CEEMEA Business Group

Human resources and talent management in Russia

Salaries, turnover, expatriates, quality of staff

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Content

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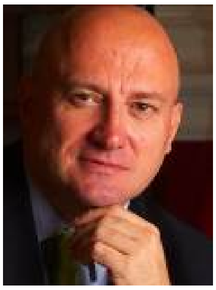

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Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) which is Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in CEEMEA, global and emerging markets especially Russia. These companies are part of the CEEMEA and Russia Business Group, which is an advisory and consultancy service. The services of the Group include written position papers, presentation slides and private client meetings as well as in-house presentations.

Danny writes a well-received monthly position paper on the Russian market as well as quarterly presentation slides on other CIS markets. He visits Moscow on business every 2-3 weeks and hosts 8-9 private meetings of the Russia Business Group annually. The most recent one was attended by some 140 senior executives. He is also invited to make some 50 speeches/presentations each year by clients across the world on global business trends, business operations, emerging markets, corporate best practice. Many of these speeches are focused on Russia and the CIS and he has made some 60 "Russia presentations" to visiting western CEOs explaining the positives of the market without being naïve.

For 23 years (until the closure of the Vienna office) Danny was Senior Vice President and Senior Consultant at The Economist Group, Vienna on global corporate business trends, with specialisation in BRIC.

Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

Danny is regarded as a charismatic speaker who can present detailed business and economic analysis in an easily digestible fashion with a great deal of genuine humour. Danny is renowned for not using powerpoint presentation slides - never. Dr Thorniley has also given guest presentations at Executive MBA courses on behalf of Oxford University, the University of Chicago, IESE (Spain) and the Central European University in Budapest. The executive MBA students at Chicago rated him "best speaker" on 12 occasions out of 12 over 5 years.

He has worked on a personal basis with companies operating in emerging markets for 26 years and has personal contacts with most senior western MNCs operating in the Russia and the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level and has long-standing personal friendships with leading executives.

He holds and has held a number of non-executive and advisory board memberships.

Dr Thorniley was educated at Oxford University. He holds a Bachelor of Arts degree, a diploma and a doctorate degree in Soviet political economy.

He has published three books, including one on Russia with Macmillan (UK/USA) and two with Profile books on Doing Business in Global Emerging Markets.

His beloved daughter is called Natasha after he read Tolstoy's War and Peace when he was a young man. One of his other favourite books is Master and Margarita by Bulgakov.

PART ONE

The findings and commentary in this report are taken from a HR/Talent management event which I hosted last week in Moscow attended by 45 managing directors and HR directors in addition to observations drawn from other executive meetings held in Moscow in the last month. At the end of this report (Part 2) you will find the full HR summary from our regular Business Russia Survey conducted in mid-June.

Introduction

As opening remarks, 3-4 senior managers have noted that the really important changes in HR and talent management occurred after the 2009 crisis and many recent developments are only "add-ons" from the earlier crisis. As one managing director (MD) put it:

> 2009 was the real turning point. Until then we had volatility, massive job-hopping, high salaries, and unrealistic expectations. 2009 sobered people up. The mentality for many/most Russian changed dramatically then and the period 20010 to 2013 was very different from pre-2009.

Headcount surviving? Salaries negative in real terms.

The number of companies who are cutting staff is rising as the summer season is not offering a strong business rally for all companies. In our Survey (below) the number of companies cutting staff has risen from 10% some three months ago to 40% today. But most are still only trimming headcount and getting rid of low-performers. However, one major FMCG decided this April to cut staff by 20%, of which only about 10% represents natural attrition. But still, this is one of the higher numbers reported to me outside the automotive industry and some B2B companies.

Our Survey results below indicate clearly that most western companies (like Russian ones and the Russian public sector) are offering average salary increases of about 7% or even lower and with inflation running at 13-16% this means that real wages are falling 7-10% which is precisely what official statistics are reporting.

The MD of one major global FMCG said last week in Moscow:

> It now takes about 2-3 months to get someone on board whereas 15 months ago this took up to 6months. Now staff are not asking for the moon and we can move forward.

The MD of another major western investor confirmed: "We offer a 7% pay rise and the recruit says "Thank you". The MD of another consumer products company summed it up:

> Business, growth and profitability are all weak for our company at present and so salaries are going to be weak as well.

