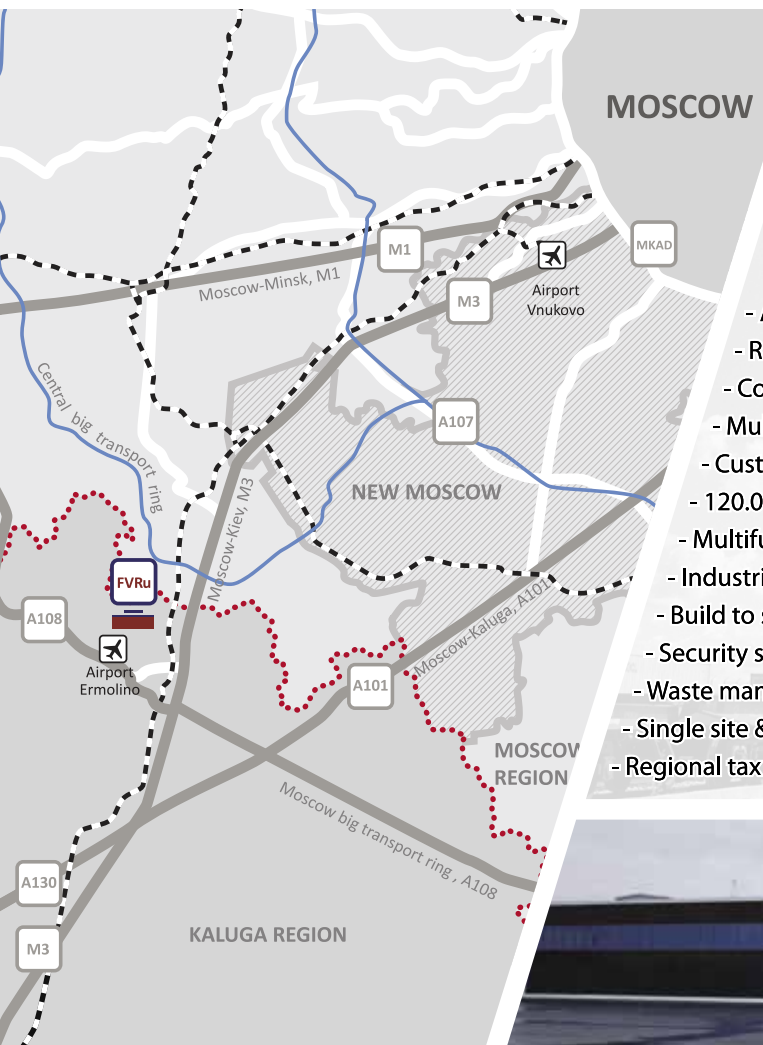


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Реклама

**ALEXEY ULYUKAYEV**

Minister of Economic Development
of the Russian Federation

Dear colleagues,

With a view to expanding investment cooperation and promoting entrepreneurship, the Government of the Russian Federation is enhancing the business environment by considerably reducing excessive administrative burdens, enforcing regulations and supporting investment projects.

Last year turned out to be fruitful for Russia. The investment climate improved as the most problematic issues in various areas of state regulation were resolved. These included connection to energy infrastructure, customs administration, business incorporation, export support, certification of ownership title and tax management.

The productiveness of our efforts has been confirmed by the business community and international experts. In particular, our country vaulted from 112th to 92nd position in the Doing Business Rating and was ranked 3rd among the top 10 countries achieving the greatest advancements in creating favourable business conditions, topping the list of BRICS countries in terms of the viability of implemented reforms.

In all the constituent entities of Russia, a regional investment standard incorporating the best local practices is being introduced; the institution of the business ombudsman is being perfected; and the efficiency of Russia's regional leaders' activity with respect to improvement of the business environment is being assessed.

Obviously, further work aimed at enhancing the investment climate in Russia is only possible through close collaboration between the state and businesses. We are willing to cooperate and render assistance to entrepreneurs, and are confident that the measures taken by the Government will contribute to the successful implementation of business ideas in Russia.



