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## Russian manufacturing industry overview

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## Introduction

Deloitte CIS thanks all those who participated in the survey that we conducted in February 2016 as part of our research entitled «Current State and Outlook for the Manufacturing Sector in Russia – 2016». We appreciate the time you shared and your interest in our research. Your expert opinions enabled us to conduct an integrated analysis of the state of the manufacturing sector in Russia, as well as to study the sentiments and expectations of the participants regarding the prospects for their own companies' development and the market overall.

We are pleased to present you with the full version of the report. The key findings of our research are to be published by leading Russian media outlets.

We have been conducting this survey annually since 2015. It serves as the basis for our integrated research on the state of the manufacturing sector in Russia. We would be grateful if you would participate in our next survey.

Please feel free to contact us if you have any questions about our research.

### Main topics:

- Current state of the Russian manufacturing sector/ companies
- Outlook for the Russian manufacturing sector/companies
- Key issues Russian manufacturing companies face
- Key stimuli and barriers for development of the Russian manufacturing sector/companies
- Priority strategies for manufacturing companies in Russia
- Influence of recent world events
- Influence of currency risks: risk management and impact
- Changes in policies on working with suppliers
- Government support measures for manufacturing companies in Russia

*Deloitte CIS wishes to express its gratitude to the Russian Managers Association for their assistance in the interviews of experts as part of our annual research project, the Russian Manufacturing Survey.*

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Our analysis shows that in early 2016, the opinions among our respondents regarding the overall condition of the manufacturing sector in Russia are divided: whereas 50 percent of the respondents have negative views on the current market conditions, the other 50 percent finds them quite favourable for further business development.

We note that in view of the current conditions, foreign companies with localised production as well as manufacturers of metal and engineering products are experiencing more difficulties (the share of negative views in these segments is higher than the average by 27 and 17 percentage points, respectively).

The opposite trend can be observed among representatives of smaller companies (with up to RUB 10 billion of annual revenue) – where the share of positive views on the current market situation is 20 percentage points higher than the average.



76%

Respondents generally describe the current state of their own manufacturing companies in Russia as being positive: the total positive response rate is 76 percent.

The lion's share of negative assessments of the companies' current positions comes from industrial equipment manufacturers, with 33 percent of them holding negative views.

Large companies (with at least 1,000 employees) are more concerned about challenges facing today's business environment than smaller companies (by 10 percentage points).



57%

The expectations regarding the prospects for the manufacturing sector in 2016 are fairly positive: 57 percent of the respondents expect improvements or no changes

Companies in the chemical industry and companies with total revenue of RUB 10-50 billion are more optimistic about improvements in 2016 (by 12 and 9 percentage points, respectively).

The opposite trend can be observed among metal product manufacturers (the share of negative expectations is 14 percentage points higher than the average) and foreign companies with localised production (the share of negative expectations is 6 percentage points higher than the average).



88%

The expectations regarding the prospects for individual companies in 2016 are very positive: 88 percent of the respondents expect improvements or no changes for their companies, provided the current positive assessment of the market conditions.

The share of positive expectations for their businesses in 2016 is significantly higher among chemical industry representatives (by 22 percentage points) and companies with revenue of RUB 10-50 billion (37 percent).

Vehicle producers (including aircraft and shipbuilding) appear to be less optimistic: the share of such companies expecting business conditions to worsen is 10 percentage points higher than the average.

Pessimistic views are also more common among foreign companies with localised production in Russia than among Russian companies (by 14 percentage points).

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## Top-5 factors affecting market development:

- Currency risk reduction
- Availability of financing options
- Geopolitical risk reduction
- Government support
- Clear and stable regulatory, tax and economic policy



## Rapprochement between Russia and the other BRICS countries has had a positive effect on the development of manufacturing in Russia, according to 70 percent of respondents.

The share of respondents who are optimistic about their business as a result of the rapprochement between Russia and the other BRICS countries is slightly higher among larger companies (over RUB 50 billion of annual revenue), by 5-7 percentage points.

Chemical industry representatives are less optimistic about the rapprochement between Russia and the other BRICS countries: 25 percent of these respondents note negative effects from the development of relations between Russia and the other BRICS countries.



## Top-3 effects of rouble devaluation:

- Product cost increase
- Increased competitiveness due to international sales in a foreign currency
- Product cost reduction



## Top-4 drivers of company development:

- Local demand growth
- Reduction in production costs (including energy resources)
- Availability of financing sources
- Enhancing the production base (launch of new facilities)



## The development of Chinese manufacturing affects 68 percent of manufacturing companies in Russia and 56 percent of these respondents note a negative effect.

In general, the development of Chinese manufacturing has a greater impact on large manufacturing companies (by 25 percentage points).

The negative effect of Chinese manufacturing is higher among foreign companies with localised production in Russia (by 16 percentage points).

Positive assessments of the impact of Chinese manufacturing on business are more common among vehicle and chemical producers (by 26 and 20 percentage points, respectively).



## Top-4 issues for manufacturing in Russia:

- Currency risks (rouble depreciation)
- Shortcomings of government regulation (administrative, trade, economic and other barriers)
- Geopolitical risks (EU sanctions, Russian embargo, etc.)
- Insufficient government support and financing



## Top-6 priority development strategies in 2016:

- Entry onto new markets
- Enhancing the production potential (launch of new facilities/increase in output)
- Organic growth
- Bringing new products to the market
- Investments in personnel development
- Cost reduction in Russia

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## Top-4 currency risk management methods:

- Rouble-denominated loans
- Hedging
- Inserting an exchange clause in contracts (fixing prices for finished goods in a currency other than the contract currency)
- Accumulating reserves (inventories, raw materials, finished goods and capital)



## The issue of loan refinancing decreased in significance by 13 percentage points from the previous year.

Compared to the other surveyed sectors, the issue of loan refinancing is of greater significance to metal product manufacturers (by 19 percentage points) and vehicle producers (by 15 percentage points).



## The most attractive source of financing is internal (66 percent).

Chemical and industrial equipment producers are more oriented towards internal financing than other sectors (88 percent and 83 percent, respectively).



## Top-5 government measures in Russia's manufacturing sector positively affecting business development:

- Innovation support
- Intellectual property protection law
- Subsidies
- Health and safety policy
- Public procurement participation terms



## The attractiveness of Russian investment for business support and development is 21 percentage points higher than the attractiveness of foreign investment.

Vehicle producers, including aircraft engineering and shipbuilding, are more interested in attracting Russian and foreign investment (by 15 and 25 percentage points, respectively).

Chemical industry representatives are more focused on attracting direct foreign investment (by 21 percentage points).

Companies with long-term strategies for business development (over five years) are generally focused on external financing: 76 percent of them plan to attract Russian investment in the near future.



## Top-3 government measures in Russia's manufacturing sector negatively affecting business development:

- Monetary policy of the Central Bank of Russia
- Energy policy (energy tariffs)
- Economic and fiscal policy



## Top-3 forms of government support for manufacturing companies in Russia:

- Tax and other benefits
- Investments in physical infrastructure, grants, subsidies
- Innovation support

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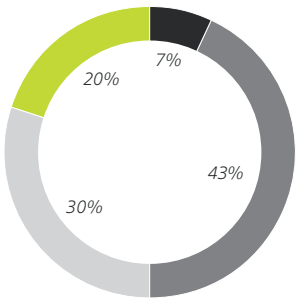
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# State of the manufacturing sector in Russia

## Current state and outlook for the manufacturing sector

### Current state of the manufacturing sector in Russia



■ Positive  
■ Somewhat positive  
■ Somewhat negative  
■ Negative

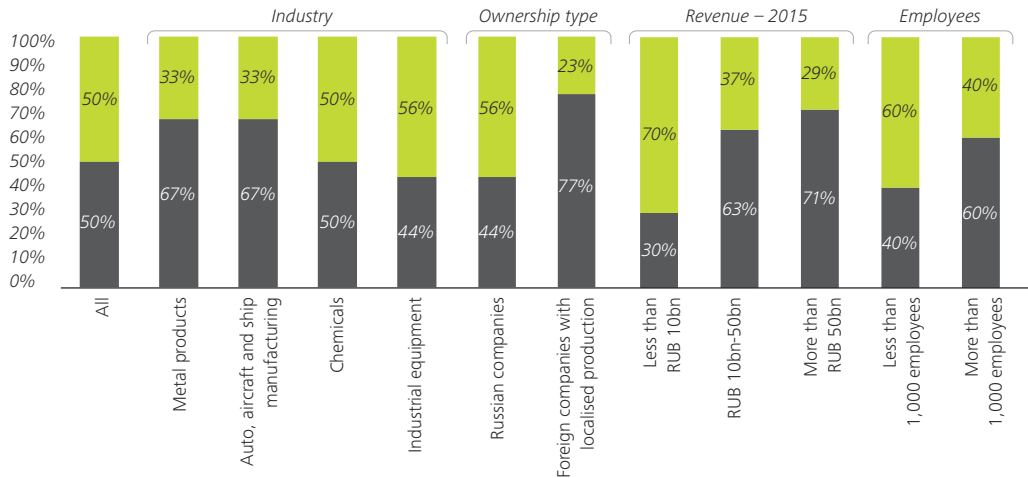
#### Trends

- Opinions on the current condition of the manufacturing sector in Russia are divided: 50 percent of respondents view the current market conditions as positive, while the other half hold negative views.
- This indicates that the conditions for conducting business have noticeably diverged in various segments of the manufacturing sector in Russia.

#### Characteristics

- Negative sentiments are highest among foreign companies with localised production in Russia. Such companies negatively assess the current conditions in the manufacturing sector in Russia at a rate of 77 percent.

- Manufacturers of metal (including machine-building) also display negative views at 17 percentage points higher than the average.
- A significantly greater level of optimism can be seen among representatives of smaller companies (annual revenues under RUB 10 billion) at 20 percentage points higher than the average. Larger companies most often negatively characterise the current conditions in the manufacturing sector in Russia (63-71 percent). This outcome corresponds to the difference in assessments depending on a company's headcount: the level of optimism among companies with less than 1,000 employees is 20 percentage points higher than those of companies with more than 1,000 employees.



■ Positive  
■ Negative

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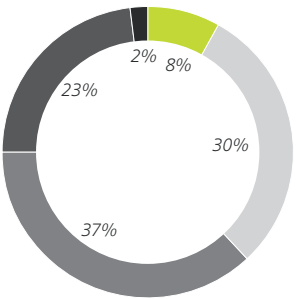
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# State of the manufacturing sector in Russia

## Current state and outlook for the manufacturing sector

### Outlook for the manufacturing sector in Russia in 2016



Will improve  
Likely to improve  
No significant changes  
Likely to worsen  
Will worsen

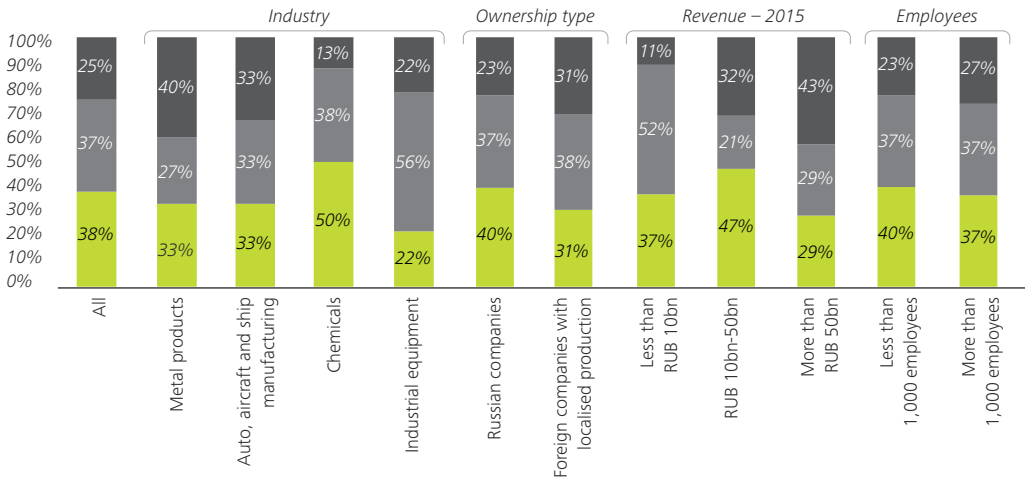
#### Trends

- The fairly high level of optimism in the manufacturing sector in Russia allows us to conclude that those not expecting significant changes also have positive sentiments.
- For instance, 75 percent of respondents do not expect conditions to worsen, while half of these even expect improvements.
- Every fourth respondent forecasts worsening condition

#### Characteristics

- Chemical industry representatives most often speak of an improvement in the Russian manufacturing sector in 2016 (50 percent).

- The opposite trend is seen in metal product manufacturers, who expect worsening conditions at a rate 14 percentage points higher than the average.
- Foreign companies with localised production also expressed negative expectations at a rate 8 percentage points higher than Russian companies.
- Manufacturing companies with revenues from RUB 10-50 billion more often expect improvements (47 percent), while companies with annual revenues higher than RUB 50 billion expect worsening conditions. This outcome correlates with the earlier identified trend of more favourable sentiments coming from smaller companies.



