

Russian channel fears threats to distribution

Russia has long been a distinctive IT market, with a limited presence of international distributors and PC vendors. Last time we visited the expansive nation, there was a sense that this could change, but while PC assemblers remain strong, the distribution channel faces a number of threats. *IT Europa* assesses how the market has developed in the last 12 months...

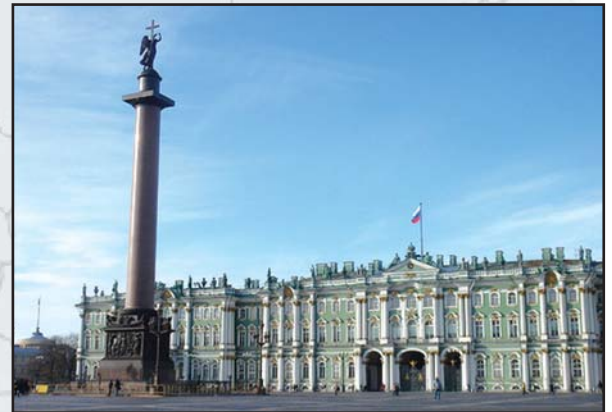


Photo: tg81

The distribution market in Russia continues to be dominated by local goliaths MERLION, Kvazar-Micro, R&K, Formoza and OLDI, the market's five largest distributors, the first of which has topped €1bn in estimated annual revenues. Other distributors include broadliner OCS and hardware rivals Rosco and Marvel, and regional components giants ELKO and ASBIS are also present, but the absence of Ingram Micro, Tech Data and Actebis stands out like a sore thumb on the landscape.

Many questions have been raised as to why the broadliners are not present in a market with such vast potential. Answers range from the strength of the local firms that prevents a simple entry into the market by foreign rivals, to the size of successful local broadliners that prevents an affordable acquisition. Questions are always abundant in Russia, but replies are sometimes scarce - the lack of transparency, combined with suspicion, means that sadly many businesses simply will not comment on-the-record.

The other issue that many overlook is corruption in the market, which, coupled with difficult import laws, wards off many foreign distributors. Last month, Ingram Micro's CEO, Greg Spierkel, told us the company is not in Russia 'because of businesses and the tax structure, particularly the playing of the system that happens around VAT'. Many of the locals also claim to be doubtful that new distributors will enter the market. Roxana

Yanborisova, vice president at OCS, says she expects 'nothing fundamental' in terms of such companies moving into the Russian market.

The most notable changes in the distribution arena concern R&K and Millennium Distribution. The former, despite being a broadliner in our distribution table, is rumoured to have planned to leave the pure distribution arena, as predicted by commentators in our last Russian national survey. According to its website, its main work is PC assembly, though it could not be reached for comment. According to one source, the rumours have not yet

Top Russian Distributors

by sales Euros (m) - *IT Europa*/market estimates. *includes non-distribution activities

Company	2004	2005	Focus
MERLION*	977	1152	Broadline, PC assembly
Kvazar-Micro*	741	883	Broadline, PC assembly
R&K*	660	787	PC assembly, broadline
Formoza*	482	574	Hardware, retail, assembly
OLDI	426	508	Hardware
OCS	278	331	Broadline
Rosco	236	281	Hardware
Marvel	229	273	Hardware

upset the balance of the rest of the distributors in the market: 'It's creating a lot more space, but I really wouldn't say that any single disti will win a larger share than another of the pure distribution business that could be left in the open.' At the time of going to press, R&K had not responded to our calls.

Another distributor, components specialist Millennium Distribution, which has a large presence across the region, is also rumoured to be planning to leave the hardware channel. But its website states it is 'one of the best IT distributors in the CIS', so the rumours seem a stretch. While the firm has not yet commented to us, a source at a rival nevertheless claims: 'The owner, who used to be a co-owner of R&K, is planning to get out of that area of business, because the return on investment is not so strong.' He says that the firm is not planning to sell up, though: 'In a mature market, it would be more normal to sell the business, but things just aren't transparent in Russia so generally few players take the risk of getting involved.'

'A lot of volume vendors totally overestimated their potential market.'

Roxana Yanborisova, OCS

A number of commentators claim that many other distributors are diversifying, or have become part of holding companies with many different activities. OCS is one such example, being part of the National Computer Corporation (NCC), which claims to be Russia's largest IT firm. NCC also owns distribution activity Landata, system builder Aquarius, software developer AND Project, and IT services and consultancy business Sistematica. While this model appears to be working for NCC, at least on revenue terms which are estimated at nearly €820m for 2005, a number of holding companies are said to be neglecting their distribution activities in favour of higher margin services.

