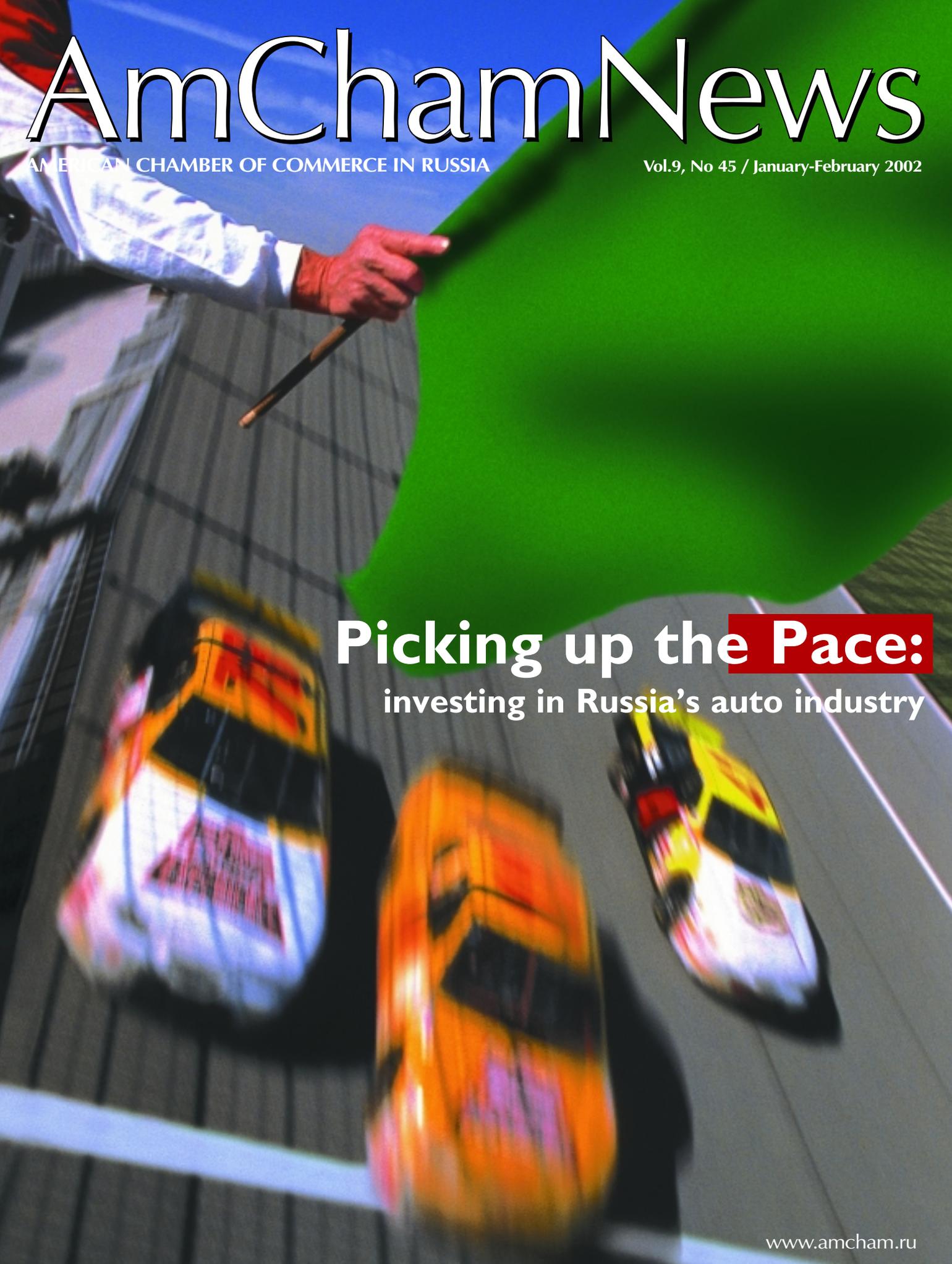


# AmChamNews

A hand in a white shirt and red glove holds a green flag on a wooden pole. The background is a blurred race track with several colorful cars (yellow, orange, white) moving quickly. The sky is blue.

