MARKET OUTLOOK
RUSSIA 2017

SWEDISH BUSINESS IN RUSSIA, TEMPORARY IMPROVEMENT OR FRESH START?
The Russian market is entering into a growth phase. The long term perspective is promising. Watch out for the mid term, new turbulence might come without warning.

The past few years, all of us working with Russia have followed the market development closely. There have been many reasons to worry; conflicts and political disagreements affecting the relations with other countries, oil price reduction and sanctions harming the Russian economy, policy decisions changing the conditions for business.

This report is an aggregation of the situation for the Swedish companies on the Russian market. Over 100 companies with local representation in Russia have answered questions on their outcome and expectations on the market, on plans and intentions, on worries and hopes.

This provides a unique insight in the realities of Swedish business in Russia and a complement to statistics and other data from the market.

We see from the data in 2017 that expectations are high on the year ahead of us. Companies gear up for a positive period, investments are coming back to the Russian operations, staff reductions have shifted to a stable or hiring mode. The expectations on growth is overall on a very encouraging level.

In the long term perspective, a decade or more, we believe that the Russian market provides for large opportunities. The domestic market is large and growing over time, investments are needed and ongoing, there is a need and a demand for foreign products and services.

By experience though, we can assume that new times of trouble can emerge suddenly and without warning. For this all players on the market need to be ready with a long term strategy and an agile approach to turbulence.

Andreas Giallourakis
Trade Commissioner Russia
SWEDISH COMPANIES BELIEVE IN RUSSIA LONG TERM AND ARE GETTING READY TO GEAR UP SHORT TERM

Coverage
- 112 of 176 surveyed companies participated in the survey
- 40% represent large companies

Profile
- Diversified respondent base in terms of both size and sector

Advantages
Top 3 advantages of doing business in Russia
- Swedish brand: 99%
- Profitability: 84%
- Market size & growth: 50%

Challenges
Top 3 challenges for Swedish companies are
- Bureaucracy: 22%
- Political aspects: 14%
- Uncertainty: 14%

Growth
- 61% expect the general market to turn to growth in the coming two years

Expansion
- 82% plan long term expansion on the Russian market, 26% already in 2017

Investments
- Plan investments in 2017, Out of those:
  - Production: 23%
  - Sales: 19%
  - Equipment: 19%

Corruption
- 13% have been exposed to some kind of corruption in 2016. Most commonly external fraud from private counterparts

STRUCTURAL CHALLENGES REMAIN, IMPACTING BUSINESS NEGATIVELY
GOOD COVERAGE AND RESPONSE RATE IN SAMPLE

112 respondents contributing to the survey

- 176 companies with permanent representation in Russia were sent a request to fill in the survey
- All sizes and industries represented among respondents
- Regional and country managers, other leading positions surveyed
- Survey open 4 weeks in February, March 2017
- Representative sample for the Swedish business in Russia covering most company groups represented on the market
RUSSIA FUNCTIONS AS A HUB OFFICE FOR A MAJORITY OF THE RESPONDENTS

57% use Russia as a hub for other markets

- 47% mention all or parts of CIS as their responsibility
- Kazakhstan and Belarus most common individual countries
- Georgia, Armenia, Azerbaijan, Mongolia also mentioned

Production in Russia increases likelihood of covering other markets

- 74% of locally producing companies use Russia as a regional hub

The Russian language provides for a natural link to the region
THE MARKET STABILIZED IN 2016 AND PROVIDED FOR INCREASED REVENUE

62% reported top line growth in 2016 in group reporting currency
- 37% saw moderate growth (0–20%)
- 25% saw high growth (more than 20%)
- Large companies perform better, 71% report growing revenue
- Significant improvement from previous years

The Swedish companies beat competition
- Market share is up for 40% of the respondents
- Market share is stable for 39%
Inflation reached high levels in 2015

- Past three years saw high inflation and depreciating Ruble
- Imported goods more costly amid currency drop
- Many raised prices dramatically in 2015
- Inflation is falling towards central bank target 4%
- Ruble regained strength from lows of 9 to 6.5 rub/sek

