

Impact of sanctions on the Russian fish industry: A pig in a golden poke

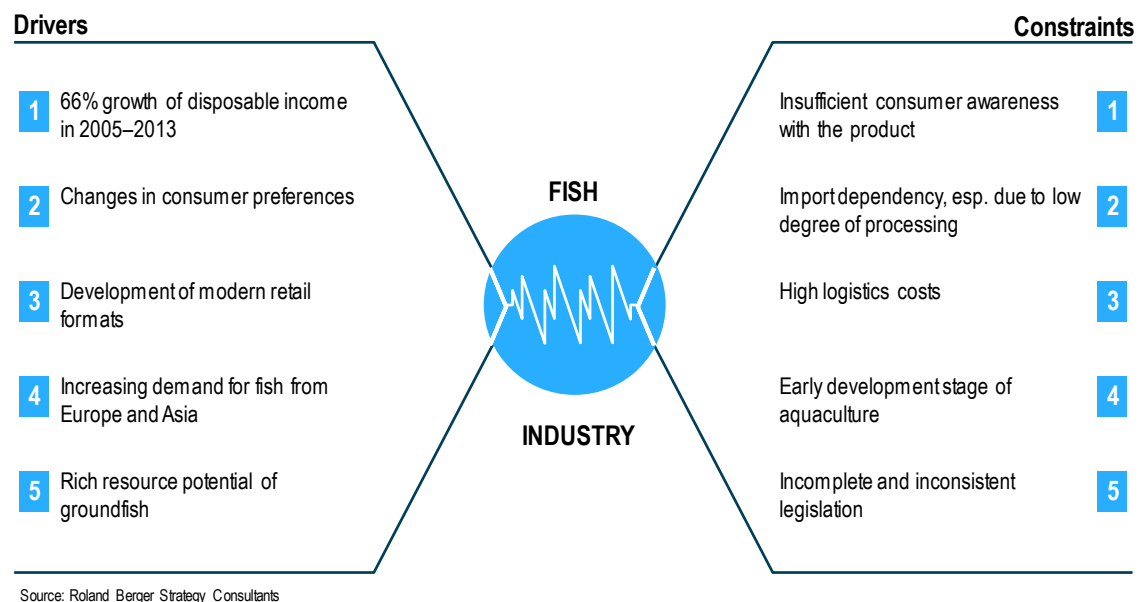
Summary of the Russian Fish Market study by
Roland Berger Strategy Consultants



Fish import embargo revealed itself as the ultimate test for the Russian fish industry. Processors lost the major part of their feedstock, some of them were forced to temporarily shut down their factories, HoReCa¹ had to hastily revise its assortment and the supply chain. But is the industry really so weak and vulnerable? Or is it about time to rethink the strategy?

Roland Berger Strategy Consultants have prepared a new study of the fish industry in Russia. The study unveiled a huge potential both in supply and demand, which is not utilized to its full extent. We believe that long-term development success of the fish industry in Russia lies in consistent and elaborate government policy as well as in timely strategic decisions by the market players.

Drivers and constraints of the fish industry in Russia



Favorable conditions for successful growth

Russia is deeply integrated into the global fish market, exporting ~60% of the total catch² (58% in 2013). The global demand, meanwhile, increased by 34% since 2002, driven mainly by population and income growth in the emerging countries of Asia, and is currently estimated at 135 m tons³. Demand from Europe is of special importance for Russia, since the EU is the largest importer of fish in the world, accounting for 24% of the global fish trade and consuming mainly groundfish, tuna and salmon (23%, 11% and 9%, respectively). At the same time, the EU self-sufficiency index (production/domestic demand) for groundfish was only 18-25% in 2008–2011 and continues to decline.

