

Successful Business in Russia!

Potential, obstacles, culture and practice

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Contents of the presentation:

1. What is the **theory** of doing business in Russia;
2. What is the **image** of Russia in the West and what is the **reality**;
3. The **opportunities** and the **risks** on the Russian market;
4. Cultural **peculiarities**;
5. How do you increase your chances of success (**Do's** and **Don'ts**);
6. Steps to take for a **successful** market entry;
7. Russia's Aerospace sector;
8. Conclusion and answers to your questions.



A. The theory of doing business in Russia:

1. ?
2. ?
3. ?
4. ?
5. ?
6. ?
7. ?
8. ?
9. ?
- 10.?



Умом Россию не понять,

Russia can't be understood with the mind,

Аршином общим не измерить:

Can't be measured with a common yardstick:

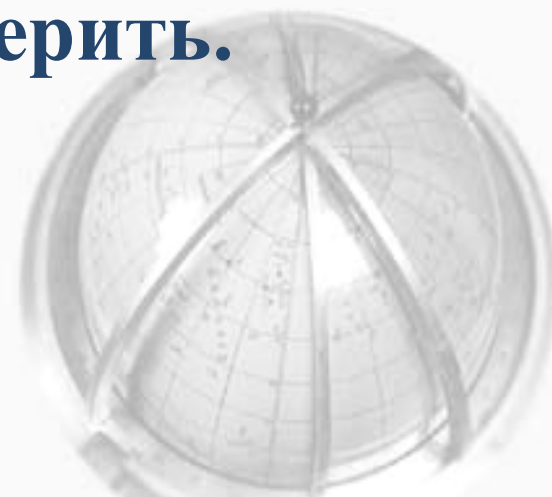
У ней особенная статья -

She has a specific characteristic -

В Россию можно только верить.

In Russia it's only possible to believe.

1886 Fedor Tiutchev



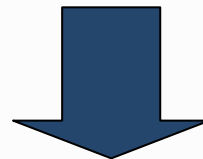
B. The theory of doing business in Russia:

11. ?

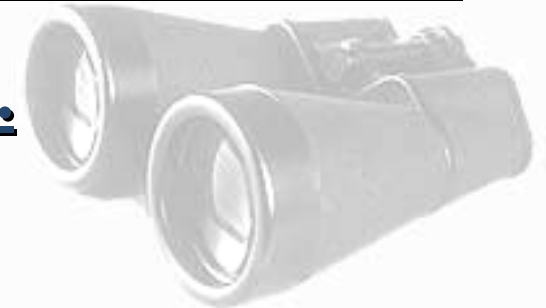
12. ?

13. ?

14. So we do it as it's done back home.



**And run into the wall of cultural differences and of
lack of understanding.**



A. The image of Russia in the West is mainly negative:

1. Mafia – Oligarchs - Polonium (Abramovich, Berezovsky);
2. Cold;
3. Russian bear;
4. Risks and danger;
5. Unreliable;
6. But also positively; culture!
7. However: Fear is leading!



B. Relevant is that Russia is a country with:

1. More than **50%** of her external trade with the EU;
2. A **stable political system**. After the recent Parliamentary elections (2007) and Presidential elections (2008), no great policy changes are expected for the next two years;
3. Economic: **Oil and Gas** (20%-30% of GDP and FDI) / Increasing purchasing power and real disposable income / Growth in many sectors;
4. Growing **wealth** but also growing difference between rich and poor/ Neglect of crucial sectors such as education and public health;
5. 17 million squared kilometres surface / 11 timezones;
6. Specific Eurasiatic **Slavonic culture**
7. Many **successful foreign businesses!!**



A. What are the opportunities on the Russian market?

1. Population of **142 million**. (8th in the world);
2. Disposable income grows with **10%** per year;
3. 15% of population has **high purchasing power** (21 million people);
4. **150.000 millionaires** and **101 billionaires**; The aggregate net worth of Russia's 100 richest businessmen rose to U.S. \$577 bln in 2007 from \$248 bln in 2006;
5. 75% of household income is spent on **consumption**;
6. Income is concentrated in **large cities** in Western Russia;
7. GDP 2007 = EUR 883 bln / Yearly growth between **6% – 7%**;
8. 30% of economy in grey sector and not accounted for;
9. Growing **demand** for consumption goods, innovative products, value-added services and modern equipment and technologies;
10. Big quantitative **potential** but strong qualitative **competition**.

