

FINANCIAL AND ECONOMIC CONSEQUENCES OF PARALLEL IMPORTS' LIBERALIZATION IN RUSSIA

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Parallel imports is the imports of original goods that are protected by a trademark without a consent of the copyright owner

According to p.1 art. 1229 of the Civil Code of the Russian Federation, the use of other's trademark in any form (including imports) without a consent of an owner is illegal. At the same time, parallel imports is not prosecuted in Russia administratively

Russia applies the principle of national exhaustion of the exclusive rights



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The EU applies the same principle; the opposite - the U.S., Japan and China apply the opposite – international - principle

The liberalization of parallel imports has been widely discussed lately. The discussion was initiated by the Russian Federal Antimonopoly Service

The advocates of liberalization of the parallel imports insist that it will strengthen competition and cut prices

The opponents believe that the parallel imports will negatively affect the investment climate and consumer protection



The goal of the study

To analyze the financial risks and social and economic consequences of parallel imports liberalization

The tasks of the study

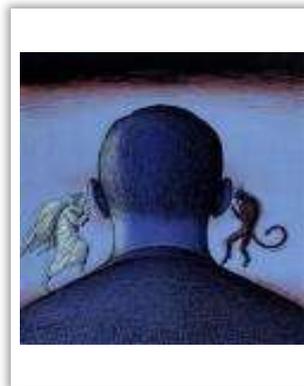
1. To estimate the influence of the parallel imports liberalization on:
 - The investment climate in Russia
 - The process and degree of production localization in Russia
 - Economic sustainability of the already localized production
 - The number and quality of the workplaces created by producers, distributors and dealers
 - Retail prices
 - The change of the counterfeit products share
 - The change of the share of the import goods on the researched markets
 - Quality of services
 - Competition development
2. Compare prices for comparable goods on the target markets in Russia and in three other European countries
3. Analysis of the socio-economic impact of the liberalization of parallel imports

Methodology



Expert poll (among 34 experts)

- Automotive
- Home appliances and consumer electronics
- Construction machinery and equipment
- Home appliances and consumer electronics retail
- Sportswear
- Footwear
- FMCG
- Electric equipment



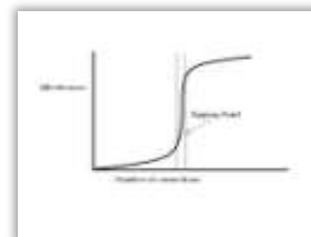
Market prices monitoring

- GfK Consumer Choices data (retail audit)
- Open data



Desk research

- Analysis of open information sources



Impact on the investment climate



The overwhelming majority of the experts believe that the liberalization of parallel imports will lead to a reduction in investments in Russia

This is associated with a decrease in profitability as a result of unfair competition

17 out of 34 companies will reduce their investments, 4 will fully close their investment programs



«Because of the chaos, confusion and uncertainty about where we are going we will have to freeze our plans for further investments» (expert № 9)

According to the experts, the level of investments in the industries will be reduced by 30-50%. The greatest reduction in investments can be expected in the automotive industry (60-70%)

The liberalization of parallel imports will allow independent importers to use the investments of the rightholders into the intellectual property objects unfairly. This will cause the deterioration of the investment climate



Impact on the amount of customs and tax revenues



All the experts expect a decline in tax revenues as a result of the liberalization of parallel imports

Tax payments of the producers will be reduced with parallel importers' payments not compensating for these reductions

Due to the nature of their business the parallel importers will be able to use various schemes to minimize tax payments, e.g. declare a lower price of a product



Reduction of tax revenues related to job payments is possible

«Liberalization of parallel imports will lead to a flashback into the 90s in terms of customs and tax fraud. The parallel importers indicate lower customs prices and «the volumes of supply» (expert № 27)

Experts believe that as a result of the liberalization of parallel imports customs and tax revenues will decrease by 5-10%

Impact on the process and the degree of localization of industries in Russia



The liberalization of parallel imports will have a stimulating effect on imports rather than domestic production

According to experts, the reduction of localized production could reach 20%

Orders for domestic production will decrease as part of the domestic production will be replaced by imports



Impact on the process and the degree of localization of industries in Russia



The most pessimistic forecasts: the closure of localized production and transfer of production to the neighboring countries (Poland, Hungary, China)

