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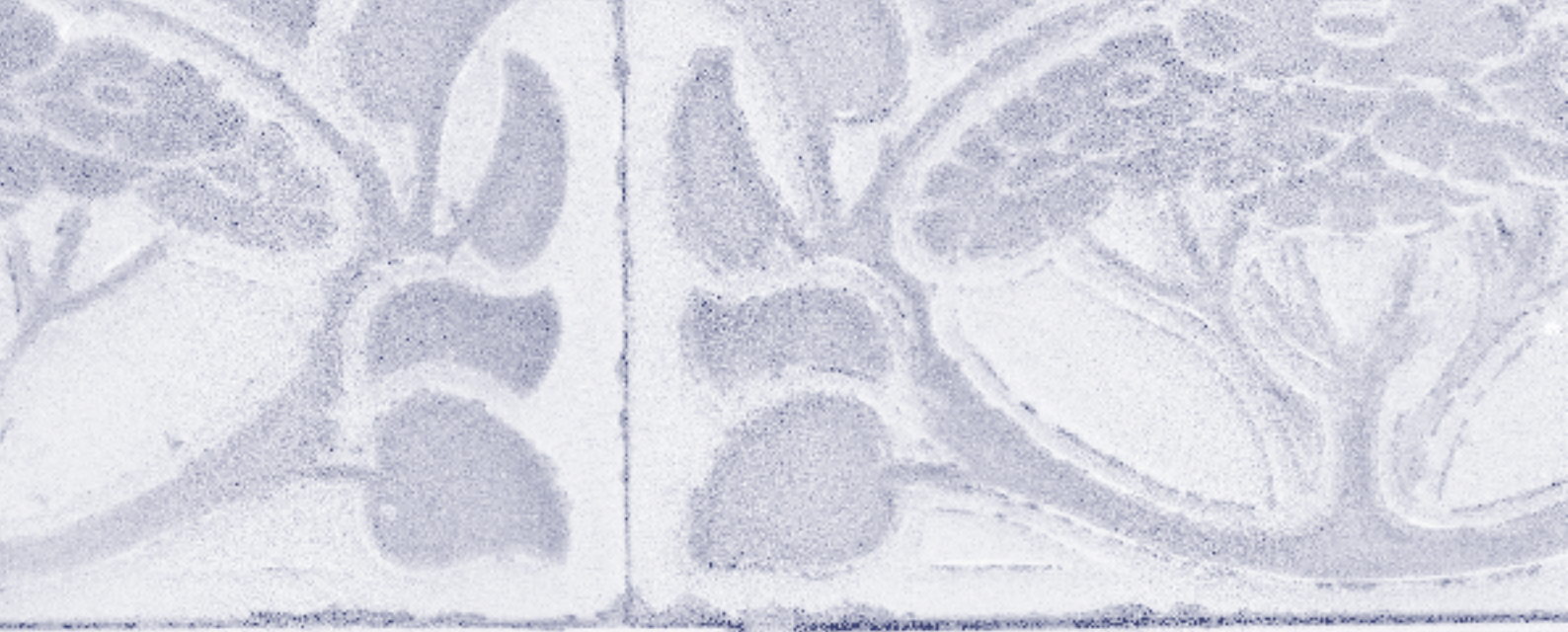
Winning Brands, Winning Formats*

2005/2006

4th Edition

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PRICEWATERHOUSECOOPERS 



Bulgaria

Bulgaria

ECONOMIC OVERVIEW

GDP and CPI

Real GDP growth reached a high of 5.6% in 2004 compared to 4.5% in 2003. CPI rose to 6.1% which was a significant jump compared to the 2.3% in 2003. The change can be explained with the rising food and petrol prices and one-off factors such as an increase in excise, duties and a 10% increase in electricity prices in 2004.

GDP and CPI

	2001	2002	2003	2004
GDP growth (%)	4.1	4.9	4.5	5.6
CPI (%)	7.4	5.8	2.3	6.1

Source: EIU, June 2005

Unemployment

The unemployment rate continued to fall steadily in 2004 and the first half of 2005. Simultaneously, growing employment also contributed to the overall improvement

in the labour market, leading to a stronger bargaining position for employees in wage negotiations.

