Retail potential in Russia
a survey to identify the retail expansion potential in Russia

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Retail potential in Russia

A survey to identify the retail expansion potential in Russia

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Preface

The rapid growth of the Eastern European real estate markets has been interesting for more than two decades since the collapse of the Soviet Union in 1989. Countries in Central-Eastern and Eastern Europe, such as Russia have rapidly established a developed retail environment. During my tenure in 2007-2008 as a Strategic Consultant at Jones Lang LaSalle in Moscow I got involved in the deepest sense with the Russian retail market. My local experience has been the input and driver for this Master thesis to investigate further the potential of retail expansion in Russia.

I would like to express my gratefulness to a number of people, who supported me during my research. In the first place, I would like to thank my mentors: Mrs. Ingrid Janssen and Mr. Aloys Borgers of Eindhoven University of Technology for their support, recommendations, brainstorming and feedback on the content and structure of my research. Additionally, I would like to thank Mrs. Yulia Nikulicheva of Jones Lang LaSalle for her support in regard to providing useful information and data of the Russian real estate market.

Last but not least, I want to thank my family and friends for their support during my research.

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Summary

After several consecutive years of constant intensive growth of the Russian retail market the crisis affected Russian retail development since 2008. Even more than before the crisis, retailers are looking for more knowledge based directions to expand their retail activities in emerging markets, which Russia still is. Expanding opportunities are still wide spread around the country, but market knowledge is rare. With guidance and direction Russia remains the land of opportunities for domestic and international retailers.

The aim of this study is to investigate the characteristics of the Russian retail market and to support potential retail developers exploring options for retail expansion in Russian regions. The research question is: how can the booming development of retail markets in Russia in the last decade be explained, and what can be forecasted regarding the potential for further retail development in Russian regions in the near future?

In order to clarify the stated problem, the thesis investigates the retail real estate development in Russia in the last 2 decades. Then the internalisation-process of the retailers has been described to formulate the drivers behind the retail expansion. The Western European planning policies have been reviewed to provide a comparison of the current more flexible planning situation in Russia. Based on Russia’s retail market development and retailers internationalisation processes, specific criteria have been defined as input of a tool to identify the potential of retail development in the different regions of Russia. The developed tool will be a guide for retailers and investors, combining supply of retail stock with demand, based on demographic and economic figures and additional important factors such as political stability.

Although shopping centres have been introduced on a large scale during the last 2 decades, a big part of Russian retail is still based on more traditional forms of retail. Kiosks, Produkti stores and city markets provide daily products on a large scale. Also many Russians are used to this form of shopping. Not only the supply of modern retail formats is underdeveloped (especially in the less developed regions), also the people are used to do their daily shopping in this more primitive form of retail.

The basic drivers of retail demand have supported retail development in Russia. The income of the Russian population has been increasing in the last decade by over 20% per annum in USD terms, while still spending a high percentage, in average approx. 70%, of their income on retail. This stimulated retail development across the whole country. However the on-going crisis has stopped the trend. The main adjustment is caused by rising unemployment, wage reductions and by the rouble devaluation.

The lack of saturation of the Russian retail market will continue to be a driver for retailers to expand their business in Russia. When retailers can face particular obstacles, including the tough business environment, they will be able to capture a market share on the Russian retail market which has enormous expanding potential. However the review of the development of retailers with establishments in Russia showed that developing retail successfully in Russia needs also new approaches to ordinary business plans and capabilities to overcome major external economic obstacles, such as the collapse of the Rouble in 1998.

Although Russian governmental institutional and regulatory factors can be flexible, in case they are on your hand, Russia is raising plenty of obstacles in different areas which can lead
to a failure on the market: 1) culture and languages; 2) tariffs, quotas, development laws; 3) cost of logistics and communications; 4) reaction of local competitors.

The review of the development of shopping centres in Moscow made clear that shopping centres have been developed on a speculative basis under flexible planning regulations, now showing more and more their weaknesses during the current crisis.

When we reflect the Western European retail policies on the situation in Russia it is clear that retail development in these two parts of the world is totally different. Due to the institutional constrains in the West many retail markets are saturated and structured by their governments. This is not the case in Russia, where there is still a lack of modern retail facilities in many parts of the Country. The protection policy for existing retail, which is one of the driving forces behind retail policies in the West, is lacking in Russia and that is also less important because existing retail doesn’t exist on such a scale in Russia.

The thesis showed that it is impossible for an international company to just copy their successful schemes from the western markets, including western employees into the Russian market. The set of external circumstances are just too different. When a company can manage to find a reliable local partner it will probably be able to catch the potential in the market, which clearly exists in every area in the country.

However market potential should not be the only variable taken into consideration when companies decide to enter Russia in a particular area. First of all they need to look at the particular set of circumstances which are always presence in the way of doing business in Russia. Most important of all is to get the right people (mainly local politicians) in the same directions. This is crucial to a successful expansion in Russia. And this could easily lead to ethical issues, such as bribery, which will continue as a common problem in Russia.

A Geographic Information Systems based tool has been developed in order to provide a user-friendly interface for retailers and investors to identify the highest retail potential in the Russian regions. The tool is able to guide and facilitate the selection of interesting areas or cities. In a next step, the targeted area/city needs to be analysed in more detail, for example regarding distances customers have to travel to the retail development. Especially regarding an investigation of the population demographics, the tool can be effective. The tool also adds very important additional information: investment risk, which is particularly in Russia of high importance. Therefore the tool can filter areas not only based on their potential in regard to demand of the population but also based on risk-levels. By combining criteria related to demand, supply, and investment (political) risk, the tool is an user-friendly system which can guide retailers and investors screening Russian regions regarding retail expansion potential.
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1 Introduction

The global crisis has hit Russia hard. In October 2009 the president, Dmitry Medvedev, admitted that the crisis had affected the country more severely than anyone had anticipated, and that the economy had "sunk below our lowest expectations". After years of dynamic development, a result of the country's stable economic growth, rising incomes and expansion of modern retail channels, the Russian economy started slowing down to encounter severe after-effects of the economic downturn in 2009.

After several years of booming consumption, the Russian retail sector has been exposed to one of its hardest trials since 1998. Market players have had to face and adjust to the new reality not witnessed on such a scale for a decade.

At the same time, the huge Russian retail market remains one of the most attractive globally, while the retail industry is one of the most promising areas of the country's economy. In 2008 the Russian retail market was worth over $500bn, and rose in value by over 28% year on year. Now, in 2010, it is still difficult to fully assess the future impact of the crisis on the retail industry. (Economist intelligence unit, 2009)

The crisis exposed the problems of bloating which afflicted the industry and thus cleared the market and pushed the country towards improved quality of retailing and service. Among many others, it holds back chaotic expansion on a first-come, first-serve basis and forced out weak, inefficient businesses from the scene. It made retailers focus most of all on effectiveness and exerted pressure for the introduction of clearer retail concepts. Nevertheless, 2009 witnessed certain changes and shifts between major players on the retail market scene. The rapidly changing market situation along with undue reliance on credit and vast investments resulted in problems with liquidity and a growing indebtedness which eventually forced out several major retailers from the market.

On the other hand, reduced purchasing power of consumers, slumping demand and changing spending patterns made further changes in the rank of the top retailers. These mostly acted in favour of grocery retailers and have also privileged the development of certain retail formats, such as discounters, and contributed to further changes in the rank of the leading retailers.

Figure 1: Russia largest cities, population in millions (Jones Long LaSalle, 2009-c)
Retailers are looking for more knowledge based directions to expand their retail activities in emerging markets, which Russia still is. Expanding opportunities are wide spread around the country, but market knowledge is rare. Figure 1 shows the map of Russia. Retailers are looking besides the capital Moscow for expanding opportunities in the bigger cities in the regions; cities with more than 1 million inhabitants, called “Millioniki”, such as Novosibirsk or Rostov on Don.

While market scandals such as bribery are expressed on a wide scale, even among respectable international firms like IKEA, it seems that Russia is still out of the own backyard territory for retailers and investors. Innovative European retailers, such as Auchan, have developed the Russian retail market in the last decade, and achieved market potential which will provide further growth for them in the future, while home markets such as France will show only a slight growth in the near future. With guidance and direction Russia remains the land of opportunities for domestic and international retailers. A tool which can help retailers and investors as a guidance to define retail potential in Russian regions will deliver the key to success to secure a market potential and sustainable growth in the near future.

1.1 Formulation of the problem:

As a result of the issues of a global crisis, and the continuing increasing interest in Russia region, the following problem definition arises:

*How can the booming development of retail markets in Russia in the last decade be explained, and what can be forecasted regarding the locations of the highest potential for further retail development in Russia in the near future?*

1.2 Objective:

Based on the problem definition, as outlined in the previous paragraph, the following objective has been formulated:

*Creating an overview of Russia’s retail real estate development during the last 2 decades and developing a retail expansion tool, in order to forecast the highest potential locations for retail expansion.*

A number of sub-questions, broken down below, helps to achieve the objective:

- Which drivers influenced retail development in Russia?
- What lessons can be learned from retail markets in Western European countries?
- How do retailers expand and what are the specifics regarding their internationalisation processes.
- Which drivers will influence retail demand in the different regions of Russia in the near future?
- Is there a significant difference between the retail spending behaviour and the demographic characteristics of the Russian population in comparison with Western-European consumers?
- Is it possible to forecast retail potential with tools?
- Can GIS be used to create forecasting models and tools?
1.3 Main setup of the Thesis

The thesis consist out of 3 main parts:
1. An overview of the retail real estate development in Russia in the last 2 decades to investigate the developments up to the current situation and the market characteristics.
2. Creating an overview of the retailers internalisation-processes to formulate the drivers behind the retail expansion. Additionally the retail planning policies in the West will be reviewed to provide a comparison of the current more flexible planning situation in Russia.
3. The development of a tool in order to identify the potential of retail development in the different regions of Russia. Combining supply of retail stock with demand, based on demographic and economic figures and additional important factors such as political stability.
2 Russian Retail market

This chapter will describe the current status of the Russian retail market. First section will continue with the 2nd ranking of Russia on the GRDI index. The typologies of the several retail outlets in Russia will be discussed. In addition an overview of the retail market development during the last 2 decades will be provided. When the supply of the retail market has been discussed, the demand side; Russian population demographics will be covered under 2.4. The development of retail chains in Russia and an overview of investments and development on the Russian retail market will complete this chapter before an overall conclusion will summarize this chapter. This chapter is mainly based on documents by Commercial Investment Real Estate (2010), Menkhaus et al. (2004), Jonsson (2007), Economist Intelligence Unit (2009) and Jones Lang LaSalle (2009).

2.1 Retail development potential in Russia

In recent times, Russia has emerged as one of the world leaders in terms of providing an advantageous retail environment. In fact, owing to its rapid economic growth and favorable policy framework, Russia is the second most attractive destination for retail after India, according to the A.T. Kearney Global Retail Development Index (GRDI) (Table 1). The GRDI identifies the opportunity to invest in organized retail. Russian retail business is considered to be very attractive since the retail segment is still underdeveloped, logistics networks are beginning to improve, disposable income has been on increase and the competition level is generally still low. In addition, the global financial crisis has served to lower the cost of entering the market, with rental rates, as well as construction material and labour costs, all having fallen.

Despite this favorable climate for investment, the Russian retail segment witnessed significant decline during 2009 due to the effects of the global financial crisis and a slowing economy, both of which have led to low consumer confidence and a decline in consumer spending. However, in the beginning of 2010 retail turnover increased slightly in volume. According to the Federal State Statistics Service 1,152,900 people work in the retail industry in Russia, a figure equating to 3.1% of the country’s total workforce. In addition, each of the seven federal districts exhibit considerable differences in terms of the current stage of development of the retail markets, competition level and thus, their development prospects. These differences are influenced by the population of the individual federal districts, their purchasing power and also the number of retail outlets in each district. For example, the smallest, but most populous federal district, the Central Federal District, which includes Moscow, is the largest retail market in the country.

The current structure of the retail market in Russia should also be taken under consideration. The majority of turnover from Russian retail is still generated by traditional channels, individual entrepreneurs in the form of open-air markets, fairs, bazaar stands, hawkers’ trays, kiosks and small corner shops.
The annual A.T. Kearney Global Retail development Index (GRDI) ranks 30 emerging countries on a 100-point scale (Table 1). The higher the ranking the more urgency there is to enter a country. Countries were selected based on 3 criteria: country risk (more than 35 in the Euromoney country-risk score), population size (more than 2 million) and wealth (GDP per capita more than $3000, with an exception for countries more than 35 million inhabitants) (AT. Kearney, 2009).

GRDI scores were based on 4 variables (each weighting 25%): 1- Country risk, 2 - market attractiveness, 3 - market saturation and 4 - time pressure. The 4 main variables will be discussed in more details:

When we investigate the individual scores of Russia on the 4 variables there is clearly a difference between Russia and other emerging countries. Firstly Russia scores relatively very low on country risk. In the AT. Kearney GRDI is a low score on the country risk variable a sign of weaknesses. The country risk variable is built up by 2 sub variables: Country risk (80%) and business risk (20%). Political risk, economic performance, debt indicators, debt in default or rescheduled, credit ratings, and access to bank financing are responsible for the country risk (80%) part. The higher the ranking, the lower the risk of failure. A low rating, Russia’s case, indicates a higher probability for failures. The business risk (20%) part is built up by business cost of terrorism, crime and violence, and corruption. The higher the rating, the lower the risk of doing business. A low rating, Russia’s case, indicates a high risk while doing business, which confirms once more Russia’s on-going challenge to reduce corruption and terrorist attacks.

Russia scores above average on the market attractiveness variable (58), relatively to i.e. India (34). This variable shows in general the development stage of the retail market in the country. The market attractiveness variable is built up by 4 sub variables: retail sales per capita (40%), population (20%), urban Population (20%), Business efficiency (20%). Retail sales per capita: a score of zero indicates that the retail sector is still underdeveloped. A score of 100 indicates that the market is already mature, indicating an opportunity. Population: A zero indicates the country is relatively small, representing limited opportunities. Urban population: Zero means the country is mostly rural: 100 indicates the country is mostly urban.
Business efficiency: parameters include government effectiveness, burden of law and regulations, ease of doing business, and infrastructure quality. Zero means the country has poor business efficiency, while a score of 100 indicates high efficiency.

When we reflect Russia’s above average score on the market attractiveness variable this can be explained by its characteristics. As one of biggest countries in the world it is urban structured with urban centres within regions. A high percentage of the population is living in the cities. Infrastructure is developed and the country is already in a relative higher retail development stage than the other emerging countries. Retail is already significantly developed in the main cities of the country, such as Moscow and Saint Petersburg, which adds significantly to the first variable, retail sales per capita.

Russia scores an average 51 on the market saturation variable which is significantly lower than India (86) for example, but comparable to China (47). When the sub variables are investigated it is clear that the relative average score on the market saturation variable shows the development stage of the countries retail landscape already including international (western) retailers.

The market saturation variable is built up out of 4 sub variables: share of modern retailing (30%), Number of international retailers (30%), modern retail sales area per urban inhabitants (20%), market share of leading retailers (20%).

A low score on the market saturation variable indicates that large share of retail sales are made through modern distribution formats, countries with maximum number of (international) retailers, retail areas per urban inhabitant is approaching the western European level, and that the market is highly concentrated with the top 5 retail competitors. In this light we can value the retail landscape of Russia (51) as average among emerging markets, but still significantly lacking behind Western European level (a score of 0 in this case). Among emerging markets Russia is average, while India (86) is still extremely fragmented and Slovenia (12) almost comparable to the Western European level.

The last variable is Time pressure which is measured by the compared annual growth rate of modern retail sales weighted by the development of the economy in general. Results are from 0 to 100, with 100 indicating that the retail sector is advancing quickly, this representing a short-term opportunity. Russia is the only emerging country which is scoring a full 100 on this variable, which confirms the rapid development of the retail landscape in Russia. As indicated is the time span for retail expansion therefore limited and timing and fast-forward development of high importance while entering/expanding in the Russian market.
When we review the relative high 2nd ranking of Russia on the 2009 edition of the annual A.T. Kearney Global Retail development Index (GRDI) it is of high importance that the basis and setup of variables of this ranking is reviewed. The success of retail expansion is not guaranteed when only the market can adapt expansion of retail economically. Country risk characteristics can easily demolish all economical potentials. And that is exactly the case with Russia. Russia is currently already in a significant development stage of its retail environment with high-end shopping centres introduced not only in Moscow but also in the bigger regional cities. Due to its urban characters and the big market size it provides a lot of potential for retail expansion. However the weak chain of Russia is the country risk. Due to its many uncertainties while doing business in Russia all the development potential of retail can easily be reduced to zero. Figure 2 shows Russia's character. Market potential is extensive, however the country risk is affecting Russia's relative attractiveness. In the following paragraphs this case will be further investigated in details.

2.2 Typology of retail outlets in Russia

Retail in Russia develop rapidly after perestroika fell down. Russian retail has gone rapidly through 3 stages of development bypassing the stage characterized as street retail. This stage characterized as street retail in the centre of the historical city has been of great importance for the development of the quality retail in Western Europe. From people selling out of their own hands, and produkty stores on the corners of apartment buildings, Russia have gone relatively rapidly to the present stage of the retail market including high class modern shopping centres. In the main cities these developed forms of retail have been introduced in the last decade. However a big part of Russian retail is still based on more traditional forms of retail, especially in the regional cities of Russia, and partly in the bigger regional cities with more than 1 million inhabitants, the millioniki cities. Kiosks, Produkty stores and city markets provide still daily products on a large scale. Also many Russians are used to this form of shopping. Not only the supply of modern retail formats is underdeveloped (especially in the region), also the people are used to do their daily shopping in these more primitive forms of shopping.
retail. Recent high class retail developments in the regions of Russia have shown less popularity by local consumers as expected due to the traditional shopping behaviour of the local population.

To summarize the Russian retail market has been the most immediate and visible sign of the shift to a market system in the former communist countries. With Perestroika the pavements of Moscow became crowded with people selling from their own hands or small tables. This was followed by a second stage of kiosks and municipal control and then later the refurbishment of buildings, often for luxury goods. The latest stage involved the construction of shopping centre complexes in and at the boundaries of the central city.

2.2.1 The development of the 7 different categories of (food) retail in Russia

During the last century in Russia 7 different categories of retail have been established, which are still all present in Russia’s current retail landscape. Below is a picture drawn of the composition and evolution of Russian retail outlets based on Menkhaus et al. (2004).

