THE ST. PETERSBURG INTERNATIONAL ECONOMIC FORUM – 2009

4-6 JUNE 2009, ST. PETERSBURG

ECONOMICS DAY

LEVERAGING THE PRODUCTIVITY IN RUSSIA

June 5, 2009

(14:30-16:30, Hall 8.3, Pavilion 8)

St. Petersburg

2009

Description:

When favourable global market conditions, positive demographic trends, and available capacity – have largely dried up, in this new environment labour and capital productivity become critical drivers for the economy's future growth. The current global economic crisis has made urgent the need to address the productivity challenge. How to close the gap and what are the drivers of low productivity? What it takes to optimise business processes and achieve investment effectiveness, upgrade obsolete capacity and production, remove administrative barriers in key sectors? What joint efforts will be required from business and government to unlock Russia's productivity potential? What are the short term and long term priorities?

Moderator:

Yermolai Solzhenitsyn, Managing partner, McKinsey & Company, Russia

Dmitry Konov, Chairman of the Executive Board, President, SIBUR Holding

Paul Betsis, Managing Director, Cisco EME

Carlo Tamburi, Head of International Division ENEL S.p.a

Vladislav Baumgertner, General Director, Uralkaly

Michael Calvey, Co-Managing Partner, Baring Vostok Capital Partners

Leonid Kazinets, President, BARKLI Construction and Development

Helmut Wieser, Executive Vice President and Group President, Alcoa Inc.

Vitaly Yakovlev, General Director, Mosenergo

Dmitry Zelenin, Governor of Tver region

Arkadiy Trachuk, General Director of Goznak

Transcript:

Y. Solzhenitsyn:

Good afternoon, dear colleagues, we are pleased you have been able to join our meeting. We have a big group of participants here – leaders of Russian companies and leaders of foreign companies which work in Russia. I will ask everybody starting from Michael to introduce briefly.

M. Calvey:

Michael Calvey, Co-Managing Partner of Baring Vostok which is the oldest and largest Private Equity Fund in Russia.

A. Trachuk:

Arkady Trachuk, General Director of Gosznak. No special introduction is required for the Russian participants, for the foreign participants we are the major producer of the protected products in the Russian Federation, in particular – ID-documents. Besides that, I teach at the Financial Academy under the Government.

D. Zelenin:

Dmitry Zelenin, Governor of the Tver' Region and the President of the Association of Managers of Russia, public organization, uniting more than 10 000 managers of the major Russian companies. The Tver' Region is between St. Petersburg and Moscow. St. Petersburg and Moscow are like suburbs of Tver', being the cause for ambitions, problems and objectives.

H. Wieser:

Good Afternoon. My name is Helmut Wieser. I'm a group President in ALCOA Aluminum Company based in New York, I'm originally from Austria and I ran the world product division from the company which consisted of 20 operations in 10 countries and 2 operations in Russia.

D. Konov:

Good afternoon, my name is Dmitry Konov, I'm the President of 'Sibur', the largest gas-processing and petrochemical company in Russia, with 63 000 employees and thirty production areas operating in Russia only.

C. Tamburi:

Hi everybody my name is Carlo Tamburi. I am responsible for the International Division of ENEL. ENEL is an Italian company utility involved in electricity and gas throughout the world.

L. Kazinets:

Good Afternoon. My name is Leonid Kazinets. I'm the President of BARKLI Construction and Development. BARKLI is one of Russian leaders in elite house-building, besides our field is infrastructure construction – we build transportation terminals, railway stations, maritime terminals, hotel chains in Russia and abroad. We work in Russia and in the CIS countries. I am a theorist and to some extent a developer and introducer of self-regulation in construction business – I'm the first Vice President of Russian Builders Association. Productivity which we'll be discussing now is quite clearly seen in our projects judging by the results. I can't say however that we have crowds here – so we might suggest that the audience underestimated the advantages and aims of our session. I hope that those who have come will be satisfied. Thank you.

V. Baumgertner:

Good Afternoon. My name is Vladislav Baumgertner. I'm General Director of Uralkaly. Uralkaly is one of the leading global manufacturers of potash fertilizers. We have great production assets, with mines, factories and logistics. It is natural that higher work productivity is one of the priorities for us which will be discussed today. Thank you.

V. Yakovlev:

My name is Vitaly Yakovlev. I'm General Director of Mosenergo. Thank you.

P. Betsis:

Good Afternoon. My name is Paul Betsis. I'm Managing Director of Cisco Systems in growing markets. For those not familiar with Cisco – we are the leader in communication technologies. We have quite a big business in Russia.

Y. Solzhenitsyn:

Thank you, my name's Yermolay Solzhenitsyn, I'm a Managing Partner of McKinsey and Company's Moscow office. I'll be the moderator of this session. Before we start to discuss the questions and ask the participants to reply, I'd like to brief you on some key conclusions concerning the state of productivity in Russia and its reasons. We came to these conclusions as a part of a six-month study published recently. They seem to serve as single background for the debate. I would also like to introduce my partners: Vitaliy Klintsov, Jean-Pascal Dyuviesar, Irina Shvakman. Vitaliy and Irina headed this research so in the course of debates we will be actively exchanging considerations.

We called our report “Effective Russia: Leveraging the Productivity Level”. The productivity seems to be the key condition of success; it is a basis for economic growth in Russia. Within the framework of our research, we have considered the sectors which were representative enough to serve as the examples of nearly half the situations in our economy. We studied the sectors of the electric-power industry, housing construction, retails, trade, bank services, and steelmaking. Ten years ago we carried out a similar research and it can be stated that the productivity in Russia has been up since then. In 1998, we were at the level of 18% from the level of the USA. Today for these five industries we have achieved 26%. Actually the productivity grew for about 6-7% a year, as well as in the USA it did grow either.

On the right we have the figures on the examined industries. On average a worker in the USA produces per day four times more than ours. The main factors of growth that had been significant during ten years before the crisis have lost their postitions. We can see that the total use of production capacity in the economy at the pre-crisis time - and you know this pretty well for your own companies - had reached rather high level, up to 80%. That is, at the beginning of the decade we had capacities, we had employees, we just began to produce more on the same assets – because of the world economic boom and because of the demand’s revival in Russia. At the same time we can see that last decade we did not experience lack in workforce. It is specified on the right as according to various forecasts and scenarios we will have decrease of workforce if we do not change radically our migration policy. Attainable workforce and available capacities had been worked out yet before the crisis. To grow, we need to be more productive in work, we need to build new capacities; otherwise we won’t move anywhere. In 2007 the rate of investments in GDP reached 19% - that is not enough for the guarantee of growth, we need to reach 25-30% the next decade. We are faced with capital development – it’s been postponed by the crisis perhaps, but according to the physics laws it is unavoidable. It is perfectly known about the condition of assets and infrastructure in our country, however we build expensively. Here is an example of construction costs of the coal-fired electric power-plants Russia-Europe-China, another example of construction costs of distribution centers. Moscow is more expensive that European capitals and there are the people from the industry here who will tell about this. Here you see the stairs: on the right the cause of the gap between our productivity figures and the productivity figures in the USA is shown. For example, retail: in many ways the gap is connected with a low share of modern formats in Russia. Thus, again, we need to develop the modern formats. We seem to have a lot of sales areas of modern formats, still we do not reach the level of many capital cities of the world. Why is this so important? Because, when we say that we have four times more people than it is needed, the question to aks is where they will go. This is an example of an industry which will grow. You can see that the receipts from a modern format sales area in Russia in twice as much as in the USA. It’s