Unemployment

	2001	2002	2003	2004
Unemployment rate (%)	18.1	17.7	14.3	12.7

Source: EIU, June 2005

Economic forecasts

According to Economist Intelligence Unit (EIU) forecasts, the real GDP growth is expected to slow to 4.8% in 2005 and perhaps drop to 4.3% in 2006. EIU's projection is for a gradual slowdown in domestic demand from the second half of 2005 as a result of the recent restrictions implied by the Bulgarian National Bank on bank lending, with growth in consumer spending easing from 4.8% in 2004 to 4.5% in 2005 and 4.4% in 2006.



Area ('000 sq km)¹: 111
(US 9,600 – EU25 3,981 – World 133,700)

Capital²: Sofia
(Number of inhabitants: 1.2 million)

Population (million)³: 7.7
(US 293 – EU25 456 – World 6,376)

GDP (USD billion)³: 24.17
(US 11,735 – EU25 12,723 – World 39,503.5)

GNI per capita (USD)¹: 2,130
(US 37,870 – EU25 22,810 – World 5,110)

Currency: Bulgarian New Lev (BGN)

Languages: Bulgarian

Main religions: Bulgarian Orthodox (82.6%), Muslim (12.2%)

Government type: Parliamentary democracy

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

The inflation rate will fall to an average of around 4.4% in 2005. The unemployment rate will continue its descending path to 11.6% in 2005 and around 10% in 2006.

Key economic forecasts

	2005	2006	2007
GDP growth (%)	4.8	4.3	4.5
CPI (%)	4.4	4.0	3.6
Unemployment rate (%)	11.6	10.5	10.1

Source: EIU, June 2005

REGULATORY ENVIRONMENT

Foreign direct investment

The fall of FDI inflow from privatisation and the more difficult conditions in foreign markets are expected to drive lower FDI levels in 2005-2006.

According to preliminary data published by the Bulgarian National Bank, FDI in Bulgaria for the period January-April 2005 was EUR334.5 million (2.1% of GDP) against EUR402.4 million (2.6% of GDP) attracted in the same period in 2004.

FDI

	2001	2002	2003	2004
FDI (BGN bn)	1.17	1.30	3.03	2.60
FDI (USD bn)	0.81	0.90	2.10	1.80

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

Expected impact following EU entry

Entry into the European Union (EU) will impact a broad range of businesses, tax and legal issues. Businesses will have to analyse their operations, identify potential risks and opportunities arising from the EU rules and prepare for the challenges of EU entry. Multinational companies operating in EU member states that joined the EU in 2004 will probably have a lead on others, benefiting from the experience. Most likely they will adapt existing EU business models to their Bulgarian operations. Nevertheless, Bulgaria's country-specific regulatory requirements will need to be considered.

On one hand, companies in Bulgaria will face the threat of increased competition, overregulation (especially in certain areas such as environmental protection, agricultural policy,

industrial standards, etc.) and uncertainty in relation to the practical implications of joining the single market. On the other hand, EU membership is expected to improve economic stability, increase legal certainty and give more business opportunities, such as access to the "big money" and free access to new European markets and clients.

Below are some examples of the challenges EU entry will present that businesses should prepare for in advance:

Removal of customs and trade barriers, and adoption of EU Customs Tariff

No customs border controls will exist between Bulgaria and the other 26 member states. The physical movement of goods across borders will become easier with quicker transportation of goods, new logistics planning and cash flow savings.

Some companies will benefit from the expected reduction of customs duties for import from non-EU countries as a result of adopting the EU Customs Tariff (currently the average customs duties applied by Bulgaria are about two times higher than the average customs duties in EU). On the other hand, importers of agricultural goods from non-EU countries will face additional burdens on import of such products (such as licensing requirements and specific duties).

Increased reporting and compliance requirements

Customs barriers will be replaced by additional administrative barriers, mainly in the field of compliance with indirect taxes, which are most harmonised across EU (VAT, customs and excise). In particular, VAT treatment of supplies of goods and services between different member states will change significantly.