PHILIPPE PEGORIER
Chairman of the Board,
Association of European
Businesses



FRANK SCHAUFF
Chief Executive Officer,
Association of European
Businesses



STUART LAWSON
Chairman, Finance and
Investments Committee,
Association of European Businesses

Dear Readers,

Welcome to the 2014 edition of the AEB's "How to Invest in Russia" guide.

This report is being released during a period of changing circumstances that make any description of the investment climate in Russia especially challenging. The articles have been written reflecting the general "business as usual" view of investing in Russia.

Over the past few years, Russia has made significant progress in improving the practical environment for investment. This was acknowledged in last year's Ease of Doing Business survey, in which Russia's ranking improved by 19 places to 92 out of 189. Areas where specific improvements have been noted were: starting and registering a business and access to utilities. This was in line with the government's target of achieving a ranking above 20th position by 2020. Alongside this improvement, there have been other advances — in the Civil Code and in the operation of the markets, both of which serve to improve the investment climate.

It is almost impossible to forecast the investment climate in the near future as the key drivers have moved from economic imperatives into the world of politics. There are interlocking elements that impact on the investment climate. Most important is the element of cross-border risk that has reappeared as investors now have to balance commercial opportunities with the potential for further negative developments in the relationship between Russia and the EU, USA and other OECD economies. The sanctions and counter-sanctions have nullified any potential positive impact from the WTO agreement. Investors are now left in a wait and see posture as to how the tense situation will develop.

The AEB states its position in favor of the de-escalation of conflict and remains against economic sanctions, or limitations on free trade or investment. We hope that the EU and Russian authorities will refrain from creating conditions that prevent the normal operation of business in their respective countries and companies, and will attempt to improve the business environment and economic cooperation between the EU states and Russia.

Apart from the direct impact of sanctions, which reduce GDP growth, increase the country risk premium, create pressure on long term funding and fuel inflation, there are the indirect impacts of higher interest rates, capital and intellectual flight and a loss of confidence by domestic investors and consumers. Given the political nature of the drivers, it is no longer possible to forecast how long these negative influences will last and how deeply they will impact the economy.

However this \$2.1 trillion economy of 143 million people will continue to present tremendous opportunities for investors who are prepared to accept the risks involved in working here. The emergence of a new middle class over the past 20 years, with a massive increase in disposable incomes, has driven the recent retail boom.

This, the 2014 edition of the "How to Invest in Russia" guide, will bring you updates on HR, customs, joint ventures, SME development in Russia and investment in the regions. In addition, it provides an inside look at investing in Russia from the companies' points of view.

We would like to thank all the authors who helped by making their valuable contributions to this guide by sharing their knowledge of the Russian market and their experience of running a business here. Also, we are most grateful to the Ministry of Economic Development of Russia and the Federal Antimonopoly Service who have supported the guide over the years.

We hope this publication will serve its purpose, which is to bring more investment to Russia and to promote a business environment which is beneficial to all interested parties.

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Part I.

Russia is the Right Place for Investing

Investment in strategic economic entities: myths and reality



IGOR ARTEMIEV
Head of the RF Federal
Antimonopoly Service

Igor Artemiev graduated from the Leningrad State University, Faculty of Biology and got his second higher education in the Faculty of Law at St. Petersburg State University. He also holds a PhD. He is the author of 43 articles and patents and six monographs on budgeting and economics. From 1989 to 1996 Mr. Artemiev took an active part in politics in Leningrad (now St. Petersburg) and held various positions on the Leningrad Council and Legislative Assembly.

From 1996 to 1999 he was the Vice-Governor of St. Petersburg and Chairman of the Finance Committee of the City Administration.

From 1999 to 2004 he was Head of the Economic and Political Research Fund, EPICenter — St. Petersburg.

In December 1999 he became a Deputy of the Russian State Duma and held positions of Vice-Chairman of the Yabloko party and Vice-Chairman of the Committee for Credit Organisations and Financial Markets.

Since 10 March 2004 Mr. Artemiev has been Head of the Federal Antimonopoly Service.



ARMEN HANYAN
Head of Department for Control
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In 2000 Armen graduated from the Russian Customs Academy, specializing in economics and enterprise business management. In 2008 he earned a Master's degree at the European Studies Centre at MGIMO University of the Ministry of Foreign Affairs, majoring in Politics of the European Union. He now also has a PhD in Economics.

