RCIS RUSSIA-CIS Business Group

DT - Global Business Consulting

Corporate Best Practice for Your 2019 Russia Corporate Budget

(Avoiding 25 regular corporate mistakes, if you can!)
No 1 in a series of 4 Autumn reports

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Curriculum Vitae of Dr Daniel Thorniley

Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) and co-founder of the CEEMEA Business Group which advises senior executives on global business trends. DT-Global Business Consulting is Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in global, and markets and the CEEMEA region and Russia. The services he provides include written position papers, presentation slides and private client meetings as well as in-house presentations. He is also invited to make some 60 speeches/presentations by clients across the world on global business trends, business operations, emerging markets, corporate best practice.

Sir John Major, the former British Prime Minister has called Danny "The world's leading business expert on emerging markets"

For 23 years Danny was Senior VP at The Economist Group, Vienna on global corporate business trends.

Danny is regarded as a charismatic speaker who can present detailed business and economic analysis in an easily digestible fashion with a great deal of genuine humour. Danny is renowned for not using powerpoint presentation slides - never. Dr Thorniley has also given guest presentations at Executive MBA courses on behalf of Oxford University, the University of Chicago, IESE (Spain) and the Central European University in Budapest. The executive MBA students at Chicago rated him "best speaker" on 12 occasions out of 12 over 5 years. Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

He has worked on a personal basis with 330 companies operating in emerging markets for 27 years and has personal contacts with most senior western MNCs operating in the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level (over 100). He has personal friendships with leading executives in Coca Cola, Procter & Gamble, Ernst & Young, Raiffeisen, Robert Bosch and many, many others.

He holds and has held a number of non-executive and advisory board memberships with major European and US corporations including the Global Advisory Board of the US company Aecom.

Dr Thorniley was educated at Oxford University. He holds a Bachelor of Arts degree, a diploma and a doctorate degree in Soviet political economy.

He has published three books, including one on Russia with Macmillan (UK/USA) and two with Profile books on Doing Business in Global Emerging Markets.

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Introduction

This report is one in a series of four reports for members of the Russia-CIS Business Group which comprise the package **Preparing Your 2019 Russia-CIS Corporate Budget**. The reports will be published for you in September 2018 and include:

1. Best Practice for your 2019 Russia-CIS Budget (this report)
2. The Economic and Rouble Background for the 2019 Russia-CIS Budget
3. The Key Business Numbers behind your 2019 Russia-CIS Budget: what do other companies plan?
4. The full Russia Survey Results to Support your 2019 Russia-CIS Budget

Factors to include behind the numbers - what's best practice?

Global cost cutting sets the mood for some/many companies

A tough feature of business globally and in Russia in 2017-2018 has been the trend for global headquarters to impose severe budget cuts on their global subsidiaries. This is often done in a "blanket fashion" with little consideration for the business cycle in any market.

As the MD of a major European investor in Russia states:

> Cost cuts are more and more demanding and I and my peers who are country/regional managers in my company and others share this. The feature of the last 18-24 months is that HQ is not just obsessed with the big picture of Capex costs but is also looking at regular Opex costs. This is certainly not timely for where our Russian business is placed and more investment would be beneficial and profitable.

Cost cuts gone down to the finest detail. The MD of one international electronics company complained that his CFO in Russia was obsessive and he noted sarcastically that:

> The strategic financial planning went so far as to change the colour of the toilet paper used in the Moscow office from an existing yellow/pink to plain white.

It is this HQ cost pressure which has spoiled the corporate mood in Moscow combined with international tensions and the uncertainty created by sanctions.

A few of these comments may help you relax, laugh and think when preparing your own 2019 budget

The MD of one major FMCG company operating in Russia:

> The numbers in all of my last 20 annual budgets proved always to be wrong but I try hard to get the trends right! ☺

The regional MD of a major pharmaceutical company:

> The annual budget is a waste of time and everyone knows it. It's a corporate game we all have to play and that's fine. But much, much more important are the questions: do I have the right team in place in the right roles which can build a business and adapt to changing times and capture market share in good and bad times. Do I have an operation which is fit for purpose? If so, the numbers should follow.

Is your operation in Russia "fit for purpose": you can't control the oil price or the rouble, but you can make sure that your systems and process are right and that you have the right people in the right jobs --- then let it go and let it happen. As the MD of one pharmaceutical company once said: "We have the right structure and a sensible business plan for Russia. That's all we can do. The team is flexible and adaptable. That's' what we need, not 100 pages of sophisticated budget numbers".