Andrey Kostevich, VP Russia and Belarus region at components wholesaler ASBIS, is convinced the number of distributors in the market will decrease, as a result of the pressures. 'Only the strongest will be able to survive, while the rest will have to merge or shift to other business areas,' he believes. 'The reason for this is more vendors are setting up representative offices in Russia, and some of them have begun working with [resellers] on their own.'

Yanborisova at OCS says the year has been 'one of the most difficult' for distributors since Russia's 1998 commodity-led financial crisis, thanks to a recent dramatic overestimation of sales by vendors and their channels. 'Though

our market continued to grow quite rapidly this year, about 25pc [year-on-year], there were problems connected with profitability,' she explains. 'The thing is a lot of volume vendors totally overestimated their potential market, forecasting a growth of as much as 50pc to 70pc for the end of 2005 to the beginning of 2006.' She adds: 'As a result a number of vendors overloaded distributors' stocks, leaving distis with no choice but to try to clear goods, leading to margin erosion.'

OCS claims to have escaped the worst effects of this, saying that its value-added distribution business, of high-margin hardware, helped to offset the effects on its broadline activities during that time. It also has a large division dedicated to information lifecycle management technology. 'Some distributors, primarily the pure box-movers, finished the first half of this year with no growth or even a loss,' she says.



Andrey Kostevich, ASBIS

But the problem of stock saturation in the market is easing, according to Yanborisova, thanks to many of the distributors coming together to make their voice heard on appropriate quantities of products for the market. She says gladly: 'Since June, the situation has largely changed, as shown in the figures of large distributors, because a number of them came together to make sure the trend was broken.'

Geographical factors literally stretch distributors across Russia, and each one of them is fighting to offer a better reach than the others by selling to remote towns across the nation. Kostevich at ASBIS says this is a factor his firm is using to raise its profile: 'Our priorities are the development of the regions we operate in, and the expansion of our product offering. The major challenge we face is the size of the country and its different time zones, which lead to

more complicated stock management and delivery. It also means we have to work remotely with some partners and it's rare for us to have face-to-face business meetings with them.'

Tougher import controls imposed by the Russian government, aimed at reducing illegal importation, have also hit distributors, according to Marina Tyschenko, PSG general manager at HP's Russia office. She explains: 'These have led to longer transit times and an increase in prices, putting pressure on distributors' finance.' She expects costs to be passed on to resellers too, stating dealers will need to 'take care to have an effective cost structure' in order to cope with the problem.

Local PC brands dominate the desktop market, as they have ever since the birth of Russia's IT industry. Confusing import laws and a difficult territory to become established in owing to its size and the strength of local players, have been cited as reasons for international PC vendors finding it difficult to establish a sales channel in Russia.

The top PC assemblers in Russia, from first to fifth, are Sunrise, OLDI, Formoza, Kraftway and Compulink, which all have revenues over the €100m mark according to estimates. But another distribution source claims to be 'surprised' that Formoza is in business. 'Formoza is a big assembler here but it had also amassed huge debts to Maxtor and may have been having trouble with supplies as a result,' the source explains. 'After Seagate bought Maxtor [last winter], the company resumed shipping the goods while reclaiming some of the debt. Seagate is not going to miss out on sales to such a big partner.' Formoza did not return calls for comment.

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Prestigio and Canyon, the ASBIS in-house brands that are ubiquitous in central and eastern Europe, are also gaining a presence in the Russian multiple retail market, capitalising on a mix of PCs, digital media centres and peripherals, and building on a track record of Prestigio monitor sales in Russia. Patrick van den Bovenkamp, chief sales and marketing officer at Prestigio, claims: 'Prestigio has become a respected brand name in Russia, and is known in both

the business and consumer environments.

From 2007, Prestigio will focus even more on sales to businesses directly and through our partners.'



Vladivostok, in south-east Russia

Last year, several A-brand vendors selling in Russia professed their undying love for the channel there. But it is starting to become apparent that some of these statements may have been made within the context of keeping the channel sweet while vendors changed their own go-to-market strategies. Now, HP, Sony and Samsung are all vendors that have been named by some sources as moving towards a more direct model, though the vendors have not confirmed this. 'Sony has started trying it out, but at a very low profile,' confides one distributor. 'HP is trying to do the same, and it is known to have a mixed model of direct and indirect sales elsewhere which could also work in Russia. Samsung has started by announcing plans to sell its mobile phones directly from January, and it is apparently considering selling some of its own printers directly from May.' The vendors have not yet commented.

This change could have a profound effect on the distribution channel, with some of the key vendors starting to tackle SMB accounts directly, using databases of end-user details they have built up during the boom in business usage of PCs. This does not preclude distributors from being involved in multiple retail sales, nor does it keep them from still shipping products, but the difference is that it would be direct to end-users.

