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Contents

1 Introduction

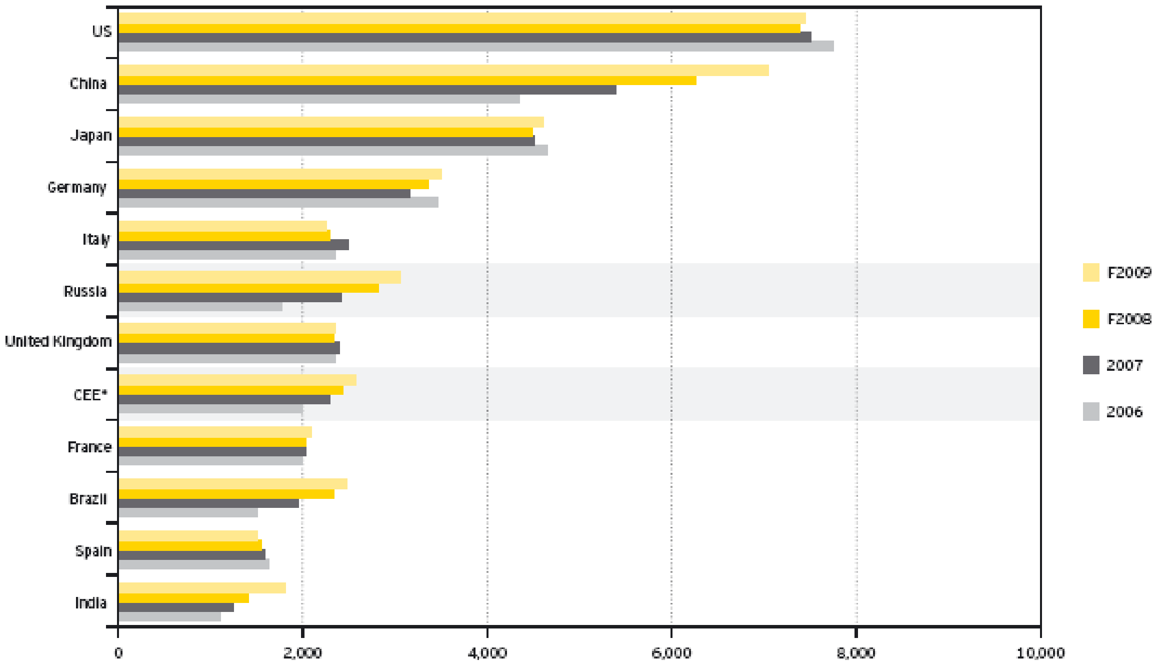
The Russian car market continues to grow rapidly. Along with China, Russia is the world's fastest-growing market for passenger cars. Despite the impressive growth throughout the past five years, the 2007 market indicators exceeded those of 2006 by more than 30%. According to a wide range of industry estimations, the growth will remain notably strong over the next five years, with the size of the market estimated to exceed 5 million cars by 2012. In addition, Russia is one of the key drivers of the global automotive production growth. According to recent estimations, Russia will contribute 10–15% of the global car manufacturing growth and some 20% of the global car sales increase by 2015.

Apart from the continued trend of shifting from domestic to foreign brands, the past two years have brought a notable shift toward a higher price segment. Throughout the 2007, foreign car manufacturers continued to establish production bases in Russia and extended their manufacturing and dealer networks. According to the 2008 survey by Ernst & Young, enhancing the regional presence was a key trend in the industry in 2007. The strong development of the Russian car manufacturing industry has benefitted the both the foreign manufacturers and brand dealers and regions with concentration of foreign assembly plants alike. In 2007, more than 10 foreign automotive car producers established manufacturing facilities in Russia. In addition, several strategic partnerships were formed in the course of 2007, both between the domestic manufacturers and the Russian and foreign producers alike.

2 The Russian automotive market overview

As of 2007, Russia was the 6th largest market for new passenger car sales in the world. According to even modest forecasts, however, the Russian market is bound to rival Germany as the largest market in Europe over the next years (Figure 1).

Figure 1 The world's largest markets by new passenger car sales, 2007 *('000 units)*



Source: Ernst & Young 2008.

