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Russian Retailers Modify Strategies as Economy Slows

Report Categories:

Agricultural Situation

Agriculture in the Economy

Agriculture in the News

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Report Highlights:

Towards the end of 2014, the Russian economy entered a very difficult period as it was hit hard by record-low oil prices, dropping consumer purchasing power, a food import ban which pushed up inflation, and ruble devaluation. As a result, Russian retailers have begun implementing new business strategies which optimize expenses and improve staff productivity. Although the government is still only considering new price control measures, local officials in the regions have held meetings with retailers and encouraged them to (a) set minimal mark-ups for socially important products, (b) sell more locally-produced food products, and (c) freeze prices for private label products. Shortly afterwards, several major Russian retailers e.g. Dixie, Metro Cash&Carry, and O'Key, announced that they would freeze prices for 20 socially-sensitive foodstuffs. Dixie notes that the cost of the basic food basket would remain unchanged until March 9, 2015.

General Information:

Towards the end of 2014, Russia entered a difficult period of economic slowdown. An already weakened Russian economy has been hit hard by record-low oil prices, food sanctions and ruble devaluation which have negatively influenced purchasing power of local consumers and complicating the business environment in the country. In recent years, the food retail sector was one of the few sectors of the Russian economy that demonstrated steady growth. In calendar year 2014, large retail chains still showed positive results of the revenue dynamic. For example, Russian leading retailer Magnit witnessed revenue growth (in rubles) of 32 percent compared to 2013. X5 Retail Group showed 18.6 percent growth while Lenta announced 34.5 percent growth in 2014. However, experts noted that despite the nominal growth of the sector, food retailers have been showing a negative trend in volume since May 2014. Currently, the growth of retail turnover is mainly due to double-digit inflation which totaled 11.4 percent in 2014, the highest number since 2009.

According to the updated forecast from the Russian Ministry of Economic Development (MED), real wages in Russia are expected to drop by more than 9 percent in 2015, real incomes – drop by 6 percent. Inflation in 2015 could reach 12 percent (although market analysts are predicting overall inflation will surpass 15 percent). According to this forecast, the retail trade in 2015 will be reduced by 8.2 percent which will be one of the main factors of the projected 3 percent drop in overall gross domestic product (GDP). The share of overall retail trade in GDP is about 15 percent. Euromonitor International analysts stated that the current economic crisis will more strongly affect small to medium-sized food stores in the regions as opposed to the stores in the major cities in Russia. Since many retailers will be forced to make additional cuts to their margins, the largest market players with strongest bargaining power over suppliers will remain better placed to withstand growing pressure on profitability relative to the smaller players. Currently, food retail chains cover only 22 percent of the overall retail market in Russia and 26 percent in the food and tobacco segment, according to Russian Federal Statistics Service (Rosstat). Overall, the challenging operating environment is expected to accelerate retail market consolidation in Russia driving out non-chain retailers. The largest retail chains have already confirmed their active market expansion and consolidation plans over the next 5 years. Russia's largest retail chain Magnit is going to open more than 2,000 stores in 2015. Auchan is planning to continue usual growth and open 7-8 stores while Lenta expects to open 10 hypermarkets in the first half of this year. Metro Cash & Carry is planning to open at least 7 new outlets. X5 Retail Group will also continue to expand and open new stores in the regions, and Dixie's plans for 2015 are to open 500 new stores.

There are several reasons for the projected retail slowdown in the future. First, the depreciation of the ruble has had an effect on import food prices. Retailers have been forced to cut their purchasing budgets in foreign currencies, which are expected to affect product range in coming months. The ruble devaluation has also affected retailers through store rental costs in shopping centers, as those are usually dependent on the euro or dollar exchange rate. The Russian central bank's rate increased to 17 percent (later decreased to 15) may force some retailers to scale down expansion plans as loans become more expensive, according to VTB Capital and INFO Line Research Company. The decision may drive rates on new corporate loans higher than 20 percent while previously Russian retailers had average borrowing costs of 10 to 13 percent. It will also contribute to a rise in prices because retailers will have to include their loan expenses to final consumer prices. High-end retail chains will be most affected during the coming recession as they tend to have a large imported-product range. For example, in February 2015,

Azbuka Vkusa supermarket chain announced that, due to the economic crisis, the company has decided to postpone the expansion of its new, more affordable, suburban outlets called "AB Market". The chain plans to return to this issue later, when the market situation becomes more certain.

