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Casas Bahia Fulfilling a Dream

Through a unique approach to customer service, Casas Bahia has developed an innovative business model that successfully serves the "Bottom of the Pyramid" (BOP) population throughout Brazil.

THE INNOVATION. . .

The poor represent a market, a big, lucrative, and sustainable one with the right financial approach in countries where even Sears and Wal-Mart have failed.

> It is all about fulfilling the customer dream. My sales agent has to be very well dressed, shaved and always smiling. If he has a personal problem, he cannot come to work. I will never allow him to transmit to my customer anything but perfection.
> – Michael Klein, Chief Financial Officer, Casas Bahia

In 1952, after surviving two years in a Nazi concentration camp, Samuel Klein left his homeland to start a new life in Brazil. In order to support his family, Mr. Klein sold blankets, bed linens, and bath towels door to door in São Caetano do Sul. Fifty years later, Samuel Klein has transformed his door-to-door business into the largest retail chain in Brazil, selling electronics, appliances, and furniture. Casas Bahia's figures are significant: R$4.2 billion in revenues (the Reais is the Brazilian currency), 330 stores, 10 million customers and 20,000 employees. Samuel Klein has built Casas Bahia into a successful and sustainable business serving Brazil's poor.

> When my father arrived in Brazil, he realized the average population was not wealthy. Thousands of people were migrating from the northeast region to work in São Paulo. That is why our name is Casas Bahia (Bahia is the largest state in the northeast region). This population needed all kinds of basic goods, such as linens, towels, and sheets. My father's vision was to fulfill the needs of the poor population. But how could they pay for it? The answer was simple: financing.
> – Michael Klein

This report was written by Sami Foguel and Andrew Wilson, under the supervision of Professor C.K.Prahalad. This report is intended to be a catalyst for discussion and is not intended to illustrate effective or ineffective strategies.

Today, Samuel Klein's two sons, Michael and Saúl, manage the day-to-day operations at Casas Bahia. Michael is responsible for finance, stores, distribution, fleet, technology, and employees. His brother, Saúl, oversees suppliers, customer sales, and marketing. Though Samuel no longer visits stores, due to security concerns, he is always at the headquarters and considered the "mind of the company." Moreover, his son Michael states, "He [Samuel] understands this business better than anyone else in the world. I would be foolish if I did not use this invaluable resource."

Casas Bahia believes in staying true to its customers. As an example of the company's ability to both reflect and support the communities they serve, Casas Bahia's headquarters have remained in the blue-collar city of São Caetano. The atmosphere and attire are casual. Samuel Klein has set the tone and philosophy of Casas Bahia. His deceptively casual attire masks an intense head for business and passion for his customers and employees. This passion for total dedication to service has led to an atmosphere of reverence from both employees and customers. When you enter the headquarters of Casas Bahia, a large caricature portrait of Samuel leaning over a Casas Bahia store greets you. A grateful employee who, despite having no formal art training, wanted to show his appreciation to the man who had changed his life painted it. One of Casas Bahia's most successful regional sales managers has a life-size painting of Samuel in his office serving as a reminder of the traditional values the charismatic founder instilled within Casas Bahia. When Michael attends store openings, life-long customers will approach him to show their appreciation and ask how his father is doing.

The culture and philosophy are important to the continued success at Casas Bahia. Maintaining control over culture is one reason Samuel Klein is adamant about not selling a stake to outside investors. "Partners boss you around," he says. This deceptively simple approach to business is at the heart of Samuel Klein's direct, old-world style of management. He does not like surprises and follows his instincts. Mr. Klein believes in an iron-fisted control over spending. Only four Klein family members have the authority to sign checks. While Michael and Saúl continue to perpetuate their father's beliefs and management style, they have begun to modernize the business. The current emphases in marketing and information technology are the clearest signals of modernization.

Scope and Size of Opportunity

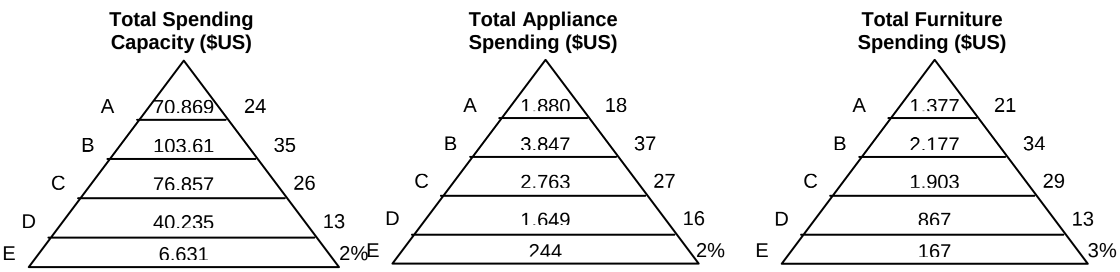
Brazil maintains a standard that stratifies individuals into one of five basic economic classes: A, B, C, D or E. C, D & E are considered to be the "Bottom of the Pyramid" (BOP). In 2002, the population in Brazil was 176 million, 84% of whom are considered to be at the BOP. The economic stratification is illustrated in the follow table:

Brazilian Stratification Breakdown

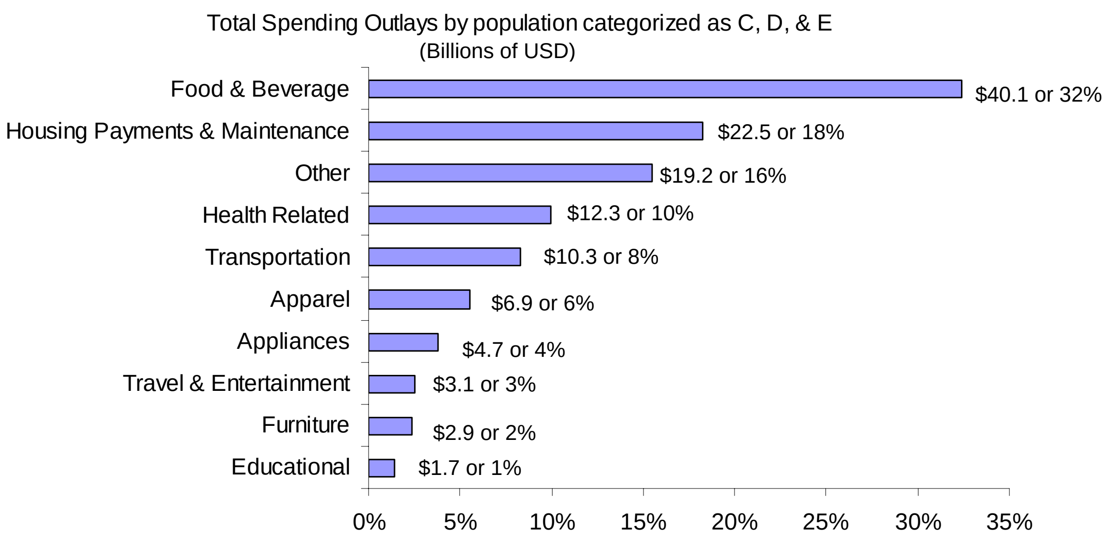
FAMILIAR INCOME (MW*)	ECONOMIC SEGMENT	POPULATION (MILLION)	HOUSEHOLD (MILLION)	INHABITANTS/ HOUSEHOLD
0-2x	E	54.3	7.6	7.1
2 – 4x	D	44.2	9.4	4.7
4-10x	C	48.9	12.6	4.0
10-25x	B	21.6	5.4	4.0
>25x	A	7.3	2.5	2.9

*MW = Minimum Wage = R$200/month

The BOP represents significant purchasing power in Brazil's economy, representing 41% of total spending capacity. This US$124 billion only accounts for the formal, reported economy. It is estimated that the informal market in Brazil for the BOP reaches an additional 50%. Specifically, 45% of total appliance and furniture spending is done by the BOP.



Source: Target, $ million



What is of particular interest is the high penetration of major appliances, such as television sets and refrigerators, at the Bottom of the Pyramid in Brazil. It is not uncommon to find households with a television or refrigerator yet lacking basic infrastructure, such as toilets and telephone lines. Those at the BOP in Brazil spend based on their needs. In a tropical climate, a refrigerator is a necessity. Everyone, regardless of class, feels the need for entertainment. For the poor in Brazil, that comes in the form of television or radio.

