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Russian Federation

Hotel, Restaurant & Institutional (HRI)

Food Service Sector Report

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Report Highlights:

Prior to the August 98 crisis, the Russian HRI market was one of the fastest growing and most lucrative food service markets for foreign exporters. Before the August 1998 financial crisis, approximately 70 percent of the food supplies to major Russian cities were imported. The crisis changed all this as payments by importers/distributors to foreign exporters slowed down or were stopped completely. This report discusses and analyzes the current market situation for this sector, recommends entry strategies, and identifies the best product prospects for the U.S. exporter interested in the Russian market.

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Acknowledgment

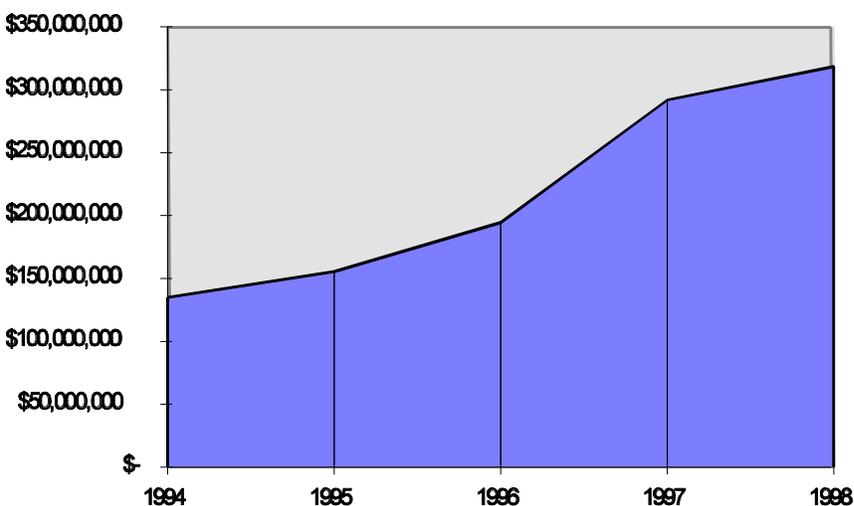
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SECTION I. MARKET SUMMARY

The Russian Federation--a country of 148 million people living in 89 regions spanning 11 time zones--underwent a financial crisis in August of 1998. The results of the crisis included a fourfold devaluation of the ruble against the dollar, the breakdown of the banking system, the bankruptcy of many Russian importers/distributors, and job losses by the emerging middle class. This, in turn, had a devastating impact on the HRI market.

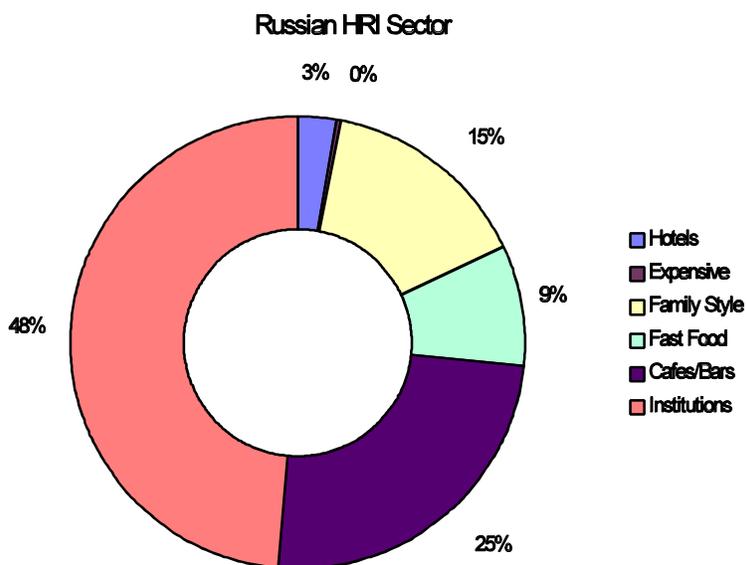
Prior to the August 98 crisis, the Russian HRI market was one of the fastest growing and most lucrative food service markets for food traders. Domestic processors were incapable of supplying the needs of HRI market participants due to lack of credit, investment in technology and quality inputs from domestic agricultural producers. This created a vacuum filled by foodtraders. Approximately 70 percent of the food supplies to major Russian cities was imported. The August 98 crisis changed all this as payments by importers/distributors to foreign exporters slowed down or ceased completely. Business travel dropped to a trickle and many in the emerging Russian middle class lost their jobs, or their wages were frozen. Those with money, accustomed to eating out in the finest restaurants and drinking the most expensive wines and spirits began to conserve their resources uncertain as to what was going to happen next.

