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Canada

International Markets Bureau

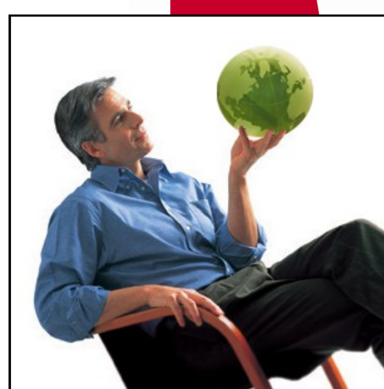
MARKET ANALYSIS REPORT | MARCH 2011

Regional Profile

Discounters in Central Europe (Romania, Hungary, Poland, Slovakia and the Czech Republic)

Source: *Planet Retail, 2010*

Source: *Planet Retail, 2010*



Growing Forward

Canada

EXECUTIVE SUMMARY

This report will focus on discounters in Central European countries including Hungary, Poland, Romania, the Czech Republic and Slovakia. These countries have four of the ten discounter markets expected to grow the fastest in all of Europe.

As the world economy declines, discounters have the advantage of providing consumers with low priced goods at a convenient location close to urban areas. Discounters are currently some of the fastest growing grocery retailers in Central Europe as consumers are not only becoming more price conscious, but are realizing the value and quality of private label products in a no-frills environment.

In general, hard discounters are moving towards acquiring the characteristics of soft discounters by increasing their offerings of brand name products, extending their range of products, and increasing advertising expenses. Additionally, supermarkets and discounters have overlapping features as the Global Grocery Discounter Cycle proceeds. This cycle denotes a gradual segregation of discounters and supermarkets based on price during economic downturns, followed by a gradual overlapping of retailer characteristics (mainstream retailers introduce discount elements and discounters introduce mid-market appeal by improving product mix and store environment) as the economy improves, until the cycle restarts with the next economic downturn.

Discounters are currently competing against a variety of retail formats such as wholesale/cash and carriers, hypermarkets/ supermarkets, and convenience stores. Discounters are able to maintain their competitiveness against wholesalers by focusing on price (by providing no-frills bulk buying) and against supermarkets/hypermarkets by extending their product ranges. By opening new stores in urban locations and offering on-the-go food products, discounters are also able to compete against convenience retailers. Additionally, discounters in Central Europe are adopting strategies from other discounters in Western Europe (range extension, premiumization, and range segmentation) to varying degrees.

The massive expansion of discount retailers in Central Europe will drive demand for private label products. Though cost competition between manufacturers is fierce, an opportunity exists for Canadian companies to provide products that are particularly value-added. This additional level of value would alleviate the cost disadvantage of transportation, duties, and other expenses that Canadian companies face in exporting to Central Europe.

INSIDE THIS ISSUE

“It’s best to have a pound of sales on a lower margin than not to have a pound at all
~ Laurie McIlwee
Tesco CFO”

Source: *Planet Retail, 2010*

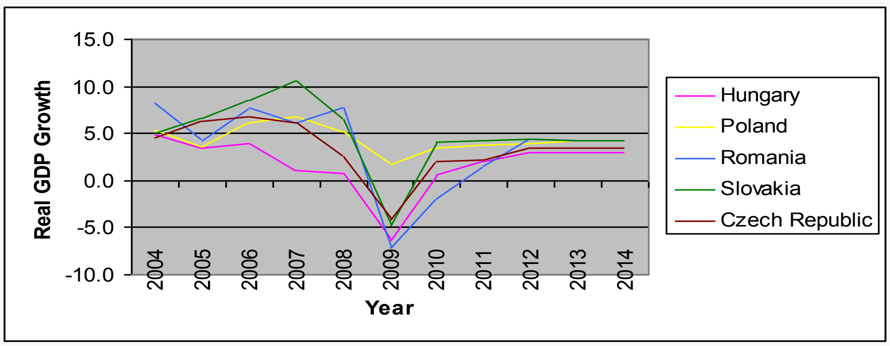
CENTRAL EUROPE—KEY FACTS

Eastern and Central Europe are home to over 330 million inhabitants, with Russia alone accounting for 141 million. The global economic recession in 2009 has impacted the European market significantly, causing real GDP to decline 4.2% in Western Europe and 6.2% in Central and Eastern Europe. By comparison, the North American market showed only a 2.6% real GDP reduction for 2009. However, before the recession, the Eastern and Central European market reached an average 6% real GDP growth rate, as compared to 2% for Western Europe.

The discount market in Central Europe has a particular advantage during a recessional period, as consumers look for less expensive products. Discounters generally offer more private label products than their supermarket or hypermarket counterparts. With private label market penetration and increasing acceptance among consumers, Canadian food and beverage producers have a growing opportunity to supply these goods.

The following chart shows the dip in GDP growth rates during the economic recession in Central Europe, as well as the forecasted rebound of each country's economies in 2010 and beyond.

Real GDP Growth Rates in Central European Countries with Discount Markets – Historic and Forecast



Source: *Euromonitor, 2010.*
Note*: Data from 2010 onward is forecast*

Czech Republic

Approximately 10.5 million people live in the Czech Republic, with around 10% of the population living in Prague. In 2009, the real GDP growth rate in the Czech Republic was –4.1% (Euromonitor, 2010). Due to the recession, discounters have emerged as popular grocery retailers, while private label offerings have expanded at the expense of branded goods. The recession also caused the unemployment rate to reach 7.8% in March 2010. Before the recession (October 2008), the unemployment rate was a low 4.3%. Despite some negative effects, the recession did not hit the Czech Republic as hard as other Central European countries, such as Hungary. Strong productivity growth, good physical infrastructure and a skilled labour force have continued to position the Czech Republic as an attractive destination for foreign direct investment (U.S. Commercial Service, 2010).

Good relationships with domestic business partners are crucial for market success. Prague is considered the economic hub of the country to which smaller foreign products are shipped. Large import loads usually enter through Antwerp port and are transported via truck to Prague (U.S. Commercial Service, 2010).

