

alized something had to be done.

DELL'S OPTIONS

Maxwell considered his options again:

1. **Dell could simply leave Brazil altogether.** After all, the country had just experienced a massive devaluation in January 1999. Dell had continued with its plans in the immediate aftermath of the devaluation, demonstrating its faith in Brazil's long-term prospects. But the country clearly had a significant degree of economic volatility, and even a fair amount of political volatility, or at least policy uncertainty, as Governor Dutra's recent actions indicated.
2. **Dell could stay in Brazil but go to another state, such as Ford had done in Bahia.** Certainly, the other states on the list that the site selection team had considered offered some interesting possibilities. Bahia would not be an option for Dell, but Minas Gerais might be. Minas met Dell's basic selection criteria and had offered an incentives package that was very similar to what Dell had received in Rio Grande do Sul.

Minas Gerais had other benefits also. It did not have the same level of partisan differences, at least with regard to attracting foreign direct investment, that Rio Grande do Sul seemed currently to be experiencing. INDI, the state government's investment promotion agency, had seemed interested in working with Dell and knowledgeable about Dell's needs, if not quite to the same extent that Pólo had been. Perhaps the impression that members of the site selection team had—that Minas Gerais was too oriented toward the mining and automobile industries—had been misleading. After all, that did not mean that the state could not also develop a niche in high-technology investment as well.

Dell had not yet begun construction on the plant in Rio Grande do Sul. As of yet, it really had no sunk costs that would make it difficult to leave the state and go elsewhere. Going to Minas was definitely still a possibility.

Brazilian executive whom Dell had already hired to serve as its new Corporate Affairs Director in Brazil. He proposed that Dell could attempt to negotiate with the governor by showing how keeping Dell in the state could help him, or at least would not be inconsistent with his own goals and agenda.

Loureiro's idea was that Dell executives could reason with the new governor by pointing out the harmony between the governor's objectives and Dell's. After all, Loureiro's argument went, Dell was a very different company from Ford. Unlike an automobile company, Dell did not manufacture something that damaged the environment; it manufactured computers. Computers provided people with access to the Internet. The Internet provided even people in poor slum areas access to information. This had a democratizing effect on society. Giving people everywhere access to information in this way could potentially create the conditions for a more just and egalitarian social order. Thus, Dell's goal to provide people with computers was in harmony with the governor's goal of working to create a more just and egalitarian society!

This last option seemed somewhat dubious to Maxwell. But, it was true that the governor had suffered a major political blow when Ford left. It would be very bad for him indeed if another major U.S. company decided to move to another state.

With such logic, perhaps the governor could be persuaded to let Dell keep all of its incentives. Loureiro had suggested this might be possible, provided that Dell offered to donate some computers to poor areas as a gesture of goodwill.

Should Dell take a chance on this last option or follow one of the others? Maxwell realized that there were risks either way. But he would be the one making the final recommendation to Michael Dell, and the decision would have to be made quickly.



THUNDERBIRD

THE GARVIN SCHOOL OF
INTERNATIONAL MANAGEMENT

Case 5 General Motors and AvtoVAZ of Russia

To compete on technology, you have to spend on it, but we have nothing to spend. Were there a normal economic situation in the country, people wouldn't be buying these cars.

VLADIMIR KADANNIKOV,
Chairman, AvtoVAZ of Russia.

There are 42 defects in the average new car from AvtoVAZ, Russia's biggest carmaker. And that counts as the good news. When the firm introduced a new model last year, a compact sedan called the VAZ-2110, each car came with 92 defects—all the fun of the space station Mir, as it were, without leaving the ground.

*“MIR ON EARTH,”
The Economist, August 21, 1997.*

In June 2001, David Herman, President of General Motors (GM) Russia, and his team arrived in Togliatti, Russia for joint venture negotiations between GM and OAO AvtoVAZ, the largest automobile producer in Russia. GM and AvtoVAZ had originally signed a memorandum of understanding (MOU)—a non-binding commitment—on March 3, 1999 to pursue a joint venture in Russia. Now, nearly two years later, Herman had finally received GM's approval to negotiate the detailed structure of the joint venture (JV) with AvtoVAZ to produce and sell Chevrolets in the Russian market.

The Russian car market was expected to account for a significant share of global growth over the next decade. Herman was increasingly convinced that if GM did not move decisively and soon, the market opportunity would be lost to other automakers. Ford, for example, was proceeding with a substantial JV in Russia and was scheduled to begin producing the Ford Focus in late 2002 (it was already importing car kits). Fiat of Italy was already in the construction phases of a plant to build 15,000 Fiat Palios per year beginning in late 2002. Daewoo of Korea had started assembly of compact sedan kits in 1998 and were currently selling 15,000 cars a year.

However, Herman also knew that doing business in Russia presented many challenges. The Russian economy, although recovering from the 1998 collapse, remained weak, uncertain, and subject to confusing tax laws and government rules. The Russian car industry seemed to reel from one crisis to another. The second largest automobile producer, GAZ, had been the victim of an unexpected hostile takeover only three months ago. GAZ's troubles had contributed to GM's fears over the actual ownership of AvtoVAZ itself. In addition, AvtoVAZ had been the subject of an aggressive income tax evasion case by Russian tax authorities in the summer of 2000. Finally, from a manufacturing point of view, AvtoVAZ was far from world class. AvtoVAZ averaged 320 man-hours to build a car, a stark comparison against the 28 hours typical of Western Europe and 17 hours in Japan.

Further complicating the situation was a lack of consensus within different parts of GM about the Russian JV. GM headquarters in Detroit had told Herman to find a third party to share the risk and the investment of a Russian JV. Within Adam Opel, GM's European division, there were questions about the scope and timing of Opel's

role. Prior to becoming GM's vice president for the former Soviet Union, Herman had been chairman of Adam Opel. Now, Herman needed Opel's support for the Russian JV and had to convince his former colleagues that the time was right to enter Russia. As he prepared for the upcoming negotiations, Herman knew there were many more battles to be fought, both within GM and in Russia.

GENERAL MOTORS CORPORATION

General Motors Corporation (U.S.), founded in 1908, was the largest automobile manufacturer in the world. GM employed more than 388,000 people, operated 260 subsidiaries, affiliates, and joint ventures, managed operations in more than 50 countries, and closed the year 2000 with \$160 billion in sales and \$4.4 billion in profits.

John F. “Jack” Smith had been appointed Chairman of GM's Board of Directors in January 1996, after spending the previous five years as President and Chief Executive Officer. Taking Jack Smith's place as President and CEO was G. Richard “Rick” Wagoner, Jr., previously the director of strategic and operational leadership within GM. GM's International Operations were divided into GM Europe, GM Asia Pacific, and GM Latin America, Africa, Middle-East. GM Europe, headquartered in Zurich, Switzerland, provided oversight for GM's various European operations including Opel of Germany and the new initiatives in Russia.

Although the largest automobile manufacturer in the world, GM's market share had been shrinking. By the end of 2000, GM's global market share (in units) was 13.6%, with the Ford group closing quickly with a 11.9% share, and Volkswagen a close third at 11.5%. Emerging markets, like that of Russia, represented so-called “white territories” which were still unclaimed and uncertain markets for the traditional Western automakers.