The managing partner of one executive search company also confirmed these remarks:

> Salaries are not usually now the deal breaker. Expectations of middle management and even above are now muted.

The general current acceptance of "weak, below inflation salaries" by Russian staff fits in well with their response in pervious crises: Russians understand when times are tough and are also generally wiling to hunker down. The general consensus is also that they are willing to work a bit harder and also to look at new ways of doing business and looking to be innovatory.

As the MD of a large western investor company commented in general context about business:

> The crisis allows us to do many things with our business model which we couldn't do in normal times. We can look at route-to-market, structure and costs overall and not just salaries and headcount.

Nearly all companies are making cuts but the trick is to achieve solid efficiencies and better productivity without destroying relationships with stakeholders and employees and especially talent; talent that will be needed as long as the current crisis persists and who will drive the business in the future "new normal".

And what about other benefits?

In an informal poll of 45 managing directors and HR managers taken in Moscow last week, there was near unanimity: no company is improving/increasing benefits (not surprising), no company is reducing them (some small surprise) and 99% of those asked are maintaining them at current levels.

The MD of an international food & beverages company commented that his company is making moderate headcount cuts but : "We are not cutting back on training programs as that would be bad for business and send a wrong message to staff".

The HR director of another western investor does say though that:

> We are keeping overall benefits at their current, historical levels but if the business pressures do not ease off, this may be harder in the coming quarters and we may have to trim them in the autumn selectively.

Another HR director wondered whether her company and others would be able to maintain MBA tuition costs.

And salaries in 2016 - same again?

It may be too early to make this call but given that business results across sectors are mixed at best and given that companies are managing costs tightly and only expect a mild business improvement next year, then it seems that many companies could be thinking that salary increases next year for average white collar staff will also be in the 6-9% range. The MD of a western consumer goods/cosmetics firm noted last week in Moscow that:

> Our salary increases this year were about 7% and I think at the moment that we may be repeating that figure in 2016.

One or two other executives and HR directors also confirmed that this was their thinking as well. One MD of a B2B company thought that:

> I think overall salaries are going to stay soft for several years as it is going to take that amount of time for large parts of industry to recover.

If companies do decide on about 7% in 2016 and if inflation trends downwards as we presume it will, then real wages will obviously improve. This year it looks like real wages in many western companies will be -5% to -8%. A 7% nominal increase next year with average inflation of about 8-9% would mean that real wages would still be negative but only marginally at about -2%. Such a nominal increase would not be seen as a boom pay increase by most Russian staff but falling inflation would help senior managers "to sell" this offer to their staff.

As a footnote, it is evident that the assumptions for 2016 will very much depend on business results in the second half of this year. But the above comments are valid at the time of writing.

Are expats leaving? Yes and No.

There is a strong "feel" that western expatriates are leaving and perhaps in large numbers. Business trends, anti-westernism and the need to cut costs would suggest that expatriates are leaving and some informal surveys suggest this is the case. But there is little comprehensive evidence to suggest that departures are massively higher than normal. Anecdotally I am seeing turnover of expatriates but personally this seems barely/marginally more than usual… for now. This could accelerate over the next 6-9 months if the mood worsens or even if business results stagnate.

At our HR event last week of the 45 executives polled, not one company state that they are seeing higher expatriate turnover in their own company or even within their business sector. This was quite a striking response even for such an informal “hand vote”.

Several executives (western and Russian) commented last week that the standard expatriate model of a foreigner arriving in a market with spouse and two children, staying for 3 years and then departing may no longer be so viable globally as well as in Russia. This is of course a bigger question. As companies seek to reduce costs, there will be a shift to looking at locals to take the top positions. Generally Russia has lagged behind other CEE markets where the post of general manager is often or invariably taken by a local, whereas in Russia some 40-60% of GMs remain expats.

It was agreed that in addition to overseeing regular business activities western expats are very useful at managing projects and step-changes in the organisation and/or communicating messages from global headquarters. They are also good at mentoring local staff and building the future local talent pool.

Executives also commented on the difference between “regular expats” who come into Russia for 2-4 years and then move on compared with “local expats” who have settled in Russia, often married a local spouse and have lived in Russia for 5-10-20 years and there are a growing number of such managers.

What do Russians want?

Money for sure! Western companies should never downplay the need to get the money “right” i.e. comparable to peers and in the right range. Good staff will leave you in Russia if the money is not in the right ball-park. But of course there is a lot more to retaining and recruiting good staff than money.

