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# Russian Federation

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# Fast Food Sector Keeps Expanding As Economy Cools

**Report Categories:**
Agriculture in the News
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**Report Highlights:**
The fast food sector in Russia has grown sharply in recent years as consumers having seen nearly 30 percent current value growth in 2013. Russian consumers demand well-known, affordable, and consistent quality standards provided by chained restaurants. Approximately100 fast food operators manage almost 3,800 chain restaurants in Russia. Today fast food is the most popular segment for young and middle-aged Russian consumers. Research has shown that more than 54 percent of fast food restaurants visitors are from 18 to 34 years old with average monthly income of 30,000 rubles. While the economic slowdown and currency devaluation are slowing down fast food expansion plans in Russia, research has shown that consumers are switching from higher end restaurants to mid-level and fast food type establishments which should help fast food chains weather the challenging economic times.

**General Information:**

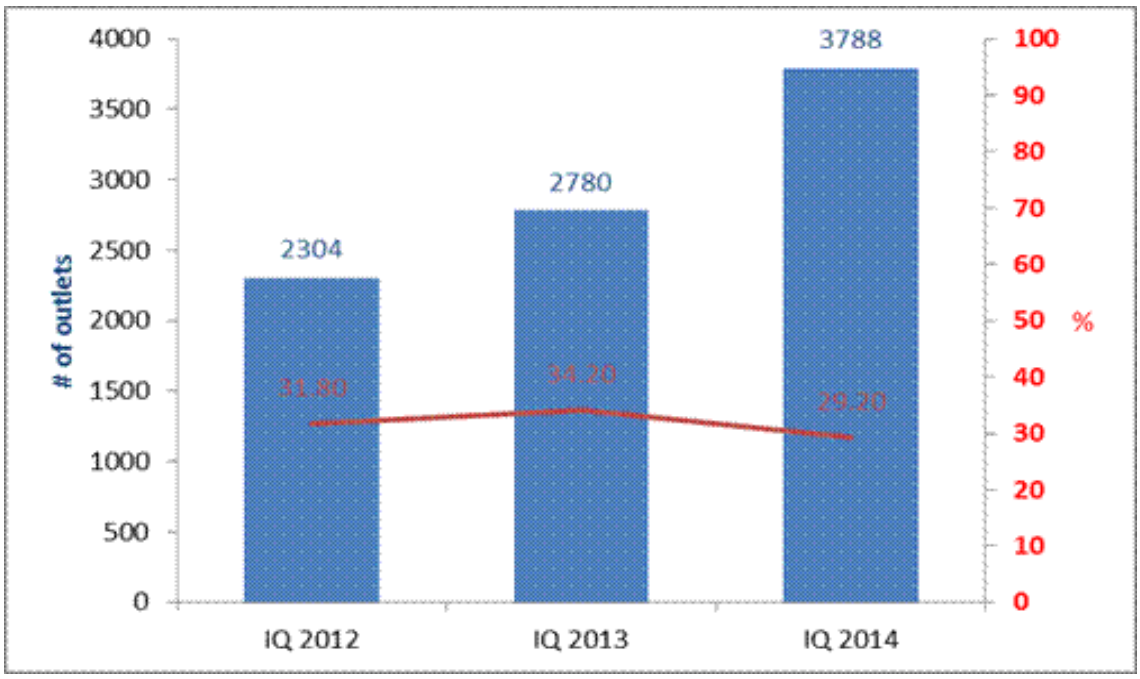
Fast food remained one of the main foodservice engines in 2013 and has continued to grow in the current year. Chained fast food is performing particularly well and has seen current value growth of nearly 30 percent in 2013. Such strong growth is caused, in large part, to the growing overall popularity of franchising in Russia, making it one of the main tools of fast food business development. This reflects Russian customers' preference for well-known and consistent foodservice standards provided by the chained segment – a fact which is confirmed by outlet growth as well. According to Euromonitor International, the number of independent fast food outlets grew only marginally in 2013 while chained fast food outlets increasing by 15 percent. Approximately100 fast food operators manage almost 3,800 chain restaurants in Russia.

The Russian economy has cooled significantly and is forecast to grow by just 0.2 percent in 2014, according to the International Monetary Fund. At the same time, the Russian Ruble has devaluated by 41 percent in 2014 while inflation is expected to reach 9 percent by the end of the year. Russia's economic difficulties intensified in early November as the Ruble crashed flamed fears that the country may be on the verge of a full-blown currency crisis reminiscent of the 1990's. The Ruble has fallen steadily in recent months amid rising tensions with the west, but it took a dramatic downward plunging more than 10 percent over a two-day period in early November surpassing 48 Rubles per 1 USD. This makes the cost of imported goods and products used in Russia's fast food sector more expensive which gets passed on to the consumers.