not about the price: we can see that the gross margin, the percentage of proceeds are about equal. This points to the fact that we are just short of capacities, a stream of people going through these areas is huge. We can see that men's efficiency falls behind either.
And to the banks. More than a half the gap with the USA is connected with the ineffective business processes, with the fact that a company organises its work ineffectively. Besides, evidently, there is a problem of regulation, a very important problem, but it develops variously in different industries. There is such a picture in the banks: our employers conduct less transactions than in other countries, therein the leader is Sweden. Why does the transaction of cash withdrawal take five times more time here than in the USA? We can see that different banks, a Russian and another one, produce different results. One of the questions we would like to discuss is as follows: is that all our culture, our genes, historical heritage, the State, or is it just easier to say this way but actually we are able to achieve a lot? Look, the labour productivity in the electric-power industry is low but it might be not so important for this particular industry as the capital productivity. On the other hand, again, according to our observations, the lion's share of the problems is connected with an internal arrangement. Nobody forces us to make it badly, we have just got used to it.
A few words about construction. There are structural disparities which depend on a number of floors and so on. But, again, at about 50% it is a matter of arrangement. But it is true that here it is connected with administrating as well. For example, it takes two years to obtain all necessary documents, necessary permissions to start construction works. You can see that our figures are at least six times worse than in other countries. It is clear that when it takes two years to solve a question, the existence of administrative leverage and access to the people making the decisions become the key factor of success.
Steel industry: here is the similar picture. However, we have to point that the leading companies are closer to the level of the international analogues.
Summarising: first, the growth we had had it was thanks to the existing reserves. After the crisis, which we will escape soon, these reserves won't exist. We need to teach people, to make their labour more productive, to build more effectively. On the left we listed the main barriers for the productivity growth which existed ten years ago. And we also tried to mark what has changed. There have been improvements in the taxation system, in the tariff subsidy, these problems are partially solved, but are partially over. Concerning the government or, say, bureaucratic harassment, it is difficult to speak about any improvements. The banking system has been developing indeed, managing skills have been developing, but the problems of undeveloped infrastructure and low workforce mobility do remain. We'd like to return to these factors in the course of discussion, as they seem to be important.
Let's get down to questions. The first question I'd like to make to three of out participants and ask

them to answer in turns. Let's begin with Vladislav Baumgertner, then Pavel Betsis and Dmitry Zelenin.
As we said, there is low labour productivity in Russia. From your experience, wherein does it show itself the most and what are the reasons of this falling behind? Are these reasons mainly internal, such as organizational management culture? Or are there any external reasons, administrative, infrastructure barriers?

V. Baumgertner:
We have just watched a presentation of McKinsey. I'm personally ready to sign to all their conclusions, though they haven't examined potash production.
Let's consider Uralkaly in order to go from the general to the special. It is a low-gain manufacturer, having one of the lowest costs in the market of potash production. For a long time the company was in very favourable conditions in terms of the market for a number of reasons, mainly objective ones: the market has high barriers to enter it, it is much consolidated. Almost all recent years the company has produced maximum quantity of the product, and all the product have been in demand. Therefore for us the aim of productivity improvement was not only to increase marketability and cut production costs, but also to produce as much product as possible using brownfield, inclusive of limited manufacturing and human resources we have. I think that this picture is common to majority of manufacturers in the Russian Federation in pre-crisis time we had to grow together with the market, we had to grow faster than the market. From 2003 to 2008, Uralkaly nearly twice increased production output. Excluding that, unfortunately, one mine was drowned, therefore productivity plan increased twice. Last year, just before the crisis, we were close to the maximum possible use of our production capacities, which were built during the Soviet period, – that is the reserve, which we inherited from the Soviet past, was exhausted. Further development of productivity is to exploit new capacities or develop productivity using brownfield.
Which are the main restraints of productivity, we can mention as exemplified by our company? They are more or less the same for all manufacturing plants in the Russian Federation. One of the key reasons is: technologies we use were developed many decades ago. Construction solutions, carried out in production facilities construction in the Russian Federation, meet standards elaborated many decades ago. Nowadays, this system is not as effective.
One of the main constraining factors was mentioned by Yermolay Solzhenitsyn: business processes are ineffective, some of them are redundant, they duplicate each other. Here we see maximum reserve for productivity increase in our company. Moreover, naturally, automation level of production is fairly low – not only us who work on it, but I think the whole Russian industry as well. In due time we carried out benchmarking in potash industry, comparing ourselves with our

main competitors – North American companies. It has been found that productivity of our enterprise, as I think also of all the enterprises in the Former USSR, about nine-ten times lower. And not only on the whole in the company, but also separately along all the lines of activity: logistics, sales, supplies, production, quality management and so on. And the main reserve is that business processes are not optimally set. Besides technologies, we have also inherited Soviet corporate culture: it is not common to delegate tasks, there is a vast number of authorities between General Director and the workers who directly control technological processes. In our case there can be about nine-ten management levels between workers and the General Director. Another constraint: genetically we are used to practice an extensive approach to output increase. Instead of thinking how to analyze "narrow" spaces and increase productivity at one factory, on one machine, we are mounting an additional machine, opening an additional mine, building an additional factory. One more constraint is deficit of qualified personnel. The question is not only and not just of management personnel: right before the crisis there was a great shortage of manpower, medium level technical engineers. A great problem, which I have already mentioned, is absence of motivation. Everything starts with a motivation: a company should have a motivation to increase productivity; the most important thing is that a high-level motivation should be properly transmitted into an organization, to all the managers, to each particular worker. My experience – we have been working on productivity increase over the last one and a half-two years – and it suggests that 95% of labour constraints in the company are internal. I believe that fundamentally this problem is in hands of management. Methodologically productivity increase is quite a simple and clear task. The problem is that it is much easier to explain how to increase productivity than really to increase it. It is a very complex, systematic, routine work. It is not about making one or two cornerstone solutions, but in making hundreds and thousands of small solutions for a long period of time, connected with motivation change, corporate culture and mentality of people change. It requires from the company management to focus on this.

There are also external causes: they are connected mainly with building construction of new capacities, and here the company has to enter into cooperation with state authorities. I would like to mention two more things. The first one is personnel deficit; the second one is outsourcing, moving of non-core functions out of the company. It is a popular trend, which was used by many companies; unfortunately, under our conditions use of outsourcing is limited. The limitations are caused by the fact that the market of the services itself in the Russian Federation doesn't work, and it doesn't work because there is insufficient support of development of small and medium businesses from the government.

Y. Solzhenitsyn:

Later we will speak about what the government can do here, thank you. Pavel, from the point of view of your industry: wherein does our low productivity show itself, why is it so low?

P. Betsis:

Much was said about internal causes. There are a lot of them in different companies and different industries. I want to add that there are also very serious external causes of low productivity in different industries and economy as a whole. They are usually connected with infrastructures, which support one or another branch of economy or the whole market. An example of such infrastructure is – by the way, it is a multi-industry infrastructure, supporting almost all the branches of economy – it is information technologies. We are one of players in this market. There are figures showing that over the last ten years productivity increase in the whole American market have been by 48% dependent exactly on information technologies. In Europe the figures are slightly lower, but close to it, 30%. Probably it seems to many people that impact of information technologies on productivity and GDP in general is greater in developed countries and developed economies. But it is quite the opposite. The World Bank estimated that impact of information technologies is much greater in developing countries and emerging markets, similar to Russian one.

Y. Solzenitsyn:

Dmitry, I'd like to ask you: where are we and why?

D. Zelenin:

Not just where we are, but who is to be blamed for the fact that we are there. Business and government are to be blamed, of course. Business is to be blamed that due to the great growth of the market, very few enterprises examined a possibility to decrease their costs. It was better to employ a person with a significantly higher salary than to re-train one's own employee. It was easier to pay higher to a work team than to conclude an agreement with a trade union. Example: The Tver' Rail Carriage Building Works. An average wage is high – 25 thousand rubles, and generally employees with a specialized secondary education but without a higher education earn 35-40 thousand rubles. For the welder in this particular region it's a 'beyond-the clouds' wage. One more point confirming that as well. Why do many of our work collectives agree to a partial employment? Even if we are talking about an enterprise with 200-300 employees, they agree with the management – temporarily, for a year, even two years, to decrease salaries and wages and to keep the work collective. For the enterprise it\s good, but it testifies that the enterprise employees do sometimes consider their salary to be too high. No professional skills improvement procedures are available. The state is also to be blamed for this situation. It excluded expenses for professional skills improvement, training from the cost of the product and service - probably, being afraid of some thefts and tax avoidance schemes, but this regulations must have been already back long ago. No culture of professional skills improvement is available. Now there are Federal programs in the regions, paying for improvement of professional skills for the employees who are expected to be discharged or dismissed on grounds of redundancy. Very few enterprises, unfortunately, participate in these programs.

What relates to industry modernization: those enterprises which have been upgraded during last five-six years, spending an amount compatible to their annual turnover, now feel sufficiently safe. That means, for them there is no threat of bankruptsy, as well as no threat of dismissals on grounds of redundancy. One more fact testifying that the enterprises taking care of costs, would continue their development in any case. Let's take an industrial area of fourteen enterprises established two years ago, this is the last industrial area working now. Ten of fourteen continue construction works. That means, they forecast sales of their products and continue to invest. And, of course, they will win in the market.

