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## Russian Federation

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### Franchise Restaurants Doing Well Despite Slowing Economy

**Report Categories:**

Agricultural Situation

Agriculture in the News

Agriculture in the Economy

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**Report Highlights:**

The Russian food service sector has faced a number of serious challenges during the past year. A smoke ban in restaurants and bars went into effect on June 1, 2014, which has hurt the growing café culture as well as many bars and pubs. Shortly afterwards, in August 2014, Russia banned a long list of food and agricultural products from Australia, Canada, Norway, the United States and the European Union for one year in response to Western sanctions. In addition, the Russian currency depreciated significantly pushing up food price inflation while dropping consumer purchasing power.

Nevertheless, the total number of franchises in Russia has seen double digit growth in the last few years - and growth is expected to continue as lower cost restaurants are expected to do well during the current economic slowdown. American fast food formats dominate the landscape in Russia.

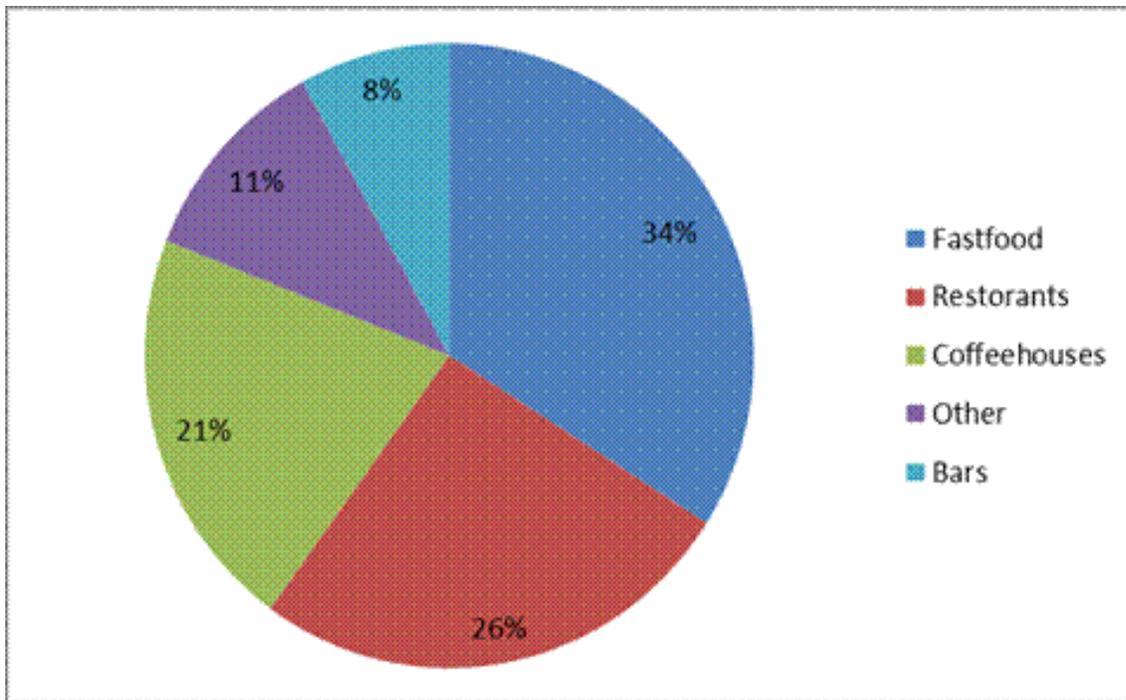
## **General Information:**

Russian food service sector has faced a number of serious challenges since the middle of 2014. A smoking ban in restaurants and bars went into effect in June 1, 2014. This had a negative impact on Russia's growing coffee culture and led to more Russians to eating and entertaining at home instead of at restaurants, bars and pubs. Shortly afterwards, in August 2014, Russia banned a long list of food and agricultural products from Australia, Canada, Norway, the United States and the European Union for one year in response to the application of economic sanctions. The immediate trade restrictions created a \$9.5 billion gap in Russia's food market that needed to be filled. The food service sector scrambled to find new suppliers from non-affected countries which provided difficult and expensive as new channels of import substitution often include higher logistical costs which impact the final price to consumers. Many Russian restaurants depended a great deal on imported food products ingredients from affected countries ranging from 15 percent to 80 percent. AS a result, HRI operators have closed unprofitable restaurants outlets, especially those where rent was fixed in dollars. Market analysts predict that from 10 to 20 percent of all restaurants will be closed in the first six months of 2015 due to high food prices, a weak Russian ruble and more careful spending by Russian consumers.

