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Role of MNCs in Changing Preferences for Food Consumption in Russia under Import Substitution

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Abstract:

The paper analyses the changes in the food market in terms of supply and demand in the context of import substitution and a decrease in the purchasing power of the population.

It explores the reasons behind a rise in food prices, studies consumer preferences and criteria for choosing food products, and reveals the distinguishing features of Russian consumers' behavior in the food market under the conditions of the import substitution policy.

The article shows that, in general, multinational companies engaged in the food industry have managed to successfully integrate into the import substitution policy in the context of post-crisis development.

Keywords: *import substitution, multinational corporations, local brands, global brands, customer loyalty, food industry, consumer stereotypes, consumer preferences.*

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1. Introduction

The import substitution policy implemented in recent years in Russia in conjunction with a significant decrease in the purchasing power of the population affects the interests of multinational corporations (MNCs) operating in the Russian market and creates both challenges and opportunities for them.

Due to the fall in the purchasing power of the population and changes in consumer stereotypes and preferences, the “Buy Russian Goods” approach has considerably grown in popularity, and that, in turn, ousted several traditional products and brands of MNCs from the Russian market. Nevertheless, the crisis opens up new opportunities for MNCs, such as participation in satisfying deferred demand coupled with an inevitable stir in consumer expectations in the context of positive economic dynamics. Another advantage is easier access to the Russian market as compared with corporations that have their production capacities outside the country and gain access to the client base via import.

The current state of foreign economic relations between Russia and other countries dictates the necessity to strengthen the domestic consumer goods market. The present paper helps to understand the internal and external effects of economic sanctions. The given analysis is aimed at identifying the factors to bear in mind when substituting products in domestic food markets, as well as at determining what company development strategies to apply.

2. Literature review and research methodology

Wide occurrence of multinational companies is a factor influencing developed and developing countries, as well as transition economies. The role and impact of multinationals are sufficiently widely discussed in the scientific literature. For instance, there are studies examining the variety of factors that attract MNCs to particular markets (Dunning, 1992; Crittenden and Crittenden, 2010; Hennart, 2012), exploring institutional conditions for promoting foreign direct investment (Puffer and McCarthy, 2011), and the reasons for Russia’s appeal for MNCs (Zvirgzde *et al.*, 2013), investigating the risks that foreign companies face when doing business in Russia (Irwin, 2015; Bondarenko *et al.*, 2017; Sibirskaya *et al.*, 2016), considering the effects of economic sanctions on Western companies (Johnston, 2015) and problems of market balance for ensuring food security.

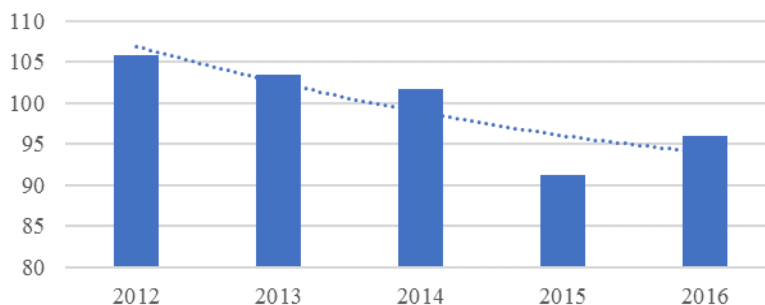
Gurkov *et al.* (2016) conducted a series of interviews with the heads of Russian subsidiaries of Western MNCs to demonstrate management practices and business experience of successful companies. At the same time, in our work, we have encountered the same problem as many other scientists before us that is, the lack of statistical data on manufacturing subsidiaries of multinational corporations and an extreme paucity of publications on the topic in the food industry of Russia.

The analysis of strategies of MNCs operating in the Russian food market was performed using the materials posted on the corporations' official websites and retrieved from other open sources.

3. Results

A sharp decline in hydrocarbon export revenues and economic sanctions imposed by Western countries are the two main factors that contributed to the depreciation of the ruble, accelerated the economic downturn which was first marked as far back as 2009 and led to negative consequences for households. The drop in real disposable income of the population commenced in 2014 – 99% of the 2013 level and continued in 2015 (97%) and 2016 (94%). The number of people whose earnings were below the subsistence level increased by 3.4 million people in 2015, by another 0.3 million people in 2016 and made up 13.5% of the total population, which is by 2.8% more than in 2012 (Russia in figures, 2017). The actual household final consumption expenditure began to go down as far back as 2012, and there was a significant decrease in 2015 (Figure 1).

