Retail Network Workshop

July 12, 2011

Auric Consulting is a strategy and business management firm located in Monterrey, Mexico. Our mission is to provide our clients with the mechanisms to generate and maintain a competitive advantage and create sustainable value.

We focus on the **development and implementation** of strategic, operative, commercial and administrative solutions to help our clients take advantage of opportunities and overcome challenges.

Auric has been working with **OXXO** during the last four years in the definition and deployment of their financial services strategy. During this period a series of Strategic, tactical and operative issues has been addressed.

Strategic
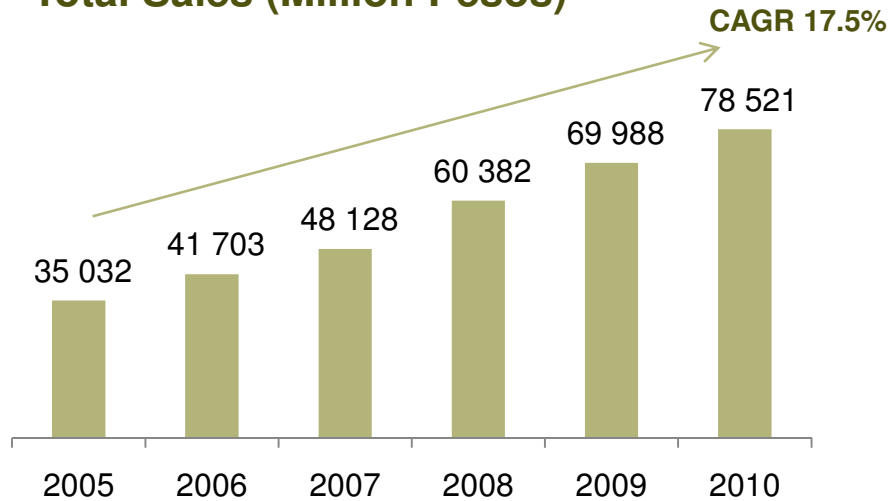- Service portfolio definition
- Strategic partner assessment

Operational
- Process streamlining
- Till saturation analysis

Tactical
- Organization Design
- Technology selection

AURIC
CONSULTING

Who is **OXXO**

Total Sales (Million Pesos)

CAGR 17.5%

- 2005: 35 032
- 2006: 41 703
- 2007: 48 128
- 2008: 60 382
- 2009: 69 988
- 2010: 78 521

Total OXXO stores

CAGR 15.2%

- 2005: 4 141
- 2006: 4 847
- 2007: 5 563
- 2008: 6 374
- 2009: 7 329
- 2010: 8 409
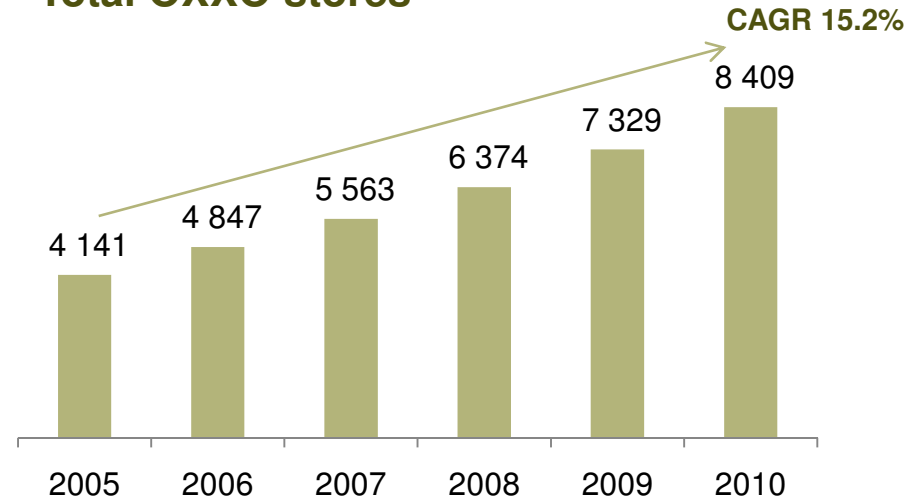
North America C Store chains

- OXXO: 8,410
- 7 ELEVEN: 8,187
- Couche-Tard: 5,878
- bp: 4,727
- Shell: 4,636
- EXXON: 4,060
- Chevron: 4,015
- Speedway: 2,759
- CITGO: 1,820
- SUNOCO: 1,811

