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NIKE, Inc.
Building a diverse business

Reference Code: ML0012-038
Publication Date: October 2013
OVERVIEW

Catalyst

NIKE, Inc. (Nike) designs, markets and distributes athletic footwear, apparel, equipment and accessories for a range of sports and fitness activities. The company’s operations span the Americas, Europe, the Middle East, Africa and Asia-Pacific. In recent years, Nike has moved away from a specialist sportswear and equipment business and has grown into a major fashion and leisurewear label. It does however, remain a major player in the field of sportswear and equipment and is now using dedicated sub-brands to grow its interest in sports such as basketball, golf, soccer, and tennis. The company has also made efforts to become more geographically diverse and has thus reduced its reliance on North America.

Summary

- Mention the brand name Nike and many consumers may think sportswear and sporting goods but while this is true, Nike has moved away from focusing predominantly on such products and has successfully established itself as a fashion brand. The company now manufactures menswear, womenswear, and childrenswear that range from tracksuits to knitwear. It also produces and sells footwear, and accessories such as gloves, hats, and wallets. This focus on fashion, coupled with the use of specialist brands such as Converse and Hurley has seen the company broaden its appeal beyond sports enthusiasts.

- Nike is one of the world’s most famous and used sports brands. It produces a range of footwear, apparel, and equipment for various sports. The company places particular focus on basketball, golf, NFL, running, soccer, and tennis and pays top sports stars to wear and use its goods. To target these sports specifically and leverage the superstar image of its sponsored athletes, Nike has launched a number of sub-brands and branded its products accordingly. The most famous of these is the Jordan brand which was built around NBA legend Michael Jordan and which targets the basketball and urban fashion markets. Similar brands have been rolled out for golf, soccer, and tennis and competitors such as adidas have followed suit. In recent years, Nike has shown a willingness to divest interests that it does not feel fit its strategic aims.

- The Jordan and TW brands have been built around two of the world’s most famous sportsmen (Michael Jordan and Tiger Woods) and have, to a certain extent, been used to enter markets in which Nike previously had little or no involvement. In the case of the Jordan brand, the confines of the sport have now been transcended and a clothing brand has been created. Both brands have been highly successful and remain key to Nike’s strategy.

- Nike is headquartered in Beaverton, Oregon and its North American origins are to be seen in its focus on sports such as basketball and the NFL. The company still derives much of its revenue from North America, but by focusing on a wide range of sports with global appeal and becoming a fashion brand, it has been able to build a global empire.
TABLE OF CONTENTS

Overview ............................................................................................................................................................................. 2
Catalyst ............................................................................................................................................................................. 2
Summary ........................................................................................................................................................................... 2

Nike is a fashion label ..................................................................................................................................................... 6
Apparel constitutes a sizeable portion of Nike’s revenues .............................................................................................. 6
Nike has a broad fashion offering ....................................................................................................................................... 7
The company operates specialist fashion brands ............................................................................................................. 7
Converse ......................................................................................................................................................................... 7
Hurley ........................................................................................................................................................................... 7

Nike as a sports brand ....................................................................................................................................................... 9
Nike’s sports interests are wide-ranging .......................................................................................................................... 9
Basketball ...................................................................................................................................................................... 10
Soccer .......................................................................................................................................................................... 11
Running ....................................................................................................................................................................... 13
Other sports .................................................................................................................................................................. 13

Nike has rolled out successful sub-brands .......................................................................................................................... 15
Jordan ........................................................................................................................................................................ 15
TW ............................................................................................................................................................................. 16
Not all collections have been a success .......................................................................................................................... 16
Competitor response ....................................................................................................................................................... 17

Non-core operations have been divested .......................................................................................................................... 17

Nike is geographically diverse ........................................................................................................................................... 18
Nike’s reliance on the US has diminished ............................................................................................................................. 18
Fastest growing regions ..................................................................................................................................................... 18

Conclusions ...................................................................................................................................................................... 20

Nike has successfully built a diverse business ..................................................................................................................... 20

Appendix .......................................................................................................................................................................... 21
Sources .............................................................................................................................................................................. 21
Further Reading .............................................................................................................................................................. 21
Ask the analyst ................................................................................................................................................................. 22
About MarketLine ............................................................................................................................................................ 22
Disclaimer ....................................................................................................................................................................... 22
LIST OF TABLES

Table 1: Nike's fastest growing regions in terms of revenue, 2011-2013 .............................................................. 19
TABLE OF FIGURES

Figure 1: Apparel as a percentage of NIKE, Inc. revenue FY2013................................................................. 6
Figure 2: Assorted Converse and Hurley products.......................................................................................... 8
Figure 3: CR7 Mercurial Vapor IX FG (top left) & Mercurial Victory IV CR7 (bottom right)............................ 9
Figure 4: Lebron collection T-Shirt ................................................................................................................ 10
Figure 5: Cristiano Ronaldo modeling Nike CR7 slim collar pique ................................................................. 11
Figure 6: Nike Mercurial Vapor attribute rating............................................................................................... 12
Figure 7: Maria Sharapova modeling Nike tennis apparel................................................................................ 14
Figure 8: Nike revenue by sporting category FY2013 ($m)............................................................................ 14
Figure 9: Jordan brand ‘Jumpman’ logo........................................................................................................... 15
Figure 10: Nike revenue by region FY2013 ($m)............................................................................................ 18
NIKE IS A FASHION LABEL

Mention the brand name Nike and many consumers may think sportswear and sporting goods but while this is true, Nike has moved away from focusing predominantly on such products and has successfully established itself as a fashion brand. The company now manufactures menswear, women’s wear, and children’s wear that range from tracksuits to knitwear. It also produces and sells footwear, and accessories such as gloves, hats, and wallets. This focus on fashion, coupled with the use of specialist brands such as Converse and Hurley has seen the company broaden its appeal beyond sports enthusiasts.

Apparel constitutes a sizeable portion of Nike’s revenues

Nike’s manufacture and marketing of clothing makes up a significant portion of its revenues and has helped the company reduce its reliance on sporting goods such as soccer boots, basketball trainers, and golf clubs. There is some overlap between the two as the apparel segment also includes sports clothes. This overlap is perhaps most evident in golf and tennis, where the polo shirts and baseball caps worn can also be worn as fashion items, but the company’s move into the world of mainstream fashion has helped it become more diverse.

There are, however, signs that apparel is falling as a percentage of total revenue as fiscal 2011 and 2012 saw apparel account for over 30% as opposed to almost 27% in 2013 and Nike must guard against an over-reliance on sports and footwear. Overall, since 2003, the percentage of revenue accounted for by the apparel segment has hovered between 26% and 31%, showing that it is relatively stable. Note, the apparel segment does not include revenue from the company’s Converse and Hurley brands.

Figure 1: Apparel as a percentage of NIKE, Inc. revenue FY2013

SOURCE: NIKE, Inc. 2013 Annual Report
Nike has a broad fashion offering

Apparel is not the only fashion category offered by Nike. Footwear and accessories also form key parts of its offering. The goods Nike manufactures and sells here include trainers (sneakers), formal shoes, sandals, wallets, baseball caps, and bags. Some of these products are linked directly to sports or sports clubs, such as football scarves and some footwear, but many are simply fashion items designed to compete with high street fashion retailer products.

This broad offering has permitted Nike to enter several different fashion sectors and compete, to a certain extent, with well-known fashion labels such as Ralph Lauren and to build a reputation as more than a sportswear company.

The company operates specialist fashion brands

Despite the company’s best efforts to establish itself as a lifestyle fashion brand, it remains a sporting goods brand in the mind of many. These consumers are unlikely to purchase Nike-branded clothing as they do not feel it matches the image they wish to portray. To combat this, Nike operates two brands that are predominantly aimed at penetrating the fashion market. These are Converse, a youth fashion brand, and Hurley a brand which focuses its offering on so-called alternative sports and youth fashions such as skateboarding and surfing.

Converse

In 2003, Nike paid $305m to acquire Converse, Inc., maker of the famous Chuck Taylor All-Stars line of sneakers. With this acquisition, Nike gained access to a new market; mass-market fashion and it is a move that has paid off. Converse is one the world’s oldest athletic footwear brands and had dominated the US market until the likes of Adidas, Nike, and Reebok entered, and eventually, cornered the market in the 1970s and 1980s. In 2001, the company filed for bankruptcy and after being rescued, was acquired by Nike. The turnaround in the brand’s fortunes since the Oregon-based sportswear giant took over has been remarkable. In fiscal 2013, the Converse brand generated revenues of $1,149m, an increase of 9% on the previous year. This came on the back of a 17% year-on-year increase in fiscal 2012 and has seen the brand become an important income stream for Nike.

Converse’s product range includes its signature Chuck Taylor All-Stars line of sneakers, Jack Purcell sneakers, casual clothing, skateboarding sneakers, and bags. With the exception of bags, none of the other lines are catered for by Nike-branded product ranges and so the Converse brand allows the company to tap consumers who are interested in a laid-back fashionable look disassociated from a sports brand.

The Converse brand has proved to be a global success with recent growth being driven predominantly by very strong sales in China and the UK. During 2012, the company moved to a direct distribution model in China, which should improve the segment’s profit margins as it reduces the need for wholesalers. There is great scope for such expansion on a global scale as a look at the number of Converse retail stores shows. There are 72 such retail units in the US, but only three outside which suggests that a move to a direct distribution model is a realistic possibility.

Hurley

Hurley International is a clothing company headquartered in Costa Mesa, California. It focuses its offering on so-called alternative sports and youth fashions such as skateboarding and surfing, using well-known figures from these disciplines to wear and promote its goods. Its endorsers include Brazilian skateboarders Bob Burnquist and Og de Souza. This relaxed style of casual clothing focusing on such sports is a niche that Nike-branded apparel does not exploit, but represented a market that Nike had been eager to enter for some time. Consequently, in 2002, Nike bought Hurley for an undisclosed sum.

When Nike acquired the company, it generated annual revenues of approximately $70m, but with Nike’s financial input and marketing expertise, it has grown into a business that in fiscal 2013 turned over $260m, an increase of 5% compared to 2012. While this is nowhere near as significant as the revenues contributed by Converse, it does show that Nike has enjoyed success in building a brand that allows it to profit from a niche market.

Much like the Converse brand, there is great scope for expansion globally, as much of the company’s business is currently in the US.
As of May 2013, Hurley had 27 retail outlets in the US, but none outside, which again suggests that a move to a direct distribution in other countries could provide a route to substantial growth.

**Figure 2: Assorted Converse and Hurley products**
NIKE AS A SPORTS BRAND

Nike is one of the world’s most famous and used sports brands. It produces a range of footwear, apparel, and equipment for various sports. The company places particular focus on basketball, golf, NFL, running, soccer, and tennis and pays top sports stars to wear and use its goods. To target these sports specifically and leverage the superstar image of its sponsored athletes, Nike has launched a number of sub-brands and branded its products accordingly. The most famous of these is the Jordan brand which was built around NBA legend Michael Jordan and which targets the basketball and urban fashion markets. Similar brands have been rolled out for golf, soccer, and tennis and competitors such as adidas have followed suit. These brands and collections have enjoyed varying degrees of success, with Jordan in particular becoming a runaway success. Conversely, the R9 collection of soccer products launched in the late 1990s flopped. In recent years, Nike has shown a willingness to divest interests that it does not feel fit its strategic aims.

Nike’s sports interests are wide-ranging

Nike’s sporting goods offering is not centered around any one sport, the company instead deciding that a diverse approach is beneficial. The company does however, have significant interests in sports such as basketball, golf, NFL, running, soccer, and tennis. It manufactures and markets a full range of relevant products for these sports that encompasses apparel, specific equipment such as golf balls and soccer balls, and footwear.

Nike also ensures that it operates across the price spectrum by offering everything from entry level products right through to professional grade equipment. So for those consumers who do not wish to, or simply cannot afford to purchase a pair of £170 ($269) CR7 Mercurial Vapor IX FG soccer boots, cheaper pairs are available, such as the Nike Mercurial Victory IV CR7 priced at £60 ($95). As figure 3 shows, aesthetically there is very little difference between the two models and the cheaper version still carries the CR7 brand linked to Real Madrid star Cristiano Ronaldo meaning that it is still a product associated with footballing excellence. The company adopts this pricing strategy across all sports and all product categories.

![Figure 3: CR7 Mercurial Vapor IX FG (top left) & Mercurial Victory IV CR7 (bottom right)](www.store.nike.com)
Furthermore, Nike markets these products to men, women, and children and combined, these two elements guarantee Nike the largest potential market possible.

**Basketball**

One of Nike’s core sports is basketball and in fiscal 2013, products related to the sport generated revenues of $2,627m, a 16% increase on the previous year. The company offers basketballs, apparel, bags, and footwear that range in price. The company uses a number of NBA superstars to endorse its products and pays handsomely for the right to do so. The three most high profile players Nike currently has under contract are Kevin Durant, Kobe Bryant, and Lebron James and while it has stopped short of creating a complete brand based around any of these players, it has launched collections named after all three.

These product lines consist of between approximately 25 and 40 products and include footwear, apparel and accessories. The players themselves endorse and wear the Nike goods both on and off the court and this association with star players lends the collections greater legitimacy as high-end sports products as elite players only use elite equipment. Each collection has its own logo and branding which helps distinguish it from ordinary Nike products and allows it to thrive almost as a brand in its own right. The use of non-Nike logos means that while some of the products, most notably the footwear and equipment, are aimed at the active sports market, the apparel also crosses into the realm of fashion, thus maximizing the potential customer base.

For example, the Lebron line, named after four-time NBA Most Valuable Player Lebron James, uses a logo that does not include a Nike swoosh. It instead uses the letters LJ topped by a crown, in recognition of the player’s nickname ‘King James’, although some of the products. Clothes carrying this logo are therefore clearly distinguished from normal Nike products which may attract non-basketball fans who are more interested in the product quality and look than the fact that it is associated with the world’s most famous basketball player.
Soccer
Soccer is also central to Nike’s offering and related products brought in revenue totaling $1,931m during FY2013. The company has adopted an almost identical strategy with its soccer offering. Nike has several top players under contract, such as Mario Götze (Bayern Munich and Germany), Wayne Rooney (Manchester United and England), and Zlatan Ibrahimovic (Paris Saint Germain and Sweden). However, the company’s star contractee is Real Madrid and Portugal star Cristiano Ronaldo. Much like Lebron James in basketball, the Portuguese is arguably the most famous face within his sport and consequently, Nike has again chosen to build of collection of products built around a player. The collection uses the name CR7, the player’s initials and squad number and includes apparel, equipment and footwear. By having one of the world’s greatest players wearing the soccer boots, they become desirable to aspiring young players and are perceived to aid performance. However, the company has also launched lifestyle products as part of the CR7 collection and some of these are again distinguished from Nike-branded products by the absence of the well-known swoosh logo. Much like the Lebron basketball line, this allows them to attract non-soccer fans.

The company’s soccer product range is not however, limited to CR7. It is in fact extensive and its main focus is on equipment.

The company manufactures and markets balls, shin guards, bags, gloves, protective equipment, and hats, but it places a particular emphasis on soccer boots.
Nike’s current range consists of five lines; each aimed at boosting performance in different ways and consequently aimed at different demographics.

Each line includes boots to suit all budgets. The Hypervenom line is aimed at attacking players, while Mercurial Vapor boots are lightweight and aimed at increasing speed and range of movement. Nike Tiempo include dampeners to improve players’ first touch, while the CTR360 boots are designed for control and precision passing. The final line of soccer footwear is the FC247 and this range consists of football trainers for use on artificial grass and indoor arenas.

This is a very deliberate marketing ploy by Nike, attempting to get players to match their boots to their style of play. To add credence to these claims, Nike uses professional players whose style it feels fits the purpose of each line to wear and advertise them. For example, Cristiano Ronaldo, a player renowned for speed and acceleration is the face of the Mercurial Vapor line, while Barcelona and Spain midfielder Andres Iniesta is used to advertise CTR360 boots, which are aimed at technical midfield players. Nike has taken the step of rating each boot on a number of attributes to help consumers make a decision about which boot best suits their needs, although the ratings do not appear to be backed up by any firm evidence, showing that it is a marketing device aimed at diversifying its product offering by both look and functionality.

**Figure 6: Nike Mercurial Vapor attribute rating**

It is, however, a marketing device that has proved successful with FY2013 and FY2012 seeing soccer product revenues increase by 4% and 12% respectively.
Running

In terms of revenue, running is the single biggest category for Nike. In fiscal 2013, the company’s running division generated revenue of $4,274m (20.5% of total revenues) and its year-on-year growth of 16% meant that it was second only to basketball in terms of the fastest-growing categories.

Recent health drives and information surrounding the importance of physical exercise have led to an increased interest in running and this has presented opportunities for Nike to market running apparel, footwear, and accessories. The company has taken full advantage. Its strategy within the running category differs however, from those employed for its soccer and basketball offerings.

The company does contract star athletes to wear and promote its goods, most notably Olympic 200m sprint gold medalist Allyson Felix, but the promotion is much less visible and Nike has not built a collection around any single athlete. It has instead focused on a strategy centered around performance and products aimed at boosting it.

At the time of writing, its most recent footwear development is the Nike Free Flyknit running shoe. The shoe combines two separate Nike technologies and adds them both to create one single product. Special zones on the top of the foot have engineered stretch to improve the shoe’s flexibility, while a tighter weave at the perimeter stabilizes the forefoot and heel. Additionally, elasticized construction fits securely around the ankle for what Nike describes as “a comfortable, secure fit.” The new upper on this shoe is also cost-effective for Nike as by knitting a one-piece upper, Nike Flyknit construction reduces Nike’s typical upper waste by an average of 88%. The Nike Free sole is flexible and moves naturally with the foot. Diagonal hot-knifed sipes (flex grooves) through the arch are said to help ensure natural movement in the mid-foot as a runner transitions stride. Unlike the marketing of its football boots, this information is backed-up by scientific evidence as Nike has invested heavily in bio-mechanical research. The company’s running apparel products also focus on improving performance through design and the company markets specialized equipment such as lightweight running gear, wet weather running gear, and compression clothing.

This focus on performance as opposed to personality has paid dividends as the category’s revenue growth shows.

Other sports

Basketball, soccer and running make up the bulk of Nike’s sports offering (42.3%) but that is not to say that they are the company’s only area of interest. The NFL (American football) provides a valuable income stream as Nike has been the official apparel licensee since 2010. Although the terms of the deal were not disclosed, the previous license holder, Reebok, estimated that the loss of the NFL license would cause it to lose approximately $250m a year in revenue. This gives some indication of how much money the contract brings Nike. NFL apparel has also provided growth for Nike and the company states in its 2013 Annual Report that it was a key factor in the growth of its apparel division.

Nike also offers a significant amount of apparel, footwear, and equipment for tennis. The company’s sponsored tennis players include several top stars such as Roger Federer, Rafael Nadal, Serena Williams, and Maria Sharapova. Much like the basketball and soccer products, these athletes use the company’s top-end equipment and footwear to add legitimacy to improved performance claims, but only Roger Federer has had a dedicated collection named after him, RF. The other players wear simple Nike-branded clothing and promote it for marketing material.

In the case of Maria Sharapova, the athlete has actually collaborated with Nike on the design of the apparel she wears both on and off the court. The latter is again aimed at broadening the appeal of the clothing line beyond people who play tennis. By obliging self-confessed fashion addict Sharapova to wear different clothes and footwear on and off the tennis court, Nike is able to do this.
This involvement and investment in a wide range of sports have helped Nike to build a diverse business that is not overly dependent on any single sport for the majority of its revenue, as evidenced in figure 8.

**Figure 8: Nike revenue by sporting category FY2013 ($m)**

- Running: 57.7%
- Basketball: 20.5%
- Soccer: 12.6%
- Other sports: 9.2%

*Source: NIKE, Inc. 2013 Annual Report*
Nike has rolled out successful sub-brands

Nike has been successful with collections such as ‘Lebron’ and ‘CR7’, but in two key cases has taken this a step further and created a standalone sub-brand. The Jordan and TW brands have been built around two of the world’s most famous sportsmen (Michael Jordan and Tiger Woods) and have, to a certain extent, been used to enter markets in which Nike previously had little or no involvement. In the case of the Jordan brand, the confines of the sport have now been transcended and a clothing brand has been created. Both brands have been highly successful and remain key to Nike’s strategy.