According to Moscow government statistics, in September 2014, there were 11,000 registered restaurants in the nation's capitol. By the end of 2014, about 900 restaurants closed in Moscow – roughly 8 percent of the total Moscow foodservice market. One of the main reasons for this phenomenon is a dropping consumer purchasing power of the general population. With a slumping economy and depreciation ruble, consumers began eating out less to economize their salaries. Moscow restaurateurs have felt this seeing a average check totals drop by 20-25 percent compared to one year earlier. Market analysts report restaurant sales are down 10 to 30 percent because of significant traffic reduction. Mid-range restaurants with average check up to 2,000 rubles are the ones feeling the biggest drop in clientele while the lower cost (fast food) style restaurants are reporting good sales.

Chained restaurant from lower-cost foodservice segments have successfully developed in recent years making franchising one of the key expansion methods for foodservice chains in Russia. According to Francon data service, the total number of franchises in Russian foodservice industry totaled 182 in 2013 and jumped to 203 in 2014 - up 11.5 percent. Currently there are 6,500 foodservice franchise outlets in Russia and its share is 8 percent of total Russian restaurant market. Roughly 44,300 people are working in food service franchise outlets in Russia.

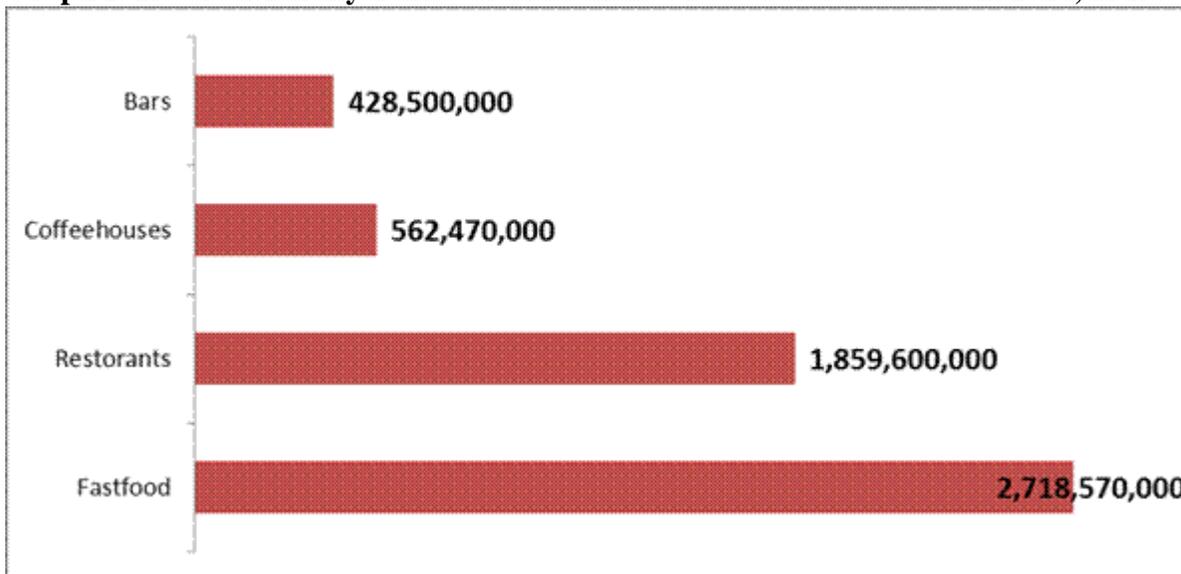
## **Graph 1. Russia: Structure of Franchise in Food Service Sector by Number of Concepts**



*Source: Francon, Franshisa.ru*

Fast food is the leader of franchise concepts by number of outlets and turnover in the food service industry. Fast food remained one of the main foodservice drivers in 2013 and continued to grow in 2014.