THE RUSSIAN AUTOMOBILE INDUSTRY

The Russian auto industry lagged far behind that of the Western European, North American, or Japanese industries. Although the Russian government had made it a clear priority to aid in the industry's modernization and development, inadequate capital, poor infrastructure, and deep-seated mismanagement and corruption resulted in outdated, unreliable, and unsafe automobiles.

Nevertheless, the industry was considered promising because of the continuing gap between Russian market demand and supply and because of expected future growth in demand. As illustrated in Exhibit C5-1, between

EXHIBIT C5-1 The Russian Automobile Industry, 1991-2000 (units)

Russian Production	1991	1992	1993	1994	1995	1996	1997	1998	1999
AvtoVAZ	677,280	676,857	660,275	530,876	609,025	684,241	748,826	605,728	717,660
GAZ	69,000	69,001	105,654	118,159	118,673	124,284	124,339	125,398	125,486
AvtoUAZ	52,491	54,317	57,604	53,178	44,880	33,701	51,411	37,932	38,686
Moskovich	104,801	101,870	95,801	67,868	40,600	2,929	20,599	38,320	30,112
KamAZ	3,114	4,483	5,190	6,118	8,638	8,935	19,933	19,102	28,004
IzhMash	123,100	56,500	31,314	21,718	12,778	9,146	5,544	5,079	4,756
DonInvest	0	0	0	0	321	4,062	13,225	4,988	9,395
Other	14	14	6	7	1	41	3,932	3,061	1,307
Total	1,029,800	963,042	955,844	797,924	834,916	867,339	985,809	839,608	955,406
Percent change	-6.6%	-6.5%	-0.7%	-16.5%	4.6%	3.9%	13.7%	-14.8%	13.8%
Russian Exports	411,172	248,032	533,452	143,814	181,487	144,774	120,551	67,913	107,701
Percent of production	39.9%	25.8%	55.8%	18.0%	21.7%	16.7%	12.2%	8.1%	11.3%
Imports into Russia	26,649	43,477	405,061	97,400	69,214	54,625	42,974	62,718	55,701
Percent of sales	4.1%	5.7%	49.0%	13.0%	9.6%	7.0%	4.7%	7.5%	6.2%
Auto Sales in Russia	645,277	758,487	827,453	751,510	722,643	777,190	908,232	834,413	903,406
Percent growth		17.5%	9.1%	-9.2%	-3.8%	7.5%	16.9%	-8.1%	8.3%

SOURCE: www.just-auto.com, February 2001.

1991 and 1993 purchases of cars in Russia had grown dramatically. But, this growth had been at the expense of domestic producers, as imports had garnered most of the increase in sales, largely because of a reduction in automobile import duties. With the reduction of import duties in 1993, imports surged to 49% of sales and Russian production hit the lowest level of the decade. Domestic producers reacted by increasing their focus on export sales, largely to former Commonwealth of Independent States (CIS) countries. Exports ranged between 18% and 56% of all production during the 1991-95 period.

With the reimposition of import duties in 1994, the import share of the Russian marketplace returned to a level of about 7-10%. Domestic production began growing again and fewer Russian-made cars were exported. Unfortunately, just as domestic producers were nearly back to early-1990s production levels, the 1998 financial crisis sent the Russian economy and auto industry into a tailspin. Domestic production of automobiles fell nearly 15% in 1998. Auto sales in Russia as a whole fell 8%. The industry, however, experienced a strong resurgence in 1999 and 2000.

Russian auto manufacturing was highly concentrated, with AvtoVAZ holding a 65% market share in 2000, followed by GAZ with 13%, and an assorted collection of what could be called "boutique producers."¹ Although foreign producers accounted for less than 2% of all auto manufacturing in Russia in 2000, estimates of the influx of used foreign-made cars were upwards of 350,000 units in 2000 alone.

Although much had changed in Russia in the 1990s, much had also remained the same. In the Russian

automobile market, demand greatly exceeded supply. Russians without the right political connections had to wait years for their cars. Cars were still rare, spare parts still difficult to find, and crime still rampant. It was still not unusual to remove windshield wipers for safekeeping from cars parked on major city streets. Cars had to be paid for in cash, as dealer financing was essentially unheard of as a result of the inability of the Russian financial and banking sector to perform adequate credit checks on individuals or institutions. And once paid for, most Russian-made new cars were full of defects to the point that repair was often required before a new car could be driven.

AVTOVAZ

It's mind-blowingly huge. The assembly line goes on for a mile and a quarter. Workstation after workstation. No modules being slapped in. It's piece by piece. The hammering is incessant. Hammering the gaskets in, hammering the doors down, hammering the bumpers. On the engine line a man seems to be screwing in pistons by hand and whopping them with a hammer. If there's a robot on the line, we didn't see it. Forget statistical process control.

"Would You Want to Drive a Lada?"

Forbes, August 26, 1996.

AvtoVAZ, originally called VAZ for Volzhsky Avtomobilny Zavod (Volga Auto Factory), was headquartered approximately 1,000 kilometers southeast of Moscow in Togliatti, a town named after an Italian communist. The original auto manufacturing facility was a JV (in effect,

¹Other Russian auto manufacturers included KAMAZ, Roslada, SeAZ, IzhMash, and DonInvest.

a pure turn-key operation) with Fiat of Italy. The original contract, signed in 1966, resulted in the first cars produced in 1970. The cars produced at the factory were distributed under the *Lada* and *Zhiguli* brands and for the next 20 years became virtually the only car the average Russian could purchase.

AvtoVAZ employed more than 250,000 people in 1999 (who were paid an average of \$333 per month), and produced 677,700 cars, \$1.9 billion in sales, and \$458 million in gross profits. However, the company had a pre-tax loss of \$123 million. AvtoVAZ was publicly listed on the Moscow Stock Exchange. The Togliatti auto plant, with an estimated capacity of 750,000 vehicles per year, was the largest single automobile assembly facility in the world. It had reached full capacity in 2000. But the company developed only one new car in the 1990s and had spent an estimated \$2 billion doing so.

In the early 1990s, following the era of Perestroika and the introduction of economic reforms, AvtoVAZ began upgrading its technology and increasing its prices. As prices skyrocketed, Russians quickly switched to comparably-priced imports of higher quality. As a result, AvtoVAZ suffered continual decreases in market share throughout the 1990s (see Exhibit C5-1), although it still dominated all other Russian manufacturers.

The financial crisis of August 1998 had actually bolstered AvtoVAZ's market position, with the fall of the rouble from Rbl 11/\$ to over Rbl 25/\$. Imports were now prohibitively expensive for most Russians.

It's cynical to say, but in the case of a devaluation, the situation at AvtoVAZ would be better. There would be a different effectiveness of export sales, and demand would be different. Seeing that money is losing value, people would buy durable goods in the hopes of saving at least something.

VLADIMIR KADANNIKOV,
Chairman of the Board, AvtoVAZ, May 1998

In recent years, AvtoVAZ senior management had been discussing the development of a more modern car that could be exported to developed countries. This car, called the Kalina, would require an investment of as much as \$850 million. AvtoVAZ Chairman Vladimir Kadannikov had stated publicly that he hoped commercial production of the Kalina could begin by 2004. He had also indicated that he was receptive to the Kalina being produced in a joint venture with an outsider automaker.

