

From the Department of  
**CORPORATE STRATEGY AND INTERNATIONAL BUSINESS**

**CASE STUDY SERIES**

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## CEMEX: Innovation in Housing for the Poor

CEMEX is a multinational cement manufacturing company out of Mexico. It is the largest cement manufacturer in Mexico, the second largest in the USA and third-largest cement company in the world. The company has operations in four continents and has recorded global revenues of \$6.54 billion in 2002 with a gross margin of 44.1%.

### THE INNOVATION. . .

**CEMEX leads the paradigm shift of companies profitably providing housing for the poor, the Tier 4 population, instead of governments or not-for-profit organizations.**

CEMEX manufactures and sells raw cement, ready-mix concrete, aggregates, and clinker (used to make cement) under different brand names. As the largest cement company in Mexico, CEMEX operated in a highly protected legal environment with little competition until the 1990s. It competed mainly on price and controlled 65% of the market share in Mexico. However, during the 1990s, the legal barriers in Mexico broke down, paving the way for international competition. CEMEX found itself operating in a highly competitive open environment.

Starting in 1987, under the leadership of Mr. Lorenzo Zambrano, CEMEX experienced explosive growth, mainly through acquisitions and global expansion. Today, the company has 235 cement and ready mix plants in Mexico, 60 in the U.S., 85 in Spain, 45 in Venezuela, four in Indonesia and four in Egypt.

In the new competitive arena and under a new leadership, CEMEX fundamentally changed its ways of conducting business. The company's strategy emphasized improving profitability through efficient operations. The company also shifted from selling products to selling complete solutions. With this new strategy, CEMEX has established a very strong brand and has managed to translate it to extraordinary profits from a commodity-driven business.

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This report was written by Ajit Sharma, Sharmilee Mohan and Sidharth Singh under the supervision of Professor C.K.Prahalad. The reports are intended to be catalysts for discussion and are not intended to illustrate effective or ineffective Strategies.

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According to CEMEX, the following are the sources of its competitive advantage, many of which have been widely acknowledged in the business circles.

- Continued innovation
- High level of commitment to customer service and satisfaction
- Proven post-merger integration expertise
- Digital evolution - efficient production, distribution and delivery processes through sophisticated information systems
- Ability to identify high-growth market opportunities in developing economies.

### **CEMEX - MEXICO**

CEMEX has 15 cement plants and 220 ready-mix plants spread throughout Mexico. The company sells cement to two main customer segments: the informal or self-construction segment and the formal construction segment. The formal segment consists of traditional large-scale customers, middle- and upper-income individuals, whereas the informal segment consists of the do-it-yourself homebuilders and low-income customers.

The company has invested considerably in information technology over the years to boost productivity and manage its operations more efficiently. CEMEX takes pride in its operations and was recently the winner of the CIO-100 from IDG's CIO magazine.<sup>1</sup> The company has gained a significant competitive cost advantage over its competitors by setting up an excellent distribution infrastructure and centralized computerized delivery network where every movement of every truck is monitored real-time, thus enabling on-time delivery of cement and ready-mix to its customers. The operation in Guadalajara boasts a 97.63% on-time delivery of cement.

### **Patrimonio Hoy**

“Patrimonio Hoy” is “Savings/Property today.” In 1998, CEMEX launched an innovative experiment called Patrimonio Hoy that enables very poor people to pay for services and building materials and upgrade their homes. This program blends the pursuit of profit and social responsiveness at CEMEX. The key objectives of the program are:

1. Generate business that represents competitive advantages.
2. Represent an accessible option for poor families looking for a better quality of life through households by offering good-quality cement and raw material at reasonable and frozen prices (i.e., no price changes reflecting time and inflation).
3. Access to credit (by providing materials in advance) not available to the poor otherwise.
4. Position CEMEX as a responsible corporate citizen that is committed to the society.
5. Build social capital.

During the Mexican economic crisis in 1994-1995, CEMEX experienced a big drop in domestic sales. Sales in the formal segment dropped by as much as 50% whereas sales in the informal /self-construction

segment dropped by only 10% to 20%.<sup>2</sup> The company realized the high level of dependency on the formal segment left it very vulnerable to the business cycle swings in Mexico.

According to an estimate made by CEMEX, the do-it-yourself segment accounted for almost 40% of cement consumption in Mexico and has a market potential of \$500-600 million annually. Realizing the potential in this segment, CEMEX expanded its presence in the retail channel by setting up 2,020 kiosks or “Construramas” to establish closer relationships with the informal segment. At the same time, CEMEX was looking for business opportunities to distinguish itself in the industry and establish a competitive advantage. The company also was keen to develop corporate citizenship and become a more socially responsive company.

