



RUSSIA'S RETAIL MARKET: TRENDS AND OPPORTUNITIES

Summary of contents

- Russia's economic outlook
- Russia's retail sector
- Case studies
- Opportunities

Russia's economic outlook

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.¹ 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 2006.² In addition, the stable political environment has contributed to making 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,³ compared, for instance, to \$14 billion in Poland in the *entire* 2006.⁴ 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."⁵ Given the most favorable conditions offered by the Russian market, the size of

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

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

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

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

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

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 drivers of the country's booming economy.⁶ 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."⁷ 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,⁸ but also "70% of Russians' income is disposable, vs. around 40% for a typical Western consumer,"⁹ making it a very attractive market for FMCG, food and beverage products, apparel, and luxury goods.

Russia's retail sector

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."*¹⁰

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."¹¹

6 "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>

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

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

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

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

11 Business Week, "Russia: Shoppers Gone Wild," February 20, 2006.

http://www.businessweek.com/magazine/content/06_08/b3972071.htm

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.

2007 rank	Country	Region	Country risk	Market attractiveness	Market saturation	Time pressure	GRDI score
		Weight	25%	25%	30%	20%	
1	India	Asia	67	42	80	74	92
2	Russia	Eastern Europe	62	52	53	90	89
3	China	Asia	75	46	46	84	86
4	Vietnam	Asia	57	34	76	59	74
5	Ukraine	Eastern Europe	41	43	44	88	69
6	Chile	Americas	80	51	42	43	69
7	Latvia	Eastern Europe	77	32	21	86	68
8	Malaysia	Asia	70	44	46	54	68
9	Mexico	Americas	83	58	33	33	64
10	Saudi Arabia	Mid. East/N. Africa	65	40	66	35	64

12

In terms of volume, within Europe, Russia’s retail is more than three times higher than that of the second-placed Poland.¹³

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.¹⁴ Growth is expected to increase at an average rate of 11.29 percent YOY through 2011, with the top retail chains expecting to register 42 percent average revenue growth.¹⁵ According to the RNCOS report ‘Russian Retail Sector Analysis (2007-2011),’

“Russian retail sales reached approximately US\$318 billion last year (2006). This has made Russia the second most lucrative and twelfth largest retail market throughout the globe.”¹⁶

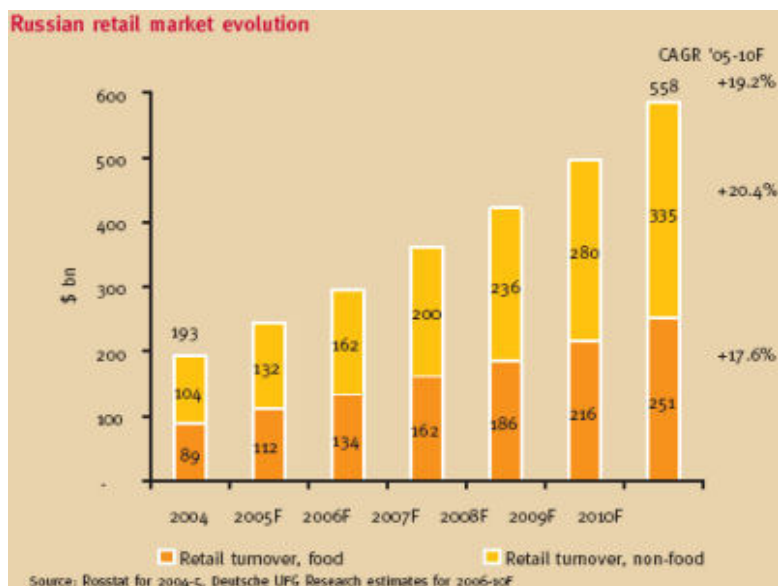
12 “Growth opportunities for global retailers.” A.T.Kearney, 2007.

13 “Russia Tops Europe’s Retail Ranking.” Available on-line at: <http://www.themoscowtimes.com/stories/2007/10/30/058.html>

14 “Growth opportunities for global retailers.” A.T.Kearney, 2007.

15 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>

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



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 US\$744.92 billion by the year 2011.¹⁷ As economic development boosts income throughout the country, retailers will expand beyond the main cities.¹⁸ Retail chains are moving steadily outside of Moscow and St. Petersburg into Russia's other major cities, where demand for Western products is burgeoning.¹⁹ According to international experts, "Russia is the market of the future."²⁰

Case studies

On average, large retail chains in Russia increased their turnover by almost 50 percent in 2005,²¹ and global leaders are experiencing exceptional success. According to A. G. Lafley, CEO of Procter & Gamble, his company "exceeded \$1 billion in sales [in Russia alone], with the latest annual growth rates of 20-30 percent."²² Another global leader in the retail sector, Johnson and Johnson, declared 80 percent growth in Russia in 2006.²³

Global players who have not entered the market yet are planning to do it soon, or else they will find it difficult to gain a significant market share. According to Mike

¹⁷ Available on-line at www.worldbank.com.

