THE IMPACT OF ECONOMIC SANCTIONS
Our Economic Scenario Update 9/2014
1. 6,200 COMPANIES from Germany do business with Russia. We formulate a number of universal recommendations and guidance to help companies decide on their own strategy for dealing with the sanctions. Analyze your situation in five steps p. 18

2. 13 INDUSTRIES. The "hard" economic sanctions imposed at the beginning of August 2014 in the conflict with Russia are having very different impacts on the different industries. For some there has been a complete ban on trading (e.g. food) while others are feeling the pain of new export restrictions (e.g. engineering). Find out who has been hit – directly or indirectly p. 15

3. 1.7% The German economy is also feeling the consequences of the Ukraine crisis. We revised our GROWTH forecast from the beginning of the year slightly – down from 2.0% to 1.7%. Read more in our economic scenario update p. 21

Latest survey p. 6
The shift from soft sanctions to hard punitive measures – and Russia's reaction to it – has exacerbated the cycle of sanction and counter-sanction. How bad could it get, who is hardest hit and how can we respond, both in terms of economic policy and on a corporate level? Our update answers the key questions and offers guidance on the decisions that need to be made.

AUTHORS Burkhard Schwenker, Tobias Raffel

SANCTIONS: FROM "SOFT" TO "HARD"
The Ukraine conflict has been escalating for months. The West and Russia are imposing ever tougher sanctions on each other.

2014

<table>
<thead>
<tr>
<th>JANUARY</th>
<th>MARCH</th>
<th>APRIL</th>
<th>MAY</th>
<th>AUGUST</th>
<th>AUGUST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our growth forecast for 2014:</td>
<td>The EU and the U.S. impose the first soft sanctions on Russia: travel bans and asset freezes on selected individuals</td>
<td>Russia retaliates with soft sanctions on the U.S.: travel bans on selected individuals</td>
<td>The EU and the U.S. impose further soft sanctions on Russia: ban on business with selected companies</td>
<td>The EU imposes hard economic sanctions on Russia: restricted access to EU capital markets, export restrictions, an arms embargo</td>
<td>Russia retaliates with hard economic sanctions on the West: ban on food imports</td>
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<td>2%</td>
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Further escalation is feared
The economic sanctions – an analysis.
Up until the summer of 2014 and all the while that soft sanctions were the name of the game, the sanctions policy did not impact the real economy.

Companies, investors and even consumers remained comparatively unfazed: The DAX continued to rise, as did consumer confidence. Though economic growth remained slightly below our expectations in the first two quarters, there was still no real cause for concern.

That all changed when the first hard sanctions came in at the beginning of August. Here’s what has been happening since then:

> Exports to Russia are nosediving even further – on the back of the 15.5% measured in the first half of 2014, many expect the figure to be down 25% or more for the full year.
> The impending recession in Russia is compromising the business of many German companies – even those in industries not directly hit by sanctions.
> The fear expressed by the Committee on Eastern European Economic Relations that more than 300,000 German jobs could be at risk is turning into a real prospect.
> Initial forecasts for Germany’s growth for 2014 are already being revised down (Commerzbank’s prediction has been scaled back from 2.0% to 1.7%, Deutsche Bank’s corrected from 1.8% to 1.5%).
> Economic sentiment is deteriorating dramatically; the ifo and ZEW indices have plummeted and even the GfK index is falling (for the first time in 18 months).
> Europe’s emerging recovery is in danger if the sanctions affect growth impulses from Germany in particular.

Consequently there has been a massive rise in the level of uncertainty felt by companies – investment decisions have already been suspended and planning corrected. Many of our clients have expressed their fears to us, and they are also reflected in the Roland Berger Uncertainty Indicator. The index rocketed to 3.0 points in the summer of 2014, up from 1.5 at the end of 2013 and 1.7 in the early months of this year.

We anticipate a further rise in uncertainty and an increasingly negative impact from the sanctions. Indeed a joint survey we conducted with the newspaper WELT found that more than two thirds of German business leaders expect the sanctions to be a cause for concern for the next one to two years, if not longer. Less than one third think the Ukraine conflict can be de-escalated any time soon. So what can we expect, and how bad could it get? Read our initial analysis here.

I. The sanctions

WHAT SANCTIONS ARE IN PLACE, AND WHAT NEW SANCTIONS ARE POSSIBLE? Europe and the United States began to slap punitive measures on Russia in March 2014. Initially these were nothing more than soft sanctions – mostly travel bans and asset freezes on leading political and business figures with close ties to the Kremlin. Moscow retaliated
with similar measures. But the sanctions have really been hurting since the start of August 2014. That was when the EU and the U.S. on the one side and Russia on the other began imposing "hard" economic sanctions on each other. For an overview of the sanctions in place, see D.

