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Report Highlights:

This is the first issue of The Russian Marketplace, a newsletter prepared by ATO staff in Moscow, St. Petersburg, and Vladivostok. The purpose of this newsletter is to report on developments and trends in the food processing, retail and food service sectors in Russia and help expand U.S. exports of agricultural, food, and beverage products.

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The Russian Marketplace**July/August 2002****Volume 1, Issue 1**

This is the first issue of The Russian Marketplace. The purpose of this newsletter is to report on developments and trends in the food processing, retail and food service sectors in Russia, identify key trade events and other marketing opportunities, and help expand U.S. exports of agricultural, food, and beverage products.

A) Market Spotlight***The Food Retail Sector in St. Petersburg*****Maria Baranova, Marketing Specialist**

The food retail sector in St. Petersburg, while typical for most Russian metropolitan areas, differs from the retail sectors in Western Europe and the United States where the bulk of food sales are made through a relatively small number of supermarket chains that dominate the retail market. For example, in Denmark several supermarket chains belonging to the FDB Company cover 35 percent of total retail food sales. The next largest chain, Dansk Supermarket, holds 17 percent of the market. A similar situation exists in Great Britain, Germany, and the United States. Currently, in St. Petersburg and other cities in Russia, most retail food sales are made through small stores and kiosks. According to the St. Petersburg Committee on the Consumer Market, over 7,000 small retail outlets operate in St. Petersburg, accounting for almost 50 percent of food product sales.

However, local retail chains have developed rapidly over the past several years. Among the best known are Pyatorochka, Kopeika, Lenta, and Nevskiy. There are also several retail alliances and unions of universamov (Soviet style supermarkets).

The discount chain Pyatorochka, which opened its first outlets in Moscow and the Moskovskaya oblast, currently has 40 stores in St. Petersburg. This year, the company began to build its own 30,000 square meter (m²) warehouse, which will have an inventory of 3,000 items and daily goods flow of 1,200 tons. The company also has plans to add 10 new stores per year. Step by step, Pyatorochka is developing into a classic supermarket chain. However, the outlets are generally small, averaging only 450 square meters in size and carrying about 1,500 items.

The Kopeika retail chain, owned by ATK Zdorovie, is also expanding, having invested about \$3 million in 2001. Currently, the chain consists of 15 regular retail stores and nine small “cash and carry” outlets.

Following the trend toward large-format outlets for furniture, building materials and home goods (Adamant, Maxidom, and IKEA), food retailers are also beginning to construct larger stores. The Liat-Dixi company has announced plans to construct a hypermarket chain in St. Petersburg consisting of six self-service stores of 5,000 square meters each, with a total investment of \$40 million. All of the sites will be located in the vicinity of subway stations. Unlike some of the existing “cash and carry” outlets in St. Petersburg, the Liat-Dixi chain will target middle-income consumers.

Large international chains are also entering the market, changing the rules for Russian food retailers

in the process with aggressive pricing and marketing strategies. In November 2001, Germany's Metro AG opened two new outlets in Moscow. The company reportedly plans to build a retail network in Russia, with St. Petersburg considered to be one of the priority regions. In fact, Metro has announced plans to open two hypermarkets in St. Petersburg in 2003 at a cost of \$25 million each.

However, Mr. I. Grigoryev, manager of OAO Petmol, suggests that foreign retailers may not yet be ready to enter the St. Petersburg market, noting that the entry process is slow and expensive. Though the large Western retail companies have huge financial resources and experience in international food distribution systems, the capabilities of local food suppliers are limited. Western chains are very strict with regard to delivery schedules and the quality of goods. Thus, local producers cannot expect to work with a Western chain if they cannot meet these exacting demands.

Nevertheless, local enterprises have begun to prepare themselves to work with these supermarket chains. For example, baked goods producer OAO Khlebnyi Dom finished the refitting of its distribution warehouse this spring. Included in this refurbishing project was the installation of an automated system for warehousing and shipping finished goods. The Baltika brewing company has installed a \$10 million warehouse management system that collects information by bar code (quantity, type and date of issue) and feeds this information to the central computer, which manages distribution. At the beginning of 2002, another producer, ZAO Svarog, finished installation of the first Warehouse Management System (WMS) in a Russian enterprise. This system makes it possible to place orders and purchase requests on-line. The basis of the system is to manage all processes in real-time mode using bar-code technology.

B) Market Tidbits

- According to The Moscow Times, Nestle Russia reports that average per capita chocolate consumption in Russia is expected to jump to 3.1 kg next year from 2.2 kg this year. The increase is largely due to a significant rise in the standard of living for many Russians. However, per capita chocolate consumption in Russia is still far below the level in developed countries. For example, average annual chocolate consumption in Switzerland is 12 kg and 10 kg in Germany and Belgium.