Also the state is to be blamed for its support for monopolism. And where monopolism exists, the costs and salaries are counted less, and very often a trend to the extensive development is observed. The overall situation in the Russian Federation and the Soviet Union is another cause. When I started to work for Norilsk Nikel in 1996, there were 120 000 employees there. When I left in 2002, there were 85 000 employees. Now a number of the personnel decreased 1,5 times. However, it took 13-15 years to bring somehow the enterprise to the normal condition. This relates to major enterprises that since the Soviet times have borne a burden of social responsibility. Nevertheless, I can say that there is a great number of enterprises where the productivity growth is sufficiently high.

Y. Solzhenitsyn:

Thank you, Dmitry, I think we'll return to the format of dialog when everybody is able to react to the colleagues' words and develop the topic. We managed to touch a lot of topics: culture, education, technology, lack of attention devoted to internal environment. We'd like to listen more stories about the experience of the other participants, well, Dmitry, first, where do you find main reserves, what was especially difficult in this job, and what was easier, what is your major success? And your advice to your colleagues, according to your experience, on leveraging the productivity.

D. Konov:

Thanks. Today Sibur employs 63 000 people. It employed more than 100 000 staff about five years ago. If we talk about levels where we are trying to find productivity growth, these levels are three.

At the level of the capacities' configuration in the industry internally, as it was fairly mentioned, much did we inherit from the Soviet Union. There, on the average, individual capacities are low, logistics is, in most cases, a point of significant costs, from the point of view of social infrastructure – on the average, 65% of people are employed in auxiliary enterprises. In holdings like ours, uniting about thirty enterprises, we see duplication of functions at the level of each enterprise – this is also a historic heritage. And so on. At this level any work to increase productivity is more long-term and more conceptual. Closing of industrial areas, setting up of major individual capacities in these areas, where we are present in order to minimize both costs per a product and logistics costs. Other measures relating, for example, to energy efficiency. The next level is a level of the company. Here we are talking about relations between various areas, optimization of logistics solution… These are the items of the short-term character to the greater extent and depending upon the company from the organizational point of view to the greater extent. And the third level is a level of industrial areas. Actions of still shorter term character are undertaken there. There are many problems there relating to excessive management, duplication of functions, to greater than necessary number of people. This is the stage we have basically completed and continue to move actively in spite of a complicated social situation. On the other hand, as of today, there are two units to measure productivity – sales per one person and EBITDA per one person. Lagging of the Russian petrochemical industry, where we work, in relation to the first index is fifteen times less than the average worldwide, in relation to the second index is seven times less than the average worldwide. The fact that lagging relating to the first index is less, is not a result of our work, but an evidence of that we are "eating off" our natural resources advantage. This gap is liquidated to a less extent by a number of the employed, as well as by re-configuration of the company and development of capacities in general.

If we talk about difficulties – these are undoubtedly, unwillingness of people to change, inability to apply the proper benchmark, inability to understand where we are. Unavailability of certain management skills and work experience in other industries and other countries. Consequently, adherence to the idea that what we do is appropriate, we have always done it, it may not be done otherwise, to change anything would be hurting for the work collective. That means that the difficulties are basically of moral and conceptual/ideological character.

Y. Solzhenitsyn:

Thank you. That is, technological modernization is one of the key factors in solution of this question.

D. Konov:

Yes, I believe, we'll talk about this in more detail in the discussion devoted to capital. I'd like to say that there are instruments of various levels, and if we are talking about short-term ones – then much shall be determined by a number of processes in the equation: more sales – less processes. If we talk about long-term ones – then dramatic decrease of lagging, significant increase of productivity shall be provided by change in business configuration in general and change in individual capacities, i.e. some new construction will be required.

Y. Solzhenitsyn:
I see. Vitaly, I'd like to ask you: Dmitry has just said that technical modernization of the basis plays a big role. We all know that our electric-power industry is planning to invest a lot in this modernisation. What is the balance of investment technical decisions in your industry, in your experience of leveraging the productivity, and which questions are of mainly behavioral, organasational kind?

V. Klintsov:
We are an old company, and it cannot be said, that the age factor is the most important for electrical energy industry. If we compare, conditionally speaking, our electric power stations with the same old electric power stations, built in the 1970-1980s in other countries, in any case we can see a great gap in number of employees at our enterprises and at foreign electric power stations. It runs up to two-three times. From behavioral standpoint, I would like to draw attention first of all to the fact that there are many common features between enterprises of the old economy (before 1991), on the one hand, and enterprises of the new economy – on the other hand. Enterprises of the old economy have an absolute inner harmony. As a rule it is a complete hierarchy of management levels, about which we have talked, management style is usually tough, authoritative, the personnel is passive, medium management doesn't want to take any responsibility for changes, it is not ready to any changes at all. These business processes are imperfect, which as my colleagues exactly say, duplicate each other. The level of automation is low and so on. All these systems, structures, culture – exist of themselves and are absolutely harmonious. Problem with such enterprises arises, when economic order pushes them into competition. Suddenly it turns out that it is impossible to impose these costs on customers any more, it turns out that it is necessary to do something. And, as I see it, the biggest problem is an approach to these changes. Technically it is quite difficult to reconstruct a station or a factory, it is even much more difficult to change business-processes. In most cases large-scale program of changes is needed, which requires not a point surgical interference into the organizational structure or rewriting of business processes. It requires just efforts along all the lines of activity – in the context of culture, business-process organization and management structure

itself, which should be made shorter, it is necessary to give much greater responsibility to personnel standing at a low level, to give them a field for decision making.

Y. Solzhenitsyn:

This question is for you, Arkadiy. We'd like to listen what experience you have had, what the specific of the company you head now is, from this point of view?

A.Trachuk:

The specificity is that labour productivity per se is not anybody's concern. And this is sad, as matter of fact. When in 2001 I came to work at Goznak, we, having completed a brief review, found out: a difference in labour productivity between Goznak as a company dealing with production of bank notes and protected documents, and companies – market leaders in the Western Europe (one can mention two larger companies with approximately the same capacity) – with similar equipment and very similar technological processes for the mainline – achieved eight times. Naturally, it was the pointa to start considering what could be done to change the situation dramatically. Besides that, I fully agree to what was said by my colleagues in relation to outsourcing – the transfer of functions did not solve and could not solve the problem we faced. I'd like to draw attention of the audience to another aspect – to an amount of the value added by Russian enterprises. A difference in price between two bank notes produced by the same equipment could be 5-7 times. A lot is determined by innovations, protective elements and by their developer.

Actually during that period we managed to solve the following problems: to provide the Russian production with main Russian elements in the field of protection, to ensure that Goznak is the owner of this intellectual property, to ensure protection of the intellectual property, and allocate production of these elements mainly in Russia. Besides that, we managed to enter a segment allowing to combine traditional techniques for protection in printing industry with modern information technologies. The most obvious example that many of the participants were faced with, are the passports containing microchips. All this together allowed us to move the segment we worked in from "the cheap" to "the average plus". That is, actually we, working both in the Russian and external markets, increased the labour productivity at Goznak four times. At the same time we are still lagging behind the leaders, as compared, our productivity is three times less – they were also developing during this period. However, there is understanding how we should work, there is understanding which particular innovation segments of the market we shall be interested in, where we could develop and increase labour productivity.

If we ascend from the particular to the general, it's clear, as the previous speaker said, that the companies do not have true internal incentives for change. And competition is that external incentive making the company to start changing. However, the problem, first, is that mainly in the Russian market there is low competition, and, second, where there is competition, the market has characteristic features of oligopoly: the price competition works very inefficiently, actually, does not work. Consequently, the only way for the company willing to be efficient, i.e. to increase the labour productivity, is to search for innovation solutions, which will allow it to make a breakthrough and to climb one step higher than its nearest competitors and – due to this – to increase its productivity. Well, what relates to the role of the state – I have my own opinion, and I will share it with you in the second part.

Y. Solzhenitsyn:

Yes, soon we'll move to the part connected with the State, and I have two questions to Michael. First, far competition, competitive pressure is different from the other markets which you have faced? Secondly, when estimating Russian companies, as it seems to you, how far the investors take into account of productivity potential? Or, maybe, vice versa, they think that those are structural features and do not input this potential into the estimation?

