

Economic and Business Impact of Crisis on Croatian Trade

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ABSTRACT.

Like in other CEE countries, Croatian retail sector copes with: a) negative (post)communist heritage (ruined communist “retail giants”), and b) inevitable processes of internationalization and concentration. Larger retail formats, as well as new stakeholders and processes in competitive retail arena led to new realities analyzed in this paper. Beside intensive retail market concentration, negative trends, decreased share in GDP and cuts in number of employees are some of the most important challenges for the Croatian economy in general. This paper also provides some of the key data related to the structure of retail offers and indicators relevant for shopping center industry in Croatia.

Keywords: trade, crisis, Croatia

1. INTRODUCTION

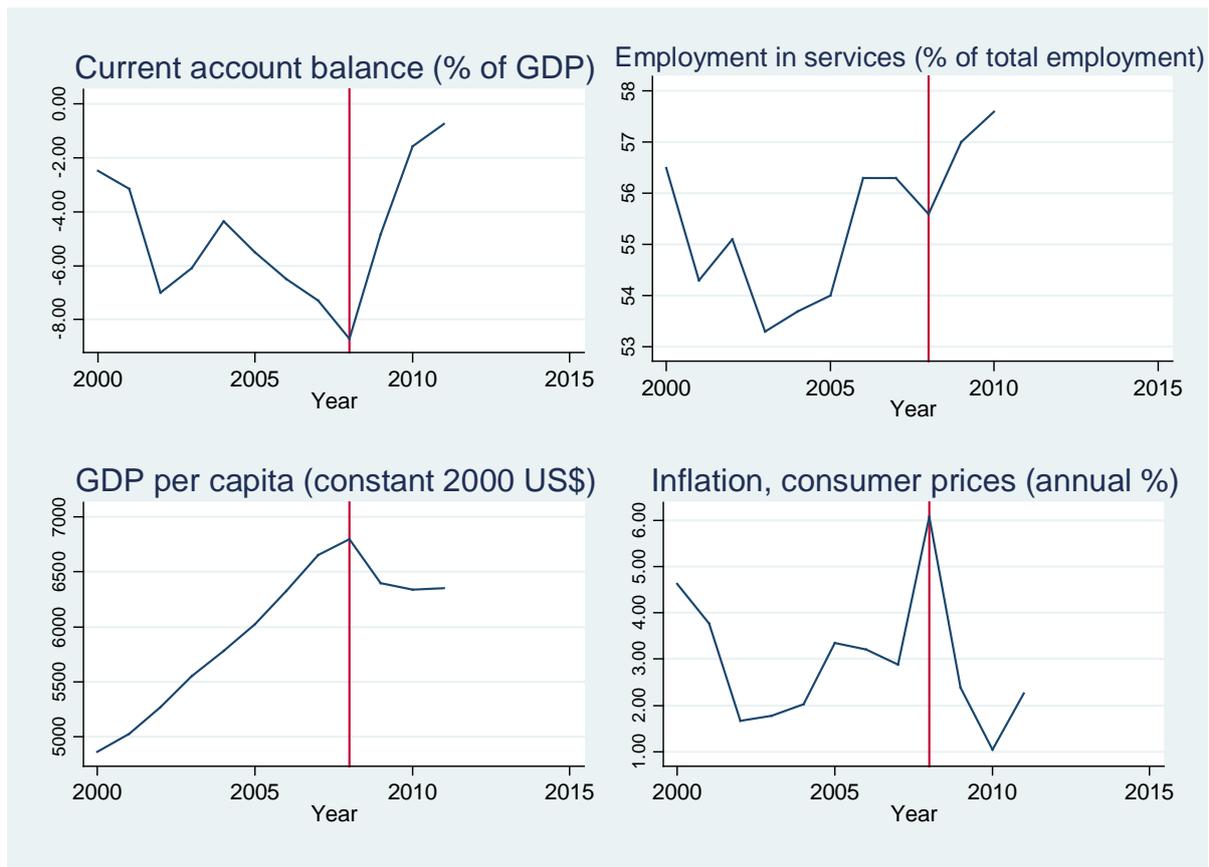
Trade sector development in Croatia has similar characteristics as any East and Central European country. It is characterized with structural macroeconomic and microeconomic imbalances in 1980s which continued through the end of 1990s. Transition to market economy helped develop retail sector, but it was not until the advent of 2000s that the retail sector grew in size and scope. This growth was supported by lack of capacities on the supply side and growth in demand fueled by increasing GDP and positive outlook at the beginning of the 2000s decade. Recession and eventual crisis hit this sector very hard and in a very short time. It was one of the first casualties of economic downturn. However, adjustment of the sector followed very quickly which reflects market forces in action. It is generally considered that retail sector in Croatia is governed by actual market forces rather than dominant players

