



SKOLKOVO
Moscow School of Management

SELECTED 15:

WINNING STRATEGIES
OF RUSSIAN
ENTREPRENEURIAL
CHAMPIONS

(includes case-studies)

SKOLKOVO Institute for Emerging Market Studies

Prepared as part of the “Unknown Russia: Powered
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“ANY GOOD BUSINESS IS A HOBBY”

— Arkady Volozh, Co-founder and CEO of Yandex

“Company shares the same genotype as that of Russian engineers, we grew out of the engineering environment and never lost our link with it” — Alexander Golikov, Co-founder and Chairman of the Board of ASCON

“It is quite likely that in a few years people will be talking to TV sets, refrigerators, or vacuum cleaners using natural language.” — David Yang, Co-founder and CEO of ABBYY

“WE WERE COMMON SAILORS, WANTING TO CREATE SOMETHING OF OUR OWN...”

— Nikolay Mujikov, Co-founder and Vice-President of Transas Group

“YET OUR SIMILARITY TO AMAZON ISN'T WHY WE'VE SUCCEEDED. TO UNDERSTAND THAT, YOU HAVE TO LOOK AT THE CHALLENGES OF RUSSIA'S RETAIL ENVIRONMENT...”

— Maelle Gavet, CEO of Ozon Group

“We do not consider ourselves to be so untalented as to just make replica copies of Manhattan or Tokyo street corners in Russia.” — Mikhail Goncharov, Founder and CEO of Teremok

“To make a black toothpaste..., you should be ready to create your own rules of the game and guess the dream of every consumer” — Yevgeny Demin, Founder and CEO of Splat

“AT PRESENT, WE HAVE THE BEST LINE IN THE WORLD FOR MANUFACTURING INSTRUMENTS FOR NANOTECHNOLOGIES”

— Victor Bykov, Founder and CEO of NT-MDT

“Business sustainability depends not on the size of the company but on the effectiveness of the business model which you have built.” — Sergey Galitsky, Founder and CEO of Magnit

“The two most important components of our company are high-tech innovations and people — more than 66 million of them are our clients.” — Ivan Tavrin, CEO of MegaFon

“IN OUR COUNTRY, NO ONE CAN AND NO ONE WANTS TO PROVIDE NORMAL CUSTOMER SERVICE”

— Oleg Tinkov, Founder and Chairman of the Board of TCS Bank

“OUR SECRET TO SUCCESS CAN BE FORMULATED LIKE THIS: THE WILL PLUS THE DESIRE TO BREAK THROUGH THE LIMIT OF POSSIBILITIES.”

— Boris Kim, Co-founder and Chairman of the Board of QIWI

“IT WAS MY DREAM AND THE DREAM OF MY COLLEAGUES: TO CREATE A COMPANY THAT WILL COMPETE AT AN INTERNATIONAL LEVEL”

— Alexander Lyskovsky, Co-founder and CEO of Alawar

“EFFECTIVE AND INNOVATIVE PRODUCTS WILL BE CONSUMED ANYWAY. WHY SIT AND WAIT FOR THE MARKET TO FORM THE DEMAND?”

— Dmitry Andrianov, Co-founder and CEO of Prognoz

“Everyone said that we did not have a chance because in Russia there were only good hackers, while programmers could neither make the end-product nor promote or develop it. But we decided to try and in 1999 began to build Luxoft” — Anatoly Karachinsky, President IBS Group

Executive Summary



Executive Summary



Introduction



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In Search
of Russian
Champions



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Entrepreneurship in Russia is generally overlooked. Indeed, the country — so strongly associated with natural resources — is not traditionally viewed as a welcome environment for dynamic, private business. Yet, the private sector in Russia that emerged almost 25 years ago continues to grow rapidly, and a great deal of companies have emerged as new market leaders.

However, entrepreneurship is not only about starting up new companies, but also about the entrepreneurial culture and spirit that help businesses continuously to reinvent themselves and exhibit top performance over the long run. It is such entrepreneurial companies with a proven track record that we have set out to identify and study in our research. The goal is to understand what strategies have led to their success and what challenges they face going forward.

Successful private companies in Russia are easier to find than one might think. While industries related to natural resources constitute almost 95% of Russian exports, they actually account for roughly 15% of Russia's GDP. Remarkably, the remaining 85% is attributable to industries which have nothing to do with natural resources — and this is where Russia's new, dynamic and entrepreneurial businesses can be found.

This study showcases 15 companies from Retail, Consumer Goods, High-Tech, Consumer Finance and Telecom. These companies have grown to outperform or at least challenge international players not only in Russia but also in the global marketplace. The study finds that the success of these companies is attributable to their ability to address challenges or leverage market factors that are specific to Russia. They then establish themselves in the market and develop a competitive advantage vis-à-vis other rivals.

LOCAL OFFERING LEADERS leverage a deep understanding of Russian consumers and their shifting needs to create tailored offerings. **BEST ADAPTORS** develop unparalleled operational capabilities

to tackle Russia's infrastructural deficiencies and lack of reliable outsourcing options by building in-house competencies or eliminating the weakest operational links. **GLOBAL NICHE LEADERS** tap into the local pool of highly qualified technical professionals to develop innovative offerings for a global marketplace. **GLOBAL CITIZENS** jumpstart their growth in Russia and then extensively globalize not only their sales but also their operations.

These four strategies have worked well considering the challenges of the Russian economy, but will they help to sustain competitive advantage in the future?

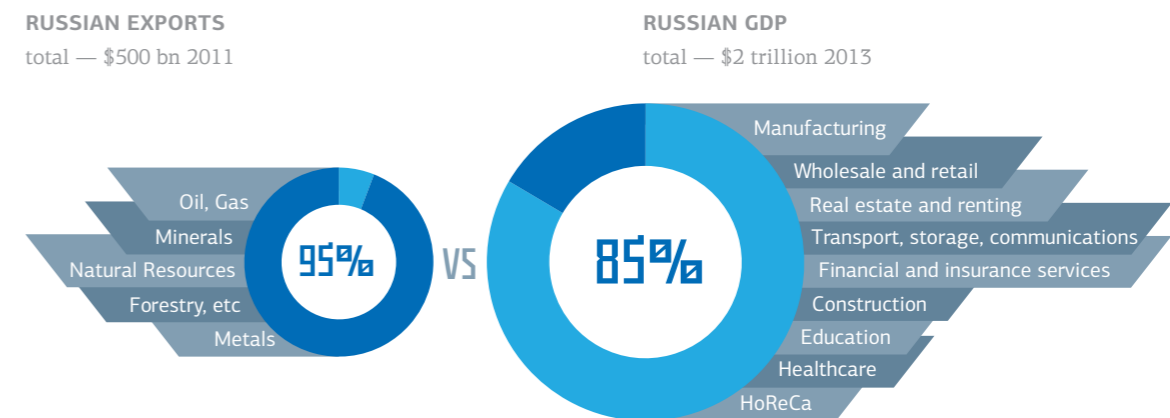
With consumers becoming increasingly demanding, competition intensifying, and economic conditions worsening, companies experience a growing pressure to reinvent their strategies and approaches. Today, the strategic repertoire of these companies is quite limited and primarily focused on product innovation, brand identity and distribution networks. In contrast, strategies that are underpinned by creative business configurations and take into account evolving client needs and shifting market conditions are often overlooked. It is, therefore, a decisive moment for many of these companies. Now that they are established market leaders, they must continue to think entrepreneurially in order to find new sources of growth in an increasingly competitive and challenging marketplace.

Introduction

It has been almost 25 years since Russia transitioned to a market economy in the 1990s. The transformation of the economy opened up previously non-existent opportunities for new businesses and ventures. The Russian private sector reacted quickly, promptly filling major gaps left behind by the state-run economy, particularly in serving end customers. Growing consumer appetites, the expanding middle class and rising disposable income additionally contributed to this trend. The new economic environment also opened for young companies a gateway to the world, in the form of access to capital, markets and technologies. As a result, the last two decades have seen the rise of many new dynamic firms with not only domestic but also international ambitions.

export rankings. These industries collectively account for almost 95% of Russia's \$500 billion in exports. What is less known is that their share in the country's \$2 trillion GDP hovers around 15%. This is according to Russian Federal State Statistics, which is sometimes criticized for its transfer pricing mechanism; however, the World Bank gives a similar number of 18.7% in its estimations which are based on resource rent. (Federal State Resource Statistics, 2013; Word Bank 2012). What is important is that up to 85% of the Russian economy is comprised of industries with no relation to commodities or natural resources (see Figure 1). Arguably, it is this 85% where the contribution of newly emergent private firms is most significant.

FIGURE 1: NATURAL RESOURCES IN RUSSIAN EXPORTS AND GDP



Source: Federal State Statistics Service

Nevertheless, little remains known about entrepreneurship in Russia. For a long time, it has been largely overlooked as something happening in parallel to the main developments in the Russian economy and viewed as a side effect rather than a driving force. Meanwhile, Russia's image continues to be defined primarily by natural resources. Indeed, Russia stands high in global oil, gas, coal, metals, forestry and other commodity

While there is no intention to conduct a comprehensive study of all private companies that comprise this 85%, this project seeks to showcase real-life stories of the entrepreneurial heroes of the past two decades.

The project's goal is to provide fresh insights into the lesser known but yet vibrant stratum of dynamic, competitive and innovative Russian

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companies with focus on their success stories, winning strategies and challenges they face going forward.

vation Index (developed jointly by the Johnson Graduate School of Management at Cornell University, INSEAD Business School and the World

The project's goal is to provide fresh insights into the lesser known but yet vibrant stratum of dynamic, competitive and innovative Russian companies with focus on their success stories, winning strategies and challenges they face going forward

The story of how these companies became market leaders is particularly remarkable as evidence of positive economic forces at work within Russia. While the Russian economy still faces a number of well-documented and persistent challenges, there are important positive developments taking place nationwide that can be attributed to the success of companies such as these. One of the major highlights is that Russia has been continuously improving its position in prestigious global rankings such as the Global Inno-

Intellectual Property Organization), Global Competitiveness Index (developed by the World Economic Forum) and the Ease of Doing Business Index (developed by the World Bank) (see Figure 2). Among its BRICS counterparts, Russia is the leader in terms of how it has improved its relative position within these three rankings. In the Global Innovation and Global Competitiveness Index, Russia is second after China. In the Ease of Doing Business Index, Russia has left China far behind.

FIGURE 2: RUSSIA IN KEY GLOBAL INDICES

GLOBAL INNOVATION INDEX				GLOBAL COMPETITIVENESS INDEX				EASE OF DOING BUSINESS INDEX			
Country	Rank 2013	Rank 2014	Δ	Country	Rank 2013	Rank 2014	Δ	Country	Rank 2013	Rank 2014	Δ
China	35	29	6 ↑	China	29	28	1 ↑	South Africa	37	43	6 ↓
Russia	62	49	13 ↑	Russia	64	53	11 ↑	Russia	64	62	2 ↑
South Africa	58	53	5 ↑	South Africa	53	56	3 ↓	China	93	90	3 ↑
Brazil	64	61	3 ↑	Brazil	56	57	1 ↓	Brazil	123	120	3 ↑
India	66	76	10 ↓	India	60	71	11 ↓	India	140	142	2 ↓

Note: Year of rank is the year of when the index results were published

Source: Global Innovation Index 2014, Cornell University, INSEAD, and WIPO; Global Competitiveness Index 2014-2015, World Economic Forum; Doing Business Index 2015, World Bank

The results of these indices reinforce each other. The Innovation Index and Competitiveness Index tout Russia's human capital as its key strength. Russia has the world's highest tertiary education enrollments with a high proportion of students going into science and engineering, combined with a large workforce of researchers producing a significant number of domestic patents and utility model applications. As a result, Russia performs fairly well in technological outputs of innovation and — remarkably — shows a positive record in online creativity.

In the Competitiveness Index, the level of productivity establishes the level of prosperity that can be attained by the economy. According to the report, such factors as size of the market, macroeconomic environment, higher education and training, health and primary education drive Russia up in the competitiveness rankings. Russia has also implemented a number of effective reforms to ease the terms of doing business. These primarily concern the notoriously troublesome property registration and electricity market. Yet, despite these effective reforms, there is still plenty of room for improvement in regulatory environment, quality of institutions and market terms.

While this leaves space for informed policymaking initiatives and targeted efforts to increase efficiency of regulatory agencies, successful individual businesses can themselves serve as engines of growth that drive Russia's innovation, competitiveness and market terms. Rather than being imposed top-down by the state, these changes are being effected bottom-up.

It is examples of these businesses that the report aims to study.

The stories of these companies are particularly remarkable because, ultimately, they have the power to shape the broader landscape of doing business in Russia. Their positive examples inspire young entrepreneurs; their increasing lobbying power challenges the traditional agenda of regulators and policymakers; and their strong market position shapes — and sometimes even creates — the industries in which they operate. Altogether, this makes the study of such companies a thrilling and insightful dive into what makes these new Russian entrepreneurial leaders so successful.

This report consists of the following chapters. Chapter 1 provides a review of the methodology used in the selection of these companies as well as a general approach to the research. Chapter 2 takes a deeper look at the market strategies of the companies under investigation and analyzes the key factors that led to their success. Chapter 3 gives an overview of the challenges the companies are likely to face going forward and highlights innovation as one of the key solutions in overcoming these challenges. Conclusions review the main highlights of the study. At the end of the report, the appendix provides descriptive case studies of fifteen Russian companies that have become market leaders.

Chapter 1: In Search of Russian Champions



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Introduction



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One of the key aspirations in undertaking this research was to showcase examples of not only established success stories but also uncover examples of successful companies that may not be as well known. As a general rule, private, entrepreneurial companies that are not dependent on natural resources for their success are considered. Although companies from different industries and of different size are studied, preference is given to mid-size technology firms. The selected companies meet one or more of the following criteria:

- The company is a **TOP PERFORMER IN ITS FIELD BOTH DOMESTICALLY AND ABROAD**
- The company has **INVENTED A NEW BUSINESS MODEL**
- The company has **SUCCESSFULLY ADAPTED AND SCALED AN EXISTING BUSINESS MODEL**
- The company **HAS OUTPERFORMED GLOBAL PLAYERS IN THE DOMESTIC MARKET**

As information about private companies is rather scattered and there are no aggregate sources, a great deal of investigative research work has been done. This primarily included qualitative research based on comprehensive analysis of secondary data.

The selection process is structured as an original research study whereby both top-down and bottom-up approaches are deployed. The logic of the top-down approach is that companies of interest are sought within industries that are traditionally most conducive to innovation and competitiveness. The bottom-up approach selects com-

panies based on the given set of characteristics by scanning existing ratings, professional contests, awards, industry news and other sources.

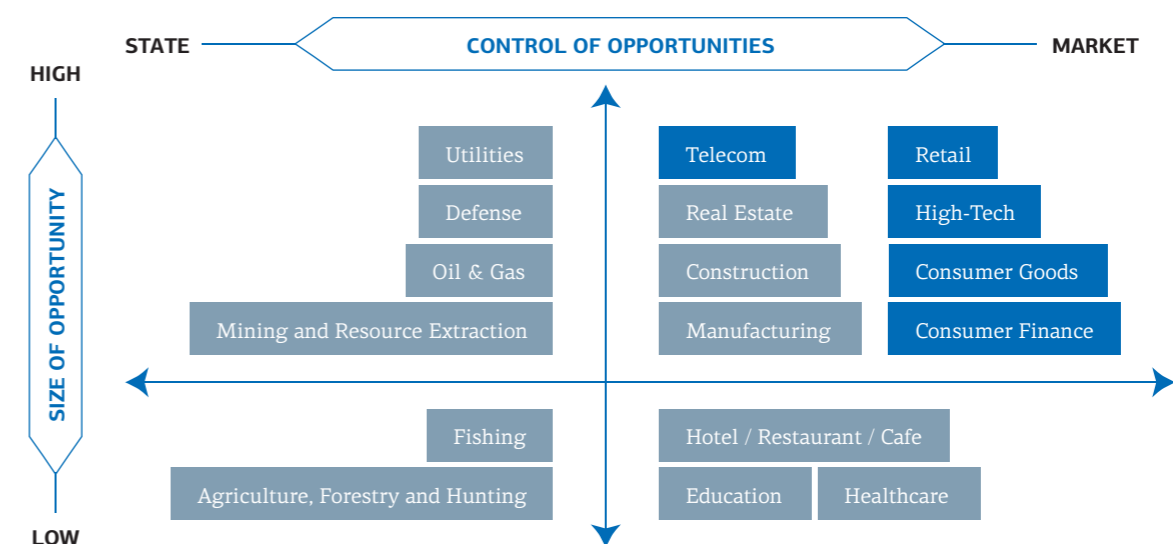
Top-down approach

To understand where success stories can be found, we have deployed a number of criteria to identify industries in which we would have the greatest likelihood of finding them. The underlying assumption is that large industries with a dynamic composition of large and mid-sized companies and minimum state intervention also have a higher probability of hosting entrepreneurial and successful private businesses.

Based on a generic set of criteria, we have identified several industries where the competitive environment appears to require creative and innovative strategies to be successful. We examined a number of industries along two dimensions (see Figure 3):

- The size of opportunity (low or high) associated with the industry's contribution to GDP, together with its ability to accommodate a critical mass of large and mid-sized companies
- Control of opportunities (state or market) associated with the extent of government regulation as well as state involvement in ownership or any other form of control in business.

FIGURE 3: HOST INDUSTRIES



Source: Federal State Statistics Service, SKOLKOVO Institute for Emerging Market Studies analysis

In addition to the upper-right quadrant (high market, high opportunity), exciting examples of entrepreneurial companies can be found in other quadrants, especially in the lower-right quadrant (high market, low opportunity), where the analysis has shown the emergence of promising start ups. However, considering the time and scope limitations of this research, we focus only on the upper-right quadrant, where we further apply an additional set of criteria to narrow down the list of industries to consider.

By adding productivity as another screening factor, we concentrate further on industries that demonstrate productivity levels and growth rates higher than average. Not surprisingly, the final list of industries for further consideration is comprised of relatively new service-rich and technology-extensive areas, primarily driven by consumer rather than business demand. These are fairly competitive markets exposed to global competition and attractive enough based on their size and growth rates. In such a context, companies are under pressure to innovate as a matter of survival. The following industries were selected: Retail, Consumer Goods, High-Tech (including IT), Consumer Finance, and Telecom. As a next step, we moved on to explore companies within these industries.

Bottom-up Approach

The bottom-up selection process started with a compilation of a long list of successful private companies. We focused on three types of sources. First — ratings and contests that specifically reward and distinguish “innovative companies” — including sources such as “Tech Up,” “Time of Innovations” or “Top-50 Innovative Companies by ISEM.” Second — lists

of Russian companies that participated in leading international innovation events such as CeBit and BioTechnica (Hannover, Germany), Analytica China (Shanghai, China), and Nanotechnology (Thessaloniki, Greece). Third — lists of resident companies in official “innovation clusters” or “incubators” or companies that have received investments from specialized VC funds. Next, we looked for proof of successful market presence, which helped to screen out businesses in the earlier stages of their lifecycle. The final criterion — degree of domestic market success — was introduced to capture the very interesting group of companies that used technological innovations to overcome important infrastructural deficiencies of the Russian market. Based on a combination of these criteria, we came up with a list of over 100 companies for further study.

Selection

The final stage of the selection process was to merge the findings of the top-down and bottom-up approaches to yield a final list of companies for the case studies. This research approach resulted in a list of prominent as well as lesser-known entrepreneurial success stories. Overall, 15 firms — the Selected 15 — from five different industries were chosen. The companies have been studied based on secondary information from open sources such as company websites, industry reviews, professional databases and public media. Figures 4 to 10 provide a short profile of the companies and their management.

