Overview of Manufacturing Industry in Russia
Key findings
Deloitte CIS Research Center
Moscow, 2017
Deloitte CIS would like to thank all those who participated in the survey we conducted in April-May 2017 as part of our “Current State and Outlook of Manufacturing Sector in Russia – 2017” project. We do appreciate your time and your interest in our research. Your expert opinions allowed 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 market participants about their companies’ development and the market overall.

We are pleased to present you with the key findings of our research. The full report will be available in September 2017.

We have been conducting this survey annually since 2015. It serves as the basis of our integrated research on the state of the manufacturing sector in Russia. We would be grateful if you could 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 manufacturing sector and companies in Russia
- Outlook for the manufacturing sector and companies in Russia
- Key problems manufacturing companies in Russia are facing
- Key incentives and development barriers of the manufacturing sector and companies in Russia
- Priority strategies for manufacturing companies in Russia
- Currency risk and its impact: how to manage
- Changes in working with suppliers
- Government support measures for manufacturing sector in Russia
- Innovation at manufacturing companies in Russia
- Relevant environmental and tax issues

Srbuhi Hakobyan
Partner,
Deloitte CIS
Overview of Manufacturing Industry in Russia | Key findings

Current state and outlook for the manufacturing sector

The Russian manufacturing sector saw signs of improvement and strengthening optimism in 2017.

Current state

For the first time in three years, the perception of the current state of the industry is dominated by positive estimates (the net balance grew from 0 to +8 percent).

+8% 0%

The share of respondents who are optimistic about the current situation in their business retains the leading position (82 percent), however their outlooks appear to be rather tempered compared to the previous year (the net balance decreased from 76 percent to 65 percent).

+65% 76%

Outlook

The share of pessimistic views on the outlook for the industry decreased by 10 percentage points (the net balance grew from +13 to +26 percent).

+26% +13%

The optimism of manufacturers with respect to the prospects for their businesses has an almost triple increase (the net balance grew from 16 to 44 percent).

+44% +16%
As in 2016 the views of the manufacturing sector players remain diverse, however the last year’s trend is accompanied by a seismic shift in the sentiments of certain subgroups of companies.

The last year saw a deterioration of the sentiment in the chemicals industry (the share of negative assessments of the industry’s current conditions 16 percentage points above the average).

The steel, automotive, aircraft and ship manufacturers are more optimistic about the overall situation (the share of negative assessments of the industry’s current conditions is 17 percentage points above the average).

For the second consecutive year industrial equipment producers retain the negative views on the overall situation and in the outlook for the industry.

Over the past year, the share of optimistically disposed foreign companies and large businesses has doubled (up to 58 and 60 percent, respectively).
Overview of Manufacturing Industry in Russia | Key findings

Current state and outlook for the manufacturing sector

Trend

Over the past year, the industry and the businesses were influenced mainly by external factors: currency fluctuations, production capacities of other countries, availability of external investments, etc.

Highlights

Top factors impacting businesses:

- **Ruble appreciation:**
  - 31 percent of chemicals producers noted negative impact of the Ruble appreciation on their businesses;
  - 86 percent of automotive, aircraft and ship manufacturers, as well as
  - 83 percent of foreign companies mentioned positive impact of the Ruble appreciation.

- **The surge in global metal prices:**
  The period from Q1 2016 to Q1 2017, saw boosting prices across many of the base metals for the Russian economy, in particular (in U.S. dollar terms):
  - steel: + 65 percent;
  - aluminum: + 15 percent;
  - copper: + 12 percent;
  - zinc: + 35 percent.

- **Ferrous metals production slowdown in China:**
  31 percent of metallurgical companies speak of the competition from the Chinese companies and the negative impact of the Chinese production development on their businesses.

- **Investment programs shutdown:**
  Industrial equipment manufacturers suffer the overall reduction in investment allocated to the purchase of machinery and equipment (over the past two years, the share of investment has decreased by 25 percent *).

Interest for public funding:

79 percent of the respondents show their interest for this source of capital.

