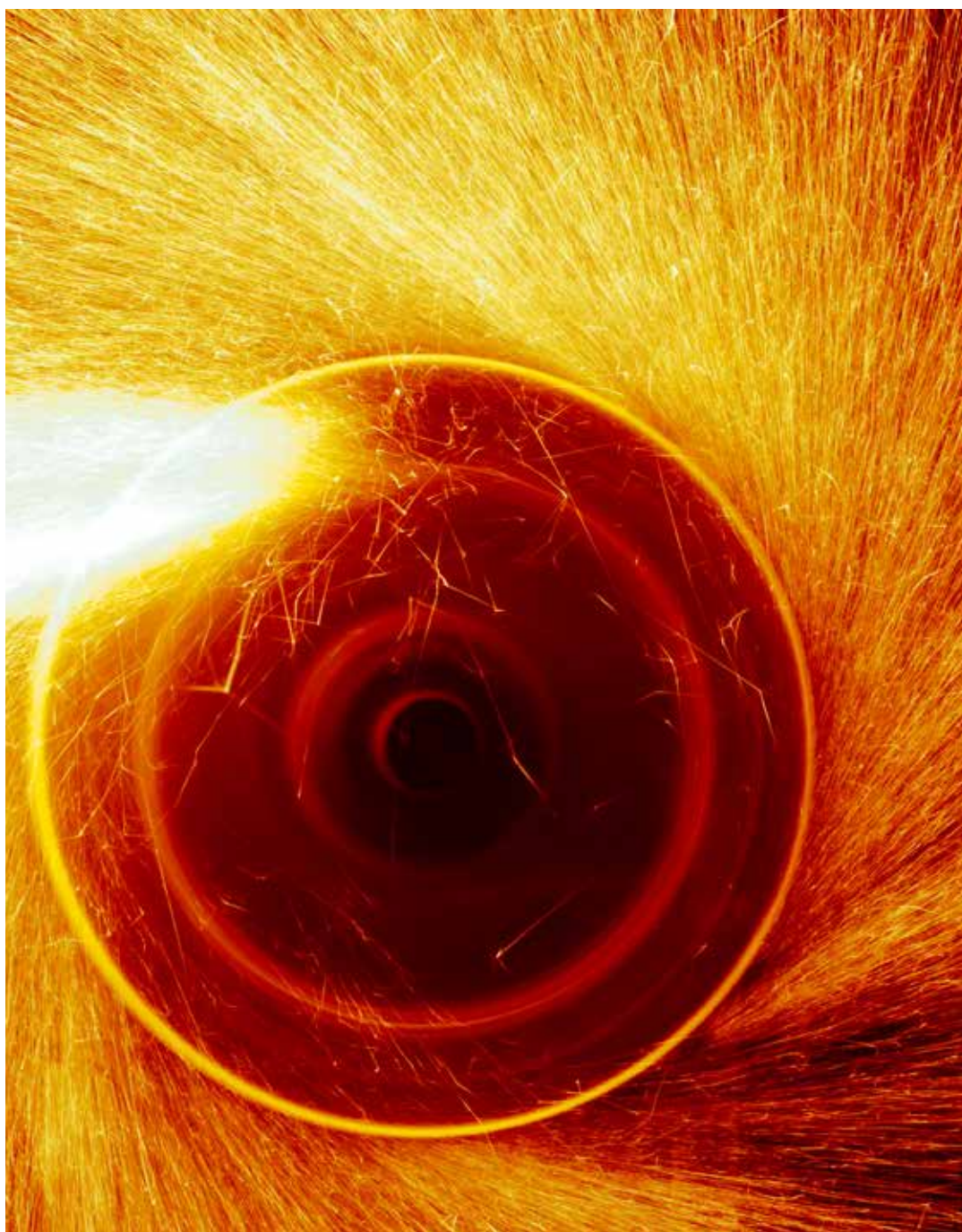


2015

Manufacturing in Russia

Key trends



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# Introduction and respondents profile

## Methodology used

The data was collected in two stages:

- 14 October 2014 – Questionnaire at a Deloitte industry event;
- December / February 2014-2015 – On-line survey.

A number of radical changes in the international economic and political situation took place during and in between the stages of the survey, therefore we present our analysis segmented by the two data collection periods.

We provide the data both on the selection in general and by key groups (those with significant differences between each other and / or the data selection in general).

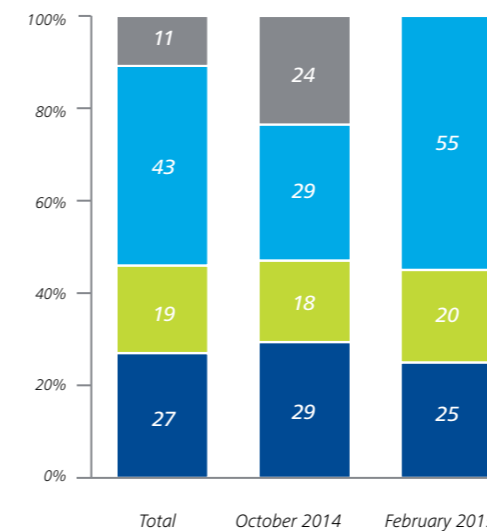
## Type and Size of companies

Based on our survey, foreign companies with local manufacturing content take the highest share of the market at 43%. These are typically small companies with headcounts of 100 – 500 people (50%).

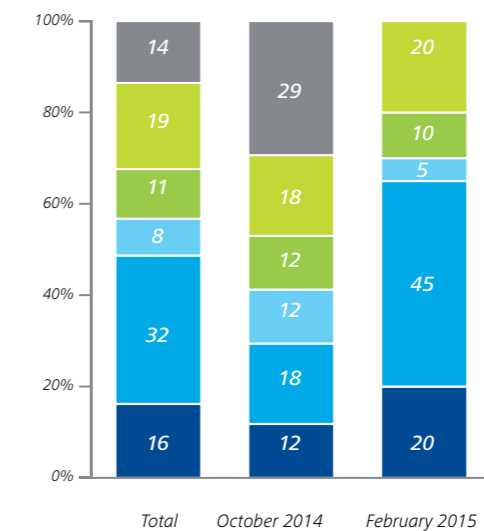
Russian companies take second place with 27% of the market. The majority of these companies (60%) comprises large organisations with over 5,000 employees.

Third place is held by foreign companies without local manufacturing content with 19% of the market. Generally these are the smallest companies with headcounts of less than 100 people (57%).

### Ownership types



### Number of employees



- Russian companies
- Foreign companies without localised manufacturing
- Foreign companies with localised manufacturing
- Don't know

- < 100 people
- 100-500 people
- 501-1000 people
- 1001-5000 people
- > 5000 people
- Don't know

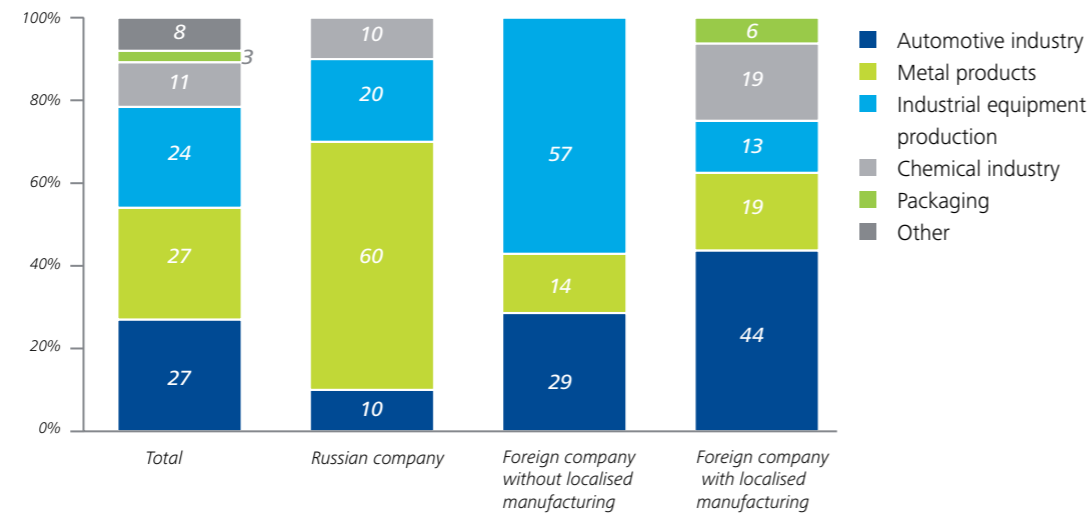
### Industry sectors

According to the survey results, the main business areas in the manufacturing market are as follows:

- Automotive
- Metal products (end products)
- Heavy industry
- Consumer goods industry
- Trade and services

Russian companies are typically metal producers (60%) with the automotive sector dominated by foreign companies with local manufacturing content (44%).