B. Economic and market trends:

Economy:

1. Average GDP (\$1.3 trillion) growth of **6,8%** (1999–2007); **5% (2008-2011)**;
2. Inflation exceeds 10% in 2008;
3. High natural resource commodity prices are a **blessing** for economic stability;
 1. Russia holds the world's largest natural gas reserves, the second largest coal reserves, and the eighth largest oil reserves.

Markets:

1. Aerospace;
2. Retail sector;
3. Oil & gas, energy;
4. Agribusiness;
5. Automotive and automobile;
6. Packaging;
7. Construction materials;
8. Telecom & IT;
9. Logistics Services & Trade.

C. Risks:

Political (Low risk):

1. Medvedev's presidency may lead to some unrest as shifts occur in balance of power. But: bread over democracy. However: play in the Russian team and share.

Regulative and administrative (Low risk):

1. Changing and ambiguous **legislation** and **regulations**;
2. Increasingly easy to **enforce** contractual and ownership rights;
3. Bureaucracy.

Economic and financial (High risk):

1. Underdeveloped banking system. Financing is expensive and scarce;
2. Underdeveloped SME and absence of strong bourgeoisie / middle class;
3. High and increasing **costs** (15+ % per year). Moscow is the most expensive city in the world. Potential reduction in consumer spending;
4. Underdeveloped **infrastructure** (gas, electricity, water and heat).

HR (High risk):

1. Difficult to find good **staff**. No new generation of scientists and engineers.

D. Will Russia remain stable?

1. Continuing **high prices** for oil and gas;
2. Low (but increasing) level of consumer **credits** and mortgage lending (The Russian owns his house, car, dacha);
3. Consumptive **spending** can be easily (temporarily) reduced by the Russian consumer – blessing or risk?;
4. Consumption over **democracy**;
5. Foreign **investments** reached \$90 billion in 2007 (150% ↑).



E. What do you hear around Moscow's Expat kitchen tables?

1. Returns higher than anywhere else;
 1. **Stock market** 2006 ↑↑ 70%, 2007 ↑↑ 19%;
 2. Gazprom capitalization from 30 bln \$ to 300 bln \$ in 3 years;
 3. Upgraded country ratings (Fitch: BBB+, Moody's: BAA2);
2. It takes determination, flexibility, stamina and hard work but **success** in Russia is very well possible;
3. The **foreign media** are much too negative;
4. Russia is not more difficult than **China**;
5. **RIC.**



F. Russia's Balance Sheet!!

1. Assets;

1. Natural resources 25% gas / 11% oil;
2. Stabilization funds > 160 billion \$;
3. International reserves > 550 billion \$.

2. Liabilities;

1. Poor healthcare;
2. Worsening education;
3. Deteriorating infrastructure;
4. Widening poverty gap.



G. What is the secret of success of foreign companies in Russia?

1. They are there and they are **committed**;
2. They **like** it 😊;
3. They **understand** Russia's market potential;
4. They are ready to be **flexible**;
5. They are **entrepreneurial**
6. They **understand** and **respect** Russia's cultural peculiarities and understand the Russian **perspective!**



A. What are the Russian's main Cultural Characteristics:

1. Building and maintaining of **trust** and personal relationships is key;
2. Informal communication **networks** are most important;
3. The **Micro Cosmos** (almost clan);
4. Different sense of public **individual** responsibility;
5. **Pride** – and now a burgeoning national assertiveness;
6. **Practical** vs. formalistic approach of things;
7. **Short term** (positively fatalistic) vision
8. Russian's are focused at Russia and consider the world to look upon them **antagonistically** (the idea of “nashiy = ours”);
9. Russian's closer to Europe then to the USA.



