# Poland

# Poland

## ECONOMIC OVERVIEW

### GDP AND CPI

GDP and CPI growth rates 1999-2003

| Key economic indicators | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| GDP growth (%) | 4.1 | 4.0 | 1.0 | 1.4 | 3.8 |
| CPI (%) | 7.3 | 10.1 | 5.5 | 1.9 | 0.8 |

*Source: Glowny Urzad Statystyczny (Main Statistical Office)*

The years 2001-2002 saw a sharp slowdown in economic growth which, coupled with a record numbers of job seekers, an insufficient supply of new jobs, continued structural reform and intense cost cutting in industry, has led to very high unemployment. Although Poland's economy picked up slightly in 2002, low levels of investment and high unemployment exceeding 20% continued to hamper growth.

### UNEMPLOYMENT

Unemployment rate 1999-2003

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Unemployment rate (%) | 13.1 | 15.1 | 19.4 | 20.0 | 20.0 |

Note: starting from 2001 data are not comparable because of change in calculation methodology
*Source: Glowny Urzad Statystyczny (Main Statistical Office),*

High unemployment is attributed to the ongoing structural reform, high non-wage labor costs, and subdued economic growth. Moreover, demographic factors have also become significant, as people born during the baby boom of the 1980s have entered the labor market. The recent economic boom has not yet led to an improvement in the situation. According to ILO methodology, unemployment reached 20.0% in 2003 and deteriorated further in the first quarter of 2004, by falling to 20.5%. This number translates to 3.3 million people without jobs. Moreover roughly half of them are classified as long-term unemployed (more than one year).


**Area ('000 sq km):** 312.7
(US 9,600 – EU 2,500 – World 133,700)

**Capital:** Warsaw

**Population (million):** 38.2
(US 288.4 – EU 305.5 – World 6,200)

**GDP (USD billion):** 191.3
(US 10,400 – EMU 6,600 – World 32,300)

**GNI per capita (USD):** 4,670
(US 35,400 – EMU 20,320 – World 5,120)

**Currency:** Zloty (PLN)

**Languages:** Polish

**Main religions:** Roman Catholic 95%

**Government type:** Republic

# Poland

### ECONOMIC FORECASTS

Key economic forecasts

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| GDP (%) | 5.0 | 4.8 | 4.2 | 3.9 |
| CPI (%) | 2.2 | 2.7 | 2.3 | 2.3 |
| Unemployment rate (%) | 19.7 | 19.3 | 18.8 | 18.4 |

*Source: The Economist Intelligence Unit – Forecast, March 2004, revised April/May 2004*

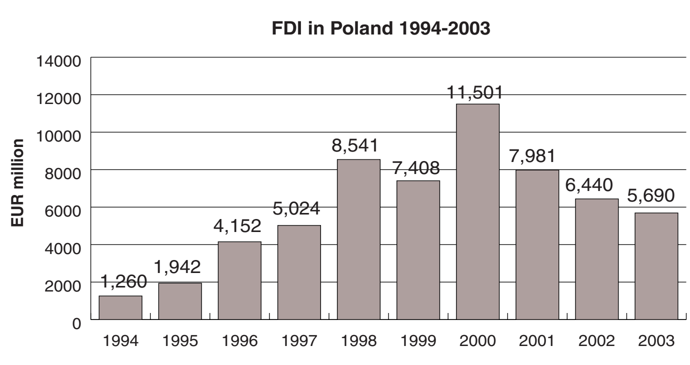
Poland began to overcome economic stagnation in 2003 when average annual GDP growth reached 3.8%. The economy has been growing strongly over the last few months, supported by robust export growth and industrial production. Inflation is forecast to increase in 2004-2005, but to remain below 3%. The current account deficit is set to remain comfortably below 2% of GDP in both 2004 and 2005.

A gradual fall in unemployment and low real interest rates will support consumer spending in 2004-2005, but the pace of wage growth will prevent a dramatic rise. Year-on-year growth in consumer prices stood at just 1.7% in March 2004. This is higher than the very low rates recorded early in 2003, but underlying price pressures remain weak.

Poland joined the European Union on May 1st, 2004. A projected rebound in investment activity as well as EU accession should permit GDP growth to reach 5% in 2004 and 4.8% in 2005.

## REGULATORY ENVIRONMENT

### FOREIGN DIRECT INVESTMENT




*Sources: Polish Information and Foreign Investment Agency (PAIIZ) 2004*

Polish and foreign entrepreneurs have equal rights in taking up and conducting business activities in Poland. Generally there are no sector restrictions for foreign capital in Poland (exemption: broadcasting, insurance, gambling & mutual betting).

Poland is offering a wide range of investment incentives. According to the Law on Financial Support for Investment of March 20, 2002, foreign investors in Poland may obtain:

- Investment grants covering up to 25% of investment outlays (in Kraków, Wrocaw, Gdañsk, Gdynia and Sopot the upper limit may not exceed 20%, whereas in Warsaw and Pozna - 15% of investment outlays)
- Employment grants - up to EUR4,000 per job created. The total value of assistance is however limited to two times the annual cost of new employees' labor.
- Training grants - up to EUR1,150 per employee
- Grants for infrastructure development that are provided to the county (gmina) administration for upgrading infrastructure related to the new investment.

