

Success in Doing Business in Russia;

POTENTIAL, OBSTACLES AND PRACTICAL APPROACH

EPP Dutch Branch

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This presentation treats:

1. **Significance of Russia for us;**
2. **The potential and obstacles of the Russian economy;**
3. **A practical approach to success on the Russian market;**
4. **Conclusion and Answers to your questions.**



A. Our perception

- Mafia - Oligarchs
- Cold
- Russian bear
- Risks and danger
- Unreliable
- But, a positive exception; culture!



B. Russian reality

- Politics
 - Vertical power / Nationalisation / Media freedom / Democracy
- Society
 - Small middle class (SME) / Growing difference between rich and poor / Neglect of crucial sectors
- Cultural
 - Eurasiatic – slavic / No sense of individuality / Pride
- Economic
 - Oil and Gas / Purchasing power / Real disposable income / Growth in many sectors



C. The significance of Russia for us:

- Necessary partner that wants to (and should) be treated as equal.

WHY?

- Geopolitical significant area that moves more and more towards China and India.
- A market and a source of natural resources that we cannot ignore.
(50% of Russia's foreign trade is with EU)

C2. The significance of Russia for EPP:

- More than 25% of pork is imported
- Pork production has risen sharply (10) during first half of 2006
- Growing purchasing power and booming retail sector
- Much attention of Russian government for development(and money)
 - national pig breeding program aimed at building new farms and modernizing existing cattle breeding complexes.
- Lack of management skills, resulting in high cost price on average Russian farm, even with modern equipment
- In 1978 developed countries produced 60% of the world's pork and the developing countries the rest. In the year 2010 it is expected that the numbers will be reversed where the developing countries produce 60% of the world's pork and developed countries produce 40%. The developing countries that are a significant part of this trend include Brazil, Russia, India and China.

C3. The significance of Russia for EPP:

Production Russia Federation in 000s of tonnes

2001 - 1,560

2002 - 1,630

2003 - 1,710

2004 - 1,725

2005 - 1,755

2006 - 1,785

Consumption Russia Federation in 000s of tonnes

2001 - 2,076

2002 - 2,453

2003 - 2,420

2004 - 2,337

2005 - 2,429

2006 - 2,484

Source: USDA-FAS Livestock and Poultry: World Markets and Trade, March 2006

D. Demographic and Geographic figures

- 143 Million people
- 17 million square kilometers
- 11 time-zones
- Natural resources
 - Oil = 9% - 12% of total world explored resources
 - Gas = 33% of total world explored resources
 - Coal, Diamonds, Precious Metals, Nickel, etc(Account for 30% of industrial output and 60% of total exports)



E. Economic environment

- High world energy prices boost growth
- GDP 2005 = \$800 billion / growth 2005 = 6.4% / 2006 = 6.0%
- Inflation 10%
- 30% of economy in grey sector and not accounted for
- WTO Accession – an open question (import quotas raised by 2 %)
- Average salary 2005 was \$302 (10% higher than in 2004)
- Increase in purchasing power
- 8% unemployment and 16% of the population (23 million) lives below the official subsistence level of \$95

A. Potential

- A market of 143 million consumers with strong demand both for modern technology and equipment, consumer and industrial goods
 - 15% of population has a high purchasing power
 - Income is concentrated in large cities in Western Russia
 - 75% of household income is spent on consumption
 - Real disposable income rises 10% per year
 - 100.000 millionaires and 33 billionaires (25 in Moscow)
 - The aggregate net worth of Russia's 100 richest businessmen rose to U.S. \$248 bln in 2006 from \$141 bln in 2005
 - Inflow of foreign capital increased 90% between 2004-2005
- **There are many successful foreign businesses active in Russia!!**

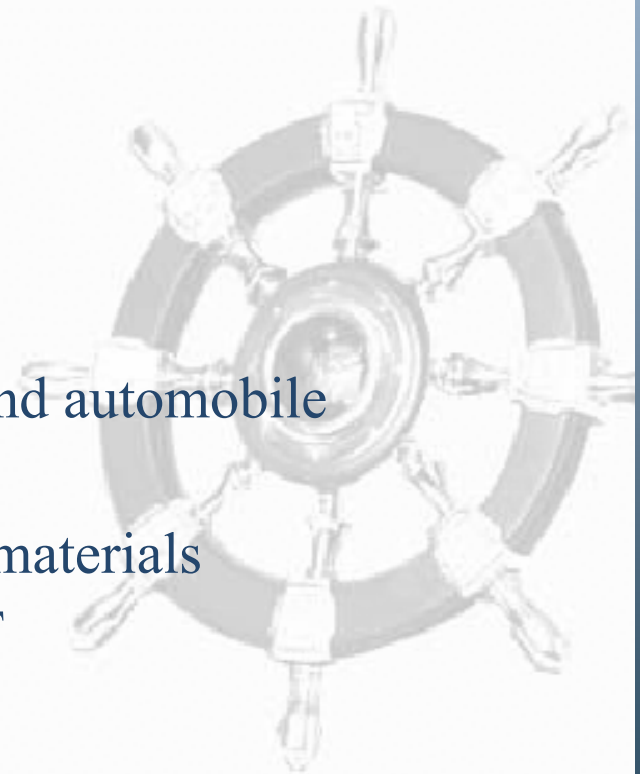


B. Developing Sectors of the Economy

- Oil & gas, energy
- Agribusiness
- Manufacturing
- Services
- Trade

Fastest growth

- Retail sector
- Automotive and automobile
- Packaging
- Construction materials
- Telecom & IT
- Logistics