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## Picking up the **Pace:**

investing in Russia's auto industry

# Russia's automobile industry

## at a crossroads

by David J. Herman,  
Vice President, General Motors CIS

There is hardly any type of investment which governments would rather have than in automobile production. It creates jobs, leads to the possibility of exports, avoids expensive imports – and above all provides an outlet for trained professionals of many disciplines. Russia's growing economy and the aspirations of its buying public are in sharp contrast to the current offer of its domestic producers. Pending World Trade Organization negotiations and related legislative developments leave Russia at a crossroads which will affect not only the Russian public but the world's automotive producers who seek opportunities to participate in this important market.

Several foreign automakers have been discussing joint ventures with local partners for years, but only BMW, Ford and GM have gone ahead with serious investments. Although the main reasons for this reluctance have been country risk and affordability, there are serious gaps in Russian industrial policy and administration which, seemingly, will be resolved over the next year or so:

**1 WTO Negotiations.** Russia's avowed desire to enter the WTO will result in an agreement on tariffs. The current rate of 25% is high by world standards, but low for countries which wish to nurture a domestic industry. With a volume of 1 million new cars and up to 600,000 used car imports, Russia has good reason to negotiate a transition period to encourage local production. The country imports 20 times more in automotive products than it exports (\$6 billion vs. \$300 million). For instance, China has tariffs currently at 70% and goes to 20% only after 5 years.

**2 Used Car Imports.** Estimates range from between 300,000 and 600,000 for the number of used



car imports into Russia. These do not pay VAT tax in the country of origin, nor in Russia. Combined with the sometimes murky nature of customs administration, used car imports are very attractive to individuals, but of course this results in losses for domestic producers and represents a major barrier to foreign investors. The public and consummate free traders see this as positive but the government has to make a policy decision based on whether it believes that Russian value – added with the attendant development of jobs and skills – justifies a long term development philosophy. The problem will grow worse as the European Union moves to more strict emissions regulation forcing more used cars into the inventories of European dealers, who in turn will try to export eastward.

**3 The Supplier Industry.** Up to 70% of the value of a new car comes from purchased parts. Because of the peculiarities of the Russian

tariff system, parts from Western Europe can be cheaper landed in Russia than some locally-produced parts. The Russian supplier industry, after years of isolation from competition, lack of investment, and with old technology, can only improve with the support of foreign technology sources and investors. Normally, their interest will depend on the previous commitment of their partners, the automotive companies, who buy from them worldwide.

Cool heads will be needed to answer these questions. Until now, the Russian Government hasn't enjoyed much foreign direct investment in the automotive industry from which to see results. That is changing and provides hope that the country will take advantage of its great engineering talent and its competitive costs for energy, materials and labor. Clearly, this should be a fertile ground to develop business ties and support economic development.



**Could you tell us about the new plant that Ford plans to open in 2002?**

This plant is the first major assembly plant by a non-Russian company in the country – complete with body-welding, part-by-part build and a complete paint shop. It is a major investment, around \$200 million. The plant will start with the production of the Ford Focus. A vehicle, which we think is very suitable for the Russian market.

The plant can actually make up to five different models. If the industry or economic development is good enough, we will add more models. The initial capacity is 35,000. With a few small investments, we can increase it to 100,000.

**In August, Ford opened a training center in Leningrad Oblast. Will the new plant's employees be trained there?**

All of the people we employ will have training in this institute. We are now hiring the people for the assembly line and talking to trainers. Today, we have 300 people hired. At the start there will be 450 – that will be for a single production shift. It will increase to 700 and our production will increase over the years, we're pretty sure. There is a lot of potential for growth in Russia.