B. Russian Business Culture:

1. Vertical **authority** / status;
2. Staff, partners and distributors require continuous **management**;
3. During first contacts the Russian partner may **promise** more than can be delivered (without bad intent!);
4. Russian businessmen can be **imposing**. Weakness is not shown;
5. The external **appearance** is very important / content vs. context;
6. Russians **pay** better than Europeans;
7. Russians have their own way of thinking and reasoning and are **reliable** within the boundaries of their own logic;
8. Russian businessmen think, speak and act **fast!**



C. The language barrier:

1. Be critical of **interpreters** as they make mistakes;
2. Be critical of written **translations** (don't use internet);
3. Many Russians know English but are not **comfortable** speaking it;
4. Have your **brochures** in Russian;
5. Have a **business card** in Russian (and check pronunciation);
6. Learn **alphabet** and a few words.



D. Market Specifics:

1. Young market with **underdeveloped** marketing, merchandising, sales and logistics;
2. Static and limited market **channels** (i.e. producer > distributor > buyer relations);
3. **Distributors** vs. agents;
4. **Particular** product-market combinations;
5. Geographic market **differences**;
6. Poor **logistics** infrastructure (transport, customs, warehousing);
7. Incomplete **Value Chain**;
8. Peculiar purchasing **motivations** (price motivated);
9. High **competition**.



B. Do's:

1. **Enjoy** Russia!
2. Do your homework and **know** your market;
3. Gain some knowledge of the Russian language and **culture**;
4. Be there and stay in **control** (of finances, management and relations);
5. Divide the shares/interests off-shore and agree on foreign arbitration and create **win-win** situation;
6. Use experienced local (general, tax and legal) **advisors**;
7. Limit your **exposure** and risks;
8. Dedicate and commit sufficient **financial & human resources**;
9. Be **flexible** and **patient** (e.g. bureaucracy, market development);
10. Think well about the **location** of your office, warehouse, and production;



D. Don't:

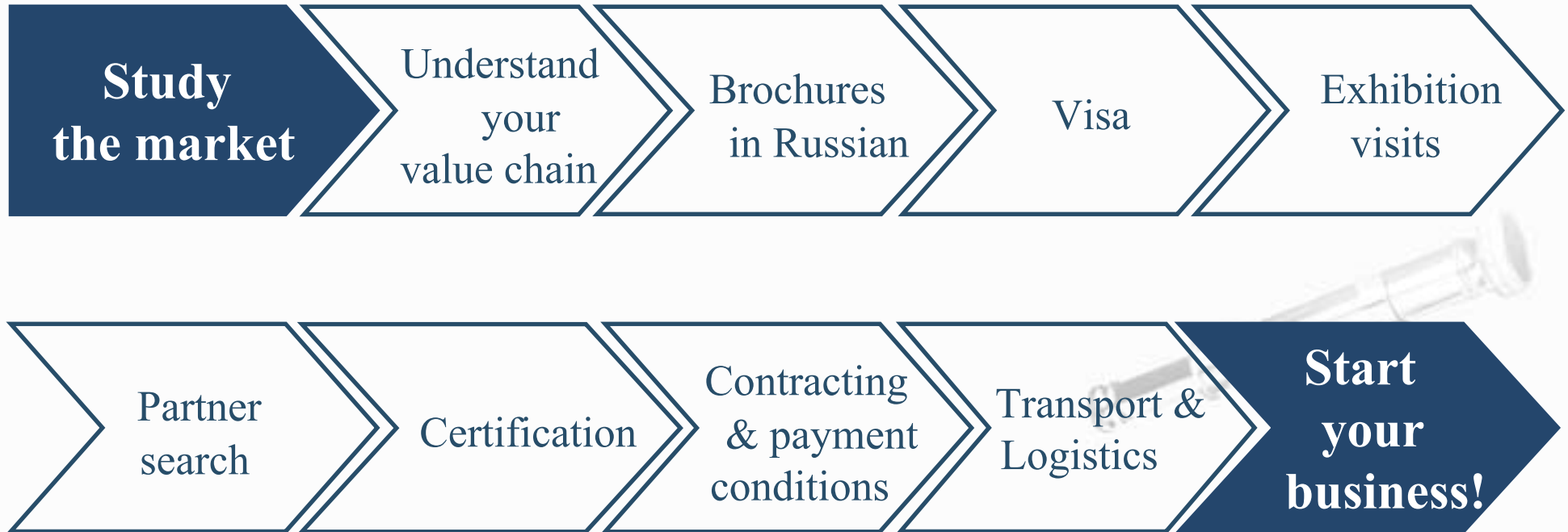
1. Be **afraid** of Russia;
2. **Underestimate** the market or your Russian business partner;
3. Think Russia is **Europe or the USA**;
4. Think Russia is **cheap**;
5. Think it is easy to find the right **staff**;
6. Let yourself in with **corruption** (payments on the basis of contracts or through third parties);
7. Give immediate **exclusivity** to distributors;
8. Forget to register your **trademark**;
9. Forget your **visa** and do not forget to have your passport on you;
10. Think **transfer** of goods and money is easy.



