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Opportunities for U.S. Supplies to the Russian Beer Industry

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Report Highlights:
The Russian beer industry is one of the most dynamic sectors of the Russian economy. Despite the August 1998 ruble devaluation and disruptions in the financial services sector, Russian production grew 33 percent in 1999 and is expected to continue growing around 20 percent annually for five years. In this environment, exporters of malting barley, malt and hops have a significant export opportunity.

Includes PSD changes: No
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Executive Summary

The Russian beer industry is one of the most dynamic sectors of the Russian economy. Despite the August 1998 economic crisis, production grew 33 percent in 1999 making beer production one of the fastest growing sectors in the Russian economy. Beer output is expected to continue growing around 20 percent annually for the next five years. This expansion has been spurred by increasing beer consumption, a sharp reduction in beer imports, large investments in the industry and favorable treatment by regional and federal governments. In this environment, U.S. exports of malting barley, malt and hops have a significant opportunity for growth. There are more than 300 breweries in Russia which have a total of 4.35 billion liters capacity, but three companies -- Sun Brewing-Interbrew, Scandinavian Baltic Beverage Holding-Baltika, and Ochakovo -- account for almost half of Russia's beer production.

Russia's Dynamic Beer Industry

The Russian beer industry is one of the fastest growing parts of the Russian economy. Despite the August 1998 ruble devaluation and disruptions in the financial services sector, production grew 31 percent in 1999 and is expected to continue growing around 20 percent annually for the next five years. This growth has been spurred by increasing beer consumption, a sharp reduction in beer imports, large investments in the industry and favorable treatment by regional and federal governments.

Rising Consumption

Although Russia is better known for vodka, beer consumption in Russia has increased dramatically during the 1990's to an estimated 3.2 billion liters annually in 1998 and an estimated 3.7 billion liters in 1999, worth $5 billion according to Business Analytica Europe Ltd. Beer consumption has increased recently as vodka consumption has fallen because of lower relative prices, increasing interest in health because beer contains less alcohol, and because vodka perceived as less prestigious then beer, especially by young people in large cities. The growing availability of beer has also increased consumption from a low in the mid-90's.

Per capita beer consumption in 1999 is 25 liters, which is a higher than the 23 liters level in 1990 and up substantially from a low of 7 liters in 1996 when the Russian beer industry was in a difficult financial situation. However, according to Business Analytica, it is far below per capita consumption in other countries such as the Czech Republic which consumes 156 liters per annum or, Germany at 130, Ireland at 123, Denmark at 117; and the United Kingdom at 104. Although consumption is not expected to reach 100 liters per annum in the near future, Russian industry sources expect that it will reach 60 liters per annum in the next 10 years, roughly equaling per capita consumption in South Africa. Consumption levels in more affluent Moscow and St. Petersburg are some of the highest in Russia at 45 and 50 liters per year, respectively.

Low Imports

The 1998 ruble devaluation cut consumer purchasing power and undermined what was a growing market for imported beer. As a result, the market share of imported beer fell from 21.7 percent in July 1998 to 4.4 percent one year later as Russians turned to domestic beer. According to Russian official statistics, imports are forecast to fall 86 percent from 1997 to 1999 -- from 89 million liters to only 12 million liters. Hardest hit were imports from the Czech Republic, Denmark, Germany, Netherlands, the UK, and the US -- all of whose beer imports fell by more than 90 percent. Least affected was Finland whose imports fell by only 22 percent and whose products currently claim one third of all Russian beer imports.

Beer imports are not expected to increase quickly in the near future because of competition from inexpensive Russian brands at the low end of the market and the introduction of high-end Russian beers -- some of which are foreign brands brewed under license. At the present time Lowenbrau, Bear Beer and Efes are being brewed under license while Holstein, Staropramen and Heineken are planning to start production soon. The high duty on imported beer (HS2203.00) of 0.6 Euro (62 cents) per liter also makes many imported beer prohibitively expensive. This fixed duty has a disproportionate impact on imports of less expensive beers and can more than double the price of a bottle. Because of these factors, industry sources expect that the share of imports will only grow slightly to 5 percent over the next few years if the ruble remains stable.

Growing Investment

With investments over the last three years approaching $1 billion, the beer industry is a major recipient of Russian and foreign investment. Particularly active have been foreign beer companies such as Sun Interbrew of Belgium, SAB of South Africa and the UK, and Carlsburg of Denmark. In addition, foreign firms like Bravo began beer production in 1999 and have become a major producer in less than a year. Other reports mention that a U.S.-based brewery is considering investing almost $150 million in breweries in Siberia and Kaliningrad which will produce 20 million liters of Russian and US brand beers by 2002.

