



Developing a competitive Russian automotive supplier industry

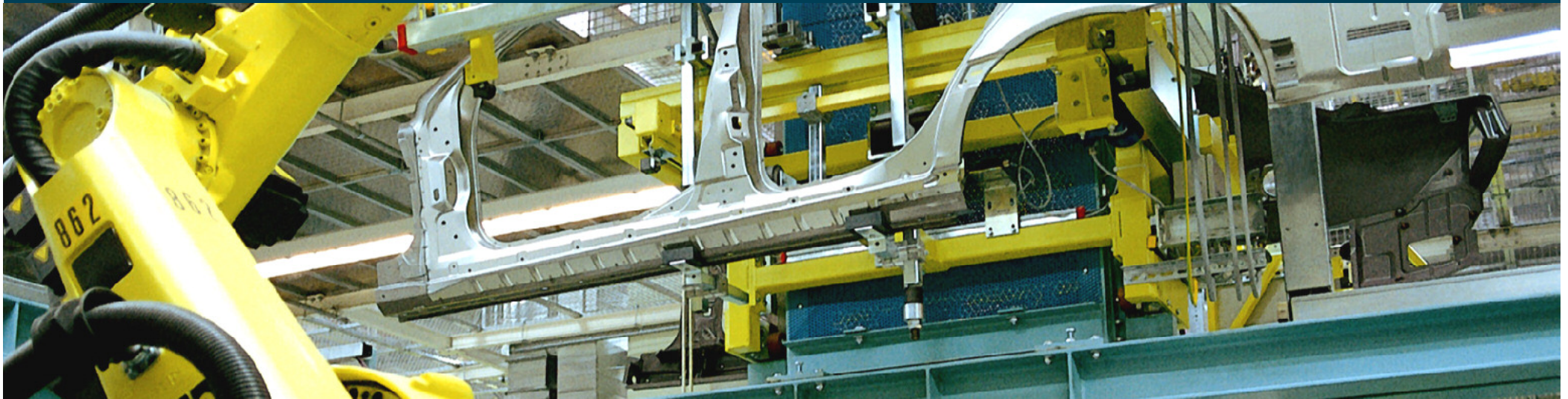
Findings of a study carried out by "Ost-Ausschuss der Deutschen Wirtschaft" and Roland Berger Strategy Consultants

Berlin, Moskau, Munich, May 2005

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A. Background and study objectives

Goal of the study is a concept for developing a competitive Russian automotive supplier industry

Background and objectives of the study

Background



- The automotive industry is strategically important for growth and employment in Russia
- International OEMs have yet to establish a significant presence in the country
- A strong supplier industry is key to Russian automotive industry competitiveness

Objectives



- Create transparency about current situation in the Russian automotive industry
- Identify the main challenges to build a competitive supplier industry Russia
- Develop scenarios for the further development of the Russian automotive industry

The study was carried out with support of sponsors – more than 50 interviews

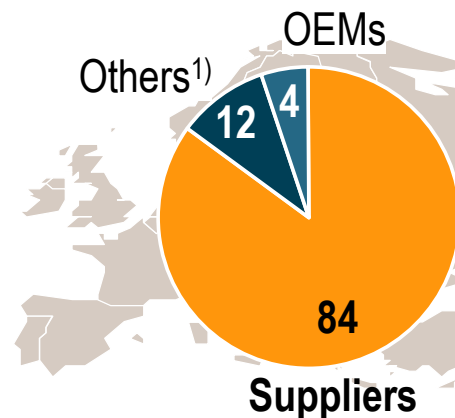
Overview participants

INITIATOR: Committee on Eastern European Economic Relations



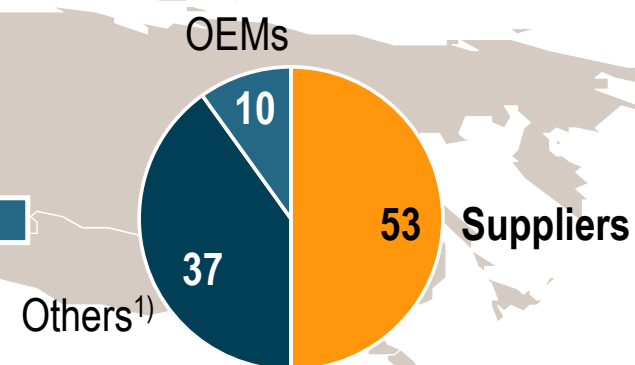
Structure of interviews in Europe [%]

Total: 25



Structure of interviews in Russia [%]