The punitive measure hurting the EU most is Russia's import ban on foods and agricultural products. But the restrictions on the export of high-tech goods and armaments – put in place by Europe itself – are also a cause of great concern to some industries and regions. Germany has the largest volume of trade of any European state and is the most entangled with the Russian economy. We are also the nation hardest hit by the sanctions – both the ban on agricultural imports and the trade restrictions on arms, special installations for the energy sector and dual-use technologies. The German engineering sector, for example, where Russia is the fourth-largest export market, sent almost 19% fewer exports to Russia in the first half of 2014. The sector fears additional significant losses in light of the sanctions. But companies from Poland, the Baltic States, Finland, the Netherlands and Spain also need to find alternative destinations for their fruit and vegetables – if that's even possible at such short notice. France, for its part, is bound to suffer under the embargo on future arms shipments and Britain's financial sector will feel the effects of the sanctions against Russian banks.

If the sanctions remain as they are, the negative impact on German and European growth will be manageable. But to judge by recent discussions we can expect a further tightening on both sides. So what new sanctions are possible?

For the moment, the EU is mainly contemplating toughening its sanctions in the areas already affected, for instance by preventing Russian financial institutions from using the SWIFT system to make international bank transfers. Russia is more explicit, however. Possible sanctions include:
> A ban on Western airlines flying over Russian airspace
> Import restrictions on Western cars

THE ROLAND BERGER UNCERTAINTY INDICATOR
The level of uncertainty has increased since May. The Ukraine crisis is increasingly worrying businesses, investors and consumers.

Methodology:
The Roland Berger Uncertainty Indicator combines ten monthly indicators, including the spread and dynamics of economic forecasts, trend indicators such as ifo and ZEW, and data on the real economy such as export developments and bank lending. A score of 0-2 indicates little uncertainty about future economic development, 3-5 moderate uncertainty and 6-8 great uncertainty. For more details please refer to our economic scenario from the beginning of the year.
> The ultimate threat: Cutting off oil and gas supplies to Europe

A "creeping" confiscation of Western assets is also possible. German companies currently have more than EUR 23 bn tied up in Russia. This could lead to massive potential writedowns on investments. The concern is that further escalation could hit many more industries than those currently affected. Indeed probably all industries will be affected, directly or indirectly (see page 15).

II. The extent of economic entanglement and its impact

WHO RELIES ON WHOM, AND WHO IS HARDEST HIT? The extent to which countries suffer from the sanctions depends on how entangled their economies are. Let’s take a look at the latest trade statistics.

Russia vis-à-vis Europe: The EU is Russia’s most important trading partner by far. Some 50% of Russian exports went to Europe in 2013, 47% of imports to

TENSIONS NOT LIKELY TO EASE ANY TIME SOON

The EU and Russia began imposing economic sanctions on each other at the start of August. How do you expect things to develop?

62.3%
Sanctions will remain in place for 1-2 years

28.9%
Sanctions will end by late 2014/early 2015

6.3%
Sanctions will remain in place long term

2.5%
Not specified

Source: Leaders Parliament survey conducted by Roland Berger Strategy Consultants and WELT at end of August 2014 among 159 German managers
EU’S SANCTIONS AGAINST RUSSIA – AND VICE VERSA
Sanctions currently in place (before going to press in early September 2014)

<table>
<thead>
<tr>
<th>EU sanctions</th>
<th>Russian sanctions</th>
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<tbody>
<tr>
<td>TRAVEL BANS AND ASSET FREEZES against 95 individuals (leading political and business figures with close ties to the Kremlin)</td>
<td>TRAVEL BANS AND ASSET FREEZES for selected Western politicians and businesspeople</td>
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<tr>
<td>BAN ON BUSINESS RELATIONS with 23 Russian companies (e.g. banks with close ties to the Kremlin, companies in Crimea)</td>
<td>IMPORT BAN ON MOST FOODS AND AGRICULTURAL PRODUCTS from the EU, U.S., Norway, Canada and Australia (initially limited to one year)</td>
</tr>
<tr>
<td>RESTRICTED ACCESS TO EU CAPITAL MARKETS Banks in which the Russian state holds a 50% stake or more can no longer buy new securities or sell shares in Russian companies on EU capital markets (rules apply for one year and will be reviewed after three months)</td>
<td>BAN ON TRANSIT FLIGHTS by Ukrainian airlines over Russian territory</td>
</tr>
<tr>
<td>BAN ON FUTURE ARMS SHIPMENTS to Russia</td>
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<tr>
<td>EXPORT RESTRICTIONS FOR CERTAIN HIGH-TECH GOODS (e.g. special technologies for oil production) and dual-use items (e.g. encryption software, high-performance computers, power transfer parts for helicopters)</td>
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ECONOMIC RELATIONS
THE EUROPEAN AND RUSSIAN ECONOMIES ARE CLOSELY INTERTWINED, THOSE OF THE U.S. AND RUSSIA ARE NOT