¹⁸ RNCOS Food industry Research, "Russian Food Market Projected to Touch US\$ 227 Billion Level," March 20, 2007.

<http://www.rncos.com/Blog/2007/03/russian-food-market-projected-to-touch.html>

¹⁹ The Russian market place, "A farewell to Russia," US agricultural trade office-Moscow, 3.

²⁰ "Go for Russia, not China, wine experts say." June 21, 2007.

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

²¹ "Foreign Retailers in Russia," Compiler Trade Portal. November 2007. Available online at:

<http://www.compiler.fi/idankaupan/tutkimukset/LTKK37e.html>

²² American Chamber of Commerce in Russia. Available on-line at: <http://amcham.ru/>

²³ Ibid.

Bratcher, Wal-Mart Vice-President, *"local retailers are experimenting with new formats and are growing rapidly. Consumers are getting richer. All this makes Russia very, very attractive to us."*²⁴

Among other examples, IKEA, though entering the market only in 2000, has already established a significant presence in Russia. IKEA has quickly become the market leader and it is expanding beyond Moscow and Saint Petersburg, opening new stores in regional cities every year. Ralph Lauren and Debenhams²⁵ set up shops in Moscow in 2007, and Starbucks opened its first location in the Russian capital in September 2007.²⁶

This high dynamism ought to attract newcomers into the market, in which the estimated profit rate is somewhere between 15 and 30 percent.²⁷ Expected strong growth of purchasing power combined with high profit margins in the Russian retail trade is likely to further enhance international interest in the market.

Opportunities

Altogether, the retail growth in the coming years is expected to be stronger than GDP growth. The government has relatively less regulations for consumer-based economy, and Russia's political stability and unexplored business opportunities make Russia all the more attractive for western players.²⁸

Moscow and Saint Petersburg still account for the lion's share of retail spending and sales growth, with about 38 percent of the country's total.²⁹ As market saturation in tier-one cities increases though, some domestic retailers have successfully branched out into second-tier locales. Kazan, Yekaterinburg, Samara, Nizhny Novgorod, Perm, Voronezh, Chelyabinsk, and Novosibirsk all have healthy retail investment, with domestic retailers leading the way.

Russia's X5 Retail Group has nearly doubled its presence in Yekaterinburg with its Pyaterochka discount store chain, and Paterson invested approximately \$35 million to expand its supermarket chain into Tolyatti, Samara, Chelyabinsk, Ufa, and Kazan.³⁰

In a move that reflects a consumer readiness concept, Carrefour entered the Russian market in 2006 via tier-two cities, skipping the saturated major cities after noting domestic movement away from them. Other international retailers are also expanding into second-tier cities. IKEA opened a shopping center in Kazan last year

24 "Wal-Mart eyes local partner for Russia-paper." Available on-line at: <http://www.reuters.com/article/consumerproducts-SP/idUSL1284304120070212>

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

26 "After years of trying, Starbucks to open first shop in Russia." Available on-line at: <http://www.iht.com/articles/2007/08/19/bloomberg/bxcoffee.php>

27 Ibid.

28 Ibid.

29 "Russian Food and Non Food Retail Forecast (2007-2011)." Available on-line at: <http://www.rncos.com/Report/IM558.htm>

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

and announced plans to keep expanding into Russian cities with population of more than 1 million people in the coming years.³¹

According to a report from real estate consultants Cushman & Wakefield, published on October 26, 2007,

“Russia will create more new shopping center space during the second half of 2007 and all of 2008 than any other country in Europe.”³²

The report in particular points to a booming market in the regions as a catalyst for the country's retail explosion.³³ Rapidly rising incomes are driving a consumer boom to follow the one that kicked off in Moscow some years ago. According to the report, more than 4.6 million square meters of new shopping space is set to hit the market in the 18 months running up to the end of 2008.³⁴

Tim Gosling, head of research at Cushman & Wakefield Stiles & Riabokobylko, said:

“Development has really taken off across the Russian regions this year, with quality developers such as BV Development and The Regions rolling out shopping centers to up the stakes in the major regional cities.”³⁵

If you would like to obtain additional information about Russia's retail sector please contact Silvio Pitter at Aginsky Consulting Group by phone at 503-922-2966 or via e-mail at s.pitter@aginskyconsulting.com.

³¹ “Growth opportunities for global retailers.” A.T.Kearney, 2007.

³² “Russia Tops Europe's Retail Ranking.” Available on-line at: <http://www.themoscowtimes.com/stories/2007/10/30/058.html>

³³ Ibid.

³⁴ Ibid.

³⁵ Ibid.