1. Individual Vendors

Individual vendors (still) engage in direct marketing of excess production from individual garden plots. It is common in Russia to see products being sold at bus stops and other high traffic areas for potential consumers. For the most part, however, individual vendors sell their products at a city market (described later). There is no elaborate marketing of these products, as they are sold as they were harvested from the gardens of individuals. Product selection is necessarily dependent on seasonal availability. Direct marketing of products is particularly useful for smaller production units that do not have access to open markets or processors. This retail outlet also provides still an alternative source of income for some in the Russian economy.

2. Kiosks and “Produkti” stores

Kiosks are small retail stalls often located near larger city markets or transport stations to benefit from customer traffic from the larger market or towards transport stations. There are usually several, possibly a hundred or more, kiosks aligned in rows within a small area, although all do not retail food items. The same individual might own several kiosks. The merchandise in individual kiosks typically is of a common type, e.g., canned and packaged goods, paper products, and detergents soaps, but also small electronics such as telecom providers. Products are moved to and from the kiosks each day from nearby storage locations. Individual or small groups of kiosks are also common near bus stops and other high traffic areas. Recently, purchases from kiosks make up a smaller proportion of total retail food sales in the larger cities such as Moscow and St. Petersburg, and a similar decline is expected in other cities as well. Product selection is limited and turnover is low, and this method of retailing is not particularly convenient for the customer. The customer might wade through a crowded of people to get to a particular kiosk, only to discover that the product is not in stock or undesirable. Local distributors are the primary suppliers to this retail outlet. Individual kiosks were more common early in the transition period but are currently declining in number and volume of products sold, as competition from other food and non-food retailers increases.

“Produkti” stores are small grocery stores located on the ground floors of residential buildings. These stores serve more products than kiosks - they are small grocery stores which provide the Russians in the neighbourhood with daily goods. “Produkti” stores or “the five minute away from home” type trading that was common with food retail outlets prior to the 1990s (Kiryan 2003, in Menkhaus et al. 2004).
3. City Markets
City markets, individual vendors, and kiosks are very closely linked, as the latter two types often are part of, or located in close proximity to, the city market. City markets are open warehouses, many of which are the former state owned facilities that might now be stock holding companies. City markets vary in size and there may be ten or more in the "Millioniki" cities of a million people. The larger facilities are carryovers from the pre-reform period. These are primary outlets for fresh products—meats and dairy products and seasonal vegetables and fruits. It is common to see several vendors of the same products in the same area of the covered market or in the adjoining outside market. Products are not packaged and the merchandising is similar to that of former times. Some merchandisers lease individual stations on a permanent basis, while others, such as individual vendors of garden products, would lease space on an as needed basis. Prices are identical for similar products at the individual stations. The atmosphere of the city market is one of "buyers beware". Quality is often an issue. Scales for weighing produce are sometimes set to favor the seller. Products might not be what they are claimed to be, particularly those in bottles or boxes. These markets often cater to special needs, perhaps related to culture, that existed in former times and still exist. Local producers provide fresh meats and vegetables, when they are in season. Wholesalers provide other products, such as non-indigenous fruits.

4. Departmentalized Stores
The format of departmentalized food retailers is similar to that of the former state owned stores. That is, the store is divided into separate departments, each with attendants retrieving those items requested by the customer from the shelf or refrigerated unit. Payment mostly is made at each department cash register. A customer entering this type of store might select bakery items and pay for those, move to the meat counter (if one exists) and make a meat purchase, then to dairy products, etc. This method of food merchandising is quite time consuming for the individual customer, but it is service oriented. Customers can get individual attention at each department station, if the attendant is so inclined. These types of outlets often are located very close to each other in a central location of the city, or they might be located near apartment complexes. They also might specialize in selected products, such as fish or meat. Location, product selection and quality, service, attractive displays, cleanliness, and the like are features characterizing these retail outlets. As a result, the customer can expect to pay higher prices for some items than at, for example, the city market: for those products that are offered by both. Local processors, such as bakeries, provide some products to these outlets, while local distributors provide other products.

One of the most famous department stores has been "GYM", located at Red square in Moscow. Nowadays this former department store is refurbished as a high-class shopping centre with luxury international fashion brands.

5. Specialty Stores
Examples of specialty store retail outlets include stores specializing in processed meats, candies, dairy products, breads, and poultry. These outlets typically are dealers for local processors, and may include processors vertically integrating into retailing. In the latter case, of course, processors have direct links to the consumer.

6. Chain Stores
This type of retail outlet features several stores in the same city with similar product selections and selling techniques, which contributes to economies of size. The customer obtains a basket or cart at the entrance, selects products, and pays for and bags all purchases one-time, altogether, at the exit. In the larger cities these stores often are quite large. In the
region and Millioniki cities, these stores could be smaller, with one or two cashiers and typically limited product display space. Product selection in most chain stores in these regional cities do not include fresh meats or vegetables. Some frozen meat and vegetable products are available. Labour costs are less for this type of store, as compared to departmentalized stores, but service can be lacking. Efficiencies are gained in the one-time check out of purchases by customers and in stocking. Sometimes the product is simply put on the shelf in the containers delivered by the distributors.

These outlets are relatively new and have only recently been established in some regions, but they are growing rapidly in size and number. This type of retail outlet represents a formidable competitor to individual vendors, kiosks, city markets, and departmentalized stores for consumer food expenditures. Moscow's local government has identified the chain store food retail outlet as a priority. Chain stores are expected to compete with both huge supermarkets and kiosk-type trading at the local city markets. Kiosks, as a result, likely will decline in importance. City markets will continue to be oriented toward trading raw agricultural commodities grown by individuals. Chain stores will offer competitive prices due to a cost advantage and be located closer to where people live, similar to “the five minute away from home” type trading that was common with food retail outlets prior to the 1990s (Kiryan 2003). The product mix, particularly in larger chains, is expanding. There also appears to be growing competition among different chains and among chain stores and supermarkets. If these stores become dominant over large supermarkets, this is a decidedly different trend than is observed in most other countries. For example, the share of supermarkets in overall food retailing is 80% in the U.S., 70% in France, 50% in Croatia and Chile, and 40% in Poland (Reardon et al. 2003, in Menkhaus et al. 2004). On the other hand, the chain stores (outlets) will likely grow in size and might become more like a supermarket.

7. Supermarkets and Hypermarkets

Western type supermarkets are entering rapidly the Russian regions but there are already several in Moscow, St. Petersburg and other more than a million inhabitants - Millioniki cities. These are oriented more toward the mid- to higher income population and are mostly located within big Shopping centers. Prices of some goods can be higher in a big supermarket than in city markets or chain stores (Kiryan 2003, in Menkhaus et al. 2004). The product mix can be greater in supermarkets, as well as improved packaging and display, which contributes to higher prices. Nevertheless, cost/price reductions may result in the future from closer linkages to suppliers and economies of size. This type of retail food outlet, in time, will move to the regions and provide formidable competition for other outlets.

Hypermarkets are rapidly opened during the last decade in Moscow and St. Petersburg and Millioniki cities. The French retail group, Auchan, market leader in the hypermarket segment, opened one of the first hypermarkets in Moscow a decade ago. Since then many hypermarkets have been opened. International and growing domestic hypermarkets on the Russian food retail sector, put strong pressure on the smaller domestic firms that have formed during the post-reform era. These large retailers typically set up their own suppliers of products or invest heavily in controlling existing channels (Swaan 1997, in Menkhaus et al 2004) and provide a wide variety of products. Increased and tighter coordination by these firms, as with supermarkets, to other sectors of the supply chain will contribute to increased efficiencies through streamlined distribution systems, enabling product delivery directly from processors to the retail shelf.
2.2.2 The visibility of the retail typology in the current food retail market in Moscow

The 7 described forms of retail are still visible in the current retail landscape in Russia. Based on updated information according to Commercial Investment Real Estate (2010), following paragraph will describe the current situation on the food retail market in Moscow where plenty of development potential in the food segment still exists. Although the main problem in Moscow is the lack of areas appropriate for the supermarket format. The Soviet premises have been already absorbed while the development of new areas is difficult given the scarcity of development plots. The development potential may be limited to the size of new construction.

The current state regarding Moscow's grocery retail market and its further development generally coincide with major trends of the commercial real estate market. Supermarkets, hypermarkets as well as small food firms have been and will be major tenants and buyers of retail space of corresponding sizes and formats. On one hand, the further market development will greatly depend on their ability to pay; on the other hand, market saturation and availability of suitable properties will be decisive factors to forecast the future of food retail. There are several major food retail formats that mainly differ in size of facilities and retailer category. As stated above in this chapter:

- Food markets and kiosks. The tenants here are generally private entrepreneurs and non-chain players. The area of leased premises ranges from 5 to 40 sq m.
- Non-chain market players (i.e. corner stores and super-markets “produkt”- type). Operators of this category are generally private entrepreneurs and small companies with one or several food stores that are not unified in a single brand or format. The area may vary from 50 to 2,000 sq m.
- Network supermarkets and department stores usually developed under a single brand, investing in building the brand image. The area ranges from 150 to 4,000 sq m.
- Hypermarkets. These are the largest (5,000 to 20,000 sq m) stores that belong to large chain operators.

Moscow currently has over 30 grocery chains that operate in supermarket and corner store segments. Pyaterochka is the market leader with its 200 supermarkets. Perekrestok and Kopeyka both have more than 100 stores in Moscow. Utkonos has over 140 stores that successfully combine “next door”, “advance order” and “internet shop” formats. Utkonos has the largest market share in this segment. The aggregated retail area of chain food operators in Moscow is about 650,000 sq m. The major players - Pyaterochka, Perekrestok, the Seventh Continent and Kopeyka - hold more than half of all retail areas.

The share of X5 Retail Group (Perekrestok and Pyaterochka chains) now reaches 26%. Keeping in mind that the company has recently acquired Patterson network, its market share will further increase. If we examine all retail chains in terms of pricing categories, 60% of retail areas belong to the medium segment, about 35% belong to discounters, and no more than 5% relates to the premium segment.

Unlike hypermarkets, most supermarkets in Moscow operate under Russian brands. Western chains are not many - ATAK (Auchan group), Ramstore, Billa and Spar. Food retail was one of the few sectors to avoid the economic crisis and its after effects. The above-mentioned examples of successful retail chain developments mostly relate to pre-crisis business plans. On the contrary, the new chain supermarkets have opened in Moscow’s prime locations because of the negative impact of the crisis that turned out to be positive for some segments.
Generally there has not been a "crisis" in Moscow's food retail segment. In 2009, only those chains that had planned development before the crisis have managed to keep growing. One of the major trends here is that chain retailers have been gradually replacing non-chain operators. Another trend is that economy class supermarkets have been expanding towards Southern and Eastern parts of Moscow while business and premium segments are more popular in the West. The most significant change that the crisis has brought to retail chains relates to new schemes of rent rate calculation for supermarkets located in retail centers. The owners of shopping centers understood that supermarkets always generated real flows of buyers. That was why the owners quickly reacted to changing market conditions and agreed to accept a part of business risks taking rent rates as turnover percentage. This scheme had been used at supermarkets even before the crisis, but a fixed rent rate was quite high. As of today, the percentage of turnover remains almost the same but the fixed rent rate has decreased. Overall, rent payment schemes in most retail and entertainment centers have not changed. Generally, property owners did not lose by switching to the new system of tenant payments. Moreover, in many cases the owners found the new system more profitable, especially when it concerns discounter format chains (i.e. Pyaterochka and Kopeyka).

The situation is different with premises located outside the shopping centers. The owners perfectly know the value of their premises, especially in prime locations, where they do not want to make concessions to tenants. In such locations they often treat anchor tenants as regular operators. In this way, the market dynamics of rent rates and sale prices fully correspond to general trends depending on property size and location.

Total supply of Moscow's population with supermarket chains is relatively high because of the two key factors: availability of suitable areas and economic efficiency of the stores. Naturally, supermarkets located in highly populated and built up areas have the greatest potential, as many visitors who live in multistorey houses close to supermarkets become their frequent visitors.

However, retail supermarket chains are not always possible to develop in the areas with high population density. Nowadays, unlike the times before Perestroika, residential infrastructure does not include any supermarket concept even in complex development projects. As a result, supply of food retail stores in new residential areas is not sufficient. For instance, the density of retail facilities in East Maryino - a district build up in late 90s - early 2000s - makes only 38 sq m per 1,000 people. To compare, West Maryino built in the 70-80s of the previous century offers 98 sq m of retail stores per 1,000 residents. In average supply of Moscow with food retail stores is 59 sq m per 1,000 inhabitants.

2.3 Retail development in Russia

Retail in Russia has been developing rapidly during the last decade. A general overview will be provided in the first paragraph. The development of the several shopping centres in Moscow and one description of a prestigious shopping centre in particular will follow in the 2nd and 3rd paragraph.
2.3.1 Overview of the current Russian retail market

![Graph showing stock, completions, and vacancy rate over time.](image)

**Figure 3:** Moscow retail stock development (Jones Lang LaSalle, 2010b)

Russia has the largest development pipeline of retail stock in Europe and since 2004 the supply of modern retail space increased more than 10 times (figure 3). Forecasts are slightly optimistic as vacancies are forecasted to reduce in the next years. Due to the crisis there will be less completions in the next years than projected and retailers are still stimulating demand for quality retail space which will result in a reduction of the vacancy rate. Despite the rapid growth, Russia is still underserved in terms of stock per capita, compared to other European retail markets (figure 4).

![Bar chart showing total retail stock per 1000 inhabitants.](image)

**Figure 4:** Total retail stock per 1000 inhabitants (Jones Lang LaSalle, 2009c)

There is a difference between the retail market development in Moscow and the rest of Russia. Development was started earlier and on a larger scale in the capital of the country.
Despite the rapid development of shopping centres Moscow, the city is still relatively underdeveloped compared to major European cities (figure 4). Due to the global crisis which hit the market in 2008 further expansion of the retail stock was reduced. Project delays remain widespread since 2008. Only approx. 20% of the announced retail supply pipeline actually reached the market. In Moscow alone 75% of the announced projects were not completed, whereas 15% of the forecasted supply was cancelled. Financing for the projects has also stopped since the crisis hit the market. Only the projects which were already under construction and have committed financing will reach completion. Due to the lack of available financing it is unlikely that any new shopping centre project will be started. Taking into account the construction process of a shopping centre, between 2 and 4 years, the pipeline of new retail developments will be drastically reduced for the coming 2 years. As a result of this lack of completions, the market will remain undersupplied for the next 2-3 years. Only in 2012 it is likely to see a pick up, firstly in Moscow, gradually in St.Petersburg and then in the major regional cities.

In general the development of the retail market in the Russian regions has lagged behind Moscow and St.Petersburg. These markets started from a position of literally no modern retail provision. Due to the size of these cities and lower per capita incomes their market size is significantly smaller than in Moscow. Despite a recent increase in retail provision, they remain considerably underserved. However the large expected development pipeline, which is shown in figure 5 and 6 has put these cities at risk of becoming quickly saturated and over-supplied. Due to the crisis also these development projects have now been put on hold. This will provide a more sustainable and balanced retail market in the regional cities for the near future.

Figure 5: Total retail stock (Jones Lang LaSalle, 2009c)

Figure 6: Retail stock per 1000 inhabitants (Jones Lang LaSalle, 2009c)

2.3.2. Overview of the development of the shopping centres in Moscow

The shopping centre development in Moscow started in the nineties of the 20th century. Characteristic for Moscow is the circular structure which is clearly visible in figure 7. Figure 7 shows an overview of the main shopping centres of Moscow, however not indicates every developed shopping centre in Moscow. Only Shopping centres with considerable quality retail space is taken into account in the overview. Moscow consist out of 5 ring roads: The
Boulevard Ring (the centre), Garden Ring (the boundary of the centre), Third Ring Road, Fourth Ring Road, and the MKAD (the boundary between Moscow and Moscow region). Shopping centre development started in the centre in the nineties with pretentious schemes such as Okhotniy Ryad next to the Kremlin, whose development will be described in more detail in the next paragraph, and GUM, former state department store next to Red Square. In the beginning of 21st century developers such as IKEA with their Megamall concept started to develop shopping centres around the MKAD, the biggest ring road bounding Moscow. The accessibility and available land plots stimulated developers to build relatively big shopping centres around the MKAD, the boundary of the city. Zolotoy Babylon located along the 4th ring road is one of the latest completed shopping centres in Moscow. With 170,000sq m of rentable area it is currently the biggest shopping mall in Russia. However the mall is suffering from significant vacancy at the moment.

**Figure 7: Shopping centre development in Moscow (Jones Lang LaSalle, 2009b)**

Although during the last 2 decades a lot of shopping centres were delivered on the market, the established existing retail stock is far from prime quality. Fast speculative development of shopping centres in Moscow is showing during recent crisis its weaknesses. Many owners of Moscow shopping centers were forced to repurpose and modernize their facilities because of the economic crisis, but so far their new developments have received little support from investors. Many shopping centres are in a bad condition due to their weaknesses in the development process. Even the first hypermarket is due to be destroyed as Moscow is planning to demolish the city’s first hypermarket. The shopping centre was completed in 1997 by Ramstore hypermarket, now known as Kapitoly, in the Kuntzevo district of western Moscow. By then,
more than a decade ago, the event was of such importance that then-Prime Minister Viktor Chernomyrdin attended the grand opening.

Even further the demolition of the hypermarket is likely just the opening bell for an emerging trend of dismantling shopping centers built in Moscow in the late 1990s.

Many existing shopping centers have been renovated. For example in 2009 renovations were done in the Atrium mall (number 5 in figure 7), one of the shopping centers located in the center in and around the Garden-ring road. New space on the first and fourth floors were added and a change of the food court. The alterations gave the mall additional square meters of retail space, and brought in more costumers.

One of the shopping centers owners mistakes has become clearly visible at a prime location in Moscow, 2500 sq m. Tverskoi Passazh mall on Pushkin Square had very few shoppers, despite its extremely busy location. Several years ago, the owners changed the building's structure so they could give the entire first floor to cosmetics retailers Rive Gauche, which ruined the rest of the entire mall already for a couple of years.