In 2013, the domestic fish market was 3.6 m t⁴. Between 2005 and 2012, it went up 35%, showing a CAGR of 4.4%. This growth was mainly driven by increase in disposable income, changes in consumer preferences and development of modern retail formats. Specifically, the

¹ HoReCa – Hotels, Restaurants, Café/Catering

² Live weight equivalent

³ Live weight equivalent

⁴ Live weight equivalent

growth of the real disposable income per capita reached 66% in 2005–2013. Penetration rate of modern retail formats in 2013 was estimated at 61%⁵ vs. 39% in 2008. The people in Russia are also becoming more involved with healthy eating, i.e. balanced, dietary, organic food. Fish is undoubtedly a key product for such a menu. The health trend is supported and cultivated through printed and online media (such as "*Zdorovye*", "*Zhit' zdorovo!*", *glossy magazines, etc.*), evolving sports and fitness industry (e.g., "*Zhivi!*" channel), healthy eating projects (e.g., "*Bud' zdorow!*" program by CAF), HoReCa and premium retailers (*Azbuka Vkusa, Globus Gourmet, Izbenka, Fresh, Starik i More, Svoi Lyudi*).

Regarding supply, Russia accounts for approximately 3% of global fish supply, represented mainly by catch⁶, and has a substantial groundfish and herring resource potential. The country is top-exporter in Pollock (90% of the global catch together with the USA) and cod (20%), and second in herring (21% of the global catch).

Russian consumers are not familiar enough with fishery products

Historically, fish used to be a rather unusual product in the menu of an average Russian, unlike meat. The Soviet Union is known for its attempt to promote fish by introducing Thursdays as fish days. This is the main reason why Russians know so little about the health benefits, cooking methods and types of fish. An interesting result was recently obtained in an expert⁷ survey: only 33% of the fish web-portal visitors ate fish regularly, and almost 100% were ready to eat more of it if they needed to maintain a healthy diet.

There is a big room for improvement in fish marketing and sales, or "route-to-market strategy". The current state – limited offer of fresh and processed fish in retail stores; poor promotion of health aspects, cooking methods (especially combination with other foods) and diversity of fish products by fisheries and HoReCa; poor assortment of fish food in grocery retail stores, including lack of specialized fish food stores. Meanwhile, meat is being actively promoted through a large number of stake-houses openings, while the white fish – a product that can at least partly substitute meat in a menu (pollock, cod, haddock, etc.) and is vastly available in the country – is out of focus. Interestingly, sushi turned out to be widely popular in the European part of Russia. Proper marketing has led to quick opening of numerous sushi bars and introduction of sushi menus in cafés and restaurants.

Import dependency: a result of the embryo state of aquaculture and inefficient logistics

39%⁸ of the fish consumed in Russia today is imported. Salmon and herring comprised the largest share of this volume in 2013 – 21% and 13%⁹, respectively. At the same time, the domestic catch of these species reached 430 and 476 thous. tons¹⁰ in 2013, but 40% and 72% of it is sold abroad.

The lack of domestic resources is the main reason for Russia's salmon import dependency. Promotion of local aquaculture could solve this issue – 77% of the salmon sold globally comes from fish farms. In Norway – the leading supplier of salmon to Russia prior to sanctions (~60%) – aquaculture constitutes almost 99% of the harvest. Key Russian salmon processors have already attempted to minimize volatility of feedstock price: Baltiyskiy Bereg and Russkoe More