Industry sectors by ownership type (number of companies responding)



### Strategy horizon

The majority of companies surveyed – 62% -- have medium-term strategies (3-5 years):

- the number of such companies rose between our survey periods, when the crisis deepened in Russia.

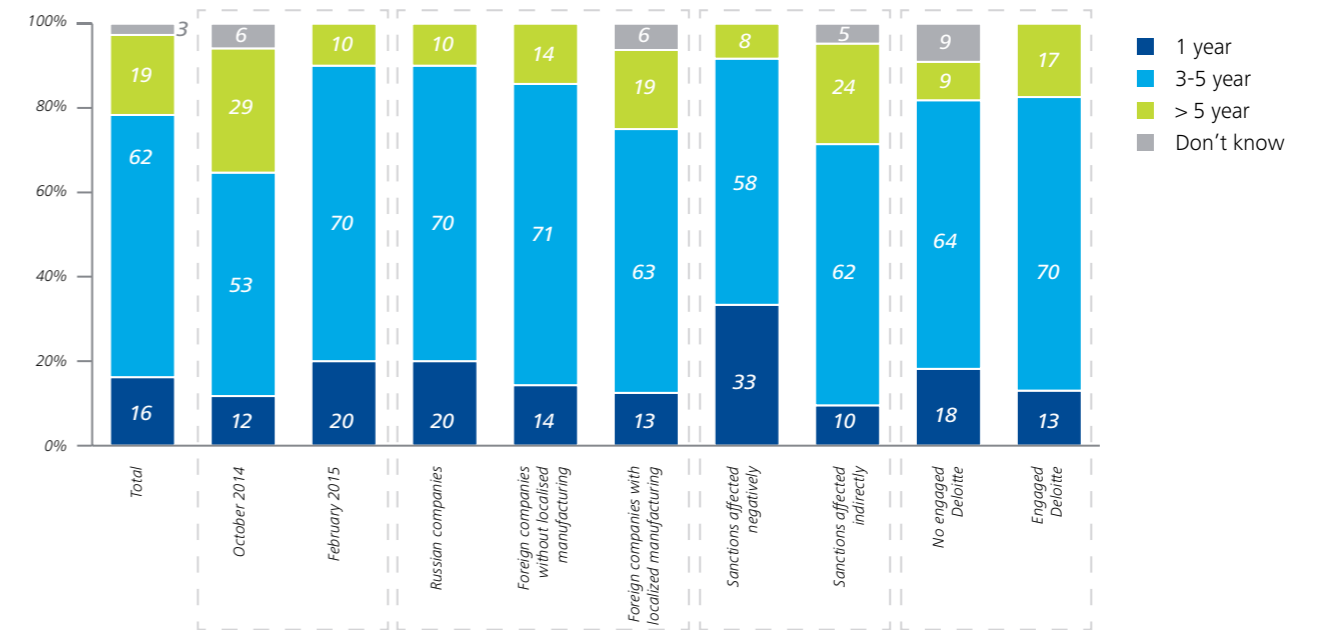
19% of companies have long-term strategies (over 5 years):

- the number of such companies fell between our survey periods that supports economically logical reaction to global economic and political situation – companies tend to design their strategies for shorter terms during times of economic uncertainty.

16% of companies have short-term strategies (1 year).

Please note that the share of such organisations is twice as big among companies that have suffered the most negative consequences of the sanctions (33%).

### Strategy horizon in different subgroups



### Applying of predictive analytics

Every second manufacturing company (51%) in our survey uses predictive analytics. Among these respondents the most popular is predictive modelling (84%), with SAP being the most common software (72%).

Predictive analytics are not used by 35% of the market, with 61% of these respondents having no plans to implement such analytics and 39% declaring an intention to employ such practices in the future.





# Russia's competitiveness in the global manufacturing market

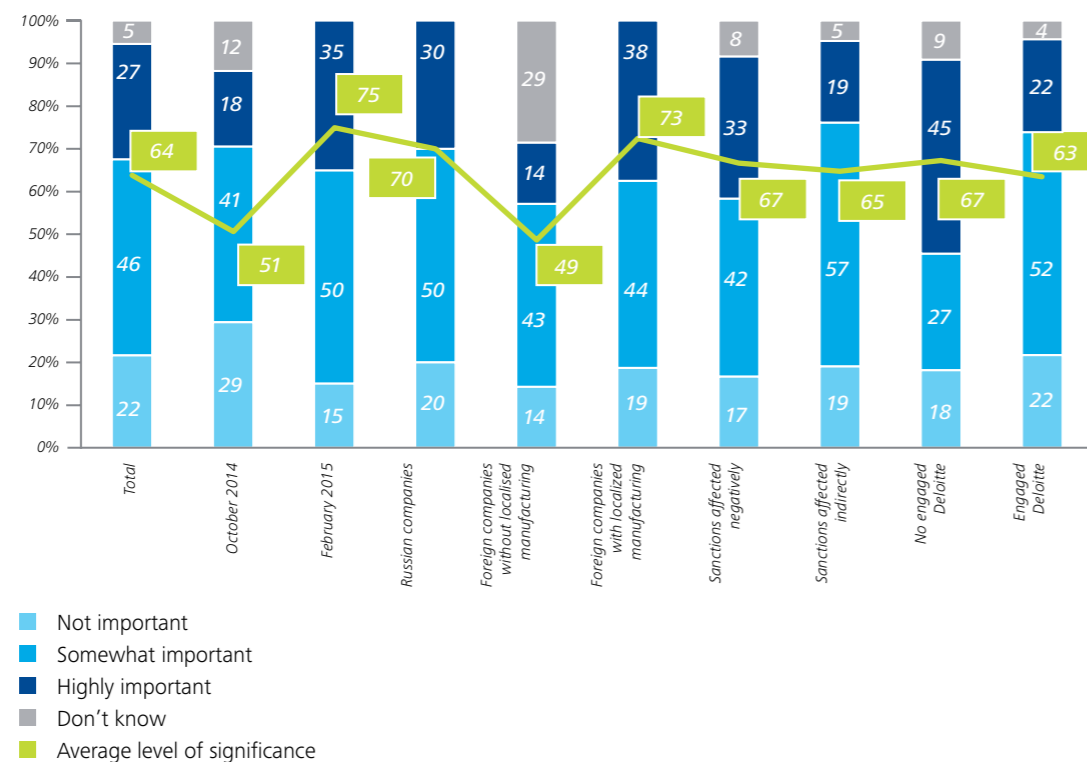
## Loan refinancing

Most companies in our survey consider loan refinancing very important (73%). The issue appears to be more relevant to those companies experiencing greater effects from the crisis; thus, the average level of relevance of loan refinancing rose by half from October 2014 to February 2015. Notably, the loan refinancing issue is important for both Russian and foreign companies, with a greater degree of importance specifically for foreign companies with local manufacturing content (73%) and those

companies that have not been clients of Deloitte (the latter group had the highest share, 45%, of those who rate the issue 'extremely important').