CEMEX as a firm was known for identifying potential opportunities and turning them into profitable ventures. Realizing huge potential in the do-it-yourself segment, the company embarked on a new venture to capture that untapped segment. This laid the foundation for Patrimonio Hoy.

The company realized the key difference between the formal segment and the informal segment was in the average revenue per customer. Though fewer big-ticket customers could generate most of the company’s revenues, the situation is reversed for low-income customers (Figure 1). It is estimated that 60% of the population in Mexico earns less than \$5 per day. CEMEX learned that by converting the low-income population (that forms a majority) into customers, the steady revenues from this segment could be very impressive.

The management team headed by Francisco Garza Zambrano and a consulting team from Business Design Associates performed in-depth market research to gain a good understanding of this low-income market in Mexico. The research was an eye-opening experience (Table A) for the CEMEX management from a business and social perspective. Project “Patrimonio Hoy” was conceived.

Before actually entering the market with this program, CEMEX had to overcome a few fundamental and critical challenges that were specific to the low-income market. First, CEMEX had to build trust and convince the poor they will indeed be able to build a house with CEMEX. Second, CEMEX had to make the poor understand that credit was not a stumbling block for the poor as part of Patrimonio Hoy. The team had to work with a different mindset that did not include sale of cement as the sole objective of the program.

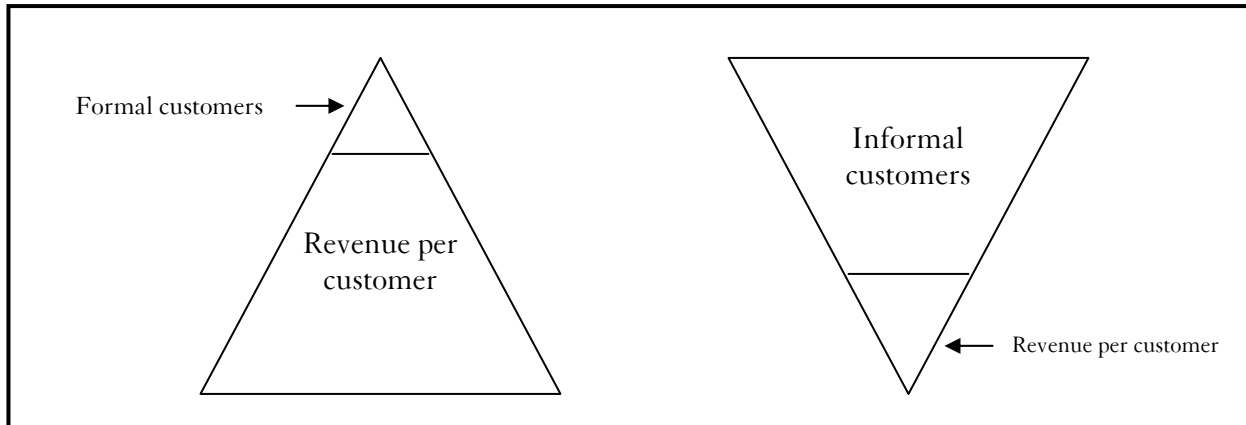


Figure 1

**Table A**

ATTRIBUTES	FORMAL SEGMENT	INFORMAL SEGMENT
Sales	Higher revenue per customer	Low revenue per customer
Payments	Financing generally not required	Financing is important
Demand	Depends on economy	More or less steady demand
Price sensitivity	Driven by bargaining power	Convenience-driven (such as credit, delivery, etc.)
Brand equity	Recognized & trusted	Should build trust to deliver as promised
Growth	Slow growth	Very high potential for growth
Customer location	Usually located in places of easy access	Mostly located in remote areas
Relationships	Stops at the distributor-level	Requires close ties with end customers

### **Mexican Society**

The Mexican society, like many other societies in developing countries, possesses certain characteristics specific to that society.

**Savings:** Low-income families in Mexico (and in many other parts of developing and under-developed countries) adopt a different savings method than the traditional methods of middle and upper-income families. Since low-income families don't receive regular paychecks and don't receive any government subsidies or grants, they don't have access to banks and credit. Within a community, neighbors, families and friends get together and form "tandas" or "pools." The members of the "tanda" pool in money "as and when" they receive paychecks and if they have any money left to save. Once a week (or at some predetermined interval), one of the members can bid for the pool by deep discounting or can win the pool

through a lottery. Typically this pool is used for unanticipated family emergencies, education and sometimes for housing. The only factor that enforces discipline in the tanda system is the social capital – the trust, reputation and participation in the community.

But the tanda system was not nearly as effective for housing. Even before money found its way to such pools, families (usually the men) spent it on various other non-primary activities – drinking, partying, etc. Also, there were too many members in pools, and it was difficult to manage and enforce discipline. People often backed out of the pools and this led to a lot of problems.

