FROM BEIJING TO BUDAPEST

Winning Brands, Winning Formats*

2005/2006

4th Edition

*connectedthinking

PRICEWATERHOUSECOOPERS

Indonesia

Indonesia

ECONOMIC OVERVIEW

GDP and CPI

The Indonesian economy grew by 5.1% in 2004, with gross domestic product totalling IDR1,660.6 trillion based on constant price from IDR1,579.6 trillion in 2003. According to Central Statistics Agency (BPS), transportation and communication posted the highest growth of 12.7%. Meanwhile, the construction sector grew by 8.2%, financial services and leasing 7.7%, processing industry 6.2%, electricity, gas and water 5.9%, trade 5.8%, service 4.9% and agriculture 4.1%.

Consumption continued to be the main driver of GDP growth. Private consumption (at current prices) reached IDR1,532.39 trillion and government consumption IDR187.77 trillion. Investment (at current prices) totalled IDR483.44 trillion, 21% of the GDP.

Standard and Poor's has upgraded the credit rating for Indonesia's long-term debt in foreign currency from B to B+. The institute also upgraded Indonesia's local currency rank from BB to B+. This is based on the stabilising economy, improved fiscal management, debt payment and external liquidity.

GDP and CPI

	2001	2002	2003	2004
GDP (%)	3.8	4.4	4.9	5.1
CPI (%)	11.5	11.9	6.8	6.1

Source: EIU, August 2005

Unemployment

Several major issues faced the new government in October 2004. One was promoting job creation. More than 10 million people are classified as unemployed and around 40 million are reported to be working fewer than 40 hours a week. About 2.5 million people enter the labour force annually and, based on past performance, the economy needs to grow consistently at 5-6% a year to absorb these new entrants into the formal sector. However, only one million new jobs have been created in each of the past two years.

Area ('000 sq km)[1]: 1,900
(US 9,600 – EU25 3,981 – World 133,700)

Capital[2]: Jakarta
(Number of inhabitants: 16.8 million)

Population (million)[3]: 223.8
(US 293 – EU25 456 – World 6,376)

GDP (USD billion)[3]: 257.6
(US 11,735 – EU25 12,723 – World 39,503.5)

GNI per capita (USD)[1]: 810
(US 37,870 – EU25 22,810 – World 5,110)

Currency: Indonesian Rupiah (IDR)

Languages: Bahasa Indonesia, English, Dutch and local dialects (Javanese)

Main religions: Muslim, Protestant, Roman Catholic, Hindu, Buddhist

Government type: Republic

Sources: CIA Factbook; (1) World Bank 2005; (2) City Population; (3) Economist Intelligence Unit 2004 data

Another dimension is that unemployment among young people has been rising rapidly; almost two-thirds of those unemployed are now in the15-24 age group. New jobs are mainly in the informal sector, where labour productivity is significantly lower. Employment in the formal sector has been discouraged by a rise of more than 60% in labour costs in the past decade without followed by a decent increase in productivity. Labour markets in the formal sector have also become more rigid, influenced by increases in minimum wage rates and by uncertainty over labour regulations. Some new jobs were being created in labour-intensive industries, such as footwear, but there is evidence that jobs in these industries are shifting to China and Vietnam.

Unemployment

	2001	2002	2003	2004
Unemployment rate (%)	8.1	9.1	9.5	9.6

Source: EIU, August 2005

Economic forecasts

Bank Indonesia estimates that a 10% hike in fuel price would raise inflation by about 0.6 point. It is predicted that inflation would increase by 7.8% in 2005, compared to 6.1% in 2004.

Real GDP is expected to grow by an average of 5.7% a year in 2003-07, largely owing to recovery in investment growth. The current account surplus will fall in 2006 due to strong growth in merchandise imports.

