

**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



# Masterclass

# Doing business in Russia

## Cultural Challenges

**20 October 2009 Eindhoven**

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

**By invitation of:**



## Contents of the presentation:

1. Why deal with the cultural challenge?
2. Why is there a cultural challenge?
3. What is the nature of the cultural challenge?
4. How to deal with the cultural challenge?
5. To deal or not to deal with the cultural challenge?
6. Conclusion and **answers** to your questions.



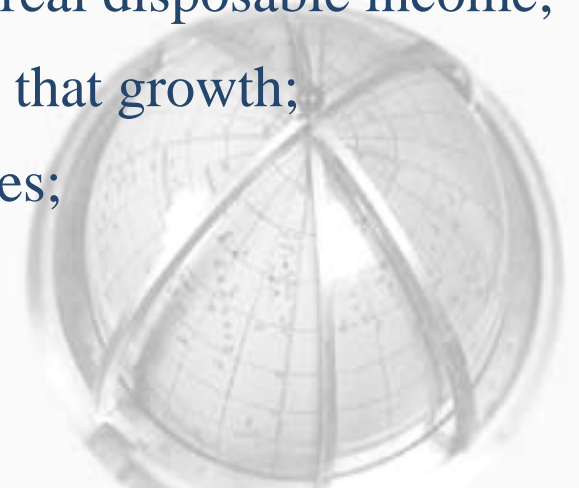
# Why deal with the cultural challenge?

- What are the reasons to be thinking about Russia?



## Russia is a country with:

1. Population of **142 million**. (8th in the world);
2. More than **50%** of its external trade with the EU;
3. **A stable political system**. No great policy changes expected;
4. An average GDP growth of 6,8% (1999–2007), but economy **shrank** in Q4 2008 and will continue to do so in 2009;
5. Large gas, coal and oil reserves (**Oil and Gas: 20%-30%** of GDP) ;
6. Growing wealth, increasing purchasing power and real disposable income;
7. Growth in many sectors although **crisis** has paused that growth;
8. 17 million squared kilometres surface / 11 timezones;
9. **Specific Eurasian Slavonic culture;**
10. Many **successful foreign businesses!!**



## Russia before the Crisis:

1. **Retail:** Rapid growth in consumer spending and underdeveloped local production → **market** for foreign consumer products.
2. Strong demand for foreign equipment, technology and know-how in **Industry, Agriculture and Oil & Gas:**
  - a. Poor quality of locally produced equipment and technology;
  - b. Government policy;
  - c. Availability of capital.
3. **Construction / Real Estate:** Boomed to address shortage of quality housing, retail real estate, offices and underdeveloped transport and logistics network
4. **Investments** in these various sectors were funded by easy available capital, both foreign and domestic.
5. Strong **ruble** vs. especially the dollar made imports relatively cheap.
6. **BUT:** Growth largely funded by borrowed money → **overleveraged.**

## Effects of the Crisis:

1. The crisis has swept away the three economic pillars on which Russia's growth was based:
  - a. Oil price fell by 70% and currently hovers around **\$50 / barrel** → budget deficit 8% GDP (2009E);
  - b. Decrease in consumer spending **4%** (2009E);
  - c. Foreign investments: Investors withdrew **\$211 billion** (Aug – Dec 2008);
2. The Russian Central Bank used its reserves for a **managed devaluation** of the Ruble (Ruble / \$ = -30% (Aug 2008 – Jan 2009) → Foreign exchange reserves fell by around **a third** to \$386.5 billion at the end of January 2009.
3. GDP growth for 2008 5.6%. 2009: **-4.5%**, 2010: +1.7%.

