

LAPPEENRANTA UNIVERSITY OF TECHNOLOGY
Northern Dimension Research Centre
Publication 29

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**ASSESSMENT OF RUSSIAN FOOD PROCESSING
INDUSTRY –FINNISH PERSPECTIVE**

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Lappeenranta 2006

ISBN 952-214-196-8 (paperback)
ISBN 952-214-197-6 (PDF)
ISSN 1459-6679

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Anna-Mari Ylä-Kojola

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Abbreviations

bln	Billion
CBR	Central Bank of Russia
CEE	Central and Eastern Europe
CIS	Commonwealth of Independent States
dal	Decaliter
ER	Exchange Rate
FTO	Foreign Trade Organization
GATT	General Agreement on Trade and Tariff
GDP	Gross Domestic Product
GRP	Gross Regional Product
ERDI	Exchange Rate Deviation Index
EU	European Union
FDI	Foreign Direct Investment
mln	Million
PPP	Purchasing Power Parity
RUB	Russian Ruble
TE	Transitional Economy
USA/US	United States of America
USD	United States Dollar
WBD	Wimm-Bill-Dann
WTO	World Trade Organization

Foreword

The Northern Dimension Research Centre (NORDI) is a research institute run by Lappeenranta University of Technology (LUT). NORDI was established in spring 2003 to coordinate research related to Russia and other countries in Eastern Europe.

NORDI's mission is to conduct research into Russia and issues related to Russia's relations with the European Union (EU), with the aim of providing up-to-date information on different fields of technology and economics. NORDI's core research areas are Russian business and economy, energy and environment, the forest cluster, the ICT sector, as well as Russia's logistics and transport infrastructures. The most outstanding characteristic of NORDI's research activities is the way in which it integrates technology and economics.

This study concerns the present situation and future scenarios of the food processing industry in Russia and takes a look at the industry in Russia from the foreign investor's point of view. This research is a part of a larger project, Competition and Co-operation between Finnish and Russian enterprises, financed by the National Technology Agency, TEKES, and run by Lappeenranta University of Technology. This report has been made in cooperation with the Finnish Food Producer Association and five food producers.

I would like to express my gratitude to Professor Juha Väättänen, who gave valuable advice and support during the study. I would also like to thank Professor Tauno Tiusanen, who contributed to the study in the final phase. My warm thanks go to my colleagues at NORDI for encouragement and help.

Lappeenranta, March 2006

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1. Introduction

Russia's food processing industry has been growing rapidly in recent years, as the huge market potential and rather undeveloped sector boosts local production but attracts also foreign investors. Since the early 90's some of the world's largest food and beverage manufacturers, such as Mars, Coca-Cola and Nestle, have been interested in Russian markets. Lack of funding and raw material shortages have hindered the development of the local industry. Those who have been able to overcome these obstacles have been able to grow substantially, such as the leading food and drink producer Wimm-Bill-Dann. The food processing industry is an important investment target for foreign investors, but also imports have a significant role in Russian food markets. Approximately 20 percent of all imports are food products. Finnish food companies have been rather cautious in Russia and have concentrated mostly on direct exports to Russia.

This study takes a look at the Russian food processing industry from a foreign investors or exporter's point of view. The study will provide valuable information for future reference for foreign investors and give them an idea of the market environment in Russia. First of all, it is essential to take a brief look at the legacy of communism. The Soviet system has affected the agriculture and food processing industry tremendously. The aim of this research report is not to cover all details of Soviet and post-Soviet economics, but to give an idea of the history. This chapter has been written by Professor Tauno Tiusanen, and he has also contributed to subchapter 3.4 and the three first subchapters in Chapter 4. Chapter 3 focuses on the Russian economic situation. The Russian economy has been growing during the past seven years and the economy has become more open, which is a very positive thing for the foreign investors. The crisis in 1998 caused huge impacts on food processing companies and especially on food imports.

Chapter 4 focuses on the development and the current state of the food processing industry. Raw material supply and consumption of food are important determinants when foreign investors evaluate market potential and entry strategies. The development of foreign direct investments in Russia is also evaluated. Russia still lags behind many Eastern European countries in attractiveness. The Russian food processing industry and agriculture have some peculiarities that are examined on this chapter.

Russia is currently applying for a membership in the World Trade Organization. The highly desired membership will bring various benefits to the Russian economy and it will have an

impact on the food processing industry as well. Especially importers look forward to this membership since it will bring some continuity and transparency to the customs formalities, as well as tariff reductions. The benefits and drawbacks of the membership are evaluated in Chapter 5.

The focus is on the meat and milk processing industries, confectionery manufacturing and bakery industry. These sectors are examined thoroughly in Chapter 6. The traditionally popular sectors among foreign investors, beverage and tobacco industry, are not included. The availability of information, especially of companies, is sometimes rather limited, which makes the analysis harder. The data has to be collected from numerous sources.

St. Petersburg and Moscow are the most popular targets among foreign investors, but Russia has many other regions as well. In the future these regions will grow fast and provide the best market potential when the markets in St. Petersburg and Moscow are already saturated. This is especially important for retailers, not necessarily for processors. A comparison of Russian regions is done in Chapter 7. The analysis reveals the regions with the best market potential.

The food markets in Western Europe are already saturated. Thus, many multinational food processing companies are looking for growth in new areas. Eastern Europe is the most obvious direction for the extension of West European companies. Chapter 8 analyses what Russia has to offer compared to East European countries and how it has survived in the competition so far.

The data on this report has mostly been collected from secondary sources, such as newspapers, magazine articles and the Internet. Statistical data has been collected from various institutes; the Russian state statistics committee Goskomstat provides the most up-to-date and extensive information on Russian agriculture, industries and regions. UNCTAD (United Nations Conference on Trade and Development), the World Bank and WIIW (The Vienna Institute for International Economic Studies) are valuable sources of information concerning the foreign direct investments and economic situation in Russia and in Eastern Europe. An important part of the study are interviews organized with Russian and Finnish experts. Table 1 lists the experts by profession. These interviews have been extremely valuable when the market environment, peculiarities and future trends have been evaluated. Also the foreign actors' concerns and problems were brought up in the interviews.

Table 1. Interviewed experts

Area of Expertise/Profession	Number of interviewees
Food industry directors in Finland	3
Food industry directors in Russia	3
Consultants (Russia)	1
Researchers/professors (including brief comments)	4
Total	11

2. The legacy of communism¹

In the 20th century, Russia became a testing ground for social sciences. After the communist revolution of 1917, the capitalist market economy was dismantled and replaced by Soviet central planning. In the Soviet Union, Russia was by far the most important republic.

In the highly centralized system of the Soviet economy the main aim was to industrialize the huge country, which in the early decades of last century was mainly agricultural. In the early period of Soviet planning the main economic problem was capital formation. In the 1930s it was decided that the capital accumulation needed to create an urban society, would be carried out at the expense of the local rural economy.

The experiment with Soviet central planning is an extremely complicated issue, which cannot be dealt with in detail here. Suffice it to say that the period of Soviet economic planning lasted about three quarters of last century. When the Soviet Union of 15 republics was dissolved in 1991, the country had a complicated industrial structure combined with an urban society of 290 million people. The rural economy was not in an optimal shape.

In the system of Soviet planning, the so called “Marxists growth model” was applied, in which industry was divided into two categories, A and B. The first one (A) produced input goods (steel, machines, tractors etc.), and the second one (B) consumer goods (including food products). It was claimed that permanent economic growth can be achieved by favoring the first group (A) in central planning. Thus, satisfying consumers’ needs had a secondary importance only.

The capital needed for the Soviet industrialization drive was mainly extracted from the rural economy by forced savings. For this purpose, the state needed controlling power in the countryside. Private farming was simply abolished. Agriculture became a part of the input-output table of central planning in the 1930s. Rich peasants, called “kulaks”, were expropriated, deported, or even executed. Agricultural produce was forcefully collected by state officials in the countryside. A considerable part of the collected grain was exported, while several million people starved to death in various parts of the Soviet Union, especially in Ukraine. This part of the Soviet economic history has been described in detail by Alexander Yakovlev (2002), who was in the leading echelon of Soviet power in the second

¹ This chapter has been written by professor, Ph.D. Tauno Tiusanen, Director of the Northern Dimension Research Centre

half of the 1980s. According to Yakovlev, the communist regime destroyed the centuries-old traditions and foundations of the Russian village, and created an essentially feudal system.

In the Soviet era, the society was urbanized in a very short period of time; new industrial centers were created in a couple of decades. Massive housing construction took place to accommodate workers who migrated from villages into urban areas, in which supplies of consumer goods became a permanent problem.

According to the communist ideology, private profiteering was prohibited. The planning unit (Gosplan) fixed all prices. However, the state was unable to guarantee that consumer goods would be available at fixed prices. As the planning favored the production of “input goods” and neglected the consumer goods market, there were permanent bottlenecks in the retail trade sector.

In the central planning of Soviet type a very peculiar form of inflation emerged; citizens had increasing monetary income, but not enough opportunities to buy consumer goods. Thus, personal savings grew, even though people had no incentive to save money (the interest rates were very low). In economic texts dealing with the Soviet system the special term “monetary overhang” is used. People accumulated savings against their will. This problem is also called “repressed inflation”, which means that the consumer goods supply is permanently lower than the demand. Fixed prices hindered “market clearing”. The result was the emergence of unofficial markets, which expanded rapidly in the last decades of Soviet power. “Black market”, “moonlighting”, and “gray market” are terms used in this context in texts concerning the economic history of communism.

In the immediate aftermath of the collapse of Soviet power prices experienced a real explosion; the repressed inflation of the Soviet era was suddenly replaced by open inflation caused by freedom of price formation. The former problem of “monetary overhang” was solved via the strong inflationary wave of the early 1990s; the accumulated savings lost value extremely rapidly. This early period of transition with rapidly rising prices and declining economy was a severe shock for post-Soviet Russians.

During this period of transition shock, some people were able to buy “real value” with their savings, while others just realized how their savings lost value. Remarkable differences in wealth started to emerge in post-Soviet Russia.

In the Soviet era foreign trade was strictly controlled by the state. No spontaneous action in importing and exporting was allowed; the state had a monopoly of external trade. This monopoly was taken care of by the foreign trade organizations (FTO) which functioned in all branches of the economy. For example, the FTO called “Avtoexport” had the monopoly of importing and exporting automotive industry products, “Soyuznefteexport” dealt with oil and oil products, “Stankoimport” with machine tools etc. All FTOs were run by civil servants, who obeyed orders of the central planning unit concerning exporting and importing. This administrative system of foreign trade was dismantled in the early period of transition.

The former Soviet Union was by far the richest country in the world, as far as the resource base is concerned. In the pre-Soviet period, the Southern part of Russia together with Ukraine was called the “bread basket of Europe”, because this region has extremely fertile soil. Oil, natural gas, and coal reserves in the former Soviet territory are plentiful. Almost all minerals were mined in the former Soviet Union territory, which also has more forests than any other place in the globe. Natural resources were wasted in massive scale in the Soviet system, in which gross production was the most important success indicator, while no attention was paid to cost saving. Thus, in the 1980s it was estimated that the Soviet economy used 4-5 times more energy per production unit than Western market economies. (Tiusanen 1991)

In the system of command economy, it was advantageous to exaggerate output figures, because fulfilling or even over-fulfilling the plan target was linked with bonuses. However, over-fulfilling the target was potentially dangerous; it was possible that future plan targets were increased by the central authorities after a clear over-fulfillment of the plan.

In sum, it can be stated that comparisons between the Soviet and post-Soviet periods are difficult. Agricultural production and foodstuff output showed deep drops in the early period of transition in Russia. It can be assumed that a part of this decline is due to statistical methods. Also the consumption of food has become more efficient. However, it is highly likely that there has also been a decrease in real terms.

All value figures are problematic. The exchange rate of the ruble was fixed in the Soviet era. The official exchange rate was very clearly distorted (did not reflect the local price level). Therefore, international living standard comparison in the Cold War period (for example on dollar basis) between East and West was extremely problematic. Not all problems in this context disappeared in the transitional period. This issue will be discussed in detail below.

The communist propaganda maintained that income was relatively evenly distributed in the Soviet system. In the post-Soviet period plenty of evidence has appeared to show the opposite; the Soviet elite had a multitude of advantages which cannot be measured in monetary terms (free housing, free cars, special shops, special health care etc.). In addition, it is estimated that a big part of the population (30-50 percent) lived below the subsistence level in the Soviet era. Thus, uneven distribution of welfare is not a novelty in post-Soviet Russia.

2.1 Some special features of Russian transition

In the first half of the 1990s, the Russian economy declined very rapidly. One of the reasons for this deep recession was in the rapid structural change of the “military-industrial complex”, which was relatively more important in Russia than in other transitional economies. However, all industrial branches suffered a severe drop in the early period of the Russian transition.

In the Soviet system of central planning, the investment quota (share of investment of GDP) was permanently high, some 30-40 percent. At the same time, the efficiency criteria used in investment decisions were sub-optimally used. Thus, terrible waste occurred.

Investments in real terms decreased permanently between 1991 and 1998. The investment quota declined to some 15 percent in the turn of the century. This trend in investment activity showed that the confidence on successful transition was rather weak.

Naturally, the capital stock deteriorated in this slump period. The machinery became more and more outdated and physically worn out. The building stock suffered from lack of maintenance.

The privatization of state owned assets took place with various methods, but in general terms extremely rapidly. The new owners of productive capacities mainly assumed that the old capacities could be run for several years.

The housing stock was partially privatized (about 60 percent of it). “Communal flats” were removed from state ownership to municipalities. This new scheme of accommodation has created a peculiar situation. A very big part of the population has now minimal housing costs, because they live in flats they own. Western-type condominium systems have hardly been established, which means that a huge amount of housing blocks are unable to cover their maintenance costs. Municipalities have scarce resources to keep their housing blocks in good condition. The housing stock obviously deteriorates. At the same time, a big bulk of the

population has convenient discretionary income, because they do not pay mortgages (like in the West) for their accommodation.

The new rich people have been able to buy luxury villas, which are visible around big cities. The upper middle class is able to get mortgages, but the whole system of crediting the housing sector is underdeveloped.

In the transitional Russia there are several “double pricing” systems. Household energy bills are not necessarily on the “market level”. Thus, the fixed costs in an average family budget are moderate, which affects the overall consumption positively.

One of the oddities in the Russian transition is the relatively high prosperity, allowing savings. Household savings have two basic forms; the first one is “normal” saving done in rubles and the second one is keeping the savings in “hard currency” (dollars or euros). The latter is often done in cash form. Saved rubles are converted into dollars or euros and the “hard cash” is kept in liquid form. This form of saving brings potential speculative gains, but it hampers the national economy; part of the savings is kept out of circulation.

The most amazing feature in the early transition of Russia can be found in the wage development in the relative early period of transition. Simultaneously with the deep decrease of GDP, average gross wages per month rose extremely rapidly, calculated in dollars or in ECU (ECU was the bookkeeping unit of the EU before the launching of euro).

This odd phenomenon has a certain background: the ruble was appreciated strongly in real terms (the Russian inflation rate exceeded the nominal depreciation of the official exchange rate). The ECU-based average monthly pay increased from 18 in 1992 to no less than 145 in 1997, which means that there was an eight-fold increase in 1992-1997. It is obvious that there was a bubble in the exchange rate that had to burst.

In 1997, Russian officials assumed that the decelerating inflation would allow the use of a semi-fixed exchange rate system, and thus a managed floating regime was introduced in the beginning of 1998. In this system the central rate of the ruble was fixed at RUB 6.2= USD 1. Fluctuations of 15 percent were permitted in this system (± 15 percent around the central rate) to allow market flexibility.

According to Tiusanen (2003) “The system collapsed in August 1998. The market lost confidence in the correctness of the central rate and the CBR (Central Bank of Russia) was

unable to defend the set 15 percent depreciation limit, which was about RUB 7 per dollar in absolute terms. Panic took over at the exchange market, bringing the RUB rate to 20 to a dollar in a couple of months, or about three times more than the original central rate of RUB 6.2 to a dollar.

In fixed and semi-fixed exchange rate regimes the officials are actually committed to maintaining relative stability: they undertake not to inflate the domestic currency more quickly than the world inflation. The fixed (or semi-fixed) ER serves as a nominal anchor for the domestic price level by restricting officials' ability to run an inflationary policy. The main aim is to "stabilize the expectations": monetary policy makers want to convince people that they are committed to a non-inflationary policy.

This background thinking was obvious in the RUB reform in January 1998. New banknotes with less zeros (one new RUB = thousand old ones) symbolized the end of the inflationary period. The new semi-fixed ER of about RUB 6–7 per dollar was estimated to be correct from the market point of view.

In the ER system of 1998, the officials actually promised that they were willing to give one dollar in exchange for RUB 6, or in the worst case RUB 7. In the managed floating (with 15% borderlines) the government ensured that the "market value" of RUB 7 was not less than USD 1. In every system of fixed and semi-fixed ERs, this sort of promise must be kept; otherwise there would be a "run" on the market, as people would start doubting their chances to convert RUB 7 for a dollar. If there is a feeling that the right relationship is RUB 10, 15 or 20 to a dollar, the "run" will continue: people will start to sell their rubles in increasing quantities.

In this situation, the monetary authorities could interfere by feeding the market with new dollars, in order to hinder the breaking of the set limit (RUB 7 or 15% down from the central rate). In this context it is important to realize that the Central Bank of Russia (CBR) can print rubles, but not dollars. The CBR could defend the ER borderline as long as it had a hard currency reserve for intervention. If the reserve were exhausted, for one reason or the other, the ER defense must be discontinued. If the market still demanded more dollars, its price (ER) would increase obviously sooner or later, breaking the fixed borderline.

The ruble crisis of August 1998 took place because the CBR was not able to defend the set borderline with massive interventions. The run against the domestic currency (RUB) was so vigorous that it increased the price of the dollar three-fold within a couple of months."

The deprecation of the ruble was a very clear blessing to the Russian economy. The realistic exchange rate gave an incentive to invest in the local economy, especially in import-substituting branches. It is no accident that an investment boom started in the post-devaluation year, 1999, after a long and deep decline. The industrial branches were not hurt evenly by the post-Soviet slump of the early 1990s. This can be shown by some index figures.

Table 2. Industrial production (1991=100)

	1999	2003	Growth 1999-2003, %
Engineering & metalworking	42.8	61.5	43.7
Food industry	53.0	74.0	39.6
Non-ferrous metallurgy	64.6	87.9	36.1
Construction materials	33.0	43.2	30.9
Fuels	70.6	91.8	30.0
Ferrous metallurgy	65.5	84.8	29.5
Chemicals & petrochemicals	54.0	68.5	26.9
Light industry	14.1	17.0	20.6
Timber, pulp & paper	43.7	52.6	20.4
Electricity	73.9	77.1	4.3
Total	55.2	72.1	30.6

Source: Goskomstat 2004

In the above table, the turnaround year (1991) is marked with a hundred. The table covers two years, 1999 and 2003. The highest figure in 1999 is in electricity production with about 74, which means that the production declined about 26 percent in 1991-1999. The lowest figure (14.1) is in the light industry (textiles, clothing, footwear etc.), indicating that this branch decreased no less than by about 86 percent. The equivalent drop in construction material production was also very deep, 67 percent, while the food industry had a more moderate, but still severe decline of 47 percent (for details see Tiusanen et al. 2006).

As the table above shows, the overall industrial production in 2003 was about 28 percent below the 1991 level. The equivalent figure in food industry was 26 percent, a bit below the average.

The branch -specific growth figures between 1999 and 2003 are highly interesting. The fastest production growth took place in engineering and food processing with an enhancement of almost 40 percent, which is 10 percent above the industry average. Non-ferrous metallurgy was not far away with its 36 percent growth.

Obviously, heavy competition hurt the local food industry in the pre-devaluation period. As the market reassessed the external value of ruble in 1998-1999, the local industry received a boost, especially in import-substituting spheres. Therefore, it is no wonder that food processing scored the second best growth rate in the table above.

3. Current economic trends

Russia is the largest country in the world. The size gives enormous opportunities; Russia is abundant with raw materials such as oil, natural gas, metals and forests. But the unfavorable location causes the country a lack proper soil and climate for agriculture; almost half of the country is permafrosted (see Figure 1). The Ural mountains divide Russia to eastern and western parts. (CIA 2005)



Figure 1. Map of Russia (CIA 2005)

By population Russia is only the eighth largest country in the world; the population was about 143.5 million in 2004. This is actually 5 million less than in 1992 and the population is permanently diminishing. The annual growth rate of population is -0.37 percent. Russians live in cities; in the beginning of 2004 there were 12 cities with a population more than one million and more than 20 cities with over 0.5 million people. Clearly the biggest ones are Moscow, the capital and the political and economic centre of Russia, with approximately 10.4 million people, and St. Petersburg, the cultural centre of Russia, with more than 4.6 million people. (Goskomstat 2005c, CIA 2005)

3.1 Macroeconomic indicators

The year 1997 was the first year with economic growth in post-Soviet Russia. The GDP increased by 0.9 percent (see Figure 2). With six years of economic reforms the country had still a lot of problems and economic turbulence that caused Russia to face a financial crisis in 1998. In the beginning of 1998 the prices of oil (see Figure 3) and nonferrous metals started to

decrease in the world markets. Followed by the collapse of Russian stock, bond, and currency markets the exchange rate was set to float and the ruble was devaluated in August 1998, as feared. The ruble collapsed from the rate 6 RUB for 1 USD to 20-25 RUB for 1 USD. By May 1999 the ruble had lost 70 percent of its pre-crisis value. As a consequence, the Russian GDP went down 4.9 percent in 1998. The industrial production declined by more than 5 percent and the agricultural production by 12 percent. The average wage before the crisis was 180 USD, when in the end of 1998 it was only 70 USD and the inflation was extremely high. Income differences were increasing. The value of imports decreased by 19.1 percent, the drop was the largest in consumer goods and pharmaceuticals. The food imports decreased by 15 percent, which is natural because the prices of imported products rose as much as four times, people did not have money to buy them and food exporters faced enormous problems. Local food producers did not suffer much. As a matter of fact, they enjoyed benefits because of the ruble devaluation and more expensive imports. (BOFIT 1999)

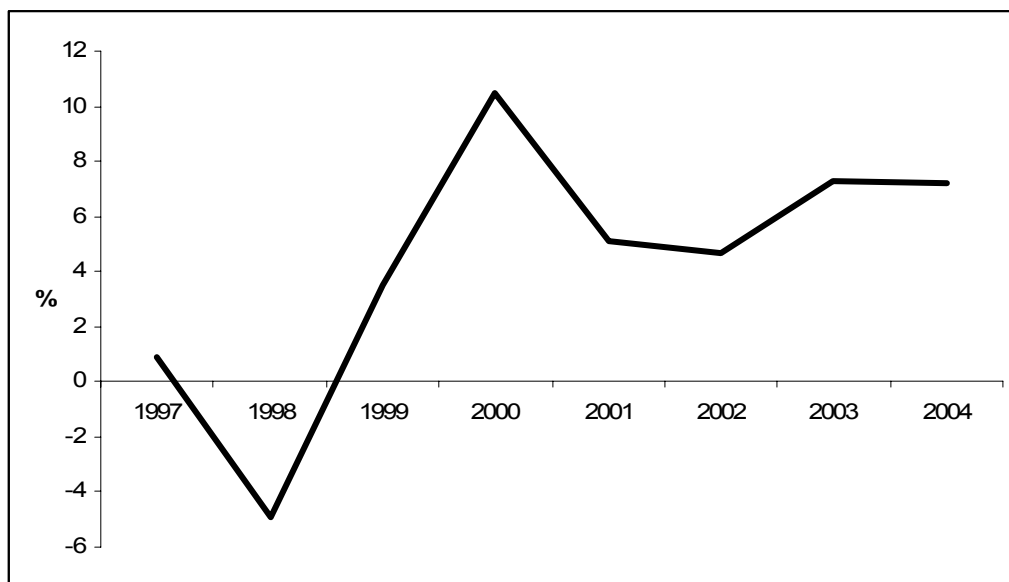


Figure 2. Russian GDP growth in 1997-2004 (BOFIT 2005)

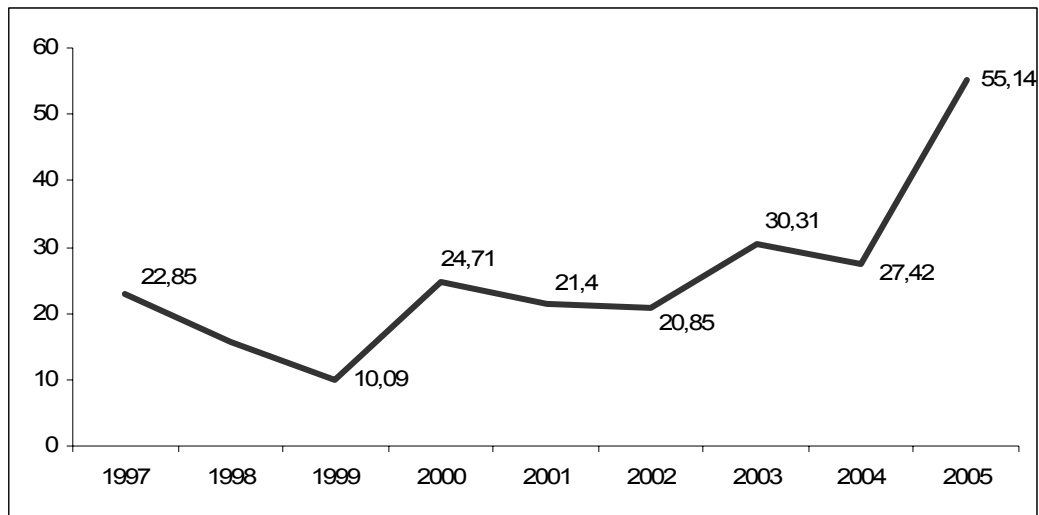


Figure 3. Urals oil price USD per barrel in 1997-2005 (EIA 2005)

The recovery of the Russian economy was faster than expected. In 1999 it was estimated that the Russian GDP may decline by as much as 8 percent, but eventually the GDP growth was 3.5 percent in that year (BOFIT 1999). Since then Russian GDP has grown every year (see Table 3). In 1999, the oil prices in the world markets started to grow. Without this positive trend, the Russian economy would not have been able to grow. Russia is the second biggest oil producer in the world with a 12 percent share of the total world production. The Russian oil reserves account 6 percent of the world total, and the undiscovered reserves are estimated to be as large as the current reserves. Oil exports account for more than 55 percent of the total oil output in Russia (BP 2005). Consumer price inflation has decelerated clearly after the 1998 crisis (see Table 3), but there are still many factors that will make the inflation high. The price of energy is rising as well as the prices of services, foodstuff and housing.

Table 3. Main economic indicators in 1997-2004

	1997	1998	1999	2000	2001	2002	2003	2004
GDP growth	0.9 %	-4.9 %	3.5 %	10.5 %	5.1 %	4.7 %	7.3 %	7.2 %
Exports USD bln	86.7	73.9	74.3	105.0	101.9	107.3	135.9	181.5
Imports USD bln	66.9	59.5	41.4	49.3	59.1	67.1	80.8	95.6
Inflation (consumer prices)	11.0 %	84.4 %	36.5 %	20.2 %	18.6 %	15.1 %	12.0 %	11.7 %
Current Account USD bln	2.0	0.7	25.3	46.8	33.9	29.1	35.4	60.1

Source: EIU 2005, BOFIT 2005

Figure 4 shows that Russian exports are growing quite rapidly thanks to the favorable situation in the world raw material prices. The share of energy products of total exports is as high as 62 percent; the share of oil is 31.8 percent, petroleum products 12.7 percent, and natural gas 14.6 percent. The share of other raw materials is also increasing. Imports to Russia are increasing at a slightly more moderate rate, and thus the Russian trade balance is positive. As Table 3 shows, the overall current account is in surplus annually. Russia imports mainly machinery, equipment, intermediate goods and transport vehicles. A large part of the imports consists of food products and agricultural raw materials. Since Russia mainly exports energy products and raw materials, it is very vulnerable to the price fluctuations of oil and raw materials in the world markets. An oil stabilization fund was established in 2004 to absorb surplus revenue from oil exports, and it can be used to stabilize the Russian economy. Currently the fund is worth of 34 billion USD. (IET 2005)

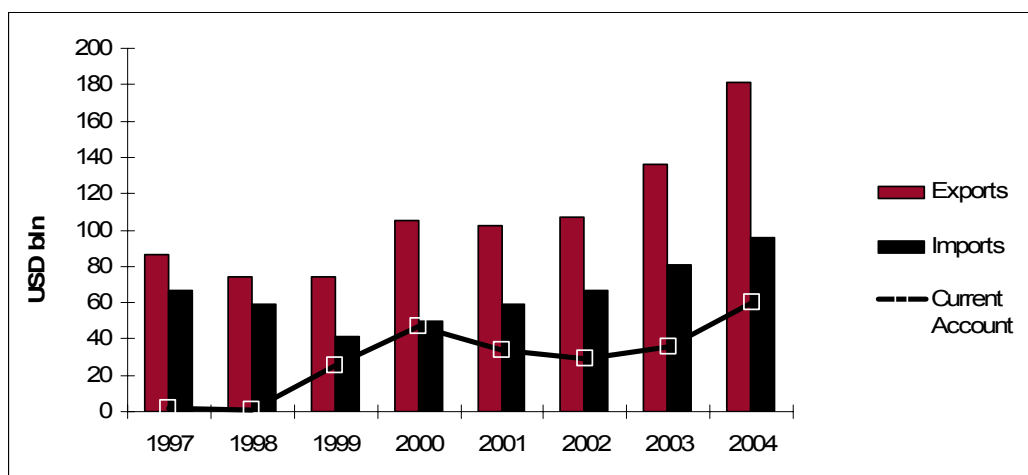


Figure 4. Russian exports, imports and current account in 1997-2004 (EIU, BOFIT)

Figure 4 also shows the growth of the Russian current account. The surplus in the Russian trade balance makes also the current account to be in a large surplus. The major export partners of Russia are Germany, Italy, the Netherlands and China and the import partners Germany, Belarus, Ukraine and the USA. (Goskomstat 2005)

As the Russian GDP has been growing, also the GDP per capita figure has grown (see Figure 5). The GDP per capita in Russia was 3 253 EUR in 2004. A more comparable and true figure is the PPP adjusted GDP, which means that the price level of the country is taken into account. This figure in Russia was 8 300 EUR in 2004. The average PPP (purchasing power parity) adjusted GDP per capita figure in the new EU member states is 11 908 EUR, which shows that Russia is still very poor.