Jordan

The Jordan brand was born out of what was originally a collection called Air Jordan, which first appeared when Michael Jordan wore them as a rookie in 1984. Various incarnations were released throughout the years and Nike started to market Air Jordan apparel and accessories. In 1997, the company decided to launch Jordan as a brand in its own right. Nike describes the Jordan Brand as “a premium brand of footwear, apparel and accessories inspired by the dynamic legacy, vision and direct involvement of Michael Jordan.” Since its launch in 1997, the brand has grown into a collection of performance and lifestyle products and has been promoted by sports personalities such as Roy Jones Jr. (boxing), Michael Jordan (basketball), Terrell Owens (American football), and Derek Jeter (baseball). The range of sports these athletes come from, coupled with the fact that entertainers such as Nelly and Damon Wayans have also been Jordan sponsored, demonstrates the fact that the brand has become much more than a basketball brand.

The brand is distinguished from Nike by its logo. There is a complete absence of Nike’s well-known swoosh as the Jordan brand uses its own distinctive ‘Jumpman’ which is the silhouette of Michael Jordan performing a layup. While the brand retains a close connection to the sport of basketball and continues to manufacture shoes used by professional players, much of its offering is aimed at the urban youth fashion market.

![Figure 9: Jordan brand ‘Jumpman’ logo](www.jumpman23.com)

Official Nike company filings do not reveal Jordan brand revenues, but analysts believe the brand is fast-growing. According to Susquehanna Financial analyst Christopher Svezia, the brand grew by 25-30% in 2012 and now generates more than $1.75bn globally, when Jordan-branded footwear and apparel are considered.
The US Jordan footwear business alone brought in $1.25bn in wholesale revenue in 2012, according to Matt Powell, an analyst at SportsOneSource and Jordan branded basketball footwear outsold Nike’s Lebron signature collection 6 to 1 in the US during 2012 according to Forbes. According to research firm SportsOneSource, Jordan controlled 58% of the US basketball shoe market in 2012. When one considers that the same source assigns Nike a share of 34%, it is fair to say that NIKE, Inc. is the dominant player. Revenue figures that exceed $1bn are testament to the success of the brand and vindicate Nike’s foresight in establishing a sub-brand to target the lucrative basketball market.

TW

Until Rory McIlroy was signed to a 10 year, $250m contract in January 2013, Nike’s golf range had been built almost exclusively around Tiger Woods. Nike consequently released golf apparel and accessories under the TW brand, although in truth, TW sits somewhere between a standalone brand and a collection. Unlike Jordan products, TW items tend to retain the presence of Nike’s swoosh logo and only on some products is the TW logo more prominent. The brand has been highly successful and Nike’s golf category has grown at an impressive rate in recent years. In FY2013, Nike Golf, including the TW brand, generated revenues of $791m, an increase of 9% on FY2012.

Prior to 1996, Nike had minimal involvement in the sport of golf. According to the National Golf Foundation, around 3 million Americans were members of private golf clubs in the mid-1990s and so the sport presented a potential goldmine for Nike. The company was therefore eager to enter but needed to find a route in to rival established players such as Callaway, Ping, and Titleist. Nike decided to adopt a similar strategy to the one that had worked in basketball, namely building the offering around one highly-talented rookie player and so once Tiger Woods officially turned professional in 1996, Nike signed him to a sponsorship contract rumored to be worth $40m over five years.

The move was a masterstroke as the young Californian proved to be a revelation. His age (Woods turned 21 in December 1996) and his youthful exuberance went against the grain in a sport long associated with conservative middle aged men and this helped attract a whole new demographic to the sport. Woods did not disappoint on the course, winning The Masters at the age of 21 while setting records for the largest winning margin in any major and the lowest ever four day score at Augusta National Golf Club (270/18 under par). Initially, Woods’ contract only involved apparel and footwear as the company did not manufacture any equipment and the sight of the young man striding down the fairway wearing his now customary final day Nike red polo shirt must have delighted the marketing men looking to ensure Nike’s success in golf. In 2000, that changed when the company launched the Tour Accuracy TW golf ball, which was then followed by the first Nike golf clubs in 2002. This coincided with a period of Woods dominance as record after record tumbled and trophy after trophy found its way into Woods’ hands. The success of a man wearing Nike clothes, using Nike balls and clubs afforded the company’s products a certain cachet and made them desirable to consumers, particularly younger ones with whom Woods connected.

Not all collections have been a success

When Nike was looking to launch what it advertised as a revolutionary new line of football boots in the late 1990s, known as Mercurial Vapor, the company decided to use then World Player of the Year and footballing megastar Ronaldo as the face of the range.

Ronaldo was, at the time, the hottest property in the sport and Nike had not long since signed an agreement with the Brazilian football association (CBF) to be the national team sponsor so it seemed a natural choice. The decision was made to launch a boot with the R9 logo (the player’s name and shirt number) and the boots were given a futuristic blue and silver look.

The boots were marketed with the slogan: “Ultralight, so your legs can be as fast as your imagination.” Nike placed a great deal of faith in Ronaldo and this reliance on one man to single-handedly promote a new product ultimately proved to be the strategy’s undoing.

Nike had pinpointed the 1998 FIFA World Cup as the launch pad for the boots and Brazil reached the final. Ronaldo, who was clearly not fully fit, did not play well as Brazil lost 3-0 to the hosts France and the next four years of his career were blighted by a series of serious knee injuries. This meant that the man who was supposed to lead the brand was not on the field to advertise it.
Nike eventually cut its losses and abandoned the R9 collection, although Ronaldo remained a Mercurial Vapor ambassador.

**Competitor response**

The success of Nike’s brands and collections linked to specific sports stars has led its competitors to adopt similar strategies. The most notable example is adidas’ Messi collection, which was launched in late 2011 and is named after Argentina and Barcelona soccer star Lionel Messi. While many of the products in the Messi collection still carry the distinctive adidas three stripe logo, it is minimized and the Messi collection logo is much more prominent. The Messi brand has helped adidas increase sales of its football-related products (according to the company’s 2012 annual report, the segment experienced ‘double-digit growth’) and the endorsement of the four-time World Player of the Year adds weight to the performance-enhancing claims adidas makes. This mirrors Nike’s strategy, but while adidas has enjoyed success, it does not rival the impact of Nike’s Jordan brand.

**Non-core operations have been divested**

Nike’s business model has become increasingly diverse as time has progressed, but Nike has shown that it is not afraid to divest of businesses that it does not see as central to its strategy.

In 1988, Nike acquired high-end shoe retailer Cole Haan as it sought to establish a presence in the formal footwear market. With 190 stores globally and annual revenue of $518m in 2011, Cole Haan was a successful business and sizeable player in the US footwear market.

However, after conducting a review of its business and objectives, in 2011, Nike deemed Cole Haan to be a non-core operation and began to begin the sale process. During the third quarter of the company’s financial year 2013 (quarter ended February 28, 2013) the sale to private equity firm Apax Partners for $570 million was completed.

Nike took similar steps with British sportswear company Umbro, which it had acquired in 2008 for $580m. In FY2011, Umbro generated revenues of $224m, which was flat compared to a year earlier. This uninspiring performance, coupled with the fact that Nike assessed Umbro as non-core, led the former to put Umbro up for sale. On November 30, 2012, the Nike completed the sale of certain assets of Umbro to Iconix Brand Group for $225m.

Nike’s rationale for the divestments was to allow it to “focus its resources on driving growth in the NIKE, Jordan, Converse and Hurley brands.”
NIKE IS GEOGRAPHICALLY DIVERSE

Nike is headquartered in Beaverton, Oregon and its North American origins are to be seen in its focus on sports such as basketball and the NFL. The company still derives much of its revenue from North America, but by focusing on a wide range of sports with global appeal and becoming a fashion brand, it has been able to build a global empire.

Nike’s reliance on the US has diminished

The company’s dominance of the basketball shoe market and the fact that it is the license holder for NFL jerseys ensure that Nike generates a great amount of revenue in the US. During FY 2013, North America accounted for 41% of the company’s total revenue, which equated to $10,387m. This is still a significant amount and it remains something the company’s management is looking to reduce. It does, however, represent progress compared to previous years. A look at Nike’s 2003 annual report for example shows that the United States alone (North America is not reported) accounted for 44% of the company’s revenue. Nike has been able to achieve this while more than doubling revenue.

Fastest growing regions

Nike’s performance varies from region. During FY2013, key markets such as Western Europe, China and Japan all suffered declines in revenue. This was more than compensated for however, by strong growth in North America, Central and Eastern Europe, and Emerging Markets, which have grown considerably in recent years.

China’s performance stumbled in FY2013 following a period of growth and this was also the case in Western Europe and Japan. No single region has been subject to a prolonged period of decline, but some regions continue to drive growth more than others. Table 1 shows the three fastest growing regions.

The North America segment has grown significantly, primarily as a result of increased basketball revenues, including Jordan. In FY2013, the company’s basketball segment grew by 21%. The licensing agreement with the NFL has also helped revenues from the region grow significantly as it is estimated to be a $250m a year business.
Growth in Central & Eastern Europe is being driven by increased economic prosperity which is translating into increased demand. Nike’s increased focus on soccer, which is the most popular sport in the region, has also played a role and has allowed the US giant to make inroads into adidas’ historical dominance. Reported future orders (footwear and apparel scheduled for delivery from June through November 2013) growth for the region stands at 14%, showing that this is more than a short-lived phenomenon.

The increased focus on soccer combined with concerted marketing drives and increasing disposable incomes has helped improve brand recognition in countries like Argentina and Mexico, and this has created the growth seen in the Emerging Markets segment. Again, reported future orders growth is high at 12%.

Table 1: Nike’s fastest growing regions in terms of revenue, 2011-2013

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<tr>
<th>Region</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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<tr>
<td>North America ($m)</td>
<td>7,579</td>
<td>8,839</td>
<td>10,387</td>
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<tr>
<td>Growth (%)</td>
<td>16.6%</td>
<td>17.5%</td>
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<tr>
<td>Central &amp; Eastern Europe ($m)</td>
<td>1,040</td>
<td>1,200</td>
<td>1,287</td>
</tr>
<tr>
<td>Growth (%)</td>
<td>15.4%</td>
<td>7.3%</td>
<td></td>
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<tr>
<td>Emerging Markets ($m)</td>
<td>2,737</td>
<td>3,411</td>
<td>3,718</td>
</tr>
<tr>
<td>Growth (%)</td>
<td>24.6%</td>
<td>9.0%</td>
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</table>

Source: Nike, Inc. 2013 Annual Report
CONCLUSIONS

Nike has successfully built a diverse business

Nike is undoubtedly one of the world’s leading sports brands. By investing in research, manufacturing performance enhancing equipment and apparel, and using elite sports stars to endorse its goods, the company has successfully established itself as a major player in sports such as basketball, golf, running, soccer, and tennis. In some cases, it has leveraged the stardom of its contracted athletes to launch collections carrying their names and in the case of Michael Jordan, built a standalone brand around them. This has allowed the company to transcend sport and establish itself as a fashion brand, thus maximizing its market and reducing its reliance on sporting products.

Nike is headquartered in Oregon and its North American origins are to be seen in its focus on sports such as basketball and the NFL. The company still derives much of its revenue from North America, but by focusing on a wide range of sports with global appeal and becoming a fashion brand, it has been able to build a global empire and focus greater attention on strong growth markets such as Argentina, Brazil, Mexico and South Korea. This has helped Nike grow into a $25bn business and one that continues to grow.

The company must continue to pursue such marketing strategies while constantly innovating and researching. This represents a significant cost and Nike must balance this with making its products affordable to the average consumer. This represents a potential threat to the business.

The likes of adidas and Puma are now using similar strategies based around superstars such as Lionel Messi (soccer) and Usain Bolt (athletics) in a bid to grow their shares of sports markets and this increases the threat of rivals eroding Nike’s revenues.

While Nike has enjoyed great success with brands and collections that leverage the star power of top sportspeople, the failure of the R9 brand in the 1990s and the furor that surrounded Tiger Woods following his admission of adultery serve as a reminder of how sensitive this strategy can be to the fortunes of one person. Nike has addressed this to some degree by using more than one player to promote many of its product lines, but the company must still be mindful of similar problems in the future.

These threats mean that Nike is unable to rest on its laurels, but the strategies the company has employed in recent years have stood it in good stead and the future looks bright for the Oregon based company.
APPENDIX

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Further Reading
NIKE, Inc. – MarketLine Company Profile
Global Childrenswear – MarketLine Industry Profile
Global Menswear – MarketLine Industry Profile
Global Womenswear – MarketLine Industry Profile
Sponsorship and sport: A marriage of convenience – MarketLine Case Study
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Portugal

In-depth PESTLE insights
OVERVIEW

Catalyst

This profile analyzes the political, economic, social, technological, legal, and environmental (PESTLE) structure in Portugal. Each of the PESTLE factors is explored on four parameters: current strengths, current challenges, future prospects and future risks.

Summary

Key findings

The ruling coalition may usher in structural reforms, but unfavorable public sentiment against austerity measures remains a challenge

In March 2011, Prime Minister Jose Socrates faced a no-confidence vote by opposition parties protesting against spending cuts and tax increases in the proposed austerity budget. He resigned soon after, and the ensuing general election resulted in the victory of the center-right Social Democratic Party (Partido Social Democrata [PSD]), which formed a coalition government with the Democratic and Social Centre – People’s Party (Centro Democrático e Social - Partido Popular [CDS-PP]). This was followed by financial assistance in the form of a bailout package from the International Monetary Fund (IMF) and the European Union (EU).

However, austerity fatigue and tension within the ruling coalition resulted in the resignation of two prominent cabinet members, triggering a reshuffle of the government. A 2013 constitutional court ruling against an important reform on public expenditure and another verdict against reforms to relax strict employment protection rules aggravated the government’s woes. The new right-wing PSD/CDS-PP alliance faces many difficulties, as structural reforms are bound to be extremely unpopular with the people. Apart from managing the debt crisis, the government has to control unemployment and relax labor laws to garner investment. The government is likely to face the public’s fury over some of the fiscal consolidation measures it needs to implement.

Fiscal consolidation measures will reduce the fiscal deficit; however, the banking system remains weak

The government has embarked on a major fiscal consolidation plan to control the deficit and debt figures. As per the statement by the EC, ECB, and IMF on the eighth and ninth Review Mission to Portugal in late 2013, Portugal is required to bring down its deficit to 5.5% of GDP for 2013, and the IMF has dubbed the progress credible as of October 2013. The government has taken up consolidation measures on both revenue and spending since 2011. The budget for 2014 has consolidation plans to the tune of €3.9 billion, out of which four fifths are in the form of spending cuts. Portugal is one of the few European countries to cut its deficit significantly, although much more needs to be done.

However, rising NPLs are a cause for concern for the banking sector, which is dependent on the Bank Solvency Support Facility under the troika program. According to the IMF, non-performing loans had jumped from around 5.2% by the end of 2010 to around 10.4% by March 2013, mainly from troubled loans to non-financial corporates. The effect of the recession has also taken a toll on banks’ profitability and net interest margins. Troubled loans can jeopardize the stability of the banking system, as the banks do not have the ability to get funding from the market and are totally dependent on external funding from the troika.
Portugal performs well on social parameters, but growing high inequality is a cause for concern

Portugal has performed well on various social parameters. According to the United Nations Development Programme’s Human Development Report 2012, the Human Development Index (HDI) for Portugal was 0.816, which placed the country 43rd among 187 nations. During 1980–2012, Portugal’s HDI rose by 1.0% annually from 0.644 to 0.816 as of 2012. Portugal has done reasonably well in terms of human development.

However, according to the Organisation for Economic Co-operation and Development (OECD), income inequality is on the higher side in Portugal. The report “Divided We Stand: Why Inequality Keeps Rising” published in December 2011 shows that out of the OECD countries, Portugal placed in fourth position, implying high inequality of market income with a Gini score of 0.46 (compared to the OECD average of 0.41). In terms of extended household income including services, Portugal’s Gini score was 0.29, which was higher than the OECD average of 0.24, reflecting higher inequality of income. Wage dispersion is also higher, with Portugal recording a score of 4.26, well above the OECD average of 3.33. In terms of inequality of household disposable income, Portugal is the fourth most unequal of the OECD nations with a Gini score of 0.35, compared with an OECD average of 0.31. High-income inequality is a major cause for concern.

While Portugal’s strength lies in producing doctorates, researchers, and scientific co-publications, a low share of high technology exports is a dampener

According to the Innovation Union Competitiveness Report 2013, new doctoral graduates per 1,000 population aged 25 to 34 stood at 1.85 in 2010, well above the EU (1.69). While, international scientific co-publications per million population were 678 in 2011, this is more than double of the European average of 300 in the same year. The figures reflect a potentially strong technological foundation for Portugal’s R&D landscape.

However, high technology exports (as a percentage of manufactured exports) were 3.5% in 2011, in comparison to the OECD (16.5%) and EU (15.5%) averages, according to the World Bank. Receipts from royalties and license fees have been low, and stood at $46.67m in 2012, well below peers such as Spain ($1.27 billion), Italy ($4.05 billion), and Ireland ($4.76 billion) in the same year. Low levels of innovation continue to be a challenge for the country.

The country has strong rule of law; however, its high tax wedge is an impediment to attract talent

According to the World Bank’s Worldwide Governance Indicators for 2012, Portugal ranked in the 82.46 percentile with respect to rule of law. A high ranking in this parameter indicates that the country has confidence in and abides by the rules of society, in particular the quality of contract enforcement, the police, and the courts. Portugal ranked much higher than Italy and Greece, which had percentile ranks of 62.09 and 63.51, respectively.

However, Portugal has one of the highest tax and social security burdens, which stands above the OECD average. According to the OECD, in 2012, Portugal has higher (one-earner couple, two children) total tax wedge (Income tax, employer and employee social security contributions and pay roll tax as a percentage of labor costs) than the OECD average. The tax burden for one-earner couple, two children was 26.9% while for OECD it was 26.1% in 2012. When it comes to the individual tax wedge (single, no child), Portugal once again had the higher tax wedge (36.7%) than the OECD average (35.6%) in 2012. High taxes on labor are likely to discourage local workers and deter prospective migrants with key skills. High taxes can also suppress entrepreneurial activity.

The adoption of renewable energy in Portugal has been impressive, but fiscal consolidation might affect environmental initiatives

The country has done well in terms of achieving its target for the generation of electricity from renewable sources. According to the Portuguese Renewable Energy Association, the country surpassed its target for the end of the decade in terms of the generation of electricity from renewable sources. At the end of Q1 2013, Portugal was able to meet 70%
of total electricity consumption through renewable sources. However, in times when fiscal consolidation assumes prime importance, it will be a challenge for Portugal to increase its monetary allocation to environmental programs. Therefore, with the deterioration of public finances, it might be difficult for the government to pursue expensive environmental reforms with the same momentum as was seen in previous years. It may prove difficult to fund the environmental initiatives of the government in the near term.

PESTLE highlights

Political landscape

- Short-term political stability is expected following the formation of the PSD/CDS-PP coalition government, which enjoys a reasonable majority, after the June 2011 general election. However, this term will still be challenging as the country copes with the economic downturn and fiscal consolidation.

- Bilateral relations have been expanding fast between China and Portugal. China made its largest foreign investment in Portugal in 2011 and the country has attracted numerous other Chinese investments in various sectors.

Economic landscape

- The economy was hit by the financial crisis of 2008–09, and GDP contracted in 2008 and 2009. The economy registered a modest recovery to grow 1.93% in 2010; however, it contracted again in 2011 and 2012 by 1.42% and 3.21% respectively. According to MarketLine forecasts, the economy will further contract in 2013, although to a much lesser extent than in 2012.

- According to the IMF, the current account deficit plummeted to 2.87% of GDP in 2012, a major improvement compared to 2010 and 2011, when it was at 9.97% and 6.44% respectively. In absolute terms, the deficit was down from $31.98 billion in 2008 to $6.04 billion in 2012.

