2018 Major Trends in the Russian Retail Market

June 2019
Executive summary

GDP grew in line with consumer price inflation, which were both driven by higher consumer spending

In 2018, Russian GDP grew at its highest rate in six years. The key driver of GDP growth was higher consumer spending rather than industrial advancements or investment.

Consumer price inflation rose noticeably at the end of the year due to the cumulative effect of expectations for higher VAT rates, utility fees and gas prices, which led the Central Bank of Russia to increase its key rate.

While Russian consumers’ financial situation has yet to stabilize, they have been shopping more

The overall financial situation of Russian consumers worsened in 2018, as real disposable income growth remains negative. Despite a gradual increase in nominal and real wages, real disposable household income continues to shrink. The accumulation of loans has been the main cause of the decline in real disposable incomes.

Consumers began to notice price increases in late 2018. Pushed by the proximity of the VAT increase, Russians began to make large purchases, which is reflected in the average check as well as in retail turnover growth.

Retail turnover growth remains positive, most food retailers are growing their revenue by opening new stores

Most food retailers reported an increase of revenue, mostly driven by new store openings and territorial expansion. The market became more consolidated among large retailers who chose the right strategic path and can resist external and internal negative factors effectively.

Convenience stores are attracting customers more than hypermarkets, which requires long trips to visit

LtL sales at most hypermarkets are under pressure as they continue to lose traffic, whereas supermarkets have reduced the size of their LtL baskets. There is a clear shift to supermarket and convenience store formats, as retailers search for more flexible business models to respond changing consumer behavior.
Content

Macroeconomic overview and forecast

Consumer behaviour and expectations

Challenges and opportunities for retailers
Strong GDP growth in 2018 was fueled by higher rates of consumer spending, but GDP is forecasted to drop as government spending levels may not provide a sufficient stimulus to the economy.

According to Rosstat, Russian GDP grew 2.3% in 2018, while international agencies estimated GDP growth at 1.7-1.9%. This represents the highest rate of economic growth in Russia since 2012. The main GDP growth driver in 2017 and 2018 was consumer spending rather than industrial advances or investment. The Ministry of Economic Development has announced that the acceleration of GDP growth was largely caused by one-off factors and not sustainable.

In 2019, both Russian and international forecasters expect GDP growth to fall to 1.5%. These forecasts reflect the combined negative impact of increases in consumer taxes and utility fees, low levels of confidence and investment, lingering Western sanctions, lack of economic growth-stimulating measures (including meaningful reforms) and worsening external demand.

According to Russian Ministry of Economic Development’s data, GDP growth will accelerate eventually after 2019. Ministry’s GDP growth estimates are based on expected socio-economic and structural changes, including the implementation of key national projects, infrastructure development plans, improvement of the investment climate, enhanced competitiveness of public-private enterprise and pension reform.

Sources: PwC analysis, CBR, IHS Markit, DT Global Business Consulting
Consumer price inflation was driven by new taxes and utility charges, and real disposable incomes are not keeping pace

Inflation is expected to increase again after a 20-year low in 2017-2018

Consumer prices inflation rate, Y-o-Y, % change

![Chart of consumer prices inflation rate, Y-o-Y, % change](chart)

From September 2017 to November 2018, inflation in Russia was at a 20-year low. The rise of the inflation rate to 4.3% in late 2018 was caused by utility fee increases and the early impact of the VAT hike (from 18% to 20%) starting in January 2019.

Furthermore, a weaker rouble (hit by US sanctions) and yield increases in the advanced economies forced the Russian Central Bank to increase its key rate by 25 basis points to 7.5% in September, leading to another spike in the inflation rate in December 2018.

However, weak consumer spending is expected to keep inflation in 2020 close to the Russian Central Bank’s 4% target.

The Russian Ministry of Economic Development expects real disposable income growth to be positive due to the sustainable growth of key income components, including wages, pensions and social payments. Nevertheless, the recent year-on-year gains in nominal and real wages have not closed the gap in real disposable household income for 2016-2018. The accumulation of loans has been the main cause of the decline in real disposable incomes. According to CBR data from December 2018, the volume of loans and other funds provided to individuals increased by 13% year-on-year.

Moreover, the growth of wages varies across Russia’s vast geography. In 2018, nominal and real wages grew significantly faster in Moscow (up to 4 p.p. and 1 p.p., respectively) than in other regions.