Hypermarkets are the most popular grocery retail format in the Czech Republic controlling a 40% market share, followed by discounters (24%), supermarkets (17%) and small grocery retailers (15%). However, sales have been declining in the small grocery retail segment, with hypermarkets and discounters picking up the slack. Smaller formats of larger hypermarkets chains have even been penetrating smaller towns, as large cities are showing signs of market saturation.

Hungary

Hungary is home to around 10 million inhabitants, with around 1.7 million people living in Budapest, the nation's largest city, however, Hungarians are moving from large cities to smaller villages and towns in what is called de-urbanization, as the standard of living in smaller towns is often higher than big cities (Euromonitor, 2010). Hungary's new and improved physical infrastructure allows citizens to commute longer distances for work, and also allows businesses to operate more efficiently.

During 2009, the country saw a significant drop in GDP, with real GDP declining 6.3%. An unemployment rate of 9.7% in 2009, as well as increased food prices in 2009, have left consumer confidence in shambles. Although the inflation rate has declined from 2007 to 2009, Hungarians have been cutting down on spending for durable goods, as well as food and beverages. Even sales of alcoholic beverages have been on the decline, which is often seen as a recession-proof product (Euromonitor, 2010). However, the drop in consumer expenditures on food and beverages created a positive impact on sales for discounters, private labels and economy brands.

Hungary's declining population, much like Romania's, is another factor which may contribute to a decline in sales of food and beverages. Fewer children, higher emigration of young workers and recent graduates, and an ageing population, all contribute to this decline. The changing demographics in Hungary is expected to lead to reduced sales of baby and infant foods, and an increase in sales of health and wellness food and beverages (Euromonitor, 2010).

Hungary has been an EU member since 2004, and therefore products must comply with EU standards, labelling, regulations and certifications. The use of a local agent or distributor is recommended when exporting to Hungary. Distributors are willing to cooperate with Canadian suppliers who have the capacity to spend on product promotion. The distributors will help with communication strategies and logistics, positioning brands through local advertising and promotional campaigns, as well as after-sales service (U.S. Commercial Service, 2010).

Poland

The economy of Poland fared relatively well during the recession, as it was one of five countries in Central, Western and Eastern Europe in 2009 that did not have a negative real GDP growth rate. This success is mainly due to government tax cuts, constant consumer spending, rising public investment by the EU, and high export output (U.S. Commercial Service, 2010). However, the Western and more urban region fared better in terms of economic growth than the Eastern region.

Poland was home to 38.2 million inhabitants in 2009. The unemployment rate reached 9.4% in August 2010, which is still relatively low compared to an incredible 20.4% unemployment rate in September 2002.

Poland's integration into the EU has been gradual, with the adoption of EU legislations allowing for changes in financial markets, competition laws and intellectual property laws. Along with a reduction in government intervention in the private sector, Poland's 2004 entrance into the EU has improved the country's economic growth (U.S. Commercial Service, 2010).

Although consumers in Poland generally have lower individual purchasing capacity and lower domestic consumption compared to Western European nations, real consumer incomes have been growing much faster. If producers can afford the costly slotting fees, entry fees, buyer conditions, and still compete effectively with the EU and domestic supply, Poland can be a profitable market (USDA, 2008). It is the largest hard discounter market in Central and Eastern Europe, as well as the fourth fastest growing discount market in all of Europe.

Romania

Romania is home to around 21.4 million inhabitants, with more than half the population living in urban areas. The country has one of the lowest urbanized populations in the EU, however, in 2006 social trends increased rural-to-urban migration, thus creating a re-modernized society (Euromonitor, 2010). The increasing urban population is leading to a proliferation of modern retail establishments, along with an increase in sales of fast-moving consumer goods. International retailers have started moving into both large and small cities, such as Bucharest, Constanta, Brasov and Ploiesti. This has allowed more imported products to enter the country, especially from the EU. Most local supermarkets are being absorbed by international chains, and discounters currently control around 80% of the expansion of modern grocery retailers.

Recent growth in wages and GDP is developing a modern middle class in contrast to the country's widespread poverty. Romania's acceptance into the EU in 2007 has allowed for harmonized tariffs, and therefore an increase in imported goods (USDA, 2010). The country's drop in GDP during the recession in 2009 is attributed to a decline in services and industry, which employ 47.1% and 23.3% of the workforce, respectively.

Romania's unemployment rate reached an estimated 7.8% in 2009 and the inflation rate rose to an estimated 5.6% during the same period. Poor physical and administrative infrastructure has marred Romania's full potential in trade and tourism. However, its ties with the EU may provide the country with funding needed to improve its foreign investment issues and infrastructure. The country also plans to adopt the Euro by 2014 (U.S Commercial Service, 2010).

Even with the market challenges discussed above, Romania is a strategic entryway to the European marketplace, with a growing foreign supermarket, hypermarket and discount market presence. In order to enter the Romanian market, a local presence through a distributor, joint venture, or subsidiary is necessary.

Slovakia

Slovakia is a smaller nation compared to Poland, Romania, and Hungary, containing only 5.3 million inhabitants. The country's discounter market is relatively small, but is growing at a rapid rate.

Slovakia recently adopted the Euro in 2009, which is expected to attract new investors into the country, and economic cooperation with the EU. It will also lower transaction costs with other countries, improve pricing transparency and ensure greater monetary stability.

