




FROM BEIJING TO BUDAPEST

Winning Brands, Winning Formats*

2005/2006

4th Edition

*connectedthinking

PRICEWATERHOUSECOOPERS 



Philippines

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ECONOMIC OVERVIEW

GDP and CPI

GDP and CPI

	2001	2002	2003	2004
GDP growth (%)	1.8	4.3	3.6	6.1
CPI (%)	6.1	3.1	2.9	6.0

Source: EIU, July 2005

Economic forecasts

Key economic forecasts

	2005	2006	2007
GDP (%)	5.1	4.8	5.2
CPI (%)	8.2	7.7	5.8
Unemployment rate (%)	12.2	12.0	11.9

Source: EIU, July 2005

Unemployment

Unemployment

	2001	2002	2003	2004
Unemployment rate (%)	11.1	11.4	11.4	11.8

Source: EIU, July 2005



Area ('000 sq km)¹: 300
(US 9,600 – EU25 3,981 – World 133,700)

Capital²: Manila
(Number of inhabitants: 14.5 million)

Population (million)³: 86.2
(US 293 – EU25 456 – World 6,376)

GDP (USD billion)³: 84.6
(US 11,735 – EU25 12,723 – World 39,503.5)

GNI per capita (USD)¹: 1,080
(US 37,870 – EU25 22,810 – World 5,110)

Currency: Philippine Peso (PHP)

Languages: Filipino, English and 8 major dialects

Main religions: Roman Catholic (83%), Protestant, Muslim

Government type: Republic

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

REGULATORY ENVIRONMENT

Foreign direct investment

FDI

	2001	2002	2003	2004
FDI (PHP bn)	56.2	101.2	16.9	28.1
FDI (USD bn)	1.0	1.8	0.3	0.5

Source: EIU, July 2005 (Exchange rate: 31 December 2004)

Property/Real estate regulations

Ownership

Ownership of private land is essentially restricted to Filipino citizens and to companies that are at least 60% owned by Philippine nationals. A private corporation that is 60% Filipino-owned may hold alienable public lands only through lease. Foreigners may own buildings on leased land.

However, foreign investors may lease land for certain industrial and agricultural projects for a straight period of 50 years, renewable for another 25 years.

Taxes on real property

Real property tax (RPT)

RPT at the rate not exceeding 2% is imposed on the assessed value of the real property, and fixed machinery and equipment of a domestic company. However, a province or a city or a municipality within the Metro Manila Area may levy and collect an additional RPT tax of 1% for the Special Education Fund. RPT is not imposed on an enterprise, which has been granted certain tax incentives provided certain conditions are met.

Documentary stamp taxes on transfer of real property

Stamp duty of 1.5% based on the selling price or market value (whichever is higher) is imposed on transfer of real property.

Local transfer tax

Transfer tax of 0.5% is imposed on the selling price or the fair market value of the real property transferred.

Other regulations

Competition law

The general theme underpinning the various Philippine laws touching on competition policy is to encourage free market enterprise.

Price controls

As a general rule, prices in the Philippines are determined on the basis of supply and demand, and interplay of market forces.

The government has some scope to impose price controls if it considers them appropriate in certain situations. Under the Price Act of 1992, the government may impose controls on the price of basic necessities to ensure that they remain available to consumers at reasonable prices, provided this does not deny legitimate business a fair return on its investment.

Monopolies and antitrust

The Philippine constitution requires the government to regulate or prohibit monopolies if that is in the public's interest. Based on the revised Penal Code of 1930, the central issue here is not whether a monopoly exists, but whether the monopolist uses its power to alter the price of a product or to restrain free competition in the market.

The Philippine Constitution, supported by the Revised Penal Code, also prohibits a combination of businesses that would result in unfair competition or restrain trade to artificially prevent free competition in the market.

Acquisitions and mergers

There are no restrictions on acquisitions, mergers or consolidations, unless they will result in unfair competition, or restrain trade to artificially prevent free competition in the market, or result in the foreign ownership that violates the Foreign Investment Negative List.

Tax

Corporate tax

The normal corporate income tax rate is 32% based on net income. However, corporations are subject to minimum corporate income tax (MCIT) of 2% of the gross income, if it is higher than the normal corporate income tax. MCIT is imposed on a corporation from the fourth taxable year following the year in which the corporation commenced its business operations.