Investors who benefit from investment grants are also eligible for other forms of support, such as: tax relief in Special Economic Zones, local tax relief etc., however the total value of grants and other kind of public aid offered to the investor cannot exceed 50% of the investment outlay.

Other financial resources available to investors in Poland will be EU infrastructure funds. Between 2004 and 2006, Poland is likely to receive over EUR4 billion of EU funds to enable it to improve the competitiveness of its regions. The biggest part of the funding will go to infrastructure development (more than EUR1 billion), followed by regional development (EUR700 million) and job creation schemes (almost EUR600 million).

The high inflow of foreign capital provides clear direct evidence of the country's appeal to foreign investors. Twelve years after the introduction of successful economic reforms, Poland is the Central European leader when it comes to attracting foreign direct investment. According to Polish Information and Foreign Investment Agency (PAIIZ) statistics, the amount of foreign capital invested in Poland so far exceeds EUR72.7 billion (as of end 2003), more than for any other country in the region.

## EXPECTED IMPACT OF EU ENTRY

Poland's accession is likely to improve the country's image with foreign investors and stimulate the inflow of direct foreign investment. Lower investment risk should attract euro zone companies, particularly small and medium-sized ones, that have so far regarded the achievable return rates as too low compared with the risks. At the same time, the arrival of new companies, while favorable from the whole economy's point of view, will put pressure on domestic groups.

Potential investors will pay closest attention to the fastest growing sectors. Mentioned most frequently in this regard are retailers and suppliers of household goods and leisure products in the consumer goods industry. Consumer behavior is also expected to change, with consumers expected to spend increasingly less on basic needs such as food, and more on luxury goods, high-quality products, and new or exotic foodstuffs. Seasonal products should also become more easily available. While these trends have already been observed, their intensity will depend on growth in household income.

The introduction of EU competition laws means that dominant companies will find themselves under increased regulatory scrutiny, particularly in the telecom industry where liberalization has proceeded at a painstakingly slow pace. At the same time, more merger and acquisition deals will be subject to regulatory approval, including by the Commission itself.

## PROPERTY / REAL ESTATE REGULATIONS

From May 1, 2004 EU citizens or corporations are not obliged to obtain permits for the purchase of real estate or shares in a non-publicly listed companies (companies not listed on the stock) in possession of real estate except for transactions involving forest or farming land and so-called second homes. The respective transition periods in the latter two cases are 12 and 5 years. Agricultural property can be sold to EU farmers working and living in Poland after a 3-year lease period (or after seven years in western and north eastern Poland).

## CORPORATE INCOME TAX

Some favorable reforms have been made to the corporate income tax (CIT) law and are effective from January 2004. The government has decided to cut corporate income tax (CIT) from 27% to 19%, and introduced a flat, 19% personal income tax rate for small business owners, instead of the previous 19-, 30-, and 40-percent progression.
The move involved the elimination of exemptions related to this tax.

The government also decided not to prolong exemption from capital gains tax. The exemption expired on December 31, 2003. Capital gains tax of 19% has been imposed with effect from January 2004. At the same time, the government has increased dividend tax from 15% in 2003 to 19% in 2004.

## OTHER REGULATIONS

The development of retail trade may be limited to a certain extent by legal regulations, which are already in force. These include:

- Restrictions concerning the location of supermarkets and hypermarkets and the obligation to inform environmental organizations about planned hypermarkets. Last year Poland tightened

# Poland

up zoning laws concerning hypermarkets; the opening of new medium to large-sized outlets (from 1,000 square meters in towns of less than 20,000 inhabitants, and from 2,000 square meters in larger towns) is regulated in order to protect small Polish retailers. Approvals will be granted by local or regional authorities on a case-by-case basis, following thorough studies on possible economic and environmental impacts.

- An act to counteract unfair competition – restrictions on promotions and sales without trade margins in retail outlets with surface areas exceeding 400 square meters; restrictions on the sale of private label goods in discount store chains to 20% of their turnover; restrictions on bonus sales and trade using gift coupons.

- The waste law, which orders the owners of stores to include products with reusable packaging in their offers. The law makes it the producer's duty to reprocess 7% of the raw materials in each ton of packaging and imposes an environmental tax on those who do not attain the required recovery or recycling rate in any given year. This tax will also encompass producers and importers introducing goods on the domestic market made from: plastic, aluminum, paper, glass and wood. It will also be paid by stores with a sales area of over 500 square meters, selling products packaged in these outlets, as they are treated as the producers of this packaging.

- Regulations related to fees paid to retail chains – all fees that suppliers pay to retail chains for introducing products to a retail chain, monitoring sales, special positioning or displaying of products on store shelves, introducing new products into turnover and expanding the offer of provided services to newly opened outlets should be classified as trade services and subject to 22% VAT.

- Payment dates in the commercial transactions act – effective from January 1, 2004 stipulates that payment for products or services in commercial transactions must be made within 30 days regardless of the dates in the agreement.

There has been some backlash, with local retailers, suppliers and some politicians lobbying for laws to restrict hypermarket development and limit the power of big chains in their relations with suppliers. So far, however, these opponents have had few successes.