FIGURE 4: PROFILE OF THE SELECTED 15

Company	Industry	Established	Origin	Capital markets	Revenue, \$ mln	Employees
 QIWI	Consumer Finance	2009	Kemerovo, Moscow	NASDAQ	188 ¹	> 1,000
 Tinkoff Credit Systems	Consumer Finance	2006	Moscow	LSE	1,100 ²	> 6,000
 OZON.RU	Retail	1998	St. Petersburg	Venture Capital	~ 750	> 2,400
 MAGNIT	Retail	1994	Krasnodar	LSE	18,202	> 230,000
 Теремок	Consumer goods	1998	Moscow	—	~ 140	> 2,000
 SPLAT	Consumer goods	2000	Moscow	—	~ 100	> 700
 PROGNOZ	High-Tech	1991	Perm	—	~ 120	> 1,500
 Yandex	High-Tech	1993	Moscow	NASDAQ	1,207	> 5,300
 NT-MDT	High-Tech	1989	Zelenograd	—	~ 80	> 300
 ABBY	High-Tech	1989	Moscow	—	~ 200 ³	> 1,250
 LUXOFT	High-Tech	2000	Moscow	NASDAQ	398 ⁴	> 8,000
 TRANSAS	High-Tech	1990	St. Petersburg	—	~ 300 ³	> 2,000
 АЭКОН	High-Tech	1989	Kolomna (Moscow region)	—	~ 30	> 650
 alawar	High-Tech	1999	Novosibirsk	Venture Capital	~ 30 ³	> 400
 MEGAFON	Telecom	2002	St. Petersburg/Moscow	LSE	8,400	> 33,500

Note: revenue data is provided for full year 2013 unless specified; for listed companies official financial reports are used, for non-listed companies approximate figures are given based on secondary sources

¹Adjusted net revenue

²Interest income

³For full year 2012

⁴For FY2014 ended on March 31, 2014

Source: company websites, Vedomosti.ru, Forbes.ru, Expert.ru, Cnews.ru, SKOLKOVO Institute for Emerging Market Studies analysis

All logos are registered trademarks of their respective companies

FIGURE 5: COMPANIES BY CITY OF ORIGIN



FIGURE 6: LEVERAGE OF ENGINEERING TALENTS

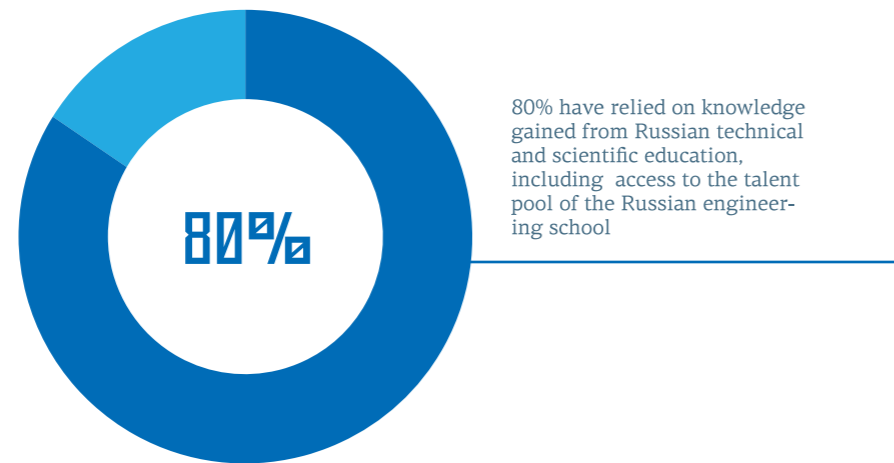
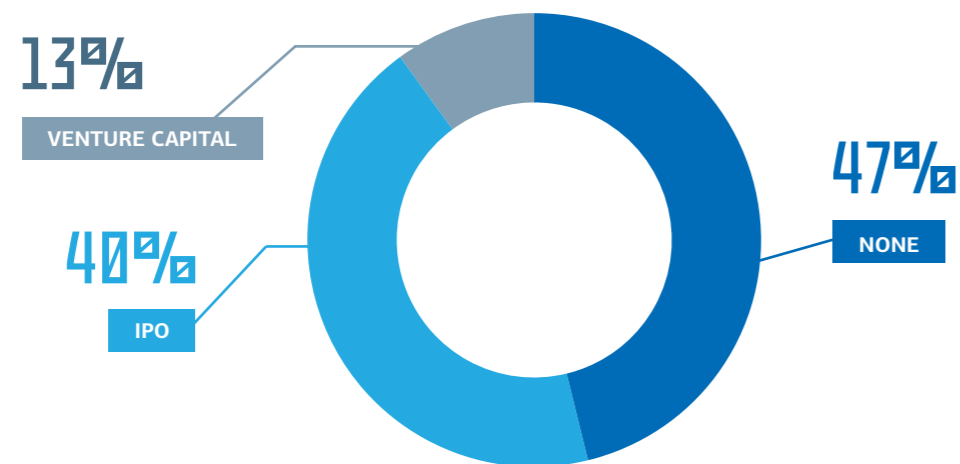


FIGURE 7: CAPITAL MARKET EXPOSURE



Note: in comparison, there were only 137 IPOs of Russian companies over the past 25 years (PwC, 2014)

FIGURE 8: AGE OF BUSINESS

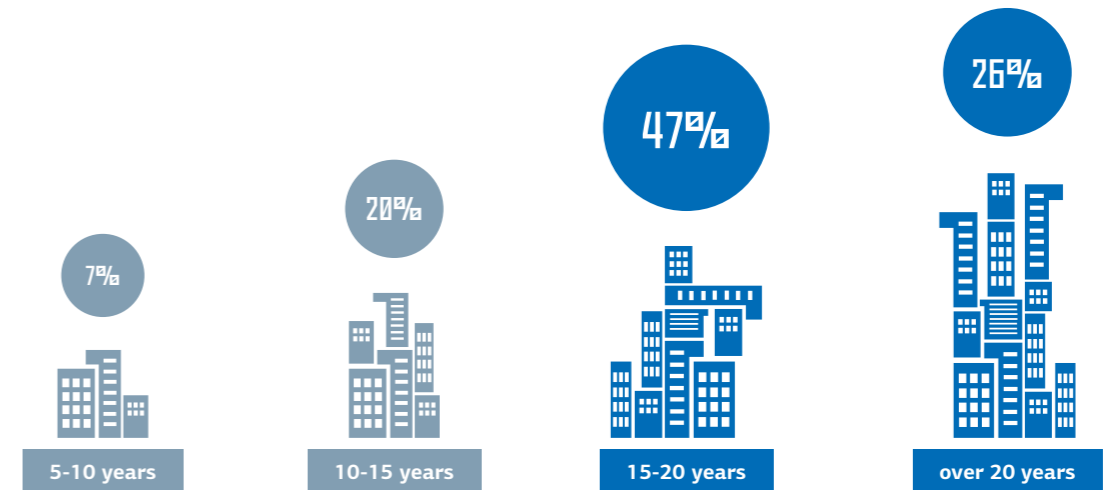


FIGURE 9: FOUNDER'S DEGREE

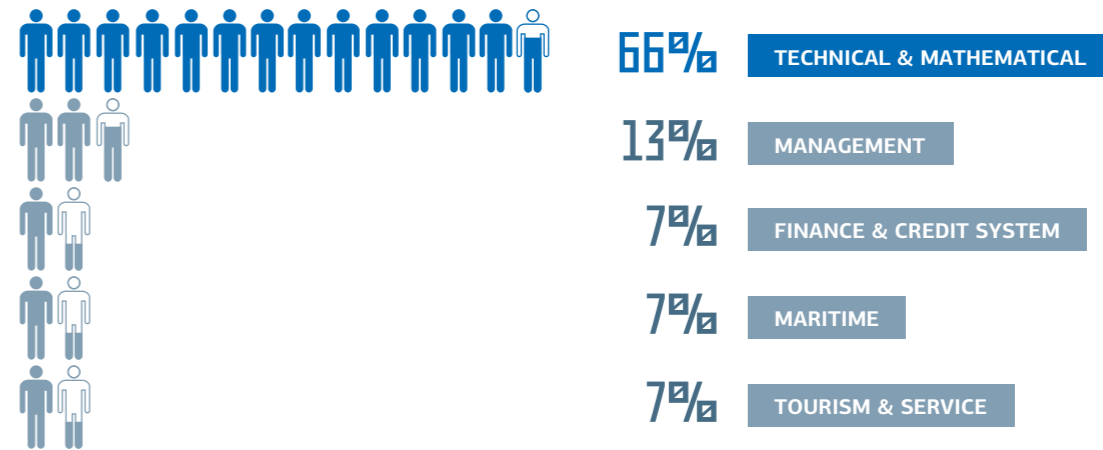
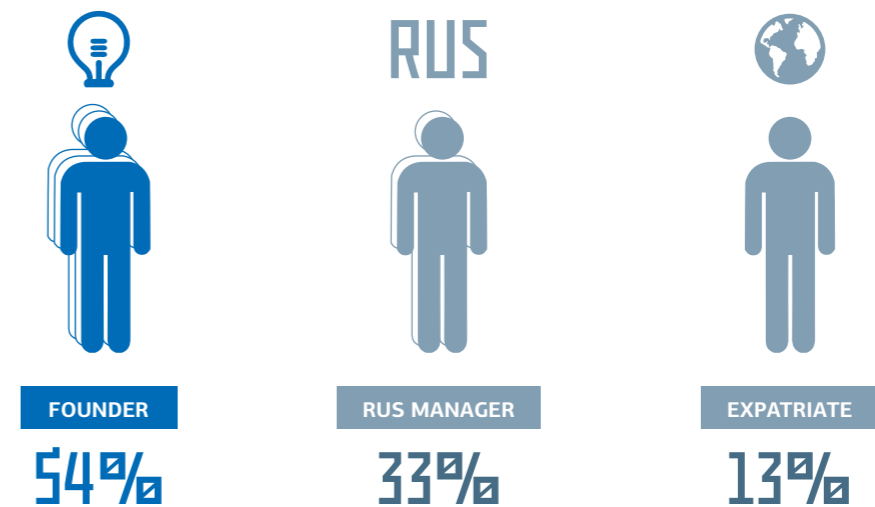


FIGURE 10: CEO



Source: company websites, Vedomosti.ru, Forbes.ru, Expert.ru, Cnews.ru, SKOLKOVO Institute for Emerging Market Studies analysis

Chapter 2: Winning Strategies



Executive
Summary



Introduction



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The companies in this study, the so-called Selected 15, managed to survive and show outstanding results despite a rapidly changing environment for Russian business. The reasons behind their formation and their strategies for success were to a significant extent determined by local Russian market conditions, which included all the advantages and disadvantages of a young developing market economy.

POOR MARKET INSTITUTIONS The political and economic crises of the early 1990s left Russia with relatively undeveloped market institutions poorly suited to the new business environment, a relatively high level of unemployment, low regard for legal institutions, low purchasing power of its citizens and a weak currency. Basic market institutions such as a banking sector, capital markets, intellectual property legislation, and private property protections simply were not available for the Russian business pioneers of the early 1990s. Gaps in legal status, tax and industrial regulations provided room for interpretation both for entrepreneurs and authorities.

DEFICIENT BUSINESS INFRASTRUCTURE The Russian economy was restrained, too, by all sorts of shortcomings related to deficiencies in the local infrastructure and the immaturity of markets. These shortcomings included impaired transportation and logistical systems, both of which are crucial given Russia's vast territory. A deficit of commercial real estate was also a business deterrent. Companies also suffered from insufficient or unreliable supply of professional services and components. Given this background, some industries developed faster, while others developed only gradually, which led to a general misalignment in the overall business environment, hampering the implementation of otherwise proven business models. Some industries were simply absent — like Telecom, Consumer Finance and High-Tech — or looked quite dif-

ferent from how they look today — like Retail or Consumer Goods. This meant that businesses had to create everything from the ground up, including business models, supply chains and customer experiences.

NO ENTREPRENEURIAL CULTURE Besides infrastructural and business environment gaps, Russian culture also acted as an impediment to the development of a vibrant business sector. Entrepreneurship has never been a trait strongly ingrained within the Russian mindset. In fact, for a long time, entrepreneurial activity of any kind has been generally perceived in a negative way, largely as a result of the Soviet legacy. The only business model familiar to the broader population — tracking down scarce goods and then selling them to those who needed them — operated for many years as a shadow part of the Soviet economy. With the dissolution of the Soviet Union, open borders and an inflow of foreign goods created opportunities to make money officially. Perhaps not surprisingly, at least one-third of the founders of the 15 companies included in our study raised initial capital in this way before switching to more ambitious goals and comprehensive strategies.

LACK OF TRUST Russian business community is highlighted by a “family and friends” culture of doing business that was based on maintaining a high level of control by a narrow set of insiders. This also meant that less attention was paid to developing best-in-class industry practices, and more to motivating and rewarding top managers. Internal approaches to problem solving (like vertical integration) were more highly valued than the exploration of potential partnership opportunities. From a customer perspective, the general lack of trust in the Russian business world was also an important issue that largely determined consumer reluctance to switch to advanced transaction mechanisms. For example,

many people still prefer to pay in cash rather than use plastic bankcards. As a result, Russia even now remains predominantly a cash-based economy. It is due to this lack of trust that all four of the companies in our study whose business models are based on direct contact with individual customers had to adapt their business models accordingly.

These difficulties of the local business environment mostly dissuaded foreign competitors from entering the Russian market and left more space and time for Russian businesses to develop. At the same time, Russian entrepreneurs started to emerge, forced by market conditions to learn

spond to and harness specifics of the local market to their benefit.

Strategies

Although each company is unique and it would be impossible to aggregate their success stories into an ultimate winning strategy, we have identified some similarities that can be integrated into a simplified picture representing generic strategies deployed by the

The adverse markets conditions, regulatory gaps, infrastructural deficiencies and lack of business practices make success of the Selected 15 even more remarkable. These companies have managed to attain market-leading positions in local and even global markets notwithstanding these challenges and often thanks to them

quickly and rapidly without any role models. In many cases, they relied on their Soviet education, which placed a strong emphasis on technical and engineering knowledge, and combined that with careful selections from an extensive menu of international best practices, business models and high-tech solutions. Russian mentality and Soviet legacy have also made business rather inward-looking. Unlike the Chinese counterparts who have been aggressively entering global value chains, Russian mid-sized companies have mostly disregarded international expansion. Consequentially, once faced with market limits, businesses have tended to consider vertical or horizontal integration rather than entrance to other countries with existing product portfolio.

The adverse markets conditions, regulatory gaps, infrastructural deficiencies and lack of business practices make success of the Selected 15 even more remarkable. These companies have managed to attain market-leading positions in local and even global markets notwithstanding these challenges and often thanks to them.

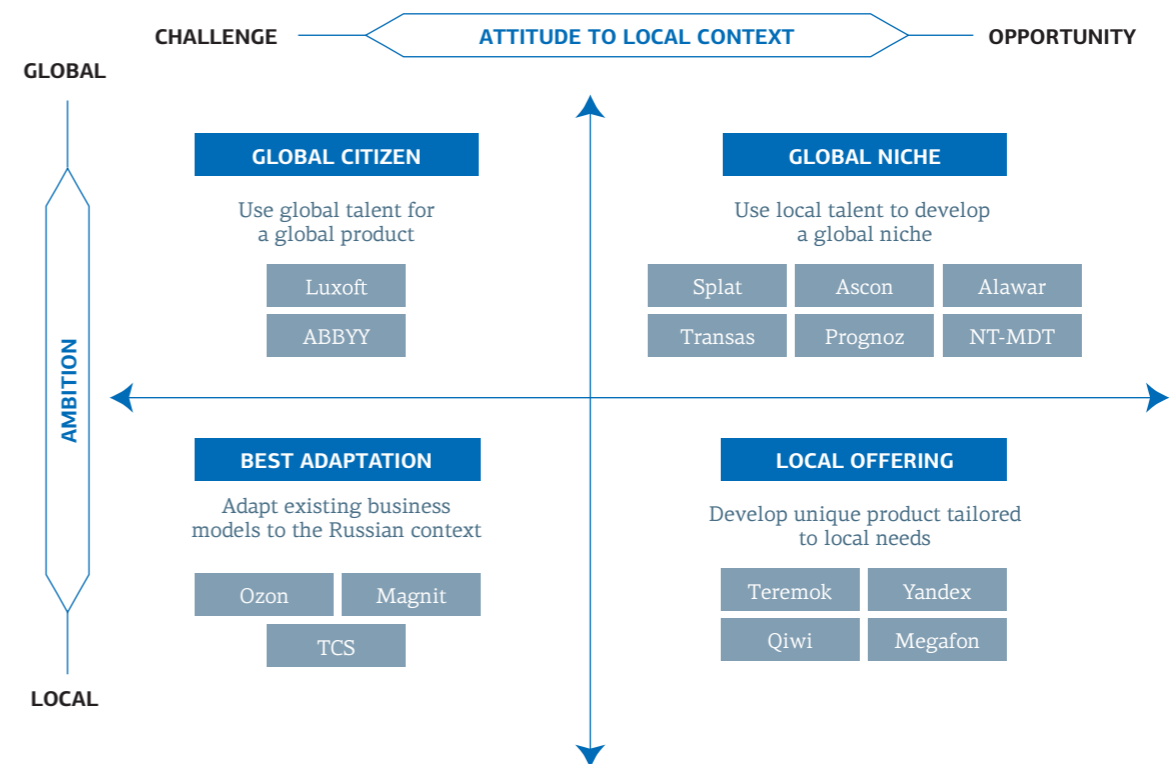
Below we consider their creative strategies to re-

companies in this study (see Figure 11).

Our major idea was to separate different approaches that the Selected 15 have undertaken while addressing or taking advantage of the specifics of the Russian business environment. Some considered the specifics of the Russian business environment a threat and successfully found a way to circumvent them, while others viewed them, instead, as an opportunity to create value and differentiate themselves from competitors.

Additionally, we have considered the approach of these companies to market positioning — either global or local — that they used to eliminate threats or create multiple benefits from opportunities. With all the diversity of the strategies below, there is one common feature for all of them: rapid deployment and a preference for market penetration strategies targeting the long tail of the market first.

FIGURE 11: MATRIX OF WINNING STRATEGIES



Source: SKOLKOVO Institute for Emerging Market Studies analysis



BEST ADAPTATION

These companies exclusively focus on the Russian market and use innovative operation strategies to successfully adapt global best practices despite shortcomings of the local infrastructure or the general immaturity of the market. In other words, they have implemented operation models that allowed them to adapt global business models for Russia's specific local conditions.

Creative operational strategies deployed by the most successful companies in this group helped them to bridge infrastructure and market gaps and build a competitive advantage. The most common solution was "in-sourcing" — building an in-house competence as a substitute for outsourced services. These in-house strategies typically evolved over time, as companies found innovative ways to use digital technology to improve and strengthen existing capabilities. In short, companies used digital technology to maximize performance of an internalized function and then

they started to offer services based on this function to the broader market. We have not found any spin-offs, but we believe this can be expected at a later stage as a natural outgrowth of overall market development and growing intensification of competition in the companies' core businesses.

By applying a best adaptation model, Russia's largest retail chain Magnit has outperformed not only its local peers but also global players competing within Russia. It has done this by relying on its in-house logistics and in-house programmers. The company maintains a homegrown, tailor-made ERP solution that is responsible for ensuring sufficient quantities of fresh goods on store shelves. In combination with a strategic decision to focus on small cities first while competitors were targeting more obvious opportunities in large cities, Magnit managed to secure the trust of customers and gain market share, while being almost invisible to competitors. As a result, it was too late for competitors to react once Magnit had already achieved a critical mass.