Penetration of Selected Goods by Economic Status

	SEGMENT E	SEGMENT D	SEGMENT C	SEGMENTS A AND B
Households	33%	21%	28%	18%
Number of toilets/household				
0	36%	14%	5%	1%
1	60%	77%	74%	39%
2	4%	8%	18%	34%
3	0%	1%	3%	18%
>4	0%	0%	1%	8%
Garbage Pick up	60%	80%	90%	96%
Electricity	87%	96%	99%	100%
Phone	11%	28%	51%	86%
Microwave	3%	9%	22%	58%
Refrigerator/Freezer	62%	88%	96%	99%
Radio	**78%**	**88%**	**93%**	**97%**
Television	**72%**	**90%**	**96%**	**99%**

Typical Customer

Seventy percent of Casas Bahia customers have no formal or consistent income. Casas Bahia customers are primarily maids, cooks, independent street vendors and construction workers whose average monthly income is two minimum wages (R$400). Customers typically live in concentrated areas called "favelas." The average size home in a favela can be as small as 215 square feet and house up to seven family members. As a result, these communities are densely populated with approximately 37,000 people per square kilometer. In comparison, according to the U.S. Census Bureau, five of the most densely populated cities in the United States are: Union City, NJ (17,962); Guttenberg Town, NJ (16,569); West New York Town, NJ (14,480); Hoboken City, NJ (10,133); and New York City, NY (9,151).

Competitive Landscape

Casas Bahia has operations in three Brazilian regions and eight states: Southeast (São Paulo, Rio de Janeiro and Minas Gerais), South (Santa Catarina and Paraná) and Central West (Distrito Federal, Goiás and Mato Grosso do Sul).

The competitive landscape of the retail industry in Brazil is constantly changing based on product offerings, geography and target population. For example, Ponto Frio offers a wide range of products, but primarily serves the medium- to high-income population. Marabrás is focused on the BOP, but only carries furniture. Casas Bahia's competition also varies by region. In the Southeast region top competitors include Ponto Frio, Lojas Cem, Magazine Luiza, Marabrás and Kolumbus. Lojas Columbo is the only serious threat in the south.

Due to difficult economic conditions, the retail landscape over the past several years has seen many competitors exit the industry as well as considerable consolidation. With no new entrants, a large portion of the market share is concentrated with only a few companies. The top five competitors comprise 45% of total retail sales. Casas Bahia remains the leader with approximately 15% to 20% of the market. The top competitors continue to grow; Casas Bahia, Ponto Frio, Marabrás and Lojas Cem averaged 10% growth per year over the past several years. Others, such as Magazines Luiza, experienced 20% growth per year in the last decade.

With average net margins in the retail sector a modest 2.5%, competition is fierce and volume based. As such, it is doubtful that many new companies can afford to enter the market. Thus, the remaining 55% of the market, which is comprised of small to medium regional stores, should provide the opportunity for further consolidation within the retail market.

Until now, Casas Bahia has only concerned themselves with "traditional" competitors. Recently, large hypermarts, such as Carrefour, Extra, and Big, have begun to enter into the appliance and furniture business. The entrance of these companies into the market represents an increasing threat to Casas Bahia. Hypermarts generate high customer traffic and have strong brand recognition. They have the physical size to accommodate additional merchandise as well as an existing distribution network of locations. Moreover, the difficult economic times are forcing hypermarts to find new ways of increasing the amount of each customer's purchase. Despite this emerging threat, Michael Klein believes the Casas Bahia business model is distinct and that "our customer service is far above the competition."

Casas Bahia Business Model / Positioning

Management Style

While his father's management style is the basis for Casas Bahia's culture, the moment you walk into Michael's office and see the large flat panel monitor sitting on his desk, you begin to notice how Casas Bahia is leveraging Samuel's traditional ideals with modern concepts. As Michael taps on his keyboard, the monitor pops to life and the modern manifestation of Casas Bahia's traditional values appears. The screen displays a large array of real-time information: total unit sales, total revenues, total financed value, average down payment, average interest paid, average payment period, percentage use of own resources to finance, use of third party for financing (borrowing) and total sales to customers who enter the store to pay an installment (cross sale).

All stores are linked and monitored real time. Casas Bahia has developed a system that can analyze data from multiple points of view: individual store, groups of stores, region, city and even by product category, individual product line or SKU. From his desk, Michael can track the results of the six million people who enter his stores every month. Those six million customers generate an average 900,000 new sales per month, 7% of whom take advantage of a cross-selling opportunity. The people comprising this 7% have an average balance of R$11.7 million and purchase an additional R$31 million. The percentage of cross selling seems relatively low because customers are eligible to make additional purchases once they have paid at least 50% of the original purchase.

Currently, the average finance term is six months, the average interest rate is 4.13% per month (ranging from 2.5% for four-month term sales to 6% for 12-month term sales), the average ticket is R$440 and the default rate is 8.5%. Default rates vary by product. For example, furniture has a default rate of 4%. Since Casas Bahia delivers and installs the merchandise in the customer's home, it is much easier to collect. Conversely, portable items such as mobile phones and bicycles have default rates of up to 10%. Casas Bahia does not monitor default rates by length of loan.

All major projects, capital or otherwise, are under Michael's supervision and direction. Though each project varies based on particular circumstance, Casas Bahia maintains general guidelines. A new store must have at least 100,000 potential customers. Casas Bahia also will examine the number of inquiries made to the Service of Credit Protection (Serviço de Proteção ao Crédito or SPC). This will provide a rough estimate of the commercial activity in a particular area. Additionally, the cost of logistics is examined, i.e., how close the facility will be to either of the three distribution facilities or the six cross-docking centers or if a new cross docking center would be warranted.

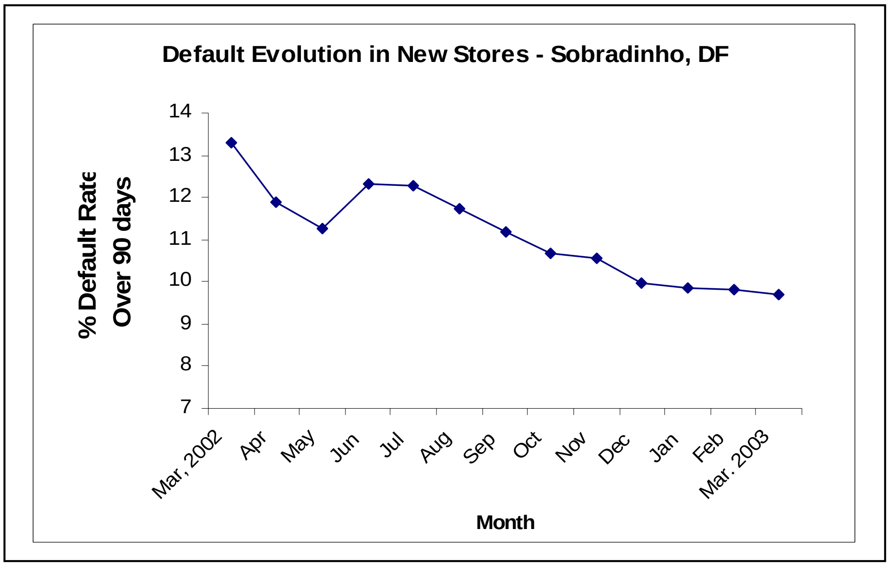
Michael gives a significant amount of freedom to store and region managers. The only requirements are predetermined revenue and profit targets. Knowing their stores' cost structure, managers have discretion to manage their operations as they see fit. A store manager has the ability to reduce the price of any product up to 10% to match the competition. If more negotiations are required, the regional manager can authorize a price reduction up to 25%. Anything greater than 25%, the regional manager will call Michael Klein directly. With more than 20,000 employees, there are only three levels from the store manager to the top executive. This autonomy does not equal a lack of control. An internal audit system is one of the important management tools for Michael.