Year-on-year inflation hit 8 percent in September, driven up by the declining value of the Ruble and Russia's ban on many food products from the United States and European Union, according to data from Russian Federal Statistics Service (Rosstat). Rising food prices were the main driver, climbing 11.4 percent year-on-year in September, up from a 10.3 percent increase year-on-year in August. While overall food prices have only risen slightly, spikes have been seen in prices for specific commodities such as meat, fish, and seafood - the same products hit by Russia's retaliatory ban in August. The price of meat and poultry rose 16.8 percent year-on-year in September, fish by 14.1 percent, and dairy products by 16.2 percent.

Today fast food is the most popular segment for young and middle-aged Russian consumers. Research has shown that more than 54 percent of fast food restaurants visitors are from 18 to 34 years old with average monthly income of 30,000 rubles. While the economic slowdown and currency devaluation are slowing down fast food expansion in Russia, research has shown that Russians are switching from higher end restaurants to mid-level and fast food type establishments which should help fast food chains weather the challenging times ahead.

**Figure 1. Russia: Number of Fast Food Chained Restaurants in Russia in 2012-2014**

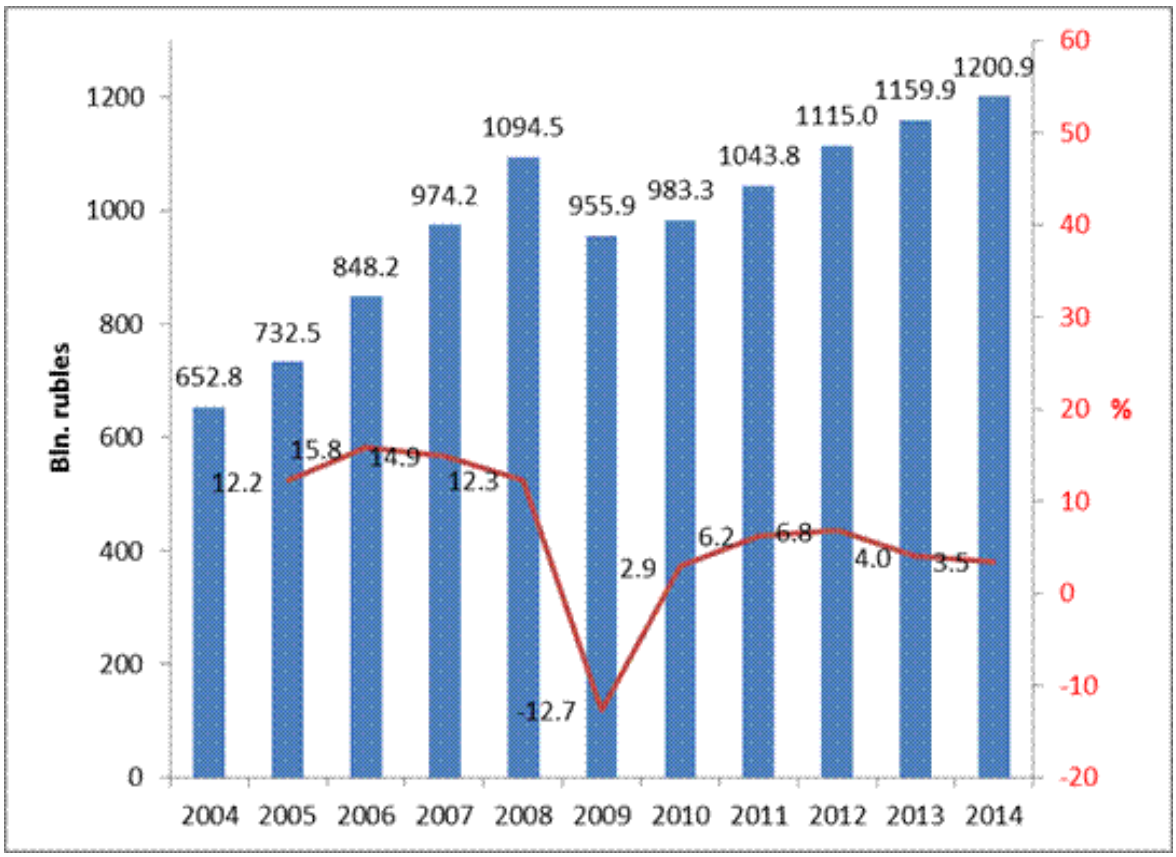



***Source:*** *RBC research*

In 2013, Russian foodservice turnover slowed considerably, mirroring the slowdown of the Russian economy, as the country recorded its weakest economic growth (1.2 percent compared to 3.4 percent in 2012) since economic crisis in 2008. Russia's HRI sales turnover in 2013 grew only 4 percent year-on-year (6.8 percent in 2012) while in value terms the indicator reached 1.16 trillion rubles. Food service turnover is expected to surpass 1.2 trillion Rubles by the end of 2014.