E. Don't forget the regions:

1. **Support** from local administration. Willingness for cooperation and openness for contacts and communication;
2. **Tax incentives** for investors;
3. Lower **costs** of resources compared to Moscow and Moscow region (on average 20% cheaper);
4. **Comparable** infrastructure and facilities;
5. Young, educated, eager and relatively cheap **workforce**;
6. Facilitating fast document transaction. **Fast** preparation and execution of decisions, resolutions and documents.

A. Steps to take for a successful market entry:



B. Russian Partner:

1. Choose your partner carefully:
 1. Good **management**;
 2. Strategy and growth **prospects**;
 3. Decent company **infrastructure**;
 4. Sufficient **transparency** (tax, legal, finance, etc.);
 5. Common **sense**; if it doesn't seem right it probably isn't.
2. When in doubt: use advisor;
3. When still in doubt: Don't continue!!



C. Problems with exports:

1. Customs;
2. Certification and documents;
3. DDP-deliveries without local representation;
4. Need to compete with grey imports.

Therefore important:

1. Good and trustworthy agent/partner/consultant;
2. Good transport company experienced in working with Russia;
3. Solid preparation and uniformity of documents;
4. Conservative payment conditions.



Russia's Aviation industry:

1. 2500 aircraft out of which 100 foreign ones that carry over 30% of passengers;
2. UAC (United Aircraft Corporation) = Government owned corporation consolidating aircraft design, manufacturing and sales companies for military, civilian, transport and unmanned aircraft. Revenue 2007 = 3 bln Euros;
3. Sukhoi, Mikoyan (MiG), Ilyushin, Tupolev, Yakovlev;
4. 7 main projects = Sukhoi Superjet 100 (75-95 seater costing \$28 million) competing with Embraer and Bombardier / MS21 – medium range plane / cooperation with Finmeccanica and Boeing (Thales, Messier, Liebherr, Honeywell) / maiden flight 19-05-08 / 171 orders;
5. Bottlenecks include shortage of experts, lack of technologies, lack of production capacity, low productivity, Chinese competition, component shortage and poor logistics;
6. Trends – investments in technology, increased international cooperation, increased components production in Russia / Russia wants to increase global market share in terms of passenger and transport aircraft from 1% to 10-12% by 2025 / Re-arming;
7. Opportunities = Russia needs cutting edge technology and Honeywell presents a solution.