Finally, foreign companies had the highest share of refinanced loans, with 46% of them declaring that all their loans had or would be refinanced in the nearest future. Russian companies' refinanced loans do not exceed 50% of total loans (one third of the companies refinanced up to 20% loans, another third is refinancing 20%-50%).

## Importance of loan refinancing



## Factor analysis

The data was collected in two periods: 14 October 2014 (questionnaire at a Deloitte event) and December / February 2014-2015 (online survey). The international economic and political situation experienced radical changes during that period, therefore the analysis included the data collection periods as criteria.

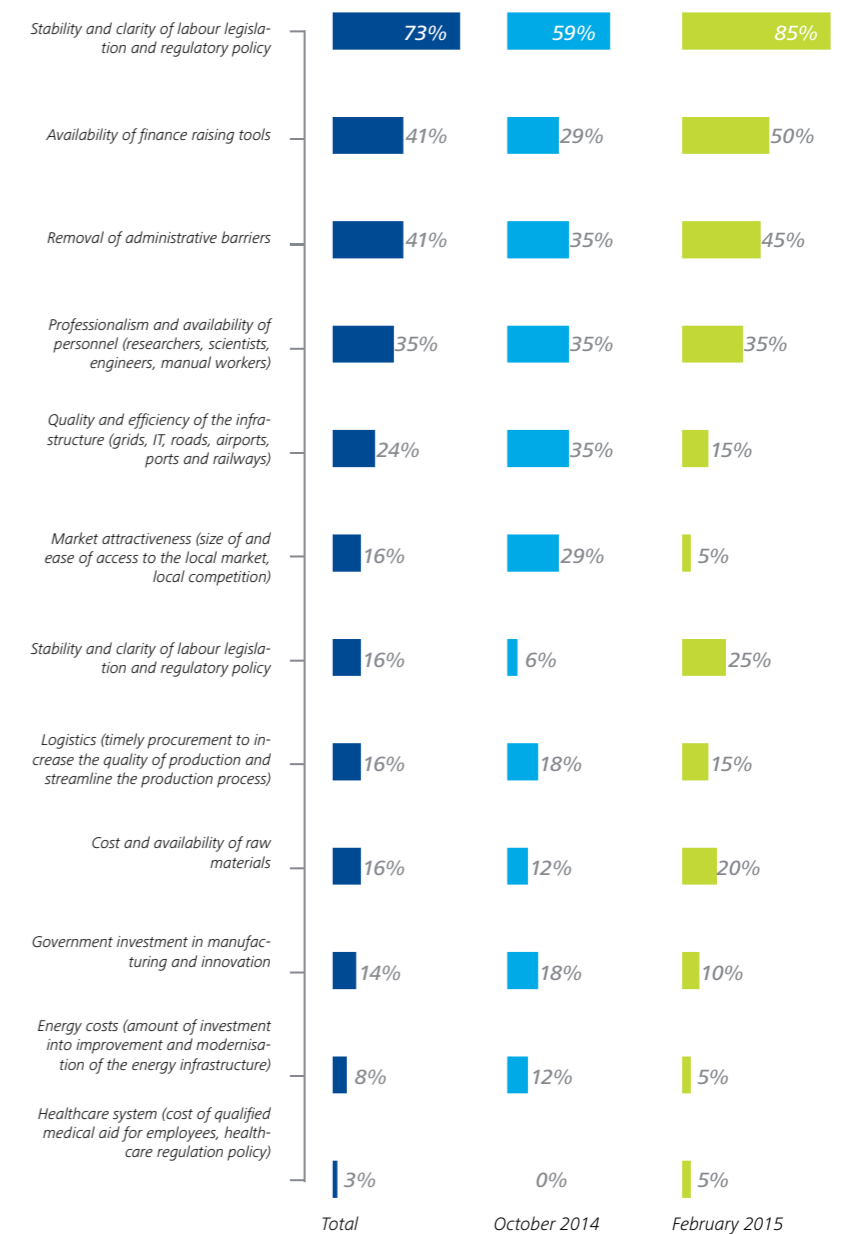
### The top five key factors cited for improving Russia's competitiveness in the global manufacturing market:

- 73% – Stability and clarity of labour legislation and regulatory policy
- 41% – Availability of finance raising tools
- 41% – Removal of administrative barriers
- 35% – Professionalism and availability of personnel
- 24% – Quality and efficiency of infrastructure

### Key trends

- The factor 'Stability and clarity of labour legislation and regulatory policy' grew rapidly in significance between the survey periods (given the financial crisis environment) (19% rise);
- Foreign companies without local manufacturing content in Russia believe that Russian development in the global market is driven by governmental investments in manufacturing and innovation (43%);
- Companies that have engaged Deloitte highly rate the importance of stability and unambiguity of labour laws and regulatory policy (26%).

## Rating of factors in Russia's competitiveness in global manufacturing



# Companies competitiveness in Russian manufacturing market

## Factor Analysis

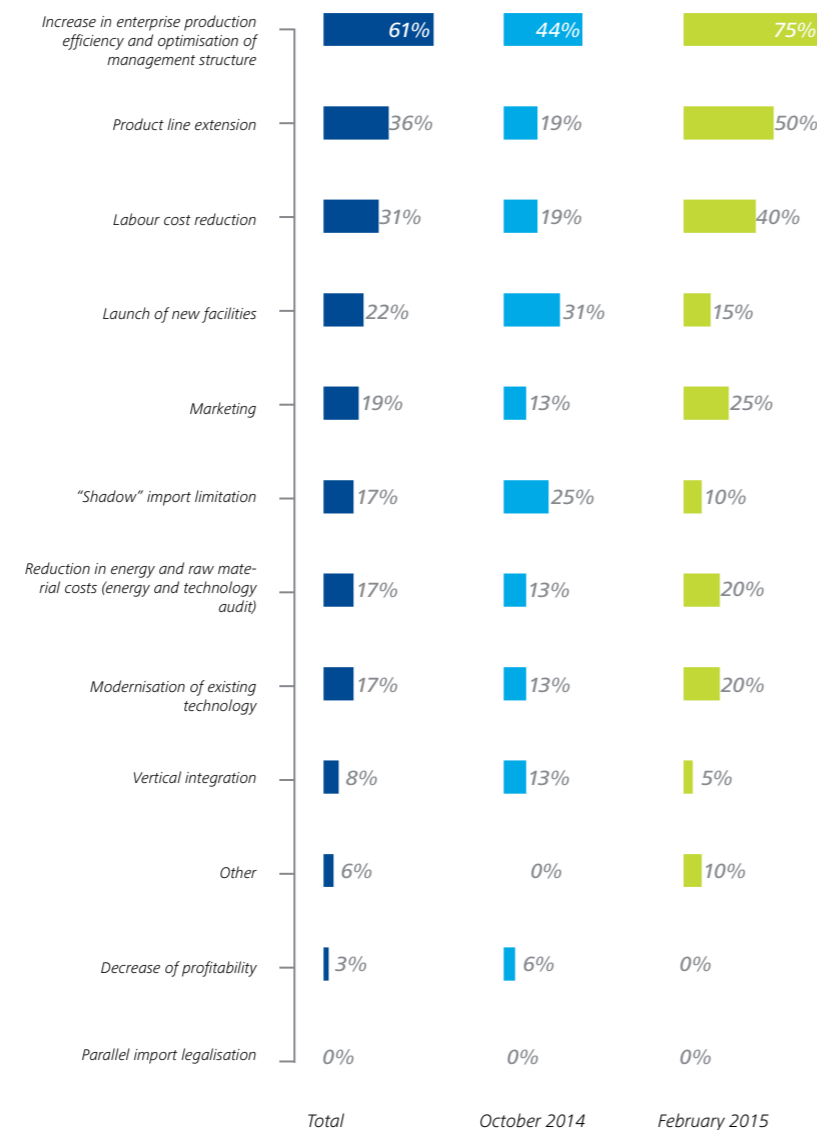
### The top three factors for improving a company's competitiveness in Russia:

