Консалтинговая компания Биммакон

Consulting company Bimmacon

Development Trends in Light Industry in Russia

Review of the situation in the branch

Moscow, November 2006

12, Nauchny proezd, Moscow, Russia, 117246 | tel|fax +7 (495) 755 90 10 (multichannel) | genmail@bimmacon.ru | www.bimmacon.com

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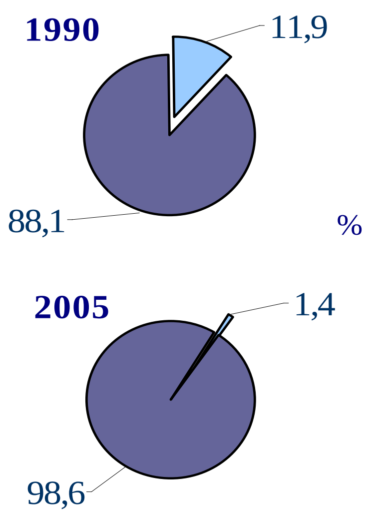
Development Trends in Light Industry in Russia

The share of light industry in the aggregate industrial production in the Russian Federation



- The share of light industry in the aggregate industrial production in Russia fell from 11,9% in 1990 up to 1,4 % in 2005 over the last few years
- Alongside with the crisis situation in the branch in 2006 there were signs of overcoming negative dynamics and some revival of production in specific segments. In particular, to the results of nine months 2006 in textile and clothing industry there was growth in volumes of production by 8,2 % compared to the fall by 2,2 % in the similar period of 2005, manufacture in the tanning and shoe industry increased by 12,9 % (-2,3 %)
- As the basic tendencies defining the development of the Russian light industry now we can mark the following:
  - tighter state regulation of the branch
  - expansion of retail networks by Russian and foreign companies
  - preservation of the negative effect of a large scale of fake production on the Russian market
  - the environment impact on the increased number of foreign players on the Russian market,
  - and also moving production capacities of the world and domestic manufacturers from China to other Asian countries, Turkey, Eastern Europe and Russia

State Regulation of the Branch

…now the Russian enterprises provide about 20% of light industry production. The branch is likely to decrease the given parameter without the state support

- From 2005 there has been tighter state regulation of the Russian light industry. In 2006 the given policy went on. We shall note a number of measures undertaken by the state bodies to support the domestic light industry
- In March, 2006 – the government approved Government Act of the Russian Federation №168 establishing the zero size of a customs duty on specific kinds of light industry process equipment. The similar measure was undertaken in 2005: the customs duty was abolished on 45 kinds of light industry process equipment. In estimation, the abolished customs duty allowed Russian companies to save up to 122 million roubles
- In July, 2006 Government Act of the Russian Federation abolishing the double control over Russian export of specific categories of textile goods and clothes was issued
- In August, 2006 validity of Government Act №605 was prolonged till June, 30th, 2007. According to Government Act №605, from autumn, 2005 in Russia customs duties on leather footwear at the cost of under 15 euros were lowered up to 2 euros, and on footwear over 15 euros customs duties were established at a rate of 10 %, but not less than 1,8 euro. Before this Act the size of the customs duty made 15 % plus 1,4 euro for a pair irrespective of footwear cost

State Regulation of the Branch

…in case of undertaking combined actions on the branch development in 2006-2008 MINPROMENERGO of the Russian Federation counts on doubling production volumes in the light industry in the nearest 5-7 years

- At the beginning of 2006 Act about change of rules of crossing borders by individuals was issued to fight a "shadow" import of goods. According to this Act, the duty-free allowance for individuals was lowered from 50 kg to 35 kg. The number of possible border crossings without paying a customs duty for individuals was reduced from once a week to once a month
- MINPROMENERGO of the Russian Federation worked out a draft plan of actions to develop the branch in 2006-2008. The draft stipulates the development of four technical regulations requiring safety of production and manufactures of light industry, the development of schemes to compensate a part of interest payments for credits taken for the purchase of process equipment and raw materials. Besides that, it is planned to develop measures to increase export duties on raw materials and decrease or abolish duties on raw materials and materials which are not made in Russia

Change of rules of crossing the Russian Federation border by individuals	
before approval of the Act	**after approval of the Act**
duty-free allowance	
50 kg	**35 kg**
number of possible border crossings without paying a customs duty	
Once a week	**Once a month**

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State Regulation of the Branch

…in the first half-year of 2006 42 enterprises received subsidies for purchase of raw material. However there are only small enterprises in the branch more than 10 thousand