In a similar way, Ozon also used operational and logistical excellence to become a market leader. Back in 1998, with a Russian postal service

that was still quite unreliable and a cash-based economy, people could hardly imagine buying online. To overcome these problems, Ozon — the Russian version of Amazon — developed its in-house transportation unit and rolled out its own network of collection points all over the country to ensure people receive their orders in time and pay cash on delivery if they wish.

Once Ozon and Magnit's in-house logistics reached critical mass and high performance levels, the companies started to provide logistics services to third parties. This was not only a way to leverage existing assets — it also encouraged both companies to remain constantly attuned to the competitive needs of the market.

There is also a proven alternative to “in-sourcing” — and that is the removal of the weakest link from the chain. For example, Tinkoff Credit Systems — a consumer finance bank without a single branch — overcame the lack of a viable commercial real estate market within Russia by adapting its business model accordingly. It simply delivers credit cards by courier and provides all customer service online and via call centers.



LOCAL OFFERING

These companies also concentrate on the local market and outperform their global and local competitors by offering distinctive value propositions tailored to Russian consumers. Their success has been determined not only by their creativity but also by a deep understanding of current needs and future expectations of Russian customers.

Qivi is one of the most prominent examples of how the inefficiency of the local market and a lack of infrastructure can be converted into a promising business opportunity. In a predominantly cash-based Russian economy with rapidly growing cellular phone penetration, many people struggled to keep their accounts funded — payment points were rare and usually very busy. Qivi installed tens of thousands of cash payment terminals in crowded places like subway stations and malls where people could immediately top up their accounts with cash. This entrepreneurial success is obviously ephemeral, but it helped Qivi to win the trust of customers, build its

brand and gain a reputable global partner — the international payment system VISA.

Unlike the above, the following set of examples stand out not for their ability to overcome local shortcomings, but for transforming local specifics — such as the Russian language and Russian cuisine — into a platform for building competitive advantage.

As the “Russian Google,” Yandex successfully differentiated its search engine by the efficiency of search in the Russian language and the rapid introduction of locally relevant services, like Yandex.Probki, which helps drivers to navigate through traffic jams in large Russian cities, or Yandex.Taxi, which helps users to hail a taxi in minutes by simply booking the nearest among thousands of cars and hundreds of providers. What made these innovations possible was not just a sophisticated mathematical algorithm created by Yandex, but also the fact that the leaders of this company were sharing the same local environment as their customers.

How local can the global fast food chain be? Perhaps never as much as Teremok — a Russian chain that successfully challenges McDonald's and Burger King by focusing on traditional Russian blini (pancakes or crêpes) instead of the Western hamburger as a base for sandwiches and rolls. As well, the company has adapted its interaction with customers to reflect Russian traditions and styles, an important complement to the excellent quality of the product.

Anticipating future customer needs was probably the only choice for MegaFon, a late entrant to the Russian cellular market. MegaFon outperformed two other entrenched competitors by prioritizing data rather than voice traffic and focusing on providing fast and reliable connections where people usually use mobile data. The company focused on transportation providers like subways and airplanes, while simultaneously rolling out the network rapidly all over the vast Russian territory. As a result, the company has consistently delivered on its customer-centric motto: “The Future Depends on You.”



GLOBAL NICHE

The companies within the Global Niche category are dedicated to world-class single product excellence and outperform their

competitors in the global market by developing a strong and constantly improving core product and then offering multiple variations and versatile applications to their customers globally. No matter if a company deploys a cost-leadership or highly focused product strategy — the key success factor is attracting highly qualified people with strong academic backgrounds. As Anatoly Karachinsky, Founder and CEO of Russia's leading IT systems developer and integrator IBS Group, once remarked, engineers offer Russia the same type of competitive advantage as oil (Vedomosti, 2013). And, given the ability of Russia's engineers to drive innovation, this advantage has at least the same potential as oil for opening up global markets.

It is the unique mix of superior engineering talent nurtured by the Soviet Union's best scientific schools and the entrepreneurial drive of specific individuals that are the key factors in delivering a competitive advantage built on world-class performance at reasonable cost. To document this model, we have studied a number of high-tech players originating from remote cities that are home to Russia's foremost research centers, with some of them originally being part of Soviet-era military and defense clusters. Alawar, now a top global player in publishing and distribution of casual games, started as a game developer in Novosibirsk, which is home to some of the best engineering schools in Russia. Asccon, sprung from the military-industrial complex in Kolomna, challenges the global leaders in computer engineering and design. Prognoz, founded by a team of economists and scientists from Perm State University, successfully challenges Oracle in the creation of business intelligence applications. Transas, started back in late 1980s by sailors who enjoyed programming as a hobby, today is No. 1 globally in navigation systems. NT-MDT — No. 2 globally in sophisticated testing solutions based on atomic microscopes — was founded by researchers from Zelenograd, which is sometimes referred as the Soviet Silicon Valley. These companies are similar not only according to the origin of their success but also by the attention they constantly pay to the improvement of the core product or technology and development of integrated solutions around it.

There are other examples of the Global Niche strategy that are similarly based on attracting the best talent available, and using that human capital potential to create premium products. For



GLOBAL CITIZEN

In addition to product or service excellence, market acumen and best-in-class operational performance, the Global Citizen strategy involves setting up multiple locations and hiring talent worldwide — all of which is probably not what one would expect from a Russian company. Indeed, the examples of the Global Citizen strategy are very rare. Perhaps one of the best examples is Luxoft, which provides offshore software development. The company outperforms low-cost Indian competitors by focusing on developing sophisticated solutions for Western blue-chip companies. Most importantly, the company has service and delivery offices not only in cost-effective locations like Russia or Vietnam but also in locations with immediate proximity to the customer — such as the U.S. and EU. This is a model the company calls “near-shore” software development.

Another bright example is ABBYY, which initially developed as a Global Niche player; however, the product soon required local expertise in targeted markets. Thus, ABBYY has transitioned to a global citizen strategy based on establishing subsidiaries in foreign markets and then hiring local staff.

Chapter 3: Challenges Ahead



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The strategies built upon the capability to leverage local specifics helped the Selected 15 to achieve their principal competitive advantage and develop a winning value proposition. Moreover, the companies have proven their global competitiveness in the sense that they either outperform or at least challenge their international rivals in the Russian market, and sometimes, even globally. That raises the obvious question as to what extent these strategies can be a source of a long-term competitive advantage: have these companies found their secret ingredient to success or are there challenges ahead that can act as a brake on further growth and possibly even convert their advantages into disadvantages?

TOUGHENING MARKET The overall economic context in Russia is not as favorable as it was a few years ago. Along with other BRICS countries, Russia demonstrated rapid growth in the 2000s, peaking at a level of 10% annual increase. However, the economy was then severely hit by a global financial crisis that cost roughly 8% of GDP loss and resulted in a steep downturn in 2009. Although the economy picked up rather quickly, its growth has slowed down, demonstrating a lowering rate of increase: 4.3% in 2011, 3.4% in 2012, 1.3% in 2013 (World Bank, 2014) and projections close to 0% for 2014 and 2015 (OECD, 2014). Perhaps the economic slowdown by itself would not be a game-changer for these companies. However, it goes hand in hand with a general maturation of markets and intensification of competition both domestically and overseas. Increasingly difficult access to external financing, especially to capital markets, also places additional barriers for the companies' development prospects. Profitable global niches become too small to accommodate further organic growth. However, the overall country risk factor influences the attractiveness of Russian M&A opportunities for foreign buyers and can derail diversifica-

tion ventures, making it altogether difficult for the companies to not only grow but sometimes merely retain existing positions.

NARROWING CAPABILITY GAPS Over the last decade, business in Russia has experienced the effects of gradual development of institutions and public infrastructure as well as the emergence of greater competition between service providers and other intermediaries in the companies' value chain. Consumers have also become increasingly demanding and promiscuous. These factors narrow the gaps between market leaders and market laggards and, thus, eliminate the competitive advantage of the Selected 15 that built their success on leveraging market shortcomings or developing value propositions based on market inefficiencies. The improvement of the business environment over the last decade has also attracted new international players, which puts additional pressure on Russia's entrepreneurial champions.

COMPETING FOR TALENTS Many of the Selected 15 have achieved their position in the global market based on niche product excellence and a low-cost value proposition. Yet, their further geographic expansion and growth in existing markets are likely to require more sophisticated international strategies. Actually, for some companies it might be a matter of survival to transform themselves from successful exporters into truly global players with supply chain reaching across borders and operational hubs scattered around the world. Such transformation asks not only for different skill sets but also new approaches to talent management. This is particularly alarming considering that hiring and retaining highly skilled personnel has become one of the biggest challenges for Russian companies. It is even more so for those competing in market niches where intellectual capital is paramount. The inevitable increase of overall human capital

costs can potentially lead to the erosion of the competitive advantage based on access to low-cost, highly skilled talent.

Innovation Aptitude

The abovementioned observations undermine exactly what helped the Selected 15 to succeed: creative strategies that circumvent or take advantage of the local specifics. Thus, it is conceivable that, over time, current advantages will be no longer sufficient for sustainable long-term development. In fact, they may even turn into a tyranny of past success with strategies that worked in the past becoming less and less relevant for the future and causing the company to contract rather than grow.

Putting it differently — most of the companies in this study tend to rely on inside-out strategic thinking that places the product front-and-center while undermining business configuration and keeping customer experience on the periphery

Tougher challenges call for innovative solutions — not creative quick-fixes but an integrated and systematic strategy built around innovative capabilities. To evaluate to what extent the Selected 15 are up to face the challenge, we have screened their strategies through the Ten Types of Innovation framework developed by the innovation guru Larry Keeley and his partners (Keeley et al., 2013). The authors define innovation as the creation of a viable new offering and stress that, while innovation may involve invention, it actually means many other capabilities, such as deep understanding of customer needs, building partnerships, and developing creative business models. The framework divides innovations into three categories of innovation types: configuration (focused on how business is done), offering (focused on a company's product) and experience (focused on more customer-facing elements and distribution). Figure 12 showcases the evaluation of the Selected 15's strategies along these types, please refer to pages 28-29.

What we observe is that half of the companies take advantage of less than a third of their innovation potential. Most underutilized innovation areas are related to services, business models and customer engagement, while the most leveraged ones pertain to product, brand and distribution. In other words, the companies tend to focus on types of innovation linked to traditional strategic thinking (e.g. product functionality) while leaving more sophisticated strategic elements untouched.

Generally speaking, this approach to innovation is not uniquely Russian. L. Keeley et al. (2013) mention that focusing on product is a widespread path trap for many companies. However, this strategy is often easily copied and truly successful firms outperform their rivals by mixing and matching differing types of innovation. Greater and more sustainable value can be creat-

ed through innovative business model configurations and unique types of customer experiences; in comparison, product innovation on its own provides the lowest return on investment and the least competitive advantage.

Putting it differently — most of the companies in this study tend to rely on inside-out strategic thinking that places the product front-and-center while undermining business configuration and keeping customer experience on the periphery.

In order to achieve further growth and create greater value in tougher economic conditions, the companies will need to consider the outside-in approach that asks for more sophisticated business systems and puts customers and market opportunities first.

The fact that the Selected 15 collectively use all ten types of innovation illustrates that the overall Russian strategic landscape is relatively diverse. At the same time, innovation repertoire of individual companies is quite limited. What once sufficed as a business model would be in-

creasingly challenged in the future market conditions. Strategies built on creative exploitation of Russia's specifics from a decade ago are becoming less effective. The overall business environment is maturing rapidly, further eroding former sources of competitive advantage. Business models built around local specifics only are not able to provide long-term growth and the companies will be increasingly pressured to introduce more sophisticated types of innovation.

Pushing existing capabilities and rethinking innovative planning will certainly challenge the existing organizational routine and skillsets — a challenge that not every company can handle. Working through the transformation will also require a great deal of multi-disciplinary collaboration and patience. Additional difficulty comes from what once used to be a success factor: More than a half of the studied companies are still being run by their charismatic founders who sometimes rely more on intuition, "gut feelings" and teams assembled out of networks of friends rather than on disciplined management and professional executives.

Undoubtedly, the future will belong to those companies that manage to develop sophisticated strategies while their existing advantages

remain relevant and their current market niches are still profitable. Given the complexity of the transformation and hostile market conditions, there is no doubt that the challenge is daunting. Yet, in a rapidly globalizing world, there is just no way around.

FIGURE 12: SELECTED 15 ALONG THE TEN TYPES OF INNOVATION

ABBYY — Leading developer of document recognition, data capture and linguistic software; supplies globally by integrating into scanners and system software; has a subsidiary in the U.S.

ALAWAR — Started as a highly acclaimed casual game developer; supplied games via all major platforms across the globe; later switched to production and publishing.

ASCON — Producer of computer-aided design and engineering solutions; diversified into applications for the low end of the market and sells the core engine to other non-competing developers.

LUXOFT — Leading software developer focusing on complex tailor-made solutions; continuously optimizes its operational configuration to deliver high customer value; relies on highly skilled professionals as well as on implementation of advanced techniques.

MAGNIT — The largest retail chain in Russia; relies on in-house logistics, IT and sourcing for operational excellence; has built a strong brand with nationwide name recognition.

MEGAFON — Late entrant to telecom market; pioneers advanced mobile network services; attracts and incentivizes innovative talent; leverages its offering via a strong brand.

OZON — E-commerce giant constantly working on broadening its product range; introduced payment and delivery systems to ensure customer value; built up a brand with strong consumer recognition.

PROGNOZ — Continuously improves its best-in-class core product in business analytics software; retains strong links with academia to attract and develop the best talent in the industry.

QIWI — Originally an innovative micro-payments operator, successfully deploying a franchising model to install its terminals; now is engaged in an alliance with VISA and has shifted its focus to online payments; makes money on transactions as well as advertising.

SPLAT — Manufacturer of oral care products; recognized for original products; distributes through pharmacies and relies on word-of-mouth; engages emotionally with customers; built a strong brand.
















TEREMOK — Fast-food chain focusing on high-quality traditional Russian cuisine at affordable prices; created a unique style of service that resonates with local Russian consumers.

TINKOFF — Bank without branches that delivers credit cards via post and sales agents; emphasizes an aggressive brand promotion strategy; recognized for operational excellence, innovative offerings and alliances with adjacent service providers.

YANDEX — Continuously innovates in value-added applications built around its core Internet search engine; has a strongly recognizable brand; constantly nurtures its talent pool and creatively engages with service providers in adjacent industries.

TRANSAS — World-leading supplier of navigation and simulation systems; continuously introduces new solutions; effectively manages the international reach of its supply chain and distribution.

NT-MDT — Recognized developer of high precision microscopes; continuously innovates in new applications; maintains excellence on its manufacturing facilities in Russia, while effectively managing international distribution.

	Configuration			Offering		Experience				
	Profit Model	Networking	Structure	Process	Product Performance	Product System	Service	Channel	Brand	Customer Engagement
How you	make money	connect with others to create value	organize and align your talents and assets	use signature or superior methods to do your work	develop distinguishing features and functionality	create complementary products and services	support and amplify the value of your offerings	deliver your offerings to customers and users	represent your offerings and business	foster compelling interactions
	■	■			■			■		
	■				■			■		
	■				■	■				
			■		■		■			■
			■	■					■	
				■	■	■			■	
			■		■	■				
						■		■	■	
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			■		■	■				
		■	■		■	■			■	

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Source: Keeley et al., 2013, SKOLKOVO Institute for Emerging Market Studies analysis

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Despite the country's well-documented challenges, positive economic forces have been at work in Russia. Private business, which has grown almost unnoticed, is just one such example. No matter how fledgling, entrepreneurship in Russia has made its way through and yielded a multitude of examples of successful and competitive private companies. While generally being off the radar, particularly to the international audience, these companies represent a new generation of Russian business leaders that have made entrepreneurial culture and behavior part of their very core.

The Selected 15 companies studied in this report are remarkable for several reasons. With the majority of them launching in the turbulent 1990s, these companies have managed to survive economic downturns and post outstanding results despite the continuously evolving and often unpredictable landscape of Russian business. The country's regulatory gaps and infrastructure deficiencies did not impede these companies from developing. In fact, if anything, they seasoned them to be more resilient and creative. Many of the 15 companies highlighted in this report come from industries which did not even exist back in the 1990s, including many in B2C industries. Having established themselves as market leaders, these companies have often played a key role in shaping their industries and, sometimes, even creating them from the ground up.

The analysis of the Selected 15's strategies shows that these companies have managed to succeed notwithstanding the challenges of the Russian reality but often thanks to them. Despite their different industry affiliations, these companies have one thing in common: an entrepreneurial mindset, which is highlighted by their creative approaches to building and growing their businesses.

The actual strategy that the individual companies have pursued is defined by how they chose to respond to the specifics of the Russian busi-

ness environment. Some have considered the specifics of the Russian business environment a threat and successfully found a way to circumvent them, while others have viewed them as an opportunity to create value and differentiate themselves from competitors.

The entrepreneurial mindset also explains these companies' international aspirations. Global ambitions, not to mention global presence, are rarely observed among Russian mid-size companies. There is just no cultural model or business mindset to follow such pursuits and this is where the Selected 15 can become a role model for other companies in Russia.

However, the companies' winning strategies, which once were their strengths, can actually make them vulnerable in the future. Given the relatively undeveloped market conditions that existed in the late 1990s, these companies have done well by focusing mainly on product, brand and distribution in their innovation repertoire. Yet, such inside-out thinking, which puts the product at the center of the business model, might not work well in the face of today's challenges: unstable economic conditions, growing competition, and increasingly demanding consumers. All of these factors can place serious pressure on the performance and growth prospects of these market leaders. The bigger challenges call for more sophisticated innovations and necessitate outside-in thinking that relies on creative business configurations and enhanced customer experience. Going forward, then, these companies need to continue to think entrepreneurially and deploy creative, flexible, and consumer-centric business models that will help them to overcome the market hurdles of the future.

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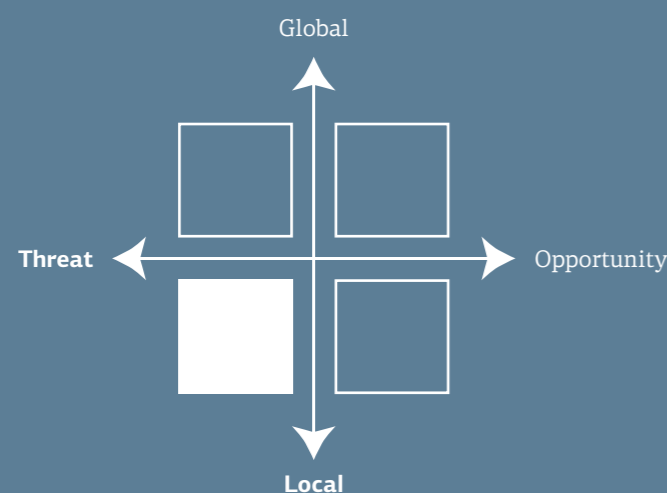
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Case Studies: Best Adaptation

- TINKOFF CREDIT SYSTEMS BANK (TCS BANK)
- MAGNIT
- OZON



Tinkoff Credit Systems Bank (TCS Bank)
 Sector: Retail banking
 Established: 2006
 Interest income: \$1,100 mln
 Origin: Moscow
 Employees: > 6,000
 CEO: Oliver Hughes
 Ownership: LSE-listed (GDRs), 50.9% Oleg Tinkov, 34.9% free float in GDRs, 14.2% international financial institutions
Tinkoff Credit Systems Bank (TCS Bank) is an innovative provider of online retail financial services operating in Russia. It offers remote access to its financial products (credit and debit cards, deposits, insurance, etc.) through online and mobile banking as well as call centers. It is now the third-leading issuer of credit cards in Russia, trailing only Sberbank and Ruskiy Standart.
www.tcsbank.ru

“In our country, no one can and no one wants to provide normal customer service.”
 — Oleg Tinkov, Founder and Chairman of the Board of TCS Bank

IN 2006, RUSSIAN ENTREPRENEUR OLEG TINKOV FACED THE CHALLENGE OF WHETHER HE COULD CREATE THE SAME TYPE OF CONSUMER BRAND WITHIN THE RUSSIAN BANKING SECTOR THAT HE HAD CREATED WITH TINKOFF BEER AND TINKOFF RESTAURANTS. TINKOV STARTED BY QUESTIONING WHAT A BANK SHOULD LOOK LIKE IN RUSSIA: INSTEAD OF FOCUSING ON BRANCHES IN MAJOR CITIES AND LOANS TO LARGE CORPORATE CUSTOMERS, TCS BANK FOCUSED ON MICRO-CREDITS FOR UNBANKED CUSTOMERS IN RUSSIA’S UNDERSERVED REGIONS AND DEVELOPED BEST ADAPTATION STRATEGY THAT ELIMINATED THE WEAKEST LINK: THE LACK OF A DEVELOPED COMMERCIAL REAL ESTATE MARKET IN RUSSIA. WITHIN SEVEN YEARS, TINKOV HAD CREATED A \$3.2 BILLION BUSINESS LISTED ON THE LSE. TCS NOW COVERS ALMOST 600 CITIES NATIONWIDE AND OPERATES OVER 4.3 MILLION CREDIT CARDS AND OVER \$1.3 BILLION IN CUSTOMER DEPOSITS, MAKING IT ONE OF RUSSIA’S LEADING BANKS.