However, a new law was passed in May 2005 increasing the corporate income tax rate to 35% beginning 1 July 2005. Moreover, the corporate income tax rate will be reduced to 30% by 1 January 2009. The law has not yet been implemented due to the Temporary Restraining Order (TRO) issued by the Supreme Court following a petition filed by a certain sector. As of 15 August 2005, the TRO has not yet been lifted.

VAT

Generally, a 10% or 0% value-added tax (VAT) is imposed on sale of goods or services. The 0% VAT may apply provided certain conditions are complied with.

Payments to non-residents for services rendered in the Philippines are subject to 10% withholding VAT. The payer, as a withholding agent, is required to remit the VAT to the government by filing a separate return on behalf of the non-resident payee. However, the duly validated return shall be used as support for the input VAT claims of the local payer.

A new law (Republic Act No. 9337) was passed on 24 May 2005 granting the President the authority to increase the VAT from 10% to 12% effective 1 January 2006, if either of the following conditions have been satisfied:

- VAT collection as a percentage of GDP of the previous year exceeds 2.80%. February 2005 Senate deliberations show collection of about 3.2% of GDP PHP 135 billion; or
- The national government deficit as a percentage of GDP of the previous year exceeds 1.50%.

Other national taxes

CGT

The net gain on sale/transfer of shares is subject to 10% capital gains tax (CGT) if not traded through the local stock exchange. However, stock transaction tax (STT) of 0.5%

based on the gross selling price shall apply if the shares are traded through the local stock exchange. The net gain may be exempted from CGT or STT under a relevant tax treaty.

Final tax of 6%

Gains on sale of real and personal property are subject to the normal income tax if real property is used in trade or business. However, gains on the sale of real properties that are treated as capital assets are subject to 6% final tax based on the gross selling price or fair market value, whichever is higher.

Withholding tax

Retail and consumer companies, as withholding agents, are required to withhold taxes on payments at the following rates: compensation 5-32%, expanded 1-20%, final 10-35%.

Excise taxes

Excise taxes only apply to certain articles manufactured or produced in the Philippines for domestic sale or consumption, or for any other disposition, and to certain imported items. For imports, excise taxes are in addition to any applicable customs duties and VAT.

The Philippines has both specific taxes (excise tax based on weight, volume or some other physical unit of measurement) and ad valorem tax (excise tax based on selling price or other specified value of an article). Among the articles covered by excise taxes are alcohol products, tobacco products, petroleum products, mineral products, jewellery, perfumes, automobiles and cinematographic films.

Local taxes

Local business tax

For retailers, local business tax (LBT) is imposed at a rate generally not exceeding 0.75% of the gross receipts of the preceding calendar year. The LBT is payable to the local government unit(s) where its principal and/or branch office(s) is/are located.

Community tax

The annual basic community tax is PHP500 plus a graduated tax of up to PHP10,000 based on the gross earnings or receipts for a maximum amount of PHP10,500.

Imports

Import restrictions

As a general rule, the Philippines permits the importation of all kinds of merchandise. The importation of certain commodities is, however, regulated or prohibited for reasons of public health and safety, national security, international commitments, or to facilitate the development or rationalisation of local industry.

In line with principles adopted internationally, safeguard measures may be imposed against increased imports that cause, or threaten to cause, serious injury to domestic industries and producers. Antidumping duties can also be imposed to protect domestic enterprises against unfair foreign competition and trade practices.

Customs duties and other taxes

Applicable customs duties are determined based on the tariff classification of the import product. Tariff classification in the Philippines is based on the ASEAN (Association of South East Asian Nations) Harmonized Tariff Nomenclature, which is patterned after the Harmonized Commodity Classification and Coding System (HS).

The Philippine Government's comprehensive tariff reform programme has reduced tariff rates significantly in recent years, with the average nominal tariff falling from 27.84% in 1990 to approximately 6.49% in 2004. As a prospective measure, the Philippines retains higher tariff rates (20-50%) on sensitive agricultural products such as grains, livestock and meat products, sugar, certain vegetables and coffee. A few agricultural commodities are subject to minimum access volumes, but these represent less than 1% of all tariff rates.

In addition to custom duties, imported merchandise is subject to VAT at the rate of 10%. VAT is based on the total value used by the Bureau of Customs in determining tariff and customs duties, plus import duties, excise taxes and other charges on imports (including postage, insurance and commission) before their release from customs custody.

Automobiles, fuel, tobacco and cigarettes, alcohol and liquor and other non-essential goods are subject to excise taxes imposed under the Philippine Tax Code. The system is complex, with the tax imposed either as a percentage of the value of goods or as a specified amount per unit of quantity.