> We are always auditing our operations. I have an internal audit team. They show up unexpectedly in one store and check everything: the money on the cashiers, the inventory, the cleanliness and the quality of in-store advertising. Everything is checked.
>
> – Michael Klein

One of the most important managerial tools at Casas Bahia is the daily Director lunch. Every day, the Klein family and key executives sit down over lunch to discuss current issues. Tuesdays are reserved for discussions with key suppliers. Occasionally, an outside guest is invited to lecture about a specific topic. The conversations are quick and informal. Typically, the food is only served once all the guests have arrived. The environment is very relaxed and lighthearted. When an attendee introduces an important topic, the atmosphere in the room will change slightly. For example, Saúl asks his Sony supplier about a price increase. After 15 minutes of negotiation an agreement is reached.

A recent change in interest rates is brought up. The change is analyzed based on the impact to final installment prices. Every executive sitting around the table knows his or her specific business down to the lowest level and what impact an interest change will have. For instance, the marketing director begins to discuss how a change will affect his current and scheduled promotions. In such a relatively flat organization, it is easy to pass decisions down through all levels of the organization. While still in the meeting, executives will be on the phone with store managers to better understand the impact. The fast-paced decision-making does not infer that decisions are uniform or made hastily. The determination of rates and terms for Casas Bahia merchandise takes into consideration the negotiation in the buying process (purchase power), market interest rates, product default rates and sales volume (seasonality, etc.). Once all issues have been finalized, lunch is complete. All executives leave the room knowing what to do and sharing a broad vision of Casas Bahia operations.

Casas Bahia maintains a simple culture dedicated to serving the customer by undertaking an aggressive style when it comes to other areas of its business. For example, when Casas Bahia enters a market, it wants to gain market share quickly. The goal is always to be first in every market. “We enter the market to be the leader, to be the best. When we arrive, we want to attract everybody, and then we clean the base and cross sell,” says CIO Frederico Wanderley. This mentality is not without a significant cost. When a store is opened, its default rate averages 16%, almost double the company average. It takes a couple of years for that 16% to come down to the average of 8.5%. The cost of customer acquisition is considered a cost of doing business at Casas Bahia.



This aggressiveness also applies to Casas Bahia suppliers. Due to their size, Casas Bahia purports to be able to buy from suppliers at lower costs than competition while still being able to sell for about the same price. “The secret is not to pass our margin on to the final product price. Thus, we respect suppliers’ brands, remain competitive and maintain our profitability,” says Allan Barros, Director of Furniture.

FINANCE

Brazilian Overview

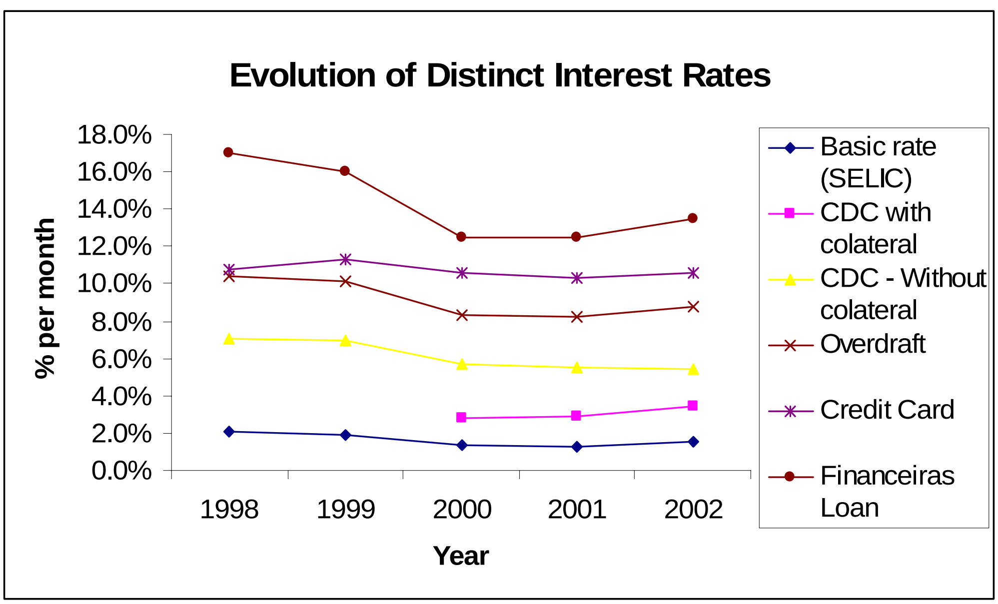
Finance here is totally different from what one learns in school. First, the informal market is twice as big as the formal market, especially in the lower-income population. Most of my customers do not declare income. I have to believe what they are telling me. Here, several multinational retailers did poorly because they were not able to understand local needs, for example, Sears and Wal-Mart.

– Michael Klein

Retail banks in Brazil are "Universal Banks," with wide national presence and complete product offerings such as credit, savings, insurance and finance products. Client information is very important because the credit bureau in Brazil, Serviço de Proteção ao Crédito (SPC), provides only positive/negative information on customers. Any disclosure of credit information is illegal. Based on historically high interest rates, the banking system is highly profitable. Maintaining this profitability has made banks' credit policies conservative toward the low-income population. Consequently, access to current account varies significantly with economic level.

Segment	Current Account Penetration (%)
A	>90
B	~60%
C/D/E	<40%

Since traditional banks would not serve the poor population, Financeiras, consumer credit companies, emerged to serve unmet consumer credit needs. Their core business is conceding credit to low-income people who do not have access to a bank account. Additionally, a significant amount of current account holders rely on Financeiras because traditional banks cannot fulfill all their credit needs. Financeiras typically have very high interest rates, up to 14% per month on personal loans, and origination fees that keep a significant share of this population away from credit products.



Casas Bahia's Role

Casas Bahia emerged by fulfilling this untapped financing need. Since joining the company 27 years ago, Celso Amancio, Director of Credit, has helped the company perfect a unique financing model that has enabled Casas Bahia to successfully serve BOP customers, customers previously ignored by the retail industry. "Casas Bahia's motto is, 'Total Dedication to You.' This dedication is evident since Casas Bahia has created a culture whose sole purpose is to fulfill the dreams of its customers," says Celso. While many companies considered Casas Bahia customers undesirable, Casas Bahia saw an opportunity.

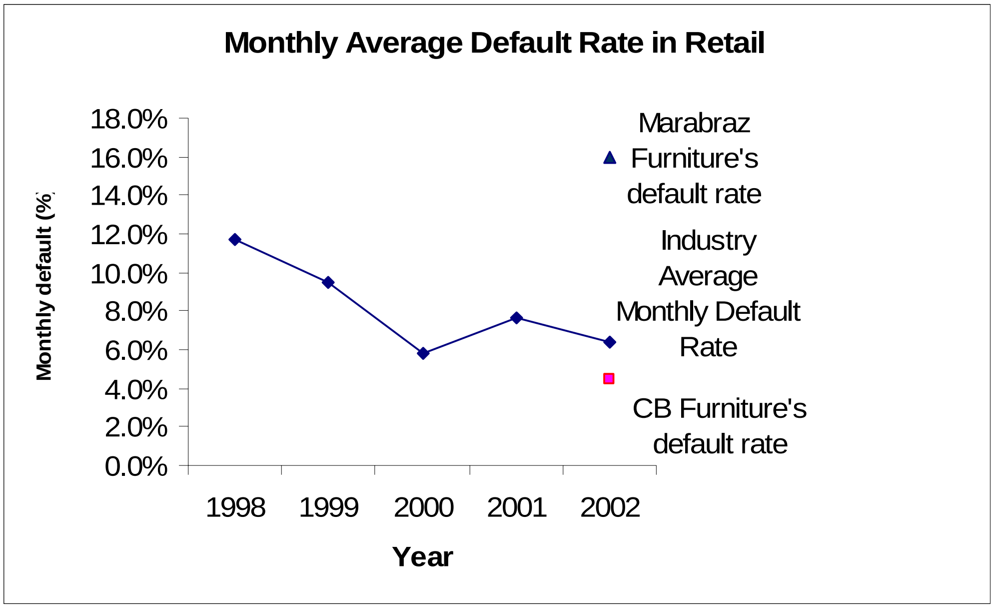
In order to serve the poor population, Casas Bahia developed an innovative approach. Part of the solution is the now famous "carnê," or passbook, that allows its customers to make small installment payments for the merchandise. Payment schedules range from one to 15 months. The passbook is payable only at Casas Bahia stores, and every month consumers must enter a store to pay their bill. This method also helps to maintain relationships with clients. The financed sale is responsible for 90% of all sales volume: 6% are cash payments and 4% are credit card.