Creating new consumer brands in highly competitive markets and developing aggressive marketing strategies are Tinkov’s strong suit. In the Russian business community half-educated in Leningrad Mining Institute, Russia and a graduate of the University of California, Berkeley, USA, Oleg Tinkov is famous as one of the most eccentric entrepreneurs in Russia with a knack for buying and selling at the right time. The idea of a new project emerged in 2000 when Oleg Tinkov came to San Francisco and, from the comfort of his home, was able to open a bank account, take out an insurance policy and receive

credit cards from the local bank. It inspired him to create a similar banking business in Russia, but sufficient investments appeared only in 2005 after the sale of his beer business. In September 2006, he bought a blank check bank with a license and renamed it “Tinkoff Credit Systems.” This virtual bank, which didn’t have a single branch, began to specialize in supplying credit cards that offered customers low initial limits that could be increased, depending on repayment behavior. TCS Bank guaranteed 24/7 high-quality customer service throughout Russia that would be provided via phone and the Internet.

“... The model of my bank has been successfully tested in such a competitive market as the American one.” — Oleg Tinkov

The TCS Bank business model was based on the experience of Capital One and ING Direct, with the goal of providing innovative solutions for the Russian retail banking sector and creating competitive advantages for TCS over its traditional rivals. By rejecting the need for offices and making a full transition to a remote service model, TCS saved up to 70% on offices costs, up to 60% on staff and up to 80% on ATMs in comparison with traditional retailers. A core of the business model was TCS Bank's high-tech platform developed with the technical support of MasterCard Advisors that cost \$20 million — almost seven times more than the systems of the bank's most advanced competitors. The bank's virtual model relied on the most modern and high quality software solutions and equipment. As a result, improving the quality of services and creating in-house IT solutions has become a key competency for TCS Bank.

Being himself unfamiliar with the banking business, Tinkov set about attracting the best market experts and formed a highly competitive retail banking team, which was rather challenging for a highly risky startup. Boston Consulting Group prepared an initial market study, MasterCard Advisors, which usually works with existing leading banks agreed to provide technical support, and recruiting agency Egon Zehndler searched for top executives and managers. Oliver Hughes also agreed to join the project as TCS Bank CEO and placed at stake his professional reputation that was built up as a VP for Visa International (CEMEA region). The bank's operational staff mainly consisted of top ranking graduates from the departments of the most prestigious Russian mathematical and technical universities.

questionnaires and trying to withdraw cash from paper cards in advertisements that looked similar to real ones. As Tinkov remarked, "Using direct marketing, TCS Bank managed to reach the most financially illiterate people in the country." As a result, TCS decided to create its own service of "smart" couriers and sales agents to educate clients and bring the product to life. Today, about 15% of all employees are engaged in this activity, while another 20% of the bank's employees answer questions by phone.

In 2007, the first influx of clients appeared and contributed to the bank's word-of-mouth advertising. By the end 2008, the bank was already beginning to show the first profits using the opportunities of the growing market and relatively high interest rates (35-50%). As its credit portfolio increased, the range of products diversified. Whether they were TCS-only products, or products developed with partners, all of these products were based on the same mix of innovative technology, cutting-edge marketing strategies and a singular focus on delivering more value and convenience to customers than its competitors. In 2012, TCS Bank launched a new credit card product ("Tinkoff ALL Airlines") and a new unsecured lending product ("POS") that allowed customers to make online purchases through Internet retailers with over 300 virtual partners. TCS Bank also experimented with innovative formats of payments like e-wallets and contactless payments to diversify its product portfolio. Due to its efforts, TCS Bank was awarded as the Best Internet Bank in Russia in 2012, according to Global Finance rankings, and The Bank of the Year in Russia in 2013, according to The Banker.

"We have a very strong team — one of the strongest in the market. Everyone who was the best in the credit cards business in the former Soviet republics, we have collected in our bank." — Oleg Tinkov

Despite the implementation of a business model that had been validated in Western markets and the recruitment of a highly professional team, winning over Russian customers was not that easy. To reach the target audience, TCS Bank applied direct marketing techniques such as sending mail via post to 60 million potential customers. This created one of the sector's biggest databases, but the average response rate was less than 1%. People were sending back blank

Winning in capital markets seems to be easier for TCS. After the first sale of a minority stake to Goldman Sachs in the initial six months after the start of the project, another one was sold to Vostok Nafta and other financial institutions. In 2008-2009, when the bank faced budget deficits, Tinkov raised funds through his friends, business partners and customers' deposits. It took the company less than five years to boost its capitalization seven-fold and start prepa-

rations for IPO. In 2013, TCS Bank raised \$1.1 billion in an oversubscribed IPO on the London Stock Exchange. TCS priced its global depository receipts at \$17.50, giving the company a valuation of \$3.2 billion.

Going forward

Since the IPO, the value of TCS global depository receipts have fallen as low as \$5, primarily due to the negative situation in the Russian retail banking industry overall. Still, TCS is showing higher profits and boasts a better quality credit portfolio than competitors and is continually exploiting new opportunities for growth, including the acquisition of Mosk-

va Insurance Company to capitalize on possible synergies with the client bases of both businesses. Oliver Hughes states that the bank has to tighten its risk control procedures, since consumer payment discipline is deteriorating in general. Annual growth rates in retail banking, especially in credit cards, continue to decline. In addition, regulators are planning to implement new restrictions for retail banks in order to cap maximum interest rates. Finally, TCS continues to face a tougher regulatory environment from the Central Bank of Russia, including stricter capital guidelines. All of this creates a number of challenging competitive issues for the bank.



Magnit
Sector: Food retail
Established: 1994
Revenue: \$18,202 mln
Origin: Krasnodar
Employees: > 230,000
CEO: Sergey Galitsky
Ownership: LSE-listed (GDRs); Sergey Galitsky and Vladimir Gordeychuk (53%)
Magnit is the largest food retailer in Russia. It operates over 8 000 stores across the country with a wide presence in Russia's regions.
www.magnit-info.ru

“Business sustainability depends not on the size of the company but on the effectiveness of the business model which you have built.”

— Sergey Galitsky, Founder and CEO of Magnit

MAGNIT IS A BEST ADAPTATION STRATEGY SUCCESS STORY, WITH THE BUSINESS EXPANDING FROM ONE STORE IN THE MID-SIZED CITY OF KRASNODAR IN THE SOUTH OF RUSSIA TO A NATIONWIDE RETAIL EMPIRE WITH UNRIVALLED LOGISTICS CAPABILITIES. OVER THE YEARS, THE COMPANY HAS GROWN ORGANICALLY WITH FOUNDER SERGEY GALITSKY BEING A KEY VISIONARY BEHIND ITS SUCCESS. THE COMPANY SUCCESSFULLY DEVELOPED A WORLD-CLASS LOGISTICS OPERATION AND FINE-TUNED ITS BUSINESS MODEL WITHIN A LIMITED GEOGRAPHIC AREA BEFORE EXPANDING TO RUSSIA'S MAJOR CITIES. IN-HOUSE PROGRAMMERS USING CUSTOM ERP SOLUTIONS ENSURED TIMELY DELIVERIES TO RETAIL STORE SHELVES ACROSS RUSSIA. IN APRIL 2013, FOR THE FIRST TIME IN ITS 15-YEAR HISTORY, MAGNIT BECAME THE #1 RETAILER IN RUSSIA. IN 2014, MAGNIT TOPS THE BOSTON CONSULTING GROUP'S 2014 LIST OF VALUE CREATORS IN THE RANKING OF “THE RETAIL TOP TEN,” OUTPERFORMING SUCH GLOBAL RETAILERS AS WHOLE FOODS, STARBUCKS AND AMAZON.

For retail in Russia, the name of the game is logistics. The vast size of the country, underdeveloped infrastructure, unreliable suppliers and limited options for outsourcing logistics make it a tough place for a business to survive, let alone to succeed. Magnit has managed to do

items but gradually went on to develop its own IT expertise. Today, there are over 200 in-house programming specialists who work on a continuous refinement of the enterprise resource software that feeds into the inventory management and distribution.

“I think that technologically our business is one of the most difficult. We have 5.5 million customers a day and this is around 40 million transactions and 2,500 payment settlements with suppliers. Every day about 2,500 — 3,000 trucks arrive at and leave our warehouses. This is very difficult process-wise.”
— Sergey Galitsky

just that. Its combination of efficient logistics, advanced IT systems and smart operations has pushed the company to the top of the Russian food retail industry.

The company's focus has been on building in-house competencies. It transitioned to a technology-driven model early on. All its operations, especially logistics, are heavily automated. Originally the company deployed external ERP sys-

Magnit has also brought its supply chain completely in-house. Today it has a fleet of almost 5,000 trucks, making it Russia's largest shipping company. To ensure consistent quality and timely delivery of produce, in 2011 Magnit made the decision to set up its own greenhouses. Once its “Green Line” complexes reach their full capacity in 2015-2016, they are expected to supply up to 70% of Magnit's products. абвгд Magnit's

“We establish greenhouses for the simple reason that in Russia it is impossible to buy some vegetables — cucumbers and tomatoes — in a good quality. We have to develop this in order to meet the needs of our clients.” — Khachatur Pombukhchan, Magnit CFO

market strategy sets it apart from its main competitors. Originating in the Russian regions, the retailer began to emphasize and learn two main capabilities — focusing on small cities and serving price-sensitive consumers. That was at a time when incumbent retail chains were going for the affluent yet highly competitive markets of Moscow and St. Petersburg.

The company's early mover advantage helped it to secure best-available retail spaces in cities across Russia. This asset is now becoming of critical importance in an increasingly dense retail market. Magnit's regional expansion has always been incremental. When entering a new region, the company opened up a few stores, built a distribution center, studied the local market and only then went on to establish a wider retail network. This enabled the retailer to gradually adjust its logistics and IT systems — something that its competitors failed to do when they eventually started their regional pursuits. Targeting the lower end of the market facilitated Magnit's expansion. On average, a Russian household spends around 40% of its budget on food, which

makes it highly price-sensitive.

Strong and confident, starting from 2012 the company set out to conquer the big cities. In the first nine months of 2013 alone, the company opened 903 new stores in large cities across Russia, including 80 in Moscow and 30 in St. Petersburg.

Going forward

The Russian retail market is becoming increasingly saturated. Nevertheless, Mr. Galitsky has set aggressive plans for the next five years and places high hopes on new formats and product categories. By 2018, the chain is expected to enlarge to 12,000 “around the corner” stores, 650 hypermarkets and 4,500 beauty shops. Compare this to the 2013 numbers of 7,500, 178 and 685, respectively. These are ambitious plans given that Magnit holds only 6% of the Russian retail market, but there is definitely still room to grow.

Ozon
Sector: Online retail
Established: 1998
Revenue: \$750 mln (Ozon Group)
Origin: St. Petersburg
Employees: > 2,400
CEO: Maelle Gavet
Ownership: Private; Baring Vostok, AFK Sistema, MTS, ru-Net, Index Ventures, Alpha Associates, Rakuten, Cisco Capital, Holtzbrinck Ventures
Ozon.ru is one of the largest online hypermarkets in Russia. Its assortment consists of more than 3.5 million different products including books, movies, music, games, software, electronics, consumer goods and general merchandise. The company's website receives up to 15,000 orders a day and is available to over 6 million customers.
www.ozon.ru



“Yet our similarity to Amazon isn’t why we’ve succeeded. To understand that, you have to look at the challenges of Russia’s retail environment, which is very different from America’s or Western Europe’s.” — Maelle Gavet, CEO of Ozon Group

THE CONCEPT OF BUILDING A “RUSSIAN AMAZON” TURNED OUT TO BE MORE DIFFICULT THAN THE TWO CO-FOUNDERS, ALEXANDER EGOROV AND DMITRY RUDAKOV, EVER ENVISIONED. OZON WAS ESTABLISHED AT A TIME WHEN THE INTERNET IN RUSSIA WAS STILL EMERGING AND E-COMMERCE WAS PRACTICALLY NON-EXISTENT. THE NEW START-UP FACED A LONG LIST OF OTHER OBSTACLES AS WELL: LACK OF EXPERIENCE ON PART OF THE FOUNDERS TO UNDERTAKE SUCH AN AMBITIOUS PROJECT, LOW LEVEL OF CONSUMER READINESS FOR ONLINE SHOPPING, AND A LACK OF INFRASTRUCTURE TO SUPPORT LOGISTICS AND ORDER FULFILLMENT. THIS LED THE COMPANY TO DEVELOP THE BEST ADAPTATION STRATEGY. THE COMPANY BUILT IN-HOUSE COMPETENCY, ENABLING OZON TO OVERCOME INFRASTRUCTURE AND LOGISTICAL CHALLENGES IN THE RUSSIAN MARKET. BY CONTINUALLY FINDING INNOVATIVE WAYS TO DELIVER ON ITS PROMISES TO CUSTOMERS, TODAY OZON IS A LEADER IN RUSSIAN E-COMMERCE AND THE MOST POPULAR ONLINE STORE ON THE RUNET.

E-commerce is all about convenience: a user-friendly interface, a wide variety of products and timely delivery, and the availability of convenient and reliable payment options. These are no obvious attributes for an e-commerce pioneer in Russia. Ozon has literally had to develop these capabilities and processes around them from the ground up. While the technical background of its founders facilitated technological issues around the website, product sourcing and category management turned to be a challenge. In the beginning, many publishing houses and offline book retailers were distrustful of the young Internet venture. Others proved to be unreliable. There

were times back in the late 90s when Ozon employees had to go to a local book market to buy a print in order to fulfill a customer order. For category management, the company had to set up its own editorial office and hire literature experts to compile databases, write product descriptions and assign unique numerical codes. Today, smart IT systems support all Ozon’s processes, including search algorithm, customer loyalty program, order tracking systems, diverse payment mechanisms and many other. However, Ozon’s biggest success stems from its ability to address deficiencies inherent within the Russian market.

“No amount of web functionality can make up for a parcel arriving late or not at all. ... People don’t pay until the parcel is delivered. That means if you don’t deliver, you don’t get paid — and you handle a lot of cash.” — Maelle Gavet

Unreliable distribution systems, combined with a weak national postal service and a predominantly cash-based economy, have made it immensely difficult for Ozon to deliver on its promises to its consumers, especially in smaller cities. To solve this logistical problem, in 2011 Ozon went on to set up its own distribution company, O-courier, which now operates in more than 500 cities across the country and relies on over 2,000 pickup points. Having its own logistics solution is also instrumental in controlling cash-based payments, which still remain the dominant preference among Russian consumers.

“This would be a source of competitive advantage that could not easily be replicated: Why give up control of such a key link in the value chain?” — Maelle Gavet

No matter how much Ozon has advanced in its logistics, commoditization of services starts to take place. Amidst the tightening competition, Ozon has managed to grow through widening and diversifying its product variety. Starting in books, audiotapes and movies, Ozon has moved into electronics, household goods, software and eventually travel services as part of its startup project Ozon.travel. It is estimated that in 2012 alone, Ozon’s revenue increased by 91% mainly due to the widening of its assortment that year. The company also made a major acquisition of online clothes retailer Sapato.ru — the Russian version of Zappos. As of 2012, the new additions accounted for about 39% (Ozon.Travel) and 18% (Sapato) of the Group’s sales with Ozon.ru accounting for 42%.

“That’s the Ozon story: Creating a business model and a team that can adapt and grow with the huge opportunities we have.” — Maelle Gavet

Going forward

Ozon is without a doubt a behemoth of Russian e-commerce. Yet in recent years, it has lost much of its competitive advantage. At the same time, the development of Russia’s online market still has a long way to go. Out of 140 million people in Russia, approximately 55% are online and only around 15% use the Internet to shop. This leaves many opportunities for growth.

Ozon’s likely next sources of revenue will come from further expansion of its customer base, possibly through acquisitions as well as leveraging its existing platform to provide B2B services. The latter is actively being explored by the company O-courier, which in addition to handling Ozon’s own orders provides logistical services to other online retail companies in Russia. Ozon’s eSolutions functions as an e-commerce enabler for third-party merchants. It is aimed at Russian and foreign e-retailers seeking to benefit from Ozon’s expertise in Russian e-commerce, technological solutions, order processing and deliveries.

The market challenge is no news for a company that is known to not only survive critical moments but also use them as a springboard for the next great move.

Case Studies: Local Offering

- QIWI
- YANDEX
- MEGAFON
- TEREMOK



QIWI
 Sector: Banking, High-tech
 Established: 2009 (through a merger of companies established in 2004)
 Adjusted net revenue: \$188 mln
 Origin: Moscow and Kemerovo
 Employees: > 1,000
 CEO: Sergey Solonin
 Ownership: NASDAQ-listed; Mail.ru Group, Mitsuni Fudsan, Platinum Investment Management, company management
 QIWI is a provider of payment services in Russia and the Commonwealth of Independent States (CIS). The Company has an integrated network that enables payment services across physical, online and mobile channels.
www.qiwi.ru

“QIWI’s secret to success can be formulated like this: the will plus the desire to break through the limit of possibilities. If we look at the evolution of QIWI products we’ll see that each new product did totally cannibalize the previous one.” — Boris Kim, Co-founder and Chairman of the Board of QIWI

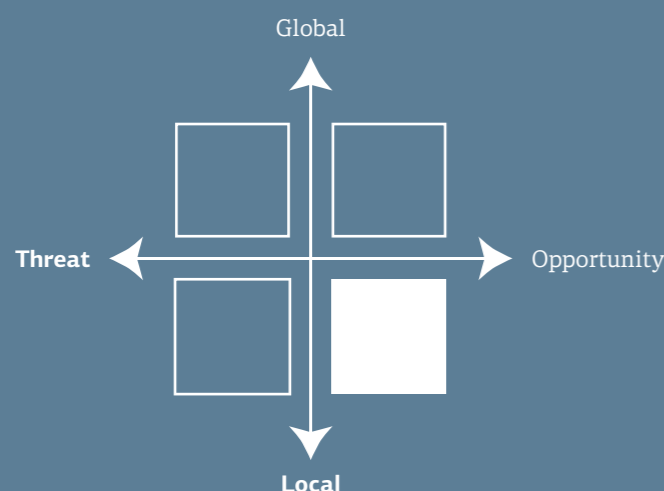
DURING THE EARLY 2000S, RUSSIANS FACED A GROWING PROBLEM — HOW TO PAY FOR SERVICES SUCH AS MOBILE CONNECTIONS IN AN EASY AND CONVENIENT MANNER WHEN MANY OF THEM DID NOT HAVE CREDIT OR DEBIT CARDS, CHECKING ACCOUNTS WERE ALMOST UNKNOWN, AND INTERNET BANKING WAS STILL YEARS AWAY FROM BEING A REALITY. QIWI SOLVED THIS PROBLEM BY APPLYING LOCAL OFFERING STRATEGY, DEVELOPING A UNIQUE OFFERING TAILORED TO THE NEEDS OF LOCAL CUSTOMERS. QIWI CREATED A NATIONWIDE NETWORK OF MACHINES THAT CAN TAKE IN CASH AND THEN TRANSFER PAYMENTS TO A NUMBER OF PRE-SELECTED SUPPLIERS, INCLUDING MOBILE OPERATORS AND UTILITY COMPANIES. CREATING A VAST NETWORK OF EASY-TO-USE TOUCH-SCREEN TERMINALS FOR HANDLING HIGH VOLUMES OF MICROPAYMENTS GAVE QIWI A COMPETITIVE ADVANTAGE AGAINST OTHER RIVALS. THE SOLUTION FOR CASH PAYMENTS WAS ESSENTIALLY A “REVERSE ATM” THAT COULD BE INFINITELY NETWORKED AT RELATIVELY LOW COST.