There is a broad consensus that while money remains (very) important, hiring and retention success depends on so many other things: the work atmosphere, ethics and feel of the company, challenges offered, career path, training but also very important is the role of management because as ever, people tend to leave because of their boss.

Last month in Moscow, one HR director of a western FMCG company summarised what you need for good retention:

1. Challenges
2. Fair/good money package and other benefits
3. Good charted career path at least over the next 5 years

And other supporting factors are:

a. Work/life balance
b. Autonomy
c. Good supportive middle level managers

Other key expectations from the Russian staff were: education, commitment and cordiality.

The MD of a major food & beverages firm commented two months ago that you “need to make an investment in each staffer as an individual”.

A very good point often raised is the attitude of different generations: the young generation often want some degree of autonomy but their direct line-managers at middle management level are often educated and trained from a more formal “Soviet” period or have more conservative attitudes. There is a mis-match. MDs must appreciate this and be prepared to train and communicate to middle management that they too may have to adopt change management in handling a younger work force with different expectations.

Related to this is the point that MDs have to be more coaches than managers.

There is also a clear consensus that you need to set challenges for Russian staff who are becoming more demanding. The salary has to be right and competitive but when you want to hire new staff or retain existing ones, you need to answer the employee's question of "Will I be empowered?" Candidates are asking themselves, "Which matrix or company will offer me the most opportunities to grow and to be empowered?"

But what comes across very clearly is that younger Russian people (and globally) expect a better work/life balance than their predecessors and senior managers, and thus expatriate and Russian MDs need to act on this. As one speaker noted: "I used to work non-stop in my earlier career and now as MD I also work non-stop and at weekends. But I see in my good Russian staff that they want to come to work at 09.30 or even a bit later and leave at 18.00. They have other things to do".

With the current crisis though, managers are putting more demands on staff to do more with less and this often demands longer and more stressful hours. But this is part and parcel of working through any crisis.

Companies are aware that staff can easily waste 2-3 hours per day in traffic and so the option of working some days from home is being addressed more.

Average staff not moving much

The cosnensus is that staff are moving less and want more security especially as they see wages decline and unemployment creep up. This certainly applies to "average white collar and blue collar staff" with voluntary turnover levels below the usual averages of 7-10% in B2B and IT and 13-18% in consumer products. In many sectors of the industrial sector, staff are hardly willing to move as the environment is quite weak.
The MD of one western food and beverages company commented that:

> We are creating a new division and we found no difficulty in obtaining middle level positions. Talent is a little more difficult.

And are those being released at the moment just low performers? There is obviously an element of this and HR directors are cautious about who is "on the market" currently and are enforcing a rigorous interview and selection procedure. But one HR director of a major US industrial conglomerate noted last week that:

> Not everyone on the market today is poor quality. Yes, we have to watch who is out there but some companies can find good people among this "discarded group of people". Just because people have left a company or been let go, does not mean that other companies cannot benefit from their skill sets. Many people leave because the chemistry is not right in their company and elsewhere they may have high potential or we can train them better.

And another MD notes that "We are getting "returnees", those who leave and after 4-6 months phone me asking for their old job back".

What's happening with talent?

Generally the view is that it is still difficult to attract talent as they are deciding to stick with their companies and these companies ought to be ensuring good packages and prospects to retain their talent. So the broad picture is that talent is difficult to come by and one managing director of a fragrances company noted last week in Moscow at dinner that:

> I am trying to find 3 key positions and it is proving much more difficult than I imagined. I did not think there would be a flood of people coming to our door but nor did I expect such a paucity of good people.

But there is a reverse of this taking place and the picture may be a bit more complicated. Several companies are reporting the loss of good people whom they wanted to retain: so some talent is available. The regional MD of one drinks company commented two weeks ago by phone that:

> We have lost top talent in the last 3-4 months with 3 people departing whom we would have liked to retain: one went to a Russian company, one went to a western competition and one decided to set up his own firm, so quite different reasons.

A good handful of other MDs have also commented that they have lost 1-2-3 top talent over the last 6 months but this is not a massive exodus.

The MD of an executive search firm noted:

> Specialist and technicians and key posts are in demand and these people are often getting poached with pay increases offered of at least 30%. The same dynamics do not apply to regular blue collar workers and they are reasonably easy to find currently.