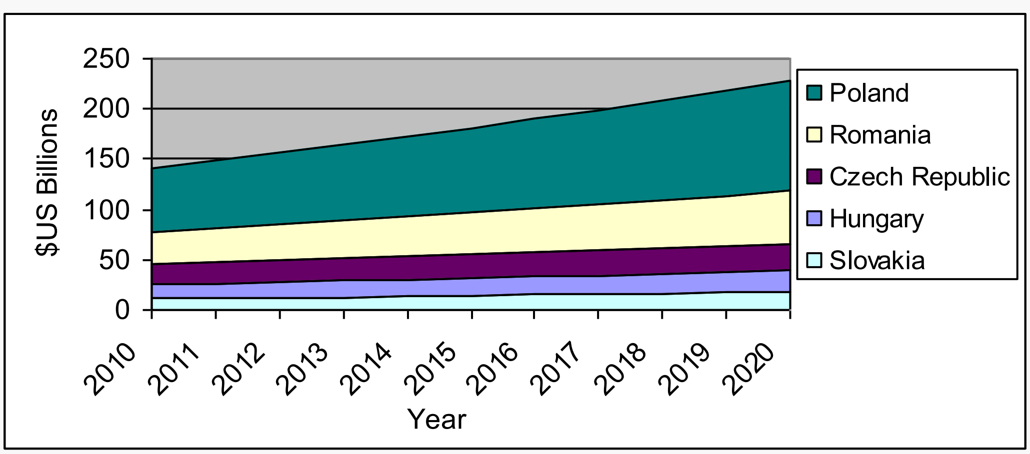
The unemployment rate in Slovakia was around 14.6% in August 2010, however it has been one of Central Europe's strongest economic performers, hitting a high 10.5% real GDP growth rate in 2007. During the recession there has been a decline in overall spending, however, spending on non-alcoholic beverages and food has declined only slightly, as the number of grocery retail stores continues to grow and consumers spend more on private label and economy brands (Euromonitor, 2010).

Much like Hungary and Poland, small retailers dominate the grocery market in terms of sales, however, hypermarkets and discounters are catching up. The key to success in the Slovakian market is to build close relationships with distributors and agents (U.S. Commercial Service, 2010).

Expenditure on Food and Beverage

The following graph shows consumer expenditure on food, alcoholic and non-alcoholic beverages in select countries in Central Europe. Expenditures in the Czech Republic, Romania, Hungary and Slovakia are dwarfed by that of Poland, where expenditures reached US$64.5 billion in 2009. Consumer expenditures in Hungary, in comparison, only reached US$14.3 billion. Only Poland saw increases in food and non-alcoholic beverage expenditures in 2009, while only Hungary saw declines in alcoholic beverage consumption. In 2009, Slovakia had the highest per capita consumption of food and beverages at $3,630.3 per person, followed by Poland with US$1,636.7. The Czech Republic had the lowest per capita consumption at US$1,035.4.

Consumer Expenditure on Food, Non-Alcoholic, and Alcoholic Beverages
Historic and Forecast – US$ Billions – Current Prices – Fixed 2009 Exchange



Source: *Euromonitor, 2010.*
Note: *Data from 2010 onward is forecast*

PACKAGED FOOD SALES

Overall, expenditures on food and beverages in Eastern and Central Europe declined, while expenditures in North America rose slightly during the recession. Eastern and Central Europe were the worst hit in terms of food expenditures, showing a decline of 17.1% from 2008 to 2009, while Western Europe showed a decline of 8.3%, and North America, 0.2% (Euromonitor, 2010).

As eating less food is generally not an option for consumers, declining food expenditures can be explained by a decreasing population in certain Eastern and Central European countries, as well as by declines in foodservice purchases. Consumers are also purchasing more products from discounters and hypermarkets, as a result of eating out less and trimming overall food budgets.

Packaged food sales in Eastern and Central Europe have not declined during the recession, with the exception of the Slovakian and Czech Republican market. The following table shows the per capita packaged food expenditure in the Central European countries of focus, as well as North America for reference. Although Canadian consumers currently spend more on packaged food, they are actually consuming less food volume-wise compared to the United States. Per capita packaged food sales have declined in the Czech Republic and Slovakia, as more consumers purchase discounted and private label goods. Consumers in Hungary, Poland and Romania, are also purchasing more discount products, but they are also eating out considerably less and therefore packaged food sales have increased.

Packaged Food Market Sizes in Selected Countries — Historic — Retail/off-trade Value RSP — US$ Per Capita — Current Prices — Fixed 2010 Exchange Rate

Country	2004	2005	2006	2007	2008	2009
Canada	1,127.9	1,164.5	1,203.7	1,242.4	1,281.7	1,313.4
USA	967.4	979.5	993.3	1,018.2	1,055.3	1,063.8
Czech Republic	620.2	637.9	658.8	690.1	734.1	733.7
Hungary	530.6	561.7	594.9	633.0	685.1	710.4
Slovakia	443.3	475.0	507.0	597.9	623.5	617.7
Poland	383.6	404.8	425.4	444.0	468.2	487.7
Romania	176.8	199.5	225.0	267.8	306.1	316.4

Source: *Euromonitor, 2010.*

Forecasted Growth for Packaged Foods in Major Central Europe Markets Retail Value RSP – Period Growth (%) 2009 – 2014

Food Category	Czech Republic	Hungary	Poland	Romania	Slovakia	Average Growth
Total Packaged Food	**18.0**	**16.8**	**24.1**	**29.6**	**12.5**	**20.2**
Baby Food	38.8	23.7	44.4	44.7	17.9	33.9
Bakery	8.8	8.0	11.9	39.3	9.8	15.6
Canned/Preserved Food	16.5	27.0	24.6	16.0	10.9	19.0
Chilled Processed Food	19.4	28.9	28.1	25.2	11.2	22.6
Confectionery	16.8	12.9	45.6	23.8	16.7	23.2
Dairy	20.1	12.5	23.7	26.7	14.2	19.4
Dried Processed Food	20.6	20.4	21.5	15.3	14.0	18.4
Frozen Processed Food	17.8	19.9	18.9	23.7	13.6	18.8
Ice Cream	32.2	22.1	43.1	32.1	14.4	28.8
Meal Replacement	12.1	8.3	10.7	104.0	10.3	29.1
Noodles	23.1	43.4	32.4	46.2	5.0	30.0
Oils and Fats	16.0	23.6	18.3	16.9	16.6	18.3
Pasta	21.6	11.7	26.2	13.8	7.8	16.2
Ready Meals	26.4	12.3	21.9	14.0	20.6	19.0
Sauces, Dressings and Condiments	20.3	21.0	19.4	18.7	4.5	16.8
Snack Bars	0.3	21.0	100.8	16.7	27.8	33.3
Soup	24.9	16.8	20.1	18.8	25.2	21.2
Spreads	15.1	37.6	13.4	41.2	3.4	22.1
Sweet and Savoury Snacks	23.7	15.5	20	18.9	13.0	18.2

