



Overview of the Fast Food Industry in Russia and Ukraine

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Ukrainian Economic Overview

“Market growth and a relative lack of market saturation make Ukraine the third most attractive consumer market in the world.” - A.T. Kearney

After Russia, Ukraine is by far the most important economy in the Commonwealth of Independent States (CIS), producing four times the output of the next ranking country. Its population is nearly 50 million people and its GDP (at Purchasing Power Parity) is more than \$350 billion.¹ With rich farmlands, a well-developed industrial base, highly trained labor force, and a good education system, Ukraine has become a major Eastern European power. Ukraine has experienced rapid growth since the turn of the century and these trends are expected to continue into the future.

The annual economic growth has averaged 7.4 percent per year since 2000, reaching 12.1 percent in 2004 and 7.0 percent in 2006.² GDP grew by more than 50 percent from 1999 to 2004, which, in combination with significant improvement in the country’s fiscal position, led to a dramatic decrease in its debt-to-GDP ratio. Personal incomes are also rising rapidly and total disposable income grew to \$49.9 billion dollars in 2005, a 23 percent increase over 2000.³ Consumer spending in Ukraine has increased by 25 percent YOY to \$50.7 billion in 2004, and expanded by an estimated 35 percent to \$68.5 billion in 2005.⁴

Ukraine actively encourages foreign trade and investment. Their foreign investment laws allow Westerners to purchase businesses and property, to repatriate revenue and profits, and to receive compensation in the event that property is to be nationalized by a future government. Ukraine

1 “Country Report: Ukraine,” The World Bank. November 1, 2007. Available online at: www.worldbank.org

2 U.S. Department of State: Bureau of European and Eurasian Affairs. March 2007. Available online at: <http://www.state.gov/r/pa/ei/bgn/3211.htm>

3 “Overview of Ukrainian Retail,” Dragon Capital Corporate Finance. Available online at: [http://www.horizoncapital.com.ua/files/Ukrainian%20Retail%20Overview%20\(Eng\).pdf](http://www.horizoncapital.com.ua/files/Ukrainian%20Retail%20Overview%20(Eng).pdf)

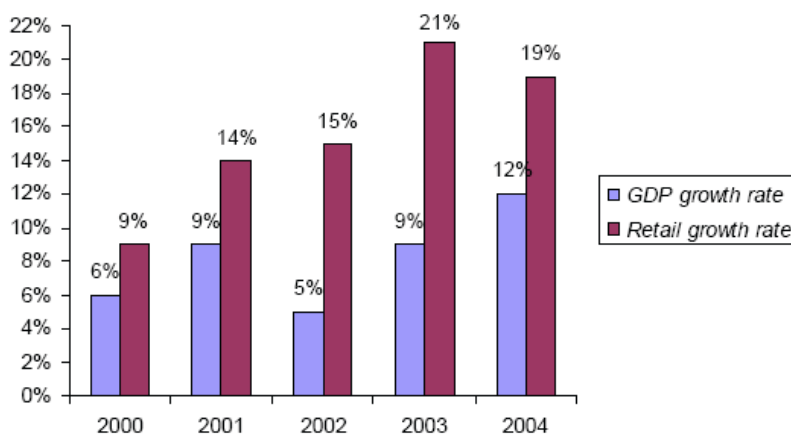
4 Ibid.

passed more than 20 laws in 2006 to bring its trading regime into consistency with the World Trade Organization standards. These changes are validated by positive indicators such as dramatically heightened investor interest, a surge in foreign direct investment (FDI), sales by financial and industrial groups of subsidiaries and banks, continued growth of services, increases in light industrial production, and continuous entry of small and medium enterprises. In 2005 and 2006, Ukraine received a record amount of FDI, bringing total foreign investment in Ukraine to \$19.9 billion.⁵ This figure is expected to grow to more than \$21 billion in 2007.⁶ Russian and European exporters dominate the Ukrainian market, while US exports are steadily climbing, reaching over \$500 million in 2006.⁷