Social landscape

- In 2012, 18.20% of the Portuguese population was above 65 years of age. Around 65.70% of the population belongs to the 15–64 age group and 16.10% are in the 0–14 age group. This age structure is similar to the demographic trend in the rest of Europe, where populations are aging and fewer people are entering the workforce.

- In accordance with the structural measures required under the bailout program, the government has taken steps to reduce segmentation of the labor market, fostering job creation and enhancing worker mobility.

Technological landscape

- The number of patents granted by the US Patent and Trademark Office to Portugal increased from 30 in 2011 to 40 in 2012; however, in comparison, Spain was granted 642 patents, Greece 82 patents, and Italy 2,120 patents. This indicates that the country has not consistently encouraged innovation and that the R&D scenario is not well developed.

- R&D subsidies in Portugal are amongst the highest in OECD countries—much above the EU average and the US. Giving impetus to R&D is the key for Portugal to raise its productivity and living standards and the government rightly provides high subsidies to R&D activity.
Legal landscape

- According to Paying Taxes 2013, businesses in Portugal suffer from one of the highest tax compliance costs in the EU & EFTA area. It takes 275 hours to comply with taxes in Portugal, compared to the EU & EFTA average of 184 hours.

- In 2013, the government announced comprehensive corporate income tax reforms to boost investment and growth. The reform measures include the gradual lowering of the rate to around 18% by 2018, rationalization of incentive schemes and broadening of the tax base.

Environmental landscape

- Under Portuguese law, environmental permits are generally required for polluting or potentially environmentally damaging activities in sensitive areas, especially those involving water, air, and noise pollution.

- Portugal was ranked 41st out of 132 countries in the Environmental Performance Index 2012; neighboring Spain fared better, placing 32nd.

Key fundamentals

<table>
<thead>
<tr>
<th>Table 1: Portugal – key fundamentals</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
<tr>
<td>GDP, constant 2005 prices ($ billion)</td>
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<tr>
<td>2010</td>
</tr>
<tr>
<td>GDP growth rate (%)</td>
</tr>
<tr>
<td>1.93</td>
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<tr>
<td>GDP, constant 2005 prices, per capita ($)</td>
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<tr>
<td>18,565.64</td>
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<tr>
<td>Inflation (%)</td>
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<tr>
<td>1.39</td>
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<tr>
<td>Exports, total as a percentage of GDP</td>
</tr>
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<td>31.62</td>
</tr>
<tr>
<td>Imports, total as a percentage of GDP</td>
</tr>
<tr>
<td>40.15</td>
</tr>
<tr>
<td>Mid-year population (millions)</td>
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<tr>
<td>10.64</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
</tr>
<tr>
<td>10.80</td>
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<tr>
<td>Mobile penetration (per 100 people)</td>
</tr>
<tr>
<td>153.79</td>
</tr>
</tbody>
</table>

Source: Country Statistics, MarketLine

MARKETLINE
# TABLE OF CONTENTS

**Overview**  
- Catalyst  
- Summary  

**Key Facts and Geographic Location**  
- Key facts  
- Geographic location  

**PESTLE Analysis**  
- Summary  
- Political analysis  
- Economic analysis  
- Social analysis  
- Technological analysis  
- Legal analysis  
- Environmental analysis  

**Political Landscape**  
- Summary  
- Evolution  
- Structure and policies  
- Performance  
- Outlook  

**Economic Landscape**  
- Summary  
- Evolution  
- Structure and policies  
- Performance
## TABLE OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1</td>
<td>Map of Portugal</td>
<td>12</td>
</tr>
<tr>
<td>Figure 2</td>
<td>Public finance in European countries</td>
<td>17</td>
</tr>
<tr>
<td>Figure 3</td>
<td>Youth unemployment in selected European countries</td>
<td>18</td>
</tr>
<tr>
<td>Figure 4</td>
<td>Change in structural balance, 2009–12</td>
<td>19</td>
</tr>
<tr>
<td>Figure 5</td>
<td>Banking sector statistics</td>
<td>20</td>
</tr>
<tr>
<td>Figure 6</td>
<td>Population that has attained tertiary education (2011)</td>
<td>22</td>
</tr>
<tr>
<td>Figure 7</td>
<td>Aging population</td>
<td>23</td>
</tr>
<tr>
<td>Figure 8</td>
<td>Tax subsidies for one dollar of R&amp;D expenditure</td>
<td>25</td>
</tr>
<tr>
<td>Figure 9</td>
<td>High-technology exports, 2011</td>
<td>26</td>
</tr>
<tr>
<td>Figure 10</td>
<td>Product market regulation in selected European countries</td>
<td>28</td>
</tr>
<tr>
<td>Figure 11</td>
<td>Share of energy from renewable sources</td>
<td>31</td>
</tr>
<tr>
<td>Figure 12</td>
<td>Revenues from environment related taxes</td>
<td>32</td>
</tr>
<tr>
<td>Figure 13</td>
<td>Renewable energy primary production: solar energy</td>
<td>33</td>
</tr>
<tr>
<td>Figure 14</td>
<td>Portugal – key political events</td>
<td>35</td>
</tr>
<tr>
<td>Figure 15</td>
<td>Portugal – key political figures</td>
<td>36</td>
</tr>
<tr>
<td>Figure 16</td>
<td>Composition of the legislature, 2011</td>
<td>38</td>
</tr>
<tr>
<td>Figure 17</td>
<td>Portugal’s historical GDP growth, 1992–2012</td>
<td>42</td>
</tr>
<tr>
<td>Figure 18</td>
<td>GDP and GDP growth rate in Portugal (constant 2005 prices), 2006–16</td>
<td>45</td>
</tr>
<tr>
<td>Figure 19</td>
<td>GDP composition by sectors, 2013</td>
<td>46</td>
</tr>
<tr>
<td>Figure 20</td>
<td>Agricultural output of Portugal, 2008–13</td>
<td>47</td>
</tr>
<tr>
<td>Figure 21</td>
<td>Industrial output of Portugal, 2008–13</td>
<td>48</td>
</tr>
<tr>
<td>Figure 22</td>
<td>Services output of Portugal, 2008–13</td>
<td>49</td>
</tr>
<tr>
<td>Figure 23</td>
<td>External trade of Portugal, 2008–12</td>
<td>50</td>
</tr>
<tr>
<td>Figure 24</td>
<td>Consumer price index and consumer price index-based inflation in Portugal, 2006–16</td>
<td>51</td>
</tr>
<tr>
<td>Figure 25</td>
<td>Unemployment in Portugal, 2006–16</td>
<td>52</td>
</tr>
<tr>
<td>Figure 26</td>
<td>Major religions of Portugal, 2001</td>
<td>54</td>
</tr>
<tr>
<td>Figure 27</td>
<td>Expenditure on healthcare in Portugal, 2005–11</td>
<td>55</td>
</tr>
<tr>
<td>Figure 28</td>
<td>Internet users and growth rate in Portugal, 2008–12</td>
<td>58</td>
</tr>
<tr>
<td>Figure 29</td>
<td>Carbon dioxide emissions in Portugal, 2004–11</td>
<td>64</td>
</tr>
</tbody>
</table>
TABLE OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 1</td>
<td>Portugal – key fundamentals</td>
<td>5</td>
</tr>
<tr>
<td>Table 2</td>
<td>Portugal – key facts</td>
<td>11</td>
</tr>
<tr>
<td>Table 3</td>
<td>Analysis of Portugal’s political landscape</td>
<td>14</td>
</tr>
<tr>
<td>Table 4</td>
<td>Analysis of Portugal’s economy</td>
<td>16</td>
</tr>
<tr>
<td>Table 5</td>
<td>Analysis of Portugal’s social system</td>
<td>21</td>
</tr>
<tr>
<td>Table 6</td>
<td>Analysis of Portugal’s technology landscape</td>
<td>24</td>
</tr>
<tr>
<td>Table 7</td>
<td>Analysis of Portugal’s legal landscape</td>
<td>27</td>
</tr>
<tr>
<td>Table 8</td>
<td>Analysis of Portugal’s environmental landscape</td>
<td>30</td>
</tr>
<tr>
<td>Table 9</td>
<td>Mid-year population by age (million), 2012</td>
<td>54</td>
</tr>
<tr>
<td>Table 10</td>
<td>Patents granted by the USPTO, 2009–12</td>
<td>58</td>
</tr>
</tbody>
</table>
### Key Facts and Geographic Location

#### Key Facts

**Table 2: Portugal – key facts**

<table>
<thead>
<tr>
<th>Category</th>
<th>Details</th>
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<tbody>
<tr>
<td><strong>Country and capital</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Full name</strong></td>
<td>Portuguese Republic</td>
</tr>
<tr>
<td><strong>Capital city</strong></td>
<td>Lisbon</td>
</tr>
<tr>
<td><strong>Government</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Government type</strong></td>
<td>Republic; parliamentary democracy</td>
</tr>
<tr>
<td><strong>Head of state</strong></td>
<td>President Anibal Cavaco Silva</td>
</tr>
<tr>
<td><strong>Head of government</strong></td>
<td>Prime Minister Pedro Manuel Mamede Passos Coelho</td>
</tr>
<tr>
<td><strong>Population (July 2013)</strong></td>
<td>10.80 million (July 2012)</td>
</tr>
<tr>
<td><strong>Currency</strong></td>
<td>Euro</td>
</tr>
<tr>
<td><strong>GDP per capita adjusted by PPP (2012 est.)</strong></td>
<td>$23,800</td>
</tr>
<tr>
<td><strong>Internet domain</strong></td>
<td>.pt</td>
</tr>
<tr>
<td><strong>Demographic details</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Life expectancy (2013)</strong></td>
<td>78.85 years (total population)</td>
</tr>
<tr>
<td></td>
<td>75.61 years (men)</td>
</tr>
<tr>
<td></td>
<td>82.32 years (women)</td>
</tr>
<tr>
<td><strong>Ethnic composition</strong></td>
<td>Homogeneous Mediterranean stock; citizens of black African descent who immigrated to the mainland during decolonization number less than 100,000; since 1990 many Eastern Europeans have entered Portugal</td>
</tr>
<tr>
<td><strong>Major religions</strong></td>
<td>Roman Catholic (84.5%), other Christian (2.2%), other (0.3%), unknown (9%), none (3.9%)</td>
</tr>
<tr>
<td><strong>Country area</strong></td>
<td>92,090 sq. km</td>
</tr>
<tr>
<td><strong>Language</strong></td>
<td>Portuguese (official), Mirandese (official, but locally used)</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td>Agricultural products, food products, wine, oil products, chemical products, plastics and rubber, hides, leather, wood and cork, wood pulp and paper, textile materials, clothing, footwear, machinery and tools, base metals</td>
</tr>
<tr>
<td><strong>Imports</strong></td>
<td>Agricultural products, chemical products, vehicles and other transport material, optical and precision instruments, computer accessories and parts, semi-conductors and related devices, oil products, base metals, food products, textile materials</td>
</tr>
</tbody>
</table>

**Source:** CIA – The World Factbook

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Geographic location

Portugal is located in Southwest Europe, bordering the North Atlantic Ocean, west of Spain.

Figure 1: Map of Portugal
PESTLE Analysis

PESTLE ANALYSIS

Summary

Portugal registered impressive economic growth during the 1990s. Despite this, it struggled to keep up with its European Union (EU) peers. Portugal’s low cost advantage has crumbled in recent years with the emergence of competition from Asia and Eastern Europe. In addition, the average income has dropped further behind the Western European average, and unemployment has been in the double-digits since 2010. Furthermore, Portugal’s government deficit widened, forcing the previous administration to embark on a fiscal consolidation strategy.

The Socialist Party (Partido Socialista [PS]) proposed an austerity budget as one of the fiscal consolidation steps in March 2011. However, the budget proposed by the government was rejected by the entire opposition, leading to an early election. In June 2011, Portugal had to seek a fiscal bailout package from the International Monetary Fund (IMF) and the EU, which mandates multiple structural reforms and fiscal consolidation in order to face the fiscal crisis. It is expected to be a difficult term for any political party in power as it implements politically unpalatable reforms amid poor economic growth. Tight financing conditions and poor domestic consumption have weighed heavily on the economy.

A wide income gap is a major challenge for the country; a high dropout rate and low tertiary education attainment adds to the nation’s woes.

The country’s R&D expenditure as a percentage of GDP is also comparatively lower than in other developed countries and it has been granted very few patents. Portugal has witnessed a robust increase in broadband connectivity, especially mobile broadband, which is an encouraging sign for the e-commerce industry.

The country has a strong legal setup, however, a high tax compliance cost and tax wedge is a dampener. Moreover, high product market regulation hampers competition in various sectors.

The government has consistently encouraged the generation of electricity through renewable sources. In fact, the country has done well in this respect by surpassing the target that it set for itself in 2010, and the country achieved its greenhouse gas emissions Kyoto Protocol (2008–12) target in 2009.
**Political analysis**

**Overview**

In March 2011, after six years of socialist rule, the leader of the PS and the then Prime Minister Jose Socrates had to resign after failing to pass his austerity budget through parliament. The ensuing general election saw the center-right Social Democratic Party (Partido Social Democrata [PSD]) win, but fall just short of an absolute majority. They formed a coalition government with the smaller, conservative Democratic and Social Centre – People’s Party (Centro Democrático e Social - Partido Popular [CDS-PP]). Since June 2011, Portugal has been ruled by a PSD/CDS-PP coalition led by Prime Minister and PSD leader Pedro Passos Coelho.

<table>
<thead>
<tr>
<th>Table 3: Analysis of Portugal’s political landscape</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current strengths</strong></td>
</tr>
<tr>
<td>■ Stable political environment</td>
</tr>
<tr>
<td><strong>Current challenges</strong></td>
</tr>
<tr>
<td>■ Politically unpalatable austerity measures</td>
</tr>
<tr>
<td><strong>Future prospects</strong></td>
</tr>
<tr>
<td>■ Growing ties with China</td>
</tr>
<tr>
<td>■ Political will in implementing structural reforms</td>
</tr>
<tr>
<td><strong>Future risks</strong></td>
</tr>
<tr>
<td>■ New government under pressure</td>
</tr>
</tbody>
</table>

**Source:** MarketLine

**Current strengths**

*Stable political environment*

The winning PSD/CDS-PP coalition holds a reasonably strong majority at the center. The major opposition, the PS, in principle supports the austerity drive and fiscal consolidation measures being carried out by the ruling party. Hence, the government is expected to last its full term. Furthermore, being party to the negotiations of the bailout package, the ruling coalition has exhibited a proactive stance since June 2011, which indicates that it has the commitment and political will required to pull Portugal out of the current debt crisis.

**Current challenges**

*Politically unpalatable austerity measures*

Any government in power needs to have extremely strong political will to enforce drastic fiscal consolidation measures to counter the debt crisis faced by countries in the eurozone. The public strongly opposes budget cuts and the austerity drive proposed by the former and current governments to tackle the debt crisis. The current government is facing increasing opposition over austerity measures in the 2014 budget presented in October 2013. The government has proposed a total fiscal adjustment of €3.9 billion in the budget for 2014, out of which four fifths are in the form of spending cuts. Many parties and trade unions have voiced their displeasure and have criticized the government’s stress on more austerity. The increasing fractiousness in the political sphere makes it difficult for the government to implement the structural reforms required by the bailout deal from the troika (the IMF, EU, and European Central Bank [ECB]). This presents a challenging paradox for the current ruling party, whereby voters’ approval and fiscal responsibility are difficult to achieve simultaneously.
Future prospects

Growing ties with China

Bilateral relations have been expanding fast between China and Portugal. China made its largest foreign investment in Portugal in 2011 and since then bilateral relations have grown stronger. Portuguese exports to China grew by around 45.8% in the first three quarters of 2012 compared to the same period in 2011. Moreover, for the first time Portuguese exports to China crossed the $1 billion mark in 2011, ahead of Brazil. Exports to China for the first nine months of 2012 were worth $1.19 billion. China’s increased participation in acquiring stakes in the privatization of Portugal’s utilities reflects the growing bilateral relationship. For instance, China’s Three Gorges Corporation acquired a 22% stake in Portugal’s national energy company, Energias de Portugal (EDP) for $3.5 billion in late 2011.

The China Development Bank also extended a €1 billion loan to the company. In 2012, China State Grid bought a 25% stake in Portuguese power company Redes Energeticas Nacionais’ (REN) for $524 million at a 40% price premium. Further, China’s Sinopec purchased 30% of the operations of Portugal’s state-owned oil company, Galp Energia SGPS in Brazil for $4.8 billion in 2012 and China Mobile has shown interest in Portugal Telecom, which has a strong presence in Angola, Mozambique and Timor-Leste. In addition, China has bought of Portuguese debt worth around $1.3 billion. Chinese accounted for around 80% of the residence visas issued by Portugal through a program which encourages investment in the battered Portuguese real estate market. As of November 2013, Portugal has received foreign investment of €185 million through this program—with 80% coming from China. China and Portugal signed a memorandum of understanding in June 2012 to boost scientific and technological ties. Stronger ties with a fast-growing economy should create market opportunities for Portuguese exports, and help Portugal attract much-needed foreign capital investment.

Political will in implementing structural reforms

Prime Minister Passos Coelho has shown the will to implement structural reforms in the country. He favors private initiatives and smaller state machinery, with a flexible labor market to promote employment and growth. Some of his measures include privatization, reduced transfers to state-owned bodies, tax deductions and benefits, lower government employment, opening-up of closed professions, and the rationalization of healthcare and education. If the government continues to internalize the culture of fiscal discipline and implement structural reforms with the same political will, Portugal will emerge from the current fiscal turmoil. The assessments made by the IMF in November 2013 were positive. In their eighth and ninth review mission to Portugal, the IMF approved a €1.91 billion disbursement, reporting that the country had progressed towards the program’s objectives. This will further enhance the credibility of the government in the international market.

Future risks

New government under pressure

Austerity fatigue and tensions within the ruling coalition resulted in the resignation of two prominent cabinet members, leading to a government reshuffle. An adverse constitutional court ruling against an important reform on public expenditure and another against the relaxation of strict employment protection rules exacerbated the government’s problems in 2013. The roadmap for the new right-wing PSD/CDS-PP alliance faces many difficulties, as structural reforms are bound to be extremely unpopular with the people. Apart from managing the debt crisis, the government has to control unemployment and relax labor laws to garner investments. The government is likely to face a furious public reaction to some of the measures that it will have to undertake as part of the fiscal consolidation measures.
Economic analysis

Overview

The country’s public finances are reeling under a high fiscal deficit and public debt. The government has taken steps to lessen the deficit and the debt burden. Rising competitiveness is a positive sign, and the export sector will benefit from it in the long run. The government has embarked on a major fiscal consolidation plan to control the deficit and debt, which is expected to bring about macro-economic stability in the near term. Further, growing non-performing loans (NPLs) along with a fall in domestic demand and productive investments will hurt the recovery.

<table>
<thead>
<tr>
<th>Current strengths</th>
<th>Current challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ease of starting a business</td>
<td>Huge fiscal deficit</td>
</tr>
<tr>
<td></td>
<td>High unemployment</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Future prospects</th>
<th>Future risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal consolidation measures</td>
<td>Rising NPLs</td>
</tr>
<tr>
<td>Narrowing current account deficit</td>
<td></td>
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</tbody>
</table>

Source: MarketLine

Table 4: Analysis of Portugal’s economy

Current strengths

Ease of starting a business

Starting a business is easy in Portugal. According to the World Bank’s Doing Business 2014 report, it takes only two and a half days to start a business in Portugal, compared to the Organisation for Economic Co-operation and Development (OECD) average of 11.1 days. Moreover, the number of procedures it takes to start a business is three, which is lower than the OECD average of five days. The cost (percentage of income per capita) of starting a business is only 2.4%, well below the OECD average of 3.6%. In addition, the time required for getting electricity and registering property is well below the OECD average. In 2013, Portugal eliminated the requirement to report to the Ministry of Labor, which made starting a business lot easier.

