

Carrefour's misadventure in russia essay sample

[Business](#), [Company](#)



This case was written by P. Indu, under the direction of Vivek Gupta, IBS Center for Management Research. It was compiled from published sources, and is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

Carrefour's Misadventure in Russia

“ In the space of just four months, Russia has gone from a “ strategic priority” to an afterthought at Carrefour, the giant French retailer.” 1

– New York Times, in October 2009.

“ Carrefour's pending exit underlines the fact that Russia remains a highly challenging market despite its fundamental draw. Although MGR (Mass Grocery Retail) sales are forecast to strengthen by a dynamic 66. 4% to RUB 1, 423bn (US\$ 48. 53bn) through to 2014, the country's business environment is among the least forthcoming in emerging Europe. Despite topping our Q110 food and drink regional business environment ratings, Russia's market risks score (encompassing regulatory environment and barriers to entry) is the region's second lowest behind Ukraine.”

Business Monitor International³, in October 2009.

CARREFOUR EXITS RUSSIA

On October 15, 2009, just four months after opening its first store in Russia, France-based Carrefour SA (Carrefour), the second largest retailer in the world, announced that it planned to exit the Russian market. The company announced, “ Carrefour has decided to sell its activities in Russia and pull out of the market, given the absence of sufficient organic-growth prospects and acquisition opportunities in the short- and medium-term that would have

allowed Carrefour to attain a position of leadership. This decision is consistent with the Group's strategy which aims at building leadership positions that will ensure strong and lasting profitable growth." 4 Carrefour started the groundwork to enter the Russian market in 2007, looking out for suitable locations for opening its stores.

It opened its first store in the country, a hypermarket, in June 2009. Its second store was opened soon after. It also procured a location for its third store, which was to open by the end of the year. However, in a move that took industry analysts and observers alike by surprise, Carrefour announced its exit from the country in October 2009. Analysts opined that Carrefour's failure to acquire Russia-based grocery chain Sedmoi Kontinent5 (Seventh Continent) and shareholders' pressure on the company to focus on its core business were the main reasons for the exit decision.

They were of the view that the bureaucracy, complicated legislative framework, corruption, and red tape that existed in the country were factors that could have influenced Carrefour's decision to quit Russia. Some of them opined that Carrefour had not given enough time for its operations to stabilize in the market. Viktoria Sokolova, Senior Analyst at Troika Dialog6, said the company's strategy was flawed and had come too late. She said, "Carrefour simply failed with its strategy to enter Russia. There is plenty of growth opportunities out there. Its nearest competitor, Auchan, has opened its 34th hypermarket in Russia, and continued its opening program, even during the crisis times. Carrefour came to Russia a little bit too late, and was

talking, perhaps, not to the best operator in the market, without the distribution reach, to acquire them, as a means of an entry point.” 7

Industry analysts, who had observed the Russian market closely, said that Carrefour's exit could affect the entry of other international retailers like Wal-Mart and Tesco, which had plans to enter the country. According to New York Times, “ It also indicates that a good deal of the shine has come off the Russian retail market, in recent years one of the fastest growing in the world because of trickle-down oil wealth that helped lead a consumer boom built on decades of pent-up demand from the bleak Soviet era.”

BACKGROUND NOTE

Carrefour was founded in 1960 by two entrepreneurs - Marcel Fournier, a textile retailer, and Louis Defforey, a wine and food wholesaler from Annecy in Eastern France. The first two stores that they opened were highly successful. In 1963, a 2, 500 square meter store was opened in SainteGenevieve des Bois, a Paris suburb. It occupied an area of 2, 500 square meters and had enough space to park more than 400 cars. The store provided a wide range of items, including self-service grocery at discount prices, and clothing, sporting equipment, electronic goods, and auto accessories. The store was inaugurated in June 1963 and its huge size earned it the name „ hypermarket“ in the media. Carrefour offered products at the lowest prices as compared to its competitors by negotiating with wholesalers and suppliers. The concept of a hypermarket found instant acceptance among the younger people, suburban dwellers, and price conscious consumers.