Total: 30



Developing a
competitive
Russian
automotive
industry

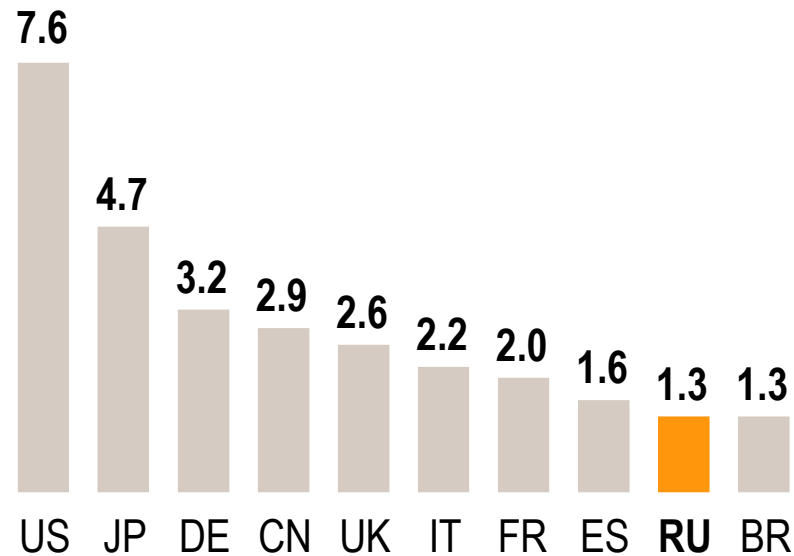
SPONSORS

1) Authorities, Services, Government etc.

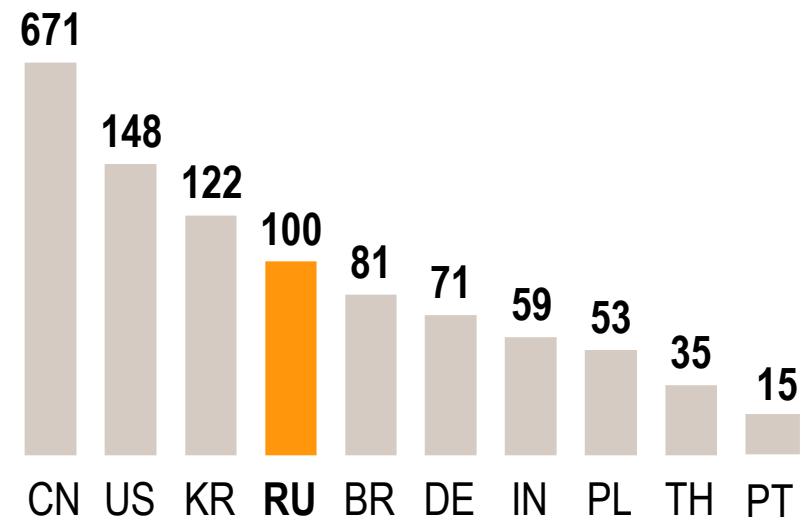
Russia belongs to the Top-10 automotive markets worldwide in terms of market volume and growth

Global importance of Russia as an automotive market

Top-10 car markets worldwide
2004 [m cars]



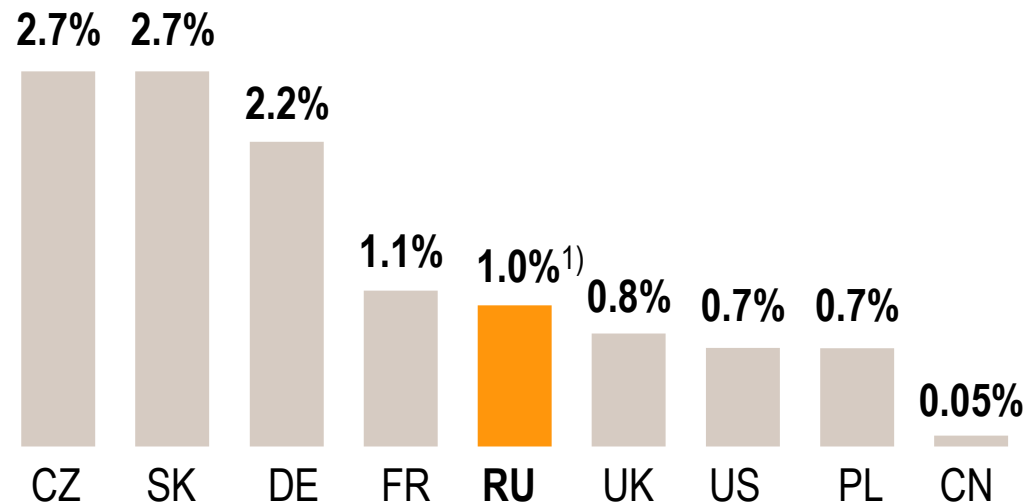
Average annual growth of selected markets
worldwide 2004-2014e ['000 cars]