AvtoVAZ also suffered from tax problems and was called a "tax deadbeat" by the Russian press. In July 2000 the Russian Tax Police accused AvtoVAZ of tax fraud. The accusations centered on alleged under-reporting of automobile production by falsifying vehicle identification numbers (VINs), the basis for the state's assessment of taxes. The opening of the criminal case coincided with warnings from the Kremlin that the new administration

of President Vladimir Putin would not tolerate continued industry profiteering and manipulation from the country's *oligarchs*, individuals who had profited greatly from Russia's difficult transition to market capitalism. AvtoVAZ denied the charges and less than one month later, the case was thrown out by the chief prosecutor for tax evasion. A spokesman for the prosecutor's office stated that investigators had found no basis for the allegations against AvtoVAZ executives.

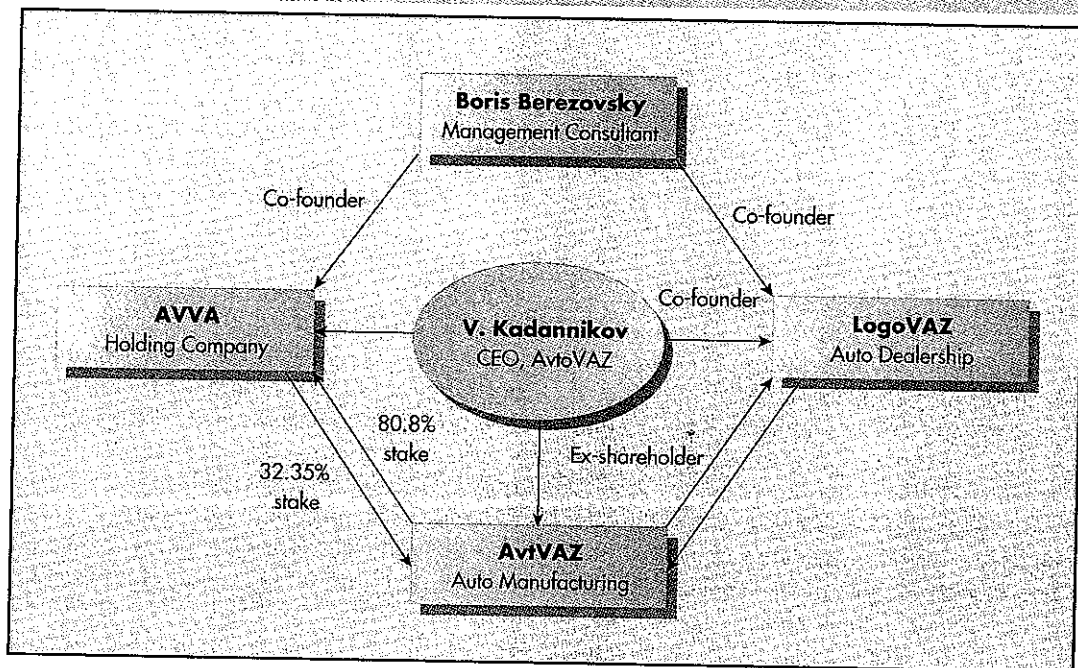
AvtoVAZ Ownership. One of the primary deterrents to foreign investment in Russia had been the relatively lax legal and regulatory structure for corporate governance. Identifying the owners of most major Russian companies was extremely difficult.

Although the exact ownership of AvtoVAZ remained unclear, two different management groups controlled the majority of AvtoVAZ shares. One group, the All-Russian Automobile Alliance (AVVA) was based in Moscow and led by Mr. Yuri Zektser. AVVA held 32.35% of total shares. A second group, the Automobile Finance Corporation (AFC), owned 19.19%. Two other groups, OAO Russ-Invest and ZAO Depository Center, owned 5.45% and 5.05%, respectively. The remainder of the shares were widely held. AvtoVAZ itself held an 80.8% interest in AVVA (see Exhibit C5-2 for an overview of the complex relationships surrounding AvtoVAZ). AVVA itself was in some way influenced, controlled, or owned in part by one of the most high profile oligarchs in Russia, Boris Berezovsky.

In 1989, prior to the implementation of President Boris Yeltsin's economic reforms, Boris Berezovsky, a mathematician and management-systems consultant to AvtoVAZ, persuaded Vladimir Kadannikov to cooperate in a new car distribution system. Berezovsky formed an automobile dealer network, LogoVAZ that was supplied with AvtoVAZ vehicles on consignment. LogoVAZ did not pay for the cars it distributed (termed "re-export" by Berezovsky) until a date significantly after his dealer network sold the cars and received payment themselves. The arrangement proved disastrous for AvtoVAZ and incredibly profitable for Berezovsky. In the years that followed, hyperinflation raged in Russia, and Berezovsky was able to run his expanding network of businesses with AvtoVAZ's cash flow. (Mr. Berezovsky has admitted to the arrangement, and its financial benefits to him. He has also pointed out, correctly, that under Russian law he has not broken any laws.) LogoVAZ was also one of the largest auto importers in Russia.

In 1994, the Russian government began privatizing many state-owned companies, including AvtoVAZ. Boris Berezovsky, Vladimir Kadannikov, and Alexander Voloshin, recently appointed Chief of Staff for Russian President Vladimir Putin, then formed AVVA. The stated purpose of AVVA was to begin building a strong dealer network for the automobile industry in Russia. AVVA quickly acquired its 32.35% interest in AvtoVAZ, in

EXHIBIT C5-2 AvtoVAZ's Web of Influence and Ownership



addition to many other enterprises. AVVA frequently represented AvtoVAZ's significant international interests around the world.

By 2000, Berezovsky purportedly no longer had formal relations with AVVA, but many observers believed he continued to have a number of informal lines of influence. In December 2000, AVVA surprised many analysts by announcing that it was amending its charter to change its status from an *investment fund* to a *holding company*. Auto analysts speculated that AVVA was positioning itself to run AvtoVAZ, which had reorganized into divisions (car production, marketing and sales, research and development).

Share ownership anxiety had intensified in November 2000 when the second largest automobile manufacturer in Russia, GAZ, had been the victim of a hostile takeover. Beginning in August 2000, Sibirsky Alyuminiy (SibAl) started accumulating shares in GAZ until reaching the 25% plus one share threshold necessary for veto power under Russian law. The exact amount of SibAl ownership in GAZ, however, was unknown, even to GAZ. Current regulations required only the disclosure of the identity and stake of stockholders of 5% equity stake or more. Only direct investors were actually named, and those named were frequently only agents operating on behalf of the true owners. Adding to the confusion was the fact that frequently the "nominees" named represented multiple groups of ultimate owners. The inadequacy of information about ownership in Russia was demonstrated by GAZ's inability to actually confirm whether SibAl did indeed have a 25% ownership position.

Rumors surfaced immediately that AvtoVAZ could be next, and the threat could arise from the Samara

Window Company (abbreviated as SOK), AvtoVAZ's largest single supplier. Many industry players, however, viewed this as highly unlikely.

Besides Kadannikov, the brass at AvtoVAZ tend to keep a low profile, but they still rank among Russia's elite executives, and they are independent," said an official of a foreign supplier in Russia. "SOK may be powerful with AvtoVAZ, and AvtoVAZ may find SOK highly useful, but I doubt SOK ever could impact AvtoVAZ strategy, and I think SOK ultimately plays by rules set by AvtoVAZ.