Will improve  
No significant changes  
Worsen

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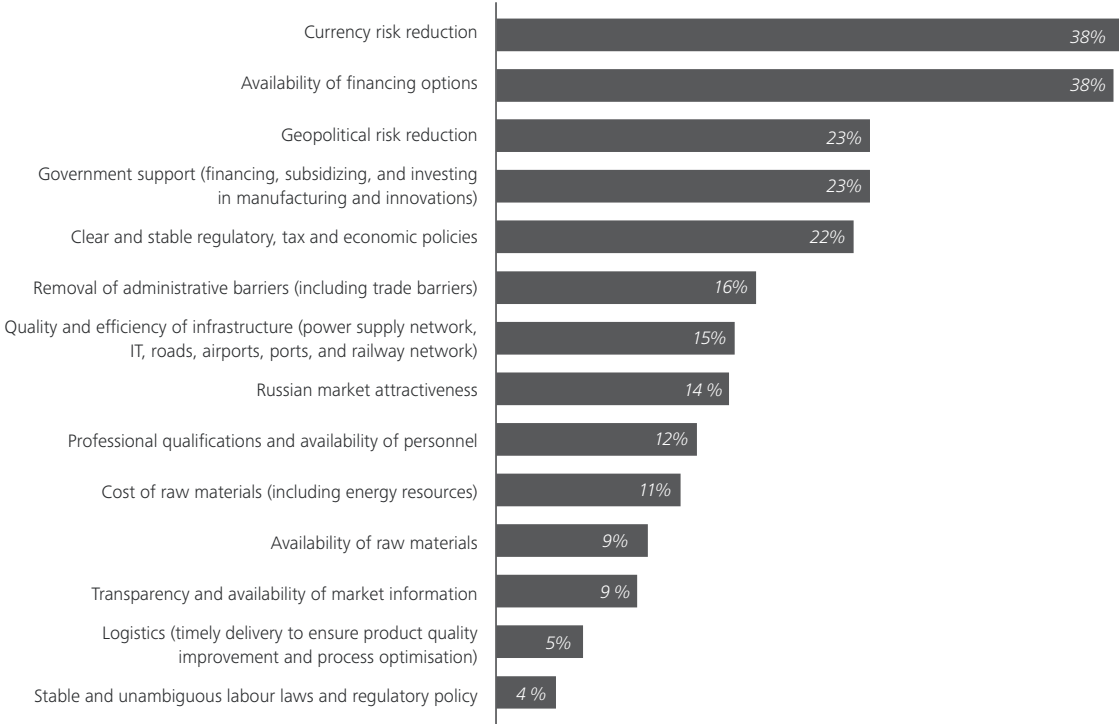
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# State of the manufacturing sector in Russia

## Current state and outlook for the manufacturing sector

### Rating of competitive factors affecting market development



### Trends

#### Top-5 factors stimulating market development:

- Currency risk reduction
- Availability of financing options
- Geopolitical risk reduction
- Government support
- Clear and stable regulatory, tax and economic policies

### Characteristics

- A reduction in currency risks is rated as having the greatest influence on the Russian manufacturing market's development by industrial equipment producers (62 percent). Meanwhile, chemical industry companies cited a reduction in currency risks at a rate of only 10 percent.
- Availability of financing is most significant for metal product producers (51 percent).
- Demand for government stimulus for developing the manufacturing sector in Russia is most prevalent among vehicle producers (including aircraft and shipbuilding), as well as industrial equipment producers (44 and 48 percent, respectively).
- Transparency and stability of regulatory, tax and economic policy was rated to a higher degree by chemical and vehicle producers (43 and 40 percent, respectively).
- The significance of factors such as worker qualifications and availability as well as transparency and availability of market information (as stimuli for manufacturing market development in Russia) for metal product producers is twice higher than the average (24 and 19 percent, respectively).
- Chemical producers are more sensitive to raw material prices and the quality and efficiency of infrastructure (by 17 and 13 percentage points, respectively).

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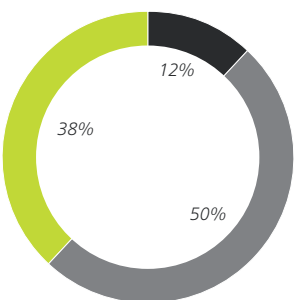
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## Current state and outlook for companies

### Current state of manufacturing companies in Russia



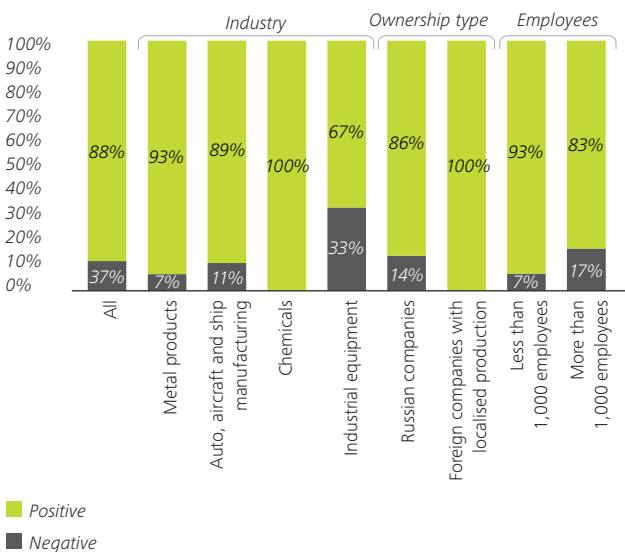
■ Positive  
■ Somewhat positive  
■ Somewhat negative

#### Trends

- In general, the current state of manufacturing companies in Russia may be described as positive: the total positive response rate is 76 percent.
- The majority of survey participants rated the current conditions of their own companies as positive (88 percent).
- Every tenth respondent (12 percent) was inclined toward a more negative assessment of his/her own company's condition.

#### Characteristics

- The lion's share of negative assessments of companies' current conditions comes from industrial equipment manufacturers, with 33 percent of them holding negative views.
- The opposite trend (the greatest share of positive assessments) comes from chemical producers. Every survey participant from this segment declared their own business to be in positive condition.
- We note that large companies (with at least 1,000 employees) are more concerned about the challenges facing today's business environment than smaller companies (by 10 percentage points).



■ Positive  
■ Negative

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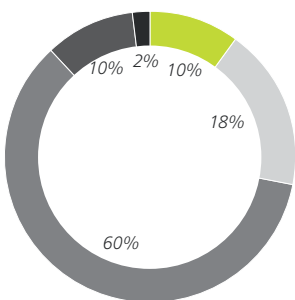
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# State of the manufacturing sector in Russia

## Current state and outlook for companies

### Outlook for companies in 2016



Will improve  
Likely to improve  
No significant changes  
Likely to worsen  
Will worsen

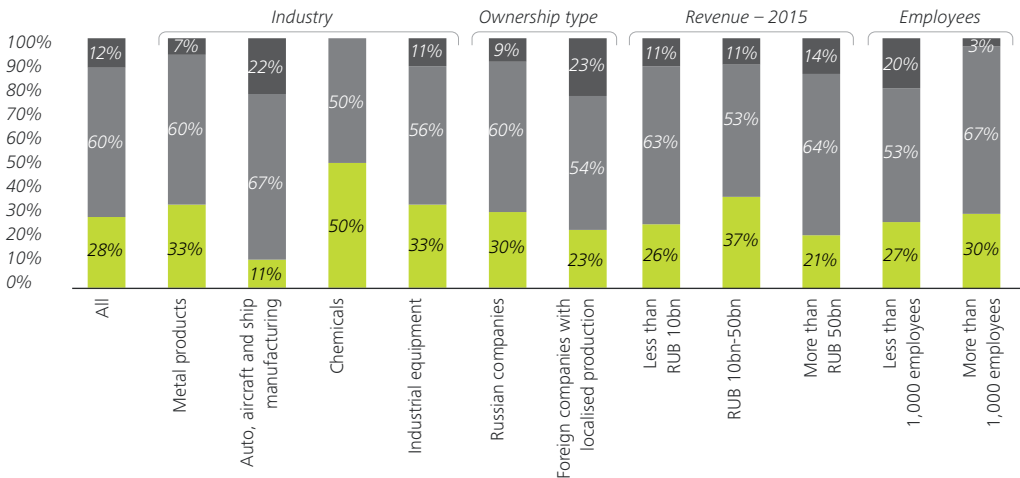
#### Trends

- The fairly high level of optimism inside manufacturing companies in Russia allows us to conclude that those not expecting significant changes also have positive sentiments.
- For instance, 88 percent of respondents do not expect conditions to worsen for their business, while a third of them expect improved prospects (32 percent).
- Every tenth survey participant expects a worsening outlook for his/her company (12 percent).

#### Characteristics

- Chemical companies have positive expectations for business development in 2016 at a rate 22 percentage points higher than the average.

- Meanwhile, vehicle producers (including aircraft and shipbuilding) are somewhat less optimistic in their forecasts. The share of such companies expecting a worsening environment for business development is 10 percentage points higher than the average.
- Pessimistic forecasts are also more characteristic of foreign companies with localised production in Russia. The share of respondents expecting worsening conditions is 14 percentage points higher among representatives of foreign businesses than Russian companies.
- Manufacturing companies with revenues of RUB 10-50 billion somewhat more often expect improvements (37 percent), while companies with annual revenues higher than RUB 50 billion expect worsening conditions (21 percent). This outcome corresponds to the earlier identified trend of large companies having less favourable sentiments.



Will improve  
No significant changes  
Worsen

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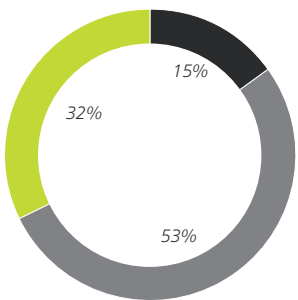
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## Current state and outlook for companies

### The impact on individual companies of the rapprochement between Russia and other BRICS countries



■ Positive  
■ Somewhat positive  
■ Somewhat negative

#### Trends

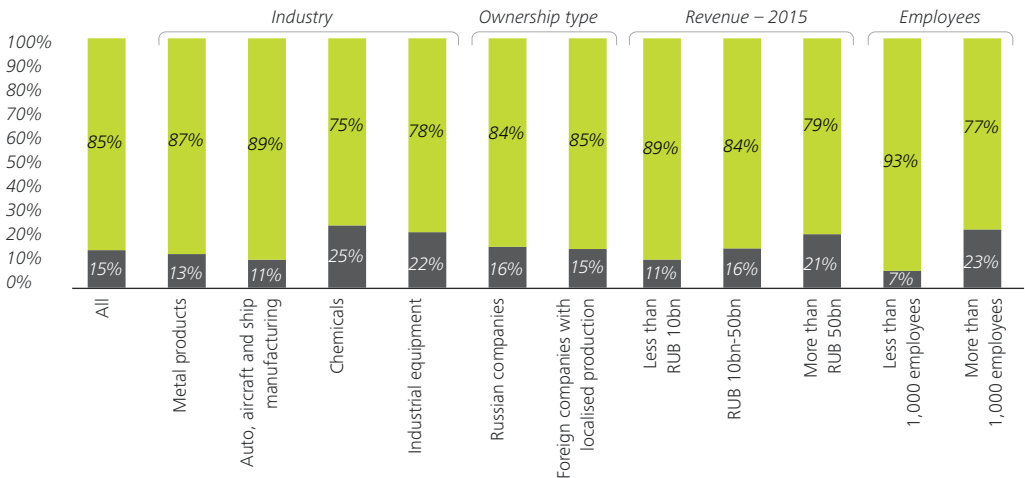
- The rapprochement between Russia and the other BRICS countries is generally characterised as having a positive influence on the development of manufacturing in Russia (overall 70 percent of respondents rated the potential prospects as positive).
- An absolute majority of survey participants (85 percent) positively rate the prospects for their business due to rapprochement between Russia and the other BRICS countries.
- At the same time, 15 percent of companies claim a negative effect from such changes.

#### Characteristics

- Chemical companies are rather less optimistic about the rapprochement between Russia and the other BRICS countries: every fourth survey participant from this segment sees negative effects from such a development.

- The share of respondents who are pessimistic about the rapprochement is slightly higher among larger companies (annual revenue over RUB 50 billion) at 21 percent and companies with more than 1,000 employees (23 percent).

We note that according to the earlier identified trend, large companies characterised by less favourable positions on the market are more frequently encountering difficulties developing, and see fewer prospects for an improvement in 2016. However, such companies see potential for new opportunities arising from the rapprochement between Russia and the other BRICS countries through possibilities of increased business efficiency.



■ Positive  
■ Negative

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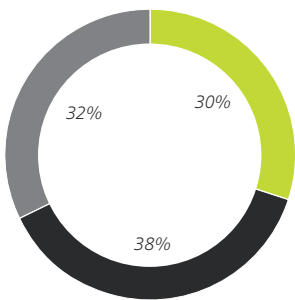
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# State of the manufacturing sector in Russia

## Current state and outlook for companies

### The effect of the development of Chinese manufacturing on Russian companies and world markets



■ Positive impact  
(they are our suppliers)

■ Negative impact  
(impairs our competitiveness)

■ No impact (neutral)

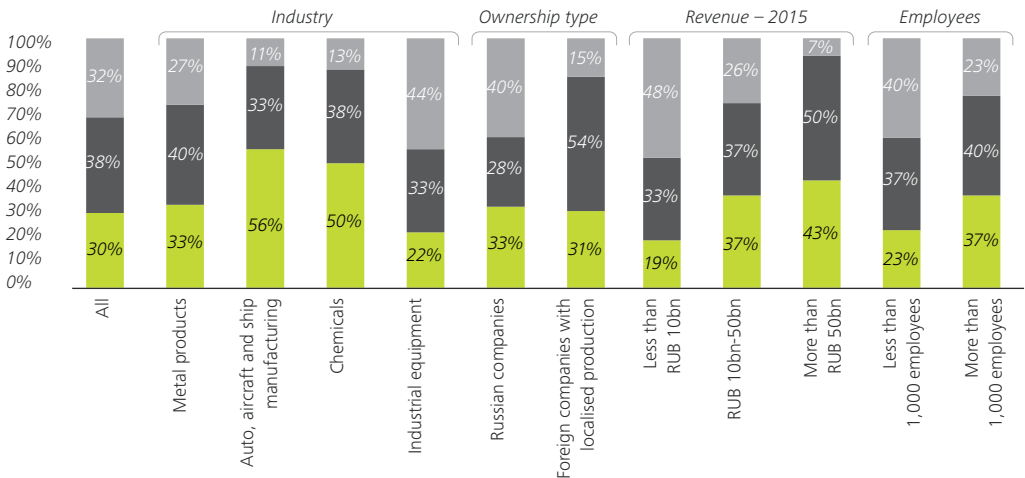
#### Trends

- The majority of those surveyed (68 percent) believe that the development of Chinese manufacturing will affect their companies' positions. Of these, 56 percent believe the effect will be negative.
- A third of the survey participants are certain that the development of Chinese manufacturing will not influence companies' activities on the Russian or world markets.

#### Characteristics

- Vehicle producers and chemical industry companies positively assess the impact of the development of Chinese manufacturing on business (higher than the average by 26 and 20 percentage points, respectively).

- Foreign companies with localised production in Russia had the largest amount of negative views of this factor (by 16 percentage points above the average).
- In general, the development of Chinese manufacturing has a greater impact on large manufacturing companies (by 25 percentage points) due to logistical connections.
- Every second representative of large businesses (annual revenue of more than RUB 50 billion) notes a negative influence from the development of Chinese manufacturing through a weakening of Russian companies' competitiveness. At the same time, 43 percent of respondents from the same group indicate a positive effect due to Chinese companies being their suppliers.



