“Now it is a very good time to enter into the Russian market. There are some niches and free space in the market due to the crisis. There is market share to be captured. According to my estimations this easy-to-enter market situation will last a year or two...”

“...Mentally and culturally Russian people are Europeans, which means more comfortable conditions for Western businesses here.”

EXECUTIVE SUMMARY

The wealthiest market per capita of all BRIC countries, Russia combines the best of Europe and Asia. Together with the Commonwealth of Independent States (CIS), it represents a market of around 300 million consumers and offers many opportunities not only for multinationals but also for middle-size players.

The best time to enter the Russian market is probably now, when companies can look for opportunities during periods of turmoil and crisis. Possibly this will be the last chance for a while for good expansion opportunities. In one or two years, the window will close and it will be necessary to either invest heavily at the entry stage or develop more slowly.

Mentally and culturally Russian people are Europeans, which means more comfortable conditions for Western businesses if compared to some other developing markets.

Russia is not only a big market; it offers also huge intellectual and creative potential for those looking for R&D and innovations.

Along with traditional intelligence challenges for emerging markets, specific issues face an entrant to the Russian market:

- Russian market having been relatively open, the competition is rather tough by now, even though the crisis has opened up niches
- Specific economic structures and business models remain as a handicap from Soviet times

Deep market analysis and a sophisticated approach to the market entry strategy are required from newcomers.

See below more details about doing business in Russia, from an interview with Vsevolod Gavrilov, Head of Russian Office, Volvo Penta Corporation.
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1. INTRODUCTION AND BACKGROUND

Although the Commonwealth of Independent States is a political and economical association of States, it is more practical to look at CIS from a different angle.

Historically, CIS was an association of former Soviet Republics, formed in 1991 during the break-up of the Soviet Union. CIS included in some form all of the former Republics, excluding the Baltic States (Estonia, Latvia and Lithuania): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan, and Ukraine.

Since 1991 many things have changed: Georgia has walked out of CIS, Ukraine has not signed some agreements, and Turkmenistan has become an associated Member in 2005. Mongolia, which never was part of the Soviet Union, joined CIS as an observer, and even Afghanistan has expressed a wish to join.

In contrast to all these developments, CIS in reality is not a strong community, which would act together and make significant common decisions. The most practical way to think of CIS is to consider these 12 countries as a region, formed by countries with very close historical and political ties.
Looking at the historical context, all CIS countries became part of the Russian Empire during the 18th and 19th centuries and remained together - with some exceptions right after the Russian revolution in 1917 - until the disintegration of the Soviet Union in 1991. Some of them – for example, Ukraine and Belarus - have close common roots dating back to the formation of Slavic statehood in the early Middle Ages.

Due to 70 years of common history in the Soviet Union, all CIS countries have similarities in political regimes and economical and social conditions. Many mental patterns are shared across the region, originating from the very deep social transformation and unification in the Soviet period.

A very important unifying factor is the Russian language, which was the national tongue in USSR. Russian is well-known throughout the region. In some countries, like Ukraine or Belarus, nearly everybody speaks Russian as well as Ukrainian or Belarussian. A common language makes it easier to communicate and conduct business across the CIS area.

On the other hand, there are few other regions in the world with so many fundamental differences. In Latin America, for example, most nations are Christian and have similar linguistic roots. On the post-Soviet space you will find completely Islamic countries like Azerbaijan or Uzbekistan, and orthodox Christians in Russia and Ukraine.

The same difference can be found in economical sphere: the GDP per capita in Tadjikistan is 7.5 times lower than in Russia. This results in strong labour migration flows between countries, mostly towards Russia, which accounts for more than 75% of regional GDP. Nearly half of the GDP in countries like Tadjikistan or Uzbekistan is formed by money transfers made by guest workers from Russia.

To sum up, CIS is not an actively-functioning economical or political treaty; rather it is a number of countries unified by Russian language, intimate economical and interpersonal ties, as well as historical and structural ties.
The 12 CIS countries represent a market of around 300 million consumers. Regional GDP accounts for 2,500–3,000 billion USD (by PPP). The CIS territory covers around 22 million sq. km, which is 5 times bigger than Europe and twice as large as China or US.

The breakdown of economic activity across the region is very uneven. Russia is the biggest economy, representing nearly 80% of regional GDP. The next two most promising markets are Ukraine and Kazakhstan, which boast an overall GDP substantially higher than in the rest of the CIS countries.

Other countries are poorer and less developed in terms of their infrastructure and economic activity. It is considered quite risky to do business in these other countries, but with risk comes rich profits if you find the proper market niche.

From the geographical, economical and cultural point of view, it is useful to divide the CIS countries into three groups:

- European group: Russia, Ukraine, Belarus and Moldova
- Caucasian group: Armenia, Azerbaijan and Georgia
- Middle Asian group: Kazakhstan, Kyrgyzstan, Tadjikistan, Turkmenistan and Uzbekistan

The European group represents countries which are located in close proximity to the European Union. Their historical development has close ties with Europe. The level of economic development is higher within this group than in the two others, with the exception of Moldova. Countries in this group share the Orthodox religion and common linguistic roots.

Caucasian countries are located further to the south from Europe, between the Black and Caspian Seas. These countries tend to be more rural while less developed in industrial produc-
tion. Climate is mild and healthy. The Caucasian countries have a rich history and culture, with a higher level of education than in the Central Asian region of CIS. Armenia and Georgia are Orthodox countries, while Azerbaijan, bordering Iran, is Muslim.