Source: *Euromonitor, 2010.*

PACKAGED FOOD SALES (CONTINUED)

As shown on the previous page all categories of packaged food are expected to maintain positive period growth rates from 2009 to 2014. This is in stark contrast to Western European countries such as France, Germany, and Italy, where certain categories are actually slated to decline during the forecast period. Romania is expected to have the fastest growing packaged food market during the forecast period, at 29.6%. Growth opportunities in packaged food categories in the five Central European countries include:

- Baby food in the Czech Republic, Romania and Poland (average 33.9%)
- Snack bars in Poland (100.8%)
- Meal replacements in Romania (104%)
- Confectionery in Poland (45.6%)
- Ice cream in the Czech Republic (32.2%)

Growth in beverage sales is expected to remain positive for the forecast period as well. Growth opportunities are the largest in Hungary and Romania for hot drinks and soft drinks. Soft drinks include carbonates, juices, iced tea, water, and flavoured water.

Forecasted Growth for Beverages in Major Central Europe Markets Retail Value RSP – Period Growth (%) 2009 – 2014

Drink Category	Czech Republic	Hungary	Poland	Romania	Slovakia	Average Growth
Alcoholic Drinks	10.0	22.5	11.3	23.0	10.3	15.4
Hot Drinks	21.7	49.3	18.7	50.4	25.2	33.1
Soft Drinks	18.0	57.8	32.3	41.2	26.9	35.2

Source: *Euromonitor, 2010.*
Note*: All sales are off-trade (non-foodservice)*

TRENDS IN GROCERY DISCOUNTING

Hard discounters are generally described by the following characteristics:

- Efficiency focus
- Low-price focus (everyday low prices)
- Very limited product range (800 to 2,000 SKUs)
- Selling mostly private label products
- Limited supplier promotions and no supplier negotiations on net prices
- Located in proximity to full-range stores (Planet Retail, 2010).

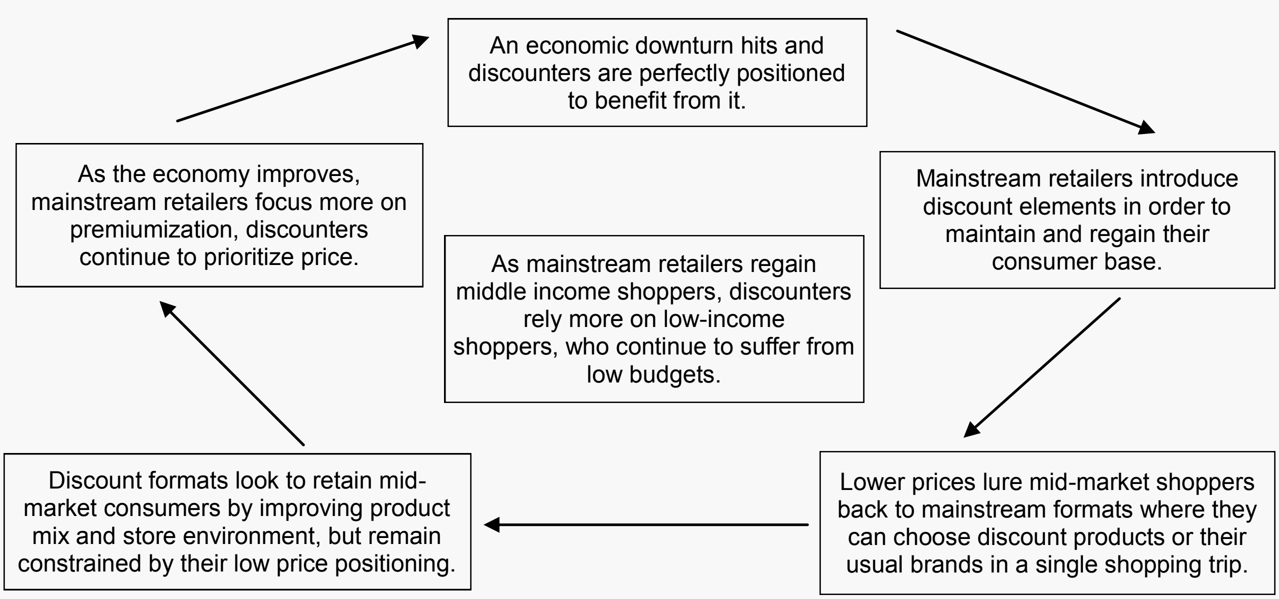
Recently, hard discounters have been taking on the characteristics of soft discounters, such as increased offerings of brand name products, a larger product range, an increased range of fresh, frozen and chilled products, and increased advertising spending. However, some differences in soft discounting still exist, such as the existence of heavier price promotions, brand promotions in-store, stand-alone locations (not next to other full-range stores) and negotiations with suppliers on packaging and bonuses.

Supermarkets and discounters are also copying features from each other. Supermarket trends include range rationalization, more private label offerings, and a stronger focus on price, while discounting trends include range extension, more branded product offerings and more convenience and premium foods. Supermarkets are also moving towards smaller store sizes, and charging customers for shopping bags, while discounters have been providing more services online, more price promotions, and increased marketing spending (Planet Retail, 2010).

TRENDS IN GROCERY DISCOUNTING (CONTINUED)

The issue with soft and hard discounters, as well as supermarkets/hypermarkets, wanting to become more like each other is that it leads to a closed loop cycle. During an economic downturn, all grocery retailers use a market strategy that is completely different from their usual positioning. Discounters focus on branded goods and premiumization, and supermarkets/hypermarkets focus on price and private label. This causes a blurring of the lines between retail channels during a recession, which is brought back to normal as the economy improves, as retailers regain a hold on their market niches. The graphic below explains this phenomenon.