■ Positive impact  
(they are our suppliers)

■ Negative impact  
(impairs our competitiveness)

■ No impact (neutral)

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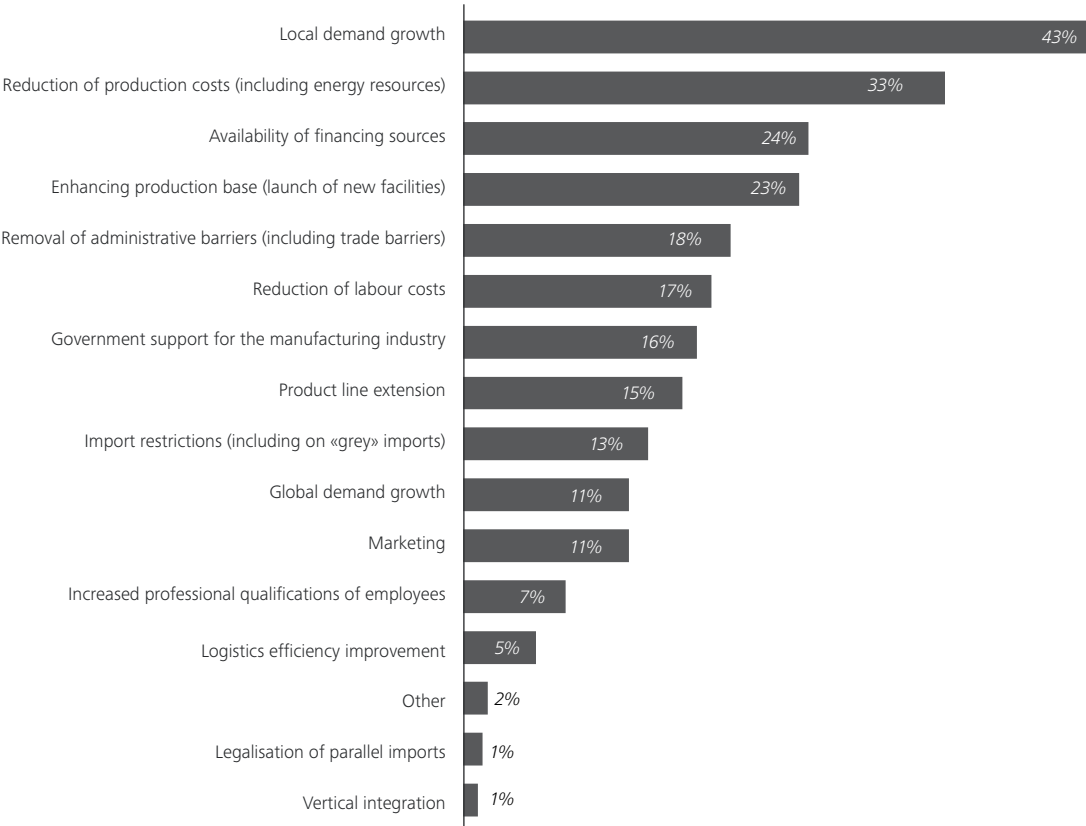
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# State of the manufacturing sector in Russia

## Current state and outlook for companies

### Drivers necessary to improving company competitiveness



### Trends

#### Top-4 drivers of company development:

- Local demand growth
- Reduction in production costs (including energy resources)
- Availability of financing sources
- Enhancing production base (launch of new facilities)

### Characteristics

- The automotive industry is the most sensitive to growth in domestic demand (78 percent).
- A reduction in production costs is the main factor of increasing the competitiveness of chemical companies (60 percent).
- Availability of financing is more of a concern for Russian companies than foreign (by 19 percentage points).
- Increasing the production base most often enables chemical companies to develop (38 percent).
- Expanding the product line is a big stimulus for the competitiveness of industrial equipment producers (33 percent).
- Chemical manufacturers are most sensitive to import limitations (including raw materials) as well as lowering administrative barriers and increased worker qualifications (28, 30 and 15 percent, respectively).
- Government support and global demand growth have more influence on vehicle manufacturing (27 and 24 percent, respectively).

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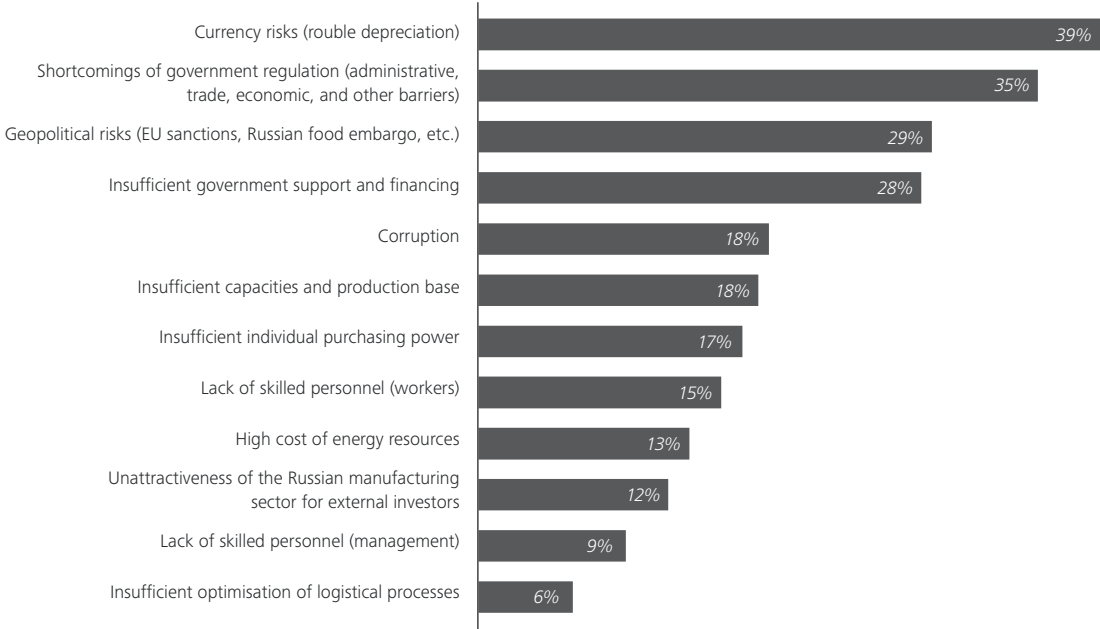
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# Main issues for the manufacturing sector in Russia in 2016

## Most important issues for manufacturing companies in Russia



### Trends

#### Top-4 issues for manufacturing in Russia:

- Currency risks (rouble depreciation) (39 percent)
- Shortcomings of government regulation (administrative, trade, economic, and other barriers) (35 percent)
- Geopolitical risks (EU sanctions, Russian embargo, etc.) (29 percent)
- Insufficient government support and financing (28 percent)

### Characteristics

- Automotive manufacturing is most sensitive to currency risks (62 percent).
- Shortcomings of government regulations are the key issue for chemical enterprises (45 percent) and metal product manufacturers (40 percent).
- Geopolitical risks concern vehicle manufacturers (40 percent) and the chemical industry (38 percent) to a greater degree.
- Additionally, vehicle manufacturers more frequently note insufficient individual purchasing power (by 10 percentage points).
- Vehicle manufacturers also are affected to a greater degree by the high cost of energy resources (22 percent).
- The unattractiveness of the Russian manufacturing sector to foreign investors is of greater concern to producers of industrial equipment (22 percent) and metal products (23 percent).
- Metal product producers place high significance on a lack of qualified executives (22 percent).
- Foreign companies with localised production are more sensitive to geopolitical risks and shortcomings of government regulation (35 percent).
- Overall, the main problem for large businesses (annual revenue of more than RUB 50 billion) is geopolitical risk (49 percent), while smaller companies react to a greater degree to shortcomings in government regulation and insufficient government support.

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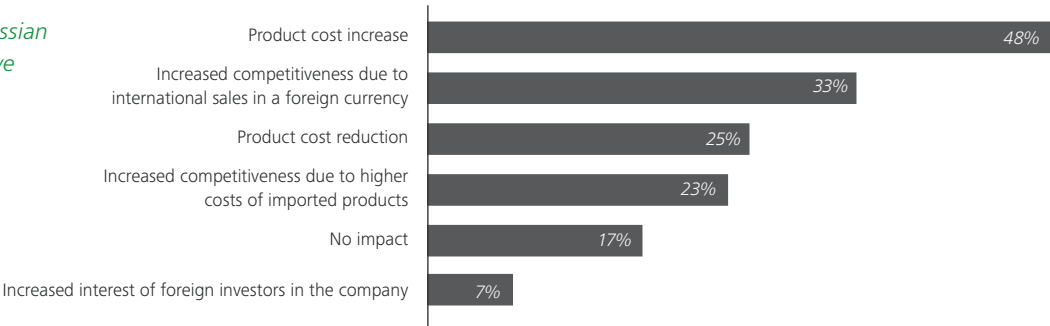
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# Main issues for the manufacturing sector in Russia in 2016

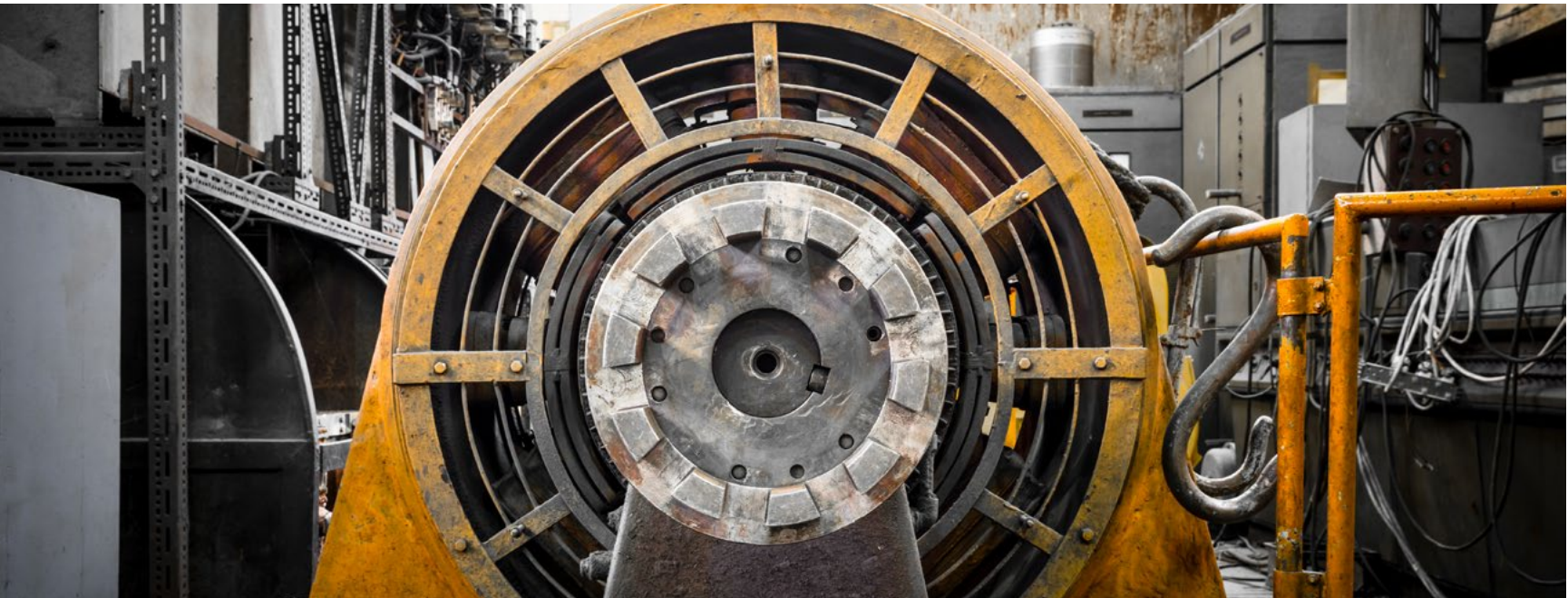
## Currency risks

What impact did the Russian rouble's devaluation have on your company?



### Trends

- Almost every second company participating in the survey cited increased cost of production as the main consequence of rouble devaluation (48 percent). At the same time, one-fourth of respondents felt a decrease in product costs (25 percent).
- A third of those surveyed (33 percent) noted a rise in competitiveness due to sales abroad in foreign currency. Twenty-three percent of respondents indicated a rise in their competitiveness due to imported products becoming more expensive.



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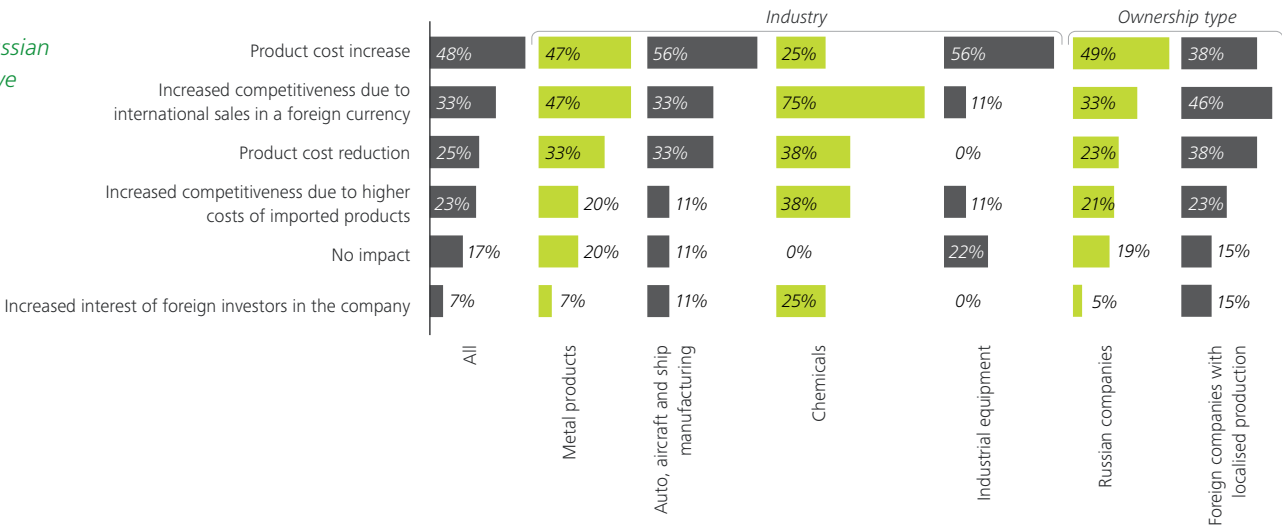
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# Main issues for the manufacturing sector in Russia in 2016

## Currency risks

What impact did the Russian rouble's devaluation have on your company?



### Characteristics

- A rise in product costs from rouble devaluation was felt to a greater degree by vehicle and industrial product manufacturers (56 percent).
- A decrease in prime costs from rouble devaluation was noted to a large degree by chemical producers (38 percent) and foreign companies with localised production (38 percent).
- Rouble devaluation triggered increased competitiveness from international sales in foreign currency for chemical producers (75 percent, two times higher than the sector average) as well as for metal product manufacturers (47 percent). Industrial product manufacturers, who more rarely sell products abroad, accordingly cited increased competitiveness from rouble devaluation at a rate of only 11 percent.
- Chemical producers more often claimed a rise in competitiveness due to more expensive imports (38 percent) as well as increased interest from foreign investors (25 percent). All chemical producers participating in our survey were affected by devaluation in one way or another; every respondent from this segment indicated that devaluation affected the company's activities.
- It also is worth noting that large (57 percent) and medium size (53 percent) companies (revenue of more than RUB 10 billion) to a greater degree experienced increased competitiveness from sales abroad in foreign currency. Companies with revenue of less than RUB 10 billion noted such a result to a significantly lesser degree (7 percent).

