

Island of OPPORTUNITY

WHAT **RETAILERS NEED TO KNOW** ABOUT **CUBA**. > *By Gina Acosta*



The normalization of diplomatic relations with Cuba in December 2014 and the death of long-time dictator Fidel Castro last November were huge developments for the isolated nation. The allure of a market with 11 million residents – three times the size of Puerto Rico – has businesses eager to tap an essentially greenfield opportunity tantalizingly close to the United States. However, all is not as it seems when it comes to the Cuban opportunity, as *Retail Leader* Managing Editor Gina Acosta discovered. The Miami native recently spent a week in Cuba with her mother, a Cuban native, who was returning for the first time to the country she fled in 1959 at the age of 8.

The phrase, “Asi es aqui,” is heard often in Cuba and it doesn’t take long before visitors arriving at Havana’s Jose Marti International Airport learn its meaning.

Terminal 2 at the airport is dirty, dimly lit and there is nowhere to buy food or drinks. It takes three hours for luggage to clear customs and more than an hour to hail a vehicle that passes for a taxi. A dilapidated hotel room can cost \$500 a night, basic items such as toothpaste and shampoo are impossible to find, and locals wait in line more than an hour for melted ice cream. Using a cellphone or credit cards and accessing the Internet are extremely difficult. The tourism industry tends to glamorize Cuba’s lack of modern conveniences and decaying infrastructure the way a real estate agent describes a small old house as “quaint”

► **The Cuban opportunity looks appealing long term, but early entrants to the market face numerous challenges.**

or “charming.” But make no mistake, visitors accustomed to the modernity of life in the United States and other countries are met with frustration at every turn in Cuba.

Why? Cubans simply shrug and offer, “Asi es aqui,” as an explanation for all manner of inconveniences. It is a response learned during nearly six decades of communist oppression and the phrase loosely translates to, “That’s how it is here.” It is a safe response, a defense mechanism really, to offer when a truthful explanation would touch on the many failings of the still-feared Castro regime.

A NEW ERA?

While there have been some encouraging recent developments, all signs point to a long and rocky road ahead to a free market economy in Cuba and truly normal relations with the United States. This much becomes evident after spending a week criss-crossing the island, staying in people’s homes and resorts, all the while struggling to find gas, food and water in a country devoid of U.S.-style retail.





▲ A freshly butchered hog brought to market on the back of large tricycle speaks volumes about the state of Cuban supply chains and food safety practices.

It wasn't until 2014 that Cuban President Raul Castro announced a "new course" in U.S.-Cuba policy. That year, the Obama administration eased restrictions on travel to Cuba for Americans whose trips fit into one of 12 approved categories, including educational, religious and humanitarian reasons (the Treasury Department still prohibits U.S. travelers from partaking in "tourist activities" on the island). Since then, embassies have opened in Havana and Washington. U.S. cruise ships dock regularly in Havana and there is a new Sheraton hotel. Ironically, business executives now have a familiar place to stay, but for the vast majority of U.S. companies, doing business in Cuba is still illegal.

The trade embargo imposed in 1960 by the United States remains in place, as is the Helms-Burton Act (passed in 1996), which only tightened the rules by punishing foreign companies that trade with Cuba.

Despite the embargo, Cuba is a hot tourism market these days. The island welcomed a record 4 million visitors in 2016, a 13 percent increase over the previous year that also was a record; about 614,433 of those visitors in 2016 were Americans, a 34 percent boost, according to the Cuban Ministry of Tourism. And the increase in visitors is certain to continue in 2017. Two more cruise lines — Norwegian and Royal Caribbean — have announced trips for 2017. Car rental prices and nightly rates at hotels have quadrupled, especially in high season.

Yet, Cuba is not equipped to accommodate the tourist hordes that are straining the country's infrastructure and putting pressure on the food supply and transit system. There are too many tourists and not enough cars, for example, which is

why we waited more than an hour. When a vehicle did arrive it was a noisy, beat up 1960s Fiat with no seat belts and a broken exhaust system. All of those classic cars running around Cuba contribute to choking levels of smog.

At the car rental office in Havana, the agency was sold out of cars (even though we had pre-paid for a compact Kia months in advance). We had to take another cab to the hotel and wait for someone from the agency to call when a vehicle was available. Experienced travelers know to go with the flow when encountering difficulties in foreign lands, but in Cuba nothing is as it seems or should be and everything is negotiable (especially for those with dollars or euros).

One of the things that is clear, especially from the back of a speeding cab, is the lack of retail. The ride from the airport into the city reveals no modern malls, freestanding stores, restaurants or gas stations. Even if there were, driving to them would be an adventure because the roads are a disaster, with giant potholes and all manner of obstacles: pedestrians, bicyclists, horses, oxen, cattle, dogs and pigs.