Preliminary data for 6.4% year-on-year (YoY) GDP growth in Indonesia in first quarter 2005 was surprisingly strong in view of the devastation caused by the tsunami in late 2004 and rising expectations of interest rate and fuel price rises. Growth in exports of goods and services was particularly robust given the general weakening of OECD (Organisation for Economic Co-operation and Development) demand. Although import growth remained strong, it slowed from the 24.9% YoY rate recorded in fourth quarter 2004 to 15.4% YoY in first quarter 2005. Despite a slow down in consumer demand growth in 2005 due to inflationary pressures, the fuel price rise and higher interest rates, the Economist Intelligence Unit expects the slack to be taken up by stronger investment growth.

The government is prioritising infrastructure development and there will be a boost in construction for the need to rebuild in the province of Aceh. Ongoing reforms in the banking sector mean that it is in a stronger position to resume lending to the corporate sector. By 2006, upward pressure on inflation and interest rates will have receded and private consumption will grow solidly in that year. Growth in exports of goods and services will slow in 2005-06, owing to weaker global demand and competitiveness problems.

Key economic forecasts

	2005	2006	2007
GDP (%)	5.6	6.0	5.7
CPI (%)	7.8	6.2	4.3
Unemployment rate (%)	9.4	9.5	9.3

Source: EIU, August 2005

REGULATORY ENVIRONMENT

Foreign direct investment

The Investment Coordinating Board (Badan Koordinasi Penanaman Modal—BKPM) is responsible for promoting foreign investment and approving project proposals in Indonesia. Other government agencies or ministries handle investments in the oil and gas, banking and insurance industries. The BKPM or the corresponding provincial board (BKPMD) approves foreign and domestic investment in all other sectors.

The government signed a decree in April 2004 to make the BKPM a one-stop agency responsible for approving and monitoring new investments. The move to centralise licensing procedures aims to increase cooperation between the BKPM, local ministries and regional administrations. Local governments will still be involved in issuing the appropriate documents and permits for investment, but the BKPM will be in charge of obtaining these permits and documents for investors, who must submit their investment proposals only to the BKPM.

In an attempt to attract more foreign investors, the government proposed a national investment law in November 2001 to give foreign businesses the same opportunities and facilities as their Indonesian counterparts. For example, it would let foreigners hold majority or full ownership of companies in almost all business sectors. The cabinet discussed this legislation in July 2004 but had not passed it by year-end. It is slated for review in 2005.

The National Export and Investment Board (Nasional Peningkatan Ekspor dan Peningkatan Investasi, or PEPI), a new national team to promote export and investment, was preparing guidelines in mid-2004 to open sectors of the economy that have been closed to foreign investors.

The government also has other ideas to promote investment, such as ensuring that land for industrial and commercial use is readily available to overseas investors. In January 2004, the authorities issued Law 3/2004, which allows for quicker resolution of industrial relations disputes. Indonesia has been a member of the International Centre for Settlement of Disputes in Washington, DC, since 1968.

During January-November 2004, the government approved 1,066 foreign direct investment (FDI) projects, amounting to USD9,580.3 million. Compared to the same period last year, there was a 0.5% decrease in projects approved representing a 29.6% drop in value.

However, actual investment funds continue to flow out of the country. Indonesia was the only country in East Asia to have suffered capital flight every year since 1998, according to the United Nations Conference on Trade and Development's World Investment Report 2004. It is ranked near the bottom at 139 out of 140 countries in attracting foreign investment, beating only Suriname in South America.

FDI

	2001	2002	2003	2004
FDI (IDR bn)	27,679.8	1,304.8	-5,498.7	9,692.6
FDI (USD bn)	-2.97	0.14	-0.59	1.04

Source: EIU, August 2005

Property/Real estate regulations

The government has enacted a number of policies and regulations with a view to regulating and controlling modern retailers and modern market formats, and protecting small retailers and traders. So far the implementation and supervision of these regulations has not been strong enough. Legal permits to establish new modern retail market formats are continuously being issued, even in areas where their issue is ostensibly prohibited. As a result, government regulations are in many ways failing to control the existence of modern markets and retailers, and small domestic traders are becoming vulnerable.

