

A research of The Economy of Runet

The economy of Internet services and content
markets in Russia in 2011 and 2012

By the RAEC (Russian Association for Electronic Communications)
and the Higher School of Economics National Research University

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From Russia with web

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About the project

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THE RUSSIAN ASSOCIATION FOR ELECTRONIC COMMUNICATIONS

Up to this day, there has been no sole, authoritative and regular research into Russian Internet economy, a study that both business entities and state authorities could cite and use in their work; and, importantly, a study that would work as a guide in Russia for Western experts, analysts, investors and entrepreneurs.

So far, experts' opinions of Russia's Internet economy have differed, with estimates of its size ranging from 0.5% to 2% of the country's GDP.

Both Russian and international experts, however, agree on one thing: Runet is the fastest-growing Internet economy in Europe, and one of global leaders in terms of growth rate.

For us, representatives and consolidators of Russia's web industry, and also for researchers studying Runet, it is obvious that the Internet has not just penetrated all areas of life of the public, business and government, it has become the very innovation economy that was so often mentioned

recently, the industry that is expected to be the driver of Russia's whole new economy.

As we rightfully take pride in the achievements of our national Internet business, we must make them known to the public, both in Russia and abroad. To present Runet's history as an inspiring success story of a national scale, to see the ways in which its further development can be supported and stimulated, to find ways to remove and overcome obstacles. These are the goals that we, initiators of this research, have set ourselves.

The Russian Association for Electronic Communications have long been working in this direction, and the current study was conceived as one of the most important steps to help achieve these goals. The study must become, in a manner of speaking, a 'theoretical basis' for demonstration of Russian Internet segment's achievements, and for defining the priorities for its future development.

The Economy of Runet in 2011 and 2012. Results.

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In the course of this research, we have received data and expert evaluation of the most rapidly evolving segments of Russian Internet economy.

The value of Runet's software as a service (SaaS) solution market was estimated at \$64.4 m, as of 2011.

Three major segments of Russia's electronic commerce industry were studied:

- Retail (\$10.43 Bn);
- Electronic payments (\$5.68 Bn);
- Sales of digital content and games (\$280.8 M).

The experts have evaluated the most active and prominent markets of the Internet advertising industry:

- The value of Russian contextual advertising reached \$825.9 M in 2011;
- Media advertising market volume comprised \$539.5 M.

Emerging and rapidly evolving new markets of advertising and marketing services were studied separately:

- Video advertising market (\$27.3 M);
- Social media marketing (smm, \$101.5 M).

Search engine optimization (SEO) market value comprised **\$294.7 m**, and web development market reached **\$334.9 m**.

The experts estimated the hosting and domain registration services market at **\$178.2 m**.

The markets singled out in the findings of the research are part of a broader Internet economy that includes electronic commerce, advertising and marketing services, hosting and domain sales, SaaS solutions markets.

Total value across the eleven studied markets comprised **\$18.87 bn in 2011**, with expected growth rate of 30%, based on the results of 2012.

Special characteristics of the studied markets

The research showed that, in a developing Internet economy, experts and players may have different views on the structure and boundaries of particular markets.

For instance, all segments related to advertising and marketing are intertwined and integrated. Contextual and media advertising, video ads and SMM, SEO, and most of the web development markets must be viewed as segments of one, larger Digital Marketing industry.

Building on this understanding, we managed to interpret the study findings correctly.

One of the future tasks of The Economy of Runet research will be to reveal the full market structure and interlaced segments that form markets, as well as mapping the links between the various segments of Russia's Internet economy.

It is important to mention that our study did not take into account the Internet service providers market, which we view rather as part of the telecommunications industry.

Although many providers and mobile network operators are increasingly becoming players in the market the research looks into, we do not find it possible to see communication services as part of Internet economy.

The same can be said about system integrators, who were not included in the study as well. Cloud technology B2B and B2G services are gaining an increasing share in the market, but this segment differs dramatically from the SaaS segment in terms of competition structure, player composition and pricing. These segments, however, may be included in the study in the future.

Although electronic trading and public purchasing can formally be classified as electronic commerce, their inclusion in the study would have expanded the field of study manifold, resulting in our inability to evaluate the development of this particular segment of Internet economy.

