

# **Success in Doing Business in** **Russia**

**How to use cultural differences to your  
advantage!**

**29 May 2008**

**KvK Utrecht**

**By: Jeroen Ketting, Managing Director of Lighthouse Russia BV**

## 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. 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:

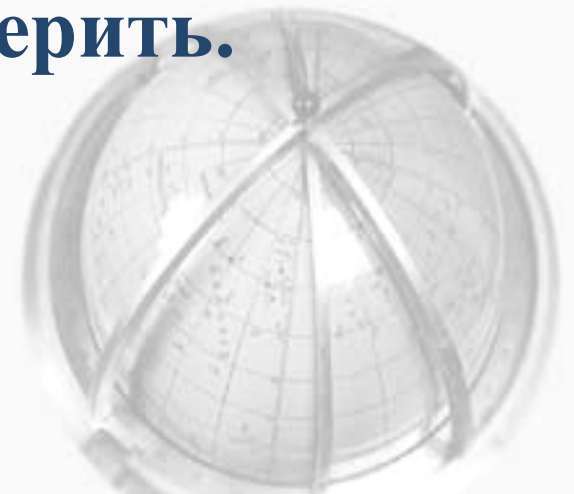
**У ней особенная статья -**

She has a specific characteristic -

**В Россию можно только верить.**

In Russia it's only possible to believe.

1886 Fedor Tiutchev



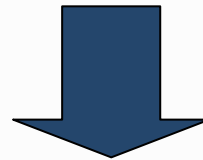
## B. The theory of doing business in Russia:

11. ?

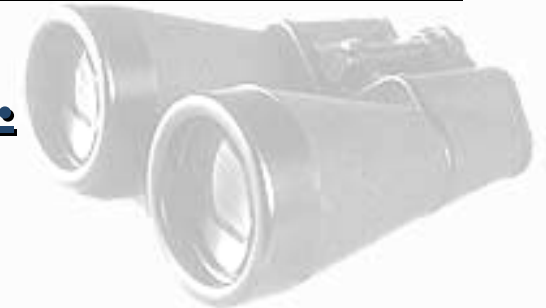
12. ?

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) / 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**. (8<sup>th</sup> 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 growth of **6,8%** between 1999 and 2007; **5% (2008-2011)**;
2. High natural resource commodity prices are a **blessing** for economic stability;
3. WTO accession will lead to: lower import tariffs, increased FDI and more competition and efficiency.

### Markets:

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

### Regulative and administrative (Low risk):

1. Changing and ambiguous **legislation** and **regulations**;
2. Difficult but not impossible to **enforce** contractual and ownership rights;
3. Bureaucracy.

### Economic and financial (High risk):

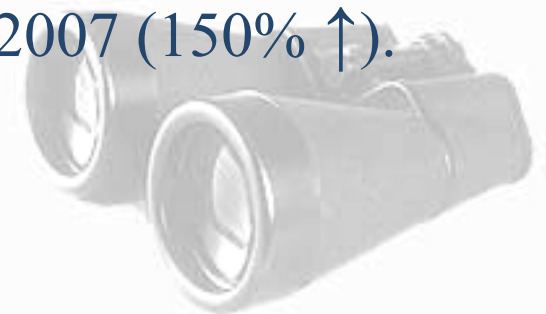
1. Underdeveloped banking system. Financing is expensive and scarce;
2. Underdeveloped SME and absence of strong bourgeoisie / middle class;
3. High and increasing **costs** (10+ % per year). Moscow is now the most expensive city in the world;
4. Underdeveloped **infrastructure** (gas, electricity, water and heat).

### HR (High risk):

1. Difficult to find good **staff**. Check backgrounds, networks and loyalties.

## D. Will Russia remain stable?

1. Continuing **high prices** for oil and gas;
  - Account for 20-30% of GDP.
2. Low 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;
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. 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 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**;
6. **Practical** vs. formalistic approach of things;
7. **Short term** (positively fatalistic) vision.