The Russian automotive industry has enormous job potential

Jobs benchmarks in the automotive industry

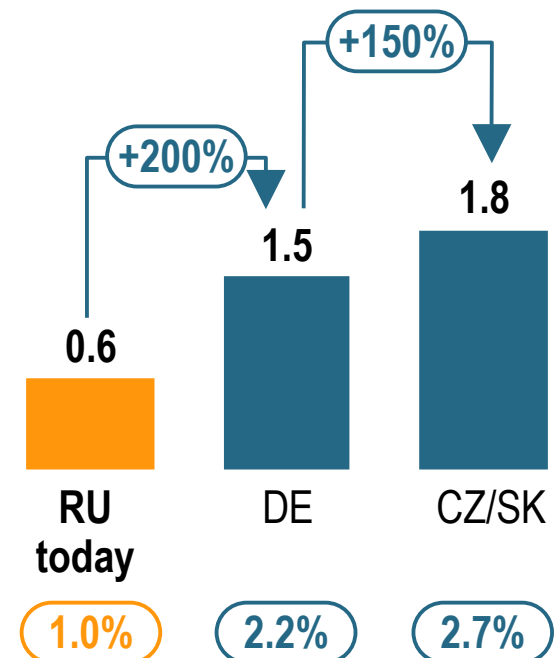
Employees in the automotive sector (production)
[in % of total employment in the country]



1) 66.6 Mio employees in total

Source: Eurostat, World Bank, Employment Report, IIC, Roland Berger

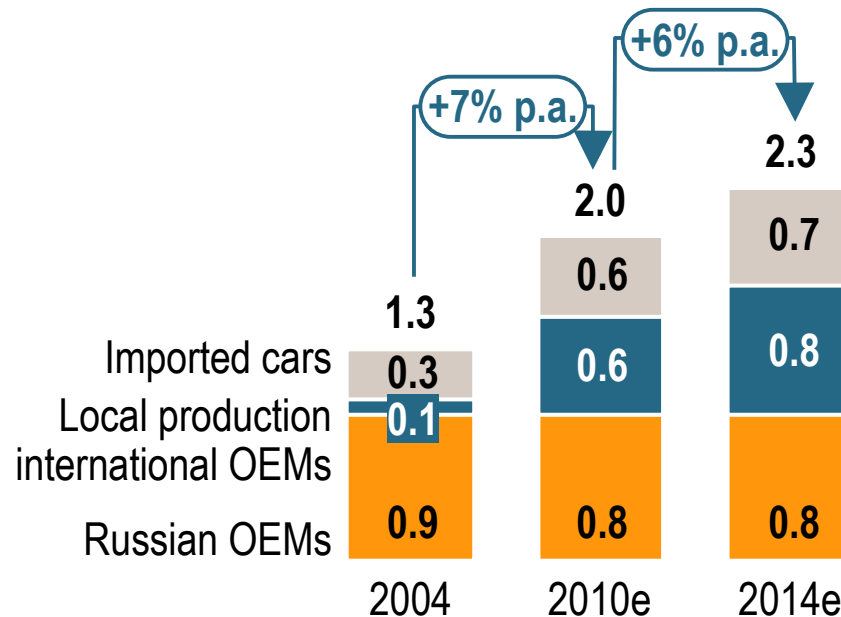
Potential jobs in the Russian automotive industry [m]



The Russian automotive market will continue to grow – particularly for the foreign OEMs

Russian new car market
2004-2014e [m cars]¹⁾

SALES VOLUME



COMMENTS

- > Increase in sales of the foreign manufacturers is caused by
 - Increasing income
 - Increasing customer demand for comfort/security
 - Decreasing import duties for the cars/ components (also due to WTO-entry)
- > Local and planned assembly of international OEMs takes place independently (Ford, Renault, Toyota) or with local partners (GM, Hyundai, KIA, BMW)
- > Russian OEMs are able to keep their position only in case of modernization

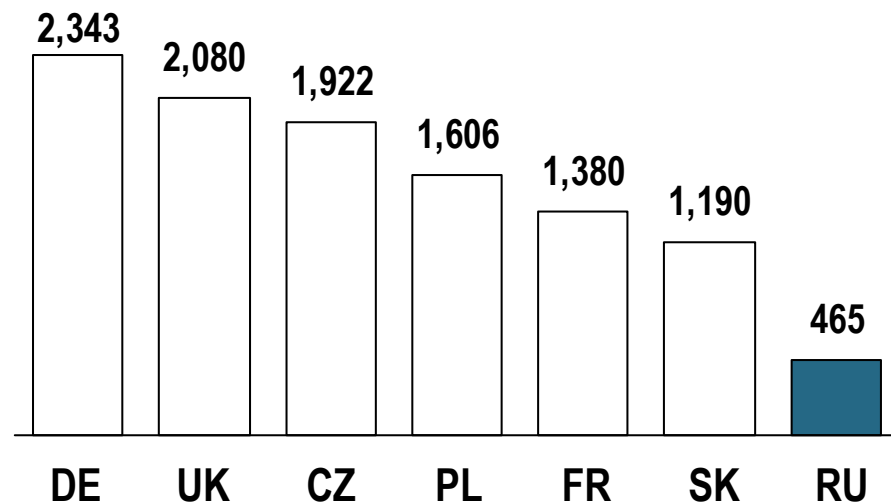
1) Based only on publicly disclosed plans of foreign manufacturers