In 1966, a 10, 000 sq. meter hypermarket was opened in Lyon and a 20, 000 sq. meter hypermarket was opened in Vitrolles. In 1967, Carrefour opened an office in Paris to coordinate the activities of its various stores in the country. The company began to enter international markets after a law was passed in France in 1963 to restrict the development of large stores. Its first international venture was in Belgium, where it opened an outlet in association with Delhaize Frères-Le-Lion⁹, in 1969. In 1970, Carrefour's shares were listed on the Paris stock exchange. By 1971, Carrefour was directly operating 16-wholly owned stores, with an equity interest in five more stores. It also operated through franchises. In its first venture outside Europe, Carrefour opened a hypermarket in Brazil in 1975.

Troika Dialog is one of the largest private investment banks in CIS. Its main lines of businesses include capital markets, investment banking, asset management, personal investments, and finance. About 33% of the equity stake in the company is owned by the Standard Bank Group and the rest is owned by 109 employee partners.

In 1978, Carrefour developed a hard discount store¹⁰ format under the banner Ed, in France. The stores offered a limited range of products at very low prices. By 1985, Carrefour was operating in ten countries and had introduced private label products that were priced 10-20% lower than branded products and were said to be of superior quality. In 1988, Carrefour entered the US market by opening a 330, 000 sq ft hypermarket in Philadelphia. Another hypermarket was set up in 1991¹¹. In 1991, Carrefour acquired French hypermarket chains – Euromarche and Montiaur. In 1992,

Carrefour reported sales of € 17. 86 billion and a net income of € 271 million. In the early 1990s, Carrefour concentrated on establishing larger stores in France (with an area of more than 2, 500 square meters) and sold off its smaller stores.

By the mid-1990s, Carrefour's European operations were spread across Italy, Spain, Turkey, Greece, and Portugal. In 1996, Carrefour opened 30 hypermarkets across the world, of which 15 were in South America. By 1997, the number of stores in South America had increased to 60 (Refer to Exhibit I for the timeline of Carrefour's entry into international markets). Carrefour operated through franchises in the UAE, Saudi Arabia, Oman, Qatar, Egypt, Tunisia, Algeria, and the Dominican Republic. In 1998, it acquired Comptoirs Modernes SA, which brought 790 supermarkets into its fold. In 1999, it acquired Promodès SA12, which owned several hypermarkets, supermarkets, convenience stores, and discount stores. The acquisitions helped Carrefour become the top retailer in Europe by the late 1990s.

As of 2008, Carrefour was the second largest retailer in the world and the largest retailer in Europe (Refer to Exhibit II for the list of global powers of retailing). By the end of 2008, it was operating 15, 430 stores globally. It operated through different store formats like hypermarkets, supermarkets, convenience stores, hard discount stores, and cash & carry outlets (Refer to Exhibit III for Carrefour's store formats). Carrefour's revenues were at € 108. 629 billion for the year ending December 2008 (Refer to Exhibit IV for Carrefour's country wise sales).

CARREFOUR'S PLANS FOR RUSSIA

In every international market in which Carrefour operated, it essentially focused on becoming one of the top three players in terms of market share. Commenting on the criteria for entering new markets, the Chairman of the Management Board of Carrefour, José Luis Duran, said, “ We’ll look toward new markets. That means local acquisitions in countries where we currently operate, but it also includes the possibility of establishing a presence in new countries, such as Russia and India. However, any such store openings will have to satisfy three criteria: we must be able to capture a leading market position within the medium term, establish our brand quickly, and secure a return on investment. It is only under these conditions that we will expand our scope of operations.”¹³ Carrefour initially showed an interest in operating in Russia during the mid-1990s and opened a representative office in Moscow. It also finalized two prime locations, one in the center of the city and the other on the outskirts. However, during the 1998 financial crisis¹⁴, it exited from the country.