Ukrainian Retail Market

Retail trade is one of Ukraine's fastest growing sectors and the most rapidly growing retail market in Central and Eastern Europe. Retail turnover has grown to \$45 billion, rising by \$4.6 billion or 24.8 percent in 2006.⁸ More than half (51.6 percent) of retail goods are sold through large retail chains, while 31.3 percent are sold at markets, and 18.1 percent sold by sole proprietors.⁹ The structure of turnover is stable, with wholesale trade representing 70 percent and retail 30 percent. Nearly 70 percent of enterprises engaged in the retail trade are profitable. The retail market expanded by more than 26 percent from 2000-2005, outpacing nominal economic growth by nearly five percentage points.¹⁰

Growth Rates of Real GDP and Retail Revenue



5 "Ukrainian Commercial Guide," US Commercial Service. March 2007. Available online at:

http://www.buyusainfo.net/docs/x_2557634.pdf

6 U.S. Department of State: Bureau of European and Eurasian Affairs. March 2007. Available online at:

<http://www.state.gov/r/pa/ei/bgn/3211.htm>

7 U.S. Department of State: Bureau of European and Eurasian Affairs. March 2007. Available online at:

<http://www.state.gov/r/pa/ei/bgn/3211.htm>

8 "Consumer Market - Retail Chains, foodstuffs, FMCG," Accessed: November 9, 2007. Available online at: <http://www.ukraine-arabia.ae/economy/market/>

9 "Consumer Market - Retail Chains, foodstuffs, FMCG," Accessed: November 9, 2007. Available online at: <http://www.ukraine-arabia.ae/economy/market/>

10 "Overview of Ukrainian Retail," Dragon Capital Corporate Finance. Available online at:

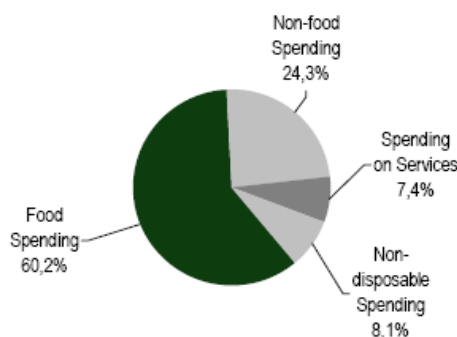
[http://www.horizoncapital.com.ua/files/Ukrainian%20Retail%20Overview%20\(Eng\).pdf](http://www.horizoncapital.com.ua/files/Ukrainian%20Retail%20Overview%20(Eng).pdf)

Kiev is the largest regional retail market in Ukraine. It is the largest and wealthiest city and is at the cutting edge of the new changes taking place in the sector. In 2004, Kiev had 550,000 square meters of modern retail space and in 2005, an additional 220,000 were commissioned. This kind of growth is expected to continue for years to come.

The Ukrainian retail sector is represented in various formats ranging from hypermarkets to street vendors and kiosks, which are still predominant. However, these venues, which symbolize the past, gradually surrender to large multi-functional shopping centers. Rapid development of contemporary retail outlets in large Ukrainian cities is evidence of the country's economic progress. In the past several years the retail space in the Ukrainian capital has been growing by 50-70 percent annually. As of January 2005, over 40 percent of all retail space (600,000 square meters) in Kiev was offered in large outlets. There is an average of 100 square meters of new retail space per 1,000 Kiev residents. In spite of this incredible growth Kiev is still far behind western European capital cities in terms of retail space per capita.

According to the Ukrainian Government statistics authority, Derzhcomstat, private spending is growing on the tide of rising wages. Per capita nominal income was up 16 percent and real income was up 7 percent on average in 2004.¹¹ Consumer confidence is also on the rise as economic recovery continues and wages increase.

Food represents a majority of retail spending.