Finally, in the digital goods segment, we were unable to evaluate whole ticket and tour packages sales segment, due to methodological shortcomings. This should also be rectified in the next round of our study.

Growth Rates

10 out of the 11 markets we studied, based on the data from 2011, showed a growth rate of more than 20%, and average growth rate across all markets was 33%:

- The fastest-growing segments, with growth indicators of over 50%, were contextual advertising on the Internet and video advertising (+53% each).
- Growth of over 40% against the volumes

of 2011 was seen in the SaaS solutions segment (+46%), social media marketing (+43%) and media advertising (+41%).

- Electronic payments market grew by 34% in 2011, online retail market – by 30%, and digital content and games market – by 26%.
- Web development market added 31% if compared to the volumes of 2010, while hosting and domain services market grew by 25%, and search engine optimization market – by 18%.

We estimate that all the markets we looked into will maintain the positive growth dynamics as result of 2012. Experts have predicted some markets will be able to improve their 2011 growth rate indicators.

- By the end of 2012, video advertising market may have grown by 59% (+3%), and electronic content market – by 27% (+1%).
- Hosting and domain registration market, as well as web development market, will both lose 4% (down to 21% and 27%, respectively).
- Experts believe that two markets will lose momentum most dramatically by the end of 2012: the media advertising market growth will slow down by 8% (33%), and contextual advertising by 14% (39%).

By the end of 2012, average growth rate across all the studied market segments will be at least 30% up from the volumes of the previous year, surpassing the growth rate of general Russian economy and some of its sectors.

Research Context

This study looks into the economy of Internet services and content markets that together form a part of Internet-dependent markets ecosystem that also includes segments such as Internet access services, electronic trading and investment in Internet projects. The accumulated value of Internet-dependent markets, including the studied markets, exceeded 2.52 bn rubles at the end of 2011, or equivalent to 4.62% of Russia's GDP in the same year.

Figures

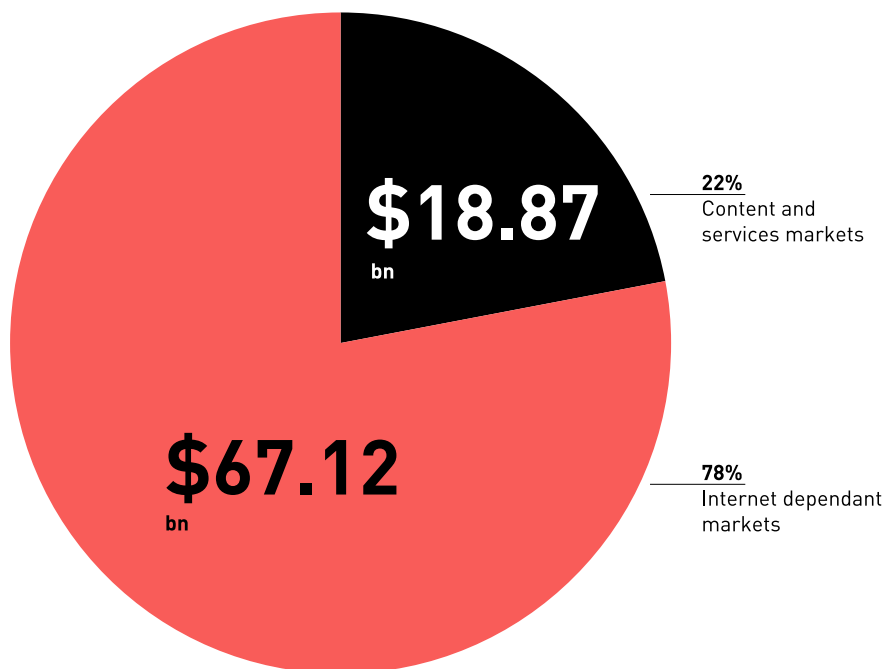
Content and services markets: \$18.87 bn

Internet access market: \$6.81 bn

Investment market: \$2.39 bn

Electronic trading market: \$57.32 bn

As result of this study, we have received volume indicators on 11 key, most active Internet economy markets, as well as their growth rate indicators in 2011 and expected growth rate in 2012.