Russia's Space sector:

1. Roskosmos – 26 space launches in 2007 (38% of world's total), orbital constellation of 101 spacecraft, ISS;
2. S.P. Korolev Rocket and Space Corporation Energia also known as RKK Energiya, is a main Russian manufacturer of spacecraft and space station components;
3. Plans: Develop leading position in commercial launch services, booster rocket development, spacecraft development (e.g. scrapped "Klipper"), satellite development (GLONASS navigation system) / upgrade existing satellite fleet;
4. New launch site in Vostochniy in Amur region;
5. Mars in October 2009;
6. Consolidation in 3-4 core enterprises by 2015 of current 112 companies employing 250.000 people;
7. 11 bln \$ budget for 2006-2015 and increasing 5-10% per year / Stop space tourism by 2010;
8. Same bottlenecks as in aviation sector worsened by Soviet management style;
9. Need for competitive technologies, market know-how, commercial skills.



Russia Rosoboronexport (ROE):

1. ROE is the sole state intermediary agency for Russia's exports/imports of defense-related and dual use products, technologies and services;
2. State arms exporter (7 bln \$ per year) embracing also helicopter production, engine manufacturers and titanium producers;
3. ROE supplies 65% of Airbus' titanium needs and 30% of Boeing's;
4. On August 4, 2006, the U.S. State Department announced sanctions against Rosoboronexport (and the aircraft manufacturer Sukhoi) for alleged violations of the Iran Nonproliferation Act of 2000, thereby barring U.S. companies from dealing with those Russian entities for two years, but.....
5. Russia is re-arming (partly as reaction to Nato expansion en Central European rocket defense shields);
6. ROE's role will increase and become an increasingly important target for Honeywell.



International activities in Russia's Aerospace sector:

1. Airbus' history in Russia dates back to 1991. Since 1995 Moscow office involved in marketing, PR, lobbying. Since 2006 cooperation in Research and Technology, Engineering, Components' manufacturing and materials sourcing;
2. EADS (European Aeronautic Defense and Space group) owns 10% in Irkut and Russia's VEB owns 5,02% in EADS;
3. Boeing since 1992. Now about 1600 engineers work in Moscow's Boeing Design Center performing work on all of Boeing's commercial airplane programs. In 2007 agreement was signed with UAC for cooperation in R&D, Manufacturing, Design and Marketing Research. January 2008 Boeing signed a billion dollar titanium deal with ROE for supply of parts to be used a.o. in 787 Dreamliner;
4. Window dressing in order to secure orders for aircraft?
5. Snecma, Pratt & Whitney, Liebherr, Rolls Royce, Thales, B/E Aerospace, Intertechnique, Messier/Dowty, Goodrich and many western MRO suppliers. Also Hindustan Aeronautics (Il 214 tactical transport aircraft).



Ukraine:

1. Aviation – Antonov (124 and 225 – $43*6.4*4.4$ / $280m^2$ / $1300m^3$ / payload 250 tonnes and 4000 km range);
2. Space – Ukraine inherited one third of Russia's space industry. 90 launches since independence from USSR. The National Space Agency of Ukraine oversees 30 entities including industrial and design companies, military facilities and research institutes (e.g. Yuzhnoje Design Office and Yuzhmash Machine Building);
3. Cooperation with Russia, EU (ESA and EADS) and China;
4. Same bottlenecks as in Russia;
5. Growth trends less impressive;
6. Opportunities minor when compared with Russia.



Kazakhstan:

1. Baikanur cosmodrome;
2. Titanium – EADS signed titanium 850 million Euro deal with Kazakh titanium supplier UKTMP and Eramet's Aubert & Duval;
3. Relatively small airfleet but increasing replacement and renovation needs;
4. Growing market for executive aircraft;
5. Only one airport that can accomodate the 747 (Almaty);
6. Relatively small interest for Honeywell.