Source: Roland Berger market model

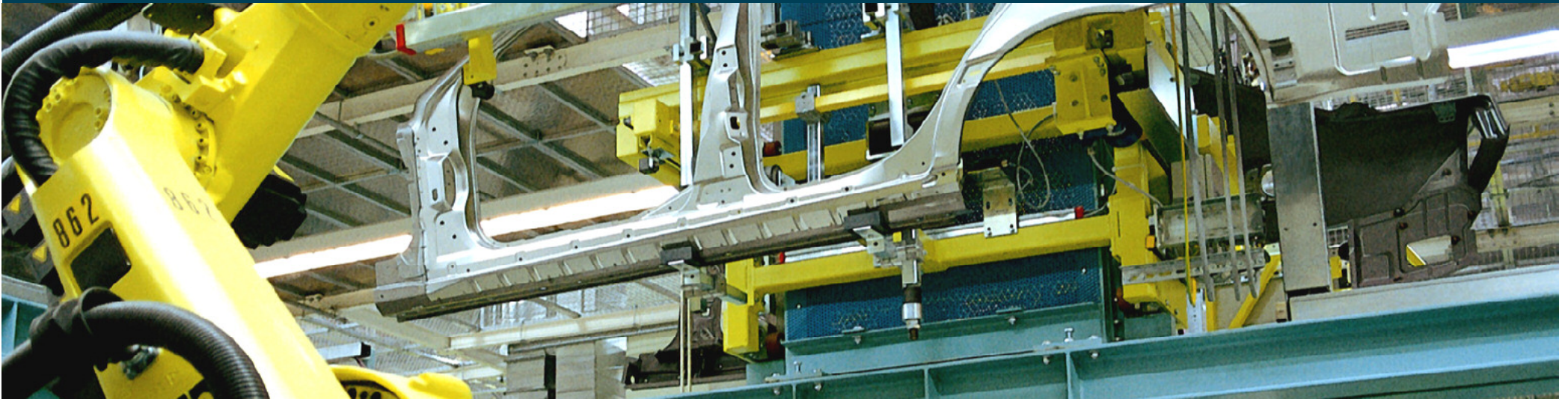
Capital investment into Russian automotive industry is not aligned with international benchmarks

Capital investment benchmarks in the automotive industry

Capital investment in the automotive industry, 2002 [EUR/produced vehicles]



- > The Russian automotive sector is, compared to other countries, heavily underinvested
- > Supply and demand incentives in order to generate investments:
 - Special depreciation
 - Tax incentives
 - Investment programs
 - Special economic zones
 - Export promotion programs