⁵ Euromonitor

⁶ Aquaculture represents 3% max. in the Russian production

⁷ Fishnews – web-portal specialized in information support of fish industry

⁸ Equals to 60% in live weight

⁹ 214 and 129 thousand tons in product weight

¹⁰ Live weight equivalent

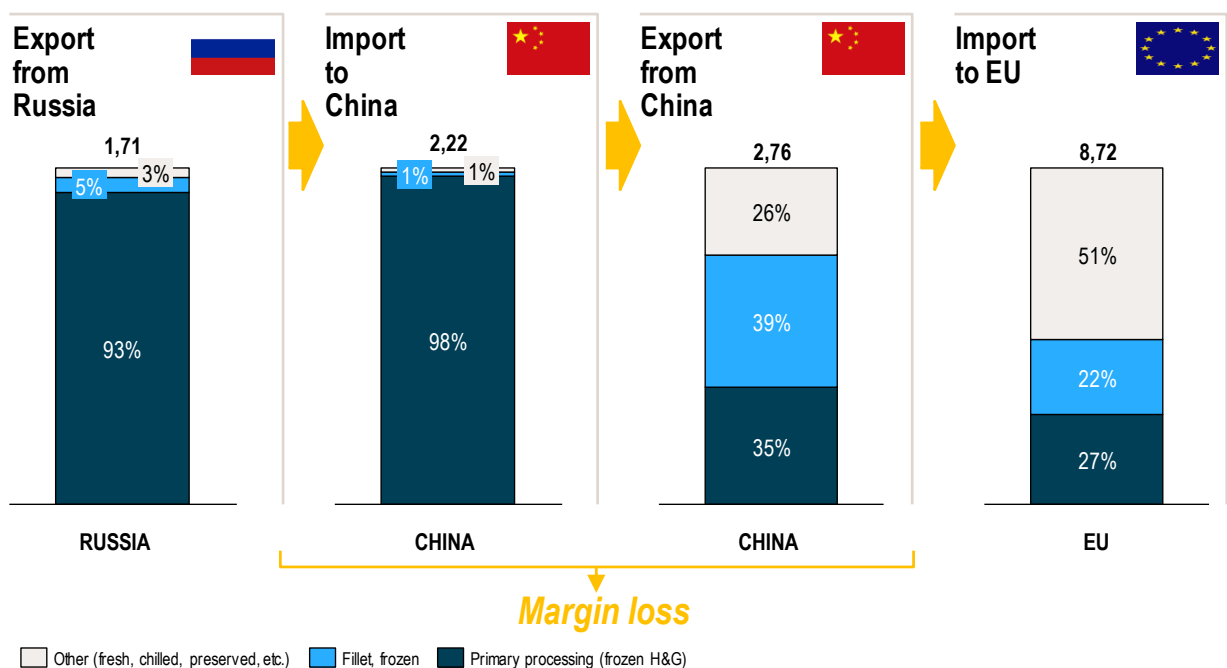
(Russian Sea Group), two large processors, have been trying to conquer this difficult segment since 2005, but, 34,000 t of salmon coming from domestic aquaculture (in 2012) are still too low to satisfy the domestic demand. The processors are ready to supply 130,000 t by 2020, provided that the economic and regulatory environment is favorable. As for now, aquaculture development in Russia is being held back by the lack of consistent aquaculture legislation and high CAPEX that very few players can afford without state support.

Another reason for import dependency is distorted production and consumption geography. 80% of herring and 85% of salmon are harvested in the Far Eastern District. For Far Eastern fisheries, export makes much more sense as the logistics of fish delivery across Russia is very expensive and unpredictable (especially during the fishing season). Chinese and Korean buyers offer good prices for Russian fish to keep high utilization rate of their factories and benefit from growing Asian and European markets. This issue is especially true for herring due to its low margin level (ex-vessel wholesale price in the Far Eastern District is approximately RUB 20-30 per kg). Besides, exporters deal with considerably less bureaucracy than their peers selling on the domestic market.

Purely raw-exporter on the global market

Over 90% of fish exported from Russia is primary processed (frozen H&G). Such product, however, constitutes only 25–30% of the European import. The EU is among the largest importers and consumers of white fish in the world, but receives the fish mainly from China, Norway, and Iceland, while often it is a Russian fish in the first origin. Basically, Russia loses the margin and the processor's status in favor of the largest global "fish factories" – China and Korea – by selling them 98% of caught pollock, 80% of haddock and 25% of cod.

Current export chain of fish from Russia (export and import structure of key counterparties, processing degree, in m t)



Source: FAO Fish Stat, Roland Berger Strategy Consultants

For comparison: in the U.S. and Norway primary processed fish accounts only for 5% and ~40% of the export, respectively. Therefore, promotion and support of domestic groundfish processing

in Russia are required to raise the economic potential of the industry and build the country brand in the global fish market.