From Boom to Bust and Back Again—The Global Grocery Discounter Cycle



***Source**: Euromonitor, 2010, Retailing: Discount Formats*

The grocery discounter cycle not only occurs during a recession; smaller scale versions of this cycle happen on a regular basis among discounters and modern retailers, as each retailer tries to increase their market share to different types of consumers. However, each retailer reaches a point where their stores no longer attract the consumers that they were targeting in the first place (i.e. discounters targeting low-income consumers), and are forced to return to their original format, with some marked differences and improvements.

Discounters are currently competing against a variety of retail formats such as wholesale/cash and carriers, hypermarkets/supermarkets, and convenience stores. Discounters are thus providing themselves with strategies to combat each type of retailer. To combat wholesalers, discounters are offering no-frills bulk buying. Consumers can purchase staple products at a low price in this fashion, and can also purchase non-bulk items within the same store. The only advantage that wholesalers have is a larger selection of bulk products, as prices between discounters and wholesalers can often be comparable. Discounters are competing against supermarkets and hypermarkets by extending their product range to include specialty foods. Finally, discounters are competing against convenience retailers by opening new stores in urban locations, as well as offering on-the-go food products (Planet Retail, 2010).

***Source:** Planet Retail, 2010*

TRENDS IN GROCERY DISCOUNTING (CONTINUED)

Some global companies may try to be everything for everyone, Wal-Mart Supercentres in Canada for example, sells groceries among other non-grocery items. On the other hand, some retailers are noticing that too much is too much, and are thus resorting to range rationalization and smaller store formats to cater to urban markets. Discounters also notice that catering to a particular demographic of low-income consumers can prove to be profitable, showing that providing everything to everyone is not the only way to make a sale. As discount market sales are expected to continue to grow as the economy improves, it would be best for discounters to focus on their competitive advantage of providing low cost goods to consumers, rather than focus too much on being more like other grocery retailers. However, if they can continue to provide consumers with low-priced goods, as well as increase the size of their product line among other changes, they would be at an advantage to do so.

The following is an in-depth look at the strategies for discounters in the overall European market, and a look into whether or not these trends are being followed by retailers in the Central European market.

Range Extension

The most prominent strategy for discounters to compete with supermarkets and hypermarkets is to provide consumers with more brands through range extension. Range extension also includes providing more types of products to consumers such as more fresh and frozen foods. The extent of the range extension is different for each discounting company, and sometimes each market of operation. Aldi generally focuses more on private label brands, and its extensions to include branded products are very limited, while Lidl is generally more open to listing brands. Penny market generally has a more balanced approach to offering both private label and branded products. Private labels in Penny markets are also tailored to the country in which the store operates (Planet Retail, 2010).

Private label and branded soft drinks in a Hungarian Profi store.
Source: *Planet Retail, 2010*

In recent years, discounters in Central Europe have been delisting secondary brands, and only focusing on the top large brand name products, along with private label offerings. This is particularity good for top brands, but is also good for Canadian companies wishing to source private label products for these discounters, as there will be less competition for these products on the shelves.

Premiumization

Premiumization has been identified as a trend in international retailing, not just among discounters. However, premiumization will show a different face in discount retailers, especially in Central Europe. Unlike affluent consumers in Western Europe and North America, consumers in Central Europe will not usually be willing to pay more for a premium product. These consumers will expect quality and uniqueness among products, but will also expect not to pay more for them. Standard and economy private label lines are currently more popular in Central Europe, lagging behind the full premiumization trend of Western Europe (Planet Retail, 2010).

Again, because of the grocery discounter cycle mentioned on page 8, discounters will never include as many premium products as their hypermarket and supermarket competitors. However, after the recession, discounters are expected to keep an array of “premium” product lines that are just as concerned with their price as their premium qualities. Conversely, hypermarkets will continue to include and introduce premium product lines, but will never reach the level of premiumization and price levels seen in specialist food retailers. This is because each retailer must carve out a niche for themselves to stay competitive, but must also provide products to cater to their competitors’ customer demographics, in an attempt to capture higher market shares.

Example of premium product in Czech Republic Lidl store

Source: *Mintel, 2010*

Private label limited edition Ceylon tea at Biedronka store

TRENDS IN GROCERY DISCOUNTING (CONTINUED)

Range Segmentation

Western European discount retailers have been particularly successful with providing consumers the choice between premium, standard and economy products, known by retailers as range segmentation. In Central Europe, standard and economy lines will fare better than premium products, as many consumers will not pay more for premium products (Planet Retail, 2010). However, the definition of premium does not have to denote better quality or a higher price. Consumers in Central Europe expect even economy brands to be of good quality, and therefore both private label and brand name manufacturers should note that premium may only be in the packaging and labelling itself.

Lidl is the leader in product segmentation. According to Mintel, the company currently had more premium product introductions in the past few years than Penny, Biedronka or Aldi. As consumers in Central Europe become more affluent, we may see more range segmentation as more premium products are introduced and companies are more willing to spend on product packaging.

***Source:** Planet Retail, 2010*

Example of premium, standard and economy range segmentation in discount retailers