DEMOGRAPHICS AND CONSUMER BEHAVIOUR

Population

Population evolution

Population

	2001	2002	2003	2004
Population (m)	81.4	83.0	84.6	86.2

Source: EIU, July 2005

Population by age group

Age profile

% of total population	1998	2003	2008 (f)
0 – 14 years	37.7	36.2	34.1
15 – 64 years	58.6	59.9	61.7
Over 65 years	3.6	3.9	4.2

Source: EIU, May 2004

Urbanisation of the population

Urban/Rural split

% of total population	1998	2003	2008 (f)
Urban	56.8	60.9	64.8
Rural	43.2	39.1	35.2

Source: EIU, May 2004

Income/Buying power

Income buying power (monthly average)

	Income	Expenditure
2001 – 2002 growth (%)	8.0	7.4
2002 – 2003 growth (%)	10.2	5.6

Source: Euromonitor

RETAIL & CONSUMER SECTOR PERFORMANCE

Major retail players

Retail sales

Total retail sales growth

	2002	2003
Total sales (USD bn)	27.11	28.48
Growth rate (%)	4.5	5.1

Source: Euromonitor, BusinessWorld (average exchange rate per year)

Breakdown by number of stores

	Hypermarkets and Supermarkets	Convenience stores
2003	5,105	1,438

Source: Euromonitor

Key food retailers

Retail formats	Group name	Store brands	Number of stores 2005	2003 net sales (PHP m)
FOOD				
Hypermarkets/Supermarkets	Supervalve	–	25	16,111
	Super Shopping Market	–	3	2,932
	Rustan Supercenters (Shopwise)	–	5	3,817
	Robinsons Supermarket	–	14	6,061
	Grand Union Supermarket	–	9	3,901
	Tropical Hut Food Market	–	7	2,013
Discount/Warehouse club	Pilipinas Makro	Aro	9	11,411
	Puregold Price Club	–	5	5,618
	S & R Price Club	–	4	4,400
	Puregold Duty Free	–	2	1,642
Convenience stores	Philippine Seven (7-11)	–	256	3,333
	Robinsons Convenience Stores	–	126	146

Sources: Top 5,000 Corporations in the Philippines 2004 Edition, Euromonitor, Company's website, Online news

Key specialty stores

Retail formats	Group name	Number of stores 2005	2003 net sales (in PHP m)
SPECIALTY STORES			
DIY	Ace Hardware	19	2,561
	Hardware Workshop	6	792
	Handyman	41	605
Home equipment (electrical goods, furniture)	Abenson	55	4,096
	Homeworld Shopping Corporation	17	3,961
	Automatic Appliances	11	1,803
	Casamia Furniture Center	6	687
Apparel	Rustan Marketing Specialists (Marks & Spencer)	5	981
	Suyen Corporation (Bench)	99	724
	Golden ABC (Penshoppe, Oxygen, Memo)	300	665
	Cinderella Marketing Corp.	60	543
Department stores	SM Department Store	22	29,895
	Landmark	1	4,430
	Robinsons	20	1,337
	JS Gaisano	20	411

Sources: Top 5,000 Corporations in the Philippines 2004 Edition, Euromonitor, Company's website, Online news

E-commerce

According to Philippine APEC Study Center Network (PASCN), total e-commerce-related revenue in 2005 is projected to account for 1% of nominal GDP, contributing up to 8% of the total GDP growth in the country. Among the 11 industries in the study, tour and travel agencies, electrical communication equipment, and forwarding and packing industries are estimated to grow in terms of revenue. It should be noted that retailing is not included since Filipinos, generally, are not accustomed to purchasing online even with the advent of the internet and high-tech gadgets.

While there are almost three million internet users in the country, the traditional Filipino shopper still wants to go through the full shopping experience. Filipinos are somewhat averse to technology and generally resistant to change in the way things are done.

The only products that are highly saleable over the internet are flowers, wines, books, CDs and DVDs – products that do not require physical assessment of fit.

Source: Euromonitor

M&A activity

In the first five months of the year, investors' confidence improved, mainly due to the progress in fiscal reform, evidenced in part by the budgetary surpluses in April and June 2005, and reports of strong earnings performance for a number of listed firms. However, the allegations against the First Family and the issuance of the TRO on the implementation of the EVAT Law, led to the downgrading of the country's credit rating outlook and the mixed movements in foreign portfolio flows from the second half of June.

M&A activity in the Philippines is likely to be limited in the near future due to uncertainty over the impeachment case filed against President Gloria Macapagal-Arroyo and the political conflicts between senators, congressmen and local government units, not to mention the economic uncertainties which includes implementation of the EVAT Law and increasing oil prices in the global market.