GERMANY FOR RUSSIA
Very important

> Germany is Russia's second-largest trading partner (7% of imports, 8% of exports) after China
> Russia is dependent on German high technology to modernize its economy
> Germany is Gazprom's most important customer

THE EU FOR RUSSIA
Crucial

> The EU is Russia's biggest trading partner: 50% of exports → EU, 47% of imports ← EU, 75% of FDI ← EU
> The energy sector is the most important industry: 80% oil and 70% gas → EU
> The second-largest trading partner, China, accounts for only 1/5 as much trade as the EU

THE U.S. FOR RUSSIA
Secondary

> The U.S. is Russia's 10th biggest trading partner (USD 38 bn)
> U.S.-Russian trade is only 1/12 the size of EU-Russian trade
> US banks have lent Russia USD 20-30 bn
Russia for Germany

Important

> Russia is Germany's 11th biggest trading partner:
  Export share 3.3%, trade volume EUR 77 bn
> Energy supplies are particularly critical: 39% of Germany's gas comes from Russia
> 6,200 German firms operate in Russia

Russia for EU

Very important

> Russia ranks 4th in exports (after the U.S., Switzerland, China) and 2nd in imports (after China)
> The energy sector is the most important industry: 31% of gas and 20% of oil ← Russia
> 50% of the gas flows through Ukrainian pipelines

Russia for the U.S.

Secondary

> Russia is the U.S.'s 20th biggest trading partner (<1% of U.S. foreign trade)
> Some U.S. companies have extensive activities in Russia (Boeing, Cargill, Ford, General Motors, ExxonMobil)
> Russian Central Bank owns U.S. government bonds worth USD 138 bn
Russia originated in the EU, and 75% of all foreign direct investment in Russia came from Europe. Russia's trade with China, its second-largest business partner, amounts to just one fifth of that volume (10% of exports). Relations are particularly intricate in the energy sector, which is of paramount importance for Russia: 80% of all Russian oil exports and 70% of gas exports go to Europe. Germany's role is crucial here as Gazprom's biggest customer, ahead of Ukraine, Turkey and Belarus.

**Europe vis-à-vis Russia:** Russia is also important to the EU, though not to the same extent as the EU is to Russia. In 2013 almost 7% of all EU exports went to Russia (approx. EUR 120 bn, putting the country in fourth place after the U.S., Switzerland and China). The same year more than 12% of the EU's imports came from Russia (approx. EUR 207 bn, second only to China). This makes Russia the EU's third-biggest trading partner after the U.S. and China. Here, too, the energy sector is critical: The EU meets around 31% of its gas demand and 20% of its oil demand from Russia, with some EU countries up to 100% dependent on Russia. And about half of the gas supplied to Europe flows through Ukraine.

**Russia vis-à-vis the U.S.:** The U.S. economy is much less entangled with Russia. American companies do not rely on energy from Russia and just 1% of U.S. exports went to Russia in 2013. Russia therefore ranks down at number 20 in America's trade statistics. Similarly the importance of the U.S. economy to Russia is secondary, with Russia exporting goods to the value of some USD 27 bn to the U.S. last year (ranking tenth). Russo-American trade amounts to only one twelfth of the volume of trade that passes between Russia and Europe overall.

Even this brief analysis of trade statistics is enough to show how different nations are affected differently by the sanctions:

> Russia is severely impacted by any escalation of sanctions. The economy is close to recession, stock markets have tumbled, Russian companies have to pay more for their financing and the modernization drive that Russia desperately needs has failed to materialize.

> The United States is practically unaffected by the sanctions, which explains its tough stance in the sanction dispute.

> Europe is significantly impacted, albeit to varying degrees. Basically, the further east the country and the less diversified its energy supplies, the bigger the blow from the sanctions. Poland, the Baltic States, Finland, Hungary and the Czech Republic are directly affected. But France (particularly in the area of defense) and the UK (particularly in the financial sector) are also feeling the impact.

**Germany is suffering the most,** owing to Russia's status as an important trading partner – Germany's 11th biggest:

> Trade with Russia was almost EUR 77 bn in 2013, about half the level of trade with France (EUR 164 bn), China (EUR 141 bn) or the U.S. (EUR 137 bn).

> As a proportion of total visible exports from Germany, goods destined for Russia accounted for more than 3%.

> Germany's imports from Russia are practically all raw materials, with oil and gas making up 84%, producing an energy bill of some EUR 36 bn in total.

> Gas imports from Russia are most critical from a German perspective, as 39% of the country's gas needs are met by Russian supplies.

