How to Source from Russia

-A multiple Case study of six companies' experience of Purchasing in Russia

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This article is an attempt to summarise a master thesis about how Scania should act when trying to source from Russia. A multiple case study was made to find out what the best course of action is, and also to find out what is different between Russia and Western Europe when it comes to business culture and industry. Based upon the findings three scenarios are presented which covers different choices Scania can make and the best alternative is then recommended.

Introduction

The study was conducted together with the Swedish automotive company Scania.

Traditionally Scania has used suppliers located in Western Europe but since competition is increasing, sourcing from low cost markets is becoming more common. Scania has been able to find assured suppliers in East European countries like Poland and the Czech Republic, but so far, not in Russia. The Russian supplier market is interesting for Scania for several reasons. The wage level is a lot lower than in Western Europe and the distance to the production site in Södertälje is relatively short compared to low cost markets in Asia. Furthermore the technical level is believed to be sufficient and the raw material cost is low which stems from almost endless resources.¹

The purpose of the study was to find out whether it is worthwhile for Scania to look for new suppliers in Russia, based on other Swedish companies’ experiences of purchasing in the country.

The following issues were presented:

- What characterise Russia as a supplier market?
- Which sourcing experiences have been made by other Swedish companies in Russia?
- How can this knowledge be utilised at Scania?

Mode of Procedure

The research was divided into four phases. The first phase - the pre-study - included project planning, method discussions, interviews with purchasers at Scania and a first general study of Scania and its purchasing organisation. In the second phase - the internal scan - a more thorough study of the purchasing process was carried out together with a search for relevant theories connected to procurement. The third phase - the external scan - begun with a literature study of Russia, complemented by interviews with two Russians living in Sweden and the study of the Russian automotive producer. The case studies were also carried out in this phase. Purchasing managers at the Swedish companies in Russia were

¹ Lars-Erik Nerback (2006-02-08)
interviewed via telephone and complemented with interviews on site. The final phase – analysis - were initialised after a mid term seminar, where a reference thesis group as well as teachers gave us feed-back. This phase, and our thesis work, was completed with a presentation of our results at both Scania and the concerned institutions at Lund University.

**Empirical findings**
The empirical study was divided into three parts: Russia, Scania and the Case Companies.

In the Russia part we look at e.g. the society, the automotive industry, how a company is organised and how to do business in Russia. We found out that there are both similarities and differences between Russia and West Europe. We also realised that the huge natural resources in Russia creates many economic advantages. Hence, they don’t invest very much in any other kind of industry.

At Scania we examined their purchasing department and what kind of demands they have on suppliers. The Purchasing department is responsible for buying components, material, and tools for running production, spare parts and non-automotive products. It is organised as shown in figure 1. All of the functions are situated in Södertälje except SLA and SE. The different functions in Södertälje are responsible for buying different components and materials except SE and SR that are looking for suppliers on new supplier markets.

Scania’s demands on current and potential suppliers are e.g. ISO/TS 16949 certification, ISO 14001 certification and that they follow the OECD guidelines.²

The case companies are presented as well as a description of their experience in Russia. The case companies are:

- Alfa Laval
- Electrolux
- IKEA
- Skanska
- BBH

It is clear that the case companies have similar experiences from Russia. IKEA is the only company which has a substantial global sourcing from there (1 %). Electrolux has the same experience as Scania in Russia and doesn’t believe it is possible to find any global suppliers there. The other companies have local sourcing in Russia.

**Discussion of our findings**
The chapter was divided into three parts to conform to the issues presented in the introduction. Last in the chapter we present three possible scenarios, or choices, Scania can follow.

The first part discusses the Russian industry structure and its impact on foreign companies searching for suppliers. The economical transformation of Russia, which is still going on, has lead to a warped ownership structure where the old leaders still have a lot of power and the power distance is high. The last years rising raw material prices has correlated with increasing power

2 Scania internal document
concentration in Kremlin which exemplifies the widespread corruption that exists in Russia. Fortunately it does not seem to strike foreign companies that much according to our interviewees at the case companies.

That the transformation is not yet completed can also be seen at company level. The business making competence is rather low and the Russian management is, according to Westerners, generally poor. Managers from the past, referred to as Red Management is avoided carefully while younger Russian managers, preferably those with experience from West, are considered as competent and easy to cooperate with.

We have in our study identified two important factors that we believe influence the Russian industry negatively; obsolete machinery and low competitiveness. The obsolete machinery limits the companies’ possibilities to deliver to high demanding companies such as Scania. It stems from the short term thinking that typifies Russia and make them less inclined to make new investments. It is also caused by the lack of financial stability.

The low competitiveness within the industry makes the development go slow. In the discussion we argued that the low competitiveness stems from three restraining factors; an industry structure that is dominated by huge conglomerates without specialisation, the nearly endless natural resources that create a situation similar to that in Middle East, that it is no need for development since exports of raw material creates enough wealth by itself, and finally a gigantic domestic market with many customers but not that many producers.

