

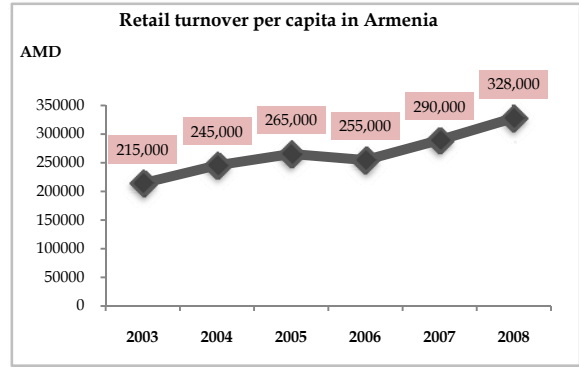
Retail Sector Analysis

January 2009

The recent progress in the retail sector of Armenia is apparent. Backed by heavy investments, the segment experiences rapid transformation of retail formats, shifting to a new, more sophisticated stage of market development.

GENERAL OUTLOOK: The growing income levels and improving living standards in Armenia have paved the way for the accelerated growth of the retail sector. The annual retail turnover per capita reached the level of 1,100 USD in 2008.

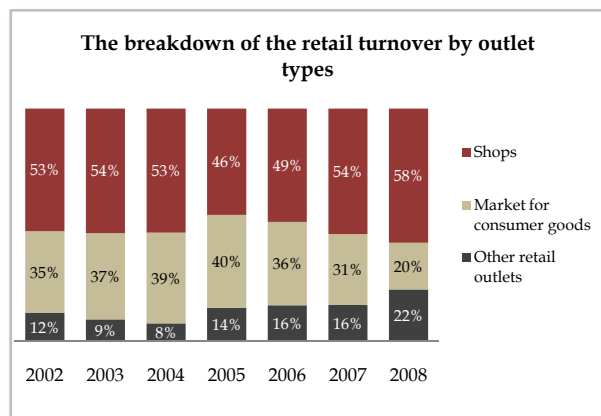
The average retail consumption in 2008 increased by as much as 13% compared to 2007.



Food retail comprises the major share in total retail turnover, illustrating the structure of consumer spending. Building materials, followed by furniture and clothing dominate in the retail of non-food products.

PREVAILING TRADE FORMATS:

The retailing industry's performance standards increasingly go up, imposing new competitive benchmarks for the market players. The basic milestone of the thriving forerunners is the careful attention to the management and organization of the merchandising processes. The opportunity of economies of scale enhances the aggressive expansion of retail chains. The non-branded retail has substantially decreased; however, the overall sector remains highly fragmented and is yet at premature stage. The fragmented nature of the retail sector is reflected in the medium level concentration ratio, which indicates that the major portion of the retail turnover is implemented through small size retail outlets. The development gap is also profound between the central locations and the rural suburbs.



A significant portion of the retail turnover is implemented through shops and markets for consumer goods (bazaar type establishments). The share of the shops in the total retail turnover has gradually increased throughout the last three years. So does the share of the supermarkets, along with the declining trend of bazaars in total turnover. Several grocery and consumer goods bazaars operate in Yerevan at present, with the total estimated area of more than 30,000 sq.m. – the

major part of which can be viewed as potential future shopping centers. These areas are very active and considered as strategic retail zones of the city.

There is no clear information about the share of supermarkets in the retail trade of Yerevan, however, it is estimated to reach about 8-10% for the city. The average market share of supermarkets in Central and Eastern Europe (CEE) is 44%, while the indicator in old EU member states is 81%.

MAJOR OPERATORS: The development of the retail sector is largely enhanced by the recent infusion of international financial resources, which supported the expansion of sophisticated market players, such as Star and SAS supermarket chains and other key players. The major proportion of supermarkets still operates under the formula of "group of independents (except for Star and SAS supermarket chains) and run decentralized distribution/management systems in place. The most significant market player of this format is Yerevan City, which is owned by a well-known business-man in Armenia. The supermarket's affiliation with numerous same-owner businesses provides it a significant advantage over its competitors, namely, the possibility to impose cheaper prices on the products supplied by affiliated companies.

Another emerging cluster of retail chains in the local market is the street retail, focused on the merchandise of construction materials and home furnishings. These analogues of DIY format, widely accepted in the global retail platform, are gaining increasing popularity in Armenia.

In general, growth in scale permits the emerging large retailers to achieve greater purchasing efficiency in sourcing, information technologies and advertising. On the other side, the diversification of retail formats creates more opportunities for niche players and specialized retailers. However, the benchmark of the local retail chain development levels is assumed to be that of the current CEE countries, which Armenia is assumed to reach in the upcoming 6-8 years. The saturation point is yet far away and this is a good sign for both incumbents and potential innovative new entrants.

CRISIS IMPLICATIONS: The retail sector is significantly vulnerable to the changes in consumer preferences and household consumption patterns. The year 2008 was especially rich with major volatilities in the country, which hit the retail sector to some extent: the political unrest of the election period, the war in the neighboring Georgia (and the closed borders and halted supplies as a result), and the escalating threats of crisis. Despite the volatilities, the sector has managed to record some growth over the last year - 13%. The most likely consequence of the crisis has already started to reveal - the increasing share of food products in the overall retail. Also, the "*December boom*" in household consumption has largely neutralized the crisis effect at least for a short period of time.

LONG TERM PERSPECTIVES: Development of a strong retail sector can contribute immensely to the economic development of the country. One of the inevitable strengths of the retail industry is its ability to generate large volume of employment, currently being the third major employer in Armenia. Also, with an advanced retail sector, the local manufacturers and other suppliers gain access to a stable distribution system, thus ensuring stable market for their produce.

As the market becomes more competitive and the consumers - more sophisticated, only the retailers that can react swiftly to market trends and consistently respond to new customer behaviors and values will achieve

development. The more competitive market will impose significant challenges for the smaller market players (the retail format of “budka”s), which lack the powerful advantages inherent to large players and will gradually be eliminated.

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