Food Service Sales to Hotels and Restaurants



However, over a year has passed since the crisis, the situation has stabilized and is beginning to improve. The ruble has been relatively firm at approximately 28 rubles to the dollar. Those importers/distributors who survived have in the main paid their foreign business partners. There has been a consolidation among importers/distributors with the strongest most financially viable remaining. These survivors are using more conservative business practices and becoming more professional. While business travel is nowhere near pre-crisis levels, foreign business travelers are coming back. And the middle class, many having found other, though lower paying jobs, have started to go out to eat again. There are over 70,000 companies in the Russian catering market, 50 percent of which are restaurants and 50 percent institutional outlets at factories, schools, and

hospitals.



The following sections look in more detail at the three major sub-sectors of the HRI market.

Hotels And Resorts

There are approximately 1,970 hotels in Russia providing approximately 360,000 beds nationwide. The greatest concentration of hotels is in Moscow--the third largest city in Europe with a population of around 12 million--with over 200 hotels, and St. Petersburg--the fourth largest city in Europe with a population of around 9 million--with over 100 hotels.

While every regional capital has at least one or two hotels that purportedly cater to the international business traveler, as well as other hotels that service domestic travelers in the short to medium term, by far the best opportunity for foreign exporters is providing food service products in demand by the hotels of Moscow and St. Petersburg.

With the exception of a handful of foreign restaurants located in Russian hotels, primarily in Moscow and St. Petersburg, the restaurants in Russian hotels, especially since the crisis, serve dishes prepared with locally sourced products rather than imported products. The only exception to this is alcoholic beverages, principally wine and sprits other than vodka.

Thus, from the perspective of a U.S. exporter, the market can be divided into two halves. The first half is comprised of hotels serving the international and wealthy Russian business traveler and tourist and the second half the remaining hotels. The focus of this report on this market will be the former group of hotels.

Prior to the crises there were over 5 million foreign business and tourist visitors per year and occupancies at top hotels were 75 - 85 percent during most of the year and sometimes 95 - 100 percent. A year after the crisis,

foreign visitors number about half pre- crises levels and occupancy rates at top hotels today are approximately 40 percent.

Moscow has approximately 41,000 hotel rooms with 76,000 beds. Among 4- and 5-star hotels, the Savoy opened in 1989; the Radisson, Penta, Areostar and the remodeled Metropol in 1991. In 1992, the Kempenski, Sheraton, and Marco Polo opened and over the next seven years other hotels were opened until today a total of 15 international 4- and 5- star hotels, which can accommodate approximately 7,000 guests per night are located in Moscow. There are three Marriott hotels in the capital city.

St. Petersburg has 3 five star hotels: the Astoria, the Grand Hotel Europe and the Sheraton Nevsky Palace.

The remaining Russian hotels are generally acknowledged to be far from international standards. In the regions, the majority of hotels that cater to the few international business travelers were part of the Intourist hotel system which was responsible for providing hotel rooms to foreign travelers during the Soviet period.

Resorts are generally former “rest bases” owned or formerly owned by various government agencies and factories with the notable exception of a few such as the Radisson in Sochi on the Black Sea Coast and Le Meridien Moscow Country Club managed by Le Meridien International Hotels & Resorts - Russia’s first and only championship 18-hole, par 72 golf course.

In the short to medium term, these “rest bases” are of little interest to U.S. exporters as their dishes are almost entirely prepared on site with local products.

Restaurants

There are approximately 35,000 restaurants in Russia. Pre-crisis the number of restaurants in Moscow was growing by 100 - 150 percent per annum. On the eve of the crisis, they numbered approximately 1600. After the crisis, the number of restaurants fell to 800. The market of greatest interest is Moscow and St. Petersburg as restaurants in the regions--with the exception of some alcoholic beverages--do not generally use imported foodservice products due to the higher price.

Restaurants especially have been suffering since the crisis due to the drop in business travel and the loss of the emerging middle class customer base. Pre-crisis, 25 percent of Muscovites ate at fast food restaurants. Post crisis, only 18 percent eat out. For example, Sbarro, with 8 outlets in the city lost 70 percent of its customers in the first three months of the crisis. They cut prices 40 percent on average in a bid to attract customers back.