## Effects of the Crisis:

1. **Lack of capital → break on investments.**
2. **Retail:** Period of uninterrupted growth (annually 13% from 2003-07) will end in 2009 as sales are expected to fall (particularly in services and non-food items). Domestic retail chains, heavily leveraged, are experiencing a liquidity crisis since April 2008 → longer credit terms or bigger cash discounts.
3. **Industry, Agriculture and Oil & Gas:** Reduced growth rates primarily due to the decrease in demand. Also, demand for foreign equipment will fall due to the fact that imports will become more expensive.
4. **Construction / Real Estate:** Is suffering from a lack of capital and decrease in demand (e.g. Moscow City).
5. **But:** Weakening of ruble will make imports relatively **less competitive.**

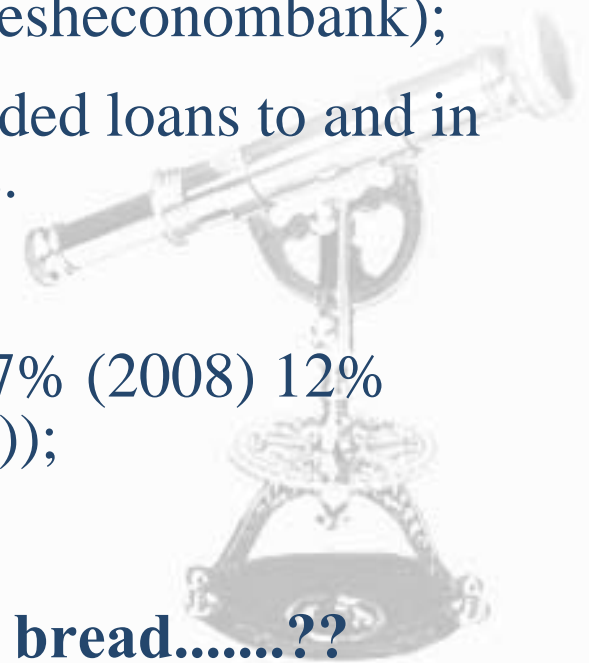
## Effects of the Crisis:

### 1. Political:

- a. Increasing **nationalization** of the economy;
- b. \$50 billion facility for troubled companies to refinance foreign debts;
- c. Money is channeled through the VEB (Vnesheconombank);
- d. VEB took shares in the companies it provided loans to and in some cases a seat on the board of directors.

### 2. Social:

- a. Growing **social unrest** (unemployment 7.7% (2008) 12% (2009), inflation 13.3% (2008) 17% (2009));
- b. Protests in several Russian cities.
- c. Bread over democracy, but what about the **bread.....??**



## Effects of the Crisis:

1. Russian companies are adapting to a **new reality** that the crisis has brought about:
  1. Drop in demand;
  2. Lower margins;
  3. Weaker Rouble;
  4. Uncertainty about the exact effects of the crisis.
2. In reaction to this new reality, companies are:
  1. Cutting **costs** (e.g. laying off staff);
  2. Reluctant to expand business activities → focus on **optimizing existing activities**;
  3. Switching from Contracts Ex Works / foreign currency → **DDP Russia** (thus: Rouble).



## Interesting markets:

1. Retail sector (consumer goods);
2. Oil & gas, energy;
3. Agribusiness;
4. Aerospace;
5. Automotive and automobile;
6. Packaging;
7. Construction materials;
8. Telecom;
9. IT;
10. Manufacturing;
11. Logistics;
12. Trade;
13. And so on.

## Risks:

### Political:

1. The system is firmly in control. Increasing nationalization. Bread over democracy.

### Regulative and administrative:

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

### Economic and financial:

1. High dependence of volatile oil, gas and commodity prices (80% of exports);
2. Underdeveloped financial sector. Financing is costly and scarce. Liquidity crisis;
3. Consumer spending fluctuates;
4. Underdeveloped SME and absence of strong bourgeoisie / middle class;
5. High and increasing costs (10+ % per year). Moscow is now the most expensive city in the world. Inflation around 15% in 2008;
6. Underdeveloped infrastructure (gas, electricity, water and heat).

### HR:

1. Difficult to find good staff.

## Russia's Balance Sheet!!

### 1. Assets;

1. Natural resources 25% gas / 11% oil;

2. Stabilization funds;

3. International reserves.

### 2. Liabilities;

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



## **But Actually: >>>>Russia's Balance Sheet!!**

1. Assets;
  1. Natural resources 25% gas / 11% oil;
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  3. International reserves .

