

# “From Risk to Opportunity. Russia and Ukraine in the Focus of Medium-Sized Machinery Builders and Automotive Suppliers from the State of Baden-Württemberg, Germany”

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# SECTION 1 | **Macroeconomic Processes and Regional Economies Management**

## **From Risk to Opportunity. Russia and Ukraine in the Focus of Medium-Sized Machinery Builders and Automotive Suppliers from the State of Baden-Württemberg, Germany<sup>1</sup>**

Helmut Kohlert\*

### **Abstract**

The article describes the ambitions of German automotive and machinery companies to enter the Russian and Ukrainian markets. The results are based on an empirical study which was conducted together with PricewaterhouseCoopers in Summer 2005. It describes the activities of the German firms in these countries, and how these medium-sized companies make the first steps of entry. It also points out the differences between the automotive suppliers and the machinery builders. The article concludes with the connecting and discerning factors between these countries.

**Key words:** new market entry, market entry Russia, market entry Ukraine, automotive, machinery, cultural differences.

**JEL classification:** M31.

### **Introduction**

With the globalization, the extension of the European Union and the political changes in the world, medium-sized companies are facing new challenges. Changes are also accompanied by opportunities, but companies have to search, to recognize and to use them. Medium-sized companies everywhere in the world will have to work on current and future strategies which provide other answers to reach better results than to optimize the business processes, to lower costs of staff and to reduce the overhead costs. These kinds of optimized business models have a very limited charm. A strategic alternative is to look for new country markets. While everybody looks at China as the gigantic market for western products, the real “backyard of Western Europe”, namely Russia and Ukraine, is not arrived in the consciousness of the western companies yet.

### **Russia and Ukraine as Appreciated Locations**

Machinery builders are driven by the market expectations, automobile suppliers are driven by the measures of the automotive assemblers and the labor costs, when they decide to enter a foreign market. A study of the PNB Company with 106 companies which have been already invested in Russia and 49 companies which have not invested up to now, came to the following conclusions: 88% of the companies called the size of the Russian market as well as 77% the persistent economic growth as reasons for the investments or the interest<sup>2</sup>.

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<sup>1</sup> The article is based on a study conducted together with PricewaterhouseCoopers in Summer 2005. The study was published as book: Kohlert, Helmut: Vom Risiko zur Chance. Russland und die Ukraine im Fokus mittelständischer Maschinenbauer und Automobilzulieferer aus Baden-Württemberg, Stuttgart 2005.

<sup>2</sup> PNB Company: Russia. Investment Destination, 2005, p. 32.

The advantages and disadvantages of the Russian and Ukrainian markets appear as follows:

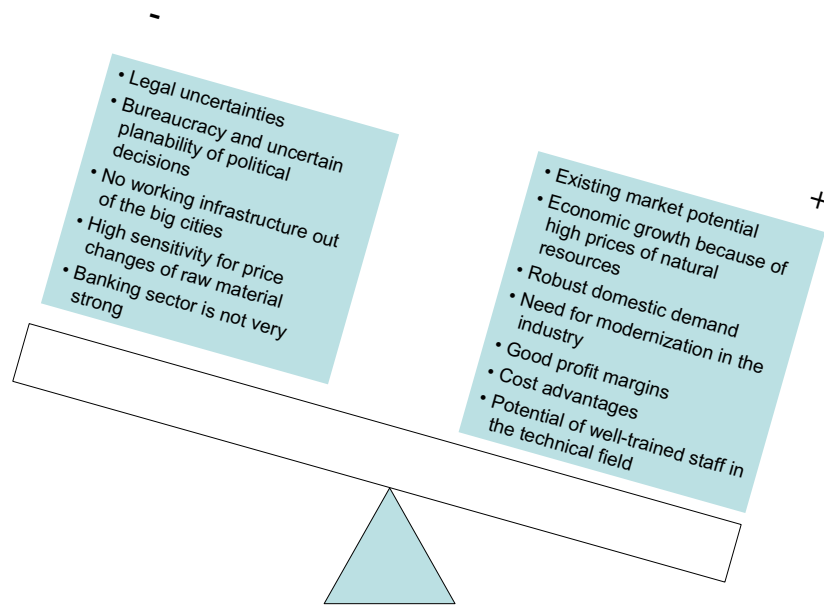


Fig. 1. Risk assessment – Russia and Ukraine

The attractiveness of Russia and the Ukraine in spite of different challenges is very high in particular for companies of Western Europe, they are close in geography and culture. The advantages of Russia are based on the present “windfall profits”, because of the high oil prices. Ukraine does not have this advantage.

### Cultural Differences to the Big Neighbor

If you ask the Russians how they see themselves, the following characteristics are often mentioned<sup>1</sup>:

#### Russian-picture of the Russians

- generous, hospitable
- teachable, open to the new
- big heart, ready to help
- courageous, but also distrustful
  
- want to do everything on their own
- big acceptance of authorities
- authorities are not questioned

Fig. 2. Russian-picture of the Russians

<sup>1</sup> These statements were collected by the author from numerous participants of his marketing seminars in Russia during the years 2001-2005. They show a list of characteristics, how the Russians see themselves.

These answers open a picture which reflects their values and norms; these will effect business behavior.

If you ask the Russians how they see the Germans, the following statements are done<sup>1</sup>:

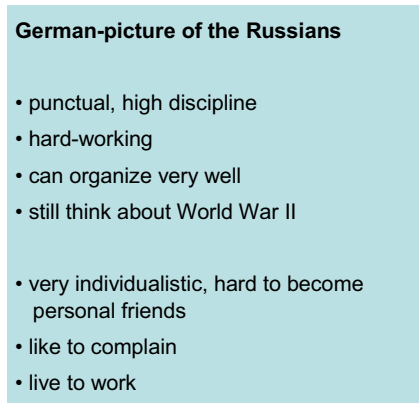


Fig. 3. German-picture of the Russians

### Objective and Approach of the Study

The objective of the study was to reveal the ambitions and possibilities in Russia and in Ukraine of medium-sized companies, machinery builders and automotive suppliers, in the German state Baden-Württemberg with its capital Stuttgart. For this purpose the study was carried out in medium-sized companies in the heart of the German “Mittelstand” industry: the State of Baden-Württemberg. These companies were interviewed in teams with two interviewers with semi-structured interview guidelines. The size of the empirical study were 27 companies, interview partners were in more than two thirds of the companies the managing directors of the companies.

### Present Engagement in Russia and in Ukraine

The engagement is focused on sales as the following graph points out:

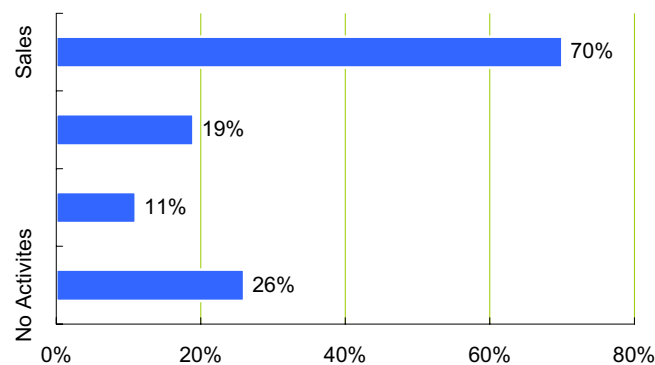


Fig. 4. Today's engagement of the companies in Russia and in Ukraine (multiple answers were possible)

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<sup>1</sup> These statements were collected by the author from numerous participants of his marketing seminars in Russia during the years 2001-2005. They show a list of characteristics, how the Russians describe the Germans.