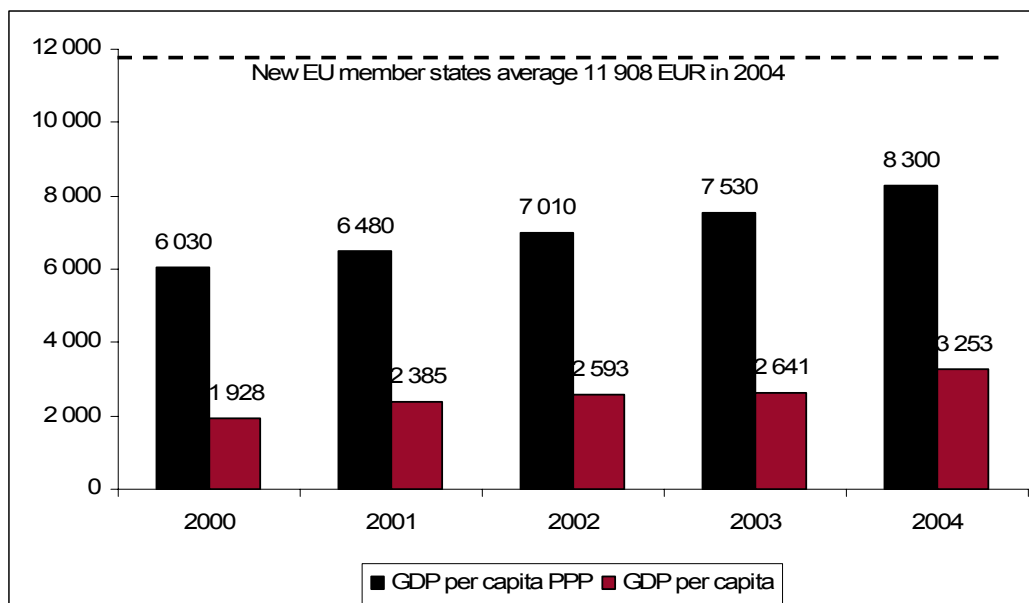


Figure 5. GDP per capita in euros in 2000-2004 (WIIW 2005)

3.2 Gross wages

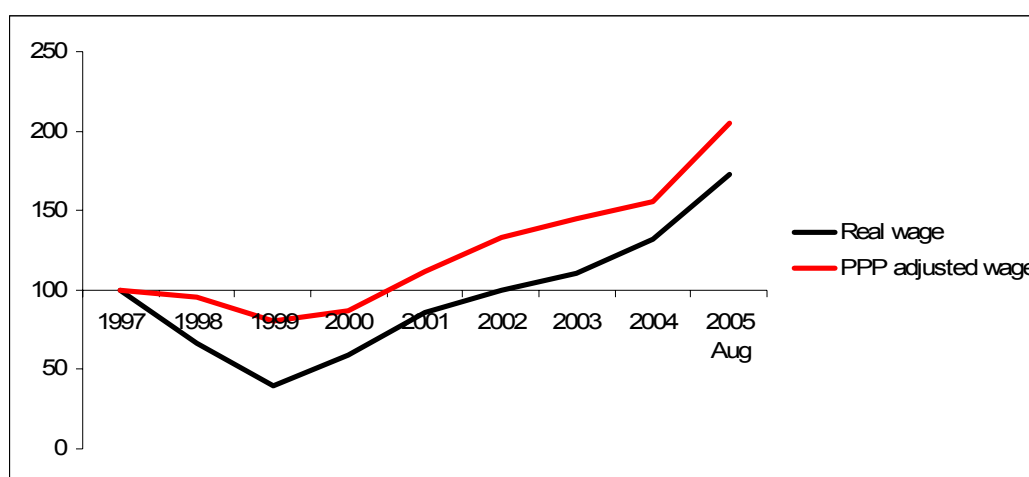
In addition to a macroeconomic review, it is essential to take a look at the wealth of the Russian population. Table 4 shows the development of the monthly wages in Russia. The wage analysis has been done in euros, since the euro figures are more readily available. Because of the crisis in 1998, Russian real wages decreased heavily in euro terms. Many companies had problems to pay their employees' wages regularly. In 1999 the average monthly gross wage was 58 euros, which is only about 40 percent of the wage level in 1997. Table 4 also shows the purchasing power parity -adjusted wages calculated with ERDI (exchange rate deviation index) figures. In 1999 the Russian ruble was extremely undervalued (the ERDI figure is 4.35), and when this is taken into account the wages do not seem to be that low anymore, about 80 percent of the wage level in 1997. After 1999 the wages have been growing steadily, the ruble is still undervalued but not as badly as after the crisis. The decline of the ERDI figure means that the ruble has been appreciated in real terms. It can be assumed that the growth of monthly wages will continue; the wages in August 2005 were already 251 euros and if it is assumed that the ERDI figure remained the same as in 2004 the average wages adjusted with PPP were 638 euros. The ruble figures mentioned below are not PPP adjusted.

Table 4. Average monthly gross wages in 1998-2005

	1998	1999	2000	2001	2002	2003	2004	2005 Aug
RUB	1 052	1 523	2 223	3 240	4 360	5 499	6 832	8 564
Euro (Exchange rate)	95	58	85	124	147	159	191	251
Euro (PPP)	296	252	271	348	414	452	486	638
ERDI	3.12	4.35	3.18	2.80	2.81	2.84	2.54	2.54

Source: WIIW 2005

Figure 6 shows the development of Russian real wages and PPP adjusted wages compared to the year 1997. The real wages reached the level of 1997 in 2002, but the PPP adjusted wages reached the level already in 2000, which shows that Russians had the same living standard in 2000 as in 1997 before the crisis. The positive development of wages and income is also a good sign for the food processing industry. When the disposable income increases, and it can be assumed that it will, people will have more money to spend on processed food items.

**Figure 6. Real wages and PPP adjusted wages, Index 1997=100 (WIIW 2005)**

As mentioned above the Russian economy is heavily dependent on oil and gas production. This is the branch of the industry where the highest salaries are earned. Figure 7 shows that in 2004 the workers in the gas industry earned almost 1 000 euros monthly, whereas the agricultural workers earned only about 80 euros per month. The salaries in public sector, such as in public health care and education, are very low and quite far away from the average monthly wage in Russia. This has caused strikes and demonstrations throughout Russia, when the public sector workers have demanded higher salaries. The food industry has been able to pay wages that are almost on the average level.

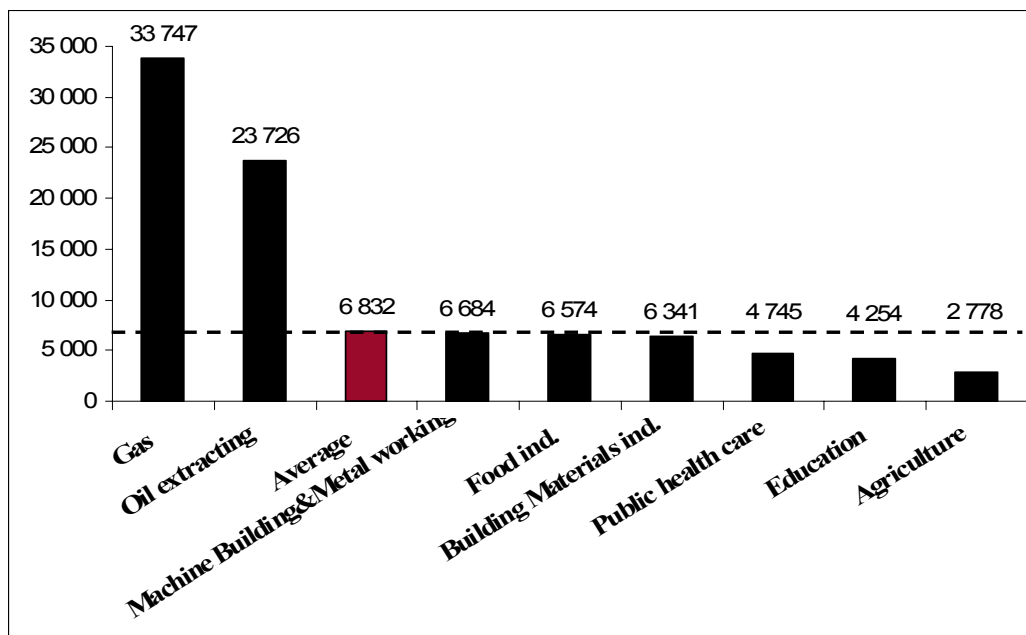


Figure 7. Monthly wages (RUB) in selected industries compared to the Russian average in 2004 (Goskomstat 2005)

3.3 Distribution of income

The income distribution in Russia is far from equal. There are many people whose income is below the minimum subsistence level, which is currently 2 451 rubles (72 euros). For example the average monthly pension in 2004 was just a little bit over the official monthly subsistence level, 75 euros. The official minimum wage was raised in September 2005, but is still only 23 euros, which is not even close to the subsistence level. In Russia the minimum wage is mostly used to calculate allowances, such as pensions. It is not considered to be the minimum price floor for wages. After the crisis in 1998 the gap between the rich and the poor even widened (see Table 5). Income distribution is usually measured by dividing the population into quintals and calculating how much of the total income is acquired by these groups. The poorest 20 percent, which is 28.7 million people, of the population earned only 6.1 percent of the total income in 2000, and respectively the richest 20 percent earned almost fifty percent (47.2) of the total income. This trend has not changed much over the years; the situation in 2004 was rather similar.

Table 5. Distribution of income between quintals %

	1998	2000	2002	2004
Poorest 20%	6.0	6.1	5.6	5.5
Second 20%	11.6	10.6	10.4	10.2
Third 20%	17.6	14.9	15.4	15.2
Fourth 20%	26.5	21.1	22.8	22.7
Richest 20%	38.3	47.2	45.8	46.7

Source: Goskomstat 2005

When the share of people in various income brackets is taken into account (see Table 6) it can be calculated that 27 percent of the population earn less than 88 euros per month. The figures below have been calculated on the gross (not net) income basis. The five income quintals can be described as follows:

- According to Goskomstat (2005), 17.8 percent of people live below the minimum subsistence level, which means that the poorest 20 percent of the population live in poverty.
- The second 20 percent of the population earn less than 3000 rubles (117 euros) per month and some of them hardly reach the level of minimum subsistence.
- The third quintal earns monthly less than 4 500 rubles, which is still far away from the average Russian wage. The first three quintals, 60 percent of the population, consume only the basic food products and can not afford to purchase highly value added products.
- The fourth quintal earns 22.7 percent of the total income and can be considered to be the average Russian workers.
- The richest 20 percent earn 46.7 percent of the total income, and most of them have an income of more than 7 000 rubles (206 euros). The two richest quintals are the most potential consumers for processed food products. When their income increase, they will start to buy more quality products and spend more money on processed food items. Also dining out will increase.

Table 6. People in various income brackets %

RUB/Month	1998	2000	2002	2004	2004 mln people
Less than 500	23.9	3.1	0.8		
501- 750	21.9	7.2	2.3		
751- 1 000	16.9	9.8	3.9	1.9	2.7 mln
1 001- 1 500	19.6	20.7	10.7	4.3	6.2 mln
1 500- 2 000	8.9	17.0	11.9	6.2	8.9 mln
2 001- 3 000	6.3	21.1	21.0	14.6	20.9 mln
3 001- 4 000	1.7	10.2	15.2	13.9	20.0 mln
4 001- 5 000	0.8	10.9	34.2	11.8	16.9 mln
5 001- 7 000				17.0	24.4 mln
Over 7 000				30.3	43.5 mln

Source: Goskomstat 2005

The above analysis can be somewhat misleading; it can be assumed that there is more consumption potential than the incomes show. A substantial part of the Russian economy still exists outside the official statistics. First of all, many people have another, unofficial job or other incomes that are hidden. One good example of this are the private taxi drivers who can easily earn 1 000 rubles per night. It is estimated that the Russian shadow economy is as much as 40 percent of the GDP (RIA Novosti 2005). Secondly, many families grow their own vegetables and other agricultural products, sometimes even more than for their own use. By selling these products they earn extra income, which is not reported. Thirdly, when the total population of Russia is taken into account the analysis includes also children, students and grandparents; it is natural that their incomes are low. Usually the head of their family earns adequately to provide a sufficient living standard also for them.

3.4 Comparison to other transitional economies

In international living standard comparisons the most frequently used measure is the Gross Domestic Product (GDP) per head of population. It is a crude but fundamental reference point that is relatively easy to obtain and is readily understood. Several international organizations, such as the World Bank, give yearly GDP figures per capita converted to USD or euros.

In this method, all incomes are measured in US dollars (or euros) at the official exchange rates. One difficulty with this measurement is that the ruling exchange rates (ER) are not necessarily reliable tools in converting national money units into dollars (euros). Imperfections on the exchange market may overvalue some currencies and undervalue others. A tourist can normally buy more goods and services with 100 € in a poor country than in a rich one. GDP figures are thus made more accurate if the dollars (euros) are converted into

other countries' currencies via ERs calculated on the purchasing power parity basis –that is, the exchange rates are adjusted so that an identical sample of basic goods and services costs the same in each country.

Even when the GDP per capita figures are PPP adjusted, there still is space for criticism on using statistical aggregates to measure development. Many poor people may not be in close contact with the monetary economy. Much of what they consume might be provided by them or bartered for in unrecorded trade. Subsistence farmers fall into this category. Similarly, many participants in the informal sector (street vendors, stall holders, taxi drivers etc.) may be more integrated into the modern market economy but will rarely disclose their output or income. These points are very valid in emerging economies, Russia included.

Table 7. Gross domestic product of CEE countries and Russia

	Population, mln	A) GDP per capita USD 2004	B) GDP PPP per capita USD 2004	ERDI B/A
Slovenia	2.0	16 091	20 749	1.29
Czech Rep.	10.2	10 495	19 350	1.84
Hungary	10.0	9 971	16 758	1.68
Slovakia	5.4	7 610	14 493	1.90
Estonia	1.3	8 314	14 279	1.72
Poland	38.6	6 265	12 734	2.03
Lithuania	3.6	6 184	12 439	2.01
Latvia	2.3	5 926	12 061	2.04
Russia	143.4	4 061	9 823	2.42
Bulgaria	7.5	3 217	8 306	2.58
Ukraine	36.1	1 805	8 401	4.65
Romania	22.3	3 281	8 177	2.49

Source: World Bank 2005

Table 7 gives the GDP per capita at the official exchange rate (A figures) and the same in PPP adjusted (B figures) in US dollars. Twelve transitional economies (TE) are included in this comparison. In the light of the A figures, the majority of the TEs are rather poor by European standards. The equivalent figure in Finland is roughly \$ 36 000, which is more than double of that in Slovenia, the richest TE in the table. In comparison to Russia, Finland seems to be about nine times better off.

As the official exchange rates reflect local price levels in TEs very poorly, it is worthwhile to concentrate on the B figures, which take the price levels of transitional economies into consideration. The B figures are essentially higher, which indicates that the currencies of the

transitional economies are undervalued. Actually, the A and B figures ought to be identical; in that case the official exchange rate would reflect the local price level correctly.

The differences in the A and B figures thus indicate that ERs in the TEs are not in equilibrium; the exchange rates have biases, which can be measured by a tool called exchange rate deviation index (ERDI). The ERDI values, given in the above table, have been derived by dividing the B figures with corresponding A figures.

The ERDI in Russia, according to the World Bank, is 2.42 (WIIW uses an almost similar figure, 2.5). This means that a Finnish tourist in Russia can buy with his/her 100 € a local consumer basket containing goods with the total value of 242 €. This basket must contain average consumer goods, which are all included in international PPP comparisons. The tourist does not necessarily get a cheap room in the local luxury hotel or a nice meal in a fancy restaurant a half a price.

The countries in Table 7 are listed according to their relative wellbeing; Slovenia has the highest living standard measured in GDP per capita at PPP. In the B figure ranking Ukraine and Romania are at the bottom of the scale. Slovenia is about twice as rich as Russia. Slovenia has a very moderate ERDI value, while Romania and Ukraine have relatively high ERDI figures. Thus, it can be concluded that relatively sophisticated economies have low, and relatively primitive economies high ERDIs. However, this general rule has no universal validity, which is also visible in the table; Estonia is in the fifth place in the B-ranking (living standard), but has a lower ERDI than the Czech Republic, which is second after Slovenia in the living standard comparison. Ukraine has an exceptionally high ERDI value (4.65), much higher than that of Bulgaria and Romania.

Undervaluation gives price competitiveness to transitional economies by helping exports and keeping imports relatively expensive. An undervalued currency tends to make a country's goods cheaper, causing its trading partners to import more than they would otherwise. The higher the ERDI value, the higher is "the undervaluation advantage" for the country.

It is obvious that a high ERDI is a tool to attract FDI, especially in fields which are labor intensive. As strong undervaluation makes imports expensive, local production (in a high ERDI country) may be a viable alternative for direct export for many multinational companies. In Russia, the ERDI value is amazingly high, almost 2.5. In the first years of the present century Russia has earned current account surpluses, which are about 10 percent of the GDP on average. Thus, Russia is an important net capital exporter (in relative terms). A high ERDI figure is obviously an important background factor in current account surplus formation.

It is absolutely necessary to consider PPP-adjustment in international living standard comparisons. As mentioned above there is a deep gulf between the Finnish and Russian development level in the light of the original GDP figures. On the basis of PPP-corrected data, the difference is essentially more moderate; Finland is about three times better off than Russia.

One important determinant, when foreign investors are choosing a country to enter, is the wage level of the country. Table 8 (notice that the figures are euro-based in this table) shows that the wages are highest in Slovenia and lowest in Ukraine and Bulgaria. Russia is just above the latter two. Again the PPP adjusted figure is more realistic, when comparing the purchasing power of people. The price level, when comparing to the average of 25 EU countries, is highest in Slovenia, where of course people have higher wages, too. When the low price level of Ukraine is taken into account, the extremely low wage level does not seem to be such a bad thing anymore; actually this makes Ukrainians better off than Bulgarians.

Table 8. Wages in CEE countries and Russia

	Average monthly gross wages 2004, EUR	PPP adjusted gross wages 2004, EUR	Price level index EU 25=100
Slovenia	1 190	1 597	75
Czech Rep.	585	1 047	54
Poland	505	1 034	49
Hungary	579	986	59
Estonia	466	791	59
Slovakia	395	748	53
Lithuania	335	687	49
Latvia	314	641	49
Romania	204	530	38
Russia	191	485	39
Ukraine	89	480	19
Bulgaria	153	409	37

Source: WIIW 2005

4. Food processing industry in Russia –General overview

In order to understand the ongoing and future development of the food processing industry in Russia, it is necessary to take a look at the sector in general, and also how the sector developed during the Soviet times. There are some factors and peculiarities that make the industry in Russia different from many other countries. During Soviet times the agricultural production was collectivized to kolkhozes and sovkhozes, collective-owned and state-owned farms. Further production of food was mass production; the amount was more important than the quality. In the centralized planning system the decision making took place from top down rather than bottom up, and thus consumer preferences were not taken into account. The government fixed the prices so that the industry had hard times to meet the supply requirements and were making hardly any profit. The consumers also suffered from shortages or even famine. In sub-chapter 4.1 the stage of agriculture and food processing industry during the Soviet times is described in detail.

When the Soviet Union collapsed, the development of the food processing sector started. The big bulk of companies was privatized. Now the prices of products were set by the markets, not by the government. Companies started investing in new equipment, if they were able to get funding. Foreign direct investors were also very interested, and many companies were able to find Western partners. Some of the sectors had problems with raw material supplies, since the ownership of farms was also changing to private. Agriculture was not so heavily subsidized anymore. Imports started to grow and would have grown even more if the Russian economy had not have collapsed in August 1998. The ruble lost a big part of its value, and imported products became four times more expensive. The average Russian did not have money to buy any imported products. As a consequence those foreign producers, who were able to do so, started production in Russia, but others had to reduce trade with Russia significantly for some time. The local producers who were able to get funding, saw their opportunity and started to produce products that were previously imported.

Currently Russia depends heavily on food imports. It is hard to be self-sufficient when the agricultural producers have so many problems. Especially livestock and milk production, which require more high tech equipment in order to produce good quality, is in trouble. The government has cut subsidies quite heavily and farmers can not get funding or credits easily. When the quality is not good enough and the quantity is low, these farmers can not supply for demanding food processing companies, whose profits are low and who can not pay very good prices. However, complicated and unstable rules concerning imports of agricultural products

aggravate problems in raw material supplies. There are some positive elements in the Russian agro-business, especially in grain growing. The grain harvests have been good during the last years and Russia has been even able to export grain. The following sub-chapters explain exports and imports, as well as raw material supply in detail.

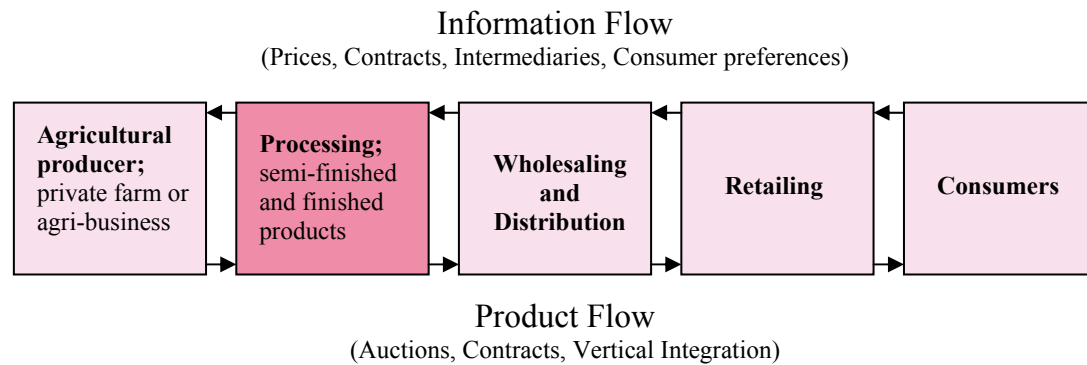


Chart 1. Value chain of food processing industry (adapted from Menkhaus et al. 2004)

Chart 1 illustrates the value chain, or more precisely the value system, of the food processing industry. The food value chain consists of a series of factors involved in the production of raw agricultural commodities, processing of raw materials into food products, wholesaling and distribution, retailing, and finally consumption. The analysis in this study focuses mainly on the processing of raw materials into food products.

Food retailers collect valuable information from consumers, such as their preferences and purchasing decisions, transmitting the information to the wholesalers, producers, and further to agricultural producers. This information flow was unnecessary during the centrally planned economy, when the information was transferred only downwards. Nowadays a tighter cooperation between retailers and other parts of the value chain is necessary when a company wants to be successful. The importance of food retailers is growing; the number of large food retail chains and supermarkets is increasing in Russia all the time, and they have increasing negotiation power and good knowledge of their customers. In order to fulfill the requirements of the retailers the food processors have to increase their volumes, integrate, and create horizontal and vertical alliances. (Menkhaus et al. 2004)

4.1 Agriculture in the Soviet Union

In the Cold War period, the Soviet Union became the most important grain importer in the global economy, even though the Eastern superpower permanently aimed at self-sufficiency

in food supplies. As the former “bread basket” of Europe became a net importer of food, it was obvious that the institutional framework was suboptimal.

Collectivization of the agro-business took place in the 1930s. Virtually all peasants were forced to enter collective farms, which had two forms; the kolkhoz was a co-operative farm, and sovkhoz a state farm. The former was nominally an enterprise which was supposed to have some leeway in its operation, while the latter was directly subordinated to the central administration. However, in reality the kolkhoz had a very limited freedom of action because the state determined both the input and output prices of the kolkhoz sector. The governmental control was strong; growing industrial centers needed food and this required a decrease in the consumption of food in rural areas.

It is a well-documented fact that the peasants slaughtered livestock in a massive scale before entering collective farms. This event caused serious harm for the Soviet food chain. Several authors (see for example Fitzpatrick 1994) describe the passive resistance of the Soviet peasantry after the collectivization of the rural economy. It has been maintained that apathy and inertia were the dominant features of collective farms.

Kolkhoz farmers were allowed to have a small private plot (0.5 ha) to cultivate vegetables for their personal use. Also a limited number of private livestock was allowed. These private plots were used very intensively; many households were able to produce some surplus from their private holding, and thus, the “kolkhoz market” came into being. The peasants were allowed to bring their surplus products to open markets in nearby cities. After paying a low fee, the farmer was able to sell his or her own products at market prices. The “kolkhoz market” became an important part of the food supply in the post-war period. According to Soviet estimates this marginal free market system supplied some 30-50 percent of the potatoes, vegetables and eggs in urban centers. Also milk, milk products and meat were available in the “kolkhoz market” at prices that were essentially higher than the equivalent prices in official grocery stores. Thus in the last decades of the Soviet power it became obvious that private farming was more efficient than collective farming; private plots comprised some 2-3 percent of the overall cultivated area, but still played an essential part in the food supply. However, as late as in the 1980s the expansion of the “kolkhoz market” was regarded as ideologically questionable.

The production of agricultural products required machines and a lot of labor force, and most often the quantity was emphasized over the quality. The quantity was also the main objective in food processing factories; the hardest task was to produce enough to feed everyone. The

government fixed the prices and the producers did not have much leeway; sometimes it was impossible to make any profit when the production costs were higher than the eventual price of the product.

It was mentioned above that natural resources were wasted in massive scale in the Soviet system. About 20-30 percent of grain was lost annually because of careless transportation and insufficient storage facilities. The cheap price of bread gave an incentive to use it as animal fodder. More than half of the fruit and vegetable harvest was lost because of negligence. Roughly 15-20 percent of the meat and fish went rotten before reaching the market. (Tiusanen 1991)

During the 19th and 20th century the self-sufficiency of Russian consumers was quite significant. The allotment gardens were an essential resource of food. People used to grow vegetables and berries. People also sold their produce and gave it to relatives and friends. This was an additional income for the family budget and also a reason to the survival of the Russian population during periods of crises. Traditionally, the food supply in rural areas was characterized by seasonal differences and minimum product variety. (Ekström et al. 2003)

4.2 Development in the 1990s

In the 1990s the agriculture and food processing industry went through a huge structural change. Changes took place for example in pricing strategies, agricultural subsidies, renovation and modernization of production facilities, product varieties, ownership structures, and last but not least, in foreign trade. The clearest structural change was the increase in the number of private farms (Helanterä 1998). One significant change happened in government intervention; the prices were not fixed anymore. Now companies were able to set their own prices and see if anyone was interested to buy at that price. The number of products increased when the prices were no longer regulated.

In the period of transition, many post-communist countries carried out restitution of farmland; the previous owners of private farms were able to claim their property back. Mortgage systems were developed to give new private farmers access to capital. At the same time, markets for real estate, including farmland, emerged. In this respect, the development in Russia (and other CIS-countries) has been rather slow. Obviously the restitution of farmland in post-Soviet Russia was not a viable alternative; it would have been impossible to identify the real owners (or their relatives) of the estates in the pre-revolutionary time (pre-1917).

In the post-Soviet Russia, all kolkhozes and sovkhoses were transformed to “commercial structures”, in which the members of the former collective farms are “stakeholders”. In this context it became possible for farmers to establish private units by buying land from the “collective”. Obviously, it is in the interest of the co-operative unit to sell the worst possible part of the farmland at the highest possible price to the potential private farmer. It can be assumed that the potential private farmers have no easy access to capital. Therefore private farmers have not emerged in massive scale. Some big companies have acquired farmland. So called “oligarch firms” have the necessary capital. Obviously, some co-operatives are willing to sell; if all the stakeholders of a co-operative are old, they may be willing to give up the farm, provided that the price is right.

Certain aspects of the former “kolkhoz market” are still in existence. A big part of foodstuffs are bought in the outdoor markets and bazaars in Russian cities. The members of “co-operative” farms sell their produce by themselves, or use middlemen, who collect the products from several farms.

Large-scale, high productivity farms have been slow in coming up in the post-Soviet Russia. The key question is capital; how the rural economy can be mechanized and modernized in a large scale. Solving this problem seems to take time. Overcoming the communist legacy in the Russian rural economy is not easy.

The agricultural production declined about 40 percent during the 90’s. The share of agriculture of GDP was 16 percent in 1990, in 1998 it was only 5 percent (Tekoniemi 2003). The decline in the production of food happened because of the structural changes and weak purchasing power of the consumers. The government rarely subsidized the food products, and thus the price of the products increased. Also the prices of raw materials for food producers have increased. The food producing industry was unable to pay good prices and the farmers were eager to sell their unprocessed products directly to the consumers. (Helanterä et al. 2002, Tekoniemi 2003)

According to the World Bank (World Development Report 2006), the productivity of Russian agriculture is very low. In the Soviet period, especially in the 1970s and 1980s, the state invested rather heavily on agriculture to improve its performance. However, the allocation of these investments was suboptimal.

The agricultural machines in the Soviet Union were notorious. The farming units had hardly any say in ordering technology. The tractors and combine harvesters were often too heavy.

Spare part supplies were a permanent problem, making maintenance difficult or even impossible. Skilled labor to handle the machines was often missing in the countryside. Now, 15 years after the collapse of communism, the machine fleet inherited from the previous system is hopelessly outdated, and in many cases physically out of order.

Table 9. Aggregate agricultural productivity

	Value added per agricultural worker in 2001-2003 (Dollars of 2000)	
	Aggregate	Annual
France	38 647	12 882
Finland	30 391	10 130
Hungary	4 041	1 347
Russia	2 204	735
Ukraine	1 442	473

Source: World Development Report 2006

The figures in the above table indicate that there is a huge difference in agro-business productivity between East and West. Three post-communist countries have been selected to the table; Russia, Ukraine and Hungary. The last one is a member of the former Eastern Bloc with a long and strong agricultural tradition. Actually, all three countries are in the “European bread basket” mentioned above. Two EU-countries, both of Western Europe, are included; Finland and France. The latter is the most important food producer in the EU.

Persons involved in Russian agriculture create value added of \$ 735 a year. That is almost twice as much as the equivalent achievement in Ukraine, but only roughly half of the Hungarian figure. Thus, rural productivity varies essentially within the chosen groups of transitional economies.

In the early years of the 21st century persons involved in Finnish agriculture were about 14 times more productive than those in Russia. The equivalent difference between Finland and Ukraine is no less than factor 21.4; one person in the Finnish countryside makes the work of 21 Ukrainians. The highly productive French farmers create per capita about 18 more value than their Russian counterparts. The equivalent difference between France and Ukraine is no less than factor 27.

The figures in the above table have been calculated in “stable dollars” (year 2000), and thus, inflation does not distort the results. However, the different price levels in the five countries listed in the table have not been taken into consideration when the national values have been converted into dollars via official exchange rates. The low price level, which is very

imperfectly reflected in the official exchange rates in transitional economies, obviously affects Russian figures in the table.

The Russian per annum figure of \$ 735 ought to be multiplied by about 2.5 to get the purchasing power parity adjusted result (see above), which is \$ 1 838. After this correction, it can be maintained that agricultural productivity is about 5.5 times higher in Finland than in Russia. This means that there is a remarkable difference in the efficiency levels between Finland's and Russia's agricultural sector even after PPP adjustment. Obviously, the poor performance of the Russian countryside is an essential part of the communist legacy in post-Soviet Russia.

During the 1990s the biggest survivors in the food processing sector were breweries and sugar producers, partially because of foreigners. Foreign investors were in an important role in the development of Russian food processing industry. Imported products were popular among Russians because finally they had a chance to try western products. Sometimes a foreign product had a strong demand only because no other company in Russia produced that product. Imported products gained a strong position also because of the actions of regional governments, who limited the distribution of products between the regions. On the other hand, the Russian food producers were unable to compete with the western companies, because they were so inefficient, they did not have access to capital and they were not used to working in a market economy (Helanterä et al. 2002). A foreign product also gained strong position in the market if the product was clearly superior to the local products. One example of this is Finnish margarine in Russian markets (STT 1999).