Companies in Bulgaria will have to make significant changes in their IT and accounting systems in order to comply with EU rules and new invoicing requirements. Extra processing will be required and new tax and statistical documents will have to be generated.

What else can be expected?

The EU has implemented rules that prohibit state aid and harmful tax competition. As a result, Bulgaria will abolish or change any tax incentives that qualify as illegal state aid or harmful tax competition.

Expected amendments to competition law, consumer protection legislation, environmental law, intellectual property rights, social security and labour law in view of EU Accession will also directly affect businesses. Some of these changes will be considerable and will require review of existing structures, contracts and planning for necessary changes.

What budget must be planned for the accession preparation?

Businesses will have to include the costs of the accession process into their budget planning, such as costs for training, professional advice and assistance, adjustment and upgrading of computer systems, necessary changes of contractual arrangements, the growth of administrative requirements and many other issues.

Property/Real estate regulations

In February 2005, an important amendment of the Constitution of the Republic of Bulgaria concerning property acquisition has been adopted. It shall be implemented as of the date of entry into force of the Treaty concerning the accession of the Republic of Bulgaria to the EU.

Under this new constitutional provision, foreign individuals and entities are entitled to acquire property over land under the conditions ensuing from Bulgaria's accession to the EU, or by virtue of an international treaty that has been ratified, published and entered into force by the Republic of Bulgaria, as well as through inheritance by operation of the law.

Until the date of entry into force of the Treaty concerning the Accession of the Republic of Bulgaria to the EU, foreign individuals and entities are not entitled to acquire ownership over land. Foreign individuals and entities are allowed to acquire such ownership through inheritance by operation of the law, however, they have to transfer it within three years.

Foreign individuals and entities are entitled to acquire user rights, building rights and other real rights in both land and other real estate, on terms and conditions established by law.

Other regulations

Bulgaria's regulatory environment contains numerous legislations applicable to the retail and consumer sectors. The following are the most important ones.

Consumers and competition regulations

The Commerce Act (effective 1 July 1991 as amended and supplemented) regulates the types of companies by means of which business may be conducted in Bulgaria, and develops the principles of the Obligations and Contracts Act as to certain types of contracts between traders, and between traders and consumers. The insolvency procedure is also regulated under the Commerce Act.

The Protection of Competition Act (effective 5 May 1998 as amended and supplemented) provides protection against agreements, decisions and concerted practices, abuse of monopolistic and dominant position on the market, concentration of economic activities, unfair competition and other actions that may result in prevention, restriction or distortion of competition. The authority in charge of control over compliance with the requirements of the Act is the Commission on Protection of Competition.

The Protection of Consumers and Trade Rules Act (effective 3 July 1999 as amended and supplemented) defines the main rights of consumers in their relation with traders of goods and services, and regulates the consumers' right to receive proper information on the goods and services, guarantee periods, safety and packaging requirements, claiming damages by consumers, etc. The Act provides for nullity of certain types of clauses in terms and conditions of traders that affect the rights of the consumers. Consumers' and traders' rights are protected against misleading and dishonest advertising. Distance sales and out of trader's premises sales are also regulated under the Act. The Bulgarian Commission on Trade and Protection of Consumers is in charge of control of compliance with the requirements of the Law.

A new draft Protection of Consumers and Trade Rules Law has been prepared with the aim of achieving compliance with the EC legislation. The draft Law has been passed by the Parliament in the first hearing. The second hearing is not expected until autumn 2005.

VAT

VAT registered retailers are obliged to charge 20% VAT on their local supplies. They are entitled to credit for the VAT incurred in relation to supplies used for their taxable activities.

One of the interesting VAT issues relevant for the retail sector is the VAT treatment on discounts provided by

retail companies. In general, discounts and rebates are deductible for VAT purposes if provided at the date of the taxable supply. Discounts in-kind are recognised if they are of the same type as the main supply, or if they are designed for testing or facilitating of the main supply. Therefore, it is advisable that promotional and marketing activities are structured from a VAT perspective.

