

**NEWSLETTER**

INTERNATIONAL

 ENGLISH VERSION



## RUSSIA – BUSINESS SUCCESS THROUGH LOCALIZATION?



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## “AMOUNT OF SPECIAL INVESTMENT CONTRACTS SPEAKS FOR EXISTING INTEREST”

### What considerations are connected with “localization” from a legal point of view?

In principle, these considerations are not new - they began many years ago with the so-called „industrial assembly agreements“, which aimed at bringing investors from abroad to Russia, especially in the automobile industry.

Industrial assembly agreements are based on a variety of government and ministerial regulations and are designed as individual agreements between the investor and a government agency.

Within the context of the later tensions, Russia has decided to continue the localization efforts, which led to the „Industrial Policy“ Act of 30 June 2015. Together with the foreign investment law and local laws, it creates the legal framework for localization as well as special investment contracts.

The German investment contract would presumably be classed as a classical public-law contract between the company and the state, from a Russian perspective, this would be classified as a civil contract with the state on the one hand. In Russia, the state’s participation in a civil-law treaty is expressly provided for in Article 2 (1) of the Russian Civil Code.

Contracts always include rights and obligations for both parties. Since, on the one hand, the Russian state makes certain privileges or commitments under these treaties (tax privileges at federal and regional levels, advantages in the leasing of state assets, subsidies from the federal or regional budget), it also wants to see commitments to investment and know-how transfer, to create new jobs and to set up new plants, etc. These commitments then have to be respected, non-compliance is sanctioned. Investors need to consider very carefully whether they are willing and able to comply with such legal and economic obligations, which must be sustained over a long period of up to ten years.

### What criteria must a production meet to be considered „localized“?

This depends on the basis on which the assessment is based.

According to the Government Decree of 17 July 2016, No. 719 „On the criteria for the classification of industrial products as industrial products with no substitutes produced in the Russian Federation“, all products listed in the Annex to this Government Order have no counterpart in Russia and are therefore considered „Made in Russia“. This list is several pages long and contains eight sections with a few hundred precisely listed products. It is worthwhile to study this list carefully.

Another way of classifying a product as „Made in Russia“ is to measure the share of value added in Russia. This is assessed by the final price of the respective product - the proportion of imported raw materials or semi-finished products must not exceed a certain limit which varies from product to product.



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## To what extent are the regulations on the investment contract (SPIK) attractive for companies?

At the end of February 2017, eight SPIKs have already been signed. 73 other projects with Russian and foreign participation are in various stages of elaboration and evaluation by the relevant government agencies.

From our point of view, this amount of projects speaks for the interest of addressing the issue of localization under a special investment contract. With regard to further sales of „Made in Russia“ products in the Eurasian Economic Union (EAWU), localization in Russia is becoming more and more interesting.

Due to a lack of experience (the first SPIK was signed on June 17, 2016), it is difficult to assess the extent to which a desired legal and planning security for foreign companies can be achieved by the above-mentioned legal framework. But there are several positive signs in this direction. It is a great challenge for those involved - not just for foreign investors, but also for the Russian state.

INTERVIEW

## “COMPANIES STILL NEED TO INVEST A LOT IN EDUCATION”

### How has the Russian labor market changed since 2014?

The Russian labor market of the early 2000s and the first period after the financial crisis of 2009 was overheated - a large number of foreign companies coming to the country faced an extremely limited range of qualified local executives. As a result, the companies have waged a „War for Talent“ to meet their HR needs. The fluctuation rates and the annual salary increases, which were not always in a reasonable ratio to the productivity of the employees, were correspondingly high.

With the political and economic frictions that began three years ago, this has changed radically. In particular, executives have much less opportunities in the current labor market than in the past, as demand from Russian and international companies remains relatively low. Companies who want to invest in Russia and offer a long-term career perspective are therefore in a good position. At the same time, the loyalty of the employees has increased - in difficult times, they consider twice whether a change of employer is worthwhile.

The availability of qualified personnel increases from year to year in the management sector as well as in the production and administration functions. Over the last 25 years, the foreign companies in Russia created a talent pool by training and development that is, in some segments, up to international standards.



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## How have remunerations developed in Russia?

The ruble rate has recovered in the last few months against the euro and the dollar, but it is still almost 40 percent below the rate of autumn 2013. Measured in euros, the employment of Russian employees has therefore become much cheaper.

In the light of the economic downturn, salary increases in most companies have been moderate over the last two years. Many employees have even seen a real decline, taking inflation into account, especially in 2015. While the official inflation rate was just under 13 percent, the statistical salary increase amounted to 4.5 percent only. In the management sector, however, the figures are quite different. According to the job portal Headhunter.ru the remuneration of the Russian top managers nominally increased by 20 percent in 2015. Some of these senior employees may have had their salaries fixed in euro or dollars in their contracts - or they found a way of negotiating substantial salary increases. However, last year the remuneration of this group rose by only 2 percent.

## What specific HR challenges do companies face when setting up production in Russia?

As described, management talent supply in Russia has improved noticeably. However, this potential is unequally distributed in the country: the situation is favorable in cities and regions with a high density of international companies; in remote regions recruitment of executives is still far more difficult.

Companies that want to manufacture in Russia still have to invest a lot in education and training. The quality of vocational training in technical professions is usually not as high as in Western Europe. In clusters with many international companies the situation may be somewhat better, because there is already a reservoir of more or less „finished“ skilled workers.

## When does it make sense to second an expatriate?

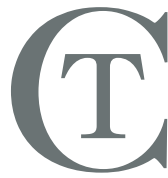
Even before the developments since 2014, the number of expatriates in Russia has been declining. However, this trend towards local executives has accelerated due to the need for cost reductions in difficult times.

Over the past three years, companies have released many expats or fixed their salaries in rubles to eliminate the risk of exchange rates fluctuations.

So far, no renaissance of the classic expat model is recognizable, ie the employment of a foreigner on the basis of a secondment contract with the headquarters. Secondments are typically restricted to a few contexts, for example, where the transfer of proprietary know-how, technologies or processes are concerned.

Large international companies routinely assign key positions with expatriates as part of their global talent management. In these cases Russians, too, usually have the opportunity to „rotate“ into other countries.

Finally, expatriates are frequently seconded from the headquarters or other international locations as „firefighters“ in case of issues in the Russian subsidiaries.



## EXECUTIVE SEARCH



### EXECUTIVE SEARCH EXPERTS IN ASIA, RUSSIA&CIS AND THE MIDDLE EAST

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Via structured and documented searches processes, our consultants ensure access to the best candidates on the market. They are experts in cross-border recruitment processes and familiar with the characteristics that candidates require in order to work successfully in multinational companies.

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