2.3.3 The development of Manezh square Shopping Centre

The development of the shopping centre on the “Manezh square”/ Okhotniy Ryad (number 3 in figure 7), one of the first shopping centres in Moscow, is a good example of the earliest development process of the Shopping centres in Russia. A development which would be unthinkable under the labyrinth-like procedures of comprehensive soviet urban planning. Planning procedures were bypassed, opposing views were ignored and important laws were violated to promote an unprofitable investment that ‘the market’ would never have made. On a site of such critical importance (close to the Kremlin) it is clear that no detailed studies were carried out and no real cost benefit analysis took place. It is also evident, that no technical and environmental studies were considered despite the importance of the location and the nature of the development.

The nature of the process and the agencies involved still resembles the Soviet approach, with different State enterprises sharing responsibilities within a monopolistic governmental structure, rather than a mixed and open economy with space for private parties.

Obtaining planning permission in Moscow is normally an extremely complicated process. However, this did not apply in Manezh since, having been approved by the Mayor, the project passed the different planning stages as a simple formality.

In relation to the Manezh project there was no direct or indirect community participation.

There were no community organizations participating in the planning process, and no public consultation, even though the site was of such central importance to Muscovites.

Regarding the environmental problems of Manezh, it comes as no surprise that the project did not get the approval of the expert committee and still it was constructed.

The actual purpose of the project was to contribute to the power of political leadership through a widely promoted municipal flagship at the time of the city's anniversary celebration. Hence, the market in the example of Manezh is understood as the mimicry of a set of forms rather than a radical transformation of decision-making processes; power remaining centralized and political. However, while described above the development of Manezh could only lead to a disaster, nowadays the Manezh Square shopping centre is one of the most popular and profitable shopping centres of Moscow. Even with the completion of several high-class shopping centres in the centre of Moscow, Manezh square, stays popular among Muscovites and retailers. Part of the popularity is due to the extremely central location of the shopping centre and its unique direct accessibility to the metro.
In general the development of Manezh square shows the key issues of developing retail developments in Russia. It is extremely important to get politics on your side. Once there is major interest from important politicians, seemingly impassable obstacles are easy to overcome.

Under Annex 1 is included an article written by Pagonis and Thornley (1999), which describes in more details the mentioned characteristics of the development of the shopping centre of Manezh square.

2.4 Population characteristics

While Russia went through an enormous economic development during the last decade still Russia is not able to increase the quality of life significantly. Although it has a substantially higher GDP per head than in the other CIS countries, Russia broadly fits the CIS trend of poor family life, low political freedoms, high security risk, high corruption and weak community, with the negative social effects of the traumatic transition of the 1990s having persisted, despite the subsequent decade of rapid economic growth. In the following paragraphs also the drivers of retail demand, population demographics and characteristics will be described.

2.4.1 Quality of life index

With a score of 4.80 out of 10 for 2009, Russia is ranked 124th out of 160 countries in the Economist Intelligence Unit's quality of life index. Russia ranks 24th out of the 28 east European transition countries covered in the index, above only Uzbekistan, Ukraine, Tajikistan and Moldova. Moreover, of these countries, only Moldova's score is significantly below that of Russia's. Russia scores much less well than its GDP per head alone would suggest. In 2009 it ranks 46th out of the 160 countries on this indicator, better than any of the other countries of the Commonwealth of Independent States (CIS) by a wide margin, and also better than Romania and Bulgaria, both EU members. Russia rates poorly on most aspects of the quality of life, including family and community life, security risk, political freedoms, corruption and life expectancy. Improvement during current decade fails to close the gap.

The evolution over time of the quality of life index in Russia replicates the pattern seen in the region as a whole. There was a significant decline in the quality of life in much of Eastern Europe in the 1990s, during the shock of transition from the Soviet-era economic model. This decline was characterised by falling incomes, rising unemployment, deterioration in governance and increased insecurity. Russia also follows the regional pattern of an improvement in the quality of life during the course of the current decade, as economies stabilised and began to grow more strongly. However, even by 2009 the level of quality of life of 20 years earlier had yet to be regained. Although a small improvement was registered in 2009 relative to 2006, the severe financial and economic downturn in Russia in 2009 is almost certain to have seen a sharp downturn in the quality of life that year, in effect reversing much of the improvement that is likely to have been made in 2007-08.

Although it has a substantially higher GDP per head than in the other CIS countries, Russia broadly fits the CIS trend of poor family life, low political freedoms, high security risk, high corruption and weak community, with the negative social effects of the traumatic transition of the 1990s having persisted, despite the subsequent decade of rapid economic growth. However, its scores on family life and security risk are poor even when compared with the other CIS countries, and it also has a lower life expectancy. Although progress was made on democratisation during the initial years of Russia's transition, much of this was subsequently rolled back, especially during the second presidential term of Vladimir Putin, who is now
Prime minister. Hopes that the current president, Dmitry Medvedev, could preside over a measure of political liberalisation have so far largely gone unfulfilled. Russia's score for corruption is a little better than the regional average, but is poor by any other standard. (Economist Intelligence Unit, 2009)

2.4.2 Drivers of retail demand, population demographics

Besides the quality of life index it is important to review several general drivers of retail demand. Income of the population, unemployment rate and expenditure percentage are probably the most basic drivers of retail demand. Following graphs will identify the current Russian situation according to these basic drivers. The Russian population increased their average monthly income while still spending a high percentage, in average approx. 70% of their income on retail.

![Average monthly income (USD) Russian population dynamics](image.png)

Figure 8: Average monthly income (USD) Russian population dynamics (Jones Lang LaSalle, 2009c)

Figure 8 shows that incomes have been increasing in Russia by over 20% per annum in USD terms, stimulating retail spending. The on-going crisis has stopped the trend. The main adjustment is caused by rising unemployment, wage reductions and by the rouble devaluation.
Figure 9 shows that average monthly incomes are different in Moscow/St Petersburg and the rest of the country. However, incomes in the centre of the regions, in the Millioniki cities can be significantly higher than approximately 500 USD, which are shown in figure 9. Also, incomes can be significantly higher than recorded officially due to well-known reasons such as unregistered incomes.

Although figure 10 shows there is still a significant share of the Russian population which has a monthly income below 10,000 Roubles (equals approx. 300 USD), there is a tendency of a significant share of the population moving to the middle class. Still, more and more inhabitants are approaching middle class incomes, targeted for the modern retail landscape (above 10,000 / 15,000 RUB). Also, real incomes are normally higher as recorded due to unregistered incomes.
Figure 11: consumer inflation (YoY) (Jones Lang LaSalle, 2009g)

Figure 11 shows the dynamics of the consumer inflation which is characteristic for the situation in Russia. Over the years inflation has been relatively high, varying around 15%. Increasing incomes of the population levelled out the relatively high inflation. It is to be expected that inflation levels will also stay relatively high in the future.

Figure 12: unemployment rate (%) regional averages (except Moscow and St. Petersburg) (Jones Lang LaSalle, 2009e)

Unemployment is relatively low in Moscow and St. Petersburg compared to the regions (figure 12). Although unemployment rates in general are higher than officially recorded. Also in the Russian region certain cities are depending on one industry which can easily be affected by the crisis, pulling all inhabitants of such a city into unemployment. Taking uncertainties and intransparency of the market into consideration it is difficult to provide a reliable overview of the rate of unemployment in Russia.
Master Thesis: Retail potential in Russia

Figure 13: Expenditure structure Russian population (Jones Lang LaSalle, 2009c)

As shown in figure 13 Russians spend a relative high percentage of their income on retail and services: 72%. Their expenditure structure can be characterized by low savings. This can be explained by low fixed costs such as housing cost, electricity and gas.

Figure 14: Expenditures % of income 2009. *regional averages (except Moscow and St. Petersburg) (Jones Lang LaSalle, 2009c)

The tendency to consume and low savings is widespread through the country (figure 14). In all regions people have the tendency to spend a high percentage of their income. Russians have in general a significant higher tendency to spend their income when compared to other European cities. Additionally, Russia suffers from a decreasing population which can become a problem for a sustainable future as workable population will decrease.
2.5 Development of retail chains in Russia

To provide a full picture regarding the process of starting up a retail chain or expanding a retail chain into Russia the following paragraph will describe the development of two successful established retail chains on the Russian market. The two reviewed retail chains are Lenta, a domestic food retail chain, established in St. Petersburg and an international retailer Ikea, which has been for more than a decade on the Russian market. Both retail chains faced a lot of difficulties during building up their extensive network of stores in Russia. Nowadays these 2 retail chains have a dominant position on the retail market. However recently they have both faced difficulties and came negatively in the news. Lenta because of fights in the boardroom, and Ikea because of involvement in a bribe scandal. First we review the development of the Russian retail chains during the 5 years before the crisis hit the market in 2008.

Figure 15: Store expansion of top-10 Russian retailers (Jones Lang LaSalle, 2009a)

Figure 15 shows the store expansion of the top 10 Russian retailers during the 5 years before the crisis hit the market. The compound annual growth rate (CAGR) is 42%, which indicates that 42% more stores were opened during every year. Evroset is a retailer in the telecom business, which occupies only small stores (<100sq m). M-Video, Technosila, Svyaznoy, and Eldorado are retailers in electronics covering larger stores. Lenta, Dixy, X5 and Magnit are Russian grocery retailers operating through various store sizes.
During August and September 2009, 420 retailers were asked regarding their interests and development plans in various Russian cities. Results are shown in figure 16 with additional table. It became clear that retailers still have the most interest in Moscow and St. Petersburg to develop their business in relative smaller shops, up to 250 sq m. But also 50% and 30% of the retailers showed interest in the regional millioniki and 500,000 inhabitants cities as well.

Following an ambitious mission statement Oleg Zherebtsov developed a successful food retail chain in Russia: Lenta. The development process shows the uncertainties of establishing a retail chain in Russia. The collapse of the Rouble in 1998 due the several bankruptcies following Russian government’s default, had a big impact on Russian businesses. Due to an ambitious straightforward and relatively new business plan Oleg rebuilt his supermarket chain.

The development of Lenta shows that developing successfully retail in Russia needs new approaches to ordinary business plans and capabilities to overcome major external economical obstacles.

An additional issue towards developing a successful business is addressed through the high volatility of the rouble which results in even more uncertainties.

Under Annex 2, an article is included written by William Coyle and Natalia A. Zhiglinskaya, (2006) which describes the development of Lenta in more details.
In the development process of Lenta the difficulties based on the uncertainties regarding the value of the Rouble have been mentioned. Figure 17 and 18 show the more recent dynamics regarding the value of the Rouble versus US dollar. Due to the crisis, started in 2008, figure 17 shows the devaluation of the Rouble of more than 25%. Figure 18 shows the dynamics of the period which followed since March 2009. The Rouble recovered significantly, driven by an increasing oil price, which is also shown in figure 18.

Fact is that uncertainties regarding the value of the rouble, which has a strong link with the international oil price, can have a significant influence on international operations and businesses in Russia.

As described above Zherebtsov's determination was the key to establishing an extensive network of 37 Lenta stores throughout Russia, even when facing significant difficulties along the way. However in September 2010 Lenta came negatively in the news. Apparently there have been fights in the boardroom regarding the CEO position of the successful company. It once more shows the difficulties of doing business in Russia, and its particularities. For example under Russian law, the company can lose its CEO under two circumstances: if he dies or by a court order. It seems that there is currently a party involved at Lenta which would like to bypass that rule. Under Annex 3
Above and under Annex 3 are described the development of a domestic retail chain and its current difficulties in the board room. Also international retailers which expand in Russia are facing difficulties on a daily basis. A good example is Ikea which will be described further in this paragraph.

Nowadays Ikea stores and Mega malls are highly successful and widespread in Moscow and the rest of Russia. By the introduction of Ikea in Russia, the company faced major challenges like high import duties, relationships with bureaucratic authorities and attracting customers. The enter strategy Ikea used was based on “market knowledge” through market presence and company specific experiences based on active learning. More than a decade later this turned out to be a successful approach. Due to the changeable character of the Russian economy and its consumers, it is even more important to adapt to market changes and to be flexible, and practical.

Although the last decade showed a lot of success for Ikea in Russia and a rapid development of new stores, the current situation of the Swedish furniture retailer is as follows. It has suspended its programme of regional expansion in Russia. The construction of the company’s shopping centre in Voronezh Province is to start no sooner than the end of 2011 due to internal problems with the corruption scandal. The company first expressed its intentions to construct a shopping centre in the city in 2005. In 2008, a 50-ha site on the outskirts of Voronezh was acquired and a schedule was put in place for the centre to open by 2010.

Other openings by Ikea have also been delayed. The launch of Mega-Samara, the construction of which was finished two years ago, is still being objected to by local authorities. In Ufa, an Ikea outlet was to be opened in autumn 2008, however, problems arose when the Federal Migration Service claimed to have found irregularities in the retailer’s employment of foreigners. Another project, the construction of a $1bn Ikea mall in Mytischi (Moscow Province), has not yet started yet due to difficulties encountered by the company in registering its design plans.

There have been no new openings by Ikea in Russia for 18 months now.

As Retail Update Russia reported in June 2010, Ikea also decided to freeze the construction of new outlets in Ukraine, the market which the company has been approaching since 2006.

Under Annex 4 an article is included written by Jonsson (2007), which describes the internationalisation and expansion of Ikea in Russia in more details. According to Jonsson (2007) one of the major challenges for Ikea in Russia was how to handle the situation with high import duties. Relationships with bureaucratic authorities was also a major concern. Also in order to attract customers to their stores Ikea decided to build and invest in Mega malls, which is based on the need to develop the retail culture in Russia. Ikea will attract other retailers to their location and Ikea therefore should take advantage of that by acquiring the surrounding land. This stems from an experience learned from when Ikea entered the Austrian market.

Above described the successful establishment of Ikea in Russia. But as mentioned earlier Ikea got recently into problems as well, while doing business in Russia.

Bribery is a common problem on every scale of business. And recently also Ikea had to fire 2 general managers in the beginning of 2010 based on documents surfaced with evidence implicating them in bribery. It is even more interesting to notice that involved persons in the Ikea case are not Russian, but expatriates.

This case makes clear that companies need to look at corruption more as one of the aspects of concern when dealing with retail business in Russia. The majority of Russians
simultaneously despise bribe takers, pay bribes, think that the government should do more to combat bribery, but think that bribery cannot be meaningfully reduced. The issue is Russia’s highly inefficient, bloated, and arbitrary bureaucracy, which makes simple, mundane tasks into year-long projects. And there’s no reason to believe that Western managers are immune to this adaptation, confirms the Ikea case once more. Ironically, just IKEA which could easily be noticed among the “most ethical companies” have been involved in this scandal. The business environment in Russia probably raised up difficulties which drove IKEA to this unethical behaviour. For more details regarding the issues with IKEA, under annex 5 is an article included which provides a full picture of the developments regarding the current corruption issues. IKEA is not the only firm who got involved in corruption issues. In Russia 50% of the companies indicate corruption as a major constraint in doing business as figured out in table 2.

<table>
<thead>
<tr>
<th>Corruption in Russia</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Firms expected to pay informal payments to public officials (to get things done)</td>
<td>29.44%</td>
</tr>
<tr>
<td>Firms expected to give gifts to get an operating license</td>
<td>22.18%</td>
</tr>
<tr>
<td>Firms expected to give gifts in meetings with tax officials</td>
<td>17.44%</td>
</tr>
<tr>
<td>Firms expected to give gifts to secure a government contract</td>
<td>46.32%</td>
</tr>
<tr>
<td>Firms identifying corruption as a major constraint</td>
<td>50.00%</td>
</tr>
</tbody>
</table>

Table 2: Corruption information Russia (Enterprise surveys, 2009)

2.6 Retail Investment and development

In addition to a review of the current retail market it is also important to have a closer look on the investment and development side of retail real estate in Russia, which has a major influence on the retail landscape in Russia.

![Image of MOSCOW REAL ESTATE INVESTMENT MARKET](image_url)
After top 10 rankings in 2008 and 2009 Moscow ended in 2010 at relatively low 24th ranking for existing investment properties performances and 23th on new properties investment opportunities according to the PWC emerging trends in real estate Europe survey (figure 19). In 2008 it was even the highest ranked city for investment, and in 2009 4th and 6th. Since 2008, sentiment for investment properties has fallen dramatically. Currently there is a lot of vacancy in Moscow. On the short term investors are still quite sceptic, however on the long term there is greater optimism, particularly from local investors, who see a long-term recovery in commodity prices driving economic and occupier recovery. (PWC, 2010). According to PWC’s survey one international investor summed up the overall sentiment: “Russia is a big marketplace and a place to be in the future, but has enormous political and social issues”.

When we review the acquisitions recommendation of the survey respondents by city it becomes clear that the retail sector is still in favour (30.9%) followed by offices (26.5%) and hotels (22.1%).

Development prospects are characterized by PWC as modestly poor, with an 8th ranking on their index. One year ago Moscow was still ranked as 4th. Even more in Moscow land prices have come down. That makes in theory new developments more viable, but the lack of debt finance puts a serious stop to any kind of development.

![Figure 20: Investment deals in Russia dynamics, mln USD, excluding corporate acquisitions, land purchases, JVs, direct residential sales to end users (Jones Lang LaSalle, 2010a)](image-url)
Figure 20 and 21 shows the investment deals made in Russia since 2003. The crisis reduced significantly the increasing amount of investment deals in Russia since 2008.

When we review the investment deals per sector the retail sector has been regained some investors’ attention since the beginning of 2010 (17%), which confirms the favour for retail expressed in PWC’s survey. Several factors have been driving this interest. One of the factors is the increased availability of debt financing, reflected in increased banks’ readiness to refinance existing retail properties (for example a USD100 million loan to ImmoFinanz Group for its two Zolotoy Babylon shopping centres from Nordea Bank) as well as to provide construction debt, backed up massive developers’ announcements to resume construction of their projects. Another factor, supported by consumer sector recovery, retailers’ development plans have been revised upward, implying rental rate stability and in some cases even growth.

This has increased investor confidence in retail properties and more Russians and foreign activity, including private and institutional investors. (Jones Lang LaSalle, 2010a).

There are only currently a few existing retail properties available for sale because either those being offered to the market are not considered reasonably priced, the asking price is too high, there is too high a debt in place to be incentivizing for vendors, or there is fragmented ownership, which significantly discounts the property value. That is why investors have started to express interest in developing assets. In fact, several deals involving underdevelopment projects have been closed recently (Aviapark in Moscow and the M5 Mall in Ryazan, Millioniki, are among the examples) (Jones Lang LaSalle 2010a).

