



Russian Commerce News

Российские Коммерческие Новости



Official Publication of The Russian-American Chamber of Commerce®

Vol. 12 No. 3

Exclusive Supplement

Early Winter 2004

Industry Outlooks and More on Visa Reform

Our Exclusive Supplement this issue contains special reports generated by our Applied Business Research Center (ABRC). These include an assessment of Russia's e-commerce and insurance industries, and E.U. commercial friendly policies toward Russia. We also provide you with a profile of Kaliningrad.

E-commerce in Russia: Latest Issues and Perspectives

Shushan Kyokhvayants

The role of e-commerce in economic development of Russia and its integration into the global economic environment is growing in importance. The chairman of The Russian National Association of e-commerce (NAUET) D. Chereskin thinks that e-commerce can become a means of stimulating economic growth in Russia. A developed e-commerce system will make numerous products available to the remote regions of the country. It will help companies from all parts of Russia to cooperate with each other and create new opportunities for entrepreneurs and business with overseas partners.

E-commerce in Russia started to develop in the late nineties, and in 1998 there were less than 50 registered dotcom companies in the country. Now, more than 5,000 e-shops are operating in Russia. According to NAUET, the total online sales volume in 2004 will be about \$1.09 billion. The government of Russian Federation recognizes the role and benefits of e-commerce and supports the development of electronic trade in the country, paying particular attention to the Business-to-Government (B2G) sector. Recent studies have proved the increased efficiency of government purchases after switching to online transactions. Online sales in B2B sector are currently growing with the highest rates compared to sales in

Business-to-Consumer (B2C) and Business-to-Business (B2B) sectors. The current data about online sales volumes are presented in the table below. This year, the first quarter B2G sales have already exceeded expectations.

The B2B market in Russia currently involves more than 35,000 participants in such industries as metallurgy, agriculture, oil and gas, energy, IT, and machinery. According to estimates of U.S. analysts, in 2005, online sales of metal in Russia will amount to \$100 billion and comprise about 40% of the total sales in the industry. The majority of transactions in B2B segment are semi-electronic, that is, the arrangement and preparation of the transaction is conducted online, but the document signing and submitting, as well as payment, is carried out manually.

For the B2C segment in Russia, the most popular product group is now consumer electronics, followed by books, CDs, airline and vacation tickets, prepaid phone cards, and toys. In the late nineties, when e-commerce was emerging in Russia, computers were the most popular product sold online. This switch in consumer preferences shows that the typical Russian customer of an

online store and the purpose of making an online purchase have also changed. Initially, the majority of online store customers were qualified IT professionals, managers, or students, and the purchased product was targeted for a business use or for education. Currently, the majority of e-shop customers in Russia are working professionals who make more than \$800 a month. These people comprise the emerging middle class in Russia. They strive for a comfortable lifestyle and spend money on household items, electronics, clothing, vacations, etc. Virtual stores are convenient for this segment of population because they allow searching among a great variety of products in a relatively short period of time.

Table 1. E-commerce sales in Russia, millions of dollars

	2001	2002	2003	2004 (estimate)	1 st quart. 2004
B2C	218	317	480	615	264
B2B	99	189	316	464	173
B2G	-	10	141	275 (planned)	655

Source: NAUET, e-commerce.ru

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Special Report - E-commerce*(continued from page 7)***Issues**

As a relatively new sector of the economy, the e-commerce industry in Russia is now exploring numerous strategies to develop an efficient system and business model. Some of the common issues for all segments of e-commerce in the country include the low level of the Internet penetration in the country; limitations of current legislation regulating online trade; lack of a uniform product classification; authorization (problems still exist with the usage of a digital signature), and security issues related to the use of credit cards.

The majority of households in Russia still do not use the Internet. In only a few regions of Russia (Moscow, Saint Petersburg, and Novosibirsk), 15-20% of households have access to the Internet. Moreover, in some regions of Russia, there are villages which do not even have telephone lines. In order to improve this situation and to increase the number of Internet users in the country, it is necessary to make a substantial investment in the communications infrastructure development.

Currently, operating online stores also need to invest to expand their services and attract more customers. First of all, the stores have to promote their websites and inform more potential customers about their services. Simultaneously, they need to make their websites more convenient for conducting searches, selecting products, and making payments. Also, offering additional services to customers, such as credit, expert consultancy, and warranty, would make many products affordable and attractive, thus increasing the number of online purchases.

One of the most critical problems in the B2C segment today is an inadequate presence of credit cards as a payment method in online trade. The vast majority of online store customers still prefer to make payments directly on delivery of the merchandise or through bank money transfers. These payment methods are not as fast and convenient

as payments by credit cards. As a result, this situation discourages many potential customers to make a purchase, and impedes the development of the industry.

