, but Magazine Luiza managed not only to survive but to thrive. Sales went up by more than 600% under the new Luiza's tenure, and at one point the company opened 44 new stores in São Paulo in one day.

The key behind such outstanding growth was a finely-tuned strategy based on caring for customers and employees. Employees provided outstanding, yet cost-effective service to underserved market segments. In particular, Magazine Luiza fostered deep ties with customers at the lower end of the income scale – the so-called "bottom of the pyramid." Magazine Luiza recognized that these customers were looking for more than low prices; they also needed "affection" and to be treated with respect.

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On this front, the store more than delivered. It staged live music concerts, put on special entertainment for children and gave away free food. This "human touch" attracted more repeat customers during business days as well as on weekends. Stores became focal points for the community, offering places to gather or even to take a night class. When a new store opened, whole communities celebrated: it heralded new jobs, greater opportunities and improvements to the neighborhood.

Magazine Luiza also demonstrated its human touch by extending credit and by offering a range of financial services to consumers who usually would not qualify for them elsewhere. The close proximity with customers allowed them to approve credit lines and to collect bills; this was further facilitated by the ability of local employees to judge the credit worthiness of each applicant. Financial services became an inherent part of the business model: in the first quarter of 2011, they accounted for more than a third of Magazine Luiza's profits.

Humanistic values, training and promotion opportunities for all were an integral part of the Magazine Luiza's work culture and led to multiple awards for "Best Workplaces." If employees were to have intimate knowledge of their customers, then they needed to be hired from the local community where the store was based. As proof of the vested interest that employees had in seeing the company succeed, at the time of the IPO Magazine Luiza employees purchased 25% of all outstanding shares – a remarkably high number when compared with the usual 10%.

Magazine Luiza's phenomenal growth mirrored that of Brazil itself. Its high-growth economy was fast catching up to and surpassing some of the world's most developed nations.

Over 60% of Internet users in Brazil (belonging disproportionately to the higher income classes) enjoyed the convenience of e-commerce, citing the benefits of price, ease of purchase, speed and security, in that order. In addition, online chat facilities had improved the level of interaction between businesses and clients, giving customers the same confidence to purchase as they felt associated with traditional stores. However, two factors limited e-commerce growth: access to broadband (particularly in the lower income classes, though this was changing at the time) and consumer credit.

Among Magazine Luiza's managers there was a clear consensus that e-commerce should form part of the company's strategy; the question was to what extent. In the year 2000, Magazine Luiza started selling through its website, learning about the process through trial and error. For example, it became apparent that sales of smaller products like electronics were better served through the online channel, whereas that wasn't the case for kitchen appliances. Magazine Luiza was soon offering around 8,000 products through its website versus the 5,000 typically found in a traditional store. By 2011, the website represented its fastest-growing sales channel – more than doubling the growth rate of its conventional stores.

The rise of e-commerce coincided with a consolidation trend resulting from a highly competitive environment. In 2010, Magazine Luiza acquired Lojas Maia, adding 150 new sales points in the north of the country. Yet, geographic expansion alone was not sufficient. Many felt it was time to make e-commerce the cornerstone of the future growth strategy, but would doing so move the company away from what made the business successful in the first place?

Retail in Brazil

In the 1950's, lack of competition in the retail sector motivated companies to focus only on products and sales at store level. As the industry matured and competition became fierce, companies started paying more attention to the end consumer. In the 1990's, this transition to a consumer-centric approach incentivized companies to invest in the creation of virtual stores and fidelity programs.

Valéria Rodrigues, Director of Retailing at Ipsos, a leading research provider, explained this transition: "The situation today is different. Before, [companies] created a product and sold it. Now the retailer analyzes consumer behavior before developing a product."[2]

Market projections looked promising. The Brazilian Central Bank estimated GDP growth of 4% for 2011.[3] The overall retailing industry was estimated at R$478 billion and included over 1 million companies in 2008 (see **Exhibit 1**).[4] Furniture and electrical appliances sales in March 2011 had grown over 17% compared to the previous 12 months (see **Exhibit 2**).[5]

The Brazilian population was estimated at 203,429,773 in 2011.[6] With 37% of the population having Internet access, there were a total of 75,982,000 Internet users in 2011, compared with 5,000,000 in 2000. This represented a 1420% growth and meant Brazil was ranked 5th worldwide for number of users.[7] Plus, there was room for still more growth, differentiating Brazil from developed nations like the US or Japan which already had a higher percentage of Internet usage – 77% and 78% respectively.

The market for e-commerce was estimated at R$15 billion in 2010, having grown 40% over the previous year. It was projected that 23 million people used the Internet to make purchases on-line. Grupo Pão de Açúcar, Carrefour and Walmart led the e-commerce sector in Brazil in 2010 with sales of R$36 billion, R$29 billion, and R$22 billion respectively.[8]

Studies had shown that 61% of Internet users in Brazil considered e-commerce very convenient to make purchases on line without leaving home. The same study showed that consumers had identified the following characteristics as the main points differentiating e-commerce sites: price (51%), ease of purchase (44%), speed (34%), and security (28%).[9]

Many major companies had a multichannel strategy that included e-commerce. Online chats were added to websites as an option to improve interaction with clients in order to give them the same confidence for their purchases as they would have had at traditional stores.

According to Flávio Dias, e-Commerce Director at Walmart Brazil, "the future of e-commerce lies in the integration of different channels." Walmart had started a new integration model in the US where purchases on line could be picked up at the store on the same day of purchase. By doing so, the company could avoid one of the limitations of e-commerce: delivery lead-time.[10]

Two factors limited e-commerce growth: access to broadband Internet and consumer credit. To overcome the latter, companies started partnering with financial institutions in order to provide lines of credit to their customers. Many of these customers did not have access to credit at traditional financial institutions.