One additional concern for investors is that the situation could be really complicated for those schemes still waiting for city hall to grant permission for construction. As a result, projects that have already obtained all required permits are in a better position and could get additional interest from investors.

In the situation when completed schemes available for sale in Moscow are lacking, underserved investor demand for retail properties will be evident in the near future with greater investors’ interest towards schemes under development. For those projects awaiting approval from city hall, investors and developers will have to monitor the situation as the process of a new mayor will likely have to follow new rules.
2.7 Conclusion

This chapter described the development of retail in Russia, the current situation of the retail market, and its difficulties of doing business in Russia. Russian retail has been rapidly through 3 stages of development. With Perestroica the pavements of Moscow became crowded with people selling from their own hands or small tables. This was followed by a second stage of kiosks and municipal control and then later the refurbishment of buildings, often for luxury goods. The latest stage involved the construction of shopping centre complexes in and along the boundaries of the city. Although shopping centres have been introduced on a large scale during the last 2 decades, a big part of Russian retail is still based on more traditional forms of retail. Kiosks, Produki stores and city markets provide daily products on a large scale. Also many Russians are used to this form of shopping. Not only the supply of modern retail formats is underdeveloped (especially in the region), also the people are used to do their daily shopping in this more primitive form of retail.

When we review the relative high 2nd ranking of Russia on the 2009 edition of the annual A.T. Kearney Global Retail development Index (GRDI) it is of high importance that the basis and setup of variables of this ranking is reviewed. To state that Russia has high expansion potential for (international) retailers needs some concern. The success of retail expansion is not guaranteed when only the market can adapt expansion of retail economically (just based on the unfulfilled market size). An overview of the drivers of the retail demand have shown that increasing incomes combined with high expenditures and low saving result in plenty of potential for retail in the whole country. But of high importance to mention is that the variable, which is described by A.T.Kearney as “country risk”, and its including characteristics can easily demolish all economical potentials which clearly exists in all areas of the country. Russia is currently already in a significant development stage of its retail environment with high-end shopping centres introduced not only in Moscow but also in the bigger regional cities. Due to its urban characters and the big market size it provides a lot of potential for retail expansion. However the weak chain of Russia is the difficulties of doing business in Russia. Due to its many uncertainties while doing business in Russia all the development potential of retail can easily be reduced to zero in certain areas.

Also during the review of the development of shopping centres in Moscow it has become clear that shopping centres have been developed on a speculative basis, showing more and more their weaknesses during the current crisis. In particular the process of development of the shopping centre on the “Manež square” is a good example of the development process of a shopping centre in Russia. It showed a development which would be unthinkable under the labyrinth-like procedures of comprehensive soviet urban planning. Planning procedures were bypassed, opposing views were ignored and important laws were violated to promote an unprofitable investment that ‘the market’ would never have made. On a site of such critical importance (close to the Kremlin) it is clear that no detailed studies were carried out and no real cost benefit analysis took place. It is also evident, that no technical and environmental studies were considered despite the importance of the location and the nature of the development.

The actual purpose the project was to contribute to the power of political leadership through a widely promoted municipal flagship at the time of the city’s anniversary celebration.

However, despite that the development process is debatable, nowadays the Manezh Square shopping centre is one of the most popular and profitable shopping centres of Moscow.

In general the development of Manezh square shows the key issues of developing retail developments in Russia. It is extremely important to get politics on your side. Once there is
major interest from important politicians, seemingly impassable obstacles are easy to overcome.

The review of the establishment of 2 retail chains, Lenta (domestic) and Ikea (international) have shown different sides of the development of a successful chain in Russia. On the one hand the case study of Lenta showed how Zherebtsov following an ambitious mission statement developed a successful food retail chain including 37 supermarket stores in Russia. The development of Lenta shows that developing successfully retail in Russia needs new approaches to ordinary business plans and capabilities to overcome major external economical obstacles, such as the collapse of the Ruble in 1998. It addressed the issue of the high volatility of the rouble which results in even more uncertainties when doing business in Russia. But due to the set of circumstances which are always present in Russia, also Lenta could not avoid to become negatively in the news. Moscow news reported recently Fights in the boardroom regarding the CEO position. Apparently this is the result of Russian style of doing business, even up into the boardroom.

The experiences of IKEA’s entry in Russia have shown their approach towards a successful entry. Nowadays IKEA stores and Mega malls are highly successful and widespread in Moscow and the rest of Russia. By the introduction of IKEA in Russia, the company faced major challenges like high import duties, relationships with bureaucratic authorities and attracting customers. The enter strategy IKEA used was based on “market knowledge” through market presence and company specific experiences based on active learning.

However recently IKEA also could not avoid the difficulties of the business environment in Russia and got involved in a bribery scandal. Ironically, just IKEA which could easily be noticed among the “most ethical companies” have been involved in this type of unethical behavior scandal. The business environment in Russia probably rose up difficulties which drove IKEA to this unethical behavior. This case makes once more clear the difficulties in the business environment in Russia. Bribery is a common problem on every scale of business. It is even more interesting to notice that involved persons in the IKEA case are not Russian, but expatriates. This case makes clear that companies need to look at corruption more as one of the aspects of concern when dealing with retail business in Russia. The majority of Russians simultaneously despises bribe takers, pay bribes, think that the government should do more to combat bribery, but think that bribery cannot be meaningfully reduced. The issue is Russia’s highly inefficient, bloated, and arbitrary bureaucracy, which makes simple, mundane tasks into year-long projects. And there’s no reason to believe that Western managers are immune to this adaptation, confirms the IKEA case.

Even Russia is not able to increase the quality of life significantly. Although it has a substantially higher GDP per head than in the other CIS countries, Russia broadly fits the CIS trend of poor family life, low political freedoms, high security risk, high corruption and weak community, with the negative social effects of the traumatic transition of the 1990s having persisted, despite the subsequent decade of rapid economic growth.

In 2008 Moscow was still highest ranked city for investment, and in 2009 4th and 6th. Since 2008, sentiment for investment properties has fallen dramatically. According to PWC’s survey one international investor summed up the overall sentiment: “Russia is a big marketplace and a place to be in the future, but has enormous political and social issues”.

This chapter showed that Russia needs to deal with a lot of difficulties when it comes to retail development and doing business in Russia. The fast change from perestroika to 20th and 21st century capitalism lead to developments which would be unthinkable under the labyrinth-like
procedures of comprehensive soviet urban planning. Ruble volatility and bribes are major issues, on every scale of doing business.

Expansion potential on every scale clearly exists in the retail landscape in whole Russia. However market potential should not be the only variable taken into consideration when companies decide to enter Russia in a particular area. First of all they need to look at the particular set of circumstances which are always presence in the way of doing business in Russia. Most important of all is to get the right people and politics in the same directions. This, and only this will lead to a successful expansion in Russia. And this will sooner or later raise ethical behaviour issues, such as bribery, which is common problem in Russia.

For an international company it is unavoidable to use local employees when expanding in Russia. It is impossible to copy their successful schemes from the western markets, including western employees into the Russian market. The set of external circumstances are just too different. When a company can manage to find a reliable local partner it will be probably be able to catch the potential in the market, which clearly exists in every area in the country.
3 Internationalisation by retailers

The retail industry has worldwide shown a trend which is towards increasing scale of stores and concentration and internationalisation of businesses. As result the retail landscape is characterized by a market structure with fewer and larger retailers who closely monitor each other actions. Despite the decreasing number of retailers, competition has intensified for locations to open new outlets and for the demand of consumers. In developing marketing and location strategies of retailers, they are faced with the increased heterogeneity of consumer markets and complexity of spatial shopping behaviour. This lead to the investment of many larger retailers in the expansion of programs for strategic planning and market research (Marganovsky 1997).

Retailers have developed different marketing and location strategies to adapt these changes in the retail markets. As a result new retail formulas have been introduced such as brand integration (shopping and catering facilities), location types (petrol stations and off-centre retail parks), scale of retail facilities, institutional conditions (such as opening times) and selling techniques such as tele-shopping.

The dynamics of consumer markets and governmental retail policies force retail to continuously evaluate and reconsider their expansion strategies. As in many industries, the success on the retail market is defined by the retailers’ ability to adapt towards new developments.

In order to put the retail development in Russia in certain perspective this chapter will describe internationalisation processes of retailers. What are the strategies they use when they enter markets, and what are factors for success or failure.

3.1 History of Internationalisation

Due to growing complexity of consumer markets and intensified competition many retailers have introduced and implemented methods of strategic planning for expansion and internationalisation. Declining consumer spending and more intense competition from new entrants fighting for a share of shoppers’ shrinking wallets, are issues retailers face in developed markets. Already a big part of total sales moved from specialty and department stores to discount big-box retailers, and it seems shoppers will not return to their old shopping habits soon. To manage these risks and imbalances, leading global retailers will seek to balance their portfolios with both developed and developing markets, for example expansion in Russia.

Literature is generally more concerned with motivations for internationalisation and with the outcome of internationalisation by retailers (i.e. numbers of stores owned or franchised by various companies in various countries). However two other areas should also get attention in regard to internationalisation by retailers and understanding the relevance of institutional constrains. These two areas are the strategy behind entering new markets, and degree of success or failure achieved in those markets. Institutional matters, and government regulation policies, which will be described in the next section, can affect the location and timing of development, and also the strategy chosen for international expansion. For example companies are more likely to expand through existing retailers when conditions of control over development and/or difficult land market will restrict the opportunities.

Before these two areas of new market entry strategies and success and failure aspects will be described it is useful to get a brief overview of the history of internationalisation by retailers, because this process is already going on for centuries.
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Retailing has been historically regarded as primarily provincial in scope, although international activities by retailers are nothing new. For centuries, retailers have successfully engaged in international activities. European retailers had long relied on the colonization of the Americas, Africa and parts of Asia as a source of unique merchandise. Similarly, department stores, which gained their dominance in North America in the mid to late 19th century, also looked internationally, primarily to Europe in their case, for sources of unique merchandise (Burns, 1997).

The industrial revolution (late 19th century) increased globalization of retail. Due to the industrial revolution, small cities, turned into large conglomerations of individuals and families. The resulting growth in urban population produced an environment where large retail establishment became viable. Furthermore, availability of capital, electricity, and the growth of the use of advertising made the construction and success of large retail establishments possible (Smith, 1956; in Burns, 1997).

Also the rising standards of living during this time period provided consumers with an income necessary to ensure the success of this new mode of retailing (Benson, 1992, in Burns 1997).

In the middle of the 20th century, the US retail industry was the dominant force on a global scale, due to the rebuilding domestic operation and infrastructure in Europe and Japan after WW2. As a result, the US retail industry progressed much further than that of Europe (Burns, 1997).

Situation changed on a global scale when European retailers increased their interest in U.S. retail operations in the eighties. During the 1990s, the globalisation of the retailing industry has accelerated significantly (Myers, 1996; in Burns 1997). Since most retailers are realizing higher profitability in many foreign markets, several view globalization as the most important force in retailing today. The more recent globalization efforts by retailers increasingly dispersed (Burns, 1997) International expansion is occurring from retailers out of all areas in the world. The target of such expansion is equally varied. For example global activities of Japanese retailers with their emphasis on developing nations in South-eastern Asia (Davies and Fergusson, 1997, in Burns 1997). But also the increased interest of retailers expanding in Eastern Europe, former soviet communist states, is an example of recent internationalisation trends.

3.2 Strategic planning

Due to the increasing recent internationalisation trends and growing complexity of consumer markets including intensified competition many retailers have introduced and implemented methods of strategic planning. Nowadays, larger retailers prepare location decisions. Based on market and location research decisions where to locate or close stores are made. For smaller companies the available resources for research and planning are rather limited. The strategic approach is increasingly used by retailers as a framework to achieve the companies’ goals (Oppewal 1995).

Although it is important to understand retailers strategic management to a full detail it is irrelevant to describe all aspects in the light of this thesis. However here follows a brief theoretical overview of a frequently used process (Oppewal, 1995):

The general aim of such a strategic management is to establish an advantageous and sustainable competitive position of the firm. In general the process starts with clarifying the mission/ goal and overall objectives of the organisation. In general the goal is determined as a definition of the target markets and the retail format used to approach these markets. The following stages include the objective to translate this goal into operational retail strategies. Firstly, the situation analysis is carried out, which should determine the attractiveness of
potential markets, the strengths and weaknesses of the competition and opportunities to attract potential customers. Then strategies to attain the goal are formulated, implemented and monitored. The scheme shows how the various areas of management decision making are coordinated into a mission to approach the target markets. Previous steps result in a marketing plan with a target market, which is defined in terms of the market segment the retailer wants to address, identified by demographic and socio-economic characteristics. The retail format (2nd element of the plan), specifies how the retailer intends to approach this target market in terms of available marketing instruments including pricing policy, type of merchandise, services offered, store design location type and other variables that can communicate the retail offer to the consumer. The market plan may be formulated at different levels of the organisation, i.e. the entire chain, individual stores within a chain and departments within stores. The plan is considered essential for focusing management activities on specific targets and provides a basis for monitoring market developments and strategic control. Also the plan should be updated on a regular basis - i.e. periodically (every 2 to 3 years).

The described process of a strategic and marketing plan, is relatively theoretical, but can be applied by retailers while entering the Russian retail market. It is important to determine target areas, target customers and market potential before entering the new market. Demographic and socio-economic figures are the key to successfully predict market potential in certain areas. Although in this particular information there is a factor of unreliability involved. Even professional consultancy firms are struggling with information provided by official statistics, which is in general not always reflecting the actual situation. For example unofficial incomes are higher and unemployment rates vary significantly. Also shopping behaviour can be particular, and the market shows extremes on both ends, there is a big gap between poor and rich, which can easily influence official statistics. Market analysis is the key to a successful operation and expansion, although there should be a concern regarding the view towards the information which will be the basis for the analysis itself. Retailers follow in general 6 major steps in their strategic planning in order to identify potential and a suitable location for their new retail development.

1. A survey of the market size / potential based on population demographics within the catchment area.
2. An exploration of existing and projected retail real estate in the area.
3. A survey regarding consumer spending behaviour, and the expected dynamics in the area. How is retailing through the internet effecting current and future spending behaviour in shopping centres.
4. Is there still space in the area for a particular retail centre.
5. Will retail development be feasible in the specific political environment of the area.
6. Will retail development be feasible in regard to specific (other) risks involved.

While these steps are used to realize a new retail development, also other entry strategies are possible, such as investing in an existing retail chain. Next section will describe possible entry strategies.

3.3 Entry strategies

With regard to the history of internationalisation and more recent internationalisation patterns, two earlier mentioned areas should get more attention; the strategy of entering new markets, and degree of success or failure achieved in those markets.

When it comes down to the strategy retailers use to enter new markets, Salmon and Tjordjman (1989; in Guy 2001), firms can adopt three basic strategies for internationalisation:
1) Investment strategy. The foreign company buys all or part of an existing retail chain.
2) Multinational strategy. The foreign company develops new outlets through fully- or part-owned affiliates, which adapt their operation to the local market.
3) Global strategy. The foreign company reproduces the type(s) of outlet which operates successfully in the country of origin.

When we put these 3 strategies in the prospective of expansion in Russia it is clear that these 3 different strategies have been adopted by international retailers expanding in Russia during the last decade. The expansion of Ikea, which has been described in a previous chapter, is a good example of the Global strategy. Ikea reproduced types of outlet which operate successfully in the country of origin. Although it is important to mention that Ikea adopted an entry strategy in Russia, which previously have proven successful by the entry of the Austrian market. By developing a Mega mall concept Ikea included various other retailers within a mall concept, providing additional and necessary consumer flow.

A more recent Investment strategy approach has been shown by one of the biggest retailers in the world; American retailer Wall-mart. Previously described Russian founded and based supermarket chain Lenta, which includes 37 stores have been eyewatched by Wall-mart for a take-over. Apparently Wall-mart is looking for a fast entry into the Russian market which could be achieved more quickly by an investment strategy approach.

An example of the multinational strategy (2nd mentioned) approach is the French hypermarket chain Auchan. More than a decade ago Auchan came to the Russian market, one of the key retailers in Ikea’s mega mall concept. Auchan realised to achieve in a couple of years market leader position on the Moscow food market. Auchan is expanding locally not only through an established network of supermarkets. Three years ago, Auchan leased and bought several hypermarkets of the Turkish retailer Ramstore, one of the first retailers/developers on the Moscow retail market in the 1990s. It operates currently the Ramstore supermarkets under the “Auchan citi” brand, the addition of “citi” is probably explained by the fact that these hypermarkets are in general smaller, for example 8,000 sq m, instead of 16,000 sq m, and are located within Moscow city boundaries, within the MKAD (previously described in chapter 2). To summarize, after a successful entry to the Russian market, Auchan is now expanding under its local establishment, and through investing and leasing stores of existing retailers. There is thus also a link to the first strategy approach, the investment strategy approach.

According to Guy (2001) institutional and regulatory factors - including governmental regulation of retail and service activity - can influence the internationalisation process and the entry strategy used by retailers, for example:
- Competition regulation: a country may have legislation preventing monopolies or oligopolies in the sale of certain types of consumer goods/
- Regulation of opening hours and/or labour practices
- Control of out-of-centre retail and leisure development.
- Land and property markets which may be characterised by high prices, legal restrictions or other peculiarities.

These institutional matters can affect the location and timing of development, and also the strategy chosen for international expansion. (Salmon and Tjoejman, 1989; in Guy, 2001)

Companies are more likely to expand through existing retailers when developments are hard to control and/or when the land market restricts the opportunities. The governmental regulation of retail in Russia could be characterized as flexible, based on local experience. Regarding opening hours, shops, especially food retail is not restricted, which leads to opening hours of 24/7. There are no signs of active competition regulation,
which is a result of the drastically change into capitalism in the 1990s. Due to the many local and international players on the market, directly or indirectly, for example through international franchises, there is a competition in every retail segment on the market. Communism was always characterized as a monopoly; the state was regulating the provision of goods to the people. This changed in opposite direction, where every individual or company is fighting for the biggest piece of the enlarging cake, resulting in competition. Due to the various shopping centres which have been developed in and out of town areas, including entertaining areas, shows that control over out-of centre retail and leisure is slightly restricted. Being owner of the land and getting the responsible people in your direction is far more important, as described in chapter 2.