All customers who wish to finance their purchase must submit to an SPC credit check. If the customer has a negative SPC score, Casas Bahia will not be able to complete the transaction until the customer resolves his credit problem. If the customer has a positive score, there are two alternatives. If the merchandise costs less than R$600, no proof of income is required; a valid permanent address will suffice. If the merchandise costs more than R$600, Casas Bahia has developed a proprietary system to evaluate the prospective client. They receive a credit limit based on total income, both formal and informal, occupation and presumed expenses. This "scoring" process takes less than one minute. If the system approves the prospect, the salesperson can continue with the sale. If the client is rejected by the system, he or she is directed to a credit analyst for further evaluation. This is where the importance of building a relationship is prominent. Based on training, the credit analyst will ask a series of questions to determine a client's creditworthiness. The entire process typically is finished in 10 minutes or less.

The proprietary system that determines the creditworthiness of new clients also evaluates existing clients for potential new purchases. Based on the same drivers noted above, in addition to payment history, the system will automatically produce a new credit limit. This ability is key in the cross-selling process. When the customer comes into the store to pay their monthly installment, a new credit limit is available to the Casas Bahia salesperson. This salesperson has the opportunity to make a tailored cross sale in the amount of the new credit limit.

Many outsiders argue that Casas Bahia is simply exploiting the poor and charging them exorbitant interest rates because the poor do not know any better. Quite the opposite seems to be true. In order to maintain low default rates, salespeople must "teach" consumers to buy according to their budget. For instance, a customer enters the store and wants a new 27" television. A salesperson will sit down with the customer (a Casas Bahia Regional Manager mentions you always discuss price sitting down, so it is harder for the customer to walk away) and discuss multiple payment options. If it becomes clear the customer cannot afford the 27" television, the salesperson will work with them to "tweak" their dream to temporarily include a 20" TV.

The consumer education process is a key component for Casas Bahia to have a default level of 8.5%. To put it into perspective, the average for the entire retail sector, which serves all income levels, is 6.5%. Casas Bahia's competition at the BOP has a default rate that reaches 16%.



If you look at the default rate for furniture at Casas Bahia, it averages 4.5%. Marabrás, our main competitor in the furniture industry, has an average default rate of 15% to 16%. One of the driving factors of the higher default rate is that they don't finance the customers themselves. In the [competitor's] store you have a number of kiosks from various financeiras. The customer simply chooses a kiosk. This creates a large disconnect between the salespeople and customer. The salesperson has no incentive to build a relationship with customers or understand their abilities and needs because they are at no risk.

– Michael Klein

Though Casas Bahia has become the largest retailer in Brazil by focusing on financing BOP customers, it has also provided several challenges. Identifying and overcoming these challenges has strengthened the vision Samuel Klein had over 50 years ago. If you ask any customer they will state, "At Casas Bahia, it is easy to get credit." Samuel Klein believes that customer needs are paramount and it should be as easy as possible for the customer to fulfill their dream. To make a seamless and efficient customer-facing process requires rigorous and strict planning by Casas Bahia. It starts with the training of its credit analysts.

Training

The credit analyst plays a vital role in the success of Casas Bahia. As such, the company has devoted significant time and resources to train its credit analysts. With an average of 750,000 customers requesting financing every month (1.4 million in December), Casas Bahia's 800 credit analysts are the lynchpin, not only in maintaining a default rate below industry average but also in fraud detection. In 2002, 35,000 cases of fraud representing $440 million were averted.

Many at the "Bottom of the Pyramid" have never applied for or been granted credit, rendering the formal SPC system useless. Without a steady or reported income and a personal economic status that can change daily, it is up to the credit analyst to decide if the customer they are dealing with is honest, sincere, and will be able to make the necessary payments. Every customer who presents himself or herself has a unique situation. The training the analysts receive prepares them to make decisions that enable the continued success of Casas Bahia.

Training is a combination of classroom and informal techniques. The first step takes place in the classroom. Employees learn the basics ranging from the importance of personal grooming to the necessity of having a positive attitude toward the customers. It is in the classroom where Casas Bahia employees begin to understand the importance of building a long-lasting relationship with the customer. When people, especially the poor, walk into the store, they want a friendly face, someone who they can talk to about their day. Customers want to ensure the person they are talking with understands their background and can help them fulfill their dream. According to Celso Amancio, many customers "come in as a client and leave as a friend."

The relationship between the analyst and customer creates a virtuous cycle. For instance, a customer enters Casas Bahia in need of an oven to replace her current oven that is no longer working, yet is currently unable to pay. Based on either an existing relationship or one that is developed in the short time she is in the store, a credit analyst can approve the loan even if the customer does not currently have the necessary proof of income. The customer is grateful the analyst is taking a chance and trusting she will make the payments. Then, when things turn around for the customer, she is willing to buy more from Casas Bahia and she also tells family and friends about the experience.

It is also in the classroom where analysts learn the importance of asking the right questions. Depending on the store location, the analysts will learn about their customer's primary livelihood. For example, if a customer comes in and says he is a construction worker, the analyst will begin to discretely "size up" the customer. They will notice if the customer has calluses on his hand or wrinkles around their eyes from working outside all day. The analyst also might ask a few technical questions in the context of a project they may be involved with at home. This interaction serves two purposes: It begins to filter out fraud potential, but more important helps build the relationship with that customer. Analysts are taught to always ask questions and be creative in trying to understand the customer.

After completing classroom training, new employees "shadow" an experienced employee for two weeks in a store. Trainees learn first hand how to implement classroom teachings and the importance of cross selling at Casas Bahia. Cross selling is an important part of the company's success since 77% of clients who open an account make repeat purchases.

Another important aspect of Casas Bahia training is teaching the analyst the art of saying "no" to the customer. An estimated 16% of customers applying for credit are denied. What is a seemingly basic concept has a long-lasting importance to Casas Bahia customers. When a customer enters a Casas Bahia store, they are hoping to fulfill a dream. When you tell a potential customer "no," you are effectively destroying their dream. Samuel Klein has fostered a culture where this is unacceptable. Analysts always work to maintain the relationship. The customer should be viewed for their long-term potential as lifetime customer. Although they can't afford something right now, their situation will improve and then they can buy that new TV.

Rejection is sometime necessary and appropriate. The main reasons for rejection are threefold: negative SPC rating, credit limit and third-party acquisition. With a negative SPC rating, there is nothing Casas Bahia can do. The analyst states that if it were up to Casas Bahia, they would do business, but cannot due to the score. They apologize and mention that as soon as the "little problem" is resolved, they will welcome the customer back and finish the transaction. An insufficient credit limit is handled with offers of similar products or different brands or models. Third-party acquisition is when the actual customer has a bad credit rating or cannot afford the merchandise himself, so he has another person purchase it for them. The customer would then pay the third party. However, this arrangement usually leads to default. First, there is a reason the customer could not afford the merchandise in the first place; second, the third party who purchased the merchandise has no vested interest in paying Casas Bahia. Third-party purchase is the leading cause of default at Casas Bahia. The second is unemployment, and third is simply spending beyond one's means.

Cash Management

Casas Bahia's dependence on banks is very low. According to Michael Klein, Brazilian law does not permit Casas Bahia to fund the interest portion of its consumer loans. Therefore, that portion is packaged and sold to banks or financeiras. Casas Bahia used to have its own financeira. The company dissolved this entity because it was not the core business for Casas Bahia. Now, the company's policy is to borrow as little as possible and finance the customer while funding the expenses internally.

Additionally, Casas Bahia does not hold to external currencies. This is especially important in the Brazilian economy, where local currency devaluations have caused prices to increase dramatically. Casas Bahia believes that since they do business in Brazil, the company's currency and exposure should be within Brazil. Moreover, minimal exposure to banks for external debt is beneficial.