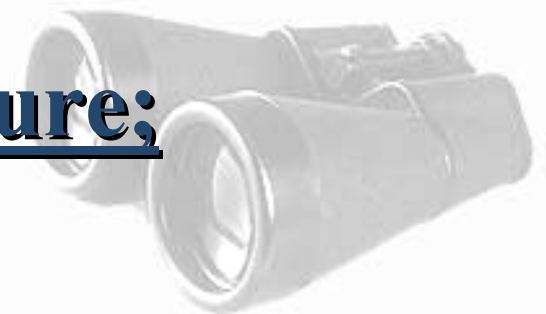
## **2. Liabilities;**

**1. Poor healthcare;**

**2. Worsening education;**

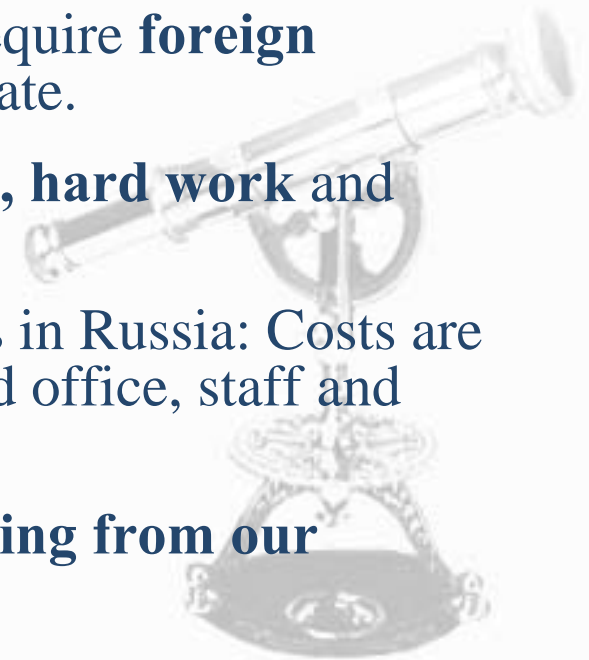
**3. Deteriorating infrastructure;**

**4. Widening poverty gap.**



## Opportunities:

1. The Russian market still has **similar opportunities** as before the crisis:
  - a. Local production continues to be **insufficient** to meet local demand for consumer goods and equipment;
  - b. Shift to (cheaper) products will occur, but Russians will continue to **consume**;
  - c. Companies in many sectors will continue to require **foreign** equipment, technology and know-how to operate.
2. Difference is it will require more **time, flexibility, hard work and commitment** to be successful.
3. In some ways, it has become easier to do business in Russia: Costs are **falling** (office rents, wages, land) → easier to find office, staff and production sites.
4. **BUT WITH CERTAIN CHALLENGES** resulting from our differences....



# Why is there a cultural challenge?

- Why is there a problem?



## Our business practice shows:

1. Many requests to mediate in Russian – Western relationships and conflicts.
2. Most of the problems are caused by “soft” factors such as:
  1. Poor communication
  2. Emotions
  3. Lack of understanding
  4. Differences in perspective
3. Most of these problems are solved by simply creating clarity on both sides.
4. But the million dollar question is: ‘How to do this?’



## The theory of doing business in Russia:

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



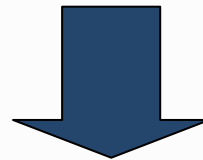
**There is no theory of doing business in Russia:**

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.**

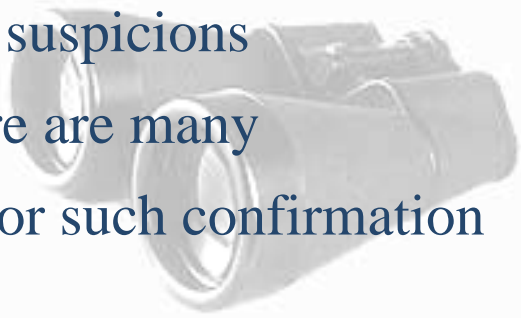


# What causes the cultural challenge?

- What's the problem?



## Our fear of what we do not understand:

1. Fear breeds conflicts
  2. Fear causes:
    1. Reduced confidence
    2. Reduced trust
    3. Fear
    4. Tunnel vision
    5. Suspicion
    6. Pessimism
  3. We test our relationships to find confirmation of our suspicions
  4. Suspicions and stereotypes (preconceived ideas) there are many
  5. And in a difficult environment like Russia a reason for such confirmation can be easily found.
- 
- A pair of black binoculars is positioned in the lower right corner of the slide, partially overlapping the text of the fifth list item.