The land and property market Russia is characterized per area. If we review the Moscow case, land costs in the centre are very high, although restrictions and regulations in regard to the function of the land are relatively flexible. Demolishing an old brownfield, and redeveloping the area with retail, offices or residential is based on the initiative of the developer, rather than directed by government. In the end developers need to get approval for their plans by local parties, decentralized regulated. If you get the responsible people on board, no legal restrictions apparently will apply, otherwise there could be “creative” ways to reach planning permission from local authorities.

### 3.4 Success and fail factors

Above described are institutional and regulatory factors and possible strategies regarding entering new markets and recent examples of adopted strategies by international retailers in Russia. As mentioned earlier it is also important to have a look at additional success and fail factors of a specific market pointed for expansion.

McGoldrick (1995; in Guy 2001) summarises possible “obstacles” to internationalisation under four headings:

1. culture and languages;
2. tariffs, quotas, development laws;
3. cost of logistics and communications;
4. reaction of local competitors.

When we review the case of Russia in the light of McGoldrick obstacles it is clear that the market in Russia provides various “obstacles”. In chapter 2 AT Kearney captured some obstacles in its GRI country risk variable. It became clear that Russian business culture will raise obstacles. Also the language barrier can provide an additional obstacle when western employees will not be able to communicate on a significant level of Russian language, and Russian employees, especially on lower hierarchical levels are not able to communicate on a necessary level of English.

Using an example out of the western European retail expansion history, the problems which Wal-Mart faced with the international expansion in the German market are explained by Ghauri and Cateora (2006, in: Jonsson, 2007): "According to analysts, the main reason for Wal-Mart’s losses was its failure to understand German culture and the shopping habits in Germany".

Import taxes and quotas are obstacles which are often mentioned by international retailers while they want to make their entry or operate their business in Russia. Due to the geographical characteristics of Russia, logistics can be a big obstacle. Especially the regional cities, often located on hundreds, even thousands kilometres of distance from main hubs such as Moscow or St.Petersburg are tough to supply, especially during strong winters, and Russia’s bad road conditions. Even between Moscow and St.Petersburg, two multimillion cities, located on a distance of 700km, there is no direct highway without interruptions, anno
2010. Cost of logistics, and setting up a logistic network can be costly, not even to mention the outflow of goods, due to common problem such as bribes and robberies.
When we review the 4th obstacle, which is mentioned by McGoldrick, it is important to mention that especially the Moscow retail market is characterized by a lot of competition among retailers, which are expanding rapidly at the moment, resulting in tough competition.
To provide one example: Carrefour, the French hypermarket retailer, came to Russia as one of the first in the 1990 to setup a local network of stores, even before Auchan was on the market. Apparently, Carrefour faced difficulties and left Russia by then. Recently Carrefour tried to re-enter Russia, and announced to open at least 2 new stores in Moscow, located in newly developed shopping centres. Due to the crisis and current existing competition Carrefour again withdraw its interest in the Russian market, and delayed its entry to Russia for the moment.
Reaction of local competitors, especially in Moscow and the main cities in the regions are tough, even more when we talk about food retailers. Local competitors are ahead of the market, developing currently even discount formats, to provide the growing segment of discount food retail.

To summarize figure 22 shows the major constraints and obstacles firms in Russia and the percentage of firms identifying this as their major problem. However it is important to mention that the table only shows the greatest obstacles; firms can be affected by additional constraints.

![Figure 22: Top 10 constraints to Firm investments in Russia (2009) (Enterprise surveys 2009)](image)

3.5 Conclusion

To summarize, although flexible governmental institutional and regulatory factors, Russia is raising plenty of obstacles in different areas which can lead to a failure on the market, as for example Carrefour already showed twice.
Common used strategic plans and marketing plans are key to success in expanding Russia. However, concern should be taken towards the information which will be used as a basis for the analysis. In Russia’s case the reliability of official statistics are not always on the same
level as in the West, as they are reflecting not always the actual current situation, for example unofficial incomes could be even higher, and employment rates may be higher as well. Nevertheless, current successful international retailers on the Russian retail market had to face the same difficulties. Investing in a local established retail chain could be a wise entry strategy to enter the market rapidly, avoiding the set of obstacles. Wal-mart is adopting this strategy, eyewatching Lenta for a take over. However, in respect to Lenta’s relatively small share of the market, in order to gain significant market segment in the Russian retail market Wal-mart needs to develop additional strategies. Sooner or later Wal-mart will face the same obstacles which successful retailers overcame during the last decade. The only advantage other retailers such as Auchan had by then was a lower exiting competition level, although there are also plenty of examples of failure with similar sets of circumstances, such as Carrefour.

When retailers decide not to invest in an established retail chain and to develop new retail developments they will follow in general 6 major steps in their strategic planning in order to identify potential and a suitable location for their new retail development:

1. A survey of the market size / potential based on population demographics within the catchment area.
2. An exploration of existing and projected retail real estate in the area.
3. A survey regarding consumer spending behaviour, and the expected dynamics in the area.
4. Is there still space in the area for a particular retail centre.
5. Will retail development be feasible in the specific political environment of the area.
6. Will retail development be feasible in regard to specific (other) risks involved.

The lack of saturation of the Russian retail market will continue to be a driver for retailers to expand their business in Russia. When retailers can face particular obstacles, such as the tough business environment, they will be able to capture a market share on the Russian retail market which has enormous expanding potential.
4 Retail regulations in Western Europe and Russia

The retail structure in Russia varies significantly from the retail structure in various Western European countries, for example the situation in the Netherlands. Many Dutch cities are characterised by a high degree of concentration of stores in centres, a high density of small neighbourhood centres, a hierarchical structure of centres and a relatively small share of peripheral retail. This specific retail structure is the result of historical development of retail since the late 20th century in combination with Dutch retail policy. The next paragraphs provide an overview of several governmental policies in regard to retail development in Western-Europe. Which lessons can be learned from the Western European planning policies? Regulated countries show generally lower risks regarding investments. Therefore countries with a regulated retail structure could be preferred over markets with less clarity regarding the system of control, such as Russia. However in general countries with less clarity show a higher degree of unsaturated markets which provides on the other hand investment opportunities.

4.1 Governmental regulations

For many decades governments use regulations to control the retail landscape in their countries. Governmental regulations have been controlling more and more the Western European retail system since the 20th century. Governments regulated new and existing retail using a centralized or decentralized approach. For example the Dutch retail system has been centrally regulated for many decades by the Dutch government. Recently, the policy shifted to a decentralized approach allowing more options for out of town retail planning. A full description of the developments regarding retail policy in The Netherlands will follow in the next paragraph.

In general is it possible to identify the system of control in a certain country. For all Western-European countries retail development is regulated. Regulation can be carried out through a centralized system of control: the power is in the hands of the central government or through a more decentralized approach, relying on the decisions of local planning authorities. The possibilities for retail expansion are therefore different per country or even per city. Regarding the effectiveness of centralized versus decentralized retail planning, Guy (1998; in Van der Krabben 2009) concluded, based on the international comparison of retail planning ideologies in Western countries, that it may be hard to choose between “systems which impose legal restraints on development (of off-centre retail) or those which rely on the decisions of local planning authorities”, but that, however, “systems of control may be less successful when they rely upon local authorities to carry them out”. Table 3 on the following page shows the various retail structures in 5 Western-European countries.
Different regulations have resulted in different retail structures among the countries in Western-Europe. Especially the presence of out-of-town peripheral retail locations are indications of the used regulations. For example in the Netherlands the peripheral retail developments have been limited to specific retail segments, mainly furniture, kitchens and DIY, resulting in a specific peripheral retail landscape in the Netherlands.

In the rest of Europe there are many thousands of hypermarkets, furniture stores, etc. built in periods of more relaxed planning policy. Guy (2001) stated that these represent a hidden resource for aggressive international developers.

Guy (2001) also stated that a link may also exist between planning property issues and the concept of retail saturation. A highly regulated property market or one affected by strict planning control is likely to demonstrate scarcity of land for certain types of development. This raises costs and requires greater levels of sales in order to provide an acceptable return on capital invested. Guy also concluded that expansion in Western Europe will be very difficult for companies who like to trade from large free standing stores. Their only realistic means is to buy up an indigenous company, or possibly a “bundle” of obsolete stores from such a company. The latter would not appear to be an ideal strategy as some of the obsolete stores are likely to be poorly located. In 2001 Guy referred to Eastern Europe, which would offer more opportunities for rapid expansion in the longer term, despite the lower income level of the population and their unfamiliarity with modern retailing concepts. Anno 2010 we can state that his prediction became reality. Plenty of retailers expanded their operation to central and Eastern-Europe, for example Russia.

Although the setup of retail regulations have been changing during time, the goal of retail policies has not changed significantly during recent years. On a global scale, governments try to establish and maintain a high quality structure of retail facilities for a local and regional community. While considering this main goal the biggest challenge will be the restructuring of the post-war period retail structures. The viability of many small neighbourhood and town centres at the bottom of the retail hierarchy has been threatened by the constant increase in scale of stores and changed consumer behaviour in the last decade. Restructuring plans for many retail facilities have already been implemented in many larger cities. A problem which will continue in the future planning is the considerable proportion of smaller centres which do not have a sufficient economic base to sustain in the longer term (Smit 1995).
According to Marganosky (1997) several retail trends are commonly observed in post-industrial countries’ retail markets. These trends include increasing quality and price awareness, increasing mobility, changing communication and information media, increasing demand heterogeneity, changing lifestyles and activity patterns and last but not least a general ageing of the population. This will lead to more market segmentation and new retail formulas. 
Above mentioned trends are also applicable to the case of Russia. Due to the further saturation of the retail market in Moscow, developers introduce also, besides more regular shopping centre types, new retail formulas to secure market potential in several areas. For example in an area where several market leading shopping centres are currently determine the market, developers may and are introducing new retail concepts such as designers outlet-centres.

While basic goals and objectives have remained the same, there are several new elements in more recent planning approaches in Western Europe. There has been a shift in emphasis towards consumer-oriented style of planning due to the increasing complexity of consumer markets. Also due to decentralisation of government power, local municipalities have initiated or consider projects for the expansion and revitalisation of inner city shopping areas. Due to the increased competition between municipalities they try to attract economic, recreational and cultural activities to their area. The used approach is characterized by a high degree of public-private partnership and the use of marketing concepts and multifunctional planning, integration of different inner city functions such as housing, recreation, work and last but not least retail.

Also the reduction of car-mobility in recent years and emphasis towards environmental friendly issues has received more attention and the national policy gives high priority to the quality of residential environments and the reduction of traffic congestion. Many municipalities are introducing more restrictive parking policies in inner city and residential areas to discouraging car-use. Although this parking restriction policy is getting relatively less attention in the last years, city centres show still a restrictive car parking environment. These adjustments influence the accessibility structure of existing shopping facilities and will lead to continue increased interest in peripheral retail facilities.

It seems that a system of control and a regulated retail structure will reduce difficulties and will increase the ability to create the retail landscape in a certain country preferred by the Government.
Sørensen (2004) described the retail development policy change in Denmark. The overall conclusion of his analysis is that in most cases the planning authorities are fully able to control the localisation of retail shops—if they want to. However, they are not able to control the development of the retail structure in a broader sense.
Second, (local) authorities are competing with each other for large new retail developments in the same way that retail companies compete for customers and the best shop positions.
This parallel competition encourage planning regulations that are formulated in vague and elastic ways, allowing retail developments to be established by stretching the planning regulations. So this indicates that having a system of planning regulations for retail not directly will result in a more balanced retail structure.
Sorensen concluded also as long as retail companies (and local planning authorities) continue to use any escapes in the legislation, and as long as planning authorities continue to act as “easy victims”, the unhealthy competition between cities will continue (in Denmark).
As a consequence, countryside impoverishment will continue, consumer welfare will decrease, unnecessary travelling to shops will continue to increase, and the vitality and the
viability of existing local and traditional shopping centres will continue to be challenged. A system of regulations is in principal initiated to avoid these unfavourable circumstances.

As outlined above, planning policy for retail development receives a lot of attention in many Western European countries. The established town centres with their established retail facilities offer limited possibilities to (re)develop additional retail space. As a result, new retail developments tend to be located in out-of-town locations, potentially harming the spatial-economic future of the town centres. (Van der Krabben, 2009). In the case of Russia, there is a total lack of these established retail centres in the centre of towns. Problems based on the Western European structure of retail are therefore not applicable to the Russian retail environment.

The regulation of retail in Russia can be characterized as decentralized in a way that local authorities provide permissions to developers. This way local planning authorities review new developments on an individual case basis. As a consequence, decisions may vary from case to case. Also local authorities in Russia have a tendency to provide permissions in their personal favour. If planning authorities can benefit personally, permission will be given with an increasing probability. Again it is important that developers have local authorities on their side.

It is clear that the retail structure is not regulated in Russia similar to many countries in the West. Although we have also seen that a prescribed regulation not directly leads to an ideal situation, for example in Denmark.

Centralized and decentralized planning regulations will reduce risks for developers, but also reduces opportunities which can be created by convincing local planning authorities. Therefore, in a land of opportunities such as Russia, it is probably preferable to act accordingly and use the opportunity to get local planning authorities on your side while developing new retail expansion. A regulated system of control such as in many Western-European countries will only reduce the speed and opportunities for retail expansion.

In order to compare the relatively unregulated retail policy in Russia the following paragraph will review the planning policy in The Netherlands, a country with an intensively regulated retail planning policy for decades.

4.2 An example of Retail planning in the West: retail planning in the Netherlands

This chapter reviews the various retail planning processes the Netherlands has adapted since the 2nd World War. The Dutch retail structure is a good example of an intensively regulated retail market. Therefore it is interesting to review the history and its changes during the last century to mirror the Russian historical development. After WWII, the Dutch government started to develop more active retail planning policies.

Before WW2, systematic retail planning did not exist in the Netherlands. The existing retail facilities were located in the historical residential cores of the various towns. There was a balance between demand and supply of retail facilities without intervention of the government. Due to the intensive growth of the population and industry after WWII, which requested an expansion of the urban areas, the government got involved in policy regarding retail development. Retail location plans were based on models finding its roots in theories such as Christaller’s theory of central places (Bolt, 2003). The results of applying the theory of Christaller are still noticeable in Dutch cities which have been developed in the post-war period (Smii, 1995). These cities are still characterized by many small centres, focused on a supply of daily goods (convenience goods) - the lowest level of the hierarchy. On top of the hierarchy, there is one single large retail centre which supplies a wide variety of high order
goods. Between the lowest and the top level there are a couple of intermediate level retail centres varying in size. This model of hierarchical retail planning has also been used in other European cities.

In comparison in Russia, with a lack of a planning ideology, there were besides local vendors and open markets in general 2 levels, the local “Produkti”-style grocery stores on the corner of the apartment buildings and more centralized state-owned department stores covering a wider area.

In the early seventies, a new type of retail facilities - peripheral retail facilities, attack the hierarchical Christaller approach which was adopted by the government. The peripheral retail facilities – large scale free standing stores outside designated shopping areas, mostly at city boundary locations – were introduced by retailers in order to benefit from increased car mobility and price and quality awareness of the early seventies consumer. This development offered opportunities for large scale retailers. In addition retailers could benefit from significant lower prices of land, which also stimulated large scale real estate developments (Kok, 1995).

In the seventies the Dutch government changed the legislation and implemented an instrument to regulate further peripheral retail expansion. The changed legislation involved the obligation to carry out retail research and prescribed in some detail the research methodology which should be used in order to receive a building permit. The government was able to refuse permission in case retail research would show that existing retail centres could be negatively influenced by the new development.

However this is not the only reason for the changed legislation – restrictive retail policy. The compact city policy probably also influenced the retail policy. This compact city policy was specified in the third bill on physical planning and involved programs for housing, city renewal and revitalisation of the city centre. Improving the local economy en quality of cities was the aim of this policy. The general movement of expansion towards city boundaries came to an end. The city centres became more popular as shopping areas.

During the eighties local and regional governments more and more criticized the obligation to carry out retail research. Focus of the criticism were the costs of the model-based research and the benefits it would gain. The research claimed too much money and time and the external validity of the expenditure distribution models that were prescribed were questioned. In 1985 regulations were withdrawn from the resolution of physical planning. From then on new retail projects were subject to only the general obligation to carry out research for plan preparation.

The change in vision of the government was the base for the removal of the specific retail research obligation. It concerned a vision what the role of the government should be in the market process. The policy changed towards a model wherein planning decision are made through dialogue between the industry and the government.

After decades of strictly protective national location policy with respect to peripheral retail development, allowing only a limited number of categories of large-size retailers to locate in out-of-town retail parks, the national government finally decided in 2004 in the new national memorandum on planning strategy, the Nota Ruimte (VROM, 2004), to “withdraw” from the retail market. This indicated a crucial turning point. As a result the previous centralized retail planning model shifted into a decentralized planning model (Van der Krabben, 2009).

A trend is that changes in the existing retail landscape are currently taking place, particularly local and regional authorities allowing large volumes of retail space to be developed outside the existing hierarchical retail structure, which shows similarity (but on a much smaller scale) to the current development of Retail in Russia where peripheral retail has been developed on a
large scale during the last decade. The retailers' preferences according large scale retail developments will continue to be met on such locations outside city centres.

The content of the retail planning process is as follows: on national, regional as well as the local level physical plans are formulated. When it comes down to retailing, national bills do not specify objectives in any geographic detail. Regional retail plans provide geographical detail. Only when retail developments with a regional function are involved regional retail plans will include geographical details. These details will be in many cases limited to locations of peripheral trade and the conditions under which this type of retail is permitted. Regional planning is also concerned with retail supply in regard to the liveability in rural areas.

4.3 Objectives of retail planning

Retail planning is all about finding a right balance between the groups involved. The various groups consist of consumers, producers and the community in general. The producer is in this case the supplier of retail facilities – developers and retailers, (Van der Heijden 1986; Oppewal 1995)

Table 4 summarises planning objectives of the various groups involved in retail planning (of public sector retail planning).

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Consumers</th>
<th>Producers</th>
<th>Community</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Improve spatial opportunities</td>
<td>- Improve spatial opportunities</td>
<td>- Improve the quality of the spatial environment</td>
<td></td>
</tr>
<tr>
<td>- Improve the accessibility, quality, choice range, diversity and price level of facilities</td>
<td>- Meet location needs of business activities</td>
<td>- Promote equity in spatial opportunities</td>
<td></td>
</tr>
<tr>
<td>- Improve the quality, safety and comfort of retail facilities</td>
<td>- Provide condition for continuity and efficiency of business activities</td>
<td>Encourage sustainable economic growth</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Assist disadvantaged consumers</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Promote equity in opportunities for consumers and producers</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Reduce negative outcomes of retail business activities</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>- Improve the cost-effectiveness of infra-structure regarding retail facilities</td>
<td></td>
</tr>
</tbody>
</table>

Table 4: Planning objectives of the various groups involved in retail planning.