Restaurants have spent the time since the crisis focusing internally on their operations, cutting operating costs, negotiating aggressively with their suppliers, modifying menus and switching to domestic products where possible. Since diners are going out less, the competition among restaurants is fierce.

However, first class restaurants are still very dependent on imported product in the short to medium term as customers are looking for value for their dining ruble and are paying more attention to the quality of the cuisine rather than just the novelty of going out. Despite the immediate post-crisis gloom, today customers are beginning to come back. For example, Rostik’s one of the biggest chains, has had a 30 percent increase in

clients over 1998, and McDonald’s client volumes are back to precrisis levels.

Institutional Contract

There are approximately 35,000 canteens and other institutional catering customers.

The most interesting area for the U.S. exporter would be airline catering products. Out of the 484 airlines that emerged from the former Aeroflot-Soviet Airlines breakup, about 27 are financially stable. A handful, lead by Aeroflot-Russian International Airlines, have made strides in onboard foodservice, and some use imported foodservice items.

As far as government, quasi-government and virtually all factories are concerned, the food supplies are basic raw ingredients sourced almost entirely from domestic suppliers and prepared by the on-site staff rather than by specialized catering companies.

Most of cruise lines and the national rail system prepare their own food from domestic ingredients with the exception of snacks such as nuts or alcoholic beverages, other than beer and vodka. In the short to medium term institutional contracts do not offer great potential to U.S. exporters as what is imported tends to be very low cost items such as jams from Hungary or Moldovian wines.

The following table lists some advantages and challenges to U.S. exporters wishing to serve the HRI market.

Advantages	Challenges
Inability of domestic producers to supply quality goods on a consistent basis.	Given that most importers/distributors pay in advance for product the longer wait for U.S. vs European products ties up the limited fund of the exporters
Unavailability of quality products in most categories from domestic suppliers.	The fourfold drop in the ruble against the dollar make imported products very expensive.
The increase in the interest of fast food restaurants.	Domestic producers are improving the quality of their product due to investment since the crisis.
The continued development of restaurant chains such as Rosinter	Foreign companies such as Unilever in margarine/mayonnaise and Efes in beer have started production onshore.
	Finding a financially viable importer/distributor to work with. Large decrease in the Russian middle class since the August crisis.

Exodus of expatriates since the Aug. crisis from around 70,000 to less than 20,000 today.

SECTION II. ROAD MAP FOR MARKET ENTRY

A. Entry Strategy

As recently as a few years ago, many hotels and restaurants were involved in the direct import of food service supplies. However, since that time, local importers/distributors have entered the market to take on the increasingly complex procedures and for some product categories--such as alcoholic beverages--expensive licensing requirements to import products. Distribution channels have been established in Moscow and the regions and the staff of these companies are becoming more and more professional. The August 1998 crisis eliminated many of the smaller and less well capitalized importers/distributors resulting in a consolidation in the industry.

The new-to-market exporter should use one of the established import/distribution companies rather than trying to sell directly to the hotel, restaurant or institutional buyer. The regulations and relationships necessary to move goods smoothly across the border and to the end users, especially with some product categories such as alcoholic beverages, make attempts to sell directly to end users more costly and risky than necessary. However, expect to have to provide considerable support to the importer/distributor in the form of product sales training.