Products

Casas Bahia carries and sells top-quality brands: Sony, Toshiba, JVC and Brastemp (Whirlpool). There is a misconception that because customers are poor they do not desire quality products. In Brazil, C, D & E customers desire the same merchandise as A & B customers. They want the dream they see on TV, not a cheapened version of that dream. The difference is that individuals at the Bottom of the Pyramid cannot afford to walk into a store and pay $500 cash for a new refrigerator. They can afford to make small installment payments to pay for that new refrigerator.

Currently, furniture is Casas Bahia's top-selling product category at 31% of total sales. Televisions place second at 14%, and audio products are third with 10% of total sales. Remaining sales are spread among phones, computers, electronic accessories and appliances.

Casas Bahia's purchasing power is one of its key success factors. In 2002, Casas Bahia sold 18% of the 4.5 million televisions produced in Brazil. Consequently, the company can determine the success or failure of a supplier in local markets. Allan Barros, Director of Furniture, related the story of a Casas Bahia supplier: "Last year Mitsubishi was out of our stores from June through December. In six months they fell from third to the 15th position in Brazilian television sales."

Due to the pursuit of higher margins and an increasingly difficult market for appliances, Casas Bahia has shifted focus and plans to increase furniture sales in 2004 to 40% of its total revenues (up from 15% in 2001). In order to keep up with demand, Casas Bahia has built its own production facility, a wholly owned subsidiary called Bartira. Producing the furniture internally also will help ensure the company can continue to provide customers great-looking furniture while controlling costs. Casas Bahia produces only large pieces of furniture, such as kitchen cabinets and room wardrobes. The remaining furniture is purchased from several suppliers.

When designing its products, Casas Bahia utilizes a reverse engineering process. First, the company determines the terms it will pass along to the customers, both price and number of installments. Based on experience and research, Casas Bahia understands what the customer is willing to pay. The product then is developed. In addition to the cost, product size and appearance are considered. An example of focusing on the importance of customer research can be seen with the success of the recently released "Top Line" wardrobe product. Traditionally, wardrobes in Brazil were 2.2 meters high. However, Casas Bahia observed that many customers had houses that would only allow furniture that was 2.0 meters high. Casas Bahia designed a product that matched the customer needs. "Top Line" products have been a tremendous success. In the first month, 7,000 units were sold, with an average price of R$1,035. Customers pay up to 15 installments of around R$70 (about US$20). In addition to the commercial success of the new wardrobe, Casas Bahia developed a manufacturing process for the product that virtually eliminated all the waste previously associated with the manufacture of wardrobes.

The production schedule is based on sales forecasts. These sales forecasts are derived based on historical sales, targets and product availability at the warehouse. Typically, Casas Bahia maintains 30 days of inventory for furniture and 45 days for all other products.

In an attempt to fully realize the benefits from the growing furniture segment, Casas Bahia brought a second furniture production online in the second half of 2003, at a cost of R$25 million. This will increase production from 100,000 to 230,000 pieces per month. In 2002, Casas Bahia had to purchase up to 60% of its furniture from external suppliers. The chain will have special promotions to continue the growth in furniture sales. For example, Casas Bahia offers interest-free financing for furniture for up to 15 months. Typically, at Casas Bahia, interest-free financing is only allowed up to the first six months.

Distribution

"The poor are requiring more. Five years ago, giving the customer a seven-day delivery window was sufficient. Now they require the specific day. The main reason for this change is that now, more than ever, both the man and woman of the household are working. As a result, we are always looking for new technology to better serve the customer. Our next step will be to be able to schedule the actual time of delivery."

– Gilberto Duarte, Distribution Director.

Unlike its competitors, Casas Bahia does not strictly focus on streamlining the supply chain, minimizing working capital or increasing its inventory turnover ratio. Casas Bahia differentiates itself by placing a large emphasis on the supplier negotiation process. The company strives to make the best possible deal with its suppliers, negotiating huge volumes at very low prices. Casas Bahia claims this strategy works best both financially and in terms of customer service. For example, Casas Bahia typically sells 1,000 units of an item per month and a supplier comes with a great offer on 6,000 units. For the right price, the deal will be executed. One reason why Casas Bahia has built the largest warehouse in South America (also one of the largest in the world) is to give management the freedom to make deals the company deems good for business. The large warehouse also allows Casas Bahia to hold large inventory positions. This can be important because the supplier and production system in Brazil can be much less reliable than in more developed countries. Casas Bahia cannot afford to be out of stock.

To support operations Casas Bahia has three distribution centers. The largest is in São Paulo, then Rio de Janeiro and Ribeirão Preto. Additionally, the company has six cross-docking facilities: Brasília, Goiânia, Campo Grande, Belo Horizonte, Curitiba and Itajaí. Due to its strategic position, the main distribution center for São Paulo is located in Jundiaí. The facility is located on several major freeway access points that provide multiple entryways into São Paulo in case of traffic problems. Also, it allows for easy access to the roads to Rio de Janeiro and Minas Gerais. There are more than 1,800 employees at the São Paulo distribution center alone.

Casas Bahia owns and maintains a fleet of approximately 1,000 trucks: 90 long-haul trucks, 700 standard trucks, 200 medium trucks and 10 small trucks. The small trucks can maneuver difficult deliveries in small streets that run throughout the "shantytowns." The fleet is entirely comprised of Mercedes trucks. This enables efficiency and cost reduction when it comes to maintenance. Casas Bahia, at its São Paulo distribution center, does all maintenance, cleaning and care.

Delivery Drivers

A successful delivery can determine whether the customer makes a second purchase at Casas Bahia. Casas Bahia employs and trains approximately 2,500 drivers and crew. All trucks for customer delivery go out with one driver and two crew members to help with delivery.

In order to reduce training costs, Casas Bahia focuses on employee retention; current driver turnover is very low, approximately 3% to 4%. The company has developed a number of programs and incentives to target retention. Casas Bahia pays its drivers more than the competition. The company offers subsidized cafeterias in each of its three distribution centers. In São Paulo, Casas Bahia provides free transportation (park and ride bus system). Finally, no one can be fired without director approval.

Drivers go through a formal training process. Drivers must always be respectful, clean, well groomed and wearing a clean uniform. The majority of people they deal with are female. Drivers are taught how to properly load and unload a truck. They always must be courteous and never bump or drag the merchandise. If they are there to replace the refrigerator, for example, the crew will dispose of the existing appliance if desired. This is all a part of respecting the customer.

Once the delivery is complete, customers are given a phone number to call if they have any complaints. If a driver or crew member receives two complaints, they are typically let go. Additionally, 3% of all customers are randomly sampled to report on their delivery experience with Casas Bahia.

Delivery Process

Do you know why I do not outsource delivery? Because I cannot permit the delivery person arriving at a client's house without a uniform, or that he doesn't have enough care and causes damage at my customer's house. If he is my employee, my client knows where to complain.

– Michael Klein

All major appliance deliveries are made from one of the three distribution centers or six cross-docking facilities and are guaranteed by a specific date. No deliveries are made from the stores. If a customer wants the item that day, they must carry it out themselves. In some instances when the customer really wants that stove or refrigerator that day and has no way to get it home, Casas Bahia will, at their own cost, hire a local service to deliver the merchandise. Other than that rare occasion, the merchandise in the store is mainly for display purposes. Once the display items begin to get old, they are moved to the clearance section for sale as an "open item." These items will be delivered by Casas Bahia the next time a truck from the warehouse arrives to replenish the store. In this instance, there is no guarantee of delivery time. Stores utilize a system that automatically reorders their inventory based on predefined reorder points. On average, each store has 15 days of merchandise on hand for small appliances.

In general, a long-haul truck that carries an average of 120 orders delivers to one of the six cross-docking facilities. At the cross-docking facilities, the orders are broken down onto four "urban" trucks that carry 30 orders. The "urban" trucks also can deliver directly from the distribution center. In December alone, Casas Bahia averaged 24,000 deliveries per day, six days a week.

Customers can pick the date they wish to have the merchandise delivered. In general, deliveries are made within 48 hours of purchase. However, a customer can make the purchase now and have it delivered six months from now. Also, a customer can purchase any item at any store and have it delivered to any location in Brazil where Casas Bahia operates.