Personal Income Structure (2005)

Source: State Statistics Committee, Dragon Capital

Ukrainian Restaurant Industry

“Good access to cheap raw materials and increased levels of tourism are driving strong growth in the Ukrainian food service sector.” - United States Department of Agriculture

The restaurant industry is enormous in Ukraine and is growing much faster than the economy as a whole. The restaurant business has grown to \$1.8 billion, rising \$140 million or 8.5 percent in 2006.¹² The restaurant sector in Ukraine is comprised of over 56,600 eateries, including 34,100

¹¹ “Retail Sector in Ukraine,” US Commercial Service. 2006. Available online at: http://www.buyusainfo.net/docs/x_2251875.pdf

¹² “Consumer Market - Retail Chains, foodstuffs, FMCG,” Accessed: November 9, 2007. Available online at: <http://www.ukraine-arabia.ae/economy/market/>

cafés, 11,500 cafeterias, 9000 bars, 1900 restaurants, and more than 100 caterers.¹³ The key factors promoting the development of consumer food service are improving consumer wellbeing through rising disposable incomes, mushrooming of Western style outlets, and busier lifestyles.

City centers are the most attractive locations for food service establishments due to significantly higher turnover and greater foot traffic. Higher-income Ukrainians, who can afford to visit consumer food service outlets on a permanent basis, usually live and work in downtown areas.

Tourism is a key driver for the restaurant market as tourists have higher disposable incomes. As tourism grows in Ukraine, so too will the restaurant industry. Ukraine saw an estimated 18.8 million visitors¹⁴ in 2006, which was up 7 percent from 2005.¹⁵ This trend is expected to continue as infrastructure in Ukraine continues to improve.

As Ukrainians get wealthier, their restaurant-going habits change too. Nowadays, the most frequently cited reasons for eating out are to meet with friends, spend time with family, and get a quick meal. Ukraine's burgeoning middle class is the local restaurant market's main driving force, which explains why fast-food, with an average check of up to \$10, is the fastest growing segment.

Ukrainian Fast Food Market

Characteristics of the fast food market in Ukraine include, reasonable prices, quick service, and versatile menus, offering dishes of American, Russian, and traditional Ukrainian cuisines. The numerous fast food chains in Kiev welcome everybody who is short of time and wants to have a snack.

The domestic fast food industry operates in three formats:

- Traditional fast food (McDonald's, MakSmak, Mister Snack, Shvydko), characterized by high client turnover, limited food selection, and visited by low-to-middle class customers, paying \$2-4 per meal on average.
- Bistro/Counter (Domashnya Kuhnya, Puzata Hata, Chinese bistros), featuring an extensive menu (up to 150 items) served at long counters; customers pay \$2-4 per meal on average.
- Quick & Casual (Pizza Chelentano, Dva Gusya, Potato House, Pan Pizza), offering a mix of traditional and fast food meals and visited by customers with higher disposable income, who pay \$7-10 on average; this is the fastest growing of the three formats.

There are 11 major competitors in the fast food industry: Domashnyaya Kukhnya, Dva Gusya, Il Patio, McDonald's, MacSmack, Pan-Pizza, Pechiona, Potato House, Puzata Khata, Rostik's, and Shvydko.¹⁶

13 "Consumer Market - Retail Chains, foodstuffs, FMCG," Accessed: November 9, 2007. Available online at: <http://www.ukraine-arabia.ae/economy/market/>

14 "Trends in the Ukraine Hotel Industry," Hotel Business Review. Accessed: November 9, 2007. Available online at: http://www.hotelexecutive.com/bus_rev/pub/003/130.asp

15 "Ukrainian Food Processing Sees Rapid Growth," Neil Merritt. June 10, 2006. Available online at: <http://www.cee-foodindustry.com/news/>

16 "Kiev Information Guide. Fast Food Restaurants of Kiev," Kiev Tourist Bureau. Accessed: November 9, 2007. Available online at: <http://www.kiev.info/fastfood.htm>

The six biggest players are listed below by number and type of locations:

Major Players

	Total outlets	Outlets in Kyiv	Number of cities covered	Number of franchisees
Pizza Chelentano	77	13	45	67
Potato House	35	6	45	33
McDonald's	52	21	16	0
Pan Pizza	18	4	5	
Dva Gusya	12	6	6	3
Shvydko	11	11	2	0

Source: Dragon Capital

Russian Economic Overview

Since 1999, Russia has experienced outstanding growth rates, constantly improving macroeconomic conditions, and a growing involvement in the global economy. These achievements, together with high world oil prices, political and economic stability, and skyrocketing foreign direct investment have all contributed to the growth of the country's economy.