- 61% — Increase in production efficiency and optimisation of management structure
- 36% — Product line extension
- 31% — Labour cost reduction

### Key trends

- The 'Product line extension' factor grew rapidly in significance between survey periods (given the financial crisis environment) (31 percentage point rise);
- Russian companies see prospects for upgrading current technology (56%) and optimising the costs of energy and raw materials (44%);
- Foreign companies without local manufacturing content in Russia believe that business development will be driven by labour cost cuts (57%) and marketing (43%);
- Foreign companies with local manufacturing content in Russia highly rate the advantages of 'shadow' import limitations (25%);
- Companies that have engaged Deloitte stand out for the high value they place on expanding the range of products (46%) and marketing activities for business development (27%).

## Rating of factors in manufacturing companies' competitiveness in Russia



# Company strategy in the Russian manufacturing market

## Factor Analysis

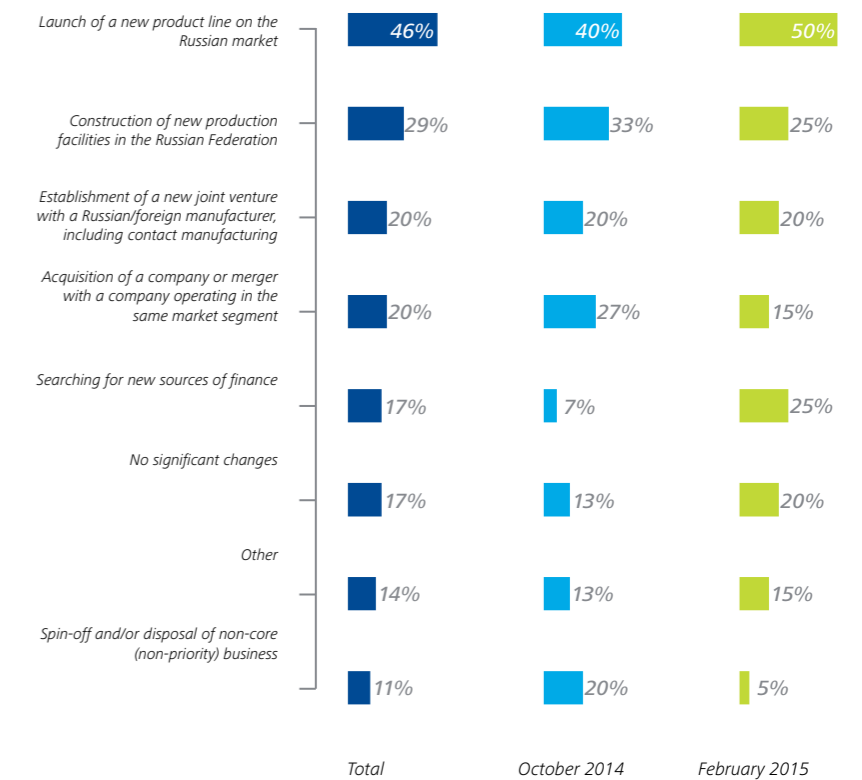
### The top three strategies for manufacturing companies' development in Russia:

- 46% – Launch of a new product line on the Russian market
- 29% – Construction of new production facilities in the Russian Federation (RF)
- 20% – Establishment of a new joint venture with a Russian / foreign manufacturer, including contact manufacturing

### Key trends

- The 'Searching for new sources of finance' factor grew rapidly between the survey periods (given the financial crisis environment) (18 percentage point rise);
- Russian companies are most likely to plan new production build-up in the RF (50%);
- Foreign companies without local manufacturing content in Russia are more likely than others to establish a joint venture with a Russian manufacturer, including contract production (27%);
- Foreign companies with local manufacturing content in Russia are more likely than others to follow a stable strategy without significant changes (by 19%);
- Companies that have engaged Deloitte are most likely to plan an acquisition or partnership with a company operating in the same market segment (by 17%).

## Russian manufacturing companies' rating of strategies



# Attitude to employee qualification

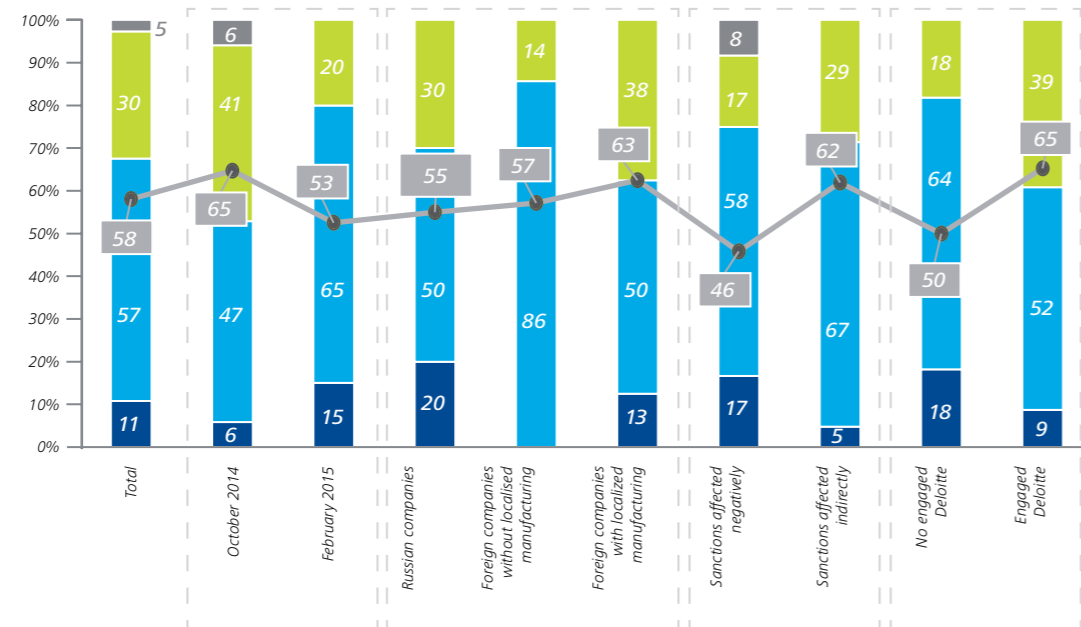
## Manual workers

- The respondents has higher satisfaction with the qualifications of blue collar workers (58%) than with the qualifications of other employees;
- The blue collar category is more vulnerable to external

changes than others — it is these employees who are affected by the dissatisfaction of the manufacturing sector representatives in a crisis environment (employee qualification satisfaction decreased 12 percentage points by the December 2014 / February 2015 survey).