**Women and entrepreneurship:** Women are the key drivers of savings in families. In the Mexican society (and most other societies), women are very entrepreneurial in nature, and they very actively participate in the tanda system. Regardless of whether they are housemakers, working or small-business owners, they are responsible for any savings in the family. Research conducted by the Patrimonio Hoy team revealed that 70% of those women who were saving, were saving money in the tanda system to construct homes for their families.

The men in the society considered their job done if they brought in their paycheck at the end of the day. The women actually manage expenses with the limited “allowance” that they receive per day from the men. They have to find very creative ways to allocate money from the allowance as savings to build a house, spend on children’s education, etc.

**Housing:** The poorest people in the city live in settlements made of raw cinder blocks, and in worse cases cardboard and corrugated sheet metal (Appendix A). Most houses have one or two rooms per family, and the size of a family ranges from 6 to 10. The homes are over-crowded and this has its own set of social problems, including friction within the family and children taking to the streets.

## INITIAL MARKET RESEARCH

### Guadalajara, Mexico

A research team of eight people selected Guadalajara in the province of Jalisco as the first city to implement the program. Guadalajara has been considered a traditional test market in Mexico for many reasons. First, the social/economic profile of low-income communities was very representative of most of the populated areas in Mexico. Over 50% of the population live in homes that hug a network of pitted, unpaved roads in unplanned settlements surrounding the city and blending into the countryside. Second, CEMEX was gradually losing its stronghold in the second-largest city in Mexico. Nearly all the houses appear to be under construction (Appendix A). The third very subtle reason was that the construction methods in Guadalajara were different from that of other places. Traditionally, for every 100 pesos spent on construction raw materials, 52 pesos were spent on cement. In Guadalajara, the southwestern region of Mexico, only 22 pesos were spent on cement. Instead, clay and limestone was used in the construction of houses. So CEMEX had to find new opportunities for growth in Guadalajara.

### **Eye-openers**

The team conducted a three-month study based on various demographic factors – social, religious, political and financial. The study also analyzed the various construction practices and methods, brand perception and image of various cement brands.

The team realized that financing was the foremost and most difficult challenge to overcome for low-income customers. Unless the poor obtain access to credit, it would be difficult to sell the idea of constructing a complete house in the near future. The second challenge was that most families employed local semi-skilled or unskilled masons who built rooms without any planning. The lack of technical expertise resulted in a lot of raw material waste. Often the masons did not order the right amount of material, and families didn't have a safe place to store the excess raw materials. They had to leave the material outside their houses to the mercy of nature and theft.

The team identified three key areas of improvement/change for CEMEX before launching Patrimonio Hoy:

1. Identify ways to provide access to credit for the poor before selling cement.
2. Improve the brand perception of CEMEX as a socially responsive company to earn trust in the people, especially the poor.
3. Change/improve distribution methods and construction practices to make it cost-effective for CEMEX, its distributors and the low-income customers.

### **Savings (tanda) Credit System**

CEMEX modified the existing tanda system within the Mexican communities and called it Patrimonio Hoy. In this system, poor people not only save their money, but also obtain access to credit based on their savings and payment discipline – a new model that moved away from a savings-only or a credit-only system to a savings-credit system. By introducing the savings-credit system, Patrimonio Hoy may have revolutionized the idea of savings by changing the basic spending pattern of the poor in Mexico.

### **Distribution Network**

In the traditional distribution network and supply-chain model, bargaining power and market dominance played a key role in the determination of prices and selection of distributors. The distributors primarily cared about prices and discounts. The industry was driven by price wars. However, the new model took a very different approach. Not all the traditional distributors were part of Patrimonio Hoy. In fact, a new methodology was adopted to select distributors for this program. Certain “prerequisites” were established for distributors and re-sellers:

- Good understanding and appreciation of the new business model
- Excellent delivery capabilities with trucks to deliver to the local neighborhoods with not-so-accessible roads and infrastructure (Appendix B)
- Capacity for storage of raw material inventory
- Exclusive relationship with CEMEX

Nearly 1/10th of the distributors qualified under the rigorous selection process. For example, in the Mesa Colorada neighborhood in Guadalajara, of the 30-odd distributors that sold CEMEX, 10 distributors sold only CEMEX products; among the 10, three to four distributors were selected to participate in the project.

### **Patrimonio Hoy – Program Design:**

#### ***1. Identification of offices/cells:***

A special research team set out to explore neighborhoods in and around the city of Guadalajara to identify high-growth opportunities. In a broad sense, the team identified potential pockets or cells based on income, construction progress, housing development, concentration of poor people, distributor network and population growth.

The team identified target communities where the average family (5-6 people) that earned around 50 to 150 pesos (US\$5 to \$15 approximately) per day. The target population for Patrimonio Hoy is not the absolute bottom of the economic pyramid, wherein the average per-capita income is less than \$5 per day.

