
Logistics Outsourcing in Russia: Factors Influencing Entrepreneurial Decisions and Market Prospects

Dmitry Stapan¹

Abstract:

The author explores history and present developments of logistics outsourcing in Russia. He does it to test the underlying set of theoretical frameworks that governs outsourcing decisions made by entrepreneurs.

The framework called the “five forces of outsourcing” consists from a blend of existing theories and includes a theory developed by the author.

The analysis is based on industries with massive logistics operations – raw materials. The article finds that the volume of the logistics outsourcing market in Russia is less than that of the developed economies.

At the same time, it has good prospect for growth with trust mounting up between outsourcing providers and customers.

Keywords: *Outsourcing, logistics, competitive advantage, transaction costs, entrepreneurship, Russia.*

¹*Russian Presidential Academy of National Economy and Public Administration (RANEPA), Moscow, Russia.*

1. Introduction

The purpose of this article is to give a comprehensive analysis on how, and most importantly, why, Russian companies and entrepreneurs, for which logistics is not the core business operation, choose to transfer (or refuse to transfer) the logistics part of their business to outsourcing (Zedgenizova and Ignatyeva, 2017; Albekov *et al.*, 2017; Bondarenko *et al.*, 2017). The author at the same time aims to test his theoretical framework of “five forces of outsourcing” that governs outsourcing decisions. Throughout the research, he finds empirical evidence of the relevance of the framework.

Logistics outsourcing is undoubtedly the trend in the development of any economy, including Russian (Zobov *et al.*, 2017). It is a powerful tool that companies employ to increase productivity, and thus to be able to concentrate on attaining significant competitive advantage.

2. Materials And Methods

The time frame of the analysis is from the beginning of the market economy era in Russia (from 1990-s) till present. The article mainly focuses on logistics intensive industries, raw materials in the first place. The research is based on a theory about the “five forces of outsourcing” that influence the development of outsourcing. These forces are (Figure 1):

1. Transaction costs is the main driver in outsourcing decisions. Entrepreneurs try to minimize these costs and purchase from the market what it can produce cheaper, faster and better than entrepreneurs themselves (Williamson, 1975).
2. The second driver of outsourcing is competitive advantage. To succeed a company should concentrate on its competitive advantages. It is more likely to concentrate on primary activities which it does better than competitors rather than on support activities. The rest can be outsourced (Porter, 1985).
3. Trust and commitment between parties help to achieve emotional satisfaction, personal success, satisfy personal ambitions etc. Immaterial gains are sometimes valued more than material ones (Blau, 1974). As commercial relationships develop trust and commitment grow. Trust helps avoid opportunistic behavior by parties.
4. The level of economic development of the country. The Russian market economy is only 25 years old. The World Bank classifies the Russian economy as an upper-middle income group together with Argentina, Brazil, Turkey, Mexico, Turkey, Kazakhstan and other countries. Many of these countries share same economic features such as oligopolies, imperfect competition, overconcentration of capital, etc.

The above factors influence whether the sourcing cycle – the fifth element – moves towards outsourcing or insourcing.

Figure 1. *The five forces of outsourcing (as compiled by the author).*



Outsourcing is not a final process, but an ever-changing mechanism of adaptation to the prevailing external economic reality, a continuous search for the optimal source of resources. At different times, due to shifting external factors, market conditions, the development of new technologies, etc., a company may decide to engage in insourcing, outsourcing, create joint ventures for this purpose, withdraw from those, go back to insourcing and so on.

All the factors equally influence logistics outsourcing in Russia, and analysis of the Russian logistics market finds the factual proof of the assumption of the existence of the sourcing cycle (Figure 1).

3. Results

The analysis of logistics outsourcing evolution led to several important conclusions:

1. Historically, raw material processing companies were forced to provide themselves with transport infrastructure. This included not only cars, but also railways: Russian Railways could not cope with the growth of cargo and investments.
2. With the rapid growth of private carriers, some companies stopped using insourcing operations in favor of outsourcing. The trend in recent years is open competition among outsourcers, which helps to reduce the price of transportation significantly.
3. Some companies have focused on the main business operations, getting rid of logistics units, while some continue to develop vertically integrated structures. Some others, such as UCL, are developing their insourcing logistics companies into leaders of the transportation market, although the latter is more an exception than the rule.

4. At the same time, it can be concluded that company owners primarily tend to continue managing their companies' entire logistics chains privately. The desire to not only control but own the entire supply chain is generally characteristic of the developing economies and first generation entrepreneurs.

5. At the same time outsourcing market will continue to grow to 100-130 billion dollars in 10 years. Growth rates of the share of outsourcing in logistics are difficult to forecast. They will strongly depend on the liberalization and demonopolization of the Russian economy as a whole.

4. Discussion

4.1 Outsourcing Market Volume For Logistics Services

According to a study by Armstrong & Associates Inc., Russia is among the countries with the highest logistics costs in the world. Russian logistical costs account for 19% of GDP, while in China the figure is 18.0%, in Brazil and India 11-13% (Volume and Structure of Russian Transport and Logistics Services Market, 2013). In Europe, the average level of logistical costs is about 11.7% of GDP (Protsenko and Protsenko, 2012).

At the same time, the share of logistics costs for different types of products in Russia varies: from 9.8% in engineering to 30% in the food industry. Russia's 2015 GDP (purchasing power parity) was \$ 3.4 trillion (WB GDP, PPP). Consequently, at a logistics cost level of 19% of GDP and a transport and logistics market volume of 15% of the gross domestic product, the Russian economy's logistics costs may amount to 200 billion dollars (per PPP).