**Why did Ford decide to produce the Focus automobile in Russia?**

It is mainly because we reckon that of all of the cars on the street, 70% are in

# Ford gears up for production in Russia

With the Ford Motor Company's plans to open an automobile assembly plant in the Leningrad Oblast, we decided to find out more about Ford's plans in Russia and about the automotive market in general. The following are excerpts from a conversation with **Henrik Nenzen**, *President Russia & CIS, Ford Motor Company*.

this segment. A little more than 70% are cars of this size. So, it's a very suitable size. It's a perfect car for the Russian market – front-wheel drive, and we will adapt it to Russian traditions and preferences... so it will take lower-octane fuel, it will start in very low temperatures and we will also prepare it for flooding on the streets.

**What are the advantages for automakers in Russia?**

Today in Russia there are 131 people per 1,000 cars. In the U.S., it's more like 750. So, if you want to just double the car ownership here to 300, which is very, very low compared to European and American levels, that means that we have to sell another 22 million vehicles... just to catch up with 300 people per 1,000. That probably means 35 million vehicles. So, this is a growth market. One of the biggest in the world by far. That is why Ford decided to come here.

**What are Ford's long-term plans for Russia?**

We are very ambitious here. We want to take a bigger share of the Russian market than what we have in Europe. Since we are first to be number one in sales, among the Western manufacturers, we hope to co-exist with Russian manufacturers, as we co-exist with German manufacturers.

One factor which is important for the Russian industry, is that our objective is to localize 50% of the components at this plant. The opportunity for the Russian economy, of course, is that if Russian manufacturers qualify to supply components to the St. Petersburg plant, then they will, if the price is right, be able to supply all of our German Focus plants. That means,

instead of selling 25,000 components to us, they can sell 1 million.

**What Russian manufacturer do you see as your biggest competitor?**

We will be attractive both to people who buy Russian makes today, mainly Lada, and to those who buy used vehicles today... The other thing which is important in Russia... if you want to sell cars to the people who buy used or Russian-made vehicles, is to have low-cost of ownership. We are working very hard to get parts to our dealers at low prices and to provide efficient service. We've launched something we call manu-pricing, where you have set prices for maintenance... it's the same price throughout Russia.

**Do you plan to open more dealerships?**

What we've found is the reason Russians don't buy non-Russian makes, is because service and parts are not available everywhere. We're tripling the number of dealers we have in Russia, so we'll get geographic coverage. We will go from having 21 service points to over 80 official, authorized service points. It's a very important security factor for those who buy vehicles in Russia.





by **Naoya Nakamura**, *Manager, Motor Vehicle Team,  
Machinery Department, Mitsubishi Corporation*

# Leasing business in Russia

The leasing business is one of the most important elements for strengthening a Russian company's productivity and increasing the demand for commodities such as automobiles. This, in turn, creates stable economic growth in Russia.

In Russia, there have been many positive and clear revisions to leasing legislation recently.

A comparison of legislation for the leasing business in Russia with that of other developed countries reveals that Russian legislation is standard as to the risk of the lessor.

According to the legislation, a lessor can secure his risk by repossessing assets in the event that the terms of the object's use do not correspond to the contract terms and/or the lessee effects subleasing without proper consent, etc.

Starting in 2002, no license will be required and the lessee will be able to insure his payment to the lessor, given that insurance companies can accept such insurance.

Leasing is also attractive according to Russian taxation legislation. As of January 2002, in the case of an on-shore company, the profit tax will be reduced from 35% to 24%, and in the near future the turnover tax will be eliminated completely.

Taking these positive factors into account, it seems that the leasing business in Russia is very attractive.

It is difficult to estimate future profit and growth since this type of business is just getting started in this market. I can say, however, that it will show some growth over the next few years, thanks to the positive revision of legislation and a sales boom. This growth could increase substantially in the future, if credit risk information for companies and individuals is made more accessible.

However, it is very difficult for foreign companies to start a leasing business in Russia, especially for commodities, as to real and actual risk. Despite the positive changes in legislation

and taxation, there are actually many barriers to enter the leasing business in Russia.

