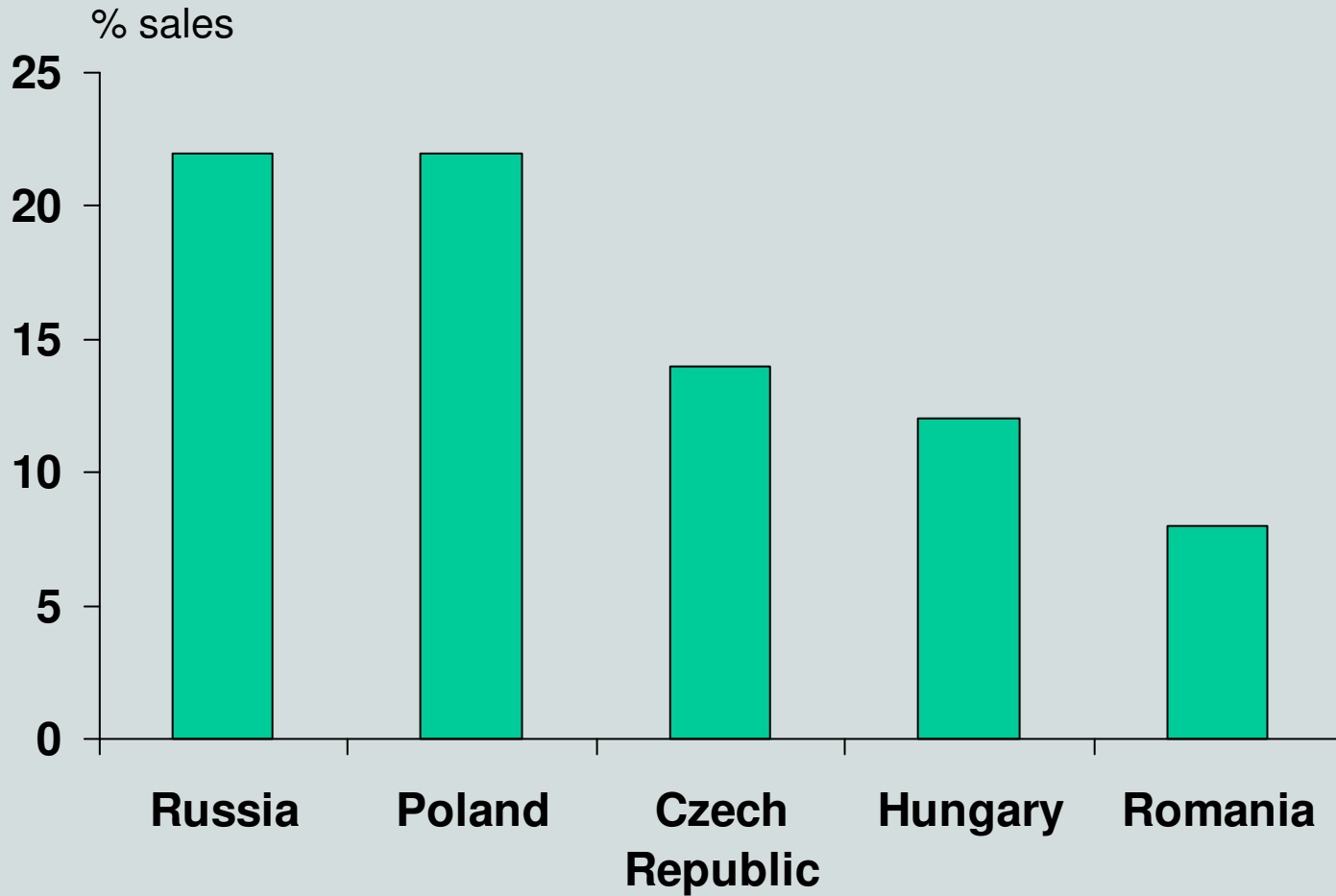


# **Business outlook and strategies in Central and Eastern Europe**

**Matthew Shinkman  
Economist Intelligence Unit**

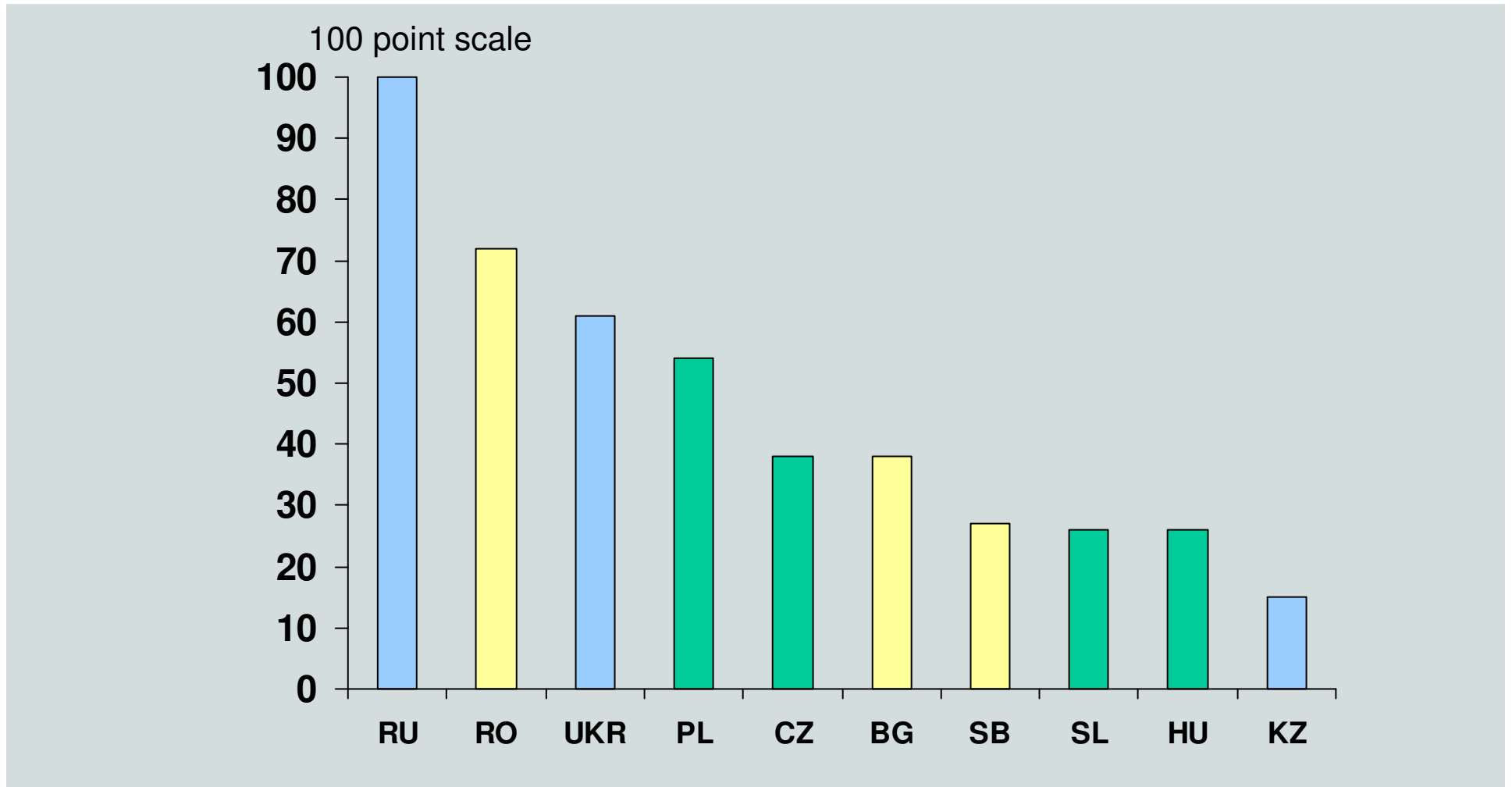
**November 2007**

# Big markets dominate



Source: EIU

# Market potential in CIS, SEE



Source: EIU

# Market is good but getting tougher

- Average profit margins:
  - Core CEE 7-10%
  - SEE 11-13%
  - Russia 14-18%
- Profit squeeze is toughest in B2C (monetary policy, wage growth, competition)
- B2B still best but will tighten (competition, opening to Asia, EU services trade)
- B2G will remain the toughest (fiscal deficits must come under control)