## **Why don't we understand?**

1. We look at each other from our own perspectives
2. We expect each other to behave as we do ourselves
3. We underestimate the importance of the environment
4. We think we are right
5. We think Russia is Europe.
6. We feel but do not recognize our differences

**We look at the same things from different angles.**



## What to do to start understanding?

1. Identify the stereotypes
2. Put them into perspective
3. Understand our differences
4. Use them to our benefit



## The image of Russia in the West is mainly negative:

1. Cold
2. Rude, grim, grey and depressing
3. Mafia
4. Poor and cheap
5. Russian bear
6. Vodka
7. Risks, danger; unreliability
8. But also positively; culture!
9. However: Fear is leading!



**В крови горит огонь желанья, - My blood's aflame! Desire and yearning**

**Душа тобой уязвлена, - Overwhelm me: stung this heart of mine.**

**Лобзай меня: твои лобзанья - O kiss me, love! Your kisses burning**

**Мне слаще мирра и вина. - Are sweeter far than myrrh or wine.**

**Склонись ко мне главою нежной, - Lay your head, dear one, on my breast,**

**И да почию безмятежный, - And blithe and happy will I rest**

**Пока дохнёт весёлый день - Till the first breath of cheerful day**

**И двинется ночная тень. - The shades of nighttime drives away.**



## Stereotypes about the West in Russia:

1. Pampered and weak
2. Dependency
3. Condescending
4. Antagonism
5. Competition with Russia
6. Only seeking to profit from Russia



## The main cultural differences between Russia and EU:

1. Building of **trust** and personal relationships is **vs. formal relations in EU**;
2. **Informal** communication **networks vs. formal (official) networks in EU**;
3. The **Micro Cosmos** (almost clan) **vs. low interpersonal cohesion in EU**;
4. **Testing** the rules **vs. abiding** by the rules;
5. Responsibility for close ones only **vs. responsibility for society**;
6. **Pride and Power vs. modesty**; Extreme vs. Average; Emotions vs. Ratio;
7. Surprising vs. predictability;
8. **Practical vs. formalistic** approach of things;
9. **Short term** (positively fatalistic) vision **vs. long term vision**;
10. Separating **business** and **personal**;
11. Single-focus thinking – holistic thinking.



## Russian vs. EU Business Culture:

1. Vertical **authority vs. consensus**;
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!) - **Intent vs. agreement**;
4. Russian businessmen can be **imposing**. Weakness is not shown and one always negotiates from a position of power;
5. The external **appearance** is very important **vs. substance in EU** / context vs content;
6. Russians have their own way of thinking and reasoning and are **reliable** within their own logic;
7. Russian businessmen think, speak and act **fast!**
8. Quantity vs. Quality / Capacity vs. Efficiency / Purpose vs. Comfort;



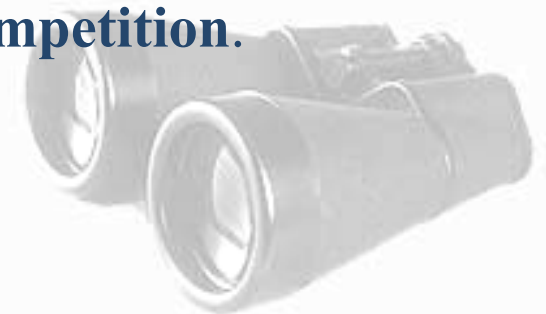
## The language barrier:

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.