#### ***2. Cell setup:***

Once a neighborhood was identified, Patrimonio Hoy set up a cell for that neighborhood. A typical cell is set up to target a customer size of 5,000 or a community with a population of 50,000 - 100,000 (or 20,000 families). There are one to four employees per cell - a general manager or chief, an engineer, a technical advisor or an architect, supplies manager and a customer service representative/administrative clerk.

The chief works in identifying “promoters” within the community who would go door to door selling the new savings-credit idea to the poor. The supply manager works closely with corporate CEMEX in the negotiation of prices for raw materials, interacts with the distributors for the delivery and monitors the quality of suppliers and distributors in terms of delivery time, customer treatment, quality of materials, etc.

#### ***3. Customer enrollment:***

Recognizing the inefficiencies inherent in the original tanda system, Patrimonio Hoy has strict rules and standards for the program.

**Socios/partners:** Socios are the actual customers who enroll in Patrimonio Hoy. The socios get together and form a group, restricted to three people. The reason for such a small group size is that it is easier to enforce payment discipline in a smaller group, and the group tends to form stronger relationships to help each other out during an emergency.

**Promoters:** Promoters play a key role as ambassadors for Patrimonio Hoy. Ninety-eight percent of the promoters are women. They work on a commission basis that is dependent on the number of socios they help enroll and on the duration of the stay of the socio within the program.

#### ***4. Savings-credit payment cycle:***

Savings and credit are the key drivers for the business model of Patrimonio Hoy. The enrollment of a socio ensures a consistent and steady source of revenue in the pipeline (for 'x' number of weeks) for Patrimonio Hoy and the distributors. The predictability of revenue has huge implications across the value chain from the suppliers to the end-customers.

When a socio group is formed, the group goes to the nearest cell and completes an application. This application is completely informational (Appendix C) and does not require any credit history or collateral. Also, the prices of raw materials are "frozen" throughout the payment period. The only requirement is a commitment from each socio in the group to pay 120 pesos per week for a definite period of time (at least 70 weeks).

After enrollment, each socio in the group sets up an appointment with the technical advisor/architect (for a low fee) for an interview. Through an interactive process, the technical advisor helps the socio decide:

- Types and quantities of the needed materials for the first room
- What the next room will be in his/her home, its placement in the current layout
- The sequence of the following rooms to be constructed in the future

The personal visits of architects make the socios feel like important customers, and have helped Patrimonio Hoy build trust among the socios.

Each socio in the three-member group takes a turn every month to collect money from the other two members and remits a weekly payment of 360 pesos (120 pesos per head). For every 120 pesos a partner pays per week, Patrimonio Hoy charges 15 pesos as membership fee per socio.

#### **Phase 1 (First 10 weeks)**

Each socio pays 105 pesos (120 pesos net of 15 pesos) for the first five weeks, totaling 505 pesos. At the end of the 5th week, Patrimonio Hoy makes its first delivery of raw materials for construction worth 1,050 pesos (equivalent of payment for 10 weeks). By advancing five weeks worth of raw materials, Patrimonio Hoy is effectively extending credit to its customers. The extension of credit by delivering raw material to partners in advance helps Patrimonio Hoy establish credibility with the socios by proving that it had lived up to its promise of delivering raw materials. This phase also serves as a pilot to test the commitment of the socios.

### **Phase 2 (11-70 weeks)**

If socios stay committed beyond the first phase, they gain from the program even more. During the subsequent phases, socios receive raw materials worth 10 weeks at the end of the second week, i.e., advance worth eight weeks. They receive raw materials worth 10 weeks at the end of the 12th week. Deliveries are made during the weeks of 12, 22, 32, 42, 52 and 62.

### ***5. Distribution and delivery:***

CEMEX offers socios two choices of delivery: receive delivery right away for immediate construction or receive a delivery voucher now that can be exchanged for raw material delivery at a later time when they are ready to start construction. However, they will never receive cash in hand unlike the original tanda system wherein pool members could receive cash.

If the partners choose to receive their raw material, Patrimonio Hoy coordinates with its distributors to arrange for delivery of the material. If partners choose to receive delivery vouchers for delivery at a later date, the inventory is stored at the distributors' warehouses.

Interviews with socios revealed the first delivery made after just five weeks of payment and consistent on-time delivery played a big role in earning the trust of the partners. The supply managers also play a role of an audit manager ensuring the distributors deliver good-quality materials on time and provide good service to the socios.

### **Value Analysis**

CEMEX was quick to realize it had to position itself as a complete solutions-provider at low cost and not as a cement seller competing on prices, to tap into the huge low-income market. It also realized if it tried to sell just cement, it wouldn't take too long for competitors to enter the arena. Hence, the company's strategy for the low-income market is to:

- Position itself as a company committed to the society by offering housing at a low cost to the poor and enabling a better quality of life.
- Sell cement and other raw materials as a package such as "pacquet tolteca." (Tolteca is a CEMEX brand of cement sold in Guadalajara.)
- Offer value-added services such as credit access, technical advice, architect visits, storage space for raw material and customer service.