According to PriceWaterhouseCoopers (2008), Russia outpaced Germany in the number of registered cars during the first half of 2008 (1.645 million against 1.63 million in Germany). Thereby, should the anticipated trends continue over the reminder of the year, Russia is to became the largest market in Europe already during 2008. During the first six months of 2008, the passenger car sales in Russia grew by 41% compared to the corresponding period of the previous year. The key elements of the impressive growth were imports of new foreign cars and foreign cars produced in Russia (Table 2).

Table 1 Passenger car market in Russia, 1H of 2007 and 2008.

Car category	Thousand units			US dollars, billions		
	First six months 2008	First six months 2007	*Difference*	First six months 2008	First six months 2007	*Difference*
Russian cars	380	300	27%	$3.5	$2.4	46%
Foreign cars produced in Russia	290	205	41%	$ 4.8	$2.8	71%
New car imports	785	510	54%	$22.2	$13.2	68%
Used car imports	190	150	27%	$3.3	$2.2	50%
TOTAL	1,645	1,165	41%	$33.8	$20.6	64%

Source: PriceWaterhouseCoopers (2008), based on various sources.

Chevrolet remained the top seller among the foreign brands, much due to its successful joint venture with the leading Russian producer, AvtoVaz. Honda, Opel and Hyundai have, however, posted notably higher growth rates in the course of 2007/2008 (Table 3).

Table 2 Top foreign brands by units sold, five months of 2007 and 2008.

Brand	**Five months 2008**	**Five months 2007**	**%**
Chevrolet (incl. GM-AVTOVAZ JV)	103,735	70,027	48
Hyundai	84,745	41,858	102
Ford	78,396	68,450	15
Toyota	70,446	59,337	19
Nissan	62,958	40,779	54
Mitsubishi	46,653	28,054	66
Renault	46,094	35,595	29
Opel	43,628	21,407	104
Daewoo	42,669	33,488	27
Kia	41,123	26,156	57
Mazda	30,906	17,422	77
Honda	28,786	10,412	176
Other foreign brands	279,068	196,818	42
Total	**855,472**	**579,776**	**48**

Source: PriceWaterhouseCoopers (2008).

The overall market is expected to carry on its ongoing shift towards the foreign cars, with both the imported and Russian-made foreign cars increasing their market shares (Table 4).

Table 3 Dynamics of the Russian car market until 2012, *units*

	Total market	New foreign cars	Russian brands	Russian-made foreign brands
2005	1,446,525	614,325	832,200	157,179
2006	1,790,000	1,020,000	770,000	276,404
2007	2,414,000	1,649,800	764,000	457,500
2008*	3,250,000	2,470,000	775,000	636,000
2009*	3,590,000	2,850,000	742,000	873,000
2010*	3,890,000	3,180,000	704,000	1,056,000
2011*	4,060,000	3,370,000	693,000	1,347,000
2012*	4,480,000	3,560,000	921,500	1,580,000