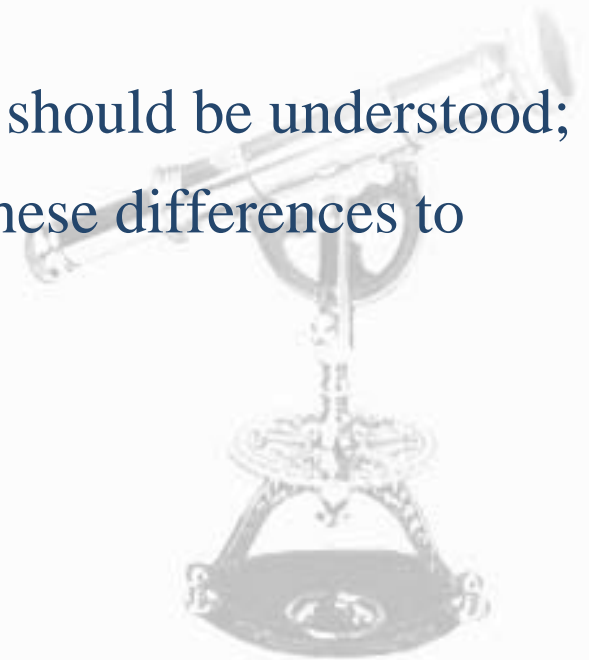
## Market Specifics in Russia:

1. Young market with **underdeveloped** logistics, marketing, merchandising and sales;
2. Poor **logistics** infrastructure (transport, customs, warehousing);
3. **Distributors** vs. agents;
4. Geographic market **differences**;
5. Incomplete and inefficient **Value Chain**;
6. Much more **paperwork**;
7. Peculiar purchasing **motivations** (price motivated);
8. Big quantitative **potential** but strong qualitative **competition**.



## Understanding of the differences will benefit your relationship

1. In times of crisis it is even more important to expand our horizons;
2. New people, new ideas, new places, more cooperation > more European – Russian business cooperation;
3. But there are many obstacles and differences;
4. Differences can be good fun;
5. But they should be accepted and for that they should be understood;
6. So that you may understand, accept and use these differences to your advantage;
7. And build lasting relationships.



# How to deal with the cultural challenge?

- Do's and don'ts



## Do:

1. Understand and respect each others cultural peculiarities and perspectives!
2. **Enjoy** Russia 😊!
3. Be committed;
4. Do your homework and **know** your market;
5. Gain some knowledge of the Russian language and **culture** (learn (alphabet and) a few words);
6. Be **entrepreneurial, flexible** and **patient** (e.g. bureaucracy, market development);
7. Stay in **control** and keep the **initiative**;
8. Create **win-win** situations in which all parties have a clear added value;
9. Use experienced local (general, tax and legal) **advisors**;
10. Limit your **exposure** and risks;
11. Dedicate and commit sufficient **financial & human resources**;
12. Be open.



## Don't:

1. Be **afraid** of Russia;
2. **Underestimate** the market or your Russian business partner;
3. Stick to your own perspective
4. Think Russia is **Europe**;
5. Think Russia is **cheap**;
6. Think it is easy to find the right **staff**;
7. Let yourself in with **corruption**;
8. Give immediate **exclusivity** to distributors and put **certificate** on your partner's name;
9. Forget to register your **trademark**;
10. Forget your **visa** and do not forget to have your passport on you;
11. Think **transfer** of goods and money is easy.



## Understand what we do or see differently:

1. Trust
2. Network (Micro Cosmos)
3. Rules
4. Society
5. Pride and power
6. Emotions
7. Future
8. Approach of things
9. Business and personal



## Understand what we do or see differently:

1. Authority
2. Agreements
3. Appearance
4. Speed
5. Language



**If you do all this you will prove Pushkin wrong:**

**Всегда так будет и бывало, - It has always been and it will be forever**

**Такой издревле белый свет: - Since old times the world is like this**

**Ученых много, умных мало, - Many are learned, but few are wise**

**Знакомых тьма, а друга нет. - Innumerable acquaintances, but not a friend.**



To deal or not to deal with the cultural challenge....



## How does the crisis affect your actions and your timing?

1. The effects of the crisis have brought about a **new reality** on the Russian market;
2. Despite this new reality, Russia still offers plenty of opportunities for **flexible** foreign companies with a clear **added value**;
3. Companies that remain present on the Russian market will be able to reap the **advantages** after the crisis.

BUT....

## Reality of the crisis:

1. There is **less money** in the market.
2. The **shock** of poor results.
3. **Inefficiencies** become apparent.
4. **Purchasing power** significantly reduced.
5. Activity on a number of markets has decreased.
6. **No** readiness for experiments.
8. The market that has **changed**.



