

A Journey to Russia
Characteristics, trends and
business opportunities in
Russian market

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IDC Herzliya Campus

Part 1.

**Major Trends in Economic Policies
and
the Macroeconomic Situation in
Russia**

Russia - 2006 versus 1999

Parameter	1999	2006
Exports (US\$ bln.)	76	304
Imports (US\$ bln.)	40	165
Investments abroad (US\$ bln.)	?	140
Government budget deficit/profit (%% of GDP)	-1,1	+8,0
Gold reserves (US\$ bln.)	12,5	303,7
Trade balance (US\$ bln.)	36,0	140,7
Stock markets (RTS Index)	175,2	1921

Russia is the Largest mineral exporter and significant consumer of machinery and equipment

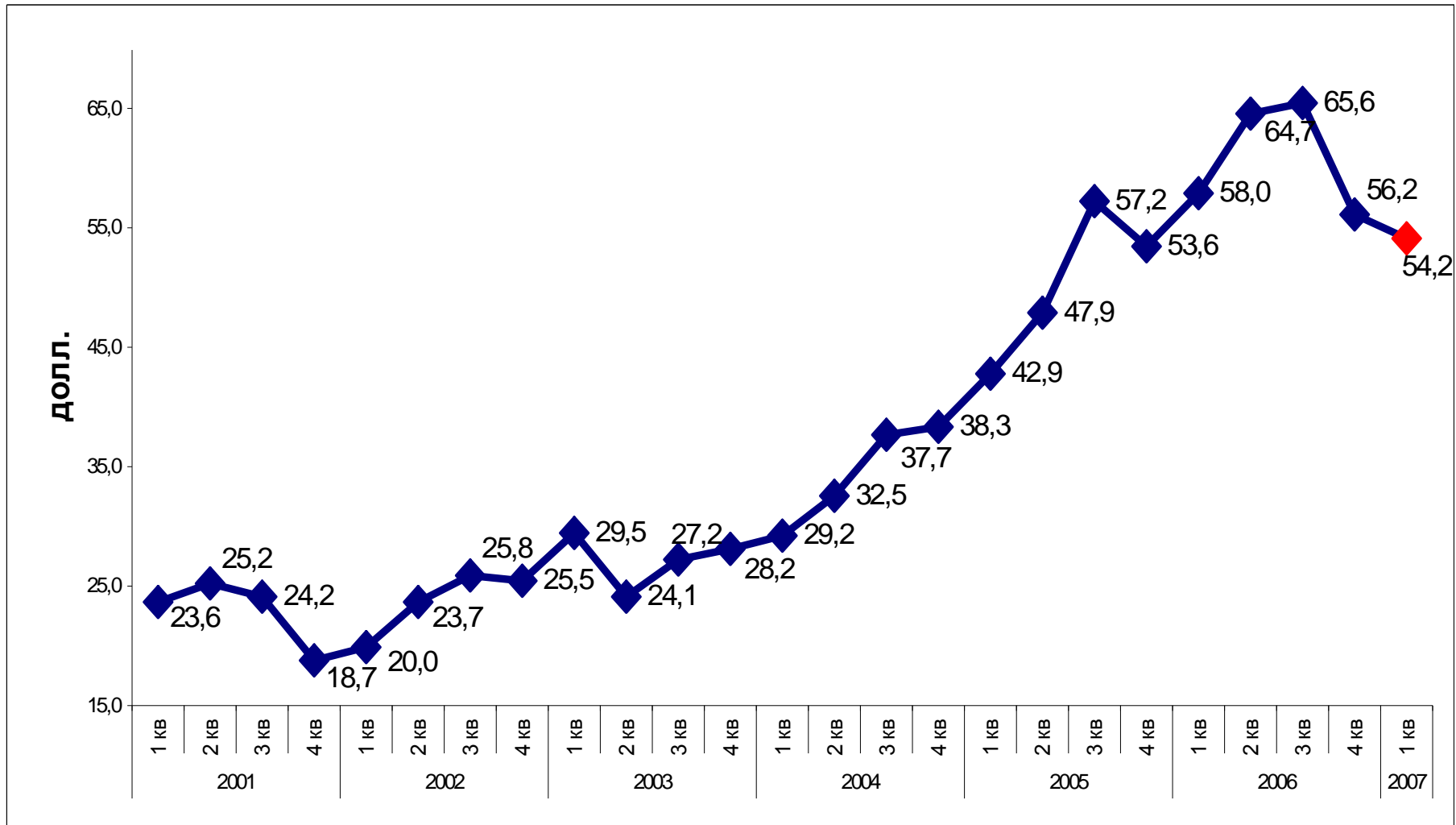
Exports in 2006 (US\$ bln.)