The CIS MD of a major European industrial company:

> When we do budgets for Russia and Ukraine, I always use the F-word! Flexibility! ☺

The MD of a major US drinks company:

> It's very easy to make great short-term decisions that help the immediate bottom line. We can all do that. But I would argue that most great short-term decisions are bad medium and long-term ones. The long-term ones are the more important.

The MD of a major consumer products company noted a few weeks ago in Moscow in a humorous mood that:

> When you are making your business presentation to the Board always include in slide no 2 the following three elements: e-commerce, digitisation and efficient growth.

Another executive commented last week in Moscow on his three favourite buzz topics:

> For the Board you have to focus on localisation, diversification and market share.

E-commerce and digitisation are certainly starting to disrupt companies and plans and budgets as Russia "catches up" in this filed and the disruption is only likely to intensify over the next 2-5 years. E-commerce and digitisation are altering much of the business model for many companies and is also have a major impact on HR-Talent trends and on some wage levels: what do you pay for a great/capable e-commerce specialist, someone who can drive your e-commerce model? Well, anything he/she wants!?

We refer to these factors below again.

Key factors to consider in the 2019 budget process

- It's not just the annual budget: think long-term; what do you do in 2018-2020?
- BUT do not get fixated with rigid 5-year plans which are never fulfilled and always fall by the wayside.
- Manage expectations with global headquarters: a serious professional exchange is necessary.
- The Russian market has gone through about 8 "New Normals" in the last 2-3 years.
- Try as hard as possible to "educate" the senior executives at regional and global HQ. Some companies do not need this, but many do.
- The Russian market has changed and will need time to recover to an "OK" market: headquarters have to realise this and face the facts.
- The sanctions uncertainty heightens short-term economic and business volatility.
- The message is "we are not the glory boys of the recent past. But we can have a reasonably good business in this market in the next 15-30 months".
- A steady, moderate recovery is foreseeable and Russia can be a decent growth and profit market in the coming years on a middle scenario.
- Tell your management colleagues that: the Russian market can still hold its head high in comparison with many other markets: Russia is often better than LatAm, Sub-Sahara Africa, the MEA regional and parts of AsiaPac: China is not as easy as it was (if it ever was!).

- **Market share is the name of the game, isn't it?**

- The business cake in Russia will not boom in the coming years (and in few others places either): aim for sustainable market share. What will be the drivers behind that?

- Plan the 2019 budget and any longer-term plans on the basis of scenarios: most companies tend to work though with "just" 1-3 scenarios.
- Last year one retailer was working on the 2018 budget with 12 scenarios! But that was not the norm.
- 2018 was more volatile than 2016 and 2017 and the level of volatility in 2019 could stay relatively high: watch out for that.
- Don't get fixated with one set of numbers: we all know about the budget trap and how budgets have become very quickly redundant in recent years.
- Diversification is a winner: are you already diversified in your portfolio offering? Then, well done. If not, can you broaden the portfolio and spread the risk? Can you introduce new global products/services from your global palette of products?
- Stay close to customers and clients: make sure they know what you're doing and why.
- Build relationships with your Russian customers and partners: Never forget that Russians never forget!
- Treat them well and they will remember you forever.
- Look at customer segmentation in greater detail: slice and dice the consumer categories.
- CRM is more important now than ever.
- But CRM is not just about spreadsheets; it's about building real, long-term relationships in tough times as well as bad times.
- Find new consumer segments: sub-premium, premium, mid and low.
- Introduce more affordable or even upward innovation.
- Decide if the focus will be more diversified from pure premium: work out where you want to be on the brand/value spectrum.
- Brands remain very important but you have to work much harder to sell those brands now: it takes 3-5 times more effort, energy, time and money to do that now.
- Does the consolidation of Russian retail combined with the arrival of e-commerce mean that traditional distributors and brands are coming under more pressure? Some executives certainly think so. One major food & beverage company plans to cut 66% of its distributors in 2018. What does this all mean for your 2019 budget?
- Decide how you will grow your business: what will be the functions of volume and/or price?
- The days of easy price increases have gone. Plan that into the budget.
- Make scenarios for phased price increases: but this depends on the rouble FX rate: most companies plan softer price increases in 2019 ranging from 1-5% to 5-10% with very few planning more than that.
- Offer clients "solutions" and integrated systems and other after-sales servicing with it. If you are selling ball-bearings, then offer all the engineering kit that goes with it and the process systems that surround ball bearings.
- This deepens and tightens the relationship with clients rather than limiting the process to a one-off sale.
- Move quickly to streamline systems.
- Delegate responsibility as much as possible to your talented local teams.
- Offer managerial autonomy when you have faith in your team.
- But never compromise on compliance: this can be dictated and top-down from HQ but also instilling local initiative and implementing compliance programs.
- Flexibility in your team and in your plans is a key defining point: as the MD of a major consumer goods company once said: "When I look at the budget, I always think of the F-word! Flexibility!"
- Look at managing costs in the supply chain and manufacturing processes.