**Graph 2. Russia: Monthly Turnover of Franchise Food Service Outlets in 2014, in Rubles**



*Source: Francon, Franshisa.ru*

Transnational chains have demonstrated most impressive fast food development since 1990. According to expert estimates, the share of foreign brands in Russia's 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 1. Russia: Leading International Foodservice Brands, July 2014**

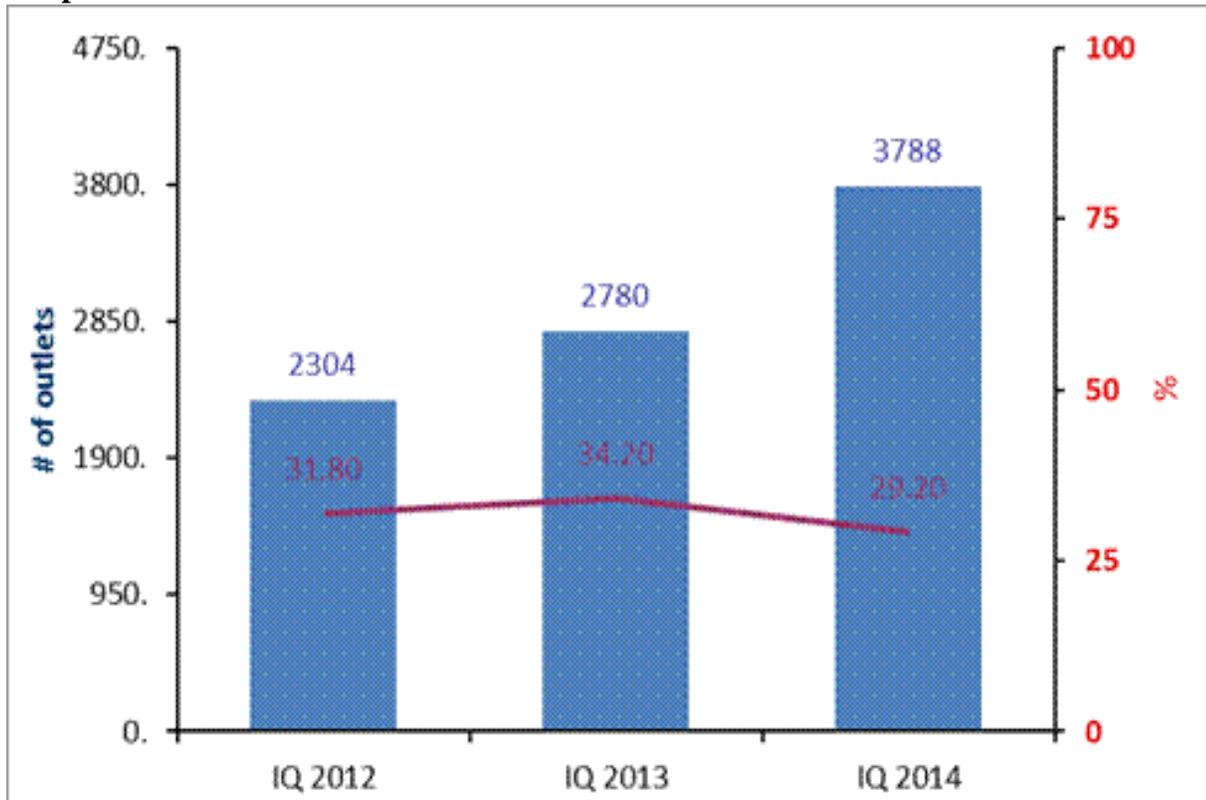
Brand	# outlets in Russia	% y-o-y change 2014	Holding company	Type	Country of origin	Year est. in Russia
Subway	691	18.7	Subway	QSR	USA	1994
McDonald's	433	14.6	McDonald's	QSR	USA	1990
Baskin Robbins	300	8.5	BRPI	QSR	USA	1992
KFC	268	16.5	Yum!Brands		USA	1993
Burger King Rus	228	101.8	Burger King	QSR	USA	2010
Sbarro	147	2.1	G.M.P. Planeta Gostepreimstva	QSR + casual	USA	1997
Cinnabon	111	8.8	Cinnabon	QSR + casual	USA	2009
Coffeeshop Company	82	12.3	Schärf Coffeeshop GmbH		Austria	2008
Starbucks	75	17.1	Starbucks Corp.	Coffee	USA	2007
Papa John's	74	N/A	Papa John's	QSR	USA	2005
Dunkin' Donats	32	N/A	Donuts project	QSR	USA	1996/2010
Krispy Kreme	6	N/A	Novikov Group	QSR	USA	2013
Wetzel's Pretzels	6	N/A	Wetzel's Pretzels	QSR	USA	2013
T.G.I. Friday's	23	0	Rosinter	Casual	USA	1997
American Bar & Grill	8	0	Rosinter	Casual	USA	1994