■ Operadas por la compañía   ■ Franquicia/Licencia
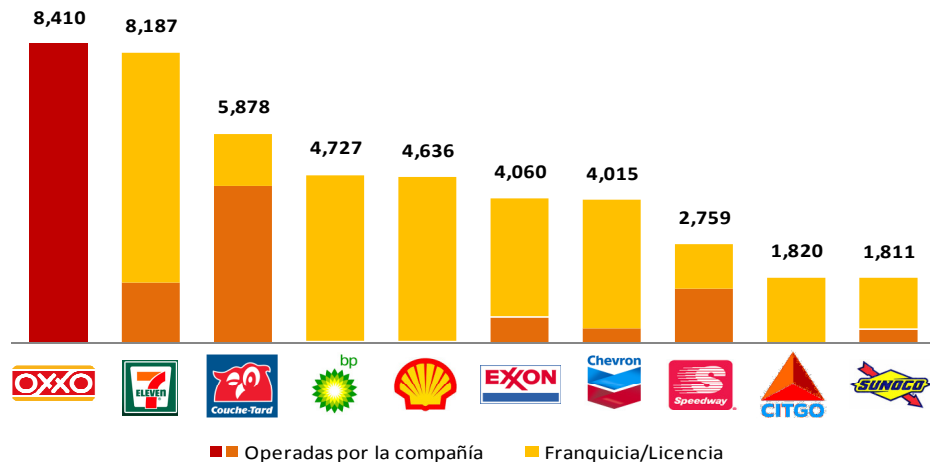
- Largest convenience store chain in North America with over 9,000 stores
- 6.5 million customers on a daily basis
- Over 73,0000 employees
- ~1,000 store openings per year
- Over 95% of open stores remain open

2

AURIC CONSULTING

Content

AURIC
CONSULTING

Multiple retailers in Mexico getting involved in the Financial Services space for underserved /nonbanked customers with different product offerings:

	Bank Agency	Simplified Account	Credit Card	National Transfers	International Remittances	Bill Payment	Prepaid P Transport
Convenience Stores (OXXO, 7-Eleven)	Higher	Higher				Higher	Higher
Super-markets (Soriana, Walmart)	Higher	Lower	Higher			Higher	
Pharmacies (Farmacias Benavides, Super Farmacia Guadalajara)	Higher			Lower	Lower	Higher	Higher
Specialty Stores (Elektra, Coppel)	Higher		Higher	Higher	Higher	Lower	
Department Stores (Sanborns, Liverpool)	Lower		Higher				Lower

FOCUS

- Higher
- Lower

AURIC CONSULTING

Case study: OXXO

OXXO

First mover in Bill Payment

–**Great value proposition to service provider**
- Largest store network
- Dedicated admin staff
- Robust settlement procedures

Great initial value proposition to consumer
- Easy
- Fast
- Close
- Reliable
- 24-7 service

Both value propositions in constant improvement and evolution
- Pay on due date
- Partial payments
- Non bar coded bills…

Undisputed market leader some service providers have built their entire collection function around OXXO's service

Decided to act as agent for multiple bank, customers of the largest bank will multiply +4x available service points, rest even more

OXXO understood that features of the channel are instrumental to the value proposition of its service offering

Services category is one of the strategic growth engines for the company

Simplified account + loyalty program to better understand their own customers

AURIC
CONSULTING

Case study: Elektra

Elektra

Core business (appliance and white line retailer), highly focused in targeting low income customers

Developed sophisticated credit screening skills specific to its customer base

—Successful Private Label Credit Card

Entered a Domestic Remittances market poorly served only by the national post service

Better value proposition to customer vs alternative

—Large store network

—Extended service schedule

—Reliable faster service

Market leader with over 50% share of Domestic Remittances

Huge national TV communication and brand building effort

—Elektra is owned by the second largest TV broadcaster in Mexico

With a well established reputation as credit provider and Domestic and International Remittances operator launched BANCO AZTECA **a bank targeting its customer base**

Elektra has expanded its retail, remittances and banking operations to:

—Brazil   —Guatemala

—Argentina   —El Salvador

—Peru   —Honduras

—Panama

6

AURIC
CONSULTING

There is a strong business rationale for retailers to provide Financial Services through their networks of stores:

Direct Revenue	Indirect Revenue	Well positioned to enhance value proposition

Direct Revenue
- Fees, transaction and float income
- Gateway to credit sales (interest income)

Indirect Revenue
- Increased foot traffic in stores
- Provides additional value to existing customers
- Enhances knowledge of customers (through loyalty schemes)
- Enhances brand
- Reach new (growing) customer segments
- Diversify sources of revenue

Well positioned to enhance value proposition
- Large footprint of store locations
- Processes in place to manage liquidity
- FS takes limited square footage of floor space
- No inventory

AURIC CONSULTING

Revenue across multiple products can be significant…

Direct Revenue | **Indirect Revenue** | **Well position to enhance value proposition**
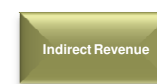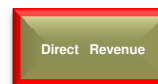
Product	Rationale / comments
Bill Payment	We estimate that the retail sector in Mexico collects the bills from 10% to 20% of all households with an average of 3 bills per household total should be around **7 to 14 million bills per month**
Bank Agent	We estimate around 90 million transaction per month subject to be handled by Bank Agents with a share similar to that of bill payment that should represent around **9 to 18 million transaction per month**
National Money Transfers	Elektra's annual income is estimated around **US133 million** for this concept, around **20% of its total margin**
Simplified Account	There are around **30 million adults** with no access to formal financial services in Mexico
Prepaid Public Transport	It may represent up to **1% and 1.5% of total margin** for C stores and pharmacies in large urban areas where implemented
Credit Card	For some retailers revenues from the credit business are at par vs revenue from sales of goods
International Remittances	Elektra pays around 75% of all Western Union USA-Mexico remittances, we estimate that to be around **17 to 14 million transactions** per year