Sources: PwC analysis, CBR, IHS Markit
Negative macroeconomic trends such as rising inflation and slow economic growth have negatively affected Russian consumer spending and expectations

Consumer confidence has been undermined by expected VAT increases and consumer price inflation

**Consumer Confidence Index, divided by quarters, Russia**

![Graph showing consumer confidence index divided by quarters, Russia, 2016-2018.](image)

Source: Russian Federal Statistics Service

**More families believe that their financial situation got worse in 2018**

Changes in Russian consumers’ financial situation, divided by quarters, % of all respondents

![Bar chart showing changes in Russian consumers’ financial situation by quarters, 2016-2018.](image)

**Russian consumers have felt the impact of price increases**

Changes in prices of food/non-food products and services, divided by quarters, % of all respondents

![Bar chart showing changes in prices of food/non-food products and services by quarters, 2016-2018.](image)

Due to expectations about rising inflation, consumer confidence started to fall in the second half of 2018. In Q4 2018, consumer confidence fell to its lowest level since Q4 2016. These sentiments could slow the growth of retail turnover.

The Consumer Confidence Index dropped due to the negative changes in Russian consumers’ financial situation. For the first time since 2016, Russian consumers indicated that their financial situation had become worse. The number of respondents who believe that their material status has become worse grew 4.1 p.p., while the number of consumers whose financial status improved decreased 1.2 p.p.

Around 72% of Russian consumers claimed to feel the impact of rapidly raising prices in 2018. Moreover, up to 8.9% of respondents felt that prices increased moderately, while up to 7.3% of consumers indicated that prices increased rapidly. Most respondents believe that the main cause of rising prices is the upcoming increase in the VAT rate. Russian consumers also believe that higher gasoline prices led to the growth of prices for other goods.

However, price increases are not in full swing, as large retail chains have sought to stretch price growth over time and make it less visible to consumers when demand is low.

Sources: FOM, PwC analysis
Increased shopping activity in late 2018 was mostly driven by the upcoming VAT increase and should not be interpreted as a market trend

Consumers reconsidered important purchases in Q4 2018

Key trends in consumers behavior, % of all respondents

<table>
<thead>
<tr>
<th>Action</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buy cheaper products</td>
<td>34</td>
<td>37</td>
<td>35</td>
</tr>
<tr>
<td>Buy less</td>
<td>29</td>
<td>30</td>
<td>27</td>
</tr>
</tbody>
</table>

Source: FOM

In 2016-2017, a declining number of Russian consumers bought cheaper products or fewer products. However, in response to their worsening financial situation and rising prices, customers tended to buy cheaper products or shop less through Q3 2018. The hype around the upcoming VAT increase led to changes in their behaviour in Q4 2018.

On average, around 29% of consumers have sought to buy cheaper products, while more than 22% have cut back on shopping.

We are witnessing a decline in consumer demand. Unfortunately, this is the trend of the year.

Igor Shekhterman, CEO of X5 Retail Group

Triggered by growing inflation in consumer product and fuel prices, more Russians have come to believe that saving is not their top priority. The share of respondents who believe that it is necessary to save money decreased by 2 p.p. to 56% in 2018, while 38% of consumers find there is no need to save money.

Around 20% of Russian consumers were prepared to make large purchases in 2018, while 35% thought it was a bad year for such purchases. The share of sceptics in 2018 was a bit lower than in previous year. More consumers are making large purchases to take advantage of lower prices before the VAT increase, although demand for non-food products fell in November and limited the traditional pre-New Year increase in sales in December.

Sources: Rosstat, FOM, PwC analysis
Despite falling average receipts and negative macroeconomic factors, retail turnover growth remained positive in 2018, mostly driven by the opening of new stores.

In the second half of 2018, the average check decreased in comparison with previous years.

**Average receipt by quarter, RUB**

<table>
<thead>
<tr>
<th>Quarter</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q’1</td>
<td>522</td>
<td>531</td>
<td>533</td>
</tr>
<tr>
<td>Q’2</td>
<td>498</td>
<td>518</td>
<td>521</td>
</tr>
<tr>
<td>Q’3</td>
<td>512</td>
<td>515</td>
<td>503</td>
</tr>
<tr>
<td>Q’4</td>
<td>560</td>
<td>554</td>
<td>552</td>
</tr>
</tbody>
</table>

**Sources:** ROMIR

Higher inflation leads to additional pressures on real disposable income. The growth in the size of average receipts was disrupted in Q3-Q4 2018 by the worsening financial situation of Russian consumers. Around 68% of Russian consumers believe their financial situation worsened in Q3-Q4 2018, and 72% felt the impact of the rapid increase in prices.