Stores and Store Fronts

All stores have roughly the same configuration, product offerings and brands. Each store will differ slightly based on the local client needs. In São Caetano more appliances are sold. In São Paulo, televisions and electronics are the biggest sellers. The layout of the stores is decided by the store and regional managers based on local needs. Generally, layouts and product mix will be adjusted over time, especially at new stores.

Training is a very important part to the success of fulfilling the customers' dream. Salespeople become experts in their particular department, and are only allowed to sell in their department. If the customer wants something from another department, the salespersons will team-sell with a representative from their respective department. The only people in the store who can sell across departments are those located at the cashier whose sole purpose is to focus on cross selling. Several sales representatives are dedicated to this function. When the customer comes in to pay their monthly bill, salespeople gather all the feedback on the purchase, delivery and process. This information is then passed on to the store manager. As long at the customer has paid off 50% of their bill, they are eligible for cross selling.

One strategy that Casas Bahia has undertaken is building several stores close together. This strategy serves two distinct purposes. In an area like São Paulo that is very densely populated, traveling can be difficult. Bringing the store to both the customer and employee is crucial. Many customers must walk to the store. A customer can take the bus, but that costs money and takes a lot of time. Stores must be accessible in order to be successful. Also, having several stores located in close vicinity effectively saturates the area, making it difficult for outside competition to enter. One megastore is not the same as four or five smaller stores serving the same population. Some cannibalization has taken place. Though individual store sales have decreased, the overall sales of Casas Bahia had increased dramatically.

To better understand the size, scale and profitability of a Casas Bahia store, we have selected a few examples. For instance, in the southern part of São Paulo, there are 15 Casas Bahia stores serving over four million people. In one large neighborhood in this region, there are seven stores in a four-block radius. In a large nearby shantytown, Jardim Angela, 350,000 people are served by one store. Despite this variation, all Casas Bahia stores average 25% to30% gross margins.

Marketing

Marketing always has been very important to Casas Bahia and is one of the key components for success. Casas Bahia strives to always be foremost in the mind of its population because potential customers tend to research prices at one of the chain's stores prior to making a purchase.

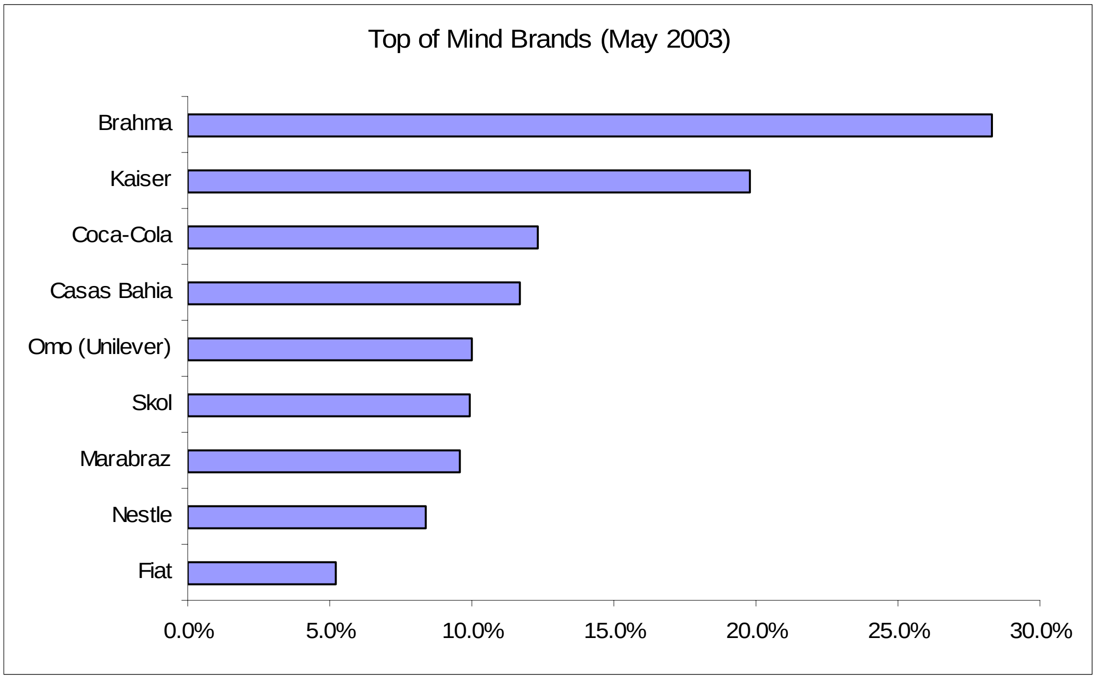
Today, fierce competition in the retail industry has increased the importance of marketing. Since most products do not differ significantly, competition is fierce. The lack of product differentiation reinforces the importance of marketing within the retail sector. Today, Casas Bahia invests approximately 3% of revenues in advertising. It maintains one of the largest advertising budgets in Brazil. In 2003, the advertising budget for Casas Bahia totaled R$200 million, equal to the combined advertising budgets of McDonalds and Pão de Açúcar (the largest Brazilian hypermarket chain) for the same period. Casas Bahia's total airtime is larger than that of the most famous Brazilian soap opera. The company's strategy to attract customers to the stores is to announce their low prices with brand name products. Michael Klein believes that, "Once in the store, the well-trained sales rep has to make the sale."

Casas Bahia's main advertising venue is television, which reaches over 90% of all Brazilian households. The company also uses significant radio time. According to Crowley Broadcast Analysis, Casas Bahia led the ranking of the 10 most invested companies in radio advertising. The survey covered 15 São Paulo-based radio broadcasters and 16 Rio de Janeiro-based stations over the second half of 2002 (Jul-Dec). The chain accounted for 17,438 radio spots in São Paulo and 11,106 in Rio de Janeiro. In Belo Horizonte, Casas Bahia ranked tenth with 1,843 ads. Throughout Brazil, Casas Bahia moved to the number-two position in advertising.

Since there is little product differentiation, sales are often made on the basis of emotion, leveraging famous singers, actors and television "anchors." Last year, Casas Bahia used a campaign utilizing client testimonials for the first time, which intended to show the emotional relationship between the company and its consumers. Casas Bahia advertisements are broadcast on main television channels, including premium programs at prime time. Advertising messages range from pure price advertising and notification of clearances to a company belief that "if the competition has better price or better payment plans, we will beat them."

Every month, Datafolha/M&M Research publishes a summary of the marketing impact on the Brazilian consumer. In May 2003, the research reported the following information: Casas Bahia ranked fifth in the overall favorite advertisements by television viewers. The top three were beer sellers and the fourth a cleaning sponge. The closest competitor was Marabrás at number 11.

Additionally, Casas Bahia ranked as the fourth most recognized brand that is on the consumer's mind.



Casas Bahia also relies on special promotions to both maintain their current customer base as well as attracting new customers. In 2002, the company pardoned debt of consumers who had defaulted on payments prior to 1997. As a result, thousands of previously inactive clients were able to purchase again. Not only did this promotion generate significant sales flow, it also provided Casas Bahia with a tax break. The company also created "unemployment insurance" for appliance sales. If a client lost his or her job, Casas Bahia would forgo the first six installments.

Other promotions include the Casas Bahia yellow preferred-client card. The card, which gives punctual payers automatic credit approval, is considered a status symbol among customers. Another marketing tool is a form letter that is generated when a customer has had no activity in their account for several months. It serves as a subtle reminder to the customer that they have not purchased anything for some time and their business is valued. The letter, from Mr. Klein, "thanks the customer for paying on time." As witness to the seeming success of this campaign, while visiting a store we noticed customers proudly displaying their letters as they waited in line to pay for their new purchase.

Technology

The role of technology at Casas Bahia is to enable three guiding principles: productivity, low- cost operations, and client satisfaction.

On April 21, 1994, while competitors were scaling back technology spending, Casas Bahia upgraded its systems. This has effectively enabled Casas Bahia to take full advantage of the economic regeneration in Brazil. The company has grown six-fold in nine years. On July 1, 1994, Brazil introduced its economic turn around plan, effectively halting its massive inflation. This improved the everyday life of those at the "Bottom of the Pyramid," triggering a consumption explosion. Today, Casas Bahia has more than 10 million customers. This figure does not include those individuals who have not been active in the past two years.