After the economic crisis in 1998 food imports to Russia decreased heavily. A number of Western exporters were forced to stop their deliveries when the prices of imported food products increased by more than four times, and the demand fell sharply. One positive trend was that the consumption of grain and bread as fodder was diminished. The grain imports have since decreased, and nowadays Russia is already a grain exporter. (Dobrov 2001)

Already before the crisis in 1998 Russian food processing companies improved a lot. They started to pay attention to the quality of products, marketing and other competitive factors. They also received some money for investments. The main reason for success has usually been vertical integration (investments in agriculture and in the whole value chain). Branding and marketing have been very important success factors, and the biggest companies have used huge amounts of money in them. (Helanterä et al. 2002)

After 1998, the development of the local food processing sector has been positive: consumers who could no longer afford imported goods increasingly turned toward less expensive domestic brands. The purchasing power of the consumers has increased and the companies are more efficient. The food processing sector will grow fastest in the areas where the strongest purchasing power exists (Moscow, St. Petersburg and other big cities, and their surroundings). In some sectors (dairy products, fruit juices) domestic suppliers have captured a market share that will be difficult to challenge (Helanterä et al. 2002). The food processing industry is one of the few sectors in Russia which can offer domestically highly processed consumer goods (Mahlamäki et al. 2005).

Importing is no longer as significant as it used to be before the crisis in 1998. But to replace the imported products, the industry needs investments in technology and know-how. Those processors who have been able to attract investments have also done a good job of improving the quality of their products and the sophistication of their marketing efforts (Taybakhtina 2004). In the future, local production will increase nearly in all industry segments, as foreign and domestic manufacturers invest in new production facilities, equipment and technology.

4.3 Characteristics of the industry

Russia's food processing industry has been growing rapidly in recent years. The growth started in 1999. The average annual growth rate in the beginning of the 21st century has been between 4-8 percent. Some segments have reached an astonishing growth rate of 30 percent (Tekoniemi 2003, Ernst & Young 2004). In 2004, the industry grew by a reported 18 percent and reached the level of 1 229 billion rubles (37 billion euros). The output of Russian food processing industry is presented in Table 10. The growth rates are expected to decelerate and will reach the level of 3-20 percent a year, depending on the segment (Ernst & Young 2004). The value of Russian food market as a whole, including agricultural production, local food processing, imports, and wholesale and retail sale transactions, was estimated to be 130 billion USD in 2003 (Ingredients Russia 2004).

Table 10. Main indicators of the performance of food industry

	2000	2001	2002	2003	2004
Output, bln RUB	527	687	825	994	1 229
Number of acting organizations, thou.	25.4	24.7	24.1	22.1	22.8

Source: Goskomstat 2004, Goskomstat 2005

Table 11 shows the production of the food industry during 1992-2004. Starting in 1992, until 1998 the clearest decrease in production volumes happened in dairy, meat and bakery segments. The clear slowdown can be seen in Figure 8.

Table 11. Production of processed food, thousand tons unless otherwise indicated

	1992	1995	1998	2000	2002	2003	2004	Change 1992- 2004, %
Whole milk dairy products	9 800	5 600	5 600	6 200	7 700	8 500	8 700	-11.2%
Bread and Bakery products	16 800	11 300	8 500	9 000	8 400	8 400	8 100	-51.8%
Granulated sugar	3 923	3 155	4 745	6 077	6 165	5 835	4 852	23.7%
Fish products (canned fish excluded)	2 800	2 200	2 400	2 800	2 700	2 800	2 500	-10.7%
Confectionery	1 829	1 372	1 403	1 628	1 958	2 167	2 240	22.5%
Vegetable oil	994	802	782	1 375	1 197	1 598	1 867	87.8%
Sausages	1 547	1 293	1 087	1 052	1 468	1 700	1 832	18.4%
Meat (including offal)	4 686	2 370	1 315	1 193	1 456	1 677	1 698	-63.8%
Pasta products	1 102	603	554	704	821	874	950	-13.8%
Meat preparations	390	268	219	244	409	599	716	83.6%
Margarine products	560	198	239	462	536	540	561	-
Fat cheeses	299	218	185	221	316	349	352	17.7%
Butter	762	421	276	267	279	285	271	-64.4%
Refined sugar	747	126	100	71	60	70	46	-93.8%
Mineral waters, mln dal	21.6	27.6	51.2	98.5	167	203	207	858.3%
Canned products, mln standard cans	5 353	2 428	2 282	3 223	5 606	7 204	8 277	54.6%

Source: Goskomstat 2004 & 2005

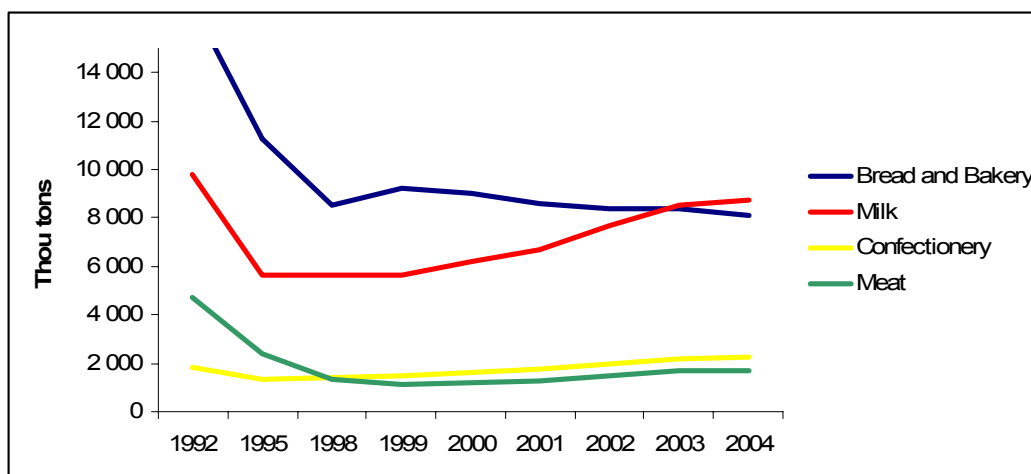


Figure 8. Production of bakery, milk, confectionery and meat products (Goskomstat 2005)

Table 11 covers the production of processed food in the transitional period (1992 was the first post-Soviet year). In very general terms, a declining trend can be observed during this period (1992-2004).

The whole milk dairy product category decreased very rapidly in the early years of the transition, but started to recover in the second half of the 1990s. In the entire period (1992-2004), there is a drop of over 11 percent, but between 1998 and 2004 the branch grew by no less than 55 percent. *The bread and bakery* product segment also decreased rather dramatically in the early transition, but recovered somewhat in the turn of the century. However, this segment has shown no clear dynamism lately. In the whole period under review, the production decreased by over 50 percent. In *granulated sugar* production a recession took place at first, but a rather strong recovery occurred in the turn of the century, but after that, the segment has lost its dynamism. However, this segment shows a growth of about 24 percent in the overall transition period.

The fish product segment was relatively stable in the timeframe under review, with some fluctuations. The overall decline was about 11 percent. *The confectionery* segment suffered a slump first, but experienced a steady growth period from mid-1990s. The overall growth after 1992 was roughly 23 percent. The most substantial growth took place in *vegetable oil* production. Not even this sphere was saved from an early decline, but in the turn of the century a strong boom started. The production almost doubled in the 1992-2004 period.

The sausage segment has a rather similar production cycle with early reduction followed by recovery with a steady growth. However, in this case the overall growth was less than 20 percent. *The meat* segment shows a very strong business cycle. In the 1990s, the production declined to one quarter of the original figure, but started to recover in 2001. In spite of the new dynamism, the overall drop of production since 1992 is rather dramatic, 64 percent.

Pasta production was roughly halved between 1992 and 1998, but has recovered lately. The production in 2004 was about 14 percent lower than in 1992. *The meat preparations* segment has - like the vegetable oil output - experienced a very strong boom, even if there was a slump in the early years of transition. The output growth, which started in the late 1990s, has been permanent and strong. The overall supplement in the period under review was about 84 percent.

Margarine production suffered an extremely severe blow in the early years of transition, obviously partially caused by competition via imports. After the ruble crisis (1998), the segment recovered and reached the level of 1992. *The fat cheeses* segment follows the general pattern of the transitional cycle with a rather deep slump and remarkable recovery. In this sphere, the overall growth rate was 20 percent (1992-2004). *Butter* production virtually collapsed in the 1990s; the output in 2000 was only about one third of the level reached in 1992. In the new century, butter production has been relatively stable on a rather modest level of annual output. The overall decrease in the transitional period, 65 percent, was substantial.

A real collapse can be observed in the output of *refined sugar*; the production went down from 747 000 tons in 1992 to 46 000 tons in 2004. No trend of recovering in this sphere can be traced in the annual figures. Refined sugar is a good example of how the loss of the “bread basket”, i.e. Ukraine, influenced the production of particular agricultural products. An entirely opposite development is visible in the *mineral water* production, which grew by factor 9 in the reviewed period. This segment is in beverages; in the food processing branch vegetable oil is the most dynamic segment.

The canned products segment suffered a very deep drop from 5.4 mln standard cans in 1992 to only 2.3 bln units in 1998, after which a rapid recovery occurred; the production reached 8.3 mln units in 2004, or about 55 percent more than in 1992. This segment grew by factor 3.5 between 1998 and 2004.

According to Ernst & Young (2004) some of the fastest growing segments nowadays are soups, seasonings and dressings, baby and dietary foods, and water and non-alcoholic drinks.

The traditionally strong segments of dairy products, confectionery and snacks will continue to grow, but at a slower pace.

The share of food processing industry of the total industrial output in Russia is between 13-14 percent, which is the biggest share after the fuel industry and machine building. Food processing has been in the third place for more than five years already, thanks to the fast growth after 1998 (Mahlamäki 2005), In St. Petersburg around 33 percent of the industrial output is produced by the food processing sector (Kommersant 2005).

In the future, Russians will gradually switch to more expensive products; the value of sales will increase while the production volume will remain the same. The increasing consumer incomes are forcing producers to put more emphasis on creating and promoting new brands in higher price categories. In recent years, the demand for expensive, high-quality products has increased in all segments of food industry. (Spiridovitsh 2004b)

4.4 Raw material supply

One significant problem in the Russian food processing industry is the availability of raw material, especially finding enough of good raw meat and milk is a problem. This is because of the inefficiency of the agriculture; old production facilities, downgoing of big farms, low quality of fodder, low profits etc. The amount of agricultural production in Russia can be seen in Table 12 and the trend of the most important products in Figure 9. It can be seen that the fluctuations in grain production have been the most severe.

Table 12. Agricultural production in 1992-2004, million tons unless otherwise indicated

	1992	1995	1998	1999	2000	2001	2002	2003	2004	Change 1992- 2004, %
Grain	106.9	63.4	47.9	54.7	65.5	85.2	86.6	67.2	78.1	-26.9%
Potatoes	38.3	39.9	31.4	31.3	34.0	35.0	32.9	36.7	35.9	-6.3%
Milk	47.2	39.2	33.3	32.3	32.3	32.9	33.5	33.4	32.0	-32.3%
Sugar beet	25.5	19.1	10.8	15.2	14.1	14.6	15.7	19.4	21.8	-14.5%
Vegetables	10.0	11.3	10.5	12.3	12.5	13.3	13.0	14.8	14.6	46.0%
Meat (slaughter weight)	8.3	5.8	4.7	4.3	4.3	4.5	4.7	4.9	4.9	-41.0%
Eggs (bln pieces)	42.9	33.8	32.7	33.1	34.1	35.2	36.3	36.5	35.6	-17.0%

Source: Goskomstat 2004 & 2005

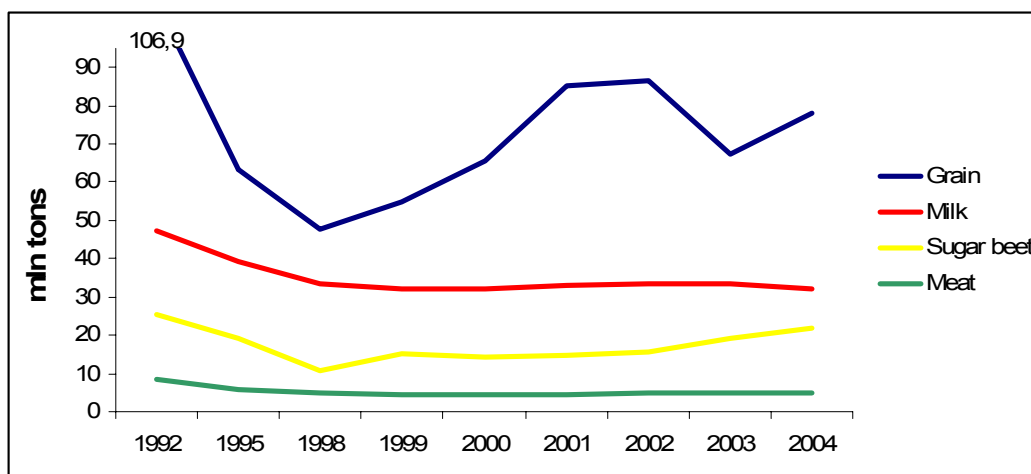


Figure 9. Agricultural production trends (Goskomstat 2005)

As the Soviet Union collapsed, it was commonly assumed that there would be a rapid and dramatic improvement in the Russian rural economy. These expectations were overly optimistic. The output of *grain* decreased rather dramatically in the 1990s, but started to recover essentially in the turn of the century. However, Table 12 above shows that there has been a 27 percent decrease in the transitional period. The annual fluctuations have been rather strong. The output cycles in grain production are obviously evened out by foreign trade; in years of big harvest there is net export of grain, while harvest shortfalls cause net import of grain.

The potato market in transitional Russia has been rather stable; the output has decreased by over 6 percent overall. Annual fluctuations occur, but not in excessive manner. *Milk* production went clearly down in the early period of transition, but stabilization of output on a rather low level took place in the late 1990s. Overall drop of 32 percent is remarkable.

The sugar beet output declined fast in the first years of post-Soviet power. In the 21st century a very clear recovery has taken place, but there was an overall decrease of about 15 percent in 1992-2004. *The vegetable* output shows exceptional development in the table with an overall growth of no less than 46 percent. The growth trend shows signs of deceleration.

The meat output is a negative mirror image of vegetable production; measured by slaughter weight, there is a drop of over 40 percent. In the 1990s, this segment suffered a setback of 4 mln tons in its annual output figure. Some recovery has occurred lately, but the yearly output level is still rather far away from the 1992 achievement. *Egg* production shows a similar cycle with a much more moderate overall decline of 17 percent.

Many companies have reported that raw material resources and specialized ingredients for meat, bakery, confectionery, juice, and dairy processing available in Russia domestically are not sufficient to satisfy the demand, neither now nor in the future. Currently 46 percent of domestic companies get their raw materials from foreign suppliers, and 26 percent market their products through foreign distributors; 27 percent of foreign multinationals in Russia get their raw materials from Russian suppliers, and 53 percent market their products through Russian distributors (Rowe 2005, Ernst & Young 2004).

Currently the situation is the worst in the milk and meat industries. Helanterä (2005) believes that it is even impossible to start a new milk processing company nowadays, since newcomers should collect milk from so many small farms and in such small quantities that it would not be efficient. The fluctuations in milk production are higher in Russia than in countries where agriculture is more developed. This means that during wintertime cows produce less milk, and milk processors may encounter raw material shortages. The shortages are so severe that it is even profitable to import raw milk from other countries. For example Petmol, a big milk processor in St. Petersburg, buys raw milk from the Finnish Valio (Meriläinen 2005). In the bakery sector it is mentioned that the basic raw materials for bread etc. are easily available from Russian suppliers, but when high quality is required it is necessary to use imported materials (Semenova 2005). Meat companies use as much as 80 percent imported raw materials. Local meat production will increase in the future, but the dependence on imports will last for a long time (Häyhä 2005).

4.5 Imports and exports

Russia has been eager to gain self-sufficiency in food production but has managed to do this quite poorly. Because of the lack of raw materials Russia imports a lot of raw meat and meat products, milk products, sugar, and other products. Before the crisis in 1998 the share of imports of food products was quite high. In the end of the 1990s and the beginning of 2000 the Russian food processing sector was sheltered from expensive import products due to the devaluated ruble (IET 2005).

Table 13. Food imports and exports and their share in Russian trade

	1995	1998	1999	2000	2001	2002	2003	2004
Total imports of Russia, bln USD	46.7	43.6	30.3	33.9	41.9	46.2	57.3	75.6
Import of foodstuffs and agricultural raw materials, bln USD	13.1	10.8	8.1	7.4	9.1	10.4	12.1	13.9
The share of food of overall imports	28.1%	24.8%	26.7%	21.8%	21.7%	22.5%	21.1%	18.4%
The share of import from CIS countries of overall imports	29.0%	25.9%	27.7%	34.2%	26.7%	22.0%	22.9%	23.4%
The share of food import from CIS countries	26.7%	20.4%	22.2%	28.4%	20.9%	17.3%	21.5%	25.2%
Total exports from Russia, bln USD	78.2	71.3	73.3	103.1	100.0	106.7	133.7	181.5
Export of foodstuffs and agricultural raw materials, bln USD	1.4	1.5	1.0	1.6	1.9	2.8	3.4	3.3
The share of food export of overall exports	1.8%	2.1%	1.4%	1.5%	1.9%	2.6%	2.5%	1.8%

Source: Goskomstat 2004 & 2005

The import and export structure of food products is summarized in Table 13. These are the registered numbers; the real figures with non-registered trade can be some 10-25 percent higher. In 1997 the registered import of food products was very high, almost 13.5 billion USD. After the crisis the import plunged and were almost only half of the level of 1997. During the last years the food imports has reach the level of pre-crisis and in 2004 they were 13.9 billion USD, about 96 USD per capita. The biggest sources of food imports in 2004 were Brazil, Ukraine, Germany, the USA, and France; they formed more than 40 percent of the total consumer-oriented agriculture import (see Figure 10). The share of Brazil was 13.8 percent, due to meat and sugar import. Import arriving from the USA to Russia (year 2003) was worth 829.5 million USD, and almost 65 percent of this was fowl (Taybakhtina 2004). The food imports from Finland decreased by 9 percent in 2004 and were worth 210 million USD (Tullihallitus 2005).

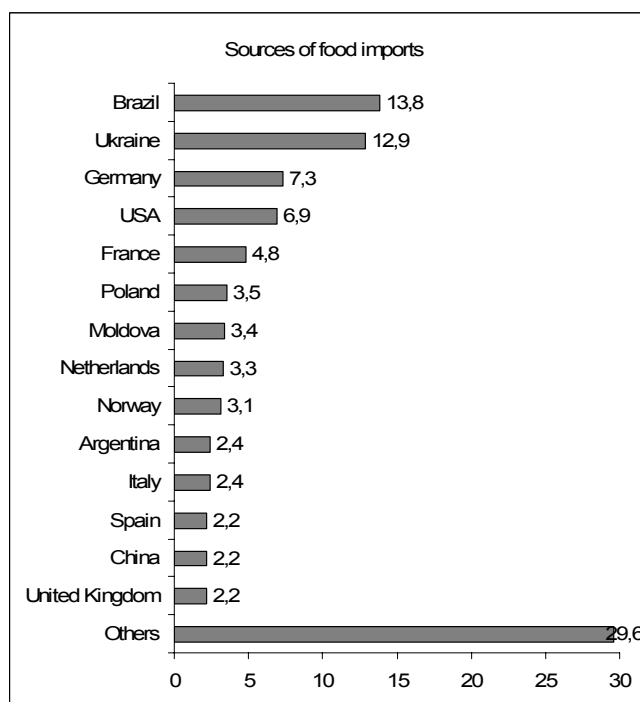


Figure 10. The main sources of Russian food import in 2004 -share of total food import of Russia (UNSD 2005)

The share of food import of total imports has been over 20 percent for many years (see Table 13). This share was on its highest level in the 1990's; in 1995 it was 28.1 percent. After the crisis the share of food products has been a little bit over 20 percent. 2004 was the first year when the share was under one fifth of the imports; 18.4 percent. However, the food import value shows an increasing trend in absolute terms, even if the relative importance is in decline.

Traditionally Russia has been a net importer of food products. Before the 1990s Russia imported meat, milk, and sugar from other Soviet republics. For example, Russia imported 550 000 tons of meat from Soviet republics, of which 190 000 tons from Ukraine. Sugar, mostly from Ukraine, it imported 1.2 million tons, while Russia's own production was only about 3.1 million tons. The amount of milk and milk product imports was 1.9 million tons from inside the Soviet Union and 3.5 million tons from outside the Soviet union. These numbers show the importance of imported food in Russia (Helanterä et al. 2002). After 1990 the share of food import from CIS countries has varied between 17 to 30 percent. When imports from western countries are more expensive, the share of imports from CIS countries increases, although the products in CIS countries are not necessarily cheaper than in the EU or the USA. For example producers in the EU get some subsidies for exporting, and thus the original prices can be significantly low.

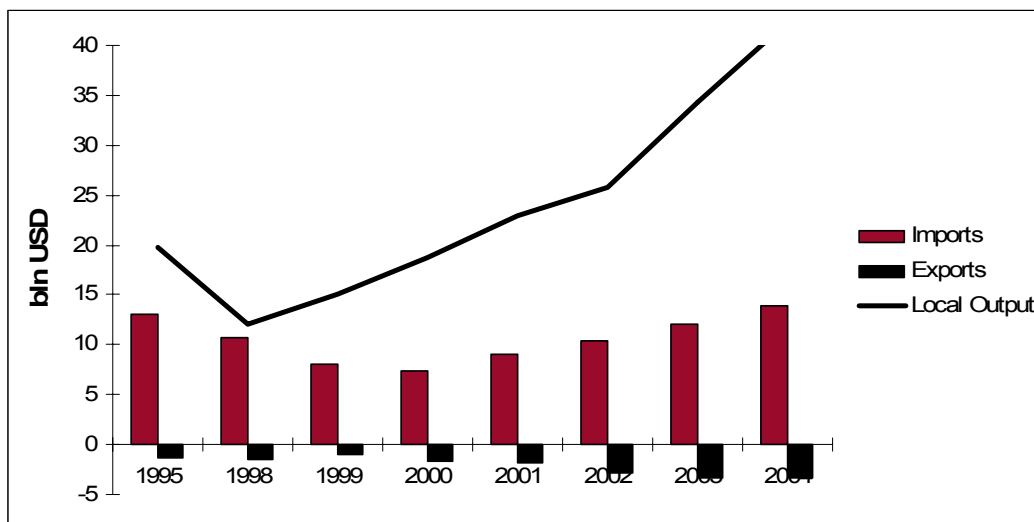


Figure 11. Food imports, exports and local output (Goskomstat 2005)

Figure 11 illustrates the food import and export and the local food output. In 1997 the share of food import was quite high and many people claimed that almost 70 percent of the products in the stores were imported, and thus 70 percent of all food was imported. But it has to be remembered that the total consumption of food not the same as the purchases of food from the stores. The share of food import has only varied between 20 to 30 percent of total imports, which shows that the volume of food import has remained almost the same. It is more important to realize that the value of food import has increased and less of low value food, for example fodder, is imported. In 2003 and 2004 the domestic output of the food processing industry increased noticeably, and the imports increased at a moderate rate, which means that the share of imports was decreasing. In 1997 the food imports consisted mostly of luxury products; people had money to buy them since the exchange rate was quite favorable. (Helanterä et al. 2002)

Table 14 provides information on the Russian import scene in connection with the main food products, covering import volumes (tons) and the relative importance of foreign sources of overall supplies. It can be seen that the amount of food import did not change dramatically during the years 1995-2004. Of course the imports varied a lot depending on the quotas, agricultural production, and harvests in Russia.

Table 14. Import of main food products, thousand tons, and share of import of total supply

	1995	1998	1999	2000	2001	2002	2003	2004	Growth 1998- 2004, %
Milk	6 300 (13%)	4 900 (12%)	4 700 (12%)	4 700 (12%)	4 900 (13%)	5 000 (13%)	5 700 (14%)	5 800 (15%)	18.4%
Grains	2 710 (4%)	1 710 (4%)	6 808 (14%)	4 677 (7%)	1 764 (2%)	1 359 (2%)	1 671 (2%)	2 898 (4%)	69.5%
Fowl	826	843	242	694	1 391	1 383	1 205	1 114	32.1%
Meat	702	733	990	517	873	1 154	1 097	1 031	40.7%
Meat and fowl together	1 528 (25%)	1 576 (29%)	1 232 (29%)	1 211 (30%)	2 264 (35%)	2 537 (34%)	2 302 (30%)	2 145 (32%)	36.1%
Butter, from CIS countries	72	27	25	49	77	43	42	80	196.3%

Source: Goskomstat 2004 & 2005

Milk import decreased in the second half of the 1990s in quantitative terms, but recovered somewhat in 2001-2004; the growth from 1998 to 2004 was over 18 percent. In the same time frame, the share of import of overall milk supply increased from 12 percent to 15 percent.

The importing of *grains* shows very strong fluctuations. In 1998, the volume of import was 1.7 mln tons, which was only 4 percent of the Russian supply. In the following year, the grain import jumped to 6.7 mln tons, the equivalent of 14 percent of local demand. The latest figure (2004) is relatively modest, 2.9 mln tons, or 4 percent of the entire supply. The growth from 1998 to 2004 is rather high, almost 70 percent. However, this figure cannot be taken as a proxy of a strongly increasing trend, because the annual fluctuations are wild.

In *the fowl* import figures, the depreciation crisis (1998) is visible. In the aftermath of the ruble devaluation, the amount of imported fowl in 1999 was less than one third of the 1998 figure. A strong recovery took place in 2000-2001. However, the demand decreased somewhat in 2002-2004. Thus, there is no clearly positive trend visible in the Russian fowl import market, even if the overall growth rate in 1998-2004 was 32 percent.

The import of *meat* shows an increasing trend with fluctuations. The growth between 1998 and 2004 was rather high, 41 percent. *The meat and fowl* imports put together show an interesting picture; the import dependency of Russia in this sphere fluctuates between 25 percent and 35 percent. The import volume has increased but not in a completely linear manner; the overall growth in 1998-2004 was relatively high, 36 percent. Roughly one third

of the meat and fowl demand in Russia is satisfied by importing. Nevertheless, Russia is the biggest importer of meat products in the world in volume. (SVKK 2005)

The butter imported from other CIS-countries has tripled since 1998. This special market in Russian foreign trade shows rather erratic oscillations.

Usually, the food import of Russia has been basic raw materials, for example meat and fruit, as well as highly value added and processed products, for example cheese and butter. It is not profitable to export any semi-processed or low value added products to Russia. The Finnish Valio has succeeded in exporting high value added cheese products and gained a big market share in Russian markets, but only in a very small segment.

The major factors influencing the import of food products to Russia are import quotas, restrictions, and tariffs. Sugar and meat were the primary objects of foreign trade regulation in 2004. Meat import quotas were introduced in January 2003 to protect Russian agri-food producers from steadily growing and unregulated meat import. The quotas stabilized the markets, and diminished the problems with shady import and smuggling. However, the shortcomings of the system are evident. A limited number of large players gain access to the imported meat, which does not motivate to price competition. The biggest share of quotas goes to the EU and the USA where the meat prices are high, when Russian companies are not allowed to import meat from cheaper countries. The quotas, and in addition the availability of domestic raw materials, have caused meat shortages and raised the price of meat. (Borisov 2004b)

The Russian authorities have also been eager to set restrictions for imports of infected or poor quality food products, sometimes without a reason. These restrictions can also be seen as import prohibitive and domestic production -favoring actions. Time to time Russia has set restrictions on meat, cheese, milk or fish import, or somehow introduced demands that are impossible to fulfill, which has caused disagreement between trade partners. For example in June 2004 Russia banned the imports of some milk and meat products from the EU, because it required a single veterinary certificate for all EU countries. Cheese import duties were increased significantly when the Russian Union of livestock breeders lobbied the Russian government to protect their local producers. (Kauppalehti 2004). The Russian government has an ambitious goal to establish self-sufficiency in the production of grain, fodder, poultry, eggs, milk and milk products, vegetables and potatoes by 2010 (Tekoniemi 2003).

4.6 Consumption of food

The success of food processing industry depends heavily on the consumers. The disposable income in Russia is rising, but is the growth fast enough? The Russian retail trade turnover in 2004 was 5 598 billion rubles (193 billion USD) and the share of food products of it was about 46 percent, 2 556 billion rubles (88 billion USD). It is estimated that Russia will be the largest food and grocery market in Europe by 2020. This requires that the Russian market will be worth more than 360 billion USD by that time (CEE-Food Industry 2005b).

According to Goskomstat, the Russians spend 36 percent of their disposable income in foodstuff, and as much as 40 percent when alcoholic beverages are included (see Figure 12 and Table 15). Depending on the research institute, but also on the income bracket, the share of food expenditure varies; usually it is estimated to be between 35 to 75 percent. The share of foodstuff of consumption is still much higher in Russia than in many other European countries. For example in Finland and in the Czech Republic only about 25 percent of spending goes to food and alcoholic beverages (EK 2004, CSU 2005). Back in the 1990s the average share of food expenditure in Russia was even higher than nowadays, sometimes more than 52 percent (Table 15). Poor people were not able to buy anything else than the necessary food. Back then the food prices were high compared to the purchasing power of the consumers, which was and still is weak.

The housing costs in Russia are remarkably low. Only less than one tenth of the average Russian's expenditure goes to housing. The respective figure in the Czech Republic is 20 percent and in Poland 25 percent (CSU 2005). In future the housing costs in Russia will increase. So far most of Russians have lived in flats they own, and thus the housing costs have been minimal. People have had convenient discretionary income, because they have not paid mortgages. In the future, when the municipal housing blocks deteriorate and more Western style blocks are built, the Russians will have to take mortgages. Thus, the cost of housing will increase. Simultaneously the cost of fuel, energy and electricity will increase, when the dual pricing of energy will be abolished. As a consequence the expenditure on food, clothing and leisure will decrease (in relative terms), when the expenditure on housing and transportation will increase.

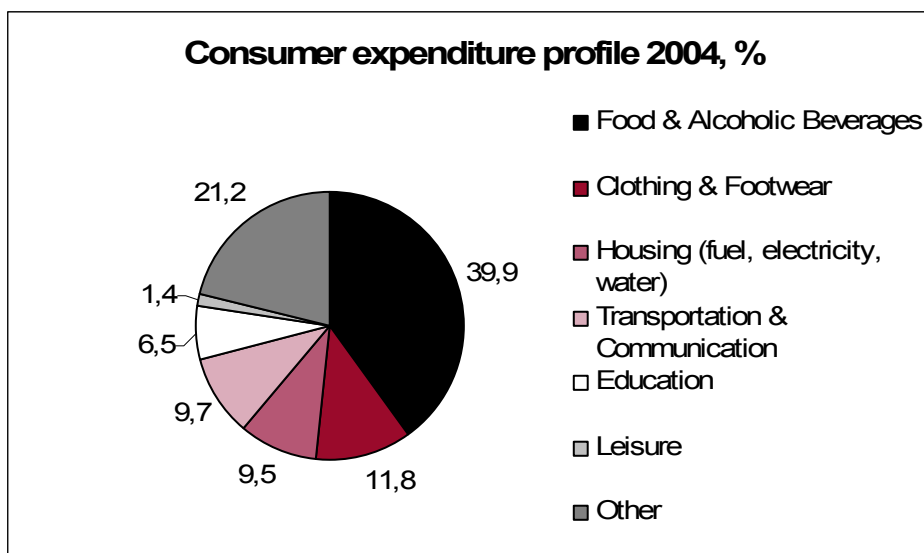


Figure 12. Russian consumer expenditure profile 2004 (Renaissance Capital 2004)

According to Katchalov & Partners (for reference see Spiridovitch 2004a) the Russians use approximately 70 USD monthly on food supplies, and in Moscow the figure is 200 USD. It is estimated that the average monthly spending will be 130 USD in 2012. Ten years ago it was only 20-30 USD per person. Eventually the growth will decelerate after 2020 and finally reach the level of 240-280 USD in Russia, and 350 USD in Moscow.