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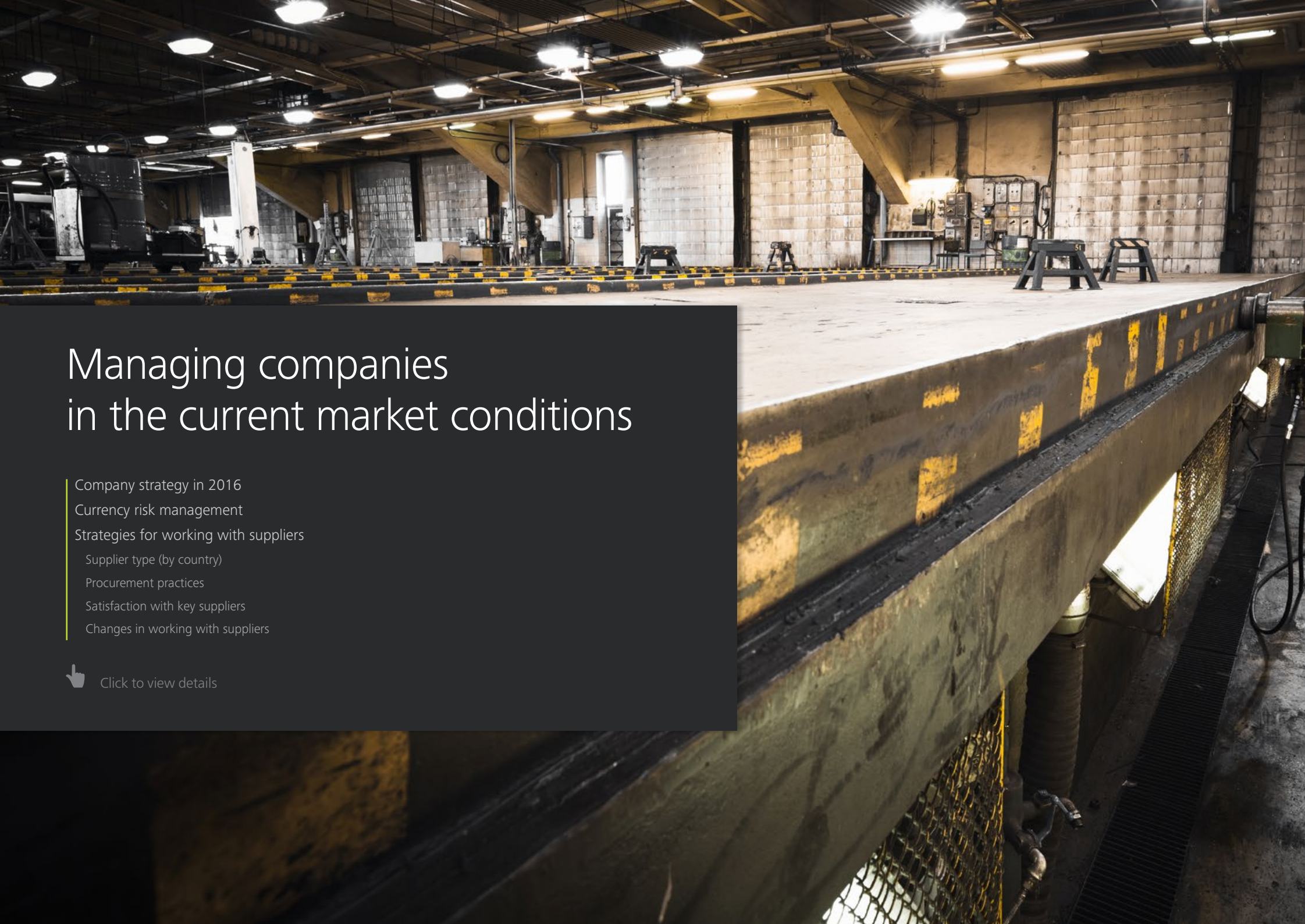
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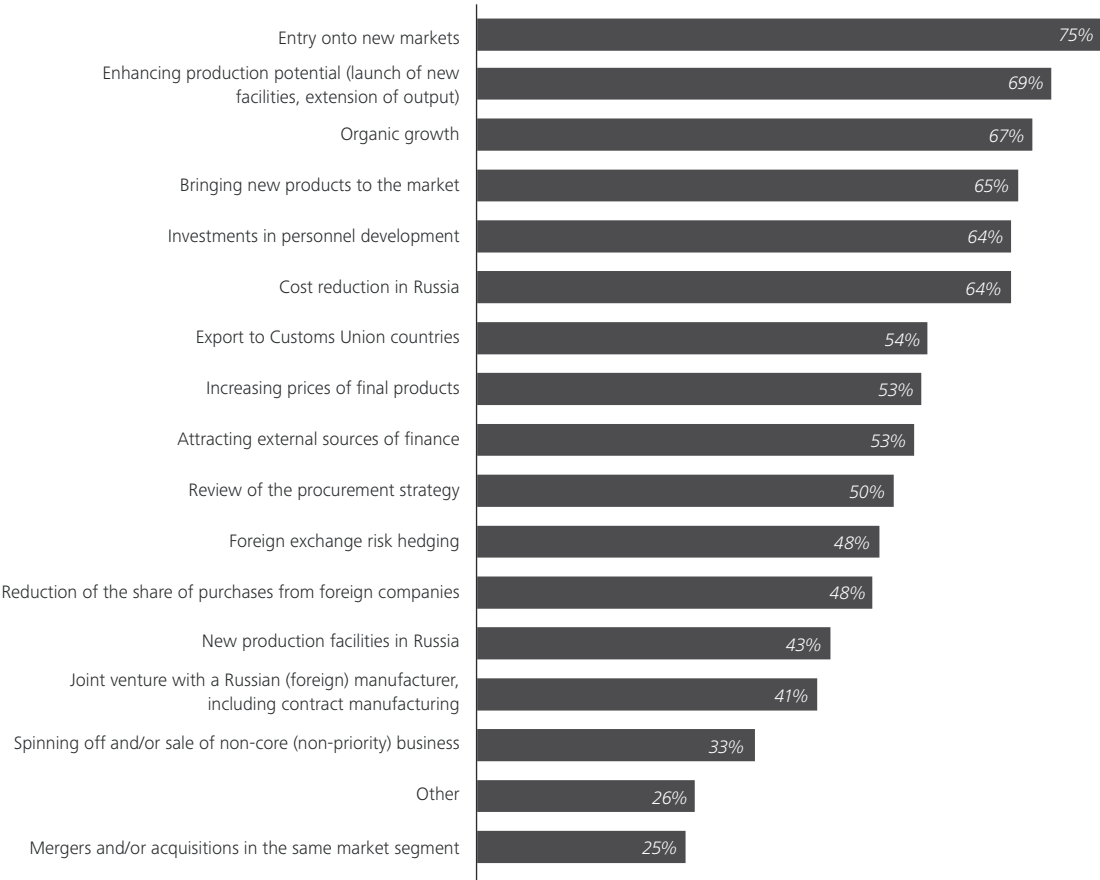
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# Managing companies in the current market conditions

## Company strategy in 2016



### Trends

#### Top-6 priority development strategies for companies in 2016:

- Entry onto new markets (75 percent)
- Enhancing production potential (launch of new facilities/ extension of output) (69 percent)
- Organic growth (67 percent)
- Bringing new products to the market (65 percent)
- Investments in personnel development (64 percent)
- Cost reduction in Russia (64 percent)



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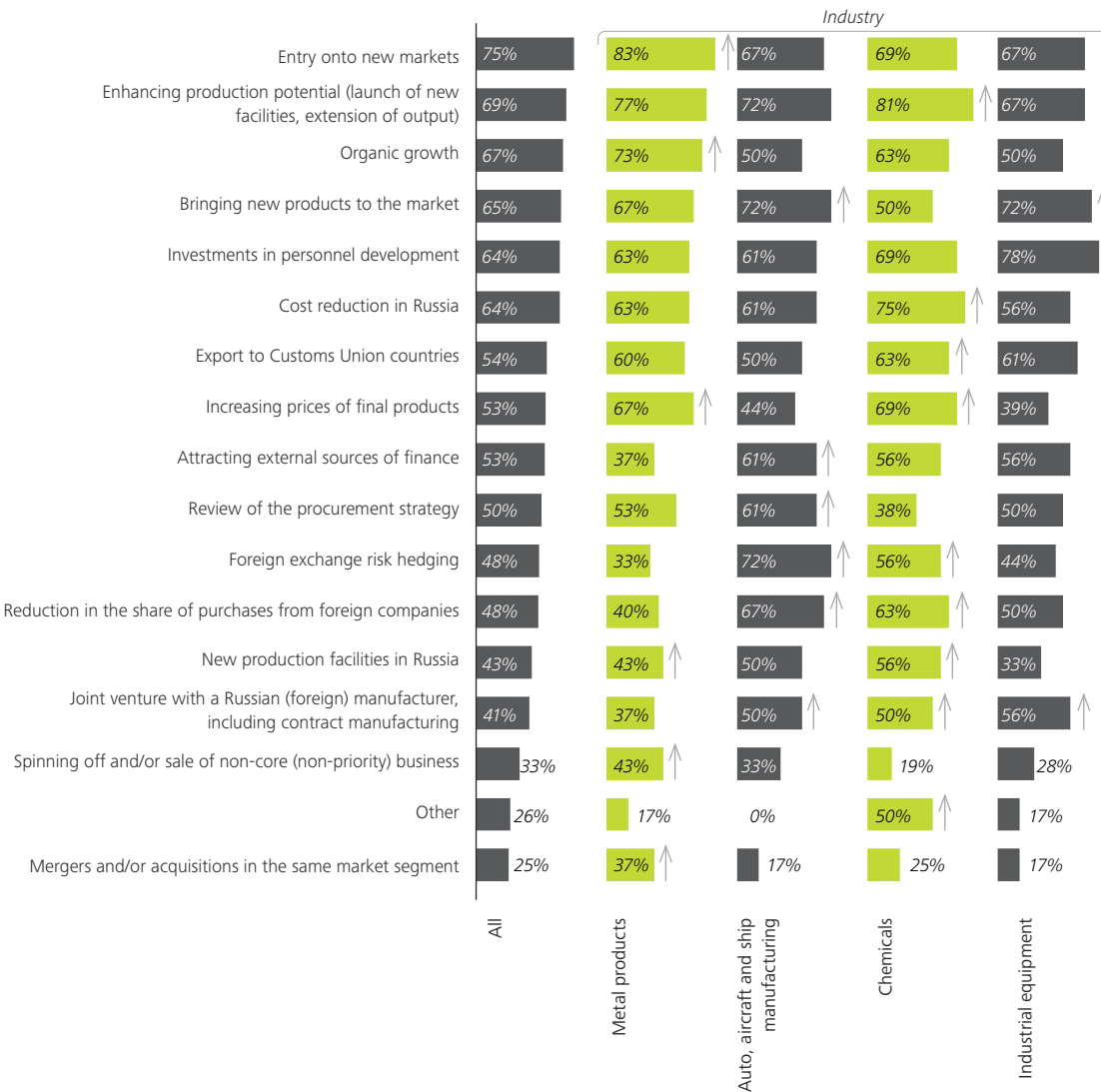
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# Managing companies in the current market conditions

## Company strategy in 2016



### Characteristics

- Expansion into new markets is most often the priority strategy chosen by metal product manufacturers (83 percent).
- Enhancing the production base (launch of new facilities/increase in output) is more often planned by chemical producers (81 percent).
- Business development through organic growth is most often cited by metal product manufacturers (73 percent).
- Bringing new products onto the market is more often prioritized by vehicle and industrial equipment producers (72 percent for each).
- Industrial equipment producers plan investment in staff development most often compared to other industry segments (78 percent).
- Chemical industry enterprises place a higher priority on reduction of expenses in Russia in comparison with other manufacturing segments (75 percent).

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## Company strategy in 2016



### Characteristics

- Foreign companies with localised production are significantly less likely to raise external financing than Russian companies (35 versus 57 percent, respectively).
- Foreign companies with localised production also are less likely to plan new production facilities in Russia than domestic companies (35 versus 48 percent).
- Larger companies are more often planning to enhance the production base (89 percent for companies with revenue of RUB 50 billion and 83 percent for companies with more than 1,000 employees).

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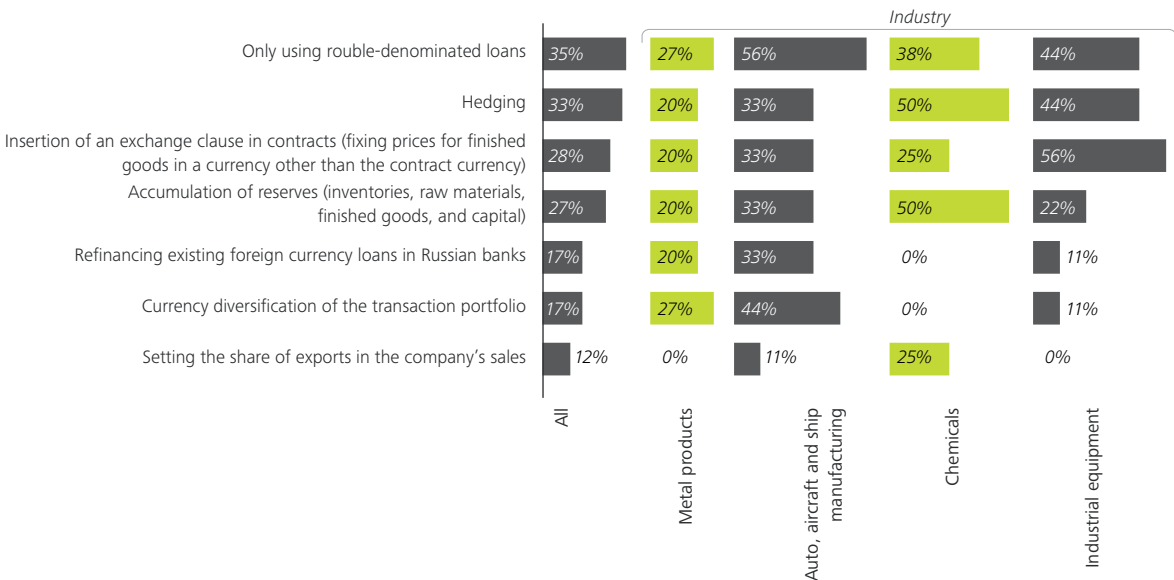
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# Managing companies in the current market conditions

## Currency risk management



### Trends

#### Top-4 currency risk management methods:

- Rouble-denominated loans (35 percent)
- Hedging (33 percent)
- Inserting an exchange clause in contracts (fixing prices for finished goods in a currency other than the contract currency) (28 percent)
- Accumulating reserves (inventories, raw materials, finished goods, and capital) (27 percent)

### Characteristics

- Borrowing exclusively in roubles is the currency risk management tool preferred by vehicle producers (56 percent).
- Hedging and establishing reserves (inventories, raw materials, finished goods and capital) are the priority currency risk management tools for chemical enterprises (50 percent for each method).
- Inserting an exchange clause in contracts is the most chosen currency risk management method for industrial product manufacturers (56 percent).
- Hedging is more often used by foreign companies than Russian (54 percent of foreign companies with localised production and 23 percent of Russian companies). Moreover, hedging is more characteristic of medium size companies with revenues of RUB 10-50 million (58 percent).
- Reserves are more often preferred by foreign companies with localised production than Russian companies (46 versus 23 percent).