Surprisingly for some, in a market that could be partly moving towards direct sales, direct-loving Dell is not yet a part of the movement. Talking to us, a wholesaler snaps: 'Dell is not smart enough to change shape as quickly as HP or Samsung. It's likely to stick with the channel for a bit, in my opinion. Bypassing the channel can be a double-edged sword.'

Notebooks are the fastest growing part of the market, and as usual, the majority of smaller PC assemblers do not sell them, because the investment costs are high, and this segment is now said to be dominated by Asian brands such as Acer and Asus. Avoiding producing notebooks, though, is not such a bad move, according to some. A source tells us: 'Laptop screens are getting

bigger to accommodate the demand for all-encompassing images and more immediate information. But desktops are a more viable offer to many offices here. All the talk of desktop sales slowing might not last forever.'

There is also much talk of the notebook growth being below expectations, despite its high pace, and desktops continue to dominate the market. Vendors are reacting by changing their pricing strategies, and Tyschenko at HP explains: 'The notebook market has experienced a drop of 10pc to 15pc in its average unit price. Notebooks below \$1000 (€790) and in some cases below \$800 (€630) are driving the growth in units sold.'

Demand for IT at home is rapidly increasing, stimulated by the growing amounts of credit available to such consumers. IT retailers are no exception to the credit boom, and are offering store cards and credit for PC purchases, often at astronomical interest rates of over 25pc. The danger with this is that the number of 'bad debts', where a financially-stretched consumer declares bankruptcy or enters an agreement to pay back a reduced amount, is increasing.

The leading retailers are as before: Eldorado is often seen as the main electronics store, followed by other players Auchan, White Wind, Mir, MosMart and M-Video. Supermarkets are also big in IT - with Carrefour leading the pack. While the 'growth effect' of Media Markt, the Metro-owned German electronics giant, was much-anticipated last time we wrote our Russian national survey, its impact is now really being felt. A distribution contact tells us that it has already put pressure on the dominant El Dorado: 'A couple of months ago, El Dorado was the worst company in terms of payment times, and on occasion we had to stop shipping to it. Now, with the new Media Markt stores here, its payment has improved a lot.'

The growth of consumer retail sales, which is estimated to be at nearly twice the pace of reseller sales to businesses, has put the squeeze on a number of local dealers in the two main cities, Moscow and St Petersburg. And medium-sized retail chains in areas across Russia are clubbing together to enlarge their sales volumes. Tyschenko at HP says: 'There is a trend of retail channel consolidation around big volume sales with a large number of IT stores and consumer electronics outlets forming regional retail chains.'

Elsewhere, though, large chains have a reduced presence, and local dealers tend to have an established business with loyal customer relationships. Some geographical areas are so difficult to reach that the only realistic delivery

method is air shipment, adding large costs to the end-user's purchase price.

Local resellers have benefitted, though, from the credit lines that distributors can raise for them to offer to end-users. A source at a large distributor tells us: 'They can offer slightly better terms than some of the large retailers might, because distributors are keen to give them some advantages - we need them around and they often give us a good sense of trends in the market.' The interest rates that end-users pay are still high, but slightly better than retail, at around 20pc. Yanborisova at OCS claims end-users are also increasingly demanding 'longer term credits' from resellers, adding that 'about 80pc of shipments are on credit terms'. And wider financial services including leasing are also ensuring customer retention and a more predictable cashflow.

As is the case with credit, repayments can become problematic when businesses find themselves over-stretched. As a result factoring, in which a company buys the accounts receivable of another company, as an additional financial facility. ASBIS offers such a service in Russia, and Kostevich calls it 'a significant advantage in the market'.

A large number of resellers, particularly outside the cities, are also small PC assemblers. While none is a major PC player, each has a good strength in its local area by offering customised PCs, and this is an area where such dealers are adding value to their deals and keeping clients on-board. Some resellers are also supplied with their distributors' own PC brands, such as MERLION, which supplies its own iRU branded desktops to its dealers. Around half of MERLION's PCs are pre-configured, and around half it assembles by order for its dealers. These sourcing strategies are changing the way PC assembly is run at a local level, in such a fast evolving SMB and consumer market. With the changes in distribution, no one is resting on their laurels.

► OUR ANALYSIS

The dangers that loom over distributors in Russia are putting everyone on their toes. It's hardly a surprise that rumours abound of distributors wanting to leave the market, and while we hate to say this phrase, in a market as opaque as Russia only time will tell how true these rumours turn out to be. But one thing is clear: there is a lot of smoke.

Locals still dominate the distribution arena, and as the large wholesalers get bigger, the others are left diversifying or even moving into other business areas to survive. It's a sign of a maturing market, but a distinct one where import issues and other legal challenges ward off many foreign firms - for the moment. The growth of A-brands may melt the ice.