

# Russia Step by Step: Renewed Opportunities in a New Reality

*“Crisis ne udalsya” –*

*“The Crisis failed”!*

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



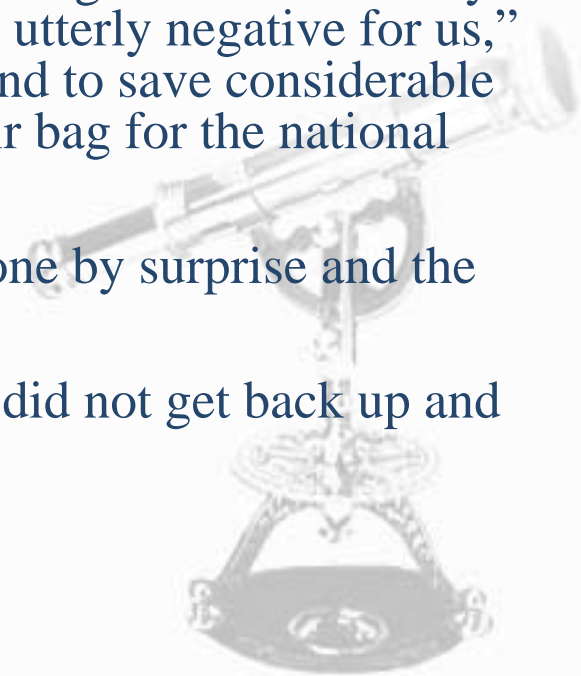
## Introduction:

1. **“Russian miracle”**: 9 years of rapid growth; third largest foreign currency reserves; newfound confidence and assertiveness.

Finance Minister Kudrin at the World Economic Forum, Davos, January 2008 offered to mitigate the world credit crisis with the help of Russia’s reserves. Kudrin stated that Russia was an “island of stability in the sea of the world crisis.”

“Investors will continue to invest billions of dollars in the rising Russian economy. Stock market crises and their consequences will not be utterly negative for us,”  
“Our country managed to achieve economic stability and to save considerable gold and currency reserves which play the role of an air bag for the national economy.”

2. **Crisis**: In Q4 2008 the bubble burst which took everyone by surprise and the ensuing 12 months were all but easy.
3. **Recovery**: Russia would not be Russia if after a fall it did not get back up and start over again.
4. **New reality**: Now there is a new reality in Russia.
5. The question is: **How to work in that new reality?**



## What happened in 2008 / 2009?

1. Global credit crunch: No capital and credits available for businesses and consumers.
2. Global drop in demand because of decreased consumer confidence.
3. Global decline in industrial output.
4. Oil price collapsed from \$140 per barrel to \$40 (Russia needed \$70 for a balanced budget).
5. Russian budget deficit and credit crunch.
6. Russian fall in demand and industrial output.
7. Imports, Exports and FDI down by 40% to 50%.
8. GDP down by 9% over that period.
9. Russia worse off than other BRIC countries and only Baltic States, Ukraine, Armenia and Moldova performed worse in Central and Eastern Europe.
10. Crisis bottomed out in Q4 2009.
11. Result: A reality check.



## Why did the crisis hit Russia so hard?

### A Giant on Clay Feet

The crisis revealed a number of structural weaknesses of the Russian economy:

1. Natural Resource dependency.
2. Lack of diversification of the economy.
3. Concentrated (oligarchic) ownership.
4. Overleveraged businesses.
5. Underdeveloped SME sector.
6. Flawed business environment.
7. Institutional weakness.
8. Poor management.
9. No capacity for import substitution.



## What is the situation now?

The situation seems to have stabilized:

1. Oil price: \$75 compared to \$45 in 2008.
2. Inflation under control (under 9%).
3. Ruble rate under control (€= 44R).
4. Official unemployment under control 8% (but much higher when including unofficial unemployment).
5. Interest rates are down (but still high) at 15%.
6. Industrial production: +2.7% in Dec. 2009 compared to Dec. 2008.
7. Consumer confidence index: +5% in Q4 2009 compared to Q3 2009.
8. RTS is the fastest growing index in the world nearly 150% in 2009 and growing.
9. S&P rating from negative to stable.
10. Grey economy increased.
11. “Bad assets” for banks: 6,7%.



## What is the new reality (II)?

### 1. Banks:

1. Interest rates indirectly controlled by the government.
2. Development of new lending opportunities: express credits.
3. Restructuring 'bad loans'.