## Effects of the Crisis:

1. Russian companies are adapting to a **new reality** that the crisis has brought about:
  1. Drop in demand;
  2. Lower margins;
  3. Weaker Rouble;
  4. Uncertainty about the exact effects of the crisis.
2. In reaction to this new reality, companies are:
  1. Cutting **costs** (e.g. laying off staff);
  2. Reluctant to expand business activities → focus on **optimizing existing activities**;
  3. Switching from Contracts Ex Works / foreign currency → **DDP Russia** (thus: Rouble).



**"Russia is never as strong or as weak as it appears to be"**

**German Chancellor Otto von Bismarck**



# Always that will happen what you least expect.

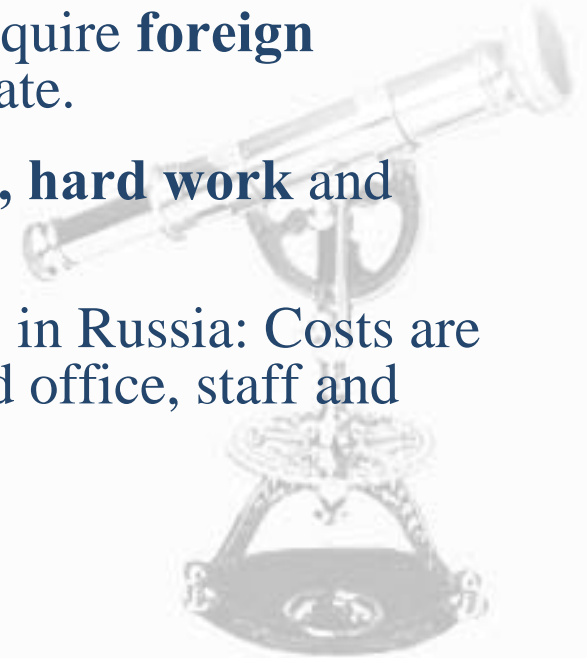
## Russia still has:

1. **Size** of economy / country.
2. Natural Resources (**oil price**).
3. **Government** support.
4. Need and potential to **add value** inside Russia.
5. Need and potential to **reduce import dependency** and to **diversify** economy.
6. Land, water, space.



## Opportunities

1. The Russian market still has **similar opportunities** as before the crisis:
  - a. Local production continues to be **insufficient** to meet local demand for consumer goods and equipment;
  - b. Shift to (cheaper) products will occur, but Russians will continue to **consume**;
  - c. Companies in many sectors will continue to require **foreign** equipment, technology and know-how to operate.
2. Difference is it will require more **time, flexibility, hard work and commitment** to be successful.
3. In some ways, it has become easier to do business in Russia: Costs are **falling** (office rents, wages, land) → easier to find office, staff and production sites.



## Understand that Russia requires:

1. Twice the **time** to manage
2. Continuous **attention**
3. A **personal** hands-on approach
4. More investment of time, money and effort
5. A **medium- to long-term** strategy

## Understand that:

1. Russia will always stay Russia
2. A Russian will always stay Russian like a Dutch will stay Dutch
3. The market will not come to you anymore but you will have to come to the market



## Crisis advice:

1. Understand Russia and its cultural characteristics.
2. Study and **know** your market more than ever before (volume, segments, regions, sales channels, price levels).
3. Clarify your **transaction costs** (travel, brochures, certification, exhibitions, logistics, management time).
4. Cost – benefit.
5. Know your **opportunity cost**.
6. Prepare yourself (travel, brochures, certification, exhibitions, logistics, management time and present added value / USP, references).
7. Prepare yourself for the medium- to long-term.
8. Financing is an issue again (back to the nineties!).
9. Move towards the market.



## Crisis advice:

1. Test the water **step by step**:
  1. Exhibition / mission.
  2. Understanding of Russia and its market.
  3. Strategy.
  4. Partner search.
2. Come with a **full cycle** approach / a total solution.
3. Take and keep the **initiative**.
4. Help in **implementing**.