* Adjusted for inflation
Drivers of competitiveness in 2017

Trend

In 2017 the industry and the businesses are becoming more independent of macroeconomic environment. The analysis of the companies’ expectations shows that the market participants see a greater stimuli for development directly in enhancing the efficiency of internal business processes.

Highlights

Top-5 factors stimulating market development in 2017:
- Lower administrative barriers
- Lower geopolitical risks
- Lower currency risks
- Government support
- Transparency and stability of regulatory, tax and economic policies

Top-5 drivers of company development in 2017:
- Reduced production costs
- Increased demand in Russia
- Extended production and technological capacities
- Lower administrative barriers
- Product line extension
### Most important issues in 2017

**Trend**

The concern of the manufacturers is shifting towards the efficiency of the government regulation and the purchasing power of the population, which reaffirms the general trend for market recovery.

**Highlights**

<table>
<thead>
<tr>
<th>Increased importance (top-3 issues):</th>
<th>Decreased importance:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shortcomings of government regulation</td>
<td>+ 9 pp</td>
</tr>
<tr>
<td>Corruption</td>
<td>+ 16 pp</td>
</tr>
<tr>
<td>Insufficient purchasing power of households</td>
<td>+ 18 pp</td>
</tr>
<tr>
<td>Geopolitical risks</td>
<td>- 10 pp</td>
</tr>
<tr>
<td>Currency risks</td>
<td>- 21 pp</td>
</tr>
</tbody>
</table>

Despite the reduced concern over the exchange rate volatility, the currency risks continue to influence businesses: 40 percent of the respondents cited that the Ruble devaluation triggered an increase in the cost of their products, and only 14-15 percent of the respondents indicated that the weakening of the domestic currency increased their competitiveness in domestic or foreign markets (mainly chemical companies and industrial equipment manufacturers; 31 and 33 percent, respectively).
Overview of Manufacturing Industry in Russia | Key findings

Other issues

Trend
An increased concern of the manufacturers in 2017 is with the following aspects of their businesses:
- supplier relationship
- talent
- energy efficiency

Highlights
Key supplier relationship issues:
- established price level
- pricing flexibility
- delivery terms
- quality of delivered components and raw materials

Key staffing issues:
- lack of staff:
  - 17 percent of the replies indicated a lack of production staff.
  - 26 percent of the replies indicated a lack of automation staff.
- lack of qualified staff:
  - 35 percent of the respondents indicated a lack of quality talent in optimization and automation staff.

The lowest satisfaction with talent was reported in the chemical, automotive, aircraft and ship manufacturing industries. The average age of production professionals in the chemical segment is five years higher than the industry average.

The key energy efficiency issues:
- high energy tariff rates in Russia (79 percent)
- The chemical industry displays certain characteristics: 31 percent of the respondents indicated a lack of the energy infrastructure quality in Russia (lack of production capacities).

Notably, the identified issue hinders the production intensification and advanced technology implementation.
Overview of Manufacturing Industry in Russia | Key findings

Priority business strategies in 2017

Trend

The priority business strategies in 2017 reaffirm the general trend for the manufacturing sector recovery:

• entry onto new markets (81 percent)
• bringing new products to the market (77 percent)

However, the so called anti-crisis campaigns (e.g. on cost reduction in Russia) have decreased in relevance (by 11 percentage points).

Highlights

Top-5 priority growth strategies for companies in 2017:

- Entry onto new markets
- Bringing new products to the market
- Enhancing the production and technology potential
- Business development through organic growth
- Replacement of imported products in the local market

The effect of import substitution policies:

Since 2016 manufacturers are actively implementing a strategy to reduce the imports share (59 percent), with 41 percent of companies having similar plans for the next year.