DISCOUNTERS IN CENTRAL EUROPE

Grocery Banner Sales of Discount Retailers in Central Europe – US$

Country	Banner	2006	2007	2008	2009	2010
Czech Republic	Lidl	617,792,809	810,016,461	1,086,480,846	983,663,995	1,036,511,345
	Norma	72,138,628	91,220,156	119,918,403	115,547,070	117,557,126
	Penny	672,334,015	835,451,068	1,408,745,826	1,394,575,808	1,400,375,837
Hungary	Aldi (Süd)	N/A	N/A	127,012,529	281,598,902	333,534,705
	Cent	N/A	N/A	N/A	1,146,003	48,383,732
	Lidl	326,150,067	440,834,532	626,779,800	631,829,620	684,731,006
	Penny	546,435,184	673,494,449	783,196,539	656,658,370	620,295,055
	Profi	179,023,421	204,566,111	227,655,521	207,347,106	202,153,718
Poland	Aldi (Nord)	N/A	N/A	56,252,241	101,182,146	182,575,270
	Biedronka	1,977,336,000	3,007,692,085	4,734,099,241	4,726,966,818	5,458,131,874
	Lidl	670,430,934	1,096,676,601	1,638,573,641	1,426,865,473	1,607,852,535
	Netto	396,039,717	537,481,612	722,587,378	626,424,330	757,820,962
Romania	Penny	110,885,648	175,854,223	273,817,986	303,547,625	38,958,197
	Penny XXL	88,755,621	96,796,548	94,349,186	75,831,371	331,986,507
	Plus	135,272,135	297,037,314	425,021,349	412,781,704	66,452,566
	Profi	52,397,902	116,622,424	149,655,405	153,752,676	472,093,878
Slovakia	Lidl	321,872,828	468,822,145	657,236,527	645,897,297	660,641,442
	Total	**7,728,475,893**	**10,517,154,925**	**13,143,393,970**	**12,745,616,312**	**14,020,055,754**

***Source:** Planet Retail, 2010.*

▶ DISCOUNTERS IN CENTRAL EUROPE (CONTINUED)

The chart on the previous page shows the top discounters in Central Europe according to grocery banner sales. The Jerónimo Martins' Biedronka is currently the top seller in this grocery format, followed by Schwarz Group, which owns Lidl. The Rewe Group currently owns both Penny and Penny XXL. Both Slovakia and Hungary Aldi stores are owned by Aldi Sud and Poland Aldi stores are owned by Aldi Nord. Dansk Supermarked owns Netto, Louis Delhaize owns Profi in Romania and Hungary, and CBA owns Cent. Tengelmann's Plus stores will be completely taken over by Lidl in 2011.

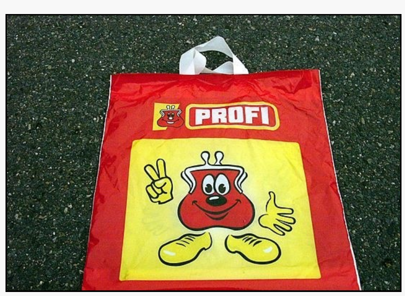
Discounters are reaching a saturation point in key markets, such as Germany, Norway, Austria, Belgium, the Netherlands and France. The Central European market has shown promise in the expansion of the discount market. Growth is expected from 2010-2014 for Central Europe.

The following chart shows the banner sales of discounters in the top European countries. Romania, Slovakia, Hungary and Poland are expected to be the top ten fastest growing markets from 2010 to 2014.

Grocery Banner Sales of Discounters in Central Europe – Current and Forecast – US$ Millions

Country	2004	2005	2006	2007	2008	2009	2010	Growth % 2010-2014
Romania	**99.95**	**185.09**	**401.80**	**701.65**	**942.84**	**945.91**	**913.68**	**52.15**
Slovakia	**66.67**	**188.03**	**321.87**	**468.82**	**657.24**	**645.90**	**660.64**	**50.99**
Turkey	1,332.68	1,556.24	1,967.62	2,883.75	4,102.15	4,230.30	5,429.88	47.91
Hungary	**1,141.49**	**1,256.63**	**1,482.13**	**1,846.73**	**1,764.64**	**1,778.58**	**1,889.10**	**43.28**
Poland	**2,377.90**	**2,943.27**	**3,680.81**	**5,159.28**	**7,163.52**	**6,881.44**	**8,006.38**	**40.36**
UK	7,997.57	7,790.20	8,522.86	7,839.06	8,607.57	7,740.51	8,426.56	40.16
Ireland	304.12	371.10	659.36	1,195.33	1,602.55	1,794.46	1,863.42	36.60
Slovenia	3.59	58.55	193.42	516.76	763.60	809.69	856.16	35.74
Portugal	1,447.83	1,557.75	1,830.41	2,270.92	2,455.13	2,314.37	2,277.87	30.94
Sweden	600.53	768.15	885.61	1,158.58	1,356.55	1,245.99	1,471.45	29.07
Czech Republic	**1,173.03**	**1,504.97**	**1,841.87**	**2,340.68**	**2,615.15**	**2,493.79**	**2,554.44**	**28.08**
Finland	945.08	1,147.04	1,367.78	1,646.32	2,015.58	1,990.46	2,095.61	27.68
Italy	4,604.07	4,961.93	5,897.55	7,366.12	8,633.63	8,250.42	8,081.77	23.47
Denmark	3,818.75	4,056.58	4,431.19	5,369.74	6,386.27	6,361.32	6,224.93	22.67
Austria	3,885.94	4,158.88	4,699.57	5,875.94	7,126.66	6,824.10	6,529.19	18.69
France	14,042.50	14,907.55	16,189.53	18,712.94	21,693.39	20,951.84	20,363.41	18.36
Belgium	3,254.43	3,567.57	3,898.91	4,657.98	5,347.53	5,169.66	4,983.44	16.77
Spain	6,265.35	6,579.49	7,023.86	8,187.31	9,205.36	8,666.00	8,464.64	16.73
Netherlands	3,147.53	3,397.28	3,671.83	4,428.29	5,438.20	5,302.50	5,132.37	16.68
Greece	879.80	1,213.09	1,758.61	2,341.76	2,722.55	2,583.98	2,449.60	15.68
Germany	57,091.06	59,398.27	62,165.78	69,449.49	77,867.72	75,078.31	73,985.57	14.36
Norway	6,689.76	7,640.11	7,212.58	8,120.35	9,132.32	8,896.94	9,766.33	13.13

Source: *Planet Retail, 2010.*



Shopping bag in Profi store
Source: *Planet Retail, 2010.*

Discounting in the Czech Republic

Discounters in the Czech Republic are a very important retail channel, even though growth is not expected to be as large as any other Central European country. The lower market growth rate may be attributed to a saturated market.

