

#1 2013

IN FOCUS:



Russia in from the cold

– the giant is integrated into the global economy

It took 18 years of negotiations, but in August 2012, Russia became a member of the World Trade Organisation, WTO. This marked the first serious step towards the integration of this massive federation, the size of a continent and the ninth biggest economy in the world, into the world economy. But what is it like to do business in Russia and what is happening in the electronics sector there? We'll be taking a closer look at these questions in this issue of "In Focus".

To get a picture of the business climate in Russia, we turned to Lidia Kochetova, Head of International Corporate Banking at Nordea Bank Russia.

There is a widespread perception that corruption is rampant in Russia. What is the situation in reality for those wishing to do business?

– Corruption is something that exists in most countries. It's true that it is an issue in Russia, but you can avoid it. The problem stems from the country's extensive bureaucracy, but you don't have to break the law in order to succeed in business in Russia. It is a matter of getting help from the right people who know how to do things legally without it taking an undue amount of time, or costing too much. You may need a little patience sometimes and have to be ready to pay for administrative costs, but you can deal with the bureaucracy without having to resort to corrupt methods.

How would you describe the business climate in Russia? How has it changed over time?

– Much has changed during the 25 years that have passed since the days of perestroika. Today, the gap between our approach to business and the way business is done in Europe has narrowed. The Russian judiciary has undergone radical changes and incorporated many of the principles and norms applied by other European countries. The economic system has survived major crises and has emerged all the wiser, for example, the banking system has been completely restructured at every level.

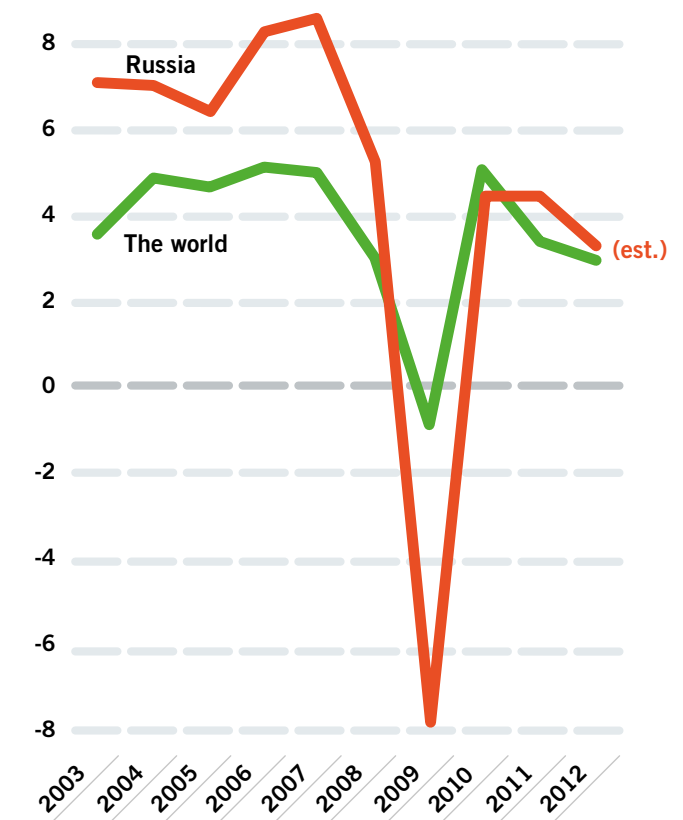


Lidia Kochetova says that given the complicated bureaucratic procedures in Russia, patience is a pre-requisite for success in that market. She also recommends recruiting help from local expertise.

– Russia is still lacking in flexibility compared to the west, but we are learning. Many of our currency control regulations have been amended or abolished. New anti monopoly legislation has been

drafted and introduced. The business climate is now more open and there is a wealth of opportunities here. And we should bear in mind that the federation stretches across 10 time zones and has a population of 140 million that comprises many nationalities; so things can't change overnight.

ANNUAL REAL GDP GROWTH %



The Russian economy grew very rapidly prior to the 2008 financial crisis, which hit the economy very hard. 2010 marked the start of a recovery process that has seen faster growth than in many other countries.

– The changes can in themselves constitute a challenge since companies have to adapt to the new demands, approaches etc. that follow in their wake, for example ERP systems, or new accounting methods. People accustomed to a more stable playing field may find it challenging. But it is important to understand that business and industry, as well as the federation as a whole, are still undergoing a process of development.

Tell us something about the opportunities and the pitfalls.

– Russia's economy is based on natural resources and raw materials. That's why there is plenty of room to become involved in many other sectors such as better quality consumer products - particularly since Russians tend to spend their money, rather than save or invest it. Another area where a great deal of work needs to be done is infrastructure, of all kinds; essentially the sky is the limit here.