Perhaps the best way to summarise things is as follows: most middle managers and "average staff" are staying put but they are available and not all people on the market are low performers. Regarding talent, many of these are sticking with their present employers but they are slightly more foot-loose and willing to leave for a new challenge, a better environment and a bigger pay cheque.

How good are the Russians?

The MD of one consumer products company with 20 years' experience in Russia is quite firm that the quality remains good despite any marginal deterioration over recent years. He explained that:

> Sure, quality may not be as good as 15 years ago but we still see very high quality overall. I think that the Russian educational system is still relatively strong and is end our two children to local school. The teachers are good and the parent community is highly motivated and committed and the relations with teachers are good.

Compared with earlier crises, more Russian staff are now aware and experience of how to manage a crisis: today most executives remember 2009 and some can still remember the traumatic 1998-1999 period. In 2009 senior managers were saying hat most Russian staff and all younger ones only knew how to perform in a booming, growing market. Today the skill experiences are broader.

There is huge and continuing debate about the quality of Russian staff.

Certainly for many years Russian staff were among the very best in the world: they worked very hard, they were well educated and they accepted reasonable salary levels. Very nice.

Over the last 10 years the overall quality level has deteriorated along with the Russian educational system but thanks to the diligence of Russian teachers (poorly-paid women) this has not turned into a collapse. But at the growing margins, quality has inevitably deteriorated and pay demands have sky-rocketed over the last 10-15 years with western companies and Russian staff are accustomed to high salary levels and expectations.

In general there remains a broad satisfaction with Russian staff and their capabilities and their diligence. But this is by no means total.

The Russian MD of one western consumer products company states that: "Russians have become lazy and increasingly dumb over the last 20 years. And I am not saying this because I come from the "golden generation" of executives who were young/middle-aged when the Soviet Union collapsed". He continued, "But the quality is night and day. I am hugely disappointed with what is on the market today".

The HR director of one major western services company reported this year:

> "We interview hundreds of candidates who are ending the final year of university and the trouble is they think themselves to be fantastic and brilliant but they are not. Most of them are ok at best. These university leavers have an extremely elevated sense of themselves and sadly for them their expectations have to be managed downwards very rapidly. Actually we are not so interested in the large majority and are forced to pick and choose. There is room to train them up but if they are arrogant about their own abilities, this becomes a waste of time."

The point was underlined when one HR Director noted that, "The curriculum at universities doesn't match our business needs". This is probably a valid complaint around the world but it seems to apply also to Russia.

Sales and marketing staff will come under more job pressure for at least two reasons: the market is getting more competitive and also companies are looking at affordable innovation. Both these factors mean that staff have to think outside the box and stretch themselves and think of change management/behaviour.

One manager stated that, "Russians have great technical skill sets and they focus on this, but they must realise that this is far from enough. They need broader education and a broader hinterland".

A senior western executive in 20 years' experience in Russia (and a Russophile) was also downbeat about the current generation in a recent dinner conversation:

> "I am disappointed with people we interview. They don't seem that interested and don't really know what they want to do. They have no fire and little imagination. They don't ask in interviews where they will be in the company in 5 years because they plan to be somewhere else. They can be quite shameless too: one candidate for the post of IT consultant wanted $20,000 per month, to work from Cyprus and to have two paid flights per month to Moscow and back. He was serious. We said goodbye to him."

This lack of commitment has been noted by the regional MD of a major western pharmaceutical investor who told me in recent conversation outside Moscow that: "Danny, there are much fewer committed leaders around in the Russian job market. We are building a big business here and we need talented people who can take responsibility and who have leadership skills but also the drive and commitment. We can train people up but I am not sure that you can train them to be committed".

Conversely the MD of a major western consumer product company with 20 years' experience in Russia has argued the situation well:

> "I don't think the quality of Russian staff has deteriorated that much; they are quite or very good. The issue is more the expectations of western companies and the real supply and demand. The demand for talent has gone through the roof in the last 5-10 years and major companies need an array of skills. The talent market simply can't match the corporate need of western and Russian companies. Also we still have to realise that the market changes in Russia have only been in place for 20 years and the first 5 years or more were turmoil and chaos. The remaining 15 years or so is just enough time to build a generation or half a generation who can adapt to western corporate needs. When a western company takes a Russian line manager and then tries to transform him into the director of major pulp mill in Russia in charge of hundreds of staff requiring developed soft internal corporate skills, I am not surprised that such Russian managers "fall short". I do think the western companies have to manage their expectations as much as the Russian staff."