Patrimonio Hoy had to offer a strong value proposition for customers to overcome their resignation to life as the ignored population segment, and also change certain fundamental and cultural spending (on non-basic events such as parties, drinking, bars, etc.) patterns. It also had to ensure its suppliers and distributors were enthusiastic about the new business model.

## **Value to Promoters**

Promoters are the ambassadors of Patrimonio Hoy who identify prospective customers, sell the idea of savings-credit to them and motivate them to enroll in the program. Hence, it is important that they are very enterprising and have active ties with the local community.

The reason for promoters to participate in the program is two-fold: They do it for a social cause to build social capital (According to Patrimonio Hoy's General Manager, "Social capital is very important for people with little economic capital.") and also earn money. Patrimonio Hoy rewards their efforts on a commission basis (points system). A promoter earns 48 points (1 point = 1 peso or 0.1 USD) for every enrolled socio for whom she is responsible. To ensure she brings in committed socios, the system rewards her with more depending on the commitment of the socio to the program. On the 30th week of the socio, she gets 32 points, and from the 30th week on, she gets one point per week per socio. For example, if a socio is enrolled in the program for 70 weeks, the promoter who is responsible for the socio's enrollment earns 120 points (48+32+40).

The system implicitly encourages promoters to bring as many committed socios as possible. Many promoters are socios themselves. At the end of the 70-week period, the promoters can convert the accumulated points on a one-to-one ratio to receive either cash or raw material (if the promoters are socios themselves).

Patrimonio Hoy offers initial training to promoters and they start with target enrollment in the range of 80-90 (per cell) socios per calendar period (28 days). Typically, each cell has 8-9 promoters.

## **Value to socios/partners**

The biggest challenge for Patrimonio Hoy is to build trust with the people. The poor people are resigned to the fact they will not be able to build a house in less than two to three years. Typically, it takes 16 years for a family to build a four-room house and an average of four years just to complete a room.

To allure the customers, Patrimonio Hoy offers the following proposition:

- Offer access to credit by providing materials in advance.
- Offer good-quality cement and raw material from a trusted national brand at reasonable and frozen prices (i.e., no price changes reflecting time and inflation) up to 70 weeks.
- Build a typical room in 1.5 years (from four years).
- Provide technical support and service such as architect visits, technical advice.
- Provide skilled masons for construction for a reasonable fee by opening a school for masonry training.
- Provide excellent customer service and good treatment.
- Provide storage space for raw material and reduce wastage.
- Offer accelerated payment options for ambitious and aspiring customers.
- Offer similar programs for schools (Patrimonio Hoy Escolar) and other infrastructure such as pavements (Calle Digna) for families and neighborhoods.
- Reduce cost of construction by reducing waste, offering technical training for self-construction.
- Offer training to socios interested in masonry.
- Build social capital.

Patrimonio Hoy helps the poor build homes that may have been a distant dream otherwise. By offering such value-added services, Patrimonio Hoy has been successful in earning the trust of the socios. The General Manager of Patrimonio Hoy claims the reduction in costs for the socios are as high as 30%, and the reduction in time translates as high as 60%-70%.

### **Value to suppliers**

CEMEX is the largest cement manufacturing company in Mexico and, by virtue of its size, has significant bargaining power over its suppliers and distributors. Patrimonio Hoy collaborates with CEMEX in negotiating prices of raw material such as bricks, steel, clay, limestone, etc. with suppliers (Appendix D). The company exerts collective bargaining power over its suppliers by negotiating on three key factors: generating a steady demand for materials, creating a consistent revenue stream and ensuring zero-risk collection of money.

According to Patrimonio Hoy's General Manager, the suppliers are very happy to supply materials to Patrimonio Hoy because of the steady demand for their materials and the quick growth in sales (as high as 30% annually) in locations of operations of Patrimonio Hoy.

### **Value to distributors**

Traditionally, the company has "pushed" its products and services through the distribution channels, and hence it was a very price-driven market. Distributors operated on a 15% average margin from sale of building materials.

However, in the new business model, Patrimonio Hoy manages the distributor relationships on its own. Though it works with the existing CEMEX distributor network, the margins in the new channel are slightly different. Distributor margin on sale of building materials sometimes drops to 12%. But the slight drop in margins is more than offset by a steady demand for cement and other high-margin raw materials such as sand and gravel where the margin could be as high as 45%. Patrimonio Hoy has effectively created a pull for cement, and CEMEX on the supply side pushes it, enabling the "push-pull" strategy for cement sales. Patrimonio Hoy has seen a very enthusiastic response from distributors who are willing to participate in this program.