*Source: FoodService magazine 2014, professional media, web-sites of companies*

In 2014, Burger King opened 104 new restaurants in Russia expanding its chain to 277 outlets nationwide. Burger King has doubled the number of its outlets from July 2013 to September 2014, demonstrating the highest fast food market developing growth in Russia. In April 2015 Burger King opened new outlets in the Russian Far East. According to press articles, Burger King will now focus on improving the quality of its products instead of opening new outlets in 2015.

McDonald's has plans to expand in Russia as well. By the end of 2014, there were 486 McDonald's fast food restaurants in Russia. McDonald's has plans to open more than new 50 restaurants nationwide in 2015, with a planned investment valued at 6 billion rubles.

**Graph 3. Russia: Number of Fast Food Chained Restaurants in Russia in 2012-2014**



*Source: RBC research*

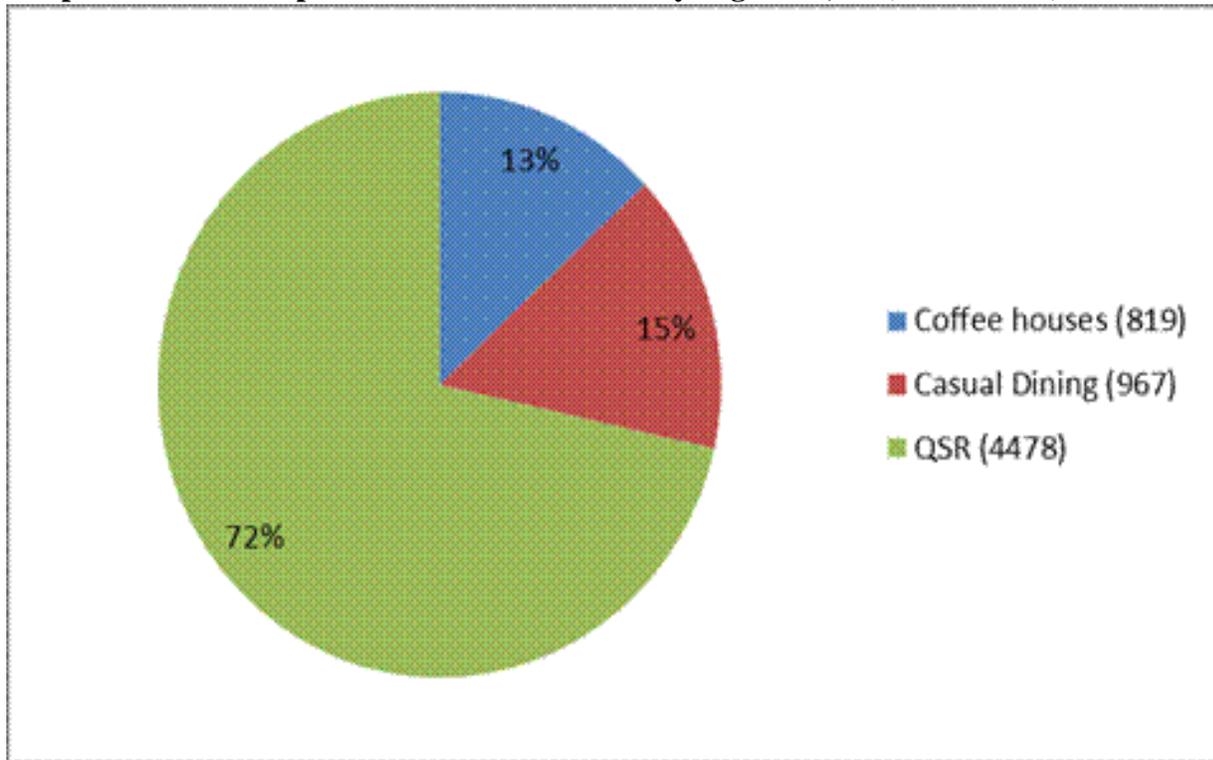
Today fast food is the most popular segment for young and middle-aged Russian consumers. Research has shown that more than 54 percent of fast food restaurants visitors are from 18 to 34 years old with average monthly income of 30,000 rubles. Pancakes, burgers, sandwiches, chicken, pizza, and baked potatoes are the most popular types of fast-food in Russia.

