

# **Success in exporting to Russia's** **Oil & Gas sector**

**A PRACTICAL APPROACH TO A DIFFICULT BUT  
INTERESTING MARKET**

**Russia Seminar: "One year focus on Russia"**

**23 October 2008**

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

## Contents of the presentation:

1. The **image** of Russia in the West;
2. The **theory** and **reality** of doing business in Russia;
3. The **opportunities** of Russia's oil & gas sector;
4. How to **sell** to Russia's oil & gas sector;
5. Cultural **peculiarities**;
6. Steps to take for a **successful** market entry and **Do's** and **Don'ts**;
7. Conclusion and **answers** to your questions.



## 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!



## 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:

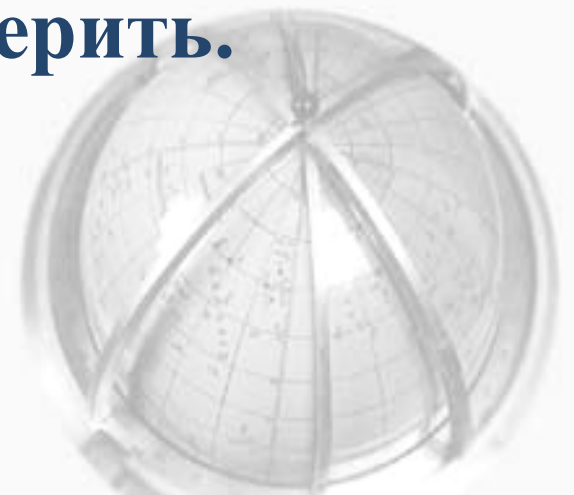
**У ней особенная статья -**

She has a specific characteristic -

**В Россию можно только верить.**

In Russia it's only possible to believe.

1886 Fedor Tiutchev



**The theory of doing business in Russia:**

11. ?

12. ?


**13. So we do it as it's done back home.**

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

**So the question rises: "Why Russia?"**

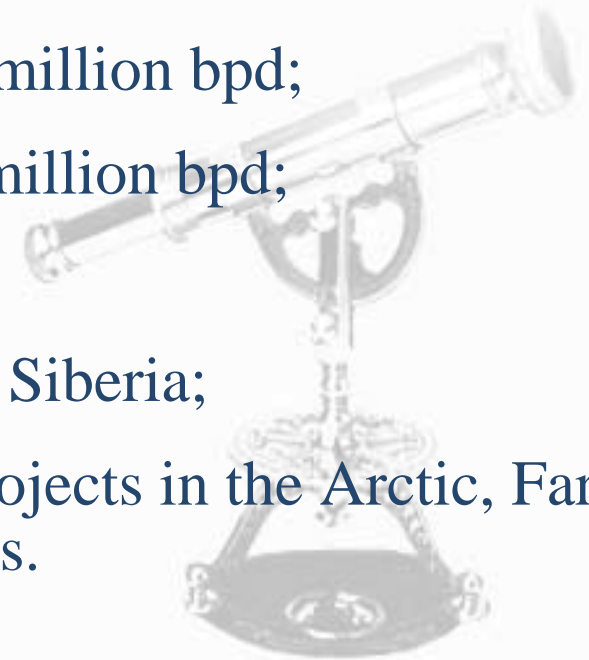


## Russia is a country with:

1. More than 50% of her external trade with the EU;
  2. Average GDP (\$1.3 trillion) growth of 6,8% (1999–2007);  
4-5% ?? (2008-2011);
  3. The entire oil & gas industry accounts for
    1. 35% of GDP;
    2. 70% of export revenues;
    3. 60% of budget revenues and
    4. 50% of FDI;
  4. The federal budget deficit would have been 6% in 2007, exclusive of oil and gas revenue. With oil price of 70\$pb the budget is in balance.
  5. A drop of oil prices below that level creates problems for budget and current accounts balance.
- 

## Russia:

1. Has the world's largest natural gas reserves – 48 trillion cubic meters;
2. Is the world's largest natural gas producer – 653 billion cubic meters;
3. Is the world's largest natural gas exporter – 200 billion cubic meters;
4. Has the world's 8th largest oil reserves – 60 billion barrels;
5. Is the world's 2nd largest oil producer – 9.87 million bpd;
6. Is the world's 2nd largest oil exporter – 6.75 million bpd;
7. Is the world's 3rd largest energy consumer;
8. 92% of gas and 2/3 of oil is produced in West Siberia;
9. Will invest hundreds of billions in offshore projects in the Arctic, Far East and Southern (Caspian, Black, Azov) seas.