## DEMOGRAPHICS AND CONSUMER BEHAVIOR

### POPULATION

#### *Population evolution*

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Population million) | 38.65 | 38.25 | 38.24 | 38.21 | 38.19 |

*Source: Glowny Urzad Statystyczny*

#### *Population by age group*

| (%) | 1990 | 2003 |
|---|---|---|
| 0-15 years | 25.0 | 17.5 |
| 15-64 years | 64.9 | 69.6 |
| Over 65 years | 10.1 | 12.9 |

*Source: Glowny Urzad Statystyczny*

In the last 14 years Poland has followed the trend observed in many other countries with the population getting older.

#### *Urbanization of the population*

| (%) | 1990 | 2003 |
|---|---|---|
| Urban | 61.9 | 61.6 |
| Rural | 38.1 | 38.4 |

*Source: Glowny Urzad Statystyczny*

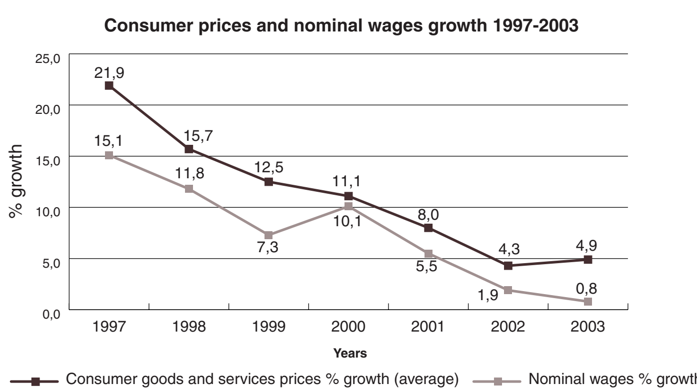
One recent development has been an apparent reversal in rural-urban migration. In the period that followed the Second World War the population clearly shifted from the countryside to the towns.
However, this process apparently slowed in the late 1990s and the urban population is reported to have

fallen every year since 1998. The trend is very clearly observed in big cities where people have been moving from city centers to neighboring villages.

## INCOME / BUYING POWER

The difficult situation in the labor market is likely to keep nominal wage growth at a relatively stable level (between 4.9% and 5.6%) over the next 4-5 years.

### Prices and nominal wage growth rate 1997-2003



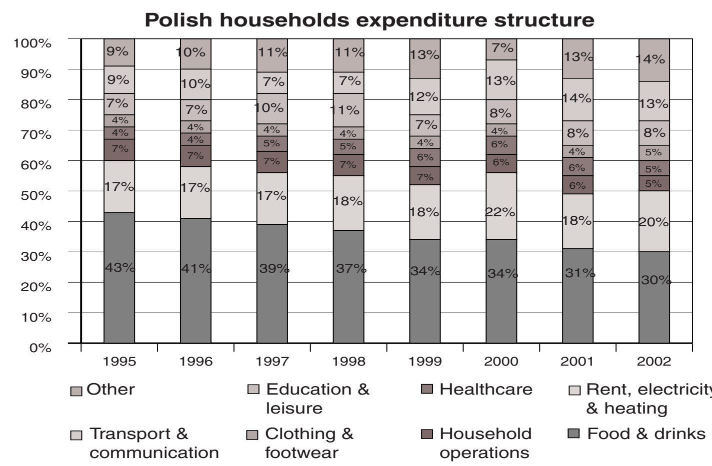

### Average monthly gross wages & salaries

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Average monthly gross wages & salaries (PLN) | 1,697 | 1,894 | 2,045 | 2,098 | 2,201 |

*Source: Glowny Urzad Statystyczny*

Average monthly gross wages & salaries can vary substantially between large urban areas and the rest of the country. The difference can be as much as 20-25% in favor of urban areas. For example, average monthly gross wages & salaries in the first quarter of 2004 amounted to PLN2,916 (EUR620) for Mazowsze and PLN2,907 (EUR619) for the Silesia region, whereas the average for the country as a whole came in at PLN2,405 (EUR512). In the poorest regions (Lubuskie, Podkarpackie and Lubelskie) average wages & salaries fall far below the country average, coming in at between PLN1,934 and PLN1,999 (EUR411 and EUR425).

### Breakdown of average monthly household expenditure per capita (1995-2002)




*Source: GfK Polonia: FMCG Strategic Report 2004; Glowny Urzad Statystyczny;*
Note: household operation include furnishings, household equipment and routine maintenance of the house/flat

Food expenditure is expected to continue diminishing in favor of house/flat related items, transport / communication and education and leisure.

## CONSUMER BEHAVIOR

### *Lifestyles / Shopping habits*

The increase in social and regional inequality since 1990 means that these overall averages conceal enormous variations in income and lifestyle. Employees in foreign firms in the big cities have already adopted western European aspirations and spending patterns, but those living in much of the countryside still keep many of their former habits and customs. Some of these inequalities are likely to narrow over time. Foreign investment and economic development is likely to spread to more of the medium-sized towns in the west of the country, as the big cities become more expensive. The underdevelopment of the eastern regions of the country will be exacerbated by the difficulties they face in trading with Ukraine, Russia and Belarus after Poland joins the EU and border controls are tightened. EU funds will help to improve infrastructure in all Poland's regions.

# Poland

### *Brand / Price sensitivity*

From the early nineties onwards, many previously unavailable brand-name goods have appeared in Polish stores. Even though Polish consumers continue to be chiefly price-oriented in their shopping decisions, they are increasingly reaching for brand-name products. This is supported by the fact that the prices of brand-name goods are falling, and these products are becoming more affordable for the average consumer. This especially applies to the top "premium" segment.