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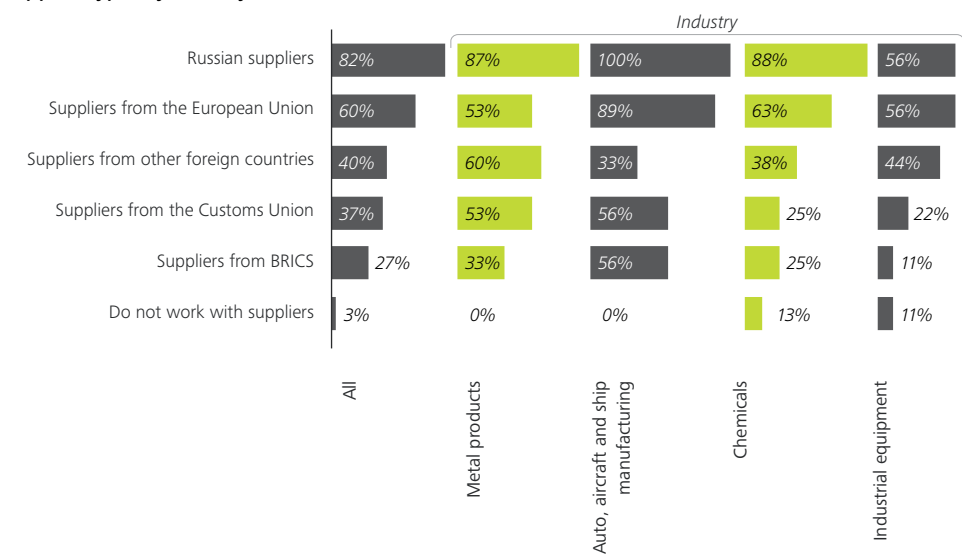
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# Managing companies in the current market conditions

## Strategies for working with suppliers

Supplier type (by country)

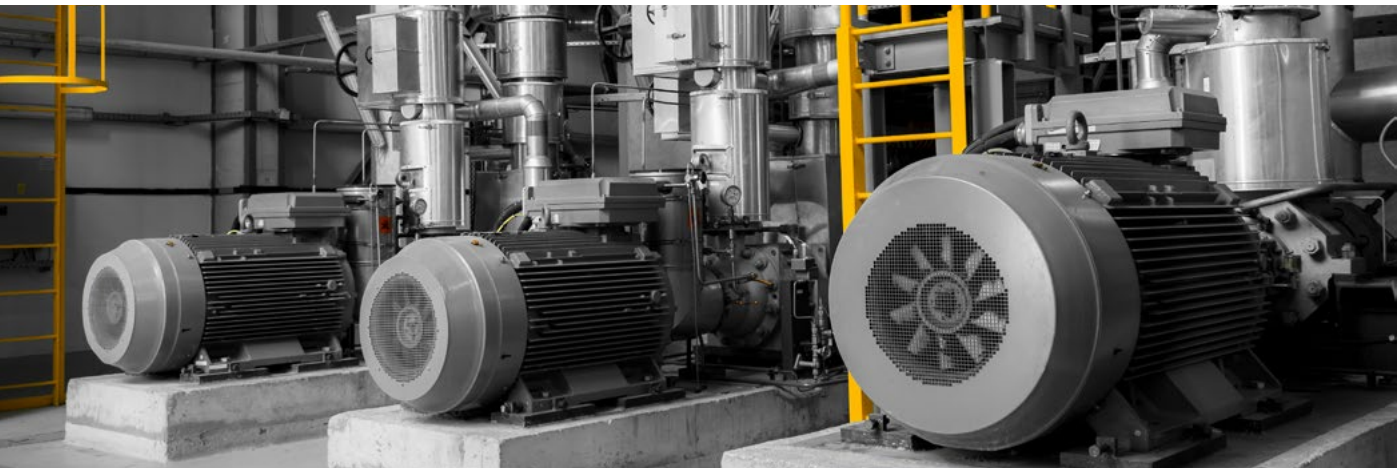


### Trends

- An absolute majority of manufacturing companies in Russia work with Russian suppliers (82 percent).
- Moreover, 60 percent of companies work with suppliers from the European Union (EU).
- Companies work with suppliers from other countries or members of the Customs Union at a rate of 40 and 37 percent, respectively.
- Suppliers from the other BRICS countries were cited by 27 percent of respondents.

### Characteristics

- Overall, vehicle producers work with foreign suppliers more often than do other manufacturing segments. In particular, such companies work with suppliers from the EU at a rate 29 percentage points higher.
- Chemical producers indicate the lowest need for suppliers, with 13 percent stating that they do not work with suppliers at all.
- Foreign companies with localised production more frequently work with suppliers from the EU (77 percent) than do Russian companies (51 percent), as well as with suppliers from other countries (54 versus 37 percent) and from the other BRICS countries (46 versus 23 percent).



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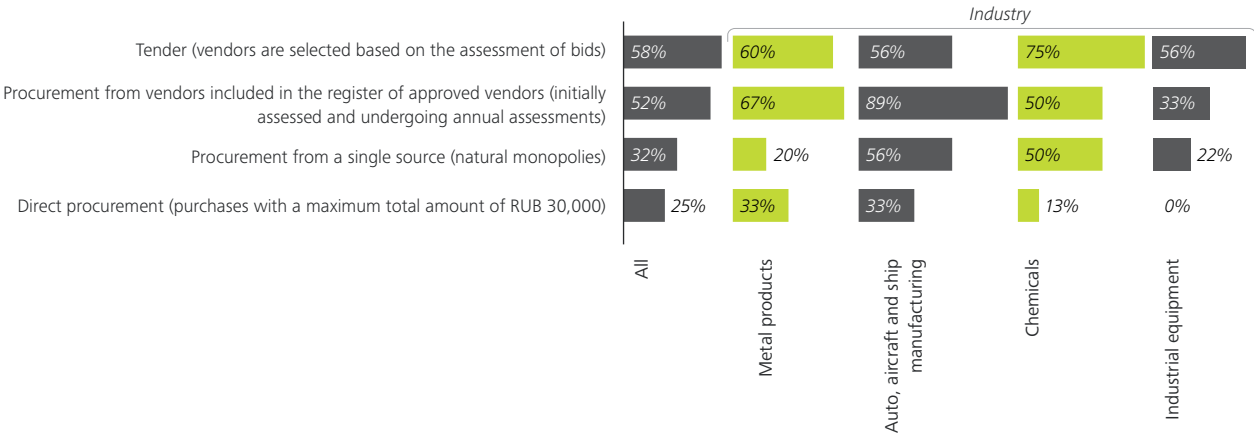
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# Managing companies in the current market conditions

## Strategies for working with suppliers

### Procurement practices



### Trends

- A majority of companies (58 percent) conduct competitive tenders (procurement with the supplier being determined through assessing competitive offers).
- Every second respondent (52 percent) prefers to purchase from vendors included in the register of approved vendors (vendors initially assessed and undergoing annual assessments).
- A third of companies (32 percent) purchase from sole suppliers (natural monopolies).
- A fourth of manufacturing companies (25 percent) conduct direct buying (applied to purchases with total value not exceeding a price threshold of RUB 30,000).

### Characteristics

- Chemical producers conduct tenders more often than companies from other segments (75 percent).
- Vehicle producers primarily purchase from suppliers included in the register of approved vendors (vendors initially assessed and undergoing annual assessments) (89 percent).
- Purchases from sole suppliers are more frequent for vehicle manufacturers (56 percent) and chemical producers (50 percent).
- Foreign companies with localised production in Russia are more inclined to purchase from suppliers included in the register of approved vendors (85 percent), while only 42 percent of Russian companies follow this practice.
- Overall large companies (revenue of more than RUB 50 billion) more often conduct procurement than companies with lower revenue. This trend concerns all procurement practices.

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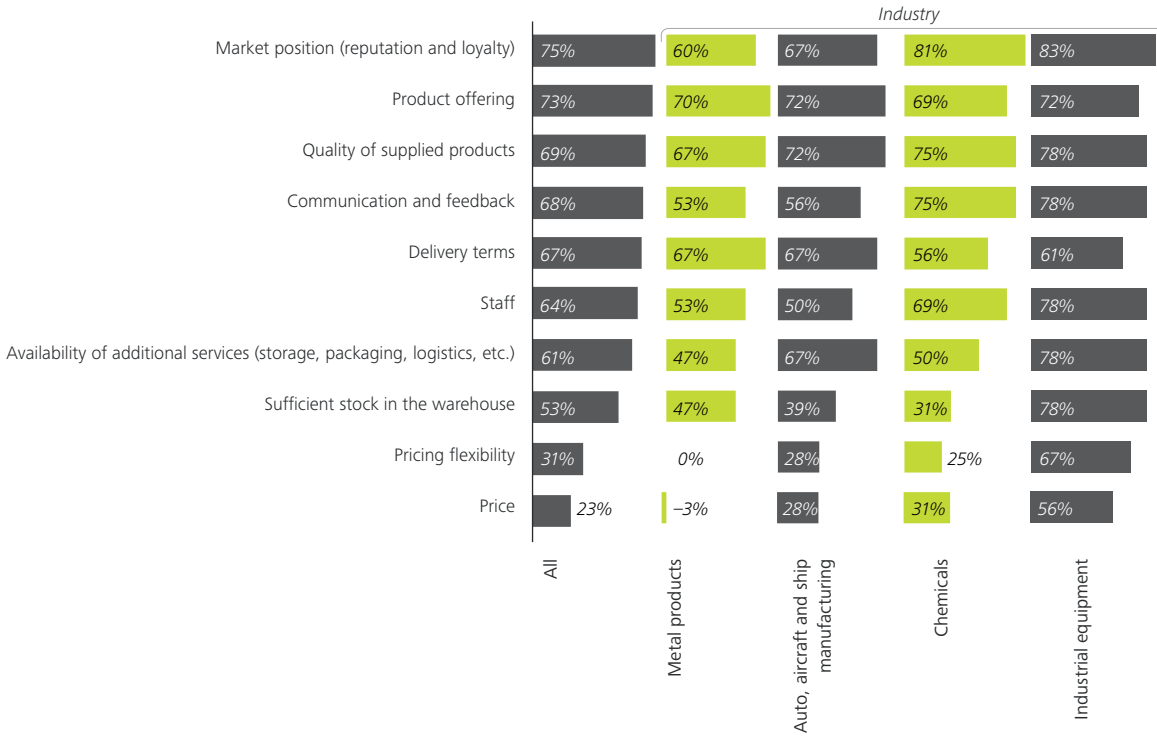
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# Managing companies in the current market conditions

## Strategies for working with suppliers

### Satisfaction with key suppliers



### Trends

- Overall, manufacturing companies report a fairly highly level of satisfaction with supplier quality against their main evaluation criteria.
- Manufacturers are largely satisfied with the positions of suppliers on the market (their reputations and loyalty) and the offerings: the level of satisfaction is 75 and 73 percent, respectively).
- Companies are least satisfied with suppliers' pricing terms: the levels of satisfaction with prices and the degree of flexibility in setting prices are rated at 23 and 31 percent, respectively.

### Characteristics

- Metal product manufacturers have the lowest satisfaction with supplier prices and flexibility of pricing (-3 and 0 percent, respectively).
- Foreign companies with localised production are more dissatisfied with prices (-4 percent) and flexibility of pricing (-4 percent) than Russian companies (27 and 40 percent, respectively).
- The highest satisfaction with pricing and price flexibility is displayed by industrial equipment producers (56 and 67 percent, respectively).
- Chemical producers more often than others encounter problems with the lack of sufficient stock at suppliers (satisfaction level of 31 percent).

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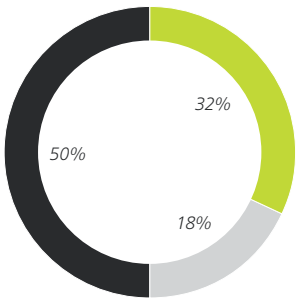
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# Managing companies in the current market conditions

## Strategies for working with suppliers

### Changes in working with suppliers



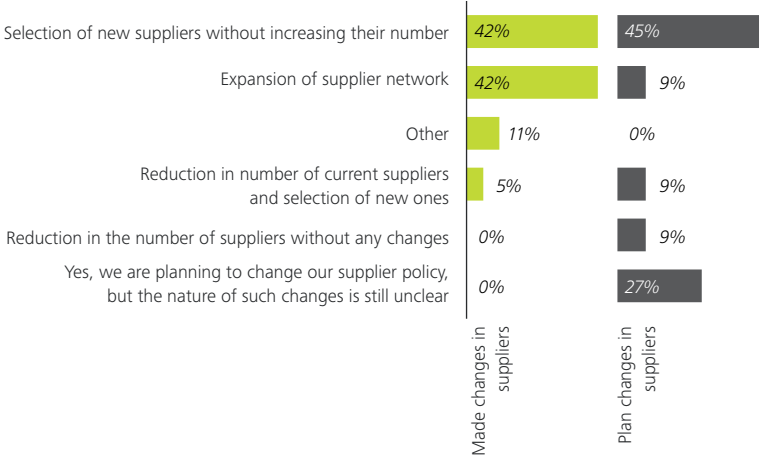
- Yes, we have made changes in suppliers
- Yes, we plan changes in suppliers
- No changes in suppliers and no plans to change

#### Trends

- Half of respondents note no changes in suppliers in the last 12 months and no plans to make changes in the near future. The remaining survey participants plan to change suppliers (18 percent) or have already done so (32 percent).
- In 2015, the manufacturers that changed suppliers either expanded their network of suppliers or chose others without increasing the total number of vendors (42 percent each).
- Manufacturing companies that are planning to change suppliers are mainly oriented toward updating vendor lists without increasing the number of suppliers (45 percent).

#### Characteristics

- An absolute majority of vehicle manufacturers have changed or plan to change suppliers (89 percent).
- Industrial equipment producers are more consistent in working with their suppliers (67 percent have not and do not plan to make any changes in this area).
- Foreign companies changed suppliers more often than Russian companies last year (46 versus 28 percent).