## Crisis advice:

1. Russian companies might be **reluctant** to start (or expand) their business activities, but the present period can be used to build up or expand your business network.
2. Be **flexible** in order to adjust to the new reality on the Russian market → Russian companies expect a commitment in order to get through these tough times together (e.g.: minimize time to market for their product in order to reduce the credit period).
3. **Presence:** Crucial to remain present on the Russian market and invest in brand awareness and the relationship with your business partners. By doing so, you will be ready to seize the opportunities as soon as the crisis ends.
4. Loyalty and resilience in times of crisis will be **rewarded** as the previous crisis in 1998 has proven.



## 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**!

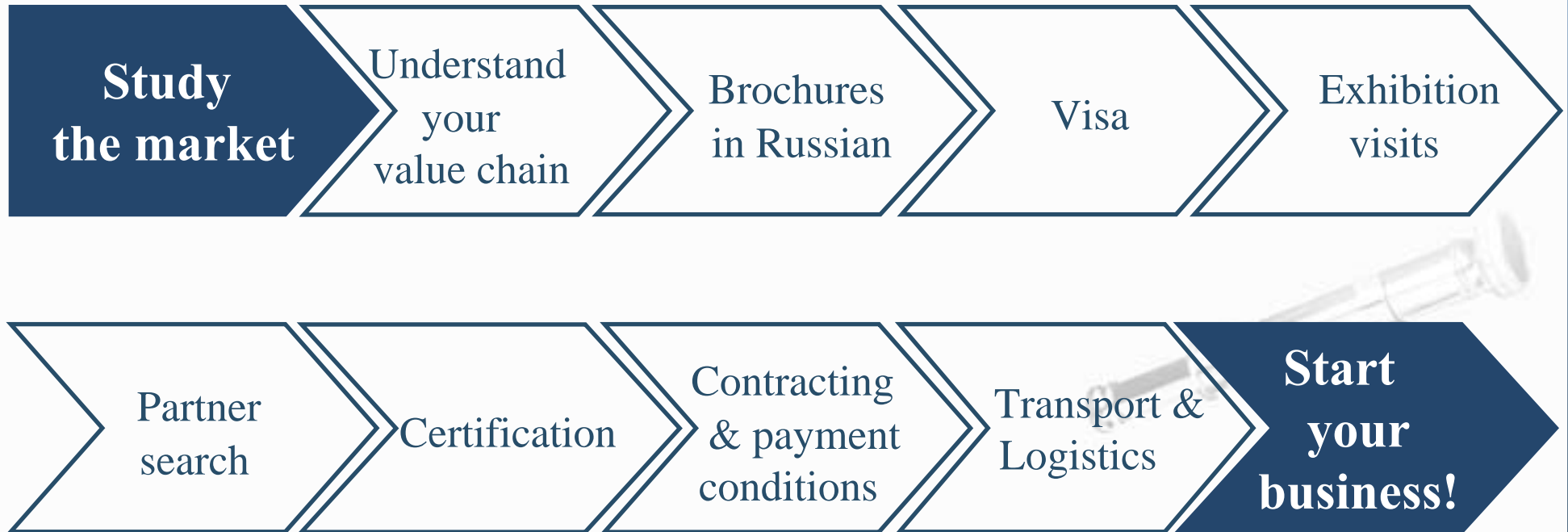


## Conclusion and Questions

Doing business in Russia is like driving a car:

1. You have to know where you are, where you want to go and how to get there.
2. You need to keep your hands on the steering wheel and your foot on the accelerator (or the brake).
3. You need to stay awake, pay attention at all times and understand when you are lost.
4. It is **not cheap**.
5. But can be a lot of **fun!**

## D. Steps to take for a successful market entry:



## **F. Problems with Exports:**

1. Customs;
2. Certification (on your company's name) 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.



## E. 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. Don't forget the regions:

1. There's a whole **market** out there that can't be covered from Moscow;
2. **Support** from local administration. Willingness for cooperation and openness for contacts and communication;
3. **Tax incentives** for investors;
4. Lower **costs** of resources compared to Moscow and Moscow region (on average 20% cheaper);
5. **Comparable** infrastructure and facilities;
6. Young, educated and eager **workforce**;
7. Facilitating fast document transaction. **Fast** preparation and execution of decisions, resolutions and documents.

## **C. Localization**

### **Documentation / contracts**

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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