The Middle Asian group consists of sparsely populated Muslim countries that have vast, arid territories. Economy is based entirely on agriculture and the extraction of minerals. The standard of living is the lowest in the whole region. The only exception is Kazakhstan, which is rapidly developing into a market economy with a relatively high level of GDP per capita.

Table 2. GDP Breakdown by industry type and some other basic info

<table>
<thead>
<tr>
<th>Country</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
<th>Key exports</th>
<th>Basic religion</th>
<th>Share of people with higher education</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>5%</td>
<td>37%</td>
<td>58%</td>
<td>petroleum and petroleum products, natural gas, wood and wood products, metals, chemicals, and a wide variety of civilian and military manufactures</td>
<td>Orthodoxy, islam</td>
<td>64.1%</td>
</tr>
<tr>
<td>Ukraine</td>
<td>10%</td>
<td>31%</td>
<td>59%</td>
<td>ferrous and nonferrous metals, fuel and petroleum products, chemicals, machinery and transport equipment, food products</td>
<td>Orthodoxy</td>
<td>43.3%</td>
</tr>
<tr>
<td>Belarus</td>
<td>9%</td>
<td>40%</td>
<td>51%</td>
<td>machinery and equipment, mineral products, chemicals, metals, textiles, different foods</td>
<td>Orthodoxy</td>
<td>56.0%</td>
</tr>
<tr>
<td>Georgia</td>
<td>56%</td>
<td>9%</td>
<td>36%</td>
<td>scrap metal, wine, mineral water, ores, vehicles, fruits and nuts</td>
<td>Orthodoxy</td>
<td>34.5%</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>6%</td>
<td>41%</td>
<td>54%</td>
<td>oil and oil products, ferrous metals, chemicals, machinery, grain, wool, meat, coal</td>
<td>Islam, Orthodoxy</td>
<td>30.9%</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>27%</td>
<td>40%</td>
<td>34%</td>
<td>energy products, cotton, gold, mineral fertilizers, ferrous and non-ferrous metals, textiles, food products, machinery, automobiles</td>
<td>Islam</td>
<td>na</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>6%</td>
<td>61%</td>
<td>34%</td>
<td>oil and gas 90%, machinery, cotton, foodstuffs</td>
<td>Islam</td>
<td>22.3%</td>
</tr>
<tr>
<td>Armenia</td>
<td>19%</td>
<td>34%</td>
<td>48%</td>
<td>pig iron, unwrought copper, nonferrous metals, diamonds, mineral products, food products, machinery, automobiles</td>
<td>Orthodoxy</td>
<td>20.2%</td>
</tr>
<tr>
<td>Moldova</td>
<td>22%</td>
<td>18%</td>
<td>61%</td>
<td>foodstuffs, textiles, machinery</td>
<td>Orthodoxy</td>
<td>27.9%</td>
</tr>
<tr>
<td>Kyrgyzstan</td>
<td>31%</td>
<td>16%</td>
<td>53%</td>
<td>cotton, wool, meat, tobacco; gold, mercury, uranium, natural gas, hydropower; machinery; shoes</td>
<td>Islam</td>
<td>41.1%</td>
</tr>
<tr>
<td>Tadjikistan</td>
<td>67%</td>
<td>8%</td>
<td>25%</td>
<td>aluminum, electricity, cotton, fruits, vegetable oil, textiles</td>
<td>Islam</td>
<td>14.0%</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>10%</td>
<td>34%</td>
<td>56%</td>
<td>gas, crude oil, petrochemicals, textiles, cotton fiber</td>
<td>Islam</td>
<td>na</td>
</tr>
</tbody>
</table>

Source: CIA World Fact Book
Despite all the differences and peculiarities described above, the mental heritage and political and economical legacies of the former Soviet Union unify the region on the world map. In the next chapter the economic situation and key business opportunities of the region are highlighted. Russia is described in greater length while other countries are outlined in less detail.

3. RUSSIAN FEDERATION

Short overview

Russia is the largest country in the world with an area of over 17 mill. sq.km. Russia extends from Central Europe until Far East Asia. More than 80% of its 140 mill. inhabitants are living in the European part of the country. Capital of Russia is Moscow with over 15 mill. citizens, followed by Saint-Petersburg with nearly 5 mill. In addition, there are 12 cities with population of 1 mill. or more. Russia possesses the biggest energy and mineral resources in the world. If measured by PPP, Russia is the 7th biggest economy in the world.

Exhibit 2. Density and distribution of population by federal districts in Russia

Key characteristics of the Russian market and economy

Russia is without doubt part of BRIC:

- **It’s a big market:** Jointly with 12 CIS countries it represents around 300 million Russian-speaking consumers.
- **It’s growing rapidly** and things are changing fast, like in other BRIC countries.
- **Russia is a very non-transparent economy** (level of grey economy is variously estimated at 20-40% of GDP) with high level of bribery, which is also typical to developing countries.
While the key fundamentals of doing business are rather similar between Russia and BRIC, Russia is also different:

- **Russia is the wealthiest market** among BRIC countries. GDP per capita (by PPP) is almost 6 times more than in India, 3 times more than in China, and 1.5 times more than in Brazil.
- **Due to the heritage of Soviet times**, Russia still possesses quite solid *intellectual and educational base and infrastructure*.
- **Difference in mentality. Russians are Europeans**, thus being culturally much closer to the West than China and India.