**Table 2. Russia: 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
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*

**Graph 4. Share of Top 40 Chained Restaurants by Segments, % (# of Outlets)**



Source: FoodService magazine, July 2014

**Table 3. Russia: Leading Franchises in the Russian Market 2014**

Holding Company	Brand	Type	# outlets Own/Franchise	Geography	Lump sum payment/Royalty
Mega Group	Cinnabon	Bakery	/more than 100	50 Russian cities	\$18,000/6%
	Hesburger	Burger	/more than 40		10000 euro/6%
Coffee Set	CoffeeShop Company	Coffee house	50/35	16 Russian cities	28,500 euro (1euro=50Rub)/6%
Double B Coffee&Tea	Double B	Coffee house	23	4 Russian cities, Kazakhstan, Prague	1 mln. Rub for Moscow and 800,000 Rub. for regions/0%
NF Rus	Nathan's Famous	Hot dogs	/11	Moscow, Sochi, Novorossiysk	\$6,000/6%
3 Papas LLC	Papa John's	Pizza	39/23	15 Russian cities, Belarus,	\$35,000/7.5%

				Azerbaijan	
Subway Russia Franchising Company	Subway	Sandwich	/more than 690	150 Russian cities	\$7,500/8%
Traveler's Coffee	Traveler's Coffee	Coffee house	80/16	40 Russian cities, China, Ukraine, Kazakhstan, Azerbaijan	1.5 mln. Rub/3%
Yum! Restaurants International Russia & CIS	KFC	Fast food	/347	10 Russian cities & CIS	\$47,700/11%
Markon	Stardog's	Street food	40/800	70 Russian cities	30,000 Rub/3-5%
Shokoladnitsa	Shokoladnitsa	Coffee house	417/88	100 Russian cities, Kazakhstan, Ukraine, Azerbaijan	\$70,000/7%
G.M.P. Hospitality Planet	Sbarro	Pizza	126/27	50 Russian cities, Kazakhstan, Azerbaijan	\$24,900/7%
	Yolki-Palki	Russian cuisine	23/28	11 Russian cities	2 mln. Rub/6%
	Yam Kee	Noodles	25	7 Russian cities	\$12,900/5%
	Vostochnyy Bazar	Asian cuisine	43/13	20 Russian cities	\$14,900/6%
Rosinter Restaurants Holding	Planet Sushi	Japanese cuisine	61/58	40 Russian cities,	35,000 euro/6%
	Il Patio	Italian cuisine	76/69	Moldova, Belarus, Ukraine, EU	