There is also an on-going discussion revolved around whether the younger generation is more focused and IT savvy which helps companies, or whether they are less hard working and not as good as their predecessors. There is no consensus on this and none is really expected.

In summary: Russian staff remain good or better in comparative terms but not as good as they were 5-10-15 years ago.

Issues between Russian and Ukrainian employees

Relations between Russian and Ukrainian staff area cause for concern with about 40-50% of companies reporting some HR management issues. A small minority of companies are transferring staff back and to between Kiev and Moscow at the request of employees. But one MD noted that Ukrainians need jobs and they're willing to stay in Russia or to be transferred from Kiev to Moscow.

The situation is unlikely to improve that much and one HR director commented last week that:

> We are only now starting to see the long-term momentum in HR from the Ukraine crisis. At the moment there are still many of the good old relationships form the past but these are getting eroded and the younger generation may feel more strongly.

Overall, the stress between Russian and Ukrainian staff has not reached crisis levels but it is challenge and a new operational headache for HR managers.

It also means that MDs and HR managers need to manage what their employees are saying on social media. One US managing director took staff to one side and said:

> You are aware aren't you that what you write and say in these public domains can be read by your colleagues? Please be more thoughtful and considerate.

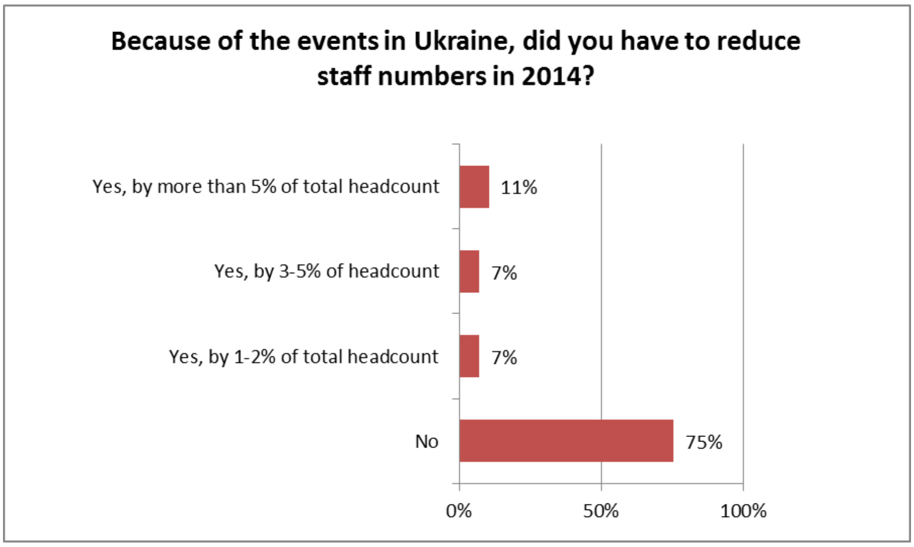
Social media does need in general to be monitored as staff are inter-reacting through these media with their colleagues with clients and with former employees.

PART TWO

HR Results from our June 2015 Russia Business Survey

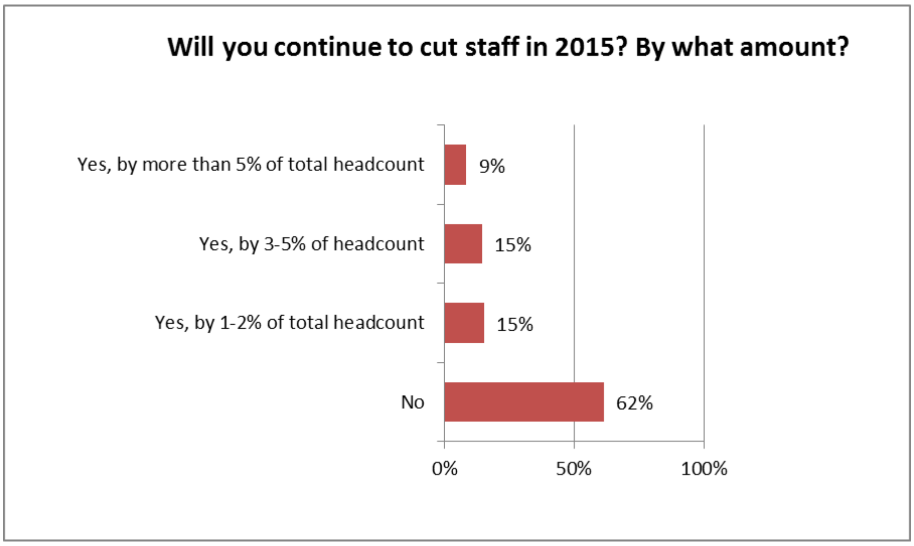
1. Companies are trying hard not to cut their staff levels too quickly (61% making no staff reductions so far). The headcount cuts which are planned are relatively small and companies are still planning some new hires in key positions. However, this indictor has worsened from 73% to 61% in the last 3 months.