DEMOGRAPHICS AND CONSUMER BEHAVIOUR

Population

Population evolution

Bulgaria's population as of 31 December 2004 was just over 7.7 million people, representing a 0.5% decrease compared to 2003. This decrease is mainly due to the trend towards fewer births and an increase in deaths over the past few years, but it is also partly explained by the high levels of external migration.

Population

	2001	2002	2003	2004
Population (m)	7.9	7.8	7.8	7.7

Source: EIU, June 2005

Population by age group

The average age in the country in 2004 was 41 years. The trend towards an ageing population continues with the average age in rural areas higher than in urban centres. As of end-2004, the active part of the population was 4.8 million people or 61.6%.

Age profile

% of total population	1998	2003	2008 (f)
0 – 14 years	16.5	14.2	12.5
15 – 64 years	67.5	68.8	69.8
Over 65 years	16.0	17.0	17.7

Source: EIU, August 2004

Urbanisation of the population

In 2003, almost 70% of the population, or 5.4 million people lived in towns and 2.3 million in rural areas. The highest share of internal migration was from town to town at 45%, followed by 23% town to village and 21% village to town.

Urban/Rural split

% of total population	1998	2003	2008 (f)
Urban	68.0	69.8	71.4
Rural	32.0	30.2	28.6

Source: EIU, August 2004

Income/Buying power

According to the preliminary data of the National Statistical Institute (NSI), the average annual pay in the country in 2004 was EUR1,850. The annual household monetary income per capita in 2004 was EUR937.

The average monthly salary reported by the NSI for the first half of 2005 was EUR160, slightly higher in nominal terms than that of the fourth quarter of 2004, but over 9.5% higher than the first half of 2004.

Annual average income, expenditure and savings rate per capita

	2001	2002	2003	2004	2001–2004 (%)
Income (BGN)	1,672	2,085	2,244	2,466	47.5
Expenditure (BGN)	1,492	1,710	1,853	2,068	38.6
Savings (BGN)	180	375	391	398	121.1

Source: NSI

Consumer behaviour

Average household spending patterns

According to a recent survey, there was a tendency for growing household consumption in the fourth quarter of 2004. It is expressed by a higher increase in the quantity of purchased products, compared to the expenditure value, which is a result of the lower levels of average prices of purchase. There are three main factors outlined as influencing the average purchasing prices: bigger packages, increased consumption of products from the low-price segment and lower producer prices (mainly local). The survey shows a 7.8% increase in purchased quantity in fourth quarter of 2004 and 4.9% increase in expenditure at a decreased end price of purchase at 2.7%.

Composition of household expenditure (by%), 1995 vs. 2004

	1995	2004
Total expenditure	100	100
Consumer total expenditure	83.7	85.3
Foods and non-alcoholic	46.2	39.3
Alcoholic beverages and tobacco	4.0	4.2
Clothing and footwear	7.4	3.4
Housing, water, electricity, gas and other fuels	7.0	13.8
Furnishing and maintenance of the house	4.3	3.2
Health	1.9	4.5
Transport	6.2	5.3
Communications	0.8	4.8
Recreation, culture and education	3.0	3.5
Miscellaneous goods and services	2.9	3.3
Taxes, household plot and other expenditures	16.3	14.7

Source: NSI

Shopping habits

A monitoring of the consumer models in Bulgaria made by a market research media shows that the shopping places, the attitude to the shopping process and the way of payment are changing. The survey made among a target group of early adopters reveals that Bulgarian consumers are becoming more demanding and are ready to pay more for better quality products. Remoteness is regarded as one of the major disadvantages of hypermarkets. Supermarkets are the most convenient stores, both for small and large purchases, because they are located close to people's homes. Cash is the preferred payment method, however payment via debit cards is becoming popular.

Bulgarian consumers as a whole demonstrate a preference for locally produced consumer goods. Recently the Bulgarian Government started a national promotional campaign under the motto "Choose Bulgarian", in partnership with select Bulgarian media, to boost demand for local products.