B. Key results of the study: framework conditions important

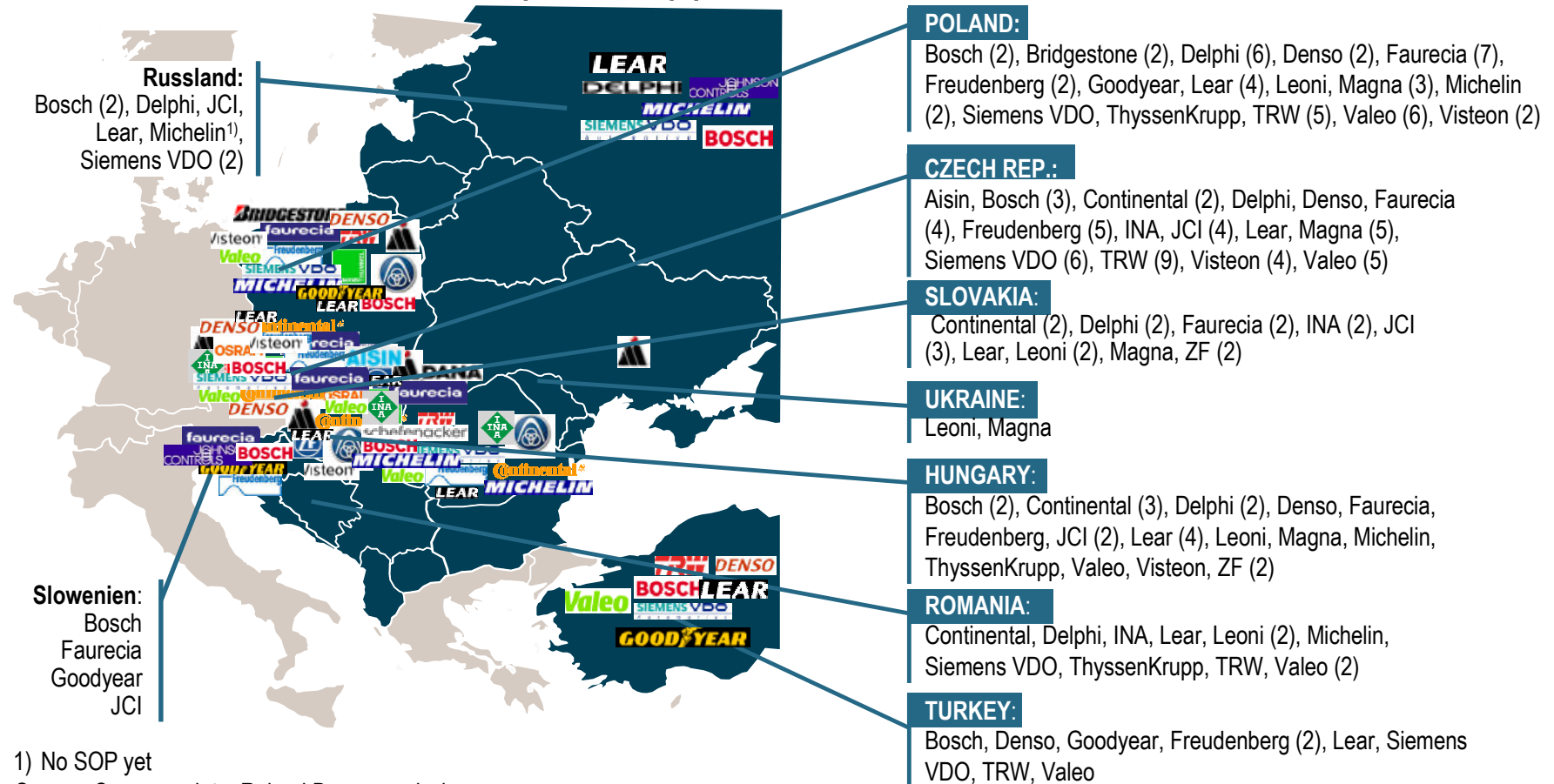
Key results of the study: framework conditions important

1. International suppliers look at **Russia as a local market** – capacities in **low-cost countries** already established
2. **Business environment** in Russia encumbers investments decisions of international market players
3. Besides **following the OEM customers**, international suppliers need to look for **access to Russian OEMs** to reach **critical mass**
4. Russian suppliers should **enter cooperations** with international partners to **increase competitiveness**

> **Framework conditions (import duties, technical standards, investment programs) are key to create a competitive automotive sector**

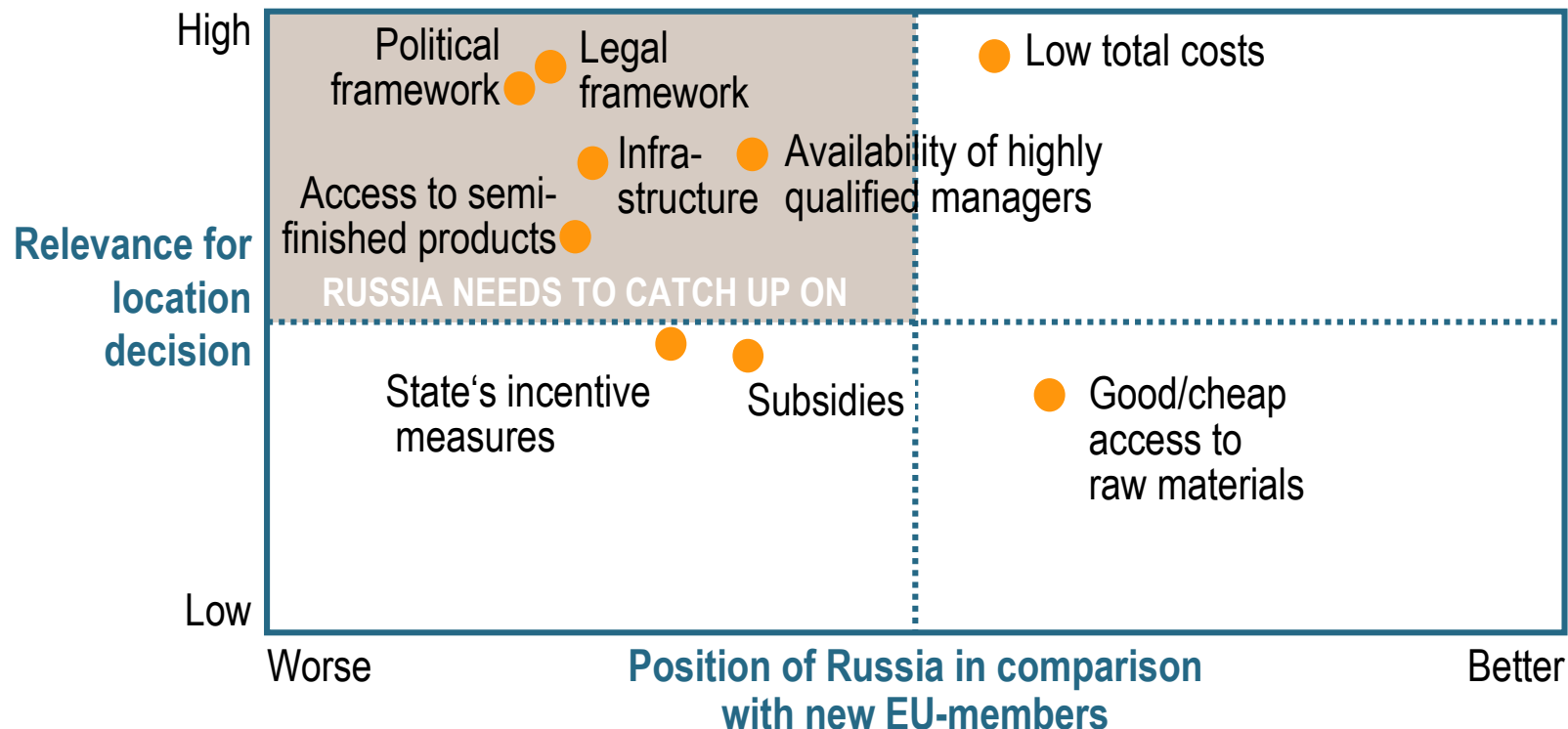
Top-20 supplier have approximately 150 production locations in CEE –only few in Russia