M. Calvey:

So I think for strategic investors and for private equity investors like Baring Vostok, low productivity which is typically still the case with Russian companies is more of an opportunity than a problem because it is one of the least capital intensive ways to raise profitability and increase the valuation of the business. I think that private equity firms in particular, and this applies not just to institutional private equity firms like Baring Vostok but to private investors generally as opposed to strategic investors have a very viable tool in their toolkit through equity incentives for managers and in our experience the two key and irreplaceable things to increase productivity are measurement and motivation. The motivation that's available through private equity owned firms for us has been a very powerful tool to align the interest of the top managers with those of the owners and to drive that straight down to the organisation. In our experience here over the last fifteen years has been divided into two different periods. The first from 1994 until about 1999, when most of our investments where in formerly state owned enterprises that had been privatised and it was a time of limited growth in Russia's economy but where there was huge value that could be created through restructuring and through improvements in productivity and there was a very specific set of steps that most state own enterprises needed to take restructure. But starting in1999 and 2000, most of our investments became in companies that were post Soviet companies, new companies that were created that were either small or usually medium sized businesses that aspired to become big businesses and you know, with them over most of the last ten years, the challenge has not been mostly about raising productivity as much as it has been managing the problems associated with huge growth. With the growth in Russia's economy a lot of private businesses especially in service sectors and consumer orientated sectors were growing in our portfolio, the average growth over the last ten years in revenues was 55 percent per year. So it's a very different type of challenge or problem. Today, I think we're going back to more of the ownership mind set which we had 15 years ago and we expect a low growth environment for sometime in the future, no one knows whether it's going to be six months or two or three years but a lot of the restructuring steps which we had to take with companies 15 years ago, we need to take and we are taking now with the new companies, the new Russian companies that never had to worry about productivity when they were growing at such a rapid rate. So I think that this is both a challenge and an opportunity and I guess we'll see where the results come in the next couple of years.

Y. Solzhenitsyn:
It is clear that the crisis puts its corrections into the treatment of the question of the productivity. We have considered a lot those industries where mutual relationship between the business and the authority is a very significant factor, however many of you have spoken about internal resources, internal reasons. Leonid, we'd like to listen to you: what is the low productivity associated with and how can this problem be solved, especially taking into account the prospects for far-reaching construction?

L. Kazinets:
Let's repeat one more time that talks about productivity efficiency are not mere words for Russia. If we from GNP – it is, roughly speaking, what is produced by one big enterprise, called the Russian Federation, – deduct raw products and industries, manufacturing them, namely gas, oil, electricity, metals, – we'll understand that at some time our resource benefits can become noncompetitive. There are a lot of scenarios, according to which it can happen. We are not the first country in terms of oil reserves; we rank tenth in the world. If we speak about gas, then as soon as Europe carries out a programme of change-over to liquefied gas, which it realizes with all might, after history with our neighbours Ukrainians, – we can lose our competitive advantages also in gas. So, if we deduct raw products from GNP, we'll see that we produce about 1000 dollars per one person. And half or one third of it can be spent on salary, it means that an average income per head in the country is 300 dollars per month, perhaps, 200 dollars – it is lower than the level necessary for people to eat properly. Are we ready to live on 200 dollars? It is not a joke, it is the situation right today. It is on the issue of efficiency of what we do.
Why the efficiency is such? We can't suggest, let us say, that a Russian bricklayer lifts a stone four

or five times slower than an American one. Let's understand that we are discussing an efficiency not of a certain_operation – we consider produced in any enterprise in whole, for example construction one, and divide by number of employees. And it becomes clear that a significant part of personnel is engaged in nonproductive labour. What are the main reasons? According to ISO system 95% – is errors of an organization, 5% – is errors of an executor. In other words, 5% – is executor's failure, and 95% – is failure of the system. Let's see structure of costs in groups in production cost of building products. 60-70% of the expenses are unproductive. These are payment for different approvals, getting of land lots, connections, administrative costs and so on. However we make the main payments about three years before launching of a project. It was said that two years are necessary to get approvals for building. It is over-optimistic. On an average it takes three years. We paid for land, then paid for city share in the federal subject, then paid to energy authorities, then paid for the approval, then paid to everybody we should pay in order to make the approvals legitimate, and in three years we started building. If today in our country money costs 16% – it is good if you find such rate of interest, – then production cost increased by 50%. So much we spend on inefficiency. The biggest division of a real estate development company is accounting one. People sit there and rewrite fiscal papers from morning till night. There are also financial analysts there; they spend all their intellect on process optimization, in order not to pay for what they don't want to pay and so on.

My message is very simple. On the average in big city we spend two-two and a half thousand dollars, in central Moscow – up to three thousand dollars per one kilowatt of connected power, the costs are official. Let us suppose that we direct our efforts to the place where we can increase labour efficiency of a concrete worker, who charges three hundred dollars per one square meter of concrete, now it is less, two hundred dollars. A square meter of concrete costs little more than hundred dollars; it is half of the material. Hundred dollars remain – vehicles, people, and machinery. Suppose that we improved labour efficiency by four times – then we saved hundred dollars, two hundred dollars, arranged payments for the land – saved 2000 dollars. Until prime costs and efforts in building are in the area of regulation and approval, assignment, connection, commissioning, designing, and God knows what else, – efficiency of construction itself will be out of the question.

Y. Solzhenitsyn:

That is, is it needed to be solved by law only?

L. Kazinets:

I can repeat that in construction area legislation is a factor, having a maximum effect on production cost of a building product. And until we remove significant factors, it is senseless to come to less significant factors. It is a simple factorial analysis. Besides, we all studied systems theory. It clearly states that system of a higher order always determines system of a lower order. In other words: the best production we can build in system with chaotically changing factors will not withstand.

Y. Solzhenitsyn:

It is an anxious prospect, again, according to lots of construction onwards. We'll return to the topic of construction in the second part of our debate which will be connected with the capital productivity, with the investment projects. I've noticed that some speeches aroused willing to speak out. For the good of the time, as we have a large group here, I'd like Mr.Wiezer to speak.

Mr. Wieser, from your perspective and your perspective globally but also since you have operations in Russia what do you notice is the biggest difference between Russian productivity and productivity in the West I guess is the difference really more between countries or do you think it's a question between plants and companies that the main difference is lying? Where do you see that and what in your experience are the key things to focus on to become a productivity leader which is certainly a goal in itself?

H. Wieser:

Thank you. I'm so happy to see that this session is turning into an opportunity session because I agree with my colleague that low productivity normally is oh you have low productivity; you have a lot of problems. And in big trouble, it's exactly the reverse I mean if you have a lot of problems, you have a lot of treasures and a lot of opportunity to improve. If you see it from this perspective, you have a very good chance to have a much better results in the future if you increase your productivity. I mean definitely the productivity is a success factor for a sustainable business and for competitiveness. As we run in the world where there are 350 operations, with around ac hundred thousand people. You already feel that if you have 350 operations you need a business process. You cannot run each plan to each factory like they would like to run it.

So we adapted the Toyota production system, I'm sure you've heard of the Toyota production system, one of the most successful automotive companies despite the fact that last year was the first time in history that they announced a loss because of this economic and financial crisis. But they were the last automotive company to announce difficulties because they are so enormously productive and they have been working on their productivity over the last 20 years so we adapted this concept. We call it ALCOA production system, we are very inventive, no? Toyota production system. I saw my colleague, Rosa from Boeing is my largest customer coming in here in Boeing.