Price increases lower in 2016

- 38% raised prices in 2016 most of them by less than 20%
- Market outlook for 2017 much more stable than previously

“We have been hit by the weak exchange rate, customers rather buy cheaper Russian-made products”

Undisclosed participant
Real salaries in negative trend since 2014
- Longest period since the fall of USSR
- 64% of respondents raised salaries less than inflation in 2016

Stronger tendency to hire in 2016 than previously
- 28% of all respondents increased their total staff in 2016
- 9/40 companies with more than 500 mEUR global turnover increased their staff in 2016, 12/40 reduced staff volume

Retail sales are lagging
- Retail volumes dropped dramatically in 2014 and 2015 in official statistics, largely due to falling real income in population
- The fall slowed down in 2016 but is still in negative territory

Earlier cost trimming has turned, 2016 companies were in waiting mode or already starting to ramp up business
EXPECTATIONS ARE HIGH FOR YEAR 2017 FOR REVENUE, MARKET SHARE AND STAFF INCREASES

74% expect higher turnover in 2017 in Rubles
  ▸ 69% expect higher turnover in group currency, weakening Ruble implicated

52% expect gaining market share in 2017
  ▸ Lower than last year (57%)
  ▸ Higher than the ones actually gaining market share in 2016 (40%)

47% plan staff increases in 2017, up from 27% in 2016
  ▸ 21% plan to increase staff more than 10%, 26% plan increases up to 10%

Low pace of hiring expats, 4 companies plan for increase
  ▸ 92% plan no change, following reductions of 16% per year in -14 and -15
  ▸ Expats have left the companies, now found only in selected key positions
CORRUPTION CONTINUES TO BE A PROBLEM

Corruption is still an issue in Russia
- Dropped to rank 131 in Transparency International index
- Score unchanged 29/100, other countries climbed the index

Swedish business not unaffected
- Recent public issues, also with Swedish companies involved
- 13% of respondents were exposed during past year

Largest problems in external private counterparts
- 4% experienced corruption in public bodies and authorities
- 7% experienced fraud among customers, suppliers etc.
- 3% encountered internal fraud among own employees

EXPOSURE

... of the companies reported exposure to some kind of corruption* in 2016

Company Exposure to Corruption* in 2016 in Connection With ...

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<th>Exposure</th>
<th>No exposure</th>
<th>I don’t know</th>
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"Tax inspector asked for money to avoid tax audit"
Undisclosed participant

"Bank has demanded bribes to provide loans"
Undisclosed participant

"Private (employee) own transport company used"
Undisclosed participant

*IN THE MEANING OF CRIMINAL BEHAVIOR SUCH AS BRIBERY OR FRAUD
THE FIGHT AGAINST CORRUPTION IS PERCEIVED TO SLOWLY MOVE FORWARD IN A POSITIVE DIRECTION

Decline in corruption noticed
- 30% noticed improvement in the past 5 years

Further improvement expected
- 34% expect decrease in the coming 5 years

Active measures visible to the public
- Court processes against state possible to win
- Governors, ministers have been removed
- Maybe politically driven, still has desired effect

Business Sweden clearly opposes corrupt business behavior. We recommend to never engage in doubtful business setups. Beside the legal and ethical aspects, companies engaging in corrupt activities take a large risk on the local markets, and also expose the brand and reputation to considerable risks on a global scale.
THE POLITICAL TURBULENCE CONTINUES TO PLAY SIGNIFICANT ROLE FOR BUSINESS IN RUSSIA

Sanctions and embargoes following the dramatic events in 2014 are still felt
- Sanctions from EU and USA are still in place, hindering specific operations and counterparts
- Import embargoes and import substitution policies reduce export opportunities
- A novelty in 2016 were the restrictions on imports from Turkey, restricting the trade further

45% were negatively affected by sanctions and embargoes in 2016
- Lack of financing, specific deals made impossible are commonly mentioned effects of sanctions
- 6% of the companies were positively affected in 2016, mainly companies with local production that have benefited from the reduced competition from imports

Import substitution has a lower influence, with 22% experiencing negative effect
- Restrictions in participation in public tenders common result of the import substitution

