

2007

U.S. Companies in Russia Business Performance Survey

Commissioned by



American
Chamber of
Commerce in
Russia

2007

 **ERNST & YOUNG**

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American Chamber of Commerce

The American Chamber of Commerce is the largest foreign business organization in Russia, effectively advocating the trade and investment interests of over 800 member companies. With its Moscow headquarters, its St. Petersburg chapter, and representatives in Washington, D.C., the Chamber advocates the interests of its members to the Russian and US governments and provides a forum for dialogue between the international business community and policymakers.

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Introduction

During 2001–2005, the Russian economy demonstrated steady growth based primarily on the favorable foreign market for raw-material exports. The year 2006 was no exception to sustained positive trends (GDP growth, net positive investment inflow, a drop in the inflation rate, a multi-billion dollar Stabilization Fund, and healthy foreign exchange reserves), with one additional distinction: a more qualitative development of the economy.

The fact that the Russian economy is restoring its investment appeal, despite certain political risks on the threshold of elections, becomes evident when we see that global American investment firms which closed down business in Russia after the crisis in 1998 are returning to the Russian market. In 2006, for instance, Goldman Sachs and Merrill Lynch began significant staff expansion of both expats and Russian professionals in the securities

and investment markets, and in early 2007 another major investment bank, Lehman Brothers, announced that it is planning to return to Russia. This complements the already successful presence of Citibank, JPMorgan Chase, and Morgan Stanley.

Currently, Russia is in the final phase of accession to the World Trade Organization (WTO). Accession should give US companies easier access to the Russian market. Measures are in process to protect intellectual property to a greater extent and to step up enforcement. This development will benefit American information technology, pharmaceutical, and consumer goods companies, which have been rapidly gaining ground in the Russian market. Russia's accession to the WTO will give US financial institutions better access to the Russian market. US insurance companies will receive the right to open branches in Russia,

while banks will gain a higher ceiling on the aggregate foreign capital permitted in the Russian financial sector. US agriculture will also benefit from Russia's accession to the WTO, as Russia reduces duties and non-tariff import barriers.

At the request of the American Chamber of Commerce in Russia, Ernst & Young surveyed the business performance and outlook of 105 well-known American companies doing business in Russia. This first of its kind cross-sector analysis was conducted from October 2006 to February 2007.

How do American companies assess their prospects for future revenue growth and investment in the Russian market, and what impact do they expect on their business if Russia accedes to the WTO? And what do the all-important numbers say about their business performance in recent years?

Major Findings

American business is successful in Russia. Companies are developing far beyond their expectations.

In 2005, the turnover of 49% of surveyed companies increased by more than 200% compared to 2001. In this respect, 50% of the companies showed a “better than budget” profit in 2001–2005. In 2008, 41% of the companies expect turnover to increase by more than 100% as compared to 2005; only 2% of the companies expect their turnover to stay the same, while 1% of the companies expect it to drop.

A new wave of American business investment entered the Russian market in the years 1999–2006.

In 1999–2006, significant new American entrants arrived in the market. More than a third (34%) of surveyed companies said they entered the Russian market precisely in this period. These are large companies with an average global turnover of roughly \$16.7 billion annually, and they have already made significant gains in Russia — their average annual turnover in Russia is roughly \$260 million.

Newcomers on the Russian market are successful but more cautious than long-time investors who are steadily integrating into the Russian market.

Companies which entered the market in 1989–1993 are steadily developing their business in Russia; the investments of one company averaged \$520 million annually in the five-year period of 2001–2005. In 2006–2008, the average annual investment of a company which entered the market in 2001–2005 will come to roughly \$360 million, surpassing investment by companies which entered the market in other periods. The majority of newcomers on the Russian market (those that entered the market in 1999–2006) are still not ready to make such major investments: the investments of one company averaged roughly \$50 million annually in 2001–2005, and approximately the same amount is intended to be invested in 2006–2008. A third of these companies (33 %) said nothing definite about intended investments.

The social component of American company activity in Russia is significant.

59 companies covered by the survey made contributions to charity in 2005; in all, these contributions amounted to almost \$1 billion.

In 2005, the 105 American companies surveyed by us provided about 100,000 Russian citizens with work.