The price sensitivity of Polish consumers – encouraged by ongoing state-sector downsizing and slowing economic growth – means that Polish companies are cautious about developing brands at the cost of losing their pricing edge.

Polish consumers who prefer to purchase branded products have yet to develop a loyalty to a particular brand and not only to the concept of brand. This factor has attracted domestic businesses to selling their products under a supermarket's own brand label rather than developing their own brands.

At present, most of the foreign retail chains operating in the Polish market and some home grown retail chains have their own private brands. Multinational retail chains treat private labels as part of their marketing strategy and as a tool for shaping their own image.
Although their share in the national volume of retail sales is no more than a few percent and research has shown that the majority of hypermarket shoppers remain unaware of their existence, the quantitative growth rate of private labels in Poland is certainly impressive.

The share of private labels in FMCG sales is set to grow substantially over the coming years. In first quarter of 2004, Leader Price, a member of Casino Group, had 140 stores selling only own-label products. For all other retailers – mostly discount stores – private labels account for only part of their range.
Private labels used to be identified with cheap and low quality goods. However, this is now not always the case; some chains have stratified their own-labels portfolio to offer both better quality and value products.

Market research shows that price is still one of the top decision factors for buyers. Being significantly cheaper than branded goods, private labels are likely to be a success in Poland.

## RETAIL & CONSUMER SECTOR PERFORMANCE

### MAJOR CONSUMER GOODS PLAYERS

*Top 20 consumer goods companies*

| Ranking | Company name | Core activity | 2003 Sales (PLN million, incl. VAT) | 2003 Sales (EUR million, incl. VAT) |
|---|---|---|---|---|
| 1 | Philip Morris Polska | Tobacco | 4,371.7 | 994.1 |
| 2 | Thomson Multimedia Polska | Electronic | 4,217.1 | 959.0 |
| 3 | Browary Zywiec | Breweries | 3,242.2 | 737.2 |
| 4 | Kompania Piwowarska | Breweries | 2,549.2 | 579.7 |
| 5 | Nokia Poland | Electronic | 2,400.0 | 545.7 |

| Ranking | Company name | Core activity | 2003 Sales (PLN million, incl. VAT) | 2003 Sales (EUR million, incl. VAT) |
|---|---|---|---|---|
| 6 | Unilever Polska | Food/chemicals/ cosmetics brandmanagement | 2,242.6 | 510.0 |
| 7 | Procter & Gamble Operations Polska | Food/chemicals/ cosmetics/ brand management | 2,219.0 | 505.0 |
| 8 | British American Tobacco Polska | Tobacco | 1,877.7 | 427.0 |
| 9 | Philips CEI Poland | Electronic | 1,814.4 | 412.6 |
| 10 | SF Holding Sp. z o.o. | Food | 1,700.0 | 386.6 |
| 11 | Central European Distribution | Alcoholic beverages | 1,669.0 | 379.5 |
| 12 | Philips Lighting Poland | Electronic | 1,573.0 | 357.7 |
| 13 | Scandinavian Tobacco | Tobacco | 1,448.0 | 329.3 |
| 14 | Krajowa Spolka Cukrowa | Sugar | 1,441.9 | 327.9 |
| 15 | Nestle Polska | Food & beverages | 1,431.8 | 325.6 |
| 16 | Avon Operations Polska | Cosmetics | 1,411.2 | 320.9 |
| 17 | Altadis Polska SA | Tobacco | 1,318.1 | 299.7 |
| 18 | Sobieski Dystrybucja | Alcoholic beverages | 1,306.9 | 297.2 |
| 19 | Action | Computers & hardware | 1,101.1 | 250.4 |
| 20 | Carlsberg Okocim | Breweries | 1,091 | 248.1 |

*Sources: Rzeczpospolita – Lista 500; Monitor Polski B, companies' data, Dun & Bradstreet*

The list of top 20 major consumer goods manufacturers in Poland is almost fully dominated by global players. Sectors such as tobacco, brewing and consumer electronics face strong competition from big multinational companies.

Aside from global manufacturers, it is worth mentioning that domestic producers linked with international players operating in Poland also have a good chance of benefiting from EU enlargement in terms of export volumes. However, in many cases, there is still a need to make quality improvements; recent EU criticism of the country's food processing sector has again revealed that a number of areas will require further development (standards in abattoirs and veterinary controls).

# Poland

### *Food & beverages*

Despite the marked progress made in recent years, Poland's food-processing industry is not quite yet able to compete on an equal footing with the rest of the EU. However, quality improvements should eventually lead many imported foodstuffs to be replaced.
The methods involved in the manufacture of beverages, confectionery and stimulants, as well as the processing of fruit, vegetables and potatoes are more or less in line with European practices.
The meat and poultry sector, as well as the oils and fats sector, are halfway towards being able to compete equally.

Meat processing plants have already adapted to EU requirements and have good control over the supply chain, which gives them a good chance of succeeding on the open market. However, the industry remains fragmented.

Dairy production in Poland faces very good development prospects. The industry has tackled the preparations for EU entry very well. More than 50% of plants already conform to EU standards, and the rest is in process of adapting. Average consumption of milk and dairy products in Poland is 200 liters per person, which is far behind the figure for EU - 330 liters per capita.