VAT

The government has revised its value added tax (VAT) policy, adopting a level 10% on retail products for all modern retailers. The new policy is stated in Kepmenkeu No. 253/2003 about Pajak Perdagangan Ritel (tax on retail trade), which was issued on 31 May 2003 and implemented 1 June 2003. The 10% VAT applies to the sale via modern retail formats of all agricultural products, as well as breeding and fishing. The policy is not effective for retail traders operating in the traditional market.

Some modern retailers are complaining about the implementation of VAT for the above stated products because it will have a direct impact on end customers, increasing prices by 10% or more. The government's decision is aimed at protecting traditional traders and increasing tax revenue, however, the move also places a bigger burden on modern retail operations and could negatively impact consumers.

DEMOGRAPHICS AND CONSUMER BEHAVIOUR

Population

Population evolution

Population

	2001	2002	2003	2004
Population (m)	214.4	217.1	220.5	223.8

Source: EIU, August 2005

Population by age group

Age profile

% of total population	1998	2003	2008 (f)
0 – 14 years	31.3	29.7	28.3
15 – 64 years	64.6	65.4	66.2
Over 65 years	4.1	5.0	5.6

Source: EIU, August 2005

Urbanisation of the population

Urban/Rural split

% of total population	1998	2003	2008 (f)
Urban	38.8	43.9	49.4
Rural	61.2	56.1	50.6

Source: EIU, August 2005

Income/Buying power

The average per capita monthly expenditure based on core data from Socio Economic Survey (Susesnas), 2003, was IDR304,751, while in rural areas it was IDR166,756. In general, average per capita monthly expenditure in Indonesia was IDR224,902, from which 56.9% was expenditure for food and 43.1% for non-food.

Changes in consumption patterns based on data compiled by Susenas in 2002 and 2003 are shown in the table below. In general, during this period, the percentages of per capita monthly expenditure for food consumption decreased both in urban and rural areas. During this period, the percentage of expenditure for food in urban areas decreased from 52.8% in 2002 to 51.1% in 2003, while in rural areas it decreased from 66.6% in 2002 to 64.6% in 2003. At national level, total (urban and rural) percentage of expenditure for food also decreased from 58.5% in 2002 to 56.9% in 2003.

Income distribution (% of population)

	2002	2003	2004
with highest income	20.9	20.6	20.8
with moderate income	36.9	37.1	37.1
with lowest income	42.2	42.3	42.1

Source: National Socio Economic Survey, Module Consumption 1999-04

Consumer behaviour

Average household spending patterns

Commodity Group	2002 Urban + Rural	2003 Urban + Rural
Food		
Cereals/Rice	12.47	10.36
Tubers (eg, Potatoes)	0.64	0.65
Fish	5.17	5.37
Meat	2.86	2.90
Eggs and milk	3.28	3.04
Vegetables	4.73	4.80
Legumes	2.02	1.90
Fruits	2.84	2.97
Oil and fats	2.25	2.23
Beverage stuffs	2.71	2.52
Spices	1.55	1.46
Miscellaneous food items	1.37	1.24
Prepared food and beverages	9.70	9.81
Alcoholic beverages	0.08	0.08
Tobacco and betel	6.80	7.56
Total of food	58.47	56.89
Non-food		
Housing and household facility	17.80	19.15
Goods and services	7.50	8.13
Education cost	2.47	2.59
Health cost	2.10	1.87
Clothing, footwear and headgear	5.18	5.49
Durable goods	4.10	3.56
Taxes and insurance	0.80	0.77
Parties and ceremonies	1.57	1.55
Total non-food	41.53	43.11
Total	100.00	100.00

Source: Statistical Yearbook of Indonesia 2003

RETAIL & CONSUMER SECTOR PERFORMANCE

Major consumer goods players

Top-10 food companies

Company name	Category of products	2003 sales (IDR bn)
Indofood Sukses Makmur Tbk	Packaged foods	7,274
Aqua Golden Mississippi	Soft drinks	4,370
Nestlé Indonesia	Packaged foods	2,922
Indomilk	Packaged foods	1,861
Gunung Slamat	Hot drinks	1,831
Coca Cola Amatil Ltd	Soft drinks	1,752
Sinar Sosro	Soft drinks	1,672
Santos Jaya Abadi	Hot drinks	1,626
Intiboga Sejahtera	Packaged foods	1,312
Unilever Indonesia Tbk	Packaged foods	1,305