Attitude toward Russia’s WTO accession

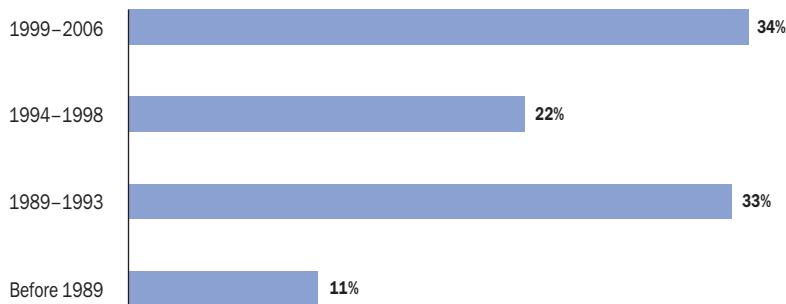
Most of those surveyed (86%) answered positively on the question of whether Russia’s accession to the WTO will offer American business new opportunities for expansion.

90% of respondents answered positively about “commercial engagement of Russia by the US.” In short, notwithstanding the existing risks, American companies display strong optimism.

Profile of American Companies in Russia

To analyze the results of the survey, we divided all the companies into four categories with regard to the year of entry into the Russian market: before 1989 (when the USSR existed), 1989–1993 (perestroika, the transition to a market economy, a difficult economic and political situation associated with the disintegration of the USSR and economic liberalization), 1994–1998 (the pre-state default period), and 1999–2006 (economic growth and stabilization):

Figure 1. Year of Russian market entry

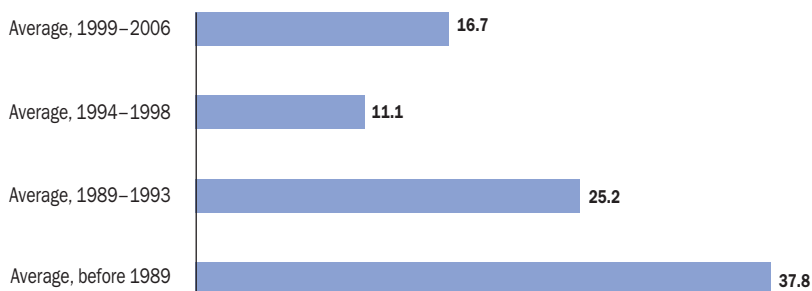


Base: All companies (105)

Most companies surveyed entered the Russian market in one of the two following periods: 1999–2006 (34%) and 1989–1993 (33%).

The world’s largest companies entered the Russian market before 1989, and their world turnover in 2005 averaged \$37.8 billion annually. Moreover, rather large companies entered the Russian market in 1989–1993 (with an average turnover of slightly more than \$25 billion annually). Relatively large companies entered the Russian market in the latest period (1999–2006) (with an average world turnover of \$16.7 billion annually):

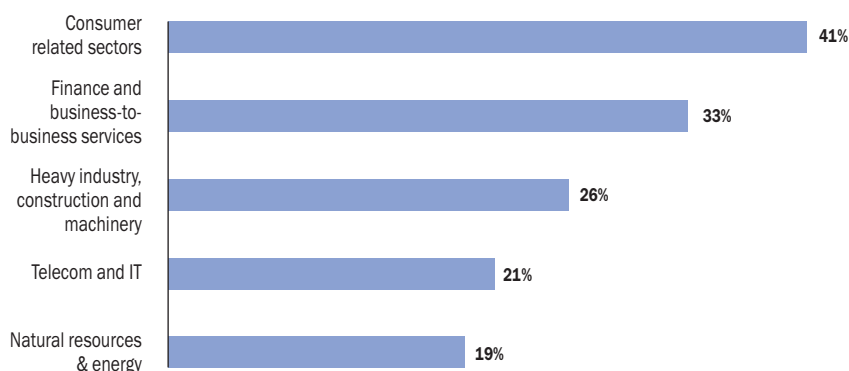
Figure 1.1. Average sales worldwide by year of entry on Russian market, USD bln.