### Table 3. Russia and other BRIC countries

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>GDP BY PPP, $ PER CAPITA, 2009</th>
<th>SHARE OF PEOPLE WITH HIGHER EDUCATION</th>
<th>SHARE OF ENGLISH-SPEAKING POPULATION</th>
<th>AVERAGE SALARY, $ PER MONTH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>15 020</td>
<td>64%</td>
<td>5%</td>
<td>500</td>
</tr>
<tr>
<td>Brazil</td>
<td>10 100</td>
<td>17%</td>
<td>1%</td>
<td>750</td>
</tr>
<tr>
<td>China</td>
<td>6 000</td>
<td>8%</td>
<td>1%</td>
<td>250</td>
</tr>
<tr>
<td>India</td>
<td>2 800</td>
<td>11%</td>
<td>21%</td>
<td>200</td>
</tr>
</tbody>
</table>

*Source: CIA World Fact Book and Ethnologue: Languages of the World, Sixteenth edition*

### Country of contrasts with vast regional disparities in development and income distribution

Russia has more USD billionaires than any other developing country. If you travel to Moscow, you could be shocked by the number of expensive cars, restaurants and hotels. But, if you travel 30 kilometers from Moscow to the countryside, you will see a completely different standard of living, and this economic disparity applies all over Russia.

Russia consists of several different markets, which should be studied separately and may require different entry strategies.

Russia can be divided into seven sub-regional markets: Central Russia with its center in Moscow, the North-West region with its center in Saint-Petersburg, South Russia, Caucasus, Ural region, Siberia, and Far East. These regions are all very different from each other in terms of market development, infrastructure, demand, key industries, and so on.

### High dependence on natural resources and commodities

More than 50% of the Russian GDP is generated by industries related to mineral resources. The dependence on raw materials drove the economy into a very deep fall (-8.5%) in 2009, due to the falling prices in the international commodities market.

### Big market, big territory, but poor logistics

While the majority of population lives in the European part of the country, most of Russia’s natural resources are found in Siberia and the Far East. This creates one of the key challenges of doing business in Russia, as logistics and infrastructure are underdeveloped.

### Table 4. Comparison on billionaires

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>NUMBER OF BILLIONAIRES</th>
<th>AVERAGE AGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>33</td>
<td>64.6</td>
</tr>
<tr>
<td>Russia</td>
<td>13</td>
<td>49.1</td>
</tr>
<tr>
<td>India</td>
<td>9</td>
<td>58.1</td>
</tr>
<tr>
<td>France</td>
<td>5</td>
<td>76.3</td>
</tr>
<tr>
<td>Germany</td>
<td>5</td>
<td>74.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>3</td>
<td>64.7</td>
</tr>
<tr>
<td>Japan</td>
<td>2</td>
<td>62.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2</td>
<td>62.5</td>
</tr>
<tr>
<td>China</td>
<td>0</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: www.forbes.com*
It can be quite tricky to travel in Russia. Imagine you need to go to Yekaterinburg in Ural from Omsk in Siberia 1,500 km away (see the map). This would be a 1.5 hour direct flight. In reality, often you end up flying from Omsk to Moscow to take another flight to Yekaterinburg, travelling about 10 hours as a result.

High role of government in economy, bribery and Russian chaebols

Despite of regional diversity, the Russian political system is highly centralized. Lack of strong value systems and the increasing share of government in the economy result in very high level of bribery as well as in high centralization of power, finances and decisions in Moscow. Therefore, even if major clients or the production site are located far from Moscow, often it is inevitable to have an office in the capital, too.

The other side of the coin is a very high concentration of GDP. Five hundred largest companies control over 80% of GDP. In addition, tens of large financial-industrial groups own diversified assets in a variety of industries. The structure of the economy thus resembles that of South Korea with its chaebols, or Japan with its keiretsu.

Bribery affects not only geographical planning, but the overall business model, depending on the industry in question. In consumer-oriented industries such as FMCG, fast food, or clothing, the level of corruption is lower than in some other industries. Still, one could face a lot of problems dealing with regulatory entities. The level of corruption increases enormously in the business-to-business industry with big corporate or state-owned clients.

Nevertheless, the overall picture is not as bleak as it could appear. If your principles do not allow you to pay bribes, it is possible to solve all problems without bribes, but it will take time, you should just be ready for this.

Specific cultural and economic phenomenon

There is another interesting cultural phenomenon which distinguishes Russia from many other countries. Memories from the times of Super-Empire combined with awareness of being economically underdeveloped create tension in self-perception and national identity. As a result of the transformation of the Soviet Union, Soviet values and principles are broken, while new ones are still in the process of formation.
4. OVERVIEW OF OTHER COUNTRIES IN REGION

4.1 Ukraine

Ukraine is the second largest economy in CIS after Russia. Its history is tightly connected with Russia and the relations between these two countries are somewhat similar to relations between the UK and France. Ukraine is strictly focused on integration with the European Union. The dominating religion is orthodoxy, and languages spoken are Ukrainian and Russian. Kiev is the ancient capital; its history started over 1500 years ago.

Ukraine can be called the ‘country of a scandal democracy’ because of flourishing political lobbying. Despite Ukraine’s GDP and production falling steeply in 2009, it took the 61. place in the Legatum Prosperity Index 2009 for the world, and placed ahead of Russia, Belarus and Kazakhstan for the right to speak.

