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Russia: going east all the way

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Philip de Leon at US Department of Commerce in Washington DC

Philip de Leon has been working for 10 years for the Business Information Service for the Newly Independent States (BISNIS) which is an office promoting U.S. exports & investments in Eurasia. He recently returned from a trip to Russia's regions that included Tatarstan (Kazan), the Urals (Yekaterinburg) and Siberia (Novosibirsk and Tomsk). In this article he will aim at dispelling some regular stereotypes and misconceptions and at depicting commercial opportunities in Russia, he will also elaborate on the regions he visited, focusing on their economic potential at a time where traditional markets such as Moscow and Saint Petersburg are becoming saturated with competition.

Russia is the 'R' in the BRIC term used in a 2003 Goldman Sachs thesis that refers to what are considered some of the most promising markets (Brazil, Russia, India, and China) that would reach leading positions in the global economy by 2050.

These countries have seen, and will continue to see their role in the global economy become more important as foreign direct investments increase, their stock market and currency grow stronger, and their respective share of the global GDP grow to outweigh that of some European and Asian countries.

Though Russia's economy remains highly dependent on the prices of oil & gas and commodities, the following numbers are still very impressive. Russia has experienced over 6.4% GDP growth since 2003. It's Central Bank's gold and hard currencies reserves have exceeded \$303 billion as of 1 January, 2007, a \$121 billion (or 67%) leap from 2005. The rouble has gained strength, with an exchange rate of 25.35 roubles to a the US dollar on September 15, 2007, down from 28.75 roubles to a US dollar on January 1, 2006. Inflation remains a challenge: the government intends to bring it down one point in 2007 to 8% from 9% in 2006, though the inflation rate rose to 8.7% in July.

Sensationalism versus commercial reality

For many, Russia is the land of all dangers. For those who work with or in Russia, this misconception is a blessing in disguise, allowing the most daring entrepreneurs (or should we say the better informed?) to seize market shares and comfort their position, rendering it more difficult for newcomers to succeed without significant additional work and money. The press also loves bad news. The takeover of a foreign-run hotel with customers asked to leave in the middle of the night, the storming of a vodka plant over a trademark battle while the director is entrenched in his office, or the loss by foreign companies of their ability to use ►

Russia – regional business opportunities

► their own trademark because someone re-registered it to a different owner, are more entertaining to cover than the success of a Nizhny Novgorod pharmaceutical company eventually bought by a German company or the successful collaborations established between foreign and Russian small and medium-sized businesses.

Yes, there are problems and challenges in Russia and not identifying and acknowledging them would be a gross mistake that could have dire consequences. This being said, many foreign companies are doing extremely well and can attest to the fact that Russia has become an extraordinary land of opportunities if the risks are properly identified and addressed.

Efforts have been made to dispel the reluctance of foreigners to fully engage with the Russian commercial arena. In 2006, the PBN Company, an international strategic communications consultancy, conducted its second survey of over 130 companies on the investment climate in Russia. The survey was commissioned by the Russian Ministry of Economic Development and the Trade and the Federal Investment Advisory Council (FIAC).

Bureaucracy and red tape (84%), corruption (78%), inadequate and inconsistent legislation (71%) and selective interpretation and application of laws for foreign companies (67%) were mentioned as the top factors impacting investment. Nevertheless, one of the most revealing findings was that over 90% of the interviewed companies said they planned on increasing their business positions and investment in the next three years (up from 70% in the 2005 survey).

Recently, the American Chamber of Commerce, with a membership of over 800 companies, commissioned a survey on business performance. The survey was equally optimistic. Some of the major findings were:

- half of the surveyed US companies reported sales increases of 200% from 2001 to 2005;
- 67% expected sales growth of more than 50% though 2008 and 39 predicted their sales to grow by 100% over the same period; and
- profitability of 79% of the surveyed companies

was on or above target for 2001–2005.

These surveys are very telling: the overall mindset is that in spite of some of the hardship associated with working in Russia, the gains by far make it worth it all.

Sectors where foreign companies have done well include, but are not limited to: agribusiness, manufacturing, consumer goods, telecommunications, and financial services. Other sectors, seen as strategic sectors by the Russian government, such as aerospace or natural resources, still have seen a good level of foreign involvement and collaboration.

Russia's regions: outshining Moscow?

If the above has convinced you that Russia could be a market for you, then beware of not letting the Moscow siren captivate you and make you forget about the other promising markets of Russia. Billions of dollars of foreign investment have poured primarily into Moscow but also NW Russia and in the remote but oil-rich Sakhalin Island on the Pacific coast. Closed cities and regions did become accessible to foreigners, but many remained the forgotten children of this growing interest.

However, things have been changing, ever more so as there is a growing middle-class in many cities that have over one million inhabitants, providing an untapped market for foreign companies, notably those dealing with consumer goods, heavy machinery, construction and infrastructure or those interested in getting involved in what the Russian government sees as 'national projects' such as education, agriculture, healthcare and affordable housing.