Overall it is anticipated that 2005 will not return to levels witnessed in 2004.

M&A activities

Year	Acquiring company	Acquiree/JV company	Nature of business	Equity stake
2004	Philippine Seven Corporation	Bingo	Convenience store chain	100%
2002	Watsons Personal Care	SM Health and Beauty Bar, South Drugstore	Personal Care and Drugstores	Joint venture AS Watson 60% SM Prime Holdings Inc. 40%
2002	Music One	Tower Records	Audio and Video CDs	–
2002	Uni-President Enterprises Group of Taiwan	RFM Group	Manufacture of instant noodles	Uni-President controls 51% of the joint venture
2001	Mitsubishi Corporation and Josco Co. Ltd. of Japan	Robinsons Retail Group	Mini Stop – convenience store chain	–

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

Challenges

Innovation

One of the biggest challenges retail businesses face today is in significantly improving the way they innovate to provide better goods and services to consumers. Historically, these businesses are proven to be the worst and slowest innovators and this will continue to hamper growth in an already difficult marketplace where others are vying for consumers' wallets (e.g., mobile phone expenditure) or stomachs (restaurants over supermarkets).

Customer retention

This area is becoming increasingly important for retailers. Retailers must therefore focus on customer relationships in an attempt to ensure customer loyalty. The ability to understand consumers and react to their requirements will enable retailers to gain a competitive edge. In the current environment, a primary way to demonstrate knowledge of the customer is by using price discrimination. Today's consumer is more demanding, knowledgeable and informed, and therefore more empowered in his or her purchasing decisions. Consumers are also more ethically concerned about the way the companies they buy from are run, and how companies source, handle, distribute and sell their products. This increase in sophistication challenges

the retail and consumer products companies to create products and services to meet the consumers' needs. Consumers are well informed about their rights, want to get a good deal and good service, and exploit offers that retailers give.

Customer loyalty provides retailers with opportunities to expand into new areas that offer a broader shopping experience. For example, supermarkets are expanding into the non-traditional market of financial services.

Technology

Retail businesses need to exploit the development of new and evolving technologies, such as digital technology and e-business, to widen the scope of product penetration and deliver the marketing message to new, potentially niche segments of the market. The ability to capitalise on the opportunities (and minimise the risks) associated with the enterprise-wide change brought by e-business is key to retail businesses' future success. They will need to adopt a flexible strategic vision to meet these challenges. The development of required infrastructure and adaptation of the company's offering (e.g., will traditional products and markets guarantee the future?) will be linked to growth in the use of e-business channels.

New markets

Retailers must identify new markets and customers in order to increase revenue. Relaxation of trade barriers, creation of trade blocs and opening of new markets presents retailers with the opportunity of going global, therefore increasing revenue and profit through exploitation of competitive advantage and economies of scale. This requires the development of a global strategy and management of cultural, legal, demographic and regulatory differences.

Pricing

Retail business margins are under threat as companies compete for customers and are forced to reduce prices.

Information dissemination

The emergence of a consumer-centric world requires retail businesses to collect and disseminate information at an increasingly rapid pace. The challenge is for retail businesses to collect meaningful data about individual consumers and transform it into actionable, consumer-focused knowledge. Customer-focused innovation will add value to their businesses and secure relationships with consumers.

Disinflation

This has been the single most important development to affect the retail industry during the past 10 years. It has changed consumer behaviour, made it more important for retailers to be merchandise managers than financial managers, necessitated larger scale operations, drove significant investments in IT, and forced consumer products companies to move from push to pull.

Opportunities

Changes in customer shopping habits towards convenience, increased demand for longer trading hours and Sunday opening provide opportunities for retailers.

Many retailers are devoting significant effort to cutting cost out of the supply chain. The development of e-commerce is a key to this process.

Emerging trends

Moving from...	...towards
Geographic based (store location)	In-store online combination
Single products	Lifestyle packages (solutions), aisles changed
Shelf space	Kiosks
Retailer-owned or vendor-managed inventory	Scan-based trading
Proliferation of new product	SKU rationalisation and optimal assortment
Product and packaging innovation	Total convenience
Regionalisation	Globalisation and consolidation
Minimal service (cashier checkout)	Self-service (consumer self-scan)
Independent operations	Company alliances
Media advertising	Web-based promotions
Super centres/hypermarkets	More global supermarket domination, such as Wal-Mart