Fast moving consumer goods (FMCG) customer's choice is based on high quality, rather than on the influence of advertising, and they have a preference for local products and brands, rather than foreign ones. Retail customers are more price-oriented than brand-oriented, and are influenced by friends and relatives, rather than by promotions.

A ConsumerScan survey, conducted at the beginning of 2004, measured the FMCG bought on promotion in the country. During the period between January and March, the purchases made on promotion constituted 1.3% of the total purchased products in all categories, amounting to 1.9% of the overall expenditures made by households.

Brand/Price sensitivity

There is a potential for development of retail brand products. Retailers have been putting more emphasis on private label products in order to provide cost efficiency to the benefit of their customers. Large retailers such as Metro, Billa and Ramstore already have their own private labels.

In the attempt to meet growing consumer demand, retailers are establishing their own point-of-sale production. Additionally, in order to maintain competitive price levels in the food sector, retailers are steadily developing their supply chains in favour of domestic suppliers, turning away from imports. Retailers have started to concentrate on CRM activities and to observe

consumer behaviour in order to retain their customers and create brand loyalty. Some of the major retailers have started implementing loyalty programmes in their stores.

Lately, consumer goods retailers have been teaming up with local banks to offer financing schemes for purchasing household appliances.

To increase market share, large supermarkets regularly conduct promotional campaigns, have initiated phone and internet purchases and delivery, and issued membership cards.

RETAIL & CONSUMER SECTOR PERFORMANCE

Major consumer goods players

Due to the absence of consolidated data, some of the leading players in the consumer goods sector are not included in the table below. If the sales revenue of their subsidiaries were aggregated, the order below would be different.

Global manufacturers of consumer goods took part in the early privatisation and acquired factories in Bulgaria such as confectionery (Nestle, Kraft Foods), soft drinks (Coca-

Cola), beer (Interbrew), refrigerators (Libherr), clothing and footwear (Nike, Miroglio, Adidas). Some of these foreign investors continued with further green field investment in the country.

Apart from the privatisation deals, there have been a number of significant acquisitions in the CPG sector, such as the Bulgarian coffee market leader Nova Brasilia acquired by Kraft Foods, the margarine producer Kaliakra acquired by Unilever, the Bulgarian breweries Shumensko pivo and Pirinsko pivo, acquired by Carlsberg.

Major consumer goods players

Company Name	Core activity	2004 sales (EUR m)
1. Blagoevgrad BT	Tobacco processing	104.1
2. Miroglio Bulgaria	Textile production	93.9
3. Nestle Bulgaria	Food processing	52.2
4. Sofia BT	Tobacco processing	48.6
5. Chipita Bulgaria	Food processing	38.2
6. Sugar Plants - Gorna Oriahovitsa	Sugar processing	32.7
7. Danone Serdika	Dairy processing	28.7
8. Meat Factory-Lovech	Meat processing	28.6
9. Aroma	Cosmetics production	26.6
10. Kaliakra-Dobrich	Food processing	26.4

Source: Companies' annual reports

Major retail players

Retail sales

Total retail sales growth

	2002	2003	2004 (e)
Total sales (EUR m)	6,165	6,870	8,072
Growth rate (%)	10.9	11.4	17.5

Source: NSI

Breakdown by number of stores by size of sale space

	under 120 sq m	120-399 sq m	400-999 sq m	over 1,000 sq m
2002	99,841	2,066	226	95

Source: NSI

Scope of organised retailing by retail format

The share of small convenience stores has been reduced; medium-sized supermarkets gained popularity due to their convenient locations and wide range of high-quality products offered in less space than hypermarkets; and large chain supermarkets gained significant share of the national market.

New companies entering the country adopted the strategy of simultaneously opening stores in a number of smaller towns. This is in contrast to the first retail companies that entered Bulgaria, which started by opening stores in the capital city Sofia, followed by gradual development in the biggest Bulgarian towns.

A significant decrease in the number of small garage shops and all-in-one outlets is observed. At the same time, there is still an unexplored market niche for high-segment boutique shops specialising in sales of products such as meat, fish, fruits and vegetables.