Russia's ban on a numerous food and agricultural products from Canada, the United States, Europe, Australia and Norway in August 2014 had a tremendous effect on grocery segment and hit retailers and Russian consumers hard. The sudden drop in food supply led to price hikes in several food categories ranging from vegetables to dairy products. Market analysts have stated that even if Russian producers are able to replace all imports eventually, prices are not likely to ever fall back to previous levels. Since introducing the food sanctions in August 2014 (for more information please see GAIN report [Russia Announces Ban on Many US Agricultural Products](#)) most of Russia's food retailers have managed to adapt by substituting the imported categories with domestically-grown food and food from other non-banned countries. And increasing prices for many food categories (fish, dairy products, fruits and vegetables) have caused customers to seek out lower price substitutes and, in turn, lowered sales of non-essential food products.

Russian retail chain managers are now changing their development strategies to meet the deteriorating economic situation and weak Ruble. Slumping consumer demand and decreasing sales are expected to intensify in 2015 putting more pressure on retailers' to find ways to keep their customers. Retailers are planning to actively implement anti-crisis business practices that optimize expenses and improve staff productivity. Retailers have announced new marketing programs aimed at increasing customer traffic, investing in private labels, and focusing on regional expansion and close cooperation with local producers. Consumer research shows that the most important factors for Russian customers during these difficult economic times are: product assortment (because Russian people, already accustomed to food diversity) and prices. Other factors e.g. convenience of location, level of service and pleasant experience of shopping, are not as important now (Source: Nielsen's Consumer Research, 2015). According to a third of respondents of the Nielsen's consumer poll, consumers are buying fewer goods than in the previous quarter as 78 percent have become thrifter. To reduce their costs, about 50 percent of Russian consumers are going to save primarily by cutting expenses on entertainment outside the home, 49 percent - on the purchase of clothing, and 46 percent – travel and recreation.

Previously, large grocery stores and hypermarkets were successful because of the high average check, but now customers actively compare prices in different stores and strive to purchase only those goods for which the price is more advantageous. As a result, discounters were the most popular format in 2014 and this trend will become even stronger in 2015. Consumers now avoid large stores to reduce impulse purchases. For this reason, retailers will work on adapting their price policy to stimulate consumers to buy everything they need in their stores. Retailers have also been working on developing their private labels as an effective tool as Russian consumers are showing strong loyalty to such products. In this regard, retailers are also focusing on increasing the number of local producers that they work with and are looking at ways to save money on packaging and marketing promotions. Private labels help to fill the shelves with goods even in cases of supply disruptions. And, most importantly, they have low prices that build loyalty. Since other retailers' expenses are also on rise - particularly property rent, transportation and staff costs - retailers will have to act carefully with prices and find a good balance between having loses and not raising prices sharply. It is important to note that from January 21-23, 2015, mass inspections were undertaken by representatives of Russia's Prosecutor General's Office in

retail stores in more than thirty Russian cities. The inspectors were looking at food prices in order to detect violations and “unjustified” markups that led to higher prices on certain categories of food products. For more information please refer to the GAIN report: [Government Inspectors Perform Mass Price Checks](#)

According to Rosstat, in January 2015, overall food prices in Russia grew by 20.7 percent compared with January last year. By the end of 2014, food price inflation reached 15.7 percent. Russian law, permits the government to set up State regulation of prices when food prices rise by more than 30 percent within 30 days. In such cases, the law allows for Russian government officials to freeze prices for up to 90 days. Although the government is still only considering new price control measures, local authorities in the regions have already taken steps to curb increasing food prices. In recent weeks, local officials held meetings with retailers and strongly encouraged them to (a) set minimal mark-ups for socially important products, (b) push sell more locally-produced food products, and (c) freeze prices for private label products. For example, the authorities of the Rostov region “recommended” that retailers and agro-producers work with a maximum mark-up of 10 percent for socially-important food products. There currently are no official federal price control regulations in place. In February 2015, several major Russian retailers e.g. Dixie, Metro Cash&Carry and O’Key, announced that they were going to freeze prices for 20 socially-sensitive foodstuffs including buckwheat, grains, rice, millet, pasta, sunflower, seed oil, butter, flour, dairy, and others. Dixie notes that the cost of the basic food basket will remain unchanged for at least four weeks - until March 9, 2015. In addition, the companies promised to preserve a maximum mark-up of 1-15 percent on some of their products, many of which are their own private labeled products.