Ukrainian economists have sadly named its economy post-industrial: machinery production has changed from 13% to 14% and ferrous metallurgy from 11% to 27% between 1990 and 2008. Main export products are metal, fertilizers and grain.

The current state of economy is not very healthy, foreign debt being close to 100% of GDP. However, after the latest presidential elections foreign investments inflows are expected in the energy, agricultural and tourism sectors.

4.2 Kazakhstan

Kazakhstan is a large country between Europe and Asia. It is the most economically developed country in Central Asia. Politics, economy and culture can be characterized by an intricate combination of eastern and western features; the Presidential Institute plays a dominating role in Kazakhstan, supporting its growth. Three large tribal unions (zhuzi) still have a great influence in decision-making. Main religions are Muslim and Orthodoxy, and spoken languages are Kazakh and Russian.

Key industries are oil, mining, metallurgy and agriculture. Large administrative financial and industrial groups have a big role in the economy. EU and the US Congress define Kazakhstan as a ‘country with market economy’.

Officially the Kazakhstan GDP grew about 1% in 2009. However, Government anti-crisis measures in the financial and industrial sectors are being criticized.

From the beginning of 2000’s large construction has taken place in Kazakhstan. Modern, bizarre skyscrapers have appeared in main cities, Astana and Alma-Ata, creating an impressive contrast in the middle of a deserted steppe. Astana became the new capital in 1997.

A significant problem for Kazakhstan is its far distance from main logistical ways. In 2007 Kazakhstan approached Russia with an offer to build a Eurasia Canal that would connect...
the Caspian Sea and the Azov-Black Sea through Russian territory. The canal would give Kazakhstan access to international sea communications and make it a potential Sea Empire.

4.3 Belarus

For the major part of its history, Belarus was part of Russia. Officially Belarus is a Republic while in fact it seems to be an authoritarian state as the president, Alexander Lukashenko, has been in office for 15 years.

The country’s capital is Minsk. Main industries are chemical (up to 40% of GDP comes from potash fertilizer exports) and agricultural machinery. Traditionally the majority of large enterprises have been under state control but since March 2008 there has been a new perspective to setting up and developing business in Belarus, after Alexander Lukashenko signed an agreement to sell some large enterprises’ shares.

Did you know?
Belarussians traditionally are fans of potato. They eat more potatoes per capita than people of any other country in the world - 180 kg, or half a kilogram per day. There are about 30 unique potato dishes in the national Belarussian cuisine.

4.4 Georgia

Georgia is a mountainous country whose people enjoy long lives. On average, the male life expectancy is about 73 years and female up to 80. The capital is Tbilisi. Georgia is very famous for its wine, many-voiced songs and resorts. In 2000’s tough liberal reforms in private, tax and budget spheres have resulted in GDP growth and a foreign investment inflow into the country.

Did you know?
Georgians are very famous toast tellers. Traditionally before each sip of a drink, a philosophic story with a very smart ending needs to be told. In one of the provinces 26 toasts have to be announced in a strict order during one feast.

4.5 Uzbekistan

Uzbekistan boasts a long history with famous ancient sights such as Samarkand, Buhara, and Horezm. The capital is Tashkent. The population of Uzbekistan (28 mill.), is the 3rd largest in CIS after Russia and Ukraine.

Main export products are cotton, grain, gold, gas, fertilizers and drapery. Many foreign experts consider the political system in Uzbekistan to be authoritarian. The dominating religion is Muslim, and spoken languages are Uzbek and Russian.

Did you know?
Louis Phillip Scholari from Brazil, who signed an 18-month contract to coach the Uzbek football club Bundekora, became the highest-paid coach in the world. He will get 13 million EUR for one season in Uzbekistan.

4.6 Azerbaijan

Azerbaijan is the largest country in the Caucasian region. Traditionally over 50% of its GDP comes from oil production. The positive balance of foreign trade in the country’s economy was over $40 billion in 2008.

The dominant religion is Muslim and the national language is Azerbaijani. The capital, Baku, is located on the Caspian Sea.

Did you know?
In 2006 the GDP growth in Azerbaijan was 36.6% and the country took the 1st place in the world according to this index.
Azerbaijan politics are traditionally strict, however the country has one of the fastest IT growth rates in the world.

4.7 Armenia

Armenia is a small Caucasian country with a history spanning over thousands of years. Armenia is famous for its ancient monasteries and cognac. The industrial processing sector brings in an estimated 2/3 of GDP. Dominant religion in Armenia is Christianity and the language is Armenian.

IT is rapidly developing in the Republic. Large multinational companies such as Lycos and SYNOPSYS are opening affiliated offices in Armenia. The IT sector share of GDP is about 1.8-2.2%, on par with technologically developed countries.

4.8 Moldova

Moldova is a small, relatively poor country in South-Eastern Europe. The capital is Kishinev. Main industries are agriculture, food and light industries. The country is especially famous for its wine and incendiary dances. According to unconfirmed statistics, about 25% of its labor force works abroad.

Dominant religion in Moldova is Orthodoxy, and spoken languages are Moldavian and Russian.

4.9 Kyrgyzstan

Historically, Kyrgyzstan is a country of breeders and riders. It is the only country in Central Asia where animal produce outruns crop production in price indicators. That can be explained by a small share of fertile land in the mountainous country. The main religions are Muslim and paganism, and the capital is Bishkek.