From the consumers perspective it is important that a new retail development will provide a wide range of opportunities, a good accessibility by public and private transport, and a high quality environment. At the same time it is important for the producers – developers and retailers – to create profitable retail facilities. In terms of the community it is important that retail facilities will match the economic as well as social objectives. Social objectives include for example that certain groups of consumer (e.g. less mobile consumers) will not be disadvantaged. Due to the ageing of the population, consumer groups consist more and more of elderly people, which is a concern. Also the vitality of smaller retailers could be a social objective as free market processes lead to a larger scale of retailers. Economic objectives are reflected in the various aspects of efficient use of space. Retail facilities should have also preferably a positive influence on the surrounding areas. The whole
neighbourhood will increase in value, which can result in increasing housing prices, and also the area will be more attractive for new retailers or new business to expand their business. It is preferable to use the above described approach when dealing with new retail developments in Russia. In general goals and objectives for producers and consumers will be met. This is easily explained by the current lack of retail facilities in Russia. Progress can be made in regard to the goals and objectives of the community. Especially encouraging a sustainable economic growth gets a lower level of priority in current Russia retail developments. Also assisting disadvantaged consumers or the improvement of infrastructure with regard to retail facilities receives currently less attention. It is to be expected that in the future these goals and objectives will receive more attention, when the retail market will enter a stage of saturation.

4.4 Conclusion

In many Western European countries, planning policy for retail development receives a lot of attention because of two characteristics that are typical for these markets. First, new retail developments often threaten existing retail locations, taking trade away from those locations. For that reason, a certain degree of planning control is necessary to prevent or reduce negative external effects of new retail developments. Second, in most European towns, the major part of the retail space is located in the (historical) town centres, which must be preserved.

When we reflect the Western European retail policies on the situation in Russia it is clear that retail development in these two parts of the world is totally different. Due to the institutional constraints in the West many retail markets are saturated and structured by their governments. This is not the case in Russia, where there is still a lack of modern retail facilities in many parts of the country. The protection policy for existing retail, which is one of the driving forces behind retail policies in the West, is lacking in Russia and that is also less important because existing retail doesn’t exist on such a scale in Russia. In Russia, which is now rapidly going through a development comparable to the West after WWII, there is a lack of existing retail in the city centres (and street retail) which is also a typical retail structure in the West. Russia passed this stage and entered straight into the development of peripheral retail. Therefore peripheral retail restrictions are not favourable in Russia, and introduction of significant retail constraints will only lead to a reduction in retail developments and limit general development of the economy in Russia.

Retail planning provides the ability to achieve goals and objectives of consumers, producers and the community in general. The goals of consumers and producers will be met in Russia for a major part. The goals of the consumers include an improvement of the accessibility, quality, choice range, diversity, price level, and safety and comfort of retail facilities. Additionally, new retail facilities should be developed in line with the goals of producers, such as specific location needs to provide a continuity and high efficiency of the retail business. The objectives for the community in general get less attention in Russia than in Western Europe. If new retail development in Russia could follow some objectives in regard to the community in general such as encouraging sustainable growth, the reduction of negative outcomes of the retail facilities and improvement of the infrastructure around retail facilities, it would have a positive effect not only on the retail centre itself, but also for the whole area around the retail development.
5 Determination of retail potential in Russia

In this chapter, a tool to determine retail potential in Russian cities and regions will be developed. Retail potential of an area depends on many criteria. These criteria will be described in the first paragraph. In the next section, GIS (Geographic Information Systems) will be introduced as a medium to operationalize the tool. To apply the tool, data is required regarding the criteria. Data and sources of data will be described in the last paragraph. In the next chapter, the tool will be illustrated.

5.1 Criteria determining retail potential in Russia

In previous chapters the history and current development stage of the Russian retail market has been described. Also the on-going internationalisation process of retailers in the current Russian market has been reviewed. A discussion about retail policies in the West stated that the Russian situation differs significantly from the situation in Western European countries. We have seen that establishing a business or developing a shopping centre in Russia has its specific particularities. The way of doing business in Russia is one which can be characterized as risky with many obstacles on the road. Political influence is high, and for every business or development it is important to have politics on your side. Russia is not equally developed through the whole country. Moscow and St. Petersburg are more developed than the rest of the country, although the Millioniki cities saw already their first modern shopping centres opening their doors some time ago. Also income levels are different among the country. In any case is the unofficial income higher than reported by official institutions. Also the source of income varies among the country. While certain areas are still heavily dependent on industrial driven income sources, other regions are already more towards a service based economy. Political instability in certain regions will lead to high risks related to developing or expanding retail in these areas. Especially several regions in the Caucasus like Chechnya suffer from strong political conflicts. Also getting the necessary approvals from government officials is an important key to success, as we have seen in previous chapters. Political stability is also very important for a successful development.

In previous chapters the drivers and decision priorities in regard to retail investment or retail expansion have been discussed. In general, the process investors and retailers use to determine retail potential in a targeted area can be broken down into 6 steps.

1. A survey of the market size / potential based on population demographics within the catchment area.
2. An exploration of existing and projected retail real estate in the area.
3. A survey regarding consumer spending behaviour, and the expected dynamics in the area. How is retailing through the internet effecting current and future spending behaviour in shopping centres.
4. Is there still space in the area for a particular retail centre.
5. Will retail development be feasible in the specific political environment of the area.
6. Will retail development be feasible in regard to specific (other) risks involved.

Especially step 5 and step 6, the political feasibility and risks involved are important criteria for retail development in Russia, as described in previous chapters. After each step, the process may be terminated if results do not meet certain thresholds. Now, criteria related to these steps will be discussed.
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Step 1: Market size: population demographics; population, income, purchasing power and additional figures about the diversification of the economy (% agricultural, % manufacturing, % service). In Russia certain areas depend heavily on one predominant source of the economy. A high percentage of agriculture will result in lower incomes and a more widespread population in the specific region. A high concentration of manufacturing (for example in cities totally relying on one manufacturing plant) is vulnerable for market conditions such as the current global crisis. In addition the quality of life index can be used to gain further information regarding the well-being of the targeted consumers. A better quality of life will be positive for retail development in a certain area.
A catchment area defines the area the shopping centre may attract consumers from. Distance plays an important role to define the catchment area. A radius up to 40km could be acceptable. In general, consumers will be able to travel this distance by car, however, local circumstances may differ significantly.

Step 2: Existing and projected retail developments in the several regions will be explored in order to identify current and future competition for potential retail developments. Millioniki cities have been targeted for a decade for new retail developments due to further tendency of market saturation in the main market Moscow, and Saint Petersburg. In the more rural areas and bigger towns with less than 1 million inhabitants, are in most cases already supplied with retail developments, however lagging behind the Millioniki, and market information will be absence and not always available.

Step 3: Shopping behaviour such as percentage spent of income will be analysed. It is unlikely that consumer behaviour will change significantly in the regions of Russia in the near future.

Step 4: A further detailed analyses of the specific region, identified through step 1, 2, and 3, should answer the question if a retail centre is economical feasible within a targeted area.

Step 5 and 6: the political environment and risks involved is very specific for the case of Russia (as described in previous chapters) and therefore it is important to include these criteria in the feasibility study of the Russian regions. An analysis of the specific investment risk and investment potential of the Russian regions cover these steps 5 and 6.

These steps 1-6 will lead to general screening and analysis of the various Russian regions / Millioniki. When a region is selected the specific situation should be analysed in details. In general Russia is centrally organized. A high percentage of the population is living within urban concentrations, cities. Basically the centre provides the surrounding countryside the necessities, although a lot of people living in the countryside are self-supportive in their daily needs. In general while investigating Millioniki cities the whole city can be taken as a catchment area as transportation within Millioniki cities is developed. In this regard it is also especially important to examine the existing retail locations within the city. Regarding the surrounding area of major cities, the catchment area can be extended with a radius of 10/20km which will in general increase the catchment zone population only marginally. Russian regions differ significantly from each other in regard to the population and city concentration. Therefore it is even more important to continue with a more detailed analysis after a general screening has been carried out. While selecting one of the major Russian regional cities for retail development it is possible to evaluate additional criteria which could influence the development. This could be covered by a valuation of the business environment including for example particular social factors, business climate and infrastructure in a selected city.
A summary of the criteria which have been mentioned during the various steps above:

- Market size; population, income, spending behaviour
- Diversification of the economy
- Quality of life
- Existing and projected retail developments
- Investment risk
- Investment potential

These criteria will be the input for the retail potential tool, explained in the following sections.

5.2 Using GIS to analyse retail potential

The traditional role of GIS (geographic information systems) in retail demand and supply analysis has been to find a suitable location for a new retail outlet. In other words, GIS is used to analyse market characteristics (such as consumer demand, demographics etc.) and search for an optimal new retail location.

Knowing the geographic distributions of retail demand and supply is vital to understanding the different Russian regional markets. Mapping these distributions will show concentrations of high and low demand and the location of potential competition. More importantly, mapping these distributions will show the relationships between demand and supply. For instance, do areas of high demand have a matching supply or do gaps exist in the market? As GIS can overlay, or superimpose, different data sets onto one another, it is an ideal tool for exploring this relationship.

Mapping demand and supply is useful for examining retail conditions in a qualitative and quantitative sense. The maps help the analyst to determine how these two market conditions are related geographically. Additionally, it is possible to include any additional market information to the map, such as political situation or business environment. In GIS it is possible to link such additional information in different layers to the demand and supply. In adding these additional layers, GIS can be used as an analytical tool.

According to Cheng et al. (2004) GIS combines spatial (geographical) and non-spatial (market-oriented) data to construct visualized information that can be easily understood and analysed by decision maker. Queries are created to find optimal solutions for four location problems: (1) minimum distance, (2) maximum demands coverage, (3) maximum incomes coverage, and (4) optimal centre. A GIS is able to address more complicated queries once an appropriate query program has been created in the system. Apart from locating and allocating retail sites, a GIS approach is adequate for other business and market strategies and analyses, such as market penetration, business forecast, consumer behaviour/profile tracking and prediction, etc.

GIS are used by the vast majority of major retail chains across North America and Europe to provide decision support for a range of location-based decisions (Hernandez, 2007). The most common retail GIS applications include customer spotting, trade area analysis (e.g., demographic reporting for given trade areas), customer profiling, competitor analysis, hotspotting, sales forecasting and consumer behaviour modelling. These can be applied to a number of decision events, from relatively low-risk store openings, renovations and merchandising decisions to major high-risk decisions, such as, corporate acquisition of competing chains or international expansion through merger activities (Hernandez and Biasiotto, in Hernandez, 2007). The vast majority of these decisions are supported by relatively rudimentary GIS-based inventory mapping and analysis, with a smaller number of
retailers pursuing more sophisticated and complex modelling applications (Hernandez and Biasiotto, in Hernandez 2007).

In addition GIS can also be applied in the retail-planning field to help urban planners in evaluating the existing location of retail centres. In this case GIS can be used to evaluate their catchment areas as well as predicting the demand flows. Results of performance are of great value to retail developers as well as for retail planners to improve performance, or to plan a new retail development.

Examples of retail applications with GIS
In order to describe the potential of using GIS on different levels of scale this section will provide a number of examples of GIS visualizations at four scales of analysis on the Canadian retail market: national, regional, local / city and shopping centre level. Examples are based on a document by Hernandez (2007).

The national-level analysis provides an example of using GIS visualization to explore trends in retail sales data across Canada, using retail-trade-data collected by the Canadian Government.

![Figure 23: Example of GIS on national level: Retail in Canada (Hernandez, 2007)](image)

The application developed allows users to select data to map retail sales, the number of retail locations, sales per location or percentage sales. The basic visualization shown in figure 23 illustrates the dominant metropolitan markets of Toronto, Montreal, Vancouver, Calgary, Edmonton and Ottawa. In the example, the colour, height and radius of the 3D bars represent total retail sales. This application allows a given retailer to map their existing network of stores to highlight the parallel growth of total retail sales against own-store and/or competitor locations. This could be used to support decisions relating to targeting areas for future development or to assess opportunities to develop merchandise mix in specific markets.
An example on regional-level is shown in figure 24 which provides an overview of sales performance for a given retail chain operating across the Province of Ontario in Canada. Retail sales performance analysis is central to network planning for major retail chains. The need to comparatively assess the performance of a portfolio of stores operating across a number of markets is a common decision support task for a retail organization.

In the example, the height and colour of the bars represent total annual sales, whereas the radius of bars represent the percentage sales. In addition, the main competitor stores are visualized as spheres and cubes.

While the data in figure 24 shows annual sales, analysis of weekly sales are able to reveal a seasonality of retail performance across Ontario, with summer and winter flows of sales between different parts of the Province. This application can be used to support a range of decisions relating to merchandise planning, store-type clustering, advertising, and seasonal staffing.
Figure 25 provides an overview of a GIS application on a local/city-level that focuses on the ethnic composition of businesses along the retail strips. The figure shows the number of Italian businesses by retail strip. The ethnic retail GIS visualization provides an example of an interface to visualize change in the ethnic retail structure. For example, identifying dominant ethnic clusters of retail and visualizing their growth or decline over time (e.g., Chinese, Italian, East Indian, Portuguese, Vietnamese, Korean, etc.). The structural analysis could include visualizing the changing mix of retail strips (e.g., the transition from business/personal services into retail), the development of particular retail chains or sectors, and the impact of bigbox retailers on shopping mall vacancy rates. These GIS applications could be used by retailers, developers and city planners to support decisions ranging from new development opportunity to revising land-use planning regulations.
Figure 26: Example of GIS application on neighborhood scale, shopping centre performances (Hernandez, 2007)

Figure 26 shows an example of a shopping centre level GIS application, a two-level mall map with the height and colour of the polygons representing sales revenue for the tenants for a 1-month period.

Shopping mall managers are concerned with the profitable operation of leased retail space. GIS applications on shopping centre level could be used to support decisions relating to, for example, lease renewals, anchor tenant subsidies, mall access planning and optimizing tenant mix.

However a practical use of GIS does not lead always to an ideal situation, as various types of issues and problems may emerge. (Cairns, 1998). Right type of data is often not available for some analysis, not reliable or basic types of information into a usable form can be time consuming and problematic. Even more the end-users of the interface, decision makers on higher management level should be able to interpretation of the results in a useful and realistic way.

As described above GIS can be used to create a user friendly retail potential interface, targeted to be used by retailers, developers and investors without any specific knowledge on a. In this case the interface will be on a national level – Russia and its regions. For the tool the software Mapinfo version 8, created by the company Pitney Bowes Business Insight, was used as it provides all the necessary functions to create the tool in the widest extend necessary.

5.3 Data collection for Russian retail expansion potential tool

In section 5.1 the criteria which determine retail potential have been identified. The criteria will be described in more detail below along with their sources, divided in 3 main categories:
population demographics, existing and projected retail developments and additional risks including political issues.

Population demographics
Data Russian regions:
Detailed data per Russian region from source: Macro economic statistics of the Russian ministry of economics, 2007:
- Market size: Population x purchasing power x average salary per inhabitant Russian (in Russian Roubles).
  - Population: Absolute population figures.
  - Purchasing power: Percentages spent from income.
  - Income: Average salary per inhabitant in Russian roubles.
- Diversification of the economy: % agricultural, % manufacturing, % service
Data based on survey by the Russian regional institute for information
- Quality of life: Quality of life can be based on the quality of life index including factors: individual incomes, regions attractiveness for immigrants, infant mortality, safety, development of service markets, unemployment rate, living conditions of population, life expectancy at birth. Figures: Quality of life index January - June 2010.

Data for Millioniki cities:
Data based on statistics from Jones Lang LaSalle, 2009:
- Market size: Population x percentage spent of income on retail x income per inhabitant (in USD).
  - Population: Absolute city’s population figures.
  - Retail spending: percentage of income spent on retail.
  - Income: Average monthly income per city’s inhabitant in USD.

Existing and projected retail real estate
Data is lacking about retail facilities in rural areas of the Russian regions Therefore regarding the Russian regions the analyses can be limited to the general market potential of a region, while regarding the millioniki cities specific existing and projected retail developments can be included and analysed:
Data from Jones Lang LaSalle, 2009:
- Existing retail real estate. Sq m of quality retail stock.
- Projected retail real estate. Sq m of projected quality retail stock

Political instability and additional risks
Data per Russian Region based on survey by Expert RA Rating Agency, 2008:
- Investment Risk: Investment Risk factor based on following aspects: economic, financial, political, social, ecological, criminal, legal.
  Grades: 1: high risk; 2 moderate risk; 3 minimum risk ;
- Investment potential: Investment potential can be based on following aspects; natural resources, human resources, production, innovation, infrastructure, financial, consumer.
Grades 1 insignificant potential; 2 low potential; 3 average potential; 4 high potential; 5 maximum potential

Data per Major city (including Millioniki), data / ranking is based on survey by Forbes Russia, 2010:
- Business environment in a certain city. Success or failure factors in cities. Including social factors, purchasing power, business climate, resistance to crisis, infrastructure, comfort of doing business.

Source, accuracy and reliability of the data
Regional data according population demographics is acquirable at the national Russian institutions for statistics, although the data is not free available or free of charge. Also the accuracy and reliability of the information and sources are still questionable. More accurate information is not possible to obtain due to lacking statistical sources. Even official Russian statistics are showing unreliability due to a lack of clarity in the market. For example real incomes are usually higher than officially registered.

Regarding the existing and projected retail in the major Russian cities data is available at several international and local real estate consulting companies, such as Jones Lang LaSalle. Companies may charge fees for this data, however as a promotion the companies will provide yearly or even quarterly free updated overviews with detailed information regarding the existing and projected retail stock. Data is overall accurate and reliable based on updated local market conditions.

Regarding the investment risk and potential, several international companies provide reports and even setup rankings as a guide for potential investors. Updated information can come at a price, however relatively older reports, indicating risk and potential 2 or 3 years ago, may be available for free.