- Mineral products (including oil and gas) – **199**
- Metals – **49,5**
- Chemicals – **16,9**

Imports in 2006 (US\$ bln.)

- Machines and equipment – **65,6**
- Chemicals – **21,8**
- Agricultural products – **21,6**

The boom is secured by the dynamics of oil prices



Major elements of the current economic policy

- Independence of government's coffers from the people's pockets (all the difference between the current oil price and US\$35 per barrel is appropriate by the state, personal income tax is 13%)
- Growing government control on “strategic sectors”
- “Liberal regime” (non-involvement) for other sectors
- Rampant corruption at all levels

The newest government (appointed on September 24th, 2007)

- Pale obedient technically efficient bureaucrats
- No independent business experience (except for control of captive companies)
- Strong family interconnections (the Minister of Defense is son-in-law of the Prime Minister, The Minister of Social Development is the wife of the Deputy Prime-Minister)

The structure of government finances

Type of taxes	% of GDP	% of total
Export tax	8,7	28,7
Profit tax	6,3	20,8
VAT	5,7	18,9
Tax on natural resources	4,5	14,9
Additional corporate taxes	4,3	14,2
<i>Personal income tax</i>	3,5	11,6

Forms of government control

- Creation of “state corporations” for particular sectors– i.e RosOboronExport (for export of weapons)
- Controlling stake in the largest corporations – Gazprom (Market capitalization -- US\$275 bln.), Rosneft (MC- US\$ 83 bln.) , Sberbank (MC -- US\$65 bln.)
- Forced acquisition of large corporations (Yukos)
- Pushing out of foreign companies from valuable assets (Royal Dutch-Shell, BP)
- State “supervisors” (usually former KGB men) in boards of directors and **managerial boards** of listed companies (AvtoVAZ)
- Periodical consultations of big businessmen in the President’s Administration for proper strategic steps and tactical decisions

Traditional “strategic sectors”

- Oil and gas
- Railroads
- Pipelines
- Non-ferrous metallurgy
- Atomic energy
- Electricity

Newest sectors with growing government control

- **Ports**
- **Nanotechnologies**
- **Electrical machinery and equipment**
- **Automotive industry (AutoVAZ)**
- **Property development and land in Moscow, St.Petersburg and Sochi (in view of Winter Olympic 2014)**

Current “non-strategic” sectors where foreign involvement is allowed

- Retail trade
- Food industry and agriculture
- Logistics and distribution
- Timber industry
- Textile and apparel
- Distribution and logistics
- Software development
- Non-military machinery and equipment
- Chemicals

Hidden Israeli Champions in Russian Business

- Africa-Israel Investments (property development)
- IAI (cooperative projects in avionics)
- Mul-T-Lock (automotive security parts)
- Teva (pharmaceuticals)
- Ahava (cosmetics)
- Sucrazit (sugar substitute)

Part 2.

**Internal logic of Russian
companies' strategic
development**

Usually mentioned factors that limit growth (national surveys)

	1997	2000	2001	2002	2003	2004	2005	2006
Lack of finance	78	74	69	65	61	56	42	41
Lack of demand	51	36	37	44	44	43	51	48
Uncertainty of economic situation	41	36	29	24	23	20	21	20
Lack of necessary equipment	14	19	20	19	19	18	30	30
High foreign competition	15	11	12	15	16	17	22	25

- http://www.gks.ru/free_doc/2007/b07_11/14-07.htm

Who makes crucial decisions?

- CEO personally -- **20,5%**
- CEO and the top management team-- **38,0%**
- Owners through the Board of Directors - **20,7%**
- General shareholders meeting -- **6,2%**
- Owner(s) personally -- **14,6%**

* Source: our survey in 2007

Corporate goals and stakeholders interests behind them

Goals	Percentages of CEOs who stressed such goals as "important"	
	Russian managers*	American managers in late 1970s**
Profitability (<i>owners' interests</i>)	92,7	89
Sales (<i>managers' interests</i>)	91,3	82
Market share (???)	83,7	66
Social responsibility (<i>authorities</i>)	71,2	65
Wagers (<i>workers</i>)	65,8	60
Quality improvement (<i>customers</i>)	55,5	50
Oversea expansion (???)	27,7	29

* Our survey

** Survey of 82 American CEOs in 1977. (see Shetty, Y.K. New Look at Corporate Goals. *California Management Review*, Winter 1979, Vol. 22 No. 2, pp. 71-79

Corporate strategies

Essence

- The scope of activities (existing **or** new business areas);
- The form of changes (green-field investment **or** acquisition of existing businesses).

