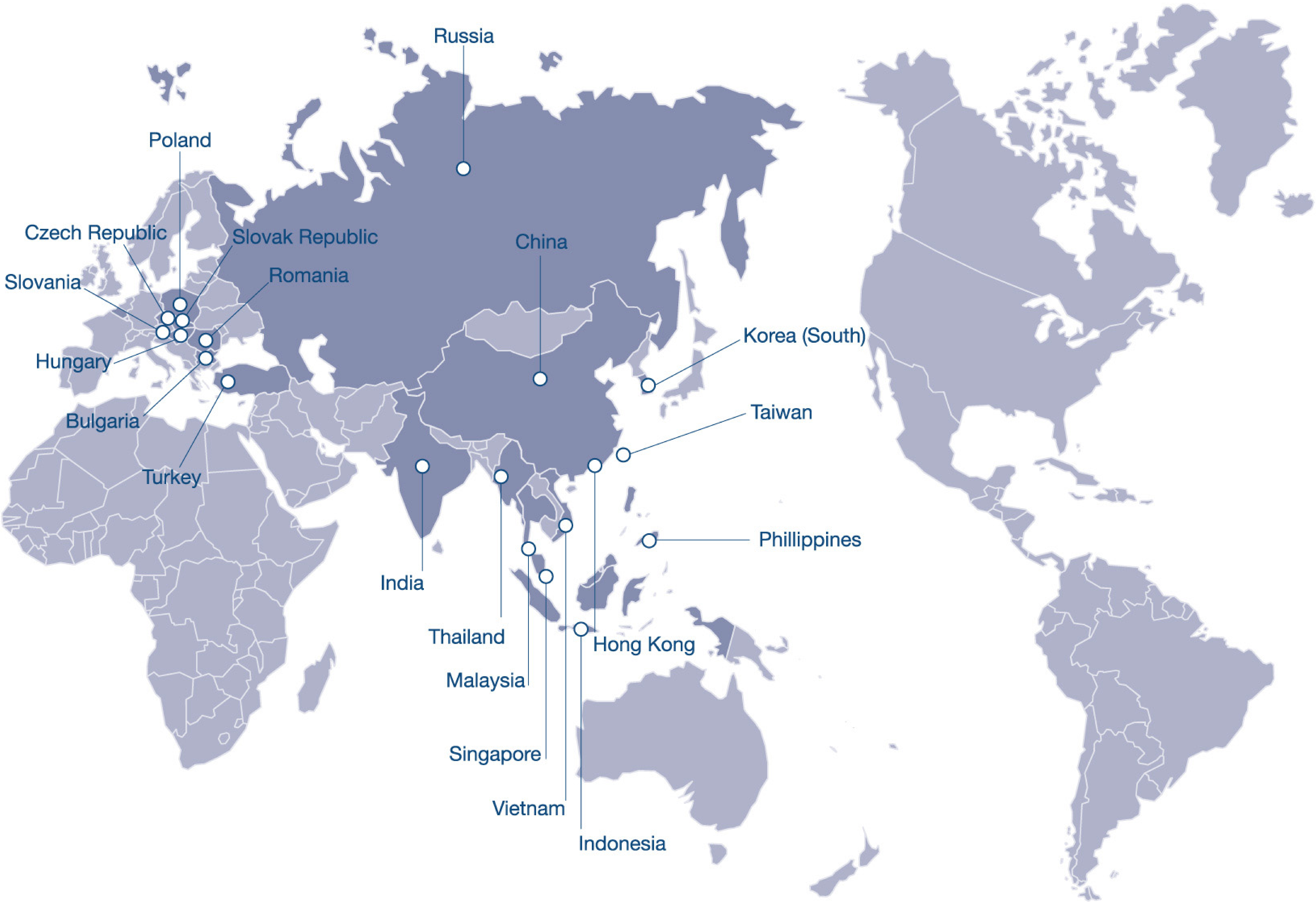
FROM BEIJING TO BUDAPEST

Winning Brands, Winning Formats*

Executive Summary 2005/2006
4th Edition

*connectedthinking

PRICEWATERHOUSECOOPERS


Russia
Poland
Czech Republic
Slovak Republic
China
Romania
Slovania
Korea (South)
Hungary
Taiwan
Bulgaria
Turkey
Phillippines
India
Thailand
Hong Kong
Malaysia
Singapore
Vietnam
Indonesia

Presence of Multinational Food Retailers in Transitional Economies

	Bulgaria	China (Mainland)	Czech Republic	Hungary	India	Indonesia	Korea (South)	Malaysia	Philippines	Poland	Romania	Russia	Singapore	Slovak Republic	Slovenia	Taiwan	Thailand	Turkey	Vietnam	Total
AEON (Japan)		X					X	X								X	X			5
AHOLD (The Netherlands)			X							X				X						3
AUCHAN (France)		X		X						X		X				X				5
AVA (Germany)												X								1
CARREFOUR (France)		X	X			X	X	X		X	X		X	X		X	X	X		12
CASINO (France)										X						X	X		X	4
COSTCO (USA)							X									X				2
DAIRY FARM INTERNATIONAL (Hong Kong)		X			X	X	X	X					X			X				7
DELHAIZE Group (Belgium)			X			X					X									3
DOHLE (Germany)	X																			1
FAMILY MART (Japan)		X				X	X									X	X			5
GLOBUS (Germany)			X																	1
INTERMARCHE (France)										X										1
ITO YOKADO (Japan)		X																		1
JERONIMO MARTINS (Portugal)										X										1
LECLERC (France)										X					X					2
LIDL & SCHWARZ (Germany)			X	X						X				X						4
LOUIS DELHAIZE (France)				X							X									2
MAKRO (The Netherlands)		X				X		X	X								X			5
METRO (Germany)	X	X	X	X	X					X	X	X		X				X	X	11
MIGROS TÜRK (Turkey)	X											X						X		3
REWE (Germany)	X		X	X						X	X	X		X						7
SEVEN – ELEVEN (Japan)		X					X	X	X				X			X	X	X		8
SHOPRITE (South Africa)					X															1
SPAR (The Netherlands)		X	X	X	X					X		X	X		X					8
TENGELMANN (Germany)			X	X						X		X								4
TESCO (UK)		X	X	X			X	X		X				X		X	X	X		10
WAL-MART (USA)		X					X													2
TOTAL SCOPE	4	12	10	8	4	5	8	6	2	13	5	7	4	6	2	9	7	5	2	119

Source: PricewaterhouseCoopers – Vigie August 2005

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Foreword

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Welcome to the 4th edition of the PricewaterhouseCoopers From Beijing to Budapest thought leadership study, an important regional research project started in 2002. From Beijing to Budapest is a challenging regional assignment which has flourished within the framework of "Brand Growth", one of PricewaterhouseCoopers' three main Retail & Consumer industry priorities.