Russia's growth: Russia is the fastest growing economy in the G8 group of industrialized nations. Over the last seven years, Russia's economy has grown by an average rate of 6.8 percent each year and is projected to grow at an average rate of at least 7 percent YOY through 2010. In 2006 and 2007 Russia's growth exceeded all expectations (7.9 percent GDP growth), accelerating in several key economic sectors such as retail, real estate, tourism, and communications.

Russia's stability: Russia has a very stable macroeconomic situation. Inflation runs below 10 percent, foreign currency and gold reserves have increased to around \$400 billion and are now the world's third largest after China and Japan.¹⁷ The strength and stability of the economy was noted by the major credit rating agencies (S&P, Moody's and Fitch), all of which awarded Russia an upgraded investment rating in 2006.¹⁸ In addition, the stable political environment has contributed to make the country one of the favorite destinations in the region for foreign investors.

Investment: The excellent macroeconomic conditions make Russia a thriving capital market that foreign investors are increasingly finding more attractive. Foreign investment for the *first half* of 2007 totaled \$67 billion,¹⁹ compared, for instance, to \$14 billion in Poland in the *entire* 2006.²⁰ Economists say that, "unlike in China, there are no signs of overheating of the economy detectible. Modern Russia has never before seen such a growth rate and economists expect the tendency to continue."²¹ Given the most favorable conditions offered by the Russian market, the size of domestic investment is soaring as well, with local entrepreneurs reinvesting their capital in the country's economy.

Consumer demand: In the past years, Russia's model of economic growth has notably changed, with retail, telecommunication, and construction, among others, becoming key

17 RIA Novosti, May 21, 2007. Available online at: <http://www.cdi.org/russia/johnson/2007-115-4.cfm>

18 Russian IT quarterly. Available on-line at: http://www.reksoft.com/misc/reksoft_co/files/137/Russian_Economy_Outlook.pdf

19 Kommersant July 23, 2007. The Russian Investment Boom Continues

20 Polish information and Foreign investment Agency. Available on-line at: http://www.paiz.gov.pl/nawosci/?id_news=1350&lang_id=1

21 Kommersant July 23, 2007. The Russian Investment Boom Continues

drivers of the country's booming economy.²² Citizens' real incomes have doubled over the past six years and consumer demand is thriving. The flourishing Russian economy has given rise to a growing middle and upper class that "has caused an explosion in all types of consumption."²³ Not only is Russia's per-capita income, at purchasing power parity (PPP), well above that of Mexico, Brazil, Turkey, China, and even EU members Romania and Bulgaria,²⁴ but also "70% of Russians' income is disposable, vs. around 40% for a typical Western consumer,"²⁵ making it a very attractive market for FMCG, food and beverage products, apparel, and luxury goods.

Russian Retail Industry

According to AT Kearney's 2007 'Growth opportunities for global retailers' market study,

*"Global retail is experiencing an explosive modernization as investment rushes into developing markets. As the wealthiest markets mature, more retailers are pursuing new growth opportunities. Retailers that can identify the most promising markets will become fierce global competitors - able to saturate the obvious markets and gain first-mover advantage in new ones."*²⁶

Rising consumer demand for new and better products and increasing incomes have significantly enhanced the growth of emerging markets' retail sector. In Russia, consumer spending has risen rapidly for the past few years, fueled by an income growth rate of 10 percent last year (2006) and 11 percent the year before. The flourishing economy has given rise to an expanding middle and upper class that "has caused an explosion in all types of consumption."²⁷

According to AT Kearney's study, for the third year in a row Russia is ranked the second best market in the world for retail - ahead of China and Mexico, and the first in Europe. In terms of volume, within Europe, Russia's retail is more than three times higher than that of the second-placed Poland.²⁸