Beer sales have risen in recent years due to the changing habits of Polish consumers, who are now increasingly opting for beverages with lower alcohol-content over the traditional vodka-related drinks.

### *Electronics*

Demand for various electronic products and equipment from both households and corporate customers continues to grow. To date, this demand has been satisfied mainly by imports. Given that Poland seems to aspire to western European standards, sales of electronic goods are likely to increase in the years to come. This view is confirmed by forecasts of electronics market research firms. The ability of Polish-based manufacturers to satisfy demand is increasingly important.

The electronics industry has seen a substantial amount of restructuring, privatization and foreign investment in recent times. Some domestic firms have had difficulty adapting to the rules of a market-oriented economy. While a number of them (e.g. Kasprzak) went into liquidation, others (e.g. Diora) have changed their profile and their range of manufactured products.

At the same time, foreign investors, such as Alcatel, Lucent Technologies, Ericsson, Philips, Thomson, Daewoo and LG, have entered the Polish market. Foreign companies that have invested in Poland have replaced domestic firms as the leaders of Poland's electronics sector.

### *Cosmetics*

A reduction of the excise duty on cosmetics and perfumes came into effect on May 1, 2004. The Polish finance ministry had originally planned to maintain a rate of 25%, but pressure from domestic interest groups in the cosmetics sector has successfully brought this level down to 10%. Nevertheless, Poland will remain the only country out of the ten new member states to impose excise duty on such products.

According to MEMRB, a market-monitoring company, the Polish cosmetics industry was worth some PLN4.7billion last year. In reality, the figure was at least PLN6.0 billion, because MEMRB data (covering retail chains, drugstores and shops) excludes open-air markets, direct sales, and exclusive perfumeries. Direct sales represent a particularly large portion of the cosmetics market; suffice to say that the largest player in the segment, Avon Cosmetics Polska, registered sales of PLN1,411.2 million last year.

## MAJOR RETAIL PLAYERS

### *Retail sales*

Retail sales in Poland and retail sales growth (current prices)

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Retail sales PLN million | 323,687 | 360,318 | 375,438 | 388,203 | 401,900 |
| Retail sales growth % | 22.5 | 11.2 | 3.1 | 3.4 | 3.3 |

*Source: Glowny Urzad Statystyczny*

The Polish market is one of the most diverse in Europe. Over the last 13 years the number of stores in Poland has risen almost threefold; according to GfK

Polonia, the number currently stands at 400,000. In Poland, there were approximately 119,000 food retail outlets in 2003, i.e. 37 shops per 10,000 inhabitants. The greatest concentration of retail chains appears to be in western and central Poland. But the fact that 38 % of the Polish population lives in over 50,000 villages makes for a very dispersed market. An analysis of the structure of stores, according to specialization, indicates a continuing rise in the number of general grocery stores and a clear drop in the number of specialty stores. At the same time we are witnessing the dynamic development of certain kinds of retail units - particularly pharmacies, filling stations, supermarkets and hypermarkets. Over the last few years there has been a clear rise in the number of large retail outlets created and managed by foreign companies. These companies are especially present in foods and everyday non-food items.

### *Major retailers*

### *Top 20 retailers*

| Ranking | Group name | Store brands | Retail formats | Number of stores (2003) | 2003 Sales (PLN million, incl. VAT) | 2003 Sales (EUR million, incl. VAT) |
|---|---|---|---|---|---|---|
| 1 | Metro Group | Makro C&C<br>Real<br>Praktiker<br>Media Markt | Cash & Carry<br>Hypermarkets<br>DIY<br>Household appliances | 20<br>27<br>16<br>20 | 11,551 | 2,627 |
| 2 | Tesco Polska | Tesco<br>Savia | Hypermarkets<br>Supermarkets | 38<br>31 | 4,500 | 1,023 |
| 3 | Jeronimo Martins | Biedronka | Discount stores | 672 | 4,233 | 963 |
| 4 | RUCH | Ruch | Kiosks | 37,000 | 3,782 | 860 |
| 5 | Carrefour Polska | Carrefour<br>Champion, Globi | Hypermarkets<br>Supermarkets | 15<br>67 | 3,600 | 808 |
| 6 | Ahold Polska | Hypernova<br>Albert | Hypermarkets<br>Supermarkets | 25<br>167 | N/A | 796 |
| 7 | Auchan Polska | Auchan<br>Elea<br>Leroy Merlin | Hypermarkets<br>Supermarkets<br>DIY | 18<br>12<br>9 | 3,384 | 769 |
| 8 | Casino Group | Geant<br>Leader Price | Hypermarkets<br>Discount stores | 17<br>133 | 3,300 | 750 |
| 9 | Lewiatan Holding | Lewiatan | Supermarkets/ Convenience Stores | 1,781 | 2,900 | 660 |
| 10 | Rewe | Selgros<br>Minimal | Cash & Carry<br>Supermarkets | 8<br>27 | 2,568 | 584 |