Favorable Regulatory Treatment

The Russian Duma views breweries as a key source of job and tax revenues. Because of this and the view that more beer consumption cuts alcohol consumption by displacing vodka, it is reluctant to undercut development of the industry. The Duma even has a working group in place to assist it. This combined with effective lobbying by the industry has resulted in a favorable legislative climate.

For example, Russian brewers successfully lobbied the Duma to lift a special stamp tax on beer in 1995. Although the Duma considered taxing beer like other types of alcohol (which would have made beer and cheap vodka the same price), the Federation Council vetoed the draft law. In 1999 the excise tax was rolled back from 40 percent to the present rate of 72 kopeks per bottle, an 84 percent cut. Although the Duma is considering raising to 95 kopeks a bottle, this would still leave the beer industry in better shape at the end of 1999 than in the beginning but is expected to hurt consumption at the lower end of the beer market. In contrast, the vodka industry has been subject to increasing taxation, regulation and threats of renationalization. Currently, the beer industry is lobbying for laws that would lower import tariffs on imported ingredients for beer production, further cut in excise taxes and increased duties on imported beer.

Many regions also assist their local beer industries. For example, Leningrad Oblast pays back its breweries half the excise tax for beer on bottles sold in the region. This strengthens local firms and provides a competitive advantage to local brewers who are often major employers. Industry sources say tax holidays and other types of de facto subsidies are commonly given by regional governments.

Consumption Patterns

Market Segments

Russia's beer market is broken down into four major segments. The first are the traditional regional beers which are very inexpensive (prices range from 3-6 rubles a bottle) and are sold primarily to low income consumers in the cities and are the most popular beers in the regions. Production of these brands, which come from about 200 regional breweries increased after the 1998 economic crisis. These breweries usually do not have money to import raw materials.

The second segment consists of the moderately-priced regional and national brands that are of better quality. These beers sell for about 6-8 rubles a bottle and often have loyal consumers in the regions they are brewed in. Typically, these companies are either not interested in expansion or are national brands with effective marketing arms. Some of these firms may be interested in imported raw materials but are very price sensitive because of intense competition.

The higher-end Russian beers are expanding market share. These are either special Russian brands produced with imported raw materials or are foreign brands produced in Russia under license. These producers are likely to have the strongest interest in imported malt, malting barley and hops because of their high quality and reliable supplies. The demand for these beers, which sell for between 12 - 20 rubles a bottle, has been increasing as the Russian economy slowly recovers from the 1998 economic crisis.

The final segment is the imported beers whose market share fell dramatically after the 1998 ruble devaluations. While imports held 10-20 percent of the beer market before the crisis, they account for only 2-3 percent now – and almost all that concentrated in Moscow and St. Petersburg.

Seasonal changes

Beer consumption tends to vary considerably over the year with peaks during the hot months of the summer and around New Years. Early Fall and Winter tend to be quiet periods. Breweries tend to buy inputs most heavily 3-4 months before peak consumption seasons.

Opportunities for U.S. Exporters

The unavailability of reliable quality malting barley, malt and hops in Russia have increased brewers' interest in imported products. According to the Russian beer industry sources, this lack of inputs is one of the largest constraints to the growth of the brewing industry. Despite some investments by breweries in improved domestic production, chronic problems in Russian agriculture mean that quality products will be slow in coming. The recent stability in the ruble and relatively strong finances have also given brewers the means to import again.

Because of these factors, imports of production inputs will be very attractive, especially for the producers of quality beers in Russia. Russian brewers are particularly interested in a long term relationship with reliable supplies available at a reasonable price. However, those minority of Russian breweries (which are often joint ventures) that buy their supplies through alliances with European breweries rarely buy directly from suppliers outside these systems. For example, Vena in St. Petersburg gets its inputs through Carlsberg of Denmark.

Malting barley

The chronic shortage of quality malting barley in Russia has been worsened by a poor 1999 harvest which fell almost 23 percent from already low 1998 levels. Most malting barley production is centered around the Black Earth region around Kursk and Orel Oblasts. Although there is no official data on imports of malting barley, industry sources report that currently most Russian breweries import barley from Europe, especially Germany, Sweden, Finland, Denmark, and France. Opportunities for U.S. exports have been boosted by increasing beer production and the construction of malting plants in Russia. For example, Efes has begun operations of a malting plant that will use 100,000 ton per year of malting barley near Moscow while the Russian brewing company Baltika is building one that will use 125,000 tons a year in St. Petersburg. US competitiveness should also be boosted by a small 1999 EU malting barley crop and a cut in EU free market restitutions (subsidies) for malting barley which fell by $10 a ton. The duty on imported malting barley (HS1003.00) is 5 percent.