Increase of the ROI period for the investments the companies have made into the localization of production by 40-50%



Impact on the counterfeit products share



At the moment most of the companies participating in the survey (25 out of 34 experts) suffer of counterfeit. The most of the counterfeit goods are made in China and are dissolved within a series of intermediary agents

The share of counterfeit products will grow under the pretense of parallel imports



In case parallel imports is liberalized the legal manufacturers and the customs will have significantly fewer tools for fighting counterfeit

On average, companies expect that the level of counterfeit will increase by 10% - 30% depending on the industry. The representatives of automotive spare parts, tires and sports goods/sportswear manufacturers expect the highest flow of counterfeit

According to experts, the liberalization of parallel imports will increase competition on the markets

In the ideal conditions, if the parallel importers were conscientious, the liberalization could have a positive impact, forcing manufacturers to optimize their business structure and costs

In fact , the competition within one brand can not be completely conscientious due to the fact that the parallel importers arrogate to themselves the effect of the investments made by others (e.g. development, marketing etc.)

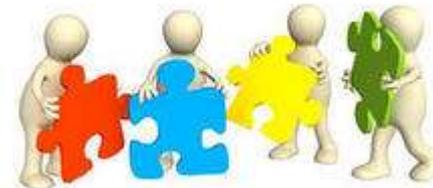
Impact on competition



In addition, as the parallel importers don't have any long-term interests, they may minimize their costs unfairly

Thus, according to experts, the liberalization of parallel imports would lead to strengthening of unfair competition within one brand

At the same time, the Russian market is already highly competitive. This is proven by both the large number of players and the range of products on the market



Impact on competition



Number of models in Russia and Europe, 2012-2013

	Number of models				Average number of models in Austria, Germany and Poland	The difference in the number of models (Russia in comparison to the other countries)
	Russia	Austria	Germany	Poland		
TVs	5 368	3 665	5 800	2 737	4 067	+1 301
Refrigerators	5 261	3 581	4 942	2 588	3 704	+1 557
Washing mashines	4 180	1 690	2 195	1 931	1 939	+2 241
Smartphones	888	706	1 281	1 440	1 142	-254
Tablets	1 546	561	811	657	676	+870
Vacuum cleaners	2 621	1 793	2 648	1 445	1 962	+659
Irons	1 980	670	1 001	860	844	+1 136

Источник: GfK Consumer Choices (Retail Audit)

The liberalization of parallel imports will not expand the Russian market, but, on the contrary, it will narrow it

The independent importers will have to import the most popular models to ensure maximum sales and cost-effectiveness



Influence on the level of retail prices



According to most experts, the liberalization of parallel imports will not lead to a reduction in retail prices. In the short term, only a decline in prices in the wholesale sector at the level of 5-10% can be expected, which will not concern consumers

Our calculations show that the initial retail prices could drop by up to 5%. This effect will soon disappear due to the erosion of the low-cost segment

Influence on the level of retail prices

«The prices will fall in the short term, however the margin of the wholesalers will increase» (expert # 26)

After the repartition of the market prices will return to the previous levels. That will result in a redistribution of income in favor of importers, which will not favor consumers



In the opinion of the experts, the liberalization of parallel imports would lower the level of customer service

The decrease will affect both the quality of product and service



Impact on the customer service



The level of service will drop because the parallel importers are not interested in the long term brand and consumer relations development

Decline in the quality of product and service undermines the value of the brand for its owner and the consumer



One of the consequences of the liberalization of the parallel imports would be the growth of unemployment in the manufacturing and service

On average, companies that have localized their production estimate the reduction of production volume and jobs by about 20% -25% depending on the industry. The largest job cuts are expected in such industries as tires production, automotive spare parts production and equipment service. The experts estimate job cuts in these sectors by 40% - 60%.



The liberalization of parallel imports will worsen the employment structure

Some increase in trade and agents staff would not compensate for the outflow of skilled workers from production and service



Social and economic consequences of parallel imports' liberalization



Worsening of investment climate

Decline in production localization

Job cuts

Reduction in customs and tax revenues

Growth of counterfeit products share

Decline in quality and service

Drop in consumer safety

Products assortment reduction

THANK YOU FOR YOUR ATTENTION!

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