or monopolists/oligopolysts. Thus, we turn our attention first to the analysis of several key macroeconomic variables and the detailed micro analysis of the Croatian retail sector follows.

2. MACROECONOMIC SCOPE OR CRISIS IN CROATIA

Croatian macroeconomic situation is similar to most East European Countries. However, there are few subtleties that can be distinguished. First, macroeconomic disequilibria did not start with transition of 1990s. It started at the beginning of 1980s. The War in 1990s pushed Croatia faster down the slope. The transition process of 1990s did the rest. Therefore, several instances of hyperinflation in 1980s and beginning of 1990s accompanied by the War of Independence made macroeconomic situation much more difficult (Šimurina, Belčić, 2010). Past ten years marked both expansion and recession, and finally overall crisis, that thus far, is still far from over. Indicators shown in figure 1 tell us this story. While roughly the first half of the decade was positive in many respects, except the current account, the other half was quite the opposite. Croatia saw continued positive growth rate until 2008 (reference line in figure 1) and continued negative current account trends, which was fueled by domestic growth and inflow of foreign capital.

Figure 1: Selected indicators for Croatia, 2000-2011



Source: WDI (2012), CNB (2012)

Macroeconomic problems in Croatia are not a direct consequence of failure of the US markets. Croatian banks did not venture in problematic markets. However, consequences came about in the form of lower foreign demand of domestic goods and services, lower possibility for refinancing public debt in foreign markets, increased cost of public and private

borrowing and unsustainable budget deficits and unsustainable public and private debt coupled with unrealistic Croatian economic outlook in 2008 and following years.

In terms of employment and unemployment, we can see from figure 1 that there was an increase in employment in services. However, overall employment dropped and unemployment rose, thus the rise of employment in services as a percentage of total employment reflects redistribution of employment not necessarily a positive trend. The trade sector saw significant drop in demand, however, due to price and income inelasticity of demand, the drop was not as dramatic compared to other sectors of the economy.

3. CROATIAN RETAIL SECTOR TRENDS

Croatian retail sector development path is similar to the ones in other Central and East European Countries. After the demise of many socialist retail giants in the first half of the 1990s, vigilant entrepreneurial spirit brought about numerous small scale retail startups. These were small retailers with just a few stores at most; whose format was that of the typical convenience store. The gap in the market was successfully sized and controlled by these retailers well into the late 1990s when two different but related processes started to synchronize the development path of Croatian retail sector with the sectors of developed countries of Western Europe.

The processes of (1) internationalization and (2) concentration impacted the Croatian market from the late 1990s well into the first decade of the new millennium (Anić, 2002; Anić, Nušinić, 2003; Brčić-Stipčević, Renko, 2004; Segetlija, 2005). As Croatian retail market was developing and maturing, numerous foreign (regional and multinational) retailers have seen it as a viable option to advance their growth. Main models of entry were direct foreign investment (Anić, Jovančević, 2004) into building new stores in the first phase with subsequent optional acquisition of smaller domestic competitors once the presence on the market has been established. Currently, majority of top regional retailers operate in Croatia (Sorić, Marković, 2010).

International competitors entered the market with large retail formats such as hypermarkets and supermarkets which started a second process on the market, the process of market concentration. Smaller competitors, with insufficient capital resources and not efficient enough operations gradually sold or closed their stores. To date, their primary format remains convenience store format and their main locations are rural areas and dense urban neighborhoods where free space for larger retail formats is scarce.

Throughout the first decade of the new millennium and till the crisis which started in 2008, Croatian retail sector experienced prolong period of growth which reflected not only in positive quantitative indicators such as total turnover or number of employees but in the qualitative ones as well. Growth was supported by parallel development of financial services industry and introduction of various models of deferred payment (consumer credit, m-payment etc.). In addition, previously almost nonexistent, shopping center development flourished in the years before the crisis (Vouk et. al, 2008). Many well-known foreign brands, not present on Croatian market have entered the market through newly build shopping centers.