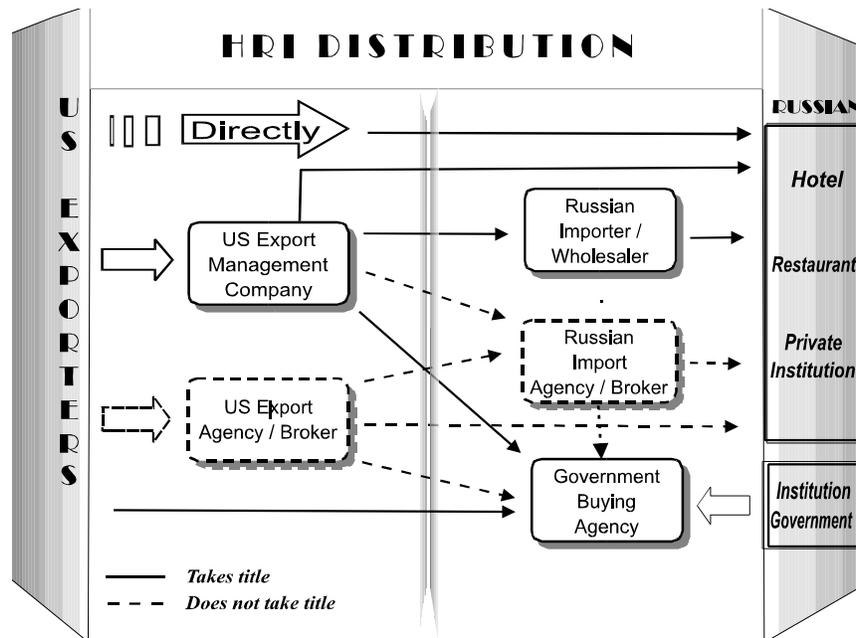
At the risk of stating the obvious, if the new-to-market exporter is interested in seriously developing the market, it is imperative to meet in person with several importers/distributors before selling into the market rather than attempting to do so by phone, fax or e-mail. Personal relationships are very important in Russia.

It is general trade practice--especially after the August 1998 crisis - for payments by importers/distributors to a foreign exporter to be made in advance. Letters of credit are rarely used, as Russian banks require the Russian importer/distributor to deposit the full the amount of the credit in a blocked account. In order to save the L/C fees, the importer prefers to pay in advance to reliable foreign exporters with established reputations.

Resources to help the new-to-market exporter are listed in Section 5 of this report.

B. Market Structure

The following flow chart illustrates how products are passed from the foreign exporter or domestic supplier to each of the HRI food service sub-sectors.



C. Company Profiles

Hotels And Resorts

Company	Rooms	Estimated Sales	Nationality
Aerostar	413	\$3.6 million	
Baltschug Kempinski	232	\$2 million	Germany
Holiday Inn Moscow Vinogradovo	180	\$1.6 million	USA
Marco Polo Presnya	71	\$311,000	
Moscow Marriott Grand Hotel	390	\$3.4 million	USA
Moscow Marriott Royal Hotel	230	\$2 million	USA
Moscow Marriott Tverskaya Hotel	162	\$1.4 million	USA
Metropol	380	\$3.3 million	UK
National	231	\$2 million	UK
Novotel Sheremetyevo 2	468	\$4 million	France
Radisson Slavayanskaya	480	\$4.2 million	USA
Renaissance Moscow Hotel	474	\$4.1 million	Japan
Savoy	85	\$744,000	Finland
Sheraton Palace Hotel	218	\$1.9 million	USA
Sofitel Iris	195	\$1.7 million	France
Astoria (St. Petersburg)	240	\$2 million	UK
Grand Hotel Europe (St. Petersburg)	301	\$2.6 million	Germany
Sheraton Nevsky Palace Hotel (St. Petersburg)	195	\$1.7 million	USA

Radisson - Lazurnaya (Sochi)	300	\$1.3 million	USA
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Restaurants

Company	No. of Outlets	Estimated Annual Food Sales	Nationality
McDonalds (a)	50	\$137 million	Canada
Rosinter	Rostiks (10) Patio Pizza (9) C 3 Others	\$34 million	Venezuela- Russia
Russian Bistro	29	\$6.2 million	
Yolki Palki	10	\$7 million	Russia
Baskin-Robbins	72		USA
Markon-Express	109 Mobile hot- dog Stand	\$19 million	Russia
MetroExpress	37	\$5 million	USA-Russia

Institutional Contract

Company	Passengers	Fleet	Nationality
Aeroflot - Russian International Airlines	3 million passengers annually	113 aircraft	Russian
Vnukovo Airlines	1.9 million passengers	52 aircraft	Russian
Transaero	1.2 million passengers	14 aircraft	Russian

D. Sub-Sector Trends**Hotels And Resorts**

- C New hotel projects are doubtful until after the results of the next round of elections are clear, sometime after March 2000
- C When development restarts expect the focus to be on 3-Star Hotels.
- C Expect the focus of Resort development to be on Black Sea locations.