### **Operating model of Patrimonio Hoy:**

The objective of Patrimonio Hoy is to not only serve a social cause, but also make it a profitable self-sustainable business. Patrimonio Hoy also recognizes that volume is very important for it to be a success, and hence has based its revenues on a per-transaction basis. These revenues are in addition to the sale of cement by Cemex.

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## Revenues

The revenue streams are:

- Membership fee of 12.5% per socio per payment of 120 pesos
- Intermediation fee in the form of a 7% margin from distributors

## Costs

The average initial investment per typical cell is 400,000 pesos. The operational cost per cell including salaries is around 85,000 pesos per month. An average cell needs approximately 700 enrolled socios (Exhibit 1) to break even on operations. According to Patrimonio Hoy's General Manager, the program generates approximately 125,000 pesos in cash flows from operations. The goal of this program is to operate as a standalone break-even unit, since the initial objective is to increase customer awareness, change consumer behavior and establish a competitive position in the market.

## Marketing

The traditional methods of marketing communication, advertising and promotion are not effective in this operating model. Patrimonio Hoy realized early on that mass media advertising through television, newspapers, etc. will not convey a personalized message and will not help build trust among the low-income people.

The Mexican people believe in leaving something behind for the next generation. Mostly, the families believe in leaving immovable property/wealth for their sons and daughters. That, in Spanish is called "Patrimonio." The program "Patrimonio Hoy" tries to convey the message by motivating the public to "Save today." In addition, the idea of being part of a family or a group, with a clear set of values, benefits, etc., is overly important in the Mexican society. Patrimonio Hoy conveys this message in its marketing communications and encourages socios to enroll with Patrimonio Hoy.

**Community outreach:** Among the poor, the best way to establish ties with the local communities is through personal interaction. Perhaps this explains the significance of the role of promoters for Patrimonio Hoy. The promoters go door to door in the neighborhood communities and talk about the benefits of the program. Patrimonio Hoy provides literature and pamphlets that contain relevant information, and provides preliminary training for the promoters. The main objective is to generate interest in the community. The sales officers and promoters periodically hold meetings and public gatherings to educate the customers. One can find messages and contact information painted on the walls of neighborhoods as bills/graffiti (Appendix E).

**Word of mouth:** Word of mouth is the single-most-important broadcast mechanism that has proved to be successful in the expansion of the program. People in the neighborhoods tend to have very close-knit ties within the community that again reflects the importance of social capital. Anything good or bad spreads very effectively through the “word-of-mouth” channel, which is often under-estimated or ignored.

**Pricing:** Patrimonio Hoy has adopted “the CEMEX way” to conduct profitable business. Though Patrimonio Hoy tries to offer cost-effective solutions to customers, it does not offer low-price or lower-quality products and services. The company has been reasonably successful in convincing distributors of the same and has avoided a price war. In fact, CEMEX sells its cement at a slightly higher price than that of its competitors. The socios are aware of this. Interviews with socios reveal that the higher price charged by CEMEX is more than offset by the value-added services that Patrimonio Hoy offers to the socios.

Patrimonio Hoy negotiates a volume-based discount of up to 7% from its distributors. The salary structure of the supply manager is based on how well he manages to negotiate discounts with the suppliers and distributors. To ensure the materials, including cement, are reasonably priced, Patrimonio Hoy conducts a market study that publishes prices of competitors, and calculates an average price for each calendar month. The socios who sign up in a particular month enjoy the same prices through the 70-week payment cycle. For example, if the price of a ton of cement is 100 pesos when a socio signs up, Patrimonio Hoy commits to sell cement at 100 pesos for the rest of 70 weeks. By offering this frozen price commitment, Patrimonio Hoy is able to charge a slight premium over its competitors. Each cell maintains its own list of prices.

**Promotion:** Patrimonio Hoy offers small-scale promotional events such as fee-waiver for the first installment or a couple of installments for new enrollees, a raffle event wherein a socio receives a room essentially for free, free “back-to-school” items for new enrollees. Some promotions have included seasonal offers such as vacation getaways and Christmas offers. However, these promotions are new, and Patrimonio Hoy doesn’t have enough data to verify if promotions are a good way to increase enrollment.

### **Risk Management**

Conducting business with the low-income population with no regular stream of paychecks seems riskier than the traditional lending models. Patrimonio Hoy claims the risks are really low. According to the General Manager of Patrimonio Hoy, the default rate so far has been an impressively low 0.45%. The huge rate of success can be attributed to three important factors: group commitment, social capital and penalty fee structure.