In the past, discount stores were located in Central and Western Bohemia, but have recently added locations in small towns with populations of around 20,000. The discount market is dominated by Rewe's Penny market, Schwarz's Lidl, and a smaller amount by Norma. The number of discount stores rose to 581 in 2009 from 556 in 2008, even though sales in all grocery retail formats (except convenience stores) have been on the decline (Planet Retail). This decline is due to the economic recession causing many retailers to drop their prices to meet those of discount retailers, and causing consumers to switch over to non-discount retailers. Due to the size of the market and that only three main companies are operating in the market, Euromonitor expects that more companies will introduce their retail banners.

Following the takeover of Tengelmann's Plus discount stores, the Rewe Group has decided to extend the use of the merchandise warehouse management system solution from Compex Commerce, a German IT vendor. The company's distribution centres in Radonice, Jirny and Lipnik are already using this system. The Rewe Group uses both the Coopernic and Eurogroup buying groups to source its products. The Coopernic buying group has three aims for its buying strategy: to negotiate with multinational companies through international agreements, to determine which products can be purchased for all the members of the Coopernic, and to develop private label and economy lines for all members (Planet Retail, 2010).

Discounting in Hungary

Certain grocery retail channels outsell discounters, such as hypermarkets, supermarkets and neighbourhood stores. However, Hungary is expected to be the fourth fastest growing discounter market in all of Europe. The number of discount retail outlets has grown 13% just in 2009 (excluding Plus stores) (Planet Retail, 2010).

Although private label goods are becoming popular in Hungary, this was not always the case. In the past, many consumers would rather purchase less product than cheaper products. However, consumers still look for quality when purchasing lower priced goods.

The discount market is controlled by five main retailers: Rewe's Penny markets, Schwarz's Lidl, Louis Delhaize's Profi, Aldi Sud, and CBA's Cent market. Tengelmann recently sold its Plus discount markets to Spar Austria. Brand loyalty between Hungarian consumers is very low, causing much competition between the top five companies (Euromonitor, 2010). Planet Retail foresees an overcrowding of the market due to the five large retailers and a comparably small Hungarian population. At least one company is expected to exit the market in the near future. Aldi generally opens stores in smaller markets, with only 20 stores operating in Budapest. Many products in Aldi stores come from Austria. Aldi Sud, which owns Hofer and Aldi Hungary, share a common purchasing system. Lidl stores are spaced throughout the country with 18% of stores in Budapest. Penny also focuses on smaller markets with only 10% of Penny stores located in Budapest. Only 50% of private label products in Penny markets are made in Hungary (Planet Retail, 2010).

Distribution channels are improving and moving towards Western European standards. A typical distribution channel in Hungary consists of importer-wholesalers to service retailers directly. The Rewe Group uses Eurogroup and Coopernic (buying groups) for its Hungarian, Romanian, and Czech Republican Penny markets. Penny market also uses a logistical service provider, Dachser, to supply the company's central warehouses. The Schwarz Group uses its own distribution network to supply most of its products from Germany. The warehouse in Hungary also supplies products for Romanian and Slovakian Lidl stores. CBA owns its own buying group, and its own logistics centre which supplies over 70 local CBA supermarkets and discounters. Most of the company's products for the Cent discounter are sourced from Hungary. Profi stores in both Hungary and Romania purchase their products through the Bloc buying group. Provera Hungary, which supplies Louis Delhaize's Cora and Match markets, is a smaller buying group under the main Bloc buying group. The Bloc buying group conducts international negotiations for commodities, organizes national and international contracts with manufacturers of branded products, and sources private label lines. The products chosen by Bloc are presented to the members of the buying group every three weeks (Planet Retail).

Discounting in Poland

Poland has the largest discounter market in all of Central and Eastern Europe. It is also the fifth fastest growing market with an expected retail growth rate of 40.3% from 2010 to 2014. Discounters currently sell more than any other retailer channel, such as hypermarket/supermarkets, cash and carriers, convenience stores, and other grocery formats. Most discount retailers are located in urban areas in small and medium sized towns, as large towns are already saturated with large hypermarkets and other grocery retailers (Euromonitor, 2010).

Jeronimo Martins' Biedronka currently dominates the discounter market, thanks to aggressive expansion and the takeover of 200 Tengelmann's Plus stores in 2007. In 2009, Biedronka had 1,500 stores located all over the country and plans to open 100 stores per year for the next few years. Other companies in the market include the Schwarz Group's Lidl, Dansk Supermarked's Netto and Aldi Nord. A new concept in discounting was created by Kaufland Dyskont Napojowy. Its store is located in Brzeg and only carries soft drinks and alcoholic drinks (Planet Retail, 2010).

Most of the private label products sold in Poland are manufactured in Poland, with around 95% of Biedronka's private label products being produced domestically (Euromonitor, 2010). Consumers also prefer to purchase products made in Poland as opposed to elsewhere. However, the increasing amount of branded products available in discount stores can include favourable prospects for Canadian companies.

The majority of retailers in Poland do not conduct direct imports and instead, rely on local importers and wholesalers to obtain products. An importer or representative office may also be a wholesaler or distributor as well. Biedronka uses direct importers/distributors and wholesalers to purchase its products (USDA, 2008). Biedronka is also part of the AMS and Uniarme buying groups. The company also has its own distribution network in Poland consisting of six centres.

Discounting in Romania

The Romanian discount market is still relatively small despite its rapid expansion in the past six years. Romania's discount market growth is also expected to be the largest in all of Europe from 2010 to 2014. The popularity of discounters in Romania is partly due to the onslaught of the economic recession, and their portrayal as more efficient outlets for shopping in terms or money and time spent for consumers (Euromonitor, 2010).

In 2009, three companies and store brands controlled the discounter market in Romania: Tengelmann's Plus, Rewe Group's Penny Market, and Louis Delhaize's Profi, with a combined total of 190 stores. In February 2010, the Schwarz Group took over Tengelmann's Plus stores, and has re-branded them under its Lidl name. The takeover will result in the Schwarz Group taking control of around 110 stores and becoming the discount market leader in 2011. The Rewe Group will be Schwarz's main competitor, with small competition from Louis Delhaize's Profi discount stores, which is set to be purchased by Poland's Gamma group (Planet Retail, 2010).