– One pitfall I have already mentioned is the bureaucracy. The system generates a continuous flow and variety of official documents. Another is the fact that the tax system is still being built up and is somewhat inconsistent. In some instances it is too open to interpretation, while in others it is, in contrast, too rigid. There is a need here for qualified help.

– We are a solid market that is growing rapidly. Russia should not be underestimated. It has an enormous potential to grow further and is a good place to do business in.

LIDIA KOTCHETOVA, HEAD OF INTERNATIONAL CORPORATE BANKING AT NORDEA BANK RUSSIA

What are the prerequisites for success in Russia?

– They are very much the same as what you need anywhere else in the world. A key factor is local presence. I'd recommend the first thing companies should do in Russia is to set up a legal entity. The next step would be to find appropriate persons who believe in your business idea and are loyal. You should have a clear business idea that you can adapt to local conditions. Listen to the input you get from your people in Russia. There's a Russian saying that reads: 'If you go to another monastery, try not to take your own set of rules along.'

To what extent does the political situation in Russia affect the economy?

– The situation is fairly stable. Russia is an important growing economy and its political influence is also growing. After the shift to a market economy and thanks to high oil and gas prices, the economy has stabilised and in many cases flourished, under Putin's leadership. We've seen a significant consolidation of civil society, as well as marked improvements.

– Russia is the EU's third biggest trading partner - after the US and China - and it has periodically returned growth rates that are almost equal to that of China. I think it's time for Russia to forget its image of a 'slow society'. We are a solid market that is growing rapidly. Russia should not be underestimated. It has an enormous potential to grow further and is a good place to do business in.

How would you describe the influence of the state on the economy?

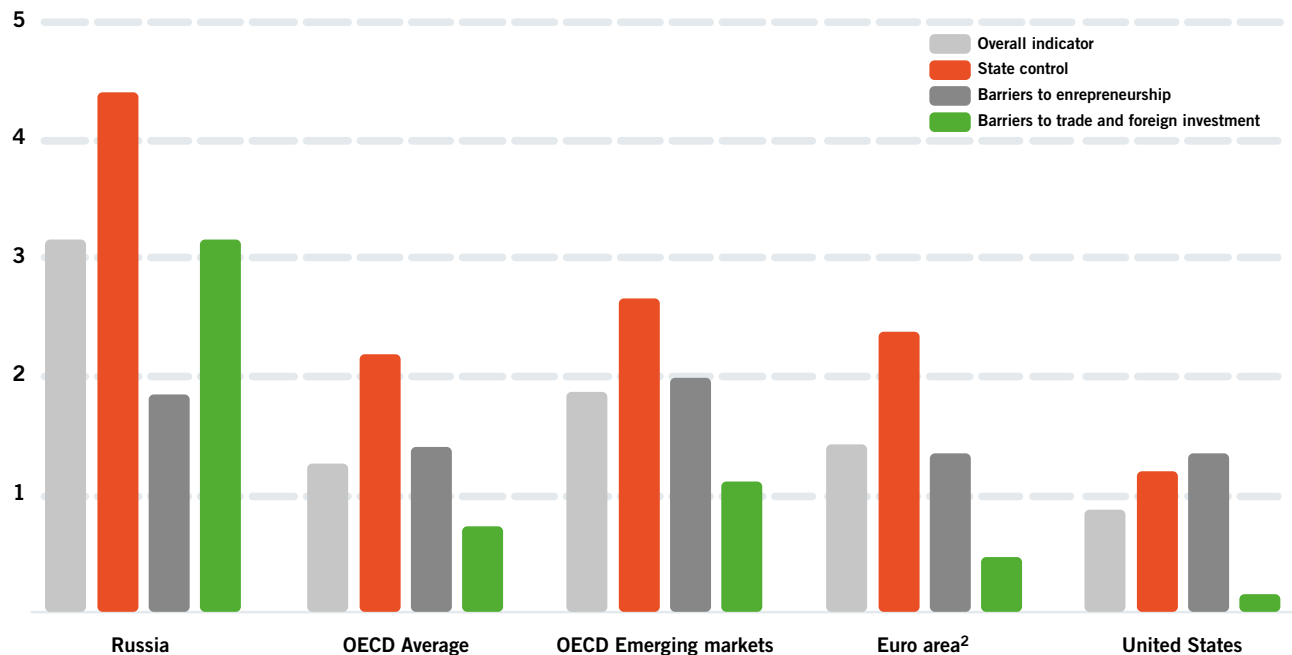
– There are some very strong state-run companies and this is a sector that would benefit from more competition. The Russian economy needs a better balance between small and medium companies versus large companies. Small businesses experience obstacles in the form of legislation and other red tape. On the other hand, a playing field with many state controlled companies could well generate opportunities for other players, within IT and infrastructure for example. This would benefit both local and foreign companies.