AURIC CONSULTING

Revenue potential is a function of per transaction margin and the market share that can be achieved…

| Direct Revenue | Indirect Revenue | Well position to enhance value proposition |

Example: Domestic land line telephone service in Mexico

Per Transaction Margin

• **What are the costs of delivering the service?** ~US 10¢
Labor
Cash management
Compliance
Communication
…

• **How much can you charge the service provider and/or consumer?** ~US 80¢
Their current costs and the cost of other options
Attributes of my service delivery
—Relative size of my network
—Service schedule (extended hours)
—Pay in due date
—Reliability
—Issue resolution

…Value of each transaction: ~US 70¢

Market share:

• **What is the total market size?** ~14.3 million
~ 23 million house holds
~ 65% penetration land lines in house holds

• **What is the portion of the market that's with in the reach of my network?** ~8.6 million
~ 60%

• **What if analysis…** ~1.0 million / yr
Every 1% of share of the market within my network reach represents…

Similar rational for electricity and water ~3.0 million / yr

A share between 1% and 3% of the market within my reach …. ~US$2.1 -6.3 million / yr

9

AURIC CONSULTING

Financial Services has been an instrumental initiative to diversify the sources of revenue for some retailers in Mexico

Direct Revenue | Indirect Revenue | Well position to enhance value proposition

Grupo Elektra Total Revenue
Billion US Dollars, 2009

Pie chart:
- Financial Services: 1.4
- Sales: 1.4
- Other: 0.6
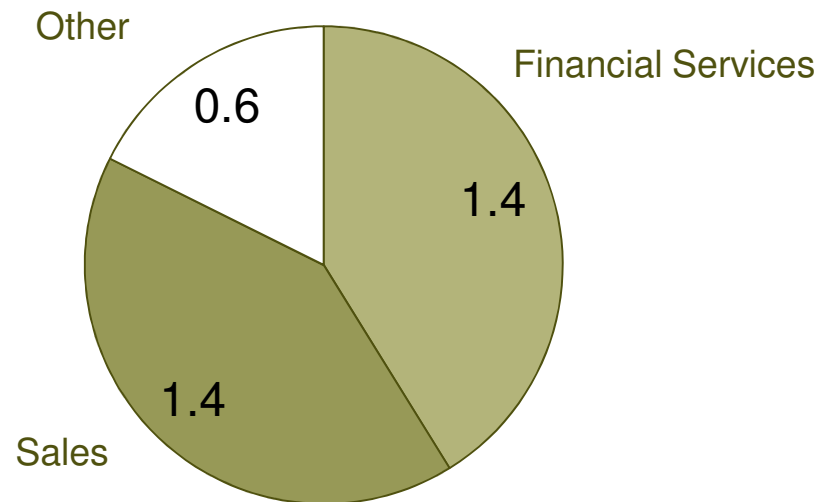
- Domestic Remittances represented ~US$133 million, 4% of financial services revenue

- We estimate that to be ~20% of Grupo Elektra's total margin

10

Source: Grupo Elektra Annual Report 2009

AURIC
CONSULTING

Some services may significantly increase the foot traffic at stores and generate additional sales…

Direct Revenue | **Indirect Revenue** | Well position to enhance value proposition

Prepaid transport reload frequency
Major city in Mexico, June 2009

42%

93% 96% 100%

22% 68% 70% 23%

26%

4% 3% 3% 4%

Everyday | 2nd day | 3rd day | 4th day | Weekly | 10th day | Fortnightly
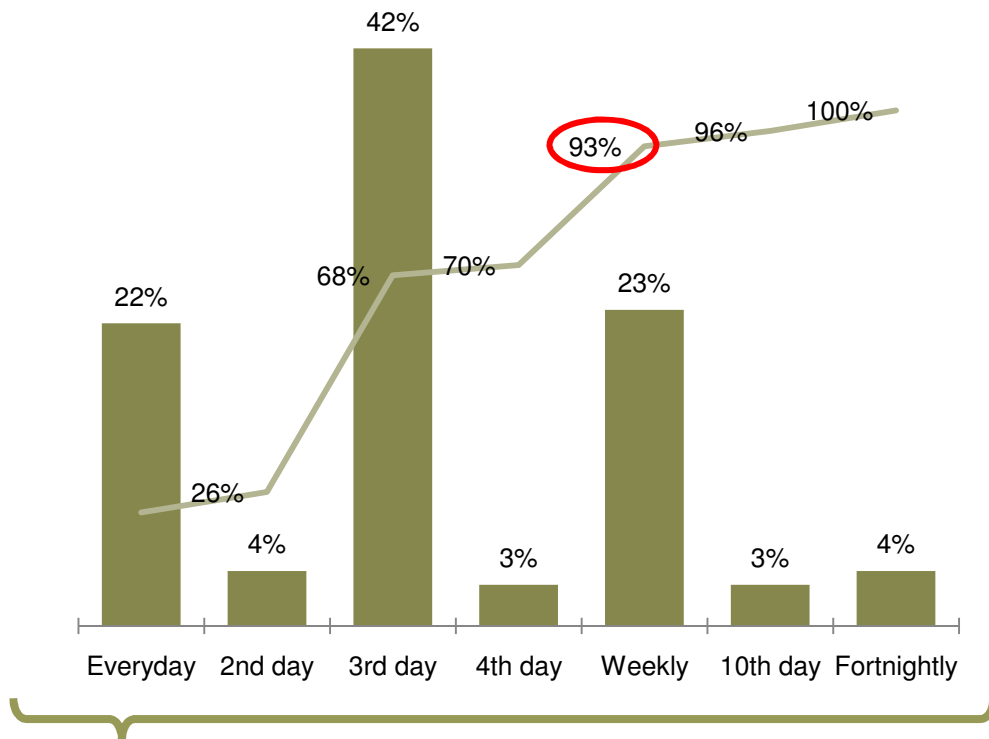
Over 90% of users visit a store to top-up once or more a week