Production locations of Top 20-suppliers in CEE



In comparison with new EU-members, Russia has to improve its competitive position

Competitive position Russia as a location for automotive suppliers



Component production in Russia lacks volume – access to the Russian OEMs is critical

Comparison of production figures and minimal volumes required ['000 cars]



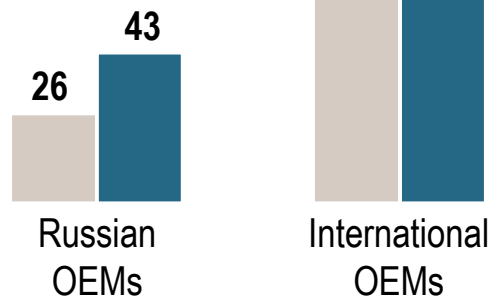
COMMENTS

- > Currently, there is a lack of the **minimal production volume required** in many areas
- > **Pooling** of several OEMs is **unlikely**, since every OEM has different technical requirements
- > **Import duties** for components are by now **already quite low** (5-20%)

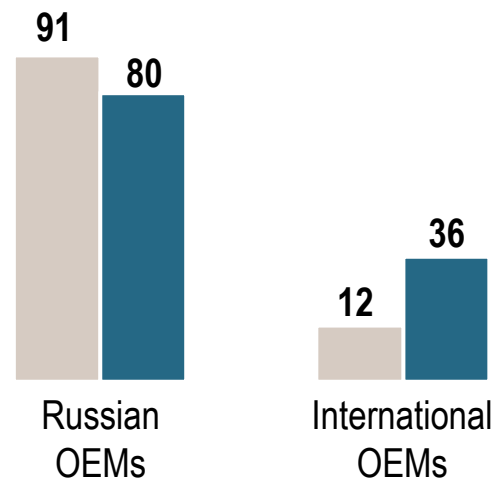
Outsourcing of Russian OEMs and increasing localization are the main drivers of supplier growth

Main growth drivers for Russian supplier industry

Supplier share in Russian OEM value creation [%]¹⁾²⁾



Local content [% of supplier share]²⁾



■ 2004 ■ 2010

1) % of value added 2) Basis: 15 interviews

Source: Interviews

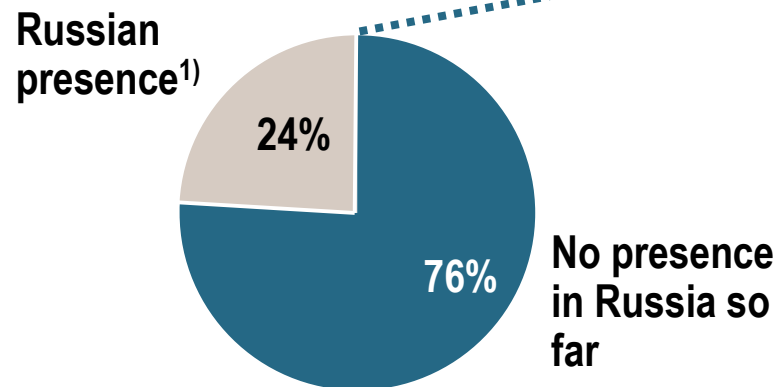
Comments

- > Suppliers are set to take a higher share of value creation in the future – good prospects at Russian OEMs in particular
- > The share of Russian parts per vehicle used by foreign and Russian OEMs is developing in opposite directions – local sourcing of western OEM expected to triple