*Source: Russian Franchising Association*

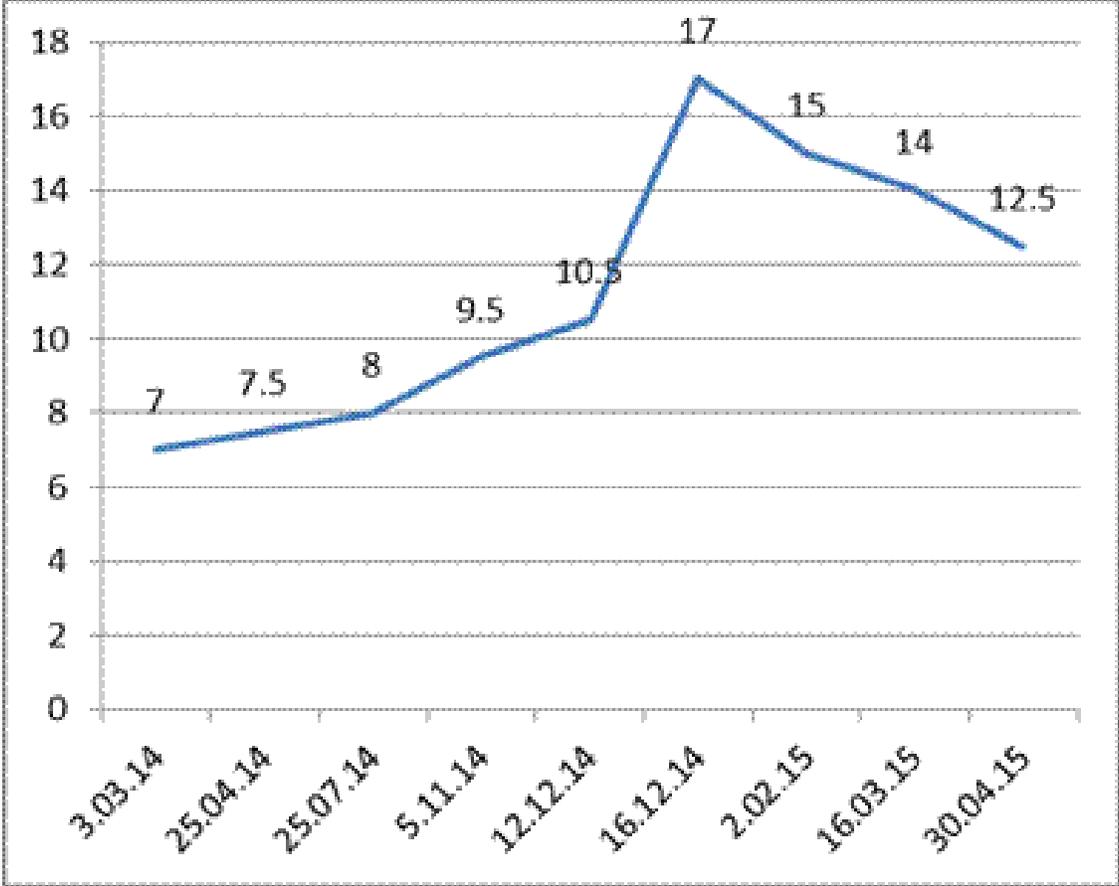
According to the Russian Federal Statistics Service (Rosstat), turnover of restaurants and cafes in Russia grew by 1.6 percent to 1.2 trillion rubles in 2014. While a decrease in turnover was seen in October and November 2014 (down 1.2 and 1.9 percent respectively), it jumped 2.8 percent in December 2014.

Annual level of inflation in Russia reached 11.4 percent in 2014. This is a large increase from the 6.5 percent inflation rate for 2013 and primarily reflects the depreciation of the ruble, along with an external effect of the food import ban which took effect in August 2014. The Russian Ministry of Economic

Development (MED) announced that economy is expected to decline in 2015. With a presumption that average annual oil prices will equal \$50 per barrel, MED expects GDP to contract by 2.8 percent, consumer prices to rise 11.9 percent, and real wages to decline by 9.6 percent over the course of 2015. VTB Capital reportedly estimates that 40 percent of Russian income was spent on foodstuffs in 2014, up from 36 percent in 2013. However, MED forecasts disposable income to decline 6.3 percent over 2015. Given the economic volatility in the market, and the fact that food prices as of April 1, 2015, have increased 23 percent year-on-year, it remains to be seen to what extent Russian consumer demand will continue to contract.