Level of manual workers qualification

- Dissatisfied
- Somewhat satisfied
- Satisfied
- Don't know
- Average level of qualification contentment



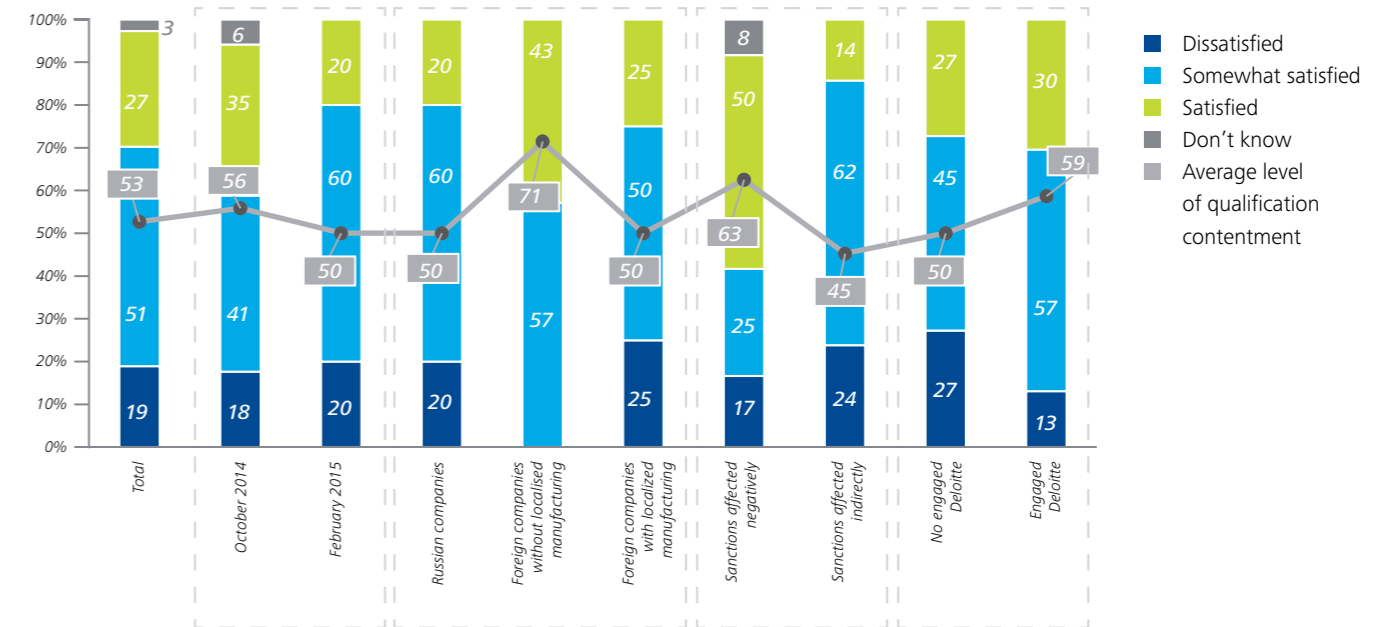
## Researchers, scientists, engineers

- The target audience's level of satisfaction with the qualifications of researchers, scientists and engineers is 53%;
- Foreign companies without local manufacturing content show a higher level of satisfaction with the work of this category of employees (71%) (the majority of these employees are likely to work at a production localisation site that is not located in Russia).

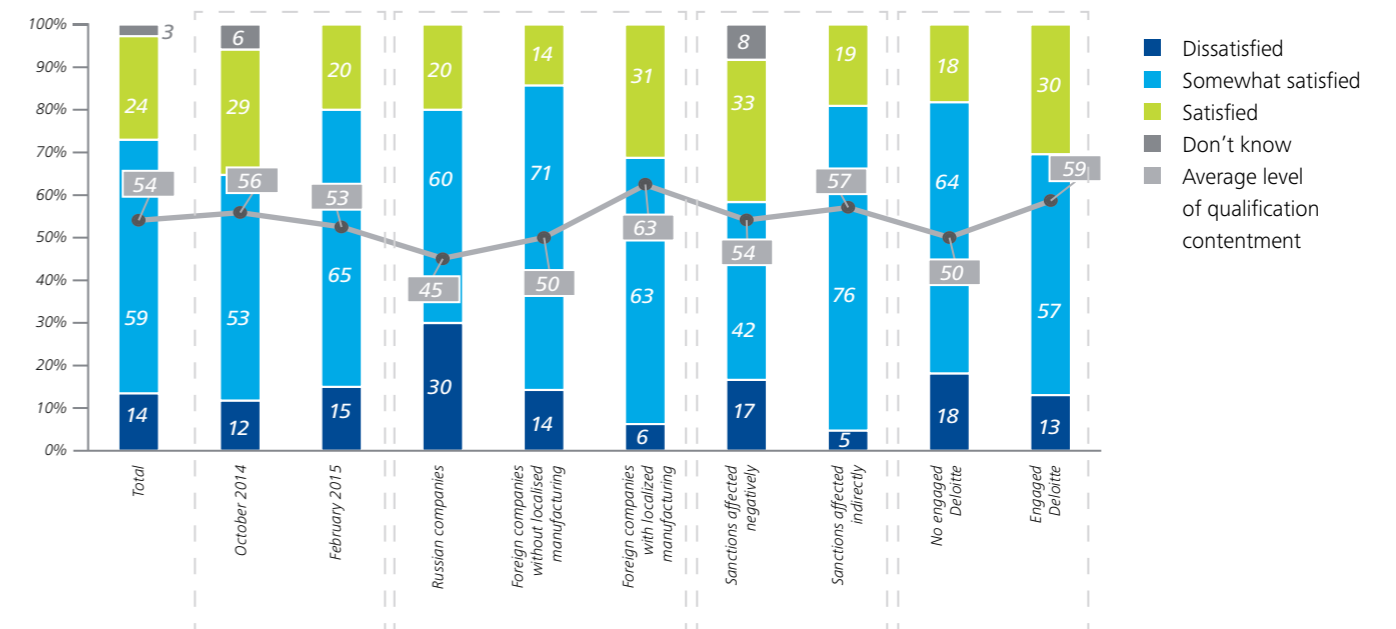
## Management

- The target audience's satisfaction with the qualifications of managerial staff is 54%;
- Foreign companies with local manufacturing content in Russia show a higher level of satisfaction with the work of this category of employees (63%).

Level of satisfaction with researcher, scientist and engineer qualifications



Level of satisfaction with management qualifications

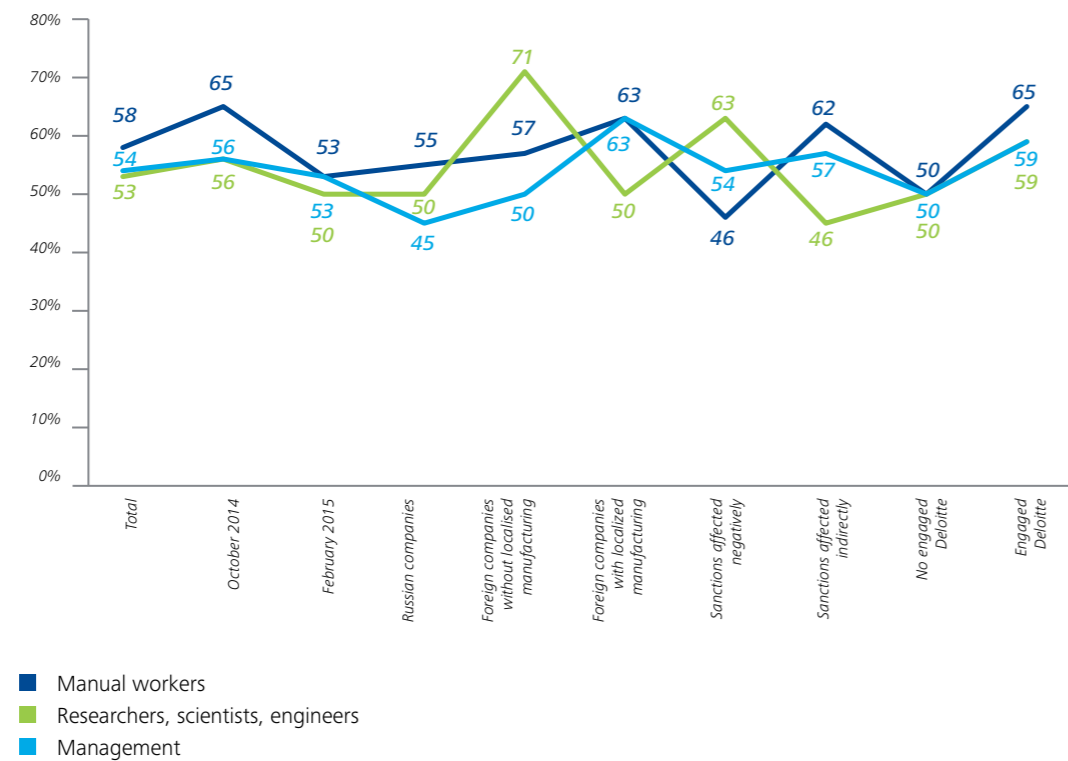


# Reaction to geopolitical and currency risks

## Integrated results (employees overall)

Representatives of companies that have been clients of Deloitte have a higher level of overall satisfaction with the qualifications of their employees. In particular, their satisfaction is higher in regard to the qualifications of the blue collars (65%).