"Domino Theory: AvtoVAZ following GAZ falling to new owner?," just-auto.com, December 12, 2000.

Management of AvtoVAZ also felt they had an additional takeover defense, which strangely enough, arose from their history of not paying corporate taxes. In 1997, as part of a settlement with Russian tax authorities on \$2.4 billion in back-taxes, AvtoVAZ gave the Russian tax authorities the right to 50% plus one share of AvtoVAZ if the firm failed—in the future—to make its tax payments. AvtoVAZ management now viewed this as their own version of a poison pill. If the target of a hostile takeover, management could stop paying taxes and the Russian government would take management control, defeating the hostile takeover.²

²The Russian government was not, however, anxious for this series of events to unfold. It would also mean that AvtoVAZ would be entering an 18-month period in which it paid no taxes whatever to the government if the option were exercised by the Tax Police.

EXHIBIT C5-3 AvtoVAZ Suppliers Owned or Controlled by SOK

Supplier	Location	Parts
Avtopribor	Vladimir	clusters for instrument panels, gauges, speedometers
Avtosvet	Kirzhach	connectors, exterior and interior lights, reflectors, signals
DAAZ	Dimitrovgrad	electronics, lights, moldings, wheels
Osvar	Vyazniki	exterior and interior lights, reflectors, signals, warning lights
Plastik	Syzran	foam, plastics, sealants
Syzranselmash	Syzran	chemicals, headliners, sun visors, window lifters

SOURCE: just-auto.com

AvtoVAZ Suppliers. Unlike many former Communist enterprises, AvtoVAZ was not vertically integrated. The company depended on a variety of suppliers for components and subassemblies and an assortment of retail distributors. It had little control over its suppliers, and was prohibited by law from retail distribution. In recent years, AvtoVAZ' supplier base had been continually consolidated. The three biggest suppliers to AvtoVAZ were DAAZ, Plastik, and Avtopribor (see Exhibit C5-3), all of which had been purchased by SOK in the preceding years. *Sok* in Russian means "juice," but in the auto sector in Russia, the English-language joke was that SOK was SOKing-up the supplier industry.

Starting from a relatively small base, SOK had grown from a small glass window factory to a diversified enterprise of roughly \$2 billion sales in 1999, with businesses that included bottled water, building construction, medical equipment, plastic parts and windows, and most recently, AvtoVAZ' largest supplier and retailer. Although SOK officially purchased only 8,000 cars per year for distribution from AvtoVAZ, it was purportedly selling over 40,000 cars per year. The difference was rumored to be cars assembled by SOK from kits exchanged with AvtoVAZ. AvtoVAZ, often short of cash, frequently paid taxes, suppliers, and management in cars.

Dealerships and Distribution. In the early 1990s hundreds of trading companies were formed around the company. Most trading companies would exchange parts and inputs for cars, straight from the factory, at prices 20% to 30% below market value. The trading companies

then sold the cars themselves, capturing significant profit, while AvtoVAZ waited months for payment of any kind from the trading companies. The practice continued unabated in 1996 and 1997 because most of the trading companies were owned and operated by AvtoVAZ managers. Russian law did not prevent management from pursuing private interests related to their own enterprises. Despite these issues, AvtoVAZ dealers across the country made up the only truly national distribution network for cars in Russia. The existence of a dealer network was viewed very positively by GM because building a dealer network from scratch was enormously difficult.

Crime was also prevalent on the factory floor. Mobsters purportedly would enter the AvtoVAZ factory and take cars directly from the production lines at gunpoint. Buyers or distributors were charged \$100 at the AvtoVAZ factory gates for protection. To quote one automobile distributor, "They were bandits. Nevertheless, they provided a service." By the fall of 1997 the intrusion of organized crime became so rampant that Kadannikov used Russian troops to clear the plant of thugs.

International activities. AvtoVAZ was actually a multinational company, with significant international operations in addition to significant export sales.

As illustrated in Exhibit C5-4, in 1991 AvtoVAZ was exporting over 125,000 cars per year to the countries of the Soviet state. With the deconstruction of the old Soviet Union, sales plummeted to the now CIS countries as a result of the proliferation of weak currencies from country to country, as well as the imposition of new import duties

EXHIBIT C5-4 AvtoVAZ Exports

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Baltic countries	8,392	3,895	3,325	590	8,832	2,648	1,101	716	487
CIS countries	126,440	42,900	19,644	4,491	1,601	1,074	962	108	331
Elsewhere	269,936	271,763	280,593	196,696	175,161	129,957	94,303	68,689	49,957
Total exports	404,768	318,558	303,562	201,777	185,594	133,679	96,366	69,513	50,775
Total sales	674,884	673,821	656,403	528,845	607,279	680,965	736,000	599,829	677,669
Export percentage	60%	47%	46%	38%	31%	20%	13%	12%	7%

SOURCE: just-auto.com

EXHIBIT C5-5 Foreign Auto Producers in Russia

Foreign Manufacturer	Russian Partner	Auto Model	Target Price Range	Capacity per year	Expected Startup
Daewoo (Korea)	Doninvest	Compact	\$6,000–\$8,000	20,000	1998
BMW (Germany)	Avtotor	523, 528	\$36,000–\$53,000	10,000	2000
Renault (France)	City of Moscow	Megane	\$8,500–\$13,500	100,000	1998
Ford (USA)	Bankirsky Dom	Focus	\$13,000–\$15,000	25,000	2002
Fiat (Italy)	GAZ	Palio, Siena	\$7,000–\$10,000	15,000	2002
GM (USA)	AvtoVAZ	Niva, T3000	\$7,500–\$10,000	75,000	2002

at every border to Russia of 30% or more.³ In the late 1990s, sales were essentially zero. Similarly, sales in the Baltic countries of Latvia, Lithuania, and Estonia had also essentially disappeared.

Brazil has been the site of substantial AvtoVAZ activity in the past decade, with starts and stops. AvtoVAZ had originally flooded the Brazilian market in 1990 with imports when the government of Brazil had opened it to imports. Despite 85% import duties, deeply discounted Ladas and Nivas sold well. However, in 1995, the Brazilian government excluded AvtoVAZ from a list of select international manufacturers which would be allowed much lower import duties. AvtoVAZ then withdrew from the Brazilian market. In November of 2000, AvtoVAZ concluded the negotiation of an agreement with a Brazilian entrepreneur, Carlos de Moraes, for his company, Abeiva Car Imports, to begin assembly of Nivas in 2001. The target price, 17,000 Brazilian *reais*, about \$8,900, would hopefully make them affordable for Brazilian farmers.

In the past decade, AvtoVAZ has exported to a variety of European countries as well, including Germany, Portugal, Spain, the United Kingdom, and Greece. These sales have typically been small special-order models of the Niva (diesel engines, Peugeot gas engines, etc.). Continued issues surrounding quality and reliability, however, had pushed the company toward an emerging market strategy. It was hoped that low-income markets such as Egypt, Ecuador, and Uruguay would reignite the export potential of the company. GM's strategy was based on extreme low prices to successfully penetrate local markets.