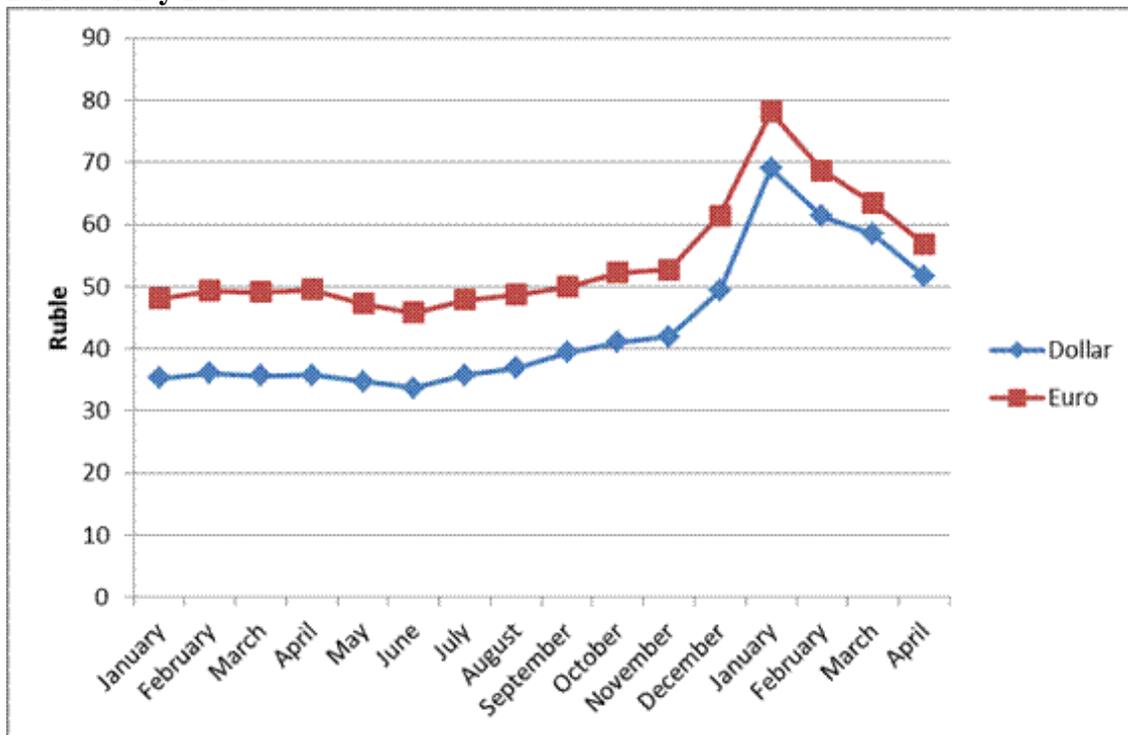
Russia is very dependent of oil prices, which declined to their lowest levels since 2010 following OPEC’s November 27, 2014, decision not to reduce its daily output quota, putting substantial depreciation pressure on the Russian ruble. In 2014, the ruble depreciated by a little over 61 percent against the dollar and 43 percent against the euro. The ruble fell to 65.45 rubles/USD and 78.87 rubles/euro on December 15, prompting the Central Bank of Russia to raise its key interest rate by a massive 6.5 percentage points to 17 percent.

**Graph 5. Russia: Central Bank’s Key Interest Rate from March 2014 to May 2015, in Percentage**



*Source: Central Bank of Russian Federation*

**Graph 6. Russia: Central Bank's Exchange Rate of \$1 USD and \$1 Euro to Ruble from January 2014 to May 2015**



*Source: Central Bank of Russian Federation*

The fall of the Russian ruble to a level 69 rubles per dollar continued at the beginning of 2015 but has now somewhat stabilized at 50 rubles to the dollar. On March 16, 2015, the Central Bank of Russia reduced its key interest rate from 15 to 14 percent per annum. The rate cut was in line with consensus expectations, after Rosstat reported flat weekly inflation in March at 0.2 percent, which translates to 16.7 percent annual inflation. On April 30, 2015, the Central Bank of Russia again reduced its key rate to 12.5 percent.