Russia's economic status worsened in early November as the Ruble crashed flaming fears that the country was on the verge of a full-blown currency crisis reminiscent of the 1990's. The Ruble has fallen steadily in recent months amid rising tensions with the west, but it took a dramatic downward plunging more than 10 percent over a two-day period. The instability of currency is reviving uncomfortable memories among Russian people, many of whom suffered after the country's default in 1998 when savings were wiped out and queues formed at exchange points as the Ruble was dramatically devalued amid spiraling inflation. Once grouped with other dynamic emerging market economies, the Russian economy is now teetering on the brink of recession, according to market analysts. The International Monetary Fund forecasts the Russian economy to grow by just 0.2 percent in 2014.

**Figure 2. Russia: Food Service Turnover 2004-14, billion rubles, % Growth Year-On-Year**




***Source:*** *RBC research*

On August 7, 2014, Russian President Vladimir Putin signed a decree banning for one year a list of agricultural products from the United States, Canada, European Union, Australia, and Norway as a result of the implementation of economic sanctions against Russia due to events in the region. The list included red meat, poultry, fruits, vegetables, dairy products, tree nuts, pulses, and many other commodities. Shortly after the implementation of the ban, food prices began to rise as importers and retailers began to look for new suppliers – both from domestic producers and non-affected countries. Russia is one of the world's largest food-importing countries having purchased more than $40 billion worth of food, beverages, and agricultural products in 2013. Initially, market analysts were concerned that the food ban would lead to shortages of food products and skyrocketing prices reminiscent of what was seen towards the end of the Soviet Union. This has not happened. While spikes have been seen in prices for specific commodities such as red meats, poultry, fish and seafood, and dairy products, overall food prices in September (year-on-year) increased by 11.4 percent, according to the Russian State Statistics Service (Rosstat). Retail chains quickly switched to more domestically-grown products and found new non-embargoed countries to fill the void. And Russian consumers have been able to absorb the higher costs of some food products by switching to discount stores and purchasing smaller amounts of higher prices items.

**Economic Slowdown And Food Ban Affecting Fast Food Restaurants**

In 2014, Russian restaurants have been particularly hit hard by the food ban along with the plummeting ruble and slumping economy. Over the last decade, Russians have enjoyed an expanding choice of eateries thanks to growing incomes and strong economic growth. The hospitality sector was flourishing

in Moscow and St. Petersburg as the incomes of their residents grew. As a result, these two cities control 14 percent of Russian foodservice market. Market analysts estimate that around 50 percent of all the ingredients used by the hospitality sector in Russia are imported from abroad. Now, restaurant owners are concerned that some hard to replace items like French cheeses, Norwegian salmon, Australian steaks, and Finnish butter had to be removed from their menus. This is an extremely difficult situation for fine dining and mid-range restaurants that serve sushi, seafood and European-style menus.

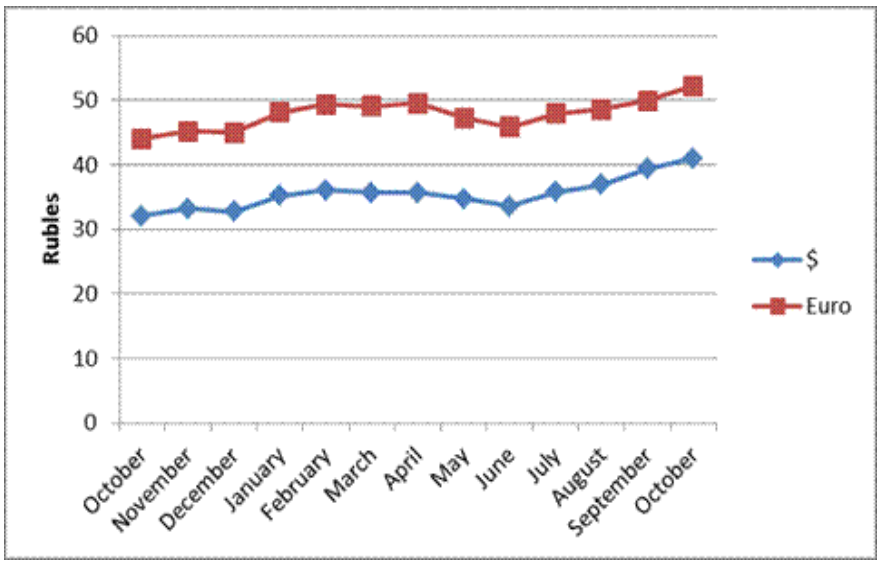
Restaurants serving Russian or regional foods are also being affected by the food ban even though they have seen a boost in their popularity with a growing "Buy Russian" campaign. Like most restaurants in Russia, Russian and Central Asian restaurants also sourced meat, vegetables, and dairy products from abroad when cheaper than local products. Restaurant suppliers are still scrambling to find new sources while quickly consuming what is available in current stocks and cold storage. Many restaurants have already increased menu prices to compensate for the sharp increase in prices set by wholesalers many of which have been charging more amidst the instability caused by the food import ban. Market analysts say that the current ban will increase prices in most restaurants by as much as 20 percent by the end of the year. As a result, Russians are eating out less and switching from higher end restaurants to mid-level and fast food type establishments. Fast-food restaurant chains are in a better situation because they tend to use a higher percentage of local ingredients (around 70-85 percent) as compared to other restaurants and charge much less. Several fast-food chains have created internal supply-chains based in Russia in recent years. For example McDonald's, which operates roughly 450 restaurants throughout the country, gets 85 percent of its menu items from domestic suppliers.