> Moreover large numbers of German companies are active in Russia – some 6,200 of them, more than from all other EU nations put together.

> Exports are mainly cars, machinery, chemical products and electronics.

> German foreign direct investment in Russia was approx. EUR 23 bn at the last count.

Given the extent of this economic entanglement, it comes as no surprise that tougher sanctions would have a lasting impact on the German economy and our potential for growth. An analysis by the Kiel Institute for the World Economy concluded that further escalation of the conflict would cause German exports to post just 3.6% growth in 2014 (instead of 7.2%), oil prices to rise by USD 20 a barrel, exchange rate turbulence to weaken other growth markets as well, and the pace of German growth to virtually halve as a result, falling from the expected 1.9% to just 1% 📉.
SELECTED SCENARIOS ON SANCTIONS

Most research institutes have published assessments of the macroeconomic consequences, spanning the whole range from "barely perceptible effects" to "major global distortions".

<table>
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<tr>
<th>ASSUMPTIONS/SANCTIONS/SCENARIOS</th>
<th>CONSEQUENCES</th>
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| **Kiel Institute for the World Economy (April 2014)** | > Germany's GDP growth for 2014 declines from 1.9% to 1.0%  
> Germany's export growth is halved in 2014 from 7.2% to 3.6%  
> Unemployment exceeds the 3 million mark again in 2014 (instead of being at 2.9 million) |
| > German exports to Russia fall 10% in the face of hard sanctions  
> Reduction in Russian energy supplies pushes up the oil price by USD 20 a barrel  
> Exchange rate turbulence even causes exports to Brazil and India to contract  
> The Chinese renminbi is devalued by 5% to prop up Chinese exports | |
| **EU Commission (May 2014)** | Germany's GDP growth is 0.1 percentage point lower in 2014 and 0.1 ppt lower in 2015 |
| **Light sanctions:** Import restrictions on Russian luxury goods (furs, caviar), travel bans on selected individuals | |
| **Moderate sanctions:** Import bans on Russian primary products, Russian bank accounts frozen | Germany's GDP growth is 0.3 ppt lower in 2014 and 0.1 ppt lower in 2015 |
| **Strong sanctions:** Russian gas and oil supplies to the West are halted, capital movement restricted | Germany's GDP growth is 0.9 ppt lower in 2014 and 0.3 ppt lower in 2015 |
| **Oxford Economics (July 2014)** | > Oil price rises to USD 200 a barrel (brent, currently USD 102)  
> Eurozone's economy contracts by 3.5% owing to the lack of energy  
> GDP even falls in the U.S. (-3%) and Japan (-2.4%)  
> Russia falls into a deep recession (GDP -10%) |
| **Scenario A:** All Russian gas and oil supplies to the West are halted | |
| **Scenario B:** Russian gas and oil supplies to the West decline as the pipelines through Ukraine remain empty | > Gas price rises 10%, oil price rises 15%  
> Zero growth (technical recession) in the EU (equates to a 1.5 percentage point fall in GDP over the latest forecast)  
> Spillover effects on the U.S. and Japan (GDP growth in each country 0.5 ppt lower than in the latest forecast)  
> Russia's economy contracts by 2% |

ASSUMPTIONS/SANCTIONS/SCENARIOS

- Light sanctions: Import restrictions on Russian luxury goods (furs, caviar), travel bans on selected individuals
- Moderate sanctions: Import bans on Russian primary products, Russian bank accounts frozen
- Strong sanctions: Russian gas and oil supplies to the West are halted, capital movement restricted
- Scenario A: All Russian gas and oil supplies to the West are halted
- Scenario B: Russian gas and oil supplies to the West decline as the pipelines through Ukraine remain empty
The effects of this would be significant for Europe as a whole. If Germany drops out as a driver of European growth, there is a danger that the incipient economic recovery in Europe could grind to a halt – hampering the resolution of pressing European problems such as the high rate of youth unemployment. If the cycle of sanction and counter-sanction continues, the question of impact also becomes one of timing and of capabilities: Will Europe be quicker to establish economically sustainable alternatives to its Russian energy supplies, or will Russia be faster at developing new sales markets for its oil and gas? Russia evidently sees China as a possibility – which would have unforeseeable geopolitical consequences. China could certainly step in as a product supplier and modernizer to the Russian economy within a medium-term horizon.

III. Economic policy options

WHAT MUST EUROPE DO NOW, AND HOW CAN WE LEVERAGE NEW GROWTH POTENTIAL? More than two thirds of the German managers we surveyed back the use of further sanctions if the political situation is not defused. Just 28% are against further economic sanctions. So there is broad consensus on the fact that politics is king when faced with this geopolitical threat.