Technology has been a key enabler to the growth of Casas Bahia. Prior to upgrades in technology, Casas Bahia required an average of 30 credit analysts per store. Every customer was treated as new whether they had been a loyal customer for 30 years or just walked in off the street. The average wait time for credit approval was 30 minutes for all customers. There was no purchase history or documented behavior for the customers. There were several clerical mistakes and considerable redundancy.

The entire process is now automated. Stores require only four or five credit analysts. For purchases under $600, customers experience virtually no waiting times. If the purchase is greater than $600, average wait time is one to two minutes. If there is a new customer or a credit limit extension is required, the wait time can be up to 10 minutes. Since all information is only entered once, processing time and related mistakes essentially have been eliminated.

Technology also has helped to greatly reduce fraud. All customer information is now centralized and available to all stores. Information is stored regardless of whether a purchase was made or not. Technology also has allowed for a centralized database of all names and companies associated with fraud or attempted fraud at all their stores.

Example of Technology at Casas Bahia

One important aspect of the Casas Bahia customer relationship is that every month the customer must enter the store to pay his or her bill. Until 1995, customers and salespeople would complete a form by hand and then turn it in to the credit department to have it typed. In addition to errors, customers were forced to wait for extended periods of time.

The first significant change came in 1995, when Casas Bahia developed a system that would print the passbook from a computer. The company also decided to make it easier on the customer by sending the bill directly to the customer's home. The speed and accuracy of the customer ticket increased dramatically and the waiting time decreased. However, the customer default rate and associated costs increased dramatically. Disturbed and surprised by the two negative side effects, Casas Bahia quickly began to investigate the root cause.

The problems stemmed from two simple issues. First, the new computer generated a passbook that could not fit into a shirt pocket. Until then, customers carried the passbook in their pocket as a reminder to pay their bill. Now, customers would simply forget to pay their bills. Customers also claimed they never received the passbook or it took too long to arrive at their house. Though some customers actually did not receive the book, others were tempted to default. Within a year Casas Bahia had developed a new system that solved these problems. The new passbook could fit into a shirt pocket and people remembered to pay. Also, all paperwork was completed at the store, and the customer would provide a signature confirming receipt of the passbook and an understanding of the terms. Moreover, costs decreased due to the lack of postage and handling. With the modifications put in place, default rates returned to their normal levels.

The new system significantly increased customer satisfaction. Every time a customer made a new purchase, their information was already in the system. There was effectively no waiting time associated with receiving a passbook. This system saved Casas Bahia over $4 million in annual labor and printing savings.

The next evolution of this idea is currently in process. All customer-related materials will be optically scanned and digitized. Casas Bahia will be able to examine any information by customer, store, contract number, credit analyst, etc. at the source document level. With an average of 800,000 tickets printed per month, any incremental efficiency has a significant impact.

History with IBM / Linux

In 1994, Casas Bahia was running on an IBM 3090. It was the first company in South America, and second in the world, to run IBM 2074 OS 1.2 and 1.4. From 1994 to 2002, Casas Bahia used IBM OS2 for their point-of-sale (POS) terminals. The technology was solid, stable and no serious problems occurred. In 2002, IBM announced they would no longer support OS2.

Initially, the only option for Casas Bahia was to migrate to a Windows environment. The migration worried the company for several reasons. First, it would cost over $20 million. Second, it would effectively change the systems and processes employees were accustomed to. Retraining thousands of employees would require a significant investment in time and resources in addition to the cost of software. Moreover it would be difficult to quantify the effect on sales and customer relationships that would result from the distraction of a major systems implementation. (Casas Bahia would switch to smart terminals.) Finally, the expense associated with ongoing maintenance and individual site licenses was significant.

Casas Bahia was not satisfied with a Windows solution, so it began to investigate alternatives. Casas Bahia researched Linux. Since Linux is an open system, Casas Bahia developed a solution that closely matched its existing setup but with more flexibility and scalability. The company would be able to remotely boot and utilize frame relay and dummy terminals. The end user would never know the difference. Casas Bahia was the first to transition from the IBM OS to Linux. The company was the first in the world to come up with this solution for POS.

Recently, IBM contracted Casas Bahia to become strategic partners, helping IBM sell this solution to other companies looking for an alternative to Windows. As of March 31, 2003, Casas Bahia is one of three companies worldwide to have this agreement with IBM. Effectively, IBM can use Casas Bahia as an example and Casas Bahia gets 24/7 tech support from IBM and access to their development labs. When asked if Casas Bahia is concerned about opening up its solution to the competition, the Director of IT responded, “We are already two steps past that. Competition is good and gives you perspective as to what others are doing.”

Technology Today

Casas Bahia spends 0.8% of its revenues on technology, including capital and maintenance spending. It is estimated that competitors spend an average of 3% of revenues on similar expenditures. The key to cost savings is really three-fold. First, Casas Bahia employs a relatively low level of employees: 30 developers, 50 technicians and 50 relatively inexpensive support staff. Second, Casas Bahia does not utilize third-party vendors. As seen with the Microsoft example above, licensing third-party software for an entire company is expensive. Finally, Casas Bahia invests its resources into infrastructure. In partnership with CISCO and Telefonica, Casas Bahia had installed an IP network that connects all stores, warehouses and cross-docking facilities. Casas Bahia also worked with Telefonica to develop state-of-the-art frame relay with voice and data over IP, the first for both companies. Because this was a new venture for both Telefonica and Casas Bahia, Casas Bahia was able to lock into a long-term contract with a low rate. Finally, IT constantly focuses on reducing costs and improving productivity.

The majority of work today is focused on maximizing the customer experience. The new POS and passbook system enables the customer to have a great store experience with as little waiting as possible. The POS terminals and related system also enable the salespeople to cross sell more effectively. They instantly have the ability to know where the customer is in their payment stream and how much more the customer can afford. Casas Bahia utilizes an integrated warehouse system to ensure customers receive the product they want when they want it. Also, the integration between the front and back office enables management to be more responsive to customer needs.

Currently, Casas Bahia has no plans to integrate with its suppliers. The model in Brazil is much different than that in more developed countries. The economy is not as stable and the vendor mix changes quickly. Also, Casas Bahia focuses on personal negotiations for every major purchase. It would be inefficient to maintain a system that would have to keep up with constantly changing terms. It is easier for Casas Bahia to leverage their purchasing power without an automated system.

In the Store

Every month, the Casas Bahia system handles an average 800,000 contracts. Thirty percent are new clients and must be set up in the system for the first time. Approximately half of all returning customers are automatically approved, while the remaining half are rejected by the system and must be approved by an analyst. There are several reasons why the system will reject a customer. For a majority of those reasons though, the credit analyst will override the system and, based on their relationship with the client, grant the credit. The system does not capture if the customer has had a change in circumstance, such as a new job. It is up to the analyst to take a risk based on the relationship with the customer. Though overrides increase the default rate, the increase in the amount of sales greatly outweighs the corresponding risk. If a customer is new and has no history, the analyst must determine if the customer is a good risk. The ability of the analyst to override the system and provide the customer what they require is vital in earning the trust of the customer. Once the customer trusts Casas Bahia, the virtuous cycle can begin.

Uniqueness

According to Casas Bahia, no competitor has developed, or is in the process of developing, a comparable IT backbone or infrastructure in Brazil. This unique network infrastructure is important in the company's ability to respond quickly to the unforeseen problems that arise. All stores have remote connectivity. Approximately one-third of the stores are connected via 256kps. The remaining stores are connected at a rate of 128kps. The warehouse is at 512kps. Whether it is due to the lack of creativity or funding, the competition does not invest in technology. "Our competitors rely on third-party vendors that do not develop specific solutions, but rather a generic solution that can fit anyone's problem. It doesn't work," says Frederico Wanderley, CIO.

Ongoing IT Projects

Casas Bahia has four major initiatives. The first, which is currently being implemented, is linking sales with marketing at the POS. The company will be able to custom design, roll out and track promotions by store and customer. All stores will track the productivity and profitability of each campaign. This initiative only took four months from concept to implementation. The second major initiative is to improve deliveries. As customers become more demanding, Casas Bahia must find a way to meet their needs. The current process requires manual entry of the customer's address for all deliveries and leads to wasted time and errors. The third is the switch to optically scanning and digitizing all customer-related documents and binding them together in one electronic file. Soon, all customer-related information will be centralized and viewable at the POS. Casas Bahia has invested in a six-terabyte hard drive to house all the data. The fourth initiative is to develop a desktop managerial tool based on the new Linux infrastructure.