Russia's 85 federal subjects — 21 republics, 47 provinces known as oblasts, 8 territories (krajs), 6 autonomous districts (okrugs), 2 federal cities and 1 autonomous province — are very eager to draw in more foreign investors and businessmen. The fact that foreigners will make the efforts to come will be appreciated, as a significant amount of time is needed to reach some remote areas. This being said, the occasional foreign delegation has been replaced by a steady flow of visitors, from heads of states, trade missions and delegations, company teams, consultants, etc. As a result, regions and cities are slowly but surely following the footsteps of Moscow in being able to pick and choose among multiple contenders. Competition exists also between regions and large cities, leading them to establish special economic zones, tax incentives and to commit, to a certain extent, to a greater involvement in helping the daring foreign entrepreneurs.

However, those who want to be in and out to make a quick "buck" are bound to be disappointed. I was once told when I was too eager to talk about my business proposal "Philip, first let's talk, then let's become friend, and then only shall we talk about business." With this principle in mind, if you are a business manager with 20 countries to cover, you may want to go back to you headquarters and ask to be relieved of about 19 countries as relationship building is not done overnight.

Important regional events in 2007

2007 is not over yet, but it has seen two important



events whose significance should not be neglected as they send a strong message that future opportunities are east and south of Russia.

The first one was the annual meeting and business forum of the European Bank for Reconstruction and Development not taking place in an Eastern European capital city, but in Kazan, capital of the Republic of Tatarstan. At the annual meeting, Alexei Lavrov, the head of budget policy at the Russian Ministry of Finance stated, in a session entitled 'Russia's regions: Russia's future', that following important administrative reforms, it was now up to regional authorities themselves to attract business and promote growth. "Some regions have fulfilled their potential, others haven't," Lavrov said. He urged foreign businesses to grasp the opportunity to influence local business practices in Russia's regions.

The second event was the southern Black Sea resort and port city of Sochi winning its bid for the XXII Winter Olympic Games of 2014. The amount of federal and regional money to be spent to prepare the city is considerable, well over \$12 billion. Even Russian oligarchs committed to invest at least an additional \$5.5 billion. In addition to the sport facilities, apartments, hotels, business complexes, shopping centers to be built, supporting infrastructures will be needed such as electric power plants, roads, hospitals, etc

Tatarstan: an experimental laboratory

Kazan (1.1 million inhabitants) hosting the EBRD annual meeting came as no surprise to those who have been there. The Republic of Tatarstan has very skillfully over the years managed to remain independent and autonomous and to promote its Tatar and religious heritage without being at odds with the federal government or forgetting its allegiance to the Russian Federation.

The republic is oil-rich, has a highly developed petrochemical industry, and prides itself at contributing more to the federal budget than it receives. Tatarstan is the only one of the now 85 federal subjects of the Russian Federation to have trade representatives in over 10 countries. This approach has greatly contributed to exposing foreign companies and investors to the potential of Russia's regions. Tatarstan also takes pride in the peaceful coexistence of Christianity and Islam on its soil and what has been called 'Euro-Islam,' a sort of emerging liberal brand of Islamic thoughts, bridging two worlds towards peaceful coexistence and mutual acceptance.

Yekaterinburg: the gate eastward

Just like St. Louis, Missouri was seen as the gateway to the great American west, Yekaterinburg (1.3 million inhabitants) can be considered as the juncture between Europe and Asia. It is a major industrial and trading center as well as a key transportation hub, and the capital city of the Urals federal district, one of the seven federal districts. One striking feature when visiting Yekaterinburg is the sea of cranes demonstrating a construction boom in residential and commercial buildings.

The dynamism of Yekaterinburg and of the Sverdlovsk province to which it belongs, and their readiness to accommodate the needs of investors can be seen



through the high number of foreign companies in Yekaterinburg alone.

Siberia: warm to investment

Though the main cities such as Novosibirsk (1.4 million inhabitants) — which is the capital of the Siberian Federal District — Omsk or Krasnoyarsk, are right in the middle of Russia and seen too remote, many are still closer to you than Brazil, China or India. Also, if the fear of cold temperatures is a deterrent for you, always remember that there are no bad winters, there are only bad winter clothes.

Akademgorodok, south of Novosibirsk, is the educational and scientific center of Siberia and was a key center of Soviet research. Projects for a techno park are under way to develop and commercialize innovative technologies in various sectors, such as biomedicine, biotechnologies and IT.

Tomsk, with a population of about 490,000 and a 400 years old history, is an example of a mid-size city that deserves greater attention. Not only does it harbor architectural wonders, such as its wood-carved houses, it is also a city making the most of its intellectual talent such as by establishing a special economic zone for high-tech development. In 2004 the city authorities adopted a program called 'Tomsk – Big City' which includes about 20 sub-programs dealing with city development such as power efficiency, residential housing, urban development, and restoration of wooden architecture.

To conclude, if Russia remains a mystery to you, read the annual addresses to the Federal Assembly where the President of the Russian Federation clearly states the priorities for the country. If you are afraid of being a pioneer, then simply follow the footsteps of fast food chains such as McDonald's or Subway, retailers such as Ikea or Auchan, airlines such as Lufthansa and Turkish Airlines, or financial services companies such as Citibank and Société Générale, as none of them would have started operating in the regions if they had not identified a potential for success that outweighed the commercial risk. ■