- As you examine the Russian regions more closely, what does that mean for affordable innovation, route to market, marketing and pricing?
- Can you squeeze more juice from the Russian regions and from the CIS markets? We know it's not easy but take another look.
- Most companies think that other CIS markets will be moderately positive for business in 2019. Can you squeeze a bit more out of them for the 2019 budget?
- Localisation is at the forefront of business thinking: can you do more?
- Re-visit your sourcing strategy: can you realistically source more from within Russia? Look at Asia, China and SE Asia: this helps you in terms of costs and in presenting a good face to Russian authorities regarding sanctioning nations.
- Look at small bolt-on acquisitions: some European mid-size companies are doing just this.
- Acquire in order to tie in distributors and customers; acquire to capture a bit of market share; acquire to show long-term commitment to customers and to the Russian government.
- Invest in logistics and warehousing and distribution.
- Look at Russia as a market of channels: distributor, direct, key accounts, mix of own and distributor services; split distribution into consumer-focused part and physical logistics part.
- Think a bit more about Russia as an export base but realise that it is not plain-sailing.
- For retail and FMCG there is a sub-set of factors to consider:
    - Pressure on the traditional distributor model;
    - Pressure on traditional brands?
    - increase of home consumption;
    - growth of modern trade;
    - authenticity, trust sustainability in products; home-grown, nostalgia;
    - cost-effective/smart shopping;
    - growth of discounters, private label;
    - more promotional pressure;
    - On-line, e-commerce.

- How to respond to these drivers and what balance to achieve?

Words of advice from senior executives

The retired EMEA president of one of the world's largest consumer goods companies told me:

- Delegate downward and try to avoid going through headquarters.
- Always innovate downwards – reach out to your customers.
- Control your working capital and protect your distribution network.
- Maximise your local content.
- If you have excess HR capacity, train them to do something else, something new. Don't abandon them.

The regional head of a European pharmaceutical company advised: Share the pain.

- Share the pain with customers and raise prices but explain how and why you are increasing those prices.
- Share the pain with distributors and the supply chain by discussing payment terms. But do not brutalise your distributors, you don't want to destroy them and end up with one distributor in Russia in 2016.
- Share the pain with your Russian staff and explain why salary increases will be below inflation again in 2016.

- And toughest of all, explain to your CEO and European Board that sales and profits will be smaller than in the past.

Another way of saying this is:

- Don't cut costs so deeply that you damage long-term relationships with customers and clients.
- Don't cut cost so deeply that you damage relations with distributors and suppliers.
- Don't cut cost so deeply that you damage relations with your HR and talent whom you will need in years to come.

In closing, after a lot of basic, common sense advice, I would underline yet again that the name of the game is market share in Russia today and for the next 2-5 years (and by the way this applies to most markets in the world today).

Always watch out for the budget trap!

In 3 out of the last 4 years, executives in Russia and globally have been caught in some degree of a budget trap when the calmer times of autumn were quickly followed by the turn of the year when the global and Russian markets turned much more volatile. This year in September (2018), when many budgets are being drafted for 2019, the rouble is more volatile and much depends on the uncertain sanctions outlook. Executives will probably need to do a bit more scenario panning and include more "fudge and bluff" in the budget.

I hope you have found this report useful and if you have any queries, do get in touch danielthorniley@dt-gbc.com

5 September 2018

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SOUTH GATE INDUSTRIAL PARK

Leroy Merlin's growth in Russia reached a tipping point – we wanted to grow and operate more efficiently. We turned to Radius Group to build supply chain capacity that will support our future growth for the next 20 years, and position ourselves for the explosive e-commerce growth ahead in the next five. Together with Radius as our development partner, we've taken ownership of the largest and most efficient build-to-suit warehouse in Russia's history.

Eric Poulet,
Supply Chain Director, Leroy Merlin

Leroy Merlin's sought to build an omni-channel national distribution center as well as an e-commerce fulfillment center. With our unique expertise in e-commerce and our proprietary Radius InSite Digital 5D Design Modeling & Construction Analytics Platform, we delivered the design Leroy Merlin wanted and the building they needed, on-time and on-budget.

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