How do you see the future shaping up, over the next 5-10 years?

– I think we are on the right track when it comes to integration with the global economy, as well as with the European economy. Our finally joining the WTO is evidence of that. We will see a gradual reduction in import duties in the future. Ten years from now we will be much more integrated into the global economy, to the benefit of both Russian and foreign companies. It'll take time, but we will get there.

OECD'S PRODUCT MARKET REGULATION INDICATOR (2009)

Note: Index scale of 0-6 from least to most restrictive.



An OECD study of Russia's goods and services market published in its 2009 Economic Survey of Russia in 2009 reveals the significant role played by the state in the economy.

Major development potential for the Russian electronics industry

Semyon Lukachev is the managing director of Altonika, one of NCAB's customers and a leading EMS company in Russia, with over 300 employees. Altonika specialise in non-consumer electronics for automotive, medical equipment, security systems and telecom industries among others. The company manufactures over 4.5 million products a year. We asked Semyon Lukachev to share with us his view of the Russian electronics industry.



Altonika is one of the biggest EMS companies in Russia.

How big is the Russian electronics industry?

– It is very difficult to make a precise analysis of the market, since many companies are subdivided into smaller corporate units and it is hard to identify those that are just holding companies. Many producers focus solely on the domestic market. What I can give you is my personal estimate of the volumes being produced, based on the import of components. I'd say they're in the region of 250 million dollars annually; that figure encompasses both EMS and OEM companies.

Where are the main growth centres for the electronics industry?

– We're seeing growth mainly in the regions around Moscow and Saint Petersburg. There is an outward trend, away from the cities themselves, but remaining within these regions.



Semyon Lukachev would like to see more simplified customs procedures in order to facilitate exports and enable Altonika to clinch EMS orders from the rest of Europe.

How important is this sector for the Russian economy?

– The electronics sector accounts for a very small part of the economy. Most of its manufacturing activities are geared to military production. There is very little being manufactured for the consumer market. It doesn't need to be this way. This state of affairs is very much a result

of the lack of support from the Russian government for our industry.

– Exporting our products is extremely difficult due to all the complicated customs procedures. We are unable to gain EMS assignments from other parts of Europe. No one in Europe is prepared to wait 2-3 weeks for customs clearance. If Russia improved its customs regulations and other conditions, the electronics industry here would expand very rapidly. We've been waiting ten years for a change, but nothing has happened.

– As a complement to our manufacturing operations in Russia, Altonika will be opening a factory in Latvia in April. In contrast to what is happening here, the Latvian government has created a favourable platform from which we can grow our operations. Our move will also make a big difference when it comes to logistics and will enable us to take delivery of our components without having to wait for customs clearance.

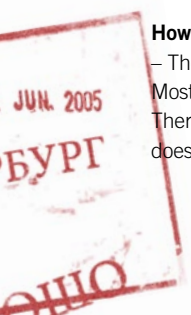
Are there any other factors apart from the customs regulations that prevent Russia from exporting electronics products to the EU?

– I don't think that Russian companies have the mind-set to look beyond the domestic market. I have come across many interesting products and asked customers why they don't try to export them. Sometimes they say the Russian market suffices for them and sometimes that they lack the know-how, but I think they also lack vision.

How would you describe the outsourcing trends in Russia?

– Outsourcing is more widespread in Europe than it is here. With larger projects, product owners have usually found it more economically feasible to set up their own production facilities. Finding EMS companies that can provide the quality and capacity required for medium to large volume production is not an easy task.

– At the same time, there is a growing demand for high quality EMS services and Altonika, who are focusing on this niche, are growing rapidly. We are getting orders that Russian companies formerly placed in China. This is very much thanks to our being close to R&D as well as to the market. I see considerable potential here; Russia outsources some \$200 million worth annually of manufacturing orders to foreign suppliers.



How many EMS companies are there in Russia?

– It is not all that easy to identify the genuine article when it comes to EMS manufacturers, since many companies who produce end-products also offer EMS services - at least they try to. However none of the major and well-known customers would choose to use them. If we define an EMS company as one whose operations centre on EMS, then I'd say there are no more than 10 of them. However, if you include all those who say they can offer EMS services, then there are probably around 50 in all.

To what extent are EMS companies involved on the design side?

– We see both extremes. We have customers who don't want us to touch anything. Then we also have those who do a great deal of R&D and create new devices. They engage with us during the design process so that we may together with their teams find the best solutions for volume production. That is the way Altonika want to work. The bigger the project, the earlier we want to be involved in order to prevent problems in production. That's not the way all Russian EMS companies work. Smaller companies just take the customer's data and start manufacturing.

If we look at PCBs specifically what types are being manufactured in Russia?

