

# RETAIL: RUSSIA

## RISK ASSESSMENT: MEDIUM

### HIGHLIGHTS

Retail trade accounts for 16% of GDP (2017). Food and non-alcoholic beverages (30% of household expenses), clothing & footwear (10%), alcohol & tobacco (6%) constitute the bulk of households' everyday consumption. Home spending with furnishing, appliances and electronics constitute 6% of household expenses.

Opposite to food retail which is dominated by local players, non-food has attracted Western European companies like Inditex, H&M, Benetton and LPP, in clothing; Ikea, in furnishing; Leroy Merlin (local leader), Castroma and OBI, in the DIY sector. However, electrical & white goods retail is dominated by Russian M Video/Eldorado (majority-owned by tycoon Mikhail Gutseriev's Safmar) and DNS, since German Media Markt sold its business to Safmar. Popular department stores are mostly owned by local companies (GUM and TSUM at the high end, a local licensee of Marks & Spencer in the middle, and small players at the bottom).

Like in any other significant emerging market, modern retail has been regularly gaining market share to the detriment of 'mom & pop's' stores in big cities, mostly located in 'European Russia' (Russian regions geographically located on the European continent) and to the benefit of the bigger players. The modernization and concentration processes were accelerated by the crisis and the related declining sales, and it will not stop despite (or because of) the lacklustre recovery.

Russian retail sales are highly sensitive to economic conditions. After declining in 2015 and 2016 with the domestic crisis, they barely grew in 2017. In 2018, according to the Russian ministry for Economics, retail sales could post a near 3% rise, which we see as a quite optimistic forecast. As a result of limited competition and low emergence of hard discounting, margins have remained comfortable, at least for larger players which were able to conduct aggressive promotions and discounts to win more market share. Foreign grocery retailers have found it difficult to maintain their ranking.

Even if retail sales growth persists in 2019, its rate will remain lower than the pre-crisis level (over 6% in 2010-12, 3.9% in 2013). The standard VAT (Value Added Tax) rate will rise from 18 to 20%. The introduction of the VAT refund scheme for foreign tourists (October 2018) will not counterbalance this. Real disposable household income, which fell over 2015-2017 back to the 2012 level, has just started to recover slowly this year and is expected to do so in 2019 offering new opportunities. Higher oil & gas revenues should translate into higher wages and social transfers should benefit from higher fiscal revenues, while inflation could accelerate somewhat due the VAT rise and, possibly, a limited depreciation of the rouble. Nevertheless, widespread income inequality including average GDP per capita in Moscow and the surrounding region being 87% above the national average in rouble terms, and a high poverty rate in remote and rural areas, are limiting factors. Only a third of consumers have sufficient income and access to credit to buy durables. Moreover, whereas food retailers can to a great extent accommodate middle and lower class consumers with locally produced groceries as substitutes to dearer foreign products, business remains difficult for the fashion items and household goods retailers, which suffered the most in the crisis, leading a number of foreignowned ones to leave the country.

## Strengths

- Third largest market of retail trade in Europe (144 million inhabitants), expected to expand further with the population rising (albeit slowly)
- Quite high urbanization (74% of the population) and moderate concentration in the sector favour modern retail development

## Weaknesses

- High sensitivity to economic conditions: oil price / rouble exchange rate / imported inflation
- Sensitivity to geopolitical risks: sanctions and counter-sanctions can hamper sector financing and imports
- Business growth in the sector is lacklustre and concentrated in big cities

## Key Players

*(by sales volume)*

- **X5,** the main player is 47.9% owned by Alfa Group (CTF Holdings)
- **Magnit,** the number 2, has, among its shareholders, VTB (17%) and Aleksander Vinokurov's Marathon Group (12%)
- **Lenta** is 34% owned by TPG's Russian arm

*Source: Lebensmittel Zeitung, June 2018*

## Regional Risk Assessments: Retail

| | |
|---|---|
| ASIA | LOW |
| CENTRAL & EAST. EUROPE | MEDIUM |
| LATIN AMERICA | MEDIUM |
| M. EAST & TURKEY | HIGH |
| NORTH AMERICA | HIGH |
| WESTERN EUROPE | MEDIUM |

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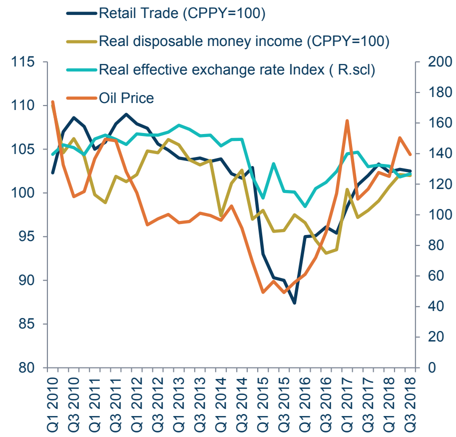
## SUPPLY