Future

The project next on the horizon is wireless in the stores. We see this as a better way to serve the client. It will provide an easy and cost effective way to change the layout of the stores to meet changing customer demands. Our main concern here is the security [encryption] issue.

– Frederico Wanderley, CIO

The future of technology at Casas Bahia can be described as "day by day." Though A & B customers' behavior is predictable, the behavior of C, D & E customers is not. Casas Bahia must remain flexible enough to react to quick changes. Frederico further explains:

I see a problem, I create a solution. It has to be creative. My development teams are constantly in the stores talking with the users trying to understand current issues and determine future needs. We are constantly evaluating requests to see if they make sense for Casas Bahia and are feasible. Casas Bahia works very hard to foster an environment of trust where people feel safe to share their ideas.

– Frederico Wanderley, CIO

Human Resources Management

Casas Bahia has approximately 20,000 employees. The company employs an additional 2,500 contract installers. Until 1996, all human resources-related decisions, including training, hiring and firing, were made at the corporate level. After the rapid expansion began in 1996, all HR-related functions, except for specialized training and the administrative aspect of the function, moved to the local stores. All policy decisions are still centralized at headquarters.

Most employees spend their entire career at Casas Bahia and believe they have good jobs. Average employee turnover is only 1%. Most middle managers and above have been with the company for more than 20 years. They start at the bottom and work their way up. For example, the typical path in the sales function is salesperson, manager trainee, classroom training, manager, regional manager trainee and regional manager.

All along the way they are taught and come to believe that the better Casas Bahia does, the better off they will be personally and professionally.

Prior to 1994 there was no formal training. Training is now a two-step process that includes formal classroom training as well as two weeks of on-the-job shadowing. The actual shadow time can vary according to the specific job requirements. This system enables employees to quickly learn and become comfortable with their functions. Casas Bahia developed specialized teams in finance, sales and management to assist in the training process. Additionally, suppliers now come to Casas Bahia to train employees on the uses and benefits of their respective products. This is a relatively new and welcomed occurrence. The centralized HR department occasionally will sponsor small, specialized training or contract out to a third party if specific skill training is required.

Compensation for salespeople is based on performance. Though salaries are commission-based, salespeople are guaranteed a salary of R$500 per month (2.5 x minimum wage). Brazilian labor laws do not allow for 100% commissioned salaries. The base salary is set well below the employees' sales targets. Casas Bahia employees believe the labor law is just to protect bad sales reps. Salespeople make an average of 2% commission on all their sales. However, as soon as the employee's salary from his or her commissions exceeds R$500, he or she switches to 100% commission only. The average salesperson makes R$1,500 per month (7.5 x minimum wage); high performers can reach R$3,500. Michael Klein says:

> If I let them, some of them would work for hours and hours without stopping. They know they can make a lot of money at Casas Bahia. Any person has to have a motivation, an ambition in his life. Nothing is better than giving my employees the freedom to pursue their ambitions.

Casas Bahia prefers to hire locally for its stores for several reasons. First, local hires tend to be more familiar with the neighborhood and the customers. Second, hiring employees who live close to the store minimizes the impact of bus and train strikes. The rainy season in São Paulo also results in major traffic problems. Finally, hiring locally helps both the employees and customers feel a sense of pride and ownership. In the southern region of São Paulo, there are typically 100 applicants for every sales opening. Due to expansion and turnover, Casa Bahia hires an average of 20-30 salespeople every month.

On average, according to José Roberto Fernandes, HR Director, Casas Bahia pays better than direct competitors. People love working for Samuel Klein. They believe in his philosophy of valuing and respecting the individual. Fernandes believes, "Samuel Klein has planted a seed in every store and person that is now growing." That seed is most evident by Samuel's belief that the more he makes the more he needs to share. For example, Brazil requires that companies pay employees one extra pay period in the month of December. At Casas Bahia, if business went well, the company often will pay employees a 14^{th} period. Also, travel incentives for achieving business goals and targets are commonplace. If a region or store meets a particular quarterly goal or special promotional target, they are rewarded with several days at Disneyworld in Orlando, Florida. Even now, when the overall economy is suffering, Casas Bahia continues its rewards practice; trips now are focused on local or in-country resorts.

Future Challenges

The most important factor in the continued success of Casas Bahia is the belief system and values that Samuel Klein has instilled in all the employees. A strong and continued relationship with customers is paramount. Also, within the company, every department believes the success of Casas Bahia is more important than the success of an individual department or group. Unlike in many organizations where the sales and credit departments have different objectives, this is not the case at Casas Bahia. Employees believes that as long as the customer is happy and Casas Bahia does well, then they will be personally better off.

Looking forward there are several challenges to maintain the success. In the short run, the introduction of credit cards poses a threat of losing the important client relationship as well as decreasing cross-selling opportunities. General acceptance of credit cards with C, D & E customers forced Casas Bahia to accept credit cards in September 2002. Casas Bahia was the last major retailer in Brazil to accept credit cards. In six months, credit card sales have reached 4% of Casas Bahia's total sales. On a positive note, when the credit card sale is made, the risk of default transfers to the credit card company. Credit card companies in Brazil offer an installment payment option without interest on a product-by-product basis. There is some concern that an increase in credit card sales may decrease customer loyalty due to the lack of in-store traffic. Currently, all customers must come in every month to a Casas Bahia store to make their monthly payment. This is the main traffic that facilitates the 77% cross-selling ability. This situation only will be enforced with the stabilization of the Brazilian economy and evolution of the financing market. Little by little banks are targeting the BOP in Brazil with accounts and credit cards. This will be an issue Casas Bahia must learn how to deal with.

Additionally, Casas Bahia has opened a few stores in neighborhoods that cater to A & B customers. Over the past 10 years, several retail chains that focused on serving the A & B segment have been forced to leave the market (Sears, Mappin, G. Aronson and Casas Centro). Also, in parallel with these companies going bankrupt, Casas Bahia was undergoing a major modernization. Due to the purchasing power of Casas Bahia, the company could offer better prices on the brands that A & B customers desired on a cash basis. This combination has allowed the company to capture some of the A & B segment. Though store locations are in nicer areas of the city, the configuration and products offered remain the same. That said, A & B customers tend to purchase more appliances and electronics than furniture.

There are two significant differences when serving the A & B segment: decreased profitability and differing needs. First, A & B customers typically pay in cash (C, D & E customers are 90% financed), so Casas Bahia receives no interest revenue. The company also must offer discounts to entice A & B customers into the stores. Also, A & B customers are much more demanding. Unlike those at the BOP, A & B customers require an exact delivery date and time. They also have a high propensity to complain. Moreover, as a low-cost operator, paying for real estate in more expensive markets will decrease the company's profitability. Casas Bahia must learn how to deal with high-income customers or risk taking the same path of bankrupted competitors.

Expansion poses three major challenges. First, Casas Bahia must quickly learn the behavior of an entirely new customer base. This will be increasingly difficult as Casas Bahia continues its rapid expansion of 25 stores per year. Second, the rapid growth also creates new distribution demands. Monitoring thousands of drivers, damages to merchandise, turnover, and attending to customer demands for more accurate delivery time forecasting is not trivial. Finally, controlling the default level may be the key challenge for Casas Bahia. The company opened a centralized call/collection center to address this challenge. Since consolidating more than 300 call center employees from all stores, collections recovery has increased 100%. Casas Bahia must develop a process whereby it can maintain or reduce its current default rate while continuing with its plan of rapid expansion.

Another threat is the increasing competition of large hypermarts. It is unclear whether or not those chains will develop the capability to serve the bottom of the pyramid with any significant presence. This competition poses the biggest worry to Michael Klein.

One of the most significant issues Casas Bahia faces is a long-term plan for succession. Samuel Klein's two sons, Michael and Saúl, have successfully transitioned the daily operations from their father, convincing both employees and customers they can continue the belief system their father has instilled. As Samuel reaches his 80s and his sons get older, the plans for succession are either not known or publicly stated.

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