# Poland

| Ranking | Group name | Store brands | Retail formats | Number of stores (2003) | 2003 Sales (PLN million, incl. VAT) | 2003 Sales (EUR million, incl. VAT) |
|---|---|---|---|---|---|---|
| 11 | Tengelmann | Plus Discount<br>OBI | Discount stores<br>DIY | 142<br>22 | 2,332 | 583** |
| 12 | MILO SA | Milo | Wholesaler & distributor | 16 | 2,237 | 509 |
| 13 | Kolporter | Kolporter | Convenience Stores / Kiosks | 528 | 1,737 | 395 |
| 14 | Avans | Avans<br>Mega Avans | Home appliances stores<br>Home appliances supermarkets | 600<br>2 | 1,610 | 366 |
| 15 | E. Leclerc | E. Leclerc<br>E. Leclerc | Hypermarkets<br>Supermarkets | 10<br>2 | 1,602 | 364 |
| 16 | Musketers Group | Intermarché<br>Bricomarché | Supermarkets<br>DIY stores | 91<br>18 | 1,450 | 302 |
| 17 | Eurocash | ABC | Cash & Carry | 82 | 1,378 | 314 |
| 18 | KDWT | KDWT | Cash & Carry | 35 | 1,197 | 272 |
| 19 | Zabka Polska | Zabka | Stores | 1,300 | 896 | 204 |
| 20 | Eldorado | Eldorado<br>Stokrotka<br>Groszek | Cash & Carry<br>Supermarkets<br>Convenience Stores | 16<br>21<br>211 | 892 | 203 |

(*) estimation by Trade Press; (**) Financial year ended 30 April 2003
*Sources: Rzeczpospolita 500; Polityka 500; Trade Press - Supermarket, Companies' annual reports,*

### *Retail channels*

Retail market share

Modern distribution channels (discount stores, supermarkets, hypermarkets) are representing a steadily increasing proportion of the Polish retail market. They currently account for around 36 -38% of total market revenues (of which 18-20% hypermarkets, 10% supermarkets and 8% discount stores).

Share of modern distribution channels* in retail sales:

| | |
|---|---|
| 1998 | 16% |
| 1999 | 22% |
| 2000 | 26% |
| 2001 | 29% |
| 2002 | 32% |
| 2003 | 36-38% |
| 2005 | 40-42% |
| 2008-2010 | 50% |

(*): hypermarkets, supermarkets and discount stores
*Source: GfK Polonia: FMCG Strategic Report, 2004*

Discount stores have very ambitious expansion plans and currently represent 8% of total Polish retail sales. These retail formats focus not only on big cities, as hypermarkets and supermarkets do, but also on small towns.

### Grocery stores in Poland in 2003

| | |
|---|---|
| Hypermarkets | 202 |
| Supermarkets | 924 |
| Discount stores | 1,274 |
| Large grocery stores | 5,700 |
| Medium-sized grocery stores | 25,100 |
| Small grocery stores | 62,000 |
| Specialist grocery stores | 23,000 |

*Source: GfK Polonia, FMCG Strategic Report 2004*

### Hypermarkets

With its eponymous Tesco outlets, British Group Tesco is now the leading player in the sector. The runners-up include French retailer Auchan (Auchan), the German Metro Group (Real) and Casino (Géant) and Carrefour (Carrefour) of France. After a considerable gap, further players worth mentioning include Dutch Ahold, French Leclerc and German retailer Schwarz Group (Lidl). There were over 200 hypermarkets operating in Poland at the end of 2003, of which 186 were foreign chains. Hypermarket expansion is expected to remain at a steady level in near term.
At the end of 2003 the total number of hypermarkets stood at 202, compared with less than 10 outfits in operation in 1995. The number of hypermarkets is expected to rise to 250-270 by the end of 2005.

### Supermarkets

Supermarkets represent a very important sales channel in Poland. It is interesting to note that supermarkets have increasingly come into the spotlight recently as tougher planning regulations have made it harder for retailers to open outlets larger than 2,000 square meters. It is also worth mentioning that many supermarkets continue to be operated by small local companies and co-operative groups and that most of these stores, at least in the cities, look very clean and attractive.

As is the case with the hypermarkets, the sector is clearly dominated by foreign operators. Dutch grocer Ahold (Albert) is the clear leader, followed by the French ITM group (Intermarché), French Carrefour (Champion), the German Rewe (Minimal), UK-based Tesco (Savia), and French Auchan (Elea). After a considerable gap, there is also a local player, Eldorado (Stokrotka), Austrian firm Meinl (Julius Meinl) and French Leclerc (Leclerc). Supermarket chain operators had a combined network of some 924 supermarkets at the end of 2003, although obviously there are many more supermarkets run by small local businesses and co-operative societies.

### Discount stores

Discount stores and other supermarkets will play significant role in modern Poland's prosperity as they reach smaller towns and remote areas, where there is still room for new entrants. Among the reasons for this there is the personal income situation, i.e. more price-conscious consumers.

The Polish discount market continues to be dominated by the formerly domestic Biedronka chain, which was taken over in 1998 and subsequently expanded aggressively to more than 672 outlets by Portuguese retailer Jerónimo Martins.

Behind Biedronka, large operators in the Polish discount market include German Tengelmann (Plus), French Casino (Leader Price), Danish Dansk Supermarked (Netto) and the German Schwarz Group (Lidl). These five companies operated a combined total of over 1,200 outlets at the end of 2003.