2. Salaries are rightly under sharp scrutiny and have been for 12 months or more. More companies than ever are now planning to pay below inflation in 2015 (approximately 85%). Of course as inflation rises this year, real wages will fall in western companies but also across the Russian economy. So it is definitely not just western firms doing this. Also companies are currently tending not to raise salaries even though inflation is accelerating. This is the status for now.



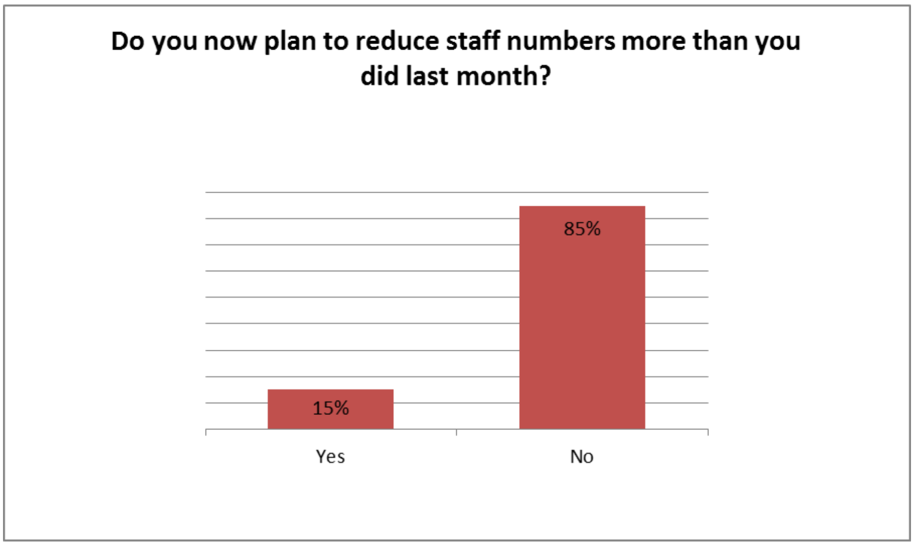
Last year companies were reluctant to fire staff and the proportion stating they have not done so is stable at 75% of companies. Some 14% of firms have made limited reductions of barely 1-5% of total staff and only 11% of companies have made cuts of more than 5% of total staff.

This approach is the best one and if sales and profits can be sustained at bearable levels, staff cuts may not become prevalent. But there is a clear risk that further staff reductions may take place and we are seeing this number creep upwards in the first 4-5 months of 2015.



Here we see that the number of companies not cutting staff is now down to about 61%, which is a 10% decline on 12 weeks ago and fits with our assessment that more companies "will have to reduce staff more this year". Most of the planned cut-backs are moderate with 13% looking to reductions of 1-2% of total staff but now 24% are proposing deeper cut-backs. There will be some churn as some companies do plan new hires and replacement ones. This indicator could worsen over the summer.

However our other surveys show that (until December) Russia remains the No 1 market in the CEEMEA region where companies still plan to hire new staff over the next 3 years. We will judge over the coming months whether this positive trends is maintained and how much HR churn takes place. The demand for top talent is still relatively high.



Salary trends 2014 and 2015

Given that salary decisions are now set for 2015, there is little change in our indicators but we are seeing some marginal movement to raise salaries a little bit by a small number of companies and at the margins. But this movement is marginal and not enough to change the indicators below regarding trends in salaries above or below inflation. We are also seeing a slight tighter clustering of companies offering low single digits or flat rouble increases. In other words, companies overall have NOT decided to re-jig or increase their salaries to compensate for the rising adjustments in headline inflation.