This year, it covers a market of transitional economies of more than half of the world's population. 40% of the population, representing 20% of the global GDP lives on three time zones, between Mumbai and Shanghai. The emerging markets, in particular China and increasingly India, are demonstrating the growing perspectives for strong international development in these regions. A new era of economic reality combined with a more and more interdependent world brings challenges and opportunities to existing and new players of the retail and consumer industry.

The scope comprises twenty countries* with the highest growth potentials from Beijing to Budapest including:

- In Asia: China, India, Indonesia, Korea (South), Malaysia, Philippines, Singapore, Taiwan, Thailand and Vietnam.
- In Central & Eastern Europe: Bulgaria, Czech Republic, Hungary, Lithuania, Poland, Romania, Russia, Slovak Republic, Slovenia and Turkey.

The main objectives of this study are to provide a broad picture of the economic, social and cultural background and to highlight the challenges and opportunities for retail and consumer goods companies wishing to invest or already investing there. Business opportunities, key consumer targets and winning formats in each country – for both foreign and local investors – have been identified. The opportunities are illustrated with success stories from successful multinational and local players in terms of winning brands and winning formats. The updated regional Retail & Consumer Barometer 2005/2006 provides for each country the PwC point of view and recommendations in terms of investment for each country.

Each country report follows a generic template structured around three main investigation topics: economic overview and regulatory environment (i); demographics and consumer behaviour (ii); retail and consumer goods sector: performance, challenges, opportunities and emerging trends (iii). The latter includes information on distribution activities, suppliers of consumer packaged goods (CPG), multinational, regional and local players from both food and non-food companies. This study aims at providing an as objective picture as possible of the structure and potential of the retail and consumer market in each country, as seen from a local perspective. At the same time it seeks to ensure consistency of information from one country to another and act as a guide on how to extract value from globalisation.

* Countries which are not in the printed version are available via our website: www.pwc.com/growth

Executive Summary

SUSTAINED GROWTH AND ACCELERATING CONSUMPTION TRENDS

Both geographical regions covered by the study saw sustained growth and an acceleration in general consumption trends, in what was a generally inflationary climate. Both economic growth and prices increased in 2004 in the majority of countries covered by the study.

Key economic growth indicators

Table 1: Key economic indicators

Ranking by country	GDP growth 2004 (%)	CPI[1] 2004 (%)	Unemployment rate 2004 (%)
China (Mainland)	9.5	3.9	9.9
Lithuania	9.0	1.2	11.5
Turkey	8.9	8.6	10.3
Singapore	8.4	1.6	4.0
Romania	8.3	11.9	6.6
Vietnam*	7.7	7.8	5.8
Russia	7.2	10.9	8.2
Malaysia	7.1	1.5	3.5
India	7.0	3.8	10.1
Philippines	6.1	6.0	11.8
Thailand	6.1	2.8	2.1
Taiwan	5.7	1.6	4.4
Bulgaria	5.6	6.1	12.7
Slovak Republic	5.5	7.5	14.3
Poland	5.4	3.5	19.6
Indonesia	5.1	6.1	9.6
Korea (South)	4.7	3.6	3.7
Slovenia***	4.6	3.6	6.3
Czech Republic	4.4	2.8	9.8
Hungary	4.2	6.8	6.1
World	4.0	2.8	6.1
United States	4.4	2.7	5.5
EU25**	2.4	2.1	9.5
BRIC[2]	7.1	6.3	10.0

Sources: EIU; (*) General Statistics Office of Vietnam – unemployment rate 2003; (**) CIA World Factbook – unemployment rate 2004; (***) Statistical office of Slovenia

GDP growth rate was up in 2004 over 2003 in all countries covered, except for India, Russia and Thailand – but India still had a growth rate of 7%, Russia of 7.2% and Thailand of 6.1%! China had the highest growth rate of all countries in 2004 with 9.5%, followed by Turkey with 8.9%, Singapore with 8.4%, and Romania with 8.3%. Hungary had the lowest growth rate in 2004 with 4.2%, just topped by the Czech Republic with 4.4%. (Table1)

CPI increased in all countries except in Indonesia, Thailand, Romania, Slovakia and Slovenia where it decreased, and in India where it was stable.

In the 19 countries for which full employment data is available, **the employment figures are fairly positive**. The unemployment rate was slightly down in 12 countries in 2004 over 2003, 4 countries had small increases in unemployment (Indonesia, the Philippines, Korea (South), and Hungary) while the jobless rate stabilized in Thailand and also in Poland, but at a much higher level of 19.6%.

Foreign Direct Investment (FDI) was up in most of the countries in 2004 over 2003, with the highest growth rates in China, Korea (South), Romania and the Czech Republic.

With the highest growth potential, both regions[3] count more than half of the world's population. The dynamic nature of these predominantly young populations contributes substantially to the extremely attractive investment climate in these regions. This is particularly true in India, where the young population, namely under 25 years old, represents 540 million and half of the total population[4]. (Table 2)

[1] CPI: Consumer Price Index
[2] BRIC: Brazil, Russia, India and China
[3] Both regions include Asia Pacific and Central & Eastern Europe
[4] The Rising Elephant: Benefits of Modern Trade to the Indian Economy, PricewaterhouseCoopers, October 2005.

Table 2: Population by country and age profile (estimates)

Ranking by country		Total population (million)	0-14 years (%)	15-64 years (%)	65 years and over (%)
1	China (Mainland) **	1,300	21	71	8
2	India	1,080	32	63	5
3	Indonesia*	224	29	66	5
4	Russia	144	16	70	14
5	Philippines	86	36	60	4
6	Vietnam	83	31	63	6
7	Turkey	72	27	66	7
8	Thailand	65	24	69	7
9	Korea (South)*	49	19	72	9
10	Poland*	39	17	70	13
11	Malaysia*	26	33	62	5
12	Taiwan*	23	20	70	10
13	Romania	22	18	68	14
14	Czech Republic	10	15	71	14
15	Hungary	10	16	69	15
16	Bulgaria*	8	14	69	17
17	Slovak Republic	5	17	71	12
18	Lithuania*	4	16	69	15
19	Singapore	4	22	71	7
20	Slovenia*	2	14	71	15
	Sub-total	3,253			
	World	6,376			
	USA	293			
	EU25	456			
	BRIC	2,703			

Sources: EIU; (*) CIA World Factbook – age profile; (**) China Statistical Yearbooks/ Consumer China 2005 – age profile; Estimation 2004

Accelerating consumption trends

The consumption trends already observed in the previous PricewaterhouseCoopers annual studies on transitional economies had a general tendency to accelerate in these regions last year.