- It is planned to compensate the interest payments for credits of light industry companies to the amount of about 100 million roubles in 2006. For comparison: in 2004 light industry companies got subsidies to the amount of 50 million roubles, in 2005 the value of subsidies made up 30 million roubles
- It is necessary to note, that despite tighter regulation of light industry, the given measures were not enough to change dramatically the dynamics of the branch development. The money allocated for subsidizing enterprises is provided for much fewer producers than those acting on the market. For example, according to MINPROMENERGO, in the first half-year of 2006 about 30 million roubles was allocated to subsidize raw material purchases. 42 companies received the subsidies. But the number of small enterprises involved in light industry production in Russia exceeded 10 thousand

Retailing Development

- Rather high profitability of retail trade in clothes and footwear (in some estimations 20 - 25 %) involves the increasing number of both Russian and foreign companies in the given segment. Besides that, compared to the European and American markets, the Russian market is still insufficiently saturated
- The development of retail networks in Russian regions is supposed to be very perspective. The tendency of penetration of regional markets by Moscow companies and the increase in activity of regional companies on Moscow market as well have been marked recently

Plans of Russian Companies on Retail Network Development

	by the beginning of 2006	plans on retail network development
FOS-P	12	plans to increase the number of shops to 35 by the end of 2006
GLORIA JEANS	200*	in the near future plans to expand the network to 1000 shops
TERVOLINA	> 50	by the end of 2006 will increase the number of shops to 70, by the end of 2007 the retail network will grow to 100 its own and franchised shops
RALF RINGER	50**	Ralf Ringer starts to develop its VIP network, by the end of 2006 it plans to open 5 VIP shops in Moscow
CARLO PAZOLINI	> 40	in 2006 plans to open shops in Tula, Kaliningrad, Novorossisk (2), Kazan (2), Nizhni Novgorod (2), Samara, Moscow, Krasnodar, St.-Petersburg (3), Yaroslavl, Minsk (Belarus). In the beginning of 2007 the shop in Tuapse will be opened
WESTFALIKA	55	the company develops its « Footwear of Russia » retail network, in 2007 it plans to open 20 monobrand shops
ECONICA	103***	by 2012 the number of shops should grow to 500

* Including 20 GLORIA JEANS shops of its own network and 180 partner shops
** 50 its own Ralf Ringer shops. In total on the territory of Russia and the CIS countries Ralf Ringer footwear is presented in 1700 mono-and multibrand shops
*** Including 46 franchised shop

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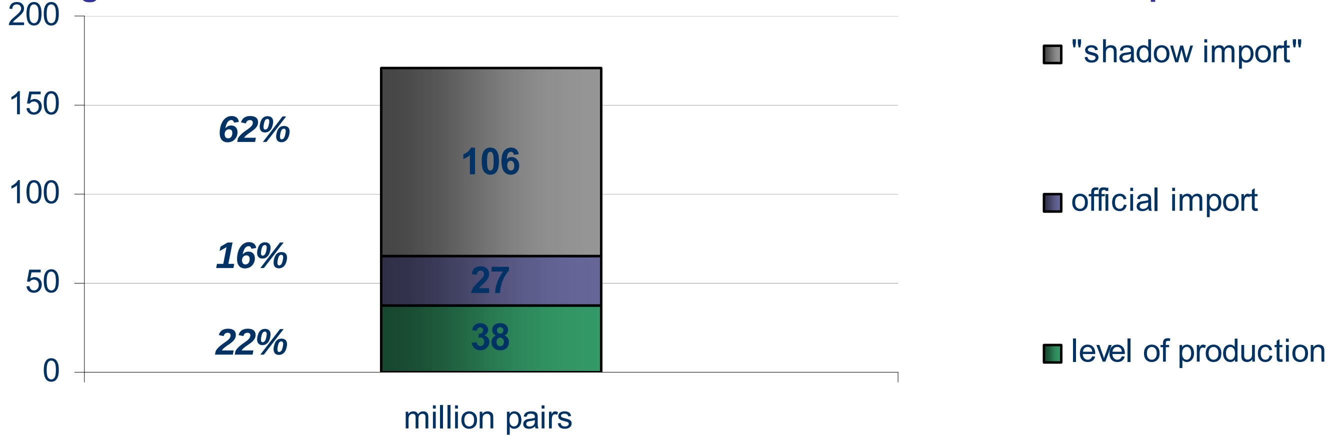
«Shadow Import» in the Russian Market

…decrease in the size of customs duties has allowed to increase the official import of footwear 3,1 times in the first half-year of 2006