But it should not stop there. What we are missing in the recent political debate is a sign that policymakers are looking at what flanking measures they could take to reduce the negative effects of the sanctions. Or better still to provide new stimulus through growth-oriented economic policy in Europe, ideally compensating
for the growth-slowing effects of the sanctions. We believe this is possible – and desperately needed. From our perspective, the following three measures would go the furthest toward achieving this:

**What this means** is that, with a smart investment policy, the right priorities and a mixture of publicly and privately funded infrastructure projects, we can stimulate significant new growth for Europe. All in all, the additional growth potential for Europe adds up to at least 2%. That would provide the prospect for Europe that we’re looking for – and deliver a strategy for dealing with the negative macroeconomic consequences of the sanctions at European level.

**Bring forward the TTIP:** The transatlantic market unquestionably represents part of our growth potential. The world’s biggest market, it accounts for 42% of global GDP, 28% of global exports, 34% of global imports and 70% of all foreign direct investments. This creates the potential for synergies. The benefit to Europe’s economy that will emerge from the Transatlantic Trade and Investment Partnership (TTIP) is an estimated EUR 120 bn per year, a good 0.5% of European gross domestic product. We should reflect on the close sense of partnership and shared values that exist between Europe and America and work flat out to conclude the TTIP negotiations.

**Strengthen the European Single Market:** We need a revitalization of the Single Market, investments in new manufacturing concepts, digitalization, support for small and medium-sized enterprises, freedom of movement and smart transportation solutions. We see growth potential of at least one percentage point here. This would also boost our industrial capability, bringing the prospect of further stabilization. For this if for no other reason, the new European Commission – with a strong Commissioner having overall responsibility for European economic matters – should address this issue without delay.

**Launch a European infrastructure program:** The scale of the investment backlog for badly needed infrastructure (transportation, water, energy, broadband) in the eurozone is now more than EUR 2 trillion by 2020. This is sheer negligence. Our industrial capability won’t be worth much unless it has effective transportation and supply networks and the communication networks to link up production systems to form the smart factories we will need in the future. An analysis we conducted recently found that the eurozone would see a growth uplift of 1% if we spent just EUR 80 bn per year more on key infrastructure projects. That would be money well spent.
Recommendations for companies.
Defining economic scenarios and determining possible actions is difficult given the geopolitical uncertainty. It's even trickier to offer guidance at the industry and company level.

Should companies pull out of Russia immediately? Is it even conceivable to find alternative sales markets? Is hibernation the right strategy? Or is it better to write Russia off as a sales market and go all out to develop other markets? And what would that mean for corporate policy and financing?

To answer these questions, we analyzed the consequences of the sanctions at industry level. We spoke with industry associations and companies to help us obtain as comprehensive a picture as possible. The overview shows the findings of our analysis, revealing that the sanctions are affecting almost all of the main industries directly or indirectly. Our analysis focused on:

> How significant the business with Russia is (export share, revenue share, employee numbers locally, investment volume). Key finding: It is most important for the German automotive industry and the engineering and energy sectors.

> How the sanctions might have an impact (directly, indirectly or in the future). Key finding: There are negative short-term effects on the food industry, automotive, engineering and the telecoms and IT sectors.

Of course, we need to look deeper than the industry level. So we could make specific recommendations to companies, we spent a lot of time speaking with clients and fellow practitioners. Ultimately we devised a five-step approach:

**STEP 1: DETERMINE THE SCENARIO**
This first step is to decide which sanctions scenario you should base your corporate strategy on. Our industry analysis provides a measure of guidance, but the scenario decision needs to reflect your company's specific situation and appetite for risk. We base our five-step approach on three robust scenarios:

**Scenario 1** is our best-case scenario: The Ukraine conflict will be resolved soon, the sanctions will end by late 2014 or early 2015. The recommendation for German companies is: Relax – it will all be over in less than six months. However the developments of recent days and weeks make this scenario increasingly unlikely, as confirmed by our survey.

**Scenario 2** takes a much longer perspective, with the conflict lasting about two years. Existing and possible further sanctions hamper companies right through into 2016. The recommendation for companies in this medium-term scenario is: Hibernate. This is the scenario that the managers interviewed in our survey consider the most likely.

**Scenario 3** describes the worst case: The conflict leads to the formation of permanent East and West
**CONSEQUENCES OF THE SANCTIONS: WHICH INDUSTRIES ARE HIT?**

Russia is very important to some industries and less important to others. But sanctions may be felt by all sectors.