3.1 Where are we now?

Negative trends in retailing sector started during 2008 and have continued to date. Trade sector (retail and wholesale) decreased in share in GDP and total number of employees

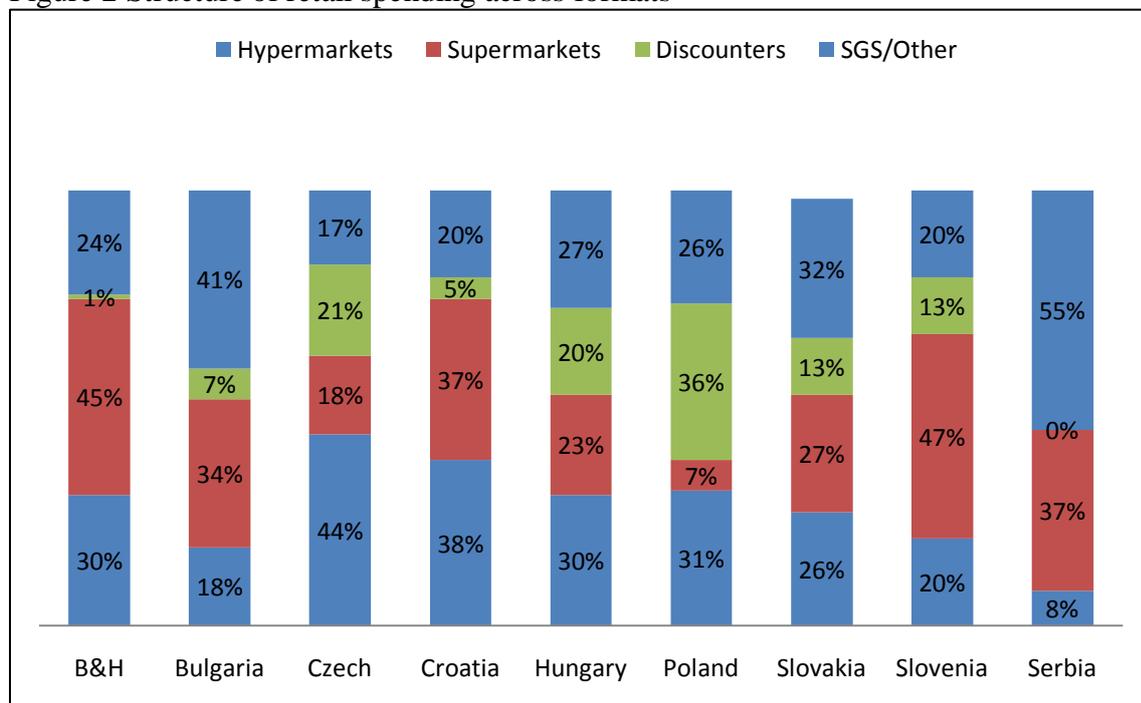
(Brčić-Stipčević et. al, 2010; Vouk et. al, 2010) with non-food trade, especially automobile sales showing the greatest decrease in all relevant indicators. Although the sector as a whole did not grow in the last four years, intrasector changes have been numerous and have moved Croatian market along the line of the development paths of Central and East Europe markets. In terms of *market concentration* (Table 1) Croatian market is among the three most concentrated retail markets in CEE. Only Slovakian and Czech retail markets are more concentrated while others fall significantly behind. It is worth mentioning that Hungary, Poland, Romania and Bulgaria have less concentrated markets than Croatian and all are members of the European Union (EU), while Croatia is expected to join the EU on July 1st 2013. Since it is a known fact that mature retail markets tend to be more concentrated than developing ones, this indicator places Croatian retail market among the developed markets of the CEE countries.