In 2018, average receipts grew in November and not in December, reflecting on the New Year average basket. Meanwhile, in the fourth quarter, when receipts typically grow the most, the average receipt was smaller than in the same period of the previous two years.

**Retail turnover continued to grow despite rising inflation and shrinking incomes**

**Overall retail turnover growth, Y-o-Y, %**

<table>
<thead>
<tr>
<th>Year</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Y-o-Y</td>
<td>8.3</td>
<td>7.4</td>
<td>6.8</td>
</tr>
<tr>
<td>inflation rate, Y-o-Y, %</td>
<td>-5.0</td>
<td>-4.9</td>
<td>-3.9</td>
</tr>
</tbody>
</table>
| Sources:** Russian Federal Service of Statistics

Rosstat data show that retail turnover continued to grow despite rising inflation and unemployment and shrinking incomes. The key factor of this phenomenon is increased consumer spending.

In Q4 2018, the retail sector experienced 2.7% growth as consumers sought to take advantage of lower prices before the VAT increase took effect on 1 January 2019.

**Revenue among top food retailers grew, mostly due to the opening of new stores**

**Estimate of revenue growth by factors,* change in FY18 compared with FY17, %**

<table>
<thead>
<tr>
<th>Retailer</th>
<th>LfL Sales growth</th>
<th>Growth by opening / closing stores</th>
<th>Total % revenue growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>O’KEY</td>
<td>-3.8</td>
<td>-2.7</td>
<td>-6.5</td>
</tr>
<tr>
<td>Karusel</td>
<td>0</td>
<td>1.7</td>
<td>1.7</td>
</tr>
<tr>
<td>Magnit</td>
<td>-2.5</td>
<td>10.7</td>
<td>8.2</td>
</tr>
<tr>
<td>Lenta</td>
<td>1.3</td>
<td>11.9</td>
<td>13.2</td>
</tr>
<tr>
<td>Pyaterochka</td>
<td>0.9</td>
<td>18.8</td>
<td>19.7</td>
</tr>
<tr>
<td>Perekrestok</td>
<td>5.9</td>
<td>17.6</td>
<td>23.5</td>
</tr>
</tbody>
</table>

*LfL effect was estimated based on reported revenue numbers and LfL revenue growth rates. LfL revenue growth rates have been applied to total revenue of the previous period, as share of LfL revenue is not available.

**Sources:** Retailers reports, PwC analysis
The two leading food retailers, the X5 Retail Group and Magnit, increased their share of retail trade volumes.

Share of retail chains in the retail trade of food products in Russia, %

By 2020, the market share of national food retail chains will expand to 40% and by 2030 to 60%. These numbers represent Western countries’ market by present days. Our market is not sufficiently consolidated yet, so there is space for national players to grow.

Martijn Peeters
Partner, Retail & Consumer Leader, PwC Russia

Sources: Retailer reports, mass media, PwC analysis
Increasing frequency of microtrips to the nearby stores is driving the trend for smaller formats, while hypermarkets are steadily losing traffic.

Hypermarkets have become less popular; key retailers have noticed that drops in LfL traffic have put pressure on LfL sales.

Comparing sales LfL, %

<table>
<thead>
<tr>
<th>Year</th>
<th>Da!</th>
<th>Pyaterochka</th>
<th>Perekrestok</th>
<th>Lenta supermarket</th>
<th>Magnit</th>
<th>Food inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>65.5</td>
<td>9.1</td>
<td>6.4</td>
<td>5.5</td>
<td>6.5</td>
<td>-5.5</td>
</tr>
<tr>
<td>2017</td>
<td>52.0</td>
<td>10.1</td>
<td>4.6</td>
<td>5.9</td>
<td>5.9</td>
<td>-3.1</td>
</tr>
<tr>
<td>2018</td>
<td>12.7</td>
<td>1.9</td>
<td>1.1</td>
<td>0.9</td>
<td>0.9</td>
<td>-0.9</td>
</tr>
</tbody>
</table>