Malt

Although Russia occasionally exports malting barley and reimports malt produced, there is substantial demand for imported malt with total demand estimated at 470,000 tons annually, with rising imports that have doubled since 1996 to almost 250,000 tons. This is especially true for firms but do not have access to malters (which are interested in producing better beers). Industry sources said that a key factor for successful U.S. exports is maintaining malt quality during ocean transit. The largest malt exporter to Russia are the EU countries, especially France, Germany and Finland. The duty on imported malt (HS1901.90.110-910) is 15 percent.

Hops

The Russian hops producers who which only harvested an estimated 500 tons of hops in 1999 cannot produce nearly enough to meet the demand of the breweries. In addition, Russian producers, based in Kursk, Mordovia, Chuvashia, Altai Krai are not considered reliable suppliers. As a result, many breweries import hops from the U.S., Czech Republic and Germany and will likely expand imports further in line with production. Because of falling beer consumption in the Czech Republic and Germany, Russian breweries have benefitted from low prices for hops coming from these countries. The duty on imported hops (HS1201) is 5 percent.

Major Breweries

There are more than 300 breweries in Russia which have a total of 4.35 billion liters capacity, but three companies -- Sun Brewing-Interbrew, Scandinavian Baltic Beverage Holding-Baltika, and Ochakovo -- account for almost half of Russia's beer production. This concentration of production is expected to deepen as the industry continues an ongoing wave of buyouts and mergers. Below is information on some major beer companies.

- A Scandinavian Baltic Beverage Holding (BBH): This holding has a 43 percent share in the popular Baltika Beer brand whose brewery is the largest in Eastern Europe. In 1998, Baltika produced 450 million liters of beer. It holds 15 percent of the beer market in Russia. BBH also owns the Yarpivo Brewery in the city of Yaroslavl, around 150 miles north of Moscow, controls the Donpivo brewery in the southern city of Rostov-on-Don and is poised to gain control of Tula Brewery. According to specialists, BBH beer production might achieve its designed capacity of 1.1 billion liters of beer annually by the end of 1999. The company has invested $222 million between 1993 and 1998 while production has risen from 27 million liters in 1991to an estimated 500 million liters in 1999. Baltika is actively promoting exports of its products which are estimated to total 900,000 liters in 1999. It recently obtained kosher approval which will open its market in Israel, home of almost 1 million ethnic Russians.

- Sun-Interbrew Brewing was created in April 1999 with the merger of India’s Sun Brewing and Belgium’s Interbrew, the fourth largest beer company in the world . The company runs 10 breweries in Russia and Ukraine and has 11 percent of the Russian market. The merger allowed these two companies to become number two in the Russian beer market with 14 percent of the market, producing 800 million liters of beer annually. The Belgians invested $40 million and hold controlling stakes in the Omsk Brewery Rosar (as well as the Desna Brewery in Chernigov, Ukraine). Sun Brewery has invested in controlling stakes in St. Petersburg, Perm, Ivanovo, Kursk, Saransk, Ekaterinburg, and Volzhskiy breweries (and Semfiropol brewery in Ukraine). The venture plans to generate most of its revenue from selling local brands of beer. According to the industry sources, the venture plans to invest around $40 million into its breweries throughout Russia and Ukraine in the near future.

- The Ochakovo Brewery is the second largest single brewery in Russia. It is a Moscow-based, 100 percent Russian-owned brewery with its controlling stake belonging to its employees and connected to the Moscow government. It is expanding its production facilities and plans to produce around 500 million liters of beer annually. It also has plans to expand into other regions and is currently building a brewery in the southern city of Krasnodar.

- Vena: In 1998, Danish Company Carlsberg-Tuborg acquired a controlling stake in this St. Petersburg brewery and invested $60 million. The investment will help to improve beer quality and increase beer production to 230 million liters annually. Founded in 1872, Vena was combined with Stepin Razin during Soviet times only to become independent again until after perestroika when the Finns bought a share in the brewery.

- Prince Rurik Efes Moscow, an affiliate of Turkish-based Efes Beverages Group, opened its first its brewery in Moscow which has the capacity to produce 150 million liters of beer annually. When the brewery is fully online, it will be able to produce 300 million liters of beer annually.

- Stepin Razin, founded in 1795 and based in St. Petersburg is the oldest brewery in Russia. It has grown rapidly in the last 4 years with capacity increasing from 24 million to 96 million liters a year.

- Bravo International's brewery has a 120 million liter capacity. Since starting beer production in March 1999, the company's products (like Bochakorov) have rapidly gained market share, making it one of the leading beer suppliers to St. Petersburg. It also sells beer in Moscow, Samara, Rostov and four 4 other cities.

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