As the big topic for German companies is how to organize sales, the question arises how these sales are organized in Russia and Ukraine? Are the companies building up and investing in sales operations or are they using “third parties”, e.g. local sales representatives to test the market and to avoid bigger investments? The following graph gives more information:

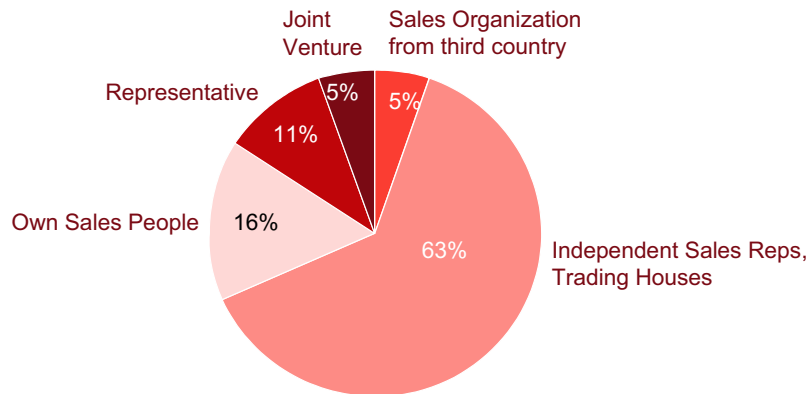


Fig. 5. Actual sales activities in Russia/Ukraine in detail

Nearly two third of all the companies which maintain sales activities in Russia and in Ukraine use free representatives or trading houses. It is obvious that many medium-sized companies enter the two markets with the least possible "commitment" and rather hesitantly. The message of the companies is that there is a high degree of uncertainty in strategic decisions.

On the other side, only big corporations can effort it to carry out extensive market research, to found full-sized subsidiaries in the foreign market and to cover the losses of the beginning years. Medium-sized companies often have limited financial resources a limitations in human resources.

However, what comes first or what does cause what? When sales are made, the company has the evidence that there is a market, or does the company have to invest at first, in order to make sales? This is the question for machinery builders. Automotive suppliers deal with their old automotive customers in Germany, sales with the existing Russian automotive companies might not be significant at the moment.

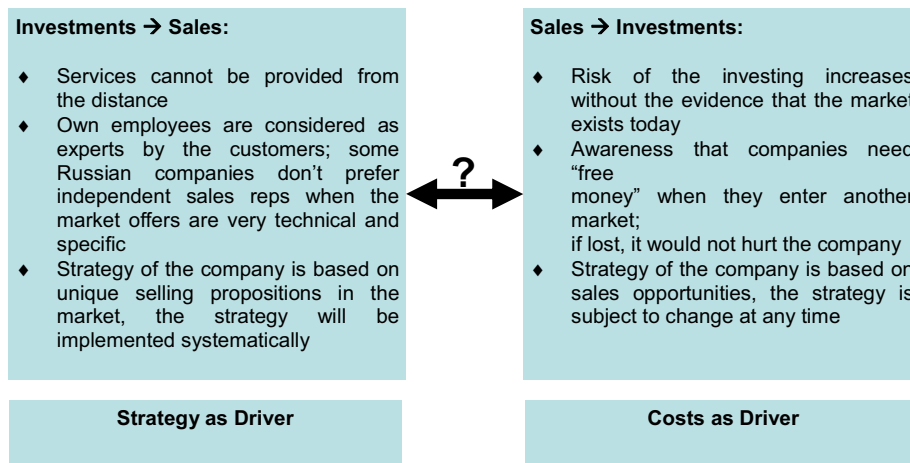


Fig. 6. Strategies or Costs as Driver on the Way to Russia/Ukraine

## **Automotive Supplier – Driven by Costs**

If an automotive supplier enters a foreign market and builds up operations, the investments are always huge. In the selection of country and location, the investment climate is altogether a very important factor. In Russia, this factor indicator is considered in general pretty good, although there is sometimes some doubt about the long-term political stability and problems with the predictability of the juridical conditions.