Table 15 shows that consumers in Russia spend most of their disposable income on meat products, 10.5 percent, and bread and bakery products, 6.5 percent. Even though bread and bakery products are in general quite cheap, they are an essential part of the diet in Russia. The expenditure in sugar and confectionery used to be much higher in 1990s, nowadays only 2.7 percent of disposable income is spent on these products. Probably the reason for this is the bigger variety and competition in snack food, candy, chocolate and confectionery sectors, and a healthier diet.

Table 15. Consumer expenditure of households, percent of total consumption

	1995	1998	1999	2000	2001	2002	2003	2004	Change 1995- 2004, %
Foodstuff	49.0	51.3	52.0	47.6	45.9	41.7	37.7	36.0	-26.5%
-Meat and meat products	13.2	14.2	13.6	13.1	13.3	12.5	10.9	10.5	-20.5%
-Bread and bakery products	8.2	8.2	8.6	8.1	8.5	7.1	6.5	6.5	-20.7%
-Milk and dairy products	7.4	7.3	7.0	6.4	6.0	5.6	5.1	4.9	-33.8%
-Sugar and confectionery	6.0	6.0	6.6	5.9	4.4	3.5	3.1	2.7	-55.0%

Source: Goskomstat 2004 & 2005

The food consumption trends vary a lot between the regions and income brackets. In rural areas and poorer regions only necessary food is bought from groceries, and these products are basic foodstuff, because consumers do not have money to buy any luxury products. In bigger cities, where people with higher income live, the consumption of food is more like that in Western Europe. Consumers have a wide variety of high-quality products to choose from and the demand for premium goods is increasing. In general the consumers in Russia appreciate quality, and if needed they are also willing to pay for it. On the other hand they are very price conscious; some of them are ready to travel to the other side of the city to get something cheaper than somewhere else. Russian consumers are not generally regarded as highly loyal to brands, and they are usually eager to try new products, and thus trial purchases are an important part of the sales promotion strategy. It is also believed that Russian consumers are becoming more conscious about their health and are shifting towards nutritious, diet-friendly food products (Ernst & Young 2004). Russians usually prefer local products, because they feel that these products are healthy, less likely to contain preservatives, and better value for money. In the 1990s they used to prefer foreign products, because they were seen as good quality products. This is the reason why for example Wimm Bill Dann has named some of its brands with western names.

In future, when the income of Russians increases, the consumption will shift to more expensive products. Thus the consumption of bread, potatoes, pasta etc. will decrease and the consumption of good quality meat and fish products, and processed milk products will increase (see Table 16). This trend will only happen in bigger cities and regional centers, where the purchasing power is strong. About 60 percent of Russians are poor, and can not afford more than basic food supplies.

Table 16. Future development of food markets in Russia

	2003	2004	2005	2006	2007	2008
Consumption of food and alcohol, share of total expenditure %	49.4	48.6	47.7	47.0	46.2	45.6
<u>Consumption, kg per capita</u>						
Meat	49.2	51.5	52.7	54.1	55.7	57.2
Milk	155.7	159.8	163.2	166.1	169.2	172.2
Fruit	41.9	43.0	43.9	44.7	45.5	46.2
Vegetables	94.7	96.5	97.9	99.2	100.6	101.9
Sweets (sales in tons)	2 147.0	2 210.0	2 272.0	2 343.0	2 415.0	2 485.0

Source: Economist Intelligence Unit (for reference see Spiridovitch 2004a)

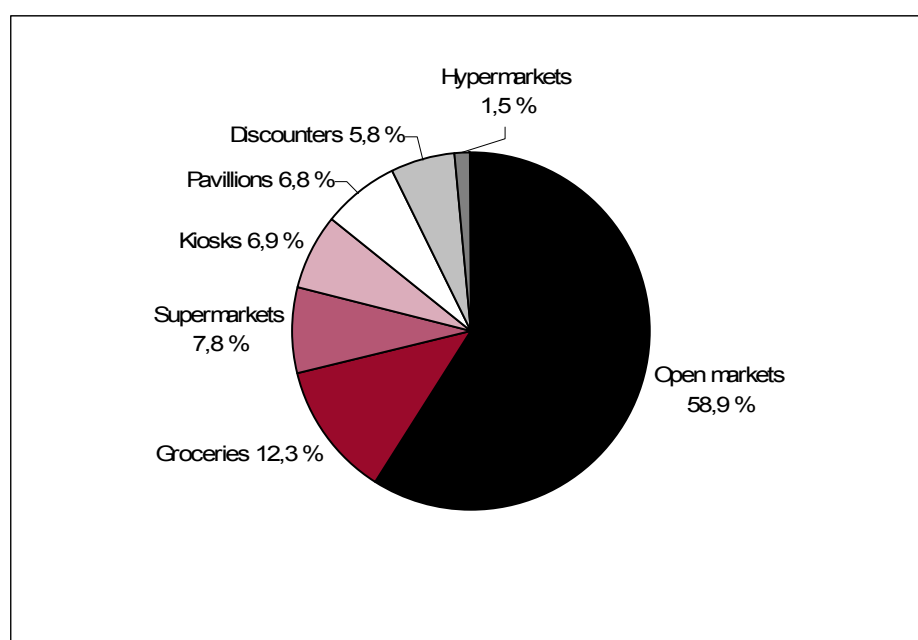


Figure 13. Retail trade by outlet type in biggest cities in 2003 (Louhivuori 2006)

In 2003 over half of the retail trade still took place in open markets, such as the above mentioned “kolkhoz markets” (see Figure 13). The share of modern retail formats, like hypermarkets and supermarkets, was less significant. This share is growing at a fast pace, and within a few years modern retailing will be in a dominant position.

4.7 Food safety and counterfeit products

It is claimed that one fifth of the food products in Russia are counterfeited and the volume of fake products continues to grow. There are claims that fake food and drink products cover over 90 percent of the market in some segments. For example the Russian Agency for Health

and Consumer Rights claims that around 75 percent of the mineral water sold in Russia is thought to be fake. Condensed milk products, baby food and canned fish are often fakes. Poor or missing labeling is another problem, 30 to 40 percent of product labels do not accurately describe the contents. For example United Confectionery, a big confectionery group, established common labeling for all of the similar products produced in various factories to avoid the copying of their products (CEE-Food Industry 2005a). Fake products are not necessarily harmful for health. The quality of the food in outdoor markets and sidewalk vendors often seems to be questionable. Food inspectors have chased down radioactive berries, contaminated meat and vegetables with high levels of nitrates; they say that infectious diseases and hormones are found more often in imports than in domestic products (Lupher 2005). This just means that in Russia the food inspection system and food safety standards need to be developed to ensure the quality of food in every market place. Also the government needs to make an effort to cut down the number of counterfeit products to protect consumers from inauthentic and hazardous products. (Ernst & Young 2004)

4.8 Investment issues

In the early period of the Russian transition, the overall investment decreased rapidly. At the same time, capital flight in various forms took place in a massive scale. In certain core activities, like in extractive industries and financial intermediation, awkward administrative rules were created, in order to hinder foreign capital to get a dominant position.

The situation in many other post-communist countries was fundamentally different. Foreign capital, especially in the form of foreign direct investments (FDI) was appreciated in the Baltic States and in Central Eastern Europe. New technology and management know-how started to flow from the West in the FDI framework. Certain incentives, for example, tax holiday schemes were created to advance FDI inflow. The results have been strikingly positive (see below).

It is surprising that the big bulk of FDI in the European transitional economies has been invested in the service sector, even if it was rather commonly anticipated that the cheap labor in TEs would attract FDI in various manufacturing branches. Western telecom operators have invested huge sums in TEs creating new cell-phone networks. Big money has flown from the West to acquire a dominant position in TE banking business. Foreign hotels and restaurants are very visible in the TE-region. Western retailers started large scale invasion in several TEs already in the 1990s.

In this post-communist FDI game, Russia is a “latecomer”. It has been often pointed out that in the 1990s the Russian capital was reluctant to take a local risk, and thus taking the Russian risk was avoided by many Western companies. International oil companies with high risk-taking capacity were forced to limit their stakes in Russian oil and natural gas business.

In the turn of the century, the Russian investment scene changed fundamentally. The ruble depreciation of 1998 made investment in Russia feasible. The substantial hike of the oil world market price in 2000 enhanced the cash flow in extractive branches, creating local funds available for investment. Repatriation of flight capital started, which is visible in FDI statistics: Cyprus, Virgin Islands etc. are present in Russian FDI figures as investing countries.

In this context, the so called “Yukos affair” is worth mentioning. In the early years of the 21st century the biggest Russian oil company was rearranged, which gave a signal to the international business community: the dominance of foreign companies in Russian extracting activities is not necessarily appreciated.

These background factors must be taken into consideration when the foreign involvement in the food processing in Russia is assessed. Obviously, the food processing branch does not involve as much emotional aspects as oil extraction and financial institutions, and thus the development of that branch by foreign investors is easily accepted. The relative importance of the food processing industry in FDI statistics in the early period of Russian transition is understandable.

In the Soviet period, milk and beer were not pasteurized in Russia. Therefore, new technology in these spheres was urgently needed. Furthermore, many Western products, like Coca-Cola, were known in Russia. Customers had a “bent-up demand” for products they knew by name, but not by taste. Customers were waiting for local supply to emerge.

In the mid-1990s, FDI in the Russian food industry started gaining substance. In 1995, there were two big investment projects: the Mars factory at Stupino (Moscow region) and Coca-Cola plant in Stavropol (Krasnodar region) with a total value of 150 million USD (Dyker 1999). In that year, the total food processing FDI flow was 250 million USD (see Figure 14). This figure more than doubled in 1996, but experienced a decline in 1997. In the year of the ruble crisis (1998), the equivalent figure was more than doubled from 506 million USD to no less than 1 192 million USD. After this peak, a declining trend can be observed in 1999-2003: the annual figure in 2003 was only 345 million USD, according to Goskomstat data.

In the last years of the 1990s, industry dominated the inward FDI scene in Russia with an about 60 percent share of the total FDI inflow. In the early years of the new century, the equivalent figure has been about 40-50 percent.

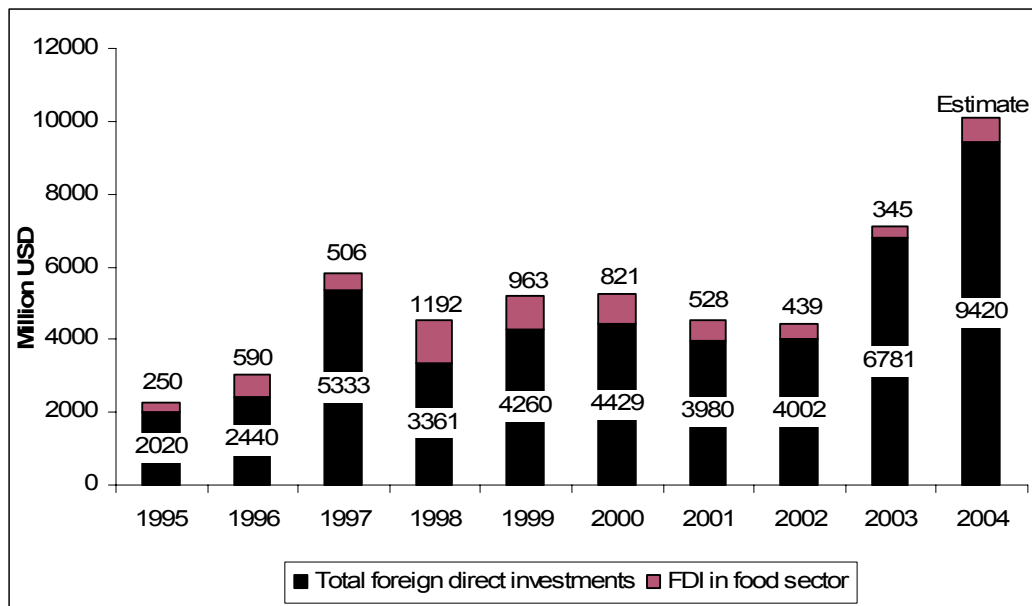


Figure 14. Annual flow of foreign direct investments total in Russia and in the food sector in 1995-2004 (Goskomstat 2001, Goskomstat 2004b)

In 1998, the food industry had a predominant position in the Russian FDI inflow: more than one third of the overall foreign direct investment took place in that branch (see Table 17). In the following year, the leading position belonged to fuel industry with almost 28 percent of the FDI total value, while the food processing branch was second with 22.6 percent.

In the early years of the new century, food processing lost ground permanently in this relative comparison. In 2000, the food industry still had a rather high marking with 18.5 percent, but in 2003 the equivalent figure was only just over 5 percent. The fuel industry is clearly a dominant field in attracting FDI.

In sum, there was a strong FDI boom in the Russian food sector in the turn of the century, followed by an absolute and relative decline. However, it cannot be assumed that the branch has reached the final phase of restructuring. The food industry still has plenty of growth potential offering good investment options for local and foreign companies. It is likely that foreign competitors will have profitable possibilities in both acquisition and greenfield modes of operations.

Table 17. Foreign direct investments in Russia 1998-2003, share of industrial branches %

	1998	1999	2000	2001	2002	2003
Industry, of which	59.2	61.1	41.6	44.0	48.3	50.4
Fuel Industry	9.1	27.8	10.0	10.7	16.6	27.9
Food Industry	35.5	22.6	18.5	13.3	11.0	5.1
Machine Building and Metal Working	3.8	3.0	5.2	7.9	6.5	4.8
Logging, Wood and Pulp	3.3	3.3	3.2	3.3	3.3	4.6
Chemical and Petrochemical Industry	1.5	0.5	1.1	2.2	2.6	1.4
Building Materials Industry	0.7	0.6	0.6	1.1	1.2	1.3
Ferrous Metallurgy	1.2	1.3	0.9	2.9	0.5	1.2
Non-Ferrous Metallurgy	1.7	0.4	0.7	0.5	1.6	0.7

Source: Goskomstat

According to a survey made by Ernst & Young (2004), the local investment level will be high in the food processing sector over the next three-year period. Of the survey respondents, foreign multinational companies are planning to invest approximately 85 million USD each to implement their expansion plans. Russian companies are planning to invest 30 million USD per company. The investments are mostly needed to improve the capital assets, i.e. production facilities and outdated equipment, and to increase the production capacity. Financing is also needed for marketing, advertising campaigns and research and development.

Due to heavy investments, some foreign multinational companies are now market leaders or major players in the food processing sector, e.g. in non-alcoholic drinks, bottled water and confectionery. Russia's domestic players consist of many medium- and small-sized companies. Large domestic companies dominate the juice, meat and vodka markets, whereas other segments (e.g. bakery, dairy, and cereals) remain relatively fragmented (Ernst & Young 2004). In Table 18 there is a list of the biggest food processing companies in Russia; this is a ranking made by the Expert-RA rating agency. This gives an idea of the size of the food processing companies, although the list is not complete. The biggest food processing company is the local Wimm-Bill-Dann, in the 48th place with reported sales of 1 189 million USD, and the major shareholders of the company are Russians. Baltika is the second biggest in the 58th place with sales of 994 million USD. Baltika can be considered to be a foreign-owned company because it is 78 percent owned by Baltic Beverages Holding (a joint venture between Scottish & Newcastle and Carlsberg). Among the 20 biggest companies there are equally both foreign and local companies; a little bit more than half of the top 20 companies are partly foreign owned, and 61 percent of the net sales are covered by these companies. In 2004 the food retail turnover was about 89 billion USD (Goskomstat 2005) and in 2003 it was

about 69 billion USD. Comparing to this, it can be noticed that ten biggest food processing companies compose more than 8 percent of the total food retail turnover.

Table 18. Russian food processing companies, ranking of 400 companies

	Company	Sector	Foreign major ownership	Rank among 400 companies	Net Sales 2004, mln USD
1	Wimm-Bill-Dann	Dairy, Juice	No	48	1 189.3
2	Baltika Brewery	Beer	Yes	58	994.0
3	Sun Interbrew	Beer	Yes	64	859.1
4	Razgulyai-Ukrros Holding	e.g. Sugar, grain	No	84	700.0
5	United Confectionery	Confectionery, Snack Food	Yes	100	571.9
6	Mars	Chocolate, Snack Food	Yes	101	570.8
7	Cherkizovsky	Meat	No	111	524.6
8	Group Tsaritsino	Meat	No	130	444.0
9	Coca Cola	Soft Drinks	Yes	134	434.1
10	Sunny Food	e.g. Mayonnaise	No	165	383.3
11	Lebedjanski	Juice	No	169	376.0
12	Odjedinennaja prodovolstvennaja kompanija		No	173	371.7
13	Aladushkin Group	e.g. Grain, meat	No	185	353.0
14	Transmark	Beer	Yes	195	338.9
15	Mikoyansk	Meat	No	197	335.9
16	Multon	Juice	Yes	200	333.3
17	Ochakovo	e.g. Beer	Yes	201	331.9
18	Moskva-Efes	Beer	Yes	211	312.7
19	Kraft Foods	Snack Food, Chocolate	Yes	233	273.8
20	Danone	Dairy	Yes	236	265.7
...					
	Rossija (Nestle)	Confectionery	Yes	248	248.1

Source: Expert-RA 2005

Some of the local companies are already looking for new markets from abroad. The most ambitious is Wimm-Bill-Dann, already operating in the CIS countries, and now trying to start exporting to the EU and the USA. It was already awarded an EU export certificate for its primary facility in Moscow (Dairy Industries International 2004). Significant numbers of Russian players are seeking foreign partnership to expand outside the country, or at least foreign distributors to market their products abroad.

Meanwhile, in the Russian markets the competition will get harder and the retailers will collect more profits, and thus some domestic and global players will be forced to consolidate

to sustain growth and remain profitable. One evidence of the ongoing consolidation process is the decreasing number of acting companies. As mentioned above (see Table 10) the number of food processing organizations decreased from nearly 25 500 in 2000 to 22 800 in 2004. Especially in the bakery and dairy segments, the players are planning to either merge with or acquire a competitor, because these segments are very fragmented, except for one or two major players. Successful market leaders are the ones who are focused on consolidation and expanding outside the most popular cities; St. Petersburg and Moscow. For Russian companies one of the main ways to gain access to foreign capital is to create a joint venture with a foreign company. Russian companies also seek for foreign partners to benefit from their business and management experience, industry knowledge or technical expertise. Foreign companies are looking for Russian partners to gain access to business alliances with local suppliers and retailers and to gain from the knowledge of the regulatory and political environment and already established personal networks. The consolidation process is sometimes hard; foreign companies are very cautious when looking for a new partner and contrary to the business culture in Russia, they work in a western way and require a detailed description of the partners' ownership structure, business plans and financial statements (Ernst & Young 2004).

5. WTO

The World Trade Organization (WTO) is an international organization dealing with the global rules of trade between nations. WTO was established in 1995, when it replaced GATT (General Agreement on Trade and Tariff). The purpose of WTO is to ensure that the global trade is smooth, free and predictable. All the decisions are made by consensus; top decisions are made in the Ministerial Committee which holds meetings every two years. The accession process is rather complicated; the country has to go through a series of multilateral and bilateral negotiations with the established Working Party and member countries and agree the terms and conditions. The WTO membership involves both rights and obligations and is best illustrated by its three main principles; nondiscrimination, reciprocity, and transparency. WTO members operate on a non-discriminatory basis; each country receives guarantees that its exports will be treated fairly and consistently in other countries' markets. They promise to do the same for imports into their own market. WTO applies also the most-favored nation principle, which requires that when a nation grants a trade privilege to one country it must grant the same privilege to all WTO members. Reciprocity, on the other hand, means that if a country receives trade concessions from another country they should offer something comparable in return. It is also expected that nations give equal treatment to foreign imports of goods or services as to domestic goods or services. Tariffs are the most acceptable method of protection since WTO regards tariffs as more transparent devices than non-tariff barriers (quotas or voluntary export restraints). (WTO 2005)

Currently there are 148 members (December 2005) and more than 30 observers, of which some are already in the application process. The members include basically all developed nations such as the EU, the USA, Japan and for example China, who joined in 2001. In addition to China over three quarters of the members are developing or least-developed countries. (WTO 2005)

5.1 Application process

The Russian Federation applied to the World Trade Organization (WTO) in June 1993, when it was still the General Agreement on Trade and Tariff. The objective was to join the organization before the end of the decade (Chowdhury 2003, p.4). A working party, which examines all aspects of the applicant's trade and economic policies, was established, and by early 2002 it had met more than 10 times. However, in late 1990's the Russian government was relatively new and the country was going through various legal and regulatory reforms, and the interest from the Russian side to the application process was rather small. Active

negotiations and discussions started again when the newly elected President Putin and the Minister of Economic Development and Trade German Gref declared the WTO accession as a main plank in the economic program (Hare 2002, p.3).

“Accession to the WTO, in case it takes place in 2006, will provide a most powerful impulse to the rise of the country’s investment appeal and the growth of its economy. It will be a serious contribution to that very redoubling of the GDP that we are talking about” -German Gref

In May 2001, Russia presented a “Review of the Russian Trade Policies” which serves as the basis for the Protocol of Accession. Now the report is reviewed and Russia has started negotiations on the conditions of entry and the required legislative reforms. WTO does not set any timetables or deadlines. The speed of accession depends on the acceding country’s ability to clarify its trade policies and make them consistent with WTO requirements (Hare 2002, p.5). During the first half of 2003 the Russian Federation, with the working party, went through an accelerated negotiation program, and completed five meetings. The 29th meeting of the Working Party was held on 19th October 2005. So far Russia has completed bilateral negotiations on goods with more than 30 WTO members (the European Union is counted as one), which represents over 85 percent of the total Russian foreign trade (Kulikova 2005). Of its biggest trading partners Russia has completed negotiations with the EU countries; Germany, Italy and Netherlands, and with China. The biggest importers, Ukraine and Belarus, are in a similar situation as Russia; they are still in the accession process and thus they are not able to intervene in each others’ processes. Ukraine is proceeding very fast and if it is able to join before Russia, it can have significant advantage over Russia. Russia still has to finalize talks with most of its significant trading partners, for example, the United States, Canada, Australia, and Norway.

The WTO membership requirements, and signing the protocols, were supposed to be completed by the end of 2005. Russia hopes to join formally in 2006, but not at any cost. *“The deadline that we establish for ourselves should not force our hands, should not force us to make compromises we don't want to make”*, Finance Minister Alexei Kudrin said in a meeting of the Group of Eight finance ministers in June 2005. One thing is clear; Russia could not finalize the negotiations before the Hong Kong Ministerial Conference in December 2005. There are still a lot of compromises to do and the process of joining WTO may last till 2008 or even 2010. A number of unsolved issues remain; flight-overs, meat quotas and low-cost energy to domestic producers (and other hidden subsidies), to mention some.

One of the most important achievements during the negotiations has been the Protocol signed between Russia and the EU. The protocol concerns access to the markets of goods and services within the framework of the process of Russia's accession to the WTO. It took more than six years for the Russian and European negotiators to finalize mutually acceptable terms and conditions for Russia's accession to this international economic organization. The protocol will work as an impetus that will advance significantly the completion of the negotiations with other WTO member-states. (Sharonov 2005)

5.2 Benefits of membership

Since Russia has been on the accession process for so many years, the membership, if it eventually happens, will not be any kind of surprise. The membership will not be as significant a milestone as the crisis in 1998 and the collapse of the Soviet Union were (Helanterä 2005). At least the impact on the economy and industry will be somewhat smaller, and even though the membership will bring some desired changes, it will also bring some drawbacks. The accession of transitional economies to the WTO is highly desirable. The accession process moves the country from a past characterized by isolationism or bilateral approaches to trade policy towards fuller integration into the world economic system. For the transitional economies, accession to WTO also means that they will be able to enjoy important benefits which have not been available to them so far (Hare 2002).

The accession to WTO is likely to generate substantial benefits for Russia. Russia is one of the largest applicant countries, and the accession will open markets for Russian exports and increase the trade. The increased trade will benefit the current WTO members and the country itself (Chowdhury 2003). The world's major trading powers also realize the importance of Russia's WTO accession. The WTO membership would foster greater competition among enterprises, increase transparency, attract foreign investment, reduce corruption, and open Russian markets for exporters. (Broadman 2004)

The WTO accession process has, though it is not yet completed, urged Russia to bring out its legislation in conformity with the rules and regulations of WTO (Sharonov 2005). Russia has desired the benefits of membership while being reluctant to contemplate the possible costs in terms of necessary changes to domestic policies, costly industrial restructuring, and possible flood of foreign goods and services entering the Russian market. These changes are sometimes perceived as unwanted external interference in Russian concerns (Hare 2002). Russia will start to realize in practice the advantages of its participation in WTO in connection with provision of equal rights for the Russian exporters in the world market. The

accession to WTO will be a necessary prerequisite for the attraction of foreign direct investments to the renovation and modernization of domestic production facilities, enhancement of the competitiveness of Russian goods and acceleration of rates of structural reorganization of the Russian economy (Sharonov 2005). The WTO membership will mean a further liberalization of Russia's domestic market. The benefits of the Russian WTO membership are presented in Chart 2.

Although it can be shown that the WTO accession will benefit most industries, there are some industries that are likely to lose, such as the car manufacturing industry. Most likely the highly protected domestic sectors that export little are going to lose, and the representatives of these industries are very much against the WTO membership. Many businessmen fear that when the tariff or FDI barriers in their sector will decline, this will impact their sector adversely.

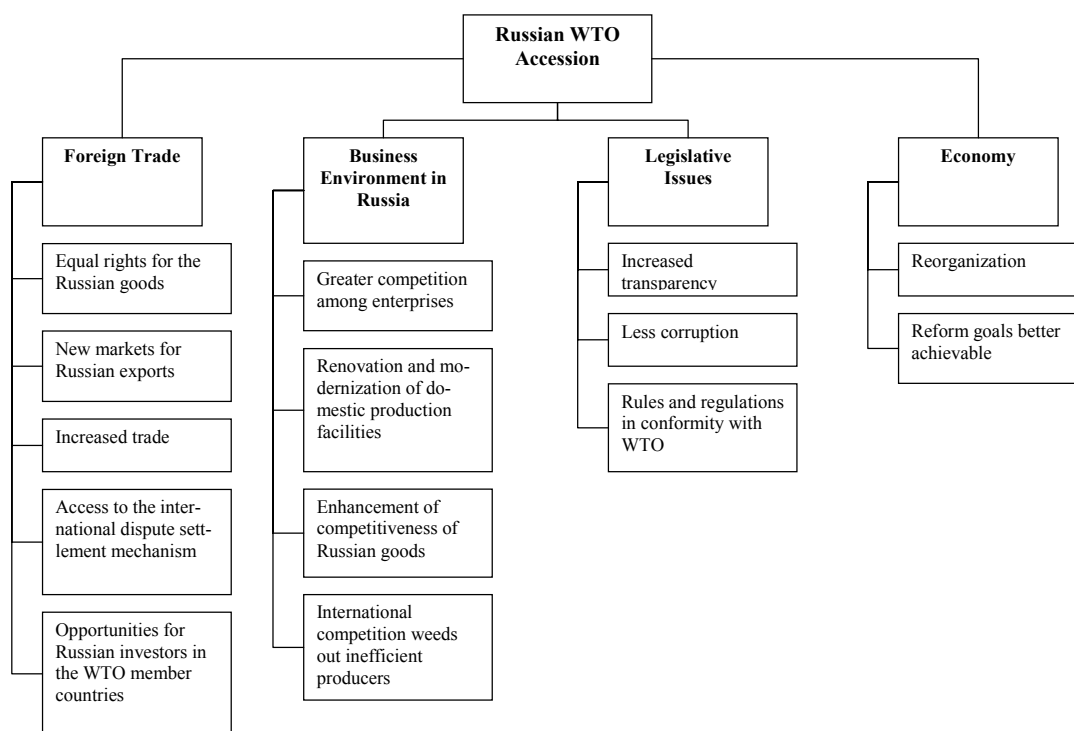


Chart 2. Benefits of Russian WTO membership

5.3 Impact on the Russian agriculture and food processing industry

The WTO membership will have some impact on the agro-industrial sector. The food processing industry will attract a number of foreign investors, and thus the productivity and the competition in the sector will increase. To remain competitive, the food processing

companies will also invest in farms and raw material producers in order to ensure the quality and availability of raw material.

But the agro-industrial sector still remains concerned about the WTO membership. It is estimated that Russia's accession to WTO will reduce its export share in the agricultural products, and increase the imports. Thus Russian farmers will lose a significant amount of money and encounter much fiercer competition in the markets. The agro-industrial sector will become less competitive in global terms. The Russian farms receive big subsidies from the government every year and are dependent on the aid they receive. If the level of subsidies is decreased because of the WTO membership, and the competition increase in the markets, many small farmers in Russia will face difficult times. For meat producers the abolishment of meat-import quotas, and lower tariffs, would mean a reduction in the demand of home-processed meat. (Zubkov, 2005)

The impact on the food processing sector and other industrial sectors, agriculture and the Russian economy in general varies a lot. Some sectors can gain and some will lose. The impacts can be rather many-sided and usually one negative or positive effect leads to another. The following arguments have been provided by Jensen et al. (2003) and Rutherford et al. (2005), and they give an idea of the possible impacts.

Liberalization of the economy. In the WTO accession Russia will gain most from the liberalization of its own economy, not from the actions of other countries. Especially the liberalization of the service sector will attract more FDI; it is expected that foreign direct investments will increase in the telecommunications, banking, insurance and transportation sectors. Also the increased transparency of the economy will attract more FDI. The WTO accession will urge Russia in reforms that it would otherwise not implement. The long term improvement of the investment climate should expand the capital stock. Not only investors but also importers, especially food importers, will gain from the liberalization. The decision making will become more transparent and long-term oriented and arbitrary decisions and actions, such as suddenly required special veterinary certificates, will become less common.

Reduction of Russian tariff barriers. When the tariff barriers are reduced the productivity will increase due to an inflow of imported technology. When Russia reduces its trade barriers also its trade partners will reduce their barriers and Russian exports will be treated fairly in the world markets, and this will increase exports. The higher value of exports will allow Russia to buy more imports. In order to be a

“development miracle” the country has to open its markets. The tariff reduction is often mentioned as a most significant gain of the WTO membership, but it is important only for a few sectors. In general the tariffs are already very reasonable in many product categories in Russia. The tariff reductions will most likely lead to improved allocation of resources in Russia, as the resources will shift to sectors where they are more valued at the world markets. The tariff reduction will reduce the costs of imported intermediate inputs.