When a group of three socios walk into a cell and complete an application, the only commitment they are expected to make is the regular payment of 360 pesos per week per group on time. If for any reason one of the team members doesn’t turn in his/her payment portion on time, the group as a whole will pay a late fee of an additional 50% (60 pesos) per late socio. Not only is there a late-fee penalty, but also the delivery for the entire group is delayed by one week. This also is recorded as a black mark, and the group will have problems later if they decide to apply for a new credit.

If one of the members defaults for some reason, news simply spreads by word of mouth and he is more or less ostracized from the whole process. He/she will lose credibility and will have problems finding a group later.

### **Strategic Importance of Patrimonio Hoy to CEMEX**

After three years of operations, Patrimonio Hoy has 36,000 customers and over \$10 million in credit. It operates through 49 cells in 23 cities across 19 states in Mexico. The customer base is growing at 1,500-1,600 per month.

It may be too early to use financial profits as a measure of success. As a standalone operation, Patrimonio Hoy might not be generating as high a margin as corporate CEMEX is through sale of cement. But the project has strategic implications for CEMEX. According to the General Manager of Patrimonio Hoy, the operation is generating positive cash flows from operations of one million pesos per month as of April 2003.

But the more important and critical factor is that Patrimonio Hoy has successfully created an entirely new channel for selling cement and other construction materials. Patrimonio Hoy has helped CEMEX triple its cement sales in places where the operations of Patrimonio Hoy are set up. This has increased from 2,300 pounds of materials consumed once every four years per family, on average, to the same amount being consumed in 16 months.

### **Sustainable Growth Strategy and Innovation**

By offering a complete and comprehensive solution for housing, Patrimonio Hoy has made it difficult for consumers to let go of this opportunity, and has fundamentally changed consumer behavior, even if on a small scale. Patrimonio Hoy is trying to find ways to keep the growth sustainable. It has introduced various innovations around Patrimonio Hoy – Patrimonio Hoy Escolar, Patrimonio Hoy Te Impulsa, Patrimonio Hoy Calle Digna.

Patrimonio Hoy Escolar (School) is a variation of the original program in that it helps improve infrastructure of the local schools. Four percent of the membership payment of socios is allocated toward improvement of school facilities.

Te Impulsa is an accelerated version of the original program where raw materials are delivered to customers earlier. The materials are delivered in three installments – weeks 6, 14 and 22 in 30-30-40%. By the 22<sup>nd</sup> week, 100% delivery is promised to the socios, though they make their usual weekly payments until the 70<sup>th</sup> week. This program is available to returning socios who have established credibility by making regular payments on time the first time they enrolled in the program.

Calle Digna (“Worthy Street”) was created in response to the request of socios who wanted to move on from building their homes to improving infrastructure in their neighborhood. This is a classical example of how Patrimonio Hoy has changed the consumer outlook and how it has changed them from people in despair to people with hope. This project brings the people even closer to work together for the cause of their communities.

Patrimonio Hoy has partnered with the Mexican government to work on public infrastructure projects. Many projects the local government hasn’t been able to implement because of various reasons have been implemented by collaborating with Patrimonio Hoy. While the local government provides

drainage facilities, Patrimonio Hoy provides the materials for paving the streets. The payment structure is slightly different. The weekly payments are 150 pesos for “x” number of weeks, depending on each family. Patrimonio Hoy provides ready-mix or raw materials starting on the 18th week of the payment cycle.

### **Challenges**

Though customer enrollment is increasing at a rapid pace, customer retention is a huge problem for Patrimonio Hoy, not because of poor quality of products and services, but by virtue of the nature of the business. After a room is done, the probability of returning customers to build another room is not 100%. Many take a break from the rigors of payment. The biggest challenge for Patrimonio Hoy is to retain those customers for a longer period of time and motivate them to return for additional rooms or other expansions.

In many cases, the socios cannot afford weekly payments for raw materials and mason fee for construction at the same time. So they first buy raw materials over 70 weeks, build houses later and then may return to save for the next room. To facilitate the continuity of the socios with the program, Patrimonio Hoy has established masonry training facilities for “self-construction” where socios can obtain technical training to build homes on their own. The socios not only get to build their own homes, but also gain a new competency.

### **Key Learnings from Patrimonio Hoy for CEMEX**

Patrimonio Hoy has helped CEMEX gain a good understanding of the low-income population. It has helped CEMEX clear the misconception it originally had about the poor, and realize they could indeed form a good and profitable segment of the market. CEMEX also learned the traditional methods of operation would not work. However, it remains to be seen if CEMEX can provide housing for the poor to serve a social cause, and at the same time remain profitable in the long run by expanding this program globally.

### **Leveraging this Learning through Construmex**

Having successfully launched Patrimonio Hoy in Mexico, Cemex turned to another possibility. It was obvious that a large number of Mexican immigrants lived and worked in the USA. They sent remittances home every week. These remittances were of the order of \$ 10 billion. Although the size of the average remittance transfer is miniscule - \$200 to \$300 – in the world of international finance, the cumulative sums were significant. Further, an estimated 10% of these funds were intended to build additions to homes of the members of the family of the immigrants.