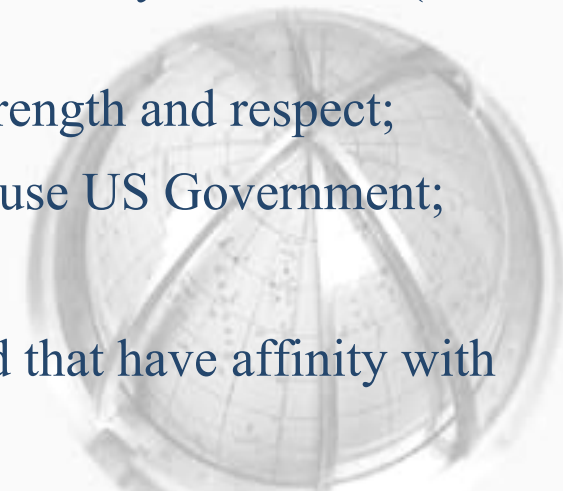
Political significance of Russia's Aerospace sector:

1. Aviation and space industry = “Pride of our country”;
2. World power – Glory scenario;
3. National champions and strategic industries;
4. UAC established by Putin to revive Russia's aviation industry;
5. Consolidation of space sector and ambitious space developments;
6. Access to space from Russian territory.



How to approach Russia's Aerospace sector:

1. Homework > strategy > preparation;
2. Appeal to national interest;
3. Commit for long term;
4. Show added value and understanding of the market;
5. Show you're willing to invest in partnership;
6. Build long term personal relationships between key/top Honeywell people and key/top Russian counterparts (key Russian is Russian with the right network and influence) / Matching of contacts CEO-CEO, military – military, and so on (status and respect);
7. Show expertise, capabilities, sincerity, understanding, strength and respect;
8. Use Western partners and clients that are already there / use US Government;
9. Step by step;
10. Have a core team that is committed for the long term and that have affinity with Russia.



Conclusion and Questions – Why Russia??

- The **economy** will continue to grow;
- Aerospace budget **spending** will continue to grow;
- Needs are enormous and the growth **potential** in the coming years in a wide number of Aerospace sub-sectors is high;
- Honeywell could solve many of Russia's Aerospace problems;
- Proximity to the market / cheap resources / specialist industries;
- Many of your colleagues / **competitors** are already there.

BUT

- Traditional problems will continue to exist so prudence and good preparation is advisable.

Tax environment:

- | | | |
|-----------------|---|--|
| 1. Profit Tax | 24% | over profit (17.5% to regional budget, up to 4% reduction is possible) |
| 2. Income Tax | 13% | over personal income (with |
| 3. Social Taxes | 26% (max) | over pay-roll (medical, social, pension) |
| 4. VAT | 18% | over turnover |
| 5. Property tax | 2.2% (max) | over property |
| 6. Dividend tax | 15% (30% to individuals)-(cross-border) and 9% (national) | |

Profit Repatriation

Dividends (or distributions of net profit for Limited Liability Companies) are payable annually, semi-annually or quarterly. In practice, profits are often repatriated through a number of techniques such as: transfer pricing mechanisms, service charges, royalties and interest payments. This is, however, coming under increasing official scrutiny.

Main forms of legal presence in Russia:

1. Representative office;
2. Limited Liability Company (OOO);
3. Closed Joint Stock Company (ZAO);
4. Open Joint Stock Company (OAO).

Since 1999 Lighthouse assists Western companies in doing business in Russia. Throughout the years, Lighthouse has successfully assisted hundreds of companies from a wide range of sectors with their business development in Russia. Whether you need to start or increase your sales, set up production or do an acquisition, Lighthouse has the experience, the network and the team to help you reach your goals faster, cheaper and with less business risks. We are always happy to exchange thoughts with you about your business in Russia.

For further information you can contact us by using the coordinates below.

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