Figure 1. Actual household final consumption expenditure as percentage of the previous year.

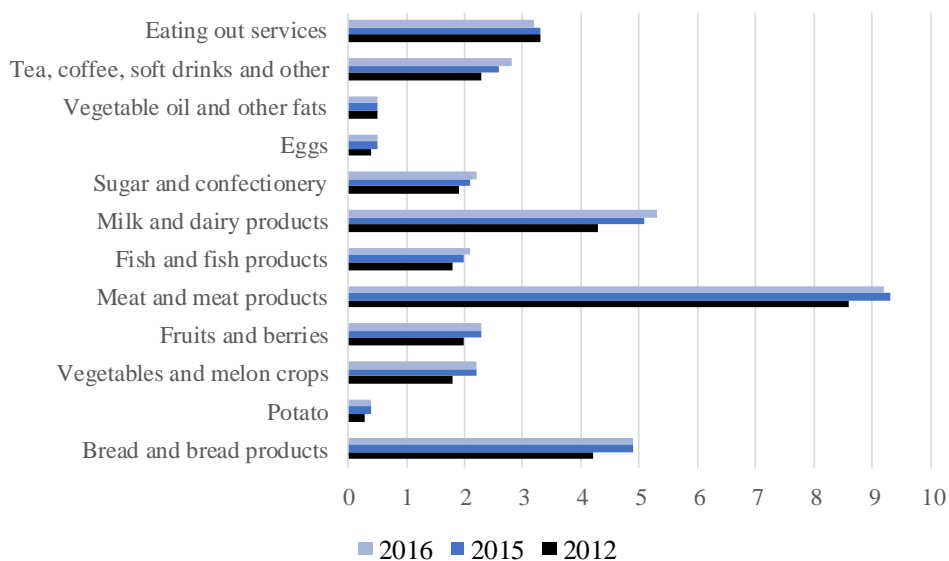


Source: Russia in figures, 2017.

At the same time, in the household expenditure pattern, there was a fall in spending on non-food products, an increase in spending on paying for services and a significant rise in expenditure on at-home food categories with a slight drop in spending on eating out services (Russia in figures, 2017). By 2015–2016, there was a shift in the household food expenditure pattern, compared with 2012. For example, in the expenditure pattern, there was a considerable growth in the share of spending on food products of primary necessity – milk and dairy products (+1.0%), bread and bread products (+0.7%), meat and meat products (+0.6%) (Figure 2).

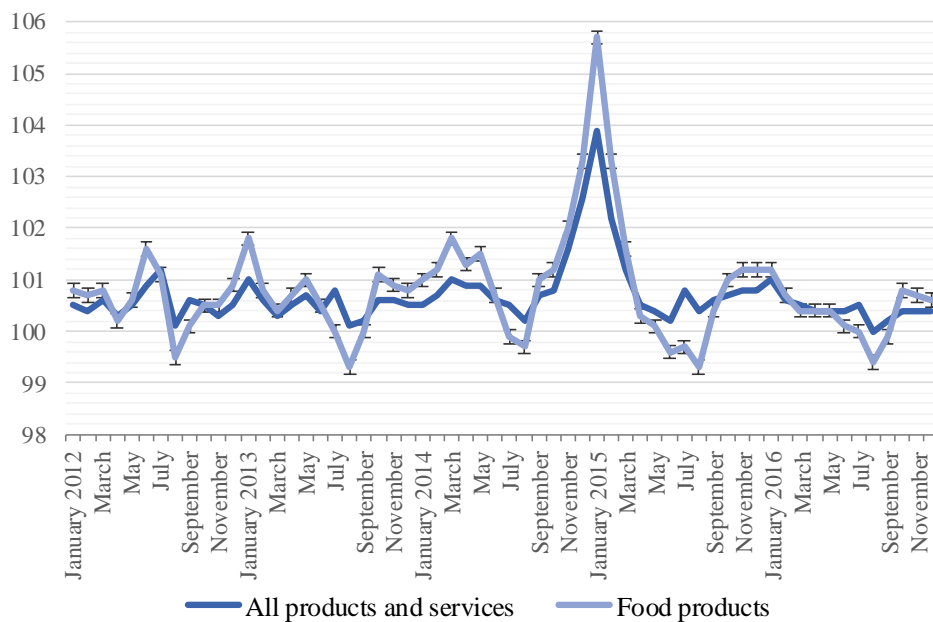
The dynamics of food prices is still characterized by a marked seasonality with the highest prices in the winter, especially before the New Year holidays, and by a decline during the summer months starting in June–July. The sharpest rise in prices was observed in late 2014 – early 2015 (Figure 3).