This Toyota production system is called Boeing Toyota Production System and it has enormous opportunities and I'll give you some examples.
A very lively example, most of you I'm sure you follow the Formula 1 World Championships and success in this race is that the cars are reliable and they run all the time. But you know also that after a so called "tyre change," you know, they come into the box and they change it really quickly in fact in 6 seconds. Most of you change your tyres for winter tyres and summer tyres and if you remember did you do it by yourself or did you go to a company? It probably takes you, if you do it by yourself about half an hour. But you have to be really well organised. If you go to a company to do the change or they probably change it in around 8 minutes. So if somebody tells you that you should do it in 6 seconds it is absolutely possible. So what I want to say is if you go to the operation and you tell the people that you have to have different productivity for survival and for competitiveness, the normal answer is we cannot. We are all so productive and it's impossible. So, we have to deal with the answer- it is impossible. So, this is one example and not a very good example, a very competitive market are the airlines.
I'm sure you've heard about the studies that the Southwest did in the US, they can do an aircraft turnaround in 15 minutes so the aircraft lands and in 15 minutes it is ready to go. It's always in the air, it's high productivity the other kind of productivity but a very high productivity. So what we do in the ALCOA business system and ALCOA production system, we engage the people. We have already heard it many times. You need passion in increasing productivity in the new operation and if you have an operation like we have here in Samara, I mean I have 5 thousand people in Samara working in the plant. It's a huge plant it's covered like an 18 hole golf course covered if you imagine a golf course with 18 holes this is what we have in Samara.
So to engage the workforce and to change the mindset you have to be competitive. This is a big task. There are around 20 thousand people working for me and what I do as a group President me, I go around four times a year to the plant to several plants and work there for one day as an average worker and I even have a supervisor. Sometimes there is a rush in Chinese, Spanish, French, English and this encourages you a little bit. It's really fun if you go to the plant and you work and you learn a lot about what's really going on. We did this and our management does it throughout the year and it gives you an enormous insight and what I want to say and to answer your question there is in reality for me no difference if I work in China, in Russia, in Tennessee, in Indiana, in Iowa, where we have our big plant, there is no difference in the people sector. So for me, on the productivity side we have too many people because in the administration and bureaucracy and capital authorisation for example in Russia, we need 16 signatures to get the capital authorisation. And you know that it's not going to work. I mean if we think about the previous example of the 6 seconds and you have 16 signatures to get 500 thousand dollars approved it doesn't work. So you

have to change it in a business process and we have heard also IT makes up around 30 percent of productivity and I fully agree with this. We put in new IT systems which always take a long time and cost more in the beginning but for sustainability it's absolutely necessary so we have a so called "E request" for authorisation electronically and it practically works in one day now. So these are the big changes which we are making around the world. Coming back again to Russia, I mean last year we finished production in 7 days. Today we produce the same amount of output in 3 days. So, enormous step changes and we heard it already before four fold, five fold and this is my experience in the manufacturing industry. We have also heard about what we do with the people who we don't need in a growing economy and Toyota demonstrates it very well. You are expanding all the time. Toyota, Boeing and many other companies for example Tetra Pack have a growing success. In a growing economy you train your people and you continuously improve. You can use the work force in different production centres while you are already starting up your new production with trained people, therefore you always have the best people available.

Now we have a different situation. Imagine in Russia last year at exactly the same time of year, we had a 65 percent growth in automotive sales, 65 percent, the fastest growing European market. Today, we have seen a number which is exactly the opposite minus 66 percent. It's a tough environment we have to deal with it how we deal with it. We have deployment centres in the different plants, we train people in other professions and it works very well. We have full government support. We do everything together with the government in Samara. We don't get the money that we really want but we get support, we get the training centres. But think about it in the growing economy, it is a very good process. You train your people, you improve, you move the people out and you have the best people available for new production centres.

So these are my comments. I think again passion, mentality, competitiveness. We have international competition, throughout the world. We have one month and most of the time it is June. We have 30 days competition and we call it "rolling mill competition" so all the rolling mills across the world compete against each other, and we have great prizes. The teams get recognition, they also get money and they get visited from the management. We visit the plants, we go there and we recognise the people. When we started 4 years ago, I mean Samara didn't want to participate in the competition because we hadn't finished our investment and a little bit from the maintenance side was obsolete and they really ended up at the end of the page. Last year Samara with one production centre came second for our worldwide activity. So there is good and bad news. I think low productivity is a great opportunity.

Y. Solzhenitsyn:

Thank you very much. I think just the way you spoke about it, the passion and the positive aspects.

In Russia people say our work force is cynical or the people are very sceptical. Their mood on their face, their mood is almost negative. I wonder going from whatever place they were to this second how the faces or the expressions of your workers have changed.

H. Weiser:
They changed definitely. I can show them to you.

Y. Solzhenitsyn:
That's a very positive thing to hear. Carlo I'd like to turn to you now. From your experience globally but also looking at Russia, again are we somehow different? Is it really more similarities that are just commonly human with other lets say countries and cultures or is there something specifically different in Russia? And what are your thoughts about priorities here?

C. Tamburi:
OK. Thank you very much. First of all, let me say that we have just started the activities in Russia in terms of, you know gaining productivity and efficiency because we both have OGK5, the generation company. Basically one year ago they consolidated the company and we changed the management so the process has only just started. But this is coming just after a couple of very good success stories which we experienced in Slovakia and in Bulgaria. These were and are two countries that are not similar from both a technological and a cultural point of view and are comparable to Russia. So I wouldn't make an example or a comparison with the North America's of America in days over the Italian activities that of course have been rehabilitated, restored and reproduced in the last ten years.
I just wanted to talk about the experience over the last 3-4 years in Slovakia and in Bulgaria and I don't think that Russia is very different from the other countries. It's not only a question of the people's mentality but also the organisation. I think that the organisation is ready to be changed because OGK5 has four plants basically 8.5 gigawatts. From the four plants 50 percent of that comes from one single plant which is coal and the other 3 are gas. The plant was basically four different individual companies and they were run like 4 individual companies with a lot of decentralisation, with a lot of local power for the plant directors and first of all we have changed a few processes, the procurement, IT system. We have centralised a little bit and we have rationalised. People are quite receptive because they understand that they can really work better, they can really get some good benefits from their day- to- day life. So it's just a question of starting and putting in good practice, taking advantage also of the local suppression because we have found a lot of technical competencies and a lot of technical skills.

We just have to readdress a little bit, actually we have changed the management because the old management, the general managers have left but we have hired a local guy from another utility company here because we wanted to exploit the local skill and competence. Then of course we have a background of having bench-marked, all our plants' technology by technology in Italy and in other countries. So we have the possibility to measure how the efficiency, improvement and productivity can be realised and within what sort of time framework and with how much money for investment. We have all this process in line and we are keeping track records. We already have some very good results coming out. Just a couple of examples in terms of results, in Bulgaria we have a coal plant which was very inefficient. We have been able to reduce the personnel from 1 600 people to 450 people in 5 years without suffering, without union and without any problem and also increasing the productivity of the plant. In Slovakia there are similar ratios on the nuclear side. So that's what we are expecting from the Russian plants.

Y. Solzhenitsyn:

A question to the participants of the debate. The figures were sounded here several times – increasing the productivity twice, three times, four times... Within you company, we speak about Russia, are you sure that for two or three years it is possible to increase the productivity as much as twice if it is at work on? Please raise your hands if you think that it is possible for you to have increase twofold. Who agrees?

D. Konov:

May I ask a qualifying question? Do you mean efficiency of the company based on its production or based on what it creates?

Y. Solzhenitsyn:

Output product value divided on the number of employees. External factors do not change, we take into consideration only internal ones.

About half of participants have raised their hands.

Now the problems with unemployment are distinct, it is in the news, it is off screen, it is, as we could see the last two days on the example of Leningrad region, on screen. A question, Dmitry, I'd like to start with you, and then, maybe, the colleagues will give a comment on. A lot of business leaders say that there is almost public ban on redundancy. The President said today that the first thing priority is the social security of the population, this is absolutely understandable priority. Is there the ban, and, if so, how will we move further? And if not, what is after the authority, the business to solve the unemployment problem at last?

D. Zelenin:

I will not tell about other regions, but for the Tver' Region there is no such a ban. First of all, the issue is about predictability. And about systematic nature. Meaning that if we have numbers describing would-be dismissals in the next 6-12 months, then the authorities understand how to act. If these dismissals happen suddenly, as it usually happens, then, of course, nothing could be done in this situation. This causes a social disturbance, and some measures have to be undertaken. Trade unions are also acting in this area. There are trilateral commissions.

There is no ban – rather, there is administrative pressure upon those enterprises – and I know their names – which have arrears in salaries and wages payments. In our Region we have arrears in salaries and wages – 86 million rubles for these ten days. As the Governor, I personnally work with these enterprises. And the commission does. I mostly work with those enterprises which do not agree to pay employees their salaries and wages.