Key food retailers

Formats	Group name	Store brands	Number of stores		Net sales (EUR m)	
			2004	2005 (f)	2003	2004
FOOD			2004	2005 (f)	2003	2004
Hypermarkets	Migros Turk KOC Group	Ramstore	4	–	6.8	–
	Dohle	Hit	1	2	N/A	–
Supermarkets	Billa Bulgaria REWE Group	Billa	13	19 – 21	74.3	95.7
	Boliari	Piccadilly	4	6	22.7	26.5
Convenience stores	CBA Bulgaria	CBA	200	210	N/A	–
	VAN Holding	Fantastico	24	27	26.5	–
	Magazini Familia Plus	Familia	15	21	N/A	–
	Boliari	Mambo	4	7	N/A	N/A
Cash and carry	METRO	Metro	7	–	319.7	327

Source: Companies' annual reports

Key specialty stores

Retail formats	Group name	Store brands	Number of stores		2003 Net sales (EUR m)
			2004	2005 (f)	
SPECIALTY STORES			2004	2005 (f)	
DIY	Metro	Praktiker	1	7	5.0 (2004)
	Doverie Brico	Mr. Bricolage	3	4	22.7
Home equipment (electrical goods, furniture)	Videolux	Technopolis	6	10	33.1
	Top Video and K&K Electronics	Technomarket Evropa	10	14	80.4
	Technolux	Technolux	23	29	12.5 (2004)
	Zora	Zora	16	21	9.7
Department stores	Tzum	Tzum	1	N/A	3.8

Source: Companies' annual reports

Food retail channels

The largest food retailers continue to build their networks and a number of new big foreign players are planning to start operations in the country in the following months.

Among the food retailers that recently entered the market are Germany's Dohle and Lithuania's VP Market, operating under the brand T-Market, which declared an ambitious plan of opening 50 stores by the end of 2005. Germany's Kaufland is building a number of hypermarkets in the country, which will be simultaneously opened in 2006. Other retailers said to be eyeing the Bulgarian market include Germany's Lidl, Aldi and Penny Market, Slovenia's Mercator, France's Carrefour and a large US retailer.

Foreign retailers regard their presence in the local market as a natural development of their regional expansion programmes, after having made successful investments in neighbouring countries, not underestimating the higher growth level of consumer demand compared to the countries in the EU.

The expected foreign new comers are not regarded as a threat by retail chains with already strong positions on the Bulgarian market, but as an opportunity to put higher pressure on the local grey market.

As the Bulgarian retail market moves to a more competitive one, it is expected that retailers will promote a more aggressive price policy in order to keep and gain new customers, resulting in a reinforced competition among the producers in the consumer goods market.

Problems experienced by foreign retail investors, already present in the local market, in their attempts to buy land plots to build new stores, led to limited investments in the past year.

The main competitive advantages for domestic retail chains are the ability to keep prices low and the favourable locations of their stores.

Operational efficiency, better use of information technology in inventory management, purchase planning, customer data warehousing, customer relationship management and category management are the main areas in which Bulgarian retailers need to improve.

In their attempt to gain competitive advantage, local retailers started building a new generation of shopping centres that fulfil not only shopping needs, but also entertainment and recreation. These shopping centres are built around the hypermarkets and supermarkets, with leisure facilities as additional attractions.

There are significant differences in modern retail formats penetration in Bulgaria. Some investors show commendable creativity in their market entry strategy, a good example of which is the unique ownership structure of CBA Bulgaria that includes the Hungary-based CBA Kereskedelmi and another 24 local retailers with equal shareholders rights. The nationwide network of some 200 smaller shops, which operate on a franchise basis, turned out to be a successful investment move.

Hypermarkets and supermarkets

Foreign retailers that first entered the Bulgaria market, continue to implement their expansion plans by building stores in different country regions. They are adapting their strategy to local market needs and will set up smaller stores with no parking lots of their own in Bulgaria's smaller towns. The turn in their strategies may be explained with the fact that the profit generated by the companies' hypermarkets and supermarkets outside the Bulgarian capital Sofia is much lower than projected. Some of the problems encountered when working in the regions are lower consumer potential, infrastructure problems, low-qualified labour force and less-developed service networks.