- One of the negative factors of light industry development in Russia is the large scale of illicit production on the market. In estimations, about 62 % is the share of illicit production presented on the shoe market. According to MINPROMENERGO, the volume of the Russian light industry market is 1.25 bln roubles, but the "shadow" import makes about 780 billion roubles. The official import totals about 240 billion roubles
- Despite the preserved high level of illicit production on the market, the state bodies achieved in 2006 positive results due to the undertaken measures to decrease the volumes of illicit deliveries. Thus, in the first half-year of 2006 Russia officially imported 17.9 million pairs of leather footwear compared to 5.7 million pairs in the similar period of 2005

Diagram 1. Estimated structure of the Russian footwear market in Jan.-Sept. 2006



Increase in Manufacturing Cost in China

…in estimations, since 2002 the manufacturing cost in China has grown on the average by 40 %

- In experts' estimations, the growth in cost of light industry production in China for the last four years has made on the average 40 %. As the main causes for the rise in manufacturing cost in the country we can mark out the following:
  - *Improved skills of Chinese workers* – as a result, growth in labour costs
  - *Reequipped factories* –Chinese factories used to install mainly second hand equipment and now Chinese companies are taking the lead in purchasing new equipment. * Besides that, China is actively developing its own manufacture of process equipment
  - *Changed situation in the world currency market* – falling American dollar against stable yuan results into rising price of Chinese goods in a dollar equivalent

- It is necessary to note, that the trend in increasing manufacturing cost in China has a long-term prospect. In the long term this dynamics will be kept. Also Chinese companies are likely to change their role on the world market: they may transform their role of executors of orders and turn into independent players on the market

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* Thus, according to the Union of German machine engineers (VDMA) and Association of manufacturers of the textile equipment, China is the world leader in purchases of the process equipment. In 2005 Chinese manufacturers bought the equipment to the amount of 997 million euros

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Possible Consequences of the Increase in Manufacturing Cost in China for the Russian Market

…in tailoring in China the term from placement an order to its reception is 45-60 days long, whereas in case of placing an order in Russia the term will be 15-20 days

- As manufacturing costs in China increase, more and more world and domestic manufacturers consider the opportunities to place their orders at foreign factories. The most attractive regions for moving manufacture are Southeast Asia, in particular, India, Thailand, Indonesia, Vietnam, countries in Eastern Europe, Turkey and Russia
- In the given conditions Russia has an opportunity to attract to the country its own manufacturers placing orders abroad and world manufacturers. In our opinion, the appearance of foreign players on the market threatens not only with the squeezing domestic manufacturers out of home market. As the positive factor it is necessary to mark an opportunity to use the expertise and technologies of world leaders at Russian enterprises
- We would like to note, that the present situation in the Russian light industry is the factor reducing competitiveness of Russia in winning the eye of foreign investors. In particular, the negative factors are: shortage and poor quality of raw materials, absence of modern capacities, large scale of illicit production on the market

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The Resume

- A revival in manufacture in some sectors of light industry was marked in 2006. To the results of nine months of 2006 there was growth in textile and clothing industry production by 8,2 %, in tanning and shoe industry- by 12,9 %
- The state regulation of light industry is becoming tighter. However the undertaken measures in the branch are not sufficient to change dramatically the crisis situation
- The large scale of "shadow" import on the Russian market, slow updating of the process equipment, deficiency in qualitative raw material, lack of credit resources are still among the major factors hindering development of light industry in the Russian Federation
- The competition in the Russian market is becoming more aggressive. Domestic and foreign companies are mostly competing in the retailing segment of clothes and footwear.

About Bimmacon

www.bimmacon.com

- Bimmacon is the Russian consulting company having been acting since February, 1998.
- Specialization of the company in the field of consulting are services in the field of management consulting and corporate finance. Besides that the company actively operates in the market of marketing, branch and macroeconomic researches.
- We have wide experience, our researches are published in the leading editions of Russia. We actively work not only with the enterprises in the Russian Federation, but also in CIS-countries, with international companies and trade agencies of foreign countries.
- More than 1000 Russian and foreign industrial corporations and institutions have appreciated our approach to quality of work. They are: Chamber of Commerce and Industry of Switzerland, Polish company Comintex, The Moscow Branch of John Deer Agricultural Holdings, Inc., Embassy of Sweden in the Russian Federation, BASF, JSC Norilsk Nickel , JSC GUM Trading House, JSC Kirovkhleb, ZAO Arcada, JSC Avtoelectronika, JSC Podolsk Battery Factory, ZAO Prommontazh, JSC NPO Saturn (Rybinsk Motors), JSC The Glushko Energomash and many other companies representing practically all industries.

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