Current challenges

Huge fiscal deficit

In the last decade, Portugal faced weak growth combined with large and permanent government budget deficits, where consumption, wages, and social spending grew out of line with economic growth, coupled with low productivity and a drop in foreign direct investment. Portugal is struggling to bring down its fiscal deficit, like many other countries in the eurozone. After the global financial crisis, finances worsened with the general government deficit skyrocketing to a high of 10.2% of GDP in 2009. According to Eurostat, Portugal’s general government deficit has been declining since then, printing at 9.8% in 2010 and 4.3% in 2011; it rebounded to 6.4% in 2012 (fig 2a), one of the highest among the European nations. The public debt to GDP ratio was also high at a whopping 124.1% in 2012, according to the Eurostat.
(fig 2b) and is expected to increase in the medium term.

**Figure 2: Public finance in European countries**

- **General government deficit/surplus, 2012, (a)**
  - EU (28 countries) average
  - Euro area (17 countries) average

- **General government gross debt, 2012, (b)**
  - Euro area (17 countries)
  - EU (27 countries)

*Source: Eurostat*
High unemployment

The labor market remains relatively rigid, and unemployment has been on the rise since the onset of the economic crisis. According to MarketLine, Portugal's unemployment rate reached 15.69% in 2012, up from 12.77% in 2011. Further, according to MarketLine, this is expected to rise to 17.59% in 2013. Rising unemployment has mainly been due to the economic contraction and corporate adjustments in balance sheets. Moreover, structural shifts in moving toward non-tradable sectors that are less labor-intensive have also contributed to the spike in the unemployment rate. The job losses in wholesale and retail trade, hotels and restaurants, and construction contributed more than one third of total job losses. According to Eurostat, as of 2012 youth unemployment stood at 37.8% (fig 3) in Portugal. High unemployment is a major challenge as it will lower consumer confidence and will further deter economic growth.

Figure 3: Youth unemployment in selected European countries

Source: Eurostat
Future prospects

Fiscal consolidation measures

The government has embarked on a major fiscal consolidation plan to control the deficit and debt. As per the Statement by the EC, ECB, and IMF on the eighth and ninth Review Mission to Portugal in late 2013, Portugal is required to bring down its deficit to 5.5% of GDP for 2013. As of October 2013, the IMF considers its progress to be credible. Since 2011, the government has consolidated both the revenue and spending. The 2014 budget calls for savings of €3.9 billion, with 80% of this coming from spending cuts. Portugal has been one of the few countries, which has been able to bring down its deficit significantly among the European nations, although much needs to be done (fig 4). Other measures include the Spending Commitments’ Control Law, expenditure ceilings drawn for the medium term and the creation of the Portuguese Public Finance Council. Future steps will include budgetary control across different levels of government, cutting arrears and framing a public financial management strategy for the medium term. These measures are expected to rein in the deficit and debt.

Figure 4: Change in structural balance, 2009–12

Narrowing current account deficit

The current account deficit has been falling since peaking at 12.63% of GDP in 2008. According to the IMF, in 2012, the current account deficit plummeted to 2.87% of GDP, a major improvement compared to 2010 and 2011, when it was at 9.97% of GDP and 6.44% of GDP, respectively. In absolute terms, the deficit was down from $31.98 billion in 2008 to $6.04 billion in 2012. The deficit is expected to further fall to 1.69% of GDP for 2013 due to weak domestic demand, the orientation of production toward exports, and a marginal increase in cost-competitiveness due to falling unit labor costs.
As of late 2013, labor costs have declined by about 4.25% from their 2009 peak, which would give a further fillip to exports. Despite strong headwinds from the euro area, the deficit has declined—a trend that should continue—powered by growing exports.

**Future risks**

*Rising NPLs*

Rising NPLs are a cause for concern for the banking sector, which is dependent on the Bank Solvency Support Facility under the troika program. According to the IMF, NPLs had jumped from around 5.2% by the end of 2010 to around 10.4% by March 2013 (fig 5a), mainly from troubled loans to non-financial corporates. Despite ongoing restructuring efforts, the eight largest banks lost €900m in the first half of 2013 due to high credit impairments and declining net interest margins. The recession has also taken a toll on banks’ profitability and net interest margins (fig 5b). Troubled loans can jeopardize the stability of the banking system, as the banks do not have the ability to get funding from the market and are totally dependent on external funding from the troika.

**Figure 5: Banking sector statistics**

![Banking sector statistics](chart)

*Source:* (a), Bank of Portugal and (b), Bank of England
Social analysis

Overview

While Portugal has done relatively well in HDI, aging population poses a challenge like in other European countries. With inequality being another key problem facing the country, the government has taken steps to reform the labor market.

<table>
<thead>
<tr>
<th>Table 5: Analysis of Portugal's social system</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current strengths</td>
</tr>
<tr>
<td>■ Strong performance on the Human Development Index</td>
</tr>
<tr>
<td>■ Weak education system</td>
</tr>
<tr>
<td>Future prospects</td>
</tr>
<tr>
<td>■ Measures to reform the labor market</td>
</tr>
</tbody>
</table>

Source: MarketLine

Current strengths

**Strong performance on the Human Development Index**

Portugal has performed well on various social parameters. According to the United Nations Development Programme’s Human Development Report 2012, the Human Development Index (HDI) for Portugal was 0.816, which placed the country 43rd among 187 nations. During 1980–2012, Portugal's HDI rose by 1.0% annually from 0.644 to 0.816 as of 2012. Portugal has done reasonably well in terms of human development.

Current challenges

**High income inequality**

According to the OECD, income inequality is on the higher side in Portugal. The report "Divided We Stand: Why Inequality Keeps Rising", published in December 2011 shows that among the OECD countries, Portugal placed in fourth position, implying high inequality of market income with a Gini score of 0.46 (compared to the OECD average of 0.41). In terms of extended household income including services, Portugal’s Gini score was 0.29, which was higher than the OECD average of 0.24, reflecting higher inequality. Wage dispersion is also higher, with Portugal recording a score of 4.26, well above the OECD average of 3.33. In terms of inequality of household disposable income, Portugal is the fourth most unequal of the OECD nations with a Gini score of 0.35, compared with an OECD average of 0.31. High income inequality is a major cause for concern as it creates political, social and economic challenges and stifles upward social mobility. Taxes and benefits need to be reformed and redistributive policies need to be framed to tackle high inequality.

**Weak education system**

Portugal’s population is considered one of the least educated in the EU. According to the OECD, as of 2011, only 55.79% of Portugal’s working age population aged between 25 and 34 years old had has attained at least an upper secondary education, well below the OECD average of 82.26%. As of 2011, only around 26.92% of the total population aged between 25 and 34 years old had attained tertiary education, compared to the OECD average of around 38.62%
Furthermore, a lack of technical education has proved to be a huge liability in claiming high-income service opportunities during the recession. A skilled labor force with technical expertise is essential in securing high value service exports, which in turn can help the country to reduce its deficit.

Future prospects

Measures to reform the labor market

In accordance with the structural measures required under the bailout program, the government has taken steps to reduce segmentation of the labor market, fostering job creation and enhancing worker mobility. Furthermore, to reduce labor costs and enhance competitiveness, the government has cut vacations, national holidays, the cost of dismissals, and severance payments, introduced flexible working hours, relaxed wage setting agreements and given more importance to firm-level agreements, reduced overtime, and implemented mechanisms for labor market arbitration. Moreover, through various public-funded programs under Estímulo 2013, the government has provided incentives for hiring people unemployed for the medium to long term in return for on-the-job training. Another program, Impulso Jovem, has been designed specifically for unemployed youth. The measures are expected to reduce dualism in the labor market and increase flexibility for both employers and employees.

Future risks

Aging population

Besides immediate fiscal challenges, Portugal faces long-term demographic problems. With one of the lowest fertility rates in Europe, the Portuguese are aging at a fast pace (fig 7a). According to MarketLine, the percentage of the total population above 65 years of age was 18.20% in 2012; this is expected to reach 32% by 2060 according to The Ageing
PESTLE Analysis

Report 2012. According to the OECD, by 2060, the difference between public pension contribution revenue and pension expenditure as a percentage of GDP will have reached -4.9%, up from close to -1.5% of GDP in 2007 (fig 7b). In addition, according to The Ageing Report 2012, the working age population (15–64 year olds) will be 5.73 million by 2060, well below the 7.11 million recorded in 2010. This means the dependency ratio will increase, further straining the pension system and the social security budget. The sustainability of the pension system is a cause for concern in the long run, and urgent measures are needed to close the sustainability gap. According to the European Commission, Portugal will be one of the oldest nations in Europe by 2050. Unfavorable demographics in Portugal are likely to put severe pressure on government finances in the long run.

![Figure 7: Aging population](image)

**Total fertility rate, (a)**

**Difference between public pension contribution revenue and pension expenditure, percentage of GDP, 2007 and 2060, (b)**

**Average annual real net investment return of pension funds in selected European countries, (c)**

Source: (a), Eurostat and (b), (c), OECD

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Technological analysis

Overview

Being a service-based economy, growth in knowledge-based services is critical to Portugal. The nation does not have a competitive advantage over other countries in research, design, manufacturing technology or IT. A robust increase in broadband connectivity is an encouraging sign for e-commerce-based industries. However, Portugal’s R&D expenditure as a percentage of GDP is very low compared with other developed countries. In addition, Portugal has been granted very few patents, which shows that the country lacks a culture of innovation.

<table>
<thead>
<tr>
<th>Table 6: Analysis of Portugal's technology landscape</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current strengths</strong></td>
</tr>
<tr>
<td>■ Geographical advantage and low cost destination</td>
</tr>
<tr>
<td>■ Strength in producing doctorates, researchers, and scientific co-publications</td>
</tr>
<tr>
<td><strong>Current challenges</strong></td>
</tr>
<tr>
<td>■ Low R&amp;D expenditure as a percentage of GDP</td>
</tr>
<tr>
<td>■ Low number of patents granted</td>
</tr>
<tr>
<td><strong>Future prospects</strong></td>
</tr>
<tr>
<td>■ R&amp;D subsidies</td>
</tr>
<tr>
<td>■ Increase in commercialization</td>
</tr>
<tr>
<td><strong>Future risks</strong></td>
</tr>
<tr>
<td>■ Low share of high technology exports and falling receipts of royalties and license fees</td>
</tr>
<tr>
<td>■ Increasing competition from emerging nations</td>
</tr>
</tbody>
</table>

Source: MarketLine

Current strengths

Geographical advantage and low cost destination

Portugal’s geographical location gives it potential as a low cost producer and exporter in the EU. As the government increases its educational expenditure with an enhanced focus on improving science and technological aptitude, the establishment of research parks, and the availability of lower level technical labor, Portugal can offer a unique trading proposition to less developed former Portuguese colonies in Africa for technology transfers—as opposed to other developed EU countries.

Strength in producing doctorates, researchers, and scientific co-publications

According to the Innovation Union Competitiveness Report 2013, new doctoral graduates per 1,000 population aged 25 to 34 stood at 1.85 in 2010, well above the EU average of 1.69. International scientific co-publications per million population was 678 in 2011, more than double the European average of 300 in the same year. The figures reflect a strong technological foundation for Portugal’s R&D landscape.

Current challenges

Low R&D expenditure as a percentage of GDP

The country’s R&D expenditure as a percentage of GDP has remained very low. According to the Innovation Union Competitiveness Report 2013, R&D intensity (gross domestic expenditure on R&D as a percentage of GDP) stood at 1.50% in 2011, compared to the EU average of 2.03% in the same year. Business enterprise expenditure on R&D as a...
percentage of GDP stood at 0.69% in 2011, well below the EU average of 1.26% in the same year. Low R&D expenditure indicates that the country has to do a lot more in terms of fostering innovation in the country.

**Low number of patents granted**

The number of patents granted by the US Patent and Trademark Office to Portugal increased from 30 in 2011 to 40 in 2012; however, in comparison, Spain was granted 642 patents, Greece 82 patents, and Italy 2,120 patents. This indicates that the country has not consistently encouraged innovation and that the R&D scenario is not well developed. Portugal has not fostered a culture of innovation and R&D, and a continuation of the trend is likely to hamper the country’s scientific prospects.

**Future prospects**

**R&D subsidies**

R&D subsidies in Portugal are amongst the highest in OECD countries (fig 8) and are much above the EU average and those in the United States. R&D impetus is crucial to raising productivity and living standards and the government rightly provides high subsidies to this end. This could be helpful in the long run, as companies will find it more attractive to invest in innovation.

![Figure 8: Tax subsidies for one dollar of R&D expenditure](image)

Source: (a), Eurostat and (b), (c), OECD

**Increase in commercialization**

According to the Innovation Union Scoreboard 2013, “sales of new to market and new to firm innovation,” an indicator for commercialization, has been showing a positive trend. Further, this suggests that Portugal off late has performed well in establishing fast growing innovative companies. This could also mean that new enterprises in the innovative sectors are scaling up when compared to other European countries.
Future risks

Low share of high technology exports and falling receipts of royalties and license fees

High technology exports (as a percentage of manufactured exports) were 3.5% in 2011, in comparison to the OECD (16.5%) and EU (15.5%) averages, according to the World Bank (fig 9). Moreover, receipts from royalties and license fees have been low, and stood at $46.67 million in 2012, well below the country's peers such as Spain ($1.27 billion), Italy ($4.05 billion), and Ireland ($4.76 billion) in the same year. This indicates that the country is dependent on the export of low end products, and will face increasing competition from countries such as India and China, which have lower labor costs. Portugal needs to create an environment conducive to R&D, which would increase its percentage of high technology exports.

Figure 9: High-technology exports, 2011

Increasing competition from emerging nations

Many emerging economies in Asia and Latin America have been investing heavily in R&D, and recent predictions indicate that around 90% of an emerging global middle class will live in developing nations by 2025. Low cost emerging economies in Asia and Eastern Europe are further eroding the cost advantage that Portugal once offered. Considering this, a new global scientific landscape is imminent. As a result, Portugal will face fierce competition from the emerging economies, and will need to enhance scientific co-operation with the rest of Europe and the US and increase financial support for innovation.
Legal analysis

Overview

The Portuguese government has introduced measures to improve taxation and the judiciary. However, high tax wedges are a dampener. The government should do more to deregulate the product services market, which should help introduce competition in this space. In order to overhaul the judicial system, the government has passed the Judicial Organization Act in June 2013, which seeks to restructure and streamline the court network.

<table>
<thead>
<tr>
<th>Table 7: Analysis of Portugal's legal landscape</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current strengths</strong></td>
</tr>
<tr>
<td>■ Strong rule of law</td>
</tr>
<tr>
<td>■ Legal framework comparable to other EU nations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Future prospects</strong></th>
<th><strong>Future risks</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>■ Judicial reforms</td>
<td>■ Tax wedge</td>
</tr>
<tr>
<td>■ Comprehensive Corporate Income Tax (CIT) reform</td>
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Source: MarketLine

Current strengths

**Strong rule of law**

According to the World Bank's Worldwide Governance Indicators for 2012, Portugal ranked in the 82.46 percentile with respect to rule of law. A high ranking in this parameter indicates that the country has confidence in and abides by the rules of society, in particular the quality of contract enforcement, the police, and the courts. Portugal ranked much higher than Italy and Greece, which had percentile ranks of 62.09 and 63.51, respectively.

**Legal framework comparable to other EU nations**

Legal and regulatory aspects are crucial to creating a successful business environment in any country. They reflect the policy framework and the mindset of the government, and ensure that every company is functioning within the law. The regulatory regime in Portugal has comprehensive laws that are in line with most other EU nations. There are transparent laws for establishing companies in Portugal, and these regulations, although enforced by regions, follow EU directives to a great extent.

Current challenges

**High tax compliance cost**

According to Paying Taxes 2013, businesses in Portugal suffer from one of the highest tax compliance costs in the EU & EFTA area. It takes 275 hours to comply with taxes in Portugal, compared to the EU & EFTA average of 184 hours. A high tax compliance cost increases the burden on businesses and renders them uncompetitive.
**High product market regulation**

Though the government has taken steps to improve competition in various markets, Portugal has not performed well in product market regulation (fig 10). Product market indicators are a set of metrics that measure the extent to which policies framed by the government promote or inhibit competition in areas where competition is possible. Many of the sectors are regulated to a greater extent compared to elsewhere in Europe. This is indicative of a less competition-friendly market and monopolies in various sectors. The government should take measures to ease product market regulation to strengthen competition, especially in the network industries, retail sector and in a number of other professions. High regulation depresses the purchasing power of households and increases expenses for businesses through higher costs of production. Moreover, the easing of regulations will attract investment in various sectors, which will open up new avenues of employment.

![Figure 10: Product market regulation in selected European countries](image)

**Future prospects**

**Judicial reforms**

The Portuguese judiciary has normally been slow in resolving civil and commercial disputes, leading to a backlog of pending cases and an atmosphere of regulatory uncertainty for businesses. According to “Doing Business 2014”, the time needed to resolve commercial disputes was 547 days in Portugal, which is around double the number of days in the five top-performing OECD countries on this parameter.

In order to overhaul the system, the government has passed the Judicial Organization Act in June 2013, which seeks to restructure and streamline the court network. A new Code of Civil Procedure, in force since September 2013, has reduced the administrative burden and empowered judges. In its short-term objectives, the government has proposed to clear the backlog of enforcement and tax court cases. The government also plans to accelerate reforms of civil and enforcement court processes. The long-term plan is to strengthen oversight and monitoring of enforcement agents.
measures are expected to improve the Portuguese judiciary over the medium term given the credible progress made in the recent past.

**Comprehensive Corporate Income Tax (CIT) reform**

In 2013, the government announced a comprehensive corporate income tax reform to boost investment and growth. The reform measures include the gradual lowering of the rate to around 18% by 2018, the rationalization of incentive schemes and the broadening of the tax base. In addition, the government also proposed lowering compliance costs to reduce litigation and improve the international competitiveness of Portugal’s tax system.

**Future risks**

**Tax wedge**

According to the OECD, in 2012, Portugal has a higher (one-earner couple, two children) total tax wedge (Income tax, employer and employee social security contributions and pay roll tax as a percentage of labor costs) than the OECD average. The tax burden for one-earner couple, two children was 26.9% while for the OECD it was 26.1% in 2012. When it comes to the individual tax wedge (single, no child), Portugal once again had the higher tax wedge (36.7%) than the OECD average (35.6%) in 2012. High taxes on labor are likely to discourage local workers and deter prospective migrants with key skills. High taxes can also suppress entrepreneurial activity.
Environmental analysis

Overview

Portugal has done well in generating electricity from renewable sources, achieving the target it set for itself in 2010. Furthermore, the country has taken measures to protect its biodiversity. The country failed to carry out proper impact assessments before giving permission for tourist infrastructure in some ecologically sensitive areas, and this prompted the EC to send it a notice for violating the habitats and birds directives. In 2010, the EC requested that Portugal ensure that coastal developments in sensitive natural areas are fully compliant with EU environmental protection laws. Since then, innovative policies to protect biodiversity in coastal regions along with marine management have been introduced; however, implementation remains a challenge.

Table 8: Analysis of Portugal’s environmental landscape

<table>
<thead>
<tr>
<th>Current strengths</th>
<th>Current challenges</th>
</tr>
</thead>
<tbody>
<tr>
<td>■ Focus on renewable energy</td>
<td>■ Difficulty in implementing environment friendly policies</td>
</tr>
<tr>
<td>■ Initiatives on biodiversity protection</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Future prospects</th>
<th>Future risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>■ Funding of environmentally friendly technologies</td>
<td>■ Fiscal consolidation might affect environmental initiatives</td>
</tr>
<tr>
<td>■ Solar energy initiatives</td>
<td></td>
</tr>
</tbody>
</table>

Source: MarketLine

Current strengths

Focus on renewable energy

According to the Portuguese Renewable Energy Association, the country surpassed its end-of-decade target for the generation of electricity from renewable sources. At the end of Q1 2013, electricity from renewable sources accounted for 70% of consumption. According to the OECD, in 2009, Portugal achieved its target for reducing greenhouse gas emissions under the Kyoto Protocol for the period between 2008 and 2012. In recent years, as per the OECD’s Environmental Performance Review 2011, the renewable energy sector in Portugal has expanded its goals for energy production, which could result in the creation of nearly 10,000 jobs. Portugal aims to develop industrial activities linked to the renewable technology sector in order to become a net exporter of such technology, especially wind and solar power.
**Initiatives on biodiversity protection**

Portugal signed the Convention on Biological Diversity in 1993. As a part of its strategy to conserve its biodiversity, the government formulated the National Biodiversity Strategy and Action Plan (NBSAP), which is based on the following 10 guiding principles: an overall higher level of protection; the sustainable use of biological resources; prevention; precaution; recuperation; responsibility; integration; participation; international co-operation; and decentralization. The NBSAP then lists 10 fundamental strategies that form the basis of the action plan which include: promoting scientific research and knowledge of local patrimony; enhancing the National Protected Areas Network; promoting the valorization of the protected areas; and ensuring the conservation of all social, cultural, and natural components.