In many countries, competition is stepping up for foreign retailers and local champions as certain markets saturate. The increasingly **price-conscious consumer** is very sensitive to the current aggressive development of the **discount format**, which in certain markets is giving a hard time to the higher-priced supermarkets and hypermarkets. At the same time, **private label** is being developed as a low price with value alternative.

As markets polarise, up-scale products and outlets are also in demand from the "new rich", with the swelling middle-class driving the growth of supermarkets and hypermarkets. Given the rural/urban disparity, many less prosperous, rural consumers remain loyal to the traditional store. This will change as purchasing power increases and with the appearance of modern retail outlets in secondary and tertiary regions, consumers will be attracted by **lower prices, better quality and more choice.**

As markets polarise, up-scale products and outlets are also in demand from the "new rich", with the swelling middle-class driving the growth of supermarkets and hypermarkets.

Table 3: GNI per capita (estimates)

Ranking by country		GNI* per capita (USD)
1	Singapore	21,230
2	Taiwan	12,570
3	Korea (South)	12,030
4	Slovenia	11,920
5	Czech Republic	7,150
6	Hungary	6,350
7	Poland	5,280
8	Slovak Republic	4,940
9	Lithuania	4,500
10	Malaysia	3,880
11	Turkey	2,800
12	Russia	2,610
13	Romania	2,260
14	Thailand	2,190
15	Bulgaria	2,130
16	China (Mainland)	1,100
17	Philippines	1,080
18	Indonesia	810
19	India	540
20	Vietnam	480
	World	5,510
	USA	37,870
	EU25	22,810
	BRIC	1,742

Source: World Development Indicators 2003
(*) GNI: Gross National Income

THE MAJOR RETAIL & CONSUMER CHALLENGES AND OPPORTUNITIES IN THE TRANSITIONAL ECONOMIES

For both new foreign entrants and for investors wishing to consolidate their operations in the transitional economies, some sort of partnership with local firms remains the most viable strategic option. As the primary cities and regions saturate, retail and consumer companies will be exploring the opportunities that exist a little further afield as well as the future potential of the internet and mobile telephony. One of the biggest management challenges that subsists is that of attracting, recruiting, training and retaining good staff.

Key Retail & Consumer Challenges and Opportunities in Transitional Economies (Asia and CEE/Russia)

The challenges:

- Consumer dichotomy and the polarisation of markets
- Connectedness: internet/mobile telephony
- Expansion into second and tertiary regions
- Attracting, recruiting and retaining people

The opportunities:

- Winning brands, Winning formats
- M&A, strategic alliances, franchising
- Offshoring, overseas sourcing, regional logistics hubs

Building strategic partnerships

Finding the right venture partner is key to success. M&A is the first path to development. But these deals need to be the object of keen business intelligence work to ground them in as much certainty as possible. The fast emerging local retail champions in Asia and the CEE/Russia will be expanding through both organic and acquisitive growth to match competition from foreign chains.

Joint venture partners are essential in understanding local consumer trends – which can differ greatly from one region to another – and in dealing with bureaucracy and local administrations.   Finding a suitable joint venture partner is key. A recent example is Tesco, which has just entered the Chinese market on taking a 50% interest in Hymall, a retailer operating 25 hypermarkets.

China will be the arena of an increasing number of deals financed by its cheap money market with loans from state-owned banks and driven by its ambition to build national champions, develop global brands and gain the expertise it lacks in certain economic sectors through tie-ups with - or takeovers of - western companies. For example, it is reported that the country's largest white goods manufacturer, Haier, may be considering joint ventures with certain US private equity groups, although it pulled out of its bid for Maytag. This contrasts with the situation in Japan and Korea (South) were national champions were nurtured through a policy of keeping down foreign direct investment (FDI).

In the increasingly dynamic Turkish retail market, Carrefour has taken a controlling interest in Gima, the number 3 retailer in order to increase its supermarket network. Carrefour also intends to develop its Dia hard discount format in **Turkey** and is planning to open the biggest shopping mall in Europe in Istanbul, in the framework of its partnership with the conglomerate Sabanci Holding. Very recently, Migros acquired a 70% equity stake of Tansas and Carrefour bought a 60% equity stake of Gima, both local retail chain operating in the hyper and supermarket segment with a total of 335 stores.

Russia has also been the scene of a number of transactions lately. On the consumer goods front H.J. Heinz, the American food manufacturer, has acquired a majority interest in Petrosoyuz, the second largest ketchup manufacturer in Russia, and Coca-Cola Hellenic Bottling has just acquired the number 2 Russian fruit juice manufacturer, Multon. Two agreements have been signed recently by Heineken, first to acquire the Stepan Razin Brewery in St. Petersburg and second the Baikai Beer Company in Irkutsk (East Siberia). These acquisitions will give Heineken a 10% share of the Russian beer market. And InBev, the world' biggest brewery by volume, has just bought Tinkoff. The Russian beer market has doubled since 1999 and is expected to grow by another 30% by 2010.

Many companies that currently are not prepared to make a major investment in the Russian market quote a concern relating to the political climate in the country. This is often due to the fact that foreign companies' board members, viewing the business climate from afar, hesitate to invest, whereas the business development executives working locally see the situation and the potential with a more positive eye. In Russia, one of the main concerns of local entrepreneurs is whether the government is going to create an environment conducive to the development of small and medium-sized companies.

Franchising as an alternative path of entry

Franchising is an **alternative path of entry into the transitional markets**. It gives local entrepreneurs the opportunity to capitalise on the experience of companies from more mature markets. It also provides a rapid development avenue for foreigners as they learn from their partners the particularities of local markets. In geographically vast and culturally diverse countries such as India, franchising helps to overcome the difficulties posed by having a chain of company owned outlets.

Pyaterochka, the **Russian** supermarket chain, is intending to buy the franchise network of Economtorg by the end of 2005. This represents a first step in a strategy to consolidate its franchise operations, which have been used to develop outlets in several different regions of Russia.