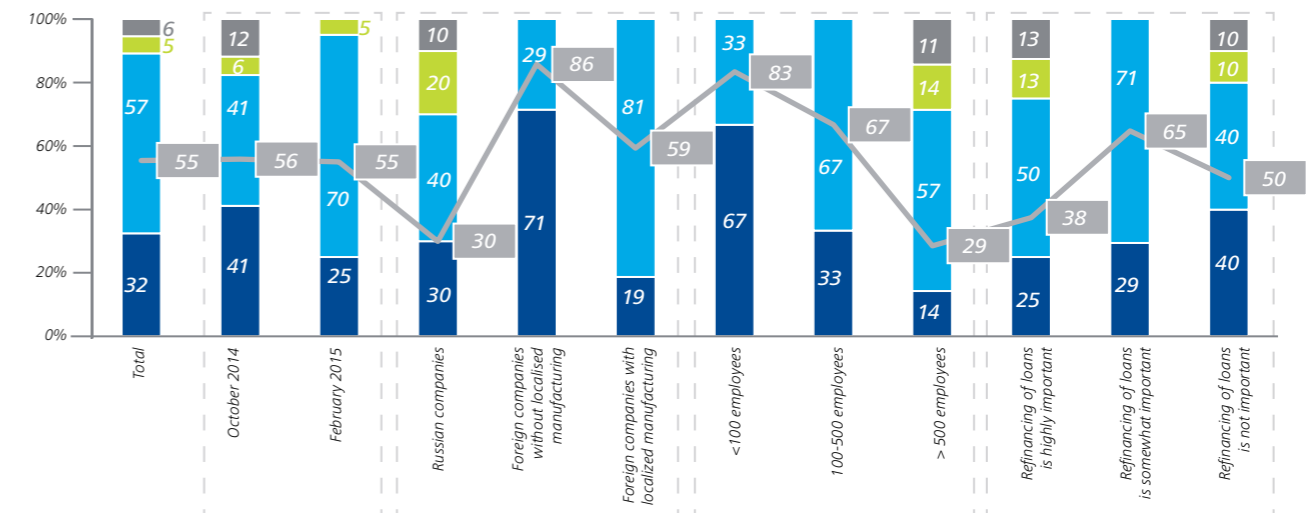
## General level of satisfaction with manufacturing employee qualifications



## The U.S. and EU sanctions effect

- The market average level of negative effects from sanctions is 55% (the average level of discomfort in the market due to the sanctions);
- The highest level of discomfort is being experienced by foreign companies without local manufacturing content (86%), small companies (83%) and companies with short-term (1 year) strategies (83%).

## Share of manufacturing companies in Russian market impacted by sanctions



## Restricted access to external sources of financing due to sanctions

- In general, the external funding resource issue is contentious – 46% of respondents say their companies have suffered a negative effect, while the same percent expressed the opposite opinion of no negative effect.
- Russian companies are most likely to feel a negative effect (70%), as well as large companies with over 5,000 employees (57%), medium-term (3-5 year) strategy companies (57%), companies requiring taxation and other financial incentives from the government, and those who use predictive analytics (63%).

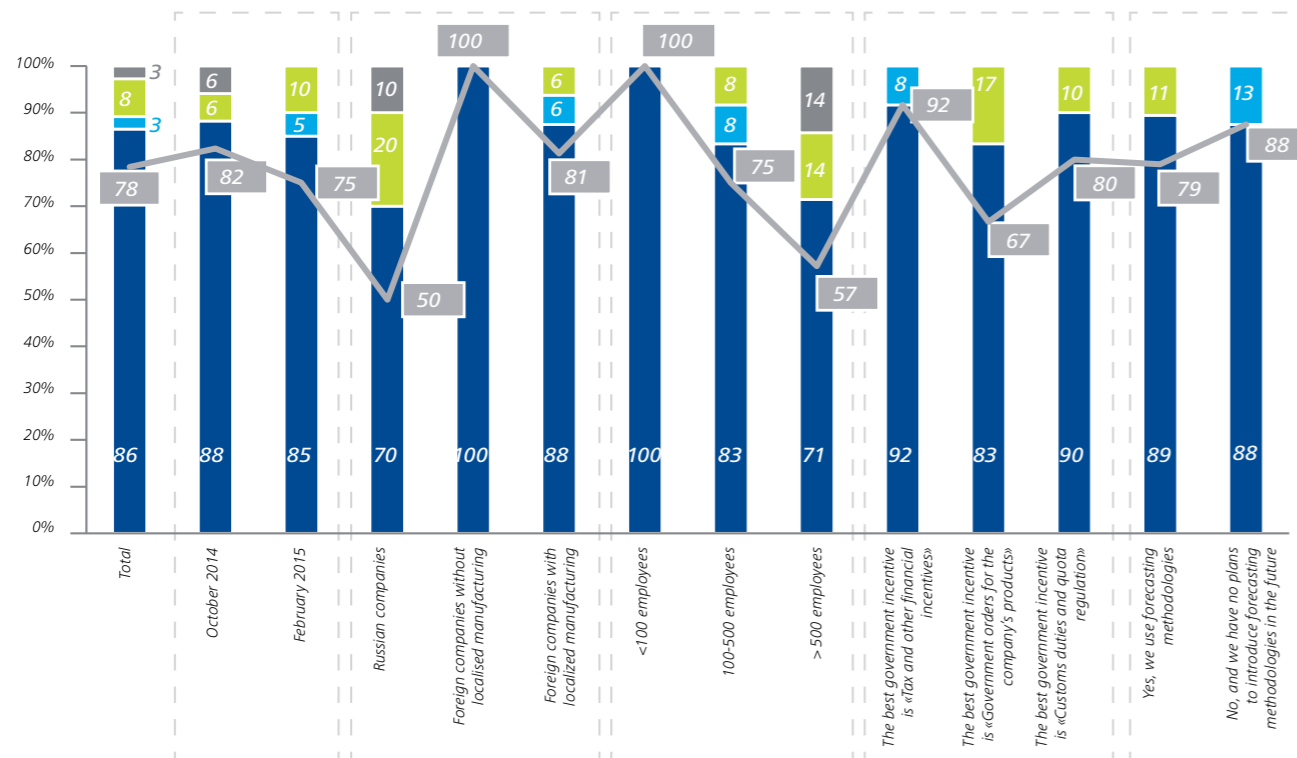
- Direct negative effect from the sanctions
- Indirect effect from the sanctions, but your company is aware of possible negative consequences in the near future
- Your company expects to benefit from the current political situation
- Don't know
- Average negative effect

# Expectations of government support

## Currency risk

- Currency exchange rate changes have a negative effect on the vast majority (86%) of respondents;
- The negative effect is slightly smaller (but still dominating) in regard to Russian companies, 20% of which stated that currency exchange rate changes had a positive effect for their business.