### Main Russian oil players:

1. Rosneft
2. Lukoil
3. TNK-BP
4. Surgutneftegaz
5. Gazprom Neft

### Main Russian gas players:

1. Gazprom
2. Novatek
3. Lukoil
4. Surgutneftegaz
5. TNK-BP

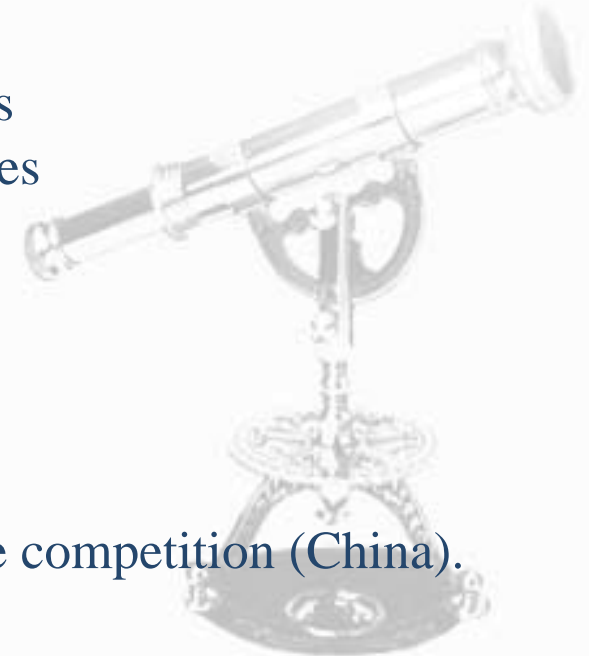
- Only Gazprom, Rosneft and Lukoil are involved offshore but lack the necessary experience, know-how, technology and staff to develop the offshore oil and gas deposits by themselves.
- Foreign companies (such as: Shell, Total, Statoil/Hydro, BP, Exxon/Mobile, Mitsui, and Western EPC contractors) will continue to play a key role in the development of offshore deposits.

## **BUT!! Russia's Oil & Gas sector is:**

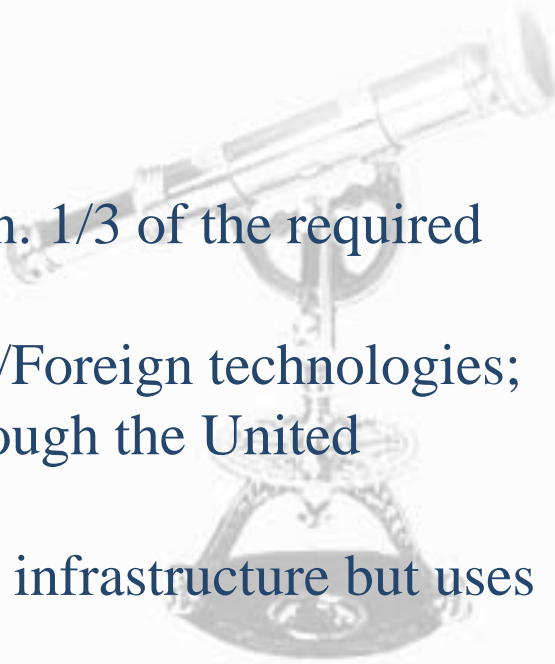
1. Becoming less cash rich;
2. Becoming increasingly state controlled;
3. Becoming less efficient;
4. Oil and Gas industry is already working close to capacity and production of oil and gas is flattening / declining (oil 2008 first annual decline -0.4% - since 1998);
5. Huge (un)tapped reserves but low cost production declining;
6. Dependent of Arctic and Far East offshore development;
  - Russia's continental shelf area is the largest in the world - 6.2 million km<sup>2</sup> (4 million km<sup>2</sup> has oil- and gas-bearing potential). 33% of natural gas, over 22% of condensate, and 12% of oil reserves but only a small part is explored.
7. The Russian government plans to increase the share of offshore oil production from current 0.5% to 20% of total by 2020.