- During 2002-2004, Seventh Continent, one of the largest Moscow-based retailers, plans to open 20 new large-scale wholesale/retail trade facilities with total area of 15,000 - 30,000 square meters. Local sources estimate that this would allow Seventh Continent to double its retail turnover. Seventh Continent, which operates 23 outlets in Moscow with total area of 30,000 square meters, had total sales of \$200 million last year.

- Russia's economy continues to expand following growth of about 9 percent in 2000 and more than 5 percent in 2001. While forecasts point to somewhat slower growth in 2002, the economy is still projected to expand by 3.5-4.5 percent. Consumer confidence and spending are also on the rise. Growth in the food sector has been especially strong – a fact that has not been lost on local and foreign retailers, who are rushing to open new supermarket outlets. Domestic food processors also are shifting to meet consumer demand for more varied and better quality foods. All of these factors point to new and growing opportunities for U.S. exporters of high quality consumer-ready food products and ingredients for the local processing sector.

- Ramenka's newest and largest shopping complex will open in November 2002, with a total area of 72,000 square meters. The new outlet will host a 35,000 square meter Ramstore hypermarket, which will carry more than 40,000 items. The shopping complex will also include a movie theater complex, roller skating and bowling centers, children's playground, and more than 100 independent shops. Ramenka was established in 1997 as a wholly owned subsidiary of the Turkish companies, KOC Group and Enka. Ramenka currently manages 9 stores in Moscow but will open another 8 to 10 stores this year. Over the next two to three years, Ramenka plans to open a total of 50 supermarkets in Russia, expanding to St. Petersburg, Nizhny Novgorod, and Yekaterinburg.

- American-style coffee houses are catching on in Moscow and other Russian cities. Restaurant holding company Rosinter, which opened its first coffee shop in Moscow at the end of April, plans to open up to 20 more Coffee House outlets by the end of 2002. Local chain, Montana Coffee, will have more than 20 shops by the end of 2004, while several other local chains also have ambitious expansion plans. According to coffee shop operators, competition is not a problem as the market is growing rapidly. By way of comparison, Moscow now has about 40 American-style coffee shops in a city of 10 million compared the 620 coffee shops for one million residents in Seattle.

Northwest Russia (St. Petersburg)

- Sergey Lepkovich, Director of the supermarket chain Pyaterochka, announced that the company's new St. Petersburg distribution center/warehouse should be operational by August 2003. The facility will be the largest distribution center in Northwest Russia and will cost an estimated \$7 million. One of the project investors is the European Bank for Reconstruction and Development (EBRD). Mr. Lepkovich noted that the company's retail headquarters would also be relocated to the new center. At present, Pyaterochka has 100 supermarkets in Moscow and St. Petersburg, with retail turnover of \$200 million in 2001 compared to only \$75 million in 2000. For 2002, the company plans to increase sales to \$400 million.

- Peterburzhenka Food Company is planning to build a meat processing plant in the Nevskiy District of St Petersburg on a 5,000 square meter site. The plant will have a daily production capacity of 30 tons, and the main product will be uncooked sausage, which is in high demand in St. Petersburg. The RF Savings Bank will provide financing for the project. The Peterburzhenka Food Company has operated in the local market since 2000 and produces 120 different items, which are distributed in St Petersburg, the Moscow Region and the northern parts of Russia.

- Imperia Trading Firm, a St. Petersburg snack producer, has acquired a new production line, which will increase the company's monthly output by 150 percent compared to the previous year (up to 1,000 tons) and expand the range of products from 40 to 60 categories.

- St. Petersburg-based Petrokhleb Holding Group plans to install a new loaf production line at its Gatchina Bakery (Leningrad Region), which will produce 25 tons of 15-18 different types of bread daily. Petrokhleb will invest a total of \$2.3 million in its bakeries and distribution network in the Leningrad Region. Currently, only 25 percent of Petrokhleb's sales are conducted through its own trading network, but the company intends to increase this share to 45 percent. Petrokhleb has 15

subsidiaries in St. Petersburg and the Leningrad Region, including mills, bakeries and trading companies. Petrokhleb also operates a distribution network of 160 outlets in the Region. Last year, Petrokhleb reported a profit of \$1.9 million, an increase of about 17 percent above the 2000 level, while sales grew from \$23 million in 2000 to about \$25.5 million in 2001.

