The logistics challenge of getting Western automobiles to Russian customers

An immense, yet specific

Almost daily, there is news about Russia's new super-rich elite buying football clubs, luxury cars and extravagant, multi-million dollar cell phones.

In the shadow of these headlines, the economic boom in the former communist country has led to the emergence of a growing middle class, which is fuelling one of the fastest growing automotive markets on the globe. Russia will eventually become the largest automotive market in Europe. Serving customers in the world's largest country is an immense opportunity for companies that are willing to tackle the logistical challenge.

High sales, heavy investments

With the GDP having more than tripled since 2001 and with total sales of new cars up by approximately 60% since 2004, the market for new cars is projected to continue to grow by around 17.5% per year. At the same time, sales of foreign brands have increased by a total of 338% (2004-2007) and are expected to grow by roughly 25% per year during the next three years, clearly outperforming Russian manufacturers' sales. Foreign brands will gain, it is expected, a market share of more than 75% by 2010. Western European and American manufacturers supply around 40% of all imported new cars and have a particularly strong presence in the upper and lower middle class segments. The remaining imports are served mostly by Korean and Japanese competitors. Chinese brands are only beginning to enter the market.

With their growing sales, major companies have started to heavily invest in their own production infrastructures in Russia to further strengthen their positions on the market. Ford, GM, Renault, and Volkswagen already operate their own production sites in Russia and other companies, such as Toyota, Nissan and Daimler, are working on plans to begin production in the future. With these developments continuing into the future, sales of Western brands are expected to continue to grow strongly. According to Business Monitor, the production of foreign brands in Russia is projected to outpace the production of Russian brands before 2014.

Automotive logistics

The structures for outbound automotive logistics in Russia have come a long way from the first direct imports of foreign cars, where the dealers or customers had to organize almost everything by themselves. Small and non-specialized logistics companies dominated the market in the 1990s. Although some large specialized companies have emerged, the market today still remains fragmented and common standards, as in Western Europe, are just beginning to develop.

When comparing the outbound logistics market to inbound logistics, it becomes apparent that the outbound market is almost entirely in the hands of local companies, while foreign companies work very closely with international logistics service providers to organize their inbound supply chains. The Western European car manufacturers are trying to ensure their production flow. In this regard, secure inbound logistics are a prerequisite in Russia, due to the absence of local expertise of foreign car manufacturers. The parts are transported mainly by ship to St. Petersburg/Finland or by truck across Poland and Ukraine. The capacity constraints at Russian ports force logistics service providers to use alternative land and sea routes. Currently, the best example is Ford's production site in St. Petersburg, where Schenker is in charge of the entire inbound logistics supply chain. As Richard Hartmann, CEO of Schenker Russija AG points out, his company's experience, its professional approach and its large range of services are the main features that differentiate his company from local competitors. Companies like Schenker Russija also have a core competency in problem-solving and often create the impression of normality. Richard Hartmann often points out that, although Russia is different, it is as normal as any other logistics market in the world for him.

Photo: CMP

By 2010 foreign brands should gain 75% share in the Russian market

While inbound logistics require logistics service providers to be very knowledgeable about the client firms themselves, the logistics for complete cars rely heavily on an in-depth knowledge of the country, local authorities, customs and business environment. This applies to outbound shipments from production sites in Russia, as well as to the delivery of imported cars.

The difficulty, when importing cars to Russia, begins with the different routes that are being used to ship cars to Russia. Most European and North-American companies send their automobiles by ship. Due to the large demand for cars and the fact that St. Petersburg has a harbour, this city has developed into the main hub for the imports of Western car manufacturers. Unfortunately, the port is struggling with inadequate organization, capacity limitations and a lack of storage. To circumvent this problem, as many as 70% of automobile imports are initially shipped to Finland, from where they are delivered to Russia by truck. For both options, however, the poor infrastructure and enormous distance between cities (especially in the Southern and Eastern areas of the country), constantly changing regulations and corruption create a vast array of problems that the logistics service providers, as well as manufacturers, face in their daily business. The successful companies have found ways to cope with the situation and are able to differentiate themselves from other competitors, who might not have the necessary experience. They just go ahead and do the job where others only see problems. These structures make a

market

significant entry into the market increasingly difficult. Some large carriers are also working hard to consolidate the market and set standards that might serve as barriers to entry. Autologistics OOO is one of the companies well positioned to conquer the market. Already one of the largest trucking companies in the Russian market, it has increased its capacity by more than 300 trucks in 2007 alone, and is planning to follow in 2008 with an investment of at least the same amount. Alexander Malishko, CEO of Autologistics explains that his company is, "setting a high standard in the market and is going to offer the same quality of service that the car manufacturers are accustomed to from Western Europe." This approach seems to pay off, as Autologistics was fast to win customers like Mercedes, Ford, BMW and Porsche. Even though the goal of "normality" might still seem distant, the market is definitely starting to value not only competitive prices, but also service quality.

This development is especially apparent when looking at the contracts to deliver goods that the logistics service providers are receiving. Even though contracts for single journeys are becoming rare, short contracts for those providers with the lowest price still make up a significant portion of the market. However, companies like Autologistics work on longer-term contracts, hence securing a market share. In order to work on such terms, companies must deliver top service, make all necessary investments and plan their growth into full-service providers.

At the moment, the quality of overall logistics services in Russia is not up to the standard of developed countries. Nevertheless, in the long run, logistics structures in the automotive industry will become as well organized and standardized as they are in other countries. Local companies, however, will likely still play an important role in the development, since local expertise will remain the key to successfully delivering cars in Russia.

Conclusion

The opportunities that the Russian market offers are immense. With growth in the regions outside of Moscow and St. Petersburg projected at twice as high as in the two cities themselves, the logistics structures will become even more important and offer enormous opportunities for logistics service providers, strengthening their position in the value chain. The car manufacturers will require developed and efficient solutions for inbound and outbound logistics that can only be established with experience. The adaptability of the strategy and daily business to the specifics of the Russian market is a key issue for success. There are many challenges and chances for logistics service providers in the future. Companies that want to participate in the Russian logistics market for automobiles need to start preparing today in order to benefit from the growing demand in the future. Entry barriers are increasing. Some have already achieved a high performance and will certainly profit greatly from the Russian market.

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