Industrial sectors. More sectors will expand than contract, and export-intensive manufacturing sectors are likely to experience the largest expansion. Companies will most likely gain if they are attractive to foreign investors. Openness and trade liberalization will have a strong positive influence on productivity. Sectors that are relatively unprotected compared to other sectors of the economy and sectors that will experience a significant reduction in the cost of their intermediate inputs are likely to expand.

Income and employment. Almost all households will experience some increase in their income; the wage rate of skilled labor will increase more since the industries with large amount of skilled labor will do better. Unfortunately the food industry will not gain, since it is estimated that the highly protected domestic sectors exporting little are likely to lose. The employment will decline in the light industry, food industry, mechanical engineering and metal-working and construction materials. On the other hand, the employment will increase in the export oriented sectors, and thus overall the employment will not change. The gains will only happen in the medium or long term, during the transition period it is possible that many households will lose when they have to find new jobs in different sectors.

Removal of subsidies and dual pricing, and counterfeit products. Currently the domestic energy prices in Russia are lower than the export prices. If Russia has to raise the domestic prices the production costs of industry will increase. Agriculture has received a lot of subsidies, and will be in trouble if the subsidies are diminished together with the energy price increase. Counterfeited products will decrease when the legislative issues in Russia are in conformity with WTO.

Russia will lose if it will not join WTO. As a matter of fact it is estimated that if Russia stays out of WTO but the WTO Doha Agenda, i.e. agricultural reforms, will be implemented in other countries, Russia will lose. These losses will happen because

Russia has to pay higher prices for food imports due to export subsidy removals in importing countries. However, these changes will not happen in near future. The elimination of agricultural product export subsidies in the EU and the USA will happen in 2013 at the earliest. The elimination of domestic agricultural subsidies, which is an even more substantial part than export subsidies, still requires a lot of time and effort and will happen much later.

6. Sectors of food processing industry

This chapter focuses on the most traditional sectors within food processing; milk and meat processing, confectionery manufacturing and bakeries. The milk processing sector is partly consolidated, including big foreign companies. Information on the largest companies is readily available. The meat processing sector is more scattered and only a few foreign companies are operating on this sector. Confectionery manufacturing is led by foreign companies and the sector is highly consolidated. The bakery sector is dominated by a few big companies, but many small bakeries are operating profitably. Exact information on the bakery sector is hard to find, because of the multitude of small units.

6.1 Dairy sector

The consumption of dairy products has traditionally been high in Russia. In recent years the consumption has been booming. Dairy companies have had hard times to meet the growing demand. Successful mid-sized companies are growing by 50-60 percent a year and the overall market growth is around 5-10 percent. The strongest growth happens in the sectors of enriched products, desserts, hard cheese, and baby food, more specifically baby milk formula. The market of long life dairy products is increasing (Borisov 2004a). In 2004 the share of whole milk product sales of the total retail turnover of 193 billion USD was 2 percent; approximately 3.9 billion USD (Goskomstat 2005). In the early period of transition, Russia's output of milk and dairy products declined until 2000 (compared to the 1990s), when the production increased by almost 10 percent (see Table 11). New attractive products have emerged and the quality of milk products has improved.

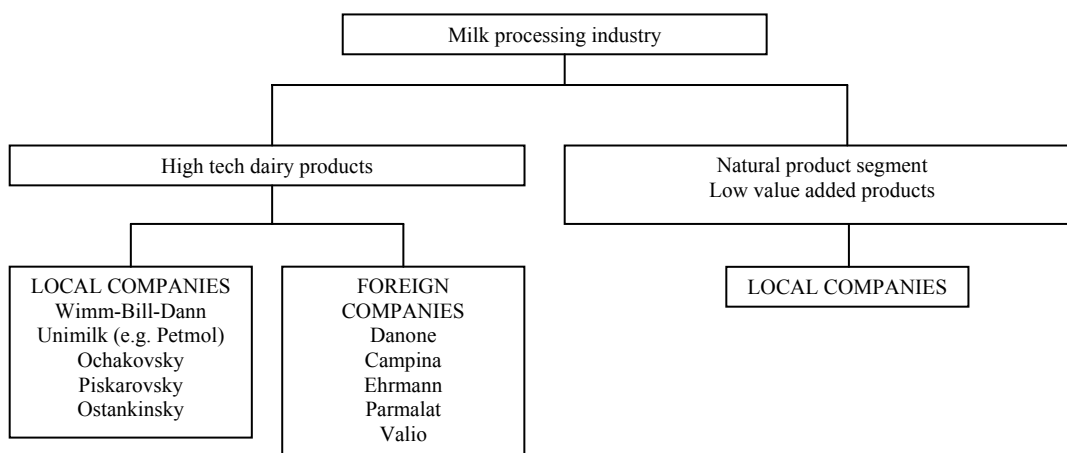


Chart 3. Structure of the milk processing industry

Chart 3 shows the structure of the milk processing industry, including the biggest companies. Currently there are over 1700 dairy processors in Russia, ranging from small local operators to large national and multinational firms. The dairy industry is regionally fragmented, although there are some big enterprises or groups operating all over the country. The largest players are the local Wimm-Bill-Dann, the German Ehrmann, French Danone, Dutch Campina, and Petmol owned by the Russian Unimilk. A dozen of large players control more than half of the market. The dominance of large players is not as strong as in Western Europe. For example in Holland and Sweden two or three of the biggest companies dominate 80-90 percent of the markets. Consolidation is likely to take place in Russia. However, Russia is a big country, with a low population density and a weak retail network. Therefore, local production with local brands is likely to continue, even if the nationally operating giants dominate the scene. (Diosi 2003)

It is essential to divide the Russian dairy industry to two segments when evaluating the success and size of the companies. The first segment is the *“high-tech” dairy product segment* with Western technology, and the second one is the *natural product segment* with traditional Russian technologies. In the first segment large domestic and multinational players dominate, as mentioned in the previous paragraph. Their products are mostly positioned in the mid-priced to expensive market segments, such as milk drinks, yoghurt, desserts, and enriched products. This kind of products require high-tech machinery as they are more difficult to produce, but generate the highest profits. The more affordable segments are in smaller regional companies' interests. They do not have expensive Western equipment as their resources are limited. These companies focus on simple, natural products, such as generic milk, kefir, cheese and butter without brands. (Borisov 2004a)

In the natural product segment the companies can not compete with big advertisement campaigns or innovative quality products because their financial resources are limited. They compete rather with production costs, pricing, flexible deliveries, private label products, good reputation among consumers, and interestingly enough with package design, which is sometimes even better than that of market leaders. They find customers only on local markets and their production volumes vary seasonally, due to the fluctuations on milk supply. Small and medium sized regional companies do not have any chance to compete with national and multinational companies. Yoghurt, milk drinks and desserts are very profitable and attractive products but require high tech production equipment, and thus regional producers are not able to compete in this sector. Many of these regional companies survive only because of the support from the regional government. However, some of these companies have been very successful during the recent years in regional markets, gaining leading positions locally. The

reason for the success has been the improvement in hygiene and the shelf life of natural milk products. Small units have found market niches, in which it is not necessary to compete with Wimm-Bill-Dann or other big companies. (Borisov 2004a, Obuhova 2004)

In the “high-tech” dairy segment the competition is fierce. From the international point of view yoghurt, enriched milk products, milk drinks and cheese products are the most interesting segments of the milk processing industry. Everyone can process generic milk but cultured products are something else. In recent years the largest players have reshaped the industry and brought it into a new and more efficient manufacturing era. The Russian dairy sector is considered to be the most innovative within the country’s food industry.

6.1.1 Competition in the dairy industry

The overall share of international dairy products in Russia is about 18-19 percent. In the thick yoghurt segment the international brands accounted for 67.4 percent in 2002, in dairy dessert segment the international share was 42.2 percent, and in butter and margarine 34 percent. The segments of ryazhenka and chocolate-coated cheese remained untouched by international producers and in other product groups the share remained below 8 percent. It is estimated that the leading international players, Campina, Danone and Ehrmann, together supply more than 65 percent of the thick yoghurts in Russia (Razova 2003). The market shares of companies are listed in Table 19.

Wimm-Bill-Dann (WBD), founded in Russia in 1992, is the market leader in the dairy industry. Its sales in 2004 were 1.2 billion USD, of which 71 percent came from the sales of dairy products and 29 percent from juice products. WBD controlled about 37.7 percent of the packaged dairy products market in Russia in 2004. In the Moscow market the dominance of WBD was even higher; 59 percent in 2003. Wimm-Bill-Dann is known for its high investment rate and interest in acquisitions. Recently WBD has invested in bottled water producing facilities, milk farms in South and North West Russia and in a dairy producer in Uzbekistan. WBD has been eager to expand abroad, especially in CIS-countries. WBD is one of the few Russian companies listed in the New York stock exchange.

In the beginning of the 21st century, oil and mining companies, as well as the banking sector got interested in the agriculture and food processing industry, following the demand of the government to increase investments in one of Russia’s most troubled industries. The consequences were quite predictable when various companies with almost unlimited financial resources entered the market. The values of agricultural assets increased as holdings were

competing fiercely of the acquisition of the most interesting producers. One such holding is the Planeta Group, which is controlled by Millhouse Capital, an investment group set up by shareholders of the oil company Sibneft. Planeta concentrates mostly on milk and meat processing, as well as retailing. Planeta's milk processing branch is called Unimilk, which was set up to challenge the leading position of Wimm-Bill-Dann. Other holdings are for example Agros, Stoilenskaya Niva and Rusagrocapital. (Dobrov 2004)

In the milk and kefir segment the main competitor of WBD is Unimilk, thanks to the huge investment potential. Unimilk was founded in 2002 when nine dairy businesses in Russia and Ukraine merged; currently Unimilk has at least 12 factories. Unimilk integrates quite big regional milk processing enterprises, such as Petmol, LipetskMoloko, Samaralacto and Milko. Petmol, the largest factory in the Unimilk group, is the largest dairy producer in Northwestern Russia. Petmol's operations cover mostly this region; in St. Petersburg its market share is over 40 percent but on the national level the market share is only 4-5 percent. Of its total output Petmol supplies about 88 percent to the St. Petersburg region. (Petmol 2005, Dairy Industry International 2004)

Danone, the world's second biggest dairy producer, with French origin, has been producing yoghurt in Russia since 1995 in its Togliatti plant in the Volga district. It has established another plant in Chekhov, Moscow region. The total Russian investment by Danone in the dairy sector exceeds 150 million USD, when its greenfield investments and the purchases of WBD shares are added together. Danone also operates in the confectionery sector in Russia under the name of Bolshevik. The market share of Danone in the yoghurt market is approximately 15.5 percent, in the cottage cheese market 7 percent and in the dairy-based desserts segment 5.5 percent. (Dairy Industry International 2004)

The German Ehrmann opened its first plant in Russia near Moscow in 2000, but the operations in Russia started already in 1995. It is estimated that Ehrmann's market share is about 11 percent of all yoghurts sold in Russia (Dairy Industry International 2004). Ehrmann has invested at least 100 million USD in the dairy sector in Russia. The third of the big foreign dairy companies in Russia is the Netherlands-based Campina. Campina's most popular brand in Russia is "Fruttis", which at some point held the number two market position in the yoghurt segment. Campina's production plant is located close to Moscow in Stupino. The investment in this plant is at least 50 million USD (Dairy Industry International 2004). The Italian company Parmalat produces milk in one of its three plants in Russia. The recent bankruptcy of the Italian parent company has complicated the operations in Russia and Parmalat may end up in a situation where it is forced to sell off its profitable business and pull

out of Russia. An extensive list of the most important milk processing factories in Russia can be found in Appendix 1, where the information has been collected from various sources. The list contains information of the production facilities and capacity, as well as turnover.

Table 19. Market share of dairy companies in Russia, different segments and regions

Company	Market Share				
	Russia	Moscow	St. Petersburg	Yoghurt Russia	Yoghurt St. Petersburg
Wimm-Bill-Dann	36%	59%			18%
International Brands	20%			65%	
Petmol	7%		40%		29%
Ochakovsky	6%	11%			
Piskaryovsky	5%		20-28%		
Danone	4%	5%		16%	14%
Ostankinsky	3%	5%			
Campina	2%				
Parmalat	1%				
Ehrmann	1%			11%	

Source: Various articles, own calculations

Consolidation has been characteristic for the milk processing industry recently. Wimm-Bill-Dann and Unimilk are actively looking for acquisition options among regional processing plants, and also Lebedyansky, a juice producer, is planning to enter the dairy product market via acquisitions. All of them are planning to buy at least three or four regional dairies. Smaller companies are also consolidating by mergers. Danone has obviously tried to get a dominant stake at WBD, but has not been able to reach this aim. Currently Danone owns about 8-10 percent of Wimm-Bill-Dann shares.

6.1.2 Market of dairy products

In the 1990s, about 55.7 million tons of milk was produced in Russia annually. Thus, the per capita production was 376 kg a year. This sounds rather astonishing. It has to be taken into account that the inefficient production process is not able to utilize all raw materials. The reliability of the statistics can be challenged. Presently there are about 12 million cows producing 32 million tons of milk a year. Thus, the per capita consumption of milk is around 220 kg a year. The consumption of milk is less than the average in Europe. Thus, it can be assumed that it will grow in the future as consumption of milk is very traditional in Russia compared, for example, to Asian countries (Goskomstat 2005, Chehovskaya 2003). The share of unprocessed milk compared to processed milk products can be significant. It is estimated

that almost half of the production is sold and consumed unprocessed. This means that people buy raw milk from farms and open markets (Helanterä 2005, 1998).

Dairies are dependent on their local milk suppliers. Milk is supplied to dairy plants by farming companies, state farms and dairy farms, most of which struggle for survival. Farms are unable to provide dairy processors with a sufficient volume of raw material. Private family-owned farms sell their production to friends and in the open markets, unprocessed. The competition over quality milk supplies is quite high among processors. Dairy companies constantly try to make exclusive, long term agreements with the surviving farms to ensure the availability of raw material. Farms are eager to set up cooperative agreements through which dairy processors assist their suppliers, for example, with investments and fodder. Without external financial support farmers can not develop their business. In the dairy sector the highest profit goes to retail stores, while dairy farms get the lowest profit or no profit at all. Grocery stores sell 55 percent of dairy products calculated in value (not on volume) basis, kiosks and pavilions only 1 percent. (Obuhova 2004, Chehovskaya 2003)

The import of dairy products has been decreasing. For example the import of milk and cream in 2004 was only 16 percent of the import in 2000 measured in quantity. However, the trade value of the milk and cream import was still 47 percent of the level in four years earlier. The greater value of import means that more quality products with high prices have been imported. (UNSD 2005)

6.1.3 Butter and margarine

The domestic production of fats, i.e. full-fat butter, combined butter, and margarine has a decreasing trend. Nowadays the production is only about one third of the level reached in the beginning of the 1990s (see Table 11). In this sphere, the domestic producers include for example Wimm-Bill-Dann and Nizhegorodsky Milk and Fat Company. International producers include Unilever and Raisio. Import plays an important role permanently in this sphere; approximately 120 000 tons of butter is imported to Russia annually (UNSD 2005). The share of import is about 13 percent of the total market volume. In this segment, 89 percent of the import in Russia is full-fat butter products and only 11 percent is margarine and combined butter products. There are about a dozen popular imported margarine brands in Russia from suppliers like New Zealand Dairy Council, Valio and Tulchinsky Creamery in Ukraine (Buyanov 2003).

6.2 Meat markets

Import quotas and the poor condition of local meat production have been hampering the growth of meat markets for almost 15 years. In 1990, the consumption of meat was 75 kg per capita. In 2000 it was only about 45 kg, and presently the annual consumption of meat is 50 kg per capita. Thus, the yearly consumption is 7.3 million tons. The input issue has been one of the most crucial problems Russian meat companies have faced. Russian agricultural producers are unable to provide the meat processing industry with sufficient amount of raw materials. Meat producing farms are unable to enhance their supply under present circumstances of low return on investment. (Gutnik 2003)

Meat import quotas were introduced in 2003. The reason for introducing the quotas was encouraging domestic meat production, but the desired goal was not achieved because the Russian meat producers could not meet the demand. Livestock has a long production cycle, which means that the increase in output can not be rapid. In order to maximize profits at high prices, agricultural producers have rather increased the slaughtering of the livestock than enhanced the amount of cattle. In the middle of 2003, the prices of raw meat and finished meat products in the domestic markets started to grow, which is a natural response of the market to the meat shortage. Russian meat prices increased by 30 percent in 2003 and even doubled in 2004 (see Figure 15). Private farms produce about 45 percent of the total output, which means that this part of the production is used by private families and is not available for the meat processing industry. (IET 2004)

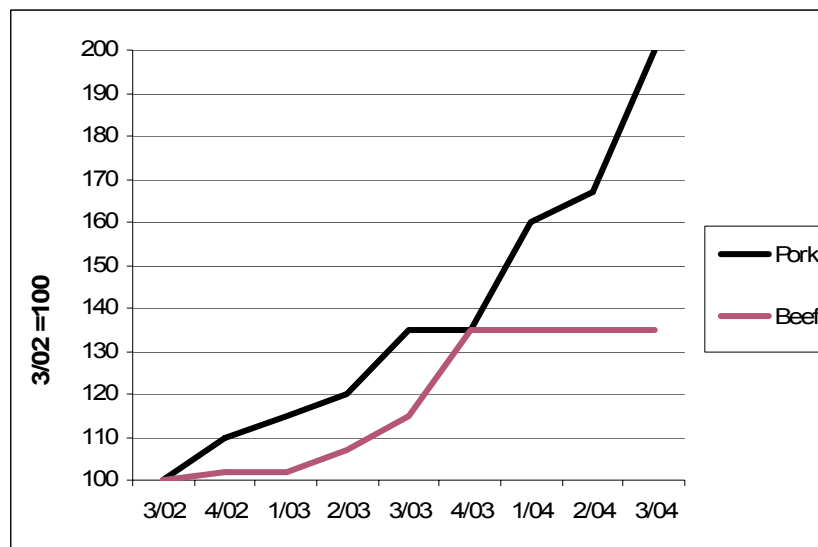


Figure 15. Development of meat prices after the third quarter of 2002 (Borisov 2004)

Not only is the introduction of quotas a problem, but also the unequal distribution of the quotas among the supplying countries. Currently 1.05 million tons of fowl, 450 000 tons of pork and 447 500 tons of beef can be imported annually, but unfortunately the imports have been 10-30 percent below the quota level (Drujinina 2004a). The biggest quota shares for fowl are allocated to the United States (74 percent) and to the EU (18 percent). These quotas are allotted by the Russian Ministry of Trade and Economic Development according to the countries' volume of the previous year's import. Only 10 percent of the quota is sold by auction. This quota system is criticized to be unfair because most of the meat comes from countries where the price of meat is high and overly subsidized. Russian companies are not allowed to purchase cheap meat freely, for example from Latin America (Borisov 2004).

From the point of view of retail turnover the situation does not look that bad. In 2004 of the total retail turnover of 193 billion USD, the share of meat and meat products was 9.8 percent (approximately 19 billion USD), which is at least 3 billion USD bigger than in 2003. (Goskomstat 2005)

6.2.1 Meat production

Currently, when the high prices of beef and pork affect their consumption negatively, consumers are using more product substitutes, such as fish and fowl. It is estimated that in 2005 the per capita fowl consumption in Russia will increase to 17.6 kilos from 16 kilos in 2004. The production of fowl can increase as much as by 20 percent in 2005, while the production of beef and pork is decreasing. The amount of cattle has declined by 10 percent. It remains to be seen how the bird flu will affect the fowl production in Russia. In some regions, for example in Novosibirsk, all poultry has been slaughtered to avoid human contaminations. (Interfax 2005b)

It is estimated that the share of domestic meat will increase only slowly. Approximately 27 percent of the consumed meat is imported. This estimate seems to be too low. Some producers in the European side of Russia use as much as 80 percent of imported meat (Häyhä 2005). The development of the meat and fowl import can be seen in Table 14. After the introduction of meat import quotas in 2003, the import decreased slightly, but has started to grow after that. In the first half of 2005 the meat import from non-CIS countries increased by 20.4 percent compared to the same period in 2004, while meat import from CIS countries dropped by 36.4 percent. In total, Russia imported 421 000 tons of beef and 577 500 tons of pork in the first half of 2005. Pork was only imported from non-CIS countries (Interfax

2005a). With these figures Russia is said to be the biggest meat importer in the world, after Japan. The total production of meat and meat products can be seen in Table 11.

6.2.2 Companies in meat processing

The raw material shortage has given an incentive for Russian meat processing companies to seek vertical co-operation. When raw material forms about 60 percent of the total production costs, the producers are forced to find the most profitable ways to purchase it (Häyhä 2005). Many processors have made supply agreements with farms, or even bought their own farms. Currently the situation in the meat processing sector is confusing. In many companies the lack of investment funds hampers the development only a little. Many companies seem to be on sale, because of fierce competition. Capital injections and better management are needed (Häyhä 2005). At the same time there are new companies emerging, because the market gives very deceptive signals of the current potential; the prices are high and the market is thus attractive. These new companies are very small and usually give up easily when they face difficulties. The meat processing sector is very fragmented. Regional companies have played a more important role than national companies (Borisov 2004). The most important meat processing companies are listed in Appendix 1. Some companies are introduced here. When evaluating the market share of the companies it is important to realize that processed meat accounts for up to a quarter of all the meat consumed in Russia. Thus, companies might have a big market share in the processed meat segment, but the overall market share remains quite insignificant. Compared to the milk processing sector, these companies are rather unsophisticated, and they do not reveal as much information as the dairy companies.

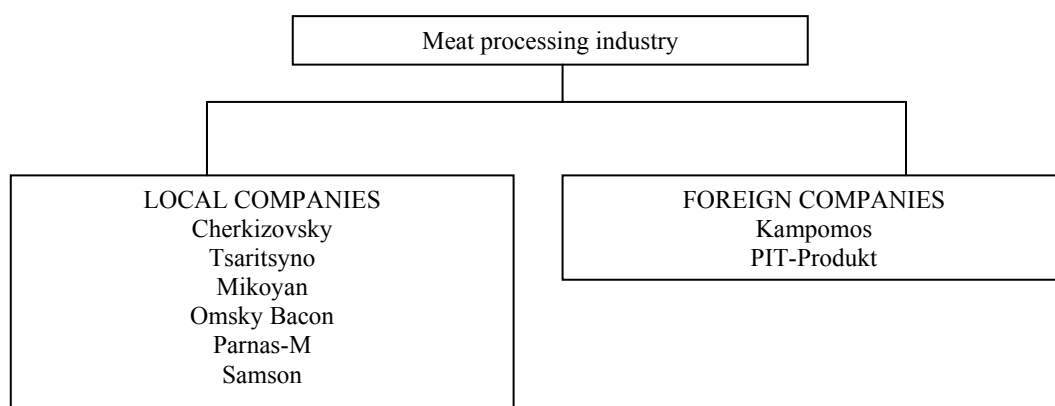


Chart 4. Meat processing companies

Chart 4 presents the most important meat processing enterprises. Cherkizovsky is the biggest meat processing enterprise in Russia, being the seventh biggest food processing company (see

Table 18). It has an about 10-12 percent market share in the processed meat sector. The company produces a full range of processed meats, including more than 300 types of sausages and hams under eight different brands. The holding company of Cherkizovsky, ZAO Ekotorg unites more than 30 meat processing companies located in various Russian regions, for example Moscow, the Rostov oblast, Krasnodar territory and St. Petersburg. Cherkizovsky is a vertically integrated holding, including farms and processing facilities.

Tsaritsyno is one of the biggest competitors of Cherkizovsky in the Moscow area. Tsaritsyno had four meat processing plants in 2002 and it has distribution to more than 300 Russian cities and to other CIS countries. Tsaritsyno is among the top 20 food processors (see Table 18), and so is Mikoyan. Mikoyan is a Moscow-based meat processing company and its market share in the Moscow region is about 6 percent. The Mikoyan brand was re-launched in 2000 and is nowadays owned by Exima, an agricultural conglomerate. Mikoyan products are produced in three factories. Another meat processor owned by a bigger conglomerate is Omsky Bacon, controlled by the Planeta Group. Omsky Bacon is Russia's biggest pig breeder and pork producer. Planeta's other meat processing enterprises include for example Klinsky meat plant. (Sfera 2004)

The largest foreign-owned meat processing company in Russia is Kampomos, a subsidiary of the Spanish Campofrio. The company in Moscow was founded in 1990, and it is one of the top meat processors in Moscow, with a 7 percent market share. Kampomos has two production plants in Moscow. Campofrio has invested more than 85 million USD in Kampomos since it was founded. Just recently Kampomos invested in two new production lines to manufacture fresh, sliced meat products. With these new lines Kampomos will produce products for high price segments. (Drujinina 2005a)

The major players in the St. Petersburg market are totally different than in Moscow. Parnas-M is the largest meat processing enterprise in North-West Russia; in St. Petersburg its market share is as high as 30 percent. Overall in Russia the share is only 3-4 percent. Samson's share is much smaller in the North-West Russia and St. Petersburg but it is still one of the biggest meat producers in this region. PIT-Produkt, recently bought by the Finnish Atria, has a 20 percent market share in the St. Petersburg region, but in the entire Russian market only 1 percent. With support from Atria, PIT-Produkt aims to gain a 30 percent market share in St. Petersburg.

Meat processors sometimes specialize in specific segments; some of them produce only sausages, pelmeni, cutlets or other semi-finished meat products, and can only reach big

market shares in their regional markets and small niches. These regional companies include for example Mirital, Talosto, KEMP, Darja, Morozko, PoCom, Komsomolsky and Gourmand, to mention some. Russian consumers usually favor local producers, and thus these producers do not necessarily have to worry about national competition. The dominance of large players in the meat sector is definitely not as strong as it is in the milk sector.

6.3 Confectionery

The confectionery industry includes a wide range of sugar-based sweets, all chocolate products and flour-based baked sweet products such as cookies, wafers and other long shelf-life products. Traditionally popular products in Russia have been loose chocolate sweets (sold by weigh) and chocolate slabs and also some flour-based delicacies. Flour-based confectionery products comprise the lion's share of this segment; in 2002 it was already 57 percent. Chocolate and chocolate-based items accounted for 25 percent of this segment and sugar-based sweets for 18 percent (Candy Industry 2003). In the biggest cities, Moscow and St. Petersburg, the consumption of confectionery items focuses on chocolate and chocolate products. Chart 5 illustrates the basic segments of confectionery in Russia and the biggest companies in each segment.

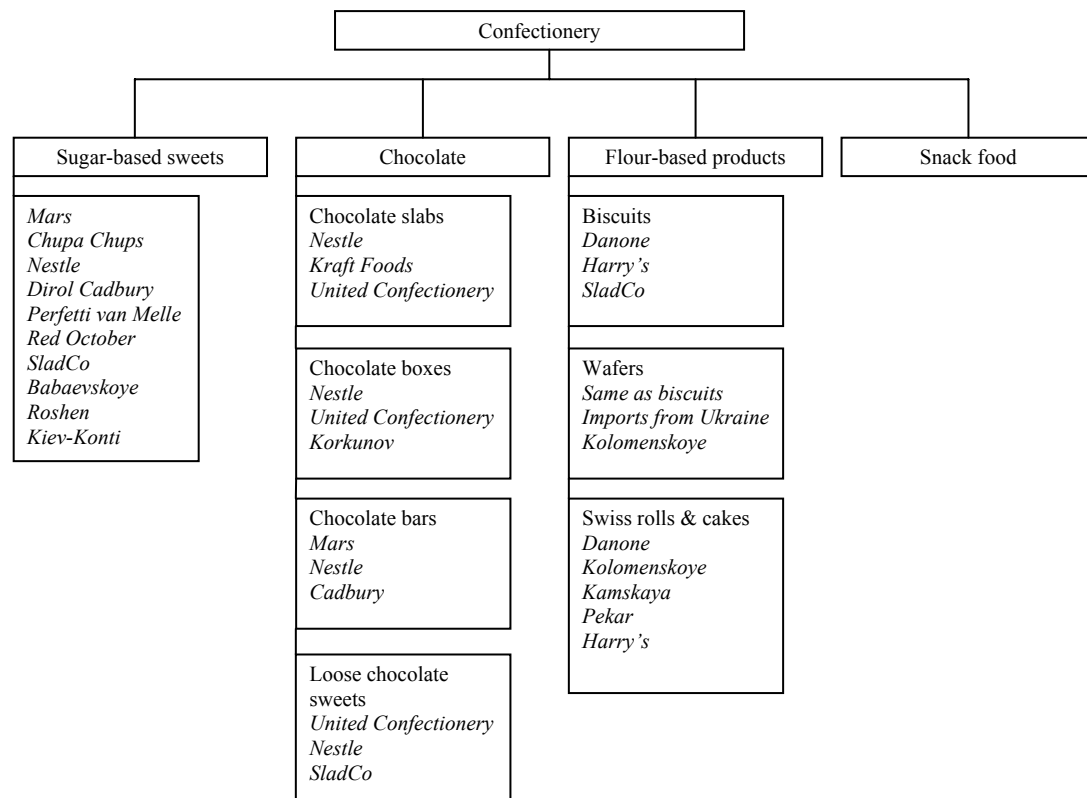


Chart 5. Structure of confectionery manufacturing industry and biggest companies

The production of confectionery has been increasing steadily since the beginning of the 1990s (see Table 11). The annual growth rate is estimated to be around 2-5 percent. In value terms the market grew by 15-20 percent in 2004, which means that the product range has concentrated on high quality and expensive products. In 2004 Russia produced over 2.2 million tons of confectionery products, which means that the market is the fourth largest after the UK, USA and Germany in absolute terms (Confectionery News 2005). It is estimated that the annual per capita consumption of sweets is around 15 kg (Candy Industry 2003). Traditionally Russians spend a big portion of their income in confectionery products. In 2004 of the total retail turnover, 193 billion USD, the share of confectionery was 2.6 percent (approximately 5 billion USD). In 2003 the value was 4.2 billion USD and in 1998 1.5 billion USD (Goskomstat 2005). The Russian confectionery market is one of the largest parts of the Russian food industry. The market is saturating, however, and the growth in this segment is likely to decelerate. Only the luxury product market, especially chocolate, will expand significantly in the coming years. (Ernst & Young 2004)

Russia, where the consumption of sweets dates back to Tsarist times, is a lucrative market for foreign producers. Already in 1994 the Russian sweets market was the third largest in Europe in absolute terms. Foreign producers entered the market in the beginning of the 1990s when the local production was of low quality, with a limited range of products, and unprepared for competition. Mars started its conquest in the very early 1990s with fierce advertisement campaigns. Many Russians were eager to try the chocolate bar and viewed it as a small piece of western life. However, Mars was not the only Western confectionery company in Russia, which started local production in the 1990s (Tiusanen et al. 1999). Approximately 50-70 percent of the market is controlled by foreign companies, such as Mars, Nestle, Kraft Foods, Dirol-Cadbury, Perfetti Van Melle, Orkla and Danone. Successful local companies include Red October, Babayevskoye and Rot Front which are united in one (United Confectionery). The Krupskaya Confectionery factory is especially successful in St. Petersburg.