– Mainly double sided boards, generally of a lower quality. The state-run companies that mainly supply the military industry, receive large grants from the state. They use these to invest in cutting-edge equipment and produce flex rigid boards and multilayer boards, the latest technology. The trend at Altonika is similar, with more advanced types of board being produced, but when it comes to large volumes, we import them.

How would you describe the quality of your customers PCB designs?

– It varies widely from case to case. Sometimes we start from scratch. In other cases, the designs are excellent. R&D has come far in the past 20 years, but we do still get rather many poor designs. We are always looking for mistakes. That takes time, but it has to be done.

– The electronics industry has the potential to be much larger.

SEMYON LUKACHEV, MANAGING DIRECTOR OF ALTONIKA

What requirements do the EMS companies place on the PCB suppliers?

–We want support from their engineers. We could place orders directly with the factory, but we need engineers right here where we are, who can communicate with our customers' engineers in Russian. That is the PCB supplier's job, since it isn't part of our core operations. They are the ones with the specialist knowledge.

How do you see the future shaping up?

– I think we are going to see rising manufacturing costs in China, which could open up possibilities for the EMS companies who are



Altonika produces electronics for the automotive, medical equipment, security systems and Telecom industries among others.

located closer to the European market. In the future we'll see more focus being put on transport costs and so on. Buyers will choose manufacturers based closer to their markets and obtain competitive prices. In Russia, we'll see improvements on the manufacturing side, with more appropriate price-levels. It will be up to the owners and the EMS companies to compile new offers and explain the advantages they can offer in terms of geographical proximity and time factors.

Questions around the world: What effect does bureaucracy have on the business climate in your country? Do you see it changing in the near future?



CHINA
ANDY LIU

Managing Director, NCAB Group China

– Bureaucracy is just one of a number of challenges that companies in China have to address simultaneously. Other problems include for example finding suitable candidates for management positions, as well as managing ambiguous laws and regulations. I think it is impossible to overcome all these challenges in one sweep. However an increasingly globalised economy will see businesses focusing more on value and thus put pressure on the authorities to reduce bureaucracy.



MACEDONIA
SLOBODAN SOKOSKI

Managing Director, NCAB Group Macedonia

– Due to EU integration, laws are in the process of being changed or revised across former Yugoslavia. Many new laws have been introduced in order to simplify procedures for business and industry, but these need to be tried and tested in reality as well. Entrepreneurs find themselves having to grapple with bureaucrats who act inappropriately and exploit their positions of power. Time is lost looking for answers or getting the required documentation. My hope is that things will improve with time.



FRANCE
CAROL OUCHAKOFF

Managing Director, NCAB Group France

– France has one of the most expensive bureaucracies in the EU. Companies are forced to spend a great deal of time and money on paperwork and administration. In the current economic situation, where the manufacturing industry laid off 24,000 jobs during 2012 alone - bringing the total number of jobs lost since 2009 to 120,000 - the bureaucracy remains inflexible. This is seriously undermining our ability to compete. Reducing bureaucracy would be a major boost for small and medium sized companies.

Russia – building for the future

HANS STÄHL
CEO NCAB GROUP



Russia has been undergoing a massive process of expansion and development. To fully grasp how quickly things have changed, you only need to remember that barely a quarter of a century ago, a totalitarian state and a communist economy reigned supreme here. Private businesses were banned. I have experience of the Soviet Union from that period myself and can only say that it seems like a different world today; one symbol of this perhaps being the growing number of Russian travellers one sees in tourist destinations around the world.

NCAB has had a presence in Russia for 10 years. Much has happened during this time, not least in the electronics industry. Today the companies in this sector have become established and more

niche-oriented in their roles which has led to significant improvements in efficiency and cost. OEM companies are today for example subcontracting to EMS companies, who in turn are commissioning specialists such as NCAB, instead of buying the PCBs themselves.

I would also like to stress that a precondition for success in Russia is to have good local staff working for you. We have managed to create a super team in Russia, which is highly focused on delivering top quality PCBs.

I am convinced that Russia will be an attractive production base for foreign companies. Sometime in the not too distant future we will see the Russian government set about simplifying their administrative procedures and thus make it easier to do business.

Would you like to know more
about the electronics industry
in Russia?

- » [Nordea's continuous analysis of Russia](#)
- » [IMF: Russian reports and forecasts](#)
- » [Russian Federation and the WTO](#)

Subjects we have covered earlier

Do read our earlier newsletters. You will find them all on our website, www.ncabgroup.com/newsroom/

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» **Customer Relations**

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» **Securing quality**

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Are we taking up the wrong subjects?

We are always looking for interesting subjects that we could take a more in depth look at.

If there is something you would like to learn more about, or perhaps you would like to comment on anything we have written, do get in touch with us and tell us more.

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