Franchising also appeals to the entrepreneurs of **India** and **China**. There are now some 200 franchise brands in China, ranging from drug stores and laundries to supermarkets and convenience stores. But some foreign investors are cautious about this path of development in order to protect their intellectual property and brand names. For example, Starbucks is planning to fully control its existing joint venture operations in 5 years time. On the other hand, McDonald's and KFC are cautiously developing the franchise approach in China.

In India, the franchise business has grown at an average rate of between 20-30% since the 1990s. Both local companies such as Aptech, NIIT, Cafe Coffee Day and Apollo Healthcare and international investors such as Pizza Hut, Marks & Spencers, McDonald's, Taco Bell and Kentucky Fried Chicken are expanding their operations quickly.

The franchising formula is particularly prevalent in **Malaysia**. Over the past 5 years there has been a 10% annual increase in franchise outlets. 40% of the country's franchise outlets are foreign owned.

Seizing opportunities in secondary and tertiary regions

Table 4: Major cities above 3 million inhabitants (estimates)

Cities[5]	Number of inhabitants (million)	Country
Bombay	19	INDIA
Delhi	19	INDIA
Jakarta	17	INDONESIA
Calcutta	15	INDIA
Manila	15	PHILIPPINES
Moscow	14	RUSSIA
Shanghai	13	CHINA
Seoul*	11	KOREA (SOUTH)
Istanbul	11	TURKEY
Beijing	11	CHINA
Chongqing	8	CHINA
Bangkok	8	THAILAND
Madras	7	INDIA
Hong Kong	7	CHINA
Bangalore	7	INDIA
Taipei	7	TAIWAN
Hyderabad	7	INDIA
Tianjin	6	CHINA
Ahmadabad	5	INDIA
Saint Petersburg	5	RUSSIA
Guangzhou	5	CHINA
Wuhan	5	CHINA
Ho Chi Minh City	5	VIETNAM
Harbin	5	CHINA
Singapore	5	SINGAPORE
Shenyang	5	CHINA
Poona	4	INDIA
Kuala Lumpur	4	MALAYSIA
Chengdu	4	CHINA
Busan	4	KOREA (SOUTH)
Ankara	4	TURKEY
Surat	4	INDIA
Izmir	3	TURKEY
Bandung	3	INDONESIA
Nanjing	3	CHINA
Kanpur	3	INDIA
Surabaya	3	INDONESIA

Source: www.citypopulation.de, 2004
(*) Seoul population does not include the province of Kyonggi-Do

[5]Important note: according to the above mentioned source, population figures relate to "core cities". In particular for Chinese cities, these figures may contradict with information from other sources, which may take into account "greater city" populations (e.g., "Greater Beijing" amounts 14.9 inhabitants, and Shanghai 17.4, according to the China Statistical Abstract – also refer to sources used in the China country report).

As the first wave of retail and consumer development into the primary cities and regions of the transitional economies subsides, a second wave is gaining momentum. As regional cities become more prosperous and in turn produce a burgeoning middle-class, there is a new set of opportunities for investors in the sector, who can **capitalise on their "first-wave" experience**.

Government officials in **China** are looking to encourage the creation of modern retail outlets in the less developed regions in cities such as Dalian in the north and Chengdu and Chongqing in the west. This represents a third wave of retail development as investors target about 100 towns with a population of over 1 million. Yes! Everything in China is on gigantic scale! Carrefour is looking to operate 100 stores by 2008 and Metro is set on doubling its outlets within a year.

In **Thailand** and **Malaysia**, it is expected that new investment activity will be mainly concentrated in the provincial areas where modern retailing penetration has been low.

Income and purchasing power varies significantly from region to region in **Russia**. The wealthiest pockets of consumers are concentrated in Moscow (which, according to estimates, still accounts for some 30% of Russian retail sales), St. Petersburg, large regional centres and several smaller cities where the extracting industries are located (such as the Tyumen region and the Republics of Komi and Sakha). Retail and consumer goods companies are now shifting their focus to the growing middle class in these secondary and tertiary regions.

With the first rush of investment over, and as markets in Poland, the Czech Republic, Slovakia and Hungary saturate, investors are now turning to the **Baltic states** and the nascent economies of Bulgaria and Romania.

The internet/mobile telephony as new, promising retail channels

The internet and new mobile telephony will gain importance with advertising and sales channels as the new tech generation has access to increasingly sophisticated internet infrastructures. In the future, anything that is screen-based will become a vehicle for advertising as the marketing revolution moves into cyber-space.

One of the most wired countries in the world is **Korea (South)** with **35 million** mobile phone subscribers for a population of 48.2 million. The country's dense and urban population and the government's encouragement have made Korea (South) fairly easy to wire up. Korea (South) boasts one of the highest internet penetration rates in the world with more than 31 million people connected. This makes Korea (South) a good launching pad for new consumer electronic products, which can be tested at home before being developed for export.

China boasts 103 million internet users, second only to the US, but with a penetration rate of just 8% compared with a 69% US rate. Around 20% of China's internet users make online purchases. As far as research engines are concerned, five years after its creation Baidu.com, China's answer to Google, has just been listed on America's NASDAQ exchange to see the stock soar by 354% on its first day. Baidu.com forecasts that the number of Chinese search-engine users will increase from 115 million today to 187 million in 2007. Compounding this interest in China's cyber future is Yahoo's payment of 1 billion USD for a 40% stake in Alibaba which runs e-commerce and search and communication services.

As yet, **India** is still far behind China with 25 million people connected to the internet. But given high levels of education and India's success with its offshore service economy, the situation stands to change rapidly.

In Poland there are 8 million Internet users, a third of which buy goods, mostly books and CDs. 80% of companies say they use B2B systems.