FOREIGN ENTRY INTO RUSSIA

GM interest in Russia extended back to the 1970s when Opel had proposed shipping car kits to Moscow for assembly. The plan foundered because of GM concerns about quality control. In 1991, GM renewed its interest in Russia, once again opening talks with a number of

potential JV partners. But after more than a decade, few deals had materialized.

In December 1996 GM opened a plant in Elabuga, Tatarstan, in a JV with Yelaz to assemble Chevrolet Blazers from imported kits (complete knockdown kits or CKDs). The original plan had been to ramp up production volumes rapidly to 50,000 units a year, but the operation struggled. One problem was the product; the Blazers were 2-wheel drive with 2.2 liter engines. The Russian consumer wanted the 4-wheel-drive version widely sold in the United States, typically powered by a 3-liter engine. A second problem was the origin of the kits. The CKDs were imported from Brazil and most Russians did not have a high degree of respect for Brazilian products.

In September 1998 operations were suspended as a result of the Russian financial crisis. Only 3,600 units had been assembled. An attempt was made to restart assembly operations in 1999, this time assembling Opel Vectras, but when it became apparent that the market for a vehicle costing \$20,000 would not succeed in the needed volumes, the JV's assembly operations were closed. GM still had over 200 Blazers in inventory in January 2001 and was attempting to close out the last vestiges of the operation.

There were a number of foreign automobile producers in various stages of entry into the Russian marketplace, as summarized in Exhibit C5-5. Daewoo of Korea, which had made major volume achievements in a number of former Eastern Block countries such as Poland, had begun assembly of compact sedan kits in 1998, and had quickly reached a sales level in Russia of 15,000 units in 1999. Similarly, Renault of France had followed the kit assembly entry strategy with the Renault Megane in 1998, but had only assembled and sold 1,100 units by end of year 1999.

Others, like Ford Motor Company of the United States, had announced JVs with Russian manufacturers to actually build automobiles in Russia. The Ford Focus, priced on the relatively high side at \$13,000 to \$15,000, was planned for a production launch in late 2002. The facility plan was to produce 25,000 cars per year. The Russian government had given its blessing to the venture by allowing the elimination of import duties on imported inputs as long as the local content of the Focus reached 50% within five years of startup (2007 under current plans). Ford was already importing the Focus to begin building a market, but in the early months of 2001, sales were sluggish.

³AvtoVAZ did attempt to restart CIS sales in 1997 with the introduction of hard-currency contracts. The governments of Uzbekistan, Byelorussia, and Ukraine, however, forbid residents from converting local currency into hard currency for the purpose of purchasing automobiles (in two cases, specifically the product of AvtoVAZ). AvtoVAZ accused the authorities in these countries of working in conjunction with Daewoo of Korea, who had production facilities in Uzbekistan and the Ukraine, of working to shut them out.

Fiat of Italy was potentially the most formidable competitor. Fiat planned to introduce the Fiat Palio and Fiat Siena into the Russian marketplace through a JV with GAZ in 2002. Although the planned capacity of the plant was only 15,000 cars per year, the Fiat Palio was considered by many auto experts as the right product for the market. The critical question was whether Fiat could deliver the Palio to the market at a low enough price. In its negotiations with the Russian government, Fiat announced its intentions to make the Palio a true Russian-made automobile which would quickly rise to over 70% in local content. If Fiat could indeed achieve this, and there were many who believed that if anyone could it was Fiat, then this would be the true competitive benchmark.

RENEWED INTEREST

For most Russians, price was paramount. The average income levels in Russia prevented automobile pricing at Western levels. As seen in Exhibit C5-6, prices over the past few years had dropped as a result of the 1998 financial crisis. For 2001, analysts estimated that almost the entire market in Russia was for cars priced below \$10,000. Given that the average Russian's salary was about \$100 per month, cars remained out of reach for the average Russian.

In a September 2000 interview, David Herman summarized GM's viewpoint on pricing and positioning:

We could not make an interesting volume with a base price above \$10,000. Such a vehicle would feature few specifications—ABS [anti-lock braking systems] and airbags plus a 1.6-liter 16-valve engine. But, if the car costs \$12,000, it is only \$2,000 less than certain foreign imports, and this gap may be too small to generate enough sales to justify a factory. We knew we could make a vehicle cheaper with AvtoVAZ, but we need to ensure the price advantage of T3000 imports over competitive models is closer to \$7,000 than \$2,000.⁴

GM had originally considered the traditional emerging market approach of building complete cars in existing plants and then disassembling them by removing bumpers, wheels, and other separable parts, shipping the disassembled "kit" into Russia, and reassembling with

local labor. The disassembly/assembly process allowed the automobile to be considered domestically produced by Russian authorities, thereby avoiding prohibitive import duties. The market assessment group at GM, however, believed that Russian buyers (as opposed to customs officials) would see through the ruse and consider the cars high-quality imports. But marketing research indicated the opposite: Russians did not want to buy cars reassembled by Russians. The only way they would purchase a Russian-made automobile was if it was extremely cheap, like the majority of the existing AvtoVAZ and GAZ product lines, which retailed for as little as \$3,000 per car. GM, realizing that it could not deliver the reassembled Opel to the Russian marketplace for less than \$15,000 per car, dropped the kit proposal.

GM's marketing research unveiled an additional critical element. Russians would gladly pay an additional \$1,000 to \$1,500 per car if it had a *Chevrolet* label or badge on it. This piece of research resulted in the original proposal that David Herman and his staff had been pursuing since early 1999: a two-stage JV investment with AvtoVAZ that would allow GM to both reach price targets and position the firm for expected market growth. In the first stage, GM would co-produce a four-wheel-drive sport utility vehicle named the Lada Niva II (VAZ-2123). The target price was \$7500 and plant capacity was to be 90,000 cars. The Niva II would be largely Russian-engineered and, therefore GM would avoid many of the development costs associated with the introduction of a totally new vehicle. The Lada Niva I had originally been introduced in 1977 and updated in new models in 1990 and again in 1996. It had been a successful line for AvtoVAZ, averaging 70,000 units per year throughout the 1990s.⁵ Since the Niva II was largely Russian-engineered, GM would bring capital and name to the venture. Because the Niva II supplier base was in place and component costs already established, GM would not have to deal with issues of local content compliance. In other parts of the world, such as China, local content requirements meant that multinational firms were often forced to source parts from technically unqualified suppliers unfamiliar with the demands of world standard competitive sourcing. As well, existing Niva II suppliers would likely appreciate becoming GM suppliers because they would get paid on time and possibly receive technical support and advances for new tools.

The second stage of the project would be the construction of a new factory to produce 30,000 Opel Astras (T3000) for the Russian market. Herman's proposal was for AvtoVAZ to use a basic Opel AG vehicle platform as a pre-engineering starting point. Pre-engineering represented about 30% of the development cost of a vehicle. The remaining 70% would be developed by AvtoVAZ's 10,000 engineers and technicians who worked at a much lower cost than Opel's

EXHIBIT C5-6 Russian Auto Market Shares by Price

Price Range	1998		1999	
	Seg	Cum	Seg	Cum
Below \$5,000	3%	3%	85%	85%
\$5,001–\$10,000	65%	68%	12%	97%
\$10,001–\$15,000	15%	83%	1%	98%
Above \$15,000	17%	100%	2%	100%

SOURCE: General Motors.
Seg=segment, cum=cumulative.

