

## Retail Trade and Retail Chains in Russia and the Kaliningrad Region: From Dynamic Development to Prolonged Recession

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### Abstract

*The collapse of the Russian stock market, which brought the RTS index almost 45% down in the end of 2014, reaching a minimum value in Russian economic history, was named as a 'black Tuesday'. Along with the collapse of the currency market and a sharp depreciation of the ruble, the situation led to a radical change in the environment in which the Russian retail trade is operating. Within the frames of this publication the current situation (at the end of 2014) is analyzed and forecast of the industry in the second half of 2015 and thereafter in 2016 is formulated, both for the industries in the Kaliningrad region, and nationwide.*

**Keywords:** Kaliningrad region, retail trade, trade chains

### 1. Introduction

Retail trade as a sector of the regional economy is characterized by the ability to extremely fast reflect all the changes that occur in social and economic development of the territory. If the pace of development in the region grows, then the retail trade is the industry, which will demonstrate the immediate positive change. Although, if the region is about to face a crisis, the first signs of it can be seen in this particular sector. In fact, the retail trade stands as an indicator of the overall socio-economic situation in the country and in a certain region. It makes sense to consider the change in the situation in the retail sector of the period in order to understand how socio-economic situation was changing in the Kaliningrad region in 2014 – 2015. The first part of the article gives the analysis of the situation in the retail trade in the region in the first half of 2014 (i.e. before the crisis). The second part is devoted to the situation in the period of external (followed by domestic) changes in the development of the region, i.e. the second half of 2014 – the first half of 2015. Finally, the authors forecast the situation in the retail trade in the short term, namely the period from the second half of 2015 to 2017.

### 2. Retail Trade of the Kaliningrad Region in Comparison to the Average Russian Indicators

Since the beginning of market reforms in the country and over another 25 years the retail trade both in Russia and in the Kaliningrad region was one of the fastest growing sectors of the economy, it accumulated significant labor force and showed substantial growth throughout the period under study. In 1999 - 2012, the turnover of retail trade in the country increased by 2.6 times (Bolychev, 2013). The same indicator dropped in 2008-2009, caused by the consequences of the global economic crisis, though the retail trade as well as the entire economy of the country coped with it fairly quickly as early as 2011 (for some indicators by 2010), having returned to the pre-crisis level.

At the end of 2013, retail trade turnover in Russia in current prices amounted to 23 trillion roubles (MED, 2013), and in prices compared to 2012 its growth was around 3.9%, which is a significant slowdown compared with the industry's growth in previous years. Thus, in 2006 - 2009 Russia, along with Brazil was among the world leaders in terms of retail sales growth, the Russian figures for this period fluctuated between 6.3 - 7.9% (Bolychev, 2013).

Despite the fall in growth rates, retail sales in Russia continued to show a positive trend in 2013- 2014, exceeding the growth rate of other economy sectors. For example, in the first quarter of 2014 the turnover growth reached 3.2% in retail trade, 1.4% in the industry, 1.3% in agriculture, 0.9% in public paid services. (Business climate, 2014).

Compared to the average national, indicators of the Kaliningrad region are much more modest, which is primarily determined by the region exclave location. Thus, the slowdown in retail development in the Kaliningrad region was noted as early as 2013 (retail trade turnover at the end of 2013 grew by only 1.5%, while at the end of 2012 this figure was

4.8%). Given the political isolation of the region, area retailers compete not only among themselves, but with other countries counterparts (mainly Polish and Lithuanian), which objectively, technically, and institutionally are more advanced. Compared to Russian companies, their administrative costs and corruption are significantly minimized, which makes Russian retailers uncompetitive. Shifts in exchange rates, which took place at the end of 2014 (primarily the rate of the Russian ruble to the Polish zloty and Lithuanian litas), formed a more objective picture. Many experts acknowledged that before the events of 2014 many Russian goods and services were overpriced in comparison with Poland and Lithuania. It is proved by an instant reaction of the population, when the queues at the Russian-Polish and Russian-Lithuanian border crossings changed their vector and significantly reduced the flow of travelers subject of the Russian population, the Russian outflow decreased while the incoming flow from neighboring countries rapidly increased.

According to the Federal Statistics Service of the Kaliningrad region, in October 2014 goods and services cost 72.8% of incomes of the population in the region (in September 2014 the figure was 74%). The costs of savings amounted to 6.6% (9.4% in September), foreign currency purchase amounted to 14.1% (7.7% in September) (Structure, 2014). In the dynamics of retail trade turnover in September 2014 sales of food products increased by 8.7% compared to September 2013 and decreased by 5% compared to August 2014 (Dynamics, 2014). Sales of non-food products dropped significantly, amounting to only 94% from the level of 2013 and 96% from the 2012 level.

In September 2014 compared to December 2013 prices increased by 30% on poultry, 28% on meat products, 22% on fruit and vegetable products, 11% on alcoholic beverages of more than 30% for cereals and beans. Analysis of the retail trade turnover dynamics and the growth of food prices, combined with the continuing decline in real income of the population meant redistribution of expenditures, giving priority to food products, primarily in the lower price segment. Higher food expenditures are known to be typical for less affluent population, therefore there is a tendency for lower standard of living in Kaliningrad.

### **3. Retail Trade of Russia in the Second Half of 2014: A Change of Forecast and Analysis of the Current Situation**

We must recognize that the modern Russian expert community is more engaged in commenting on the current situation, rather than analyzing and forecasting the development of retail trade. This statement is graphically illustrated by three analytical reviews of "The National Rating Agency" on the retail trade in Russia. For example, a report in 2012 was named "Retail trade: A Favorable Forecast" (Retail trade, 2012), in 2013 - "Retail: growth drivers" (Retail trade, 2013), in 2014 - "Retail: modest prospects" (Retail trade, 2014). Even considering the names of analytical reviews, predicting the situation at least in the medium term (two years or more) became visibly difficult. Meanwhile, the expert community almost unanimously agreed that the performance of the retail trade exhibited in 2006-2008, would inevitably exhaust themselves and the growth would get replaced by a significant decline in a maximum of 5-6 years.