## B. Russian Business Culture:

1. Vertical **authority**;
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;
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. Stay in **control** (of finances and management);
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:

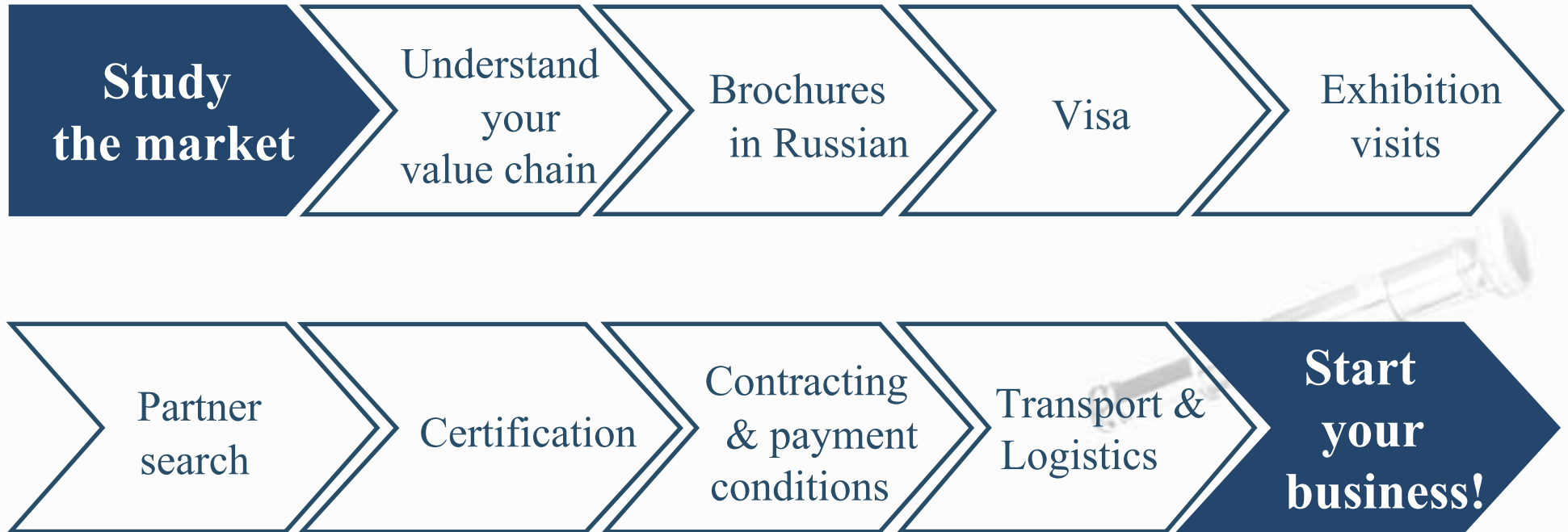
1. Be **afraid** of Russia;
2. **Underestimate** the market or your Russian business partner;
3. Think Russia is **Europe**;
4. Think Russia is **cheap**;
5. Think it is easy to find the right **staff**;
6. Let yourself in with **corruption** (payments on the basis of contracts or through third parties);
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.



## Conclusion and Questions – Why Russia??

- The **economy** will continue to grow;
- Consumer **spending** will continue to grow;
- The growth **potential** in the coming years in a wide number of sectors is high;
- 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.

## Contact LIGHTHOUSE

	Director	Jeroen Ketting	<a href="mailto:jeroen@thelighthousegroup.ru">jeroen@thelighthousegroup.ru</a>
	Client Relations and Information	Birgit von Oehsen	<a href="mailto:birgit@thelighthousegroup.ru">birgit@thelighthousegroup.ru</a>
	Finance & administration	Elena Kabko	<a href="mailto:elena@thelighthousegroup.ru">elena@thelighthousegroup.ru</a>
<b>Tel.:</b>	+7 (495) 980 09 77		
<b>Fax:</b>	+7 (495) 502 92 86		
<b>Website:</b>	<a href="http://www.thelighthousegroup.ru">www.thelighthousegroup.ru</a>		
<b>Address:</b>	Mytnaya Ulitsa 3, office 41, Moscow, Russia, 119049		