Discount stores

Hard discount stores are expected to enter the local market in the future and should be able to gain a significant market share due to the uneven income distribution and low level of disposable income.

Convenience stores

Convenience stores are a market niche dominated by local retail chains, with their advantage being the established network of well-positioned outlets in the most populated areas of Sofia and other big cities.

A market niche is also occupied by convenience stores located at petrol stations. Petrol retailers such as Shell, OMV, LUKoil, Opet AYGAS and Petrol, with outlets across the whole country, provide a wide range of consumer goods, ranging from food to auto supplies and accessories, in almost all of their petrol stations. The quality of retail services and consumer goods, together with location, are regarded as being the main market differentiator, not petrol prices.

Non-food retail channels

Department stores

Department stores were very popular in the past, but are currently not an exploited retail format, mainly due to the high rental prices of stores, reflected in the higher retail prices of goods offered and therefore oriented towards the high market segment.

Specialty stores

The opening of hypermarkets for electronic goods has created significant pressure on the reduction of prices for electronic consumer goods.

Largest importers of consumer electronics are also the leaders of retail sales, owning household appliances and electronics hypermarkets under own-brand chains.

Importers and retailers report increased demand and volume of household appliances purchases, as the reasons for the increasing number of leasing opportunities; growing purchasing power; relatively secure employment relationships and ability to forecast household budget; and high competition between producers, importers and retailers, leading to greater choice, lower prices and attractive promotions for customers.

The specific feature of local importers and retail chain owners is the production of household equipment and electronics under own brands aimed at low-price buyers. Two main reasons for this development are better quality control for electronics assembled in Bulgaria and the savings made from custom taxes on spare-parts import.

E-commerce

Although possible and used to some extent, online purchasing is not yet developed in Bulgaria.

According to data gathered with a representative survey for the Bulgarian people aged 15 years and over, internet access and usage keeps rising. For the year 2003 access was 14.5% and usage 12.8%.

The same survey shows that a majority of people (54%) use the internet at internet clubs, followed by use at home and work.

M&A activity

Consumer products are one of the preferred sectors for investment made by private equity funds and venture capital. The forthcoming accession of Bulgaria to the EU is regarded as the right moment for funds to sell off to strategic investors.

There are many attractive potential acquisition targets and well-known local brands in the CPG industry that deserve investors' consideration.

M&A activity since 2003

Year	Acquiring company	Acquirer/JV company	Nature of business	Equity stake
2004	Obedinena Mlechna Kompania	Vitalakt Milk	Dairy products	100%
2004	Loulis Flour Mills	Sofia Mel	Flour mills	100%
2004	Chipita East Europe	Bakery Foods Bulgaria	Bakery foods	100%
2004	Slanchev Den	TZUM shopping centre	Central store	99.5%
2003	Mr. Bricolage SA	Doverie Brico	DIY retail	40.4%
2003	Loulis Flour Mills	Kraps Mel	Flour mills	100%
2003	Strandzha Chateau Rosenovo	Vinex Preslav	Winery	100%
2003	Penguen Gida	Storko	Canned food	100%
2003	Unilever	Kaliakra	Margarine production	100%
2003	Finance Consult	Gamza 1922	Winery	52%
2003	Global Finance	Obedinena Mlechna Kompania	Dairy products	48.5%

Source: PricewaterhouseCoopers Central and Eastern Europe M&A Survey

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

Challenges

Increased competition due to growing number of foreign big players entering the market

The Bulgarian retail market remains attractive for foreign retail investors. There is still enough room for growth, even though the number of outlets has increased considerably. Price leadership and supplier relations have been core success factors for foreign chains. However, in the attempt to keep price levels low, they compromise on the quality of products and services, which are lower than what is offered by the same retailers in other European countries.

The next few years will see further expansion of foreign chains in Bulgaria, and their share in retail sales will grow.

The main factor stimulating retailers to invest in the sector and to build modern structures has certainly been growth potential due to the unsaturated market conditions. Moreover, factors such as low prices of land and labour costs, expected growth of disposable income, lifestyles and consumption patterns have all fostered positive expectations.