It is risky to extend financial leasing and operational leasing to Russian companies, since it is difficult to determine the company's actual credit risk, due to its undisclosed financial status. Officially, this information is disclosed, but it is still very difficult to understand the actual situation.

The leasing business is, as you know very well, the financing business, which means that a company would have to invest high-risk money into its leasing business.

Before entering the leasing business in Russia, foreign companies should make sure they have reliable partners with marketing expertise and the know-how of risk hedging in this market.

# BMW:

## Building on its proven track record in Russia

BMW has been assembling cars in Kaliningrad Region of Russia since 1999. We asked for the company's thoughts on the Russian auto market, including its future plans here. Below are excerpts from an interview with **Wolfgang Schlimme**, *General Director of BMW Russland Trading*

### **Could you tell us about the BMW assembly plant that you have in Russia?**

The project to produce BMWs was developed in 1999 and provided for the production facilities of our Russian partner Avtotor to assemble cars on the basis of SKD and CKD processes with components supplied from Germany. We have already produced and delivered over 3,500 cars.

### **How many employees work at the plant?**

Over 1,000 jobs were created when we opened the production facilities.

### **What models are produced in Russia?**

Currently, we produce 3 and 5 Series models at the plant in Kaliningrad. Since opening the plant, we have increased the number of types of engines and options offered. We now have 14 different model specifications for cars that are manufactured in Kaliningrad.

### **What are the advantages for foreign automakers in Russia?**

Foreign manufacturers are able to meet those needs of customers, which local producers cannot.

### **What are your long-term plans for Russia?**

We plan to steadily increase the volume of our production and our share of the market. In the luxury segment of the market, our aim is not only to increase

volume, but to maintain our customer care system, quality and style as a leading premium brand.

### **Do you plan to open more dealerships?**

We currently have an extensive dealership network in Russia. There are 21 authorized dealers in 16 major cities. Regional sales account for 35% of our total sales. Four more new dealerships will open in 2002.

### **What is your share of the Russian market?**

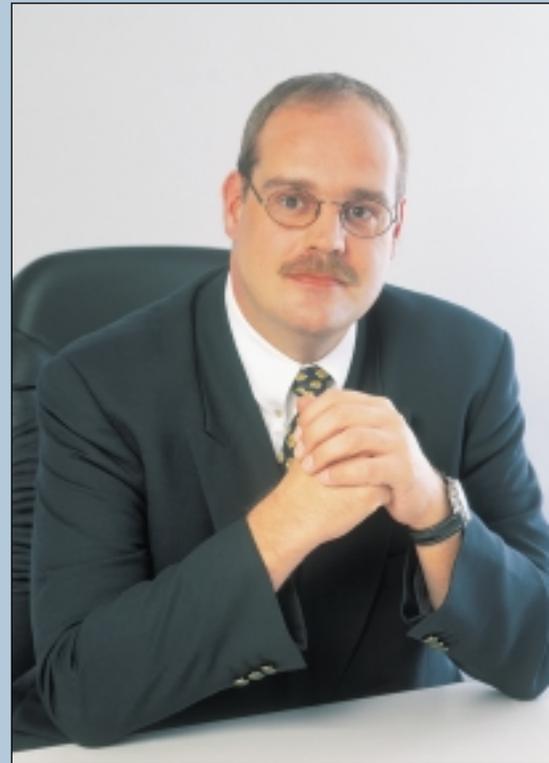
This year the auto market showed a very positive trend on the background of a stabilizing economy. In 2001 we doubled our sales, compared to 2000. We hold the leading position of the 5 and 3 Series, "business class" and "middle class" segments.

### **Do you have any other plans for expansion in Russia?**

We have very ambitious plans for the year 2002. We plan to achieve even higher sales volumes, to expand our dealer network to better serve our customers.

### **What is your opinion on import tariffs?**

We are in favor of the most recent tariffs that have been introduced for used cars that were produced before 1995. We feel that this step will make the driving environment in Russia much safer.



### **What kind of growth potential do you see in Russia?**

Russia has great potential for growth. Of course, a lot will depend on the global economy and the political situation. We consider Russia one of the top strategic locations for further development and growth.