Table 1 Retail market concentration in CEE countries

	Country	Top 10	Others		Country	Top 10	Others
1	Slovakia	83%	17%	7	Serbia	41%	59%
2	Czech	81%	19%	8	Romania	35%	65%
3	Croatia	74%	26%	9	Bulgaria	32%	68%
4	Hungary	67%	33%	10	Russia	18%	82%
5	Poland	61%	39%	11	Ukraine	10%	90%
6	B&H	45%	55%				

Source: http://www.gfk.hr/public_relations/press/press_articles/009459/index.hr.html

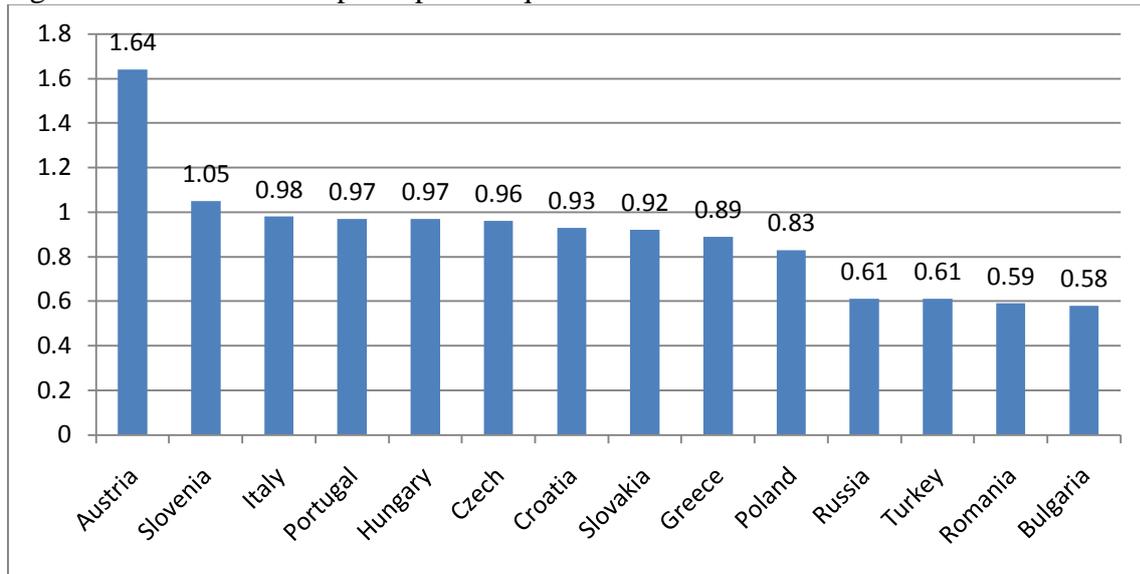
Figure 2 Structure of retail spending across formats



Source: <http://www.gfk.hr/imperia/md/content/gfkaustria2/pdf/nlo30.pdf>

In terms of retail sales area per capita, Croatia is in the middle among the CEE countries, leading Slovakia and Greece and following Portugal, Hungary and Czech Republic.

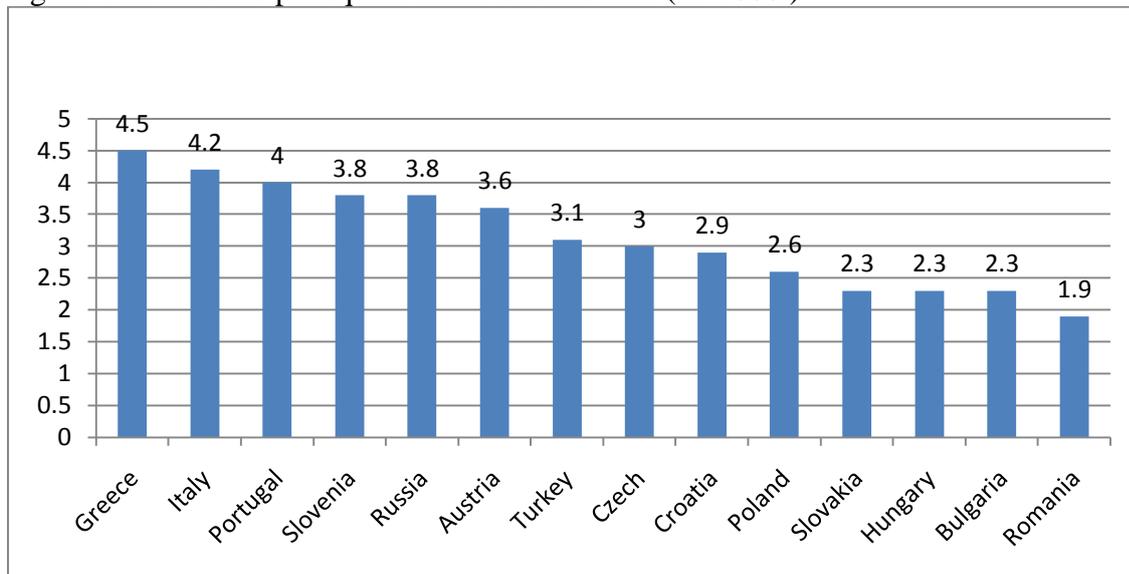
Figure 3 Retail sales area per capita in square meters