There are many mechanisms which may compensate the expected dismissals. Here is, for example, an excavator producing plant, 3 000 people employed, 1 500 dismissed. It happened in November, without any notification at all, while physically nothing could be done. If, after all, there are prospects for the enterprise, various methods could be applied – for example, temporary works, community works, with a low pay, but yet it's some employment. Helmut enumerated the measures – improvement of professional skill partially paid by the state, a free six-month training for those who would like to take up small business. Besides that, if we talk about smaller enterprises wishing to oursource meals, cleaning or dry cleaning – some help in outsourcing shall be provided. Even if this enterprise is a mono-enterprise for this or that formation – on my part, there is no pressure.

An issue of the population mobility. Yes, new routes are needed for the people to be employed – in any case somewhere people are lacking.

In the Region, for example, every two months new enterprises are launched. In Tver' alone 400-500 employees are wanted monthly. We can prepare and sent proposals to train personnel to those enterprises which dismiss people.

Unemployment service is presented by twenty four subsidiaries and this actually satisfies our needs. Besides that, of course, municipalities and the enterprises themselves must work. Meaning that if we are guided by a period of six or more months, then, indeed, we really understand what to do.

There is an interesting fact relating to Tver': until now 25% of dismissed people added every ten days to the unemployed – these are people who live in the region but have never worked there. These are Moscow and St. Petersburg. Meaning that there is mobility, but sometimes it has a negative effect.

Y. Solzhenitsyn:

I see. Who wants to comment?

V. Baumgertner:

I will comment upon it. The thing is that personally I haven't heard actual prohibitions from any representative of state organs. The problem is in another thing. When the crisis came on, it is already late to start working on labour productivity and trying to adjust number to new volumes, corrected by the market. It is always necessary to overcome any problem in advance. And now, under crisis condition, it is necessary to remember that crisis is not forever, it will continue for one, two, maximum three years. Analysis, made by McKinsey, – is fairly objective. In 2008, the whole Russian economy worked with maximum capacity. Growth reserve with the existing capacities was almost exhausted. Market will return to a positive growth trend, and we'll have to increase productivity not by means of reduction in number of personnel, but by putting of new facilities into production. How will we meet the challenge?

Now I would like to go back to the thesis, with which I concluded my last speech. Let's consider potash industry. It is a perfect basis to introduce new projects. During the last few years the government sold at an auction several licenses overall cost of which is 2,5 billion dollars in Ural and Privolzhsky districts. Five new potash enterprises should have been built. And in one, two, three years owners of the assets will turn back to the question. Only in Solikamsk-Berezniki region of Permsky Kray four such enterprises should have been built. Aggregate investments of 10 billion dollars as well as more than 10 000 qualified persons will be needed. I can't imagine where our enterprises are going to find so many qualified employees – now there is a natural drift of people from our region as it is. It happens due to objective causes – demographic and for the reason that is it much more comfortable for people to live not in such towns as Solikamsk and Berezniki, but, let us say, in Ekaterinburg or Perm. In addition there is also a necessity in many thousand builders, who should build these potassium plants. I am trying to lead on to the subject that it is necessary to consider problem of productivity not in the term of one year, but much longer period.

Y. Solzhenitsyn:

That is, we will escape the crisis earlier than we think?

V. Baumgertner:

Surely.

From the audience:

I'd like to disagree about the statement that the crisis will stop in a couple of years. The crisis will never stop. You have heard the speeches of the leading economists and the President, who said that the picture of the world after the crisis would be economically different. The crisis is not a crisis but it is a critical situation, after which it will be a different picture of the world. I certainly agree with the idea that it is better to work in advance, but a crisis took place, or even it is not a crisis but an economic turn, the economy will certainly develop, will grow but absolutely different. There was one clever Spaniard who had seen a lot in his life, was in prison, was a galley slave. His surname is Servantes. He said when one door closed another one opened. The global destruction of economy is what will let us develop differently in new conditions. If you put a frog into boiling water, it will jump out of it. And if you put it into cold water, which is comfortable for it, and begin to heat it very slowly, physiologists are aware of this experiment, it won't jump out, it will be boiled. That is, slow changes, if there is not low-level detection mechanism, lead to a very global consequent effect. And in this case, the crisis is good, the crisis says, "Guys, it won't be the same as it was. But it will be differently".

Y. Solzhenitsyn:

I see. Which other thoughts can be on the topic of the bans from the authorities? Dmitry.

D. Konov:

I would not agree with the previous speaker and would note that the crisis effected differently two absolutely different industries, two different segments. Further development of productivity and economic growth will be different for agriculture and construction of elite real estate. One may not transfer conclusions relating to one segment to another segment. In relation to the ban, there is an anecdotic example from the Chinese chemical industry, where there was a ban for dismissals. One of the very large companies set up a network of shops, where it had transferred a significant part of its personnel, then it sold those shops – and thus it reduced its personnel under the conditions of the ban. I believe, it should not be a concern of the private companies alone – there must be a joint program by the state and companies with an aim to understand where the personnel will be wanted in some time and to re-train the people for this industry. There is one more point – lately the immigrants have come to the construction industry, where Russian citizens did not want to work for the money they would have been paid. So it's not true as well that if some construction workers would be wanted, it would be possible to re-train the employees to be dismissed with the same costs.

Y. Solzhenitsyn:

Helmut, this question is for you. From International experience certainly the European steel industry is one example, obviously some industries had to release redundant labour over time and for example in the Russian steel industry, we did not talk about this in detail, but Russia's steal industry employs 400 thousand people. If you benchmark it to international levels it needs 130-140. Mr Zelenin talked about the need for re-education and the question of mobility. What lessons should Russia learn from international experience about how to attain these shifts between industries and maybe geographical shifts of labour from your experience?

H. Wieser:
I mean it depends very much on the country. Well you see we had our headquarters in Pittsburgh, I mean Pittsburgh where it has a complete steel industry. I mean 80 per cent of the work force was in steel. Today, I think in Pittsburgh we only have 2 steel mills and now the city has changed completely to a service city. Many new companies were formed and Pittsburgh has worked very well with the change but when we talk about the change it took 20 years. It is not a quick fix. The Spanish steel industry, with a new technology, with a complete steel production. The now [01.37 metal], but the former Spanish state-owned industry in one plant employed 4 thousand people. They invested in a new technology and today this plant with the same output transferred 380 people. The Spanish government did a good job redeploying. Despite the fact that when we talk about countries and worldwide and labour disputes, I mean one of the most difficult countries to make this adjustment is Spain. So, you also have different plants in the South and in North and we have 6 plants in Spain to react in the crisis short term. They have a good long term solution, but short term when you are fighting for survival it is very difficult in Spain. In the US, it is much easier but there are benchmark numbers where you can see that the city's really transformed from basic industry, heavy steel industry, smelter industry to a service industry.

Y. Solzhenitsyn:
While we were conducting the research, we saw that the low labour mobility remained a big problem what has sounded, in my opinion, not from one tribune. And at the end of our debate, we also have a block about capital, a block about construction, I'd suggest the participants to mention their three major recommendations to the business society or, maybe, to the authorities, maximum precise, if it is possibly. Three priority questions which as you think is needed to pay attention by the business society and the authority in the nearest one or two years to let us move, to increase the productivity. A phrase often sounds that we will certainly escape the crisis being stronger than we were entering it. It seems to me that the question mainly belongs to the area of the productivity, if we do not increase our productivity as a result of the crisis (a lot of other countries are increasing

it), we will possible be weaker as we leave.
The question on the new industries has just sounded: where the labour can overflow. I'd like to ask Paul and Michael to comment. Do you think if there are any pre-conditions for occurring of new innovation areas of economic growth in this country? Is it possible within the nearest five years or there are, so to say, beautiful aims for the XXI century? Michael?