The NBSAP’s responsibilities include ensuring conservation and valorization of areas within the Natura 2000 network; implementing actions specific to the conservation and management of species and habitats of particular interest across the entire national territory; and integrating conservation and sustainable use principles into national and regional policies and laws. Finally, the NBSAP reinforces co-operation between all levels of administration; promotes education in conservation fields; ensures public education, awareness, and sensitization; and strengthens international co-operation. These measures have been taken with a view to meeting the objectives of the convention, and have succeeded in conserving biodiversity in the country.

**Current challenges**

**Difficulty in implementing environment friendly policies**

Portugal faces increasing difficulty in implementing environmental policies due to conflicting interests among various stakeholders, funding constraints, and fragmented institutions. The government needs to do away with environmentally
damaging tax concessions and implement green taxes instead. The share of environmental tax in total tax revenue has declined—this may lead to inefficient resource allocation. The price of scarce energy resources should take into account the environmental and social costs, and introducing a tax is an effective way to curb reckless use of non-renewable natural resources. Moreover, the distortive pricing mechanism is inhibiting the development of green technology.

Future prospects

Funding of environmentally friendly technologies

The Portuguese government has decided to encourage the adoption of environmentally friendly technology. In late 2008, Crédito Agrícola, the Portuguese agricultural savings and credit institution, launched Eco Soluções, which is aimed at financing environmentally friendly technologies. These loans can be used to purchase solar panels, photovoltaic panels, and micro wind turbines, as well as vehicles with low carbon dioxide emissions. Further, the government also subsidizes purchase of electric vehicles and has already installed around 1,500 charging points in various cities. This is expected to spur the adoption of environmentally friendly technology in the country.

Solar energy initiatives

Portugal’s efforts to stimulate energy production from renewable sources of energy have given rise to a large-scale solar energy project that could power 30,000 homes. The government has set a target to generate 670 MW of power from solar energy. In 2012, Portugal had added 67.8 MW of solar power, a big jump from 2011 when it added 32.4 MW of new
capacity. Although the rise of solar energy in Portugal has been slow, it is sure to gain popularity over time.

Future risks

*Fiscal consolidation might affect environmental initiatives*

In times when fiscal consolidation assumes prime importance, it will be a challenge for Portugal to increase its monetary allocation to environmental programs. Therefore, with the deterioration of public finances, it might be difficult for the government to pursue expensive environmental reforms with the same momentum as was seen in previous years. It may prove difficult to fund the environmental initiatives of the government in the near term.
Political Landscape

POLITICAL LANDSCAPE

Summary

Six years of socialist rule ended in March 2011 when Prime Minister Jose Socrates resigned after parliament opposed his proposed austerity budget. In June 2011, the center-right Social Democratic Party (Partido Social Democrata [PSD]) won the general election and formed a coalition government with the conservative Democratic and Social Centre – People’s Party (Centro Democrático e Social – Partido Popular [CDS-PP]) under the leadership of the new prime minister—PSD leader Pedro Passos Coelho.

Evolution

Pre-1945

During the 15th and 16th centuries, Portugal was a major naval power, and its extensive trading empire stretched from the Americas to Africa and South and East Asia. The 1755 Lisbon earthquake and an economic decline throughout the 18th and 19th century, compounded by Brazil’s independence in 1822, saw Portugal lose much of its power, prestige, and economic fortune. For much of the 20th century, Portugal was ruled by a repressive right-wing dictatorship, under which the economy stagnated and living standards fell significantly behind those of Northern Europe.

1945–2013

Following a bloodless coup against the military regime in 1974, Portugal embraced both the democratic model and the European project wholeheartedly. Economic development, led by the tourism industry, created a sustained increase in living standards. Membership of the European Union (EU) (then the European Economic Community [EEC]) in 1986 and Brussels development aid, as well as the flow of inward investment that accompanied it, added to the growing prosperity. Between 1995 and 2001, the center-left government presided over a sustained economic upturn. It also successfully steered Portugal into full euro membership, surprising the critics who doubted whether Portugal and other Southern European countries had the fiscal resolve necessary to meet the tough Maastricht convergence criteria. The economic downturn that started in 2001, combined with a marked fiscal deterioration and a series of policy blunders and u-turns, led to an early election in the spring of 2002, which was won convincingly by the center-right opposition.

The new government, under the leadership of Prime Minister Jose Manuel Barroso, demonstrated the political will needed to tackle the fiscal disarray that it inherited, pegging back the government deficit in 2002 through a mixture of tax increases, expenditure restraint, and asset sales. While reduced government spending, especially on infrastructure and education, had short-term implications, the newly introduced government policies were largely responsible for the stabilization of inflation. However, the departure of Barroso to head the European Commission (EC) in July 2004 and the election of the relatively inexperienced Pedro Santana Lopes as his successor heralded a sharp decline in the center-right government’s fortunes. In the parliamentary elections held in February 2005, the Portuguese Socialist Party (Partido Socialista [PS]) prevailed convincingly over its closest rival—the PSD—with 45% of the vote, and Jose Socrates was named prime minister. Anibal Cavaco Silva was elected president in January 2006 after the first round of voting, obtaining 50.6% of the vote. He was sworn to office in March 2006.

The Portuguese economy was suffering from severe structural problems when the PS came to power. The government faced pressing issues such as overstuffed public services and a large budget deficit, and had to address these problems as soon as it came to power. Although it successfully contained the budget deficit, it was not successful in restraining public expenditure. Furthermore, the government initiated reforms in the education and health sectors and the labor
market in the first half of 2008. These reform measures, however, were met with public protests from affected parties, which prompted the government to backtrack on some reforms, especially in the health and education sectors. Still, the PS government led by Socrates succeeded in most of its plans. The center-left PS retained power in the September 2009 general election.

However, Portugal faced mounting fiscal debt amid an economic slowdown in 2010. The economic troubles were further aggravated by downgrades from several leading credit rating agencies. The government did try to introduce an austerity budget including several expenditure cuts, but it faced public anger at pay cuts and restrictions. After six years of socialist rule in Portugal, in March 2011 Prime Minister Socrates had to resign after failing to pass his austerity budget through parliament. Following the resignation, the country faced a general election. The winning party, the center-right PSD, fell just short of an absolute majority and formed a coalition government with the smaller, conservative CDS-PP. Since June 2011, Portugal has been ruled by a PSD/CDS-PP coalition led by Prime Minister and PSD leader Passos Coelho.

Figure 14: Portugal – key political events

1910−44  
- Portugal was proclaimed a republic in 1910.  
- In the same year, Manuel Jose de Amilga was elected as the first president of republic.  
- General Antonio de Fragoso Camona became the president in 1926 after a coup.  
- Camona appointed Antonio de Oliveira Salazar as minister of finance in 1928.  
- Salazar became prime minister in 1932.  
- Salazar established “New State” (“Estado Novo”) constitution in 1933.  

1945−75  
- Portugal became a founding member of Nato in 1949.  
- In 1961, India annexed Portuguese Goa and rebellion broke out in Angola, Guinea and Mozambique.  
- Salazar was succeeded by Marcello Caetano in 1968.  
- Salazar died in 1970.  
- Guinea-Bissau, Mozambique, Cape Verde Islands, Sao Tome and Principe, and Angola gained independence during 1974−75

1976−99  
- Military Council of the Revolution was abolished and civilian government was formally restored in 1982.  
- Portugal became EEC (later EU) member in 1986.  
- Macau was handed over to Chinese administration in 1999.

2000−05  
- Social Democrat leader Jose Manuel Durao Barroso forms centre-right coalition after general election in 2002.  
- In 2003, forest fires swept across vast areas of woodland and damages were estimated at €1 billion.  
- Mr Barroso resigned as prime minister to become president of the European Commission in 2004.  
- Socialists achieved victory in general elections in 2005.  
- In the same year, economic and social reforms are greeted with a series of strikes.

2006 onwards  
- Anibal Cavaco Silva, centre-right prime minister during 1985–95, was elected as president in 2006.  
- Economic reforms were greeted with mass demonstrations in 2007.  
- In the same year Portugal took over EU presidency.  
- Portuguese parliament voted in favor of EU’s new treaty in 2008.  
- Socialist government was ousted by the Centre-right Social Democrat PSD-PP alliance in June 2011 elections.  
- Portugal sought €78bn from IMF and the EU in May 2011.

Source: MarketLine
Structure and policies

Key political figures

Key political figures in Portugal are:

- President Aníbal Antonio Cavaco Silva.
- Prime Minister Pedro Passos Coelho.

![Figure 15: Portugal – key political figures](image)

Aníbal Antonio Cavaco Silva is the president of Portugal. He was the prime minister of Portugal from November 1985 to October 1995. His tenure as prime minister was the longest since the time of Dr. Salazar. He won the January 2006 presidential poll to become the first centre-right president since the coup of 1974. He was re-elected as president in January 2011. The president can appoint prime ministers and call for elections. However, the role of the president in the country is largely ceremonial.

Pedro Passos Coelho is the prime minister of the country. He heads the coalition government that was formed in June 2011. Coelho’s Social Democratic Party won the elections by defeating Jose Socrates of the Socialist Party. Coelho’s government was forced to agree to implement austerity measures in return for a rescue package.

Source: MarketLine

Structure of government

The country’s legislative power rests in a 230-seat unicameral assembly of the republic, which is elected for a maximum term of four years. The president of the republic is directly elected for a five-year term. The president has no executive power, but has a role in foreign policy (in former colonies such as East Timor) and plays an important role as a political arbiter, while maintaining political neutrality. The president is also commander-in-chief of Portugal’s armed forces.

Key political parties

Mario Soares founded the PS in Germany in 1973. After the 1974 coup, the party challenged the Portuguese Communist Party (Partido Comunista Português [PCP]) for the working class vote and gained popular support. The PS was in opposition for 10 years and went on to form minority governments in 1995–99 and 1999–2002 under the leadership of Antonio Guterres. The PS promotes policies such as European integration and privatization and puts great emphasis on social spending.

The PS not only prevailed in the June 2004 elections to European Parliament, but led by Socrates, also won an overall majority in the national parliament in the 2005 general election. In June 2009, the PS lost the European Parliament election to the PSD, but it won the general election in September 2009, forming a minority government.
Political Landscape

The Portuguese economy suffered a setback in the 2009 financial crisis, resulting in a large fiscal deficit. In order to bring the fiscal deficit under control, Prime Minister Socrates announced an austerity budget in 2011. The cut in government expenditure and tax increases were resisted by the entire opposition, and triggered Socrates’s resignation. Socialist rule ended with the party’s defeat in the general election in June 2011. Having lost by a higher margin than expected, Socrates resigned as the general secretary of the PS in June 2011. The present party secretary is Antonio Jose Seguro. The PSD was founded in 1974 and its leader, Francisco de Sa Carneiro, was elected as prime minister in 1979. However, his death in 1980 in a plane crash was followed by five years of infighting. Anibal Cavaco Silva became party leader in 1985, and he favored pro-market and pro-European policies. The PSD subsequently dominated the political scene for 10 years, but was defeated in the 1995–96 elections. The PSD came back to power in a coalition with the CDS-PP following the 2002 elections under the leadership of Barroso. Subsequently, however, the party suffered its worst electoral defeat since the 1980s in the early general election in February 2005 under the leadership of Lopes. After losing the general election in 2009, the party was the largest opposition in parliament until June 2011, when it won 38% of the vote and formed a coalition government with the ultra-conservative CDS-PP. The CDS-PP emerged as the new right-wing under the leadership of Manuel Monteiro in the 1990s, adopting an anti-EU stance. However, this was later reversed under the leadership of Paulo Portas, who adopted a more restrained and moderate line. The party has similar policies to the PSD; indeed, the two were in a coalition government during 2002–05. In 2009, the party won 21 seats, which increased to 24 seats in the 2011 general election. At present, the CDS-PP is once again in a coalition government with the PSD.

Composition of government

In the 2011 general election, the PSD won 108 seats in parliament; the PS won 74 seats; the CDS-PP won 24 seats; the PCP/Green Ecologist Party won 16 seats; and the Left Bloc (BE) won eight seats. The PSD formed a coalition government with the CDS-PP under the leadership of Passos Coelho. The PS is the largest opposition party.
Key policies

**Economic policies**

After the bailout deal from the EU and the International Monetary Fund (IMF) in 2011, the country has had to abide by agreements concerning structural reforms and an austerity drive, which will be closely monitored by the EU. Economic policy revolves around conditions attached to the bailout program. The government is continuing with the process of fiscal consolidation along with structural fiscal measures and belt-tightening on fiscal policy over public-private partnerships and public enterprises. Moreover, the government has been taking measures to shore up banks’ balance sheets against disorderly deleveraging, as well as creating backup facilities. In addition, structural reforms are being stressed in order to improve competitiveness and boost potential growth. The conditions mandate that Portugal is to implement comprehensive measures including the privatization of state-owned enterprises and the reform of its labor market and legal sector. The Portuguese government has been implementing wide-ranging reforms in the country. The government has also embarked upon tax increases and cuts in public spending. Portugal was given conditional financial assistance to the tune of €78bn from the IMF, the EU, and the European Central Bank (ECB) in May 2011, which necessitates structural reforms in public finance, job creation, and overall competitiveness.

**Social policies**

The government has recently decided to initiate reforms to cut social spending and make up for the budget shortfall. The government has approved measures to reduce social security benefits. Measures will be implemented to reduce expenditure on medicines and other health costs. As part of the austerity drive, there has also been a significant reduction in unemployment benefits and pension plans. In addition, measures have been taken to reduce labor market duality, retain the minimum wage, and introduce progressive cuts of pensions and public wages. Moreover, the eligibility period for receiving unemployment benefits was relaxed.
Political Landscape

Foreign policies

Portugal is a founding member of the North Atlantic Treaty Organization (NATO) and entered the EEC in 1986, which went on to become the EU in 1994. It held the six-month presidency of the EEC/EU in 1992, 2000, and in 2007. When Portugal held the presidency of the EU during July to December 2007, the EU reform treaty was signed by all 27 countries. Moreover, Portugal is a founding member of the Organisation for Economic Co-operation and Development (OECD) (1961).

The country has friendly and strong relations with the US, which has an air force base at Terceira in the Azores. In addition, NATO has a command center near Lisbon. Furthermore, Portugal, along with 14 other European countries, signed the Schengen Agreement in 1990, which eliminates border controls between signatory countries. Portugal is a major contributor to peacekeeping operations in Africa, and has deployed troops in Afghanistan, Lebanon, and Bosnia. Portugal is one of the most significant European contributors to international peacekeeping operations in per capita terms around the world.

The EU, transatlantic ties, and Lusophone states form the cornerstone of Portugal’s foreign policy, of which the EU is the most important. EU policies and regulations direct Portuguese laws and policies. An active participant in UN organizations, Portugal is seeking a seat on the Human Rights Council for 2014–17. Portuguese forces participate in many UN operations, including those in Congo, Guinea, Lebanon, and Timor-Leste.

Portugal’s former colony of East Timor remains an important focus area; in fact, the country did not recognize the annexation of the colony in 1975 by Indonesia. Furthermore, Portugal pursued the cause of East Timorese independence in international forums for many years. In the subsequent period of the UN Transitional Authority, Portugal was engaged in helping East Timor in its transition to independence. Portuguese armed forces and around 130 paramilitary police have participated in UN Security Council-endorsed activities in the area. Portugal remains a significant donor in terms of bilateral trade to East Timor and actively advocates EU assistance for the country.

Portugal is the key member of the Community of Portuguese-Speaking Countries, an organization headquartered in Lisbon that promotes bilateral relations between Portugal and the former Portuguese-speaking countries in Latin America and Africa. Moreover, during 2011–13 bilateral relations grew between China and Portugal in both the commercial and technological spheres. Expanding relations with China should help Portugal gain access to a major growing economy, giving it a platform to reach out to developing Asia.

Performance

Governance indicators

The World Bank report on governance used voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption as indicators for 215 countries and territories over 1996–2012. Daniel Kaufmann of the Brookings Institution, Massimo Mastruzzi of the World Bank Institute, and Aart Kraay of the World Bank Development Economics Research Group conducted the study. For any country, a percentile rank of zero corresponds to the lowest possible score and a percentile rank of 100 corresponds to the highest possible score.

As of 2012, Portugal was ranked in the 78.20 percentile for voice and accountability. This parameter measures the extent to which a country’s citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and freedom of the media. After the 1974 Revolution of the Carnations that overthrew its long-running dictatorship, Portugal embarked on a course of rapid democratization, and the country has done remarkably well to preserve its traditions of a direct democracy in which citizens are involved in important legislation. In comparison,
Spain had a percentile ranking of 79.62.

Portugal’s percentile ranking was 69.67 for political stability and absence of violence in 2012. This was mainly due to the minority government managing the challenging economic environment after the recession. In comparison, Spain had a lower percentile rank of 43.13.

In terms of government effectiveness, Portugal had a percentile rank of 81.34 in 2012. Government effectiveness measures the quality of public and civil services, and the degree of governmental independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies. In comparison, Spain had a higher percentile rank of 82.30.

Portugal’s percentile ranking in terms of regulatory quality was 75.60 in 2012. Regulatory quality measures the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. In comparison, Spain had a higher percentile rank of 77.99.

On the rule of law parameter, Portugal’s percentile ranking was 82.46 in 2012. Rule of law measures the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence. In comparison, Spain had a higher percentile rank of 83.41.

Portugal’s percentile ranking in terms of control of corruption was 78.47 in 2012. Portugal has ratified the OECD Anti-Bribery Convention and has passed legislation to bring its criminal code into line with it. In comparison, Spain had a higher percentile rank of 81.82.

**Outlook**

The overall political climate is expected to be stable due to the clear majority held by the PSD/CDS-PP coalition after the general election in June 2011. Prime Minister Passos Coelho has shown the will to implement structural reforms in the country. If the government continues to internalize the culture of fiscal discipline and implement structural reforms with the same political will, then the possibility exists that Portugal will emerge successfully from the current fiscal turmoil. The political will of the government reflects in the gradual improvement in the economy. The assessments made by the IMF in November 2012 were positive. In their eighth and ninth review missions to Portugal, the IMF reported that the nation had progressed toward the program objectives and consequently approved a €1.91 billion disbursement.
ECONOMIC LANDSCAPE

Summary

Portugal has undertaken a wide range of reforms to liberalize the economy over the past two decades, and membership of the European Union (EU) has hastened its reforms. These reforms spurred GDP growth, and Portugal managed to match the living standards of more affluent Organisation for Economic Co-operation and Development (OECD) economies in early 2000. Thereafter, however, growth stalled, unemployment increased substantially, and the convergence process suffered a reversal. Lower tariffs on cheap textiles from Asia and the inclusion of China in the World Trade Organization hurt the Portuguese economy, which until then was largely dependent on cheap textile exports. Further, limited technical knowledge and poor educational attainment at the tertiary level have eroded the country’s competitiveness and ability to move up the export value chain. It was not until 2004 that economic growth picked up again, thanks in part to a renewed effort at macroeconomic and structural reforms. Growth averaged 1.54% during 2004–07.