Source: http://www.fmig-online.de/fileadmin/user_upload/PDF-Dokumente/Studien/Studie_Key_European_retail_data.pdf

Figure 3 indicates that Croatia is still trailing behind the developed CEE countries in terms of retail sales per square meter of sales area.

Figure 4 Retail sales per square meter of sales area (in €000)



Source: http://www.fmig-online.de/fileadmin/user_upload/PDF-Dokumente/Studien/Studie_Key_European_retail_data.pdf

In terms of private label brands, Croatia is well positioned on the fifth place among the selected CEE countries, leading Bulgaria by eight percentage points and following Czech Republic by just 2 percentage points. Croatia is expected to increase the percentage of private brands in total retail sales due to two interrelated issues. First, current crisis has increased price awareness of Croatian shoppers and made them more prudent in planning their retail spending. Since private label brands are on average less expensive than national brands, their sales increases in periods of crises. Additionally, hard discounters have just began to spread on Croatian market, and it is well known fact that they carry up to 80 or 90 percent of private

label brands in their retail offer. That being the case, with increased market share of hard discounters on Croatian market, it is reasonable to assume that the share of private label goods sold will increase as well.

Table 2 Share of private label brands in CEE countries

	Country	Private labels	National brands		Country	Private labels	National brands
1	Slovakia	29%	71%	7	Romania	8%	92%
2	Hungary	28%	72%	8	Serbia	5%	95%
3	Poland	24%	76%	9	B&H	2%	98%
4	Czech	20%	80%	10	Russia	1%	99%
5	Croatia	18%	82%	11	Ukraine	1%	99%
6	Bulgaria	10%	90%				

Source: http://www.gfk.hr/imperia/md/content/gfkaustria2/pdf/nlo28_final.pdf

Based on previous analysis it can be concluded that Croatian retail market is moderately developed among the CEE countries in some indicators, while other indicators show above average development of the market. Relatively small retail spending, undoubtedly dampened by the current crisis, is shown in Figure 3 where Croatia is positioned among the lower half of neighboring countries.

3.2. The challenges of shopping center industry in Croatia

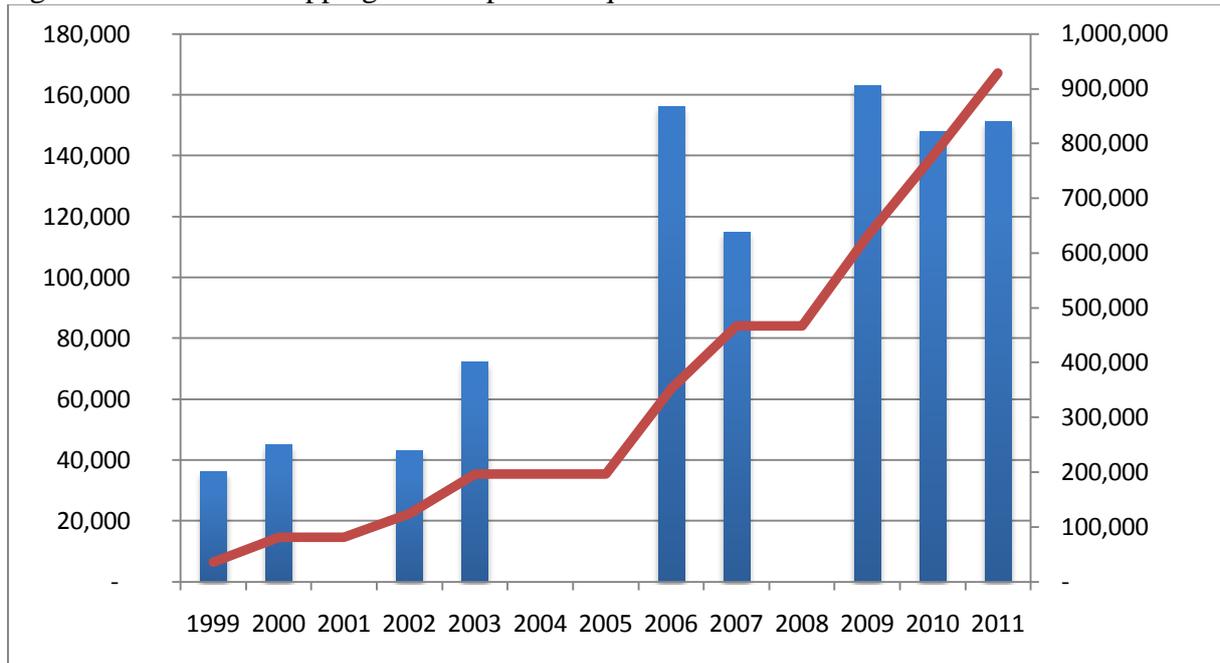
Shopping center industry in Croatia was one of the primary drivers of retail spending during the previous decade and it continues to be today as well. First shopping centers were built during the 1990s and in the first years of the 2000s. Those were enclosed shopping centers, located in urban neighborhoods on multiple levels, with one anchor tenant and a balanced offer of retail and entertainment facilities (Marković, 2008).