**Inflation Boosted by Rising Food Prices**

Year-on-year inflation hit 8 percent in September, driven up by the declining value of the ruble and Russia's bans on many food products from the United States and European Union, according to data from Russian Federal Statistics Service (Rosstat). Rising food prices were the main driver, climbing 11.4 percent year-on-year in September, up from a 10.3 percent increase year-on-year in August. While overall food prices have only risen slightly, spikes have been seen in prices for specific commodities such as meat, fish, and seafood - the same products hit by Russia's retaliatory ban in August. The price of meat and poultry rose 16.8 percent year-on-year in September, fish by 14.1 percent, and dairy products by 16.2 percent. The cost of imported goods and products has also been hit by the rapid devaluation of the ruble, which recently surpassed 48 rubles to the dollar - the highest since Russia's 1998 bank default.

Since July 2014 the ruble has weakened sharply against dollar and euro, falling to a historic low against the euro of RUB 57 per euro and the dollar trading at RUB 46 per 1 USD in mid-November 2014. The ruble has lost about 41 percent against the dollar since the start of this year, and 24 percent since September 1, in part due to Western sanctions on Moscow for its role in the Ukraine crisis. The fall accelerated in September as the price of oil – Russia's main export – dropped to four-year lows.

**Figure 3. Russia: Central Bank's exchange rate, 1 USD to Ruble & 1 Euro to Ruble, October 2013 to October 2014**




***Source:*** *Central Bank of Russian Federation*

As much as 69 percent of consumers have re-evaluated their planned spending on items such as food, clothing and entertainment, the Intelligent Research for Growth (IRG) company noted in its survey, which was carried out in Russia's largest cities. Half of the respondents said they had felt the economic situation worsen since the beginning of the year, and 40 percent expect further deterioration by the year end, so 39 percent of responders are ready to stop visit restaurants to save money. Foodservice players have confirmed trend on traffic reduction of 10-15 percent depending on restaurant format. According to Head of Russian Franchise Association, today foodservice market sees some shift of customers from expensive restaurant formats to casual places with affordable prices. Currently about 70 percent of the residents of major Russian cities several times a month have visiting fast-food outlets with average checks of 150-300 Rubles ($5-$10) on a regular basis. Pancakes, burgers, sandwiches, chicken, pizza, and baked potatoes are the most popular types of fast-food in Russia.

**Table 1. Fast Food Formats in Russia**

| Type | Leading Brands |
|---|---|
| Burger and sandwich | Subway, McDonald's, Burger King, Carl's Jr., Stardog!s |
| Chicken | KFC, Southern Fried Chicken |
| Ice cream | 33 Penguins, Baskin Robbins, Tutti Fruitti Frozen Yougurt |
| Pizza | Sbarro, Papa John's, Pizza Hut, Domino's Pizza, Tashir pizza, Dodo pizza |
| Potato | Kroshka-Kartoshka |
| Blini | Teremok, Chaynaya lozhka |
| Bakery | Cinnabon, Dunkin' Donuts, Wetzel's Pretzels, Krispy Kreme, Magnolia Bakery, Auntie Anne's |

***Source:*** *Fast Food Market research*

Transnational chains have demonstrated the most impressive fast food growth in recent years since 1990. Franchising is one of key expansion methods for foodservice chains in Russia. According to expert estimates share of foreign brands on Russian restaurant market is about 40 percent. American fast

food formats dominate in Russia and have fastest growth; among them are Subway, McDonald's, Burger King, and Baskin Robbins.