## Increasing need for equipment, technology and services

1. Demand for Western know how, technology and equipment is increasing as economic pressure increases and volatile oil and gas prices drive the need for increased efficiency;
2. Russian companies do not possess the know how and technologies to work on fields under harsh climatic conditions, as in the Arctic seas;
3. Demand for oilfield services will surpass 22 bln \$ by 2010 as more and more work will be outsourced;
  1. Well control and enhancement services
  2. Drilling services and work-over services
  3. IPM services
  4. Equipment Rentals
  5. Work shop facilities
  6. Inspection Services
4. LNG technology;
5. Big quantitative potential vs. strong qualitative and price competition (China).

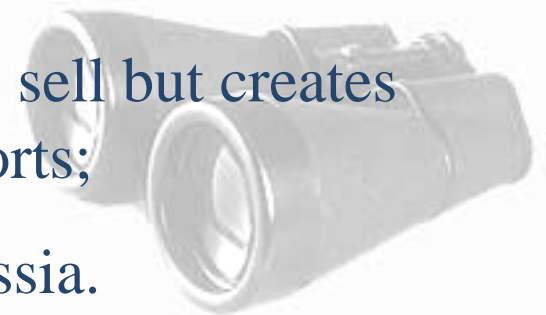


## Increasing need for vessels

1. Gazprom, Rosneft and LUKOIL have defined their needs for vessels and equipment for the various offshore projects until 2030 as follows:
    1. 200 Sub sea systems
    2. 49 ice resistant oil platforms
    3. 15 gas platforms
    4. 90 ice class shuttle tankers
    5. 30 ice class gas carriers
    6. 140 support ships and icebreakers
  2. The total cost investment in vessels over \$83 billion. 1/3 of the required ships will be imported, 2/3 will be built in Russia;
  3. There will be an increasing focus at mixed Russian/Foreign technologies;
  4. 6 bln \$ program to revive Russian shipbuilding through the United Shipbuilding Corporation;
  5. Russia has historically shipbuilding experience and infrastructure but uses outdated technologies. Great opportunities!
- 

## Selling to the Russian Oil & Gas sector (do your homework)

1. Understand who could be your potential clients;
2. Know your target audience within the oil & gas firms;
3. Know the alternatives for your product that are used/applied in Russia and know the purchasing motives of your client;
4. Know and present your added value;
5. References in similar environments are key;
6. Allow for time to develop the market and to establish a name;
7. Presence at exhibitions does not directly help to sell but creates confidence in combination with direct sales efforts;
8. International certificates are not accepted in Russia.



## Selling to the Russian Oil & Gas sector (identify your buyer)

1. Russian oil & gas companies have a very long track record and a high technological level;
2. Russian oil & gas companies are complicated organizations;
3. Distinguish between Western and Russian companies;
4. Distinguish between State and Private companies;
5. Gazprom is a state in itself and is also becoming increasingly involved in oil and power;
6. Don't forget the activities of Russian oil & gas companies abroad.



## Selling to the Russian Oil & Gas sector (identify your contacts)

1. It's a people's business based on trust, therefore:
2. Use Russian Distributors, Agents, Representatives;
3. Check if they have the right:
  1. Background and network (Gubkin, Industry);
  2. Knowledge of inner workings of oil & gas companies;
4. Know how the decision making process runs;
5. Talk to the right people;
6. Understand the different interests;
7. There are many people circling around oil & gas firms that present themselves as if .....;
8. However, it is often helpful to use middle-men ....



## Selling to the Russian Oil & Gas sector (use enablers and “go local”)

1. Use all possible business enablers:
  1. EPC contractors;
  2. Drilling companies;
  3. Design and engineering institutes;
  4. Your Western network;
  5. Sector specialists;
2. Strive to co-operate with Russian partners.



## 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**!



## 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.



## 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 / 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!**



## 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:

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**.