### 2. Foreign investors:

1. Shift from financial markets to industry and trade.
2. Large investment programs in the energy sector.
3. Increase in other investments (trade credits, cash operations, loans).

### 3. **Government** is playing a more active role in the economy (anti-crisis manager)

1. Manages depreciation, inflation and interest rates.



## What will happen in 2010?

### Economy:

1. Better global conditions (stability on the global stock exchange markets).
2. Bigger global risk appetite.
3. High commodity (oil and metal) prices and increasing demand.
4. Consumption growth (household expenditures grew by an average of 10% during 2H2009; pensions were increased starting from 1 December 2009).

### Private sector:

1. New funding sources: internal, IPO (“Prof Media” of Potanin; Russian Railways; OGC-1; RUSAL).
2. M&A activity esp. from middle sized companies.
3. Investing into existing projects (re-equipment).
4. Tight control on costs, finances, purchasing and investments.
5. Stable cash flow over assets.
6. Efficiency management systems and business model optimization



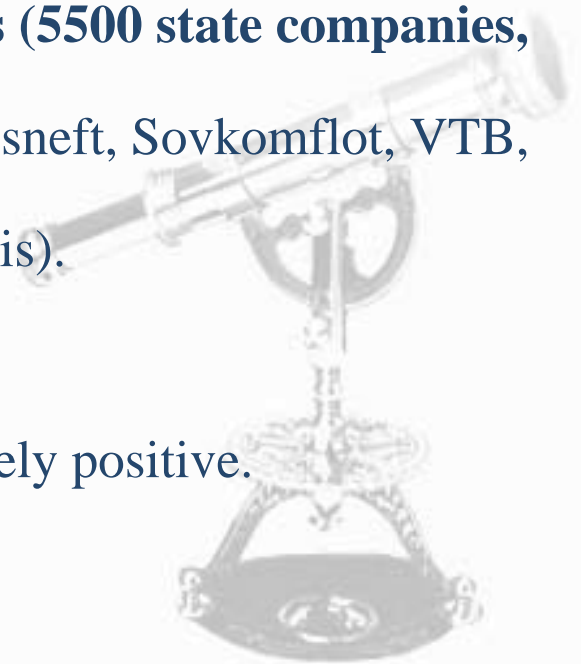
## What will happen in 2010 (II)?

### Government:

1. **Continuing government stimulus measures:**
  1. Restructuring of business debts.
  2. Support through long-term lending programs (mortgages).
  3. State procurement programs.
  4. Investment into modernization of economy (EE, re-equipment).
2. **Government will start a new wave of privatisations (5500 state companies, 50% of the economy is in state hands):**
  1. State companies sell core and non core assets (Rosneft, Sovkomflot, VTB, Svyasinvest, Russian Technologies, etc).
  2. Government holdings (partly acquired during crisis).
  3. Utility sector.

### Society:

1. The mood went from very pessimistic to moderately positive.
2. No risk of social unrest.
3. Political leadership still popular.





## What will happen in 2010 (III)?

### Overall, these tendencies will result in:

1. 2% economic growth.
2. Consumption growth.
3. Inflation around 8%.
4. Increase in FDI.

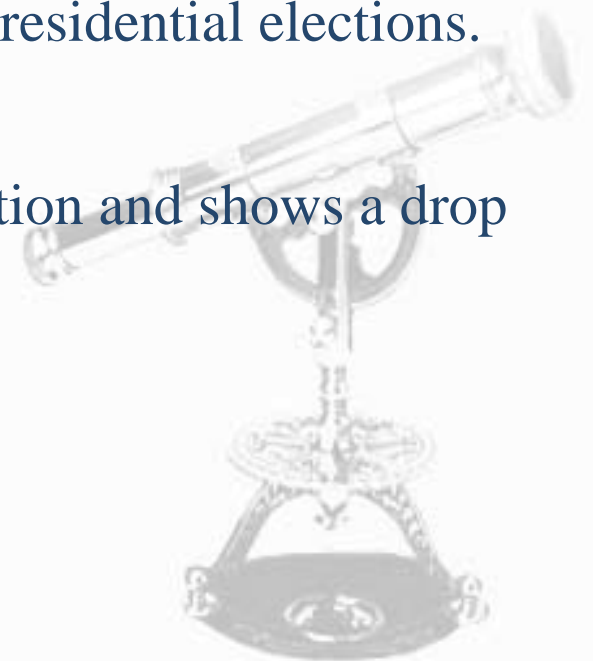
### MAIN RISKS:

1. Slow recovery in the rest of the world.
2. Low oil price.
3. NPLs



## What will happen in 2011?

1. 3-4% economic growth.
2. Stable import (limited import substitution).
3. State Corporations: Some will be incorporated (e.g. Rosnano, Russian Technologies and Vneshekonombank) while others will be restructured or liquidated.
4. Risk of political unrest in the run-up to the 2012 presidential elections.
5. Q4 may see risk of overheating.
6. The economy always booms leading up to an election and shows a drop directly after an election.