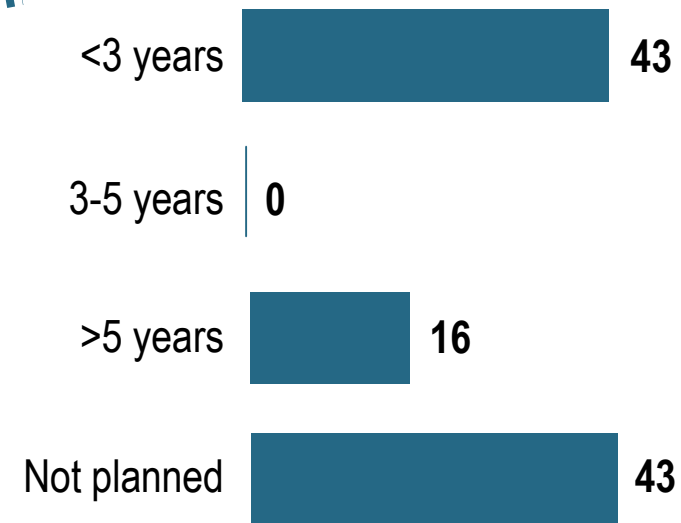
A significant number of suppliers considers entering Russia shortly

Local production by foreign suppliers [%]

Existing Russian commitments



Planned Russian commitments
(Scheduled for implementation in ...)

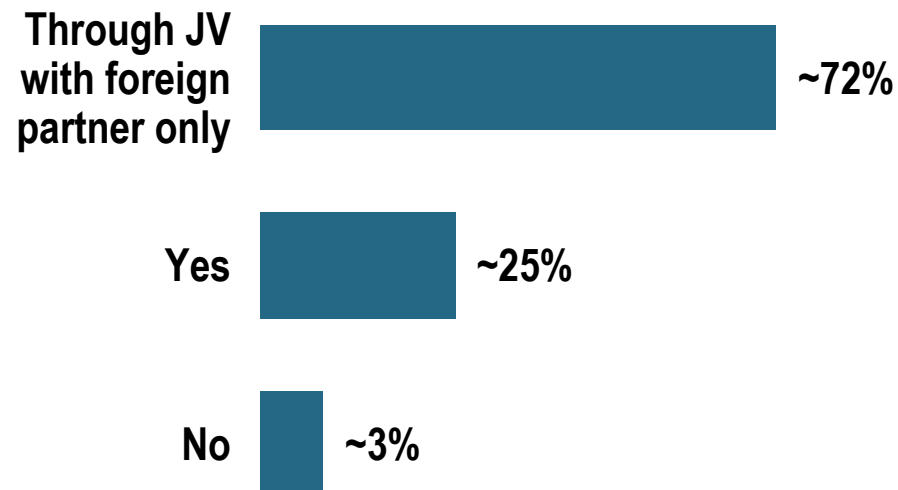


1) Present in Russia for more than 5 years

Russian suppliers will only be able to reach international standards by entering joint ventures with foreign partners

Production of car components in Russia

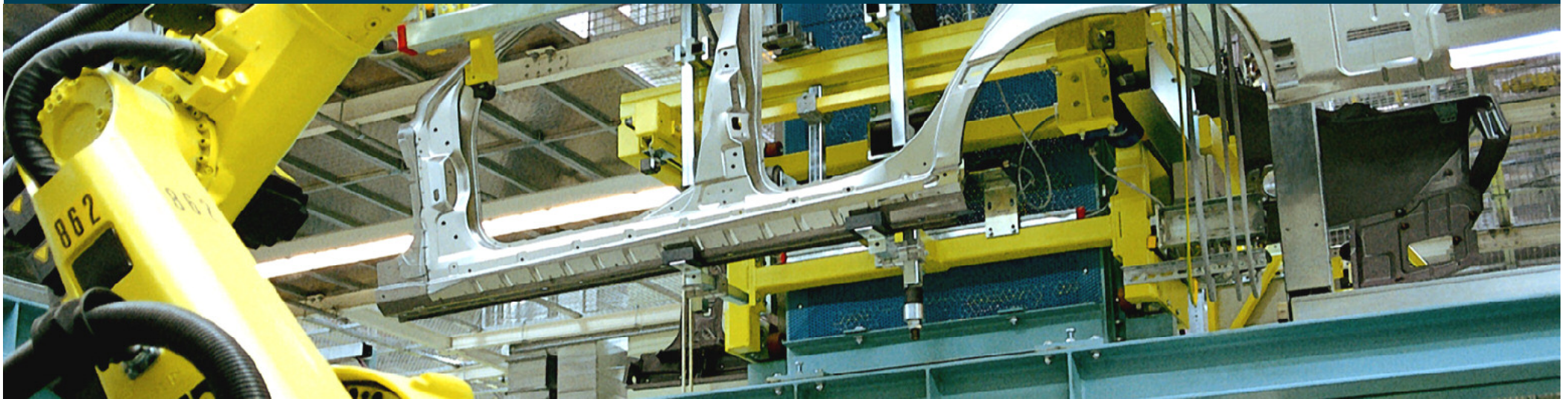
ABILITY OF RUSSIAN SUPPLIERS TO PRODUCE THE COMPONENTS OF INTERNATIONAL STANDARDS [%]