Hard discount stores sell products at prices that are even lower than those in traditional discount stores like Wal-Mart. They are small in area and sell a limited assortment of products. Subsequently, Carrefour suspended the US operations in 1993, as the stores were not profitable. Promodès SA was established in 1950, and played a major role in promoting supermarkets in France. During the 1960s and 1970s, the group expanded rapidly in other countries in Europe and South America. In 1999, Carrefour purchased Promodès SA to become the second largest retailer in the world. “ Interview with the Chairman of the Management Board,” Annual Report 2006. The

Russian financial crisis of 1998 was triggered by the Asian financial crisis of 1997 and resulted in high inflation. The food prices went up by 100% and with people stocking up essential items, shortages were witnessed. By 1999, the country recovered from the crisis.

In June 2006, Carrefour again started contemplating an entry into the Russian retail market. A delegation from Carrefour toured across Russia looking for locations, met local officials, and interacted with other retailers. After spending considerable time studying the markets, Carrefour announced its intention of entering the Russian market in June 2007. The retailer planned to open only hypermarkets initially. It would then follow this up with other store formats. At that time, it intended to open its chain in 20 cities. A group of managers from France were stationed in Russia to prepare for the launch of a new store by early 2008.

Analysts were of the view that Carrefour had delayed its entry into Russia (Refer to Exhibit V for a note on retail industry in Russia). According to Maria Sulima, a retail analyst with Metropol¹⁵, " They are rather late in coming. At this point, it would be more effective to purchase a chain with already developed logistics and distribution networks." ¹⁶ By the time Carrefour entered the market, Auchan SA¹⁷ (Auchan) and Metro AG¹⁸ (Metro) had established a significant presence in the country. Auchan had a presence in eight Russian cities while in Moscow alone, it had 20 stores. Metro had 74 stores across the country. Other competitors included local players like X5 Retail Group NV¹⁹ (X5) and Mosmart CJSC²⁰ (Mosmart). On Carrefour's delayed entry into the country, Thierry Garnier (Garnier), Group Executive

Director, Carrefour, said, “ We were waiting for the best moment to enter the market. We are in Russia for the long term.”²¹ In order to step up its presence, Carrefour wanted to have an association with a local partner, and intended to acquire local grocery chain Seventh Continent, which operated through 140 stores.

In February 2009, Carrefour made a non-binding offer to Seventh Continent valuing it at US\$ 1.25 billion. On Carrefour's interest in Seventh Continent, Marie Lhome, analyst with Aurel BGC22 in Paris, said, “ It is more expensive and difficult to set up operations in Russia. Some retailers, like Ikea, have run into legal issues there. The interest in Seventh Continent comes from the company's stores prime locations in the center of Moscow.”²³ Analysts also expressed doubts about the fit of Seventh Continent with Carrefour's overall strategy, as Seventh Continent was a luxury store. However, the offer was rejected by the shareholders of Seventh Continent. Carrefour persisted with its acquisition effort and in May 2009, the company signed a preliminary letter of intent to acquire a 75% equity stake in Seventh Continent. Reports suggested that both the companies were under the exclusivity period²⁴ due to which Seventh Continent could not enter into agreements or talks with any other potential buyers. Analysts were of the view that after the acquisition, the Russian retail market would account for 1% of Carrefour's total sales.

IFC Metropol is a Russia-based investment and financial company. Its activities include corporate finance, debt instruments, equities, research, depository services, and legal services. “ Carrefour Opens First Russian

Store,” [www. russianamericanchamber. com](http://www.russianamericanchamber.com), June 19, 2009. Auchan is a France-based multinational retail group. The group is controlled by the Mulliez family of France. In 2008, its revenue was € 39. 284 billion and net income was € 744 million. Metro is a Germany-based retail group. It was the fifth largest retailer in the world as of 2009. In 2008, its revenue was € 67. 96 billion and profit was € 403 million. X5 was the largest retail group in Russia as of 2009. It operates through three formats – hypermarkets, supermarkets, and soft discount stores. In 2008, its sales were US\$ 8892 million and EBITDA was US\$ 803 million.