Table 5: Mobile/Internet phone users (estimates)

	Ranking by country	Mobile subscribers (million)[1]		Ranking by country	Internet users (million)[2]
1	China	333	1	China	103
2	Russia	81	2	Korea (South)	32
3	India	54	3	India	25**
4	Korea (South)	37	4	Russia	22
5	Turkey	36	5	Indonesia	15
6	Philippines	35	6	Taiwan	14
7	Thailand	29	7	Malaysia	11
8	Indonesia	27	8	Thailand	8
9	Poland	25	9	Poland	8**
10	Taiwan	23	10	Philippines	8
11	Malaysia	16	11	Turkey	7
12	Czech Republic	11	12	Vietnam	7
13	Romania	11	13	Romania	5
14	Hungary	8	14	Czech Republic	4
15	Bulgaria	5	15	Hungary	3
16	Vietnam	5	16	Singapore	2
17	Slovak Republic	4	17	Bulgaria	2
18	Singapore	4	18	Slovak Republic	1
19	Lithuania	4	19	Slovenia	1
20	Slovenia	2	20	Lithuania	1
	World	N/A		World	N/A
	EU25*	315		EU25	223
	USA	183		USA	198

Sources: (1) Global Mobile Subscriber Database 2005; (2) EIU Forecast 2005/ Internetworldstats 2005/ Telecom Regulatory Authorities;
(*) FY 2002 for mobile subscribers; (**) Country report 2005/2006 and local sources

Attracting, recruiting and retaining people

Attracting, recruiting, training and retaining good staff is at the **top of the transitional market challenge** for foreign and local companies alike. The retail and consumer sector is very much a people-based business with retail stores situated at the interface between business and the customer. The sector is therefore a very visible part of the economy and retail and consumer companies in the transitional economies need to "sell" themselves as important motors of change, both through their job-providing and training capacity and that of providing a wider choice of better quality and cheaper products.

In **China**, fierce competition rages for a limited number of top candidates, especially in the marketing area, which results in high staff turnover rates. One report indicates a nation-wide staff turnover rate of 11.3% in 2004, up from 8.3% in 2001. In **Russia**, it is not uncommon to experience high levels of turnover amongst shop floor employees, particularly checkout staff, with an annual rate in the 80% to 100% range.

Foreign investors are taking steps to help alleviate the problem of an increasing shortage of executive talent by investing in training and recruitment strategies. In 2004, Metro opened a training centre at its Shanghai campus "The House of Training". This is the fourth training facility it has opened after its centres in Germany, France and Russia. In China, L'Oréal and Danone have both launched initiatives to attract high-level staff.

WINNING BRAND STRATEGIES

One key finding of this year's report is how being present in the transitional economies is challenging foreign retail and consumer goods companies to create new products and new formats tuned to the new, quickly evolving consumers of these markets. **On-going innovation and cross-fertilisation are enriching the product/service offer not only for their customers in these countries but also for those in markets across the world.**

Winning products

The successful development of brands in the transitional economies lies in finding the **right balance, blend and mix of product**. The global image of world-class brands needs to be balanced with a keen sensitivity to local tastes. A careful blend of local and western cultures has to be fine-tuned. And finally the right mix between traditional and modern products needs to be nurtured.

Extreme price sensitivity at one end of the market, and a move towards upscale products at the other is leading to **consumer dichotomy** and **market polarisation**. Therefore, premium brands, private label and value, low-price labels are all being developed equally successfully.

At the same time, with improved lifestyles and an increased knowledge of healthy diets and physical well-being, there is a nascent demand for health and well-being products and functional foods enriched with health supplements.

Premium brands

In **Russia**, an increasing number of consumers buy luxury goods and look on shopping as an entertainment experience. Two groups of consumers can be identified at the high end of the market. 19% of consumers form what is considered the top, high consumption index. This is composed of high-income consumers, who are often young and very well educated. The average consumption index forms the next group and represents 27% of consumers. These are again highly educated 20-34 years olds who pay more attention to quality and packaging than to price.

Asian consumers are also very sensitive to premium brands and luxury products and the traditional department store is being reinvented to capitalise on this growing trend. In **Korea (South)**, a similar group of consumers exists who try to differentiate themselves from other consumers by purchasing luxury goods, most of which are international brand imports. This consumption pattern is termed the "luxury race".

High profile international retailers and the global mass media have also played a hand in shaping consumer-buying behaviour in **Malaysia**. Malaysians are becoming more affluent, sophisticated and cosmopolitan. They have moved on from the simple need for sustenance to key leisure themes such as health, beauty, lifestyle and fitness.

Private label

Private label gives increasingly informed customers the value proposition they are looking for: **low priced but quality products**.

For example, retailers in **Turkey** have been putting more emphasis on private label products as consumers are more and more inclined to buy these goods because of their price advantage. The share of consumers buying private label products amounted to almost 55% in 2004 – up from 39% in 1999. The increasing number of discount stores has reinforced this trend.

In **Thailand**, Siam Makro (a joint venture between Makro SHV and the local operator Charoen Pokphand) has started focusing on private label products, as has Foodlands Supermarkets which operates a factory producing own label products.

Innovative, low-price labels

Attracting as many customers as possible – even those with very modest incomes – was the philosophy behind Danone Shanghai Biscuits' launch of two new, small portion, very low price products. The first is a version of Tuc, a cracker enriched with vitamin B, and the second Danone & Milk, a health and well-being product for children, enriched with calcium. The results since these two products were put on the market have been impressive: 50-100% increase in sales without detracting from the sales of existing products. These products have enabled Danone to be present in small sales outlets because of their high margin.

The LG Story

LG, the South Korean consumer electronics giant, is fast becoming an international champion. It is the world leader in LCD screens, DVD readers, air-conditioners and up-market refrigerators. It has also shot up to be the fourth biggest manufacturer of mobile phones, close on the heels of Samsung, Motorola and Nokia. In 2004, LG sold 44 million mobile telephones worldwide. The company has pulled out all the stops on innovation and has just set up a brand new research centre in France, near Paris, to pick up on European consumer trends. The force of companies such as LG lies in the convergence of modern communication technology and the synergies that can be capitalised upon in the development of different but connected products.

Health and well-being products

As their tastes become more sophisticated, customers in the transitional economies are turning to new product ranges such as health and beauty aids, well-being products and functional foods.

In **China**, Danone is also the first supplier of bottled water with a 27% market share. Functional drinks – with added vitamins and health supplements - should make up an important part of its future product offer.

In **Poland**, there is a strong trend towards health and fitness products: 5 out of 7 fastest growing product categories have health and/or fitness attributes.

The Danone Zen Story

Although much of the approaching revolution in marketing will be virtual - corresponding to today's tech-literate consumer's universe - there will be a second, complementary and softer side to selling as well. In what appears to be the result of cross fertilisation with its activities in China, Danone, the France based international food manufacturer, has just launched a gym centre in Paris called "and your body smiles…". The spa seems to have taken its inspiration from the Evian-branded spa that was opened in Shanghai. The Paris centre is no place for hard work-outs; body building methods such as Pilates, tai-chi and yoga are the preferred, more zen-like philosophy.

On-going innovation and cross-fertilisation are enriching the product/service offer not only for their customers in these countries but also for those in markets across the world.