However, the global economic crisis led to a contraction by 0.01% in 2008 and by 2.91% in 2009. Amidst a weak economy, cheap credit inflows pushed the country’s net external debt to more than 100% of GDP in 2010. An increase in borrowing costs after parliament refused to pass the austerity bill in March 2011 led Portugal to seek a €78bn bailout from the EU and the International Monetary Fund (IMF). As per the terms of the bailout package, the government is on course to implement several austerity measures and structural reforms. There has also been an unprecedented cut in government spending in the social sector, particularly on pensions and unemployment benefits.

Evolution

Pre-1950

Although the first republic ended in a military coup, the new government failed to solve the difficult economic problems. Therefore, President Oscar de Fragoso Carmona invited Antonio de Oliveira Salazar to head the ministry of finance, who agreed on condition that he would have the power to veto all fiscal expenditure. Salazar was the finance minister during 1928–32 and he went on to become prime minister during 1932–68. Salazar’s political and economic philosophy shaped Portugal’s destiny in those 36 years. His economic view was based on the pillars of a balanced budget and monetary stability. Between the 1930s and 1960s, the country always had a surplus, which gave the state the wherewithal to finance public infrastructure projects without resorting either to inflationary financing or to borrowing from outside.

At the peak of the great depression in the early 1930s, Salazar had laid the foundation of his estado novo (the “new state”), which was neither capitalist nor communist. This new state was based on the principles of extensive state regulation and predominantly private ownership of the means of production. Moreover, the state exercised extensive de facto authority over private investment decisions and the level of wages. The central state apparatus controlled the entire corporate institutional network, including the setting up or relocating of industrial plants, and investing in machinery and equipment designed to increase the capacity of existing firms.

1950–90

A moderately outward-looking trade and financial strategy was initiated in the late 1950s, which gained momentum during the early 1960s. Most industrialists and technocrats favored greater integration with the countries in the north, in the belief that this would help spur the Portuguese economy. A number of Europe-oriented technocrats found a place in Salazar’s government, which led to an increase in foreign investment. The projected foreign investment component...
during the first plan (1953–58) was envisaged at less than 6% of total investment, which increased to 25% during the second economic development plan (1959–64). Moreover, the same technocrats favored a policy that Portugal should become a charter member of the European Free Trade Association (EFTA) when it was organized in 1959. Furthermore, Portugal joined the General Agreement on Tariffs and Trade (GATT), the IMF, and the World Bank in 1960.

To conform to the EFTA and GATT guidelines, the Portuguese government liberalized the industrial licensing system and reduced trade barriers. Salazar's successor, Prime Minister Marcello Jose das Neves Caetano (1968–74), continued with the process of liberalization, as under his administration industrial licensing requirements for firms in most sectors were abolished. Furthermore, a free trade agreement was signed with the newly enlarged European Economic Community (EEC) in 1972. Under the new guidelines of the EEC, Portugal was given until 1980 to abolish its restrictions on most community goods and until 1985 on certain sensitive products. Membership of the EFTA and GATT led to industrial modernization and diversification of its exports during 1960–73.

Portugal's per capita GDP was only 38% of the EEC average in 1960, but by the end of the Salazar period in 1968 it had risen to 48%. In 1973, on the eve of the revolution, Portugal's per capita GDP had reached 56.4% of the EEC average. In 1975, the year of maximum revolutionary turmoil, per capita GDP declined to 52.3% of the EEC average. It was only after 1985 that Portugal's economic resurgence drove the convergence of real GDP growth toward the EEC average.

**Figure 17: Portugal's historical GDP growth, 1992–2012**

![Graph showing Portugal's historical GDP growth, 1992–2012](image-url)
1991–2013

During the late 1990s, headline indicators of Portugal’s economic performance were generally good. GDP growth averaged 4.23% per year during 1996–2000. Inflation, although above the EU average, remained in low single figures. Unemployment fell markedly, from 7.29% in 1996 to 3.97% in 2000, while the labor market participation rate remained high, reflecting a notably better labor market performance than that of Spain and other continental European economies.

Against a weakening global backdrop, GDP growth fell back to 1.97% in 2001 and slid further in 2002, registering a mere 0.76% growth rate. Rising inflation and a downturn in the labor market added to the negative economic picture. In 2002, inflation stood at 3.55%, edging close to double that of the European Central Bank’s (ECB’s) target of 2%, while unemployment accelerated to 5.06%. In addition, the external deficit decreased because of declining domestic demand. The overall picture continued to darken in 2003, as output contracted because of a steep decline in domestic demand, and unemployment rose to 6.34%. However, the weaker conditions led to a modest decline in inflation and the external current account deficit. Due to subdued economic activity, inflation was modest at around 2.33% in 2004, although it again increased to 3.10% in 2006. Weak domestic demand and rising unit labor costs severely hampered the economy in 2005, with growth a meager 0.78%. The unemployment rates continued to rise from 6.70% in 2004 to 7.75% in 2006. The economy improved in 2006, with real GDP growing by 1.45% in 2006 and 2.37% in 2007, due to growth in external demand. The economy contracted marginally during 2008 before the global economic crisis took a toll on Portugal, leading to a 2.91% contraction in 2009. Portugal emerged from recession in 2010, growing by 1.93% owing to an increase in private consumption, but contracted by 1.42% in 2011 and 3.21% in 2012, as the debt crisis lingered.

In 2011, the then minority government failed to pass the austerity budget in parliament, leading to a sharp rise in borrowing costs. This pushed the country to seek a bailout. This €78bn bailout from the EU and the IMF came with a string of conditions, which led to structural reforms and policy overhauls to bring the economy back on track.

Structure and policies

Financial authorities and regulators

Banco de Portugal is the central bank of the country and is an integral part of the eurosystem. It issues banknotes, however, the European Central Bank has the exclusive right to authorize the issue of the banknotes. Other function is to oversee and promote the smooth operation of payment systems, and manage the nation’s foreign assets. The bank also acts as an intermediary in the international monetary relations of the state and advises the government in economic and financial matters. It is headed by the governor and the board of directors and is largely independent of the political power structure.

Due to the increasing integration and interdependence of the financial sectors, the Portuguese government proposed to strengthen co-ordination between the three financial sector supervisory authorities through the National Council of Financial Supervisors (Conselho Nacional de Supervisores Financeiros [CNSF]). The permanent members are the governor of the Banco de Portugal (the member of the board of directors of the bank responsible for the supervision of credit institutions and financial companies), the chairman of the Securities Market Commission, and the chairman of the Instituto de Seguros de Portugal. The chairperson is the governor of the Banco de Portugal. The council has the following responsibilities:

- Foster co-ordination of actions undertaken by the supervisory authorities.
- Facilitate the exchange of information between the supervisory authorities.
- Foster the development of supervisory rules and mechanisms for financial conglomerates.
Economic Landscape

- Formulate proposals for the regulation of issues within the scope of more than one of the supervisory authorities.
- Issue opinions at the request of the minister of finance or the governor of the Banco de Portugal, or on the CNSF’s own initiative regarding any matter within its remit.
- Stimulate the definition or adoption of co-ordinated policy measures with foreign entities and international organizations.
- Continue any activities that its members deem adequate for the purposes of the CNSF.

The CNSF has created efficient channels for communicating material information and co-ordinating the activities of the three regulators with a view to eliminating conflicts of power, regulatory hiatus, and multiple use of resources.

The Instituto de Seguros de Portugal (ISP) is the regulatory and supervisory authority of the insurance sector. The ISP endeavors to protect policyholders, insured persons, members, and beneficiaries. In its supervisory role, it monitors the activity of insurance undertakings, intermediaries, and pension fund managers, and ensures their compliance with applicable legislation.

**Stock markets**

The Lisbon exchange was started on January 1, 1769, on the east side of the Praça do Comércio, and the Porto Stock Exchange was created a century later. The Lisbon Stock Exchange went through some difficult times in the early 1970s and eventually closed down. However, on February 28, 1977, all the transactions of all the securities listed on the Lisbon Stock Exchange restarted. Four years later the Porto Stock Exchange began to trade. Euronext Lisbon was created in 2002 when Euronext NV bought up all Bolsa de Valores de Lisboa e Porto shares. The exchange was amalgamated into the pan-European exchange. In 2007, NYSE and Euronext merged and Euronext Lisbon became a part of NYSE Euronext group. The market capitalization of NYSE Euronext (Europe) as of October 2013 stood at $3.48 trillion.

**Insurance**

The leading companies in the non-life segment are Fidelidade Mundial, Império Bonança, AXA Portugal Seguros, Tranquilidade, and Zurich. The leading life insurance companies are Fidelidade Mundial, Ocidental Vida, Santander Totta, Bes Vida, and BPI Vida. Total premiums of both the life and non-life segment amounted to $13.55 billion in 2012.

**Performance**

**GDP and growth rate**

Portugal joined the EEC in 1986 and enjoyed a long economic boom in the 1990s, driven by its status as a low cost agricultural and industrial base. However, annual GDP growth slowed to an average of 0.83% over 2001–05 in the face of increasing competition from Eastern European and Asian manufacturers. GDP grew at a reasonably good rate of 2.37% in 2007. However, the economy was hit by the financial crisis, and contracted in 2008 and 2009. The economy registered modest recovery to achieve growth of 1.93% in 2010; however, it contracted again in 2011 and 2012 by 1.42% and 3.21%. According to MarketLine’s forecasts, the economy will further contract in 2013 although to a much lesser extent than in 2012.
GDP composition by sector

The Portuguese economy is largely dependent on the services sector, which is estimated to have contributed 76.11% of GDP in 2013, compared to the 21.63% and 2.26% contributed by the industrial and agricultural sectors. The country’s major industries include automotive components, tourism, textiles, footwear, wood products, metalworking, oil refining, chemicals, wine, and wood-pulp and paper. Tourism constitutes a key part of the services sector in the country.
Agriculture

Wine, fresh fruits, and vegetables are Portugal's main agricultural products, and they represent about one third of overall agricultural production. Grape vines grow in nearly all parts of the country, and around 350,000 hectares are dedicated to wine production. Portugal has vast forest cover, making it a key supplier to furniture manufacturers like Ikea; it is also the world's largest supplier of cork.

Agricultural output declined from €3.22 billion in 2012 to €3.19 billion in 2013. Crop yield and animal productivity in Portugal are lower than the EU average owing to low agricultural investment and mechanization, the limited use of fertilizers, and fragmented land use. Low productivity is also linked to the poor educational standard of farmers and inadequate distribution and infrastructure channels.
Industry

Although Portugal is gradually shifting toward becoming a service-based economy, its manufacturing industry has witnessed considerable expansion in terms of both level of output and value added, particularly since Portugal joined the EU. However, the global financial crisis slowed down the growth momentum witnessed up until 2008. The traditional sectors such as textiles, clothing, footwear, ceramics, ornamental stones, food, and beverages continue to maintain significant importance in total manufacturing activity in Portugal. The industries that stand out, especially with regards to greater technological content, are the automotive sector and its components, molds, electrical machinery, paper, and plastic materials.

Industrial output declined from €32.12 billion in 2012 to €30.56 billion in 2013. Industrial output contracted by 4.84% in 2013.
**Services**

The services sector in Portugal includes wholesale and retail trade; hotels and tourism; restaurants; transport, storage, and communication; real estate; banking and finance; repair; and the government, civil, and public sectors. The services sector’s output contracted from €108.78 billion in 2012 to €107.57 billion in 2013. Services output contracted by 1.11% in 2013.
Fiscal situation
Portugal’s general government deficit stood at 6.4% of GDP in 2012, one of the highest among the European nations, according to Eurostat. The public debt to GDP ratio was also high at a whopping 124.1% in 2012 according to the Eurostat, and expected to increase in the medium term.

Exports and imports
Exports were $82.54 billion in 2012 while imports were valued at $85.40 billion in the same year. Total trade was down to $167.94 billion in 2012, down from $184.23 billion in 2011. The country’s main export partners as of 2012 were Spain (22.7%), Germany (12.4%), France (11.9%), Angola (6.5%), UK (5.3%) and Netherlands (4.2%), according to CIA – The World Factbook. The main import partners were Spain (32%), Germany (11.5%), France (6.6%), Italy (5.3%) and the Netherlands (4.9%).
International investment position

**Foreign direct and portfolio investments**

FDI inflows fell to $8.91 billion in 2012, from $11.15 billion in 2011, according to the UNCTAD World Investment Report 2013.

**Key monetary indicators**

**Inflation**

According to MarketLine, inflation stood at 2.80% in 2012 and is expected to go down to 0.56% in 2013, due to slack in domestic demand.

As of November 2013, the ECB held the eurozone interest rate at 0.25%. The bank has kept rates low in a bid to stimulate the eurozone economy following the global economic crisis.
Employment

According to MarketLine, Portugal's unemployment rate reached 15.69% in 2012, up from 12.77% in 2011. Rising unemployment has been mainly due to economic contraction and adjustments in corporate balance sheets. Moreover, structural shifts in moving toward non-tradable sectors (not export-oriented), which are less labor-intensive, have also contributed to the spike in unemployment. The job losses in wholesale and retail trade, hotels and restaurants and construction contributed to more than one third of total jobs lost. According to the Eurostat, as of 2012 youth unemployment stood at 37.8%. High unemployment is a major challenge as it will lower consumer confidence and will further deter economic growth.
Outlook

Fiscal consolidation and various structural reforms have helped the economy to reduce its huge deficit, however, much more needs to be done, as it is still high. Further reforms in education and the relaxation of stringent labor laws are essential to improved competitiveness and an economic revival. Rising non-performing loans are a cause for concern. Falling private consumption and a massive fall in productive investments are going to hurt growth and job prospects. The economy is expected to stay in recession in 2013. However, on the brighter side, the economy has started to show some upturn as reflected in the Portuguese economy’s GDP growth of 1.1% in the second quarter of 2013. The government’s fiscal consolidation measures have been commendable, although the extent of successful implementation remains uncertain, amid growing protests by the people and political parties.
SOCIAL LANDSCAPE

Summary

The Portuguese constitution guarantees a citizen’s right to health through a universal, comprehensive, and free National Health Service (NHS). The social security system in the country comprises pensions, unemployment benefits, and care insurance. The income gap in Portugal is increasing, and the president of the country has criticized it. The government is trying to contain social expenditure in an effort to bring down the fiscal deficit. Further cuts are expected in the medium term.

Evolution

Primary healthcare was not the subject of public intervention until the 1960s when new powers were established for its financing and organization. The principle of a citizen’s right to health was embodied in the Portuguese constitution as early as 1976, which stipulated that citizens’ healthcare should be delivered through a universal, comprehensive, and free NHS (National Health Service). The law enabling the implementation of this principle was not passed until 1979. This law laid down the principles of centralized control but decentralized management within the NHS. Central, regional, and local bodies were established to this end, bringing together public health services and the health services provided by social welfare, leaving the general social security system to provide cash benefits and other social services (for instance, to the elderly and children).

Structure and policies

Demographic composition

Age and gender composition

In 2012, 18.20% of the Portuguese population was above 65 years of age. Around 65.70% of the population belongs to the 15–64 age group and 16.10% are in the 0–14 age group. This age structure is similar to the demographic trend in the rest of Europe, where populations are aging and fewer people are entering the workforce. According to CIA – The World Factbook, the sex ratio at birth was 1.07 males per female in 2013. The infant mortality rate was 4.54 deaths per 1,000 live births in 2013.
Religious composition

According to the 2001 census, Roman Catholics constituted 84.5% of the total population, other Christians constituted 2.2%, unknown religions 9%, and others 0.3%; people who follow no religion constituted 3.9% of the total population.
Education

The education system in Portugal is governed by the constitution of 1976. The constitution guarantees the right to start private schools and grants priority to the elimination of illiteracy and the providing of special education to those children who need it. The constitution also guarantees the autonomy of universities. Furthermore, it guarantees the rights of teachers and students to take part in the democratic administration of the schools. In addition to the constitution, Portuguese education has been governed by decree laws promulgated by the executive branch, some of which date back to the 18th century.

Basic education in the country is compulsory up to the age of 14, which is followed by an optional secondary curriculum (either general or vocational) up to the age of 17. Basic education is divided into three stages of four, two, and three years respectively. Secondary education is optional and consists of a three-year cycle after having completed the third cycle of basic education. Access to secondary education is through the Certificate of Basic Education. There are two types of courses: general courses and technical/vocational courses, providing instruction in technical, technological, and professional fields as well as in the Portuguese language and culture. Higher education in Portugal is divided into two subsystems: university education and non-university higher education (polytechnic education).

Performance

Healthcare

In 2011, total healthcare spending accounted for 10.45% of GDP, which in absolute terms reached $24.86 billion, up from $24.49 billion in 2010. The number of physicians per 1,000 population stood at 4.0 in 2011, in comparison to the OECD average of 3.2, according to OECD. However, the number of nurses per 1,000 population stood at 6.1 in 2011, which is well below the OECD average of 8.7.

Figure 27: Expenditure on healthcare in Portugal, 2005–11

Source: Country Statistics, MarketLine
Social Landscape

Education

Portugal’s public education expenditure was $15.97 billion (6.72% of GDP) in 2011. One of the serious problems affecting the country is the low level of education among the young, with many leaving school before completing their secondary education. Although the literacy rate was 95.4% in 2011, according to CIA – The World Factbook, educational attainment at the tertiary level is on the lower side. This low level of educational attainment is a great challenge for the country in an increasingly knowledge-based economy.

Outlook

To counter fiscal challenges, the Portuguese government implemented measures to contain social expenditure in the 2013 budget, and further measures have been proposed for the 2014 budget. It is imperative that the government reforms social welfare programs to reduce expenditure and contain the fiscal deficit. In accordance with the structural measures required under the bailout program, the government has taken steps to reduce the segmentation of the labor market, fostering job creation and enhancing worker mobility. The country still faces the issue of an aging population and a widening income gap.
TECHNOLOGICAL LANDSCAPE

Summary

The establishment of the Ministry for Science and Technology encouraged the development of industry within the country. Portugal has witnessed a sharp increase in its broadband penetration rate in recent years. Although research and development (R&D) expenditure contracted between 2001 and 2011 (at an average rate of -0.16% when compared a growth of 0.8% in the EU), the country’s expenditure on R&D as a percentage of GDP stood at 1.50% (EU average of 2.03% of GDP) in 2011.

Evolution

The Ministry for Science and Technology, which was created in 1995, has contributed to the development of the science and technology system. Successive governments have attempted to encourage R&D in the country. In 1996, a systematic evaluation process was initiated, which was to be carried out every three years. At the same time, Portugal has benefited from considerable structural funds for science and technology through successive community support framework programs.

Structure and policies

The technological plan outlines Portugal’s main innovation policy objectives. Many of them were reasserted in later documents, namely the Lisbon National Reform Program, the Commitment to Science document, and the NSRF 2007–13. The innovation part of the technological plan is aimed at fostering R&D in the business sector by facilitating the adaptation of economic structures to the challenges of globalization. Furthermore, the NSRF 2007–13 has the objective of increasing the skills of Portuguese citizens and fostering innovation in the country. The NSRF also encourages knowledge creation, dissemination of science and technology, and the use of technology for the creation of high and sustained levels of economic and social development. However, a systemic, consistent approach to innovation policy is still lacking.

The main guidelines of the science and technology policy in the country are:

- Overcome backwardness and strengthen scientific institutions.
- Improve research quality by fostering internationalization and diversifying partnerships.
- Support technological ability and business innovation.
- Establish roots of science in the country and strengthen scientific and technological culture.
- Promote the information society.

Intellectual property

The number of patents granted by the US Patent and Trademark Office (USPTO) to Portugal increased from 17 in 2009 to 40 in 2012; however, in the same year Spain was granted 642 patents, Greece 82 patents, and Italy 2,120 patents. There has not been a substantial improvement in the innovation scenario in the country, which indicates that Portugal has not consistently encouraged innovation and that the R&D scenario is not well developed. Portugal has not fostered a culture of innovation and R&D, and any continuation of this trend is likely to hamper the country’s scientific prospects.
Performance

Mobile and internet

According to MarketLine, mobile penetration stood at 159.30 per 100 people in 2012 with total subscribers at 17.02 million. Mobile subscribers grew by an average of 10.92% during 2000–12. Internet users as of 2012 stood at 6.84 million, with a penetration rate of 64% of the total population in the same year. Internet subscribers grew at an average rate of 12.82% during 2000–12.
Technological Landscape

Outlook

The country’s R&D expenditure as a percentage of GDP and its investment toward innovation has remained rather low. The Portuguese government targeted improving the innovation climate in the country through the formation of the NSRF 2007–13. Moreover, there is a consensus in Portuguese society that innovation has a key role to play in the contemporary world. The trade unions also appear to increasingly recognize the need for innovation and change if Portugal is to respond to the globalization challenge.