Share of manufacturing companies in Russia impacted by currency fluctuations



- Negative effect of currency exchange rate
- No effect of currency exchange rate
- Positive effect of currency exchange rate
- Don't know
- Average negative effect of currency exchange rate

## Rating of government support measures

### First place: Tax and other financial incentives (32%).

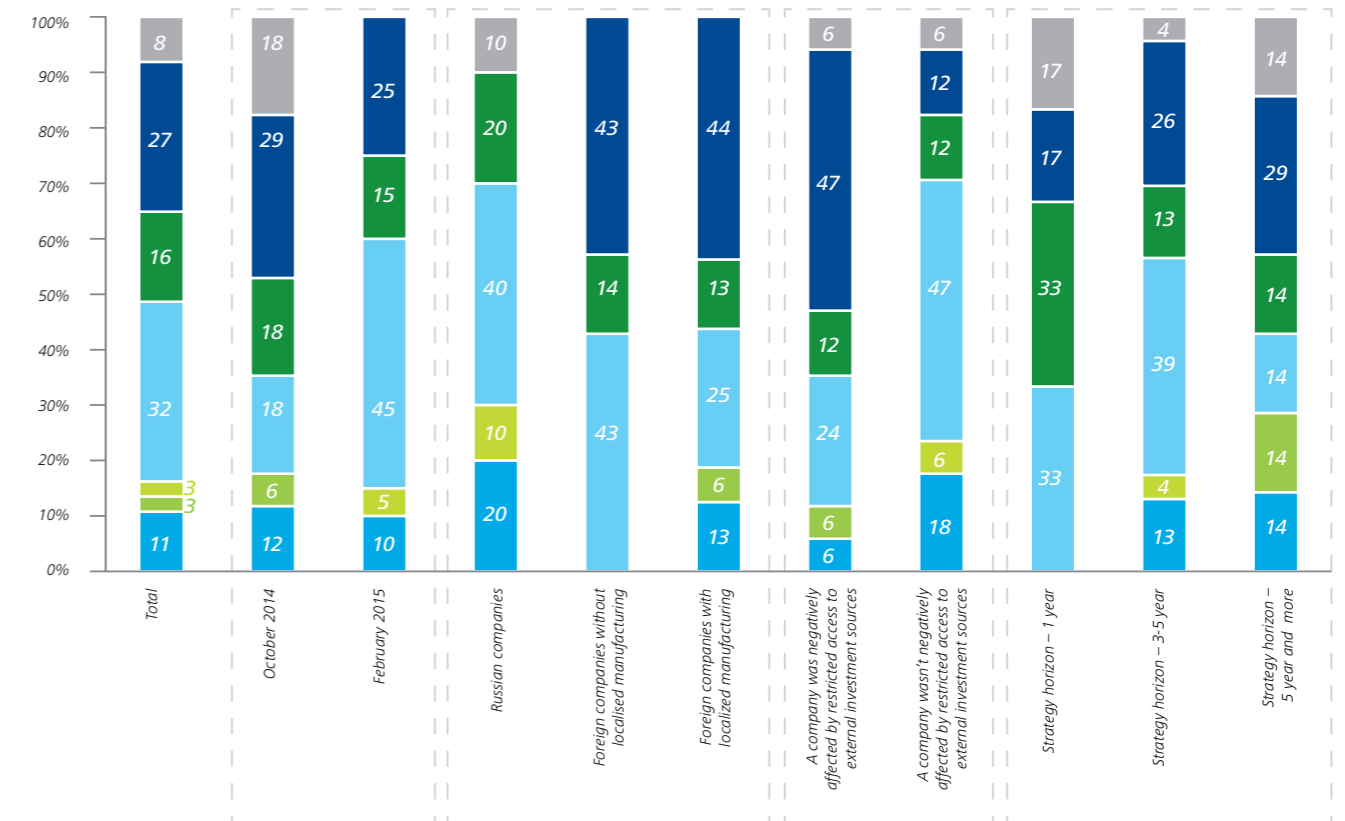
- This form of business support rose in priority as the crisis deepened (the percentage of those who selected this option during the second phase is 27 pp higher than in the first phase);
- Russian companies and foreign companies without local manufacturing content find government tax and financial incentives more important (40% and 43%, respectively);

### Second place: Customs duties and quotas (27%).

- This form of support is more important for foreign companies (43-44%);
- This form of business support is also interesting for those who suffered a negative effect from limitations on external funding sources (47%).

In conclusion, we note that companies that have engaged Deloitte are most likely to mention the necessity of governmental support preparing a qualified labour force (17%), while companies without experience with Deloitte do not recognise the importance of this area.

Government incentive



- Qualified personnel training
- Support for innovation
- Investment into infrastructure, grants and subsidies
- Tax and other financial incentives
- Government orders for the company's products
- Customs duties and quota regulation
- Don't know



# Measures to reduce energy costs

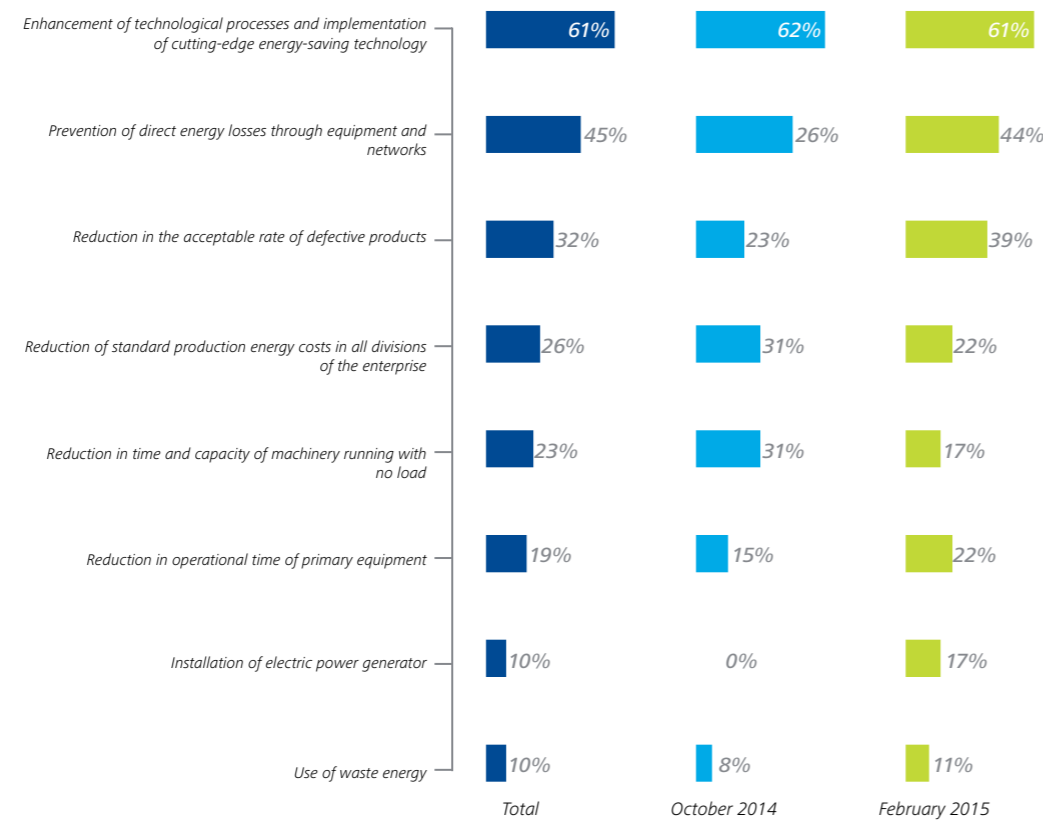
## The top three priority measures to reduce energy costs:

- 61% – Enhancement of technological processes and implementation of cutting-edge energy-saving technology;
- 45% – Prevention of direct energy losses through equipment and networks;
- 32% – Reduction in the acceptable rate of defective products.

