

How Russian Business Can Survive the Ruble's Fall

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Recent drastic changes in ruble exchange rates have had a major impact on short-term survival and long-term strategies in the world of Russian business. There are different marketing strategies of "survival," for example, someone may temporarily waive margin and marketing expenses to preserve or increase market share. But in the last few weeks, the exchange rates reached the level that even the rejection of profit does not compensate for a premium for imported goods and components.

Localization, local content and local assembly are important to improve the situation, especially considering the limited diversification of the Russian economy, the continuous growth of imports of manufactured and innovative industrial goods, and limited domestic development. Local assembly and production, however, only partly protect against currency fluctuations.

The multilateral trading system is based on the concept of economic efficiency. This philosophy promotes the idea that investors in any country should be free to source

components for their manufacturing processes abroad if foreign inputs are cheaper and better than local ones. Local content requirements are prohibited under the World Trade Organization's rules of trade-related investment measures. Those provisions would not apply to government transactions involving government property and acquisition of services to explore and develop that property.

International suppliers and producers note several factors that hinder localization in Russia, such as low production volume, difficulties in staff recruitment due to shortage and cost of qualified labor, lack of second- and third-tier suppliers, and lack of materials meeting quality standards.

There are several reasons why Russian manufacturers do not supply foreign assembly plants: primarily a lack of connections with global producers, since Russian suppliers are usually not involved in the global supplier chain. And particularly important are economic reasons: cheap loans are unavailable to Russian suppliers.

Another concern is that the purchase prices in Russia can be higher than in Europe for a number of reasons: Russian producers have to import production equipment, raw materials and components. This adds customs and import duties to the cost of Russian manufacturing.

There are limitations related to the cost of transportation due to the infrastructure cost and enormous distances in Russia. Energy prices have a major impact on the competitiveness of Russian manufacturing. The previously low energy costs in Russia were due to local power production and subsidization, but current increases are particularly sensitive for industry due to low energy efficiency and high energy transmission costs.

A number of studies indicated that previously ruble appreciation led to a slowdown in many manufacturing industries. The experience of other resource-rich countries suggests that natural resource wealth may lead to lower growth in the non-resource sector and additional state support and incentives are needed to boost industrial growth.

The government should prioritize infrastructure investment to reduce costs and provide favorable conditions for localized manufacturing.

Economically sound policies to stimulate localization that are focused on the best examples of international practice can contribute to improving the investment climate and the development of mutually beneficial cooperation between Russian and international businesses.

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