The initiatives taken by the government would go a long way in fostering R&D. However, the country’s low share of high technology exports and falling receipts from royalties and license fees will remain a challenge in the near term.
LEGAL LANDSCAPE

Summary

The judiciary is independent and impartial in Portugal, and the legal system is based on the civil law system. Ordinary and special courts such as the constitutional court and the Supreme Court administer justice in the country. Portugal has courts of first instance in every district and courts of appeal, at Lisbon, Oporto, Coimbra, Evora, and Guimaraes. After being reintroduced in 1976, the jury system is used only when it is requested by either the prosecutor or the defendant. The country has relatively rigid employment regulations, which impede its productivity growth and employment opportunities.

Evolution

Portugal is ruled under the constitution of 1976, which provided for a parliamentary system, elections, a parliament, and a prime minister. The constitution also provided for an independent judiciary and the establishment of human rights. The constitutional revisions of 1982 and 1989 included provisions such as the rights of workers and the desirability of a socialist economy. Under these revisions, which were proposed by Portuguese Communist Party and Socialist Party representatives, business activity and private investment were restricted. The revisions also included a singular objective for the country, which was to transition to a socialist republic. The military was given enormous political power through the Armed Forces Movement-controlled Council of Revolution. The council functioned as a constitutional court and ensured that the laws passed by parliament were in accordance with its desires.

A combination of center-right and left forces managed to end military control in 1982 by abolishing the Council of Revolution. The Higher Council of National Defense was constituted in place of the Council of Revolution, and it had a say only in military-related matters. A constitutional court was created to review the constitutionality of the legislation passed by parliament. Of the 13 judges, the Assembly of the Republic chose 10, which ensured that it was under parliamentary control. The second review of the constitution was brought about in 1989, which disposed with economic restrictions and the socialist ideas that were incorporated in the early 1980s. These changes in the constitution enabled the government to privatize state corporations. In order to overhaul the system, the government has passed the Judicial Organization Act in June 2013, which seeks to restructure and streamline the court network. In addition, a new Code of Civil Procedure has come into force since September 2013 to reduce excessive administrative burdens, and it empowers the judges on various lines. In its short-term objectives, the government has proposed to resolve the backlog of enforcement and tax court case while it proposed to accelerate the process of reforming court organization, civil and enforcement court processes, and strengthening oversight and monitoring of enforcement agents as its long-term agenda. The system has been able to review all pending cases as of May 2011 and more than 45% of the half a million cases have been resolved due to the government’s judicial reforms.

Structure and policies

Judicial system

Roman civil law was the basis of the Portuguese legal and judicial system. It was also heavily influenced by the French system. The Portuguese legal and judicial system is different from those of the US and the UK in that a complete body of law was founded in the codes. Consequently, judicial reasoning was deductive, and prior cases or precedence played little part in the judicial process. A judge was, therefore, seen mainly as a civil servant whose role was to find out the appropriate law from the codes and apply it. Furthermore, law was seen as fixed and unchangeable. However, it did
change over time. An ombudsman serves as the nation's chief civil and human rights officer, and elected by the Assembly of the Republic for a four-year term. Portugal accepts the jurisdiction of the International Court of Justice, with some reservations.

**Structure of the system**

Portugal’s judicial system consists of the constitutional court, the Supreme Court of Justice and the supreme administrative court (both of which have subordinate courts), and a variety of special courts, including a military court system. The constitutional court came into existence after the constitutional reform of 1982. The constitutional court judges whether legislative acts are legal and constitutional, and the court has the responsibility of ascertaining the physical ability of the president to carry out presidential functions and to examine international agreements for their constitutionality.

The highest court of law is the Supreme Court of Justice, which deals with civil and criminal cases. However, it does not impinge on the jurisdiction of the constitutional court. The municipal and district courts are the courts of first instance and the courts of appeal are the courts of second instance. The Supreme Court of Justice may serve as a court of first instance in some cases and as an appeals court in others.

**Tax regulation**

**Individual income tax**

Portugal has a pay-as-you-earn system, and the employer withholds the employee tax. Portugal has a progressive tax rate that is in the range of 14.5–48%, with an additional 3.5% surtax for income exceeding the minimum salary (€6,790) as of 2013. In addition, a surtax of 2.5% is levied on income between €80,000 and €250,000 and 5% on the taxable income above €250,000.

**Corporate tax**

Companies and other corporate entities, which include public enterprises, co-operatives, and non-profitmaking organizations, are subject to corporate tax. The 2013 rate of tax for a corporation in Portugal is 25%. A municipal surcharge ranging between 0% to 1.5% is levied over the taxable profit. Moreover, a state surcharge of 3% is levied on taxable profits exceeding €1.5 million up to €7.5 million, and 5% on profits exceeding €7.5 million. A municipal surcharge is charged on taxable profits at rates up to 1.5%.

**Withholding tax**

Dividends paid to a non-resident company are subject to a withholding tax of 25% (these are taxed at 35% if paid to a resident of a listed tax haven). Withholding tax can be exempted only under the European Commission Parent-Subsidiary Directive. For interest payments, the rate is 25% and for royalties it is 25%, unless the rate is reduced under a tax treaty.

**VAT**

Portugal has a standard VAT rate of 23%, while a reduced rate of 13% and 6% applicable in certain cases. The standard VAT rates in Madeira and the Azores are 22% and 16%, respectively.

**Performance**

**Effectiveness of the legal system**

Portugal was ranked 31st out of 43 European countries and was in 67th place globally in the 2013 Index of Economic
Freedom published by the Heritage Foundation and the Wall Street Journal. Portugal’s economic freedom score was 63.1. The country scored low in terms of labor freedom, fiscal freedom, and government spending, but scored high in terms of business freedom, trade freedom, monetary freedom, financial freedom, and investment freedom. According to Transparency International’s Corruption Perceptions Index 2012, the country was ranked 33nd out of 176 countries.

Outlook

As per the bailout package agreement, the government has to bring about several structural reforms for the economy to meet its fiscal targets as part of the bailout program. The high tax wedge is a dampener in attracting talent and is likely to hurt the economy. However, the government has proposed cutting corporate income tax over the medium term, which is likely to make the country attractive to investment. As a next step in structural reforms, the country has implemented several measures in the product services market to stimulate competition, nevertheless more needs to be done. In addition, the judiciary is also undergoing restructuring. The reform measures are expected to deregulate the market and ease the cost of doing business in Portugal.
ENVIRONMENTAL LANDSCAPE

Summary

Portugal has established a legislative framework and has constituted the environment ministry and the regional bodies for supervision of the environment. The Portuguese government has encouraged the use of renewable energy and promoted the shift to environmentally friendly technologies. Moreover, the nation’s carbon emissions of the country registered a decrease in 2011 compared to previous years.

Evolution

Portugal succeeded in formulating a new environmental legislative framework in the 1990s. The country also strengthened its environmental institutions by establishing a single ministry, and related regional bodies were established to supervise environment and land use. Portugal also formulated its first national environmental plan in 1995, and strategic plans concerning water and waste services were devised. Moreover, physical plans covering the entire country such as national coastal area protection plans, national nature protection plans, and municipal land use plans were developed in the country during the same period. Furthermore, the government has invested in water and waste-related infrastructure, particularly in the context of the 1994–99 and 2000–06 European Union (EU) Community Support Frameworks.

Structure and policies

Environmental regulations

There are several laws in place to protect the environment and enforce waste management. There are mechanisms spread throughout statutes such as the Portuguese Criminal Code, the Basic Law on Environment, and the Environmental Impact Assessment Law. A significant environmental regulation within the country is the Waste Management Law (decree law no. 239/97) that prohibits the unauthorized storage and disposal of waste. Under article 6.1 of this law, the final responsibility for the waste lies with the producer. Moreover, under Portuguese law, environmental permits are generally required for polluting or potentially environmentally damaging activities in sensitive areas, notably water, air, noise, and waste. Some of the important permits that are required in the country deal with noise pollution, water usage (private, industrial, and energy production), wastewater management, use of land adjacent to water bodies, in-water construction and beach construction, emission of pollution into the atmosphere, and greenhouse gas emissions.

Performance

Environmental impact

Portugal was ranked 41st out of 132 countries on the Environment Protection Index (EPI) 2012 released by the Yale Environment Center. The country had an EPI score of 52.64. The country performed poorly in terms of forests and water resources, placing 119th and 111st respectively, while it secured first place in the air (effects on human health) parameter.

CO2 emissions

Considerable improvements in renewable energy are reflected by the fact that carbon dioxide emissions steeply
contracted by an average of 3.63% during 2010–11 to drop to 54.17 million metric tons in 2011. During 2000–11, CO2 emissions contracted by an average rate of 1.18%.

![Figure 29: Carbon dioxide emissions in Portugal, 2004–11](image)

**Outlook**

The Portuguese government encourages the use of renewable energy and environmentally friendly technologies. In addition, the government is planning to promote the use of renewable energy and encourage the shift to technology with a low carbon footprint.

Environmental challenges for the future will be the degradation of Portugal’s water bodies by waste disposal from industries and household effluents. In addition, as Portugal is bound to the agreements of the International Monetary Fund and EU bailout package, it has to bring about several structural reforms with the aim of fiscal consolidation. The ambitious environmental policies might be difficult to achieve, as the government would have to implement structural reforms involving spending cuts.
Appendix

APPENDIX

Ask the analyst

MarketLine’s Country Analysis Practice consists of a team of economists, analysts, and researchers, all with expertise in their given fields. For any questions or comments about this report you can contact the author directly at reachus@marketline.com

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American Tire Distributors Holdings
Autoliv, Inc.
BAE Systems plc
Bayerische Motoren Werke AG (BMW Group)
BBA Aviation plc
Booz Allen Hamilton Holding Corporation
Brembo S.p.A.
Bridgestone Corporation
Cognizant Technology Solutions Corporation
Daily Mail and General Trust plc
Dollar Thrifty Automotive Group
E. I. duPont de Nemours & Company
Eaton Corporation plc
Federal Signal Corporation
Ford Motor Company
Garmin Ltd.
General Electric Company
General Motors Company
GKN plc
Glanbia plc
Google Inc.
Group 1 Automotive, Inc.
Holmen AB
Inchcape plc
Infosys Limited
Jardine Matheson Holdings Limited
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Lagardere SCA
PACCAR Inc. - Strategy and SWOT Report
Pitney Bowes Inc.
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Porsche Automobil Holding SE
Renault SA
Scania AB
Sequa Corporation
Serco Group plc
Sonic Automotive, Inc.
Stora Enso Oyj
Teleperformance SA
The Brink’s Company
The Goodyear Tire & Rubber Company
The Hertz Corporation
The Interpublic Group of Companies, Inc.
The Timken Company
Thomson Reuters Corporation
Volkswagen AG
WPP plc
COMPANY PROFILE

American National Insurance Company
# TABLE OF CONTENTS

- Company Overview .................................................................................................................... 3
- Key Facts .................................................................................................................................... 3
- Business Description .................................................................................................................... 4
- History ........................................................................................................................................ 6
- Key Employees ............................................................................................................................ 8
- Key Employee Biographies ......................................................................................................... 10
- Major Products and Services ..................................................................................................... 17
- Revenue Analysis ....................................................................................................................... 18
- SWOT Analysis ........................................................................................................................... 19
- Top Competitors ......................................................................................................................... 23
- Company View ............................................................................................................................. 24
- Locations and Subsidiaries .......................................................................................................... 25
COMPANY OVERVIEW

American National Insurance Company (American National or “the company”) is a US-based insurance provider. The company operates on a multiple line basis and offers a line of insurance coverage including individual and group life, health, and annuities, personal lines property and casualty, and credit insurance. The company also offers mutual funds. It primarily operates in the US. The company is headquartered in Galveston, Texas and employed 3,075 people as on 31st December, 2012.

The company recorded revenues of $2,987 million during the financial year ended December 2012 (FY2012), a decrease of 1.2% over FY2011. The operating profit of the company was $271.8 million in FY2012, an increase of 8.1% over FY2011. The net profit was $191 million in FY2012, an increase of 0.1% over FY2011.

KEY FACTS

| Head Office       | American National Insurance Company  
|                  | American National Insurance Company  
|                  | One Moody Plaza  
|                  | Galveston  
|                  | Texas 77550 7999  
|                  | USA  
| Phone            | 1 409 763 4661  
| Fax              |  
| Web Address      | http://www.anico.com  
| Revenue / turnover (USD Mn) | 2,987.0  
| Financial Year End | December  
| Employees        | 3,075  
| NASDAQ National Market Ticker | ANAT  

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BUSINESS DESCRIPTION

American National Insurance Company (American National or “the company”) is engaged in diversified insurance business. The company operates on a multiple line basis and offers insurance coverage including individual and group life, health, and annuities, personal lines property and casualty, and credit insurance. In addition, through its non insurance subsidiaries, the company offers mutual funds and invests in real estate. It operates in all US states, as well as Puerto Rico, Mexico, Guam and American Samoa. American National’s major insurance subsidiaries include American National Life Insurance Company of Texas, Standard Life and Accident Insurance Company, Garden State Life Insurance Company, American National Property and Casualty Company, Farm Family Life Insurance Company, Farm Family Casualty Insurance Company and United Farm Family Insurance Company.

The company has five operating segments; property and casualty insurance, life insurance, annuity, health insurance, and corporate and other segments.

Property and casualty insurance segment provides auto, home, boat and agribusiness and commercial insurance to small businesses and individuals in 48 US states. These products are distributed through multiple line agents and independent agents.

Life insurance segment markets whole life, term policies, universal and variable life insurance policies. The company distributes insurance products and services through career, independent and multiple line exclusive (MLEAs) agents, as well as through direct distributions.

Annuity segment offers fixed deferred annuities, immediate, variable and indexed annuities. The segment also provides pension plans and pension services for small businesses. The products are distributed primarily through independent agents and brokers, but are also sold through financial institutions and multiple line agents.

The health insurance segment distributes and administers health and disability insurance products to employers, individuals and associations. The primary products marketed are Medicare Supplement, medical expense, employer medical stoploss, true group, other supplemental health products. Health insurance products are marketed by American National’s Credit Insurance Division, career sales and services division (CSSD), health/senior age marketing division and multiple line division. The segment also offers credit insurance, which offers disability insurance that pays the insured’s monthly payment while the insured is disabled.

The corporate and other business segment consists of net investment income on the capital not allocated to the insurance lines and the operations of non insurance lines of business. This segment also provides mutual fund products.

The non insurance enterprises include several real estate investment companies, a securities broker dealer and joint ventures. The company has various subsidiaries and affiliate companies, engaged in the sale of insurance and non insurance products across locations.
American National Insurance Company of Texas markets life and health insurance products through alternative distribution systems.

The American National Property and Casualty Companies primarily write auto and homeowners insurance. The Farm Family Companies assume property and casualty and life insurance, concentrating on the New York and Northeast US market.

Securities Management and Research (SM&R), is a wholly owned subsidiary of American National and is a registered investment adviser and broker dealer. SM&R is a member of FINRA and SIPC.
HISTORY

American National Insurance Company (American National or “the company”) was established in 1905.

The company’s subsidiary, American National Property and Casualty Company was incorporated in 1973 to provide property and casualty insurance.

American National established operations in Mexico, becoming an international insurer in 1999.

The company acquired Farm Family Holdings in 2001. Farm Family Casualty Insurance Company, Farm Family Life Insurance Company, and United Farm Family Insurance Company were a part of the Farm Family group of companies, which has been providing insurance protection for families and businesses in rural and suburban areas since the mid-1950s.

American National saw record growth during 2003 in its net income and revenues, making it the best year in the company’s history. The company celebrated its centenary in 2005.

In 2006, American National Insurance Company entered into a partnership with Vontu, leader in data loss prevention solutions, with an intention to use its software to stop the loss of confidential information. The confidential information included policy-holder data and other privacy related information.

A year later, in 2007, American National Insurance Company along with Pegasystems, leader in unified process and rules technology expanded its use of business process management through Pegasystems’ SmartBPM Suite(R) to drive efficiency and deliver continuous improvements across the organization.

In 2009, AM Best downgraded the financial rating of American National and its subsidiaries from A+ (Superior) to A (Excellent) and assigned a stable outlook. These ratings were primarily a decrease in the company’s capital and surplus and reduced operating performance.

Towards the end of the first quarter of 2010, the company floated new subsidiary American National Life Insurance Company of New York (ALICN) headquartered in Glenmont, New York. ALICN offers life insurance, accident and health insurance and annuities.

During the second quarter of 2010, American National discontinued the sale of individual medical expense insurance plans with effective from June 30, 2010 to focus on Medicare Supplement insurance and large group coverage.

In June 2011, A.M. Best Co. affirmed the financial strength rating (FSR) of A (Excellent) and issuer credit rating (ICR) of “a+” of American National. Additionally, A.M. Best affirmed the FSR of A

The company introduced the ANICO Strategy Indexed Annuity PLUS series on June 1, 2013.
<table>
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<tr>
<th>Name</th>
<th>Job Title</th>
<th>Board</th>
<th>Compensation</th>
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<tr>
<td>Robert L. Moody, Sr</td>
<td>Chairman of the Board and Chief Executive Officer</td>
<td>Executive Board</td>
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<td>James E. Pozzi</td>
<td>President and Chief Operating Officer</td>
<td>Non Executive Board</td>
<td>2351365 USD</td>
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<td>Arthur O. Dummer</td>
<td>Director</td>
<td>Non Executive Board</td>
<td>150553 USD</td>
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<td>Shelby M. Elliott</td>
<td>Director</td>
<td>Non Executive Board</td>
<td>144080 USD</td>
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<td>Frances Anne Moody Dahlberg</td>
<td>Director</td>
<td>Non Executive Board</td>
<td>223923 USD</td>
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<td>Director</td>
<td>Non Executive Board</td>
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<td>Frank P. Williamson</td>
<td>Director</td>
<td>Non Executive Board</td>
<td>150924 USD</td>
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<td>James D. Yarbrough</td>
<td>Director</td>
<td>Non Executive Board</td>
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<td>Irwin M. Herz, Jr.</td>
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<td>Non Executive Board</td>
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<td>R. Eugene Lucas</td>
<td>Advisory Director</td>
<td>Non Executive Board</td>
<td>117893 USD</td>
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<td>E. Douglas McLeod</td>
<td>Advisory Director</td>
<td>Non Executive Board</td>
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<td>Robert L. Moody, Jr.</td>
<td>Advisory Director</td>
<td>Non Executive Board</td>
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<td>Ronald J. Welch</td>
<td>Senior Executive Vice President, Corporate Risk Officer &amp; Chief Actuary</td>
<td>Senior Management</td>
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<td>David A. Behrens</td>
<td>Executive Vice President, Independent Marketing</td>
<td>Senior Management</td>
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<td>John J. Dunn, Jr.</td>
<td>Executive Vice President, Corporate Chief Financial Officer and Treasurer</td>
<td>Senior Management</td>
<td>771960 USD</td>
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<td>Hoyt J. Strickland</td>
<td>Executive Vice President, Career Sales and Service Division</td>
<td>Senior Management</td>
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<td>Dwain A. Akins</td>
<td>Senior Vice President, Corporate Affairs, Chief Compliance Officer</td>
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<td>Albert L. Amato, Jr</td>
<td>Senior Vice President, Life Insurance Administration</td>
<td>Senior Management</td>
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<tr>
<td>Scott F. Brast</td>
<td>Senior Vice President, Real Estate / Mortgage Loan Investments</td>
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<td>Frank V. Broll, Jr.</td>
<td>Senior Vice President &amp; Actuary</td>
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<tr>
<td>William F. Carlton</td>
<td>Senior Vice President &amp; Corporate Controller</td>
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## American National Insurance Company

### Key Employees

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<tr>
<th>Name</th>
<th>Job Title</th>
<th>Board</th>
<th>Compensation</th>
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<tr>
<td>Gordon D. Dixon</td>
<td>Senior Vice President, Stock/Bond Investments</td>
<td>Senior Management</td>
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</table>
KEY EMPLOYEE BIOGRAPHIES

Robert L. Moody, Sr

Board: Executive Board
Job Title: Chairman of the Board and Chief Executive Officer
Since: 1991
Age: 77

Mr. Moody has been the Chief Executive Officer of American National Insurance Company since 1991. He has been Chairman of the Board since 1982. Mr. Moody is also the Chairman of the Board, Chief Executive Officer and Director of Moody National Bank and of National Western Life Insurance Company, respectively. He also serves as the Trustee of The Moody Foundation (charitable and educational foundation).