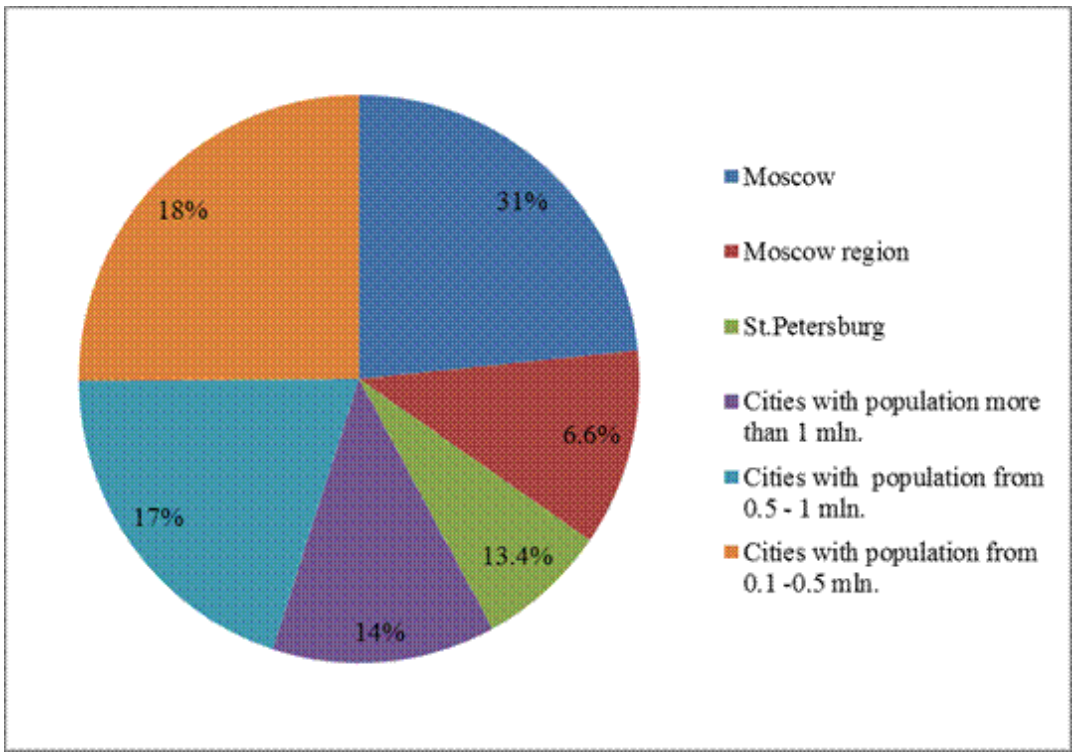
**Table 2. Growth of fast food restaurant chains in Russia, 10 leading chains**

| Chain name | Country of origin | Year est. in Russia | # outlets July 2013 | # outlets September 2014 | % change for 14 months |
|---|---|---|---|---|---|
| Stardog!s* | Russia | 1993 | 685 | 758 | 10.6 |
| Subway | USA | 1994 | 582 | 704 | 20.9 |
| 33 Penguins | Russia | 2004 | | 485 | |
| McDonald's | USA (Canada) | 1990 | 378 | 444 (435) | 15.1 |
| Kroshka-Kartoshka | Russia | 1998 | 320 | 373 | 16.6 |
| Baskin Robbins | USA | 1992 | 274 | 327 | 19.3 |
| KFC | USA | 1993 | 230 | 290 | 26.1 |
| Teremok | Russia | 1998 | 215 | 251 | 16.7 |
| Burger King | USA | 2010 | 113 | 235 | 108 |
| Sbarro | USA | 1998 | 144 | 160 | 11.1 |
| Podorozhnik* | Russia | 1995 | 148 | 153 | 3.3 |

***Source:*** *Foodservice magazine, trade press, companies' web-sites*
**street-food kiosks*

According to the RBC research, 31 percent (1,178 of 3,788) of fast-food restaurants are successfully operating in Russia's capital. St. Petersburg today accounts for slightly more than 13 percent (503 of 3,788) fast-food restaurants.