% of reloads with purchase of another product Major city in Mexico, June 2009

17% of reload customers purchased something else at the store

Source: Auric, with 5,000 reload ticket sample and 2.5 travels per day   **Source: Auric, 350 observation at store**

AURIC CONSULTING
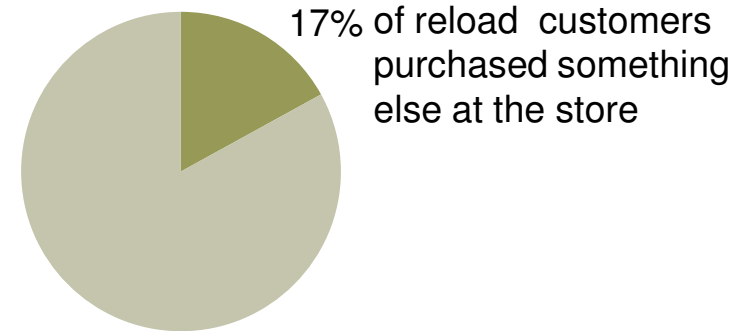
…others may not provide a strong economic boost, but have strategic value

Direct Revenue	**Indirect Revenue**	Well position to enhance value proposition

OXXO Simplified Account

- **Visa / MC branded, bank issued**

- **Vital to achieve a critical mass of users**

- **Once a critical mass is achieve, other financial products may be targeted to the customer base to generate revenue**

- **There is strategic value in better understanding customer behavior inside and outside the store**