CEMEX saw an opportunity to capture a share of the remittance market to Mexico. This would further its business of helping the poor build good quality houses.

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### **Evolution of the Business Idea:**

CEMEX knew a significant portion (Approx. 10%) of remittances to Mexico is used for construction of houses. Most of these people remit money using traditional money transfer companies like Western Union. This process is fraught with inefficiencies:

- The money transfer firms (oligopoly) charge high flat fees for transferring money.
- The exchange rate offered is less than the market rate.
- Relatives back home could spend a significant portion of remittance, meant for building the house, for other purposes.
- There is a risk of theft when collecting money from counters of money transfer agencies in Mexico.

CEMEX identified the need for an easier and cheaper way to help the Diaspora build houses back in Mexico. A subsidiary, Construmex, was formed to serve this need. Following a small-scale market research, Construmex set up its first experimental office in Los Angeles in July 2001. The significant Mexican population of Los Angeles made it the natural choice for trying out this Business model.

### **The Business Model:**

In short, Construmex allows Mexicans living in the U.S. to send their money directly to cement distributors in Mexico. Distributors receive the order and the money, and deliver cement and other building materials to the site of the person's future home or business.

Broadly, there are two types of customers:

- Individuals remitting money for building their homes in Mexico.
- Home Town Associations (HTAs) remitting money for public service projects in their hometowns in Mexico.

### **Construmex USA**

The express purpose of Construmex is to channel as large a share of the remittance flows to CEMEX as possible. It is not a profit center and has little revenues. Hence the primary activities of Construmex center around generating customer awareness, customer education, building trust in the Mexican community, spreading through word of mouth and working with HTAs to capture a share of the HTA remittances. Not surprisingly, 60% of Construmex's budget is dedicated to marketing.

Construmex offices typically have one to two sales representatives. These sales representatives are multi functional in that they:

- Answer customer queries.
- Are trained Mexican architects and consult the customer about the architecture and plan of the house.

- Estimate building material requirements based on the house plan.
- Help customers do price comparisons and choose the best distributors.
- Register customers in the Construmex database.

### **Dolex USA**

Dolex is the money-transferring agency, which transmits the money from the customer to the Construmex account in Monterrey, Mexico. The money is transferred in dollars, and there is no exchange of currency. Construmex is still trying to define the perfect business model according to GM Luis Enrique Martinez. However, it has tried out two variants until now:

1. Construmex sales office has a Dolex counter within it. When a customer comes into this sales office, he has the option to remit money through Dolex or to send building materials through Construmex [e.g., Broadway office, Linwood Office, Fresno Office, Santa Ana office].
2. Construmex sets up a simple kiosk explaining the value proposition in a Dolex sales office. The customer has the option to send building materials through Construmex instead of remitting cash, e.g., the Huntington Park office].

Dolex started its U.S. operations in 1998 and is still a very young player in the money transfer business. Dolex has 600 sales offices in the U.S., and Construmex wants to scale up its operations by using this existing network. Construmex will try out the second model in Chicago where Dolex has around 25 counters. There will be one Construmex sales office to answer any questions and provide consultation. The lean cost structure in the later model is obviously very appealing for an organization that has no revenues and controlling costs is critical, since that is the only variable that is under its control.

### **Construmex Mexico**

The Construmex office in Mexico does the following:

- Selects distributors for the Construmex program.
- Receives money from Dolex and processes the accounting of the money transferred.
- Transfers the order to distributors.
- Verifies delivery of material to beneficiary.
- Releases money to the distributor.

### **Construmex Distributors in Mexico**

According to the general manager of Construmex, the quality of service provided in the U.S. as well as Mexico is critical for generating trust and acceptance. Because of this, Construmex carefully selects distributors for its program. The different criteria applied are (1) accuracy of materials delivered, (2) adhering to the five-day delivery guarantee and (3) prompt service. Until now, 1,600 of the 6,000-CEMEX

distributors are part of the Construmex program. They cover all states of Mexico except Tijuana. These distributors are typically known to the beneficiaries and hence help in building trust with the clientele. They are happy to work with Construmex since this means more business for it.

### **International Growth**

In 2002, a team from CEMEX Philippines, visited LA to study the operations of the Construmex program. There is strong interest in CEMEX Philippines to replicate this model. This has great potential since they send much more money than Mexicans back home.

### **Endnotes**

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<sup>1</sup> [http://www2cio.com/info/releases/08150212\\_release.html](http://www2cio.com/info/releases/08150212_release.html)

<sup>2</sup> [www.vision.com](http://www.vision.com) – Media Coverage 2002: Enabling the poor to build housing: Pursuing profit and social development together.