- Lenstroimaterialy Construction, based in St. Petersburg, will invest \$7 million in its own facilities in 2002. The company plans to spend \$2 million for FAVA equipment (Italy) to be installed in the 1st St. Petersburg Macaroni Factory, which will increase annual output by about 50 percent (up to 45,000 tons). Another Lenstroimaterialy project involves the acquisition of new flour milling equipment from Germany worth \$5 million to be installed at the St. Petersburg Flour-Milling Plant. The project is to be financed under a German credit line within the framework of a Russian-German intergovernmental agreement.

- The Stepan Razin Brewery, St. Petersburg, is installing a new \$2 million can-filling line from Germany. The new line is capable of filling 20,000 cans per hour, which means that the company will be able to increase its annual output by 30 percent. Rostar Company will supply the cans. Stepan Razin production facilities are located in St. Petersburg, Vyborg and Cherepovets, and produce 12 types of beer.

C) Trade Events and Other Market Promotion Opportunities

World Food Moscow 2002 (September 25-28, 2002, Moscow)

In 2001, World Food Moscow (WFM) drew 670 exhibitors from 39 countries and attracted nearly 50,000 visitors from all parts of Russia and from many neighboring countries. For 2002, FAS has organized an American Pavilion in which several U.S. companies and trade organizations will be exhibiting. Unfortunately, exhibitor space at WFM 2002 is already sold out, but visiting the show would still provide an opportunity to learn more about the dynamic Russian market and meet potential trade partners. For more information on World Food Moscow, contact the U.S. Agricultural Trade Office in Moscow.

Peterfood 2002 (November 11-14, 2002, St. Petersburg)

This show, which focuses on the Northwest Russia food market, has exhibited steady growth over the past several years. For Peterfood 2001, the number of exhibitors was up by 20 percent and visitor attendance increased by 25 percent over the previous year. ATO staff recorded over 1100 visitors to the FAS Information Booth. About 55 Russian importers and producers, mostly from Northwest region of the Russian Federation, demonstrated strong interest in purchasing a wide range of U.S. food and agricultural products, including frozen chicken, beef, pork, soybeans, dried fruits and nuts, and other food ingredients. This level of interest demonstrates the increasing potential for U.S. products in the Russian food and edible oil processing industries. For more information on Peterfood, contact FAS/St. Petersburg or the U.S. Agricultural Trade Office in Moscow.

Ingredients Russia 2002 (November 26-29, 2002, Moscow)

This show focuses on the fast-expanding food processing sector in Russia, with an emphasis on food additives, dairy ingredients, spices, emulsifiers, stabilizers, dehydrated fruits and vegetables, starches, enzymes, cereal products, flavorings, yeast, sugars and preservatives. The show organizer,

ITE Group PLC, expects 250 exhibitors and more than 11,000 visitors. For more information on Ingredients Russia, contact the U.S. Agricultural Trade Office in Moscow.

KhabProdMarket (December 13-16, 2002, Khabarovsk)

This show, which is held in Khabarovsk, is the largest food and beverage exhibition in the Russian Far East RFE). The 2001 show drew nearly 200 exhibitors and more than 12,000 visitors, including importers, distributors, retailers and processors from the Russian Far East and some neighboring countries. Given the proximity to the U.S. west coast, the RFE could be a very good market for many U.S. consumer-ready food products, as well as a variety of food ingredients. FAS plans to organize a sample/catalog exhibition at the KhabProdMarket show. For more information on KhabProdMarket, contact FAS/Vladivostok or the U.S. Agricultural Trade Office in Moscow.

Prodexpo 2003 (February 3-7, 2003, Moscow)

The largest food and beverage exhibition in Russia, Prodexpo 2002 attracted 1,700 exhibitors from 55 countries and more than 50,000 visitors from all parts of Russia and from many neighboring countries. For the 2003 show, FAS is planning to organize an American Pavilion. Please contact the U.S. Agricultural Trade Office in Moscow for additional information on Prodexpo.

Northwest Food Forum/Interfood 2003 (April 2003, St. Petersburg)

The Northwest Food Forum/Interfood Trade Show is held annually in St. Petersburg and is the largest food show in Northwest Russia. For 2002, the number of exhibitors participating in the show increased 25 percent and visitor attendance was up by 30 percent over the previous year. ATO staff recorded over 2100 information booth visitors during the show, with about 150 Russian importers and producers, primarily from the Northwest region of the Russian Federation, showing strong interest in buying U.S. food and agricultural products, including animal protein meal, popcorn, beef, pork, soybeans, dried fruits and nuts, and other food ingredients. Please contact FAS/St. Petersburg or the U.S. Agricultural Trade Office in Moscow for additional information on the Northwest Food Forum.

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