Source: Companies' annual reports

Top-10 non-food companies

Company name	Category of products	2003 sales (IDR bn)
Unilever Indonesia Tbk	Cosmetics and toiletries, household care	5,665
Sayap Mas Utama	Cosmetics and toiletries, household care	1,845
Procter & Gamble Home Products Indonesia	Cosmetics and toiletries, disposable paper products	768
SC Johnson & Son (Indonesia) Ltd	Household care	590
Kao Indonesia	Disposable paper products, cosmetics and toiletries, household care	512
Ultra Prima Abadi	Cosmetics and toiletries	434
Tempo Scan Pacific	Healthcare	523
Kalbe Farma Tbk	Healthcare	367
Suryamas Mentari	Household care, disposable paper products	274
Konimex Pharmaceutical Laboratories	Healthcare	339

Source: Companies' annual reports

Major retail players

Retail sales

Retail sales growth

	2002	2003
Total sales (IDR bn)	38,573	44,483
Growth rate (%)	13.7	15.3

Source: Companies' annual reports (Exchange rate: 31 December 2004)

Market share of modern retail by format and retailers (2003)

Supermarket	Department store	Hypermarket	Minimarket
Hero 18%	Matahari 35%	Makro 38%	Indomaret 62%
Alfa 13.5%	Ramayana 22%	Carrefour 24%	AlfaMart 26%
Matahari 12%		Indo Grosir 14%	
Ramayana 8%		Alfa 13.1%	
Super Indo 7%		Goro 9%	

Source: Companies' annual reports (Exchange rate: 31 December 2004)

Key food retailers

Food retail formats	Group name	Store brands	Number of stores 2004	2004 net sales (in IDR bn)
Hypermarkets	PT Carrefour Indonesia	Carrefour	15	4,857 (EUR382 m)
	PT Hero Supermarket Tbk.	Giant	10	3,781 (Hero Group)
	PT Retailindo Tbk.	Alfa Retailindo	35	3,265
	PT. Matahari Putra Prima	Hypermart	4	5,620 (Group)
	PT Makro Indonesia	Makro	15	3,118
Supermarkets	PT Hero Supermarket	Hero	100	3,781 (Hero Group)
	PT Matahari Putra Prima	Matahari	50	5,620 (Group)
	PT Lion Superindo	Superindo	35	N/A
	PT. Akur Pratama	Yogya	20	N/A
Discount stores	PT Matahari Putra Prima	Cut Price	1	5,620 (Group)
Convenience stores	PT Sumber Alfaria Trijaya	Alfamart	939	
	PT Indomarco Prismatama	Indomaret	1,000	N/A
	PT Inti Cakrawala Citra	Mitra Indogrosir	101	N/A
	PT. Global Niaga Perkasa	Ceria Mart	70	N/A
	PT Hero Supermarket Tbk	Starmart	41	3,781 (Hero Group)

Source: Companies' annual reports (Exchange rate: 31 December 2004)

Key department stores

Group name	Store brands	Number of stores 2004	2004 net sales
PT Ramayana Lestari Sentosa Tbk	Ramayana & Robinson	83	3,799
PT Multipolar – Group Lippo	Matahari	79	5,620
PT Akur Pratama	Yogya/Griya	43	N/A
PT. Panen Lestari	Lotus/Java	5	N/A
PT Metropolitan Retailmart	Metro	5	N/A

Source: Companies' annual reports (Exchange rate: 31 December 2004)

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

Challenges

High risk political climate

One of the biggest considerations for local or foreign companies, or individuals wishing to run retail operations in Indonesia, is the country's high-risk political climate.

However, retailers still see potential. Although Wal-Mart withdrew from the country a few years ago and Makro downscaled its expansion plans, Dairy Farm, Carrefour and even Tesco are among those still interested in either entering the market or increasing their presence.