Figure 2. Household food expenditure pattern.



Source: Russia in figures, 2017.

Figure 3. Dynamics of food prices, %.



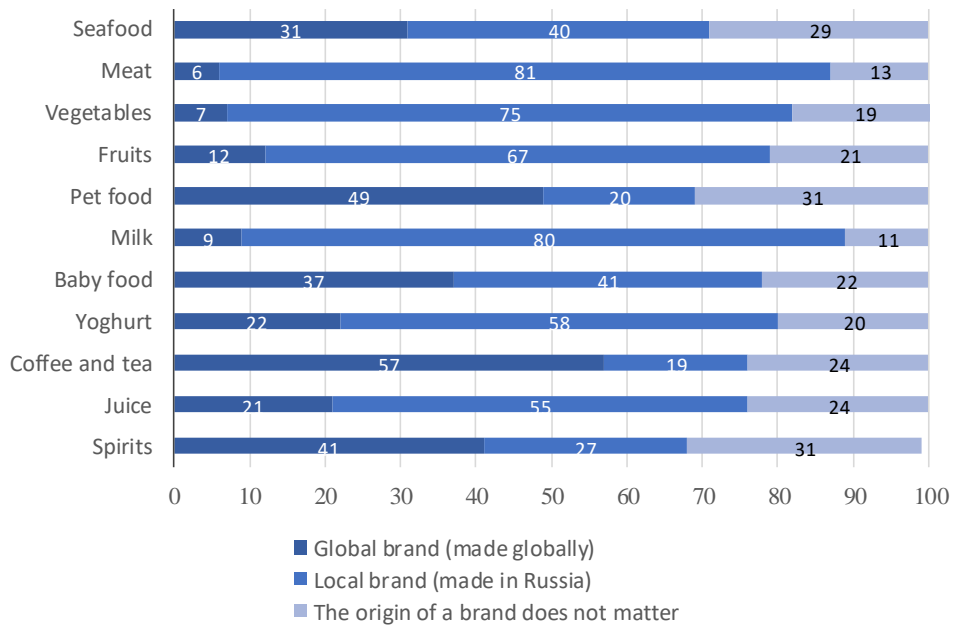
Source: Russia in figures, 2017.

A drop-in household real disposable income and a significant increase in food prices encouraged Russian consumers to change their strategy of behavior. The most popular strategies incorporate buying products in cheap supermarkets, using special offers and discounts, purchasing only the most necessary foodstuffs, as well as acquiring products in larger-size packages that reduces the overall costs. According to Nielsen (Nielsen, 2016a), in March 2016, the popularity of low-price stores among Russian consumers reached 63%, and 15% of respondents expressed interest in purchasing larger-size packages as a means of reducing costs.

A range of other scientific research (Kisin, 2016) also note the trend in Russian consumers' behavior towards economizing when buying food and highlight the distinguishing features of such conduct: increased attention to special deals and sales, purchasing exclusively discounted products, planning their route for making purchases at shopping centers, concentration on stores with low prices, choosing discount shops over conventional supermarkets, exercising a rational approach to planning their budget, acquiring products in accordance with the pre-compiled grocery list and control over impulse buying. Among the population groups with lower income (in 2016, the number of people with income below the subsistence level rose by 4.4 million people as compared with 2013 and made up 13.5% of the total population), there was a clear tendency to buy cheaper products at the expense of their quality. At the same time, a decrease in the purchasing power of the population influenced the food market to different extents: the thrifty model of consumers' behavior exerted the most profound effect on cheese supply; the minimal effect was observed in the market of fast moving consumer goods – milk, sour cream and milk kefir.

The first signs of recovery in food retail business appeared in the spring of 2017 and already in June the growth was 1.2% in comparison with the same period in 2016. This was due to falling inflation rates and, as a result, to stabilization of demand, which demonstrates an increase in the consumer confidence index. Nonetheless, Russian consumers still prefer to be economical. Moreover, according to the results of the survey (Nielsen, 2017), 86% of respondents are going to follow the economy strategy even if the economic situation improves and 77% respondents do not think of the present moment as an appropriate time for making purchases.