About 40% of industrial production is gold-mining. The major part of gold is mined in the Kumtor goldfield. In 2008 the Kyrgyzstan Superior Court overruled an agreement with the Canadian company Gold Centerra, which resulted in significantly reduced foreign investment into the industry.

4.10 Tadjikistan

Tadjikistan is located in the heart of Central Asia - over 90% of the country territory is occupied by the Pamir ridges. The capital is Dushanbe. Main export products are cotton, aluminum, gold and drapery. Tadjikistan is one of the poorest countries in CIS.

According to EBRD estimates, money sent back to Tadjikistan by its citizens living abroad amounts to about $1 billion (app. 50% of GDP). Heroin trade and transfer from Afghanistan makes also part of the country’s GDP. The dominant religion is Muslim, and languages spoken are Tadjik and Russian.

Did you know?
The Armenian Diaspora (Armenian emigrants all over the world) is actively investing into the Armenian economy – for example, the Linsy Foundation headed by the Armenian billionaire Kirk Kirkorian.

Did you know?
Moldova is the single country in the world where fertile lands occupy about 80% of the whole territory.

Did you know?
The ancient Kyrgyz epic poem about hero Manas, who united the Kirghiz people, has more than 500 000 lines. It is the longest epic in the World. One poem of Manas can last for several weeks.

Did you know?
People of Tadjikistan are famous for their handicrafts. Tadjiks make fabrics, pottery, musical instruments, carpets, furniture and jewelry in unique colored styles. There are whole dynasties of craftsmen that pass on ancient arts from one generation to another.
4.11 Turkmenistan

Turkmenistan is a country with the least economic transparency in Central Asia. Economic privatization has been very restricted, taking place mainly in the service sector. The Turkmenistan economy is based on gas and oil exports. A significant part of the population are still occupied in cotton and drapery production.

The dominating religion is Muslim, and the language is Turkmenian. The capital is Ashhabad.

Did you know?
Saparmurat Niyazov, also known as Turkmenbashi, was the first, lifelong president of Turkmenistan. He held this post for 16 years. In the middle of his term, the People Council (Halk Maslahati) renamed months and days of the week in honor of their President.

5. BUSINESS OPPORTUNITIES IN RUSSIA & CIS

The wealthiest market per capita of all BRIC countries, Russia combines the best of Europe and Asia. Together with the Commonwealth of Independent States (CIS), it offers many opportunities for different types of companies.

- The best time to enter the Russian market is probably now, when companies can look for opportunities during periods of turmoil and crisis.
- Many costs for starting businesses, like real estate, salaries or advertising, are currently relatively low.
- The current situation in Russia is quite unique, as due to the crisis and high debt-to-equity ratio, many leading companies have become cheap to acquire and are looking for buyers. So, newcomers can rapidly get a foothold and gain market share.

Possibly this will be the last chance for good expansion opportunities. In one or two years, the window will close and it is necessary to either invest heavily at the entry stage or develop more slowly.

Consumer market opportunities: luxury or value-for-money?

Due to the high number of rich people, Russia is one of the biggest markets for luxury goods. High loyalty towards international brands gives opportunities to premium players almost in every consumer good sector.

On the other hand, the recent crisis will also lead to substantial changes in consumer behavior. There will be growing demand for consumer goods in the value-for-money and budget segments.

After slowdown during the crisis, the growth of middle class along with rapid mortgage development will stimulate construction growth, thus offering attractive opportunities for residential goods manufacturers.

Established retail and distribution channels as a chance for niche players

Many big multinational companies have been present on the Russian market already for a long time. Competition is quite tough in many industries. Still, the Russian market offers opportunities not only for big corporations but for second tier companies as well.
Retail was one the fastest-growing industries before the crisis, and continues to grow. There are a number of strong nationwide retail chains, all of which are actively seeking private labels.

An interesting situation could be seen also in the distribution and wholesale sector. Plenty of successful nationwide distributors with a good sales and marketing workforce and a developed warehousing infrastructure are now slowly losing their exclusive contracts with big international brands as a result of market maturity. These distributors are at strategic crossroads: one alternative for them is to find second-tier brands to leverage their market know-how and distribution capabilities.

Developed distribution and presence of strong retailers will offer interesting opportunities for middle-sized niche players in the FMCG sectors.

**Enormous potential in the service sector**

Service industries for end customers were highly underdeveloped in the Soviet times. Despite of rapid development, there is still a lot of free market space in industries such as hotels, restaurants, retail, medical care, tourism etc. Even in the most developed retail sector, the combined market share of the 10 biggest retailers does not exceed 15%. Falling salaries and prices for real estate rental, advertising etc. offer unique opportunities in service sectors, proven by Burger King and H&M opening their first Russian stores in 2010.

**Not only market, but an intellectual and creative partner**

Thanks to the historical tradition and heritage of the Soviet times, Russia possesses quite solid intellectual and educational base and infrastructure. The number of people with higher education exceeds that of many developed countries. Russians also are a very creative and inventive nation. The Cold War period, when military progress was required constantly, favored the culture of breakthrough creative teams and ideas.

This culture is an opportunity for companies looking for innovations and ideas. Companies such as Google, Intel, Microsoft and many others have realized this and established R&D centers in Russia. Even for those planning mass production in China, Russia could be a good place for R&D and pilot production. The advantage of such model is the ability to hire qualified personnel at relatively competitive salaries.