NEXT RETAIL FRONTIER

Does Cuba really represent a new growth opportunity for U.S. retailers and if so, what does the timeframe look like? The answer is, like Cuba itself, very complicated. For starters, now that Fidel Castro is no longer in power, his brother Raul's free market reforms are expected to fuel growth of the private sector, which could translate into wage growth and spending power for many Cubans. And after Raul Castro dies (he is 85), his hand-picked successor, Miguel Diaz-Canel, 56, has signaled softer positions on economic reforms.

Cuba is also one of the fastest growing and most promising economies in Latin America. According to the CIA's World Factbook, Cuba has one of the largest economies in the Caribbean. Estimates vary widely regarding the outlook of Cuba's GDP growth (an estimated GDP of \$82 billion as of 2014) and mostly depend on government reforms and geopolitics.

As the normalizing of relations spurs many U.S. retailers to take a look at Cuba, the trade embargo still poses a big problem. Although exceptions to the embargo are being leveraged by U.S. companies (the Sheraton in Havana is a good example), most future contracts would be contingent on ending the embargo. As a result, the most immediate opportunity for U.S. retailers and brands is to market to the tourists flocking to Cuba.

Indeed, during seven days on the island, it was clear that it's not just cars that are in short supply. Cuba still exhibits many of the characteristics of a communist state: food shortages, empty shops and long lines. And these deficiencies are being amplified by the boom in tourism. Basic staples such as bottled water and ice are hard to come by. Most bodegas, or grocery stores, have empty shelves. Fresh produce and meats are non-existent (these items tend to be purchased in open-air markets). Or the stores may have full shelves stocked with only fruit juice and hair gel. The assortment seems driven by what is available rather than by what shop-



▲ This newly opened Zona+ store, the only one in Cuba, is operated by a branch of the Cuban government and is considered the most modern retail establishment on the island.

pers' needs and wants are. Freezers don't freeze, and items such as ice cream are sold defrosted (according to locals, ice cream, even melted, is a very popular item).

"I have to go to the one shop at the airport to buy feminine napkins," said Margarita Alvarez, a resident of Havana that we met at a restaurant. Alvarez said she knows one entrepreneur who runs a restaurant, or paladar, in Havana and has to fly to Mexico to buy food at Sam's Club because of shortages.

U.S. retailers could set up shop in the touristy areas in Cuba and at the airports. But there are many, many challenges for retailers, and most of them aren't even embargo-related.

One of if not the biggest obstacle to retailing in Cuba is the current political regime. Retail business in Cuba is mostly a state-run enterprise. When you walk into one of the few restaurants or stores, they are government entities, such as the rental car agency and the grocery stores. Although in the past few years, the Cuban government has allowed some entrepreneurs to operate food carts, restaurants and vacation rentals, most commerce remains nationalized.

PricewaterhouseCoopers said in a 2015 report that the potential for retail investment in Cuba is substantial but "dependent on government reforms." In Cuba's current restrictive system, there is a lack of administrative and judicial transparency, as well as much corruption. Several Cubans we spoke to who work in tourism-related retail jobs said that "gaming the system" is the only way to get ahead there. Meeting workers who boast about skimming at their retail jobs is common. Corruption is often a problem in less developed economies, and is likely to be a huge deterrent to U.S. business looking to establish a presence. The Cuban government under new, more progressive leadership would need to reverse a culture of corruption and establish a func-

tioning regulatory structure before most U.S. retailers would feel comfortable establishing a presence.

ROADS TO NOWHERE

Even the most intrepid retailers willing to look past corruption, Cubans' lack of spending power and a still oppressive government would be faced with a major operational challenge. The infrastructure in Cuba is beyond crumbling and in a state of crisis, especially when it comes to the roads. We drove from Havana to Cienfuegos to Trinidad to Varadero to Viñales and back to Havana, and we covered about 1100 kilometers, or nearly 700 miles. The highways, warehouses and rail lines are in deplorable condition and cannot handle heavy volume. There are so few gas stations (and during our visit half of them either had no power or no gas), that ensuring your vehicle has fuel is a constant source of anxiety.

As far as the availability of commercial structures in Cuba, currently they are too small or dilapidated to accommodate U.S.-style retail. While U.S. brands have some recognition in Cuba thanks to tourism, the country currently prohibits all marketing to consumers. No TV ads, no product billboards, no retail signage whatsoever is allowed in Cuba.

Political marketing, however, is perfectly legal. Socialist and communist billboards that say, "Embargo: The longest genocide in history," line the roads while Cuban hitchhikers beg for rides wearing T-shirts from the Gap and carrying reusable bags from Walmart (which reportedly sell for \$10 apiece in the black market in Havana). Indeed, many Cubans already have a certain level of U.S. brand awareness — a good head start for many companies.