This solution, in which the owner of a payment terminal receives income from commissions (usually 10-15%) either from the payer or — increasingly — from the receiver of the payments, really took off and now the number of payment terminals in Russia is estimated at over 220,000 — four times the number of ATMs. And some 120,000 are part of the QIWI network, by far the biggest system of electronic payments in Russia with a total number of users estimated at 70 million (roughly half of the entire population). Moreover, 15 million of them are the owners of personalized, though anonymous, accounts.

The whole system works mostly with micropayments with the average check being about just 30 rubles (1 dollar). This sum will typically cover 2-3 days of mobile phone usage and it appears that consumers find certain psychological com-

fort by operating within such a short timeframe. The majority of operations are made by the fully “unbanked” part of the population — semi-employed, self-employed and numerous migrant workers from the countries of the former Soviet Union — but almost every Russian uses occasionally the services, thanks to the number of the terminals, many of which operate 24/7. However the sum total of the micropayments is impressive. In 2013, total payments were estimated at 1.1 trillion rubles (over \$30 billion). About 85% of the sum is processed through freestanding terminals, while the rest comes through devices operating within bank branches alongside traditional ATMs.

The idea of the payment terminal is believed to be pioneered by a company called Elexnet around the year 2000. The QIWI of today was formed through the merger of two companies



in 2009, E-port and OSMP, from Moscow and Kemerovo respectively, which entered the terminals business around 2004. In 2012 Qiwi conducted an IPO and is now traded on the NASDAQ, where its market capitalization is just under \$2 billion. It has also tried to expand its geography of operations, expanding to the CIS markets (Belarus, Kazakhstan and Moldova) and also to Romania, Brazil, Jordan and even the U.S. The franchise was sold to another 15 markets. Yet, this expansion has not yet provided a substantial source of revenue primarily because it has been hard for Qiwi to find and hit in these foreign markets the same sweet spot of infrastructural deficiency. Countries with a longer history of banking have consumers with settled payment habits and routines that may be very slow to change. For the developing world, the solution appears rather expensive and demanding for the communications infrastructure. Thus, markets like Kenya prefer to rely on simple mobile P2P payments rather than building an entire hardware network.

However, within Russia, the company is an undisputed success. Consider that the pioneer of the micropayments market, Elexnet, now has a network of just 3,700 devices — about 3% of the size of Qiwi, which put its first terminal into service some four years later.

The first players on the market seemed to be overly concerned with the issues of security and fraud prevention. It went without saying that too big a network would become unmanageable from this point of view and would soon go bankrupt because of losses. Qiwi challenged this assumption, choosing to focus on the quick growth of the network through franchise agreements with tens of thousands of agents. This strategy paid off. The small retailers found an opportunity to receive some additional income at no cost or risk — the only thing required was 1 square meter of floor space and an electric socket.

Owning a network bigger than the number of ATMs in the country generated huge cash flows that turned Qiwi into a very important mechanism of payments for such powerful market players as the three leading mobile operators (MTS, VimpelCom and MegaFon, with a combined market share of 90%). Those companies are quite famous for their ability to negotiate beneficial deals from any supplier, but this time they suddenly met a powerful opponent. Qiwi was among the first on the market who secured “zero commission” deals for its customers — meaning that the receiver of the payments, the mobile op-

erators, took it on their account to remunerate the network. This obviously created a significant competitive advantage on the customer side — generating still more cash flows and strengthening the company’s bargaining power. And the fraud risks turned out to be quite manageable.

Another factor of market success was the friendly user interface. The terminals often cater to the segment of the population with limited education or computer experience, including many immigrant workers with poor ability to read Russian. Having a truly intuitive interface is essential for attracting and retaining such an audience and Qiwi came close to perfection in its design. It was also among the first to introduce a system of accounts that are identified by mobile number and require no formalities in opening. These store the settings of frequently done payments — much like modern Internet banks — and allow doing repeat payments easily and quickly. The system was later “exported” into the Internet, providing a local analogue of PayPal. Those moves turned Qiwi into a well-known and highly trusted brand that stood out in the generic market of payment services.

Going forward

The company is currently structured according to three business lines: the terminals network, an online payment system, and an advertising service (which could potentially provide monetization opportunities based on the reach of the company’s audience of 70 million). The latter activity is relatively new for the company, and it has uncertain market potential since very few advertisers have the possibility to segment and target consumers by payment volume.

The brightest days of the terminals are passing. With all their convenience, they are a less comprehensive solution than a bankcard, not to mention an Internet bank. The customers who honed their basic skills of personal finance through the friendly interfaces of Qiwi systems are now ready to become regular bank clients or to use online payments without leaving home. In 2013 the online payment systems for the first time overtook the terminals in market share — and this trend will likely continue. This may be the usual fate of frugal innovations in any emerging market —

their lifespan is limited, as the “mainstream” infrastructure provides a more comprehensive customer solution. And they have limited export possibilities — the technology and the very business model often is too market-specific.

Qiwi management is fully aware of the trend and actively seeks diversification. The company is increasingly focused on its online payments busi-

ness. In 2012 a strategic alliance with VISA was signed, and the whole system is now branded as Visa QIWI Wallet. Virtual payment cards for secure online purchases have been introduced, and this is a promising business — e-commerce in Russia has significant potential for growth (its overall market share is almost 5 times lower than in the U.S. or the UK).

“The company will continue to grow. This is a unique product. There are no direct analogies because of our product mix, chain effect of the terminals, our presence both in the physical space and online.” — Sergey Solonin, Qiwi CEO, in an interview with Bloomberg

Yandex

Yandex

Sector: High-tech

Established: 1993

Revenue: \$1,207 mln

Origin: Moscow

Employees: > 5,300

CEO: Arkady Volozh

Ownership: NASDAQ-listed

Yandex has recently become a very high-profile case both globally and within Russia as “the Russian Google.” Yandex has expanded beyond basic search to include functionality related to online advertising, e-commerce, payments and data analytics.
www.yandex.ru



“Any good business is a hobby.” — Arkady Volozh, Co-founder and CEO of Yandex

CREATING A MULTI-BILLION-DOLLAR COMPANY CAPABLE OF GOING HEAD-TO-HEAD WITH GOOGLE IN THE RUSSIAN SEARCH MARKET ALL STARTED WITH NICHE SOFTWARE THAT WAS ORIGINALLY DESIGNED AS A DOCUMENT SEARCH SOLUTION. THE COMPANY HAS FOCUSED ON BECOMING A LEADER IN LOCAL OFFERING, PROVIDING AN INTERNET SEARCH SOLUTION CUSTOMIZED FOR RUSSIAN LANGUAGE USERS. YANDEX BEGAN TO MONETIZE SEARCH BY SELLING ADVERTISING BANNERS AND TEXT ADS, AND BY THE MID-2000S, THE RUSSIAN ONLINE ADVERTISING MARKET HAD BECOME ATTRACTIVE ENOUGH THAT GOOGLE MADE AN ACQUISITION BID FOR YANDEX. THE COMPANY HAS CONTINUALLY BOOSTED ITS R&D EFFORTS, STRENGTHENED ITS SALES E-TEAMS, AND RELENTLESSLY SEARCHED FOR NEW PRODUCT OFFERINGS TO MEET CUSTOMER NEEDS. YANDEX NOW CONTROLS NEARLY TWO-THIRDS OF THE RUSSIAN INTERNET SEARCH MARKET, AND HAS EXPANDED INTO ADJACENT MARKETS WITH NEW PRODUCTS FOR E-COMMERCE, DATA ANALYTICS, AND ONLINE PAYMENTS.

In 2000, Yandex attracted its first round of external investments when ru-Net Holdings put \$5 million into the venture, a record-breaking sum at that time. The company was making money through selling advertising banners and within a year, new text ads were added. The new format looked more like a secondary source of business in the beginning, but started to grow at an en-

seemed to find the text ads very useful — unlike the traditional banners that were largely seen as distracting. The new system blurred the line between “advertising” and “content,” a concept that seemed to be firmly established in the business.

By the mid-2000s, Yandex had become the dominant search engine in Russia, outcompeting

“We’ve been in the business longer than other search engines and have created many original products.” — Arkady Volozh

couraging pace. In the first year, it attracted more than 2,500 advertisers, considerably expanding the customer base. An important feature of the system was its full automation — even if it was not generating huge revenues, it added almost no costs, unlike the traditional process of ad sales. Another unexpected outcome was that the users

a few other local startups.

Its competitive advantages were a superior quality of search and the concept of “light” interface design, providing maximum speed of response. At about the same time Google was conquering the U.S. market with the same vision of “nothing matters, but speed and quality of search.” Around

the mid-2000s, the Russian market of online advertising became visible enough that it attracted the attention of Google, which was looking to add yet another market to its search empire. There were extensive M&A talks between the two companies, but Yandex pulled out when it became clear that the U.S. giant intended just another acquisition, not a merger of equals. While the relative size of the business justified such an approach, the Russian team felt that it had some superiority in technology.

And so the battle started — in 2006, Google officially launched in Russia its localized search site as well as its AdWords sales engine. Yandex responded through intensifying its research and development efforts, strengthening the sales teams for all types of clients, and also launching its first major consumer advertising campaign. It was probably its success with Russian small businesses that was instrumental in winning the battle. In the world of text-based ads, the more advertising Yandex collected, the more useful it appeared to the audience — a paradox within the traditional advertising paradigm. After some initial successes by Google, the local incumbent managed to restore its share of Internet searches to about 67%, with an even higher share of the related advertising market. This situation seems stable enough in the past two to three years, making Russia one of just four countries in the world where the American giant is not the leader. Both the technology and the business operations of Yandex have passed the most challenging test. It looks very simple for an uninformed user: You type in a phrase or a question and you immediately get back the list of Internet sites which contain the information that is relevant to your query. Yet when doing this you are in fact employing the services of one of the world’s most sophisticated pieces of applied mathematics and linguistics. From understanding what you actually meant by your request to the definition of what could be relevant to you, depending on the analysis of your previous searches — all this is the result of millions of man-hours of development. The key source of monetizing this is advertising, with the majority of income now coming from text ads (Yandex, unlike Google, also sells banners). However, the company is on an active search for new applications and sources of revenue. The same mathematics that powers Internet search can be used in a host of other analytical applications. The expansion of the business depends

on the company’s ability to invent as many services as possible using the same mathematical “core.” Whenever Yandex succeeds in this it creates both a new revenue stream and another strong tie with the audience, with no real increase in its cost base. Building these services around areas that are more or less specific to Russia permits Yandex to gain a competitive advantage against Google.

Probably the second most popular service of Yandex is the real-time analysis of traffic jams in Russian cities, Yandex.Probki, which is available both for desktop computers and mobile devices. Yet the question was how to make money out of it — especially given the traditional unwillingness of Russians to pay subscription fees. The company came with the idea of the Yandex.Taxi service, which enables Russian taxis to reach clients in close proximity, while clients can choose the taxi that will be either quicker to pick up, the cheapest or the most comfortable. The service is used monthly by 110,000 people on average three times a month, providing another example of turning the peculiarities of Russian infrastructure into a lucrative business.

Yandex has ventured successfully into online payments, introducing the Yandex.Money system as early as 2002. In 2012 its majority share was sold to Sberbank, the largest Russian bank. Another successful major development was Yandex.Market — a service that searches e-shops, compares prices and provides some parts of the logistics for e-tailers.

Projects like these make the company ever hungry for advanced data experts so that it had to open its own School of Data Analysis in 2008, providing a free two-year Masters’ program. The move also ensures that the company has a lock on the best data talent on the market — a move comparable to proactive bidding for potentially oil-rich land by oil companies.

Going forward

Despite its very effective business expansion, Yandex is still very dependent on its advertising revenue, which is quite a volatile source. No matter how effective its search technology or customer service may be, a slowdown in this market will put a strong check on the company’s double-digit growth rate.

Google is facing the same sort of challenge globally and seeks to solve it through an ambitious M&A program aimed at diversifying revenues. Yandex does not have the pockets that deep. Targeted organic diversification is needed and the company actively pursues new business venues, based on its core competence in technology of data analysis. Recently it has started to apply its “big data” skills to a completely new field, geological analysis for oil and gas exploration (the Yandex.Terra project). Theoretically there is huge room for efficiency improvement in this process which is vital for any oil company, so if the experiments are successful Yandex has a chance to become a key supplier to giants like Gazprom or Rosneft. On the other hand dealing with such customers — powerful, bureaucratic and conservative — may require creating completely new sales and client services skills.

Expanding in electronic payments on the basis of Yandex.Money is another interesting option. Much is said now in financial circles about the possibilities of new, smarter algorithms for credit scoring and risk management. If the company finds a way to apply its audience knowledge for the benefit of its partner Sberbank (which has a personal loan portfolio alone worth over \$100 billion) the resulting revenues have the potential of overshadowing the current flows from advertising. The company seems to be on the verge of very important strategic decisions — maybe the biggest ones since pulling out of the Google M&A deal. Thinking big and broad — that’s what is required to sustain the track record of strong growth.



MegaFon
 Sector: Telecom
 Established: 2002
 Revenue: \$8,400 mln
 Origin: Moscow/St. Petersburg
 Employees: >33,500
 CEO: Ivan Tavrin
 Ownership: LSE-listed (GDRs); TeliaSonera, Telecom Holding, Allaction Limited
 MegaFon is one of the largest telecommunications operators in Russia. It is a leader in mobile Internet and second in the number of mobile subscribers.
www.megafon.ru



“The two most important components of our company are high-tech innovations and people — more than 66 million of them are our clients.” — Ivan Tavrin, CEO of MegaFon

MEGAFON HAS SUCCESSFULLY CAPITALIZED ON NEW INNOVATIONS IN THE MOBILE SPACE TO PROVIDE HIGH TECH LOCAL OFFERING. IT WAS INITIALLY FOUNDED AS A JOINT VENTURE OF FIVE RUSSIAN AND THREE SCANDINAVIAN COMPANIES. THE COMPANY WAS LATE TO ENTER THE COMPETITIVE RUSSIAN TELECOM INDUSTRY ALREADY DOMINATED BY TWO HEAVYWEIGHTS, VIMPELCOM AND MTS, YET QUICKLY GAINED A LEADING POSITION AND BECAME THE FIRST OPERATOR WITH A NETWORK COVERING ALL REGIONS OF RUSSIA. TODAY, MEGAFON IS ACCLAIMED FOR ITS INNOVATIVE CORPORATE CULTURE, WHICH HAS BEEN INSTRUMENTAL IN THE COMPANY’S ABILITY TO DEVELOP UNIQUE OFFERINGS TAILORED TO LOCAL CUSTOMERS. THE COMPANY PRIORITIZED DATA RATHER THAN VOICE TRAFFIC AND FOCUSED ON PROVIDING FAST, RELIABLE CONNECTIONS WHERE PEOPLE ACTUALLY USE MOBILE DATA. THE COMPANY’S CONTINUOUS EFFORTS TO CREATE THE MARKET’S MOST ADVANCED MOBILE NETWORK AND NON-STOP FOCUS ON GIVING CUSTOMERS INNOVATIVE PRODUCTS HAS RESULTED IN A HIGH-QUALITY SUBSCRIBER BASE, A STRONG BRAND AND HIGHER PROFIT MARGINS.

“MegaFon has created a unique innovative corporate culture which attends to motivated and engaged professionals. This feature defines MegaFon as one of the best in class companies in the world... and it keeps improving its results every year.” — The Boston Consulting Group

MegaFon’s heavy reliance on technology is a key driver of its unprecedented advancement on the Russian market. In its early days, MegaFon’s subscriber base was three times smaller than that of its main competitors, which were primarily delivering voice services. Mobile data was still considered a niche market and few believed that it would take off in Russia. Yet MegaFon made an audacious move and decided to focus exactly on this service. The company was the first to launch a 3G network in Russia, starting in 2007 in St. Petersburg. Over the next five years MegaFon installed more 3G base stations than any of its competitors and became the leading mobile data provider.

The year 2013 established a new record for the telecom giant. MegaFon acquired Scartel (Yota), then the only operator in Russia with a 4G/LTE network — the next stage in telecom services, providing customers with much faster data speed than 3G. The company’s pursuit of innovation did not stop there. In February 2014, MegaFon was the first in the world to announce the commercial launch of an LTE-Advanced network based on yet a more sophisticated set of standards and technologies that are able to deliver bigger and speedier data. Being highly customer-oriented, the company continually seeks to please its clients. In 1999 MegaFon was ahead of its competitors in intro-

ducing roaming capabilities. The company was the first to launch mobile data services in the Moscow and St. Petersburg subways in 2009. A year later, it partnered with Aeroflot, Russia's leading airline company, to offer onboard mobile services.

The strategy yielded results. The company has won customers' hearts, including in Moscow, where it historically had weak positions. In 2010 MegaFon outplayed VimpelCom and became Russia's # 2 telecom provider, holding approximately a 27% market share.

"GSA is delighted to welcome the world's first commercial launch of a 300 Mbps LTE-Advanced network today by MegaFon. We congratulate this pioneering achievement by Megafon and their partners and applaud their strategy to deliver the best possible mobile broadband user experience." — Alan Hadden, President of Global Mobile Suppliers Association

Despite its stronghold in the mobile data segment, MegaFon is experiencing intensifying competition. Its strategic advantages built up in the earlier years are starting to fade.

To work closer with its customer base, the company has diversified upstream by buying a 50% stake in cell phone retailer Euroset. The investment is aimed at helping to enhance the quality of its subscriber base, promote MegaFon's brand and reduce churn.

"Our task is to retain our leading position by aiming to provide our customers with service and products which would never make them think about switching." — Ivan Tavrin

Recently, the company has also been actively expanding into fixed line and broadband business. In 2010 MegaFon acquired Synterra, a local telecom operator, specializing in long-distance calling and broadband Internet. The deal is expected to open up new sources of revenue, particularly in service convergence — the transition of multiple communications services into a single network, which is particularly valuable for business clients. This goes hand-in-hand with the company's recent efforts to improve service quality in its corporate segment.

Going forward

Every visitor to the Sochi 2014 Winter Olympics had an opportunity to become the face of the Winter Olympics by posting a 3D selfie on a large kinetic façade of the MegaFaces Pavilion. The installation was designed by London designer Asif Khan and commissioned by MegaFon, one of the primary sponsors of the Games. The piece of work received multiple accolades, including Grand Prix for Innovation at the

prestigious Cannes Lions festival. Yet it is the notion of individual freedom and expression that makes that story so interesting and ultimately transmits MegaFon's motto, "The future depends on you."