Another significant issue for the industry is the inefficient mailing and delivery system in the country. The consequence of this situation is twofold: first, it makes many people avoid making online purchases, and second, because of unreliability of mailing and delivery system, many online stores have their couriers delivering the purchased products to the customers. Although they offer courier delivery service to the close locations only, it increases the price of the online purchase for the customer.

NAUET researchers discovered that many businessmen in Russia do not have enough information about e-commerce and the opportunities it provides for expanding their businesses. And, in order to stimulate the growth of e-commerce in Russia, particularly, in B2B sector, it is important to introduce market participants to e-commerce, and provide them with necessary training.

Currently, the failure rate among newly established online businesses is very high in Russia. The reason is that there is no efficient business model developed yet that the new companies can follow. This situation is worsened by the absence of risk hedging and conflict resolution mechanisms for business engaged in e-commerce in Russia.

Payment Systems

Due to its security and safety, cash on delivery is still the most popular way of payment for online purchases in B2C sector in Russia. In B2B and B2G segments, direct bank transfer is the most popular payment method. Other than that, there are three major groups of payment options for online trade available in Russia: bank client systems, credit cards, and electronic cash. **Bank-client** systems allow making online payments through banks registered in the system. To ensure the security of these transactions, online banking clients must authenticate themselves by passwords

and digital signatures.

The circulation of credit cards in Russia grows fast; however, they still constitute less than 2% of the total financial cards in the market. The number of **credit cards** in 2003 in Russia grew by 141% from 2002 with a total turnover of \$525 million. Nevertheless, the majority of credit cards, about 18 million, are **debit cards**. The reason is that debit cards are less risky for the banks to issue. Besides, the majority of cards (over 80%) in Russia are issued for salary purposes, and the cardholders use them only to get cash from their accounts. Credit cards are mainly used to pay for online transactions with foreign partners.

The following credit cards are currently available in the Russian market: **VISA International, EUROCARD/MASTERCARD, Diners Club, JCB, Union Card, and STB** (Russian payment system card). In order to ensure the safety of using credit cards, some online stores have their carriers check the ID of the customer when delivering the product. Today, credit card transactions constitute only about 5% of all online trade payments in Russia.

Electronic cash is used for about 2-3% of online payment transactions. The experts estimate that the share of this type of online payment will grow in the future as more people know about it. Currently, PayCash and Webmoney are the most popular eCash systems in Russia.

Since 2002 Russian Internet port Yandex together with **PayCash** payment system started to offer Digital Money service for online trade (<http://www.paycash.ru>). Recently, this Internet Money service became available also in Ukraine, Byelorussia, and Armenia. The customers can get their electronic wallets on this site and deposit money in order to get an "Internet Wallet". The system offers the service for a 0.5% fee, and customers do not need to have a credit or debit card to get an Internet Wallet. PayCash

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Special Report - Insurance

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operations are expected to pass away as another sign of transition period.

On the side of prospective clients, the major problem is lack of money to pay for insurance policies. In this sense, the remarkable growth of voluntary medical insurance premiums points out an increasing concern of the public for health and medical services. Life insurance is supposed to be next. In the list of similar services is also retirement plans reform that is now serviced by insurance industry only partially, providing trustees' liability insurance.

On the international arena, WTO participation is considered the most influential factor of the economic development, including insurance. Pros and cons for Russian insurance as results of WTO participation are considered. (see Table 2).

Analyzing the Table's points in terms of European insurers' recent behavior and expressed concerns, we see that pros and cons can be effectively balanced out.

Generally, I am optimistic about the future growth of Russia's insurance industry. □

For more information, visit:
AIG Russia Insurance Company www.aigrussia.ru;
 'Gateway to Russia' project www.gateway2russia.com;
Ernst and Young www.ey.com

Marianna Arzangulyan wrote this profile while a Visiting Researcher at the Chamber's Applied Business Research Center during Summer 2004. She is a graduate student at University of Georgia.

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customers can use these wallets in a number of online stores in Russia both to make purchases and sales.

WebMoney Transfer offers services similar to those of PayCash. The advantage of this system is that WebMoney operates in 661 cities in 23 countries, including most of former Soviet Union Countries. (<http://www.webmoney.ru>)

Rapida is another payment system operating since 2001. Rapida allows its clients to make online payments using the money on their accounts in the system or prepaid cards (<http://www.rapida.ru>).

Created in 2000, **Cyberplat.com** is one of the leading Russian companies offering a number of services for e-commerce including online payments processing, Internet banking with a registered bank, and secure documents a communications infrastructure and online trade regulation, there are still some barriers existing in the industry. However, there is no doubt that there are also great opportunities for profitable online business in Russia. □

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Shushan Kyokhvayants wrote this article as a visiting researcher at the Applied Business Research Center in summer 2004. She is a graduate student at Tulane University.