Form

- **organic growth** - growth of sales in the in the already established areas by the development of the existing corporate units;
- **"organic" diversification** - expansion of corporate activities into new business areas by the development of the existing corporate units;
- **horizontal integration** - acquisition of businesses in the already established areas.
- **"integrated" diversification** - expansion of corporate activities into new business areas by acquisition of other businesses;

Types of corporate strategies

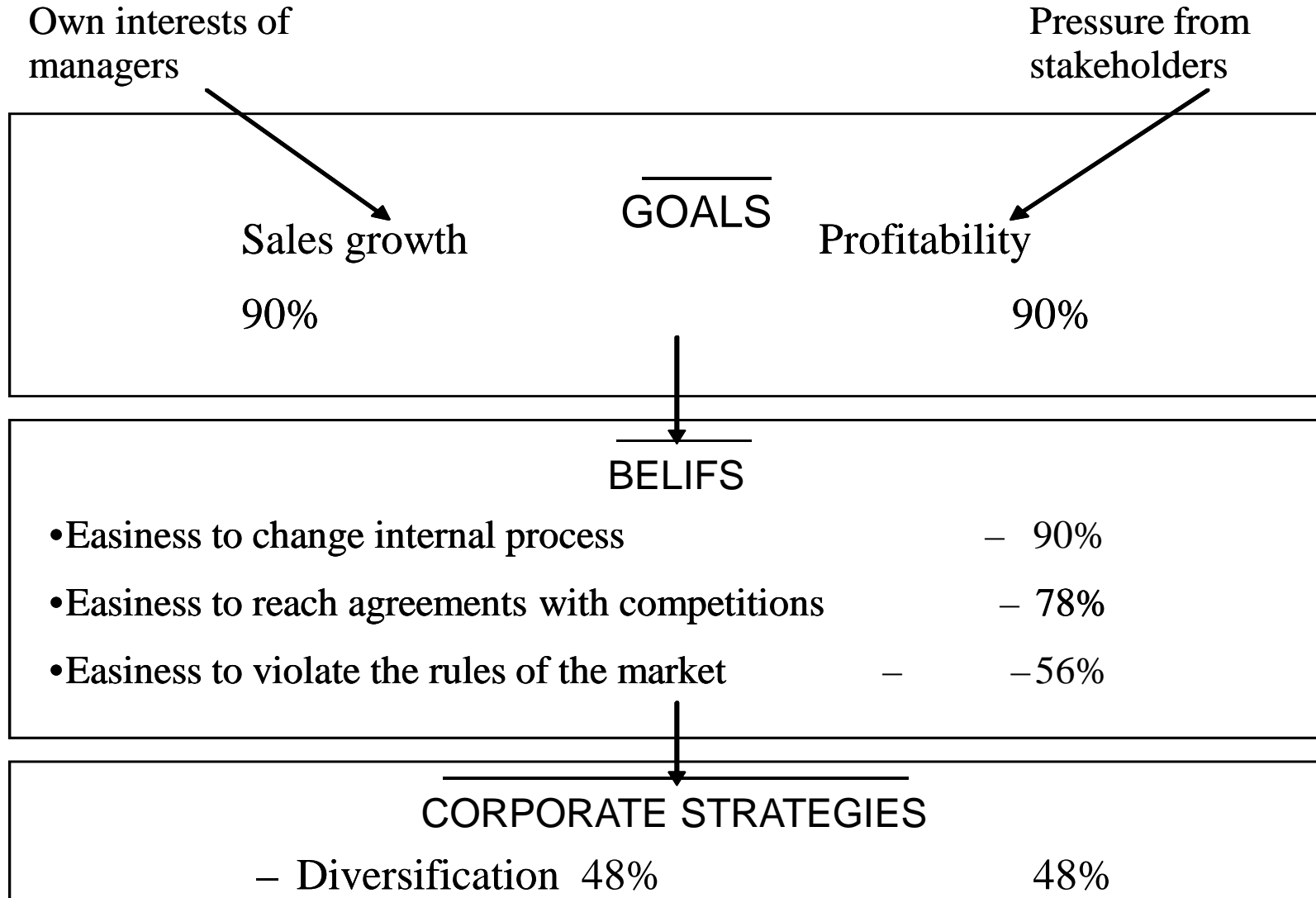
Type of strategy	Percentage of firms
Organic growth (no diversification, no acquisitions)	44,0
Organic diversification (no acquisitions)	32,1
Integrated growth (acquisitions no diversification)	8,8
Integrated diversification (diversification by acquisition)	15,2