More regulatory requirements

With the forthcoming accession of Bulgaria to the EU, retail and consumer goods companies will face the challenge of more regulatory requirements covering VAT issues, legislation for protection of consumers' interests, trained work force etc.

Insufficiency of qualified work force

The recruitment of qualified staff appears not to be an easy task for investors entering the Bulgarian market, mainly due to the low salaries offered in the retail sector resulting in low interest by potential employees.

The retail companies already active on the local market experience the pressing need for staff training and for improved human capital policy.

Opportunities and threats

EU accession

The EU accession process and the corresponding changes in legislation are expected to have a positive impact on the economic environment and investment activity in Bulgaria. It is believed that Bulgaria's entry into the EU in 2007 will attract more foreign investment from European companies looking for the expansion of their operations to the Balkans. However, many small and medium enterprises in the consumer products sector may not survive due to inability to comply with the EC regulations.

Sustained economic growth

Consumer goods companies can look forward to stable consumer demand in the next few years in Bulgaria and the region as a whole.

Economic growth combined with stable but still low disposable income and more cost-conscious consumers is the prerequisite for a stable market, but without dramatic growth of the retail market. The reliability of the official statistics, however, may be questioned, as it is believed Bulgarian consumers have, and spend more money than it is generally thought.

Consumer credit, which in the past was not popular due to high interest rates and insufficient income levels, is likely to become more widely used. Banks reached a peak in provision of consumer loans in the first quarter of 2005. However, the central bank's restrictions on bank lending with effect from April 2005 are expected to lead to a slowdown in domestic demand, with year-on-year growth in consumer spending easing from 4.8% in 2004 to 4.4% in 2005.

Developments in Bulgaria's retail and consumer sectors reflect general trends of the overall economy. Big retail chains have been expanding their networks by opening new stores and shopping centres. Their expansion plans are ambitious and the boom of store openings may be expected to continue over the next two to three years. Retail chain operators are making large investments in new stores to secure a stronger position when the market matures and growth slows. Big retailers will gain stronger market power and smaller players will be exposed to increased competitive pressures.

Increased M&A activity

Bulgaria today is regularly and systematically considered for investment projects by international and regional investors. In the coming years, the major part of FDI will come from M&A and green field investment, with the completion of the major part of privatisation in the country (2004 was a record year in number of privatisation deals concluded). It is likely that the new investments mainly will be made by investors already active in the country and the region.

Emerging trends

Forthcoming expansion

There is a trend for market expansion, mainly of foreign food retail chains, simultaneously in a number of country regions by building smaller scale shopping centres, followed by local retailers of consumer electronics and household equipment.

The main operation factors considered as potential competitive advantages by new companies entering the local market are convenient location, food quality, services quality and available parking space.

Local food retail players are facing strong competition and the need for more investments, long-term strategy and an adequate people management policy. Despite their high ambitions, they still show low performance.

A number of local retail chains back their future development with financing received through bank loans, usually provided by two banks, or through selling equity share to venture capital funds.

Among the main development factors and areas for investment outlined by the local retailers are the building of new outlets with improvement of surrounding infrastructure, personnel training, acquisition of know-how and development of new products and services.

In their long-term development strategies, many of the big local retail players displayed an interest in expanding their presence to the neighbouring countries in Western Balkans; some of them already have opened stores there.

The existence of large stores in city neighbourhoods is likely to attract other businesses and induce further development of these areas and the surrounding infrastructure.

Consolidation in the retail sector

Local retail players are actively investing to increase market share in order to become attractive to strategic investors after 2007. EU entry will provoke a tendency towards fair, market and rules-based competition, thus more local players are trying to get out of the grey market, which will also result in improved employment conditions.

Qualitative switch in consumer behaviour and shopping habits

The main factor influencing the choice of outlet for the Bulgarian consumers appears to be proximity to their home.

A change in the general trend of the shopping habits of the population can be noted. The “once-a-week” shopping attitude is becoming more popular, which benefits, to some extent, larger supermarkets and hypermarkets.