Mosmart is a Russia-based multi-format retail chain.

“ Carrefour Opens First Russian Store,” [www. russianamericanchamber. com](http://www.russianamericanchamber.com), June 19, 2009. Aurel BGC is the result of a merger between ETC Pollak, Aurel, and BGC. The services provided by Aurel BGC include fixed income and equity derivatives. It also conducts economic and financial research and provides forecasts.

Javier Espinoza, “ Carrefour Flirts with Seventh Continent,” [www. forbes. com](http://www.forbes.com), April 20, 2009. During the exclusivity period, both Carrefour and Seventh Continent was banned from negotiating with any other potential buyers. This, according to analysts, showed that the deal was imminent.

Carrefour's Misadventure in Russia

But before Carrefour could conclude the deal, the owner of Seventh Continent ran into financial problems. The company defaulted on bond payments in June 2009 and went in for debt restructuring. Ultimately,

Valdimir Gruzdev who controlled a 10% equity in Seventh Continent, decided not to sell the company, citing that the time was not right to sell well-performing assets.

OPENING STORES

In June 2009, Carrefour opened its first store in Moscow. Commenting on this occasion, Jacobo Caller, General Director of Carrefour in Russia, said, “ We are very happy to start our business operations in Russia where we will follow our client-oriented principles: offering quality products at low price, great value, and high level of services to Muscovites. We believe that the opening of the first Carrefour store in Moscow is an important step for Carrefour’s development in Russia and will have a positive impact on the economic development of the city.”²⁵ At that time, Carrefour announced that it believed in the long-term potential of the country and considered the Russian market to be strategically important for the development of Carrefour. According to Garnier, “ As the second world and most internationalized retailer, the Carrefour Group is now developing its activities in a new country.

Starting our operations in Russia is an important milestone for our company. The Carrefour Group believes that the Russian retail market has outstanding long-term potential and considers it to be one of the strategic priorities for the company’s international development.”²⁶ However, analysts cautioned that it would be difficult for Carrefour to expand in the country without acquiring an established player. According to Mikhail Terentiev, analyst with Nomura International²⁷ in Moscow, “ It is not very easy to establish a

footprint in Russia. If you want to expand in Russia rapidly it would be a good idea to buy somebody else with a very developed market.”

Carrefour's first store was located in Fillion Shopping Mall, and occupied two floors with a sales area of 8, 000 square meters, 58 checkout counters, and 450 staff. It sold 15, 000 food items and 30, 000 non-food items. Of the total 45, 000 SKUs on offer, over 5, 000 were private label products.

Fillion Shopping mall occupied an area of 87, 000 sq. meters and included a 10-screen multiplex cinema and a theme park. The shopping mall had facilities to park 3, 000 cars. Carrefour had reportedly invested € 8. 8 million on its first store and its opening was a grand event with the guests being entertained by mime artists, musicians, dancing troupes, etc. However, industry experts were not impressed with the location of Fillion Shopping Mall, pointing out that though it was located close to the city center, it was not easily accessible, not prominently visible, and was located among low-income group families.

Carrefour instantly attracted customers who mostly shopped there for food products. One item that proved to be highly attractive was the different varieties of bread that Carrefour sold. As most of the customers were used to the French retailer Auchan, they found shopping at Carrefour convenient due to the high service standards, availability, and wide choice of products. Just after the first store was opened, newspapers reported that negotiations between Carrefour and Seventh Continent had been stopped. Thus, Carrefour was not able to acquire Seventh Continent on which it was banking for its expansion in Russia.

The second store was opened on September 10, 2009, at Krasnodar in South Russia. For this store, Carrefour entered into an MoU with the local government to implement an investment project. As per the MoU, the company planned to invest up to US\$ 100 million in the region, over five years. Carrefour was to be provided with support in terms of business development, finding suitable plots, infrastructure, etc. by the regional authorities.