Base: All companies (105)

Most surveyed American companies (41%) are engaged in the consumer-related sector (FMCG*, retail, health care) of the Russian market, a third of those surveyed (33%) are in finance and business-to-business services, 26% are in heavy industry, construction and machinery, 21% are in telecom and IT, and 19% are in natural resources and energy. In this respect, 29% of surveyed companies indicated that they are engaged in two or more sectors at the same time:

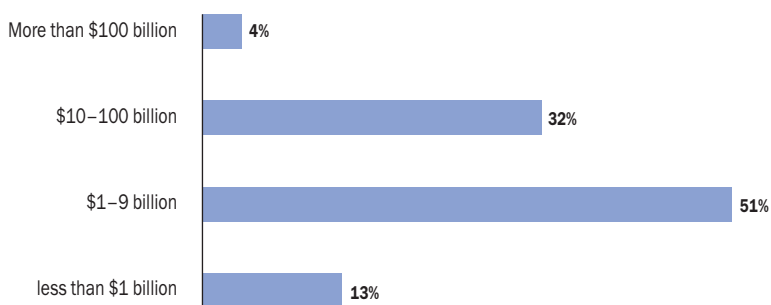
Figure 2. Industry sectors



Base: All companies (105)

The following figures show the size of the companies on a global scale: in 2005, half of the companies surveyed had a worldwide turnover of \$1–9 billion, about a third (32%) had a turnover of \$10–100 billion, 13% had less than \$10 billion, while 4% had more than \$100 billion:

Figure 3. Sales worldwide in 2005

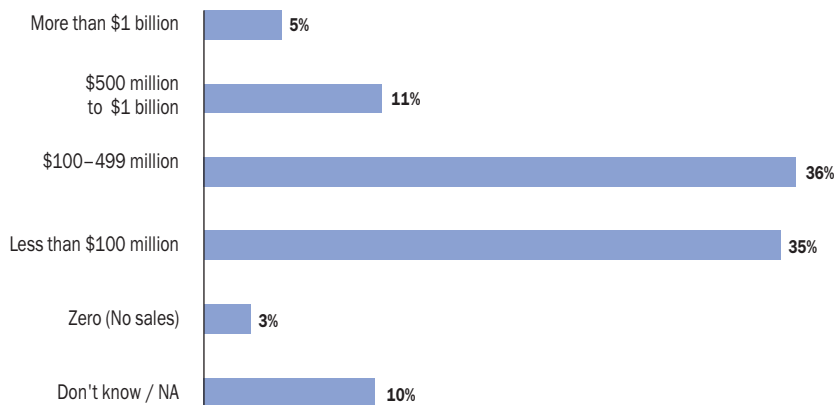


Base: All companies (105)

* Fast Moving Consumer Goods

The local turnover of 36% of the companies on the Russian market was within \$100–499 million, 35% had less than \$100 million, and 10% had from \$500 million to \$1 billion. In 2005, the turnover of only 5% of the companies on the Russian market exceeded \$1 billion:

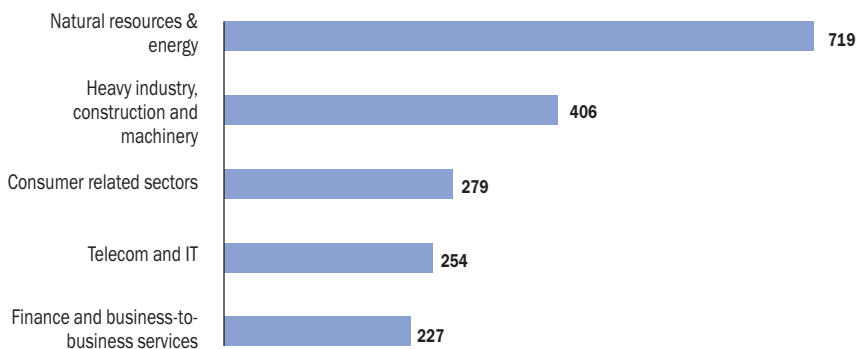
Figure 4. Sales in Russia in 2005



Base: All companies (105)

In 2005, companies working in the natural resources and energy sector had the highest average turnover on the Russian market (\$719 million):