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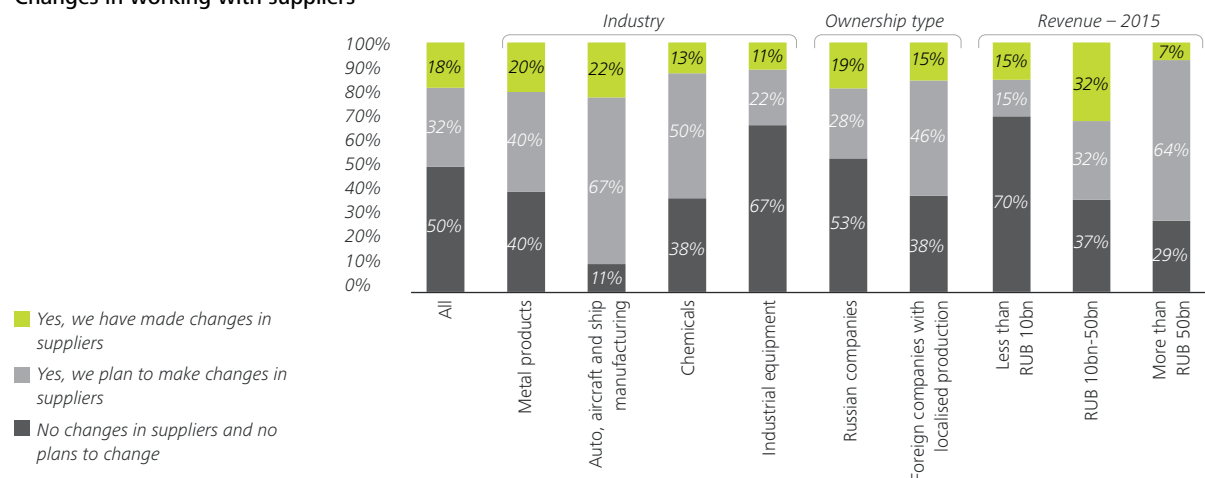
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# Managing companies in the current market conditions



## Strategies for working with suppliers

### Changes in working with suppliers



- Last year large companies more often changed suppliers (64 percent of companies with revenue of more than RUB 50 billion changed suppliers, in particular by widening or updating their list of vendors without increasing the number of suppliers).
- Small companies (revenue of less than RUB 10 billion) are more stable in their relations with suppliers (70 percent did not and do not plan to change suppliers).



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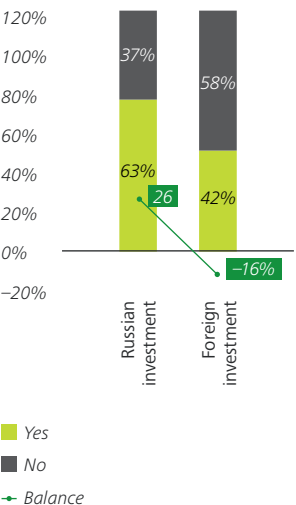
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# Sources of capital

## The attractiveness of external financing sources for supporting and growing a business

Are you planning to use external sources of finance in the near future to support and develop your business?



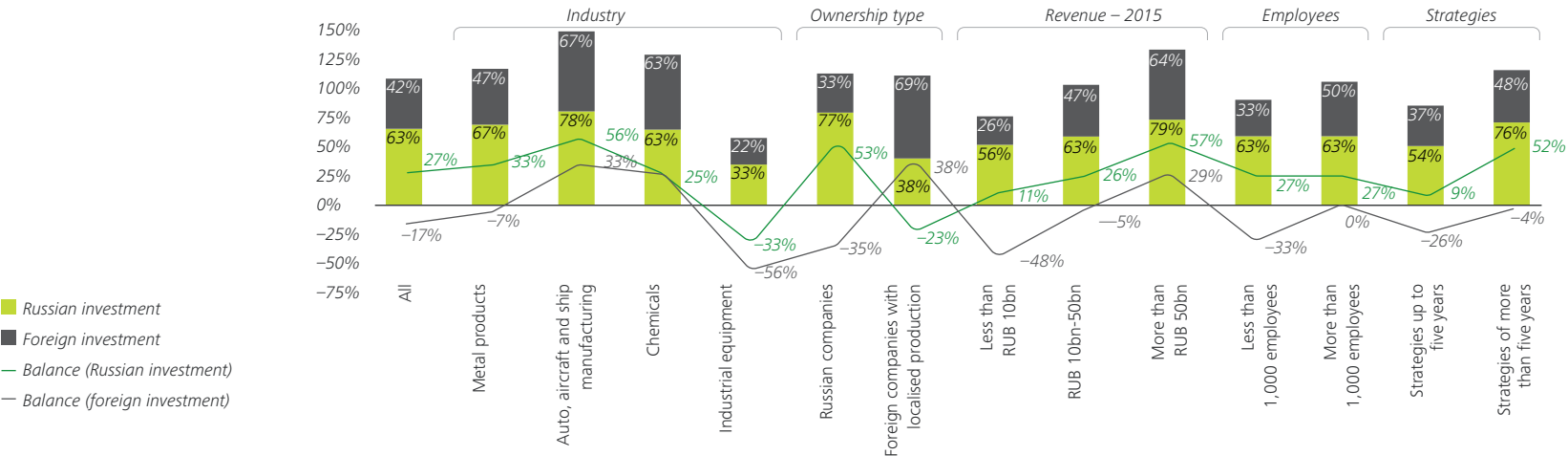
### Trends

- Overall, the attractiveness of Russian investment for support and development of a business is 21 percentage points higher than foreign investment (the net balance for Russian investment is 26 percent, while for foreign investment it is -16 percent, which also indicates the lower interest in the latter).
- Most manufacturing companies in the country plan to raise capital externally, in particular from Russian sources (63 percent).
- Moreover, 42 percent of respondents stated that they plan to attract foreign investment in the near future to support and grow their business.

### Characteristics

- Raising external investment is of more interest to vehicle producers (including aircraft and shipbuilding). The share of such companies planning to attract Russian and foreign investment is higher than the average by 15 and 25 percentage points, respectively.
- Chemical industry representatives more frequently state plans to attract direct foreign investment (by 21 percentage points).

- The opposite trend characterises industrial equipment producers: the majority of them do not plan to raise external investment in the near term (67-78 percent).
- The larger the business, the clearer the tendency to raise external financing. Companies with revenue of more than RUB 50 billion are ready to raise external financing at a higher rate than companies with revenue of less than RUB 10 billion; the larger companies rate foreign capital 38 percentage points higher and Russian capital 23 percentage points higher than smaller companies.
- Companies with long-term strategies for business development (over five years) are generally more inclined toward external financing: 76 percent of them plan to attract Russian investment in the near future.



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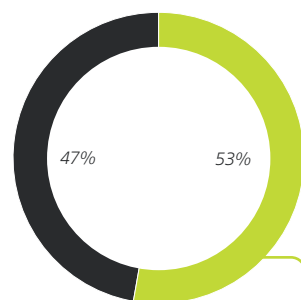
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# Sources of capital

## Capacity for attracting foreign investment

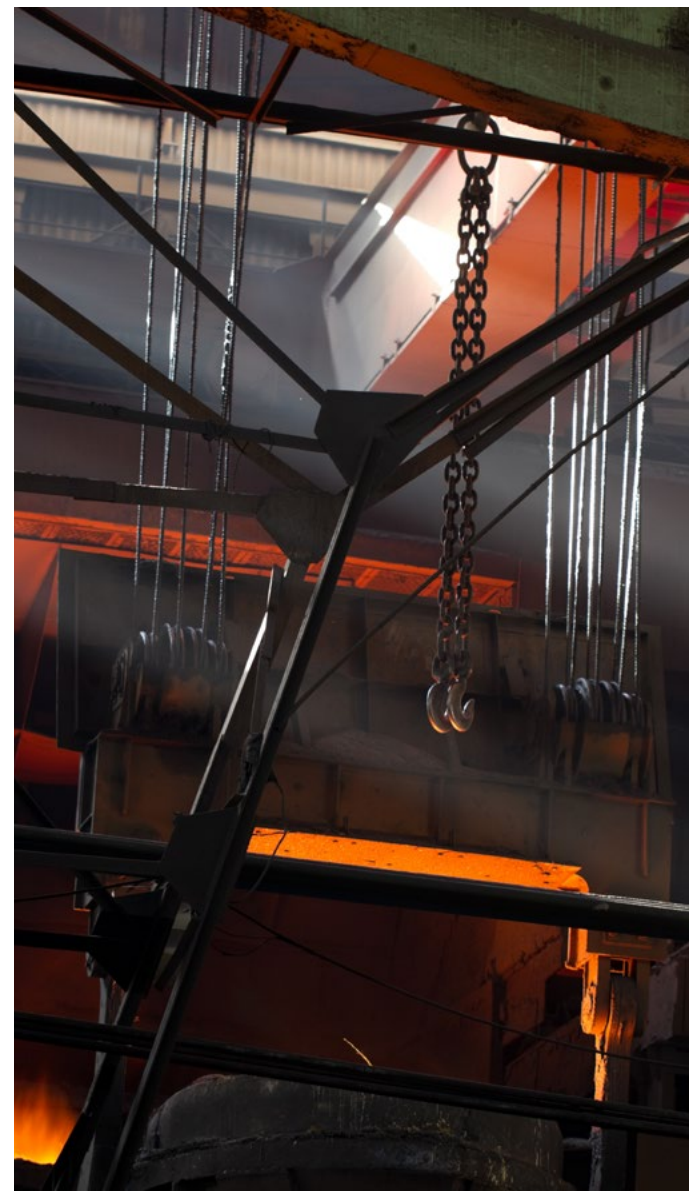
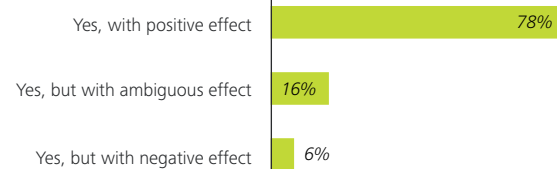
*Do you have experience in attracting foreign investment? If yes, how do you rate the effectiveness of this type of financing?*



■ Yes, with positive effect  
■ No experience attracting foreign investment

### Trends

- Every second survey participant (53 percent) has experience in raising foreign investment.
- We note that the majority of companies using foreign financing note a positive effect on the development of their business (78 percent). Meanwhile, every fifth respondent (22 percent) characterises the influence of foreign investment on the development of their business as ambiguous (16 percent) or negative (6 percent).
- Representatives of large businesses (annual revenue of RUB 50 billion) have the most experience in raising foreign capital (86 percent).



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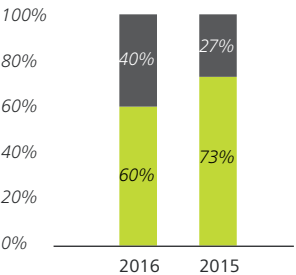
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# Sources of capital

## Debt refinancing

Is the issue of loan refinancing important for you?



■ Important  
■ Not important

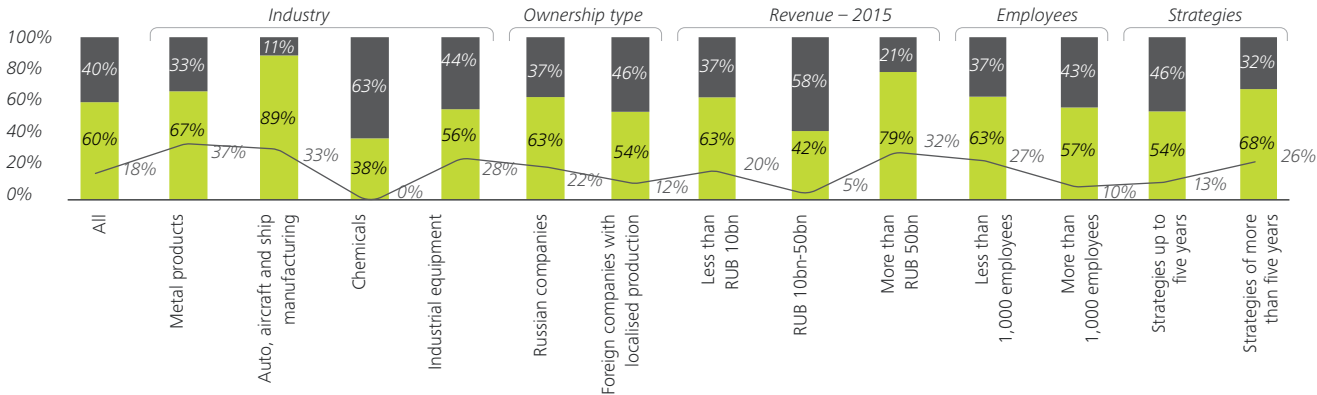
### Trends

- The significance of loan refinancing has somewhat decreased (by 13 percentage points) in comparison to a year ago.
- This is primarily because many companies refinanced loans during 2015. In particular, the main trend in this area is the elimination of loans in foreign currency and/or from foreign banks.
- Overall, loan refinancing remains a current issue for the majority of manufacturing companies in Russia (60 percent).

### Characteristics

- The issue of loan refinancing is of greater significance to metal product manufacturers (by 19 percentage points) and vehicle producers (by 15 percentage points).
- The opposite trend is seen from chemical producers, the majority of which do not consider loan refinancing to be a current issue (63 percent).

- Availability of financing is more of a concern for Russian companies than foreign companies (by 10 percentage points). This result correlates with manufacturers in Russia having a fairly high debt load in foreign currency and/or with foreign banks.
- Medium-size companies (annual revenue from RUB 10-50 billion) indicated less need for loan refinancing (42 percent), while 79 percent of larger companies (annual revenue of more than RUB 50 billion) declared a need for loan refinancing.
- Companies with long-term strategies (more than five years) cited the importance of loan refinancing at a twice higher rate than companies with shorter strategy horizons (less than five years): 26 versus 13 percent, respectively.