Also Russia could be not only a source for innovative ideas, but a strategic partner and source of innovative investment capital, especially in the hi-tech domain. The Russian government has established a corporation called RosNano with the mission to turn Russia into one of the leading countries in nanotechnologies. Besides, private investors, having made their wealth in natural resources, are actively looking for promising companies and projects in innovation and technologies.

**Logistics and Infrastructure**

Vast territory and the relative lack of infrastructure means there are opportunities for companies in logistics and transportation, building and construction, engineering, telecommunication, etc.

Like many other business processes in Russia, logistics has traditionally not been outsourced. Key Russian exporters of coal, oil, gas and metals etc. have maintained their own fleets of wagons, investing in cars, trucks, new warehouses, distribution centres, ships and even their own ports. The main reasons are poor infrastructure, complexity across 11 time zones, administrative barriers, lack of reliable service providers, plus rapid growth and affordable credit.

Since the crisis, businesses have been rethinking their investment strategies and business models. This is stimulating the outsourcing of non-core activities such as logistics, industrial services etc. Importantly, infrastructure is now one of the key priorities for Russian government, which translates into a more favourable business climate for both domestic and international companies.
Advanced processing technologies

Russia is extracting more minerals than most other countries, but the level of processing is still quite low in oil & gas, chemicals, wood, metals and other mineral processing industries. Hence Russia is a promising market for competitive mineral processing technologies that allow for increasing value added created in-house. There are opportunities both for engineering companies as well as for commodities companies that could offer strategic partnerships in the technological sector.

Energy-saving technologies

It is a paradox, but Russia lacks energy-saving technologies. Some experts say the reason for this is a wasteful attitude to things found in excess in the nature. Another reason could be the legacy of the Soviet period when economical thinking was not a priority. Anyway, the situation is changing. Internal prices for oil and gas are rapidly narrowing to the international levels. Taking into account the cold climate, demand for technologies which could reduce energy consumption or minimize ineffective losses is growing rapidly.

Components, parts and supplies

Many domestic as well as multinational companies operating assembly facilities in Russia suffer a shortage of reliable local suppliers of parts, components and business services. The shortage spans from quality castings to on-time repair services to corporate catering. As long as the level of localization of production is growing, the demand for reliable suppliers will grow in return.

6. CHALLENGES AND SOLUTIONS IN CONDUCTING MARKET INTELLIGENCE IN CIS

Experienced MI professionals or strategists will face in Russia and CIS the typical problems of conducting market intelligence in developing markets.

Poor secondary information structures and low reliability of public information calls for primary research

Despite the requirement to disclose financial information in for example Russia and Kazakhstan, the CIS markets do not offer many reliable sources of information. There is a lack of ready-made reports, statistical data, industry associations and magazines, etc. High level of non-transparency in economy such as common usage of cash, grey customs operations, tax avoidance, and bribery force companies to misrepresent data thus making even publicly available information non-reliable. This results in need for cross-checking and primary research with in-depth interviewing. Some industries are so untransparent that it is hard to find out real decision-makers.

Regional diversity which results in need for broader scope research

Vast social disparity and differences between regions in Russia and even a broader diversity between CIS countries leads to the necessity of studying several segments and regions in order to get a proper market picture.

For example, you could find the retail market in Saint-Petersburg not very interesting because it is highly competitive with leading retail chains dominating by a 60-70% market share, but already in Moscow it is different – share of retail chains there is 40-50%. In Perm or Volgograd you can find a less competed retail market with only a 30% share by established chains.

There are several examples of companies, now national leaders, that have started their expansion not from Moscow, but from regional markets. It is strongly recommended to study different CIS countries separately because the level of market maturity can be completely different in each.
Importance of local contacts and relations

Low level of trust or transparency mean that in some markets it is quite hard to recruit decision-makers or high-level executives for interviewing. The only way to get the required info or expert opinions, however, is to find proper contact persons and relations.

Role of government to be studied separately

The increasing role of government in economy requires specific research methodology not only for sectors with high public influence (real estate, construction, infrastructure), but also for many others. It is necessary to study government plans to invest or to buy assets in the target industry, and to understand whether or not there are any support programmes for any competitors, etc. Also trade barriers and the tax environment should be carefully analysed because rules and policies in Russia and CIS are changing constantly. The role of government role is growing, it now controls around 50% of GDP.

Apart from these quite common factors for developing markets, there are two distinctive characteristics:

Specific industry structures and business models require deeper analytics

The Soviet economy was centrally planned, and in some aspects its constitution was very different from that of other developing economies. Some of these peculiarities last still today. For example, there are specific entities called “Project Institutes”, which were responsible in the Soviet times for research, engineering and innovation in almost every industry. During the 90s some of them closed, some transformed, but most of them still exist in some form, playing their specific role in the industry.

If you are developing a strategy you should be informed of all such circumstances and their implications for the competitive landscape.

Also, one should pay attention to possible metric differences and taste peculiarities. For example, Western people eat long cucumbers, but Russians prefer short ones; American and European companies usually use rectangular plywood, but the Russian industry uses square material; Western agriculture uses wheeled tractors, but Russian farmers unexpectedly often use track-type ones...