On this store, Carrefour invested € 8 million. The store had a sales area of 8,500 meters, and employed 350 people. The company invested € 7.8 million on developing the store. At that time, it announced that though Russia was under a recession, for the first time in a decade, the crisis would not change Carrefour's plans for the market and it would open its third store as planned. According to Jacobo Caller, Carrefour Russia's Director, " For Carrefour, (the) Russian retail market has outstanding long-term potential. Despite the crisis, we are not going to change our long-term vision of this country. With Brazil, India, and China, Russia is one of the priorities in the longterm expansion of Carrefour." 29 At that time, he also announced that in a few months' time, Carrefour would come out with its elaborate expansion strategy for Russia. By the time the second store was opened, Carrefour had already announced its plans to open a third store in Lipetsk and had also entered into a lease agreement to open its fourth store at River Mall in Moscow. According to the analysts, Carrefour chose these locations as the major locations like Moscow and St. Petersburg were stagnating and Krasnodar and Lipetsk were some of the regions that were experiencing rapid growth.

.... AND PULLS OUT

In September 2009, a report in Le Monde³⁰ mentioned that Carrefour was under pressure from top shareholders to pull out of emerging markets. Carrefour, on its part, denied the report. According to a Reuters report, “French retailer Carrefour is seriously considering exiting Latin America, one of its most lucrative markets, under pressure from top shareholders, Le Monde newspaper reported.... But the board of the world’s second-biggest retailer has rejected the idea of abandoning all emerging markets including Asia as this would give the impression the company was being broken up, the newspaper said.”

However, on October 15, 2009, Carrefour announced that it had decided to close down its Russian operations. The company cited inadequate growth and acquisition opportunities as the reasons for its exit. It did not reveal details of total investments in Russia and said that the losses due to the exit were not significant. Carrefour also said that there were no prospects of its being among the top three retailers in the country, as it had planned.

Carrefour also announced that the stores in Russia would continue to remain open till the company found a buyer for them, and that it would also open the third one as planned. This was done in order to cut the costs of exit and also to reduce the penalties that it could attract for severing the contracts with suppliers and landlords. Carrefour also looked around for a franchising partner to operate the stores and to develop the brand in the country.

Industry experts opined that it took retailers several years to establish themselves in new markets, especially emerging markets like Russia which

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had high growth potential. They were surprised that Carrefour did not stay long enough to test the market. According to them, four months was too short a time to gauge the potential of the market. They said that Carrefour's justification about lack of acquisition and poor sales targets appeared more like excuses. The exit also made analysts question Carrefour's commitment to countries with high potential, but short-term difficulties and problems. According to Jaime Vazquez, an analyst at JPMorgan Chase & Co. in London, "Turning around the hypermarkets in a deflationary environment and with a weak price image is not going to be easy.

Stores in emerging markets are the only ones doing well and offering good growth prospects," so selling them makes no sense other than making short-term financial gain. 32 Analysts also said that Carrefour had spent more than three years studying and understanding the market and this time was sufficient to understand the difficulties associated with the retailing industry in Russia and also about the potential acquisition targets. As it knew the market well, it was not right for Carrefour to expect positive results within such a short span of time, that too when Russia was in the midst of recession, they said. The analysts said Carrefour could have halted expansion and waited in the market for a few more years before taking a final decision on its operations in the country.

According to industry observers, Carrefour's failure to acquire Seventh Continent was the main reason for its exit. They said that without Seventh Continent, Carrefour did not find enough scope to grow in the country, though the market was highly lucrative. The retail industry in Russia was

concentrated mainly around Moscow and St Petersburg, and in these locations, retailers like X5 and Auchan were firmly established and the markets were also oversaturated. With the retail space in limited supply, it was not possible to establish a significant presence in these markets without acquisitions (Refer to Exhibit VI for major retailers in Moscow and St Petersburg). In spite of its high growth potential, there were several obstacles which international retail companies had to face in the Russian retailing industry. A complicated legislative framework, bureaucracy, along with corruption hampered the operations of several companies in Russia. Analysts said red tape, poor economic conditions, etc. could have influenced Carrefour's decision to exit the market.