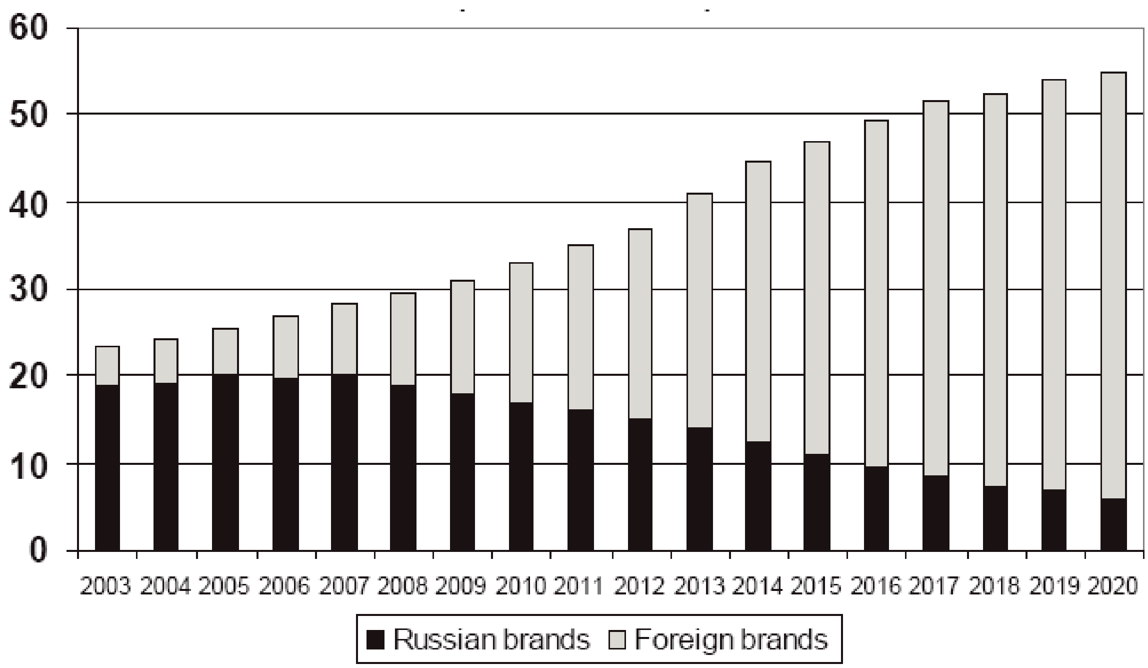
Source: Ernst & Young (2008).

As indicated by the preceding table, the share of foreign brands manufactured in Russia is expected to grow beyond that of imported cars. The market share of Russian-made foreign brands is estimated to reach more than a third of the total market by 2012, up from mere 11% in 2005 and 19% in 2007. In quantitative terms, the trend anticipates an increase of more than one million Russian-made foreign models between 2007 and 2012.

3 Car manufacturing in Russia

Russian passenger car fleet is estimated nearly to double by 2020, from the current 30 million cars to almost 60 million. During the same period, the share of foreign brands in the fleet is expected to grow from mere 30% to 80–90%.

Figure 2 Passenger car fleet in Russia, *mln units*



Source: PriceWaterhouseCoopers (2008).

The passenger car production in Russia is dominated by domestic producers and AvtoVaz and its leading brand, Lada, in particular. The share of foreign manufacturers in overall production is, however, increasing rapidly with foreign brands accounting for 35% of the passenger cars produced in Russia against 24% in 2006 and only 15% in 2005.

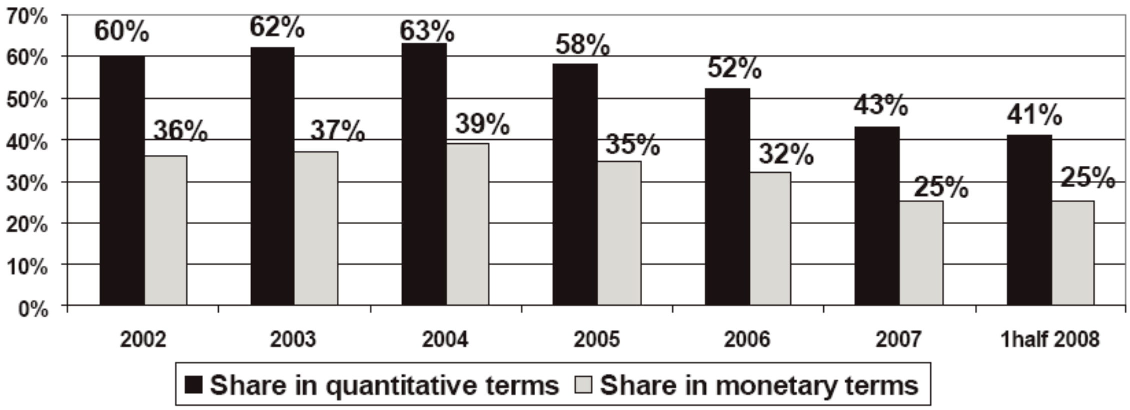
Table 4 Passenger car production in Russia, 2005–2007, *units and change in %*