# Succeeding in hybrid markets

- Retain the right aspects of an emerging market strategy
  - Stay close to customer and supplier
  - Retain control over sales and marketing, product development...but rely on HQ for governance/audit/compliance support
  - Localise to retain cheaper cost structure – bottom line can continue to grow as top line growth recedes

# Finding growth

Three sources of substantial potential upside:

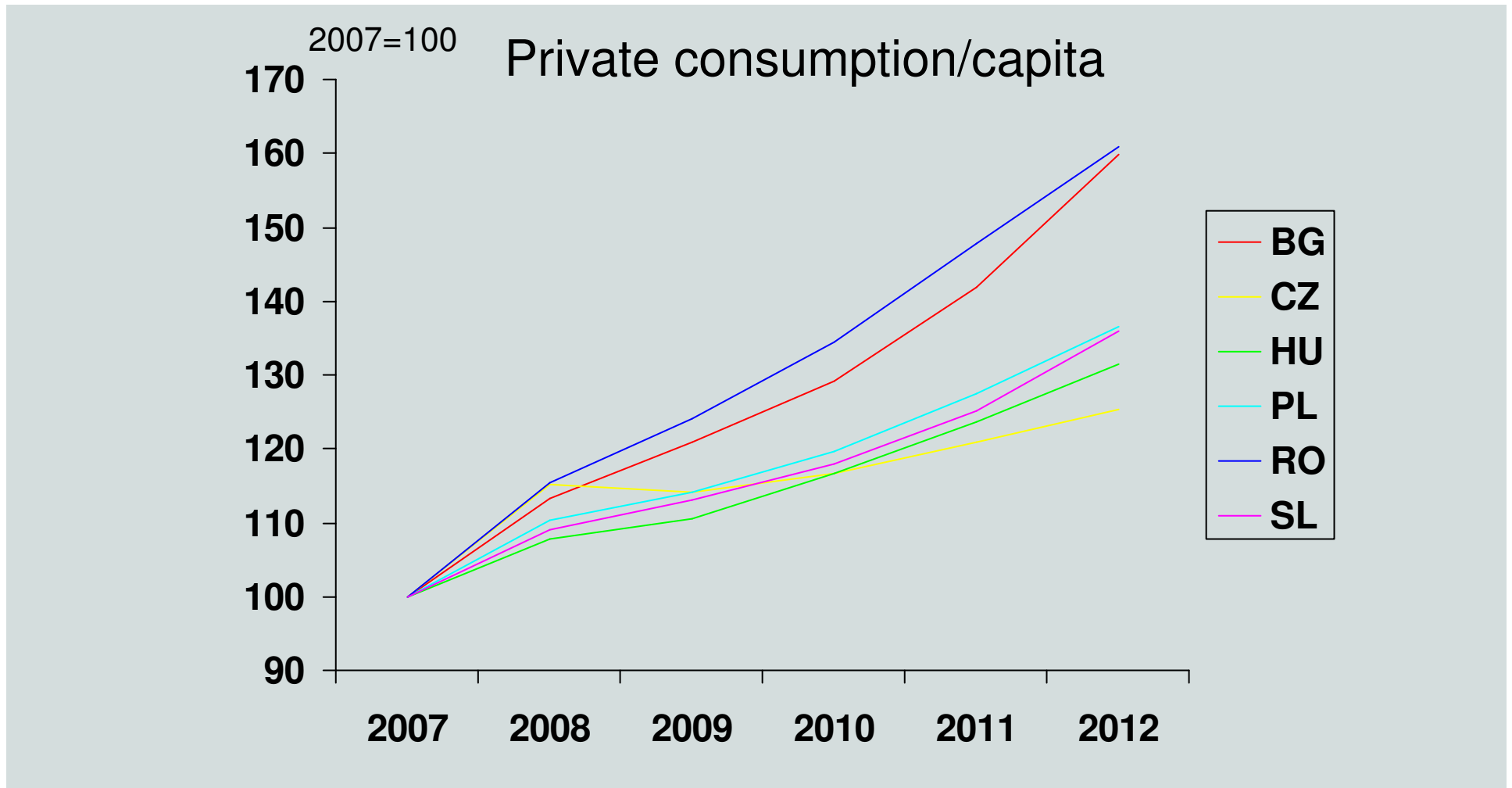
- Per capita sales
- Rural/lower middle income sales
- Credit growth