AURIC
CONSULTING

Retailers networks are typically larger than banks branch networks…

National formal retail chain
Number of outlets, different segments 2010

Total Number of formal outlets: ~16,900

~1.7 X Total current bank branches

Four largest Banks

	Branches
BBVA Bancomer	~1,800
Banamex citi	~1,500
HSBC	~1,190
BANORTE	~1,140

Convenience Store — 10,518
- 990 — 7- Eleven
- 1 228 — Other
- 8 300 — Oxxo

Informal Mom & Pops — 930,000

Specialized Store — 2,471
- 440 — Other
- 931 — Elektra
- 1 100 — Coppell

Supermarket — 1,726
- 378 — Soriana
- 530 — Other
- 818 — Walt-Mart

Pharmacies — 1,720
- 260 — Other
- 710 — Benavides
- 750 — Guadalajara

Department Store — 421

13

AURIC CONSULTING
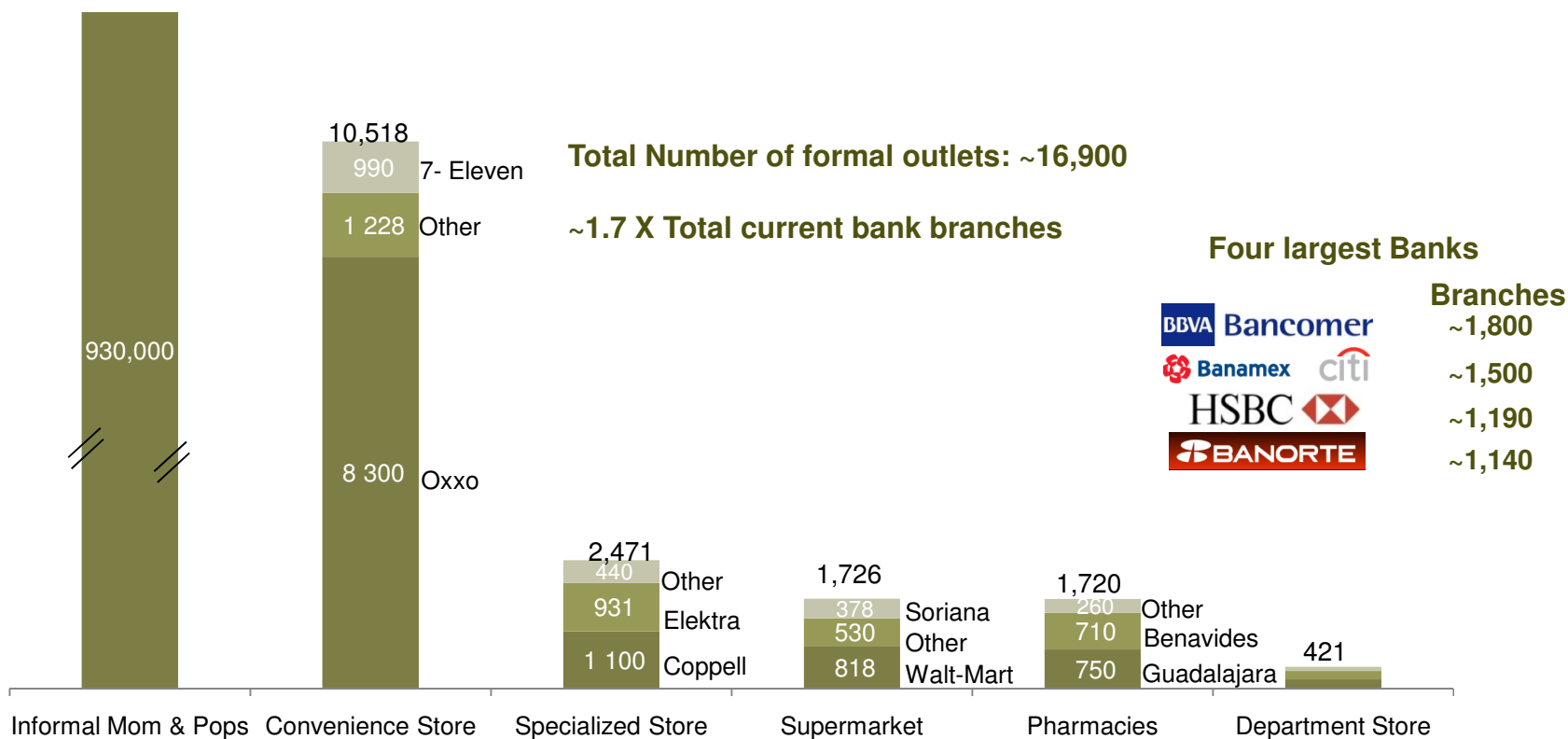
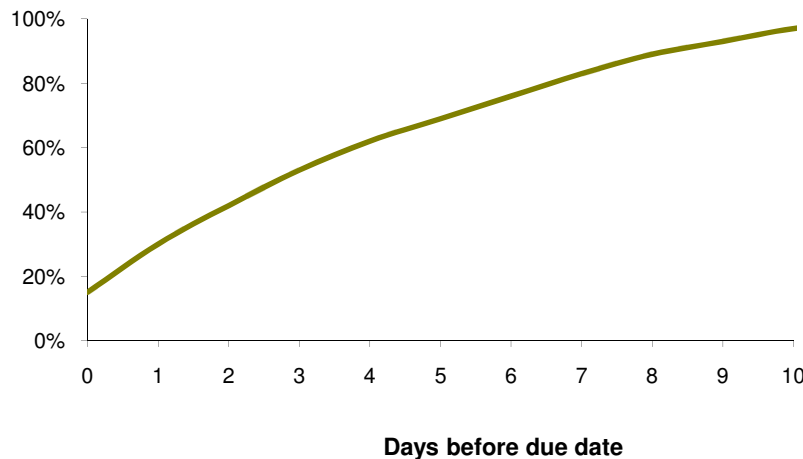# A large proportion of the customers pay close to the due date and are willing to pay a premium at convenience stores

Direct Revenue | Indirect Revenue | **Well position to enhance value proposition**

CFE bills collected in a C store
Major city in Mexico May 2007

Days before due date

Amount of CFE bills collected in a C store
Major city in Mexico May 2007

Minimum Consumption Fee ~14% of Bill

Medium consumption Fee ~ 3.5%

Amount payed (Pesos)
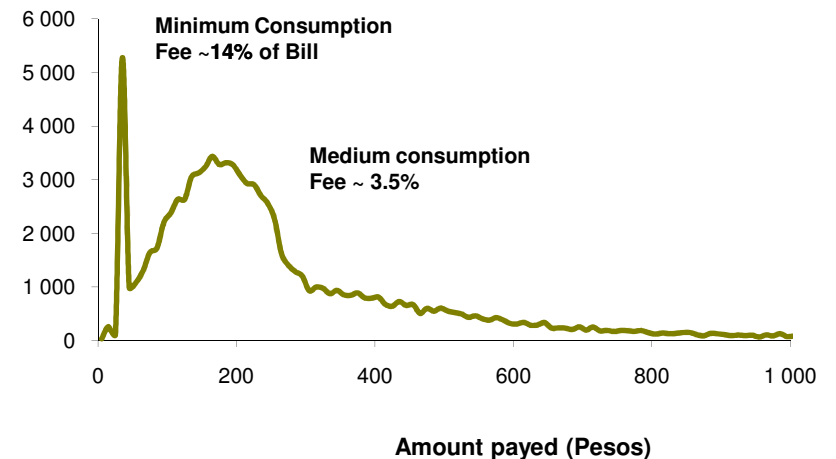
Total transactional cost in a Convenience store