Impact on regulations

The overall number of policies issued by the government involving retailers and shopping centre entrepreneurs is, ultimately, putting a burden on consumers. While the government gives a variety of unreasonable excuses to raise tax and local authority income, entrepreneurs will ultimately pass the additional costs onto the consumer.

With government policy leading to soaring electricity and gas costs, rising VAT and higher parking tariffs, most retail entrepreneurs are likely to increase the prices of their products by between 2-3%. The act of setting retail prices should ensure retailers' profits do not decrease. As usual, the end consumer will be hardest hit.

Opportunities

Consumer demand

Consumer demand is expected to remain the main driver for the Indonesian economy over the next 12 months. Car sales remain strong, with Astra reporting domestic sales up 28% up to June 2005. Consumer confidence remains strong and although recent retail sales by volume have been flat they should increase as Ramadan and Christmas approach. This has already prompted a lift in advertising expenditure starting August 2005 following a stale past few months.

Although inflation has been stable at just over 6%, it is expected to increase towards year-end as the festive season gets underway bringing an increase in the one-month certificate of deposit (SBI), which is currently at 9.5%. In common with some other regional currencies the, rupiah has followed the US dollar down against both the euro and yen. It is likely to remain weak over the next 12 months due to political uncertainties and market concern over financial stability following Indonesia's exit from the IMF programme in 2004 as well as increasing energy costs.

Hypermarket and mini-market formats

The modern retail market is predicted to reach IDR80.7 trillion in 2007, representing an average growth of IDR9.5 trillion per year. The biggest contributor to this growth is the hypermarket segment (36.7%), which emerged as the main format in 2003. Mini-markets are the other growing format with a market share of 9% in 2007 (up 2.5% compared to 2001).

Market share of modern retailers (IDR bn)

Year	Supermarket	Share (%)	Hypermarket	Share (%)	Mini-market	Share (%)	Dept. store	Share (%)	Total	+/- (%)
2001	11,783	34.7	10,108	29.8	2,212	6.5	9,824	29.0	33,928	
2002	12,808	33.2	12,292	31.9	3,002	7.8	10,471	27.1	38,573	13.7
2003	14,330	32.2	14,678	33.0	3,693	8.3	11,782	26.5	44,483	15.3
2004	16,320	31.7	17,426	33.9	4,353	8.5	13,324	25.9	51,422	15.6
2005	18,689	31.1	21,093	35.1	5,171	8.6	15,178	25.2	60,131	16.9
2006	21,363	30.7	25,108	36.0	6,146	8.8	17,072	24.5	69,688	15.9
2007	24,429	30.2	29,659	36.7	7,308	9.0	19,371	24.0	80,767	15.9

Source: Prospect of modern retail business in Indonesia, 2004

Emerging trends

Increasing market share of foreign retailers

As foreign retailers continue to penetrate the Indonesian market, major domestic retailers are stepping up efforts to compete. Competition is likely to get fiercer as global retailers enter Indonesia following the 2004 general election.

At present, domestic retailers represent 74.3% of the modern retail market, while foreign retailers account for 25.7%. The power of funds owned by foreign retailers drives them towards expansion to gain market penetration and accelerate selling. Based on estimated growth of around 19-23%, foreign retailers could represent as much as 31.1% of the market in 2007, while domestic retailers look set to see market share slide to 68.9% with average growth of 14% per year.

Repositioning of domestic retailers

In the past two years, some domestic retailers have begun to reposition. Matahari has returned to the galleria format, with Mega M, under one brand. The move is based on a one-stop shopping concept (department store and supermarket) and is effectively targeting the middle- to lower-class market segment. In 2003, Matahari launched a new concept, namely Matahari Market Place under the hypermarket format. Similarly, So Rimo, which had previously been cultivating the upper-middle class market, is now focusing on the middle-class segment. The strategies being implemented by Matahari, Hero and Rimo are aimed at confronting tight competition in the lower-middle class market, which is an exceptionally large segment.