**Modern retail has been regularly gaining market share** to the detriment of 'mom & pop's' stores and open-air markets in the last 15 years, at least in larger cities, overwhelmingly located in European Russia. Retail chains' share of general retail turnover was 27.2% in 2016, 33.1% in food retail alone. With other forms of modern retailing activity (department stores, home shopping…), 68% of the Russian grocery market can be considered modern and organized, leaving old fashioned formats (kiosks, street markets, small grocery stores, informal retailing…) to smaller cities and mostly rural areas. Soft discounting represents 22% of modern grocery retail, the third highest level in Europe. Despite the arrival of international actors in the last decade, domestic chains continue to dominate the grocery market. With the first two food retailers (X5 and Magnit), and the leading seven (the above two plus, after a large gap, Lenta, Auchan, Dixy, O'Key and Metro) representing, respectively, 26% and 44% of the Russian grocery market (44% and 74% of modern grocery retailing), **concentration is moderate**. Generally located east of the Urals, but also, to a lesser extent, west of them, some regions, where national leaders are under-represented or absent because of remoteness and logistical complexity, there is a modest chain at national level (Intertorg, Monetka, Komandor, Maria Ra…) occupying first place. The latter benefit from their strong regional network, cooperation with local producers, adaptation and knowledge of local tastes and proximity to local politics. Reflecting their dominant position in Russia, Magnit (mostly convenience and forecourt stores), and X5 (mostly discount stores) were, respectively, numbers 57 and 62 on the world stage in terms of turnover (Deloitte's Global Power of Retailing 2018), and numbers 10 and 29 for their growth in 2016. Next Russian actors in the aforementioned global ranking (Dixie and Lenta, respectively in 202th and 207th places) but also smaller ones like Intertorg, Komandor, Torgservis, Monetka…) have also seen their business grow rapidly, while foreigners based in Russia have seen theirs shrink. **The decline in old-fashioned retail and the concentration process were accelerated by the crisis and related declining sales**, especially among food and fashion chains, with the exit of some smaller players through failure or sale, the closing of unprofitable stores and diversification in their retail formats, boosting the revenues of **the leading players which were already enjoying comfortable margins, thanks to limited competition and low emergence of hard discounting**. With the lacklustre recovery and central bank anxiety to rein in the strong growth of consumer credit, these trends will continue. Moscow and Saint Petersburg retail markets are dominant. **Ecommerce, despite a strongly rising turnover** (+21.5% since 2015, +33% expected in 2018) **represents only 4% of the retail market**, led by local Ulmart (electronics, garden items, childrens' things, and automotive accessories), Wildberries (cosmetics, clothing, footwear), Citilink, Mvideo (electronics) and Exist.

## DEMAND

**Like in any other emerging market, Russian retail sales are highly sensitive to economic conditions.** Retail sales declined by 10% and 4.6% in 2015 and 2016 respectively. This is connected with the fall in household real disposable income provoked by the fall in oil prices and concomitant slide of the rouble which, in turn, induced rapid inflation in the price of the many imported consumption goods that started at the beginning of 2014. The fall in real disposable income reached 10% in total over the three years to 2016. Despite a further fall of 1.7% in real disposable income, retail sales registered a 1.2% rise in 2017, the first time since 2014. This was the result of stable grocery sales and higher non-food sales, especially home electronics and mobile phones. Households were encouraged to consume by the reduced inflation rate (2.5% after 7% and 15.5% in preceding years) due to the stabilization of import prices / appreciation of the rouble, the increase in consumer credit, marketing efforts by retailers, and the return of household confidence, accompanied by a 3 percentage point drop in their savings rate. According to the Russian ministry for Economics, in 2018 retail sales could post nearly a 3% rise. We consider this forecast optimistic due to the modest growth in economic activity and income. Household real disposable income will register a modest rise, with the help of government subsidy programmes for families, and the write off of some USD 700 million in accumulated debt for 42 million Russians (45% of total overdue household loans). Nevertheless, even if retail sales growth should persist in 2019 (launch of VAT tax refund in October 2018 for tourists), its rate will remain lower than before the crisis, which is perfectly in line with the lacklustre recovery. Imported consumer goods will remain relatively expensive, as the rouble is far from having erased its past depreciation and could weaken again with accrued political risk / sanctions, rising inflation and stopping the decline in interest rates. Despite all of the above, and relatively low and still below pre-crisis level disposable household income per capita (USD 11467), the Russian consumer market remains appealing with its almost 144 million inhabitants (largest national market in Europe), of which 74% are already concentrated in urban areas which are more prone to modern retailing. 13 cities counting over 1 million inhabitants offer opportunities to expand beyond the major cities of Moscow and Saint Petersburg.

## RETAIL IN RUSSIA: HIGH SENSITIVITY TO KEY SELECTED INDICATORS




Sources : Rostat, CBR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