⁴"Exclusive Interview: David Herman on GM's Strategy for Russia," just-auto.com, September 2000.

⁵One of the primary reasons for the success of the Niva was the poor state of Russian roads. The four-wheel-drive Niva handled the potholed road infrastructure with relative ease.

engineers in Germany. Herman's Russian Group estimated that even if GM and AvtoVAZ used AvtoVAZ's factory to build the existing Opel Astra from mostly imported parts and kits from Germany, the resulting price tag would have to fall to between \$12,500 and \$14,000 per car. This was still considered too expensive for substantial economic volumes. Using the Russian engineering approach, the car would be cheaper, but still fall at the higher end of the spectrum, retailing at about \$10,000 per car. As seen in Exhibit C5-5, this would still put the higher-priced Chevrolet in the lower end of the foreign-made market.

By no means was there consensus within GM and Opel about the viability of the proposed JV. One concern was that as a result of the cash shortage at AvtoVAZ and the slow rate of negotiation progress, in order to build test-models of the new Niva, AvtoVAZ had to use 60% of the old Niva's parts. Although many of the consumers that tested the Niva II ranked it above all other Russian-built cars, the car was rough riding and noisy by Western standards. One Opel engineer from Germany who safety-tested the Niva II and evaluated its performance declared it "a real car, if primitive." Heidi McCormack, General Director for GM's Russian operations believed that with some minor engineering adjustments, better materials for the interior construction, and a new factory built and operated by GM, the quality of the Niva II would be "acceptable."

GM management was pleased AvtoVAZ appeared willing to contribute the rejuvenated Niva to the JV. "That's their brand new baby," said McCormack. "It's been shown in auto shows. And here's GM, typical big multinational, saying, 'Just give us your best product.'"⁶ But in the end, AvtoVAZ's limited access to capital was the driver. Without GM, AvtoVAZ would probably take five years to get the Niva II to market; with GM the time could be cut in half.

NEGOTIATIONS

Negotiations between AvtoVAZ and GM had taken a number of twists and turns over the years, involving every possible dimension of the project. The JV's *market strategy, scope, timing, financing, and structure* were all under continual debate. GM's team was led by David Herman.

Herman had been appointed Vice President of General Motors Corporation for the former Soviet Union in 1998. Starting with General Motors Treasury as an attorney in 1973, Herman had extensive international experience, including three years as GM's Manager of Sales Development in the USSR (1976-79), and other Managing Director positions in Spain (1979-82), Chile (1982-84), and Belgium (1986-1988). These were followed by Chief Executive positions for GM (Europe) in Switzerland and Saab Automobile. From 1992 to 1998, Herman had been Chairman and

Managing Director of Adam Opel in Germany. Although Herman's new appointment as head of GM's market initiatives in Russia was described by the press as a Siberian exile, Herman actually requested the position in 1997. Herman's parents were Belorussian and he had studied Russian at Harvard. In addition to Russian and English, he was also fluent in German and Spanish.

Market Strategy. Back in Detroit, the JV proposal continued to run into significant opposition. GM President Rick Wagoner continued to question whether the Russian market could actually afford the Opel-based second car, the Opel T3000. Wagoner wondered whether the second phase of the project should not be cut, making the Niva the single product which the JV would produce. This could potentially reduce GM's investment to \$100 million.

A further point of debate concerned export sales. As a result of the 1998 financial crisis in Russia, a number of people inside both GM and AvtoVAZ pushed for a JV which would produce a car designed for both Russian sales and export sales. After 1998 the weaker Russian *rouble* meant that Russian exports were more competitive. If the product quality was competitive for the targeted markets, there was a belief that Russian cars could be profitably exported. As a result, Herman expanded his activities to include export market development. The working proposal now assumed that one-third of all the Chevrolet Nivas produced would be exported. The domestic market continued to be protected with a 30% import duty against foreign-made automobiles, both new and used.

Herman brought AvtoVAZ senior management to the Detroit auto show in the spring of 2000 to meet with GM President Rick Wagoner and Vice Chairman Harry Pearce. The meetings went well. In March 2000, however, GM announced an alliance with Fiat. A key element of the alliance involved GM acquiring 20% of Fiat's automotive business. GM paid \$2.4 billion using GM common stock for the 20% stake, which resulted in Fiat owning 5.1% of GM. In June 2000, GM and Fiat submitted a joint bid for Daewoo, which was part of the bankrupt Daewoo *chaebol*. The bid was rejected. Herman returned to Russia, once again slowing negotiations until any possible overlap between GM and Fiat ambitions in Russia were resolved.

Timing. In the summer of 1999, AvtoVAZ had formally announced the creation of a JV with General Motors to produce Opel Astras and the Chevrolet Niva. However, this announcement was not confirmed by GM. Later in 1999, GM's European management, primarily via the Opel division, lobbied heavily within GM to postpone the proposed Chevrolet Niva launch until 2004 to allow a longer period of economic recovery in Russia. Upon learning of this, Kadannikov reportedly told GM to "keep its money," that AvtoVAZ would launch the new Niva on its own. The two sides were able to agree on a tentative 2003 launch date.

Financing. In May 2000 Herman's presentation of the JV proposal to Wagoner and Pearce in Detroit hit another

⁶Gregory L. White, "Off Road: How the Chevy Name Landed an SUV Using Russian Technology," *Wall Street Journal*, February 20, 2001.

roadblock: the proposed \$250 million investment was considered "too large and too risky for a market as risky as Russia—with a partner as slippery as AvtoVAZ."⁷ Wagoner instructed Herman to find a third party to share the capital investment and the risk, as GM would not risk more than \$100 million itself. Within three months Herman found a third party—the European Bank for Reconstruction and Development (EBRD). EBRD was willing to provide debt and equity. It would lend \$93 million to the venture and invest an additional \$40 million for an equity stake of 17%.⁸

The European Bank for Reconstruction and Development was established in 1991 with the express purpose of fostering the transition to open market-oriented economies and promoting private and entrepreneurial ventures in Eastern Europe and the Commonwealth of Independent States (CIS). As a catalyst of change the Bank seeks to co-finance with firms that are providing foreign direct investment (FDI) in these countries in order to help mobilize domestic capital and reduce the risks associated with FDI. Recent economic reforms and the perceived stability of President Putin's government had convinced the EBRD's senior management that conditions were right.

GM management knew that \$332 million would be insufficient to build a state-of-the-art manufacturing facility. However, given that AvtoVAZ contributions would include the design, land, and production equipment, \$332 million was believed to be sufficient to launch the new Niva. The planned facility would include a car body paint shop, assembly facilities, and testing areas. AvtoVAZ would supply the JV with the car body, engine and transmission, chassis units, interior components, and electrical system.

Structure. A continuing point of contention was where the profits of the JV would be created. For example, AvtoVAZ had consistently quoted a price for cement for the proposed plant which was thought to be about 10 times what GM would customarily pay in Germany. Then, just prior to the venture's going before the GM Board for preliminary approval for continued negotiations, AvtoVAZ made a new and surprising demand that GM increase the price the JV would pay AvtoVAZ for Niva parts by 25%. (Vladimir Kadannikov demanded to know where the profits would be, "in the price of the parts each side supplied to the joint venture or in the venture itself?").⁹ When Herman warned them this would scuttle the deal, AvtoVAZ backed-off. After heated debate, the two parties now agreed that they would not try to profit from the sale of components to the JV.