If the manufacturing is very labor cost-intensive, the labor costs play a significant role. The cost situation is no argument when a large part of the costs is material. In these cases, customs and “local content laws” will be taken under consideration, at least in the short run.

Market factors like market size might arrive in the picture if the Russian and the Ukrainian automotive industries start to modernize or when foreign manufacturers establish production facilities to a bigger extent.

## **Situation of the Machinery Builders – Driven by Market**

The focus of many machinery builders with their sales activities and their service is on Moscow. Because there are more and more customers outside the big center, it requires to penetrate the Russian and the Ukrainian markets and turning away from the exclusive concentration on the capitals of Moscow and Kiev.

For machinery builders, an engagement in Russia and in Ukraine is based on market factors like the market size, trends to modernize industries, and the establishment of foreign production facilities. It is still on hold in Russia and in Ukraine. According to a study of the PNB Company the number of the companies which are motivated by the market situation lies with 79 of questioned 104 companies<sup>1</sup>. In the meanwhile, companies could do the spare part business as well as services, possibly supporting the modernization of existing machinery equipment. This could show a possibility to come with the Russian customers in contact and to start a business relationship.

The attractiveness of markets in general is given by the following criteria<sup>2</sup>:

- ◆ The market segment has a high profit potential, because the customers need the market offering. It solves an important problem of the customer.
- ◆ In the market segment the own company is able to dominate because of his differentiated market offering with unusual strengths. The differentiation is sustainable and competitors are hardly able to copy or to imitate it. With these strengths the own company is able to satisfy customer needs better than anybody else.
- ◆ In the market segment others, e.g. distributors, have no power. That means to find and the access to these customers is relatively easy.

## **Machinery Builders – Market Entry with “Small Steps“**

While the automotive suppliers do not have this option at all, machinery builders can absolutely develop their business step by step. In the hope that the market behaves very statically, a phase-by-phase market entry is possible:

- ◆ An export arises from the first contacts which are often generated on fairs, chambers of commerce, etc. Opportunities to receive market information exist only if the initial con-

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<sup>1</sup> PNB Company: Russian investment destination, 2005, p. 29.

<sup>2</sup> Kohlert, Helmut: Marketing für Entrepreneure, in: Kohlert, Helmut: Entrepreneurship für Ingenieure, München/Wien 2005, pp. 159.

tact will be intensified and the personal contact is established. Often this is more used as a “market test”.

- ◆ The first appearance on the Russian or Ukrainian market often starts with an independent sales representative or a trading house. Unfortunately, the company receives only a few information about customer, market and competition. This kind of information are the assets of sales representatives and trading houses, they will not share it with their customer for free: There is nothing like a free lunch!
- ◆ If steady sales are achieved, the companies think about opening their own sales branch in the country, which might handle the spare part business as well as other market offerings in the new market. Now market information can be collected systematically by the company itself and personal customer contacts can be built up.

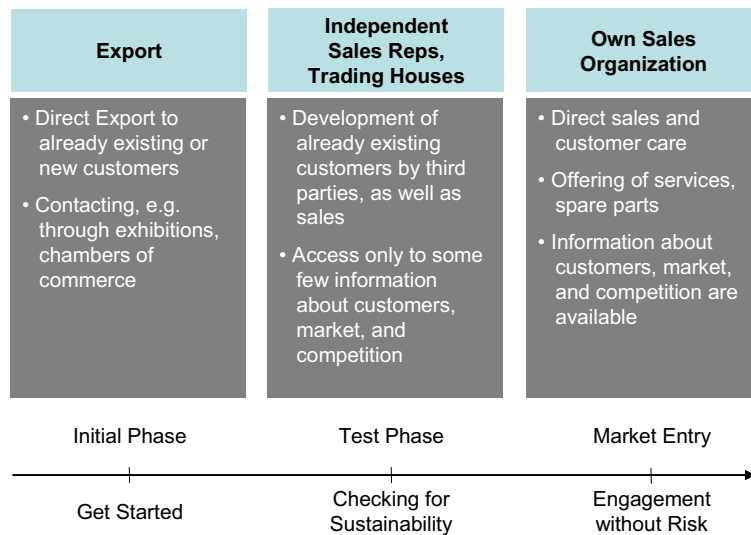


Fig. 7. Step-by-step entry into the Russian/Ukrainian market by machinery builders

This seems to be the way of many machinery builders in Russia and in Ukraine. There a continuous presence is important, medium-sized companies are aware of that. The network of contacts should be kept in its own hand. German medium-sized companies seem to tend to search a "market potential with a measurable risk". There is nothing bad with that.