When it comes to food, Russian consumers prefer to buy from domestic producers (Fig. 4). For example, milk and milk products, meat, fruits and vegetables, and juices are among the products that are usually purchased from Russian manufacturers, whereas tea and coffee are bought abroad. The major factors that persuade consumers to make their choice in favor of locally produced food products are the following: price (56% of respondents); past positive experience (43% of respondents); safer product ingredients (32% of respondents). Russian consumers (53% of respondents) assert that past positive experience is the crucial factor in choosing a global brand product (Nielsen, 2016b).

Figure 4. Preferences of Russian consumers for brands

4. Discussion

The Russian market is the 11th largest consumer market in the world with a huge market potential. Now, in the territory of Russia, there are leading global multinational corporations with global sales volumes exceeding 22 billion dollars (the share of Russian production is within 10%), as well as MNCs of “the second tier” with aggregate sales varying from 1 to 22 billion dollars (the share of Russian production is between 15 and 25% of the total sales). In the food industry, among such MNCs are Nestlé, Unilever, Coca-Cola, PepsiCo, Kraft Foods, Mars, Danone, etc. According to different estimates, foreign MNCs control from 70 to 80% of the volume of production and food supply to the Russian market (Khasbulatov, 2015; Kazantseva, 2014). The main factors of Russia’s attractiveness for MNCs are: impressive market size with a potential for growth in consumer demand; huge amount of resources at low price and more than satisfactory state of the infrastructure (Kalinin *et al.*, 2016), and strategically important access to knowledge and workforce (Zvirgzde *et al.*, 2013).

In the context of the population’s declining income and the transition to the thrifty behavior model with the growing popularity of domestic food products among Russian citizens, MNCs apply mostly the following main strategies of brand management in the Russian food market:

1. Acquiring local and global brands based on cross-border mergers and acquisitions.

This strategy is applied if the following conditions are satisfied: the presence in the local market of competitive national companies that own brands with a significant share of brand loyal customers; the country provides favorable institutional conditions.

2. Promoting their own global brands to the local market and their adaptation.

This strategy is applied if the following conditions are satisfied: the portfolio of MNCs embraces brands that are widely known in the local market with a significant share of brand loyal customers; MNCs have a past successful experience in launching global brands into similar markets; the presence of high solvent demand in the local market; similarity of the target audience from different countries (Beregovskaya, 2015).

When implementing the strategy of local brand acquisition, the primary targets of MNCs are thriving Russian companies. If MNCs pursue the strategy of global brand promotion, they usually apply the following instruments for adapting a brand to the Russian consumer in view of the differences in culture, mentality, values and financial capabilities that Russian consumers have:

- Advertising campaign designed specifically for the Russian market;
- Restyled packaging, since in Russia, customers pay more attention to the emotional component of the packaging rather than the material which it is made from;
- Changing the price segment; transferring a brand to a segment of cheaper products available to a larger number of Russian customers (Yampolskaya and Chernova, 2014);
- Rolling out a global brand into the Russian market using a local brand.

In addition to the strategies of managing brands in the Russian food market, MNCs implement a number of measures aimed at cutting production costs, reducing risks and dependence on economic sanctions, as well as take actions on integrating into the import substitution policy through localizing the purchase of raw materials and packaging (for instance, over the past 18 years, the Coca-Cola Company has increased the share of local purchases from 10 to 95% (Ishchenko, 2016), Mars, Inc. buys 85% of the ingredients from local suppliers located in close proximity to factories or from large-scale suppliers (RNS, 2017) logistics optimization; manufacturing products in different price categories (for instance, Danone has improved the quality of the products and enhanced the product range of the acquired Unimilk Company (Ishchenko, 2016), cutting production of those products which Russian consumers typically economize on and producing more of those highly demanded by them; improving the efficiency of suppliers, introducing new technologies and practices, protecting the entire chain.

3. Conclusion

Under the import substitution policy, MNCs tend to localize purchases of raw materials and packaging and buy them from local producers, as well as are oriented towards long-term partnership with them. In those segments in which Russian consumers prefer to buy products made locally, MNCs mainly execute strategies of acquiring local brands; in the segments in which Russian consumer usually purchase imported goods, MNCs follow the strategies of global brand promotion and adaptation. The current study allows us to conclude that the obvious desire of MNCs to continue doing business in Russia forces them to adjust their market strategies and activities considering the real distinctive features of the Russian consumer and challenges of the Russian market.

Even though the mid-2017 witnessed the first signs of recovery in food retail segment, Russian buyers still intend to follow the same balanced and economical consumption strategy while maintaining their preferences for home-produced goods, which, in their opinion, are cheaper or the same price in comparison with foreign-made goods, of the same quality and more secure.

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