- *The better the past performance of a Russian company the higher the chances for diversification: past successes in the familiar business justify the penetration into unfamiliar ones*

Major beliefs of Russian CEOs

Beliefs	Share of believers (%%)
To changes tasks and job descriptions of employees is a very easy task (<i>Organizational context</i>)	90,3
Our business is strongly affected by the world competition (<i>International context</i>)	54,3
Our actions usually meet proper understanding from our competitors (<i>Network context</i>)	78,5
We may easily violate the rules of the markets by monopolistic pricing or dumping (<i>Industry context</i>)	56,6

Roots of strategies (figures -%% of occurrence)



Looking deeper....

1) The major difference is between management-controlled companies who see business as a living organism and strive for continuous growth

And

owner-controlled companies who view businesses as time-specific projects that may be sold out at any time for a good price

Looking deeper (cont.)

2) As many of the controlling owners are currently also involved in day-to-day decision-making, there is a visible schizophrenia in business goals (sales growth and profit maximization are pursued simultaneously)

Looking deeper (almost end)

3) At the best sake this leads to a division between the major (continuous) business and new **innovative** business(es) nourished for later spin offs and sale

Looking even deeper (the starting point)

- The search for new business ideas and business technologies is the key for development for medium-size companies in Russian non-strategic sectors

Part 3.

**Technology and Know-how
Transfer to & from Russian
Companies - Managerial
Aspects**

Three major issues in Technology and know-how transfer

- 1) Getting the knowledge**
- 2) Paying for knowledge**
- 3) Implanting the knowledge**

Share of “innovative companies” in manufacturing (national surveys)

Russia-2000	10,6
Russia-2005	9,3
Poland	18,1
Czech Republic	32,1
United Kingdom	39,2
France	45,5
Germany	65,8

Major sources of innovative ideas in Russian companies

Source	Percentage who marked the item as the "main source"
Back engineering and industrial espionage	51
Retraining programs for managers, including MBAs	32
Newly recruited employees	27
Consultants	24
Technology audit (patents, prospects etc.)	24
Foreign partners	23
Customers	21
Contacts and cooperation with competitors	14
Suppliers	7

Source: our survey in 2007

(Non) Paying for knowledge – major tricks of Russian companies

- Unauthorized reproduction of licensed technologies
- Breaking the consultancy (technical assistance) contracts at the point when the major ideas are exposed
- Offering lucrative contracts and employment to the key personnel in the technology provider

At the same time...

- Russian managers (together with accountants and tax authorities) value the amount of knowledge (in pages and kilos)
- “Non-invented here” syndrome works positively and increase value of any text, draft, slide in English or in German

Thus...

- Any piece of information transferred to the Russian partner should be accounted and priced separately
- Do not hesitate to make additional agreements to the initial contracts if the amount of work to be done will grow
- Play the “reverse techniques” of know-how transfer **from** Russians

Implanting the knowledge - preferred organizational forms (the priority order of Russian top managers)

- Turn-key project
- Separate venture
- Semi-autonomous unit within the existing business
- Integrated project within the existing business

Major difficulties for new projects (our survey of Russian managers in 2007)

Action	%% marked as “difficult”
To finance the project	36
To reach the necessary quality level	36
To orchestrate the work of various departments	35
To synchronize the work of business partners	34
To find the necessary workforce	33
To maintain new requirements for employees	29
Получить доступ к технологии производства	26
To get necessary licenses and permissions	24
To reach understanding with competitors	23
To change job descriptions and work duties	17
To set competitive prices	17
To explain the benefits of the project to the top management	15
To secure the proper accounting of innovation expenses	12
To set new product specifications	8

Source: our survey in 2007

The turn-key project dream

- Foreigners take the complete responsibility for a new business, including appointing operating staff and recruiting the necessary Russian staff
- They bring all the necessary equipment, technology etc.
- They start marketing etc.
- The final payment is done as the business will reach the pre-agreed levels of sales and profitability

The way ahead for Israeli businesses

- To discover (strengthen its presence) in the “non-strategic sectors”
- To account for the internal logic of managers and owners
- To structure the deals making them more “comfortable” in terms of organization and processes to local expectations
- ***To earn profit from the deals, after all!***