Gradually, newer shopping centers have increased in size and started to saturate suburban retail space. Offering climate controlled shopping environment with balanced mix of desirable retailers they have come to be perceived as one-stop-shop destinations. Consumers have adapted their shopping patterns as a response to a changing retail landscape. Retail spending has shifted from the main street shops to newly built shopping centers. Decreased main street retail spending put out of business many independent retailers on the main street. As a natural consequence, main street retail rents and occupancy rates dropped significantly (Knego et. al, 2010).

Gradual saturation of inner Zagreb city ring resulted in two trends in shopping center development in Croatia. First, shopping center projects were increasingly being developed in other major cities in Croatia. Secondly, new shopping centers had significantly differentiated retail offer among each other (Anić, Marković, 2011a). First two Outlet centers in Croatia were built in outer ring of Zagreb, along the main motorways. Due to the occupancy rate and profitability issues, exacerbated by the current crises, one of the outlet centers was soon closed.

As can be seen from Figure 4, the biggest surge in shopping center space addition was present just before and during the first few of years of the current crisis. Total number of square meters of shopping center space is currently around 1.000.000 m².

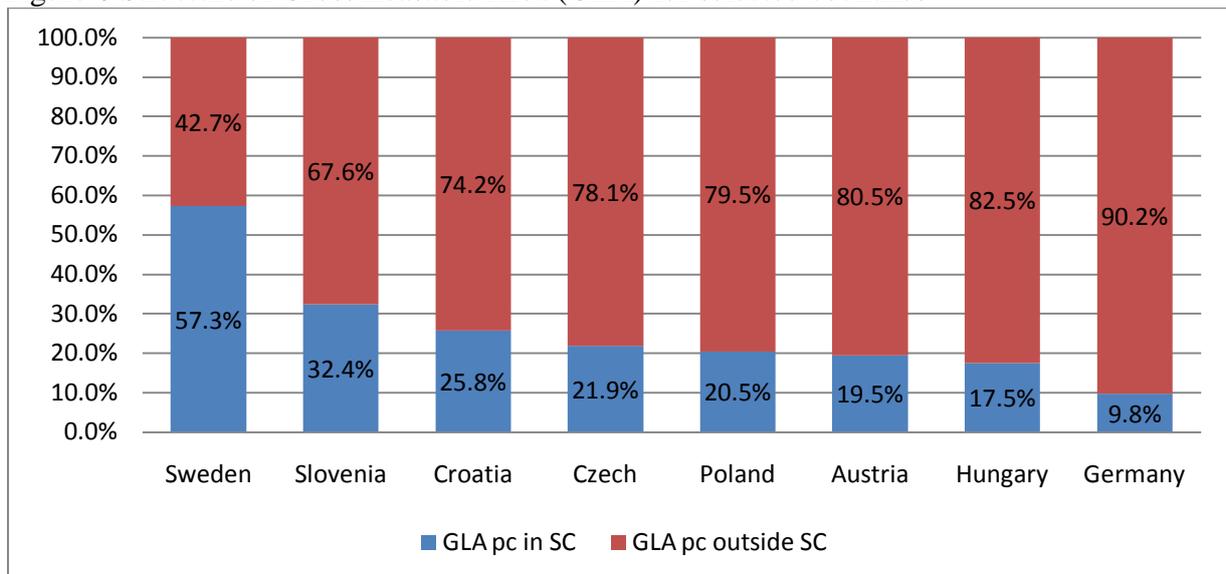
Figure 5 Growth of shopping center space in square meters in Croatia