In the second part of the discussion we look at the case companies and their experience. In the beginning of the study we had the impression that many Swedish companies had sourcing from Russia. This quickly turned out to be a false assumption and the experiences made by Scania are quite similar in the case companies as well. We got a lot of input about factors Scania should consider when trying to find and work with suppliers in Russia. Some of the most important are:

- Use Russian purchasers when working in Russia.
- Use purchasers with extensive knowledge about the Russian automotive industry and basic demands on suppliers.
- Be flexible with demands on suppliers.
- Help possible suppliers; both financially and with technical competence.
- Take an active decision regarding sourcing from Russia.

In the third part of the discussion we use all relevant information from our study of Russia and the case studies in order to formulate advises to Scania concerning further sourcing attempts in Russia. We begin with an analysis of Scania and continue with a comparison of Scania and the case company. With the analysis of Russia from the beginning of the chapter and the key learning’s from the case companies at hand we sum up our findings in the final section; Implications for Scania.

Electrolux is probably the most similar company to Scania of the case companies. They both have strict demands and a standardised way of searching for new suppliers. Unfortunately Electrolux has not been able to find suppliers in Russia either. It is probably because of the high demands or on the kind of products they want to buy. We have found that the earlier in the value chain a company sources from, the easier it is to find suppliers in Russia.
The three Scenarios

In the first scenario Scania believes that the supplier market in Russia is underdeveloped and not worthwhile to penetrate, at least at the moment. The opinion is based on the experience from the former attempt and studies such as this one which indicates that the Russian supplier market will not be interesting for high-demanding Western customers for years. The situation in Russia does not motivate more investment that will probably be wasted. Also Scania is not required to do any structural changes and it will decrease the workload on SE that is responsible for the search in Russia today. If they choose this scenario there is a risk that Scania will be left behind other competing companies when/if Russia’s industry does improve. It also sends the signal that Scania is not at all interested in Russia which might affect the sales performance in Russia.

In the second scenario Scania believes that Russia is a supplier market for the future and will consequently continue the active search they have had before with someone working full time to find global suppliers in Russia. They believe that Russia, with its low wages, high education and closeness to Sweden, is an even better sourcing option than China or India, if they can just find the suppliers, which they are confident exist. The benefits of finding suppliers in Russia are low wages and closeness to Sweden which facilitates logistics. Since Scania already have a lot of information about the supplier market the search should be more effective now. The costs of finding the right purchaser to work with the project might be big; there is also a big risk that the project may fail again, because of the same reasons as last time.

In the final scenario Scania consider the Russian sales market to be very attractive and they are consequently planning to set up an assembly plant as soon as possible in order to satisfy it. The company believes that it is important to increase the local presence in order to keep or increase their high market shares. In addition to planning a plant set up they actively search for potential Russian partners as many other foreign automotive producer has done and still are doing. Furthermore the supplier market is believed to develop fast the next few years which implies a quick response from Scania what regards purchasing. To satisfy the increasing demand of local supply which the assembly plant will cause they also plan to establish a local purchasing office (LPO) in Russia. The LPO will also put a lot of efforts in finding global suppliers that could be used at Scania’s production sites all over the world. The Russian sales market is growing fast. By setting up an assembly plant Scania increase their possibilities to keep a strong market position. This will also affect their possibilities to find both global and local suppliers in a positive manner. There are many risks and disadvantages with this alternative. First of all; the business environment in Russia is somewhat unstable with an uncertain political and industrial development. Huge investments like this alternative can therefore turn out very costly for the company if it does not result in a sufficient return.

Conclusions

The purpose of the three scenarios presented above is to show that Scania can be a winner in Russia by choosing a number of different strategies, all dependent on how much faith they have regarding the Russian supplier market. However, our study indicates that a course of action similar to that presented in scenario 1 is the one that should be taken. The concerning companies in Russia are simply not ready to deliver products to demanding Western companies such as Scania, without a certain amount of help and a lot of patience. For the moment we do not believe that the potential that the Russian supplier might have, make up for
the additional work and probable investments that will be needed.

Instead we recommend Scania to leave Russia for the moment and evaluate other potential regions. We have for example gotten some indication that the CIS countries are developing positively which can be worthwhile to investigate more. The development in Russia could probably be observed without local presence, e.g. by continuous contact with the sales representation, Scania Peter and trade chambers in Sweden respectively Russia. Falling raw material prices should be seen as something good since that might turn the negative trend of stately hostile take-overs and strong political interventions.

Because, as the last years booming Russian stock market has shown, things can change fast in a developing country like Russia. So, even if Scania follow our advice and put the project on hold, we recommend them to keep an eye on the development. As they say you never know when the Russian bear wakes up…