In developed countries, the percentage of logistics services outsourced in 2012 ranged from 81% in the US to 63% in Western Europe. In Russia, the potential share of logistics services outsourced by companies is about 30% (RBC expertly estimates it at 32%). When operating at 30%, the share of outsourcing in the transport and logistics market should be about 50-60 billion dollars.

Back in the 1990s exporters of primary commodities were the first to think seriously about the logistics of cargo transportation. This state of affairs is natural: oil and coal alone have long occupied and still occupy more than half of all rail transportation. In turn, raw materials are very sensitive to the cost of transportation, because it is a significant part of their total cost. Experts note that current Russian industrial entrepreneurs inherited a vertically integrated model of the production cycle, whereby all transport needs were usually met by the company's own forces, from the Soviet period of industrial development.

4.2 Logistics Insourcing by Producers of Raw Materials: First Steps

Naturally, it all started with the creation of privately owned captive transport units, often in the form of insourcing (shared service centers – SSC), and since no one thought about outsourcing at that time, all oil companies were striving for vertical integration. For Vertically Integrated Oil Companies, privately-owned rail transportation was a reasonable step, as they provided and accounted for the transportation of 34% (256 million tons) of oil and oil products (Grigoriev, 2016).

Thus, in 1998, YUKOS established the YUKOS-Transservice Company, an operator of tank railway cars. In 2005 the company ranked the 256th largest company in the ranking of 400 largest companies in Russia. In 2005 Rosneft acquired this company, renaming it into RN-Trans (now a captive operator of Rosneft's bulk oil cargo).

In 2002, Gazprom established a private limited company – Gazprom-Trans (which transports liquefied hydrocarbons). In 2008, Lukoil established Lukoil-trans, a rail carrier for liquid cargo. Sistema Joint Stock Financial Corporation acquired one of the largest carriers of liquefied hydrocarbons, SG-trans, during privatization trades. After the purchase of Bashneft, in 2014, Sistema Joint Stock Financial Corporation joined SG-Trans Bashneft-Trans.

Coal companies also kept up with the oil companies in creating their own insourcing logistics structures. This is natural, since coal is the main cargo on the Russian railway (more than 25%) (Bulletin of the Socio-Economic Crisis in Russia).

Major coal-metallurgical holdings like SUEK, Mechel, Evraz, Siberian Business Union (SDS), Norilsk Nickel, Ural Mining and Metallurgical Company (UMMC), etc. established private captive carriers and even possessed hundreds kilometers long private railroads. In 2012 the Novolipetsk Metallurgical Combine purchased the freight company and rebranded it to Universal Cargo Logistics (UCL).

Chemical holdings also own their own carriers. In 2002, Phosagro established Phosagro-Trans. EuroChem, SIBUR and Uralkali followed the same path. Like other companies, due to the catastrophic shortage of specialized railroad cars from Russian Railways, chemical companies also historically followed the path of creating their own logistics companies. This was a forced, last-resort step. Without creating their own private wagon operators, the companies would have inevitably faced problems in delivering their own goods for export.

Many producers of raw materials decided to go further on the vertical integration of logistics chains into their businesses and, in addition to the means of transportation (the railway), reached the ports. Such a strategy is quite logical from the point of view of ensuring the delivery of a company's own products from the place of production to the consumer – the foreign importer: railway – port - dry cargo ship / tanker. SUEK, EuroChem, Mechel, UCL, NOVATEK, SIBUR, etc., built or acquired sea terminals.

At the same time manufacturing companies are not able to fully utilize the capacity of their own ports. This is an example of a situation when vertical integration loses to outsourcing – although private port infrastructure allows controlling logistics costs, it diverts funds and the owners' attention from the main target of reducing the cost of production and finding new customers.

4.3 Logistics Outsourcing: The Continuation

For Russian producers of raw materials, vertical integration with logistics chains is not the only way. For example, Evraz was one of the first companies to switch to outsourcing, selling its insourcing company in 2012. Magnitogorsk Iron and Steel Works (MMK) also sold its carrier to Globaltrans. Severstal switched to the outsourcing model by selling Staltrans to UCL as well. The coal producing company, Siberian Business Union (SBU), sold its in-house carrier Novotrans in 2015.

Even Rosneft's 'Rosneft Trans' was gradually transformed from a carrier into the company's captive operator, and now only partially covers Rosneft's requirements with its own transportation. In 2015, Rosneft Trans's main rail transportation was handed over to 5-year outsourcing suppliers.

In 2015, SIBUR sold the terminal built in Ust-Luga. Russia's largest aluminum producer, Rusal has similarly withdrawn from possessing a port. Evraz is also planning to follow the example.

5. Conclusion

Outsourcing of logistics services in commercial organizations in Russia has considerable potential. To start with, companies will inevitably seek to outsource more and more logistics services in search of greater cost effectiveness. Many large producers, such as Evraz, Rusal, Severstal and others, have already taken this path.

The greater transfer of logistics to outsourcing will lead to the emergence of a larger number of independent logistics companies and, in the future, to the inevitable consolidation of the market and the formation of new or reinforcement of the existing players (UCL being an excellent example).

Many of the outsourcers will be small and medium companies, which, according to Dudin, are one of the main carriers of innovation (Dudin, 2013). There is no universal answer to the question of whether it is absolutely necessary to outsource logistics. The art of proper management is best demonstrated when a company correctly chooses its preferred option of sourcing logistics, adequate to the level of the company's development, the market situation, and the company's customer requirements. And it is quite apparent that indeed that logistics outsourcing is one of

the powerful business tools that companies can implement to focus on competitive advantages and gain markets.

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