### In Search for the "Russian Soul" – Connecting Factors

Here are the factors which can be used for building up a business relationship between Germans, Russians and Ukrainians, from the German point of view:

1. Russians and Ukrainian are considered as “straight forward”, this is appreciated by the Germans very much. The matter of fact, emotions and ratio are mixed also in business in Russia and in Ukraine, Germans can be inspired, because they do not know this but they seem to like it. Without good personal relations there are no good business relations: “Business is people” or how the Russians use to say: “You should not have 100 rubles, but 100 friends”.
2. The hospitality is very high in Russia and in Ukraine. So business visitors have to spend much more time than in other countries: “While you go with the customer for lunch in Germany, you have to spend with the Russian a whole week”. Indeed, this investment is well spent, because if you have a foundation of trust, it will help later. The customer relationships are more intensive in Russia and in Ukraine than in Germany. So the time you have to dedicate to a customer is much higher. The further away from Moscow, the more friendly and cordial the people are.

3. The cultural differences between Germans, Russians and Ukrainians seem very low, compared with other countries. Values like punctuality and reliability are very widespread if you have found the right people. The willingness to perform and to build up something has risen. In the companies which have modernized, the organization is good and the working flow runs without delays.
4. The qualification of the employees is excellent, the education in general is considered as very good. However, it is necessary to start a stringent selection process to find the right people.
5. There is a big interest in technology. So many people from different departments attend technical presentations. The Russians and the Ukrainians know a lot about technological-scientific issues. So the collaboration in this field is often very successful. In the areas of marketing, sales organization, logistics, controlling, a high training need still exists<sup>1</sup>.
6. Risk consciousness develops, namely that a lower price often leads to a higher risk. However it is difficult to evaluate whether a higher price really means a higher value. Risk considerations of the Russians and the Ukrainians are very often focused on formal data, but not on unforeseen incidents. There are not enough experiences available at the present time.
7. Contract loyalty is given. However, it is decreasing since a couple of years.
8. There is a respect for German quality, a big understanding for the German culture and an appreciation of German work ethics.

### **In Search for the "Russian Soul" – Discerning Factors**

Here are the factors where Germans can run into trouble if not considered or known. These factors are revealing experiences of Germans in Russia and in Ukraine:

1. The general director is not always a final decision maker. Decision making processes can be very long in Russia and in a Ukraine, e.g., four months of assessment phase, then the decision is made and they expect a delivery time of four days.
2. The usage of mobile phones during the meeting is very usual and shows the importance of people, Germans think: "The more often his mobile phone rings, the more important he is". Also it can happen that during discussions a constant arrival and walking takes place and only some people attend all the time. This is very unusual for Germans.
3. Business lunch and alcohol play a big role in this business world. Friendships are made there. At least older Russians appreciate Vodka. If the German businessman stands not so much, he should limit himself with the drinking to the toast<sup>2</sup>. Nobody requires from a foreigner that he can fully "keep up". It is sufficient when he sips while raising the glass.
4. The way to the real topic of conversation leads us indirectly. This indirect conversation style creates a good base for the personal understanding and new ideas. An invitation to a private home is very rare, and would be a special honor.
5. Direct criticism is taken by the upper level, only the own general director may criticize! Criticism is accepted only by an approved authority, then, however, without contradiction. The community ("We") is lived in spite of clear hierarchy and shows no contradiction. The executives of the Russian and the Ukrainian companies are well trained, have good manners and a healthy self-confidence. They are able to let the suppliers feel: "I am a customer – you are a supplier".