More spending by Russian consumers translated into an overall retail sales growth rate of 25.5 percent in 2006 and there is no sign of slowing down.²⁹ Growth is expected to increase at an average rate of 11.29 percent YOY through 2011, with the top retail chains expecting to register

22 "Where until 2004 and largely 2005 the growth model was based on an accelerated extraction of natural resources, primarily hydrocarbons, in recent years the structure and sources of growth have absolutely changed. Exports, including the exports of hydrocarbons, have ceased to be the main motive force of economic development, being supplanted by investment demand and the end household demand." Interfax News Agency, Source: The Financial Times Limited. Available on-line at: <http://www.tmcnet.com/submit/2007/05/21/2641275.htm>

23 Business Week, "Russia: Shoppers Gone Wild," February 20, 2006 Available on-line at: http://www.businessweek.com/magazine/content/06_08/b3972071.htm

24 International Monetary Fund, World Economic Outlook Database, April 2007, for the year 2006.

25 Business Week, "Russia: Shoppers Gone Wild," February 20, 2006. Available on-line at: http://www.businessweek.com/magazine/content/06_08/b3972071.htm

26 "Growth opportunities for global retailers." A.T.Kearney, 2007.

27 Business Week, "Russia: Shoppers Gone Wild," February 20, 2006. Available online at: http://www.businessweek.com/magazine/content/06_08/b3972071.htm

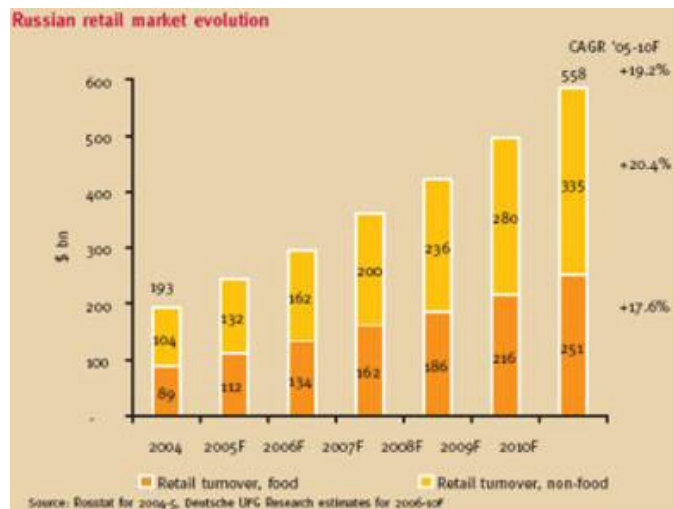
28 "Russia Tops Europe's Retail Ranking." Available on-line at: <http://www.themoscowtimes.com/stories/2007/10/30/058.html>

29 "Growth opportunities for global retailers." A.T.Kearney, 2007.

42 percent average revenue growth.³⁰ According to the RNCOS report ‘Russian Retail Sector Analysis (2007-2011),’

“Russian retail sales reached approximately \$318 billion last year (2006). This has made Russia the second most lucrative and twelfth largest retail market throughout the globe.”³¹

According to the World Bank’s June 2007 report, the ongoing strengthening of the currency (Ruble) and stable growth in personal incomes are expected to help expand the retail market’s size to \$744.92 billion by the year 2011.³² As economic development boosts income throughout the country, retailers will expand beyond the main cities.³³ Retail chains are moving steadily outside of Moscow and St. Petersburg into Russia’s other major cities, where demand for Western products is burgeoning.³⁴ According to international experts, *“Russia is the market of the future.”³⁵*



Russian Restaurant Industry

The Russian restaurant industry accounts for 46 percent of all retail sales in Russia.³⁶ The Russian food-retail market also offers excellent growth opportunities. The retail food sector has grown 24 percent during 2001-2006 and has reached \$144.62 billion in revenue.³⁷ The steady growth in personal incomes and ongoing real Ruble appreciation will help food retail reach sales of more than \$350 billion by 2011.