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Market / Segment	Market volume in 2011, USD millions	Gain from 2010, %	Expected 2012 growth rate, %
SaaS	64.4	+46	+46
E-Commerce: payments	10 430	+34	+32
E-Commerce: retail	5 680	+30	+27
E-Commerce: content and games	280.8	+26	+27
SEO	294.7	+18	+19
SMM	101.5	+43	+40
Video advertising	27.3	+53	+59
Media advertising	539.5	+41	+33
Contextual advertising	825.9	+53	+39
Web development	334.9	+31	+27
Hosting and domains	178.2	+25	+21
TOTAL	18 870	+33	+30

Russian Internet economy: major development trends



As part of our research, experts were asked to fill in a questionnaire on the development of the studied segments of Russia's Internet economy in 2011 and 2012. The respondents named the following major trends:

- The market has mostly entered the phase of maturity. However, speedy growth is accompanied by some 'developmental diseases'.
- New and fast-growing market segments emerge, in line with global trends. Russian market used to lag behind that of other nations, but now it is gradually catching up.
- Market consolidation trends are apparent; at the same time new competitors, coming from adjacent and legacy markets are entering the game.
- There is a growing tendency toward self-regulation, by means of industry associations
- Domestic companies attempt to go beyond the Russian/CIS market, yet the industry is still largely restricted by the boundaries of inner market, because of its size and unfulfilled niches.
- Many indicators place Russian market at the first position in Europe, which begins to attract major international players to the country's domestic market.



Maelle Gavet

CEO Ozon.ru Holding

As you know, Russia has the largest number of Internet users in Europe, more than 50 million, and the prospects for further growth are great, too. But there are also some aspects, some issues that we must address together: there are few online shoppers. Yes, although there are so many Internet users, there are still very few people buying online. And that is something we need to work with. There's too many competitors. Even today, Russia already has 25,000 Internet shops. Two years ago, it was the beginning of the long road for the market, but now it is entering maturity. Online retail accounts for 2% of total retail today, and that is a serious share, one that could even be compared with that of some Western countries. And if today we make a mistake in our work with a customer (doesn't matter on what stage: product range, usability, delivery, etc.), they will leave us for another online store, as there are so many, and trying to get them back won't be easy or cheap. International online shops have a certain advantage over Russia ones: they can deliver their shipments to Russia without paying custom duties or VAT (given that their customer keeps within a certain amount). This makes competition even more intense.



Boris Omelnitsky

President IAB Russia

The current share of Internet advertising in Russia is only about 16%, and all Internet advertising market players together have somebody to challenge. That is why they are rather competing other media channels. In other words, Internet advertising is trying to be more technically advanced, more targeted. Being the no. 2 medium in terms of budget in 2011, it is currently trying to challenge the TV advertising, which accounts for almost 50% of all ad budgets in Russia. So the competition is not within the market, it is between various media markets, it is against other media channels.



Alexey Belyaev

Head of Internet research department,
VVideo International Analytical Center

The amount that Russian market yields in a minute of a user's time is comparable to that of the American market. Yet in America, the market is significantly more advanced technologically, much more branched, there are some niches that are not yet developed here, and we are only trying to create them today. Technological development is the general direction now, and, judging by various announcements and presentations at industry conferences, Ru-net is closing the gap there rather rapidly. That is easy to explain: the American web adverts market has to cut its way through an uncharted territory, through countless experiments, hitting many branches and raising many bumps. But we are taking the paths that were made by them before us. Yes, we make our own mistakes, we hit our own trees, because we are going through our own forest. But we can see the light on the edge of the forest already, we can see the high-tech future of media advertising from here.



Andrey Sebrant

Product Marketing Director, Yandex

Unlike media advertising, the contextual advertising market depends much more on medium and smaller business. Major brands who spend billions of dollars control media advertising, but the contextual market is much flatter, meaning that there are hundreds of thousand advertisers working there. One can say that the general well-being of this segment of the economy – small and medium business – defines the amounts of money that small and medium business will spend on advertising. And the more small and medium business are developing, the larger the volume and turnover of contextual advertising will be, because for this segment, contextual ads are the most beneficial means of promotion.



Sergey Ryzhikov

CEO Bitrix

The development market has been steadily growing for the past 10 years. The demand for Internet solutions is increasing, especially the demand for e-commerce solutions for online retail, which has become an integral part of retail business. And that market segment is developing much faster than the others. We can also speak of two other directions that have very good prospects: cloud services and mobile applications, they are evolving very well. They may not have yet won themselves a position as important as online retail or Internet projects, but we can be sure that in four years time they will be used everywhere.