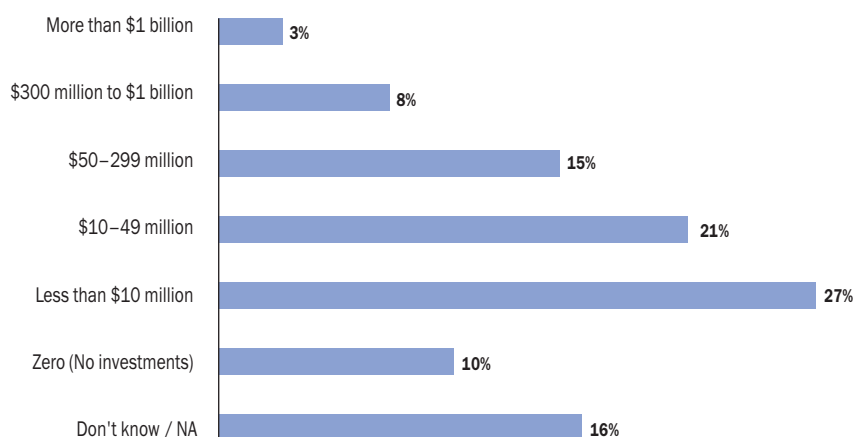
Figure 5. Average Companies Sales by Industry Sector, USD mln.



Base: All companies (105)

Most companies (76%) made investments in 2001–2005. In this respect, 27% invested less than \$10 million, 21% invested \$10–49 million, 15% invested \$50–299 million, 8% invested from \$300 million to \$1 billion, and 3% invested over \$1 billion:

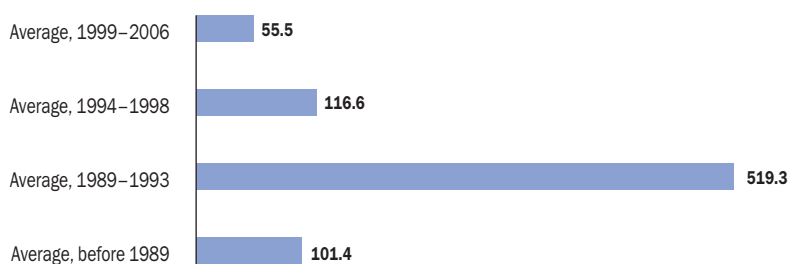
Figure 6. Investment volume in Russia in 2005, %



Base: All companies (105)

In 2001–2005, investments were made most actively by companies which entered the market 15–20 years ago (1989–1993); investments in that period averaged \$519 million per company. The “newcomers” to the Russian market (who came in 1999–2006) invested an average of \$55.5 million in that period:

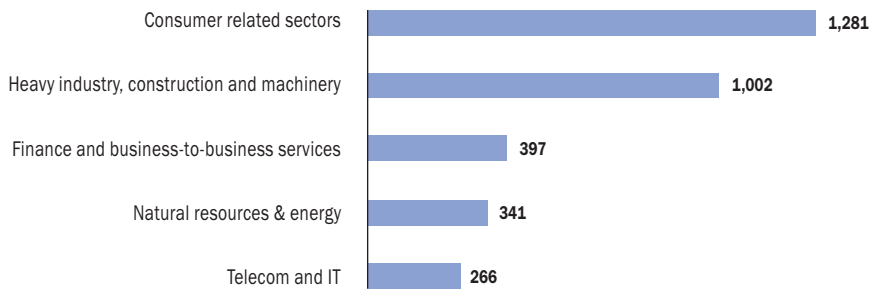
Figure 7. Average investment volume in Russia in 2005, by year of entry, USD mln.



Base: All companies (105)

In 2005, companies engaged in the consumer sector had the largest staff (an average of 1,281 employees, including foreigners working in Russia). IT and telecom companies had the smallest staff (an average of 266 employees, including foreigners working in Russia). The share of foreigners working in Russia who are on the staff of the companies surveyed is 1.3% of all employees:

Figure 8. Average headcount in Russia in 2005 by industry



Base: All companies (105)

Business Performance of American Companies in Russia

The companies covered by the survey showed high overall indices of business activity in Russia in 2005. Below, we give our estimates of the overall indices of business activity of 105 companies in Russia that were covered by the survey.