## Key trends

- The priority of the measure 'Reducing allowable faulty product volume' grew rapidly between survey periods (16 percentage point rise);
- Foreign companies with local manufacturing content in Russia are more likely than others to plan cost reductions through cutting the allowable volume of defective products (46%);
- Long-term (over 5 years) strategy companies are most likely to plan a reduction in standard production energy costs in all divisions (50%);
- Companies that have engaged Deloitte are most likely to plan minimisation of costs through reducing the operational time of main equipment (32%).

## Rating of measures to reduce energy costs



# Appendix

## Appendix 1.

The first hypothesis for differences between the data from the survey's first phase (industry event) and the second (online survey) supposes structural differences in the target audiences (by company type). However, this theory was not supported as there were no statistically significant differences by company type (see full report, section 'factor analysis by company type').

The second hypothesis for differences between the data from the event and online survey lies in the data collection time period differences, as the event took place on 14 October 2014, and the field stage of the online survey was held during the period from 10 December 2014 to 28 February 2015. It is common knowledge that those periods differ in terms of the degree of financial, political, social and economic instability in the Russian and global markets.

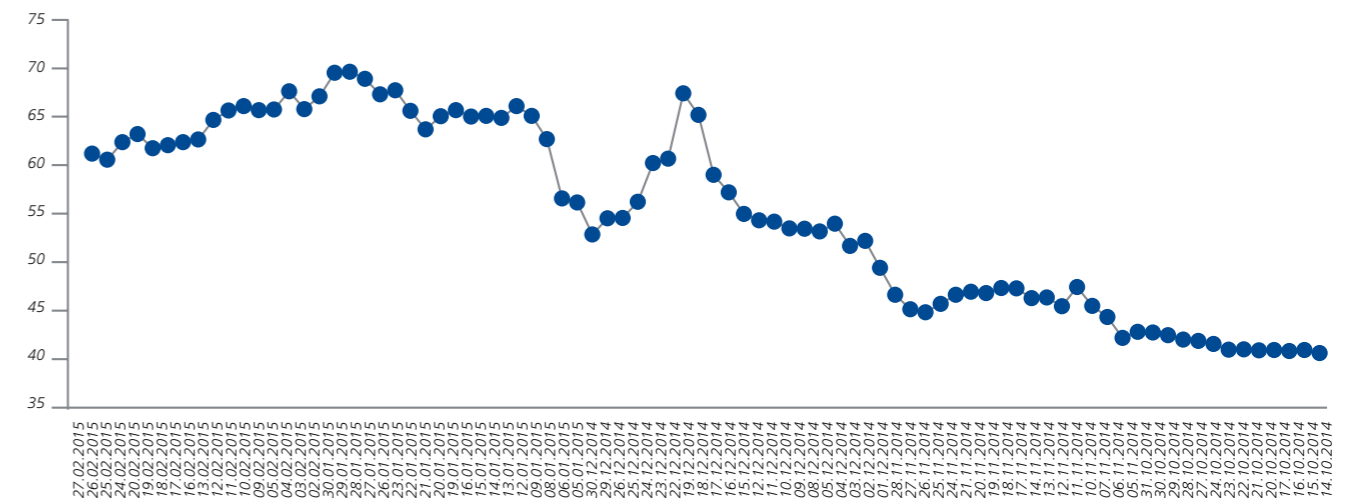
For a complex analysis please see the chart below for the currency exchange rate fluctuation for the period from 14 October 2014 (the date of the event) to 28 February 2015 (the date of the online survey conclusion).

The Central Bank of the Russian Federation specified the USD exchange rate at RUB 40.3251 as at 14 October 2014. As at 10 December 2014 the USD exchange rate was RUB 54.2116.

The first peak day was Tuesday, 16 December 2014, when the USD exchange rate rose by 14% in one day (by 17 December 2014 the USD exchange rate amounted to RUB 67.4157).

The currency risk was coupled with dramatic events on the geopolitical scene – the introduction of sanctions, counter-sanctions and the media frenzy. Considering the above, the results of each block will require a comparative analysis of the two groups of respondents – 'event participants' and 'online survey respondents' – both between each other and with the data selection average.

Dollar exchange rate in roubles for the period from 14 October 2014 to 28 February 2015



**Appendix 2. Comparative analysis between Russian and Deloitte Global Manufacturing Research (global data from 2013 year)**

Ranking by Deloitte Russia	Deloitte Russia					Deloitte Global		Comparative analysis Global Russia	Deloitte Russia			Deloitte Global					
	Companies	Share of companies (multiple question)	Rating (%), the amount is 100%	Position	Total (in points / 10 scale)	Total (in points / 10 scale)	Position		Russian company	Foreign company without localised manufacturing	Foreign company with localised manufacturing	Germany	U.S.	Japan	China	Brazil	India
Transparency and stability of regulatory, tax and economic policy	27	73%	24%	1	10.00	8.42	2	TOP-3 (more significant in Russia)	10.00	10.00	10.00	7.12	6.83	6.19	5.87	4.84	4.01
Removal of administrative barriers	15	41%	13%	2	5.56			no in Global	6.25	4.00	5.00						
Availability of finance raising tools	15	41%	13%	2	5.56			no in Global	5.00	4.00	6.67						
Professionalism and availability of personnel (researchers, scientists, engineers, manual workers)	13	35%	12%	3	4.81	10.00	1	TOP-3 (less significant in Russia)	2.50	4.00	6.67	9.47	8.94	8.14	5.89	4.28	5.82
Quality and efficiency of the infrastructure (grids, IT, roads, airports, ports and railways)	9	24%	8%	4	3.33	6.47	6	"+2 positions" (more significant in Russia)	5.00	0.00	2.50	9.82	9.15	9.07	6.47	4.23	1.78
Cost and availability of raw materials	6	16%	5%	5	2.22	8.07	3	"-2 positions" (less significant in Russia)	2.50	0.00	2.50	3.29	3.97	2.59	10.00	6.70	9.41
Logistics (timely procurement to increase the quality of production and streamline the production process)	6	16%	5%	5	2.22	7.76	4	"-1 position" (less significant in Russia)	2.50	4.00	1.67	8.96	8.64	8.03	8.25	4.95	4.82
Stability and clarity of labour legislation and regulatory policy	6	16%	5%	5	2.22	7.60	5	5 (the same with Global)	1.25	4.00	1.67	9.06	8.46	7.93	3.09	3.80	2.75
Market attractiveness (size of and ease of access to the local market, local competition)	6	16%	5%	5	2.22	3.99	8	"+3 positions" (more significant in Russia)	2.50	2.00	1.67	7.26	7.60	5.72	8.16	6.28	5.90
Government investment in manufacturing and innovation	5	14%	4%	6	1.85	1.00	10	"+4 positions" (more significant in Russia)	0.00	6.00	1.67	7.57	6.34	6.80	8.42	4.93	5.09
Energy costs (amount of investment into improvement and modernisation of the energy infrastructure)	3	8%	3%	7	1.11	6.25	7	7 (the same with Global)	1.25	0.00	1.67	4.81	6.03	4.21	7.16	5.88	5.31
Healthcare system (cost of qualified medical aid for employees, healthcare regulation policy)	1	3%	1%	8	0.37	2.48	9	"+1 position" (more significant in Russia)	1.25	0.00	0.00	9.28	7.07	8.56	2.18	3.33	1.00

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