The structure for the management team and specific allocation of managerial responsibilities had yet to be determined. Although both sides expected to be actively involved in day-to-day management, GM had already made it clear that management control of the JV was a priority for going forward. GM also wanted to minimize the number of expatriate managers assigned to the venture. AvtoVAZ saw the JV as an opportunity for its managers to gain valuable experience and expected to have significant purchasing, assembly, and marketing responsibilities. AvtoVAZ expected GM to develop and support an organizational structure that ensured technology transfer to the JV. AvtoVAZ knew that in China GM had created a technical design center as a separate JV with its Chinese partner. The specific details as to how GM might be compensated for technology transfer to Russia remained unclear. Finally, the issue of who would control the final documentation for the JV agreement had yet to be agreed.

The JV would be located on the edge of the massive AvtoVAZ complex in Togliatti. It would utilize one factory building which was partially finished and previously abandoned. The building already housed much equipment in various operational states, including expensive plastic molding and cutting tools imported from Germany in the early 1990s which AvtoVAZ had been unable to operate effectively but could not resell.

Progress. Again, primarily out of frustration with the pace of negotiations, AvtoVAZ announced in January 2001 that it would begin small scale production of an SUV under its own Lada brand. Herman once again was able to intervene. Herman promised GM's Board that AvtoVAZ would actually build no more than a few dozen of the SUVs "for show." The two sides also continued to debate whether AvtoVAZ would be allowed to sell the prototypes of the new Niva that AvtoVAZ planned to build (approximately 500). GM was adamant, according to long-standing policy, that these should not find their way to the marketplace. AvtoVAZ countered that this was routine for Russian manufacturers and served as a type of "test fleet."

Finally, on February 6, 2001, Herman presented the current proposal to GM's board in Detroit. After heated debate, the board approved the proposal. The possibility of entering a large and developing market, with shared risk and investment, was a rare opportunity to get in early and develop a new local market. According to Rick Wagoner, "Russia's going to be a very big market."

We'll sell it in former Soviet Union, and eventually export it and because of the cost of material and labor in Russia, we should reach a price point which gives us a decent volume. That will give us a chance to get a network and get started with suppliers and other partners in Russia in a way which I hope will make us amongst the leaders.¹⁰

⁷Wall Street Journal, February 20, 2001.

⁸The willingness of EBRD to invest was a bit surprising given that two of its previous investments with Russian automakers, GAZ and KamAZ, had resulted in defaults on EBRD credits. A third venture in which EBRD was still a partner (20% equity), Nizhegorod Motors, a JV between Fiat and GAZ, had delayed its car launch from late 1998 to the first half of 2002.

⁹Wall Street Journal, February 21, 2001.

¹⁰"David Herman on GM's Strategy for Russia," just-auto.com, September 2000.

David Herman had gained the approval of the General Motors Board to pursue and complete negotiations with AvtoVAZ. The negotiations themselves, however, represented an enormous undertaking, and both GM and

AvtoVAZ had many issues yet to be resolved. The two sides at the negotiating table in June included David Herman and Heidi McCormack of GM Russia and Vladimir Kadannikov and Alexei Nikolaev representing AvtoVAZ.

APPENDIX 1 OAO AvtoVAZ Profit and Loss Statement, 1996-1999

(Thousands of roubles)	1996	1997	1998	Jan-Oct 1999
Net sales less VAT	23,697,167	26,255,183	9,533,172	33,834,987
Less cost of goods sold	(18,557,369)	(21,552,999)	(7,650,161)	(25,998,011)
Gross profits	5,139,798	4,702,184	1,883,011	7,836,976
Gross margin	21.7 %	17.9 %	19.8 %	23.2 %
Less sales & marketing expenses	(638,739)	(497,540)	(168,381)	(603,170)
Operating income	4,501,059	4,204,644	1,714,630	7,233,806
Operating margin	19.0 %	16.0 %	18.0 %	21.4 %
Interest	—	—	—	—
Dividend income	3,366	3,392	159	8,749
Income on asset disposal	3,084,203	23,052,035	2,516,466	4,115,346
Loss on asset disposal	(3,935,990)	(21,718,864)	(3,430,751)	(5,716,732)
Income from core business	3,652,638	5,541,207	800,504	5,641,169
Non-operating income	400,185	372,340	69,415	252,713
Non-operating expenses	(1,136,225)	(1,033,305)	(299,123)	(1,124,448)
Income for period	2,916,598	4,880,242	570,796	4,769,434
Less income tax	(682,556)	(1,166,911)	77,268	(1,112,039)
Disallowable expenses	(409,906)	(7,069,333)	(251,574)	(1,674,947)
Net income	1,824,136	(3,356,002)	396,490	1,982,448
Return on sales (ROS)	7.7 %	-12.8 %	4.2 %	5.9 %
In U.S. dollars				
Exchange rate (roubles/US\$)	5.6	6.0	9.7	24.6
Net sales	\$ 4,231,636,964	\$ 4,375,863,833	\$ 982,801,237	\$ 1,375,405,976
Gross profits	917,821,071	783,697,333	194,124,845	318,576,260
Income from core business	652,256,786	923,534,500	82,526,186	229,315,813
Income for period	520,821,071	813,373,667	58,844,948	193,879,431
Net income	325,738,571	(559,333,667)	40,875,258	80,587,317

SOURCE: AvtoVAZ.

APPENDIX 2 AvtoVAZ Product Prices by City (February 2001, in roubles)

Code	Model	Type	Tolyatti	Moscow	St. Petersburg
21060	Lada Classic	1976 sedan	84,100	86,500	90,100
2107	Lada Classic	1982 sedan	86,700	91,700	94,400
21083	Lada Samara	1985 3-door hatch	111,900	117,500	115,800
21093	Lada Samara	1987 5-door hatch	112,200	119,700	115,800
21099	Lada Samara	1990 sedan	122,500	132,000	132,600
21102	Lada 2110	1996 sedan	146,500	150,700	151,700
21103	Lada 2110	1997 station wagon	161,100	164,800	162,300
21110	Lada 2110	1999 5-door hatch	157,200	161,900	168,900
2112	Lada Samara II	2001 3-door hatch	167,300	168,600	168,300
2115	Lada Samara II	1997 sedan	143,000	153,700	149,600
21213	Lada Niva	1997 SUV	103,500	111,300	111,100
Average (roubles)			126,909	132,582	123,582
Exchange rate (roubles/US\$)			30.00	30.00	30.00
Average (US\$)			\$4,230	\$4,419	\$4,111

SOURCE: AvtoVAZ.