Comparing average LfL check in 2018, %

<table>
<thead>
<tr>
<th>Store</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Da!</td>
<td>1.2</td>
<td>0.5</td>
<td>-1</td>
</tr>
<tr>
<td>Pyaterochka</td>
<td>0.4</td>
<td>0.4</td>
<td>-1</td>
</tr>
<tr>
<td>Perekrestok</td>
<td>0.4</td>
<td>0.4</td>
<td>-1</td>
</tr>
<tr>
<td>Lenta supermarket</td>
<td>0.4</td>
<td>0.4</td>
<td>-1</td>
</tr>
<tr>
<td>Magnit</td>
<td>-1</td>
<td>-1</td>
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</tr>
</tbody>
</table>

Comparing LfL traffic in 2018, %

<table>
<thead>
<tr>
<th>Store</th>
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<td>6.2</td>
<td>1.6</td>
<td>-2.1</td>
</tr>
<tr>
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<td>0.4</td>
<td>-1</td>
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<tr>
<td>Lenta supermarket</td>
<td>0.4</td>
<td>0.4</td>
<td>-1</td>
</tr>
<tr>
<td>Magnit</td>
<td>-1</td>
<td>-1</td>
<td>-1</td>
</tr>
</tbody>
</table>

Sources: Retailers reports, PwC analysis
Both small format retailers and hypermarkets are prioritising cost optimisation and a better customer experience. Both of these issues are key success factors in the current market environment.

Smaller formats have become more popular among Russian consumers and most retailers report positive traffic growth in these formats, although their LfL sales are still under pressure.

The main challenge for retailers is improving operational efficiency, including reducing losses and staff turnover, adopting innovative solutions and automating key business processes. This is not just about in-store technology. For example, Magnit and Headhunter launched automated system for staff recruitment, which helped to select 25% of potentially suitable candidates.
Key news for 2018

Management

Deputy Prime Minister Dmitry Kozak was assigned to oversee the retail sector among other areas

**Magnit**
- Olga Naumova (former CEO of Pyaterochka) became CEO at Magnit
- Vladimir Sorokin (former CEO of Perekrestok) became deputy CEO at Magnit
- Valeryia Solok became the leader of the Zdorovy’e project at Magnit (previously director of real estate management at Magnit and CEO of the 36.6 pharmacy chain)

**Lenta**
- Jan Dunning (former CEO of Lenta) was appointed at Magnit and replaced by German Tinga, former CFO of Lenta
- Rud Pedersen (former CFO of Carlsberg Eastern Europe) became CFO of Lenta
- Dmitry Bogod (former associate partner of McKinsey & Co) was appointed Lenta strategy director

**O’KEY**
- O’KEY Group Board of Directors appointed Armin Burger as the new CEO of the retail network
- O’KEY welcomed five new senior managers: Martin Piterak, operational director (Ahold and Kaufland); Pavel Remezov, real estate (Lenta, OBI, Metro Cash & Carry); Niksha Nekich, domestic production (Kaufland); Tino Andjich, strategic marketing (Leo Burnett, WPP and J. Walter Thompson); and Dinko Gadzhev, fruit & vegetables commercial directory (Kaufland)

**Azbuka Vkusa**
- Khachatur Pombuhchan (former CEO of Magnit) joined the board of directors of Azbuka Vkusa
- Vadim Dolgov became president of Azbuka Vkusa (previously vice-president of AV Market format)

**X5 Retail Group**
- Sergey Goncharov (former head of Magnit Cosmetic) became CEO of Pyaterochka
- Rinat Muhametvaleev (former CEO of Galamart) was appointed CFO of Perekrestok
- Vladislav Kurbatov was appointed CEO of Perekrestok (previously operational director)

**Other retailers**
- Oleg Paroev became the new CEO of McDonald’s, previously CFO of McDonald’s
- Oleg Minaev (former CEO of Karcher Russia) became new CEO of KupiVIP

Strategy

Metro returned to the cash & carry format and made the wholesale price available on the shelf for all. The Real supermarket chain is for sale.

The X5 Retail Group plans to slow the growth of new stores and concentrate on three key formats, while continuing to develop the online segment starting with Click&Collect in Pyaterochka.

Magnit sought to consolidate more than half of its stores in renewed formats, expand the range of products and services and move away from traditional food retail in collaboration with partners, while planning to double sales from private labels.

Auchan plans to build two hypermarkets in 2019 and intensify focus on ultra-proxy store formats.

Pyaterochka is shifting to a new management model with five macro regions whose directors will report directly to the CEO. Each macro region includes two-four territorial divisions.