### Convenience Stores

Given the relatively low incomes in Poland (i.e. low by Western standards), independent convenience / neighborhood stores continue to play a key role in the national food supply, especially in the small towns and poor rural areas. However, to a certain degree they are also popular in large cities, including the capital Warsaw, where they cater for customers picking up lunches to eat at the office or factory.
According to GfK Polonia, there were some 116,600 traditional food shops trading in 2003. This corresponded to 98.0% of all food stores, thus the number is virtually unchanged from the 98.1%

recorded a year earlier. At the same time, the value of an average shopping basket in the small stores has decreased over the last few years in favor of the increasingly popular hypermarkets.
As regards the small store sector, it is interesting to note that there are also huge numbers of kiosks spread across the country, where people cannot only buy standard kiosk ranges such as newspapers, tobacco products and confectionery, but also a range of health & beauty items. The leading player here is the state-owned Ruch chain, which has over 13,000 20-square meter kiosks spread across Poland. Indeed it is difficult to walk a distance of 300 meters without encountering such an outlet, even in the capital Warsaw.

### Cash & Carry

The national cash & carry sector is without the slightest doubt dominated by German grocery giant Metro Group, which is the national market leader with a market share of around 10% (even without its Real hypermarkets, the group would still be market leader). The company is clearly benefiting from the large number of independent shops that are still around and will be around for some time to come. Another important customer group for Metro are restaurants and caterers.
Aside from Metro, German company Rewes Selgros is also worth mentioning, as are the local C&C network of Eldorado and, last but not least, the Eurocash stores which were formerly owned by Portuguese grocer Jerónimo Martins but were bought out by local management in early 2003.

## RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

### CHALLENGES

#### *EU accession*

Since May 1, 2004 Poland has become even more attractive as the barriers for flow of goods, labor and capital have been removed. General investment risk is diminishing, yet ensuring high return rates. From a long-term perspective, the introduction of the euro as the national currency will virtually eliminate exchange rate risk.

Standing at a crossroads, it is thought that Poland could either follow the successful path of Ireland or squander its great opportunity in the European Union. According to Professor Witold M. Orowski, a third way is most likely: steady economic growth as seen with Spain. However, this will require a vast overhaul of public spending practices, including cuts in excessively generous social transfers and incentives for investors (low taxes / good business environment), as well as the efficient administration of EU funds and investment in human capital.

#### *Working costs*

Even though the productivity stands at 48% of the average for the existing 15 member states, cost of labor stands at only 20%. This makes Poland a good place for labor-intensive investments.

#### *Large consumer market*

Poland with its population of over 38 million is the third-largest consumer market in central-eastern Europe, behind Russia and Ukraine. This, combined with a favorable demographic profile (one of the youngest societies in the enlarged EU) makes it very attractive both as an investment location and a consumer market.
Purchasing power is rising, but it varies considerably between countryside and city (62% of the population are city dwellers).

### OPPORTUNITIES

#### *Logistic interface*

Taking into account the position of the country, Poland could come to act as a logistical interface between West & East and South & North.
On the other hand, in the long-term, EU accession allows for cost cutting by decreasing warehouse space in Poland and making deliveries directly from other

European countries. This is however subject to improvements in communication infrastructure and transportation costs.

*Low price and private labels*

The rising number of discount stores and increasing share of private labels in their sales creates a long-term opportunity for Polish producers for entering foreign markets through multinational chains.

Since May 1, 2004, as a result of the harmonization of telecommunications law with EU standards, television advertising supply has decreased by 9 – 20 %. The decline in advertising revenues is expected to be offset by price increases. Given that television is the main advertising channel for FMCG products, this will have implications for their manufacturers.

Even though Poland is among the fastest growing markets in terms of private labels, registering year-on-year growth of 115% in 2003, only 2% of retail sales are derived from own-label products (according to AC Nielsen). This figure is lower not only compared to the European average of 22%, but also to neighboring countries (Germany 27%, the Czech Republic 4%). One of the reasons for this is the relatively low (38%) portion of modern trade in Polish retail.
This market is expected to continue to grow. Retail chains are maintaining the pace of new openings; Polish customers are cost conscious and the price differential of 50% between private label and branded goods is one of the highest in the region.

| Chain | Operator | Number of stores (2003) | Total space in '000 m2 |
|---|---|---|---|
| Castorama | Castorama Polska | 19 | 185 |
| Leroy Merlin | Leroy Merlin Polska | 11 | 120 |
| Nomi | Nomi | 39 | 190 |
| OBI | OBI Centrala Systemowa | 22 | 180 |
| Praktiker | Praktiker (Metro Group) | 16 | 103 |
| **Total** | **-** | **107** | **778** |

*Source: Company's data*

*Home improvement retailers*

In the early 1990's, specialized hypermarkets came into Poland, offering a wide variety of home improvement goods. In the first quarter of 2004 there were 107 stores of this type, representing five multinational chains.

After dynamic growth between 2000 and 2002 (on average 15 stores per year), only seven new stores opened in 2003. As target locations – mainly big cities – become progressively saturated, further expansion is expected to proceed at a flatter pace. Another threat for the chains are common specialized niche stores, which can successfully compete with the giants. Considering the fast-growing economy, expanding investments and increasing purchasing power of consumers, the long-term outlook for the Polish construction market look bright. This also offers bright prospects for home improvement retailers.

*Shopping malls*

According to Polish Retail Market, an annual report by international property consultant Cushman & Wakefield, Healey & Baker, European Union accession has made Poland one of the strongest expanding shopping-center markets in Europe.