Source: Roland Berger study

COMMENTS

- > Transformation of the supplier industry is only possible with the help of the international partners
- > Benefits of the JV with the foreign partners for the Russian suppliers:
 - technology
 - manufacturing techniques
 - quality systems
- > Russian suppliers could be of big use for the foreign manufacturers providing them with:
 - access to the client base
 - access to the regional markets
 - existing structures



C. Building a competitive automotive sector in Russia

Framework conditions are key to build a competitive automotive sector in Russia

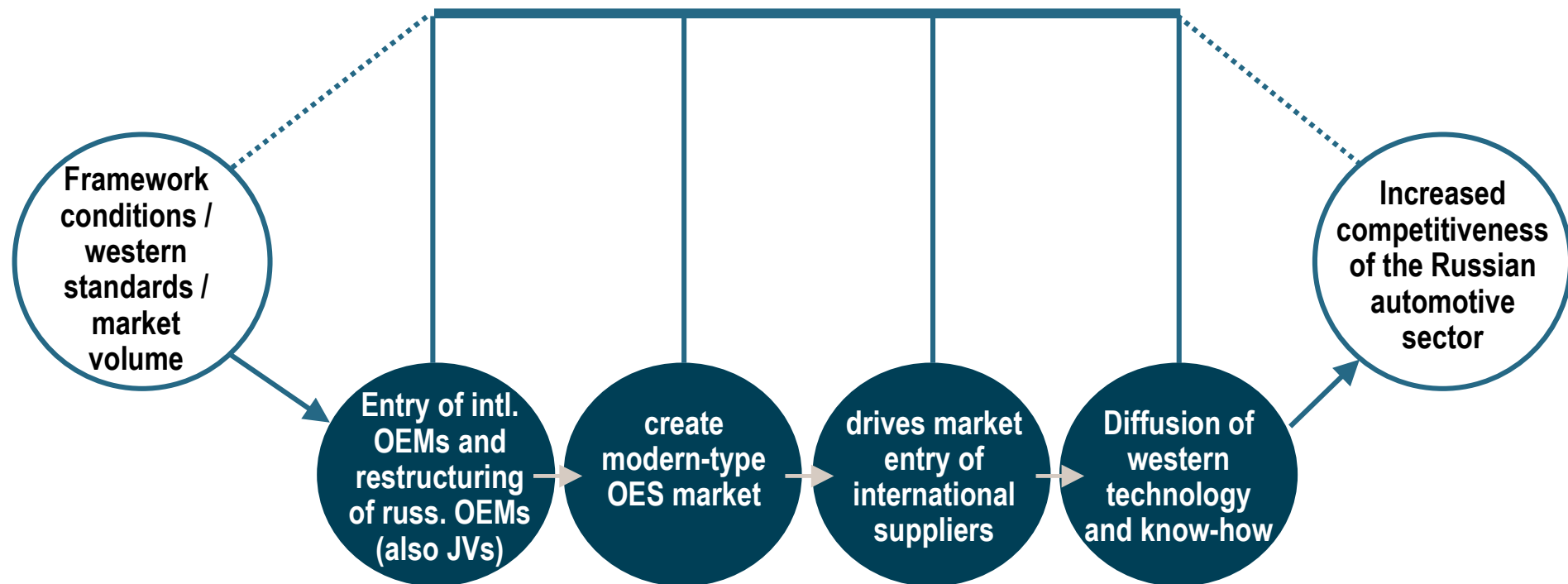
Required framework conditions

- > Lower import duties on components for vehicle and module assembly
- > Use technical standards (safety, emissions) to upgrade products
- > Facilitate foreign investment (e.g. through investment agencies, special economic zones etc.)

- 1 Attract international OEMs and OES
- 2 Improve global competitiveness of Russian OEMs and OES

Establishment of the international suppliers will be driven by OEMs

Relation between establishment of OEMs and suppliers



Within the next 10 years, the Russian automotive market can achieve international standards

Hypotheses on the development of the Russian automotive market

- > The Russian automotive industry is facing a sustainable transformation: Consolidation of structures and modernization of products and processes
- > International OEMs are becoming more important – a modern supply industry is emerging
- > The Russian economic area (incl. CIS) and its neighboring regions offer additional growth prospects beyond Russia itself
- > Given the right legal and business framework, Russia has the resource base to establish itself increasingly as a competitive production location

> Beside market growth, Russia offers opportunities as an export base