Empowering customers by providing them with possibilities for a wide range of personalized and sophisticated services is the area where MegaFon seeks new sources of growth. Its MegaLabs subsidiary, established in 2011, is the compa-

ny's in-house center of innovative developments in the areas of content and media, mobile finance, mobile advertising, cloud solutions, M2M, e-government and m-health. For now, these are just strategic explorations but perhaps in the future they will turn into a new source of competitive advantage.



Teremok
 Sector: Fast food
 Established: 1998
 Revenue: ~\$140 mln
 Origin: Moscow
 Employees: > 2,000
 CEO: Mikhail Goncharov
 Ownership: Private; major shareholder Mikhail Goncharov
 Teremok is one of the leading fast food chains on the Russian market. With a menu based on Russian culinary traditions, Teremok's core product is traditional Russian "blini" (pancakes) with various fillings. The company serves more than 30 million customers annually.
www.teremok.ru

"We do not consider ourselves to be so untalented as to just make replica copies of Manhattan or Tokyo street corners in Russia." — Mikhail Goncharov, Founder and CEO of Teremok

IN WAS DURING THE 1998 FINANCIAL CRISIS WHEN MIKHAIL GONCHAROV, THE FOUNDER OF TEREMOK, LOST HIS FIRST BUSINESS (AS AN ELECTRONICS IMPORTER) AND AGAIN RETURNED TO THE IDEA OF DEVELOPING A FAST FOOD CHAIN. INSTEAD OF OPENING A "RUSSIAN MCDONALD'S," AS HE ORIGINALLY PLANNED, GONCHAROV DECIDED TO START SELLING TRADITIONAL RUSSIAN "BLINI" (PANCAKES) AND BECAME A CHAMPION IN LOCAL OFFERING. THE CHALLENGE WAS TRANSFORMING NATIONAL RUSSIAN CUISINE INTO A PROFITABLE FAST FOOD BUSINESS BY MEETING LOCAL CUSTOMER NEEDS. SINCE THEN, THE FIRST STREET KIOSK IN RUSSIA WITH HOT PANCAKES HAS GROWN INTO ONE OF THE LEADING FAST FOOD CHAINS IN THE COUNTRY WITH 250 OUTLETS. TEREMOK'S SINGLE PRODUCT BRAND HAS EXPANDED WITH AN ADVANCED MENU OF MORE VARIED OFFERINGS. IN 2012-13 TEREMOK WAS INCLUDED IN THE RANKINGS OF "THE WORLD'S BEST FAST FOOD NETWORKS TO BE OPENED IN THE U.S." AND "10 EUROPEAN CHAINS YOU'LL HAVE TO TRAVEL TO ENJOY."

In 1998 the idea of an affordable national cuisine was already popular in Russia: There were fast food chains like Kroshka-Kartoshka, Elki-Palki and others, but none of them worked with pancakes. At the same time, Russian pancakes was a traditional dish which, according to Mikhail's expectations, should have been in demand in Russia and furthermore, able to compete with Western offerings like hamburgers, pizza and hot dogs.

From day one, it was decided that pancakes should have "homey" taste and differ as much as possible in appeal and flavor from the ones being served in public eateries. The diameter

of the pancake was increased to 40 cm. Despite the fact that its major product was not created with specific dietary needs in mind, Teremok has positioned itself in the healthy nutrition niche — only fresh and natural products "without chemicals" were used in preparation. The most popular fillings and price points were identified during a survey of 1,500 potential customers. Flavors of the products were adapted to local customers' preferences while responsibility for all recipes was delegated to the founder's mother, who preserved Russian cuisine traditions.

The customer service model — 'to prepare an order at customer's eyes' has favorably distin-

"I have no clue how to cook. There should be a person in the company who is absolutely trusted and who will always control the quality of products as if they were for himself." — Mikhail Goncharov

guished Teremok from most other “traditional” fast food chains. At that time, only direct competitor Kroshka-Kartoshka has successfully operated the same way. The production process was designed to fit the model, including arrangements of own production facilities with night shifts for the procurement of fresh batter and fillings for the next day. Teremok’s design was rather simple, printed with Khokhloma (Russian style of decorative painting of wooden housewares and furniture) and addressed Russian traditions as well as titles did. Use of “My Lord” and “My Lady” were implemented to simplify first contact with a client and became a distinctive feature of the brand.

A question of unified business standards came

“We relied on the following major idea: not to get hung up on the antique, but to take a tradition and create something new based on it.” — Mikhail Goncharov

up as a basic requirement of future sustainable growth. The company has developed a multi-level control system to ensure high quality of products and services. For example, surplus restrictions were implemented for product expiration dates to exclude any failures. A motivation system was tied to the results of inspections, including “mystery visits.” Suppliers of ingredients were duplicated, regularly tested and replaced. In addition to high quality standards, cost control and optimization have become a part of Teremok’s DNA. Finally, the Japanese Kaizen operational system has become a part of Teremok’s daily operations.

“We are opening only our own restaurants, because our concept is extremely difficult to replicate by people who do not share our principles of quality control and management.” — Mikhail Goncharov

After successful pilot sales over the Maslenitsa national holiday — “Pancake Week” — Teremok opened its first kiosk in Moscow in 1999. \$80,000 in initial investment that was raised with the support of partners allowed Goncharov to launch several street kiosks one by one. Each cost about \$12,000 and started to yield profits already during the first year of operation. By 2001 there were already 15 outlets in Moscow and 12 in St. Petersburg. Still, street expansion was restricted by local legislation. It also required the company

to struggle permanently with red tape and municipal bureaucracy. Owning restaurants — even small ones — required much more in the way of investment, which also reduced the company’s room for maneuvering.

The beginning of the retail property boom in the mid 2000’s provided Teremok with a new opportunity — to move from kiosks with pancakes in front of busy metro stations to food courts in shopping centers. This resulted in changes to both the profile of the average customer and the chain’s chief competitors. To meet new requirements, Teremok has developed a full menu. Following this approach, in 2010 Teremok even launched a new and more comfortable format with a separate coffee counter to attract more cli-

ents and encourage them to stay longer.

Today Teremok’s 250 outlets are mostly located in Moscow and St. Petersburg, despite opportunities in other regions that are used by competitors. Goncharov states that Teremok needed time to establish unified standards of business before starting regional and international expansion. It also allows reducing the operational cost per outlet. Economy of scale through geographical concentration is vital for Teremok’s organic strategy. The popular way for fast food chains to expand — through franchising — was curtailed a few years ago after two unsuccessful experiments in Surgut and Tyumen.

Going forward

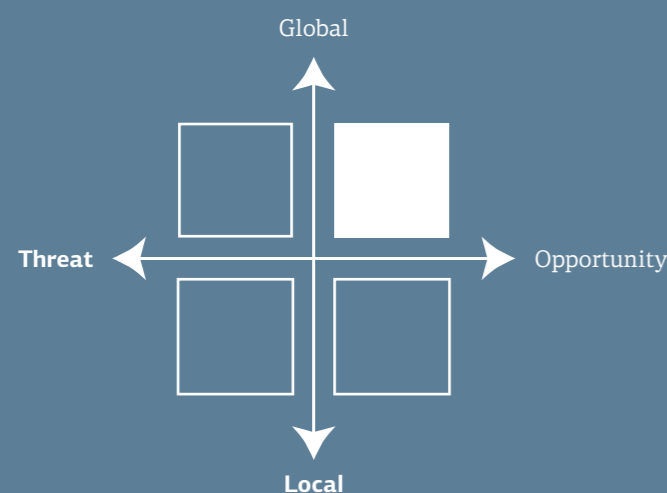
Mikhail Goncharov intends to turn his business into the largest nationwide chain in Russia with 400 outlets by 2016 and to compete with global operators. He sees Teremok not as a Russian, but as an international brand, “just like McDonalds, Pepsi-Cola, Coca-Cola.” The first foreign outlets should open

in the U.S., and here the chain has already appeared in fast food rankings.

Taking into consideration Teremok’s present operational model, expansion into foreign markets might pose a significant challenge for two major reasons. First, having abandoned the franchise model, the company does not have experience in scaling its business, for example, to Russia’s regions. Second, in comparison with the way Russian consumers view the business — as being one focused on traditions, Teremok will have just the opposite image in foreign markets. Here, consumers of Russian cuisine will be considered innovators. The question is whether Teremok should continue its present core competency of making Russian pancakes or create a completely new one — which would involve the tricky task of guessing local preferences — in order to help it win in global markets.

Case Studies: Global Niche

- SPLAT
- NT-MDT
- TRANSAS
- PROGNOZ
- ALAWAR
- ASCON



Splat
 Sector: Oral care products
 Established: 2000
 Revenue: ~\$100 mln
 Origin: Moscow
 Employees: > 700
 CEO: Yevgeny Demin
 Ownership: Private; Yevgeny Demin (50%), Elena Belous (50%)
 Splat is a manufacturer of professional oral care products. It develops its own recipes and produces over 50 types of toothpaste, oral rinses, manual toothbrushes and dental flosses for specific customer needs and preferences based on innovative and environmentally friendly ingredients. Splat exports products to 28 countries.
www.splat.ru

“To make a black toothpaste or toothpaste with pepper, you should be ready to create your own rules of the game and guess the dream of every consumer.”

— Yevgeny Demin, Founder and CEO of Splat

IN RUSSIA, WESTERN CONSUMER BRANDS HAVE ALWAYS DOMINATED THE PREMIUM END OF THE MARKETPLACE, BASED ON THEIR ABILITY TO AGGRESSIVELY SATURATE THE MEDIA WITH EXPENSIVE ADVERTISING CAMPAIGNS. RUSSIAN PRODUCTS, IT WAS THOUGHT, COULD NEVER COMPETE WITH THEIR FOREIGN RIVALS. SPLAT TURNED THAT LOGIC ON ITS HEAD BY APPLYING A GLOBAL NICHE STRATEGY, USING A WORD-OF-MOUTH ADVERTISING PLATFORM TO SELL ORAL CARE PRODUCTS. SPLAT CREATING A UNIQUE BRAND THAT RESONATES EMOTIONALLY WITH CUSTOMERS AND FOCUSED ON ATTRACTING TOP TALENT WHO COULD CONSTANTLY IMPROVE AND ITERATE UPON EVERY ELEMENT OF THE BRAND — FROM THE PACKAGING TO THE INGREDIENTS — TO OUTPERFORM COMPETITORS. AS A RESULT, SPLAT HAS BEEN RECOGNIZED AS THE FASTEST GROWING COMPANY AMONG RUSSIAN MID-SIZED BUSINESSES. SINCE 2010, IT HAS HELD THE #1 POSITION AMONG RUSSIAN PRODUCERS AND #3 AMONG GLOBAL PLAYERS IN THE RUSSIAN ORAL CARE MARKET.

“I really wanted to do something outstanding, world-class, not to be ashamed in front of my twenty-year-old peers who had grown up in the era of abundance of imported products.” — Yevgeny Demin

Splat (at that time called Splat Cosmetics) started with the distribution of bioactive additives. The company concluded an agreement with a group of scientists from the biology department of Lomonosov Moscow State University who had been developing para-pharmaceuticals based on the bacterium *Spirulina platensis* since the early 90s. By that time, university professors had already registered and promoted the trademark Splat (“Сплат”). Distribution helped Splat to raise in-

itial capital and buy the trademark from the scientists, lease production facilities and expand its business to cosmetics manufacture. After a few years of smooth operations in which business went largely according to plan, the Splat team started to make a dangerous U-turn. In 2002, the company completely abandoned distribution, which by that time provided two-thirds of its revenues. At the same time, the company switched from cosmetics to a new product —

toothpaste. In the early 2000s, the oral care market penetration in Russia was already 95-98% and both the mass market and premium segments were filled. This forced Splat to choose the mid-market. Still with international FMCG giants and local brands active in the market, it was almost suicide to launch a new brand.

The core of each product became a combination of a unique formulation, developed in the company's own laboratory, an emphasis on natural ingredients and confirmed high efficiency in the area of application (whitening, protection, fresh breath, etc.). The principles of creating a product were always the same: the product must be high quality and environmentally friendly. Splat launched its first products and found out quickly that making a perfect product wasn't enough. Poor sales at the beginning made Splat reconsider its approach to product development and add some fun. As strange as it may sound for a manufacturer of toothpaste, but Splat's second competitive advantage became emotions as it created an "emotional paste" with unique protective properties. A diversified portfolio of products should have considered various preferences to fit them all, like hypoallergenic with gold particles for VIP clients; gently balanced products for pregnant women; and edible oral care products for children. Some ideas were being gathered directly from the customers. Since 2004, Splat has started to include letters from the CEO to customers inside its products. Replies are coming each day. 18 months for a 50-fold growth of sales in comparison to initial volume — that's how Splat's "star" products win consumers' hearts now.

"The same way as a French baker I want to sell not only the product, but also the emotion." — Yevgeny Demin

A new product required a new marketing strategy. Having an original concept, Splat still was facing difficulties with promotion and sales. At the same time, the company dismissed the idea of aggressive advertising traditionally used by most FMCG companies. Splat couldn't compete with the marketing budgets of international players like Colgate-Palmolive, Procter & Gamble and Unilever and just decided to forego it en-

"We simply follow the other way... we'll spend this money — tens of millions to make our product more interesting, then invest it inside in the ingredients and components." — Yevgeny Demin

tirely.

To promote their innovative products, employees themselves have visited pharmacies as "mystery consumers" asking for Splat products and arousing the interest of potential sales outlets. A week later their colleagues came back to the same outlets and suggested signing a contract for Splat products. Splat also worked with dentists forming a positive image of the product in the professional community. In comparison with the general approach of distributing professional care products through "professional" channels like pharmacies and dentists, Splat has also established a platform for word-of-mouth advertising. The targeted channel was retail, but the market didn't want to recognize a future leader at Russian "Сплат" that cost twice as much as the well-known Western brand Colgate and showed a blue dolphin on the package (same as in the 90s). A new design and Latin transcription of the brand placed Splat in line with foreign brands and intrigued the consumer. Today, Splat's products are distributed through 35,000 outlets, including leading retail chains like Auchan and Perekrestok.

Going forward

Over the years, Splat has showed outstanding results with an annual growth rate reaching 200% in its most successful years. Since 2008, it has started export sales with branches in CIS countries — Ukraine, Kazakhstan

and Belarus. Today it controls 13% of the Russian market and exports products to 28 countries. 90% of products are manufactured by Splat's own production facility in Russia when up to 90% of primary components for them are imported from foreign manufacturers. Further expansion on the global markets might require optimization of the operational model that was initially formed mostly for the local Russian market and the markets of the CIS countries.



NT-MDT

Sector: High-tech

Established: 1989

Revenue: ~\$80 mln

Origin: Zelenograd (Moscow suburb)

Employees: >300

CEO: Victor Bykov

Ownership: Private (no additional information available)

NT-MDT is a Russian nanotechnology company that traces its origins back to the perestroika period of the former Soviet Union. The company is at the forefront of offering atomic force microscopy (AFM) and scanning tunneling microscopy (STM) capabilities to researchers. www.ntmdt.com



"At present, we have the best line in the world for manufacturing instruments for nanotechnologies. That is a fact." — Victor Bykov, Founder and CEO of NT-MDT

NT-MDT WAS FOUNDED IN THE LATE YEARS OF THE SOVIET ERA WHEN A GROUP OF RESEARCHERS FROM ZELENograd, WHICH IS SOMETIMES REFERRED TO AS THE SOVIET SILICON VALLEY, DECIDED TO DEVELOP THEIR OWN VERSION OF THE SCANNING TUNNELING MICROSCOPE THAT WON A NOBEL PRIZE IN PHYSICS IN 1986. THE CHALLENGE FACING NT-MDT WAS HOW TO SIMPLIFY THE USE OF COMPLEX NANOTECHNOLOGY FOR A WIDER MARKET AUDIENCE AND BECOME A GLOBAL NICHE COMPANY. NT-MDT CREATED AN ORIGINAL VERSION OF THE DESIGN, AND UNLIKE MANY OF THE RESEARCH TEAMS OF THAT ERA, IT MANAGED TO PUT IT INTO SERIAL PRODUCTION AND MARKETING. THE COMPANY ALSO BEGAN PARTNERING WITH WORLD-CLASS INSTITUTIONS AND FOCUSED ON HIRING INNOVATIVE TALENT. THE COMPANY IS NOW RECOGNIZED AS AN R&D LEADER WITHIN RUSSIA. STARTING WITH THE BIG GOLD MEDAL IT WON AT THE INNOVATIONS FAIR IN BRUSSELS IN 1996, THE COMPANY BEGAN COLLECTING TOP INTERNATIONAL AWARDS ON A SERIAL BASIS — INCLUDING FOUR APPEARANCES ON THE R&D 100 AWARD LIST FROM R&D MAGAZINE.

"We were 150% not ready for that [the first foreign orders]. At that time, we were not even zero: we were less than zero. And this was not due to the technology gap. The Soviet Union was a different country, different from the rest of the world." — Victor Bykov

The company caters to a rather narrow but very demanding market — top international research laboratories and, increasingly, to the industrial companies involved in all things related to nanotechnology. Manufacturing instruments whose level of precision makes it possible to see atoms (and whose working tip itself has the diameter of several atoms) is no business for amateurs: perfection is required not just in the design, but in the manufacturing of every detail and assembling the device. The latter set of skills was seldom seen as a domain of strong competence in Russia. In fact, much anecdotal evidence stat-

ed that Russian engineers design things with the implicit assumption of bad manufacturing. Yet NT-MDT managed to prove that this notion is worth no more than any other shallow stereotype. Indeed the devices by the company are pieces of absolute manufacturing craftsmanship. In 1995 the company added the Atomic Force Microscopes (AFM) to its range. The AFMs were invented by the same team of Gerd Binnig and colleagues in 1985, their advantage being versatility (unlike STM they don't need high vacuum for operations and can be used for non-conductive materials). This, however, comes at the cost

of resolution and speed of scanning. NT-MDT chose to focus its product development efforts on two venues: simplicity of operations and integration of scanning microscopy (either STM or AFM or both) with other research methods. Those were the areas of weaknesses of the technology: With all its capabilities it had to be supplemented with other techniques to provide comprehensive research answers and operation of the device initially required a Ph.D. qualification. Both drawbacks were creating considerable costs for the research laboratories and were heavily limiting their output. NT-MDT gained significant competitive advantage through becoming a global conceptual leader in overcoming those weaknesses.

After bringing their skills of producing the “straight” STM and AFM devices nearly to perfection, in 2004 they launched the NTEGRA Spectra system integrating three leading high-tech research methods: STM, laser confocal microscopies and Raman spectrometry. In 2009 its Solver Next solution was among the first in the world to offer both atomic force microscopy (AFM) and scanning tunneling microscopy (STM) capabilities in a single, automatically exchangeable platform. The automation of the settings of the Solver Next opened a whole new era in the organization of laboratory work. Now the most complex tasks could be routinely delegated to regular technical staff — a breakthrough in decreasing the cost of research work and expansion of data collection possibilities.