Brand	2007	2006	2005	2007/2006
LADA*	757,805	799,768	780,736	-5.2%
GAZ	39,005	51,688	51,765	-24.5%
UAZ	31,869	28,528	29,141	11.7%
OKA (ZMA+SEAZ)	4,902	16,420	43,335	-70.1%
IZH	0	0	5,871	N/A
Other	572	268	439	113.4%
Total Russian brands	**834,153**	**896,672**	**911,287**	**-7.0%**
Chevrolet**	106,272	67,809	53,587	56.7%
Ford	69,088	62,409	33,047	10.7%
Renault	69,241	51,179	10,335	35.3%
Hyundai	71,050	48,397	42,451	46.8%
KIA***	62,635	27,719	15,611	126.0%
Chery	40,002	12,157	0	229.0%
Geely	3,509	0	0	>1,000%
BMW	4,521	3,831	2,293	18.0%
HUMMER	958	466	161	105.6%
Cadillac	2,085	303	228	588.1%
Volkswagen****	1,198	0	0	>1,000%
ZMA*****	21,678	4,567	22	374.7%
Other******	2,262	828	226	173.2%
Total foreign brands	**454,499**	**279,665**	**157,961**	**62.5%**
TOTAL	**1,288,652**	**1,176,337**	**1,069,248**	**9.5%**

Source: Ernst & Young (2008).

The strong growth of foreign brands manufactured in Russia is estimated to continue as the Russian consumers increasingly opt for the more expensive and comfortable cars. As of early 2008, all the major global car producers have manufacturing in Russia and three of the top five foreign car models by sales (Ford Focus, Renault Logan and Hyundai Accent) are manufactured in Russia. The Russian authorities have voiced plans of domestic production reaching up to 80% of the cars sold in Russia. Despite the powerful entrance of global producers and ambitious plans for increasing the domestic production, the share of car manufactured in Russia has decreased over the past five years (Figure 2). This development, above all, indicates the rapidly declining demand for domestic brands, but also the growing preference of Russian consumers for imported cars.

Figure 3 Market share of cars produced in Russia, 2002–2007



Source: PriceWaterhouseCoopers (2008).

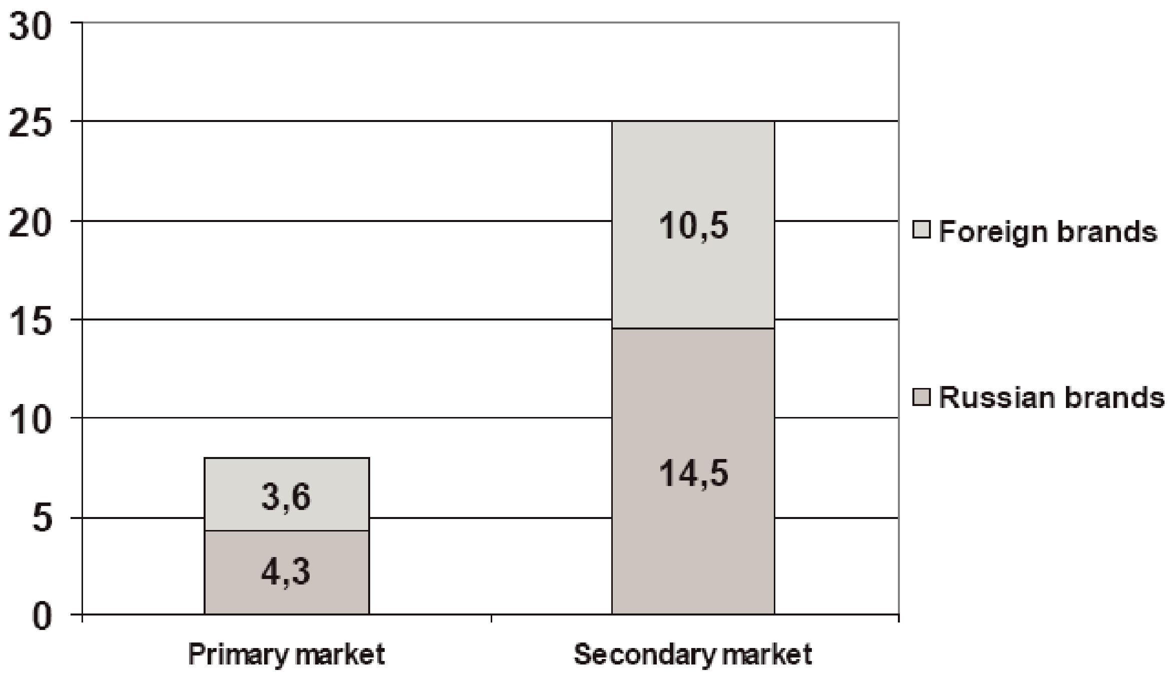
As the majority of the foreign brands manufactured in Russia are classified as more affordable budget models, the trend additionally indicates the growing appetite of the Russian consumers for the more expensive upper class models. Several foreign manufacturers have, in turn, reacted by voicing plans of establishing production lines for more exclusive cars in Russia.