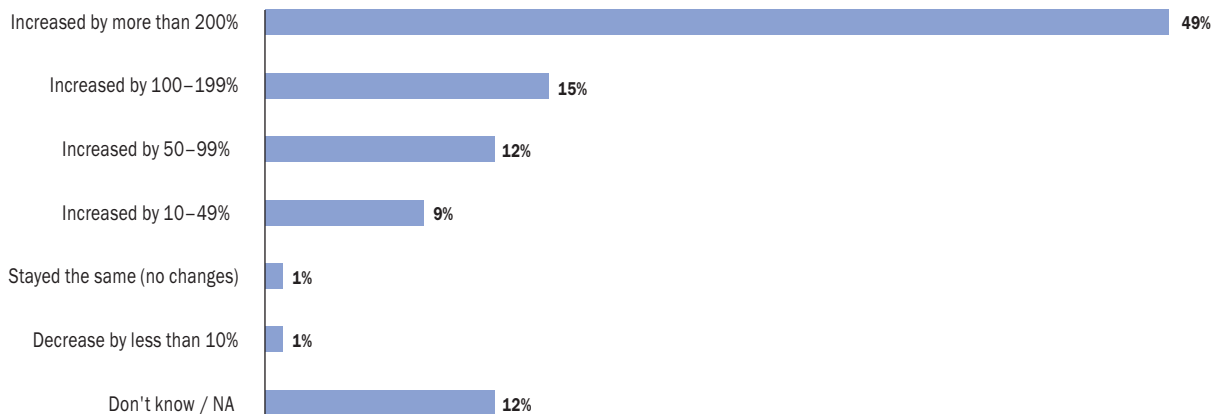
\$2,154 billion in sales worldwide
\$36.7 billion in sales in Russia
\$1 billion in charity spending in Russia
100,000 Russian employees in Russia
460 American employees in Russia
34 consumer brands per company world-wide and 11 in Russia

Base: All companies (105)

Sales in Russia by the companies covered by this survey made up nearly 2% of their sales worldwide in 2005.

Since 2001, the companies have demonstrated significant growth. Nearly half of the companies surveyed (49%) said their sales in 2005 grew by more than 200% over the figures for 2001:

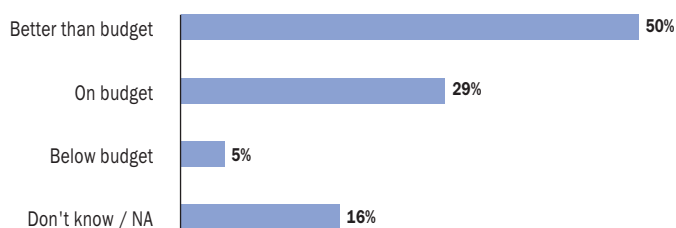
Figure 8. Growth of sales in 2005 (compared with 2001, %)



Base: All companies (105)

American companies' profitability was unexpectedly high in the last five years. During this period, the profitability of the surveyed companies was better than budget in 50% of cases and on budget in 29% of cases:

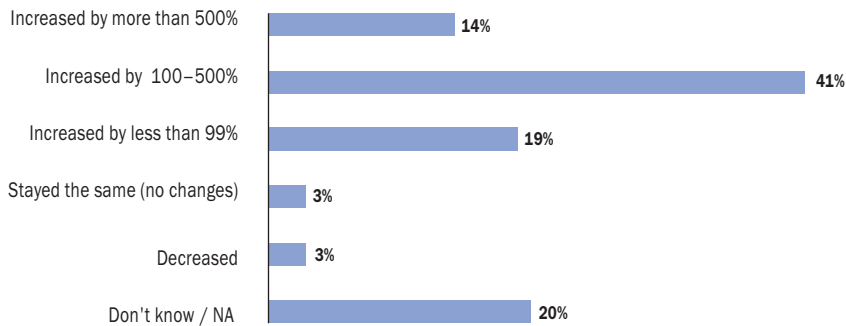
Figure 9. Profitability in 2001-2005 (%)



Base: All companies (105)

In 2001–2005, there was a considerable increase in the staff of most American companies operating in Russia. Over 40% of the companies said their staff in 2005 increased by 100–500% in comparison with that in 2001:

Figure 10. Headcount of American companies in Russia in 2001 and 2005

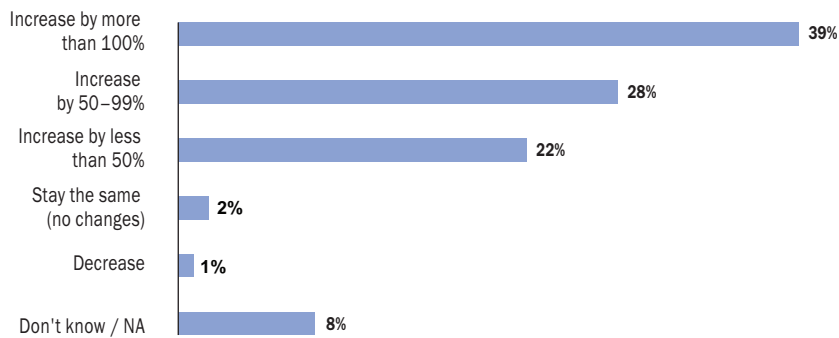


Base: All companies (105)

Looking ahead, companies are making ambitious plans for 2008.

We analyzed the data of the companies which provided us with their projected sales growth figures: 39% expect their sales in 2008 to grow by more than 100% as compared with 2005, and 28% expect their sales to grow by 50–99% in this period:

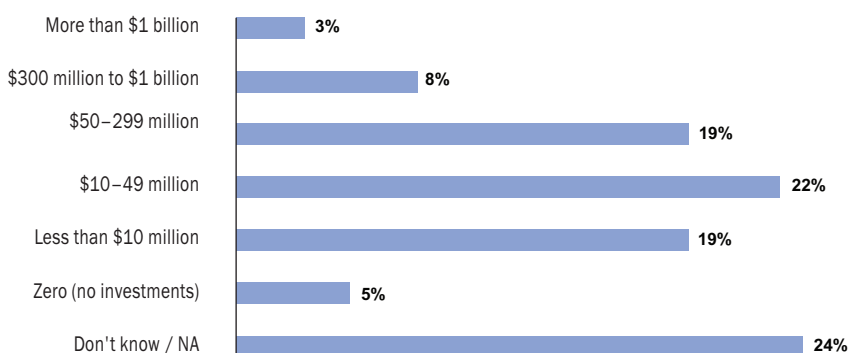
Figure 11. Expected sales in 2008 in Russia (%)



Base: All companies (105)

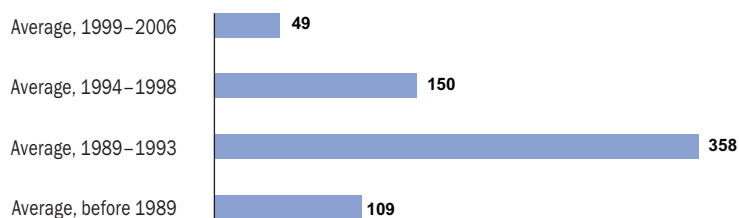
Over 70% of surveyed companies definitely intend to make investments in Russia in 2006–2008. In this respect, 23% of them intend to invest \$10–49 million during that period, 19% plan to invest \$50–299 million, another 19% plan to invest less than \$10 million, 8% plan from \$300 million to \$1 billion, and 3% plan more than \$1 billion. Only 5% of the companies do not intend to make any investments in that period. Among the 24% of companies with no definite investment policy, half are companies which recently entered the market (in 2001–2006):

Figure 12. Planned investments in Russia through 2008, %



Base: All companies (105)

Figure 12.1 Average planned investments in Russia through 2008, USD bln. per year

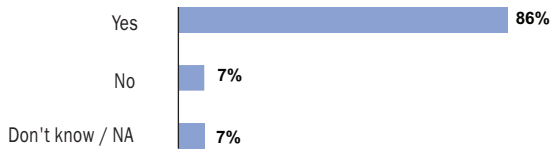


Base: All companies (105)

Attitude Toward Russia's Commercial Engagement

Most of the companies surveyed (86%) see opportunities to expand business in Russia if the country accedes to the WTO:

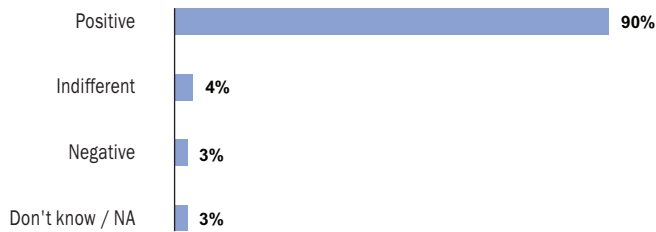
Figure 13. Do you think that Russia's WTO accession will give new opportunities for expanding your business in Russia?