The key reason for a decreased share of imports in the procurement structure stems from the increase in prices for foreign products as a result of the weaker Rouble. However, the results of our survey revealed that 20-24 percent of the respondents eliminated import products from their structures indicating higher quality and lower prices for Russian products.
Other business strategies in 2017

Trend

The manufacturers have noted an increased interest for the following strategic plans in 2017:

- Changes in strategies for working with suppliers
- Changes in personnel policy
- Energy efficiency strategies

Highlights

Strategies for working with suppliers:
While in the last year the most common strategy was to change suppliers without increasing their number, this year the manufacturers have announced strategies for their suppliers’ networks expansion (with 41 percent of the respondents in the process of the strategy implementation and 47 percent planning the implementation in 2017).

Changes in personnel policy:
56-58 percent of the respondents plan to introduce changes to their personnel policies in 2017. It should be noted that the absolute majority of the respondents intend to increase the pay level, while half of the companies surveyed plan to reduce headcount.

On average, the planned changes in the pay level and headcount do not exceed 5%.

Notably, foreign companies expect to increase both their headcount and average pay for all employee categories mentioned, particularly for optimization professionals (+7 and +7 percentage points, respectively).

74 percent of the respondents note the need for automating HR management processes, however only half of those companies have estimated the respective costs.

Over the past year, the share of companies concerned about the energy efficiency has increased by 9 percentage points. 77 percent of the companies surveyed have planned the relevant measures. The highest priority is placed on such measures as the intensification of technological processes, the introduction of advanced energy-saving technologies and the prevention of direct energy losses.
Overview of Manufacturing Industry in Russia  |  Key findings

Sources of capital

Trend

In 2017 the respondents pointed to the attractiveness of financing through government investment.

In 2016, the business was focused on a single source of capital (own resources). Today, however, the companies are more disposed to external investments.

Highlights

69 percent of the companies surveyed stated their intention to attract external investment.

In 2017 the respondents pointed to the attractiveness of financing through government investment.

In 2016, the business was focused on a single source of capital (own resources). Today, however, the companies are more disposed to external investments.

69 percent of the companies surveyed stated their intention to attract external investment.

69 percent of the companies surveyed stated their intention to attract external investment.

69 percent of the companies surveyed stated their intention to attract external investment.

Most respondents (58 percent) have experience in raising foreign investment.

65 percent of companies surveyed, have recognized the importance loan refinancing for their businesses.

Notably, the majority of them (63 percent) indicate positive non-financial results from such cooperation.

“Despite the fact that attracting government investments is associated with a whole range of difficulties, they are often provided on more favorable conditions than those available on the market.”

Srbuhi Hakobyan
Partner, Deloitte CIS
Overview of Manufacturing Industry in Russia  |  Key findings

Efficiency of the government regulation

Trend

2016 is characterized by a stronger loyalty of the business to government efforts.

It is noteworthy that positive impact of the state support of innovation is rated the highest.

Highlights

The integrated assessment of the government support for business and development of the Russian manufacturing industry has increased by 0.2 points from 2016 and scored 1.7 at the three-point scale, indicating an average satisfaction of the business with government efforts.

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

- Public procurement orders
- Tax and other financial incentives
- Investment in physical infrastructure

Notably, in 2017 two times as many businesses expressed their interest for public procurement orders on their products (by 17 percentage points).

Among other government measures, the state support of innovation receives the most positive views: +26 percent.

At the same time, the energy policy, energy tariffs in particular, is seen as negative: –25 percent.

“In the face of unfavorable market environment, the manufacturers are not willing to adopt transformative measures to increase efficiency, but rather rely on the government support.”

Srbuhi Hakobyan
Partner, Deloitte CIS
94 percent* of the surveyed CFOs of leading manufacturing companies in Russia stated the need enhancing the economic efficiency of business functions through automation of the key business processes.

72 percent* of the surveyed CFOs of leading manufacturing companies in Russia stated that they take part in the evaluation of new technology solutions and launch of innovative projects in their companies.

Over the past year, the average revenues spent on innovation and digital solutions grew by 0.5 percent to 9 percent, which in turn confirms the global trend of growing interest of manufacturers for technological innovation and new digital solutions.