# Per capita sales (1)

	<b>GDP per head at PPP (EU15=100) 2007</b>	<b>Long-term growth in GDP per head, %</b>	<b>Catch-up time yrs</b>
Czech Republic	67.0	3.3	37
Hungary	57.7	3.6	36
Poland	46.5	3.5	53
Slovakia	58.6	3.8	31
Slovenia	80.0	2.8	29
Bulgaria	33.6	3.8	62
Croatia	42.8	3.4	63
Macedonia	23.9	3.7	87
Romania	31.6	3.8	66
Serbia	23.0	4.2	69

Source: EIU

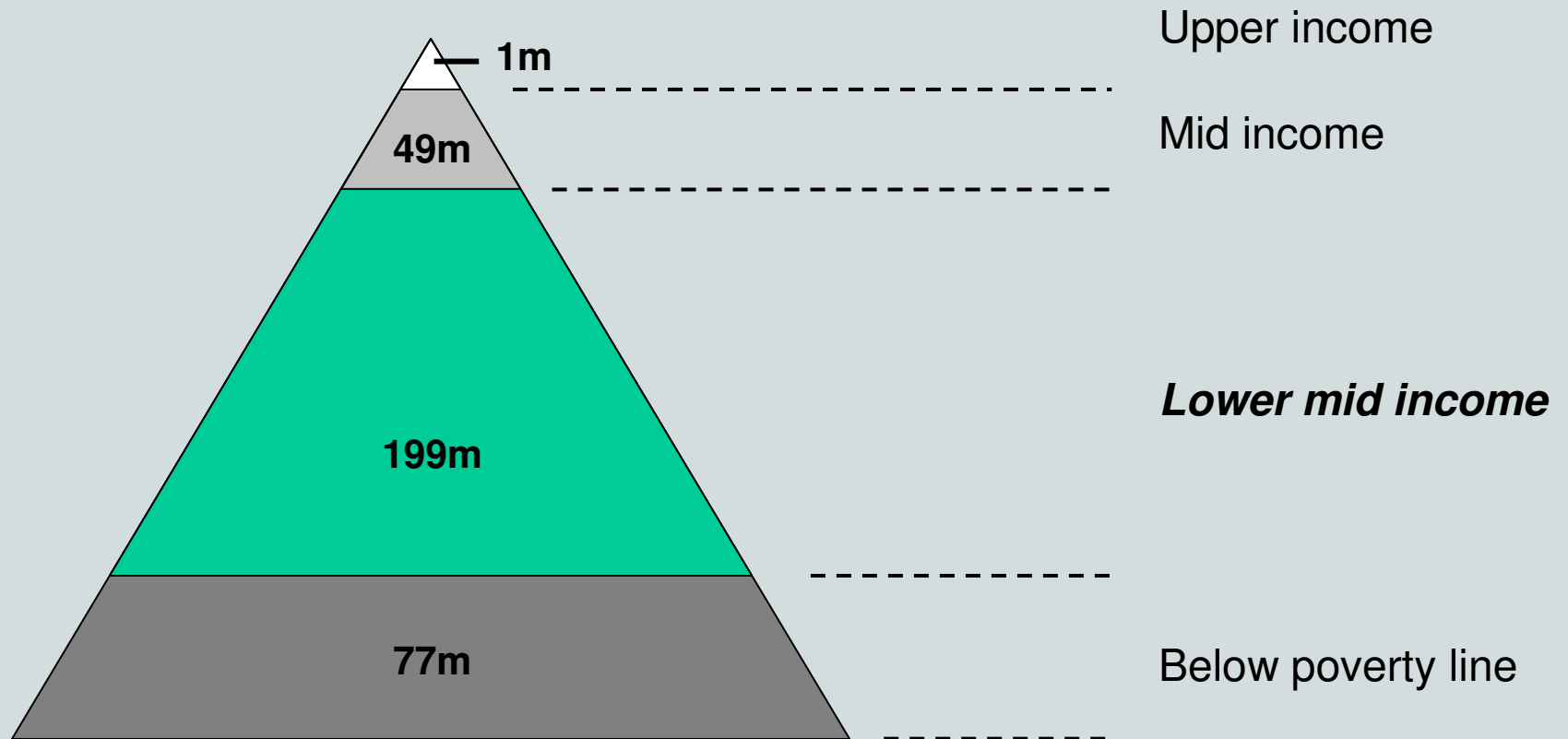
# Per capita sales (2)