Base: All companies (105)

Moreover, 90% of the companies covered by the survey believe that commercial engagement of Russia by the US will have a positive effect on American business and on Russia's economy:

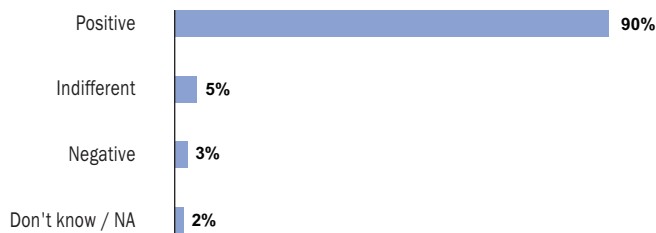
Figure 14. Attitude toward commercial engagement of Russia by the US. Is it positive or negative for US business?



Base: All companies (105)

Figure 15. Attitude toward commercial engagement of Russia by the US. Is it positive or negative for the Russian economy?

Base: All companies (105)



Conclusions

Over five years (2001–2005), American companies have made considerable gains in Russia: in 2005, the overall turnover of the companies covered by the survey reached \$36.5 billion, and investments in five years amounted to \$24 billion. The profits of most of those companies were “on budget” or “above budget” for that period.

The results of the survey show that American companies are taking a keen interest in the Russian market. This is evident from the fact that 14 out of the 105 companies covered by the survey had entered the Russian market in 2006. The 105 companies surveyed are pinning high hopes on the Russian market: almost 50% of them believe

that their turnover in 2008 will increase by more than 200% as compared with 2005, and 71% of them intend to make investments in 2006–2008.

This survey confirms that Russia’s accession to the WTO will allow American companies to accelerate growth and better protect them from risks.

Appendix: Frequency Tables for All Questions

1. In which year did your company open its office in Russia?

Before 1989	10%
1989–1993	33%
1994–1998	22%
1999–2006	34%

Base: 105

2. In which sectors are you operating in Russia?

	%
Consumer-related sectors	41%
Finance and business-to-business services	33%
Telecom and IT	21%
Natural resources & energy	19%
Heavy industry, construction and machinery	26%

3. In which cities and regions of Russia are your offices and/or production facilities presently located?

Moscow	97%
Moscow Oblast	21%
St. Petersburg	48%
Leningrad Oblast	8%
Chelyabinsk Oblast	8%
Khabarovsk Krai	10%
Kostroma Oblast	0%
Krasnodar Krai	17%
Krasnoyarsk Krai	8%
Lipetsk Oblast	1%
Nizhny Novgorod Oblast	17%
Novosibirsk Oblast	22%
Omsk Oblast	5%
Perm Krai	6%
Republic of Sakha (Yakutia)	1%
Republic of Tatarstan	10%

Rostov Oblast	15%
Sakhalin	10%
Samara Oblast	19%
Sverdlovsk Oblast (and Ekaterinburg)	19%
Tiumen Oblast	8%
Vladivostok and Primorski Krai	9%
Vologda Oblast	3%
Yamalo-Nenets Okrug	2%

4. How many consumer brands does your company have globally?

How many of your global consumer brands are present in Russia?

	Average number per company
Worldwide	34
Russia	11

5. Please state your sales volumes for the 2005 calendar year worldwide. If you don't know exact figures, please estimate.

less than \$1 billion	13%
\$1–9 billion	50%
\$10–100 billion	32%
More than \$100 billion	4%

6. Please state your sales volumes for the 2005 calendar year in Russia. If you don't know exact figures, please estimate.

Don't know / NA	10%
Zero (No sales)	3%
Less than \$100 million	35%
\$100–499 million	36%
\$500 million to \$1 billion	10%
More than \$1 billion	5%

7. Compared with its sales in 2001, my company's sales in Russia in 2005...

Don't know / NA	12%
Decreased	2%
Stayed the same (no changes)	1%
Increased by 10–49%	9%
Increased by 50–99%	12%
Increased by 100–199%	15%
Increased by more than 200%	49%

8. Compared with its sales in 2005, my company's sales in Russia in 2008 are expected to ...

Don't know / NA	9%
Decrease	1%
Stayed the same (no changes)	2%
Increase by less than 50%	22%
Increase by 50–99%	28%
Increase by more than 100%	39%

9. My company's profitability (EBIT) dynamics in Russia during the past five calendar years (2001–2005) has been...

Don't know / NA	17%
Below budget	5%
On budget	29%
Better than budget	50%

10. Please state your company's total direct investment volume in Russia during the past five calendar years (2001–2005). If you don't have exact figures, please estimate.