Source: Anić, Marković (2011a)

If we compare gross leasable area of retail space in Croatia that is located within the shopping centers (Figure 5) it can be seen that it roughly correspond to data for neighboring countries as well. In addition to existing sales area in shopping center and despite harsh economic conditions, new 350.000 square meters of shopping space in shopping centers was announced to be available in the following couple of years. However, some projects have already been postponed, with economic downturn named as the primary reason of postponement (Anić, Marković, 2011b).

Figure 6 Structure of Gross Leasable Area (GLA) for selected countries



Source: Knežević, Szarucki (2011)

Shopping center development is gradually slowing down under the negative economic trends. Main urban areas are already saturated rather well with shopping center selling space. Indicators show that shopping center development peak in terms of GLA added to the market

is behind us. New shopping centers are expected to be built in smaller and medium cities. In the same time, existing centers in larger urban areas will gradually experience renovation with the goal of increasing consumer attractiveness and differentiating their offer from competing centers.

3.3. What can we expect in years ahead?

Consumers are adapting their shopping habits in response to changing economic conditions and retailers are adapting their offer to respond to new consumer demands. Two major retailers have recently introduced new distribution channels –web shops – hopping to attract young, time scarce and technology savvy consumers. At the same time they are experimenting with self checkout cash registers. Additionally, one of the two aforementioned retailers has introduced a self scanning shopping in one of its supermarkets for its most loyal consumers in order to test the acceptance of the shopping concept. Rumors are the mobile scanning/shopping is the next logical step, although without any concrete introduction dates mentioned.

Leading Croatian retailer has already introduced drive-in-shopping and currently is in the process of opening gas stations adjacent to its supermarkets. The ultimate goal is to provide one stop shopping experience for most of the household needs in as convenient as possible shopping experience.

Probably the biggest challenge for all retailers will be consumer acceptance of discount retailing. Biggest growth rates in Croatian retailing industry are among the discount retailers whose offer has sort of a natural fit with the consumer habits for controlled spending on increasingly functional products duo to diminishing household budgets.

Shopping center industry will probably experience the effect of the crises the longest. Majority of shopping center investment was made just before the crisis, when prices were on its peak. This will inevitably prolong the payback period for the investors, inhibiting new investments in refurbishment and growth.

Boost to retail spending could come from two related sources in the near future. Croatian accession to EU is almost but over which will result in increased mobility of goods and people between current EU members and Croatia. Additionally and related to EU accession, Croatian tourism sector, a huge generator of retail spending in the coastline during the summer months, will undoubtedly benefit from Croatia's entering into the EU. Some retailers have taken the necessary steps to capture the tourism Euros, growing their network of stores along the cost and building distribution centers nearby in order to efficiently support the supply chain operations.

4. CONCLUSION

This analysis shows performance of a sector using dominantly microeconomic analysis with macroeconomic variables as support variables. Even though macroeconomic problems are at the core of current crisis in Croatia and in the world, there are peculiarities that distinguish Croatia in this respect. Unlike Island Croatian banks were not exposed in the US markets that crumbled. Current crisis is reflection of impossibility of Croatian government to put public finances in order while world demand for product and services declines. As the crisis is all encompassing one, there are no quick fixes.

The retail sector in Croatia is termed to be concentrated which makes is one of the developed markets of CEE. This situation helped the sector to feel immediate downturn but once stabilized it did not sink any further. Even though Croatian GDP is in continuous fall since

2008, Croatian retail sector, after initial significant downturn, managed to fend of adverse macroeconomic situation. Given the data, there may be further adjustment in the retail sector, however this may not necessarily spell huge downturn in demand, but may be associated with modest downturn and larger repositioning of retail sector in term of size, scope, location and pricing.

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