30 Russian Food Market Projected to Touch US\$ 227 Billion Level. Available on-line at: <http://www.rncos.com/Blog/2007/03/russian-food-market-projected-to-touch.html>

31 “Russian Retail Market to Hit US\$ 744.92 Billion Mark by 2011.” Available on-line at: <http://www.newswiretoday.com/news/18038/>

32 Available on-line at www.worldbank.com.

33 RNCOS Food industry Research, “Russian Food Market Projected to Touch US\$ 227 Billion Level,” March 20, 2007. Available online at: <http://www.rncos.com/Blog/2007/03/russian-food-market-projected-to-touch.html>

34 The Russian market place, “A farewell to Russia,” US agricultural trade office-Moscow, 3.

35 “Go for Russia, not China, wine experts say.” June 21, 2007. Available online at:

http://www.breitbart.com/article.php?id=070621045143.mp9e76kt&show_article=1&cat=0

36 „Russian Food and Non Food Retail Forecast (2007-2011),” September 2007. Available online at” http://www.researchandmarkets.com/reortinfo.asp?report_id=556427

37 Ibid.

Moscow and St. Petersburg have the largest share of restaurants in the country, with approximately 38 percent of the total market.³⁸ However, because Russia is more developed than Ukraine, there is a bigger opportunity for expansion into the more remote regions of Russia.

The Russian restaurant market consists of several market niches:

- “Boutique” restaurants - higher priced outlets
- “Democratic” restaurants - moderately priced outlets
- Coffee shops - combination of coffee and food, counter-style service
- Fast food - which has two separate sub-segments
 1. Street/Mobile fast food - kiosks, stalls, and carts
 2. Walk-in/Sit-down fast food outlets - with counter service

Russian Fast Food Market

The development of the Russian retail market and rising disposable incomes is precipitating a major change in the way Russians buy their food. The country’s emerging middle class consumers are looking for better comfort, quality, and safety when shopping, all of which is good news for chain operated fast food restaurants. People are moving away from shopping in outdoor venues and moving toward more modern establishments. The market share for organized food chains has risen from 9.5 percent in 2005 to an estimated 15.6 percent in 2007.³⁹

There are many competitors in the Russian fast food market including McDonald’s, Rostick’s, Russkoye Bistro, Sbarro, Mobile “Stop-top” units, Kroshka-Kartoshka, Teremok Russian Bliny, and KFC, which are amongst the biggest players. McDonald’s is by far the biggest fast food operator in Russia, and one of the oldest, entering the market back in 1990. They now operate more than 175 outlets across the country, with more than 100 in Moscow. According to Michael Roberts, president and senior director of McDonald’s corporation, “Russia was the fifth most profitable market in Europe, and by far the most profitable in Eastern Europe.”

There are 13 cities in Russia with populations of more than one million, which are optimal locations for fast food expansion within Russia, especially for those who already have a foothold in Moscow and St. Petersburg.

Opportunities in Eastern Europe

Ukraine and Russia have experienced fantastic growth in the retail and restaurant industries since 2000. This growth is expected to continue into the next decade as tourism continues to rise and the stable macroeconomic conditions produce rapid growth of infrastructure and rising personal incomes. As consumer spending continues to grow people will opt for consumer food services, finding them convenient and time- and effort-saving. Cities will be the areas where consumer foodservice grows most dynamically, both in value and volume terms.

The opportunities for fast food establishments do not stop with Russia and Ukraine. There are opportunities for expansion throughout Eastern Europe. Countries in this region are experiencing very similar growth rates. Other optimal targets for expansion within Eastern Europe include, but are not limited to, Poland, Czech Republic, Hungary, and Romania. These markets are experiencing similar trends and overall development throughout the region is booming.

³⁸ “Food Buying Patterns Change as Russian Retail Market Booms,” March 1, 2007. PMR Consulting Group. Available online at: <http://www.just-food.com/article.aspx?id=97679&d=1>

³⁹ Ibid.