Source: EIU



# Rural/lower middle income sales



Source: BCG

# Rural/lower middle income sales

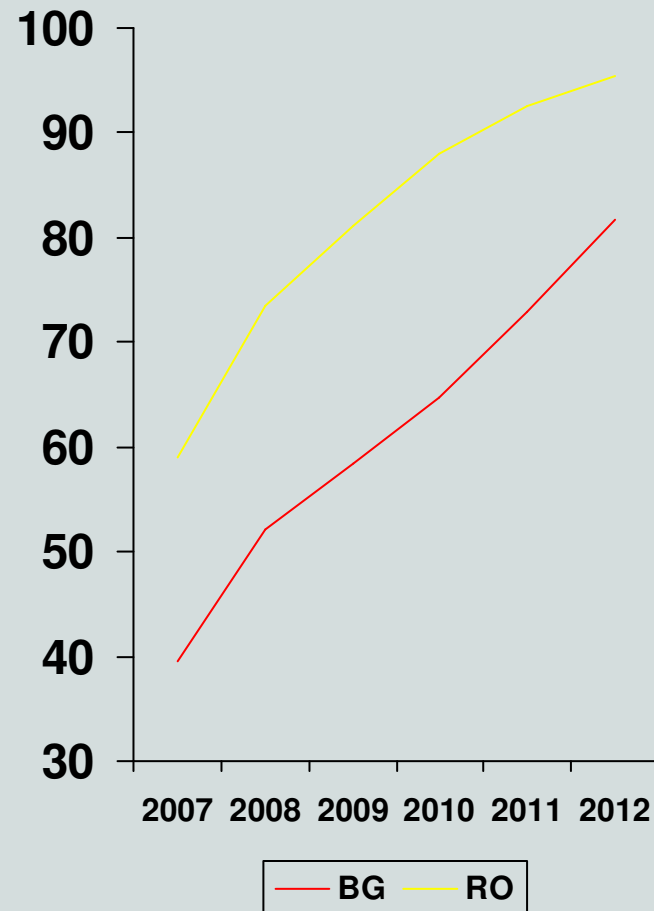
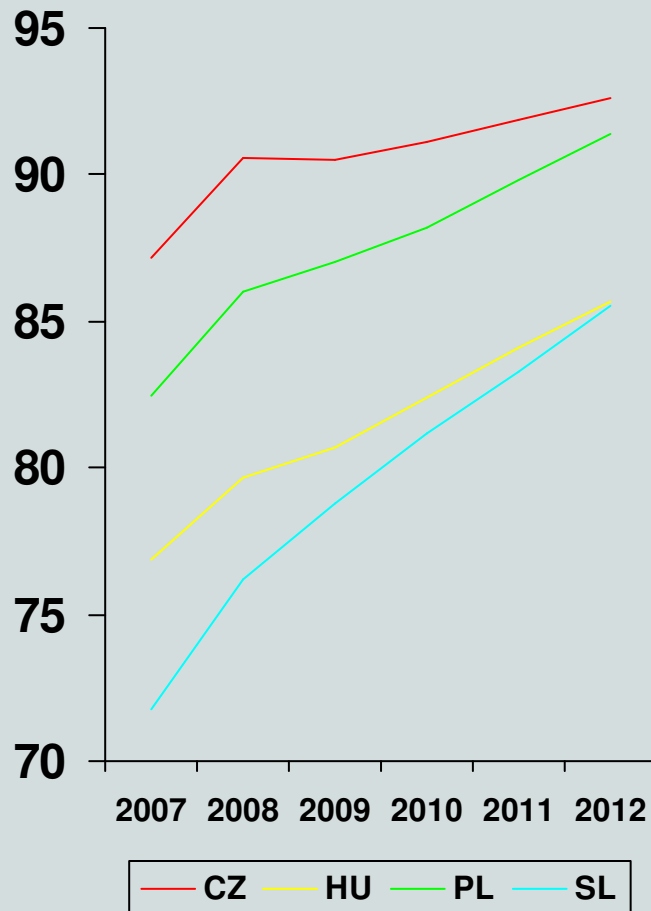
- Focus has been on skimming upper middle with “one size fits all” go-to-market
- Clearance approach to LMI won't work
- Need region-specific strategy and product development