5.4 Conclusion

In this chapter the criteria have been selected which determine retail potential in Russia:
- Market size: population, income, spending behaviour
- Diversification of the economy
- Quality of life
- Existing and projected retail developments
- Investment risk
- Investment potential

Geographic Information Systems has been introduced and selected to create a user friendly retail potential interface for the Russian retail market, targeted to be used by retailers, developers and investors without any specific knowledge.

Data for the GIS tool has been acquired through several sources including reports from various consultancy companies and Russian statistical institutions.
6 Tool and illustration

This chapter will describe the creation-process of the tool, a user-friendly interface to identify retail potential in the Russian regions and Millioniki cities. After the general tool setup has been drawn two illustrations of virtual companies with expansion goals in Russia will demonstrate the potential outcome of the tool.

6.1 Setup of the tool

As discussed before, the tool to assess retail potential will be implemented in a GIS system, in this study MAPINFO. The geographical information has to be imported into the system. First of all, maps representing the regions and big cities have to be created. This can be done according to the following steps:

1) Import a map of Russia in Mapinfo and use it as a ground layer.
2) Create in one layer for every different Russian region an individual area.
3) Add Millioniki cities to the area in a separate layer (the result is shown in figure 27).

![Figure 27: overview Mapinfo map with 2 layers: Russian regions and Millioniki cities](image)

Next, data regarding the criteria discussed in chapter 5 have to be imported and attached to the different Russian Regions (table 5) and Millioniki cities (table 6). Note that the criteria market size has been computed from the variables population, income, and spending behaviour before the data was imported. However, this kind of computations can be executed in most geographical information systems as well.
6.2 Two Illustrations of the tool

To illustrate the user-friendly tool in this section two virtual companies will be used to demonstrate the potential outcome of the tool. One company will be a company who is already settled in Russia willing to expand their network further in the regions of Russia. The second company is an international company without presence in Russia but wants to expand directly into the bigger cities of the regions to capture existing market potential.

Company 1
A domestic food retailer already widely established in Russia with several stores in Moscow, Moscow region and St. Petersburg.
Goal is to enter at least 4 new regions in Russia, with several supermarket stores in each region. Select at least 1 Millioniki city with highest potential for expansion.

Requirements regarding the targeted areas:
% Agriculture: <20% Average share of GDP produced in Agriculture in Russian regions is 10%. Therefore, when the share of the sector is higher than 20% it indicates that significant share of the region's population lives in rural areas. Labour productivity in agriculture is quite low, meaning that these regions should have lower levels of income which results also in a lower purchasing power.
% Manufacturing industry: <35% Regions with high level concentration of manufacturing industry (incl. construction), will suffer from the crisis or any other external influences of the economy. Therefore if manufacturing industry in the region generates more than 35% of GDP then the region cannot be considered as sustainable as in case of economic slowdown. The regions will experience difficulties and their population income level will decrease.
% Services, <45%: For the Russian regions a high share of services in GDP means that this is based on one or two service segments which attract high portion of employment in this region and which may suffer from lower demand when the economic situation in the country and in the region goes down. Typical dominating service segments in the Russian regions are tourism and retail or transportation services in particular cities in East Russia. Only the largest cities which serve the country as a whole for example Moscowa and St. Petersburg will not suffer on such a scale during economic slowdown as they have a very diversified set of services provided not only for businesses but also for the local and federal governments.
Quality of life: > 55. For sustainable retail investment above average quality of life is required.

Required average income: > 250,000 RUR. When income will drop by 20%, income will remain more than 200,000 RUR.

Required Market size: > 650 MLN RUR. When income will drop by 20%, income will remain more than 520 MLN RUR.

Investment risk: ≥ 2; moderate risk or lower. Due to the domestic presence and good connections with governments the retailer can take moderate risks while expanding.

Investment potential: ≥ 3: average potential or higher. Due to the domestic presence the company is able to expand and capture potential in areas with average investment potential.

Results using the tool and requirements for company 1

Using the regional requirement in the tool results in 4 targeted regions: Rostovskaya oblast, Samarskaya oblast, Tatarstan republic and Kemerovskaya oblast.

Three of the targeted regions include Millioniki cities: Rostovskaya oblast- Rostov on Don, Samarskaya oblast - Samara and Tatarstan Republic – Kazan.

Additional data for the selected Millioniki cities:
Requirements: Market size > 4500 Million USD
Retail stock per 1000 inhabitants: < 250 sq m per 100 inhabitants

<table>
<thead>
<tr>
<th>Millioniki City</th>
<th>Population (Million)</th>
<th>Average monthly income (USD)</th>
<th>Retail spending of income (%)</th>
<th>Market size Million USD</th>
<th>Retail stock (sq m) Existing</th>
<th>Retail stock (sq m) Projected</th>
<th>Retail stock per 1000 inhabitant existing</th>
<th>Retail stock per 1000 inhabitant Incl. projected</th>
<th>Ranking doing business 1-30</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rostov on Don</td>
<td>1.05</td>
<td>447</td>
<td>85</td>
<td>4500</td>
<td>211.332</td>
<td>113.600</td>
<td>202</td>
<td>309</td>
<td>7</td>
</tr>
<tr>
<td>Kazan</td>
<td>1.15</td>
<td>538</td>
<td>78</td>
<td>5,500</td>
<td>406.000</td>
<td>46.900</td>
<td>353</td>
<td>404</td>
<td>15</td>
</tr>
<tr>
<td>Samara</td>
<td>1.13</td>
<td>584</td>
<td>82</td>
<td>6400</td>
<td>227.621</td>
<td>117.600</td>
<td>200</td>
<td>356</td>
<td>8</td>
</tr>
</tbody>
</table>

Samara would be the Millioniki city with the highest potential to expand the company's retail business. Not only is the supply side - existing retail stock per inhabitant with 200 sq m per 1000 inhabitants - the lowest of the 3 millioniki. Also at the other hand the demand side - the income and Market size - is the biggest in Samara.

**Company 2**

An international electronics retailer not established in Russia.

Goal is to enter several new regions and 5 Millioniki cities in Russia with highest potential for expansion.

Requirements regarding the targeted areas:
- % Agriculture: < 15%
- % Manufacturing industry: < 40%
- % Services: < 45%
- Quality of life: > 50
- Required average income: > 250,000 RUR
- Required Market size: > 250 MLN RUR
- Investment risk: ≥ 2; moderate risk.
- Investment potential: ≥ 3; average potential or higher
Results using the tool and requirements for company 2

Using the regional requirements, 8 regions could be selected: Rostovskaya oblast, Samarskaya oblast, Tatarstan republic, Bashkortostan republic, Permsky krai, Sverlovskaya oblast, Kemerovskaya oblast and Irkutskaya oblast.

6 of the targeted regions include Millioniki cities: Rostovskaya oblast - Rostov on Don, Samarskaya oblast - Samara, Tatarstan Republic - Kazan, Bashkortostan republic - Ufa, Permsky krai - Perm, Sverlovskaya oblast - Yekaterinburg.

Additional data for the selected Millioniki cities:
Requirements: Marktsize > 4500 Million USD
Retail stock per 1000 inhabitants: < 250 sq m per 100 inhabitants
The 5 targeted Millioniki cities for retail expansion are: Perm, Yekaterinburg, Ufa, Samara and Rostov on Don, in order of lowest existing retail stock per inhabitant.

6.3 Conclusions

This chapter showed the setup of the GIS interface to identify retail potential in the regions of Russia. Additionally, two virtual companies have been used to demonstrate the potential outcome of the tool. For both virtual companies, their specific goals in regard to the selection of regions and Millioniki cities have been achieved through using the developed interface. Several regions and Millioniki cities have been selected based on the company characteristics and their requirements regarding the various criteria.
7 Conclusions

In this chapter conclusion regarding the Russian retail market will be formulated. In the first section conclusion of the investigations of the Russian retail market will be described. The second section will highlight the benefits of the created tool. The end of this chapter will provide recommendations for further research and possible optimisations for the tool.

7.1 State of the Russian retail market, particularities and outlook

This thesis described the development of retail in Russia until the present situation of the retail market. Russia is currently already in a significant development stage of its retail environment with high-end shopping centres opened not only in Moscow but also in the bigger regional cities. Although shopping centres have been introduced on a large scale during the last 2 decades in Russia's retail market, a big part of Russian retail is still based on more traditional forms of retail. Kiosks, Produkti stores and city markets provide daily products on a large scale. Also many Russians are still used to this form of shopping. Not only the supply of modern retail formats is underdeveloped (especially in the region), also the people are used to do their daily shopping in this more primitive form of retail facilities. For retail developers, doing retail business in Russia is still problematic, because of the particular way of doing business in Russia, which results in a difficult set of external circumstances.

Russia's relatively high 2nd ranking of the annual AT. Kearney Global Retail development Index (GRDI, 2009), needs a closer review regarding the variables which have been used for this ranking. To state that Russia has high expansion potential for (international) retailers needs some concern. The success of retail expansion is not guaranteed when the market can adapt expansion of retail economically (just based on the unfulfilled market size). An overview of the drivers of the retail demand have shown that increasing incomes combined with high expenditures and low saving result in plenty of potential for retail in the whole country. However it is important to mention that the variable, which is described by AT. Kearney as “country risk”, and its including characteristics, can easily demolish all economical potentials which clearly exists in all areas of the country. Due to its many uncertainties while doing business in Russia the development potential of retail can easily be reduced to zero in certain areas.

It has become clear that shopping centres in Moscow have been developed on a speculative basis, showing more and more their weaknesses during the current crisis. The development process of one prestigious shopping centre, “Manezh square” showed a very particular Russian development process. A development which would be unthinkable under the labyrinth-like procedures of comprehensive soviet urban planning. Planning procedures were bypassed, opposing views were ignored and important laws were violated to promote an unprofitable investment that the “market” would never have made. The actual purpose of the project was to contribute to the power of political leadership through a widely promoted municipal flagship at the time of the city's anniversary celebration. In general the development of Manezh Square shows key issues of developing retail developments in Russia. It is extremely important to get politics on your side. Once there is major interest from important politicians, seemingly impassable obstacles are easy to overcome.
Although governmental institutional and regulatory factors can be flexible, Russia is raising plenty of obstacles in different areas which can lead to a failure on the market: 1) culture and languages; 2) tariffs, quotas, development laws; 3) cost of logistics and communications; 4) reactions of local competitors. Common used strategic plans and marketing plans carried out by retailers are a first step to successful expansion in Russia. However, concern should be taken towards the information which will be used as a basis for theses analyses. In Russia’s case data of official statistics are not always reliable. Nevertheless, current successful international retailers on the Russian retail market, such as Ikea and Auchan, had to face the same difficulties in the past. Even more investing in a local established retail chain could be a wise entry strategy to enter the market rapidly, avoiding a major part of the set of obstacles. The lack of saturation of the Russian retail market will continue to be a driver for retailers to expand their business in Russia. When retailers can face particular obstacles, they will be able to capture a market share on the Russian retail market which has enormous expanding potential. However the review of the development of retailers with establishment in Russia showed that developing retail successfully in Russia needs also new approaches to ordinary business plans and capabilities to overcome major external economic obstacles, such as the collapse of the Rouble in 1998. The high volatility of the rouble which results in even more uncertainties should never be under-estimated, also in the current situation. The review of Ikea’s entry in Russia, through its Megamall concept, has shown a successful entry strategy. Nowadays Mega malls including Ikea stores are highly successful and widespread in Moscow and the rest of Russia. During Ikea’s entry in Russia, the company faced major challenges like high import duties, relationships with bureaucratic authorities and attracting customers. The entry strategy Ikea used was based on “market knowledge” through market presence and company specific experiences based on active learning.

A major issue in Russia is that bribery is a common problem on every scale of business. Companies need to look at corruption more as one of the aspects of concern when dealing with retail business in Russia. The majority of Russians simultaneously despises bribe takers, pay bribes, think that the government should do more to combat bribery, but think that bribery cannot be meaningfully reduced. The issue finds its origin in Russia’s highly inefficient and arbitrary bureaucracy, which makes simple tasks into year-long projects.

When we reflect the Western European retail policies on the situation in Russia it is clear that retail development in these two parts of the world is totally different. Due to the institutional constrains in the West many retail markets are saturated and structured by their governments. This is not the case in Russia, where there is still a lack of modern retail facilities in many parts of the country. The protection policy for existing retail, which is one of the driving forces behind retail policies in the West, is lacking in Russia and that is also less important because existing retail doesn’t exist in such a scale in Russia. Russia, which is now rapidly going through a development comparable to the West after WWII, entered straight into the development of peripheral retail. Therefore peripheral retail restrictions would not be favourable in Russia, and significant retail constraints would only lead to a reduction in retail developments and limit general development of the economy in Russia.

Development and investment in a certain area in Russia is always a trade-off between risk and return. For many continuous years, including 2008, Moscow was still ranked high regarding investments in retail real estate. Since 2008, sentiment for investment properties has fallen dramatically. According to PWC’s survey one international investor summed up the overall
sentiment: “Russia is a big marketplace and a place to be in the future, but has enormous political and social issues”.
This once confirms that risk remains high in Russia, but the return could be still exceptional, which would drive developers and investors to continue expanding in Russia in the future.

The thesis showed that it is impossible for an international company to copy their successful schemes from the western markets, including western employees into the Russian market. The set of external circumstances are just too different. When a company can manage to find a reliable local partner it will probably be able to catch the potential in the market, which clearly exists in every area in the country.
However market potential should not be the only variable taken into consideration when companies decide to enter Russia in a particular area. First of all they need to look at the particular set of circumstances which are always presence in the way of doing business in Russia. Most important of all is to get the right people and politics in the same directions. This, and only this will lead to a successful expansion in Russia. And this could easily lead to ethical behaviour issues, such as bribery, which will continue as a common problem in Russia.

7.2 Tool

A tool has been created in order to provide a user-friendly interface for retailers and investors. When retailers decide to investigate expansion potential in the regions of Russia they will go through 6 steps:
1. A survey of the market size / potential based on population demographics within the catchment area.
2. An exploration of existing and projected retail real estate in the area.
3. A survey regarding consumer spending behaviour, and the expected dynamics in the area.
4. Is there still space in the area for a particular retail centre.
5. Will retail development be feasible in the specific political environment of the area.
6. Will retail development be feasible in regard to specific (other) risks involved.

The tool is able to guide and simplify the selection of interesting areas or cities, until it exceeds the screening level. Then the target area/city needs to be analysed in more detail, for example regarding distances customers are prepared to travel to the retail development. Especially regarding step one to four, mainly an investigation of the population demographics, the tool will be effective. The tool also add significant value with adding a very important additional criteria, investment risk which comes along in step 5 and 6 of the development process. Investment risks are particular in Russia of high importance. Therefore the tool can filter areas not only based on their potential in regard to demand of the population but also based on risk-avoidance levels of the retailer.
Also step 2 of the retail development process is included into the tool. However because of the lack of available information regarding existing and projected retail in the smaller cities of the regional areas of Russia, only data regarding retail stock of the Millioniki cities is included in the tool.

Due to the combination of linking supply, demand and additional criteria such as investment (political) risk in the presented tool, an user-friendly interface has been created which can guide retailers and investors during their 6 step screening process searching for highest retail expansion potential among the regions of Russia.
7.3 Recommendation for further research

Recommendations for further research on the Russian retail market:
- The reliability of data in Russia is still lagging behind Western standards. Further research regarding dealing with the lack of data and reliability of the data in Russia would be recommendable.
- Unofficial Russian incomes are in general higher than official stated incomes. Further investigations regarding real incomes in the Russian regions are recommendable.
- Further research in regard to political influences and risks regarding retail development in the various Russian regions is recommendable.
- Further research regarding specific obstacles for international companies willing to expand their business in the regions of Russia is recommendable.

Recommendations to optimize the Tool:
- The tool can be extended to combine and weight the individual criteria accordingly. When there are combinations possible, the results will show a more balanced outcome. In the current tool areas can be filtered out of the selection only based on shortcomings on one of the criteria, for example too low market size, while areas with a lower density of the population (resulting in a low market size) could still offer a high potential due to the relatively higher incomes. The current tool is not able to compensate relatively low scores on one criteria by high scores on other criteria. It will lead directly to a knock-out of the specific area. A more intelligent tool, weighting and combining different criteria could optimize the screening process.
- Another recommendation is to add more geographical information to the GIS powering the tool. If for example the number of inhabitants of small areas, the locations and some characteristic of shopping centres and traffic infrastructure would be available, the system would be able assessing retail potentials significantly more accurate.
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Annex 1: The development of shopping centre
"Manezh Square"

The following text is based on an article written by Thanos Pagonis and Andy Thornley, (1999), the characteristics of development of the shopping centre of Manezh square are described in more details.

Shopping centre ‘Manezh Square’ was one of the first examples of this stage and certainly the most ambitious. The complex, modelled after Les Halles in Paris, resembles the typical Western luxury shopping mall but is extraordinary as it is located right in front of the Kremlin Walls in the very centre of the city.

Construction began in May 1995 and finished in October 1997 in time for the city’s 850th anniversary celebration. The complex of Manezh Square has been one of the most celebrated municipal investment plans, advertised as the pride of the Moscow City Government and a personal success of the Mayor. Situated between three of the busiest metro stations in the city and linked to the underground passage running beneath the city’s main commercial north-south axis Tverskaya, the area is a major hub with approximately 3.5 million people passing through every day. The complex is a longitudinal four-floor structure, mostly underground, providing for 70,000 sqm of (luxury) shopping space.

Most of the luxury goods and services in Manezh was targeted at tourists and ‘New Russians’ coming from all over the country to celebrate their newly acquired wealth. Prices are beyond the reach of mainstream Muscovites, who can do little but wander around, as if in a gallery exhibiting a new lifestyle of very distant dreams.

The fact that the city mobilized the funds, completed the technical studies, constructed and leased the site just three short years after the initial idea was proposed, is alone an impressive achievement that would have been unthinkable under the labyrinth-like procedures of comprehensive soviet urban planning. It is estimated that 1500 people were working in three shifts 24 hours a day for more than 2 years to finish the construction in time (Babakian, 1996). However, it is worth calling into question whether this was the result of newly introduced effective management techniques or the skipping of essential planning steps and democratic procedures under the cover of a powerful municipal administration. Russian public administrative bodies are not known for the transparency of their actions. Still, even on a site of such critical importance it is clear that no detailed studies were carried out. No real cost benefit analysis took place.