“Export denial by ISP for specific products”
Undisclosed participant

“Less sales in Metallurgical sector due to restrictions from US and EU”
Undisclosed participant

“We had to say goodbye to customers”
Undisclosed participant

“Positive in the local assortment that we produce in Russia”
Undisclosed participant
Foreign Direct Investments dropped significantly 2014–2016
- Slow recovery in last quarters of 2016 in official statistics

30% of the respondents have production in Russia, 20% are not producing at all
- 59% of the companies with local production, are planning further investments in that production
- 73% of the companies without local production, are not considering establishing production in Russia

31% of the companies made investments in 2016, same share as last year
- Equipment, staff, and real estate most common responses

36% of the companies plan for investments in 2017
- In addition to the items mentioned above; IT, production and logistics were also frequently mentioned
- Plans for investments slightly up from last year’s survey, when 31% indicated such plans
COMPANIES CONTINUE TO EXPAND IN RUSSIA

The outlook is positive on long term expansion

- 82% aim at long term expansion on the Russian market
- A minor share of companies are withdrawing their presence
- Largest companies most expansive, 19/20 companies with more than 5000 mEUR turnover plan expansion in Russia

Short term expansion is on the rise

- 26% plan to increase geographical footprint in 2017, up from 18% intention and 18% outcome in 2016
- 3% plan to reduce the footprint in 2017 and 5% did in 2016
- Far East, Southern Russia and the "Millioniki" attract most

Market turnaround expectations are rising

- 61% believe the market will return to growth within 2 years, compared to 32% in last year’s survey
- 6% don’t foresee any positive scenario, 20% in 2015
MARKET DOWNTURN HAS MADE RECRUITMENT EASIER

Companies find it easier to recruit in 2017
- In 2014 59% considered finding management difficult and 40% considered it difficult to find staff
- In 2017 the share perceiving availability as high has grown to 36% for management and 51% for staff

The labor market has gone tougher since 2014
- Finding jobs has become harder during the downturn leading to more free resources to recruit
- Real salaries have not kept pace with inflation, making it easier to give attractive offers to candidates
- High skilled people are still in high demand, not immediately available and have good opportunities on the market

"Fantastic tech talent, but competition for that pool is intensifying. For high-skilled business talent a lot of people are unfortunately eyeing to move to the west"
Undisclosed participant

"Difficult to find english speaking staff outside Moscow and St.Pete"
Undisclosed participant
WHY STAY IN RUSSIA?

The long term profitability is high
- 46% consider their long term profitability high and 38% consider it moderate
- Only 9% claim their long term profitability low

The large and growing market
- 50% name the large and growing market being a main advantage for them

The Swedish brand stays strong
- 99% claim that the image of Sweden is positive, up from 84% last year
- All companies that profile themselves as Swedish say this has a positive impact
- 15% don’t profile themselves as Swedish
UNCERTAINTY AND ADMINISTRATIVE HURDLES REMAIN ISSUES THAT SLOW GROWTH

Extensive bureaucracy named as troubling
- Companies are held back due to administrative obstacles
- Growth is slowed down unnecessarily

Regulatory environment troublesome
- Unpredictability and constantly changing laws and regulations makes forward planning hard
- Weak protection and low institutional capacity in legal system continues to trouble businesses

No fundamental system reforms in sight
- Incremental procedural improvements connected to business are under way
- Russia is climbing the ease of doing business index
- Larger overhauls of the system’s more problematic areas; IP protection, ownership rights etc. are still lacking
TIME HORIZONS, SHORT AND LONG GOOD, BE PREPARED FOR MID TERM TURMOIL

The time horizon is one main factor to consider in a strategy for Russia

- The Russian market is characterized by periods of modest to high growth, interrupted by drastic declines
- Current indications point on a positive short term
- The long time outlook for Russia must be assumed to be positive
- The mid term is the wild card; when and why will we see the next crisis?
The Russian market shows signs of recovery