<table>
<thead>
<tr>
<th>BUSINESS WITH RUSSIA</th>
<th>CONSEQUENCES OF SANCTIONS</th>
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<tbody>
<tr>
<td><strong>Agriculture/food</strong></td>
<td>Ban on imports&lt;br&gt;Ban on imports&lt;br&gt;Loss of revenues, risk of prices collapsing&lt;br&gt;Risk of permanently losing business to the competition</td>
</tr>
<tr>
<td>2.8%&lt;br&gt;EUR 1.5 bn</td>
<td>EUR 1.4 bn*&lt;br&gt;+++&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Chemicals</strong></td>
<td>Loss of revenues&lt;br&gt;---&lt;br&gt;---</td>
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<td>3.3%&lt;br&gt;EUR 5.2 bn</td>
<td>approx. 7,000&lt;br&gt;++&lt;br&gt;---&lt;br&gt;---</td>
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<td><strong>Pharmaceuticals</strong></td>
<td>Loss of revenues&lt;br&gt;---&lt;br&gt;---</td>
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<td>3.4%&lt;br&gt;EUR 2.1 bn</td>
<td>&gt;2,500*&lt;br&gt;+++&lt;br&gt;---&lt;br&gt;---</td>
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<td><strong>Automotive (incl. suppliers)</strong></td>
<td>Loss of revenues&lt;br&gt;Threat of import restrictions for Western cars&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td>4.0%&lt;br&gt;EUR 7.6 bn</td>
<td>&gt;10,000*&lt;br&gt;++++&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Engineering</strong></td>
<td>Restrictions on dual-use items&lt;br&gt;Loss of revenues&lt;br&gt;---&lt;br&gt;---</td>
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<td>5.5%&lt;br&gt;EUR 7.8 bn</td>
<td>EUR 628 m&lt;br&gt;+++&lt;br&gt;---&lt;br&gt;---</td>
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<td><strong>Infocom (telecoms, IT, media)</strong></td>
<td>Restrictions on dual-use items&lt;br&gt;Loss of revenues&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td>3.5%&lt;br&gt;EUR 1.03 bn</td>
<td>n.a.&lt;br&gt;+&lt;br&gt;---&lt;br&gt;---</td>
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<td><strong>Construction</strong></td>
<td>---&lt;br&gt;---&lt;br&gt;---&lt;br&gt;---</td>
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<td>0.2%&lt;br&gt;EUR 55 m</td>
<td>&gt;3,500*&lt;br&gt;+&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Retail</strong></td>
<td>Problems with supply chain&lt;br&gt;---&lt;br&gt;---&lt;br&gt;---</td>
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<td>n.a.&lt;br&gt;n.a.</td>
<td>&gt;30.000*&lt;br&gt;+&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Consumer goods</strong></td>
<td>Loss of revenues&lt;br&gt;---&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td>approx. 4%*</td>
<td>&gt;15.000*&lt;br&gt;+++&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Financial services</strong></td>
<td>No business with Russian banks&lt;br&gt;---&lt;br&gt;---&lt;br&gt;---</td>
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<td>&lt;1%<strong>&lt;br&gt;EUR 16.8 bn</strong></td>
<td>approx. 2.1 bn*&lt;br&gt;+&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Defense</strong></td>
<td>Arms embargo&lt;br&gt;Loss of revenues&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td>approx. 1%&lt;br&gt;EUR 38.2 m</td>
<td>&gt;1.000*&lt;br&gt;+&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Transportation/logistics</strong></td>
<td>Fewer freight transports&lt;br&gt;Threat of a flyover ban for Western airlines&lt;br&gt;---&lt;br&gt;---</td>
</tr>
<tr>
<td>approx. 1%*</td>
<td>&gt;5.000*&lt;br&gt;+++&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td><strong>Energy</strong></td>
<td>Risk of strategic investments losing value&lt;br&gt;---&lt;br&gt;---&lt;br&gt;---</td>
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<tr>
<td>No exports but considerable imports (EUR 29.3 bn)&lt;br&gt;(Imports and strategic investments)</td>
<td>&gt;5.000*&lt;br&gt;+++&lt;br&gt;---&lt;br&gt;---</td>
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</table>

Sources: Industry associations, Destatis, company figures; latest available data (2013 or 2012)<br>*Own estimates (based on foreign trade statistics and/or company data) **German banks’ exposure in Russia
THREE SCENARIOS
AND GENERAL MEASURES –
WHAT GERMAN COMPANIES CAN DO NOW

Scenario 1: "Relax"
The conflict will soon be over, the sanctions will end by late 2014 or early 2015.

- Don't let it worry you too much
- Keep production and distribution channels open
- Engage in relationship management
- Take advantage of re-export possibilities
- Hedge against a weak ruble
- Secure credit lines
- Manage cash flow
- Quickly optimize costs
- Keep the capital markets informed
- Check out (political) relief programs

Scenario 2: "Hibernate"
The conflict will last about two years, the existing (and possible future) sanctions will hamper companies during this period.