Riki Drori

Marketing Director for South-Eastern Europe, Middle East and Africa, Google

In 2011, Google commissioned BCG and McKinsey to make the first global study of how the Internet influences the economy and the society, and the study was conducted in over 50 countries around the world. Russia was the 35th nation out of 46 in BCG's Internet usage intensity rating, outstripping China and India. While global economy is in crisis (GDP growth in US and Europe are predicted to drop to 1.5%), the Internet industry is dynamically developing in many countries, being, in effect, the driving force of innovation economy. The Internet's aggregate contribution to the economies of G20 nations is over 4%, and the new/cut jobs rate rose to 2.6. The Russian study was made across Runet's 11 most actively developing markets. The economy of Runet is expected to grow by about 30% in 2012, which is considerably higher than the average growth rate of Russian economy as a whole and many of its various segments.

Recommendations for the development of Internet economy in Russia for business

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Based on the findings of our study, we have come up with this list of recommendations regarding the development of Internet economy, aimed at market players and commercial entities. Industry experts think the following directions are important:

1. To create and promote industry standards and service quality requirements; as part of self-regulation process, and with the aim of greater transparency of the market.

2. To participate in creation of professional education and personnel training, in

collaboration with secondary and higher educational institutions.

3. To inform and educate consumers, in order to form and promote demand for services and improvement of computer literacy level.

4. To help the creation of an innovation-friendly environment and startup ecosystem in Russia.

5. To be involved in the life of international professional community; to study international experience and trends in industry development and regulation.

Recommendations for the development of Internet economy in Russia for government

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Based on the findings of our study, a list of expert recommendations regarding the development of Internet economy was drawn up, aimed at various government bodies. Industry players think the following steps are to be taken:

1. To improve and harmonise the laws on personal data, introduction of a simplified processing procedures for personal data necessary for deals on the Internet.

2. To devise and put into action, with the help of industry experts, a plan for exact changes aimed at increasing efficiency level of law enforcement practices in the field of combating illegal and malicious content, leveling down the risks for Internet companies, such risks arising from unfair competition, abuse and mistakes in the work of filtration systems.

3. To devise and carry out an information campaign aimed at increasing awareness of the population in regard to opportunities and safety of interactions via the Internet.

4. To create a standing competence centre – an authoritative and trusted educational organisation that would devise, support and develop industry learning programmes at educational institutions; as well as initiate projects aimed at improving media literacy.

5. To devise and implement a programme for improving media literacy of the population, i.e. promoting on the Internet.

6. To devise and put into action a long-term strategy for the government's policies in the field of intellectual property, i.e. legal reform concerning copyright and related rights.

7. To stimulate internet economy by introducing temporary simplified tax schemes.

8. To devise and implement, with the participation of industry experts, a project for reform of laws governing the work of the federal postal system; to give a boost to competition in the postal services market.

9. To stimulate the development of Internet economy on regional level, with the aim of decentralisation and even development of the industry throughout the nation.

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Vodka, caviar, balalaika, matryoshka nesting dolls, Putin, Medvedev, Yuri Milner and Yandex – how much more do Western professionals know about Russia and its Internet industry?

Alas, very little.

With TheRunet, we hope to change this situation for the better. Our aim is to introduce international readers to most recent developments in the Russian-speaking sector of the Internet, with its rapidly growing number of users, eCommerce and advertising market, innovative startups, major deals and more Russian players entering European, American and Asian web markets.

Today, when Russian giants such as Yandex and Mail.ru Group are among the largest companies in Europe, we see a great interest

in Russian Internet business in the West, but we also see a great shortage of information on the subject.

TheRunet is a blog dedicated to news and analysis on the Russian Internet Industry. Every day, we will bring you news on Russian companies, current research data and commentary from the leading experts.

We hope that the blog will prove useful to professionals from Paris to Hong Kong, from Dublin to San Francisco, to those representing large international corporations or small startup businesses, to investors, business angels, media managers and journalists.

Our experience in Russia includes organizing major professional events, such as the Russian Internet Week and managing popular publishing projects, such as The Internet in Numbers magazine. So, if you are interested in Russia's Internet business, you've clicked the right link: www.theRunet.com!

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