M. Calvey:
I'm sceptical about government initiatives to promote innovations, even though Russia is already a major source of innovation in the world. Most of the potential for Russia to develop a Silicon Valley type of venture capital industry, I think, is limited by the fact that domestic consumption of high technology in Russia is relatively low. So for venture funding companies here to succeed, they need to succeed by finding customers outside of Russia and it's very difficult to do that in our experience. So what innovation is happening is often happening by big global strategic players, that have set up R&D centres in Russia, that today are creating some world class innovative products and technologies across a range of sectors, the IT sector, the aviation sector, the electronic sector and others. Unfortunately it's not a major stimulant to the economy because it creates thousands of jobs, not millions of jobs, but there are a lot of innovative companies in Russia that are addressing domestic markets for example Yandex . We are the first and only investor in Yandex. When it was a pre-revenue company and over the course of 10 years it has grown to have a 60 percent share of Internet search through tremendous innovation and a constant and relentless desire to innovate and to provide better services. Now withstanding the fact that there are only 3 or 4 countries in the world, in which Google does not dominate in terms of Internet search, - Russia is one of them. And that's a testament to, I think, the quality of the human capital specifically in Yandex. Another company is CFT – Центр финансовых технологий – Novosibirsk, it is a leading banking software company in Russia. It is also the leading payment system company and again it is a sector where many foreign players have tried to enter and address, but it's been difficult. CFT has managed to maintain it's market share though relentless innovations. And finally OZON, which is, again, adopting a successful business model from the rest of world and Russia. So I think there are a lot of examples, these are the type of companies that created a lot of jobs, they have a lot of multiplier effects on the communities where they operate. So I think that those kind of opportunities have much more prospect for Russia than the government funded companies are likely to have in the next few years.

Y. Solzhenitsyn:
You spoke of IT. Paul, what is the potential for innovative growth in Russia in the next 5 years as

far as creating jobs is concerned?

P. Betsis:

As for the next five years I probably have to agree with my colleague. But on the other hand, I think it is a more complex question, to which there is no simple answer. Most probably Silicone Valley won't appear in Russia in five years. But on the other hand, in the context of innovation potential and spreading of innovation technologies production Russia looks quite not bad in comparison with other countries. And it is connected in particular with quite large gross product of the state and there is a vast number of highly educated people in technics. Therefore I would like to consider this question after all in connection with investments in process engineering sector, not only from the point of view of private equity, but also an increase in gross product of the whole country and an impact on all the other industries. Besides in this connection a new industry called "information technologies" is being created. All the factors together though can have a very strong impact on productivity growth and increase in gross product of the country. However I agree that without government participation it will be difficult to achieve fast results.

Y. Solzhenitsyn:

Thank you. We have one more block which we'd line to mention, but we'd like to hear you recommendations as well. That's why I will summarise a bit the question and will ask everyone to speak briefly: those who feel the question concerns their company. It is a question of investments. Leonid has already spoken about construction, we build very expensive. They are not only housing construction but also capital construction projects. Recently companies might have built more in Russia. We haven't begun a huge construction yet, we expect this, but we have experience in building. What is your experience in carrying out of infrastructural, large-scaled investment projects, what barriers occurred and how did you overcome them? Are there any lessons we can learn? I'd ask Mr. Tamburi to comment after the Russian examples what do you think after Russian panellists talk about capital productivity, – for you, globally, what are the key lessons learnt? Dmitry, could we start with you?

D. Konov:

Again – Sibur includes several business segments. If we take a classical petrochemistry in Russia and compare it with a classical petrochemistry in Europe, for example, and in China, then the cost of the construction in our country is 40% more than in Europe, whereas in China the cost of the petrochemical objects construction is 40-50% lower than in Europe. The gap is 2 times. Finally we have very capital- intensive projects of many years, and our long-term competitiveness – due to the high cost of the construction – is dramatically different. There are several reasons why it happens. Something is seen better in our examples, something else, may be, seen worse. Why the construction in Russia is more expensive than in Europe? Lower productivity in all chain, bad equipment produced in Russia, consequently, transportation costs to deliver this equipment not from Russia by a unit cost of any construction are higher. The results from the point of view of construction volumes are worse – the construction is longer, the construction is more expensive. Adaptation of updated technologies to the Russian norms is also a noticeable differentiating factor: in spite of the fact that in Russian there is no experience to use such more progressive installations of this type, technical regulations themselves this construction needs to be approved by, allow a tougher mode of adaptation, and the construction becomes more expensive due to necessity to lay thicker pipes with a larger diameter or make technological chain gaps between installations times more than it is stipulated in the West.

Y. Solzhenitsyn:
Helmut has a brief comment to add to that.

H. Wieser:
A quick comment. I agree with everything that you said, Dmitry. My final comment is, you know, even last year we spent 200 million in the new facility in Samara. I am super happy that it's over and we have it and it's done and it's constructed and we will do the inauguration in 2 weeks. So I'm very happy that we have finished our construction.

Y. Solzhenitsyn:
Vitaly, - the experience of optimisation of innovation projects or the problems in an investment process? What is wrong, what works?

V. Yakovlev:
Mr. Konov nearly took from my mouth an example concerning tubes, their thickness, Rostekhnadzor – it is rise in the cost of a project. Particularly at our electric power station the rise of the cost is by 10%. We changed the project three times because Rostekhnadzor didn't know that it is possible to do like that, – it is a classic example. There are a lot of such examples. Regulation is still a problem, it is much of it, it is diverse, variform, creative, I should say. And it has a very strong affect, really, on the process. I would also like to mention internal problems with project management. At the level of engineering companies, even of internal units, we don't have the quality of project management, which is customary in the West. As a rule it alone causes extra

expenditures. It goes in this way.

Y. Solzhenitsyn:

Carlo, the Chinese- Indian experience was mentioned and we have just now heard some reasons from Russia. What lessons do you think Russia should learn from international best practice in its capital construction activities?

C. Tamburi:

Yes, the main key success factor for our big project in Western Europe, in Italy especially, has been, first of all the retaining of the engineering skills and competence within the company in terms of project, basic design and technical design and then project management. So, you have to have clear ideas of what you need, so you have to study the market very well and the offer of the market. The second point is the quality, you know 360 degrees of the suppliers. You have to have the possibility to understand the offer of that market. You have to qualify the good suppliers and then you have to make tender and to put pressure and competition on the suppliers. And this is something that in Russia probably needs a little bit of improvement. We are building 2 big plants here, fortunately all the procurement and title awards were already done before we came in, so we are just trying to manage the existing contract and we are trying to change it a little bit. But the idea to have independent suppliers, competition among suppliers, qualified and good suppliers is the key success factor in order to lower the cost, the supply costs, of course, and to regain some of the productivity that is, – I agree with Dmitry, – is along the whole value chain. I mean the cost is very high also because the entire system is not acquainted with competition in general terms I would say.

Y. Solzhenitsyn:

Arkadiy, you have experience on this topic too. How will you comment the investment task that faces us?

A. Trachuk:

If I start to comment upon projects that Goznak made for itself, I will not add anything new connected to relations with the regulating authorities, the Engineering Supervision, the Fire Inspection, and engineering companies themselves – there were attempts to create together with them some systems to manage projects. I'd like to draw your attention to other projects that, in my point of view, may create long-term preconditions for growth of labour productivity in some industry or in a certain group of enterprises. As an example, I'll tell about a project implemented lately that - due to its specificity – was financed mainly by the Government. This is a project of implementation of the so-called biometric passports. It's interesting in one aspect only: unlike an ordinary book a passport looked like before, after some actions, after realization of the noticeable large project, we got 'a very technological product', for which IT-companies had time to work and continue working and in which participated the Russian developers of microelectronics. For my company the result was that efficiency of this product in terms of proceeds at the end increased by nearly an order of magnitude. Strategically there appeared new services unavailable before, appeared new partners – this is not a one-day effect, it will increase. The nature of such projects is extra-economic targeting, and here I would draw your attention to the part that may be acted in this project by the state. The similar objectives emerge for the state in the fields of ecology, security, execution of international agreements, so in the long run formulation of regulations of this kind and their persistent realization may bring very positive effects. As an example, I could cite a situation with environmental standards relating to exhausts by vehicles. Europe has been working under the standard Euro-4 since 2005, and by 2012, if I'm not mistaken, it is planned to transfer to Euro-6. How it will effect oil-processing, automobile industry, engine production, what will be the price for such products – one can imagine. One can imagine what will happen to our automobile industry and all that is connected with it, if we have introduced Euro-3 since 2008 and so far it's unclear how the situation would develop further. A second brief example. In the lobby I met representatives of the company Philips: in 2009 New Zealand, Australia, it seems to me, the European Union as well, stop to sell incandescent light bulbs with capacity of more than 100 Watt. In order to prevent the climate changes, luminous tube lamps will be used. I don't know about changes in climate, but such product will be three, four, could be five times more expensive. So, projects of this type, where extra-economic targeting of the state is in place, if such policy is consistently implemented may and must positively effect productivity of capital and labour; on the other hand, conservation of old solutions, even under pretence to help the industry, may have a long-term negative effect. In crisis relevant requirements, in my opinion, must be applied to those companies which lay claims to get a government support.