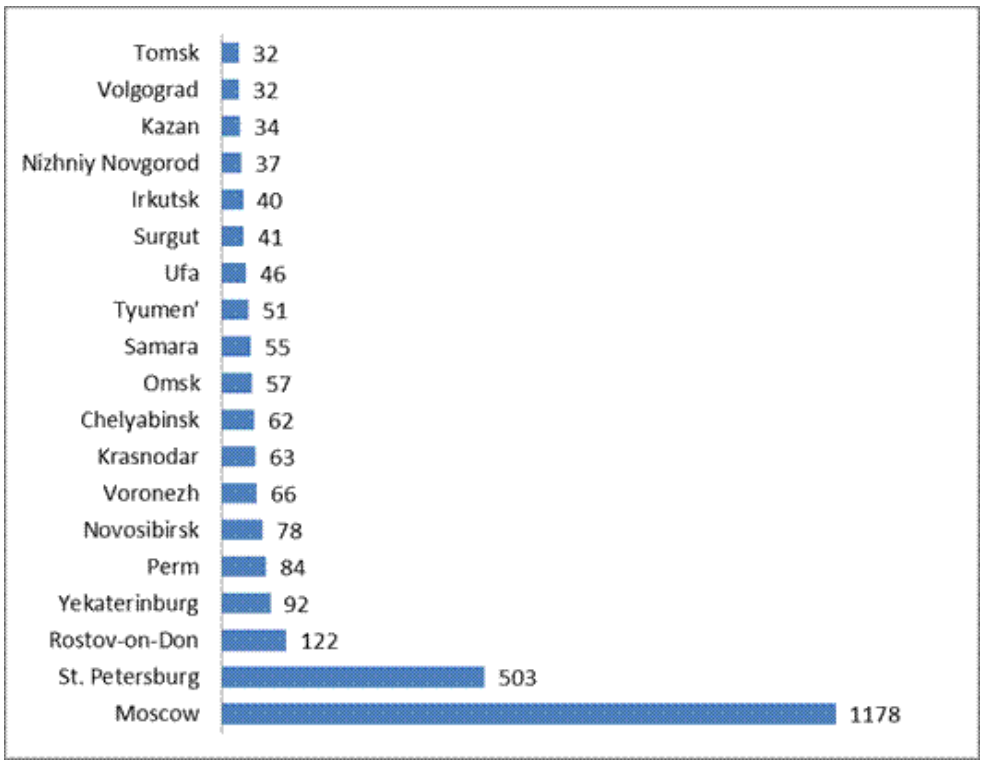
**Figure 4. Russia: Fast Food Restaurants Shares in Value Terms**




***Source:*** *RBC research, May 2014*

Almost half (44.4 percent) of all fast food restaurants in Russia are concentrated in Moscow and St. Petersburg of which combined have only 12 percent of the total population. Thus, 55.6 percent of the remaining fast-food restaurants cater about 88 percent of the Russian population. In this context, the relatively high level of competition in Moscow and St. Petersburg is pushing many franchises to more actively open fast food restaurants in regions. Beyond the two largest Russian cities there are thirteen cities (Novosibirsk, Nizhniy Novgorod, Yekaterinburg, Samara, Omsk, Kazan, Ufa, Chelyabinsk, Rostov-on-Don, Volgograd, Perm, Krasnoyarsk, and Voronezh) with a population of more than one million people.

**Figure 5. Russia: Number of Fast Food Restaurants in Cities**




***Source:*** *RBC research, May 2014*

International franchises doing business in Russia include Burger King, Subway, Baskin-Robbins, Dunkin' Donuts, and KFC with the franchise system are most prevalent in Moscow and St. Petersburg. The most dynamic chains -- including Subway, Burger King, KFC, Kroshka-Kartoshka, and Baskin-Robbins -- have opened numerous outlets in shopping malls and hypermarkets.

As of September 2014, the fast food chain leader in Russia is **Subway** which has 704 outlets in all Russian regions, including the Far Eastern Federal District. Subway is one of the most rapidly developing fast food chains in Russia having surpassed McDonald's in terms of outlets in Russia in 2011. Subway maintains an ambitious plan of expansion in 2015 and beyond.

**McDonald's** is the leader of the Russian fast food market in value terms and also has big extension plans. McDonald's entered Russia in 1990 and opened its first restaurant in the center of Moscow. As of September, 2014, McDonald's had 435 restaurants in 85 Russian cities, including McCafes, operating throughout Russia and serving about 1 million customers daily. On McDonalds's 20th anniversary in Russia in January 2010, company reported about serving 2 billion customers. Until April 2012, McDonald's had been expanding in Russia through self-operated stores only. McDonald's gave Rosinter Restaurant holding the subsidiary right to develop the chain in railway stations and airports in Moscow and St. Petersburg. To date, only one McDonald's outlet has been opened by Rosinter in St. Petersburg airport Pulkovo. McDonald's sales in Russia totaled $2.2 billion (641.4 billion Rubles) in 2013 or about 8 percent of its worldwide sales of $28.1 billion. Recent press articles announced that McDonald's is planning to open 40 new restaurants in 6 cities in Siberia including Novosibirsk, Tomsk, Omsk, Barnaul, Novokuznetsk and Kemerovo.

On August 20, 2014, the Federal Service for Supervision of Consumer Rights Protection and Human

Welfare (Rospotrebnadzor) launched a campaign of sanitary checks at various McDonald's premises throughout the country, which resulted in 10-12 outlets being temporarily closed. The Russia's consumer watchdog stated that McDonald's products contain more fat, protein and carbohydrates than are allowed in Russia. The most recent closure of a McDonald's restaurant in Volgograd was as a result of it failing to reach Russian hygiene standards, including some of the products testing positive for E.coli bacteria. According to Business Insider, the company has stated that more than 200 of McDonald's restaurants in Russia are now under government investigation. Overall profits in Russia have fallen nearly 30 percent in the third quarter of 2014 due mostly to the temporary closures of the restaurants in Russia and Ukraine. McDonald's is planning to appeal the court decision on the closure of the restaurants at a higher judicial level. Many analysts have noted that the "attack" on McDonald's restaurants in Russia appear to be politically motivated as it began shortly after the United States applied economic sanctions over the conflict in Ukraine.