In 2004, the German confectionery Alfred Ritter announced that it will build a factory near Moscow. Before that, Ritter created a joint venture with the Odintsovo candy factory to produce chocolate. Leaf has built a production line in St. Petersburg. New factories and production lines are also in Perfetti Van Melle's, Wrigley's and many other companies' plans (Candy Industry 2004). Local Russian producers may have some surprising advantages in the competition; for example the consumers are used to the taste of slightly burned products produced by very old machines and thus it is impossible to build a new production line which maintains this kind of uniqueness. The consumers would be disappointed if the taste of the product changed. (Safarov 2005)

6.3.1 Chocolate

As mentioned above, chocolate comprises only 25 percent of the total confectionery consumption, although the chocolate market is developing fastest of all confectionery markets and will have a bigger share in a few years. It is estimated that the chocolate market will grow by 30 percent in value terms by 2010. However, the volume of sales, which was estimated to be 634 700 tons in 2003, will not increase that much because the consumption will focus more on premium and high quality segments. The premium segment hardly existed at all in Russia before the foreign investors entered the market. (Drujinina 2005b & 2004b)

Currently up to 70 percent of the Russian chocolate market is controlled by foreign companies. Figure 16 shows the share of the biggest companies in 1996 and 2004. The division is only suggestive, and varies a lot depending on the point of view of the research institute. In 1996 Mars was the biggest player in the Russian chocolate market, but now it is not even in the top three. Nestle, United Confectioners and Kraft foods are assumed to be bigger, and Orkla with its acquisition of SladCo will gain a bigger market share in the future. Together, these companies cover 63 percent of the market. In 1996 the dominance of the top five companies was less noticeable. In 2004, the group “Others” include for example Cadbury, A.Korkunov, Ferrero, Fazer, Perfetti Van Melle and Alfred Ritter.

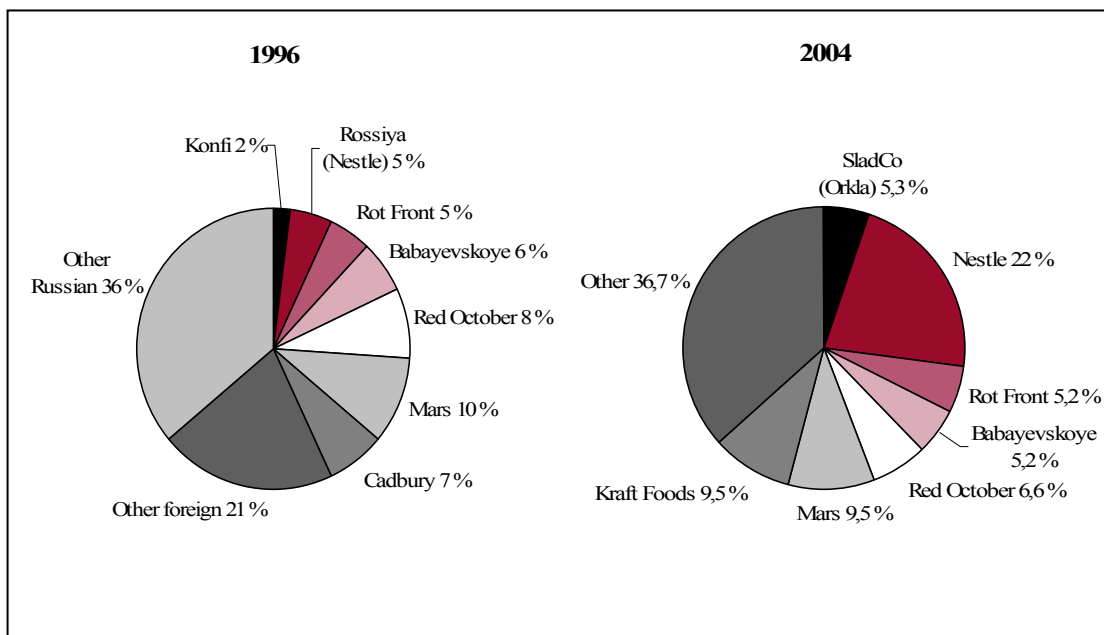


Figure 16. Chocolate market share in Russia in 1996 (Robert Flemings Securities Ltd, for reference see Tiisanen et al. 1999) and 2004 (Business Analytika, for reference see Drujinina 2005c)

Russians consume 2-3 kg of chocolate per head each year. In the Soviet era, the consumption was closer to 8 kg per capita. Thus, in relative terms, Russia has still a long way to the European level; for example, in UK the annual consumption of chocolate is close to 10 kg per head. According to ACNielsen (for reference see Drujinina 2005c) milk chocolate was the most popular type of chocolate in 2004, accounting for 61.4 percent of products in Russia. The second place went to dark chocolate with 23.9 percent, while white chocolate accounted for 9.4 percent and mixed varieties only 5.4 percent of the total.

The chocolate sector can be divided into four major segments (rating according to Business Analytika, for reference see Drujinina 2005c); 1) chocolate slabs, 2) boxed chocolate, 3) weighted (loose) chocolate sweets and 4) chocolate bars. The overall market share of the companies is illustrated in Figure 16. The market shares in different segments vary a lot. It is likely that the growth in different segments will be uneven and will cause many changes in the structure of chocolate markets in the coming years.

The segment of *loose chocolate sweets* is the biggest segment; it covers almost half of the general chocolate sales, in terms of volumes. The leadership of loose sweets can be explained by low pricing and consumer habits, which are inherited from parents and grandparents. In this segment the manufacturers usually compete with the price-quality ratio. The segment is dominated by United Confectioners with a 42.3 percent market share. For a long time the only foreign company in this segment was Nestle with the second biggest market share, but still very much behind United Confectioners, 11.2 percent. SladCo, also considered as a foreign owned company, has a 5.3 percent share. Overall, the demand for plain chocolate is losing its popularity. People consume more products with additional ingredients e.g. nuts and raisins, and fruit fillings. The market share of cheaper sweets in this particular segment decreased from 84.8 percent in 2003 to 76.8 percent in 2004, while elite chocolate sweets had already a 8.4 percent share of the sales. (Drujinina 2005c)

In the segment of *chocolate slabs* the leader is Nestle with a 35.4 percent market share. The second place goes to Kraft Foods with 27.4 percent and the third place to United Confectioners with a 14.3 percent market share (Drujinina 2005c). In Russia the most popular chocolate slabs are sold in packages of 51-100 grams, and thus, are very close to the sizes of biggest chocolate bars. In the segment of *chocolate bars*, only including the so called western candy bars, Mars is the leader with 66.3 percent. After that comes Nestle with 20.7 percent and Cadbury with 9.2 percent (Drujinina 2005c). Altogether, the foreign producers Mars, Nestle, Cadbury and SladCo hold 93.9 percent of the market segment. This segment is most popular among young consumers. (ACNielsen 2004)

In the segment of *boxed chocolate* Nestle leads with 25.7 percent. The second place goes to United Confectioners with 14.4 percent, and the third place is held by A.Korkunov (Odintsovo Confectionery Plant) with 12.8 percent. In most cases boxes of chocolates are presented as gifts. Thus, the consumption is more concentrated on premium and high quality products. Especially Cadbury, Ferrero and Odintsovo are popular in the premium segment. (Drujinina 2005c)

6.3.2 Sugar-based sweets

There are several kinds of caramel products available in the Russian market. Usually the following products are included in the segment: all kinds of hard candies, packed or loose, pralines, marmalade and fudge. Caramels are always considered as cheap sweets and are traditionally *sold by weight* in Russia. This type of products are produced either in Russia or in the former Soviet Union republics, especially Ukraine or Belarus. Western companies also gained a market share in the 1990s when they introduced new products such as lollipops and “Stimorols”. Generally western companies have ruled in the *packed candy segment*. In 1998 confectionery import dropped by 10-50 percent and the importers started to look for investment opportunities inside Russia. The CIS countries have gained good market positions in the Russian candy market. Ukraine, for instance, supplied three years ago as much as 86 percent of Russia’s hard candy import, and nearly 60 percent of wafer import. (Titov et al. 2003)

The thirty leading players produce about 350 000 tons of caramel each year. The market is estimated to grow by 5-8 percent annually and the biggest growth will be in the cheap and premium priced segments. It is estimated that hard sugar and candy covers 30-40 percent of the production structure of confectionery plants (Obuhova 2003). The leading western players are Mars, Chupa Chups, Nestle, Dirol-Cadbury, Orkla, and Perfetti Van Melle. The most popular domestic players are Red October and Babaevskoye (Confectionery News 2004). The market shares of these companies vary a lot in different segments. Unfortunately, current market surveys are conducted only on small segments and they do not cover the overall situation. However, it can be mentioned that the most recognized brand is Bon Pari from Nestle, followed by Chupa Chups, and Orbit (Wrigley), Savinov (Nestle) and M&M’s (Mars) (Obuhova 2005a).

The biggest Ukrainian candy exporters to Russia are Roshen, AVK and Kiev-Konti. The Ukrainian producers are able to compete with price. Ukraine has plenty of cheap sugar and other raw materials, while the quality is on the same level with Russian products. Ukrainian

products have been so successful in Russia that the companies have made investments in Russian markets. In 2001, Roshen bought the Lipetsk confectionery factory and in 2004 Kiev-Konti bought Konditer, a small Russian player. Roshen is building a new factory in the Lipetsk region. (Confectionery News 2004)

One growing segment is sugar-free pastilles, such as menthol pastilles and health candies. In this segment most of the products are imported or produced by western companies. Such companies as Mars, Perfetti Van Melle, Cadbury, Wrigley and Leaf are the most well known in this segment. (Confectionery News 2004)

6.3.3 Flour-based products

Flour-based confectionery products can be easily mixed up with bakery products. Traditionally the segment consists of biscuits, wafers, waffle pies, Swiss rolls and other cakes with long shelf-life. The biggest group is biscuits with an approximately 59 percent share in volume terms; wafers have a 24 percent share and Swiss rolls and cakes 17 percent. In value terms the share of biscuits is a little bit smaller, 42 percent. Other groups have a little bit larger shares than in the comparison of volume terms. The value per kilogram of Swiss rolls and cakes is higher than the value of biscuits. The general trend in this segment is that the consumption of packed, premium priced and branded products has increased and the competition has become more intensified. The total size of the segment is estimated to be around 1 million tons. (Sterlina at al. 2004, Sedova 2003)

The total size of the *biscuit* market was 562 thousand tons in 2003. The consumption of biscuits has decreased in recent years; this is natural because nowadays there are more varieties and substitute products in the market. Although the market is diminishing, it is estimated that there can still be room for new products and trademarks, if they are lucrative enough. Large producers do not see the market of biscuits as an attractive one. The biscuits market can be divided into two segments: products *sold by weight* and *packaged biscuits*. These segments differ both in price and structure. The most popular segment in Russia is the biscuits sold by weight, and this segment has even grown slightly. This can be explained by the constantly expanding assortment and the wide price range, and thus people of various income groups are able to purchase them. Two thirds of biscuits are sold by weight. In value terms packaged biscuits have a 57 percent market share. The five biggest producers comprise only 30 percent of the segment's sales. (Obuhova 2005b, Sedova 2003)

Absolutely the best known company in the *packed biscuits* segment is Bolsevik, owned by Danone. Bolsevik has various popular trademarks, such as Yubileinoe and Prichuda. Harry's CIS (the Harry's group is owned by Barilla) is the second biggest producer and after that come Volzhanka and other facilities owned by SladCo (which is owned by Orkla), Orion and Altai (owned by Nestle). Traditionally Russians prefer regional products to national trademarks. (Sterlina at al. 2004)

The size of the *wafer* segment was 195 thousand tons in 2003. This is the second biggest market after biscuits. Wafers have been long present in Russian markets but still the demand is much lower than the demand of biscuits; only one fourth of the consumers say that they consume wafers regularly. The number of brands in the wafer segment is not very big and most brands have been known since the Soviet times, such as Artek and Rot-Front. People prefer quite simple products and there are also a lot of popular regional producers which are not known outside the region, such as Pekar in St. Petersburg. As mentioned above, Ukraine exports a lot of wafers to Russia. The same Ukrainian and Russian companies as in the biscuit segment are popular in this segment. Especially in the packed wafer segment Volzanka is now the biggest one and Bolsevik comes second. The Russian company Kolomenskoye was not mentioned in the biscuit segment, but in the wafer sphere it is the third biggest company. (Sterlina at al. 2004)

The segment of Swiss rolls, wafer pies and cakes, i.e. baked desserts with long shelf-life is the smallest one, but only in volume terms. The segment is constantly growing. The production of these products requires quite complicated production technology and expensive investments, and thus the segment is highly concentrated and in the hands of a couple of big producers. This means that there are strong national brands and fierce advertisement campaigns. The five biggest producers make up more than 80 percent of the sales, sometimes even 90 percent. The most popular in the *wafer pie* segment is again Bolsevik, followed by Kolomenskoye, Kamskaya and Pekar. In the *Swiss roll* segment the most popular are Chok and Rolls (Danone bought this from Chupa Chups in 2004), Harry's, Krasnoselskaya owned by Chipita, and the Ramenskij baking company. In the near future it can be expected that some new companies will appear in the market, like SladCo did a couple of years ago. (Sedova 2003)

6.3.4 Snack food

The consumption of savory snacks, such as potato chips, nuts, popcorn, croutons etc., is a relatively new concept in Russia. Although still small, this sector is set to grow rapidly. Snacks are usually consumed in connection with beer drinking. As the consumption of beer

has increased, eating snacks is growing (Ernst & Young 2004). The Russian market for sweet and savory snacks grew fastest in value terms during the years 1998-2004. The sales of snacks in 2004 were worth of 982 million USD. A few years ago there were only foreign snack producers in Russia, such as Pepsi's Lay's. Nowadays Russian companies are very active in introducing new products and conquering markets, but the majority of snacks are still sold in Moscow and St. Petersburg. Russian people are very open to novelties, and local companies have introduced very successfully such products as dried calamari and croutons with exotic flavors. In 2004 croutons accounted for 34 percent of total snacks in value terms and chips/crisps accounted for only 28 percent. Croutons are only made by local manufacturers. It can be assumed that foreign producers will make investments and start production in Russia in the future. (Euromonitor 2005)

6.4 Bakery

Traditionally the bread consumption is very high in Russia. Due to traditions and low price, bread is eaten a lot. As much as 40 percent of the total daily calories were acquired by eating bread even as late as in 1997. In the Soviet era, artificially low bread prices caused extensive waste; a considerable part of bread sold on the market was used as fodder. This senseless waste partially explains the deep drop in bread production figures in the early period of transition (see Table 11). Nowadays it is estimated that the bread consumption is decreasing by 2-3 percent annually, although some segments are growing rapidly inside the bakery sector. According to Ernst & Young (2004) Russians are changing their habits and beginning to eat less traditional bread. However, the value of bakery products is increasing. Bakeries are manufacturing more premium products; different kinds of buns, rolls and waffles with additional flavors and ingredients (Ernst & Young 2004). People also more and more substitute fresh bread with confectionery products, crisp bread and cereals.

Russia is totally self-sufficient in grain production. According to SovEkon's forecasts, Russia would export 8-10 million tons of wheat and 1.5-2 million tons of barley in 2005 (Interfax 2005c). The production of grain is concentrated in the South of Russia, but nowadays this is not a problem; the transport infrastructure functions well enough to make grain available all around Russia. For bakeries, all the necessary ingredients are available domestically. Only when some high quality or specially processed ingredients are needed, they have to be imported. Approximately 25-35 percent of the production costs of simple bread are raw material costs (Semenova 2005).

During the Soviet times the production of bread was mass production. The only purpose of the production was to feed people, without considering the taste and quality of the product. There were only a couple of huge bakeries in every city, feeding the local community. Especially in cities bread was bought from stores: Russians do not have a tradition to bake at home.

The general opinion among Russian and Finnish interviewees is that the bakery market in Russia is divided between large and small bakeries, medium sized bakeries hardly exist. The revolution destroyed the small private bakeries but they started to emerge in Russia again after 1991. Now small bakeries are popular in rural areas and sparsely populated areas. They also have their own niche markets in big cities. Thus, it can be assumed that the number of small bakeries will remain the same or grow in future. They cannot achieve the same economies of scale as big bakeries, and their prices are higher, but still there are a lot of consumers who like to buy fresh bread without preservatives. Medium sized bakeries have hard times in Russia; they do not have the necessary negotiation power with suppliers or retailers. They do not have money for investments. Large bakeries have a big share of the markets, and it is growing all the time. For example in St. Petersburg Hlebny Dom has a 30 percent market share and its most important competitor 20 percent (together they have 50 percent of the market). In 1997 these two units had a 34 percent market share (Karimaa 2005). Large bakeries have negotiation power with suppliers and especially with retailers and distributors. Big companies have money for investments, and thus modern equipment able to turn out high quality products with knowledgeable personnel.

Big bakeries have to think about the whole value chain in order to be successful. In many countries bakeries only concentrate on their core business, but in Russia there are bakeries that take care of the distribution as well. It is very important to get bakery products with a short shelf life in the stores as quickly as possible. Many smaller stores have a limited amount of shelf space, and thus need deliveries every day. It is up to the bakery's negotiation power how much shelf space they are able to get in the stores. Only a bakery that can fulfill all these requirements can grow. (Safarov 2005)

Back in the 1990s, especially during the crisis in 1998, price was the most important aspect: consumers wanted to buy cheap bread, and thus the ingredients had to be cheap too. In many regions the government regulated the price of bread: it is a product that everyone has to have money to buy. Nowadays quality comes before price and the quality of the bakery products in Russia is good. Especially in St. Petersburg the sector is led by one company, Hlebny Dom, which has standards and quality that all other bakeries follow and copy. Obviously,

conquering the market leadership takes time and money invested in new technology, as well as innovative thinking (Semenova 2005). As an example, Hlebny Dom was the first to use plastic transport cases that were re-usable. All big companies in St. Petersburg have copied this method (Karimaa 2005). St. Petersburg and Moscow are the leading cities, where the bakery sector is most developed, but regional big cities are only few years behind. In the European part of Russia the growth of the sector is already decelerating, but behind the Urals and in the South of Russia the bakery sector will grow fast in the coming years (Semenova 2005).

Most of the FDI is in Moscow, where bakeries look for foreign partners. As the bakery market in Europe is saturated, many European producers look for opportunities in Russia. In 2005 the Finnish Fazer announced an acquisition of the Moscow-based bakery Zvezdny. Moscow is a good base to expand to other regions across Russia. The bakery sector is not yet very consolidated in Russia. Really big bakeries with national coverage do not exist yet. Fazer is the biggest owner of Hlebny Dom in St. Petersburg. Such foreign companies as Schulstad and Delifrance (the Irish firm IAWS) are in the Russian market (CEE-Food Industry 2005c, Karimaa 2005). Some of the local investment companies are interested in the bakery sector. As many local bakeries suffer of capital shortage, it is highly likely that investment funds with available risk capital will be involved in the consolidation of the branch. Thus, it can be assumed that the competition will intensify in the near future in the Russian bakery branch.

7. Comparison of Regions

In order to make business in Russia it is essential to know the geography of the country. Despite the overwhelming size and opportunities in Russia, foreign firms usually start in Moscow or St. Petersburg. The competition in these cities is already very strong, and thus other regions and cities offer enormous, untapped potential. The following chapters focus on the Russian federal districts and the purchasing power of the regions.

7.1 Russian regions and federal districts

Russia is not a homogeneous country. The vast size, ethnic and natural diversity make the regions of the country rather unequal. The federal structure of Russia is anything but simple; the Russian Federation consists of 88 administrative regions after the Perm Region and the Komi-Perm Autonomous District merged in 2004 (Mosnews 2004). The 88 regions consist of 21 autonomous republics, six krais (provinces), 49 oblasts (regions), two cities of federal status, one autonomous oblast and nine autonomous okrugs (districts). These regions do not have equal status; they have different political, economical, territorial and administrative statuses. Bradshaw (for reference see Ahjokivi 1998) describes the regions as follows:

- **Republic** is an administrative unit formed by a notably large ethnic group that gives the name for the republic, as Tatars in the Tatarstan Republic. However, in many republics ethnic Russians are in majority, for example in the Karelia Republic.
- **Krai** is a vast administrative unit often situated in sparsely inhabited eastern or southern parts of the Russian Federation.
- **Oblast** is a relatively homogenous and self-supporting region that is usually named after the centre of the region, for example the Novgorod oblast.
- **Autonomous oblasts and okrugs** are lower level administrative areas that to some extent function as a part of a bigger federal region. Autonomous oblasts and okrugs are usually remote, backward and sparsely populated territories.
- **Federal cities** refer to the two biggest cities, Moscow and St. Petersburg, which have a distinct federal status.

President Putin created seven federal districts in 2000, attempting to regain control over the regions. During the 1990s president Yeltsin had lost control over the regions by encouraging regional bosses to take as much sovereignty as they could in order to buy their loyalty. The power of the federal government was weak, and continuous conflicts between the president

and parliament was weakening it further. The regional governors tried to please the local elite rather than the federal government or the president. The federal districts created in 2000 followed the same lines as military districts, definitely not by coincidence. They were the Central, North-Western, Southern, Volga, Urals, Siberian and Far Eastern Federal Districts (see Figure 17). Now the federal districts have two sources of power; institutions of the federal government and the regional governor, who has less power. Table 20 lists selected economic indicators of Russian federal districts.



Figure 17. Map of Russian regions

Table 20. Selected economic indicators of Russian Federal Districts

Federal District	Territory thou km ²	Population 1.1.2005, thou	Urban Population	Gross Regional Product, 2004 billion RUB	GRP per capita, RUB
Russia	17 075	143 474 (100%)	73.0%	11 582 (100%)	80 727
Central	651	37 546 (26.2%)	80.1%	3 939 (34.0%)	104 928
Volga	1 038	30 710 (21.4%)	70.8%	1 964 (17.0%)	63 953
Urals	1 789	12 279 (8.6%)	80.9%	1 777 (15.3%)	144 733
Siberia	5 115	19 794 (13.8%)	71.2%	1 266 (10.9%)	63 968
North-West	1 678	13 731 (9.6%)	82.4%	1 154 (10.0%)	84 029
South	589	22 821 (15.9%)	57.5%	900 (7.8%)	39 451
Far East	6 216	6 593 (4.6%)	76.0%	581 (5.0%)	88 154

Source: Goskomstat 2005, Goskomstat 2005c

The Russian population is extremely unevenly distributed over the vast country. The Far Eastern and Siberian Federal Districts cover more than 66 percent of the total Russian

territory, but the population is only about 18 percent of the Russian population. Over 26 percent of Russians live in the Central Federal District, and almost one third of them in Moscow city; just like a third of the population in the North-West Federal District live in St. Petersburg. In 2005 there were only 38.8 million people living in rural areas, which means that 73 percent of the Russian population live in cities (Goskomstat 2005). The location of Russian cities is rather different than in Europe. Big cities are located far from each other and they do not form any kind of networks; more likely they have only linear connections, such as the main railway routes (Helanterä et al. 2002).

The western parts (west from the Urals) of the country form two thirds of the Russian GDP of which the Central District, with Moscow, forms a half (see Table 20). The gross regional product per capita figures vary a lot between the regions. The poorest district seems to be the Southern Federal District where the GRP per capita is only 39 451 rubles (1 160 €), whereas the wealthiest district is the Urals Federal District with the GRP figure of 144 733 rubles (4 257 €). The nominal GRP figures have increased dramatically during last five years, although the ranking of the districts has remained the same. In 1999 the GRP per capita figure in the Urals Federal District was a little bit above 46 000 rubles and in the Southern Federal District only 16 000 rubles.

7.2 Purchasing power of Russian regions

The potential markets for food processing companies and retailers are in big cities. Russia is very sparsely populated and the cities are located far away from each other. Distribution from a single production unit is almost impossible. On the other hand, several cities with over a million inhabitants offer enormous potential. Russia has twelve cities where the population reaches the level of one million. In addition to this, there are more than 20 cities where the population is over 0.5 million. The “million cities” and the regions where they are located are listed in Table 21.

Table 21. Russian regions with cities of over one million inhabitants, selected indicators

City/Region	Federal District	Population, thou	GRP per capita RUB	Average Monthly Wages RUB	Retail Trade Turnover mln RUB	Retail Trade per capita, RUB
RUSSIA		143 474	80 727	8 051	5 597 703	39 015
Moscow region	Central	6 630	67 439	8 964	283 362	42 741
1) Moscow	Central	10 407	234 601	13 039	1 370 135	131 660
Leningrad region	NW	1 653	80 102	8 111	38 135	23 071
2) St. Petersburg	NW	4 600	94 717	10 178	199 245	43 314
Novosibirsk region,	Siberia	2 662	63 103	6 885	104 234	39 151
3) Novosibirsk		1 413				
Nizhny Novgorod region,	Volga	3 445	64 552	6 214	115 731	33 590
4) Nizhny Novgorod		1 297				
Sverdlovsk region,	Urals	4 428	70 864	8 145	173 715	39 229
5) Yekaterinburg		1 287				
Samara region,	Volga	3 201	85 871	7 205	182 205	56 916
6) Samara		1 144				
Omsk region,	Siberia	2 047	61 419	6 685	66 508	32 497
7) Omsk		1 122				
Republic of Tatarstan,	Volga	3 769	84 676	6 690	121 737	32 304
8) Kazan		1 107				
Chelyabinsk region,	Urals	3 551	64 876	7 401	104 535	29 435
9) Chelyabinsk		1 071				
Rostov region,	South	4 334	42 313	5 611	152 255	35 127
10) Rostov		1 062				
Republic of Bashkortostan	Volga	4 079	68 574	6 354	133 568	32 747
11) Ufa		1 041				
Volgograd region	South	2 655	51 785	5 627	80 031	30 141
12) Volgograd		1 004				

Source: Goskomstat 2005, Goskomstat 2005b, Goskomstat 2005c

Multinational retailers, such as Metro and IKEA, have already noticed the market potential of the “million cities” in Russia. They will not start expanding before they have assessed the purchasing power of the regions thoroughly. Metro has seven stores in Moscow, three in St. Petersburg and one each in Yekaterinburg, Kazan, Krasnodar, Nizhny Novgorod, Samara, Rostov-on-Don, Tumen, Ufa, Volgograd, Yaroslavl and Voronezh, and all these are cities where the population is more than half a million. Metro has also plans to open stores in Chelyabinsk and Togliatti (Metro 2005). The existence of such a big retailer in the city or region creates opportunities for local food producers and definitely attracts new producers in the region. International retailers have quite high quality standards and big volumes, and thus small local producers do not have a chance to sell their products in the hypermarkets.

IKEA, the Swedish furniture company, trusts the purchasing power of the growing middle class and has plans to open as much as 20 stores in Russia, or at least one in every “million

city". Currently it operates five stores in Russia; three in the Moscow region, close to the city of Moscow, one in the Leningrad region, close to St. Petersburg, and one in Kazan. The Mega mall in Kazan is co-anchored by IKEA and Ramstore and it is the largest regional mall in Russia. Big malls containing food, clothing and furniture retailers are also a good opportunity for food producers. (IKEA 2005)

As can be seen in Table 21, four regions, each with a city of over one million inhabitants, have GRP figures above the Russian average. Thus the wealthiest regions in Russia are Moscow city, St. Petersburg, the Samara region and the Republic of Tatarstan, with the cities of Samara and Kazan. However, the average monthly wages in the Samara region and the Republic of Tatarstan are actually below the Russian average. There are five regions where the wages are above the average. These are of course Moscow and St. Petersburg, and the regions surrounding them, Moscow region and Leningrad region, and also the Sverdlovsk region with the city of Yekaterinburg. In terms of retail turnover and retail trade per capita the most promising regions with the most sales potential for food processors are again Moscow and the Moscow region, St. Petersburg, the Sverdlovsk region and the Samara region.

When all regions are included in the comparison the order looks somewhat different; the top ten regions are listed in Table 22. In terms of retail turnover the most promising regions, in addition to those already mentioned, are the Tumen region, the Krasnodar Krai, and the Republic of Tatarstan.

Table 22. Retail trade turnover in Russian regions, top ten

	Federal District	Population, thou	Retail Trade Turnover mln RUB	Retail Trade per capita RUB	Average Monthly Income, RUB	Retail Trade; Share of Food Products %, 2002
RUSSIA		143 474	5 597 703	39 015	7 874	47
Moscow	Central	10 407	1 370 135	131 660	24 240	41
Moscow region	Central	6 630	283 362	42 741	7 548	44
St. Petersburg	NW	4 600	199 245	43 314	12 080	43
13) Tumen region	Urals	3 308	186 293	56 324	14 571	51
Samara region	Urals	3 201	182 205	56 916	9 428	45
Sverdlovsk region	Urals	4 428	173 715	39 229	8 501	51
14) Krasnodar Krai	South	5 100	167 382	32 818	5 556	48
Rostov region	South	4 334	152 255	35 127	6 494	45
Republic of Bashkortostan	Volga	4 079	133 568	32 747	6 689	52
Republic of Tatarstan	Volga	3 769	121 737	32 304	7 109	n.a.

Source: Goskomstat 2005, Goskomstat 2005b, Liuhto et al. 2004



Figure 18. Regions and cities with highest retail trade turnover (the numbers refers to the numbers mentioned in Table 21 and Table 22)

Figure 18 shows the “million cities” and regions with the highest retail trade volumes. Most of the regions include “million cities”, only the Tumen region and Krasnodar Krai do not have “million cities”. It is obvious that the retail trade volume is high in densely populated regions. When comparing the relative figure of retail trade per capita, it can be seen that Moscow (number 1 in Figure 18), the Moscow region, St. Petersburg (2), and the Tumen (13), Samara (6) and Sverdlovsk (5) regions have a figure that is higher than the average in Russia. In these regions people also have above the average incomes.

Even though the Krasnodar Krai, in the Southern Federal District, has quite a high retail trade volume it is not a very promising region. The population in the region is so high that it gives a deceptive view of the region. The retail trade per capita figure is considerably low, as well as the average income of the people; both figures are below the average level. There are only two big cities in the region; Krasnodar (640 000 people) and Sochi, a well known tourist resort (330 000 people). There are also two ports by the Black sea that are focused on oil and gas product exports. (Liuhto et al. 2004)

Unlike the Krasnodar Krai, the Tumen region is very promising. Tumen is located in the Urals Federal District and has big oil and gas resources. The biggest city is Tumen (510 000 people). The Tumen region alone produces 67 percent of the oil and 91 percent of the natural gas in Russia (Liuhto et al. 2004). The retail trade per capita figure is the highest after Moscow and the Samara region, and with over three million inhabitants the retail trade turnover is also remarkably high. In addition, the average monthly income is the second highest after Moscow.

One of the basic features of economic development is that the relative importance of the food component in the average consumer basket decreases with the improving income. As Moscow has the highest living standard, the share of food products in the retail trade is only 41 percent, while people in the Republic of Bashkortostan have to spend on average 52 percent of their income on food products.

The regional price differentials must be taken into account. Table 23 gives an overall view of the average purchasing power of the Federal Districts in terms of income and expenditure. When comparing the price of a minimum food basket, the Far East Federal District is the most expensive and the Southern and Volga Districts the cheapest ones. When the income and price level are taken into account, it becomes clear that the Central District has the highest purchasing power and Urals the second highest, while in the Southern District the ratio between the income and minimum expenditure is the lowest.