Each retailer targets certain areas of the market, with Penny targeting cities with less than 20,000 inhabitants and Lidl targeting small cities with more than 30,000 inhabitants. To combat supermarkets, some discounters have opened stores in shopping centers in cities other than Bucharest, as some supermarkets had to withdraw from local markets due to low sales (Euromontior, 2010).

Discounters are the only food retailers that announced that they would further expand in 2010 at the same pace as 2009, while investments in the general food market have almost halved as a result of a lending freeze and consumption decline. In 2009, a total of 190 discounters were operational in the market and by 2011, an estimated 380 outlets are expected to become operational. The supply chain for discounters is different from that of small retailers, food kiosks, and convenience stores. When selling to smaller retailers, products usually go through a distributor/importer and then a wholesaler or cash and carrier. Larger retailers purchase through an importer/distributor. Penny market purchases its food from a direct importer, while Profi purchases from a direct distributor, and Plus used to purchase from a direct importer. However, when dealing with private label foods, some retailers prefer to conduct business directly with the exporter (USDA, 2010).

DISCOUNTERS IN CENTRAL EUROPE (CONTINUED)

Discounting in Slovakia

The Slovakian discount market is still relatively small, despite rapid growth in the past few years. The market is expected to grow 50.1% from 2010 to 2014. Supermarkets and neighbourhood stores represent the vast majority of grocery retail sales, followed by hypermarkets and superstores, however, the combined banner sales of all discount stores is expected to reach over US$1 billion by 2013 (Planet Retail, 2010).

Currently, the Schwarz Group's Lidl controls the discount market, while Aldi is expected to enter the market in 2011. Lidl had only 130 stores in operation in 2009, compared to Lidl in the Czech Republic, opening 200 stores during the same year.

The popularity of discounters extends past low-income consumers in Slovakia. Shopping at a discount store is seen as smart shopping, and a way to purchase basic groceries and substitutes at lower prices. Most of the discounters are located in towns with more than 5,000 people and in residential areas. The main products purchased in discount markets include non-alcoholic beverages and ambient goods. These foods are generally sourced from Austria, Poland and the Czech Republic, with very few products actually produced in Slovakia. However, in 2008, Lidl changed its product lines to carry more Slovakian products. (Euromonitor, 2010).

The Lidl outlets in Slovakia are supplied by a warehouse and logistical centre in Hungary. Many of the private label foods sold in Lidl stores are German owned, with some from the United Kingdom and the Czech Republic. When shipping food products to Slovakia, the United States generally uses European intermediaries in Germany and the Netherlands (Planet Retail, 2010). Canadian companies would most likely benefit from using these same channels.

Discounting in Other Countries

The Slovenia discount market, although quite a bit larger than the Slovakian market, is expected to grow at a slower rate. The Slovenian market is dominated by the Schwarz Group's Lidl, Aldi, Eurospin and Mercator's Hura!. Most of the products sold in Slovenian Aldi stores (under the name Hofer), are sourced from Austria. Lidl's expansion in the Slovenian market is also controlled in Austria. Lidl currently operates 37 stores in the Slovenian market.

Although Turkey is not part of Central Europe, it is the third fastest growing discounter market in all of Europe. However, the market is dominated by very different retailers such as BIM, Migros Ticaret, Carrefour and A101. BIM is much like Alidi, but operates a harder discount format than most retail chains seen in Central Europe (Planet Retail, 2010).

MARKET ENTRY STRATEGIES

The massive expansion of discounters in Central Europe will lead to a demand in private label products. Although many of the private label products sold in Lidl stores are German brands, they may not necessarily be produced in Germany. Discounters such as Jeronimo Martins, print the name and location of the private label supplier on the product packaging to highlight their origin (Planet Retail, 2010). Therefore, some producers will not have to sacrifice their brand identity entirely. However, sourcing for private label is also a good idea for companies who do not have a particularly strong brand, but wish to export their product to the European market. Discounters usually only sell leading brands, with private label products dominating many categories. It would be very difficult for small companies to introduce branded products to discount stores, as small producers usually do not produce leading brands. Sourcing for private label is a less risky way to enter a market, and removes the need to get a brand noticed. As long as the small company can produce enough private label products to be able to supply many stores at once, and to provide profits from products with such a small profit margins, sourcing for private label may be a good idea. Producing private label foods for hypermarkets and supermarkets can also be an option, as these types of retailers are also growing in terms of retail sales in Central Europe.

MARKET ENTRY STRATEGIES (CONTINUED)

The competition for manufacturers, even for sourcing private label products, is tough. Many products in certain discount stores in Central Europe are produced from European countries in close proximity to the discount operation, from the discount chain's home country, or country with the closest distribution centre. Canadian companies need to provide products that have a particular added-value, are unique, or are produced at a significantly lower cost than other sources. Due to transportation, import duties and other expenses, the lowest cost option is not usually available for North American producers, but the value-added option is.

According to Planet Retail, Polish wholesalers such as Eurocash and Emperia Holding have not yet developed extensive private label ranges. However, increasing competition may force their development, and may open opportunities for partnerships.

When deciding to source private label products to discounters, suppliers should consider the following:

- Understand that private label is about volume, not value. Even though many private label companies are extending their range to include more premium products, the goal is the same; to sell more than branded products at a lower margin.

- A close relationship with a buyer or importer is important in this market. The best strategy is to work with and understand your domestic buyer.

- Usually discounter chains will want to feature a product in all their stores operating in a certain country. These chains may also want to feature the same product in other countries of operation as well. This depends on the particular chain that the supplier is dealing with. As a supplier, be prepared to be asked by the retailer or buyer to provide supply for more than one store in a particular market and region. If you have limited supply, it would be best to deal with smaller discounter chains, or find a different retail channel (i.e. convenience stores, or smaller supermarkets).

Source: *Planet Retail, 2010.*

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Agriculture and Agri-Food Canada
1341 Baseline Road, Tower 5, 4th floor
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Canada K1A 0C5
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