The group of top five fast food chains also includes Tomsk-based ice cream cafes **33 Penguins** with 485 outlets. 33 Penguins is seeing rapid growth based on its low start-up and operating costs (the only equipment needed is a refrigerator). Outlets are primarily located in retail locations and serve a quick, low-priced demand.

**Baskin Robbins** is lagging behind the leaders with 327 chain eating places under this brand. Baskin Robbins, the world's largest chain of ice cream specialty shops, entered Russia in 1990. In 1996, the company opened a major ice cream plant in Moscow -- the biggest in Europe -- able to churn out 16,500 metric tons of ice cream annually. The company sells more than 140 flavors of premium ice cream. In 2010, the company expanded its assortment range and increased the number of prepackaged ice-cream products offered at its outlets. The largest Baskin Robbins ice cream cafe in Europe opened in Moscow's Novy Arbat in July 2011.

Stand-alone kiosks are popular in Russia, but there is some consolidation taking place in the industry. The number of independent stands is decreasing, but sales and the number of chained outlets are increasing. Domestic chains dominate the street fast-food market such as **Stardog!s** (hot dogs), **Kroshka-Kartoshka** (potato stand), and **Teremok** (Russian crepes), which are located throughout the major cities and are expanding regionally as well. Thank to developed franchise schemes transnational chains are starting to gradually push Russian restaurant projects off the market. This first of all refers to chains Teremok and Kroshka-Kartoshka. Despite a distinct target of Russian consumers, well-thought menus respecting national preferences (traditional Russian meals - pancakes/crepes and baked potatoes), these chains have lost market share to global players in recent years.

Impressive expansion and high marketing activity of **Burger King** pushed Kroshka-Kartoshka to fifth place making Burger King as one of the most well-known and frequently visited fast food restaurants in Russia. Burger King has established a presence by opening its first restaurant in Moscow in January 2010 and quickly began using its traditional franchising scheme to expand the chain in Russia. In order to launch operations in Russia, Burger King has established a daughter company Burger Rus. Under the terms of its franchise agreement, Burger Rus is required to give 5 percent of its turnover to Burger King, while Burger King is obliged to pay for the opening of each restaurant. In June 2012, Burger King and Burger Rus established a joint venture with VTB Capital - the investment arm of Russia's second biggest lender - to develop and expand the restaurant's chain and brand presence in the country. Thanks to that partnership, Burger King opened 58 new restaurants in Russia from July 2012 to July 2013,

expanding its chain to 105 and opening outlets all over the Russia. Burger King doubled the number of its outlets from July 2013 to September 2014 making it the fastest growing fast food chain in Russia. Currently there are 235 Burger King restaurants in Russia with 10 of them in various airports.

As of September 2014, 290 KFC restaurants are operating in Russia. And there are plans to expand further in 2015. According to recent independent surveys, the typical KFC customer is between 16 to 39 years of age, is not afraid to try new things and wants to see social progress while enjoying a Western dining experience. The average check at local KFCs amounts to 265 Rubles per person.

2014 is one of the key years for development **Sbarro** in Russia as the company launched a project of assortment standardization. Currently, Sbarro operates 160 pizza restaurants with an average check of 290 Rubles.

According to RBC research, when choosing a fast food place 54 percent of Russians prefer McDonald's, which speaks for high customer loyalty. McDonald's strong brand helps keep a large gap between the chain and its closest rivals in terms of popularity and image. About 78 percent of Russians visited McDonald's at least once during first six months of 2014, meanwhile same index for KFC, Subway and Burger King constituted 47, 37 and 34 percent respectively.