# Rural/lower middle income sales

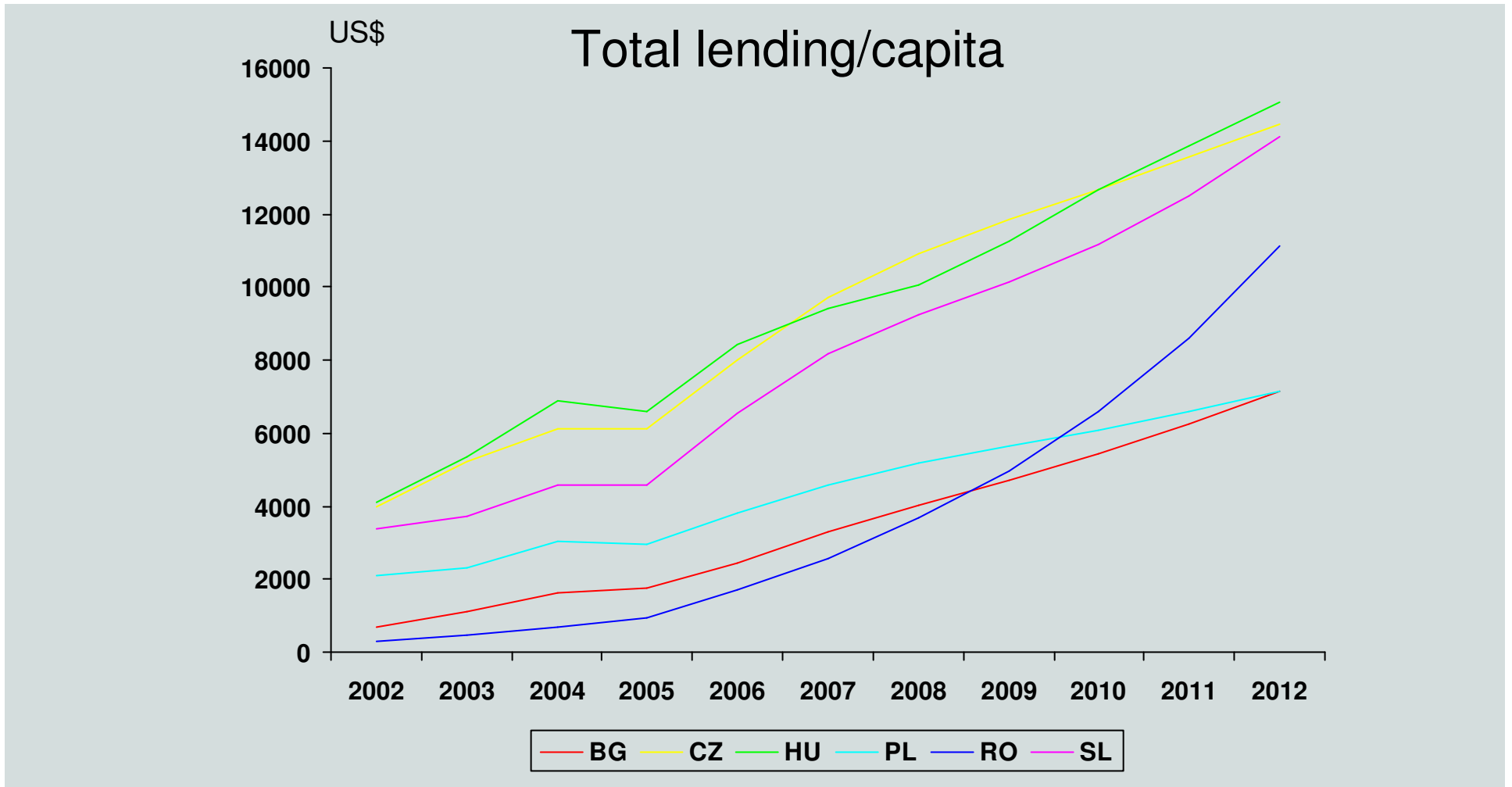
- Innovate up down and laterally
- Design to cost
- Build low-cost manufacturing
- Leverage direct distribution
- Flexible pricing
- Low-cost flanker brands