WHERE WE GO FROM HERE

So what could a Cuba retail strategy look like? First of all, retailers should be aware that geopolitical challenges remain, on both sides of the Atlantic.



▲ An oddly configured interior offering a limited assortment of non-U.S. brands fails to live up to the Zona+ tag line of "Lo que necesitas y mas," which translates to "all you need and more."

On the U.S. side, there is no guarantee that the trend toward warmer relations will continue. President Trump has threatened to reverse Obama's actions to normalize relations with Cuba, and the few U.S. deals that have gone through might be in jeopardy. On the Cuba side, the nation would need to continue to reform its economy and system of government for the island's economic potential to grow.

For retailers looking for immediate opportunities, focusing on the tourists swarming Cuba should be Priority No. 1. Discounters such as Dollar General or Walmart would be overrun with tourists and locals, assuming the companies could cope with the corruption and supply chain deficiencies.

It is also conceivable that an Internet-first strategy becomes the quickest path to retail success in Cuba (presuming that Cuba follows a retail development pattern similar to the United States and overlooks the experience of other developing nations). In many parts of the world, China and India for example, retail development has leapfrogged the decades-long evolution that unfolded in the United States. Assuming the widespread availability of the Internet and smartphones, Cubans may discover mobile and chat commerce and crowd-sourced home delivery before the first big box store opens.

Either way, one thing that's for sure is there is tremendous pent-up demand for low-cost food and consumer

products judging from the lines at a shop called Zona+. The store, operated by a government-owned corporation called CIMEX, is similar to a Sam's Club but with a much smaller footprint: about 20,000 square feet. It is located in a tony Havana neighborhood, wedged between two private homes. In December, the lines were out the door. The shelves were packed with a limited assortment of low-cost European brands, and Cubans and tourists alike were buying up as much as they could. After traveling many hundreds of miles and visiting shops, this was the only store with adequate lighting, stocked shelves and employees offering to help customers. It was the closest thing I saw to U.S.-style retail and it hints at the potential that exists on an island that has been locked in a time capsule.

To understand that potential, U.S. retailers should hop a flight to Havana, stay at the Sheraton and then venture outside the city to get a sense of the pace of daily life and the operational challenges that exist. Cuba won't stay the way it is today forever, but the pace of change is impossible to gauge accurately so the best strategy when it comes to Cuba is to simply have one. The day will come when U.S. retailers and brands are part of a Cuban economic revival and in the process they will give a new, more optimistic meaning to the phrase, "Así es aquí." **RL**

A WHOLESALE PERSPECTIVE

One of the most popular things to do in Cuba for both Cubans and tourists is dining out at private restaurants known as paladares.

Until about six years ago, restaurants and other small businesses were operated strictly by the government. Then President Raul Castro loosened restrictions on small businesses, and many have flourished — especially the restaurants. Indeed, it's hard to get a table at many Havana paladares, with some requiring reservations weeks in advance.

But many diners at these paladares might be surprised to find Member's Mark-brand salt and pepper shakers on the tables. Or to learn that much of the food served in these restaurants comes from warehouse club retailers based in the United States.

Despite rules mandating that owners of paladares must buy their supplies only from state-run stores, many of these proprietors routinely fly to the United States to shop at Sam's Club or travel to Jamaica to shop at PriceSmart. Why? There simply isn't enough food in Cuba to supply these businesses and there are no food wholesalers.

In Cuba, government entities are the only ones able to import and acquire goods at wholesale, and wholesale has been a critical demand of restaurant owners. The Cuban government has promised to set up wholesale markets for entrepreneurs. In the meantime their only options have been the same retail stores where

the general population shops at high prices, or flying to other countries on shopping trips.

It's an opportunity that club retailers such as PriceSmart are in a perfect position to leverage. The San Diego-based operator of small format warehouse clubs in Latin America and the Caribbean recently acquired a 330,000 square-foot distribution center on the outskirts of Miami. In addition to the new DC, PriceSmart says it plans to retain approximately 102,000 square feet of space from its currently occupied leased building also located near Miami where it will continue to operate a recently expanded refrigerated and frozen distribution facility.

More than any other U.S. retailer, PriceSmart is familiar with the type of challenges awaiting retailers keen to enter Cuba. The company currently operates 39 warehouse clubs in 12 countries and one U.S. territory, including four in Trinidad, three in the Dominican Republic and one each on Aruba, Barbados, Jamaica and the U.S. Virgin Islands. The company also operates seven locations in Colombia, six in Costa Rica and five in Panama and three each in Guatemala and Honduras and two each in El Salvador and Nicaragua.

The expansion and configuration of the company's new facility will enable it to better serve its existing operations throughout the Caribbean basin and support future growth. PriceSmart hasn't announced any plans to enter Cuba, but having the supply chain capacity in place to serve the market is a good place to start.