The growth forecast in retail trade turnover in Russia in 2015 was originally established at a rate of 2.1%, but later the Ministry of Economic Development of Russia significantly reduced the growth forecast to 0.6% (MED, 2014), due to growth of real incomes by 1.2%.

The forecast of socio-economic development of the Kaliningrad region for 2014 and the planning period of 2015-2016 set the average increase in consumer prices in the range from 4.7 to 5.2% (Ministry of Economics, 2014). In reality, by January 1, 2015 the increase in the consumer price index in the region for all kinds of goods and services amounted to 19.5% compared to the corresponding period of the previous year (the increase in food prices by 22% and non-food by 15.1%) (Index, 2015). In August 2015, consumer price index was 16.1% for all kinds of goods and services (increase in food prices was 18% and 15% for non-food) in relation to the corresponding period of the previous year.

Per capita retail trade turnover in the region in 2014 amounted to 123.1 thousand rubles (average Russian figure in 2014 amounted to - 165.0 thousand rubles). The retail trade turnover structure in the Kaliningrad region to a small extent is dominated by non-food products, whose share at the end of 2014 was 54.7%.

Given the role of border factor in the development of retail trade in the Kaliningrad region, it should be noted that Polish experts predicted great future for retailers in Polish border regions (Poland, 2014) due to the difference in prices on goods, works and services between regions of Poland and the Kaliningrad Region (Results, 2013). According to some Russian experts, Kaliningrad retail chains have lost from 7 to 20% of their turnover since the start of the small border traffic (Musevich, 2014). The steps taken neither by the retailers in the region, nor the government of the Kaliningrad region could change the situation. It is actually a change in the geopolitical situation and the adjustment of exchange rates that could, in fact, turn the situation quite to the opposite.

#### 4. Recommendations and Suggestions for Improving the Strategies of Retailers in the Kaliningrad Region: A Short-term Forecast

In the current 2015 in the Kaliningrad region all sectors of the economy, including in the retail sector are undergoing a recession. Retail trade turnover in the region in January-August 2015 amounted to 94.8 billion rubles, which in comparable prices is 96.4% of the corresponding period of 2014, in August of 2015 - 12.5 billion rubles, compared with August 2014 - 94.4% July 2015 - 103.2%. In the considered time period the turnover was formed by trading organizations and individual entrepreneurs operating outside the market by 96.5%, the share of retail markets and fairs was 3.5% while in January-August 2014 the respective figures showed 96.9% and 3.1%. In the structure of retail trade turnover the share of food products, beverages and tobacco products amounted to 51.4%, non-food products - 48.6%.

Russian expert community expects a challenging situation in the national economy for at least 2-3 forthcoming years. After two years of stagflation, or deceleration of the economy in 2014 and its fall in 2015 alongside with a two-year acceleration of price increase, 2016 and 2017 will be another two years of recession. Experts predict an economic recession of at least 5% due to a stronger than expected slowdown of consumption and worsening investment crisis. In the current 2015, not a single component shows any positive dynamics. Industrial production, retail trade turnover, investment in fixed assets, foreign trade, real incomes - all these components show a negative trend. The economy can develop some growth trends, at best, only after 2018, when it can reach growth rates of 2-3% per year.

Considering this situation, retailers of the Kaliningrad region are advised to make an adjustment of the market strategy for the second half of 2015 and 2016 (and possibly until 2018). Summing up, the adjustment steps could include: firstly, to sort out the base assortment of goods opting for a lower price category, to reduce or convert some retail facilities of large retail chains. It would greatly minimize the cost of the enterprise; Secondly, the current real wages and rents must be retained in rubles, which will also reduce the costs and increase the competitiveness of a certain retailer.

A significant fall in the ruble exchange capacity makes retailers of Poland and Lithuania uncompetitive, which will facilitate a massive outflow of Russian buyers from retailers of Lithuania and Poland and attract a significant influx of buyers from these countries to retailers in the region. Thus, companies in the region can enter a very large market in the neighboring countries. It will save (and even increase) profit to a company. Moreover, lower volumes of consumer credits enable retailers to rely not only on the current savings of the population, as it will affect the purchase of expensive durable goods for at least the next two years. This must be considered in determining the retail specialization and adjusting the assortment.

The current situation is forcing retailers to reduce or waive the investment projects in short term. Moreover, reducing the number of jobs could become a forced measure to preserve one's own competitiveness. Overall, in 2015 the Kaliningrad retail trade expects to reduce jobs by 7-9% of the number of employed in August 2014.

#### 5. Conclusion

The main and indisputable conclusion that can be formulated in the current situation is that the entire retail trade both in Russia as a whole and in the Kaliningrad region in particular is having very hard times, which require a new strategy for the development of retail trade enterprises. Basic provisions of this strategy have been formulated above. We see it unlikely for the retailers to get back to the growth of major economic indicators before 2017 (assuming positive external and internal factors) or even 2018 (according to a realistic forecast of the socio-economic situation in Russia in general and in the Kaliningrad region in particular). In addition, we believe the growth of retailers will be encouraged by a systemic policy aimed at minimizing administrative barriers, increasing and strictly adhering to the rules of competition freedom both on the domestic and foreign markets, providing free access to credit on the terms reasonable for retailers.

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