## 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.



## Don't:

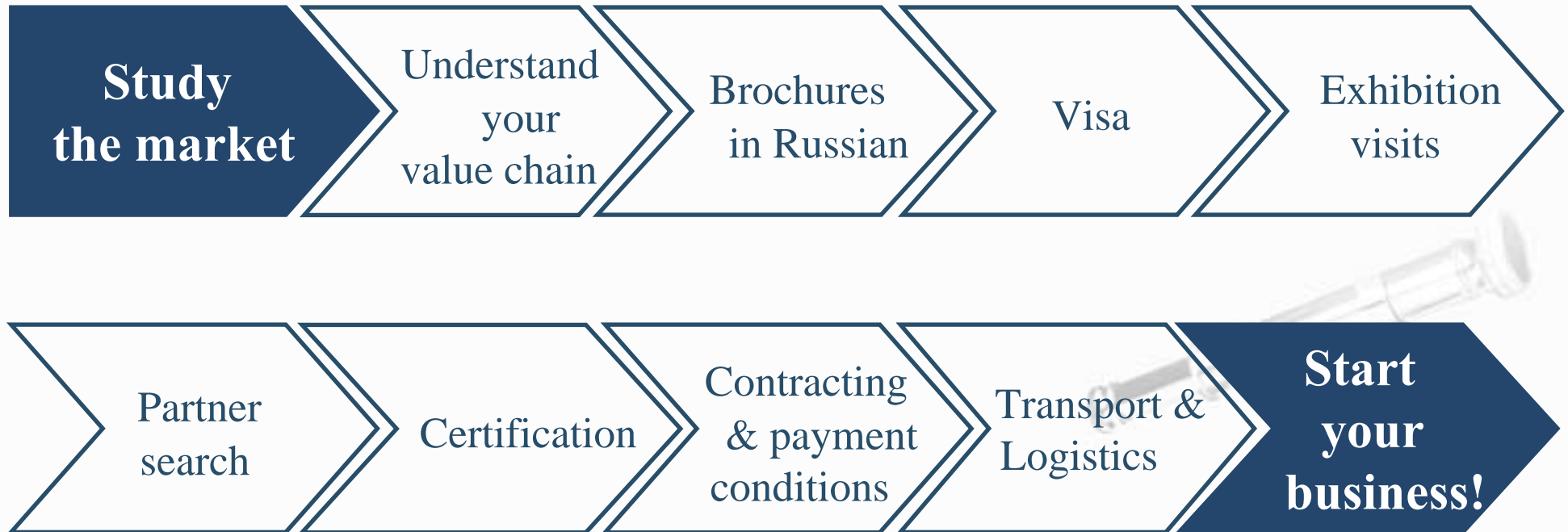
1. Be **afraid** of Russia;
2. **Underestimate** the market or your Russian business partner;
3. Think Russia is **Europe**;
4. Think Russia is **cheap**;
5. Think it is easy to find the right **staff**;
6. Let yourself in with **corruption** (payments on the basis of contracts or through third parties);
7. Give immediate **exclusivity** to distributors and put **certificate** on your company's name;
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.



## Don't forget the regions:

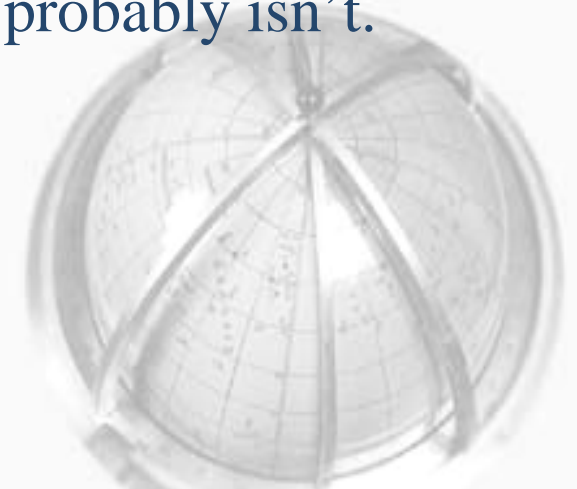
1. There's a whole **market** out there that can't be covered from Moscow;
2. **Support** from local administration. Willingness for cooperation and openness for contacts and communication;
3. **Tax incentives** for investors;
4. Lower **costs** of resources compared to Moscow and Moscow region (on average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

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



## 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!!



## **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.



## Conclusion and Questions – Why Russia??

1. Oil and gas sector **spending** will continue to grow;
2. The growth **potential** in the coming years in a wide number of sectors is high;
3. Many of your colleagues / **competitors** are already there.

### **BUT**

4. 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		