### **What are the advantages/disadvantages to producing automobiles in Russia?**

The market continues to grow. A Russian distribution company can provide more qualified service to a dealer network and its customers. Of course, there is also a price advantage of roughly 20% compared to imports.

# Car insurance: a "must-have" accessory

by **Paul Goncharoff**, Director,  
ATG Russia Agencies



**The** highly volatile automobile environment in Russia includes congested roadways, roads under construction, expensive automobile repair, high rate of auto thefts, other malicious acts, and of course road accidents as everywhere else in the world.

For these reasons, as well as particular local specifics, automobile insurance in Russia for both companies and individuals is a necessary, ultimately cost-effective service. As of this writing auto insurance is voluntary in Russia, the resultant costs for auto insurance in Russia are therefore higher than in Europe and the United States as the comparative volume of vehicles on the road **which are insured** is less by a wide margin.

The Duma of the Russian Federation is seriously considering introducing a mandatory third party liability insurance sometime in the near future. The considered minimum coverage at this time corresponds to approximately \$3,000. However, at this stage and writing nothing has been finalized.

Today in Russia, voluntary auto insurance generally provides clients with indemnification as a result of an automobile accident, fire or natural disaster. The insurers pay expenses related to the auto owner's liability as well as covering accident expenses for those passengers who may have been injured in the insured's car. An auto policy can provide the necessary assistance for a company's management in the event of an automobile accident, and frees the company from the countless local complications associated with an automobile accident.

Where some, but not all insurers take that extra step is in the realm of theft. Should you choose to include vehi-

cle theft in your company's auto coverage, and this is recommended, it then makes sense to choose a policy wherein the stated value of your vehicle remains unchanged for the life of that policy. Traditional among local insurers is: if a theft has occurred, a discount is attached to the reimbursement akin to time depreciation. Depending upon the local insurer, this can range from -10% to -30%, and can be particularly painful if the stolen car was recently purchased.

Due to the low percentage of insured vehicles on the roads of Russia, a local scam has been practiced as more privately owned foreign cars appeared on the streets. Say you are travelling in the left lane on the Garden Ring, suddenly behind you a very impatient car is flashing its lights, honking, tailgating and generally carrying on. Being a normal driver, you think "crazy driver, better change lanes," and you signal to move right one lane. As you do so, you feel a sudden light impact on your rear bumper from the same car who was tailgating you (who is now miraculously in the right lane). Being a law abiding driver in Russia means that you stop your car immediately, even if blocking traffic, define the situation with the other driver, and wait for the traffic police to conduct an investigation at the scene and issue necessary documentary findings.

The other driver points to his front left fender (which unknown to you has been suitably pre-smashed), and recites the "letter of the law" to you. In sum: you pulled into the right lane where he had right of way, hence you're guilty no matter what, unless lengthy and involved investigation proves differently. At this psychological moment the driver, in an attempt to be reasonable, proposes that you settle promptly in cash and all will be forgotten, otherwise the slaving maw of the local legal system awaits... Until you mention that you really don't mind, and will wait for the traffic police as you are covered by auto insurance which includes third party liability. All potential benefits for the miscreant have suddenly disappeared, and with a no-doubt piquant gesture directed at you and your insurer he should drive away.

So now you know that the overly large insurance company stickers covering the rear windshield of Russian cars aren't just an expression of pop-culture. The car may not be insured, but the sticker is a "must-have" accessory.

As with any service anywhere, the buyer wants to get the most for the least. Where it concerns insurance and Russia in particular, it is worthwhile to take the time to thoroughly assess and question the actual terms and conditions of local insurance, claims servicing and language. Just as vital is determining the ability of the insurer to pay potential claims. Transparency and an independently determined financial reputation of the insurer is a good place to start, and can be accessed on the international insurance sectors of the websites at Moody's, S&P, etc. A good guideline is the tried and true: "If it sounds too cheap, it probably is."