Y. Solzhenitsyn:

Certainly, the topic is very abundant. We are coming to the end of the session. I would like to apologise to the audience that we were not able to let you ask questions, - I think all participants will appreciate continuing of the debate behind the scenes. All these sessions are recorded both on video and on audio, so the ideas sounded will be fixed. Before we close the session and sum up the results, I want to point out that, in my opinion, more positive ideas and phrases about existing potential were sounded than sorrowful thoughts, rather fair, how many wrong things we have. The examples of companies' achievements and the fact that half of us have confirmed that they are able to increase the productivity as much as twice, - it looks promising. When we were conducting our research, a lot of people told us: you see the reality through rose-coloured glasses – you just got away thanks to the oil and now have reached a dead end. The dead end, in my opinion, was not specified in the course of our debate, however, the barriers certainly exist. I'd suggest finishing our session as follows: to ask each participant simply per twenty or thirty seconds to mention two or three major recommendations which you could give for the nearest two or three years to your colleague in business or authority. What do you think is the most important on the assumption that was said in the course of our today's debate? Pavel?

P. Betsis:

My recommendation is to elaborate a complex of programs for promotion of investments in information technologies. First of all this complex of programs should be created and supported at the national level, but I also don't leave out, of course, participation of private sector. Concurrently with it I would recommend to create another complex of programs for carrying out mostly of education, special trainings, which can help to direct manpower surplus from outdated to new branches of economy. That is my recommendation.

V. Yakovlev:

I would say, probably summing and agreeing with Mr. Kazinets, that one of key factors is government derestriction, which comes very expensive for us. It is an additional control, it suppresses initiative, it costs a sight of money, and in most cases it results in ineffective use of resources. As for productivity – if we talk about future, I think, that there is really a huge amount of reserves, but it is extremely difficult to reveal and implement them today. To do it we need normal, system, competent approach. Thank you.

V. Baumgertner:

I totally agree that the mentioned situation should be seen not like a problem, but like an opportunity for further improvement. I fully agree that it is necessary to work on productivity increase in terms of long-term outlook; the work should be system-based, including change in mentality of people. And now about things which depend to a greater extent not on a company but on the government: I would like to say again that the government should pay attention to questions of education, demography and the question which hasn't been discussed today, – that is priority development of infrastructure for new construction. And of course, it is difficult to argue with Leonid Kazinets – everything concerning approval of new projects is of the utmost importance.

L. Kazinets:

I have three wishes, two to the companies, that is to my colleagues-businessmen, and one – to the government. They are simple. Start with telling the truth to yourselves. For example, I gave my directors sheets of papers with three simple questions: how can you evaluate with five-point system your own work, work of the shareholder and the company in general. The people evaluated their work as 4,5 points – it is modest. The work of the shareholder is 4,2 points – thanks as well. The company in general is three points. We have fifteen directors and one shareholder; where is the invisible enemy which decreases mark of all our work till three points? Tell the truth to yourselves, estimate real things – not just income per an employee, but income with respect to the market, not just expenses in time units, but expenses with respect to the competitors, quantity of transactions per product unit in time. Measure yourselves – figures don't lie, tell the truth to yourselves. Train willpower – it is useful. Stick with your policies, if you used some mathematical methods and chose points in which force application gives maximum efficiency. It is necessary to keep the line, cavalry charge is required. It is impossible to do something fast, well and cheap. If you took a decision to increase efficiency due to these and those factors, keep the line, no matter how it is difficult. That is have strong will and be logical in realization of the strategies. And a wish to the government – stop issuing laws. For a year at the federal and subject levels twenty laws concerning our industry were adopted, nineteen of them distinctly aggravate situation of domestic manufacture. But if you have such a law making itching, make the cornerstone a very simple principle – adopt laws, which clearly improve conditions for domestic manufacture. Otherwise don't adopt them at all.

C. Tamburi:

About the energy sector, I think that most of the concept will also be applicable to other sectors. The only way to improve productivity is to create deregulation, liberalisation and further competition. That's the only way to help the entire system. In our sector in particular since there is a big need for further investment, we also need long-term perspective, clear rules and transparency in the system, so that both Russian or international investors can have their own clear scenario to invest and to increase the profitability and the productivity for the entire system.

D. Zelenin:

I have, probably, two considerations. In our economy the entrance barriers are very high, whether it's access to raw materials, or an administrative possibility to get a good plot of land for housing construction, and this objectively, leads to decrease in labour productivity. That's why if we are talking about the state, then increase in competitiveness of our economy is the right way to increase productivity. Secondly, if we talk about management, it must have internal confidence that those

changes are needed. And the only proper way is to create the right motivation for the management by the shareholders and on the management's part is a change in the corporate culture and creating motivation internally in the company.
I have already said that in our industry a greater effect upon the productivity is provided not by a number of the employed, but by increase in capacities. One of our competitors has spend the last four years actively investing into increase in capacities, without any improvements in operations. As a result, the company has actually turned to be a bankrupt. There is also a coincidence of the market factors and other aspects but to fight one thing and miss all the rest leads to a deadlock.

H. Wieser:
I think support for foreign direct investment in Russia has clear rules, most of which you have already said, and you'll probably communicate to the Prime Minister that there is an opportunity for productivity and there is not a problem and eliminate bureaucracy and the obstacles.

D. Konov:
Thanks for the creative discussion. The enterprises that are present here are large enough to be measured from the point of view of regional authorities. I mean that enterprises in regions have a lot more problems including those with personnel training, so interaction with authorities relating to changes in cirricula of vocational training schools, say nothing about institutions of higher education, is very insignificant. And it would be better if business were not afraid of the authorities, were not afraid of criticizing the authorities, were not afraid to join the authorities to solve its problems, including problems to eliminate bureaucratic and other barriers. What will be a result is another point, but here, as it has been already said, one must manifest one's willpower. The second point – I don't agree with Leonid Kazinets – the laws need to be adopted, the existing ones need to be changed, we have Construction Norms and Regulations, Sanitary Regulations and Norms, technical regulations have not been adopted or changed so far in such a way it would be possible to act, for example, in construction. Welding works, for example, may not be performed by a welder alone, two people are needed. A number of the wrong laws and technical regulations which have not been adopted is such that it 'brakes' any promotion, any activity to increase the labour productivity. And the last – of course, one needs to search for creative solutions to reduce costs. I'd like to cite one example. Company Telekontakt, providing outsourcing services for call-centres to reduce their costs relating to salaries, opened a subsidiary in Torzhok. There the salaries are 30% lower than in Tver', but nobody could operate a computer, it's true, it happened four years ago. So there they were rendering those services that did not require the use of the computer. Two hundred people were runing on the phones in the call-centre. They saved up to 30% on salaries. Of course,

later together with them we launched – through the unemployment service – a training course of computer literacy in Torzhok, but, after all, such actions critically reduced their costs and increased income.

A. Trachuk:

What relates to recommendations for business – nothing else, except saying that everything here depends upon ourselves, I could not say. Yes, to increase creativity is necessary, to think, see and move forward is the only recommendation. What relates to the state – in my opinion, it's important that a motto for modernization, that has been perceived by us all, would turn into something more specific. Meaning that if we talk about modernization of our economy, it must be applied in some industries, where specific results must be achieved. So a small step to be taken at the border between business and a state is development of outsourcing. This is an objective for both small and big business in order to establish contacts.

M. Calvey:

I agree with Helmut that the real problem with productivity in Russia is a lack of competition. There is a lack of alternatives for both companies and consumers. So an increase of foreign investments would be the most obvious way to increase competition, but the single government program, that can improve productivity in Russia is dealing with 'probki' (traffic jams) in Moscow and in St. Petersburg. Tens of billions of dollars of productivity are lost, because the productivity is spent on traffic in Moscow and in St. Petersburg. So one thing the government could do to improve productivity is to fix the problem of 'probki' in Moscow and St. Petersburg.

Y. Solzhenitsyn:

Colleagues, thanks a lot. We have stayed on a little, thank the participants.

I think today we have only begun the dialog and I consider your consent to participate in this debate as a sign of our entering a campaigners' community for the productivity. Thus it is the beginning of the road. Thank you.