■ Important  
■ Not important  
— Integrated level of importance

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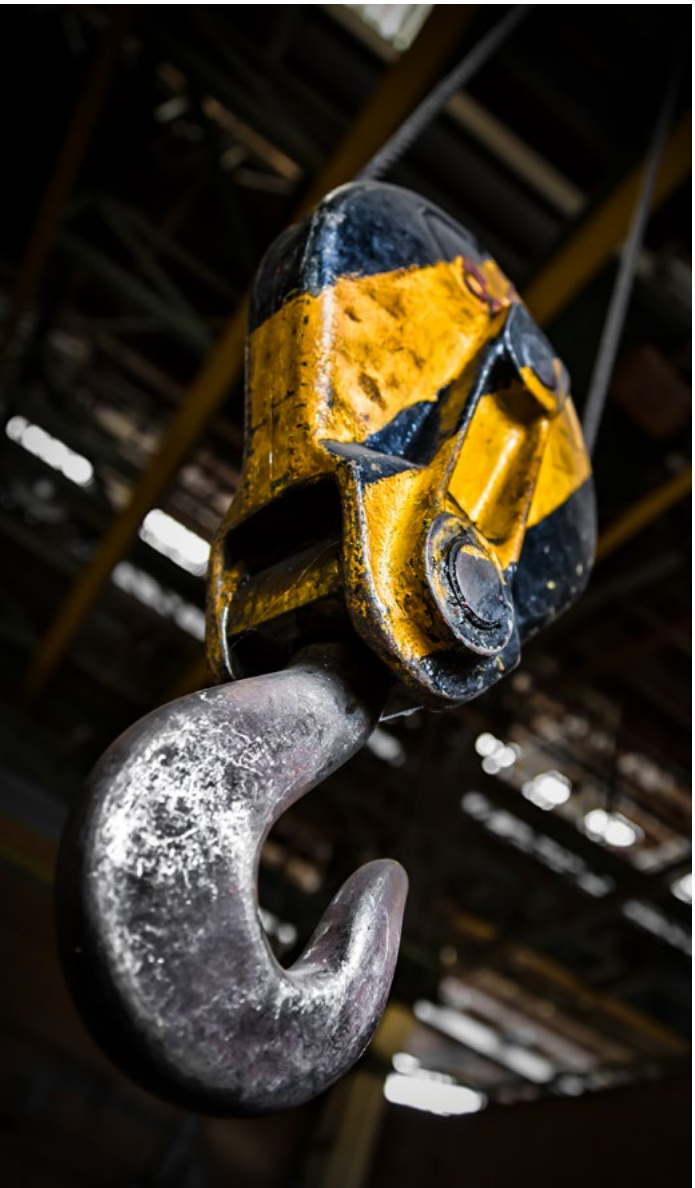
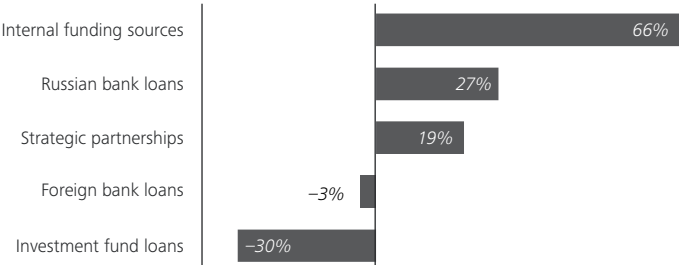
## Debt refinancing

### The attractiveness of various forms of financing

*Rate the attractiveness of the given forms of financing for developing your business*

#### Trends

- The most attractive type of financing is internal financing (66 percent).
- At the same time, an absolute majority (80 percent) rated the attractiveness of investment fund loans negatively and interest in this type of financing was –30 percent.
- Loans from Russian banks carried an average level of attractiveness (27 percent).
- Conversely, every second survey participant voiced the unattractiveness of loans from foreign banks, with the overall interest in this source of financing at –3 percent.



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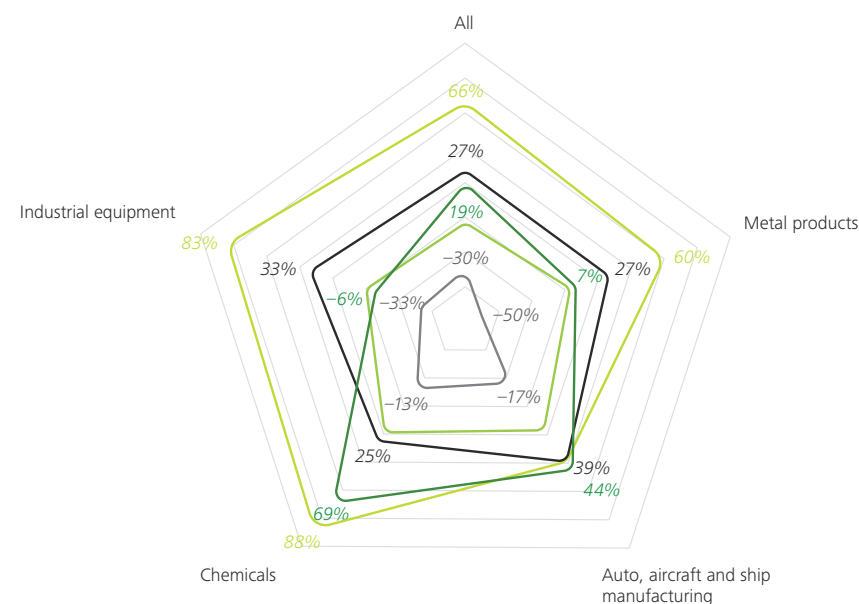
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# Sources of capital

## Debt refinancing

### The attractiveness of various forms of financing

Rate the attractiveness of the given forms of financing for developing your business



- Russian bank loans
- Foreign bank loans
- Investment fund loans
- Strategic partnerships
- Internal funding sources

### Characteristics

- Chemical producers and industrial equipment manufacturers are more oriented toward internal financing than are other segments (88 and 83 percent, respectively).
- Loans from Russian banks are more interesting for vehicle manufacturers (including aircraft and shipbuilding); they rated the attractiveness of such means 12 percentage points higher than the average.
- Strategic partnerships are attractive for business development for chemical producers (69 percent) and vehicle manufacturers (44 percent). These segments rate the attractiveness of loans from foreign banks as relatively high (17-19 percent). This could indicate that strategic partnerships are planned directly with foreign businesses.
- Investment fund loans were wholly unpopular as a means for raising capital. This view was shared by the majority of survey participants regardless of the industry segment.
- We note that the attractiveness of loans from Russian banks is significantly lower (to -6 percent) among representatives of large businesses (annual revenue higher than RUB 50 billion). Such companies are primarily oriented toward internal sources of financing (83 percent).
- Loans from banks and funds are rather more attractive sources of financing for companies with short-term strategies (less than five years): this group rates such loans 40 percentage points higher than the average and investment fund loans 13 percentage points higher than the average.
- Conversely, companies with long-term strategies are less interested in loans and rate strategic partnerships the highest (88 percent).

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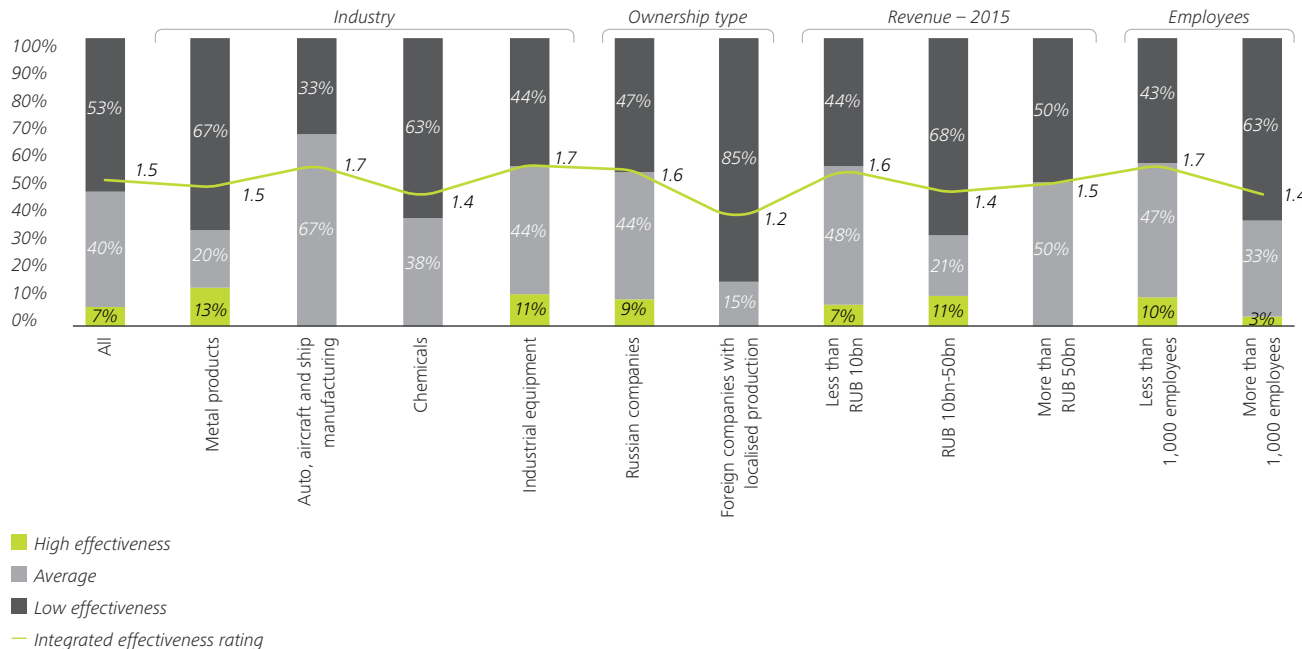
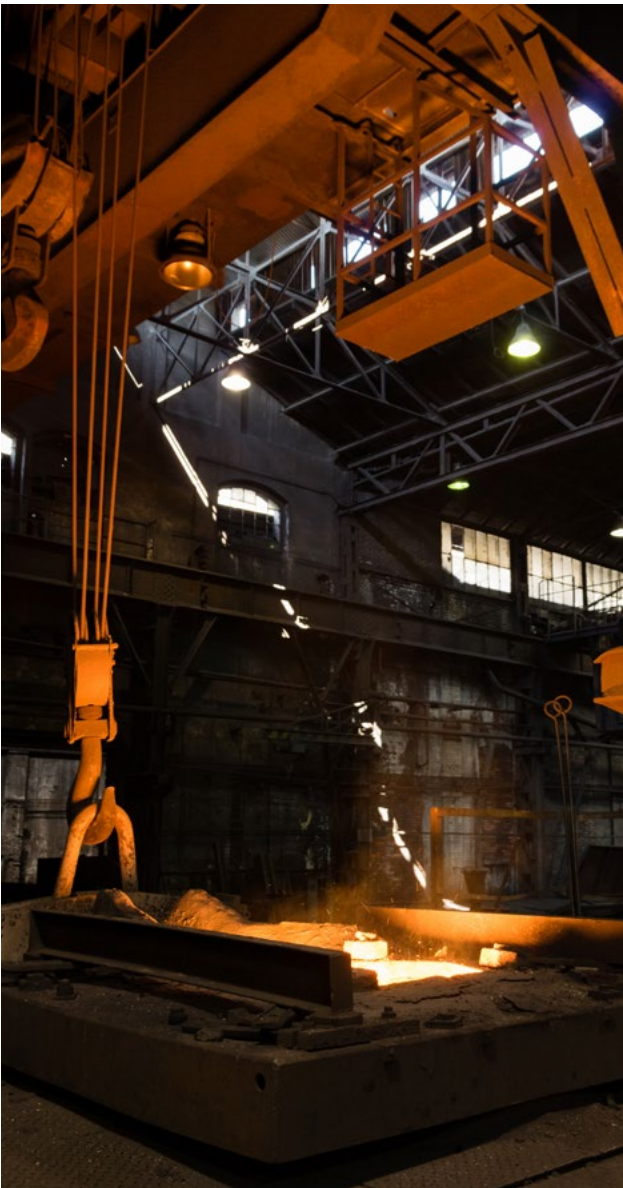
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# Government support of the Russian manufacturing sector

## Effectiveness of government support and development of the Russian manufacturing sector



### Trends

- Overall, the integrated assessment of the effectiveness of government support and development of the manufacturing sector in Russia is 1.5 points out of a possible 3 points. This indicates that business representatives' satisfaction with current government activity does not exceed the average level.
- Moreover, the majority of survey respondents (53 percent) rate the effectiveness of state activities as low.
- Only 7 percent of survey participants consider the effectiveness of state support to be high.

### Characteristics

- Vehicle and industrial equipment producers rate state support for business slightly higher (1.7 points out of 3).
- Chemical producers showed the opposite trend and rated state support the lowest (1.4 points out of 3).
- We note that foreign companies rate government support lower than Russian companies (1.2 points versus 1.6).
- Smaller companies showed somewhat higher satisfaction with state support for business: companies with annual revenue of less than RUB 10 billion rated it at 1.6 points and companies with less than 1,000 employees rated state support at 1.7 points.

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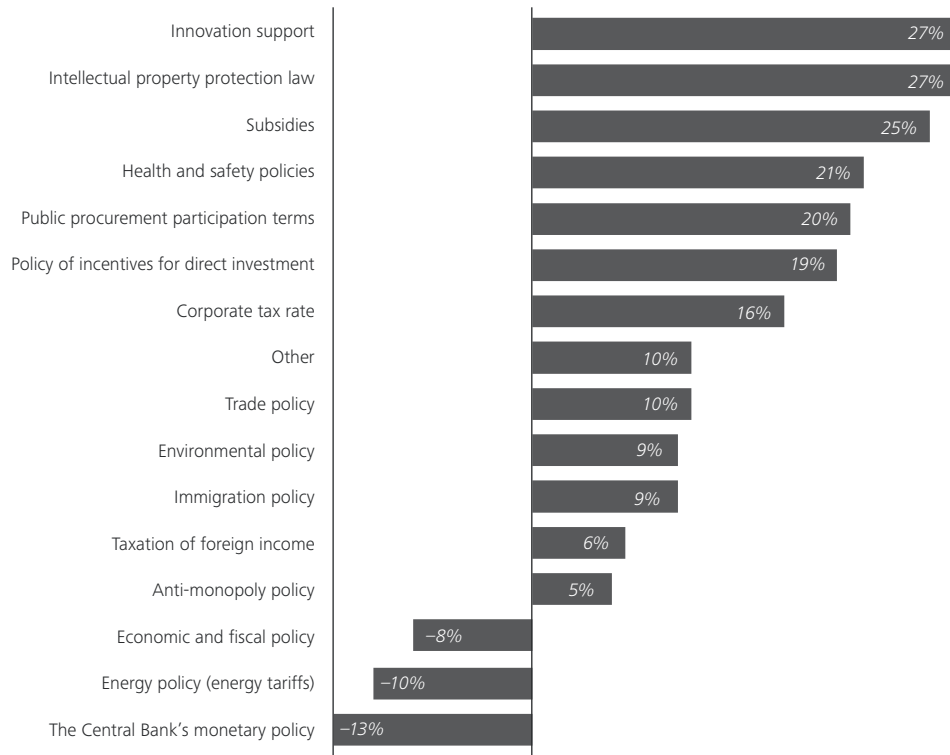
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# Government support of the Russian manufacturing sector



## Impact of state measures on the Russian manufacturing sector



### Top-3 state measures negatively affecting the Russian manufacturing sector:

- The Central Bank's monetary policy (-13%)
- Energy policy (energy tariffs) (-10%)
- Economic and fiscal policy (-8%)

### Characteristics

- State support of innovation is rated significantly higher by industrial equipment producers (50 percent) and companies with less than 1,000 employees (by 10 percentage points).
- Foreign companies with localised production in Russia most often note a positive effect from the law on protecting intellectual property (50 percent).
- The Central Bank's monetary policy is most often seen as having a negative effect by foreign companies with localised production in Russia (-38 percent), vehicle manufacturers (-22 percent) and larger businesses (annual revenue of more than RUB 50 billion) (-21 percent) and with more than 1,000 employees (-28 percent).
- Energy policy is seen as negative primarily by foreign companies (-38 percent), chemical producers (-19 percent) and larger businesses (-18 percent).
- We note that foreign companies overall are more sceptical about the influence of the state's measures regarding the manufacturing sector. In addition to the above-mentioned ratings, foreign companies negatively assess the government's environmental policy (-25 percent), subsidies and the conditions for participating in state procurement (-13 percent).