4 Automotive component market in Russia – an overview and opportunities for foreign component manufacturers

The Russian automotive component industry has been highly vertically integrated. On estimation, the level of integration was nearly 80% in 2007. As an obvious result of the high level of integration, there is a relatively small number of domestic component manufacturers; the industry comprises of only some 200 key players, the vast majority of which supply the Russian original equipment manufacturers (OEMs). According to Ernst & Young (2008), only around 5% of the component manufacturers supply foreign OEMs and a mere 1% have export activities.

The total volume of primary automotive component market reached USD 8 billion in 2007 with the volume of secondary auto component market totalling USD 25 billion (Figure 4).

Figure 4 Automotive component market value, *billion USD*



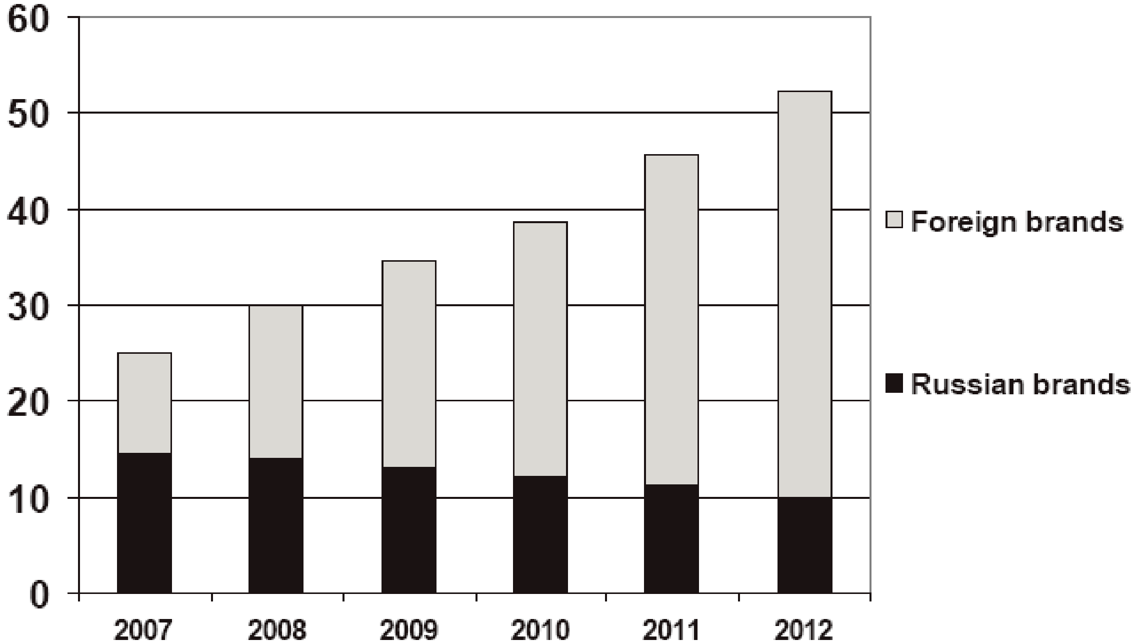
Sources: PriceWaterhouseCoopers (2008); AutoStat (2008).