C. Will Russia remain stable?

- Continuing high prices for oil and gas
 - (Account for 20% of GDP)
- Low level of consumer credits and mortgage lending (The Russian owns his house, car, dacha)
- Consumptive spending can be easily (temporarily) reduced by the Russian consumer
- Consumption over democracy (small risk of political instability)

D. And what do you hear from Moscow's Expats?

- Returns higher than anywhere else
 - Stock market 2005 ↑↑ 80%
 - Gazprom capitalization from 30 bln\$ to 300 bln\$ in 3 years
 - Upgraded country ratings (BBB, BAA2)
- It takes determination, flexibility, stamina and hard work but success in Russia is very well possible
- The foreign media are much too negative
- Russia is not more difficult than China



- B**R**IC

E. Successful in Russia I

- Independent Media (publishing)
- Baruch (clothing)
- AMS (advertising)
- Direct Star (telemarketing)
- Impress Media (real estate related publishing)
- Feadship and other Dutch yacht builders (luxury and super yachts)
- Stroymoda (office partitionings and funrniture - Ahrend)
- KPV Story (construction)
- Juralink (legal services)
- The Lighthouse Group (B2B services, publishing, energy)
- Etc.



E. Successful in Russia II

- ABN AMRO, ING, Rabobank
- Campina
- Unilever
- Shell
- Frans Maas
- Akzo Nobel
- Heineken
- Philips
- Tebodin
- Etc.



F. Obstacles

- Lack of qualified staff
- Poor physical infrastructure (gas, water, electricity, heat)
- Poor enforcement of contractual and ownership rights
- Administrative and legislative ambiguity (bureaucracy)
- Small SME sector and weak financial sector (enabling environment)
- Strong entrenched “informal” networks between legislative, executive, judiciary and business and protectionist attitude
- Corruption
- Unbalanced economy



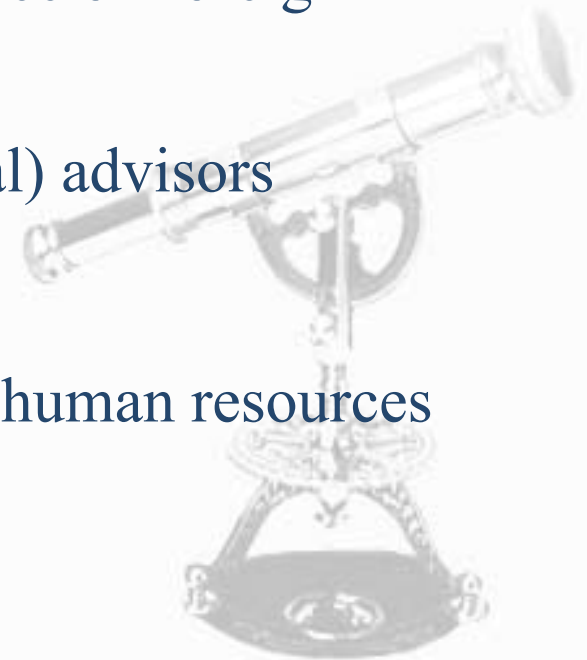
A. What is the secret of success of foreign companies in Russia?:

- They are there and they are committed
- They like it
- They understand Russia and its potential
- They are ready to be flexible
- They are entrepreneurial



B. Do's

- Enjoy Russia!
- Gain some knowledge of Russian language and culture
- Stay in control (of finances and management)
- Divide the shares/interests off-shore and agree on foreign arbitration and create win-win situation
- Use experienced local (general, tax and legal) advisors
- Limit your exposure
- Dedicate and commit sufficient financial & human resources
- Be flexible
- Understand the Russian perspective!



C. Understand the Russian perspective

- Be aware of cultural differences and language barriers
- Building of trust and personal relationships
- Informal communication networks
- Relatively short term vision
- Vertical authority
- During first contacts the Russian partner may promise more than can be delivered (without bad intent!)
- Russian businessmen can be imposing. Weakness is not shown.
- The external appearance is very important
- Russian businessmen think, speak and act fast!