Tough competition calls for sophisticated strategies

The level of competition today is relatively high in Russia, thanks to the relative openness of the market, if compared with other developing markets. In many industries one will find strong national players as well as traditional multinationals. Simple strategies do not work anymore in many industries. A good example is Carrefour, one of the world’s largest retailers, who entered the Russian market in the beginning of 2009, but curtailed operations in the end of the same year because of “lack of potential for organic growth as well as for M&A”...

Rather sophisticated analysis and strategic planning should be carried out in order to fully exploit the vast potential of the CIS markets.
7. INTERVIEW WITH EXPERT

Vsevolod Gavrilov, Head of Russian Office, Volvo Penta Corporation,
about peculiarities of the Russian market

What are the key specific features of doing business in Russia?
Russian customers are ready to pay for brands. If clients are really sure about the brand and its quality, they are ready to pay a premium. This results in much higher margins in comparison with many other markets.

Besides, brand recognition in Russia is very important, giving huge advantages for well-known international brands. Russians are very loyal to international brands with solid reputation. Of course, there is the other side of the coin – if you do not justify quality expectations, the level of disappointment will be that much higher. That is why the aftermarket strategy is so important in our diesel engines business. Even if your product is good, but you have poor aftermarket infrastructure, you will lose the market.

What is your view of Russia, compared to other BRIC nations?
Mentally and culturally Russian people are Europeans, which means more comfortable conditions for Western businesses here. There are not so many specific national traditions and small details important to follow as for example in China or India.

What information do you use in your decision making processes; what is market intelligence for your company?
Unfortunately in Russia, at least in our industry, there are no reliable sources of information. Except for the below-mentioned research project, which we conducted with ALT R&C, we usually rely on analysis of import statistics and expert judgements, which we collect through regular industry-specific events and exhibitions.

I would also like to advice potential newcomers to have a proper web strategy. Our experience shows that for the Russian market, which lacks developed professional communication channels and extends over 11 different time zones, Internet is the channel with the highest return on investment ratio.

What are the key problems for business in Russia according your experience?
It is very hard to find reliable local partners - suppliers of parts and components. For example, there are no providers of high-quality casting. This is a big problem for OEMs, who plan to start local production. On the other hand this can be a good opportunity for international companies as well as domestic component manufacturers. Russians are very creative, they could provide you a very good prototype, but when it comes to mass production, quality could vary substantially. You should be very careful about quality control!

All the problems in Russia can be solved somehow, but there is one really big issue, which you should always pay special attention to: long distances and bad logistics. Russia is the biggest country in the world, but its infrastructure is underdeveloped. A logistical issue can become a major financial issue as well and heavily affect some businesses or even completely change your economic business model.

What are the most unexpected learnings in Volvo Penta's experience of the Russian market?
I think the corruption issue is exaggerated. You just need to be ready that some things will take some time and will move slower than you expected. But they will move finally and you will be re-
warded for your patience in the long run. Even if your business is highly dependent on relations with federal or local authorities, you have to find a good partner, who can do this job well, and it is absolutely not necessary that the partner will give somebody bribes. The personal connections/relations in Russia very often mean more than money.

Another important observation – it is difficult to find the right people for a reasonable price. It takes time. You should not rush employing your staff. Don’t be scared to develop locals, they learn new things quickly. Also I have to note that HR services are quite developed in Russia.

What would you recommend to those executives who are now thinking about the Russian market?

Now it is a very good time to enter into the Russian market. There are some niches and free space in the market due to the crisis. There is market share to be captured. According to my estimations this easy-to-enter market situation will last a year or two.

From my point of view the “fast” distribution model (when you find as many distributors as you can and then choose the best ones from them) does not work well in Russia. I think it is more effective to find a partner or partners, which are really interested in long-term cooperation and will build a strong relationship as well as invest in market development.

For companies selling products requiring services, I would recommend to start the market entry with substantial investments into aftermarket network, guaranteeing the spare parts availability and service quality that your product requires. First of all, you should find dealers, technicians, pass all necessary certifications, establish customs and logistics channels, and only after that you should start aggressive sales and marketing.

I also recommend to go through a thorough selection process for the region or city where to establish operations, especially when you plan to start production. Moscow is good for lobbying and logistics, but very expensive; other regions could fit well depending on your target niche or industry sector. Sometimes good support from regional authorities in the middle of Russia gives a better return than a big, expensive office in the center of the capital.
8. BUSINESS CASES

Case 1: Assessment of Russian market of industrial diesel engines for Volvo Penta Corporation

Industry: Manufacturing & Industrial - Diesel engines
Geographic scope: Russia
Methods: Primary and secondary research, in-depth interviews, market sizing and analysis, segmentation, distribution channel analysis, recommendations

NEED
Volvo Penta, one of the world leading producers of industrial and marine engines, approached ALT Research & Consulting, the GIA Member Company in Russia, to understand the potential of industrial diesel engines market for making a decision whether to invest more in business development in Russia.

APPROACH
Secondary research was supplemented with several dozens of in-depth interviews with distributors, competitors and potential customers. The following topics were covered: market size, position of key competitors, key demand drivers, main market trends, key decision making factors, and forecast of key trends and market development.

SOLUTION
Based on market analysis, the Client’s potential to increase its market share was determined and recommendations were made on how to increase sales, including recommendations on product line, promising customers target segments, and promotion initiatives.