The company has also made a move to the lower end of the market, creating a simple and robust yet very capable device called NanoEducator. This brings the technology of scanning probe microscopy into the financial range of mid-budget universities, permitting them to expand their curricula and launch nanotechnology projects. The first version of the device was introduced in 2003 and in 2011 NanoEducator II was launched with greatly enhanced functionality. Currently the company counts global majors like Hewlett-Packard, Texas Instruments and Seiko among its clients, in addition to research institutions like Kurchatov Institute (Russia), NANOSPIN (a pan-EU initiative for the nano-scale study of magnetism), Dutch Polymer Institute and Technische Universiteit Eindhoven (Holland). Overall the company has sold its solutions to 500

“Of course we invest in brains: You cannot do without them. But the most valuable thing we have succeeded in creating is the infrastructure that allows us to implement major projects in relatively short periods of time.” — Victor Bykov

research laboratories worldwide. It operates sales and support offices in the U.S., China, the Netherlands and Ireland and its distribution network spans over 50 countries. Its global market share in the scanning probe microscopes is estimated at 16%, putting it solidly in second place after the American company Veeco. Yet NT-MDT has strong ambitions to gain share on its competitor’s native soil: it aims at controlling one-third of the entire U.S. market in the coming years.

Going forward

The company plans to maintain its focus on the development of integrated solutions. In March 2014, it announced a new ambitious product, Titanium, the world’s first AFM with a self-aligning, multiple probe cartridge for fast, automated tip exchange. The product should make the operations of some of the world’s most precise research devices easier than ever before, with further cost-reduction opportunities for nano-laboratories. The strategy of focusing on providing operational value to its customers is paying off — the business reported a CAGR of approximately 12% over the past four years. Yet, the company remains a niche player within the vast global market of precision instruments and devices.

Some important developments are expected that can potentially open new lucrative markets and increase the company’s sales. The electronics industry is on a quest to manufacture ever-thinner microchips and here the older technology of STM has strong potential, as it can theoretically be used for altering surfaces at the atomic level. The technology is in the early experimental stage still, but NT-MDT — like its competitors — is studying closely its feasibility. One thing looks almost certain — “nano” is among the buzzwords for the technological future of the world and NT-MDT is among the global elite club of nanotechnology vendors. This was recognized even by UNESCO, which awarded the remarkable efforts of the founder and CEO of the company, Victor Bykov, with a medal for “contribution to the development of nanoscience and nanotechnology.”

TRANSAS

Transas
Sector: High-tech
Established: 1990
Revenue: ~\$300 mln
Origin: St. Petersburg
Employees: > 2,000
CEO: Nikolay Lebedev
Ownership: Private (no additional information available)

Transas is a world-leading developer and supplier of navigation and simulation systems, traffic management solutions and unmanned aircraft vehicles for aviation, marine, railway, oil & gas, municipal, defense and edutainment applications. It has 23 offices and over 260 dealers worldwide.
www.transas.com



“We were common sailors, wanting to create something of our own... We were the first to develop electronic charts that were colorful and pretty.” — Nikolay Mujikov, Co-founder and Vice-President of Transas Group

THE SUCCESS STORY OF TRANSAS AS A GLOBAL NICHE BUSINESS DATES BACK TO THE LATE 1980S WHEN THREE RUSSIAN CIVIL SAILORS DECIDED TO LEAVE THEIR LONG-TENURED JOBS AND SET UP THEIR OWN COMPANY. PRIOR TO THAT, EACH OF THEM HAD ENJOYED PROGRAMMING AS A HOBBY AND EXPERIMENTED WITH THE CREATION OF ELECTRONIC MARINE CHARTS THAT WERE PRIMARILY PAPER-BASED AT THAT TIME. THEY USED THIS EXPERIENCE TO BUILD A CORE NAVIGATION PRODUCT THAT COULD BE USED ANYWHERE — EVEN IN OUTER SPACE, WHERE THE MIR SPACE STATION HAS USED A VERSION OF THE COMPANY’S NAVI-MASTER SOFTWARE. THE COMPANY BUILT ITS PRODUCT STRATEGY AROUND THIS CORE COMPETENCY, USING IT TO EXPAND INTO ADJACENT MARKETS AND BUILD A WORLDWIDE NETWORK OF PARTNERS. IN ORDER TO DO THIS, THE COMPANY HAD TO BUILD A DISTRIBUTION NETWORK FROM SCRATCH, FIND NEW WAYS TO ATTRACT THE BEST TALENT IN RUSSIA, DEAL WITH AN UNRELIABLE SUPPLY CHAIN AND WIN THE TRUST OF WESTERN PARTNERS.

“There are two other crazy buddies around here, maybe you three should meet.” — This is how — with a kind introduction by the receptionist at the Baltic Marine Shipping Company Innovation Bu-

reau — the future Transas founders got acquainted. Transas’ first flagship product was the marine navigation system Navi-Master that integrated electronic charts with satellite navigation and special software. At the beginning of the 1990s, navigation systems already existed in the market but were based on bulky industrial software and operated solely on mainframe computers that were not available on every vessel. Transas developed Navi-Master using easy-to-use software and made it operable on ordinary PCs. It resulted

“This technology set us apart from our competition by several years.” — Nikolay Mujikov

The trial version was installed free of charge on a ferryboat of the Baltic Marine Shipping Company and then referred to as a best practice example. In the following two years, the company sold over 400 installations to Russian shipping companies and seven years later, granted its latest version of Navi-Master to the Mir Space Station. Today the company reports over 10,000 installations and over 3 million electronic charts sold globally with the customer list including Boeing, Airbus, Maersk Line, Eurocopter, Hyundai Heavy Industries and many others across the globe.

Throughout the years the company has stayed focused on its core competence and built its product strategy around it. Of critical importance was the compilation of its own database of electronic charts, which underpinned the company's further product development. Today Transas is one of two companies in the world with the largest database of electronic charts. Next, in order to address its clients' evolving and increasingly complex needs, Transas expanded its offerings from stand-alone navigation systems to integrated solutions. This resulted in introduction of such high-tech products as onboard equipment, unmanned aircraft, training simulators and traffic management systems. In addition to this, the company has been actively exploring adjacent markets where it can leverage its existing technology. Today, in addition to the marine sector, Transas successfully operates in the aviation, railway, oil & gas, municipal and defense sectors. Early into Transas' history, it became apparent that the Russian market was too small for the company's production capabilities and growing ambitions. It took a company just a few years to exhaust local demand for its products. The overall local market conditions were also becoming increasingly hostile, marked by the turbulent post-perestroika times and ensuing economic perils.

It was at that time when Transas made the fortuitous decision to enter the international markets. The fact that its product did not require any specific adaptation to foreign markets was much to the benefit of the company. Yet, the international strategy priorities were affected by major challenges: a questionable reputation, zero distribution network and unreliable supply chain. Foreign counterparts did not have any experience in working with emerging Russian companies and approached Transas with apprehension. The company had to put a substantial effort into building its reputation as a trustworthy and serious partner. It started by incorporating itself in select European markets, such as the UK,

Sweden and Germany. The move validated the company's efforts to gain local recognition and negotiate business terms. Next, the company began to set up local representative offices in major ports and actively engaged dealers worldwide. A strong focus on extensive network and client engagement is still at the core of Transas' business model. Entrance to the international arena also affected the company's supply chain. On the one hand, it placed new demands on Transas' operations but, on the other hand, opened up access to high-tech production facilities and new sourcing opportunities. Today the company continues to keep its R&D in-house in Russia, but its value chain is globalized with hardware assembled on OEM terms worldwide.

Going forward

While continuing to operate in its traditional businesses, Transas is leveraging its extensive experience and technical expertise to tap into new market opportunities. The company, under its Trans-Force brand, actively experiments in the edutainment sector. Its multimedia complexes immerse participants in a virtual reality and are used in a number of Russian and international Science & Technology museums, planetariums, aquariums, schools and exhibition centers. Trans-Force interactive 5D attractions are aimed at a wide range of visitors and designed as a thematic virtual experience with clients including theme parks and children's entertainment centers in Russia, Indonesia, China, countries of the former Soviet Union, and Eastern Europe. The company is serious in its intentions to win in this promising new market and deploys the best of its assets: innovative products and ability to build an effective international distribution network.

“Attractions — this is a big world. At least for one reason — there are many more people with children than there are sailors. The market for professional simulators is in the hundreds, while that of attractions is in the thousands.”
— Nikolay Mujikov

PROGNOZ



Prognoz
Sector: High-tech
Established: 1991
Revenue: ~\$120 mln
Origin: Perm
Employees: > 1,500
CEO: Dmitry Andrianov
Ownership: Private (no additional information available)
Prognoz is a leading provider of business intelligence applications. The company delivers reporting, modeling, forecasting and visual discovery solutions, serving customers in over 70 countries across the globe.
www.prognoz.com

“Effective and innovative products will be consumed anyway. Why sit and wait for the market to form the demand? It is necessary to continuously generate, elaborate and sell new ideas. Then you will succeed.”

— Dmitry Andrianov, Co-founder and CEO of Prognoz

PROGNOZ IS A CLASSIC STORY OF HOW TO SUCCESSFULLY COMMERCIALIZE INNOVATIONS FROM ACADEMIA IN ORDER TO BECOME A GLOBAL NICHE COMPANY. IN 1987, A TEAM OF ECONOMISTS AND SCIENTISTS FROM PERM STATE UNIVERSITY AND URAL ECONOMY INSTITUTE WERE ENGAGED BY THE MINISTRY OF ECONOMY TO WORK ON AN ECONOMETRIC FORECASTING PROJECT. IN FOUR YEARS' TIME, THE PROJECT TEAM WAS RE-ORGANIZED INTO A SOFTWARE COMPANY. ITS FOUNDERS NAMED THE FIRM PROGNOZ — THE RUSSIAN WORD FOR FORECAST. DESPITE ITS GLOBAL OUTLOOK, PROGNOZ IS STILL HEADQUARTERED IN ITS HOME TOWN OF PERM AND CONTINUES TO ACTIVELY WORK WITH ITS ALMA MATER — PERM STATE UNIVERSITY (PSU) — A LEADING RUSSIAN INSTITUTION RENOWNED IN SCIENCE AND TECHNOLOGY. THE COMPANY CONTINUALLY HAS FOUND NEW WAYS TO COMPETE WITH ESTABLISHED INTERNATIONAL PLAYERS IN SELLING BUSINESS INTELLIGENCE APPLICATIONS TO USERS WORLDWIDE. ITS GLOBAL EXPANSION HAS BEEN BACKED BY AWARD-WINNING EXPERTISE AND EXPERIENCE.

The initial idea of the Prognoz founders was to focus on the development of their own predictive analytics tool to support business decision-making. However, it quickly became obvious that the most common bottleneck for decision-makers was first of all in the severe lack of relevant actual data. The company tailored its product to address the market needs. In 1992 it unveiled its first version of the Prognoz Platform — an all-in-one business intelligence solution with data integration and storage, analysis, monitoring and reporting as well as modeling and forecasting capabilities.

Prognoz solutions quickly found demand on the Russian market. The company took significant steps to deliver superior customer value and in many cases took the initiative to develop the methodology of data management and project requirements on behalf of the client. This worked particularly well with governmental agencies — Prognoz's first clients — and eventually significantly contributed to the company's expertise in understanding and serving its clientele. Starting from 1999, the company saw the inflow of high-profile corporate clients with Gazprom as the main highlight.

“It happened at a time when information technologies were not that widespread. Back then Prognoz was one of the first companies, not just in Perm but in the entire country, to develop what they now call ‘business analytics’ or Business Intelligence (BI) solutions.” — Sergey Shestakov, Head of Business Development at Prognoz

The turning point in Prognoz's development happened in 2006 when the company made the decision to go international. The fact that Prognoz's offerings and core competence were not dependent on Russian specifications made the expansion a viable plan. The company started with active participation in industry expos and conferences. Its track record, expertise and competitive pricing elicited a great deal of interest abroad. The first contract was signed with BNSF — one

Going forward

With already a long list of international clients, Prognoz continues its international expansion. Last year the company opened a branch office in Canada and now has plans for Europe and Africa. In Russia the company aims to further strengthen its position

"We are pleased to be included in the Gartner Magic Quadrant for the third straight year, and we believe our improved position is a testament to our growing global reach and the highly positive feedback from our customer references."
— Dmitry Andrianov

of the U.S.'s leading railroad operators. Shortly after this, the company opened its first office outside of Russia, in the United States. In the span of several years the company won bids for such important clients as the International Monetary Fund, World Bank and World Health Organization. Today, in addition to the U.S., Prognoz has offices in China, Belgium, Zambia, Kazakhstan and Belarus. Its most notable clients include Coca-Cola, 3M, African Development Bank, Abu Dhabi Terminals, Asian Development Bank and many others. Recognition of Prognoz' global success came in 2012 with its inclusion in Gartner Magic Quadrant, an important industry report.

by extending its partnership network. Recently Prognoz signed an agreement with Galaktika, a leading Russian provider of ERP solutions. The alliance is expected to produce more integrated product solutions — something that traditionally has been a weakness of Russian vendors compared to their Western counterparts. Prognoz' initial focus of interest — predictive analytics — is gaining momentum as more and more companies turn to data for prediction of future probabilities and trends. The company harnesses its BI platform to support this very evolution. It is also part of its cooperation with Skolkovo Innovation Center, where the company has recently become a participant along with world leaders such as Cisco, IBM, Intel and Microsoft.

"Savvy CIOs are ready to take the next step and move beyond descriptive and diagnostic BI — which focuses on backward-looking and current conditions — to predictive analytics, which supports more strategic decision-making for future planning." — Sergey Shestakov



Alawar
Sector: High-tech
Established: 1999
Revenue: ~\$30 mln
Origin: Novosibirsk
Employees: > 400
CEO: Alexander Lyskovsky
Ownership: Private; Almaz Capital Partners, company management
Alawar specializes in the development, publishing, and distribution of casual games. The company has a wide global presence and holds a leading position in Russia and Eastern Europe. It has published more than 400 casual games for most platforms.
www.alawar.com

"We create good products. It was my dream and the dream of my colleagues: to create a company that will compete at an international level." — Alexander Lyskovsky, Co-founder and CEO of Alawar

WHILE ENTERING A GLOBAL NICHE WITHIN THE ONLINE GAMING WORLD, ALAWAR FACED A NUMBER OF CHALLENGES. THE FIRST WAS HOW TO TRANSFORM A TEENAGE HOBBY, THE CREATION OF ONLINE GAMES, INTO A REAL-WORLD COMPANY. THE SECOND WAS HOW TRANSFORM THE COMPANY'S LOCATION — IN REMOTE SIBERIA — INTO A COMPETITIVE ADVANTAGE. WHAT ALEXANDER LYSKOVSKY (NOW THE COMPANY CEO) AND SERGEY ZANIN, THE COMPANY'S CO-FOUNDERS, QUICKLY REALIZED WAS THAT THE NOVOSIBIRSK AREA IS HOME TO SOME OF THE BEST ENGINEERING SCHOOLS IN RUSSIA WITH TOP TALENT AVAILABLE AT RELATIVELY LOW COST FOR CREATING CASUAL GAMES. ALAWAR EVENTUALLY SHIFTED ITS FOCUS FROM DEVELOPMENT OF INNOVATIVE GAMES TO PUBLISHING AND DISTRIBUTION IN ORDER TO MOVE INTO MORE PROFITABLE BUSINESS SEGMENTS. THE COMPANY NOW HOLDS AN ESTIMATED 70% MARKET SHARE OF THE RUSSIAN GAME INDUSTRY AND IS A TOP GLOBAL PLAYER IN CASUAL GAMES.

"Yes, it was a regular hobby that turned into a business... at that time, game creation was like a dream, like spaceflight... Nineteen-year-olds did not bother with market analysis at that time." — Alexander Lyskovsky,

In the beginning, the young developers were focused on hard-core games. But that predilection soon came to an end after the Russian financial crisis of 1998. The market, in whatever embryonic state it was in, "died" entirely, as Mr. Lyskovsky puts it.

The focus on casual games was very much a rational one and helped the company to take off. First of all, Alawar's founders quickly came to the realization that, despite the presence of a number of establishments for advanced engineering studies, the city severely lacked specialists in advanced video game creation. At the same time, there were many regular computer engineers at a relatively low cost who were the perfect re-

source for the creation of simpler games. The other reason was that casual games were easier to sell in the U.S. market, which attracted Alawar's attention as the Russian economy continued to deteriorate. The core business model was based around making many simple games and publishing them online through American shareware sites based on a "try-before-you-buy" principle. As the company continued its American pursuits, it also sharpened its game promotion and marketing skills, which eventually resulted in other companies from the former Soviet Union turning to Alawar for distribution help in penetrating the U.S. market.

Placing emphasis on casual games proved to be

a provident choice for Alawar. Since then casual games have been a booming market around the world with Alawar having an early mover advantage.

By 2004 Alawar found itself generating more profit from distribution of other companies' games rather than from its own game development. With little hesitation, the company decided to close down its development capacity

Certainly, we see not only Koreans as our partners but also all other Asian countries. We plan to not only release their products in Russia but also continue penetration of Asian markets with our games." — Julia Navieva, Head of Mobile Sales and Marketing at Alawar

and concentrate on becoming a game publisher with efforts focused on localization, testing, marketing and distribution. The publishing model maximized success rate of games due to a wider choice base as well as building on titles which have already proved successful. Today Alawar works with over 50 development companies in Eastern Europe and incorporates five design studios, which work in a semi-autonomous mode. Simultaneously with the decision to become

bestsellers and a kind of symbol of the company, each downloaded over 100 million times across the globe. Alawar has a plan to continue strengthening its position on the international game arena by growing the network of partners, especially in the emerging markets of Asia and Latin America. Its Russian version of the Korean Heroes War has already been well received at home.

Going forward

Today Alawar, in addition its core business, devotes its efforts into the development of the ecosystem for game production in Russia. Alawar as a company and its leader, Mr. Lyskovsky, in particular, play an active role

"There is no well-developed IT infrastructure in Russia yet. It has to be created so that small independent companies, with whom we work, had access to necessary information and staffing solutions. Technoparks, possibly, could be the center of gravity for such companies where they could grow bigger. ...All this ultimately helps us to develop." — Alexander Lyskovsky

a publisher, the company decided to return to the Russian and Eastern European market, which had begun to show signs of growth. In the ensuing decade the game industry in Russia alone grew at an astounding annual rate of over 100%. Alawar aggressively built up its distribution in Russia by securing its presence on all major game distribution portals as well as creating a portal of its own, which is now available in 37 languages.

Presently Alawar holds an estimated 60% to 70% market share of the Russian game industry and is a serious global player in casual games. It has produced more than 300 original games. Its Farm Frenzy and The Treasures of Montezuma became

in the establishment of the Novosibirsk Technopark.

The company also set up the venture fund Alawar Game Development Initiative aimed at financing talented teams of game developers and fostering startups in the game industry. Additionally to game projects, the fund supports development of diverse software solutions which create innovative ways of game content provision. The pipeline of new talents, projects and ideas is expected to further grow Alawar's business.



Ascon
Sector: High-tech
Established: 1989
Revenue: ~\$30 mln
Origin: Kolomna (Moscow Region)
Employees: >650
CEO: Maxim Bogdanov
Ownership: Private (no additional information available)
Ascon is Russia's leading producer of systems of computer-aided design (CAD) solutions, marketing them under the KOMPAS brand name.
www.ascon.ru

"ASCON shares the same genotype as that of Russian engineers, we grew out of the engineering environment and never lost our link with it. We have a sincere respect for engineers, considering them the elite of society, those who create the real value in our world." — Alexander Golikov, Co-founder and Chairman of the Board of ASCON

TAKING A COMPANY THAT WAS ORIGINALLY ESTABLISHED BY FORMER EMPLOYEES OF RUSSIA'S SPRAWLING AND MINISTERIAL TYPE MILITARY-INDUSTRIAL COMPLEX DURING THE FINAL YEARS OF THE SOVIET UNION AND TRANSFORMING IT INTO A LEADING TECHNOLOGY COMPANY WITH LOYAL USERS AROUND THE WORLD WAS NOT A SIMPLE TASK. THE COMPANY'S TWO FOUNDERS, WHO MET WHILE WORKING FOR A LARGE STATE-OWNED ENGINEERING INSTITUTE, STARTED BY TAPPING INTO THE MATHEMATICS AND PHYSICS TALENT POOL WITHIN RUSSIA TO TURN ASCON INTO A GLOBAL NICHE COMPANY. THEY DEVELOPED A CORE PRODUCT — A CAD SYSTEM CAPABLE OF RUNNING ON PC COMPUTERS (THEN THE ULTIMATE NOVELTY IN RUSSIA). THIS WAS THE BIRTH OF KOMPAS, THE BRAND NAME UNDER WHICH THE COMPANY IS STILL MARKETING ITS CAD SYSTEMS. FROM THERE, THE COMPANY CONTINUALLY INNOVATED ON ITS CORE SOLUTION TO CREATE NEW PRODUCTS — SUCH AS PRODUCTS FOR 3D MODELING AND PRODUCTS FOR MOBILE DEVICES — WHICH WERE SPECIFICALLY TAILORED TO CUSTOMER NEEDS.