D. Don't

- Underestimate the market or your Russian business partner
- Think Russia is Europe
- Think Russia is cheap
- Let yourself in with corruption (payments on the basis of contracts or through third parties)
 - Don't compromise on your business ethics.
- Be inflexible



E. Practical issues to be considered when starting up in Russia

- Movement of capital and equipment subject to certain restrictions
- It is difficult to attract external financing for Russian projects
- Prepare for different bureaucratic procedures
- Give immediate exclusivity to distributors
- Forget to register your trademark
- Forget your visa
- Forget to have your passport on you at all times

F. Practical issues II – Don't forget the regions:

1. Support from local administration. Willingness for cooperation and openness for contacts and communication
2. Tax incentives for investors
3. Lower cost of resources compared to Moscow and Moscow region (on average 20% cheaper)
4. Comparable infrastructure and facilities
5. Young, educated, eager and relatively cheap workforce
6. Facilitating fast document transaction. Fast preparation and execution of decisions, resolutions and documents

G. Russian Partner

- Choose your partner carefully
 - Good management
 - Strategy and Growth prospects
 - Decent company infrastructure
 - Sufficient transparency (tax, legal, finance, etc.)
 - Common sense; if it doesn't seem right it probably isn't.
- When in doubt: use advisor
- When still in doubt: Don't continue!!



Conclusion and Questions – Why Russia??

- Proximity to the market / cheap resources / specialist industries
- The economy will continue to grow
- Consumer spending will continue to grow
- The growth potential in the coming years in a wide number of sectors is high
- Many of your colleagues / competitors are already there

BUT

- Traditional problems will continue to exist so prudence and good preparation is advisable.

POLL SHOWS FOREIGN MANAGERS MORE OPTIMISTIC ON INVESTING IN RUSSIA

An opinion poll by PBN Company of top managers, board members and shareholders of 155 international companies either investing in Russia or considering such investment shows optimism. Most respondents believe that 2005 was favorable for foreign investment in the Russian economy, 94% of the companies surveyed plan to expand their operations in Russia in the next three years and 91% plan to increase their investment in Russia, up from 78% and 71% last year, respectively.

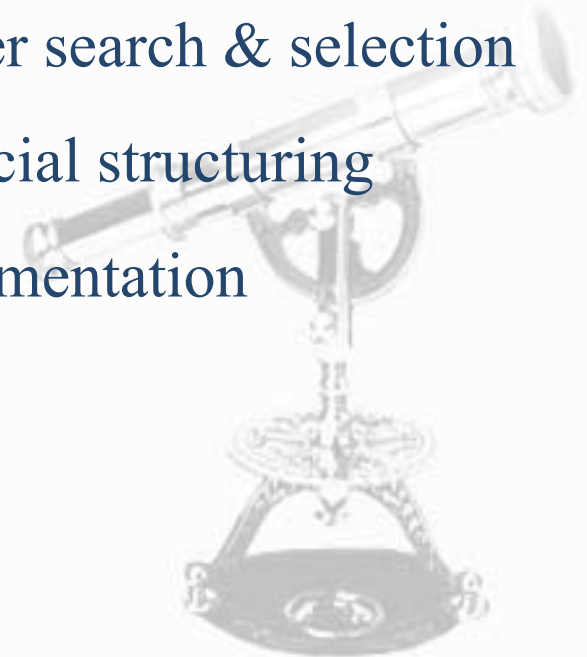
In addition, more than half of respondents believe that the investment climate in Russia's regions has improved, while 14% claim that it has become worse. The PBN company conducted the opinion poll for the Russian government's council on foreign investment and Russia's Economic Development and Trade Ministry.

Approach to Russian Market

- Step-by-step approach
- Practical
- Local assistance/partner
- Limited investment size
- Low-key

Typical steps to be taken

- Information gathering
- Business case development
- Partner search & selection
- Financial structuring
- Implementation



Tax environment

•Profit Tax	24%	over profit (17.5% to regional budget up to 4% reduction is possible)
•Income Tax	13%	over personal income (with
•Social Taxes	26% (max)	over pay-roll (medical, social, pension)
•VAT	18%	over turnover
•Property tax	2,2% (max)	over property
•Dividend tax	15% (30% to individuals)-(cross-border) and 9% (national)	

Profit Repatriation

Dividends (or distributions of net profit for Limited Liability Companies) are payable annually, semi-annually or quarterly. In practice, profits are often repatriated through a number of techniques such as: transfer pricing mechanisms, service charges, royalties and interest payments. This is, however, coming under increasing official scrutiny.

Main forms of legal presence in Russia

- Representative office – (vaste inrichting)
- Limited liability company (OOO) – “BV”
- Closed Joint Stock Company (ZAO) – “BV”
- Open Joint Stock Company (OAO) – “NV”

Contact LIGHTHOUSE

	Director	Jeroen Ketting	jeroen@thelighthousegroup.ru
	Client Relations and Information	Birgit von Oehsen	birgit@thelighthousegroup.ru
	Manager Haarlem office (The Netherlands)	Jim Jansen	jim@thelighthousegroup.nl
	Manager Obninsk office (Kaluga Oblast)	Denis Kamensky	denis@thelighthousegroup.ru
	Finance & administration	Elena Kabko	elena@thelighthousegroup.ru
Tel./Fax	+7-495-9800977 / +7-495-5029286		
Website	<u>www.lighthouseco.ru</u>, <u>www.thelighthousegroup.ru</u>		
Address	Mytnaya Ulitsa 3, office 41, Moscow, Russia, 119049		