- Wind down activities (adjust capacities)
- Ramp up local content
- Cut costs
- Maintain contacts
- Keep a local footprint/presence
- Seek/develop alternative sales markets
- Sell off certain activities
- Relocate activities to non-embargoed nations
- Adapt your strategy
- Check out (political) relief programs

Scenario 3: "Leave"
The conflict will lead to permanent East and West blocs, the spiral of sanctions is unending.

- Wind down all activities
- Exit the market, sell off investments
- Develop a new strategy
- Establish new sales markets
- Make new financing arrangements
- Examine whether the expansion of Russia's sphere of influence to CIS states requires any further adjustments
- Check out (political) relief programs
blocs, with an unending spiral of sanctions. Companies operating in Russia should give up hoping for a quick resolution and leave.

Our summary lists the general measures we would currently advise for companies affected by the sanctions. For more detail, we need to take a closer look at what the individual companies do in Russia – in other words, what their footprint is.

STEP 2: DETERMINE YOUR FOOTPRINT
The impact of the sanctions depends on whether your company is purely an export business, has its own local infrastructure or has long-term obligations from joint ventures or strategic alliances. We suggest three differing footprints for the purposes of the analysis:

**FIRSTLY** pure export businesses, with no staff and no capital in Russia

**SECONDLY** companies with their own distribution or logistics networks in Russia, in other words with staff and capital in Russia

**THIRDLY** companies operating in Russia with their own production facilities, for instance in joint ventures

STEP 3: DETERMINE THE IMPACT
The impact of the sanctions on your firm depends on a range of other aspects besides your footprint. We view six factors as crucial:

**Effect of the sanctions:** Do the sanctions stop me doing business completely (e.g. the ban on agricultural imports)? Or do I just have additional restrictions to deal with (e.g. checks and authorizations required for my visible exports, such as dual-use technologies)? Or do the sanctions only affect my business indirectly because I'm not in one of the industries facing sanctions?

**Importance of business with Russia (revenues):** Is my business with Russia so small, accounting for <3% of my revenues, that I can survive the impending business losses? Or will the sanctions affect 3-10% or even >10% of my revenues?

**Importance of business with Russia (profits):** Similarly, is my business with Russia so small, accounting for <3% of my profits, that I can survive the impending business losses? Or will the sanctions erode 3-10% or even >10% of my profits?

**Company size:** Am I a small or medium-sized enterprise (SME) or a major corporation? Large businesses are normally better than smaller ones at containing problems or getting through bad times.

**Ability to compensate:** Can I rapidly compensate for any loss of business – by being quick to make decisions, flexible and/or well networked, for instance? Or are my hands tied in the short term, meaning that I can only switch my focus in the medium term or longer?

**Company situation:** How healthy is my company? Am I fully financed? Or do I suffer from capital squeeze, which could put my company in a critical position?

We devised a points system for each of the six impact factors. Your total score ultimately suggests whether the impact of the sanctions is likely to be low, moderate or strong.
IMPACT OF SANCTIONS ON COMPANIES
FIVE STEPS TO DETERMINING WHAT ACTION YOU NEED TO TAKE

Step 1

DETERMINE THE SCENARIO: How do I expect the situation to develop?
- Scenario 1: Sanctions end by late 2014/early 2015
- Scenario 2: Sanctions hamper business for about two years
- Scenario 3: Sanctions remain in place long term

Step 2

DETERMINE YOUR FOOTPRINT: How do I currently operate on the Russian market?
- Footprint 1: I export to the Russian market
- Footprint 2: I have a distribution/logistics network in Russia
- Footprint 3: I have local production facilities

Step 3

DETERMINE THE IMPACT: How hard will the sanctions hit me?

Note down your score on each aspect of impact.

- Effect of the sanctions: The sanctions stop me doing business completely (2 points); I just have additional restrictions to deal with (1 point); the sanctions do not directly affect my business (0 points).

- Importance of business with Russia (revenues): Business with Russia makes up less than 3% of my revenues (0 points); I generate 3-10% of my revenues in Russia (1 point); my business with Russia accounts for more than 10% of revenues (2 points).

- Importance of business with Russia (profits): Business with Russia makes up less than 3% of my profits (0 points); I generate 3-10% of my profits in Russia (1 point); my business with Russia accounts for more than 10% of profits (2 points).

- Company size: I am a small or medium-sized enterprise (2 points); I am a major corporation (1 point).

- Ability to compensate: I can quickly compensate for any loss of business in Russia (0 points); I can only compensate in the medium term or longer (2 points).

- Company situation: My company is healthy and financially sound (0 points); my company is in a critical position (2 points).

Now add up your total score.