Table 23. Purchasing power comparison of Russian Federal Districts

Federal District	Population, thou	Average monthly income per capita, RUB July 2005	Price of a minimum food basket, RUB August 2005	Average monthly income divided by food basket
RUSSIA	143 474	7 874	1 344	5.86
Central	37 546 (26.2%)	10 744	1 372	7.83
Urals	12 279 (8.6%)	9 312	1 416	6.58
Far East	6 593 (4.6%)	8 845	1 860	4.75
North-West	13 731 (9.6%)	8 607	1 472	5.85
Siberia	19 794 (13.8%)	6 500	1 331	4.88
Volga	30 710 (21.4%)	6 078	1 211	5.02
South	22 821 (15.9%)	5 368	1 218	4.41

Source: Goskomstat 2005, Goskomstat 2005b

When all the regions are taken under comparison (see Table 24), the gap between the richest and the poorest region is huge. The personal income varies tremendously between the regions, but not only the income but also the cost of living varies. In Moscow people have, on average, a ten times higher income than in the poorest regions, but the price of the minimum food basket is almost the same. Therefore the people in Moscow have a clearly better living standard than the people in the poorest regions. Especially in the South and Far East, people are poorer than the national average. One drawback of the huge size of Russia is that people in the most remote places have a modest living standard. For example, in the Koryaksky autonomous area, the Northern part of the Far East Federal District, people have income that is above the Russian average, but the price of the food basket is almost three times higher than the national average. The reason for this is the remoteness of the region; transportation and distribution of food is very expensive when literally no roads exist. Almost in all regions in the Far East Federal District the price of the minimum food basket is more than 2000 rubles (see also Appendix 2)

Table 24. Purchasing power comparison, ten richest and five poorest regions

Region	Federal District	Population	Average monthly income per capita, RUB July 2005	Price of a minimum food basket, RUB August 2005	Average monthly income divided by the food basket
RUSSIA		143 474	7 874	1 344	5.86
Moscow	Central	10 407	24 240	1 635	14.83
Yamalo-Nenetsky auton. area	Ural	523	20 116	2 000	10.06
Khanty-Mansiysky auton. area	Ural	1 469	17 420	1 742	10.00
Tumen region	Ural	3 308	14 571	1 687	8.64
Saint-Petersburg	NW	4 600	12 080	1 478	8.18
Samara region	Volga	3 201	9 428	1 349	6.99
Republic of Komi	NW	996	10 751	1 554	6.92
Republic of Tatarstan	Volga	3 769	7 109	1 142	6.22
Tomsk region	Siberia	1 037	8 155	1 311	6.22
Omsk region	Siberia	2 047	7 096	1 148	6.18
Republic of Tyva	Siberia	308	3 695	1 430	2.58
Koryaksky a.area	Far East	24	8 251	3 504	2.35
Republic of Kalmykia	South	290	2 063	1 121	1.84
Ust-Ordynsky Buryatsky a.area	Siberia	134	2 061	1 235	1.67
Republic of Ingushetia	South	482	1 906	1 408	1.35

Source: Goskomstat 2005, Goskomstat 2005b

In Table 25 the personal disposable income and the volume of the region are combined in order to find out which regions have high purchasing power potential. The combined purchasing power is calculated as follows:

$$\text{Combined Regional Purchasing Power} = \text{Population} * \frac{\text{Average Personal Income}}{\text{Price of Food Basket}}$$

The average personal income divided by the price of the food basket shows how much food people are able to afford with their income, i.e. the purchasing power of their income. This takes into account the price level, as well as the wage level of the region. When this equation is multiplied by the population of the region, the overall purchasing power of the whole region is achieved as a result.

Table 25. Purchasing power comparison, twenty richest regions (summer 2005)

Region	Federal District	Share of the regional purchasing power of the total Russian purchasing power
RUSSIA		100
1. Moscow	Central	18.36
2. Saint-Petersburg	NW	4.47
3. Moscow region	Central	4.15
4. Tumen region	Urals	3.40
5. Sverdlovsk region	Urals	3.25
6. Rostov region	South	2.86
7. Republic of Tatarstan	Volga	2.79
8. Republic of Bashkortostan	Volga	2.76
9. Samara region	Volga	2.66
10. Krasnodar Krai	South	2.64
11. Chelyabinsk region	Urals	2.23
12. Nizhny Novgorod region	Volga	2.08
13. Perm region	Volga	2.02
14. Kemerovo region	Siberia	2.02
15. Krasnoyarsk Krai	Siberia	1.79
16. Khanty-Mansiysky a.area	Urals	1.75
17. Novosibirsk region	Siberia	1.55
18. Volgograd region	South	1.52
19. Omsk region	Siberia	1.50
20. Irkutsk region	Siberia	1.46
<i>20 Regions total</i>		<i>65.26</i>

Source: Own calculations

When the share of the regions is calculated with this combined regional purchasing power, Moscow is in the leading position, comprising almost 20 percent of the total Russian purchasing power. In 2000, the equivalent figure was even more significant, comprising 21.2 percent of the total. Altogether the 20 richest regions out of 88 compose two thirds of the total purchasing power. What is common to these richest regions is that they have either natural resources or they are commercial or financial centers. Regions like Tumen, Tatarstan, Samara and Bashkortostan produce oil, the Kemerovo region and Krasnoyarsk Krai are the top two coal mining regions, and Krasnoyarsk Krai has the largest wood resources in Russia. The Tumen, Sverdlovsk and Samara regions are the most industrialized regions and the Southern regions, such as the Krasnodar Krai, Bashkortostan and Tatarstan, have the highest agricultural output, together 14.6 percent of the national total (Liuhto et al. 2004). Cities like Moscow, St. Petersburg, Samara, Ekaterinburg and Kazan are major transportation hubs, and political, commercial and financial centers.

8. Russian food processing industry compared with transitional economies

Western European food companies are actively searching for new markets as their own markets are already saturated. For a long time the Central and Eastern European (CEE) countries i.e. Transitional Economies (TEs) have been in their interests. This chapter compares investments by foreign and local companies in Russia and CEE countries in the area of food processing.

8.1 Economic indicators

Agriculture and food production have played an important role in all TEs, but nowadays the share of agriculture of GDP in the more developed transitional economies is only 1-8 percent. In Romania the share is still as high as 11 percent. Also Ukraine, where one-third of the world's black soil exists, is very agriculture-oriented and offers great investment opportunities for foreign companies. The production structures vary in different countries; traditionally there are both large agri-businesses and small farms. Big companies and collectivized farming are popular in Slovakia, whereas in Poland the production takes mostly place in the private sector. Big enterprises are market-oriented, but not very efficient, and the small farms, on the other hand, are most often intended to feed the family. A big share of the population is involved in agriculture. In Poland and Romania the share is quite significant; almost 20 percent of the population is employed in agriculture in Poland, in Romania 38 percent. In the Czech Republic the share is only 5 percent. The population of the countries can be seen in Table 26. (CEJA 2004)

Living standard comparison between the TE countries was done above (Chapter 3). Slovenia is by far the best-off TE measured with PPP-adjusted GDP figures per capita: Slovenia's living standard is almost three times higher than that of Romania's. Slovenian welfare is roughly on the same level as in Greece and Portugal in Western Europe.

Also exchange rate deviation index (ERDI) values were discussed above. All TEs have undervalued currencies (ERDI value over one). The rather sophisticated market of Slovenia has a modest ERDI, while the equivalent ERDI figure in the poor Ukraine is an extremely high. In the Russian case, the ERDI is rather high, about 2.5. High ERDI values hamper direct exports from the West; gross undervaluation of a currency makes import prices high in comparison to the prices of locally produced alternatives. The labor costs in TEs with a low

living standard and high ERDI value are very low calculated in euros and in US dollars. The wage levels were compared in Chapter 3.

In the sphere of foreign direct investment (FDI), there are two major categories: market-seeking activity and sourcing activity. In the former case, new markets with reasonable purchasing power are looked for. Typically, internationally active retailers make market-seeking FDIs. In the latter case, the investor seeks minimal production costs, including cheap labor.

In the TE-countries, about two thirds of inward FDI stock is invested in services. Therefore, it can be concluded that the main investment motive in FDI-activity in the TE-region is seeking new markets with reasonable purchasing power. Finding a low-cost environment for manufacturing goods is an important, but not a predominant factor in the capital movement from the West into the TE-region.

Obviously the two FDI motives (market-seeking and sourcing) overlap in many cases. For example, Volkswagen (Germany) acquired the Skoda car-manufacturer in the Czech Republic in the early period of transition. The big bulk of Skoda's output (about 85 percent) is exported: VW is thus sourcing cheap cars for their global sales. At the same time, Skoda is the market leader (in new cars) locally. Therefore, this operation has also a successful market-seeking aspect.

Food processing is obviously a price-sensitive sector of manufacturing. Thus, production costs must be carefully taken into consideration. Direct exports from the expensive West to the low-cost TE-region have a limited scope only. Therefore, it is no wonder that many international food giants have entered the TE-region via the FDI-route. This topic is discussed below.

8.2 Foreign direct investments and foreign trade

The transformation of the economies of CEE countries and Baltic States started very fast in the beginning of the 1990s. In many countries the food sector was one of the first privatized sectors. Between 1990 and 1995 foreign investors entered the TE-region through purchasing formerly state-owned food processing companies. After 1995 foreign companies continued the expansion of production facilities through green-field investments. Foreign direct investments were, and still are, very important for the local industries. Local companies suffered capital shortages and could not modernize and improve their production facilities

without the help of foreign investors (Jansik 1999). Table 26 shows the total inward FDI flow and stock in the TEs in 2004. In absolute terms, Russia has the highest FDI flow and stock figures of the table. When comparing only the total FDI flow Russia receives the most investments, also the cumulated FDI stock is highest in Russia. Hungary, Poland and the Czech Republic have been the most interesting countries in the CEE region in the light of absolute figures. But in relative terms, when the population of the countries is taken into account, Estonia, Hungary and the Czech Republic are the winners. In 2004 the FDI flow per capita figure was the highest in Estonia. Also the FDI stock per capita is high in Estonia, the Czech Republic and Hungary. In relative terms, Russia is very low in the comparison; only Ukraine is below Russia.

Table 26. FDI flow and stock in 2004

	Population, mln	FDI Flow 2004 mln USD	FDI Flow 2004 per capita USD	FDI Stock mln USD	FDI Stock per capita USD
Estonia	1.3	926	695	9 530	7 331
Hungary	10.0	4 167	416	60 328	6 033
Czech Rep.	10.2	4 463	436	56 415	5 531
Slovakia	5.4	1 122	207	14 501	2 685
Slovenia	2.0	516	257	4 962	2 481
Latvia	2.3	647	283	4 493	1 953
Lithuania	3.6	773	215	6 389	1 775
Poland	38.6	6 159	160	61 427	1 591
Bulgaria	7.5	2 488	334	7 569	1 009
Romania	22.3	5.174	232	18.009	808
Russia	143.4	11.672	81	98.444	686
Ukraine	36.1	1.715	36	9.217	255

Source: UNCTAD 2005

The food sector has been a popular target for foreign investments; the share of the food sector of the total FDI in manufacturing is usually between 10 to 25 percent (see Table 27). The most popular sub-sectors are confectionery, soft drinks and brewing, sectors affected by strict production control in Europe (e.g. sugar and to some extent dairy), high value added and highly processed expensive food articles (e.g. coffee, confectionery, soft drinks, and certain dairy products), sectors with excellent domestic market prospects, and finally sectors with good export opportunities (Jansik 1999). The FDIs in the food processing industry are mostly market-seeking (not export-oriented, which is the other option).

Table 27. FDI in the food sector (including beverages and tobacco)

	FDI Flow 2004 mln USD	Food sector share of FDI flow in manufacturing	Food sector share of FDI flow in 2004
Ukraine	1 715	25.4	7.2
Poland	6 159	21.8	7.8
Bulgaria	2 488	17.3	2.6
Hungary	4 167	16.1	7.4
Slovakia	1 122	11.9	4.5
Czech Rep.	4 463	11.9	4.2
Russia	11 672	8.4	3.4
Slovenia	516	4.4	1.9
Lithuania	773	n.a	n.a
Romania	5 174	n.a	n.a
Latvia	647	n.a	n.a
Estonia	926	n.a	n.a

Source: WIIW 2005, UNCTAD 2005

Table 27 shows that in Ukraine as much as 25 percent of the investments in the manufacturing sector go to the food processing industry. In Ukraine most of the investments come from neighboring countries, like Russia. Western investors would like to buy existing factories, but there are not many successful ones in Ukraine. Ukraine is potentially a very attractive country due to the favorable climate and soil. Roughly 70 percent of the total land area is cultivated land. The lack of other investment opportunities increases the share of the food processing industry. As agriculture has good preconditions in Poland, it is natural that in Poland the share of food processing in manufacturing FDI is 20 percent. In Hungary, Slovakia and the Czech Republic the equivalent share is more than 10 percent. This can be explained by the market potential; people have high disposable income. Unfortunately there is no data available from the Baltic countries and Romania. In Estonia the share of manufacturing of the total FDI is only 15 percent. Thus the share of food processing of the overall FDI stock can not be very high.

In the CEE countries there is traditionally a positive correlation between foreign ownership and the level of industrial concentration in individual food processing sub-sectors. If the concentration of the sector is high, also the share of foreign ownership is high. Sub-sectors like confectionery, vegetable oils, soft drinks and brewing are highly concentrated and mostly foreign-owned (Jansik 2004). In this matter Russia shows similar trends as other transitional economies. However, in the CEE countries the concentration and foreign ownership have higher correlation than in Russia. In the future the correlation is likely to increase in Russia also in other sub-sectors.

The phenomenon of globalization will affect the food sectors in Central and Eastern Europe; multinational giants have appeared on the food markets of many CEE countries. This process is well advanced in sugar, soft drink and tobacco production and to some extent in confectionery production as well. Large international firms will continue to influence the brewing, dairy and meat processing industries (Jansik 1999). Table 28 shows the twenty biggest food processing companies in 8 new EU member countries. The ranking has been done by the Central European Capital and is based on revenues in 2003. The information of foreign ownership of the companies is based on the information readily available on the companies' web sites or on web articles. The biggest food processing company in the CEE is the Polish meat processing enterprise SF Holding, which is owned by the Animex Group (partly owned by the American company Smithfield Foods Inc.). SF Holding is on place 195 when all branches are included in the comparison. The biggest companies are in the car manufacturing, petrochemical and telecommunication sectors. The six biggest food processing companies are from Poland. The largest multinational company listed with its own name is Nestle Poland, which is in the third place in the list. Masterfoods (number 5) is a private US company producing for example Mars chocolate bars. In the top ten there are only two companies that do not have clear foreign ownership.

Table 28. Top 20 food processing companies in CEE countries

Ranking (among 1000 companies)	Company	Foreign major ownership	Country	Revenues mln EUR 2003
1 (195)	SF Holding sp. z o.o. GK (meat)	Yes	PL	386.6
2 (248)	Krajowa Spółka Cukrowa SA (sugar)	No	PL	327.9
3 (250)	Nestle Polska SA	Yes	PL	325.6
4 (296)	Cargill (Polska) sp. z o.o.	Yes	PL	278.6
5 (357)	Masterfoods Polska sp. z o.o.	Yes	PL	237.7
6 (358)	Sokołów SA GK, Sokołów Podlaski (meat)	Yes	PL	235.8
7 (364)	Nestlé Hungária Kft.	Yes	HU	231.7
8 (365)	Friesland Hungária Rt. (dairy)	Yes	HU	231.2
9 (409)	NOWACO Czech Republic s.r.o. (frozen food)	Yes	CZ	206.8
10 (416)	MADETA a. s. (dairy)	No	CZ	204.4
11 (422)	Maspex sp. z o.o. GK	No	PL	202.8
12 (444)	Spółdzielnia Mleczarska Mlekpól (dairy)	No	PL	193.7
13 (445)	Pick Szeged Szalámigyár és Húsüzem Rt. (meat)	No	HU	193.6
14 (450)	Danone sp. z o.o.	Yes	PL	191.7
15 (458)	Bunge Növényolajipari Rt.	Yes	HU	189.6
16 (482)	Ljubljanske mlekarne, d. D (dairy)	No	SLO	180.3
17 (507)	Nestlé Česko s.r.o.	Yes	CZ	169.9
18 (556)	Ferrero Polska sp. z o.o.	Yes	PL	155.0
19 (559)	Sole Hungária Tejipari Rt. (dairy)	Yes	HU	154.8
20 (580)	Spółdzielnia Mleczarska Mlekovita (dairy)	No	PL	145.0

Source: CE-Capital 2005

Compared to the biggest food companies in Russia (see Table 18) and food processing companies in Western Europe, the food processing companies in the CEE countries are rather small. The biggest food company in Russia, Wimm-Bill-Dann, is more than twice as big as the biggest food processing company, SF Holding, in Poland. However, in relative terms (in production per capita) these two companies are equal.

Table 18 and Table 28 ought to be compared with care. The former includes beverage companies, which are big units especially in beer brewing. The latter excludes this subcategory. International beer giants, like InBev, Carlsberg and SABMiller dominate the beer market in the CEE-region, where in soft drink business Coca-Cola and Pepsi Co have big stakes.

The East European market, which comprises eight new EU-members plus Romania and Bulgaria, has a combined population of some 104 million. Multinational food giants have extensive operations in this region, which has about 40 million less people than Russia.

Nestlé's subsidiaries in Poland, Hungary, Slovakia and the Czech Republic have combined revenues close to one billion euros. Danone in Poland had almost 200 million euros of revenues in 2003, the same figure Danone had in Russia in 2004. It has to be taken into account that in Russia the purchasing power per capita is weaker than that in Eastern Europe. The foreign ownership of companies in the CEE countries is a little bit higher than in Russia. Of the top 20 companies (in Table 28) foreign-owned companies comprise 67 percent of the revenues, when the respective figure in Russia is 61 percent.

After the eight CEE countries joined the EU, and the trade barriers disappeared, numerous food companies, especially in Poland and the Czech Republic which have a border with Germany, took an advantage and started exporting. For example Polish products, such as milk, meat, and vegetables, are on average 30 percent cheaper than those produced in Western Europe. The CEE countries export also a lot of raw materials and private label goods. Czech farmers have recently started to sell milk to German producers instead of local producers. It is very common that farmers and producers close to the border, in both sides, choose a partner that is cheaper or better, even if it is located on the other side of the border. This usually happens between Germany, Poland, the Czech Republic and Slovakia. Slovenian companies have close ties to the Balkan countries, and they have acquired some companies in Bosnia-Herzegovina. (Korsgaard 2005)

The international movement of goods will increase in the future, when the dominance of big retail chains, such as Metro or Auchan, will increase in Central and Eastern Europe. Retailers are buying big bulks with the cheapest possible price. The country of origin does not matter, when the products are sold in several countries by the same retailer.

Table 29 shows the export and import volumes in the TE-region in 2004, and also the share of food in the merchandise trade. It should be noticed that the food imports increased a lot after the EU accession of the 8 TEs, which happened in May 2004. Thus, the figures of 2005 will look somewhat different. The volume of exports and imports is highest in Russia in absolute terms. Compared to other countries, in Russia the share of food of all merchandise imports is quite significant and the share of exports really small.

Table 29. Exports and Imports in 2004

	Exports 2004 mln USD	Share of food of merchandise exports, %	Imports 2004 mln USD	Share of food of merchandise imports, %
Russia	182 185	2	94 834	19
Poland	74 094	8	87 849	5
Czech Rep.	66 008	3	67 876	5
Hungary	54 175	7	59 216	3
Ukraine	32 672	13	28 996	6
Slovakia	27 660	3	29 448	5
Romania	23 553	3	32 691	7
Slovenia	15 805	3	17 297	6
Bulgaria	9 888	10	14 378	5
Lithuania	9 111	12	12 362	8
Estonia	4 556	11	1 565	11
Latvia	3 882	9	6 898	12

Source: World Bank 2005

8.3 Russia compared to transitional economies –summary

During the first one and a half decades of transition the Central and Eastern European countries have attracted more foreign investors than Russia, in relative terms. The economic conditions in Russia have improved essentially in the early years of the 21st century. In the former Eastern bloc certain market saturation has been reached in many branches. Therefore, it can be assumed that Russia's relative attractiveness in the eyes of foreign potential investors will increase.

The climate and the quality of the soil create excellent preconditions for farming in Ukraine. Ukraine used to be the breadbasket of the Soviet Union. The location of Russia is not very suitable for farming; only the southern part of Russia provides good conditions for cultivation. During the Soviet time the agricultural production was centrally planned in all communist countries, but in some countries of Eastern bloc collectivized farming was more popular than in others. The privatization of farms has been less rapid in Russia than for example in Poland, and thus Russian farmers are extremely inefficient. The stage of the Russian farms influences the raw material supply and complicates the operating environment of the food processing companies. In the CEE countries the situation is not this bad anymore. The privatization process of the food processing companies in Russia has been slower than in the CEE countries.

By population Russia is a very big country and with the increasing purchasing power of consumers Russia offers good opportunities for foreign investors active in food processing.

Currently the average disposable income in the CEE countries is much higher than in Russia and the producers are better able to sell premium products. In Russia the premium product segment is still rather small in relative terms. In the early period of transition, all former Eastern bloc countries were separate units in terms of trade policy, in the framework of which agricultural produce and food industry products were sensitive items. Therefore, many Western food companies invested in several CEE-countries. After the Eastern enlargement of the EU, Western companies have no trade policy motive any more to set production units in every separate TE, eight of which are now members of the Union. At the same time, Western companies still have a considerable cost advantage in the TE-region, when locations for new production units are selected. Producing German food products in Poland, which are then sold in Germany, seems to be a viable idea. Thus, FDI cycle in CEE-region is not necessarily over yet.

Russia with her big internal market is an entirely different case in terms of trade policy. Russia protects her internal market with a multitude of methods, which will not be exhausted via the possible WTO membership. The labor costs will be advantageous in Russia for some decades. Therefore, international food companies will have strong incentives to invest in Russia for several years to come.

9. Conclusions

Russia is an interesting market and the biggest trading partner of Finland. The closeness of Russia has attracted many Finnish companies to invest there. Those who have not done it yet, are considering investment seriously. The unpredictability of the business environment is a well known fact and a reason for some companies to avoid Russia. The membership of Russia in the World Trade Organization is highly desired among foreign investors and trade partners, both Finnish and others, but seems to be a rather secondary goal for the Russians. The Russians are willing to join WTO, but not at any cost. The negotiation process has taken longer than expected and Russia does not make any effort to make it faster. The Russian WTO membership would bring benefits for Russian trading partners and companies operating in the country, but the benefits would be more substantial for Russia herself. As the application process can still take years, foreign investors should not expect the membership to solve their problems immediately.

Many companies who have been brave enough to invest in Russia have got a reasonable return for the investment. 144 million people are an attractive market. The disposable income of Russians is growing fast and people earn more money than ever. In the future the Russians will consume more expensive and high value added products.

This study has given an overview of the agri-food sector in Russia about 15 years after the collapse of the Soviet economy. The communist legacy still influences the agriculture and food processing, and all other aspects of the economy as well. Agricultural productivity is far from the level of e.g. Western Europe, and farms lack investment funds. Especially in the early period of transition, the agricultural production and foodstuff output showed deep drops. A big share of the products are still bought in open markets and unprocessed. In the Soviet era, the prices were fixed and quantity was emphasized over quality, and now the companies have to adjust to new market environment.

In 1998 Russia encountered a financial crisis, which affected the economy tremendously. The ruble lost a big part of its value and people faced decreasing purchasing power. Imports became suddenly four times more expensive. But the crisis gave a boost to local industrial production and exports as well. Russia was able to recover fast, and since 1999 the Russian GDP has been growing every year.

Energy products are abundant in Russia, and thus quite inexpensive to local consumers. Thanks to high oil and raw material prices in the world market, Russia has been able to enhance her export income. A large part of Russian exports consists of energy products and raw materials. The Russian dependence on natural resources can be fateful, since raw material prices can fluctuate in the world market hugely. Collapse in the oil and raw material prices would affect the Russian economy negatively.

Currently the raw material supply in some food processing sectors is rather hazardous. Especially milk and meat processors have problems in acquiring a sufficient amount of high quality raw material. The central planning in the Soviet system favored input goods instead of consumer goods, and overcoming the communist legacy is not easy. Farms lack funding and a big part of the produce is still sold unprocessed in open markets.

The milk processing industry suffers from raw material shortage. The competition in this sector, which is rather consolidated, is fierce. Wimm-Bill-Dann is the leading local company. Many multinational companies, such as Danone, have entered the country. Similarly, the meat processing industry suffers from raw material shortage, but this sector is not as consolidated as the milk processing sector.

Confectionery is mostly a foreign-owned sector, but recently also local companies have been able to gain a market share. On the other hand, the bakery sector is mostly locally owned. In future the food sector will consolidate further. If the trend is similar in Russia as it has been in Eastern Europe, the foreign ownership will increase.

Russian regions are not equally developed and the purchasing power of consumers varies a lot. The most obvious and lucrative direction for the expansion of successful food processing companies can be found in the regions where the purchasing power is the highest. The richest regions have natural resources, or they are commercial or financial centers. Retailers have already started their expansion into new regions, which creates opportunities for food processing companies in new locations.

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Appendix 1. Details of food processing companies

MEAT PROCESSING

Cherkizovsky

Turnover: \$ 525 mln (2004)

Market share: 12 % Russia

Web Page: <http://www.chmpz.msk.ru/>

- ZAO Ekotorg is the holding company for the Cherkizovsky meat processing group
 - Cherkizovsky is a vertically integrated holding, including e.g. farms and processing facilities
 - Produces more than 300 types of sausages and hams under eight different brands, as well as canned and frozen meat.
 - Production is 520 tons every day
 - Largest meat processing enterprise in Russia
 - Cherkizovsky includes more than 30 companies located in various Russian regions (Moscow, Penza, Ulianovsk, Belgorod, Rostov oblasts, Krasnodar territory, St. Petersburg etc.)
-

Tsaritsyno

Turnover: \$ 444 mln (2004)

Market share:

Web Page: <http://www.tsaritsyno.ru>

- Produces more than 300 products, distribution to 350 Russian cities
-

Mikoyan

Turnover: \$ 336 mln (2004)

Market share: 6 % Moscow

Web Page: <http://www.mikoyan.ru/>

- Under the guidance of Russian parent firm Exima (produces Mikoyan products in three factories)
 - Half of Moscow's inhabitants claimed to buy Mikoyan products regularly
 - Moscow factory makes more than 400 tons of products every day
-

Campomos

Turnover: \$ 123 mln (2003)

Market share: 7 % Moscow

Web Page:

- A subsidiary of pan-European meat processor Campofrio
- The company, founded in 1990, is one of Moscow's top three meat-processors in volume terms
- Produces 45,000 tons of meat and sausage products per month, helping it to sales of €96.3 million in 2004.

- Campofrio has invested roughly €69.5 million in Campomos since it was founded.
 - Campomos has two production plants in Moscow, Campomos 1 and Campomos 2.
-

Omsky Bacon

Turnover: \$ 107 mln (2003)

Market share:

Web Page:

- Controlled by Planeta
 - Omsky Bacon is Russia's biggest pig breeder and pig meat producer
 - A leading company among the 300 best Russian enterprises involved agribusiness.
 - Planeta controls 6 large Russian meat processing enterprises. Another of Planeta's valuable assets in the meat business is the Klinsky meat plant (net sales 98,6 \$ mln) in the Moscow region
-

Parnas-M

Turnover: \$ 42 mln (2000)

Market share: 30 % NW Russia, 3-4 % Russia

Web Page: <http://www.parnas.spb.ru/>

- Largest meat processing enterprise in the North-West Russia
 - Produces more than 100 various types of sausages
 - About 80% of sales are made in St. Petersburg and Leningrad region, about 15% in the North-West of Russia, and 5% -in Siberia
-

PIT-Produkt

Turnover:

Market share: 15-20 % St. Petersburg, 1 % Russia

Web Page: <http://www.pitproduct.ru/>

- Finnish Atria bought Pit-Produkt in June 2005 and is waiting for the approval from the Russian competition authorities. The company hasn't revealed how much the deal was worth or how big a share in Pit Product it bought
 - Second biggest meat producer in St. Petersburg region after Parnas-M
 - Pit Produkt supplies only about 40 percent of its products to supermarket chains
 - Production 2,275,000 metric tons in 2004
-

Exima

Turnover:

Market share:

Web Page:

- EXIMA is a multiprofile agro industrial and commercial company with vertically integrated holding structure
- The company includes 25 enterprises and farms with total staff of about 12 thousand men.
- Every year EXIMA supplies consumer market with approximately 500 thousand tons of foodstuffs including meat, meat products, sugar, butter, vegetal oil, milk and varied dairy

products, flour, cereals, potatoes, vegetables and many other kinds of commodities and foods.