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<sup>1</sup> Frank, Sergey: Intro – Zum besseren Verständnis. Interkulturelles Management – Wanderer zwischen zwei Welten, in: Lüke/Weber: So kommen Sie nach Russland. Der Wirtschaftswegweiser für den Mittelstand, München 2003, p. 297.

<sup>2</sup> Frank, Sergey, p. 294.



6. The people have made very negative experiences with planning. So it counts primarily “I live today”, because the future hardly is foreseen and detailed planning has only low chances to be realized in reality<sup>1</sup>. This maybe the reason why a long-term, strategic plan is absent in many Russian and Ukrainian companies. The reason for it is the unsteady macro economical sphere and the missing know-how of the management in this field. The business plan is often more a preparation for negotiations with banks than a management tool<sup>2</sup>.
7. Employees change very fast with a better wage offer. Many people want fast a better standard of living, other countries needed decades to develop it. There are many “job hoppers” with commercial background especially with skills in finances and controlling, as well as in management positions.
8. In general the mentality of the Russians and the Ukrainians concerning the importance of quality is a big problem, not on the management level, but on the worker level, where often old mental structures are still alive.
9. The traditional Russians often have not the decision power, but the financial investors (“anonymous investor”) who are far away from the company. If the investors have learned it the hard way, they absolutely change their decisions.
10. The often criticized passiveness of many Russians and Ukrainians is more than understandable: In more than two generations there was not much space concerning own life creation, divergences of the norms was punished immediately. Every initiative was prevented and also additional work undesirable<sup>3</sup>. So companies need more staff for the same work than in Western countries. In addition motivational problems can appear on account of outdated manufacturing sites as well as to the leadership behavior from the past. However, that does not apply to young engineers. Own responsibility has to be exercised; it is often seen by the employees as a burden and not, like in western companies, as a motivation<sup>4</sup>.
11. Corruption is very usual in Russia and in Ukraine, but partly understandable. There are many underpaid people in industry, authorities, up to teachers and medical doctors. Corruption in Russia is no invention of the last ten years. The corruption already originated under the czars. The czar only paid low wages to his officials, however they had free hand left concerning the private enrichment in the areas entrusted to them. The official committed no crime, as long as he became rich at the expenses of the society and the economy, but not at the expense of the crown<sup>5</sup>.
12. Russians and Ukrainians show what they have: The right car, the elegant clothes and the brand watch belong to it as a status symbol. Now, however, this does not mean that the German businessman should appear in the same way: Openness, politeness, modesty as well as good behavior are appreciated very much, while arrogance and boasting are considered unacceptable<sup>6</sup>.
13. Even if the Russians and the Ukrainians are very open to western know-how, still knowledge deficits can hinder the negotiations: The need for explanation can be high, patience should be brought. One small but important difference must be accepted: One should explain, but not teach!<sup>7</sup> The very distinctive national pride of the Russians and the Ukrainians understand input very fast as interference.

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<sup>1</sup> Gladkov, Sabine: Management à la russe, in: Harvard Business manager, No. 06/2005, p. 111.

<sup>2</sup> Baumgart/Jänecke: Russlandknigge, München/Wien 2005, p. 220.

<sup>3</sup> Pessenko, Valentin: Wechselwirkungen zwischen Kultur und sozialen Beziehungen in Russland, Wien 1993, p. 15.

<sup>4</sup> Baumgart/Jänecke, p. 222.

<sup>5</sup> Saizew, Sergej: Über die russische Wirtschaftskultur, in: Osteuropa-Wirtschaft, No. 01/1998, p. 65.

<sup>6</sup> Baumgart/Jänecke, p. 120.

<sup>7</sup> Frank, Sergej: Partner auf Dauer. Verhandeln in Russland, in: www.wiwo.de (27.08.2005).