<table>
<thead>
<tr>
<th>Impact level</th>
<th>Score range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impact 1</td>
<td>1–4</td>
</tr>
<tr>
<td>Impact 2</td>
<td>5–8</td>
</tr>
<tr>
<td>Impact 3</td>
<td>9–12</td>
</tr>
</tbody>
</table>

Total score
Step 4

**DETERMINE YOUR RISK POSITION: How great is the danger for me?**

> Enter the results of steps 1 (scenario), 2 (footprint) and 3 (impact) to identify your position in the cube
> The closer to the top/right/back of the cube you are, the greater the danger for you and the faster you need to act

Step 5

**DETERMINE YOUR OPTIONS: What can I do in my particular situation?**

> Each position in the cube calls for different actions
> Start with our general recommendations
> Next, specify them depending on your footprint, impact and risk profile:
  - Which actions are the most important, which are secondary (prioritize)?
  - What exactly should the actions be (structure)?
  - How quickly do I need to take them (timeline)?
  - Do I need to follow a fundamentally new path (strategy)?
STEP 4: DETERMINE YOUR RISK POSITION
Our test tool illustrates all of the steps described so far—scenarios, footprints and impact—and gives a clear indication of a company’s risk profile: How threatened is my business? How quickly do I need to respond? To what extent is my business dependent on the scenarios? What would a switch from Scenario X to Scenario Y mean for me?

STEP 5: DETERMINE YOUR OPTIONS
Your position in the risk profile shows how great the need for action is and how wide-ranging the measures you take need to be. We outlined the possible options. Knowing what the footprint, impact and risk position are, it is now possible to make specific recommendations for your company.

There is a fear that the vicious cycle of sanctions will intensify in the coming weeks. Directly or indirectly, all companies may end up being affected.
The German economy – a brief update. In our economic scenario from the end of January 2014 we presented a positive forecast for the development of the German economy with a growth rate of 2%.

That was before the Ukraine conflict and the economic sanctions. So how does it look now? We have systematically revised the forecast below:

**FIRSTLY:** We had predicted that our most important export markets would develop dynamically, our industrial capability would be used to the max and our domestic market would drive strong growth again.

Though the second quarter was below expectations and incoming orders and investments were rather disappointing, a whole series of positive developments raised our hopes of a dynamic second half to the year:

> Consumption continues to grow. Household and public-sector spending are both up again in the second quarter. The Single Market is driving growth.
> The United States is doing very well. Outstanding growth of 3.9% in Q2 means that reindustrialization is taking hold, low energy prices are stimulating business, unemployment is falling, business confidence is good and so are growth prospects.
> China is managing a soft landing. Aided by the Central Bank’s more relaxed monetary policy, Beijing is expected to make its target of 7.5% growth for the year.
> Europe is growing once more, 0.3% in the first quarter and 0.2% in the second. 1.5% growth is anticipated for the full year. Even a few tenths of a percentage point less would be good compared with the zero growth of 2013.

**SECONDLY:** Less favorable developments in Japan and Brazil, and even those in Italy and France, could not check this positive momentum. Had the economic sanctions not been tightened we would not have revised our 2% forecast. We would have relied on our industrial capability and the strength of German companies to carry the growth through. But we can no longer rely on this. The overwhelming majority of German managers we spoke to do not believe the sanctions are of a transitory nature – as we outlined above – and fear a noticeable drain on their growth. Only just under 30% anticipate no appreciable damage to the economy.

**THIRDLY:** We, too, foresee a drop in growth – but not more than half a percentage point. The U.S., fairly untroubled by the sanctions anyway, will continue on its positive trajectory and offer growth opportunities, all the more so since its advancing industrialization presents our companies with greater sales options. And our confidence in China’s ability to pull off a soft landing and remain a driver of growth remains unshaken.
On top of this we are hopeful that, faced with the challenges on the geopolitical front, the new EU Commission will take prompt and sustainable steps to strengthen Europe’s economy.

But above all we expect the German economy to be able to cope with the sanctions, at least for the next few months. The broadly diversified nature of German industry makes this possible, coupled with the global positioning and international competitiveness of German firms and the good mix of large corporations and efficient smaller companies that makes us flexible.

Overall, we see good prospects of growth not dipping to 1.5% this year but stabilizing instead at 1.7% – particularly if we stay positive and the EU quickly lays the foundation for a policy of sustainable European growth.
Roland Berger Strategy Consultants

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Further reading

INDUSTRY 4.0
How Europe will succeed

The shrinking competitiveness of Europe’s manufacturing companies, triggered especially by the entrance of new market players from Asia, is threatening the European model. The digitalization of industry is now our only chance to regain lost ground.

ECONOMIC SCENARIO 2014
Our forecast for the German economy

Our economic scenario analyzes the strengths of the German economy, describes the dynamic in our export markets and specifies risks for the German economy’s growth momentum (only available in German).

Tablet version

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