## Opportunities on the Russian market for European companies:

1. Distressed assets.
2. New services.
3. Modernization investment programs → demand for equipment.
4. The regions: Rapid development of the Krasnodar region (Olympic Winter Games 2014) → new geographical markets for Dutch companies.
5. Localization of production → drop in imports, but opportunities for European companies (equipment, know-how).
6. New hi-tech markets (IT, telecommunications) still far from saturation.
7. Retail remains interesting.



## 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.
6. Understanding of business **culture!**



## 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. Reserve**; 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.



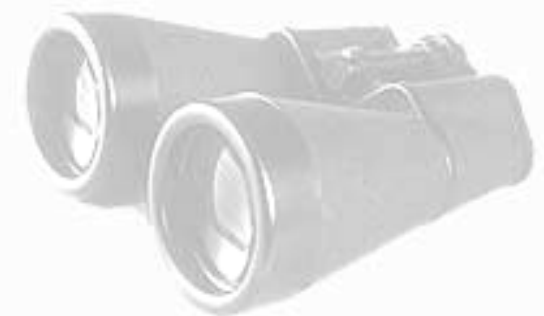
## Russian vs. EU Business Culture:

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.



## 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.





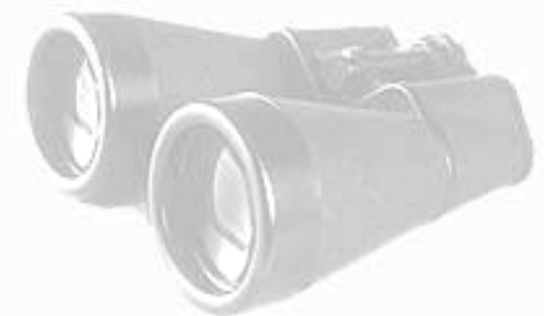
## Don't:

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.



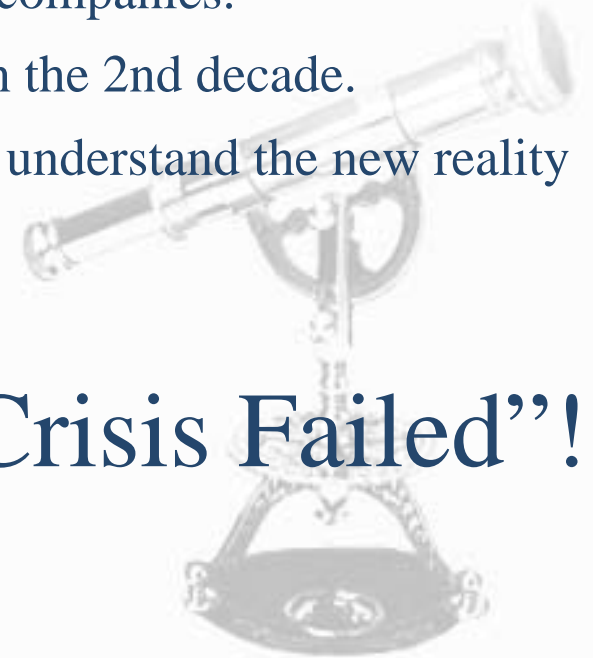
## What is the secret of success of foreign companies in Russia?

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:

- The crisis revealed structural weaknesses of the Russian economy.
  - Russian people, companies and government quickly adapted to the new reality created by the crisis.
  - Policy of reform and modernization!
  - The economic recovery, both in Russia and its export markets, and the modernization of the Russian economy create opportunities for foreign companies.
  - The 1st decade of the 21st century will not be repeated in the 2nd decade.
  - Foreign companies that remain committed to Russia and understand the new reality will be able to profit from these opportunities.
- 
- “Crisis ne udalsya” – “The Crisis Failed”!



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 through the coordinates below or visit our website: [www.thelighthousegroup.ru](http://www.thelighthousegroup.ru)

## 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>Address:</b>	Mytnaya Ulitsa 3, office 41, Moscow, Russia, 119049		