It is also evident, that no technical and environmental studies were considered despite the importance of the location and the nature of the development. Viktor Oslipv of the Russian Academy of Sciences described the project as an environmental disaster (Sindelar, 1994) while Professor Tchisthiukova, a leading Russian urban ecology expert, notes that the weight the development put on the soil caused the level of underground waters to rise (Tchisthiukova, 1998). This not only corroded the foundations of neighbouring buildings, but had the side effect of also polluting the city’s water, by allowing underground water to come in contact with the polluted upper ground level. Finally the speed of construction led to the bypassing of quality parameters. Upper floor tenants complained about the roof leaking, while those in the lower floor suffered from underground water coming in from below (Usenko, 1998).

Let us examine another aspect of possible market economy influence, namely that it leads to an interaction between public, private and other groups in the process of decision-making. In every type of mixed economy in the West there is some acknowledgement of the role of the
different interests involved in urban redevelopment. Let us look first at the involvement of the private sector in Manezh. The role of the private sector is reduced to sheer consultation and technical assistance. A concept design by British architects Lambert Scott & Innes was implemented by the municipal architecture and engineering agency Mosproekt-2. Manezhnaya Ploschad was the main developer while Bovis International was hired to assist in project management. The developer appointed directly the municipal Mosinzhstroii as the main building contractor, while private firms were contracted to small jobs such as lifts and escalators (Bovis International, undated). The nature of the process and the agencies involved still resembles the Soviet approach, with different State enterprises sharing responsibilities within a monopolistic governmental structure, rather than a mixed economy.

The latter point is strengthened if we look at the relationship between management and ownership. The overall management of the site was given to Manezhnaya Ploschad a company created with the sole purpose of building and running that particular project. Initially the city kept 30% of the shares and offered the rest to private investors in order to raise $35.4 million to finance the project (Mitulevich, 1996). It is difficult to get detailed information about the final share of the private sector in the overall finance. However, it is known that the project began immediately with the first $15 million launched by the city and was never constrained in the course of construction due to lack of finance. Hence the money was growing from somewhere. According to Piggott and Krushehnycky (1998) Manezhnaya Ploschad is one of the three assets in which the Mayor holds 100% ownership (the others being the municipal TV station and another major real estate development).

What remains to complete the picture is to examine the role of planning and third parties. Obtaining planning permission in Moscow is normally an extremely complicated process. However, this did not apply in Manezh since, having been approved by the Mayor, the project passed the different planning stages as a simple formality. The proximity to the Kremlin did not scare building contractors who broke into the ground to remove 480,000 cubic metres of soil, ‘without having any particular goal in sight’, according to an article in the Moscow Times (Babakian, 1996). The same article reveals that the initial plan was to go twice as deep (135,000 sqm, six floors and 700 cars) but was reviewed at the last minute, taking account of the psychological effect on customers and the technical difficulties. The extent that municipal actors acted without forward planning is revealed in the words of a retail expert, “9 months before completion they still had no idea about retail mix” (Treves, 1998).

In relation to the Manezh project we can exclude direct or indirect community participation. There were no community organizations participating in the planning process, and no public consultation, even though the site was of such central importance to Muscovites. The Soviet period was characterized by the use of expert committees for the expression of opinions on decisions and this approach continues to some degree. Two issues would seem to be particularly relevant to the development, the environment and the preservation of architectural inheritance. In theory environmental control in the city is still subject to a hierarchy assessment reminiscent of Soviet times. Every project has to be considered by ecological experts and there is even an ‘ecological police-force’ empowered to stop development if it is found violating the law.

Having already described the environmental problems of Manezh, it comes as no surprise that the project did not get the approval of the expert committee. ‘Still it was constructed’ notes Tchistiakova adding rather bitterly, “we still have no independent experts in this country” (Tchistiakova, 1998). The role of architectural experts and archaeologists reveals the same treatment. One would have expected that digging in front of the Kremlin would
require a whole team of experts. Indeed, there were reports from workers about ancient items and bones being found while digging (Usenko, 1998).

However, none of this gained publicity, nor was the project delayed in the course of construction due to archaeological surveys. The extent to which experts were ignored is illustrated in the way pseudo-historic mannerisms were applied next to monuments of real historical gravity (Shvidkovsky, 1997). The new development was decorated with bronze statues of Russian fairy tale characters, fountains and pools, intermingling with nearby ancient monuments creating a strange eclectic effect that ignored the historical importance of the site.

Thus the Manezh Square development cannot be viewed as an example of municipally inspired economic regeneration nor as a revenue generating project. The argument presented here is that it was a political act drawing on the image of the ‘market’. However, the employment of this term did not result in greater effectiveness and efficiency in operational management or the recognition of interest groups involved in decision-making. In a paradoxical manner the ‘market’ was used for its symbolic importance but was excluded from the way the project was carried out.
Annex 2: The development of Lenta, St.Petersburg

Following text is based on an article written by William Coyle and Natalia A. Zhiglinskaya, (2006) which describes the development of Lenta in more details:

Oleg Zherebtsov founded Lenta as a wholesale candy business in St. Petersburg in 1992 as soon as it was allowed following the collapse of the Soviet Union. In 1993, he had opened his first small cash and carry retail store and by 1997 there were three small Lenta retail stores. In 1998, Oleg primarily imported all of the food in his stores and his accounts payable were US dollar denominated. The collapse of the rouble devastated Lenta. Oleg had to lay off 75% of his workforce and renegotiate his accounts payable terms. However Lenta survived, eventually paid off all debts in full and both the company and Oleg gained the respect of the business community as a trustworthy partner.

Oleg, however, had a larger vision that was entirely new for St. Petersburg. The new Lenta was to be a warehouse cash and carry chain and sell both grocery and selected non-food items, a concept that went against the traditional retail food shopping experience of Russians in St. Petersburg. In Soviet and early post-Soviet Russia, retail food stores were small, had limited product selection and were often out of stock of those items. Since most people did not have cars, purchases were limited to what a person or family could carry from the store to their apartment.

With Lenta, residents of St. Petersburg would have a new way to shop. Oleg prepared to start construction of Lenta's first large warehouse style store, Lenta 1, in 1998 with the help of financing from the second largest bank in all of Russia. The bank, along with 19 of the largest 20 banks in Russia, failed and filed for bankruptcy following the Russian government's default on its sovereign debt in August 1998. Undaunted and still convinced that the new Lenta concept was sound, Oleg put his money and reputation on the line and opened the newly designed Lenta 1 in late 1999. Fashioned after the warehouse style of a Sam's Club or Costco in the United States, Lenta provided a wide selection of products which Lenta strove to always have available. Furthermore, Lenta capitalized on its size and supplier relations to provide products at a low price for its customers. Oleg believed its three competitive advantages were its low prices, as Lenta sold at a smaller margin than its competitors, the speed with which a shopper could shop, and the convenience of being open 24 hours a day, 7 days a week.

Lenta's Mission and Value Statement states, to give you (the customer) what you want and need and to offer you the most value for your money. While a relatively straightforward proposition in many countries, delivering on this commitment on a daily basis was ambitious in the Russian business environment.

Oleg's experience served him well as he developed and grew Lenta to where the 2004 Russian edition of Forbes magazine ranked Lenta as the 81st largest privately held company in Russia.
Annex 3: Recent issues in the boardroom of Lenta

Following text is based on an article published in the Moscow News (retrieved from www.themoscownews.com) by Bentley (16/9/2010), which describes the CEO issue in the boardroom of Lenta in more details.

A scrap for control of the Lenta supermarket chain escalated into a fistfight, complete with smoke grenades and OMON riot police, in St. Petersburg. Top managers at Lenta’s head office were caught on video brawling in their headquarters two days running - engaged in a battle over who would be the company’s CEO. Jan Dunning, who was allegedly removed from his post on July 29, arrived at the office on Tuesday afternoon, escorted by a private security firm and an OMON squad. The battle has pitted 30.8 per cent shareholder Luna - a joint venture between US hedge fund TPG and Russia’s VTB Capital - against co-owner August Meyer’s Svoboda Corporation, which owns 41 per cent, over Dunning’s position and strategy.

Luna and another shareholder, the European Bank for Reconstruction and Development, which has a stake of 11 per cent, back Dunning. The EBRD says it wants to mediate. “It is important to point out that over the past weeks I have been illegally blocked from entering my own office,” Dunning wrote in an e-mail on Wednesday. “As such I was compelled yesterday to regain access to the company of which I am the legally registered [CEO].”

His takeover bid was rebuffed three times, prompting a brawl which saw acting CEO Sergei Yushchenko barricade himself in the building. A trained assault team fired tear gas and smoke grenades as security at the building admitted firing shots to break up the fight. More police were called, and the ruckus - with both contenders for the CEO’s chair trading blows – saw Yushchenko and Dmitry Kostygin, a representative on the board of directors, detained along with 20 others.

The fight then went into a fourth round on Wednesday, according to a video on lentaconflict.com, a web site set up to “chronicle the persistent misconduct” by Luna. The spat has gotten worse since Luna bought its stake last October.

Meyer’s Svoboda Corporation has insisted that a shareholder agreement signed in September 2009 gives it the right to remove the CEO. “At any time before August 31, 2010, Svoboda may require that Mr. Jan Dunning be dismissed as Chief Executive Officer,” the document, posted on lentaconflict.com, says. But Luna and the EBRD called the change illegitimate.

“As far as we are concerned, Jan Dunning is the legitimate CEO and we have been trying to act as mediator,” Anthony Williams, head of media relations at the EBRD, told The Moscow News.

An arbitration court in London last month upheld Svoboda’s right to appoint Yushchenko as temporary CEO, according to documents posted on lentaconflict.com.

The shareholder agreement adds that all parties should ensure Yushchenko would be appointed in the event of Dunning’s exit.

While the Luna shareholders did not oppose Yushchenko’s appointment as interim CEO, they required that from August 31 someone with Dunning’s experience was appointed on a permanent basis, Interfax reports.

Meyer first informed Dunning that his position would be terminated at a board meeting on May 20. Meyer was reportedly unhappy that no stores had been opened while Dunning was CEO, but Luna blamed this on the previous management’s failure to prepare new store openings, Interfax reported.
Luna has claimed that the vote at the May 20 meeting was illegitimate as their board members walked out, while independent directors Loren Bough and Lindsay Forbes abstained.

Svoboda says that Luna failed to transfer shares that Meyer had exercised an option to buy, and had paid for on January 13. The deal – which would see Luna sell 4.6 per cent of the firm to Svoboda – was completed on August 2. Svoboda had set an April 1 deadline for completion of the sale.

But while the ousted chief executive may have won the battle of St. Petersburg, the war is far from over and Yushchenko has shown no signs of conceding his position as CEO. “Under Russian law, the company can lose its CEO under two circumstances: if he dies or by a court order,” Yuschchenko told NTV television on Tuesday, Bloomberg reported. “I am alive and breathing, and there has been no court order.”

Lenta’s website now says that Dunning will continue in his position of CEO, and the building is not being guarded by security and the police.

“I hope that the fact I am now back in my office will signal the end of this dispute and we can restore proper corporate governance procedures to the business,” Dunning said, adding that no stores were disrupted.

TPG, however, say the dispute could disrupt plans to open nine new stores next year, Bloomberg reports.

American giant Wal-Mart has reportedly been eyeing up a bid for Lenta, which has 37 stores and an annual turnover of $1.8 billion.
Annex 4: The development of Ikea in Russia

In the following paragraph, which is based on an article written by Jonsson, (2007), the internationalisation and expansion of Ikea in Russia is described.

Anno 2010 Ikea stores are widespread in Russia. The decision to enter Russia more than a decade ago was by then based on slightly vague interest in market information. It was considered that one store was likely to succeed, without any survey providing market information, simply because a lot of people live in Moscow. Concerning the specific entry approach, IKEA's view was that it is better to first live in the country in question and learn about the new market and then to set the strategies. It is clear that knowledge about the market needs to be acquired rather than information. It was argued that to set up a new business is very little theory and very much practice. The available market information collected by IKEA specialists was very limited and rather unreliable. For example, one piece of advice was that the IKEA store must be situated near a Metrostation since there were hardly any cars in Moscow. Five years later traffic jams were one of Moscow's major problems. It was argued that instead of relying on information about the market it is better to acquire 'market knowledge' through market presence and company specific experiences based on active learning. The distribution manager with many years of international IKEA experience recounted that, IKEA's view is that it is important to learn about the market in an active manner enabling the company to perceive it through the eyes of the local consumers. General 'internationalization knowledge' was thus viewed as being more important than specific information about the market when preparing to enter. In order to gain sufficient 'internationalization knowledge', the Russian country manager recruited people who had been a part of previous market entries, including several very experienced senior managers who had worked on different markets around the world. This move was in itself a consequence of previously acquired internationalization knowledge, i.e., where the earlier experiences had not been prioritized. When setting up the Chinese IKEA organization 'young potentials' persons recruited from the universities and believed to be future IKEA-leaders were recruited. According to representatives of the Russian organization the problems during the entry into China could to some extent be explained by the chosen recruitment strategy by IKEA China.
Annex 5: Ikea’s bribe scandal

In the following paragraph more details regarding the IKEA bribe scandal are provided which is based on an article published on the internet; www.therussiamonitor.com/2010/02/15:

Last Friday, Swedish furniture-giants IKEA announced that it fired two top managers at its Russian subsidiary ZAO “IKEA MOS” which shares responsibility for the management of IKEA’s chain of shopping malls named “MEGA” («МЕГА»). IKEA spokeswoman Camilla Melby stated that the two execs — from the store’s St. Petersburg branch — were fired once documents surfaced with evidence implicating them in bribery “in connection with a contractor-company that was trying to resolve the situation with the power supply at the Mega shopping center in St. Petersburg.” In typically efficient Swedish fashion, Melby stated: “We know there have been bribes … We’ve seen the documents.” She added that the managers did not appear to engage in the conduct for their own personal gain. IKEA Group CEO Mikael Ohlsson released a statement in which he said he was “deeply upset and disappointed” and that “corruption is totally unacceptable for IKEA.”

According to Vedumosii and Swedish news sources, the “documents” Ms. Melby is referring to include an email from a contractor — apparently from Renaissance Construction of Turkey — to the managers stating that Renaissance intended on using “opaque methods” to resolve the situation regarding the Mega shopping center’s electricity with Lenenergo.

On August 8, 2009, the email was sent with an attachment from Joakim Virtman — a middle manager at IKEA MOS — to IKEA MOS Director of Real Estate Stefan Gross and copied to the Director of Central and Eastern Europe Per Kaufmann as well as other top managers. The email reminded Gross and Kaufmann that IKEA’s MEGA-Parnas mall near SPB had been operating for three years without an operating license (дирекция) and that neither the Russian authorities nor IKEA’s insurer had discovered the scheme so far. Virtman added that IKEA would have been able to obtain all necessary approvals by 2006, but did not do so after Renaissance Construction obtained an operating license by paying bribes (на выбор махор). Finally, he noted that IKEA must now retroactively approve all electrical installations in writing by fall 2009 so that Mega-Parnas can connect to the electrical grid and stop using generators (see discussion on generators in this NYT article). The problem is that it would once again require the use of bribes by Renaissance.

According to Swedish “tabloid” Expressen, Gross responded on August 11, 2009 writing, “I hereby approve the acceptance of all electrical installations in line with our authorization plan (аутсорсингплан). I take full responsibility for this decision.” Gross’ email was copied to Kaufmann, Joachim Hagen-Pikwer (IKEA MOS General Counsel), and Per-Olaf Zakrissén (Construction Manager at IKEA MOS).

The major legal risk with this particular set of payments is that the utility company (Lenenergo) is 51 percent owned by the MRSK Holding Company. MRSK in turn is majority-owned by various branches of the Russian government, including 52.7 percent of stock belonging to the Federal Agency for the Management of State Property, aka Rosimushchestvo (Федеральное Агентство по Управлению Государственным Имуществом). Thus, bribes to Lenenergo can be interpreted as bribes to foreign officials.

Who Knew What When at IKEA?

In January 2010, IKEA founder Ingvar Kamprad received notice from INGKA Holding B.V. (parent of all IKEA group companies) about their suspicions regarding bribes in Russia. The fax to Kamprad — reportedly obtained by Expressen — was sent from Holland and written in English: “The whole system is improperly installed and was constructed without getting the
project approved. Today, it has been authorized and approved by the Russia utility authorities after our Country Manager allowed our general contractor to use bribes in buying the approval.

Based on IKEA's press release, it appears that they are claiming the email was discovered last Friday and resulted in the immediate termination of Gross and Kaufmann. But, Expressen reports that the announcement regarding the two managers came only hours after it informed IKEA that the paper would publish documents it had obtained regarding the corrupt payments. When the paper confronted Kaufmann regarding the bribes in Russia he responded, "I have no recollection of it."

Yesterday, Expressen reported that it has even more documents regarding improper conduct by IKEA MOS managers. Specifically, the paper alleges that the company wants to expand its Teply-Star mega-center, but there is an ongoing legal dispute with the owner - Masshtab (Macuma6) - of part of the land where the mega-center is located. Masshtab is co-owned by minigarch Vadim Nikolaevich Moshkovich, who also just happens to be a member of the Federation Council, the upper chamber of the Russian Duma. According to Expressen, Gross and others at IKEA MOS planned a series of steps to "soften up" Moshkovich with the assistance of third-party "consultants." Among other unsavory activities, the plan included: identify the lawyers and officials involved in the judicial review of the dispute; contact the Russian federal police to identify where Moshkovich is vulnerable; discretely explore opportunities for blackmail with sources in the police and intelligence organs; and plan a black-PR campaign highlighting Moshkovich's illegal and unethical business practices.

These planning documents also reportedly refer to a special section of the IKEA MOS Legal Department at its Khimki Business Park headquarters. This department's "function is to facilitate IKEA's contacts with the Russian security service, federal police, the presidential administration in the Kremlin, and independent intelligence actors."

Enemies List in Samara

Expressen also reportedly has documents showing an "enemies list" for the city of Samara drafted by Gross after IKEA's store opening there was delayed by permits and other administrative hassles. The enemies of IKEA included: Governor Vladimir Artyakov and his wife Tatiana Artyakova, who has interests in the construction industry and thus is IKEA's "competitor" in real estate; Mayor Viktor Tarkhov whose ownership in retail furniture company OOO "FOM" (OOO "fOM") made him oppose IKEA's interests. IKEA's secret report describes Tarkhov as "a former criminal figure with extensive criminal contacts that prevent IKEA from operating in Samara."