- EXIMA'S partner ties extend to about 30 thousand industrial and trade enterprises situated in 60 regions of Russia as well as to a number of internationally known firms in Germany, France, Ireland, New Zealand, Argentina, Brazil, Poland and India

Ostankinsky meat processing kombinat

Turnover:

Market share:

Web Page: <http://www.sosiska.ru>

Samson

Turnover:

Market share:

Web Page:

- Samson was founded in 1992 as a joint-stock company at the Sergei Kirov Meat Plant in Leningrad and is one of the biggest meat-processing enterprises in the Northwest Russia and St. Petersburg
-

DAIRIES

Wimm-Bill-Dann

Turnover: \$ 1189 mln (2004)

Market share: 36 % Russia

Web Page: <http://www.wbd.ru/>

- Wimm-Bill-Dann was founded in 1992
- Russia's leading producer of juices and dairy products, the firm has now about 27 dairies
- Wimm-Bill-Dann has approximately a 36% market share of traditional, enriched, yogurt, and dessert dairy products
- 71% of its net revenues come from the sales of dairy products with the remaining 29% coming from juice products. Cheese makes up around three quarters of sales
- Strong and diversified brand portfolio with over 1,100 types of dairy products
- Company's distributors work in more than 40 cities; distribution centers function in 26 biggest cities in Russia and CIS-countries
- The company also distributes its products in Canada, Germany, Israel, the Netherlands, the UK, and the United States through its own distribution network and independent distributors
- In 2003, production of dairy products 1 mln tons. In the first quarter of 2004 286,000 tons

Major Owners

Name	% of Voting Stock
Deutsche Bank	32.18
Gavril Yushvaev	18.80
Sergey Plastinin	12.16
Mikhail Dubinin	10.16

David Iakobachvili	6.41
United Burlington Investments Ltd.	6.30
Aleksander Orlov	6.22
PAREX	5.29

<http://www.rustocks.com/index.phtml/rcg/WBDN>

Equity Positions in Other Companies

Name	% of Charter Capital
JSC "Milk Company - ROSCA"	100.00
PAG Rodnik	100.00
Closed JSC "Darya"	98.84
JSC "Lianozovo Dairy Plant"	98.02
JSC "Vladivostok Dairy Plant"	97.44
JSC "Kharkov Dairy Plant"	75.08
Closed JSC "Gulkevichsky Maslozavod"	52.24
JSC "Ufamolagroprom"	47.70
JSC "Tsaritsyno Dairy Plant"	5.44

<http://www.rustocks.com/index.phtml/rcg/WBDN>

Groupe Danone

Turnover: \$ 226 mln (2004)

Market share: 4 % Russia

Web Page: <http://www.danone.ru>

- The French company operates on the Russian market since 1992
- Most dairy products that Danone sells in Russia are produced at the Russian milk processing enterprises of Danone.
- 40 percent of Danone's milk products are enriched; share on the Russian market of enriched milk products is 14 per cent. In general 4 per cent.
- Danone has two production plants in Russia, in Chekhov and Togliati
- Recently Danone expanded its operations in Chekhov site and increased production to 170 000 tons per year

Nutritek Group

Turnover: \$ 170 mln (2004)

Market share:

Web Page:

- Nutritek Group is split into two divisions – dairy and baby-food
- Core holders of Nutrinvestholding are Trade Estate (31 percent), Accord Asset Management (19 percent), Spektr (19 percent), Inter Consult (18 percent), Uralsib Depository Co. (13 percent)

Campina

Turnover: \$ 120 mln (2004)

Market share: 2 % Russia

Web Page: <http://www.campina.ru>

- The Dutch company Campina came to Russia in 1992 and was the first to introduce yoghurt to the Russian market
 - Established a milk processing enterprise in Stupino (Moscow Oblast) in 2000
 - The production capacity (2002) is 65 000 tons per year
 - Campina Russia also invests in milk-supplying farms, which guarantees a high quality of raw milk
-

Ehrmann

Turnover: \$ 119 mln (2003)

Market share: 11 % Russia

Web Page: <http://www.ehrmann.ru>

- The German company Ehrmann established its own milk processing enterprise, OOO Ehrmann, in Ramenskoe (Moscow oblast) in 2000
 - Production capacity 300 tons per day
 - Invests in raw milk suppliers
-

Petmol ("St. Petersburg Milk Combine #1")

Turnover:

Market share: 40 % St. Petersburg, 4-7 % Russia

Web Page: <http://www.petmol.ru/> <http://www.unimilk.ru/>

- Petmol is the largest dairy producer in northwestern Russia, company's main production facilities are located in St. Petersburg
 - Capable to process 550 tons of milk a shift
 - Produces more than 130 names of dairy products, including long-life milk, kefir (buttermilk), cottage cheese products, yogurt, butter, and cheese
 - Supplies about 88% of its total output to the St. Petersburg market and the Leningrad Region
 - In 2003, Petmol produced 140,000 tons of products, in first quarter of 2004 it produced already 48,000 tons of products
 - Sales 75 mln \$ in 2003
 - Unimilk is a major shareholder with 92% charter capital. Unimilk's other milk companies include e.g. Samara Lakto, Lipetsk Moloko and Milko. Totally 12 companies.
-

Parmalat

Turnover: \$ 39 mln (2004)

Market share: 1 % Russia

Web Page: <http://www.parmalat.ru/>

- Italian milk and food processing company has two production facilities in Russia; OAO BMK, Belgorodskij milk and juice processing plant (bought in 1991), and OOO Urallat in Sverdlovski oblast
 - The streamlining of the organization of the Russian operations, which got under way in 2004, will produce its full benefits in 2005. Recently Parmalat has made investments in new pasteurization department and in logistics. The future of the Parmalat operations in Russia remains to be unclear after the bankrupt of Parmalat parent company in Italy.
-

Ostankinsky molochny kombinat (Ostankinsky milk processing enterprise)

Turnover:

Market share: 5 % Moscow, 3 % Russia

Web Page:

- One of the oldest milk processing enterprises in Russia
 - Ostankinsky is traditionally the biggest sintered cheese producer in Moscow and its Karat factory has a capacity of 25,000 tonnes per year
 - The company plans to increase the factory's capacity to 40,000 tonnes per year
 - Net profit 37,59 mln \$ in 2001
-

Ochakovsky Dairy Plant

Turnover:

Market share: 11 % Moscow, 6 % Russia

Web Page: <http://www.molokozavod.ru/>

- Owned by Multon. Multon is the second largest juice-manufacturing and the 8th largest dairy-manufacturing company in Russia
 - Coca-Cola, alongside its subsidiary, Coca-Cola Hellenic Bottling Company, has agreed a deal for Russia's Multon juice company.
 - In 2004, Multon had revenue of \$336 million
-

Nidan Holding

Turnover:

Market share:

Web Page: <http://www.nidan.ru>

- Nidan's parent company is from Cyprus
 - Ownership structure in 2004; Nidan LLC (54,17%) and Texinv LLC (45,83%)
 - Produces milk in two factories in Novosibirsk region
 - Produces also juices in Moscow and Novosibirsk
-

Piskaryovsky

Turnover:

Market share: 15-20 % St. Petersburg, 5 % Russia

Web Page:

Raisio

Turnover:

Market share: 10 % Moscow and St. Petersburg

Web Page:

BAKERIES

United Bakers

Turnover:

Market share: 34 % Russia

Web Page: <http://www.unitedbakers.ru>

- Largest Russian producer of crackers, extrusion breakfast cereals, cookies, and extrusion intermediate products for food industry
- The Company's share of the Russian market of crackers accounts for 34% and at the market of extrusion products 18%.
- The share of United Bakers at the market of intermediate products and ingredients for confectionery, bakery and other food industries accounts for 90%
- Based on total annual sales 75,000 tons at the sum of \$75 mln, the Company can be regarded the absolute leader at the Russian market of flour and grain confectionery products
- 4 production plants located in the European part of the Russian Federation
- Exports its products to the NIS countries, to Poland, Belgium, Holland, Iceland, USA, and to other foreign countries

Hlebny Dom

Turnover:

Market share: 30 % St. Petersburg

Web Page: <http://www.hlebnydom.ru/>

- Fazer's subsidiary in St. Petersburg
- The market leader in the Greater St. Petersburg area

Zvezdny

Turnover:

Market share:

Web Page: <http://www.zvezdny.ru/>

- 97 per cent owned by Fazer
- Zvezdny is one of the biggest bake-off pizza and frozen dough producers in the Moscow area and had sales of RUB 830 mln in 2004 (\$ 28 mln)
- Zvezdny produces around 1,800 tons of par-baked pizzas, 5,100 tons of frozen dough, 12,900 tons of bread and 6,100 tons of pastries per year

Bosko-L

Turnover:

Market share:

Web Page: <http://www.bosko-l.ru/>

Baltic Bread

Turnover:

Market share:

Web Page: <http://www.baltic-bread.ru>

- Baltic Bread started in February 1995, when it opened the first bakery in St Petersburg operating to European quality standards, with European recipes and technologies
 - Baltic Bread is famous for its confectionery products. They have more than 30 styles of cakes, and more than 50 different pastries and sponge-cakes
-

Hleb Altay

Turnover:

Market share:

Web Page: <http://www.apkhleb.ru>

CONFECTIONERY AND SNACKS

United Confectioners

Turnover:

Market share: 24 % Russia

Web Page:

- Europe's biggest confectionery holding group (part of Guta-Group) which unites Russia's 15 leading producers. Three biggest members are Krasnyi Oktyabri (Red October), Babaevsky (<http://www.babaev.ru/>) and Rot Front (<http://www.rotfront.ru/>)
- The biggest manufacturer of confectionery in Russia and the leader in the field with a market share, in volume, of 15 per cent. United Confectioners accounts for 24 per cent of all sales in the confectionery market in Russia.
- Sales around \$670 million in 2004, 14.5 per cent increase compared to 2003
- The group sold about 270,000 tons of confectionery in 2004
- The export countries include CIS countries (Kazakhstan, Georgia, Tajikistan, Turkmenistan, Armenia and Azerbaijan), USA, Germany, Israel, Mongolia, New Zealand and Greece
- The main shareholder in United Confectioneries BV is a fund managed by Baring Vostok Capital Partners, which owns 62% of shares. A foreign institutional investor – the New Europe East Investment Fund, managed by Capital International, owns 23% of shares in the company. Minority shareholders account for 15% of shares.
- The group will increase its production to 411,000 tons by 2008
- **Red October**
 - Largest manufacturer of chocolate bars and sweets in Russia. In 2003, Red October produced 52,081 tons of confectionery
 - Produces about 30% of confectionery in the Moscow Region and about 7% in Russia as a whole. In particular, it claims to have 20% of the overall Russian chocolate production, 10% of hard-boiled sweets, and about 25% of domestic toffee.
 - Red October manufactures more than 500 kinds of confectionery and has capacities for producing more than 100,000 tons of confectionery per year.

- The company owns controlling stakes in St. Petersburg Confectionery, Tula Confectionery, Tambov Confectionery, Yoshkar-Ola Confectionery, Penza Confectionery, Ryazan Confectionery, Birobidzhan Confectionery, and Kolomna Confectionery
- Red October operates a sales network of 44 sweetshops, including 20 shops in Moscow; the company sells about 17% of its total output through the sales network.
- Annually Red October Confectionery exports about 1,000 tons of its products to Germany, Israel, Latvia, and the US. In 2003 the company exported 4.3% of its total output
- Web page: <http://www.redoct.msk.ru>

Nestle

Turnover: \$ 874 mln (2003)

Market share: 15-25 % Russia

Web Page: <http://www.rossiachoco.ru/> <http://www.nestle.ru/>

- Nestle (originally from Switzerland) started in Russia in 1995 by acquiring a majority stake in the Rossiya chocolate factory in Samara
- Nestle's main production assets are Confectionery union Rossija, Nestlé Jukovskoe morojennoe, Altay, Kamskaya, Hladoproduct (in the Krasnodar region), Vologodky Zavod Detskogo Pitania and Sveatoi istocinik.
- The company manufactures also drinks and ice-cream, besides confectionery

Mars International

Turnover: \$ 570 mln (2004)

Market share:

Web Page:

- Mars International holding purchased two factories in Stupino, on the outskirts of Moscow, in 1995. Mars also has production facilities in Luzhniki and Novosibirsk for pet food.
- In Russia Mars produces e.g. Mars, Snickers, Twix and Bounty bars

Kraft Foods Russia

Turnover: \$ 274 mln (2004)

Market share: 14 % Russia

Web Page: <http://www.kraft-foods.ru/>

- Parent company from USA
- Kraft Foods (with Nestle) dominates the chocolate market in Russia. Every seventh chocolate bar sold in Russia was made at the company's factories.
- Alpen Gold and Vozdushny chocolate bars are among the ten most popular chocolate bar brands
- Two production facilities in Pokrov and Leningrad Oblast

Danone

Turnover: \$ 265 mln (2003)

Market share:

**Web Page: <http://www.danone-bolshevik.ru/> <http://www.danone.ru/>
<http://www.chupachups.ru/>**

- Danone (French company) has been present in the Russian biscuit market since 1994 when it bought out the Russian producer Bolshevik
 - Danone acquired Chupa Chups' soft cake business in Russia in 2004 (Chok and Rolls company). Chok and Rolls sales was around \$20 million in 2003 under the Tornado brand
-

Wrigley

Turnover: \$ 175 mln (2003)

Market share:

Web Page:

- Wrigley has one production facility in Russia in St. Petersburg
 - Wrigley produces mostly chewing gum and some sugar confectionery products
-

Dirol-Cadbury

Turnover:

Market share:

Web Page:

- The Dirol-Cadbury factory opened in 1999
 - Produces 40 percent of all chewing gum sold in Russia, including the Stimorol and Dirol brands
 - The Dirol factory was built at a cost of \$100 million by a Danish company Dansk Tyggegummi Fabrik A/S (Dandy), which was later acquired by the British company Cadbury.
 - Cadbury also operates a chocolate-production plant - its largest production facility outside of the U.K. in Chudovo, in the Novgorodskaya Oblast. The facility was established in 1997.
 - Turnover in Russia \$ 200 mln in 2003
-

Orkla/Confectionery Group SladCo

Turnover:

Market share: 9 %

Web Page: <http://www.sladco.ru/>

- Founded by the Dutch company United Confectioneries and by the Yekaterinburg confectionery company OAO Confi in 2001. Merged the OAO Confi and the Kazan Zarya Confectionery Plant. Confectionery Group Sladco sold one of its three production units, in Kazan, Tatarstan in June, 2003. The partnership currently includes SladCo Confectionery Group and OAO Volzhanka Confectionery Plant.
- SladCo is one of the largest producers of confectionery products in Russia.
- The company produces all types of confectionery products – chocolate, biscuits, wafers, hard candies, etc. In each of these categories, SladCo occupies from second to sixth place in terms of market share. SladCo's overall share of the confectionery market amounts to about 9%.
- Estimated sales in 2004 \$ 160 mln
- Production in 2003 was 95,000 tons
- Orkla ASA acquired SladCo in 2004 by purchasing the shares of a Dutch company, United Confectioneries BV from Baring Vostok Capital Partners. United Confectioneries owned 96.24% shares of OJSC "Confectionery Group "SladCo" and 50.57% of OJSC

“Confectionery Factory “Volzhanka”. Separately, Orkla acquired a 45.05% block of shares in OJSC “Confectionery Factory “Volzhanka” from minority shareholders.

Pekar

Turnover: \$ 40 mln (2003)

Market share:

Web Page: <http://www.baker.spb.ru>

- Pekar, a company originally founded in St. Peterburg in 1914, specializes in the manufacturing of cakes, Swiss rolls, sweets and marshmallows
 - Largest shareholder is European Bank for Growth & Development with 28 percent.
 - Other shareholders are Pekar-service with 20.5 percent, Admiral with 16.6 percent and Pekar-plus with 10.5 percent.
 - Production of baked goods was 18,034 tons and production of confectionery 11,705 tons in 2003
-

DanCake/ Harry's

Turnover: \$ 37 mln (2003)

Market share: 12 % Russia

Web Page: <http://www.dancake.ru/>

- The Harry's group built a plant in 1997 in Solnechnogorsk (a region north of Moscow).
 - The most well-known products are Swiss Rolls, Sandwich Biscuits and Magdalenas.
 - In August 2004, Harry's Russia acquired the shares of Kondi, a confectionery and pastry manufacturer in UFA (Bashkortostan).
-

Kiev-Konti Group

Turnover: \$ 30 mln in Russia (2004)

Market share:

Web Page: <http://www.kiev-konti.com>

- Ukrainian confectionery Kiev-Konti is able to offer its caramels onto the Russian market at highly competitive prices
 - One production facility in Russia, with annual production of 25,000 tons
-

Krupskaya Confectionery Factory

Turnover:

Market share: 30 % St. Petersburg

Web Page: <http://www.krupskaya.com/>

- Established in 1938
 - The strongest player on the St. Petersburg chocolate market
 - Market share in St. Petersburg more than 30 percent for chocolate products, 18 percent for packaged candy and 77 percent for loose candy
 - Makes more than 130 brands of chocolate
 - Produces more than 20,000 tons of chocolate per year
-

Kolomenskoye

Turnover:

Market share: 12 %

Web Page:

- The Moscow Bakery Complex Kolomenskoye is one of the leading companies in bread baking industry in Moscow region.
 - Kolomenkoye produces an extensive assortment of high-quality bakery and pastry products and waffle cakes.
 - Kolomenskoye is the largest manufacturer of waffle cakes in Russia and CIS countries. The company produces 15 kinds of waffle cakes.
 - Among the most popular cakes are the "Shokoladnitca", "Magic Waltz" and "Coconut". The market share of the cake "Shokoladnitca" is 12 % in terms of sales volume
-

Frito-Lay /PepsiCo

Turnover:

Market share: 42 % Russia

Web Page:

- Frito-Lay started selling chips in Russia in 1995
-

Sibirsky Bereg

Turnover:

Market share: 30 % Moscow, 12 % Russia

Web Page: <http://www.sibbereg.ru/>

- Sibirsky, established in late 1999, with strong brands *Kirieshki* and *Kompashki*, controls 12 per cent of the Russian toasted snacks market
 - With original marketing strategy, new ways of moving the product and well-defined sales structure the company has grabbed 30 per cent of the Moscow market
 - Sibirsky has two factories – one in Moscow and the second one in Novosibirsk
 - In 2004 it had sales worth \$140 mln
 - The company has subsidiaries or sales offices in Dnepropetrovsk, Ekateriburg, Minsk, Moscow, Nizhniy Novgorod, Novosibirsk, Rostov-na-Donu, Saint-Peterburg, Samara, Ust-Kamenegorsk and Vladivostok
-

Saratovskaya Confectionery Factory

Turnover:

Market share:

Web Page:

- Saratovskaya Confectionery Factory is one of the most rapidly developing companies in the food industry of Saratov region.
- Saratovskaya started in 1924. The cooperative association produced several kinds of confectionery products, among which there were waffles and hard candies.
- The company's assortment now includes more than 50 kinds of chocolates and candies, waffles, cakes, cookies, etc.
- Saratovskaya Confectionary Factory supplies its customers in Moscow, St-Petersburg, Samara, Astrakhan, Ufa, Stavropol, Barnaul, Krasnodar, Birobidzhan and other cities of Russia

Russky Product

Turnover:

Market share:

Web Page: <http://www.rusprod.ru>

- Russky Product is the largest Russian producer of grocery product. The Company produces soup concentrates, potato chips (around 15% of the total market, in terms of physical volumes), coffee, and convenience foods (around 15 to 20% of 'sweet' products and up to 50% of bakery products)
 - The Company's specialty is high-quality foods intended for the medium-price market segment and capable of offering competition to best U.S. and European products.
 - Russky Product has production facilities in Moscow and in Kaluga Region and warehouses in Novosibirsk and Samara.
 - The Company management and a group of foreign sponsors together control 95% of Russky Product's equity capital.
-

Odintsovo Confectionery Plant (TM "A.Korkunov")

Turnover:

Market share:

Web Page: <http://www.korkunov.ru/>

- Korkunov's production facility was built in 1997–1999 outside Moscow
 - The output of the factory is more than 8 000 tons a year
-

Russky Biskvit

Turnover:

Market share:

Web Page: <http://www.rusbiscuit.ru/>

Udarnitsa Confectionery Factory

Turnover:

Market share:

Web Page: <http://www.udarnitsa.ru/>

Confectionery Factory 1st May

Turnover:

Market share:

Web Page: <http://www.1may.ru/>

Confectionery Factory Mehta

Turnover:

Market share:

Web Page: <http://www.mechta-kf.ru/>

Confectionery Factory Neva

Turnover:

Market share:

Web Page: <http://www.kfneva.ru/>

Russian Snack Company/ Chips Group /Orkla

Turnover:

Market share: 10 %

Web Page:

- Chips Group acquired Russian Snack Company in May 2003
 - The company is a wholly owned subsidiary
-

Appendix 2. Statistics of Russian regions

	Population thou. 1.1.2005	Population percent of total	Gross Regional Product 2004, billion RUB	Share of total gross domestic product	Gross Regional Product per capita, RUB	Retail Trade turnover mln RUB 2004	Retail trade per capita	Price of a minimum food basket, August 2005	Average monthly salary per capita RUB, Jan-Jul 2005	Average monthly income per capita RUB, Jul 2005	Average money income divided by food basket	Share of the regional purchasing power of the total Russian PP
Russian Federation	143 474	100.0	11 582	100	80 727	5 597 703	39 015	1 344	8 051	7 874	5.86	100.00
Central Federal District	37 546	26.2	3 940	34.0	104 928	2 162 416	57 594	1 372	8 879	10 744	7.83	34.96
Moscow	10 407	7.3	2 441	21.1	234 601	1 370 135	131 660	1 635	13 039	24 240	14.83	18.36
Moscow region	6 630	4.6	447	3.9	67 439	283 362	42 741	1 433	8 964	7 548	5.27	4.15
Yaroslavl region	1 339	0.9	105	0.9	78 061	31 653	23 645	1 300	6 929	6 263	4.82	0.77
Voronezh region	2 334	1.6	105	0.9	45 028	64 336	27 564	1 208	5 201	5 095	4.22	1.17
Lipetsk region	1 190	0.8	98	0.8	82 444	34 181	28 726	1 132	6 584	5 390	4.76	0.67
Belgorod region	1 512	1.1	80	0.7	52 726	36 560	24 186	1 187	6 387	5 102	4.30	0.77
Tula region	1 622	1.1	77	0.7	47 660	38 792	23 918	1 291	6 035	5 019	3.89	0.75
Tver region	1 426	1.0	74	0.6	51 978	40 513	28 418	1 315	6 207	5 604	4.26	0.72
Vladimir region	1 487	1.0	67	0.6	45 051	24 935	16 767	1 276	5 917	3 774	2.96	0.52
Ryazan region	1 195	0.8	66	0.6	55 491	29 967	25 081	1 212	5 845	4 676	3.86	0.55
Kursk region	1 199	0.8	60	0.5	49 621	30 525	25 456	1 131	5 248	5 035	4.45	0.64
Kaluga region	1 022	0.7	53	0.5	52 276	31 232	30 575	1 270	6 566	5 296	4.17	0.51
Smolensk region	1 019	0.7	52	0.4	50 736	30 999	30 421	1 355	5 890	5 064	3.74	0.45
Tambov region	1 145	0.8	51	0.4	44 462	29 400	25 681	1 131	4 739	5 065	4.48	0.61
Bryansk region	1 347	0.9	49	0.4	36 094	30 897	22 946	1 146	4 928	4 602	4.02	0.64
Orel region	842	0.6	46	0.4	54 494	21 357	25 356	1 181	5 100	4 826	4.09	0.41
Ivanovo region	1 115	0.8	36	0.3	32 290	17 426	15 630	1 163	5 029	3 177	2.73	0.36

Kostroma region	718	0.5	33	0.3	45 993	16 147	22 504	1 277	5 524	4 368	3.42	0.29
North West Federal District	13 731	9.6	1 154	10.0	84 029	502 974	36 631	1 472	9 271	8 607	5.85	9.55
Saint-Petersburg	4 600	3.2	436	3.8	94 717	199 245	43 314	1 478	10 178	12 080	8.18	4.47
Leningrad region	1 653	1.2	132	1.1	80 102	38 135	23 072	1 488	8 111	5 101	3.43	0.67
Republic of Komi	996	0.7	114	1.0	113 910	55 560	55 760	1 554	11 231	10 751	6.92	0.82
Vologda region	1 246	0.9	114	1.0	91 690	31 461	25 260	1 384	8 592	6 678	4.83	0.71
Arkhangelsk region	1 305	0.9	108	0.9	82 484	43 868	33 628	1 511	9 400	7 773	5.14	0.80
Murmansk region	873	0.6	82	0.7	93 492	39 312	45 041	1 687	11 868	8 233	4.88	0.51
Kaliningrad region	945	0.7	51	0.4	54 286	28 822	30 499	1 471	6 877	6 542	4.45	0.50
Republic of Karelia	703	0.5	48	0.4	68 411	24 267	34 515	1 479	8 315	6 747	4.56	0.38
Novgorod region	674	0.5	39	0.3	58 003	18 338	27 204	1 394	6 490	5 128	3.68	0.29
Pskov region	737	0.5	30	0.3	41 129	23 967	32 533	1 334	5 531	4 668	3.50	0.31
Nenetsky auton. area	42	0.0	25	0.2	600 000	1 633	38 874	2 408	21 937	14 187	5.89	0.03
South Federal District	22 821	15.9	900	7.8	39 451	618 685	27 111	1 218	5 464	5 368	4.41	11.97
Krasnodar Territory	5 100	3.6	276	2.4	54 075	167 382	32 818	1 278	6 063	5 556	4.35	2.64
Rostov region	4 334	3.0	183	1.6	42 313	152 255	35 127	1 172	5 611	6 494	5.54	2.86
Volgograd region	2 655	1.9	138	1.2	51 785	80 031	30 141	1 195	5 629	5 753	4.81	1.52
Stavropol Territory	2 718	1.9	110	1.0	40 509	79 870	29 387	1 245	5 133	5 352	4.30	1.39
Republic of Dagestan	2 622	1.8	55	0.5	20 940	58 149	22 179	1 180	3 550	4 639	3.93	1.23
Astrakhan region	998	0.7	54	0.5	54 398	25 937	25 983	1 177	6 673	5 191	4.41	0.52
Republic of Kabardino-Balkaria	897	0.6	27	0.2	30 104	18 684	20 831	1 179	4 365	4 113	3.49	0.37
Republic of Northern Osetia - Alania	704	0.5	21	0.2	29 671	12 668	17 984	1 188	4 320	5 734	4.83	0.40
Republic of Karachaevo-Cherkessia	435	0.3	12	0.1	27 388	9 601	22 096	1 186	4 553	4 332	3.65	0.19

Republic of Adygea	444	0.3	10	0.1	22 952	8 776	19 747	1 253	5 016	3 577	2.86	0.15
Republic of Kalmykia	290	0.2	10	0.1	32 770	3 001	10 352	1 121	4 160	2 063	1.84	0.06
Republic of Ingushetia	482	0.3	5	0.0	9 967	2 333	4 844	1 408	5 433	1 906	1.35	0.08
Privolzhsky (Volga) Federal District	30 710	21.4	1 964	17.0	63 953	940 792	30 635	1 211	6 146	6 078	5.02	18.33
Republic of Tatarstan	3 769	2.6	319	2.8	84 676	121 737	32 304	1 142	6 690	7 109	6.22	2.79
Republic of Bashkortostan	4 079	2.8	280	2.4	68 574	133 568	32 747	1 177	6 354	6 689	5.68	2.76
Samara region	3 201	2.2	275	2.4	85 871	182 205	56 916	1 349	7 205	9 428	6.99	2.66
Perm region	2 770	1.9	232	2.0	83 797	101 149	36 519	1 289	7 215	7 905	6.14	2.02
Nizhny Novgorod region	3 445	2.4	222	1.9	64 552	115 731	33 591	1 210	6 214	6 139	5.07	2.08
Saratov region	2 626	1.8	131	1.1	50 006	67 220	25 601	1 172	5 372	4 705	4.01	1.25
Orenburg region	2 150	1.5	125	1.1	58 222	40 886	19 013	1 183	5 677	4 919	4.16	1.06
Republic of Udmurtia	1 553	1.1	98	0.8	62 919	31 793	20 475	1 217	6 183	4 379	3.60	0.66
Kirov region	1 461	1.0	62	0.5	42 702	30 238	20 693	1 294	5 305	4 476	3.46	0.60
Ulyanovsk region	1 351	0.9	58	0.5	43 163	34 258	25 363	1 165	5 147	4 630	3.97	0.64
Republic of Chuvashia	1 299	0.9	50	0.4	38 636	23 713	18 250	1 114	4 876	4 118	3.69	0.57
Penza region	1 423	1.0	49	0.4	34 580	32 231	22 653	1 210	5 103	4 068	3.36	0.57
Republic of Mordovia	867	0.6	37	0.3	42 580	15 278	17 630	1 200	4 784	3 943	3.28	0.34
Republic of Marii El	717	0.5	25	0.2	34 314	10 787	15 047	1 185	4 806	3 150	2.66	0.23
Komi-Perm auton. area	133	0.1	3	0.0	23 343	1 327	9 990	1 126	4 266	2 733	2.43	0.04
Ural Federal District	12 279	8.6	1 777	15.3	144 733	487 826	39 728	1 416	11 037	9 312	6.58	9.60
Tumen region	3 308	2.3	1 194	10.3	361 028	186 293	56 324	1 687	18 479	14 571	8.64	3.40
Khanty-Mansiysky auton. area -Yugra	1 469	1.0	761	6.6	517 971	98 850	67 291	1 742	20 643	17 420	10.00	1.75
Yamalo-Nenetsky auton. area	523	0.4	326	2.8	623 424	34 896	66 672	2 000	26 692	20 116	10.06	0.63

Sverdlovsk region	4 428	3.1	314	2.7	70 864	173 715	39 229	1 380	8 145	8 501	6.16	3.25
Chelyabinsk region	3 551	2.5	230	2.0	64 876	104 535	29 435	1 284	7 401	6 777	5.28	2.23
Kurgan region	992	0.7	39	0.3	39 210	23 284	23 469	1 166	5 327	4 477	3.84	0.45
Siberian Federal District	19 794	13.8	1 266	10.9	63 968	653 429	33 011	1 331	7 618	6 500	4.88	11.50
Krasnoyarsk Territory	2 925	2.0	283	2.4	96 568	105 790	36 163	1 477	9 787	7 590	5.14	1.79
Irkutsk region	2 545	1.8	177	1.5	69 540	83 555	32 827	1 452	8 578	6 996	4.82	1.46
Kemerovo region	2 855	2.0	171	1.5	60 035	110 584	38 733	1 247	8 176	7 407	5.94	2.02
Novosibirsk region	2 662	1.9	168	1.5	63 103	104 234	39 152	1 312	6 885	6 421	4.90	1.55
Omsk region	2 047	1.4	126	1.1	61 419	66 508	32 497	1 148	6 685	7 096	6.18	1.50
Tomsk region	1 037	0.7	104	0.9	100 039	36 714	35 418	1 311	9 047	8 155	6.22	0.77
Altay Territory	2 566	1.8	90	0.8	35 158	66 261	25 827	1 175	4 672	4 340	3.69	1.13
Chita region	1 136	0.8	56	0.5	48 957	33 543	29 535	1 481	7 217	5 548	3.75	0.51
Republic of Buryatia	969	0.7	47	0.4	48 287	27 745	28 627	1 454	7 243	5 657	3.89	0.45
Republic of Khakassia	541	0.4	29	0.3	53 974	10 757	19 883	1 401	7 398	4 711	3.36	0.22
Republic of Altay	204	0.1	8	0.1	38 254	3 352	16 439	1 335	5 494	4 047	3.03	0.07
Republic of Tyva	308	0.2	8	0.1	26 983	4 387	14 262	1 430	6 591	3 695	2.58	0.09
Ust-Ordynsky Buryatsky auton. area	134	0.1	4	0.0	31 320	837	6 240	1 235	4 187	2 061	1.67	0.03
Taymyr (Dolgano-Nenetsky) auton. area	39	0.0	3	0.0	76 142	1 318	33 439	2 541	19 248	8 797	3.46	0.02
Evenkia auton. area	17	0.0	2	0.0	109 195	411	23 626	2 318	13 080	6 264	2.70	0.01
Aginsky Buryatsky auton. area	74	0.1	2	0.0	27 211	1 694	23 050	1 414	4 709	5 151	3.64	0.03
Far East Federal District	6 593	4.6	581	5.0	88 154	231 580	35 125	1 860	10 630	8 845	4.75	3.73
Republic of Sakha (Yakutia)	951	0.7	133	1.1	140 002	45 113	47 452	2 074	12748,0	10 647	5.13	0.58
Primorsky Territory	2 036	1.4	124	1.1	60 910	64 629	31 746	1 747	8 715	7 179	4.11	1.00

Khabarovsk Territory	1 420	1.0	123	1.1	86 326	47 597	33 514	1 738	10 102	9 712	5.59	0.94
Sakhalin region	532	0.4	67	0.6	126 597	24 400	45 831	2 113	14 044	12 884	6.10	0.39
Amur region	888	0.6	55	0.5	61 740	23 592	26 579	1 571	8 352	6 252	3.98	0.42
Kamchatka region	352	0.2	29	0.3	83 215	12 327	35 011	2 417	14 195	9 651	3.99	0.17
Magadan region	175	0.1	23	0.2	131 654	5 954	34 084	2 187	13 300	12 160	5.56	0.12
Chukotka auton. area	51	0.0	18	0.2	362 919	2 134	42 063	4 225	20 337	12 971	3.07	0.02
Jewish auton. area	189	0.1	9	0.1	45 551	5 836	30 911	1 706	7 772	6 356	3.73	0.08
Koryaksky auton. area	24	0.0	4	0.0	180 672	652	27 403	3 504	15 713	8 251	2.35	0.01

Source: Goskomstat