Winning formats

A **polarisation of formats** between discounts and upscale stores is a general trend across both the Asian and the CEE regions. This consumer dichotomy corresponds to the "new rich" and the burgeoning middle class on the one hand and the people who have not yet entered the new economies of their countries on the other. This divide often takes the form of the split between the urban and the still important rural populations. **Hypermarkets, discount stores and specialised outlets** are the main formats dominating the retail scene in both regions covered by the report. (Table 6)

Table 6: Three winning formats* under scrutiny (hypermarkets, discount stores and DIY)

Country	Carrefour	Tesco	Casino	Schwarz Group	Metro	Kingfisher
Bulgaria	–	–	–	–	DIY	–
China/HK	Hypermarket, Discount	Hypermarket	–	–	–	DIY
Czech Republic	Hypermarket	Hypermarket	–	Discount (2 formats)	–	–
Hungary	–	Hypermarket	–	Discount	DIY	–
India	–	–	–	–	–	–
Indonesia	Hypermarket	–	–	–	–	–
Korea (South)	Hypermarket	Hypermarket	–	–	–	DIY
Lithuania	–	–	–	–	–	–
Malaysia	Hypermarket	Hypermarket	–	–	–	–
Philippines	–	–	–	–	–	–
Poland	Hypermarket	Hypermarket	Hypermarket, Discount	Discount (2 formats)	Hypermarket DIY	DIY
Romania	Hypermarket	–	–	–	DIY	–
Russia	–	–	–	–	Hypermarket	–
Singapore	Hypermarket	–	–	–	–	–
Slovak Republic	Hypermarket	Hypermarket	–	Discount (2 formats)	–	–
Slovenia	–	–	–	Discount	–	–
Taiwan	Hypermarket	Hypermarket	Hypermarket	–	–	DIY
Thailand	Hypermarket	Hypermarket	Hypermarket, Discount	–	–	–
Turkey	Hypermarket, Discount	Hypermarket	–	–	Hypermarket DIY	DIY
Vietnam	–	–	Hypermarket	–	–	–

Source: PricewaterhouseCoopers – Vigie (August 2005)
*Some of these retailers operate in other formats (for example, cash & carry in the case of Metro in China, India and Czech Republic).

Hypermarkets

Foreign companies have always dominated hypermarket development in the transitional economies. Although saturated in certain markets, the hypermarket is still a leading format in a substantial number of transitional economies and still has plenty of potential.

Metro opened its first Real hypermarket format in **Russia** in July, and has two other openings in the pipeline, in addition to its cash & carry outlets. Real has also announced the development of hypermarkets in Romania. The number of hypermarkets operated by the company in Slovakia increased from 57 to 77 outlets between 2003-2004. The Russian chain Seventh Kontinent has just opened its first hypermarket in Moscow and the company plans further developments in cities of over 1 million people over the next four years.

In **Asia**, Thailand saw more growth in the dominant hypermarket sector in 2004 and in Malaysia the hypermarket format is still very popular with both foreign and local companies: Tesco, Dairy Farm, Giant Retail, Carrefour and Jaya Jusco. However, in certain areas there is now a freeze on hypermarket development because of market saturation.

The increase in car ownership is fundamental to the next phase of development of the hypermarket formula. The car industry is taking off in both China and Russia. In China there is now one car for every 125 inhabitants, and in Russia car ownership is increasing fast. It is estimated that 225,000 new foreign cars were imported into Russia in the first half of 2005, compared with 280,000 for the whole of 2004[6]. Increased car ownership will also accelerate the development of out of town shopping centres as purchasing and entertainment centres.

Discount stores

The discount store was born with the Aldi fascia in Germany in the post-war years. It was rolled out first in Western Europe and then started its expansion into CEE. This expansion is not yet finished with Lidl in the **Czech Republic** in 2003 and **Hungary** in 2004, and recently Rewe's Penny Markets in **Romania** in 2005. This format first entered **Turkey** in 1995 and **China** in 2003.

Both the hard discounts and certain hard discount hypermarket formats, such as the Kaufland fascia operated by the Schwarz chain, are quickly becoming a popular format for a second wave of retail development after the first cash & carries and more traditional hypermarkets.

The Schwarz story

The Schwarz group's Kaufland discount hypermarket concept and Lidl hard discount format is proving very successful in CEE countries and is putting pressure on competitors such as Carrefour and Tesco. Schwarz is developing operations in the Czech Republic and Poland with both its Kaufland hypermarket format and its Lidl discount store. Schwarz is now present in 19 countries with its 2 formats. This two-pronged approach to the discount market has been supremely successful.

At the same time, foreign hypermarket operators in **Poland, the Czech Republic, Hungary and Slovakia** are being hit hard by the Aldi, Lidl and Kaufland hard discount operations which are forcing them to lower their prices.

In **China**, Carrefour's first Dia discount store was opened in 2003, and there are now 164 Dia outlets. Carrefour hopes to open 200 a year over the next few years.

Speciality stores

Outlets specialised in certain product categories are another type of format with big potential for development for the future. As the new middle-class emerges and as an accrued sense of home ownership strengthens, specialised outlets selling **DIY, home appliance and consumer electronics** will all flourish.

Two strategies predominate in the DIY sector. On the one hand, Metro's Pratiker outlets have been developed from scratch, for example in **Turkey** in 2000 and **Romania** in 2004. On the other hand, taking gradually increasing stakes in local companies is the formula used by B&Q, which took a 50% stake in the Turkish chain Koctas in 2000 and the Finnish group Rautakesko which acquired Stroymaster in St. Petersburg.

In **Russia**, the local chain Shatura has been transforming its traditional furniture stores into a more modern, segmented "solutions" based concept with a design department for customers incorporated.

[6]Russian Automotive Market, presentation by Stanley Root, PricewaterhouseCoopers, June 2005

In **China**, IKEA is looking at 10 extra outlets within the next 6 years and DIY operator B&Q is seeking to double its number of operations, progressing from 20 to 39 outlets. B&Q has just purchased OBI's operations in China. Leroy Merlin has just opened its first DIY outlet in China this year.

Shopping centres and mega malls

Big shopping centres are central to retail development both in Asia and CEE/Russia. They are seen in both regions not only as a shopping destination but also as forums for leisure and entertainment and are fast becoming an essential focus of modern family and community life. These outlets will take a substantial share of future retail and consumer development in both Asia and the CEE/ Russia.