- Our survey shows high expectations for 2017
- Inflation, interest rate, currency and other indicators show strength
- Investments are coming back, starting from 2nd half of 2016
- Industry production on the rise, driven by exports
- Short term growth likely to be moderately positive

Several areas with business opportunities

- Import substitution promotes local production, technology in demand
- Agriculture, food processing, logistics attract investments

Retail has lagged behind the recent pick up

- Inflation reduced and real income returns to positive levels
- Private consumption likely to return to positive as ruble gains strength and economy accelerates

Coming out of a period with heavy challenges, we assess the short term outlook for the Russian market to be positive. A moderate economic growth will provide for favorable business opportunities for Swedish business.
LONG TERM OUTLOOK, THE DISTANT POTENTIAL

Resource rich and developed economy
- Vast natural resources and enormous reserves
- Significant Industrial capacity and sufficient internal market

Russia needs major investments to catch up
- Russia still remains underinvested compared to many western markets, significant development to come
- Infrastructure & utilities, residential property & production facilities, agriculture & extraction; have improvement potential

High academic potential
- Highly recognized academic institutions with well merited experts in engineering, IT, Physics, Mathematics etc.
- Large share of the population with higher education provide for a capable work force

The long term potential for the Russian economy is substantial. The prerequisites with large resources, an educated population and sizable industrial infrastructure are in place, enabling a significantly better performance than the current
THE MID TERM IS THE WILD CARD; WHEN IS THE NEXT PERIOD OF GROWTH, WHEN IS THE NEXT CRISIS?

There will be more challenging periods for Russia, when and why is uncertain

- Internal as well as external factors can send Russia into new periods of hardship
- New periods of falling GDP, depreciating currency, high inflation, rising unemployment, budget constraints likely to be repeated
- The timeline for when new crises may hit is uncertain, international frictions as well as internal challenges can hit near term. A lack of shocks can postpone negative scenarios by years

The Russian economy has proven to be resilient – collapse unlikely

- Monetary reserves work as cushion, low external debt in state and among individuals advantageous
GEAR FOR THE UNEXPECTED – CONCLUSIONS AND ADVICE

How to position the company on the Russian market and what level of presence to aim for depends on the company’s Resources, Risk Appetite and Time Horizon

› Work according to a conscious strategy and aim for a desired long term position on the market
› Remain in control, involve central group resources in the Russian operations, never let go entirely with full delegation of responsibilities
› Monitor the market closely, remain agile to sudden changes. Gear the Russian operations to accommodate for large movements of the market, positive and negative
› Do react on market swings, adjust operations early and forcefully to downturns and upturns, and always maintain the focus on the long term strategy
› Utilize tough periods to reinforce position for the strategic intent. The best talents, real estate, production facilities often switch hands in times of trouble
› Do the necessary homework, understand the particularities of the market, reduce risk by never cutting corners

There is a high business potential in Russia, also after the dramatic period of 2014–2016. The risk level remains high, and a robust yet flexible, strategy is crucial to deal with unexpected changes
Thank you for taking your time to read the Market Outlook Russia

The sentiment for the Russian market has turned significantly more positive during the past year. It can be seen in official statistics, in financial indicators and not least in our survey among the Swedish companies present in Russia.

On a more tangible level we see a high level of interest in market entry in Russia, from companies not yet present on the market.

We have in the past year assisted a multitude of companies finding relevant partners and distributors, we have helped setting up subsidiaries and supported market access procedures.

We have also seen recently that larger companies with many years on the market are starting to move again, refreshing earlier investment plans, reinitiating regional growth in Russia and surrounding countries.

Feel free to talk to me or my team in Moscow, Stockholm or any of the 50+ locations where we are represented in the world. We are thrilled to hear about your business, support your success and work together on the challenges on the foreign markets.

All the very best, vi hör! /Andreas

Business Sweden’s purpose is to help every Swedish company to reach their full international potential.
ABOUT BUSINESS SWEDEN

- Business Sweden is supporting Swedish companies via its 50+ offices across the world by providing strategy and operations advisory services across industry sectors.

- In-depth local knowledge and access to a global network of internal and external experts allow our 500+ professional consultants to help our clients reach their full international potential.