Modernization of coastal processing capacities is a major task in this context and relies, among other things, on consistent regulatory policy. Unfortunately, the opposite is the case today. A prominent example is the decree issued by the Russian government in 2013. It authorized at-sea reloading and processing of cod and haddock, resulting in a ~50% shortage of fresh fish for the coastal processing plants.

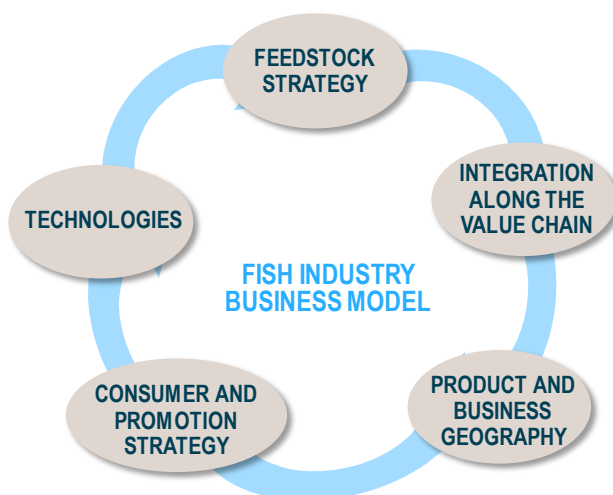
It is evident that resource and production potential utilization in the Russian fish industry is confronted with complex issues. In the context of unstable foreign trade policy and the need to develop domestic industry, it's more important than ever for fisheries to swiftly react to structural changes and set up a flexible growth strategy.

Which levers can drive the industry?

Fishing industry development is a complex process and demands active participation both by the government and the market.

From the business point of view, fish companies need to make the right strategic decision regarding their business models.

MAIN PILLARS OF BUSINESS MODEL



Source: Roland Berger Strategy Consultants

The following strategic **questions** are highly **actual for Russian players** today:

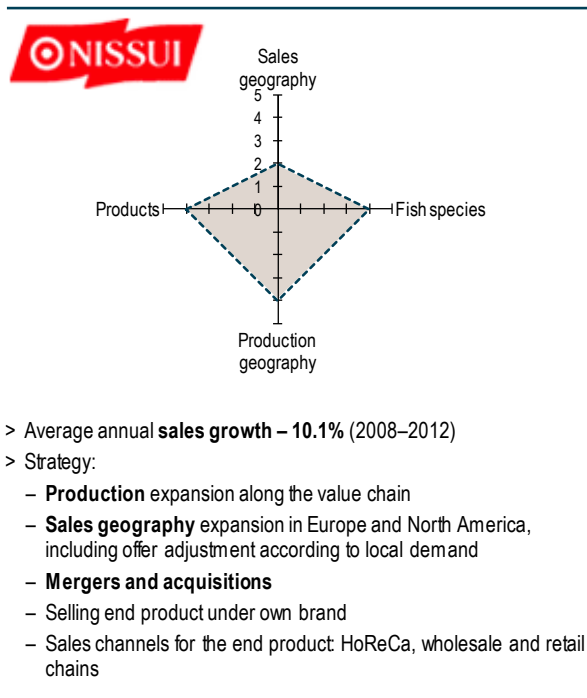
- Feedstock strategy: aquaculture or wild fishing?
- Integration along the value chain: upstream or downstream?
- Product portfolio: focus on certain species or diversification?
- Sales geography: global presence or specific markets?
- Optimal processing strategy: which end product to offer? Which technologies to use?
- Route-to-market strategy: what's the target consumer profile? What marketing policy will provide the maximum outreach? What sales structure is the best? Is it reasonable to develop own retail channels? How to optimize logistics according to feedstock and the consumer's location?
- Catching technologies: under which conditions is it reasonable to implement modern fishing technologies (including GPS, sonar, and RSW)?