Arkadia, Warsaw's latest shopping mall, is centred around 230 retail outlets, covering an area of some 110,000 sqm, making it the biggest mall in **central Europe**. The formula works well in an area which already boasts some 30 shopping centres, with a total sales area of about 800,000 sqm, including those located around hypermarket developments. But as the inner city modernises its retail offer, shopping centres will have to deal with more competition, which could slow down their development. A second wave will see malls being set up in 40 tertiary cities with populations in excess of 100,000. More shopping centres are planned in 2005-2006 in Poland than in any other country in the EU.

In **Asia**, the revitalisation of the traditional department store continues. These outlets often find their place in shopping centres at the higher end of the market with appeal to the burgeoning middle classes and the "new rich".

In **India**, mall developers are adapting to local cultures and traditional preferences. Some new genres of malls are: Automobile mall, Gold souk and Wedding mall, which are one-stop shopping destinations for what their name describes.

OPTIMISING FOREIGN INVESTMENT: OFFSHORING & SOURCING OVERSEAS

Companies developing their operations in the transitional economies are capitalising on their presence there by **offshoring** certain business processes to the countries in which they are present, and sourcing goods locally. **Risk management** and **business intelligence** are the building blocks for offshoring or overseas sourcing strategies. Information security risks, such as the confidentiality of information, and knowledge of business partners are key components for the success of this type of venture.

Infrastructure is still a major problem in many transitional markets, but it is being rapidly addressed as governments see the huge political and economic advantages to be derived from foreign investors' local sourcing and the creation of **regional sourcing hubs**.

Offshoring

Foreign companies will be moving from traditional offshoring – getting someone else to do the job for less – to transformational offshoring which involves changing, re-designing and improving the process in a strategic move that improves performance and adds corporate value.

India has built a new services industry in just ten years, employing some 800,000 employees and with annual sales of over EUR15 billion. It is expect that this industry will grow by 50% or so by 2008. In itself the call centre industry is growing at a 40% annual rate and will probably generate over 100,000 new jobs in India this year.

Tesco opened its new software centre in Bangalore this year where it will employ some 770 engineers. The facility will develop software applications and manage a certain number of financial transactions and will also serve stores in Korea (South), Thailand – and central Europe.

China is also becoming an attractive destination for IT and business process offshoring. Companies such as Microsoft, HSBC, Motorola, HP and others have invested in setting up R&D facilities or back-office processing centres since the mid-1990s. China is also viewed as a strategic offshore location for the overall support of multinationals' business operations in other countries.

Poland, the Czech Republic and Hungary are already among the 12 most attractive offshore investment locations. It is estimated that in Poland the number of people employed in offshored business services could increase from about 3,000 this year to 200,000 by 2008. Geographical proximity and cultural affinity are other bonuses.

Working with the transitional economies in CEE is teaching western European countries to take

another look at their own efficiency and marketing effectiveness. Their low-cost eastern European partners can drive them to renew efforts to cut costs, re-design business processes and on the macro-level, reform economies. The arrival of these countries into the EU should be a spur for increased productivity and innovation.

Sourcing overseas

A growing number of companies in the retail and consumer sector are sourcing globally as a means of increasing their productivity and reducing their costs. But the advantages of sourcing overseas must also be weighed against the hazards. There are some very real cultural, political, economic and commercial risks in sourcing from certain countries (eg. the impact of Chinese textile quotas which is developing as this paper goes to press). Consumers not only consider price and quality when they are making purchasing decisions; they also consider such factors as labour conditions and commitment to socially responsible business practices. Infrastructure, economic slowdown, political unrest, protectionism and product quality problems are other risks that have to be taken into consideration[7].

Wal-Mart, Gap, JC Penney, Ikea and Tesco are some of the leading global retailers currently sourcing from **India**. Wal-Mart's food exports from India could soon exceed those of its textiles procurement, which for the time being represent 65% of the USD1.5 billion worth of goods that the company sourced last year. The company's sourcing from India has been increasing at the rate of some 30% per year since 2003 and it hopes to be sourcing USD5 billion worth of goods by 2010.

In **China**, Wal-Mart exports some USD18 billion worth of goods a year. Its sourcing was multiplied by 5 when it was permitted to set up retail operations in the country. The company sources 85% of merchandise for its Chinese retail operations locally through domestic suppliers or global suppliers manufacturing locally. Metro also sources USD1 billion worth of goods from China.

China exported an estimated 20% of the world's clothing last year. The phasing out of quotas on textiles and clothing produced in China at the beginning of 2005 will enable clothing retailers to reduce their production costs and simplify their supply chains. That in turn will provide opportunities to improve their gross margins. **The retailers most likely to benefit are those that possess the right sourcing and pricing strategies, together with strong supply chain and risk management skills.** They will balance lower costs against traditional sources of competitive advantage such as better quality, smaller order sizes and shorter production and delivery times. It is expected that Chinese textile companies will initiate a buying spree for the acquisition of international brands, which will increase the visibility and quality of their products.

Li & Fung, a Hong Kong based global consumer goods trading company, sees its future as a process orchestrator for companies in the West by using a network of some 7,000 suppliers. According to this concept, yarn can be sourced in Korea (South), dyed in Thailand, woven in Taiwan, cut in Bangladesh and assembled in Mexico. This strategy is based on the development of strategic partnerships with the different parts of the network, and with which innovation and design can be driven forward.

The WIPRO story

Azim Premji is the richest man in India. He controls 84% of the IT service company Wipro which is worth some USD10 billion on the stock exchange and which employs around 40,000 people. Premji transformed part of the family food business into a computer arm in the 1980s. Since then the company has grown into an IT service giant known for its quality and its absolute commitment to top data security systems. Wipro has industrialised its processes and at "Electronic City" in Bangalore where some 10,000 people work, each project is deconstructed into coded processes. Wipro was one of the first IT service providers to organise itself by economic or business sector, with "excellence centres" for insurance, distribution, health and telecommunications. The company runs 5 training centres, which cater for 1,700 students. It is said that these centres constitute the best business school in the country.

Working with the transitional economies in CEE is teaching western European countries to take another look at their own efficiency and marketing effectiveness.

[7] Sourcing Overseas for the Retail Sector, PricewaterhouseCoopers, December 2004

CEE is also a sourcing destination, and it can be cheaper to make refrigerators or cars there than in China. If Turkey and Ukraine enter the EU, they will make up - together with Bulgaria and Romania - a big low-wage industrial powerhouse with a population of 150 million that will create competition for Asia. Labour costs are between 5 and 12 times lower in central Europe than in Germany – but productivity matches that of Germany at comparable levels of technology and capital investment. Savings of 30% can be made on the manufacture of car parts if it is shifted from Germany to Poland. For many goods, manufacturing in central Europe is cheaper than in China as shipping costs are much lower.