# Poland

At the end of 2003 there were nearly 115 shopping-centers across the country. Approximately 65% of modern retail space is located in the eight largest cities, led by Warsaw.
Poland represents a new destination for 100-125 international retailers for the five years running to end-2008. These companies are mainly interested in high street locations in big cities, but an unclear legal situation for property owners and local community objections are hindering the development of retail operations in prime locations.

There is approximately 78 square meters of shopping center space per 1,000 people in Poland, compared with a European average of nearly 170 square meters. With EU accession Poland is likely to see further growth in this sector. The main retail development destinations are the eight largest Polish cities.

## EMERGING TRENDS

*Factory outlets*

The first factory outlet in Poland was opened in 1999. But by the beginning of 2004 there were nearly 15 of them located in Poland's largest cities. The factory outlet concept, previously unknown in Poland, is now gaining popularity. The largest chain – Factory Outlet, owned by Semex-Intertrade, plans to expand to 50 stores by 2006-2007.

*Further consolidation in the wholesale market*

As predicted, the wholesale sector is continuing to consolidate. Research shows that in 2002 there were 9,000 wholesalers, compared with 9,500 in 2001. Two thirds of these companies offer FMCG products.
Since 1994 the number of wholesalers operating in the Polish market has decreased by 7% on average year on year. The number of wholesalers declined by 5% in 2002.

In order to improve competitiveness and increase bargaining power in price negotiations, medium-sized wholesalers have tended to merge with larger partners. An example of a successful consolidation in the domestic market was a series of acquisitions performed by the CEDC in 2003. The group now controls one third of the Polish market for alcoholic beverages.

Another trend among small and medium-sized wholesalers has been to join forces in trade associations; joint procurement, marketing, administration and legal support helps them to compete with foreign retail chains. Some of these groups decide to take the next step, i.e. full consolidation, by setting up a new entity.

*Winning formats*

In line with increasing wealth and purchasing power of Poles, the number of customers looking for high quality, rare products & premium client service is also growing. The rising demand is setting a pace for expansion of convenience stores.

A representative example may be the "Piotr & Pawel" delicatessens. The chain comprises 24 stores, 17 of which are franchised. The leader is being followed by BOMI, running 13 locations. Notable is the fact, that both players are owned by domestic capital.

In contrary to recent concerns about the future of small locally owned shops and the threat of impeding their existence by modern retailers, this has not been the case. In terms of number they still account for over half of all stores in Poland. According to GUS, over 63% of Polish households most frequently (every day or almost every day) do the shopping in small local shops; Over 22% of households do the shopping once-twice a month in supermarket and 21% on local bazaar/market. Small shops are targeting a different customer, using their advantage of personalized service, residence proximity, tailored product mix and quick adapting to clients' needs.
Gaining popularity are also niche, speciality shops offering very specific but deep assortment.

*E-commerce*

On-line sales are increasing rapidly. Volumes in both the "business to business" (B2B) and the "business to consumer" (B2C) sectors doubled in 2003. However, according to market research performed by I-Metria, revenues only reached PLN3 billion. B2C represents one quarter of total e-sales. The B2B segment is expected to grow at a faster pace as businesses are forced to maintain hefty investments in the IT area in order to keep up with competition and market demands.

As the number of Internet users continues to increase, so too will the scope for this distribution channel. At the same time, improvements will need to be made to IT infrastructure, to give broader access to affordable, high-speed services and build trust in the safety of on-line transactions.

According to market research, the vast majority of Polish Internet users surf the web from either work or school, thereby reducing the scope for e-shopping.

*Emerging trends concerning tax*

The Polish Tax Code has been amended to include an opportunity to request binding rulings from the local tax office (official tax office interpretations of tax provisions applicable to particular transactions or circumstances). Currently, the tax office's interpretation is not binding for the authorities conducting future tax inspections. If a taxpayer follows such an interpretation, which subsequently turns out to be incorrect, no penalties (such as penalty interest) should be applied, however the tax due will have to be paid. A dramatic change to the current system is introduction, as of 1 January 2005, of a possibility to obtain by taxpayers of a so called binding ruling, i.e. a document in which tax authorities conclude on tax consequences of a particular investment. Following such a ruling, the tax authorities are stopped from questioning the tax treatment applied by the taxpayer. In particular, should their position change in the future, the taxpayer will not be obliged to pay either any penalty interest or additional tax due on the transaction.

As regards market trends, taxpayers continue to experience growing awareness of tax authorities with respect to transactions concluded with related entities. Following the legislation, tax authorities can increase the taxable base if the pricing used between related parties differs from that which would be applied between unrelated parties in a similar business transaction and if such difference results in shifting income from a Polish taxpayer to another entity (whether Polish or foreign). Furthermore, the Polish Corporate Income Tax Law contains detailed requirements regarding transfer-pricing documentation, which needs to be presented to the authorities in a prescribed format within 7 days of their request. If the taxpayer fails to meet this deadline and the authorities adjust taxpayer's income, such income is subject to penal 50% taxation (as opposed to standard 19%).

Also, due to joining the EU, Polish legislation has faced a major change. The major amendments have been introduced to the VAT and excise tax legislation, aiming at adjusting Polish indirect taxation rules to the ones included in the respective EU Directives. Since this new legislation is still imperfect and not fully harmonized, more changes are expected in the near future. Also, as described in previous sections, corporate income tax legislation was adjusted. There were a number of changes to the civil law activities tax (a kind of transfer tax), as well.