"Of course the [first] contract for the 10 workplaces of KOMPAS was the big victory. In a couple of months, we picked up four more clients, we received money from the deal and we finally understood that... we can capture the almost empty market of a huge country." — Alexander Golikov

Despite the company's early success, significant efforts and resources needed to be invested to develop a full-scale marketable product with competitive functionality. At that time, over 90% of the installations of any software in Russia were "pirated" versions so the price of the product gave little competitive advantage — few customers were intending to pay anything at all. The selling point was effective customer support and it was then that ASCON started to build a net-

work of representatives in the Russian regions, a network that now covers every city that has a developed industry of any kind. On the product side the big advance was made in the year 2000, when the module for 3D modeling was introduced. The new functionality opened wide new horizons of applications. This was very important: The 2D-design software had a limited niche that was constantly under the pressure of the leading international systems,

primarily AUTOCAD from Autodesk. To strengthen its market position Ascon needed to add customers with a broader range of requirements, for example, industrial and residential construction companies.

The greatest challenge in developing this class of software is to create a modeling “core” (or “engine”) which will use complex mathematics and physics — as it models not only the outer design, but also the inner structure of the object based on the characteristics of the intended material. Ascon was quite successful in this, to the extent that it decided to expand into global markets. In 2006, the English version of the package was introduced and the company started international marketing through building a network of resellers which currently spans four continents,

“Within one product we supply all the functions of modeling, the solution for geometrical problems and the whole set of converters [necessary to manage the different types of files used in the process]. It is important for our clients... the whole product capable of solving all the tasks and being cost-effective.” — Oleg Zykov, the Director of C3D Labs

including both developed countries like the EU and the U.S. and fast-growing markets like Brazil, China, and India.

The strategy of the company is to cover the “core” of its technology with multiple marketable “shells” — applications. They have boldly ventured down the market, in 2013 launching KOMPAS-3D Home — a “light” version for private use by amateur and small-business designers as well as technical students. This move has the potential to create a new global market niche as the international software producers of CAD systems market only full “professional” versions, which are dozen times more expensive than ASCON’s offering.

Recently ASCON saw a market opportunity in opening its core technology to third-party developers. This business model is increasingly popular in the software world. The companies which have excelled in creating certain pieces of the core of software systems may not bother with creating end-user interfaces (which requires a completely different set of skills), but to open up their technology to the developers of end-applications through what is called the API (application programming interface), sharing somehow the revenue from sales. In line with this trend, ASCON has decided to create a ded-

icated business unit, C3D Labs, to research and develop the geometrical modeling core and market it to other software producers. The immediate targets are those who develop their own versions of CAD or CAE (computer-aided engineering), as well as Building Information Models and the software for the computer-controlled industrial machine tools.

ASCON is also building mobility into its range of end-applications, striving to provide its clients with the tools to create a “visual enterprise.” Putting 3D modeling possibilities into the context of mobile devices is a programming challenge due to the limitations in computation power, memory and storage space. The task was solved successfully and a KOMPAS:24 version was introduced in 2013. Its functions include viewing

full-scale industrial models and drawings on mobile devices. This makes industrial product design literally available 24/7, with all the results produced by one team member becoming instantly available for his/her teammates.

As of 2013 Ascon had over 8,000 clients globally, with 60,000 licensed workplaces for its CAD and PLM software. The client list includes names like Arcelor Mittal, Knauf, Evraz, Helicopters of Russia, Rusal, Kamaz, Russian Space Agency, Rosatom and Severstal. The company is important in the ratings of Russian IT vendors, routinely topping the lists of independent niche-market players.

Going forward

Significant future potential may exist in the industry of computer games, especially those for mobile devices. Many games require modeling 3D objects, yet the core competencies of the producers are in graphic design, not in complex mathematics. Being capable of using a third-party engine allows the game developers to radically speed up the time to mar-

ket and reduce the cost of development. Ascon has recently released a piece of freeware called SubDivFormer which allows advanced possibilities to create, form and transform 3D objects of any kind. About a year after the launch, the app was downloaded almost 100,000 times — quite an impressive figure for a “back-end” solution.

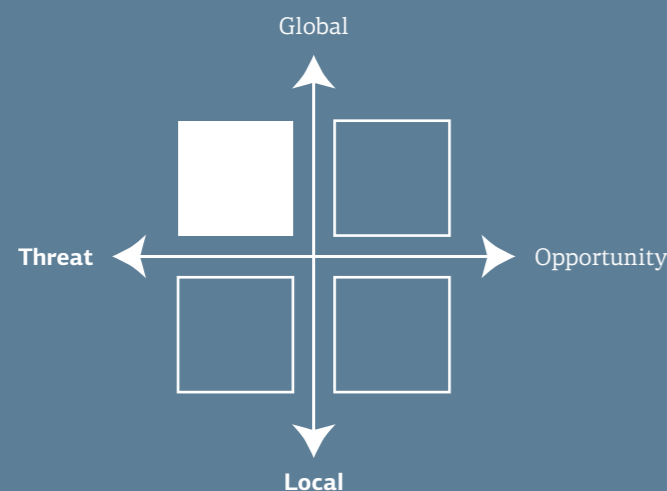
The next big task is more aggressive international expansion, through marketing of the end-applications to professional and amateur engineers.

Market analysts see the future of the industry as bright: The market of CAD systems alone has doubled globally between 2009 and 2014 — and is poised to maintain the same growth going forward. A substantial part of the growth is expected to come from the BRICS and other emerging markets, where ASCON has a strong competitive edge: holistic functionality at a fraction of the price of the products of the “majors.”

“Today, the CAD (Computer Aided Design) industry is more dynamic than ever. It is involved in every aspect of design, build, construction, and manufacture. Increasingly, CAD is becoming part of a visually connected world that can be understood and better managed. There are opportunities in new platforms, new technologies, and new customers in emerging economies. It’s a very good time for the industry.” — Kathleen Maher, Worldwide CAD Market Report 2012

Case Studies: Global Citizen

- LUXOFT
- ABBYY



Luxoft
 Sector: High-tech
 Established: 2000
 Revenue: \$398 mln
 Origin: Moscow
 Employees: > 8,000
 CEO: Dmitry Loschinin
 Ownership: NASDAQ and NYSE-listed; IBS Group Holding Ltd., Luxoft SOP S.A. and Rus Lux Limited
Luxoft is a leading provider of outsourcing services in software development and product engineering, serving multinational companies worldwide. The company has 21 offices in 13 countries across the globe. It caters to a variety of sectors including finance, energy, aerospace, automotive, transport and telecommunications. www.luxoft.com

“Everyone said that we did not have a chance because in Russia there were only good hackers, while programmers could neither make the end-product nor promote or develop it. But we decided to try and in 1999 began to build **Luxoft.**” — Anatoly Karachinsky, President IBS Group

IN 2000, THE CHALLENGE FACING ANATOLY KARACHINSKY, THE LEGENDARY FOUNDER OF INFORMATION BUSINESS SYSTEMS (IBS), WAS HOW TO CREATE A NEW COMPANY THAT WOULD NOT BE DEPENDENT ON RUSSIAN ECONOMIC CONDITIONS. INSPIRED BY THE SUCCESS OF INDIAN IT FIRMS AND BELIEVING IN THE CAPABILITIES OF RUSSIAN PROGRAMMERS, KARACHINSKY SET OUT TO ESTABLISH RUSSIA’S FIRST IT OUTSOURCING FIRM TO SERVE WESTERN BLUE-CHIP COMPANIES. AS PART OF A GLOBAL CITIZEN STRATEGY, KARACHINSKY LEVERAGED CONNECTIONS HE HAD ESTABLISHED A DECADE EARLIER, HELPING LUXOFT LAND ITS FIRST RUSSIAN AND WESTERN CLIENTS. LUXOFT FIRST TAPPED INTO RUSSIA’S DEEP TECHNOLOGY TALENT POOL AND THEN WENT TO ESTABLISH GLOBAL OPERATIONS IN ORDER TO CREATE A “NEAR-SHORE” SOFTWARE DEVELOPMENT MODEL EMPHASIZING COST-EFFECTIVE LOCATIONS IN CLOSE PROXIMITY TO CUSTOMERS. THE COMPANY NOW HAS A GLOBAL MARKET PRESENCE, WITH 21 OFFICES IN 13 COUNTRIES AROUND THE GLOBE SERVING A WIDE VARIETY OF INDUSTRIES.

The business of outsourcing is very much about the ability to compete on standards and price. Benefiting from the heritage of strong engineering schools in Russia and Eastern Europe as well as leveraging IBS’ experience in the market, Luxoft built a team of technically sophisticated IT professionals, capable of delivering a high quality product at a competitive price. It was these connections that helped the young venture of Luxoft to take off. Its CEO and Pres-

ident, 33-year-old Dmitry Loschinin, who was previously responsible for SAP implementation practices at IBS, started by opening sales offices in proximity to potential clients in California, Seattle, London and New York. Under Mr. Loschinin’s leadership, Luxoft has enjoyed exponential growth and is now ranked as one of the Top 20 Global Outsourcing Companies according to the International Association of Outsourcing Professionals ranking for 2014.

“At the end of the 1990s I witnessed many very skilled and talented software engineers in Russia and other Central Eastern European countries struggling to find jobs, while the global demand for such skills was growing. Thus, the vision was very simple — to unleash this talent potential and create an IT services company that would successfully match the intensifying global demand with the local supply of talent thereby competing with the best players in the world.”
 — Dmitry Loschinin, Luxoft CEO

To differentiate itself from the competition, from its inception Luxoft placed great emphasis on accumulating and developing industry-specific expertise. Over time, that evolved into technology-and data-intensive industry verticals enabling the company to deliver high value and differentiated solutions. Today, the company's clientele

"We are very excited about this expansion, Latin America is a brand new region for us and it further expands our global footprint. It also significantly diversifies our offering of near-shore locations for our global clients, who place utmost importance on convenience and the logistics of delivery." — Dmitry Loschinin

consists of many Fortune Global 500 companies, with Deutsche Bank and UBS being the largest customers.

The outsourcing market is constantly evolving. As clients become more sophisticated and demanding, outsourcing firms are under increasing pressure to be able to deliver innovative solutions in a cost-efficient way. The outsourcing industry has seen the evolution into what is called near-shoring — proximity to the client in terms of geography and/or time zone. Luxoft, with its human resources stronghold in Eastern Europe, now seeks to diversify its concentration on a single geography in order to more effectively reach and expand its client base in Western Europe, the U.S. and elsewhere. In 2008 the company launched a delivery center in Vietnam to secure competitive rates. In the last four years, it started to establish development centers in the UK, Germany and U.S. To build focused expertise. Luxoft's latest announcement is to open a deliv-

"I see Luxoft's future success and challenges in its continual transformation. In my opinion this transformation into a next-generation global IT service provider includes Luxoft transforming from a pure-play approach to being software services outsourcing vendor to being a solution provider of choice." — Dmitry Loschinin

ery center in Guadalajara, Mexico. Tapping into local talent potential while reducing labor costs, the office will cater to clients in North America. Guadalajara will become the company's 22nd location and 17th delivery center, thereby expanding Luxoft's presence to 14 countries around the globe.

Going forward

Luxoft's outlook for the future is positive. As more companies across the globe recognize the value of IT outsourcing, Luxoft expects to grow organically with the market. Its global delivery footprint will play to its advantage as more enterprises will look for outsourcing vendors with strong global delivery capabilities in an effort to optimize cost structure, increase scalability, and gain access to high quality IT professionals. Luxoft plans to further utilize its deep industry- and domain-specific expertise to generate new demand by actually shaping customers' agenda. This will allow the company to not only expand its offering to the existing clients but also win new customers within its industry verticals.

ABBYY®



ABBYY
Sector: IT/Software
Established: 1989
Revenue: ~\$200 mln
Origin: Moscow
Employees: >1,200
CEO: Sergei Andreyev
Ownership: Private; David Yang and undisclosed investors
ABBYY specializes in the development of technological solutions for the understanding of languages and the recognition of all sorts of visual objects.
www.abbyy.com

"It is quite likely that in a few years people will be talking to TV sets, refrigerators, or vacuum cleaners using natural language." — David Yang, Co-founder and CEO of ABBYY

WHAT STARTED WITH A DICTIONARY FOR PC AND A PROGRAM TO RECOGNIZE COMPUTER-SCANNED IMAGES HAS EVOLVED INTO A SPRAWLING GLOBAL BUSINESS BASED ON A SIMPLE MISSION STATEMENT: TO GIVE ANY USER THE CAPABILITY TO SCAN ANY TEXT AND PRINT OUT ITS QUALITY TRANSLATION INTO ANY LANGUAGE. TO EXECUTE ON THIS MISSION, THE FOUNDERS OF ABBYY INITIALLY IMPLEMENTED GLOBAL NICHE STRATEGY, TAPPING INTO LOCAL TALENT TO DEVELOP INNOVATIVE PRODUCTS FOR OTHER MARKETS. FROM PRODUCTS, THE COMPANY MOVED ON TO SERVICES WITH A DEDICATION TO MEETING ALL CUSTOMER NEEDS, NO MATTER HOW SMALL. IN FOLLOWING A GLOBAL CITIZEN STRATEGY, ABBYY SET UP LOCATIONS WORLDWIDE TO OFFER SERVICES BASED ON ARTIFICIAL INTELLIGENCE AND NATURAL LANGUAGE PROCESSING. THE COMPANY NOW HAS OVER 30 MILLION LICENSED USERS FROM 150 COUNTRIES AROUND THE GLOBE, INCLUDING RECENT EXPANSION INTO THE LUCRATIVE U.S. MARKET.

In 1989, two students of physics (from the legendary Phystech in Moscow) who thought that traditional paper dictionaries were too impractical for attempts to cram the learning of French before an exam launched ABBYY. They spent their summer holidays programming a dictionary for PC and in 1990 they went to market with their first product, Lingvo. In 1993, another important development followed: FineReader, a program designed to "recognize" computer-scanned documents by turning them into texts, not graphic images. This task requires complex and imaginative programming to ensure recognition of all the possible typographies, allowing for loose placement of text on the scanner (which makes lines of text go astray) and innumerable other real-life constraints. It is only when people started to program such systems (Optical Cognitive Recognition, OCR) that they understood what a complex task our brain performs merely understanding the letters while reading — even before

going to their meaning.

Over twenty years after the launch of its first products, the company still largely concentrates on developing and marketing them, only now on a global basis. Yet the functionality of the latest versions would probably look like science fiction in the beginning of the 1990s. And it's largely about the integration of two core competencies — knowing how to understand languages and knowing how to recognize all sorts of visual objects.

For example, the FineReader now has built-in dictionaries for 189 languages. This means that scanning and "reading" the document, it will not mix the Latin and Cyrillic letter "o". Those have no visual differences but have different computer codes — it is essential to distinguish them for the task of further text processing like spell checking, content analysis or machine translation.

The ultimate product vision of the founders of the company is very simple: the mission will be ac-

completed when a user will be capable of scanning a text and printing out its quality translation into any language. Though the formulation of the tasks sounds uncharacteristically simple for an IT company, IT implementation involves solving linguistic and mathematical problems of incredible complexity.

Recently the company has expanded into the services market, launching a subsidiary called ABBYY Language Services. It provides its clients — among them 35 of the Fortune-500 companies — with the services of translation and localization of not only the usual corporate documents, but of websites, software interfaces, technical documentation, etc. Part of the offer

“Integration of the professionally and technologically advanced team of Connective Language Services, which has almost 10 years of successful experience on the American market, will put us on a new level of development and enable us to directly challenge the current leaders of global translation services in the nearest future.” — Ivan Smolnikov, CEO of ABBYY Language Services

is that there is “no task too small” for the service. If a client needs to check the translation of just one word in the proper context (like an element of a computer menu) — he can effectively do it through a specialized on-line interface. ABBYY’s services do pay off for its clients. In the words of Ivan Smolnikov, the Managing Director of the division, “The probability of a purchase is twice as high if the product or service is described in the buyers’ native tongue, rather than when the information is available only in English. To cover 80% of the global online audience one, will have to localize into no less than 12 languages... Today the market for such services is estimated at over \$30 billion and it is growing at a fast pace.”

The company quickly moved to go international. By the year 2000 it had representative offices both in the U.S. and the EU and now its network includes 14 countries, among them Japan, Taiwan and Australia. The company counts over 30 million licensed users from 150 countries around the globe. ABBYY claims that its technologies “empower tens of thousands of organizations to process over 9.3 billion of pages of documents and forms annually. The cost savings brought by technologies amounts globally to 960 million man-hours or \$4.8 billion a year.”

The company structures its product offering into three groups: for individual users, for corporations and for third-party software developers

who may need to introduce some functionality of ABBYY products into their solutions. The FineReader software is also actively marketed to the manufacturers of scanning hardware to be included into the product installation package.

The company’s services arm has moved aggressively into the lucrative U.S. market (home to a quarter of the Fortune 500 multinational companies, arguably generating the lion’s share of global demand for corporate linguistics). In July 2012 it acquired an American company, Connective Language Services, and has launched a production center in New Jersey to handle the most complex translation projects coming from the U.S. market.

Going forward

ABBYY is firmly positioned as one of the global leaders in the development of artificial intelligence systems, and its founder and CEO foresees the coming era of a “fully natural” interface between a human being and a machine. With this in mind, the company has launched an ambitious scientific project, Compreno, with the aim of teaching computers to fully understand the meaning of natural languages. Around 1980, some influential scholars of computer science referred to this task as “strong artificial intelligence” and proclaimed it unsolvable. In the view of ABBYY’s Founder and CEO, David Yang, his team — which includes three full-scale university faculties, in mathematics, programming and linguistics — will arrive at a solution within the next five years.

SKOLKOVO Institute for Emerging Market Studies
Moscow School of Management SKOLKOVO

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Established in 2006, **the Moscow School of Management SKOLKOVO** is the largest private business school in Russia. SKOLKOVO trains business leaders to apply their professional skills in dynamically developing markets, training leaders who will set up and run their own businesses and lead the development of the Russian economy. SKOLKOVO offers a range of academic programs, including a full-time international MBA, an Executive MBA, corporate executive education programmes, the SKOLKOVO Startup Academy for young entrepreneurs, and the SKOLKOVO Practicum. The SKOLKOVO community brings together those who believe that an entrepreneurial approach and proactive attitude are the key to the successful development of the Russian and global economies. This includes representatives of the largest Russian and foreign companies, small and medium businesses, and public authorities.

SKOLKOVO Institute for Emerging Market Studies addresses the fields of strategy and innovation, global markets and institutions, «soft power» and digital technology. The mission of the institute is to promote Russia's multi-dimensional and seamless integration into the world economy. The institute helps the international business community better understand Russia as a market and as a global player, and supports the efforts of Russian businesses to attract investors and enter international markets.