Carrefour was also caught up in bureaucratic hassles as its first store in Moscow could not get a license to sell alcohol, which cost it almost 15% of the stores' revenues. Legislation in Russia that aimed at increasing the competition in the country³³ was also cited as one of the main reasons for Carrefour's plan to exit.

Due to volatile economic conditions in the Russian market, acquiring a Russian retailing company also proved to be a tough task for Carrefour. Though due to the global financial crisis³⁴, the share prices of Russian retailers were down making them an ideal target for acquisition, the lack of credit to the retailers for carrying out the acquisitions and the high debt burden of the local retailers, proved to be unattractive for Carrefour. The acquisitions were also priced high. For example, X5 with a share of 4% in the food retail market in Russia was valued at US\$ 7 billion. According to

Datamonitor, "Facing these challenges, Carrefour has probably made the right call in making an early withdrawal from the market. A dire macroeconomic environment and the strength of domestic discounters in the current climate make breaking into Russia organically a significant challenge. Furthermore, the difficulties in acquiring a local player and other market hindrances.

Ladka Bauerova, "Carrefour Replaces Head of French Superstores, Exits Russia," www.bloomberg.com, October 15, 2009.

The new retail trade law in Russia was passed in December 2009. According to the law, the government can impose price ceilings on specific products (whose prices have grown by 30% in a span of 30 days) for a specific timeframe (not more than 90 days). Limitations were set on bonuses suppliers could pay to the retailers to stock their products, payment timeframes within which retailer had to pay suppliers, etc. The Russian government aimed to increase the competition in the retail sector by passing the law. The global financial crisis refers to the credit, banking, trade, and currency crisis that emerged in 2007-08. This was the result of the failure of several US-based investment companies, mortgage companies, and insurance companies due to the sub-prime crisis in the country. The sub-prime crisis was the result of mortgage delinquencies and foreclosures, which had an impact on banks and markets around the world would have made Carrefour's quest to gain scale and leadership in the country a costly uphill struggle."

There were also reports that the company was under pressure from key shareholders like Colony Capital LLC³⁶ and Bernard Arnault³⁷, a French investor and Chairman of LVMH, who insisted that Carrefour concentrate on its French operations and exit from the emerging markets including China and Latin America after its global sales dropped by 2.9% in the third quarter ending September 2009 to € 24 billion. Reports in Le Monde suggested that the top investors were insisting on Carrefour exiting China and Brazil too, in order to regain their investment, after Carrefour lost 30% of its market value between March 2007 and September 2009. However, at the same time, other retailers in Russia were performing well. The X5 Retail Group reported that its profits had grown by 38% between January and September 2009, as compared to the corresponding period the previous year.

The store count in 2009 was expected to increase by 25%. The net revenues of another leading retailer Magnit increased by 31% in the first nine months of 2009. As of September 2009, it had 2981 stores in operation. Many analysts opined that the withdrawal from Russia meant that Carrefour remained committed to its goal of attaining a leadership position in the markets in which it operated and exiting the countries where it did not find the opportunity to be among the top retailers in a span of few years. Earlier, in 2005, Carrefour had exited from four countries namely, Japan, Mexico, the Czech Republic, and Slovakia, where it failed to make a mark, and decided to focus on Eastern Europe and Latin America. Analysts pointed out that as far as the Russian market was concerned, it had realized soon that there were not enough opportunities for it to become the top player in the country.

According to Pierre Bouchut, Chief Financial Officer, Carrefour Group, “ It is

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precisely because we are adopting a long-term stance that we are exiting from Russia.” 38 Carrefour, however, maintained that it would remain committed to its expansion plans in other emerging markets where it already had a significant presence.