# Rural/lower middle income sales

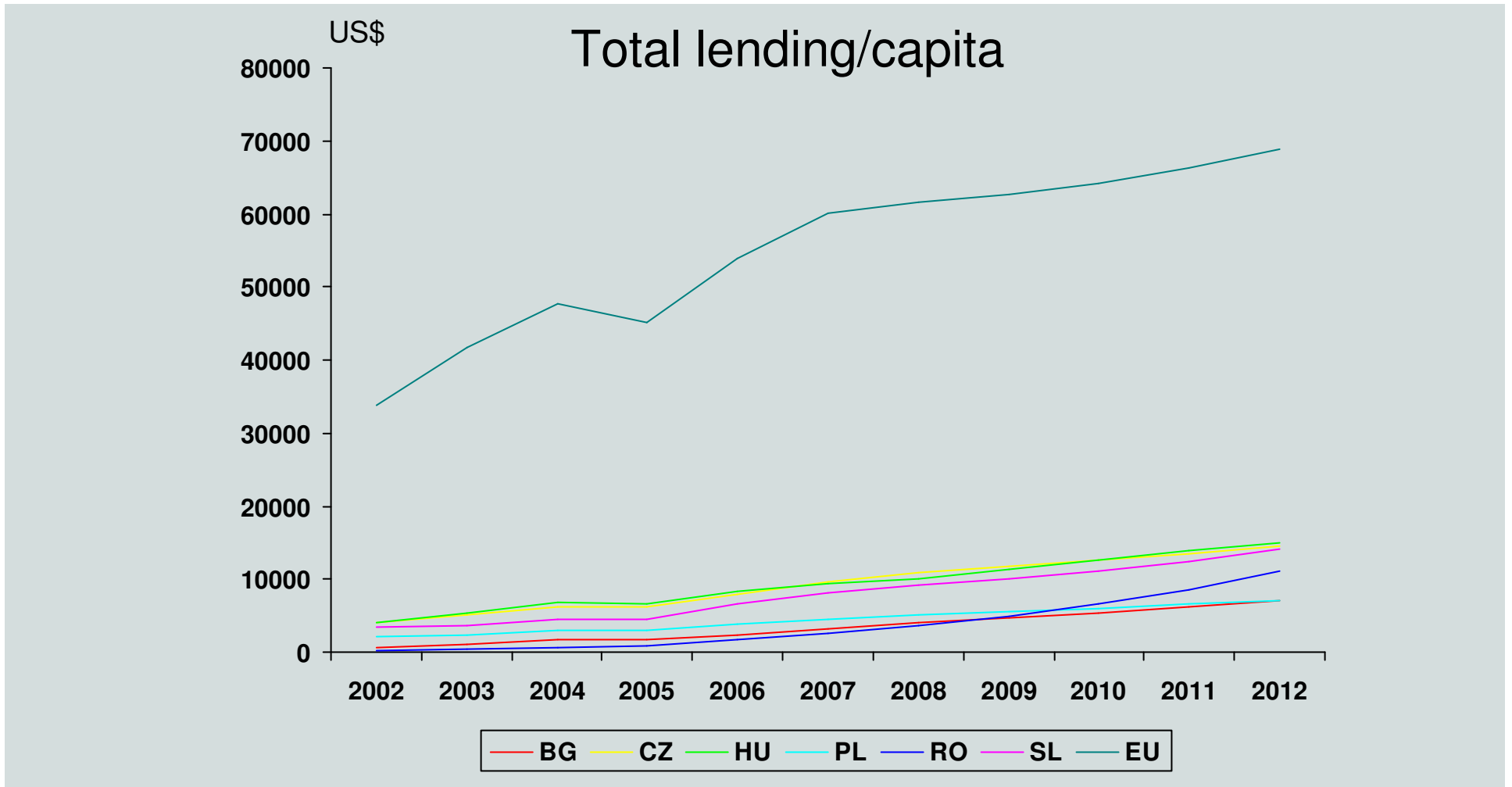
% households >\$15k



# Credit growth



# Credit growth



# Credit growth

- Huge opportunity for companies going after CEE emerging middle class
- And better access to credit will mean CEE companies become more viable suppliers, better customers, bigger investors
- But consumer credit is a dual-edged sword

# Human resources

- HR is biggest challenge facing managers in the region today
- Senior management salaries are comparable with western European levels
- Markets are tight: huge demand and limited supply (skills mismatch, low labour mobility)
- Particular difficulties in “new” positions—compliance, sales and marketing, risk management, CSR, environmental management
- Employment protection legislation, minimum wages, collective bargaining, and taxes hit competitiveness
- Governments turning to repatriation, guest worker initiatives...but EU rules can make this tricky, and it's bound to be politically unpopular



# Romania outlook

- In 2006 the best sales growth was seen in consumer goods, where 80% of consumer goods companies saw sales rise in double digits
- Given the tightening nature of the market, this underlines there are still sales growth opportunities
- But 30% of such companies did see flat profits
- For FMCGs, the days of easy money are disappearing although retail still growing rapidly
- Credit growth and removal of EU duties present opportunity
- Bucharest is a strong market, but rural population lives on 30 Euro per month
- Food & beverages account for 40% of consumer spending, compared with mid-20% figures in core CEE

# Romania outlook

- Romania is firmly on the radar screen of manufacturing companies looking for locations
- FDI surged in 2006 to over \$11bn and will average over \$7bn for the next five years
- Labour costs are comparable with main cities of China – better labour productivity above blue-collar level
- Investors on ground generally satisfied with experience and many plan expansion
- Business environment is far from perfect, but improving
- Implementation of laws is as usual the main headache
  
- Business has (so far) been insulated from political instability...
- ...but when will the macroeconomic correction come?