Don't know / NA	24%
Zero (No investments)	5%
Less than \$10 million	19%
\$10–49 million	23%
\$50–299 million	19%
\$300 million to \$1 billion	8%
More than \$1 billion	3%

11. Are you planning direct investments in Russia during the next three calendar years (2006–2008)? Please estimate how much you are planning to spend on direct investments.

Don't know / NA	24%
Zero (No investments)	5%
Less than \$10 million	19%
\$10–49 million	23%
\$50–299 million	19%
\$300 million to \$1 billion	8%
More than \$1 billion	3%

12. How many employees do you currently have in Russia?

	Average per company	Total
Russian	954	99,247
American	7	456
Other expatriate nationals	10	842
Total	958	100,545

13. By what percentage did your company's headcount increase / decrease from year end 2001 to year end 2005?

Don't know / NA	20%
Decreased	3%
Stayed the same (no changes)	3%
Increased by less than 99%	19%
Increased by 100–500%	41%
Increased by more than 500%	14%

14. The total value of social policy spending (including sponsorships, charitable contributions, etc.) by my company in Russia in 2005 amounted to:

Don't know / NA	34%
Zero (No charity spendings)	10%
Less than \$100,000	12%
\$100,000–999,000	19%
\$1–10 million	15%
More than \$10 Million	10%

15. Do you think that Russia's WTO accession would bring new opportunities for expanding your business in Russia?

Yes	86%
No	7%
Don't know / NA	8%

16. Do you believe that commercial engagement of Russia by the US is positive or negative for...

a. US business?

Negative	3%
Positive	90%
Indifferent	4%
Don't know / NA	3%

b. Russia's economy?

Negative	3%
Positive	90%
Indifferent	5%
Don't know / NA	2%

Survey Respondents

3Com	Cushman & Wakefield	MEDTRONIC
3M	Dell Inc.	Merck, Sharp & Dohme IDEA Inc.
Abbott Laboratories	Deloitte	M-I SWACO
ACE Insurance Company	Delta Air Lines	Microsoft
Accenture	Delta Private Equity Partners	Morgan Stanley
AES Corporation	DHL	Motorola
AGCO Corporation	DLA Piper	Nike
AIG/LINCOLN	Dow Corning	NVIDIA
Air Products	Dow	Organon
ALCOA	DuPont	The PBN Company
American Express	EMC Corporation	Pepsi Bottling Group
American Power Conversion	Ernst & Young	Phelps Dodge Exploration
Amway Corporation	ExxonMobil	Philip Morris
Anadarko International Energy	Ford Motor Company	PricewaterhouseCoopers
Andrew LLC	GE	Procter & Gamble
Autodesk	General Motors	Reader's Digest Publishing House
Avaya International Sales LTD	Georgia-Pacific	Renaissance Moscow Hotel
Baker & McKenzie	Google Inc.	Ritz-Carlton Company
Baker Hughes	Guardian	Rohm and Haas
Baring Vostok Capital Partners	GVA Sawyer	Rosinter Restaurants
BearingPoint	Hanover International	SC Johnson
Boeing	Hewlett-Packard	Somers & Associates
Bunge	Honeywell	Squire, Sanders & Dempsey
Campbell's LLC	IBM	Standard & Poor's
Carboceramics	Intel Technologies Inc.	Sun Microsystems
Cargill Enterprises Inc.	Jet Infosystems	Timken Company
Caterpillar	John Deere	United Technologies
CBSD	Johnson & Johnson LLC	Universal Compression Inc.
Chemtura	Kimberly-Clark	US Dental Care
Chevron	Kodak	Washington Group International Inc.
Cisco Systems Inc.	Kraft Foods	Western Union MT East Ltd.
CITIGROUP	Lucent Technologies	Whirlpool
Coca-Cola Company	Mars LLC	Wrigley
ConocoPhillips	Mary Kay Inc.	Xerox
Corning Incorporated	McDonald's	York International

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