KEY BENEFITS
Key findings of the research helped the Client to approve their chosen strategic direction, and correct segmentation. Concentrating on the most promising segments and client types resulted in an upgraded country strategy.
### Case 2. Forecast on alternative fuels market development (as part of feasibility study for an international private equity fund to enter the Russian market of peat briquettes and pellets)

**Industry:** Energy, Resources & Environment  
**Geographic scope:** Russia  
**Methodology:** Primary and secondary research, in-depth interviews, market sizing and analysis, segmentation, distribution channel analysis, recommendations

### NEED

One of the leading Russian private equities, specializing in energy, was considering opportunities to enter the market of alternative fuel. They wanted to understand the potential of the Russian market for peat briquettes and pellets in order to evaluate the feasibility of a new production plant.

### APPROACH

As the product was relatively new for Russian market, desk research on developed markets was conducted before expert interviews. Desk research was applied also for competitive analysis and forecast of new production projects. In-depth interviews with industry experts, potential consumers, competitors, and public authorities followed.

**Methods:** Secondary and primary research (50 in-depth interviews), as well as comprehensive analysis.

### SOLUTION

Provided analysis of demand driving factors, modeling of demand and supply balance, estimation and forecast of market volume in the context of regions; estimation of economical effectiveness of product use comparing with other fuel types and of technical ability of customers to switch to this product; analysis of raw material sources.

### KEY BENEFITS

Ability to make an informed decision about investment in a new production plant, based on understanding of market potential in the regions.

Ability to choose the most efficient production site and region based on understanding of demand distribution, raw material sources, and planned competing projects.
Case 3. Comprehensive analysis and forecast of the residential construction brick market for a company planning to build a new ceramic brick plant in Central Russia

Industry: Construction and Property Development
Geographic scope: Russia
Methodology: Strategic Analysis: Market Attractiveness Analysis, Advisory

NEED
The largest Russian producer of ceramic bricks planned to build a production plant in Moscow. They needed to determine the optimal production capacity and product portfolio for the plant.

APPROACH
In order to estimate the size and forecast the outlook on the ceramic brick market, the market was divided into main segments (high-rise housing, low housing and civil engineering).
As the construction market - especially low housing - is very fragmented, the main method was primary research. For forecasting the brick market development, a model was made which took into consideration over 10 factors that influence the volume of demand and supply.

Methods: 65 in-depth interviews with construction firms, realtors, management companies of cottage villages, public authorities, planners, developers, brick distributors, brick producers, industry associations; 50 structured interviews with purchase managers of construction companies; 30 interviews and 3 focus groups with private builders and buyers of low-rise houses.

SOLUTION
Market size divided into main product segments and a 10-year forecast with 3 scenarios; competitor analysis and competitors’ plans for production facility expansion; price elasticity of demand and brick price forecast; defining the most attractive customers segments and a sales forecast.

KEY BENEFITS
Ability to make an informed decision on where to build the new plant, what should be its production capacity, and the type of equipment needed, thanks to sophisticated information about the current market situation and outlook, as well as a sales forecast for the future plant.
Case 4. Analysis of market opportunities for a logistics company in Russia

| Industry:   | Logistics & Transportation |
| Geographical scope: | Russia |
| Methodology: | Strategic Analysis: Market Sizing, Outlook, Competitive Landscape Analysis, Advisory |

**NEED**
An international logistics company was formulating a strategy for next 3 years which would allow it to grow 30% per year. The company needed to determine market opportunities and niches in order to understand in which segments to develop their business.

**APPROACH**
Desk research was made, uncovering lack of information about certain segments, followed by expert interviews to fill the information gaps. A strategy was developed with recommendations based on accomplished market research and analysis of the Client’s internal situation.

**Methods:** Desk research and 15 in-depth interviews with competitors and industry associations; analysis; advisory.

**SOLUTION**
Analysis of the logistics market in general: market size, structure and trends. Detailed analysis of certain segments such as cargos with non-standard dimensions, hazardous cargos, full container and less than container load services, bulk cargos, warehousing services, multimodal shipping, 3 PL logistic services, logistic consulting services, automobile transporter services; including segment sizing, future potential estimate, and a competitive landscape analysis.

Strategy development as the result.

**KEY BENEFITS**
Ability to decide in which direction to move business in order to ensure 30% revenue growth per year as well as successful long-term development.
9. ABOUT GIA IN RUSSIA

Global Intelligence Alliance (GIA) is a strategic market intelligence and advisory group.

The company is the preferred partner to international organizations for customized solutions that help them make better-informed decisions to achieve their business goals. GIA was formed in 1995 when a group of market intelligence specialists, management consultants, industry analysts and technology experts came together to build a powerful suite of solutions; ranging from outsourced market monitoring services and software to strategic analysis, business advisory and workshops.

Today, we provide clarity on global markets to business decision makers around the world on a daily basis, through GIA’s offices around the world and a network of partners in over 100 countries.

The GIA Member in Russia, ALT R&C, is headquartered in Moscow and has offices also in Saint-Petersburg. ALT R&C has covered the Russia & CIS region since 1992. The company draws on the expertise of 8 regular consultants, 50 freelancers, and a database of 1000 industry experts who serve a variety of client industries and needs.

Key services are market intelligence, strategy development, strategy implementation, and business performance and effectiveness. ALT R&C’s main focus industries are consumer goods, retail, automotive, machinery & engineering, metals & mining, logistics and distribution, pulp & paper, chemicals, energy, construction & construction materials, cloth & textiles, IT, telecommunication & media, and public entities & administration.

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