Restaurants

- C Post crisis the restaurateurs' strategy was simply one of survival. However, restaurants have generally made all the internal adjustments they can make and are now focusing more outwardly on competition for the customer.
- C Specials such as Rosinter's Russian lunch, discount cards, and other such marketing devices will become more and more common.
- C Fast Food and Family style restaurants are the hottest topic in the restaurant trade at the moment.
- C Increased Franchising.
- C Expect to see more and more fast food restaurants offering Russian dishes rather than hamburgers and pizza such as the Ruski Bistro chain. This applies to family style restaurants as well.
- C As for expensive restaurants, there is a lot of interest in eastern ethnic restaurants serving Japanese,

Chinese or Central Asian cuisine.

- C The search for domestic suppliers continues. For example, McDonald's imported 50 percent of its raw materials before the crisis. Today the chain purchases 75 percent of its food supplies from domestic suppliers.

Institutional Contract

- C The institutional contract market will remain fairly stagnant. With publicly funded institutions such as schools reliant on unreliable public financing, they cannot purchase anything other than staple foods for the foreseeable future.
- C Reduced air, water and rail passenger traffic and increased fuel costs will prevent transport companies from offering more than very basic foods prepared primarily from domestic ingredients or very low quality imports brought in from surrounding countries.

SECTION III. COMPETITION

One of the defining results of post-crisis survival strategy has been the search for domestically produced goods.

However, the August 1998 crisis has given some domestic processors breathing room and those that were able to attract investment are reaping the benefits. In a few subsectors, some domestic suppliers have captured market shares that will probably never be recovered by imported products. An example is, domestic beers. Prior to the crisis, imported beer had approximately 75 percent of the HRI market, particularly among hotels and restaurants serving business and middle class customers. Post-crisis domestic beers, such as Baltika, have totally destroyed the market share of imported beers. As a result of investments in modern brewery technology, the quality of many local beers are up to international standards and imported beer is now 4 times more expensive.

While the search continues for domestically produced products, leading hotels and restaurants still rely on imported products in most categories. In the current market situation, regions such as Europe have a great advantage over US suppliers. Russian importers/distributors have been forced to pay in advance for food and beverage supplies. When they pay European suppliers, they generally receive delivery of goods much faster--frequently several weeks quicker than from US suppliers. Because Russian importers/distributors have tight financial resources, there is obviously a preference to purchase from European suppliers. US Exporters with product warehoused in Europe, however, can overcome this disadvantage.

SECTION IV. BEST PRODUCT PROSPECTS

For the top level restaurant market, high quality products such as:

- C Boxed meats
- C Salmon, Trout
- C Lobster, Shrimp
- C Wine and Spirits
- C Ethnic ingredients, especially for Asian menus.

For the growing fast-food and family-style restaurant trade:

- Frozen French Fries
- Frozen Dough
- Portion control products that do not rely on restaurant staff skills.

SECTION V. POST CONTACT AND FURTHER INFORMATION

The new-to-market exporter should use the following key resources to further study the market and to identify potential partners:

- The ATO office at the US Embassy (Contact information is included at the end of this report)
- The Russian- American Chamber of Commerce in Moscow. USA Tel: (303) 745-0757, Fax: (303) 745-0776, Email: russia@rmi.net, Internet: <http://www.rmi.net/racc>

Of the many industry trade shows held in Russia each year, these two are the best:

- Prodexpo-2000. Held annually in Moscow. Next show: February, 2001.
- World Food-2000. Held annually in Moscow. Next show: September 18-22, 2000.

Contact Expocenter: Russia Tel: +7 (095) 255-3733, Fax: +7 (095) 205-60-55, E-mail: centr@expocentr.ru, Internet: <http://www.expocentr.ru>.

Key trade news sources and journals:

- Restaurant Business (Bimontly, in Russian): Russia Tel: +7 (095) 232-3200, Fax: +7 (095) 150-3462
- *You and Your Restaurant* (Monthly, in Russian): Russia Tel: +7 (095) 933-4078, Email: elena.romanova@william-reed.co.uk
- *Russian Food World* (Quarterly, In Russian with English Summaries): Russia Tel/Fax: +7 (812) 252-7785, Email: info@foodmarket.spb.ru

Key Internet sites:

- (In Russian) Menu.ru

If you have any questions or comments regarding this report or need assistance exporting to Russia, please contact the U.S. Agricultural Trade Office in Moscow at the following address:

Embassy of the United States
Novinsky Bulvar, 19/23
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(We are in the midst of changing over to a new phone system. Our new fax number is not available at this time. Please check our Web Site - www.agmoscow.post.ru - for updated numbers after May 9, 2000)

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