Global leaders hold more than one answer to these questions. Based on Roland Berger project experience with international companies in fish industry and numerous analyses of business models of large players, including Maruha Nichiro, Nissui, Austevoll Seafood, and Marine Harvest, two main models could be successful, including diversification by fish species and regions with integration along the value chain (for larger volumes) and focused development even in purely B2C segment.

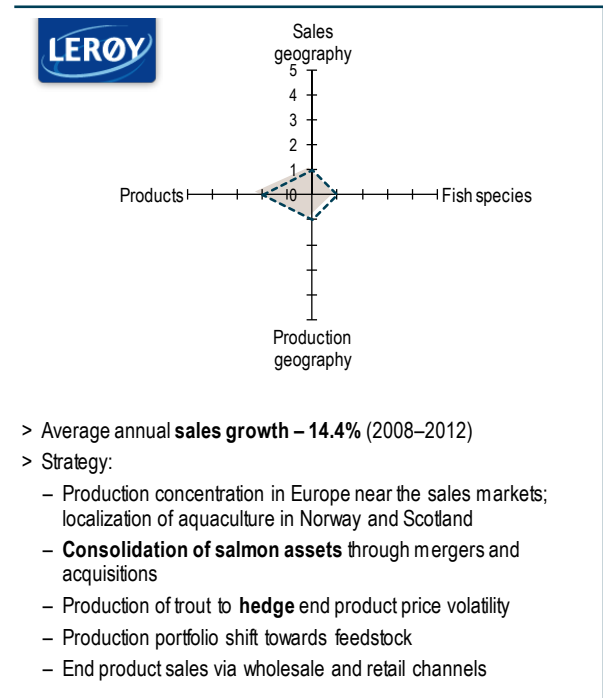
For instance, large global players like Nissui and Leroy, both very different in business models and strategic vision, have demonstrated sustainable growth of sales in the past 5 years – 10% and 14% p.a., respectively. The picture below shows results of comparison of both companies by species, sales, production geography (incl. location of aquaculture assets) and product portfolio.

Example: business models of the largest global fish industry players

Diversification



Focus



Player's index 5 = strong variability; 0 = weak variability

Source: Roland Berger Strategy Consultants

Therefore we see the following priority strategic directions for companies in Russian fish industry:

- **Aquaculture** development to reduce feedstock supply volatility
- Deeper **processing** to increase business margin and volumes
- Investments in **technology** to improve productivity
- **Distribution development** to ensure sustainable supply chain
- Improvement of positioning and **promotion of fish products** on the Russian market.

Experience shows that the described business issues are relevant not only for fish industry, but also for agriculture (e.g. animal breeding and crop farming). Initial situation may be different, but the core remains the same: for successful long-term development, it is vital to make a timely strategic decision.

Nevertheless, even the right strategy is of little value without government support. Roland Berger identified several key tasks and directions of government involvement. It is crucial to:

- **Create an extensive legal base to regulate and promote aquaculture.** The Federal law No. 148 "On Aquaculture (fish farming) and On Amendments to Single Laws of the Russian Federation", passed in 2013, only secured property rights to the market participants. Its practical application and further development of the industry in general require detailing and elaboration of bylaws;
- **Continue with "long quotas" mechanism (application, allocation and use)** to prevent market rentiers and simplify long-term investment planning for fisheries and processors. The mechanism should also reflect the model of vessel use (leasing, ownership, rent);
- **Increase transparency and predictability of export and import control (including Rosselkhozadzor activities) to reduce the risk of unfair competition.** The present export permitting mechanism for Russian companies is not transparent in the part of veterinary and sanitary control, which leads to periodic monopolization of single distribution channels and inhibits industry progress;
- **Develop logistics hubs to reduce logistics costs;** including, regulation of transportation fees from far east to central regions and construction of transport infrastructure.

In conclusion authors would like to emphasize that the described areas of systemic improvement constitute the basis for qualitative development of the fish industry in Russia. Introduction of sanctions is at most a temporary measure that attracted attention to the shortcomings of the domestic industry. This measure alone might foster import replacement only in short term.

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