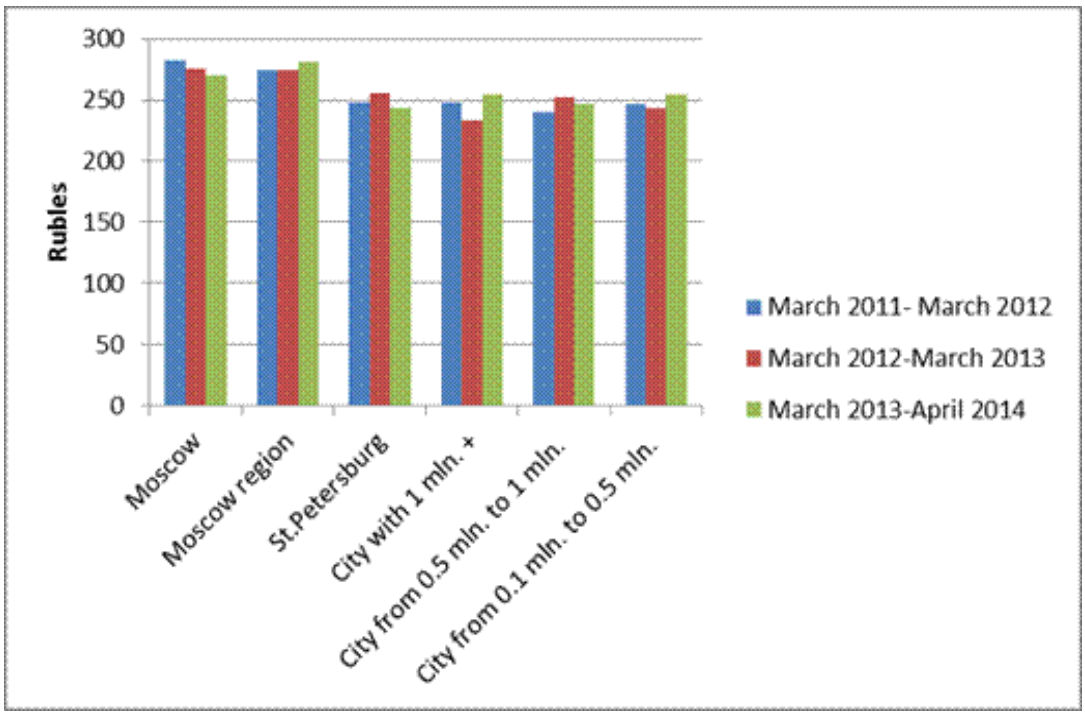
**Table 3. Russia: Other Fast Food Restaurant Chains in Russia**

| Chain name | Country of origin | Year est. in Russia | # outlets, July 2014 |
|---|---|---|---|
| Cinnabon | USA | 2009 | 109 |
| Papa John's | USA | 2005 | 74 |
| Carl's Junior | USA | 2007 | 43 |
| Dunkin Donuts | USA | 1996/2010 | 32 |
| Krispy Kreme | USA | September 2013 | 4 |
| Wetzel's Pretzels | USA | December 2013 | 6 |
| Nathan's Famous | USA | September 2013 | 1 |

***Source:*** *Trade press, companies' web-sites*

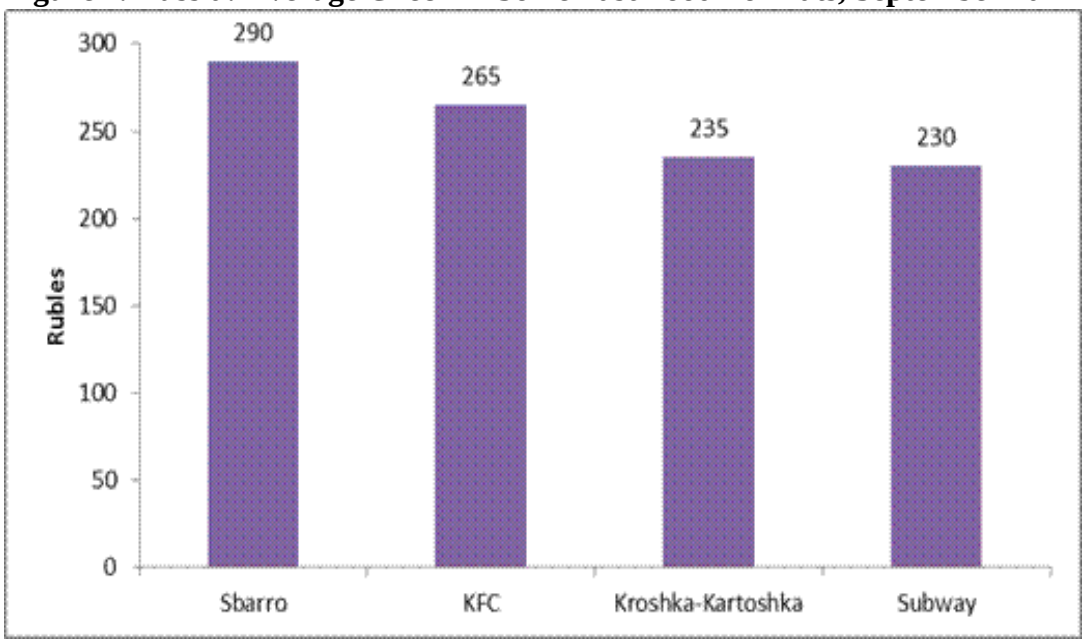
According to RBC research, the average check at fast food restaurants virtually unchanged last four years. On average, when visiting fast food establishments, the average Russian customer spends roughly 253 Rubles.

**Figure 6. Russia: Average Check in Fast Food Restaurants in 2011-2014**




***Source:*** *RBC research*

**Figure 7. Russia: Average Check in Some Fast Food Formats, September 2014**




***Source:*** *Foodservice magazine of September 2014*