As the Russian car manufacturing industry witnesses a growing need to upgrade the existing car models and requires the replacement of many components with foreign-manufactured ones, new market opportunities are rising for foreign component manufacturers. The number of foreign component suppliers still remains small and comprises mainly of lower value-added components. Until recently, despite the voiced interest to invest in component manufacturing in Russia, foreign OEMs have witnessed considerable obstacles in reaching investment agreements with the regional authorities and suppliers. Nevertheless, given the estimations of rapidly growing car manufacturing and related demand for higher-quality components in Russia, the foreign component manufacturers are poised to meet more attractive investment opportunities and environment as well as to be able to reach critical production volumes in upcoming years.

As the majority of the automotive components are currently imported, the value of primary components produced in Russia for assembly of foreign car brands in Russia was merely USD 360 million in 2007, accounting only for 10% of the total primary market value for foreign brands (totalling USD 3.6 billion, see Figure 4 above). Depending on the source, the annual volume of Russian-made foreign cars will reach 1.5–2 million units by 2012, whereas the average car price is likely to be between USD 25000 and 30000. Again, based on industry average, some 50–60% of the price will be directed to the component manufacturers, creating a potential annual market value of around USD 20–35 billion. Hence, even with a modest estimation of some 30% of the components manufactured in Russia, the domestic market for primary components should reach 7–10 billion in the course of the next five years, excluding the supplies to Russian brands.

In line with the estimations of the growing share of foreign cars in the Russian car fleet, the secondary market value of foreign-brand automotive components should more than quadruple over the next five years, reaching USD 40 billion by 2012 (Figure 5). Thus, the total value of the market for primary and secondary components for the Russian-made foreign car brands can reach an impressive USD 75 billion, based on the current estimations on car fleet and production development.

Figure 5 Secondary automotive component market value, *billion USD*



Source: PriceWaterhouseCoopers (2008); AutoStat (2008).

5 In focus: Automotive manufacturing in Saint-Petersburg

The Saint-Petersburg area presents the key concentration of car manufacturing industry in Russia. All the leading foreign brands have established or plan to establish production facilities in the region, which has justifiably earned a nickname “Russian Detroit”. By 2010, foreign manufacturers expect to produce up to 700 000 cars in the region, accounting for 40–50% of total production of foreign brands in Russia (Table 6).

Table 5 Foreign car manufactures in Saint-Petersburg

Company	**Investments,** *million USD*	**Production volume (planned)**	**Models**	**Year of installation**
Ford	330	125 000	Focus, Mondeo	2002
Toyota	150	50 000 (200 000)	Camry	2007
General Motors	300	60 000	Captiva, S-class	2008
Hyundai	390	100 000	C-class	2009
Nissan	200	50 000 (100 000)	Teana, X-Trail	2010
Suzuki	123	25 000 (100 000)	Grand Vitara	2010

Source: Kiselevich (2008).

Both federal and regional strategic policies create the preconditions for development of car manufacturing in Saint-Petersburg and the surrounding areas. Introduction of new legislative basis in the field of automotive component production aims at both attracting foreign manufactures in the region and localisation of the production process, ultimately leading to creation of a substantial car and component manufacturing cluster in the area. The production volume in the region is expected to reach up to 1 million foreign brand cars by 2012.

Apart from the supportive policy measures, foreign companies are attracted to the Saint-Petersburg and Leningrad region by the availability of skilled labour force and modern technologies, compared to several other key manufacturing areas. Although the emerging car manufacturing cluster still partially lacks sufficient industrial production infrastructure and experience in mass production of automotive components, the inflow of foreign capital and know-how has rapidly improved the stance of production infrastructure in the region. Along with the entry of some leading international car component manufacturers, such as Magna International in 2008, the output volume of the region’s component industry is expected to triple already during 2008. The development of automotive industry cluster further has positive spillover effects on the overall infrastructure development in the Saint-Petersburg region, in turn, creating yet new opportunities and preconditions for entry for the foreign car component manufacturers.

According to the recent announcement by the Russian economics ministry, more than 40 foreign auto-component plants are to be built in Russia over the next five years, with 21 investment agreements with component manufacturers already signed. More than a half of the planned plants are to be established in the Saint-Petersburg and Leningrad region. As the Government plans for overall development of the industry foresee at least 60% ratio for domestically manufactured components by 2012, however, substantial market opportunities for foreign companies remain despite the recent rush to enter the promising markets.

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