<
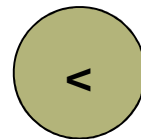
Total transactional cost in a Supermarket

+ Fee ($7)

=$7 pesos

+ Transport $_{Supermarket}$
+ Time $_{Supermarket}$

~$16

Assumptions:
- 2 public transport tickets >> $8 each
- 1 km in a 4 cylinder car ~90₵ Fuel

AURIC CONSULTING

14

Content

1. **Business Rationale for retailers to provide Financial Services**

2. **The Mexican experience**

3. **Relevance to South Africa**

4. **Lessons learnt**

5. **Issues to consider**

AURIC
CONSULTING

On the demand side there is a very similar picture in terms of financial inclusion between Mexico and South Africa

Mexico

Bracket	Households (Millions)	Monthly income (USD)	Bank account penetration (2008)
A	0.2	72,140	100%
B	0.5	37,660	100%
C+	0.9	8,160	100%
Cm	1.6	2,880	70%
C-	2.2	1,695	53%
D+	3	1,195	43%
Dm	3.5	817	35%
D-	4.9	482	25%
E	6.5	250	12%

64% Total Banked

South Africa

Financial access strand (% Adult population)

	2008	2009	2010
	24%	26%	23.5%
	11%	10%	9%
	3%	4%	5%
Banked	63%	60%	62.5%

60-63% Total Banked
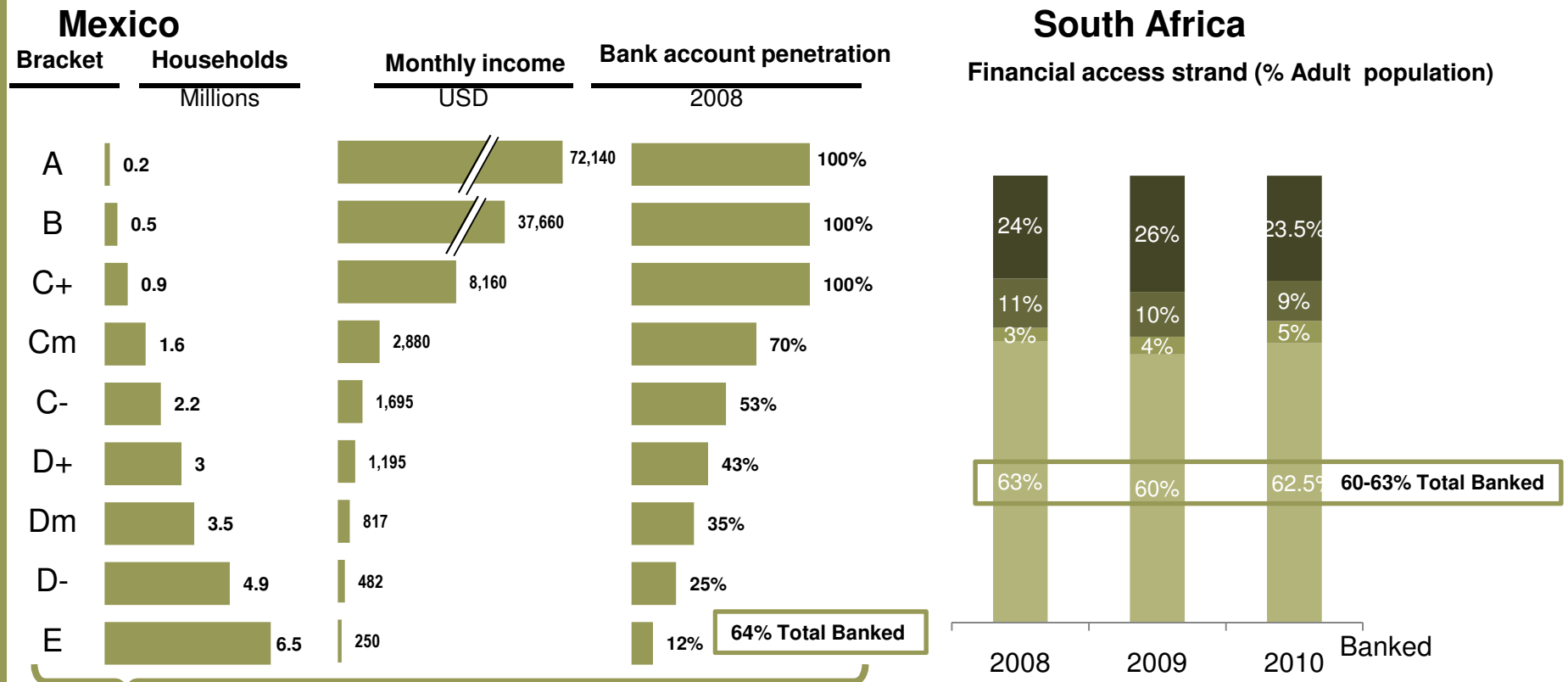
Rapid growth of lower income brackets fueled mainly by the migration of cash and check payrolls to debit cards