Infrastructure and logistics hubs

As they modernise their infrastructures, **eastern European countries** are set to become important logistics hubs for an enlarged Europe. Poland, the Czech Republic and Hungary will have a role to play because of their geographic location for the real growth markets of the future, the ex-Soviet states.

Because of its strategic central geographical position and its borders to the west, Poland is particularly well located for the development of logistics hubs. Gillette is building a 80,000 square metre production and packaging plant near Lodz and will probably supply a major part of its European market from Poland. A very big commercial and logistics hub is planned east of Warsaw by a consortium involving the Turkish Turcs Nurol International and Mesa Mesken Sanayi. Investment will amount to some USD300 million over the 6-year construction period.

Warsaw's dominance as a location for the first hubs will dwindle as new centres develop to the west. The Polish government is now addressing the question of infrastructure, having realised the importance of hubs for the country's economic development. The country should have a 1,990 km of new motorways by 2017 and 22 km of new highway should be built this year; this is, however, at a much lower rate than Spain, a country with a similar population, which manages to build some 500km of highways every year.

The modernisation of infrastructure and the development of new regional logistic hubs is also one of the major challenges that **Asian countries** are still addressing. The development of modern retail outlets and of foreign companies' overseas sourcing strategies both call for an extended and high quality infrastructure in order to move large volumes of goods across a wide expanse of regions.

As far as food is concerned, the development of modern trade in India will result in the disintermediation of the food supply chain. This will reduce wastage and the duplication of efforts. India is among the top two producers of milk, fruit and vegetables in the world, but a big percentage of produce is lost due to inadequate post-harvest handling, cold storage, processing facilities, poor logistics management and infrastructure and lack of convenient marketing channels. At the moment, some 40% of Indian produce, or some EUR10billion worth, rots due to a lack of processing facilities.

The retail and consumer goods sector can do much to help move traditional agricultural systems into a modern, efficient industry through partnerships in both Asia and CEE/Russia. Cost-efficient technology can be introduced, cold chains modernised and contract farming developed. There is a big potential for improvements in supply chain management, the offer to local populations and exports.

The retailers most likely to benefit are those that possess the right sourcing and pricing strategies, together with strong supply chain and risk management skills.

The retail and consumer goods sector can do much to help move traditional agricultural systems into a modern, efficient industry through partnerships in both Asia and CEE/Russia.

Table 7: PricewaterhouseCoopers Global Retail Consumer Barometer

Territory	Regulatory constraints	Retail organised market maturity*	Retail & Consumer challenges / opportunities*	Risks	Overall recommendation
Legend	Strong / Evolving / Non-significant	Emerging / Growing / Saturated	Strong / Fair / Weak	High / Low / Non-significant	* = CAUTION ** = OPPORTUNITIES *** = GO
BULGARIA	Evolving	Emerging	Strong	Low	***
CHINA (MAINLAND)	Evolving	Emerging	Strong	Low	***
CZECH REPUBLIC	Non-significant	Growing	Fair	Non-significant	**
HUNGARY	Non-significant	Growing	Fair	Non-significant	**
INDIA	Strong	Emerging	Strong	Low	***
INDONESIA	Evolving	Emerging	Fair	High	*
KOREA (SOUTH)	Non-significant	Growing	Fair	Non-significant	**
MALAYSIA	Evolving	Growing	Fair	Non-significant	**
PHILIPPINES (THE)	Strong	Emerging	Weak	High	*
POLAND	Evolving	Growing	Fair	Non-significant	**
ROMANIA	Non-significant	Growing	Strong	Non-significant	***
RUSSIA	Evolving	Growing	Strong	Non-significant	***
SINGAPORE	Non-significant	Saturated	Weak	Non-significant	**
SLOVAK REPUBLIC	Evolving	Growing	Fair	Low	**
SLOVENIA	Evolving	Growing	Fair	Non-significant	**
TAIWAN	Non-significant	Saturated	Weak	Low	*
THAILAND	Evolving	Growing	Fair	Non-significant	**
TURKEY	Evolving	Growing	Strong	Low	***
VIETNAM	Strong	Emerging	Strong	Low	***

Source: PwC country reports, August 2005
(*): for both food and non-food

CONCLUSION: EXTRACTING VALUE FROM THE GLOBAL ECONOMY

Retail and consumer companies whatever their size, and wherever they are based, cannot afford to be absent from the global economy. A policy of expansion into one or several of the transitional economies is a strategic "must". It drives not only core brand growth, but also, and equally importantly, new and significant **brand value**. **The PricewaterhouseCoopers Barometer 2005/2006 sets out our opinion on the opportunities, challenges and risks relevant to the different markets covered by the study**. (Table 7, on page 18)

As far as added value is concerned, cross-fertilisation and innovation are two of the most enriching outputs of expansion abroad. The new products and services that are the outcome benefit not only consumers in the transitional economies themselves, but also those in other markets right across the globe. Consumers everywhere will benefit from wider choice, improved quality and lower prices. **Winning brands** and **winning formats** are the ones that strike a balance between the attraction and sophistication of world-class brands and retail models, and a keen sensitivity to local tastes and expectations.

Companies in the retail and consumer sector are also capitalising on their presence in these regions by offshoring certain business processes and sourcing an increasing number of goods there. These two other avenues for strategic investment abroad benefit both local and home markets. One of the important outcomes of **sourcing overseas** is the new logistics hubs that are developing in both regions covered by this report. They will be playing an increasingly influential role in moving goods from one region of the world to another. Increased speed, lower costs and reduced waste will all be part of a new and optimised global logistics equation.

Investment in the transitional economies, whether through core business development, offshoring or overseas sourcing, will be defining a new deployment of work across the planet in what is an increasingly interdependent world economy. White and blue-collar jobs will go to the regions which can leverage the highest level of skills at the lowest level of cost. Everyone will benefit from the fact that greater global trade drives the search for low production costs and increases economies of scale.

Through its sheer size, coupled with its recent race forward in economic development, **China** has already shown to what extent one country can have an impact on the world economy. Commodity prices, shipping costs, wages, the price of goods, an increase in the world's labour force and global economic output have all been deeply influenced by China's new position on the world's business map. When India further liberalises its business sector, develops its infrastructure and modernises its agriculture supply chain, the world will be confronted with another giant centre of influence in Asia which represents both a huge opportunity and an enormous challenge: the Rising Elephant has yet to show its face.

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