James E. Pozzi

Board: Non Executive Board
Job Title: President and Chief Operating Officer
Since: 2012
Age: 62

Mr. Pozzi has been the President and Chief Operating Officer of American National Insurance Company since 2012. He has been the Senior Executive Vice President, Chief Administrative Officer of the Company since 2008.

Arthur O. Dummer

Board: Non Executive Board
Job Title: Director
Since: 2004
Age: 79

Mr. Dummer has been a Director at American National Insurance Company since 2004. He is a Fellow of the Society of Actuaries and a Member of the American Academy of Actuaries. Mr. Dummer has been the President of The Donner Company (privately owned actuarial consulting company) since 1985 He has fifty-two years of experience in the insurance industry, including service as the former Chief Examiner and Actuary of the Utah Insurance Department.

Shelby M. Elliott

Board: Non Executive Board
Dr. Elliott has been a Director at American National Insurance Company since 2004. He has been the President-Emeritus of Texas Chiropractic College since 2004. Dr. Elliott is a member of the American Chiropractic Association, the Texas Chiropractic Association and the Florida Chiropractic Association.

Frances Anne Moody Dahlberg

Board: Non Executive Board
Job Title: Director
Since: 1987
Age: 43

Ms. Moody-Dahlberg has been a Director at American National Insurance Company since 1987. She has been the Executive Director of The Moody Foundation (charitable and educational foundation) since 1998, a Trustee of The Moody Foundation since 2004 and a Director at National Western Life Insurance Company since 1990.

Russell S. Moody

Board: Non Executive Board
Job Title: Director
Since: 1986
Age: 51

Mr. Moody has been a Director at American National Insurance Company since 1986. He has been a Director at National Western Life Insurance Company since 1988, a Director at The Moody Endowment since July 2009 and a Director at Transitional Learning Center at Galveston since July 2009 (charitable organizations).

William L. Moody IV

Board: Non Executive Board
Job Title: Director
Since: 1951
Age: 88

Mr. Moody has been a Director at American National Insurance Company since 1951. He has been serving as a Trustee, Board of Trustees of Rosenberg Library (charitable organization); a Trustee, University of Texas Medical Branch Development Board (charitable organization); the President and
Director at Moody Ranches, Inc. (investments and ranching); a Director at American National Life Insurance Company of Texas (subsidiary life insurance company).

Frank P. Williamson

Board: Non Executive Board
Job Title: Director
Since: 2004
Age: 80

Mr. Williamson has been a Director at American National Insurance Company since 2004. He is a retired pharmacist since 2009, a Director at The Moody Endowment and Transitional Learning Center at Galveston (charitable organizations) and a Director and Member of the Executive Committee and Governance Committee of American National Life Insurance Company of New York (subsidiary life insurance company).

James D. Yarbrough

Board: Non Executive Board
Job Title: Director
Since: 2001
Age: 57

Judge Yarbrough has been a Director at American National Insurance Company since 2001. He has management experience in both the private and public sectors, including sixteen years as the chief executive of the County of Galveston. In the private sector, Judge Yarbrough has served as a bank President, Owner of a business consulting firm, and Director of numerous interests.

Irwin M. Herz, Jr.

Board: Non Executive Board
Job Title: Advisory Director
Since: 2004
Age: 72

Mr. Herz has been an Advisory Director at American National Insurance Company since 2004. He has been a Partner of Greer, Herz & Adams, L.L.P., General Counsel to the Company and Trustee of the Three R Trusts (trusts for the benefit of the children of Robert L. Moody, Sr.).

R. Eugene Lucas

Board: Non Executive Board
Job Title: Advisory Director
Since: 2004
Age: 87

Mr. Lucas has been an Advisory Director at American National Insurance Company since 2004. He has served on the company’s Board for over thirty years, including twenty-three years as a member of our Audit Committee. Mr. Lucas has been associated with Gal-Tex Hotel Corporation since 1941, including over forty years as its President.

E. Douglas McLeod

Board: Non Executive Board
Job Title: Advisory Director
Since: 2004
Age: 71

Mr. McLeod has been an Advisory Director at American National Insurance Company since 2004. He has experience as a lawyer and public servant, including as a state legislator, as well as experience in real estate development and non-profit administration.

Robert L. Moody, Jr.

Board: Non Executive Board
Job Title: Advisory Director
Since: 2009
Age: 53

Mr. Moody has been an Advisory Director at American National Insurance Company since 2009. He is the owner of Moody Insurance Group, Inc., a marketing consultant to the Company and one of the many significant producers marketing the company’s products.

Ronald J. Welch

Board: Senior Management
Job Title: Senior Executive Vice President, Corporate Risk Officer & Chief Actuary
Since: 2008
Age: 67

Mr. Welch has been the Senior Executive Vice President, Corporate Risk Officer & Chief Actuary of American National Insurance Company since 2008.

David A. Behrens

Board: Senior Management
Job Title: Executive Vice President, Independent Marketing  
Since: 1999  
Age: 50

Mr. Behrens has been the Executive Vice President, Independent Marketing of American National Insurance Company since 1999.

**John J. Dunn, Jr.**

Board: Senior Management  
Job Title: Executive Vice President, Corporate Chief Financial Officer and Treasurer  
Since: 2011  
Age: 54

Mr. Dunn has been the Treasurer of American National Insurance Company since 2011. He has been the Executive Vice President and the Corporate Chief Financial Officer of American National Insurance Company since 2010.

**Hoyt J. Strickland**

Board: Senior Management  
Job Title: Executive Vice President, Career Sales and Service Division  
Since: 2012  
Age: 56

Mr. Strickland has been the Executive Vice President, Career Sales and Service Division of American National Insurance Company since 2012.

**Dwain A. Akins**

Board: Senior Management  
Job Title: Senior Vice President, Corporate Affairs, Chief Compliance Officer  
Since: 2006  
Age: 62

Mr. Akins has been the Senior Vice President, Corporate Affairs, Chief Compliance Officer of American National Insurance Company since 2006.

**Albert L. Amato, Jr**

Board: Senior Management  
Job Title: Senior Vice President, Life Insurance Administration  
Since: 1994
Age: 64

Mr. Amato has been the Senior Vice President, Life Insurance Administration of American National Insurance Company since 1994.

Scott F. Brast

Board: Senior Management  
Job Title: Senior Vice President, Real Estate / Mortgage Loan Investments  
Since: 2005  
Age: 49

Mr. Brast has been the Senior Vice President, Real Estate / Mortgage Loan Investments of American National Insurance Company since 2005.

Frank V. Broll, Jr.

Board: Senior Management  
Job Title: Senior Vice President & Actuary  
Since: 2005  
Age: 63

Mr. Broll has been the Senior Vice President & Actuary of American National Insurance Company since 2005.

William F. Carlton

Board: Senior Management  
Job Title: Senior Vice President & Corporate Controller  
Since: 2010  
Age: 54

Mr. Carlton has been the Senior Vice President & Corporate Controller of American National Insurance Company since 2010.

Gordon D. Dixon

Board: Senior Management  
Job Title: Senior Vice President, Stock/Bond Investments  
Since: 2011  
Age: 67
Mr. Dixon has been the Senior Vice President, Stock/Bond Investments of American National Insurance Company since 2011.
American National Insurance Company (American National or “the company”) is a US-based insurance provider.

The company's key products and services include the following:

- Accident and health insurance
- Annuities
- Credit insurance
- Insurance
- Mutual funds
- Pension plan services
- Property and casualty insurance
REVENUE ANALYSIS

The company recorded revenues of $2,987 million during the financial year ended December 2012 (FY2012), a decrease of 1.2% over FY2011.

American National Insurance Company generates revenues through five business divisions: property and casualty (38.8% of the total revenues during FY2012), annuity (24.5%), life (23.6%), health (8.4%), and corporate and other (4.7%).

Revenues by Division

In FY2012, the property and casualty division recorded revenues of $1,158.4 million, a decrease of 5.2% over FY2011.

The annuity division recorded revenues of $732.8 million in FY2012, an increase of 6.5% over FY2011.

The life division recorded revenues of $705.7 million in FY2012, an increase of 1.7% over FY2011.

The health division recorded revenues of $251.1 million in FY2012, a decrease of 2.9% over FY2011.

The corporate and other division recorded revenues of $139 million in FY2012, a decrease of 13.4% over FY2011.
American National Insurance Company (American National or “the company”) is a US-based insurance provider. The company has a diversified product portfolio and strong capital cushioning against adverse market developments. However, increased incidence of natural disasters is testing the company’s claims paying capability.

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong capital cushioning against market volatility</td>
<td>Lack of scale limiting expansion of business</td>
</tr>
<tr>
<td>Broad product portfolio reducing the business risk</td>
<td></td>
</tr>
<tr>
<td>Consistent dividends increasing the investor’s confidence</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>Growing US insurance industry likely to provide growth potential</td>
<td>Intense competition likely to decrease market share and profitability</td>
</tr>
<tr>
<td>Ageing US population likely to increase demand for insurance products</td>
<td>Increased incidence of natural disasters testing claims paying capability</td>
</tr>
<tr>
<td>Rising healthcare costs could increase demand for health insurance</td>
<td>Rising fraudulent activities may keep margins under check</td>
</tr>
</tbody>
</table>

**Strengths**

Strong capital cushioning against market volatility

American National’s capital position has been strengthening over the past years ended FY2012. The company’s assets steadily increased to $23,107 million in FY2012, as compared to $21,448 million in FY2010. American National’s invested assets gradually increased to $19,238 million in FY2012, as compared to $17,907.5 million in FY2010. Stock holder’s equity of the company increased steadily to $3,828 million in FY2012, as compared to $3,637 million in FY2010. The increase in equity base was mainly through the retention of earnings, which is an indication of operational strength. Strong capital position is cushioning the company against market volatility.

Broad product portfolio reducing the business risk

American National has a diversified business and product portfolio. The company operates on a multiple line basis and offers insurance coverage including individual and group life, health, and
annuities, personal lines property and casualty, and credit insurance. American National's major insurance subsidiaries include American National Life Insurance Company of Texas, Standard Life and Accident Insurance Company, Garden State Life Insurance Company, American National Property and Casualty Company, Farm Family Life Insurance Company, Farm Family Casualty Insurance Company and United Farm Family Insurance Company. Also, through its non insurance subsidiaries, the company offers mutual funds and invests in real estate. Thus diverse business is a competitive advantage for the company as it provides cross selling opportunities to the company and enables it to spread its revenue base.

Consistent dividends increasing the investor's confidence

American National has a track record of paying dividends consistently. The year 2012 was the 102st consecutive year that the company paid dividends to its stockholders. In FY2012, the company paid its shareholders dividends at a rate of $3.08 per share. American National was named to the 2013 Ward's 50 group of top performing companies. Further, American National is one of only 13 organizations with affiliated companies in both property-casualty and life-health Ward's 50 groups of companies. The company's consistent dividend payout increases investor confidence in the company.

Weaknesses

Lack of scale limiting expansion of business

American National lacks the scale to compete with large players in the market. Some of the company's competitors are much larger in size in terms of the geographic operations. The company's operations are relatively small and concentrated in the US in comparison to global companies. For instance, its competitors such as Aviva operates in the UK, France, the Netherlands and the rest of Europe, the US and Asia. Furthermore, AXA operates in Western Europe, North America and the Asia Pacific region. Lack of scale puts the company at a competitive disadvantage against much larger rivals. In addition, the company's limited geographical spread limits its customer base and increases its business risk.

Opportunities

Growing US insurance industry likely to provide growth potential

The US insurance market is forecast to grow significantly over next four years. The US insurance market grew by 1.5% in 2010 to reach a value of $1,166.1 billion. MarketLine forecasts the US insurance market to reach a value of $1,471 billion in 2015, an increase of 26.1% since 2010. Established in 1905, American National operates in all 50 states of the US. The company provides broad line of insurance related products including life insurance, annuities, credit insurance, property and casualty, health insurance, and pension products and services. Being one of the oldest companies
and having strong understanding about the local market as well as wide network, American National is well placed to tap the growth potential in the US insurance market.

Ageing US population likely to increase demand for insurance products

There are about 76 million boomers in the US approaching retirement age and overall about $20 trillion in retirement savings are at stake. US Census Bureau estimates that by 2030 almost 20% of Americans will be 65 or older, as compared to 13% presently. Moreover, according to estimates, about three-quarters of boomers have no plan in place to create reliable retirement income and over 40% of the US population is not insured, which will offer tremendous possibilities to companies such as American National. As life expectancy and older population increase, spending on health care will also escalate. Demographic shifts would facilitate stable sales growth, even though the benefits will emerge only over the long term. It is also expected that more seniors will retire without post-retirement health coverage. This implies that a substantial section of senior citizens are currently without post-retirement health coverage. The company with its wide sales network and health care products can utilize this opportunity for its growth.

Rising healthcare costs could increase demand for health insurance

According to the government data and private studies, health care costs for the average American family have nearly doubled during 2002–10. Due to a variety of reasons, the increasing trend in healthcare costs is expected to persist in the years to come. Consequently, average American family is expected to spend more on healthcare insurance in order to pay for their healthcare expenses. Moreover, President Barack Obama's health care law, which is set to go into effect in 2014, could force Americans to buy health insurance. As a result, mutual insurers such as AFI could see their health insurance business grow at a faster pace.

Threats

Intense competition likely to decrease market share and profitability

The US financial services market, being one of the most matured markets worldwide, is featured by intense competition in all fields. Especially, the market for life insurance, retirement and investment products continues to be highly fragmented and competitive. As of end 2012, there are approximately 2,650 property/casualty insurers and 1,000 life and health insurers in the US. The competitive pressure is growing due to several factors, which includes cross marketing alliances between unaffiliated businesses, as well as consolidation activity in the whole financial services industry. The group is already facing the consequences of increased competition in terms of lack of geographic spread as compared to its competitors. The company faces stiff competition from companies such as Allstate Insurance Group, State Farm Group, Progressive Group, Nationwide Corp., and Travelers Group. Owing to increasing competition in the market, the company could witness further decline in its top line as well as profit margins.
Increased incidence of natural disasters testing claims paying capability

There is general consensus that major climate changes are likely to occur in the coming decades and insurance companies face a trend towards higher losses as population densities continue to grow in catastrophe-prone areas. Gross catastrophes for the year 2011 were $217.9 million, compared to $141.7 million for the year 2010. While the frequency of catastrophe events in 2011 was two fewer than 2010, gross catastrophe losses increased primarily from the severity of the catastrophe events over 2011. The 2011 catastrophe activity includes a record number of tornados, including two events which impacted primarily Alabama in late April, and Joplin, Missouri in May. These two events alone accounted for $102.6 million in gross catastrophe losses and $30.5 million in net catastrophe losses during 2011. Considering the fact that the company is one of the leading players in insurance industry, increase in natural disasters will impact the company's profitability.

Rising fraudulent activities may keep margins under check

Increasing insurance frauds have been taking a toll on the general insurance industry. The Insurance Information Institute estimates that fraud accounts for 10% of the property/casualty insurance industry’s incurred losses and loss adjustment expenses, or about $30 billion a year. This fraud results in higher payouts for insurance companies in terms of claims. Considering State Farm Insurance Companies’ scale of operations in property and casualty insurance market, the mounting trends of insurance frauds could increase its claim losses and may pull down its profit margins in 2013 and 2014.
TOP COMPETITORS

The following companies are the major competitors of American National Insurance Company

Conseco, Inc.
Fortis
Nationwide Mutual Insurance Company
New York Life Insurance Company
Prudential plc
State Farm Insurance Companies
Torchmark Corporation
Allstate Corporation
Mutual of Omaha Companies, The
Penn Mutual Life Insurance Co.
Kansas City Life Insurance Company
National Western Life Insurance Company
American National Insurance Company

COMPANY VIEW

A joint statement by Robert L. Moody, Chairman of the Board and Chief Executive Officer and James E. Pozzi, President and Chief Operating Officer of American National Insurance Company is given below. The statement has been taken from the company’s 2012 annual report.

American National remained strong and secure throughout 2012. After-tax operating earnings of $146.7 million increased $15.0 million over the prior year. Realized gains were lower for 2012, strongly influenced by higher real estate sales in 2011. The effect was net income for 2012 consistent with prior year results. This resulted in continued strengthening of our assets and stockholders’ equity. Improvements in every insurance segment at American National, especially the annuity and property/casualty segments, contributed to our strong operating results. Still, we faced challenges during the year. The life segment was impacted in 2012 by increased claims resulting from changes in processes related to unclaimed property, albeit to a smaller extent than in 2011. We expect any future impact to be minimal and look forward to putting this matter behind us. With interest rates remaining at historically low levels, we have further reduced our appetite for annuity sales and are conservatively managing the in-force annuity block. Management constantly monitors and prepares for the risks presented by market conditions in order to meet our customers’ needs while maintaining profitability. Catastrophes are a major influence on property/casualty results. In 2012 industry losses related to catastrophes were about double the long-term average. American National has a strong enterprise-wide risk management process that focuses on managing our exposure to severe events. Holistic risk management, combined with additional activities, such as improving rate adequacy and underwriting reviews, has led to significant improvements in this segment over the past two years. American National has designed insurance and annuity portfolios to meet the needs of individuals and small business owners throughout their lives. During 2012, we implemented a new term life insurance portfolio and a credit-related GAP product. Additionally, we expanded life insurance products available through our New York subsidiary and made several updates to current products based on customer needs. The updates to our life products were well received by customers and agents as sales for this segment increased nearly 19 percent. Our health segment continues to evolve. We expect to remain in the limited benefit health insurance market, providing supplemental benefits to individuals. Medicare Supplement products will continue to be our primary products in this segment. During 2012 we invested in infrastructure to better support our products and increase efficiencies. We registered a new wholesale broker-dealer to underwrite our variable products. We also expanded electronic signature options to include tablet based technology. American National also completed a major installation of a new enterprise reporting system during 2012, with a plan to have all subsidiary companies integrated into the system by the end of 2013. Management’s balanced focus on sustainable and profitable growth with acceptable risk contributed to our strong sales and financial results, helping to ensure that American National will continue to be a source of strength and security for future generations.
LOCATIONS AND SUBSIDIARIES

Head Office
American National Insurance Company
One Moody Plaza
Galveston
Texas 77550 7999
USA
P:1 409 763 4661
http://www.anico.com

Other Locations and Subsidiaries

<table>
<thead>
<tr>
<th>American National Property And Casualty Company</th>
<th>American National Life Insurance Company of New York</th>
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<tbody>
<tr>
<td>1949 East Sunshine Springfield Missouri 65899 0007 USA</td>
<td>Galveston Texas 77553 USA</td>
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<tr>
<th>Farm Family Companies</th>
<th>Standard Life and Accident Insurance Company</th>
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<tbody>
<tr>
<td>#344 Route 9W Glenmont New York 12077 USA</td>
<td>One Moody Plaza Galveston Texas 77550 7947 USA</td>
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<tr>
<th>Garden State Life Insurance Company</th>
<th>American National Life Insurance Company of Texas</th>
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<tr>
<td>2450 South Shore Boulevard Suite 401 League City Texas 77573 2997 USA</td>
<td>One Moody Plaza Galveston Texas 77550 7999 USA</td>
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