Evidence suggests that a significant number of these payroll accounts are only used to withdraw funds at ATM, there are challenges to *activate* these accounts

The next wave of penetration will require a product able to engage the self employed and workers of the informal economy (they're not in a payroll)
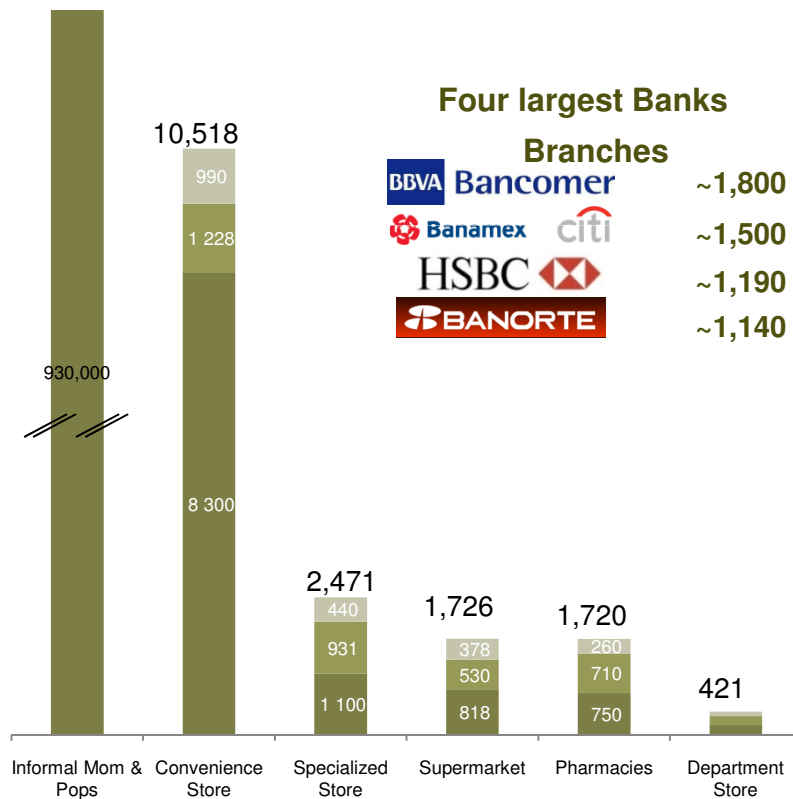
A transactional product seem the to be the way forward, a traditional saving product is unlikely to work given expected balances

Source: Auric with information from INEGI

AURIC CONSULTING

16

And on the supply side formal retail chains outnumber bank branches in both markets
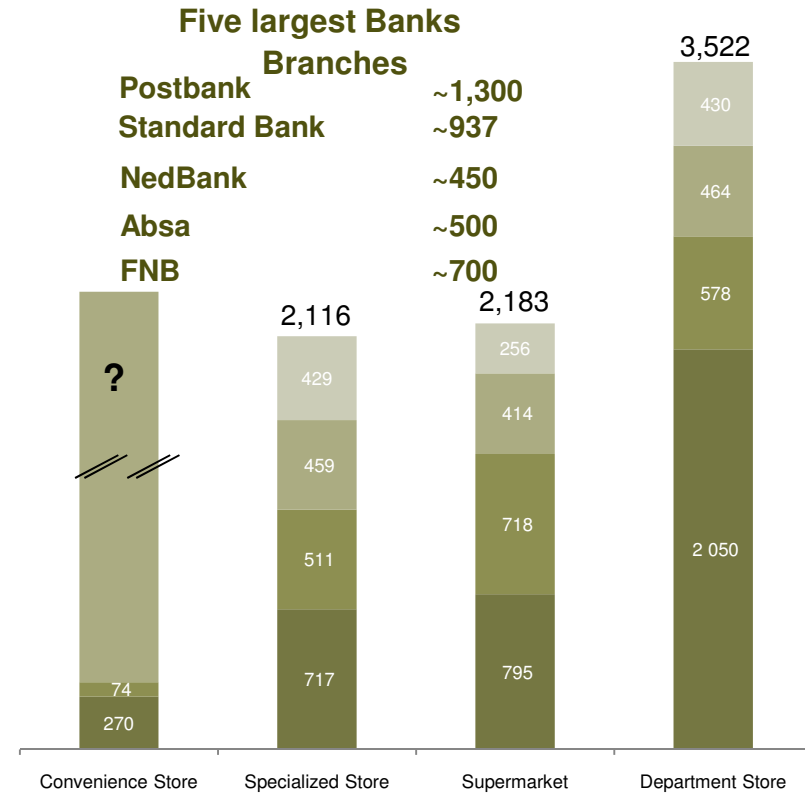
Mexico