### Trends

#### Top-5 state measures positively affecting the Russian manufacturing sector:

- Innovation support (27 percent)
- Intellectual property protection law (27 percent)
- Subsidies (25 percent)
- Health and safety policy (21 percent)
- Public procurement participation terms (20 percent)

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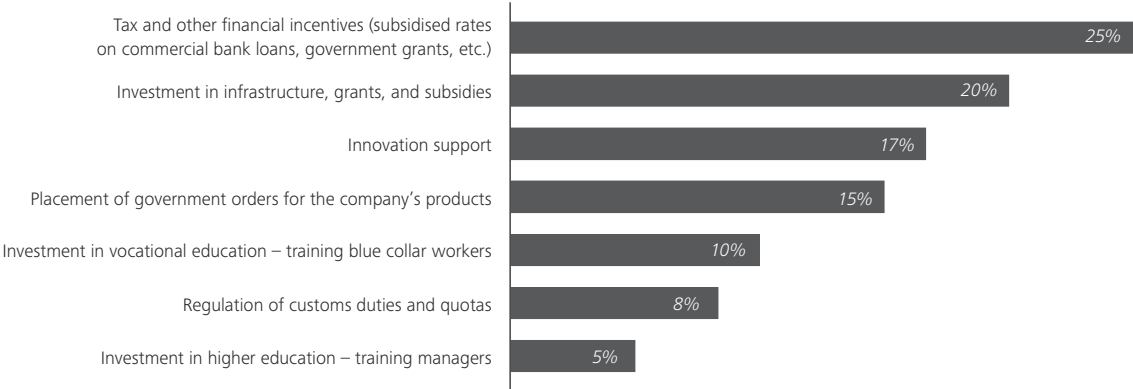
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# Government support of the Russian manufacturing sector



## Priority types of state support for business



### Trends

#### Top-3 forms of government support for manufacturing companies in Russia:

- Tax and other benefits (25 percent)
- Investments in physical infrastructure, grants, subsidies (20 percent)
- Innovation support (17 percent)

### Characteristics

- Tax benefits are of most interest to the automotive industry (33 percent), companies we classify as smaller (annual revenue of less than RUB 10 billion) (37 percent) and Russian companies (30 percent).
- Financial assistance is more of a priority for metal product manufacturers (33 percent), foreign companies (31 percent) and companies with annual revenue from RUB 10-50 billion (32 percent).
- The significance of state measures such as innovation support are substantially higher for industrial equipment producers (44 percent).
- The priority on investing in worker qualifications is twice higher for metal product manufacturers and foreign companies (20 and 23 percent, respectively) than for other manufacturing segments.
- The importance of preparing executives is significantly higher for chemical producers (20 percentage points higher than the average).
- State procurement is of most interest to industrial equipment producers (33 percent) and large businesses (29 percent).
- Customs duties and quotas are most sharply felt by chemical producers (17 percentage points higher).

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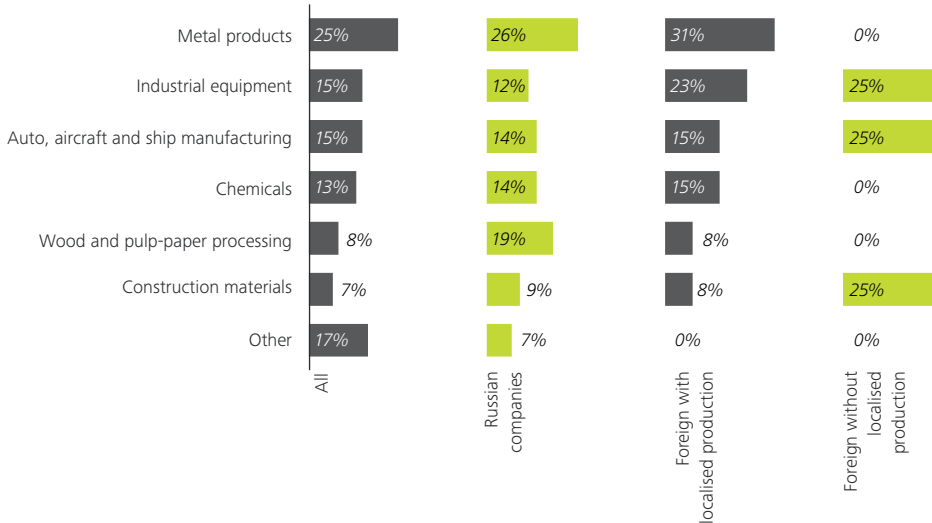
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Representatives from the following manufacturing sectors participated in our survey:

- Metal products (25 percent)
- Industrial equipment (15 percent)
- Auto, aircraft and ship manufacturing (15 percent)
- Chemicals (13 percent)
- Wood processing, pulp and paper (8 percent)
- Construction materials (7 percent)



- The number of wood processing companies is two times higher (19 percent) among Russian companies than in the selection overall.
- Foreign companies are most frequently represented in the machine-building segment (23-25 percent).



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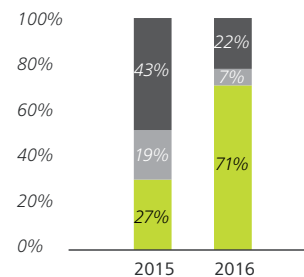
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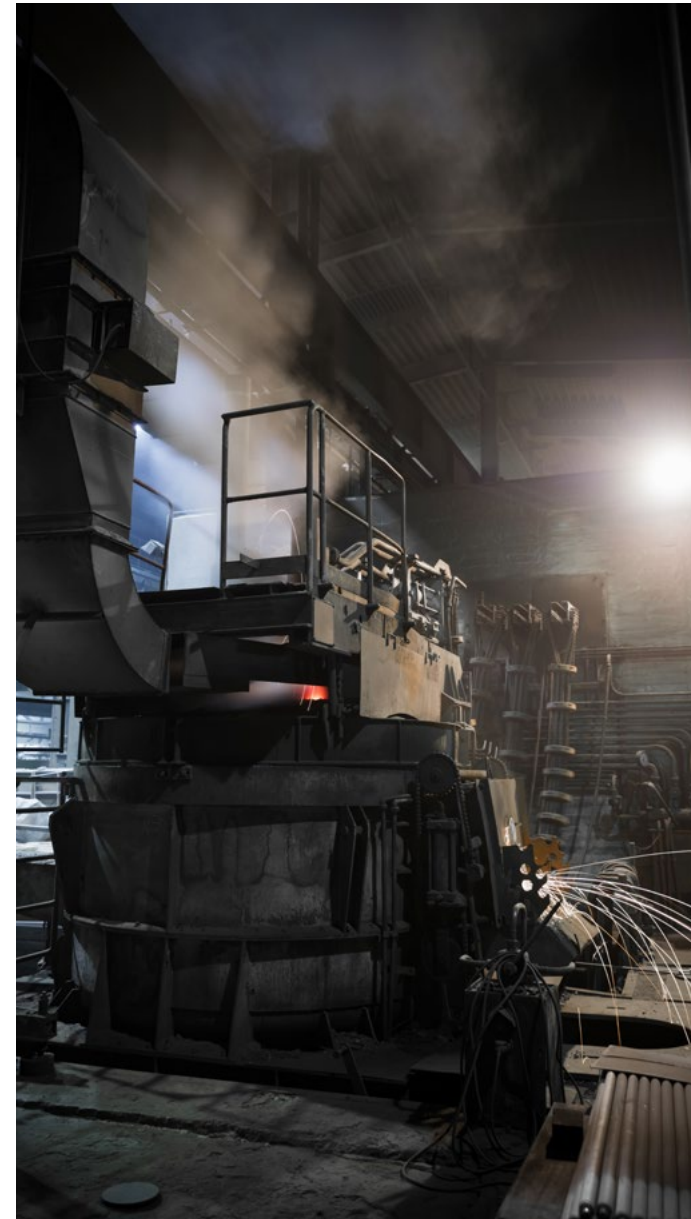
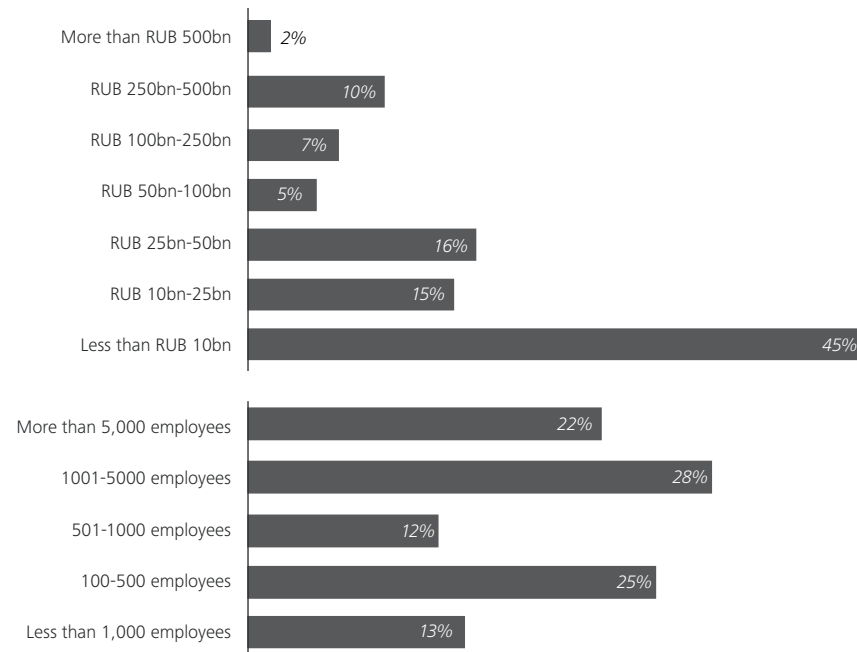


# Target audience



■ Russian  
■ Foreign without localised production  
■ Foreign with localised production

- In contrast to last year's research, in which the majority of respondents represented foreign companies, this year most survey participants (71 percent) were from Russian companies, while 29 percent represented foreign companies.
- Fifty-five percent of the companies have annual revenue of more than RUB 10 billion.
- Fifty percent of respondents represent large companies (more than 1,000 employees) and the other 50 percent represent companies with less than 1,000 employees.



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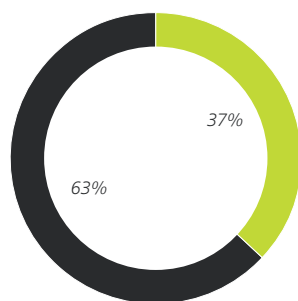
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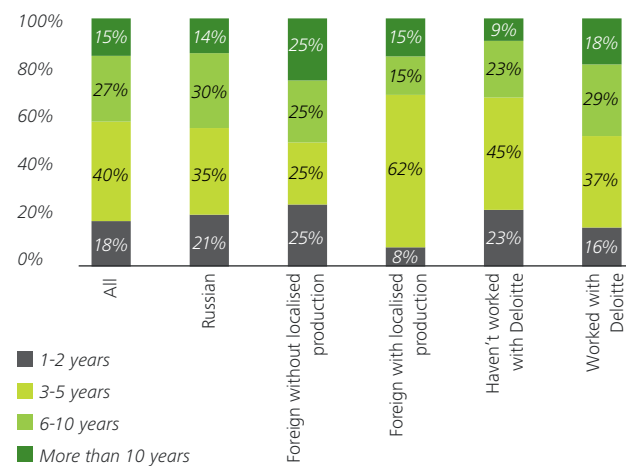


# Target audience



■ Worked with Deloitte  
■ Haven't worked with Deloitte

- The majority of survey participants (40 percent) represent companies with medium-term strategies of 3-5 years.
- A bit less than a third (27 percent) represent companies with longer-term strategies of 6-10 years; 15 percent of respondent companies have strategies of more than 10 years.
- More than a third of surveyed companies have worked with Deloitte.



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According to Russia's Federal Statistics Service (Rosstat), industrial production in Russia declined by 3.4 percent in 2015. This mainly reflected the processing industry.

A stronger fall was observed in sectors oriented toward domestic demand, as well as processing industries with high shares of value added: textiles, metallurgy, pulp-paper, and machine building, as well as the transportation sector. Exceptions were the chemical, food, and resource extraction industries.

The main barriers to growth were domestic demand and excess production capacity. Despite the rouble devaluation in 2015, not all sectors were able to reorient from domestic demand to external due to the high costs arising from the regulatory specifics of potential markets.

## Metals

Thanks to their export orientation, most Russian metallurgical companies did not experience a negative effect from the difficult financial situation. However, recently the world market has undergone substantial changes: global steel prices fell and the US and EU introduced anti-dumping duties on Russian steel that affected domestic players in the sector. Russian metallurgy is having difficulty redirecting exports to other countries, while the domestic market continues to be unfavourable. A fall in demand from the construction, automobile, machine building and electrical equipment industries has led to a decline in domestic demand for metallurgical products. Demand for metals is rising only in the oil and gas sector, which allows Russian metallurgy to feel somewhat better than the overall world market for metals.

## Automobile industry

The Russian automobile market fell by 37.5 percent in 2015 compared to the previous year. In 2016, this trend continues, and we note that this is the fourth year in a row of declines. The main stimuli that could help the automobile industry would be a rise in oil prices and an effective government support programme. The systems of demand stimulation and subsidies currently in place for the sector have not yet succeeded in substantially slowing the decrease in sales.

## Machine building

The machine-building segment is also declining, the main reason being reduced domestic demand from consumers and lower demand for equipment for investment purposes. The biggest declines occurred in automobile machinery, freight car and turbine production. In 4Q 2015 a trend emerged that opened up possibilities for an improvement in production – thanks to state support, growth resumed in the production of freight cars, trucks, grain combines and tractors.

## Chemical industry

The chemical industry, along with natural resource extraction and the food industry, showed firm growth in 2015, with output growing by 6.3 percent. Despite the reduced investment and consumer demand in the country and the worsening world market, the segment's performance was the best in recent years, and outpaced all other processing segments (including oil refining and food processing). The main reason was the rouble devaluation, which provided for a significant growth in export volumes. Chemical producers were able to increase production, despite the fall in domestic demand, as the volume of more expensive imported products decreased substantially. Construction of new polymer factories that had reached design capacity also enabled growth in chemical producers' performance.

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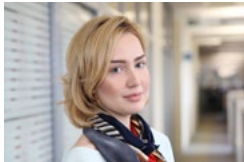
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