O’KEY plans to reduce the size of its hypermarkets and focus on optimisation rather than on the opening of new large format stores. The DA! discount chain is expected to drive development.

Deals & partnerships

Magnit and Russian Post have signed an agreement to cooperate on logistics and retail.

Azbuka Vkusa began to cooperate with Apple by selling Apple products in-store.

Magnit’s board of directors agreed to buy the SIA Group, a pharmaceuticals distributor, for RUB 5.7bn.

M.Video made a deal to acquire Eldorado.

Chains Bristol, Krasnoe & Beloe and Dixy agreed to consolidate.

VTB sold its 11.8% share in Magnit to Marafon Group (established by A1 former associates).

DIXY is no longer a public joint stock company and has changed its name from PAO Dixy Group.

Sources: Retailers reports, mass media, PwC analysis
Key news for 2018 year

New formats

Perekrestok announced the launch of a kitchen factory project worth RUB 3.5bn that has no analogues in Russia yet and opened its first dark store supermarket.

Magrit started to test cafeterias inside its stores.

Perekrestok has launched a marketplace for perishable goods in Moscow and Saint Petersburg. Suppliers have to deliver products within 5-10 hours to the store of customer’s choice.

Vkusvill launched a pilot project, Tilsy, to deliver highly perishable goods to retail chains. Perekrestok is the first client.

Vkusvill is testing the micro format, installing vending machines in office centres and underground stations. The chain is planning to cover every station in the Moscow Central Circle with vending machines placed right next to Coffee House small-format coffee machines.

Magrit has decided against developing the hypermarket format and controversially plans to open ultra-small format shops.

Magrit started a pilot project to open stores in Russia Post offices in Moscow, Krasnodar Region and Ryazan Region.

Auchan presented a new store concept with updated designs, brand new colour schemes, equipment and product assortments and switched from vertical to semi-vertical and spot goods layout.

Lamoda announced its first offline store, Lamoda Market, located in Moscow (Atrium Mall).

Detskiy Mir launched a new format store that sells large goods (such as prams) in Moscow.

Leroy Merlin announced the opening of a dark-store format hypermarket in Saint Petersburg in 2019 and opened the Leroy Merlin Market initially for four categories of home appliances.

IKEA is experimenting with new small formats presented as design studios with popular categories of goods such as kitchens and closets. The new store is available in Saint Petersburg and expected to expand to other areas.

M.Video opened its first compact stores (M_Mobile) that sell smartphones, SIM-cards, gadgets and related products.

Odoklassniki launched an online store for Chinese goods with more than 3m products in 20 categories.

Vkontakte launched an Internet store with private labeled clothing and souvenirs with different delivery types.

The Chinese marketplace Tmall started selling DIY, home improvement and repair goods in Russia, starting with 250 labels and planning to expand to 4,000 labels in the second half of the year.

Instamart is expanding delivery services for purchases from stores in Ekaterinburg, Kazan, Nizhniy Novgorod and Novosibirsk.

Sberbank is planning to open pickup points for online purchases at its bank branches.

Odnoklassniki launched a new cross-border marketplace with Zilyan Group (Turkey). The project has more than 200 shoe brands in its portfolio.

Sberbank and Yandex launched Beru marketplace; Yandex Market opened its first regional logistics complex in Rostov Region to process Beru orders.

New on the market

Alibaba Group, the Russian Direct Investment Fund, Mail.ru Group and Megafon have collaborated Aliexpress Russia, an e-commerce project with plans to lead the Russian online market.

Xiaomi has launched Mi.com, a trading platform, as it seeks to strengthen its position on the Russian market.

Alexander Kolobov, owner of Shokoladnitsa, has partnered with Igor Sosin (Starik Khottabych, OBI) to launch a chain of grocery stores with cafe zones.

Perekrestok has launched Uhtushky, its first private label brand of products for children aged 4 to 7.

Technology

Perekrestok has released a mobile application for purchases with self-scan technology which could help increase the average receipt up to 77%.

Magrit completed testing machine learning technology that helps to forecast demand for consumer goods up to 3-5% more accurately and expects to increase revenue up to RUB 4bn.

X5 Retail Group launched a laboratory at a Pyaterochka store to test digital technology, including e-price tags, video analytics, smart LED shelves and self-scan technology. The most effective technologies are implemented in chain stores.

M.Video-Eldorado Group opened a competency center specialised in data science and expects to increase revenue up to RUB 5bn.

Sources: Retailers reports, mass media, PwC analysis
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