He began his career in 2000 at the Research Centre of the Russian Customs Academy as a senior inspector. In 2005 he was appointed Senior Inspector, and later Chief State Inspector, of the Main Administration for Federal Customs Revenue and Tariff Regulation of the Federal Customs Service.

He has worked in the Federal Antimonopoly Service since 2008. In 2012 he was appointed to the position of Head of the Foreign Investment Control Administration. He has published articles and a monograph on the issues and challenges of attracting foreign investment.

One of the most characteristic features of the modern international economy which is increasingly important to the situation in each particular country is the widespread growth of foreign investments. This process is largely caused by the activity of transnational corporations and the internationalization of public production. At the same time, the development of a global system of international production based on foreign investment makes it necessary to engage a wider range of participants.

In this context, states try, in accordance with their needs and goals, to use their competitive advantages in various ways to provide, on the one hand, the required investments, and direct these to the areas that are considered to be most important to develop, and to support, on the other hand, domestic companies in their foreign investment within the available balance of payments constraints so as not to impair domestic investment.

In general, there is no doubt that foreign investment plays an important role as the development factor in any economy. Direct participation by foreign investors in national companies facilitates technology transfer, introduction of state-of-the-art equipment, sharing managerial experience, implementation of new product quality standards, enhancement of production efficiency, creation of new jobs, and many other processes.

However, the policy for attracting foreign investment has to be based on a number of complex considerations. These include the establishment of the necessary legal framework that guarantees stability and investor interest, the use of tax incentives and pledges for the security of foreign investments that create the conditions for the transfer of technologies, promote their implementation, and create a favourable fiscal environment for business activity.

Many countries impose requirements and even limitations on the inflow of foreign investment depending on the area concerned. First of all, such requirements, restrictions, or prohibitions are established for the industries directly related to the use of the nation's natural resources, with the participation of investment capital in some areas of production infrastructure, telecommunications and satellite communications, and other spheres that are related, one way or another, to the provision of state security and integrity.

The Russian Federation, as well as any other country that has a wealth of natural resources and a developed economic system, also imposes its national legal regime for foreign investments on the organizations involved in activities that are crucial to national defence and security.

Such activities are governed by special legislation, and economic entities involved in such activities are recognized as having strategic importance to national defence and public security (hereinafter referred to as "business entities of strategic importance"). Some of these strategic activities are the location, construction, operation and decommissioning of nuclear facilities; development and production of encryption (cryptographic) facilities; development of weapons and

military equipment; activities related to the use of infectious agents, harvesting aquatic biological resources, etc.

As is well known, this is the scope of Federal Law as of 29 April 2008, No. 57-FZ "Concerning the Procedure for Foreign Investment in Business Companies Which Are of Strategic Importance for National Defence and State Security."

Law No. 57-FZ has established statutory restrictions on foreign investors with respect to their participation in the authorized capital of companies of strategic importance and/or their transac-

strategic importance, has proved to be highly efficient and relevant.

Legislative regulation of foreign investment in business entities of strategic importance was introduced, on the one hand, to create a predictable and transparent business environment for foreign investors and, on the other hand, to systematize the existing mechanisms of control over foreign investment in the areas that are closely connected with defence and public security, as these require significant investments and a well-defined and clear mechanism for the investors to

Direct participation by foreign investors in national companies facilitates technology transfer, introduction of state-of-the-art equipment, sharing managerial experience, implementation of new product quality standards, enhancement of production efficiency, creation of new jobs, and many other processes.

tions that result in the establishment of control over these business entities, as well as the procedures and mechanism for preliminary approval of transactions associated with such participation.

Law No. 57-FZ, stipulating the procedures and mechanism for preliminary approval of transactions by foreign investors that would result in the investor's control over business entities of

obtain approval at the highest level with respect to certain investments.

The current regime of control over the transactions related to business entities of strategic importance is quite liberal. The procedure for obtaining prior approval is predictable, clear, and transparent.