Total Number of formal outlets: ~16,900

~1.7 X Total current bank branches

Four largest Banks	Branches
BBVA Bancomer	~1,800
Banamex / citi	~1,500
HSBC	~1,190
BANORTE	~1,140

Chart values (Mexico):
- Informal Mom & Pops: 930,000
- Convenience Store: 10,518 (990, 1 228, 8 300)
- Specialized Store: 2,471 (440, 931, 1 100)
- Supermarket: 1,726 (378, 530, 818)
- Pharmacies: 1,720 (260, 710, 750)
- Department Store: 421

South Africa

Total Number of formal outlets: ~8,200

?? X Total current bank branches

Five largest Banks	Branches
Postbank	~1,300
Standard Bank	~937
NedBank	~450
Absa	~500
FNB	~700

Chart values (South Africa):
- Convenience Store: ? (74, 270)
- Specialized Store: 2,116 (429, 459, 511, 717)
- Supermarket: 2,183 (256, 414, 718, 795)
- Department Store: 3,522 (430, 464, 578, 2 050)

AURIC CONSULTING

Estimate of direct and indirect benefits from provision of financial services in South Africa

Product	Rationale / comments
Bill Payment	9 Million households in South Africa , assuming a penetration of 50% of regular public services and 2 to 3 bills paid monthly by house hold , 9 to 13.5 million bills a month. Assuming retail captures 10% of the share, 0.9 to 1.3 million bills a month
Bank Agent	Similar bank account penetration and half the population, South Africa's bank transaction susceptible of being operated by agents should be around 45 million transactions a month, assuming retail capture 10% of the share, 4.5 million transactions a month
National Money Transfers	Services offered by SPAR and Shoprite show that there is a market for this service
Simplified Account	According to FinScope South Africa 2010 , 12 million adults do not have a formal bank product. Assuming 10% may be served by a simplified account. 1.2 Million accounts
Credit Card	
International Remittances	Fast growing immigrant community (how many economically active?)
Prepaid Public Transport	

AURIC
CONSULTING

Content

1. **Business Rationale for retailers to provide Financial Services**

2. **The Mexican experience**

3. **Relevance to South Africa**

4. **Lessons learnt**

5. **Issues to consider**

AURIC CONSULTING

Summary of lessons learned

1. Providing Financial Services through retail stores changes liquidity patterns
   → Need to rethink internal cash controls

2. Need to tailor processes to fit existing operating model
   → cannot simply take existing processes from banks

3. Should aim towards retaining customer ownership
   → Same product may have a range of customer ownership opportunities according with the value you provide to the business

4. Negotiating leverage will be determined by your value added to the service delivery

5. Tellers need to be incentivized to undertake transactions
   → either through revenue shares or targets

6. Consider the entire product roll out

7. Different products have different strategic and economic advantages
   → Short term revenue generator or long term investment

AURIC
CONSULTING

Different products have different strategic and economic benefits

Product	Strategic	Economic	Rationale / comments
Bank Agent			Increased traffic Increase in "brand trust" Retailers dominate overwhelmingly in enabled outlets
Simplified Account			Understand consumer behavior (even outside my store) It can be used to improve core business value proposition Some retailers testing the market, banks alone have not been successful
Credit Card			Increased sales through financing Additional revenue form credit business Target to offer him/her other financial products Relative to banks share is modest, much better in lower brackets
Bill Payment			Increased traffic Increase in "brand trust" In some cities bills collected at retail outlets combined reach over 25%
National Money Transfers			Increased traffic Target to offer him/her other financial products Market leader with over 50% share is a retailer, runner up is the national post, the rest are also retailers
International Remittances			Increased traffic Target to offer him/her other financial products Business dominated by the collecting party outside Mexico, however largest nonbank player is a retailer
Prepaid Public Transport			Increased traffic Increase in "brand trust" Largely dominated by retailers specially convenience stores and pharmacies

AURIC CONSULTING

Content

1. **Business Rationale for retailers to provide Financial Services**

2. **The Mexican experience**

3. **Relevance to South Africa**

4. **Lessons learnt**

5. **Issues to consider**

22

AURIC
CONSULTING

Topics for Discussion

1. Should I offer services on behalf of one bank or multiple banks?

2. Is my distribution network strong enough to go it alone or do I need to partner with other retailers?

3. What is the right product mix to offer?

4. How can I maintain ownership of the customer?

AURIC
CONSULTING

Roadmap to articulate a financial services strategy aligned with your business

Agree on vision and strategic objectives	Define and prioritize products to develop	Establish business adminsitration model

Define
- **Goals**
- **An owner of the program**

Understand
- **Resources**
- **Challenges**

- **List of possible products, for each:**
  - Estimate economic potential
  - Estimate strategic potential
  - Understand value proposition and players
  - Understand competitive position
- **Define best scheme to develop each product**
  - Own
  - Partnership
- **Estimate gaps between required and current resoruces / abilities**

- **Long and medium term objectives**
- **Projects and assistance required by different business platforms**
- **Mechanism to update tactic plan**
  - New opportunities
  - New technology
  - New regulation
  - New players

AURIC
CONSULTING