Notably, foreign companies spend on innovation almost 1.5 times the share of innovation spending in Russian companies (12 versus 8 percent).

The top requested innovations: introduction of advanced production technologies (43 percent) and launch of technically new or advanced products (31 percent).

Top-5 technologies that are implemented/ planned for implementation in the near future:
- Electronic document management (EDF) (83 percent)
- Energy saving technology (72 percent)
- Full automation of selected business processes (69 percent)
- Full automation of business process chain (63 percent)
- Advanced ERP systems (57 percent)

Key reasons for non-use/ limited use of EDF:
- Impracticality of paper flow dismissal
- Lack of resources (human, financial, qualification)
- Risks and concerns regarding the loss of documents translated into electronic form

* Based on the results of the CFO Survey (first half of 2017)
Innovations and digitalization of tomorrow

Trend

Increased manufacturing innovation activity across a variety of operations

A shift in attitude towards innovation activities

A greater automation in the manufacturing industry by 2018

Highlights

- 51 percent of the respondents plan to acquire advanced equipment
- 44 percent are focused on R&D activities
- 37 percent indicate the relevance of marketing research
- A growth in demand for marketing research and digital solutions (by 7-9 percentage points)
- Almost half of the companies surveyed plan to introduce the full automation of some business processes and business process chains (47 and 44 percent, respectively)

“Despite the fact that the business understands and is willing to adopt innovation and digital technology, the existing task distribution framework, including internal and external management, is deemed outdated and ill-prepared for the new market conditions.”

Srbuhi Hakobyan
Partner, Deloitte CIS
In 2017 the development of innovation and digitalization in the manufacturing sector will be hindered mostly by internal constraints, while external factors will have a greater boosting effect.

In 2017 (and roughly in the next two years) the main constraints for the digital strategy implementation in manufacturing companies will be the organizational structure and staffing (as indicated by 82 and 76 percent of the respondents, respectively), while only a year ago the manufacturers spoke about the greater importance of the overall economic situation in Russia and in the world.

At the same time, the key drivers for digital strategy implementation in manufacturing companies are the market and the competition, which reaffirms the recovery processes in the economy (both in Russia and globally) and the natural demand for innovations and digital developments.
Overview of Manufacturing Industry in Russia  |  Key findings

Contacts

Egor Metelkin
Partner, Audit & Assurance
Head of the Consumer Industrial Products Group, Deloitte CIS
emetelkin@deloitte.ru

Srbuhi Hakobyan
Partner, Audit & Assurance
Head of Industrial Products & Services Group, Deloitte CIS
shakobyan@deloitte.ru

Andrew Sedov
Partner, Audit & Assurance
Head of Metal Services Group, Deloitte CIS
asedov@deloitte.ru

Yulia Orlova
Partner, Tax & Legal
Head of Chemical Services Group, Deloitte CIS
yorlova@deloitte.ru

Tatiana Kofanova
Director, Tax & Legal
Head of Automotive Group, Deloitte CIS
tkofanova@deloitte.ru

Lora Zemlyanskaya
Research Centre Leader
Business Development Department, Deloitte CIS
lzemlyanskaya@deloitte.ru

Mikhail Gordeev
Senior Research Specialist
Research Centre, Deloitte CIS
mgordeev@deloitte.ru

Artyom Belyaev
Designer
Brand and Business Development, Deloitte CIS
abelyaev@deloitte.ru

Irina Yureva
Coordinator
Consumer Industrial Products Group, Deloitte CIS
iyureva@deloitte.ru
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ('DTTL'), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

Deloitte provides audit, consulting, financial advisory, risk management, tax and related services to public and private clients spanning multiple industries. Deloitte serves four out of five Fortune Global 500® companies through a globally connected network of member firms in more than 150 countries bringing world-class capabilities, insights, and high-quality service to address clients' most complex business challenges. To learn more about how Deloitte's approximately 244,000 professionals make an impact that matters, please connect with us on Facebook, LinkedIn, or Twitter.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2017 ZAO Deloitte & Touche CIS. All rights reserved.