<u>Overall, the clear conclusion for now remains: companies are trying hard to protect their headcount but are determined to manage their costs and will keep salary increases firmly below inflation, which actually matches trends visible in the Russian economy overall and within the Russian civil service. It seems that everywhere real wages (after inflation) will now trend at -7% to -10% this year and were at -10% this spring across the economy.</u>

The clear point about 2014 and 2015 is that companies will keep a very tight rein on salaries. For 2015 more companies are planning for below inflation pay increases as inflation rises further in Russia from an average 7.8% in 2014 to an average figure in 2015 which could range from a low of 9% to a worst case of 14-15%.

There are variations of course and these are averages and white collar covers a large number of positions. To assist you in budget planning, the following two tables compare previous periods (benchmarked to inflation) and also show what companies plan in 2014 and 2015 in absolute percentage terms.

Salary comparisons 2014-2015 in absolute terms
What salary increase in roubles did you pay (do you plan) <u>in absolute terms</u> in 2014 and 2015?

	2014	**February 2015**	**May 2015**	**June 2015**
Plus 10%	3%	12%	7%	6%
5-10%	27%	55%	50%	53%
1-5%	15%	16%	23%	18%
Flat	20%	13%	18%	22%
Negative	0%	4%	1%	1%

While this table makes it look like companies are being more generous, this is not the case. Given that inflation is rising noticeably in 2015, when salaries are benchmarked against inflation, they are tighter (see the next table below).

What salary increase did you pay (do you plan) in the coming 12 months?
Salary comparison over time benched to inflation - “average” white collar staff members

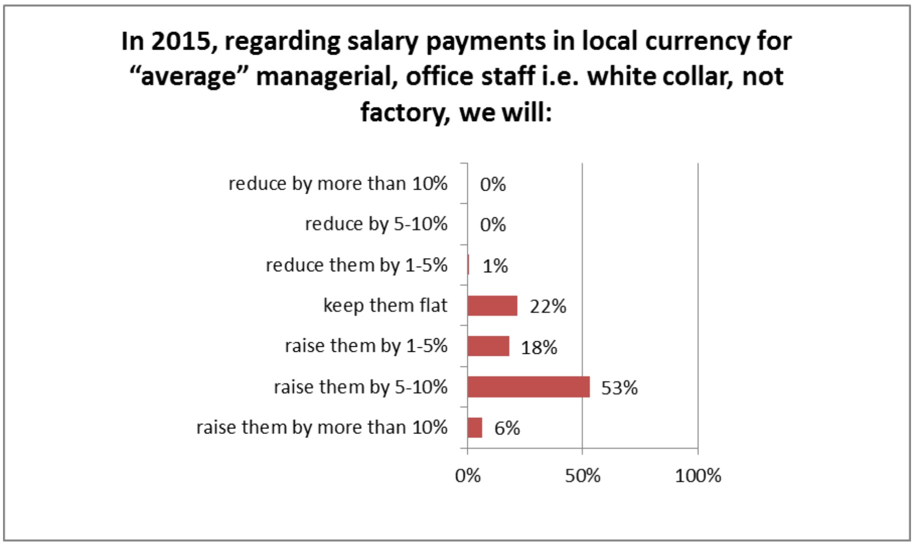
% of companies	**January 2013**	**January 2014**	**January 2015**	**June 2015**
Salary below inflation	3%	14%	89%	96%
Salary at inflation or + 1-3%	70%	80%	11%	4%
Salary at inflation +3-10%	25%	6%	0%	0%

Source: Russia Business Group Surveys

The numbers in these two tables match up/correlate when we presume that inflation in 2014 will <u>average</u> about 7.8% and will average 11-13% in 2015.

Instead of cutting staff numbers, companies are offering lower salary increases for “average” white collar staff. The upward pressures for top talent remain high but these very high levels have also declined and decelerated. What is very manifest is that while in January 2013 it was almost unheard of to propose salary increases below inflation, this has changed radically with 89% of companies now in this situation.

Also note that 81% of companies are not compensating Russian staff for the devaluation of the rouble.



As ever, I hope you have enjoyed this report and if you have any questions or comments, do feel free to get in touch at danielthorniley@dt-gbc.com.

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