APPENDIX 3 Russian Demographics and Economics, 1993–2005

Indicator	1993	1994	1995	Actual			1999
				1996	1997	1998	
Real GDP growth (%)	−8.7%	−12.7%	−4.1%	−3.5%	−0.8%	−4.9%	3.2%
GDP per capita (US\$)	1,135	1,868	2,348	2,910	3,056	1,900	1,260
Consumer price index (%chg)	875%	308%	198%	48%	15%	28%	86%
External debt (bill US\$)	112.7	119.9	120.4	125.0	123.5	183.6	174.3
Foreign direct investment (bill US\$)	N/A	0.5	0.7	0.7	3.8	1.7	0.8
Population (millions)	148.2	148.0	148.1	147.7	147.1	146.5	146.0
Unemployment rate (%)	5.3%	7.0%	8.3%	9.3%	10.8%	11.9%	12.5%
Wages (US\$/hour)						0.63	0.36
Exchange rate (roubles/US\$)	1.2	3.6	4.6	5.6	6.0	9.7	24.6
Indicator	2000	2001	Estimates			2005	
			2002	2003	2004		
Real GDP growth (%)	5.8%	3.5%	4.0%	4.0%	4.5%	4.2%	
GDP per capita (US\$)	1,560	1,760	1,970	2,170	2,390	2,610	
Consumer price index (%chg)	21%	17%	14%	12%	11%	8%	
External debt (bill US\$)	160.6	171.2	176.8	182.8	186.2	188.8	
Foreign direct investment (bill US\$)	2.0	4.0	5.7	6.5	6.5	6.5	
Population (millions)	145.4	145.1	144.8	144.5	144.2	143.2	
Unemployment rate (%)	10.8%	10.1%	10.1%	9.8%	9.2%	9.1%	
Wages (US\$/hour)	0.44	0.52	0.60	0.70	0.80	0.90	
Exchange rate (roubles/US\$)	28.4	30.5	32.0	33.5	35.0	36.0	

SOURCE: Economist Intelligence Unit, February 2001.

APPENDIX 4 Foreign Automobile Manufacturers & Russian Partners in Russia

Manufacturer/ Partner	Price Range Model	Low		Capacity per year	Startup
		Low	High		
Daewoo	Compact sedan	\$6,000	\$8,000	20,000	1998 Assembly
Doninvest					
BMW Group	523 & 528 models	\$36,450	\$53,010	10,000	2000 Assembly
ZAO Avtotor					
Renault	Clio Symbol	\$8,500	\$9,000	100,000	1998 Assembly
City of Moscow	Megane	\$13,500	\$16,000	3,000	2002 Assembly
Ford Motor Co	Focus	\$13,000	\$15,000	25,000	2002 Staged
ZAO Bankirsky Dom	to >50% local in 5 yrs				
Fiat SpA	Palio	\$9,000	\$10,000	10,000	2002 Production
OAQ Gaz	Siena	\$10,000	\$11,000	5,000	
General Motors	New Niva	\$7,500	\$10,000	75,000	2002 Production
OAQ AvtoVAZ	Astra T3000	\$10,000	\$12,000		

SOURCE: Compiled by authors.

APPENDIX 5 Russian Automobile Sales Forecasts by Scenario, 2000–2008 (millions)

Scenario	2000	2001	2002	2003	2004	2005	2006	2007	2008
Optimistic	1.317	1.387	1.439	1.498	1.538	1.560	1.615	1.650	1.710
Moderate	1.045	1.131	1.232	1.288	1.315	1.368	1.483	1.500	1.570
Pessimistic	1.017	1.090	1.099	1.125	1.145	1.153	1.174	1.191	1.135

SOURCE: www.just-auto.com, September 2000.

Average annual growth rates by scenario: 3.3%, 5.2%, and 1.4%, respectively.

APPENDIX 6 EBRD's Commitment to the GM-VAZ Joint Venture, Russia

The EBRD proposes to provide financing for the construction and operation of a factory to manufacture and assemble up to 75,000 Niva vehicles in Togliatti, Russia.

Operation Status: Signed

Board Review Date: 28 March 2000

Business Sector: Motor vehicle manufacturing **Portfolio Classification:** Private sector

The Client: General Motors—AvtoVAZ Joint Venture is a closed joint-stock company to be created under Russian law specifically for the purpose of carrying out the project. Once the investment is complete, AvtoVAZ (VAZ) and General Motors (GM) will hold an equal share in the venture. GM is currently the world's top automotive manufacturer with production facilities in 50 countries and 388,000 employees worldwide. VAZ is the largest producer of vehicles in Russia, having sold approximately 705,500 (over 70 percent of the Russian new car market) in 2000.

Proposed EBRD Finance: The EBRD proposes to provide up to 41 percent of the financing of the venture in a combination of a loan of US\$100 million (108 million) and an equity investment of US\$40 million (43 million). The loan includes interest during the construction phase. Up to US\$38 million of the loan may be syndicated after signing to reduce EBRD exposure.

Total Project Cost: US\$338 million (365 million)

Project Objectives: The construction and operation of a factory to manufacture and assemble up to 75,000 Niva vehicles per annum in Togliatti, Russia.

Expected Transition Impact: The transition impact potential of this transaction stems primarily from the demonstration effects associated with the entrance of a major Western strategic investor into the Russian automotive market. The fact that this investment has two well-known partners who are investing equally in the joint venture adds both to the visibility and the potential of the project. This complex project is one of the largest examples of foreign direct investment in post-crisis Russia in a period when many foreign investors are still adopting a wait and see approach. The use of Russian design and engineering skills together with the introduction of Western technologies, methods and processes and the related development of skills are further key sources of positive demonstration effect, especially given the huge modernisation needs of the Russian automotive sector. Other suppliers and client companies will also benefit from technological links or training programmes with the joint venture.

Environmental Impact: The project was screened B/1, requiring an audit of the existing facility and an analysis of the impact associated with the joint venture (JV). While typical environmental issues associated with heavy manufacturing are present at the main AvtoVAZ facility, there have been no prior operations at the site of the proposed JV. Potential liabilities arising from historic soil and ground water pollution were addressed as part of the due diligence, and no significant levels of contamination have been identified. The engine for the new Niva will meet Euro II (Russian market) and Euro IV (European market) standards for vehicle emissions. All vehicles will be fitted with catalytic converters. Safety standards for all vehicles will meet EU and GM standards in full. On formation, the JV will adopt GM management and operations systems and GM corporate practices for all aspects of environment, health and safety and will be in compliance with all applicable EU and best international environmental standards.

SOURCE: <http://www.ebrd.com/english/opera/psd/psd2001/483gm.htm>.

Case 6 *TelSys International: A Marriage of Two Cultures (Case or Negotiation Simulation)*

FINAL NEGOTIATIONS IN KUALA LUMPUR

James R. Chesney, a veteran engineer and former head of the Microelectronic Systems Branch at NASA's Goddard Space Flight Center, allowed his gaze to drift away from the negotiating table toward the view of skyscrapers and blue sky visible through the tall windows on the opposite wall. He smiled faintly, realizing that this was the most he had seen of Kuala Lumpur in the three days he had been there. Since then, Chesney and his colleagues had been chauffeured back and forth from their

suite at the Hilton. Each day they had encountered intense negotiations over the terms of the pending agreement with the Malaysian Venture Capital Group (VCG). Negotiations revolved around the creation of a new venture, TelSys International, Inc. (TelSys).

Only if Chesney could secure the financing he needed would TelSys be able to produce and market high-quality satellite ground station communications equipment based on his patented designs. While the company's initial customer base would revolve around the world's space agencies and major satellite providers, Chesney knew that there was a huge potential commercial market for TelSys's