The above is confirmed by statistics of the agreed transactions, where only a



few proposed transactions are denied approval pursuant to Law No. 57-FZ. Thus, during the nearly six-year period since the introduction of Law No. 57-FZ, the Federal Antimonopoly Service of Russia received 342 applications, of which:

- 174 underwent consideration by the Governmental Commission¹, including:
 - 165 with the preliminary approval (43 of them with liabilities imposed),
 - 9 without any preliminary approval;
- 124 returned as not requiring prior approval;
- 37 withdrawn by the applicants (cancellation of the proposed transaction);
- 7 under consideration.

The Federal Antimonopoly Service (FAS), as a federal executive body authorized to control foreign investment in the Russian Federation, in fact provides a one-stop solution for foreign investors, making it unnecessary to take any other steps to get approval of a transaction.

On its official website, the FAS regularly posts information both on the outcome of the regular meetings of the

¹ Governmental Commission for Control over Foreign Investment in the Russian Federation.

Governmental Commission for Control over Foreign Investments in the Russian Federation and on the regulations adopted. It also posts explanations for the operation and administration of the Russian legislation on foreign investments, based on frequently asked questions by applicant, and gives topical analytics on the operation and administration of Law No. 57-FZ.

Of special note is the continuous work on improvement of the legal regulation of foreign investments in business entities of strategic importance that is intended to reduce administrative barriers, simplify control procedures, and clarify some of the provisions of Law No. 57-FZ for the purposes of their consistent and unambiguous interpretation.

Last year, we already talked about the amendments adopted on 14 May 2013, by the State Duma at the first reading, and this year we want to inform the readers about the new amendments prepared by the FAS pursuant to the resolution of the Governmental Commission for Control over Foreign Investments in the Russian Federation. In particular, these include proposals for:

- extension of the scope of Law No. 57-FZ on transactions with the as-

sets (production capital funds) of strategic companies with a value of 25 percent or more of the book value of such business entities according to their financial statements for the last reporting period;

- adding the obligation of processing aquatic biological resources in Russia to the list of obligations provided under Article 12 of Law No. 57-FZ;
- amendment to the Federal Law "On Fishing and Conservation of Aquatic Biological Resources" to forbid granting rights to catch aquatic biological resources to Russian entities controlled by foreign investors, except in cases when such control is set pursuant to Law No. 57-FZ;
- amendment to Article 6 of Law No. 57-FZ due to the forthcoming termination of the state regulation of tariffs on the services of natural monopolies related to loading, unloading, and storage of cargo at ports of the Russian Federation, with the aim of reducing the number of business entities of strategic importance.

Generally speaking, the urgency of adopting Law No. 57-FZ and the corresponding regulatory framework was necessitated by the current situation and should not raise any doubts as the main direction of the policy for attracting investments is aimed at the formation of a stable and transparent regulatory framework, as well as expansion of the range of investment in the economy.

To sum up, we can be sure that the current procedure regarding preliminary approval of transactions with respect to the business entities of strategic importance does not imply a complicated mechanism that creates insurmountable obstacles but rather is an open system with a clearly outlined algorithm. ■

European companies in Russia: level of optimism decreases

The results of the annual joint survey “Strategies and Prospects of the European Companies in Russia” by the Association of European Businesses in the Russian Federation and International Institute of Market and Social Research GfK Rus



ALEXANDER DEMIDOV
Professor of the Higher School
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GfK Rus

Alexander Demidov is the founder and the Managing Director of GfK Rus, the Russian subsidiary of one of the largest market research companies in the world. Alexander is a recognized expert in sociology and market research, as well as a founder and member of OIROM, and a member of ESOMAR. Since 2005 he has headed the GfK Rus Chair at the Higher School of Economics.

Alexander studied law and social science. Before he founded GfK Rus in 1991, he had worked at the Institute of Sociology where he had obtained a PhD degree.



YULIA STETSENKO
Communications Manager, GfK Rus

Yulia Stetsenko is the PR & Communications manager at GfK Rus, the Russian subsidiary of one of the largest market research companies worldwide. Yulia is responsible for external and internal communications, PR activities, relations with the professional communities, implementation of global GfK communication strategies in Russia.

Before joining GfK Rus in 2010, Yulia was head of the PR department at the major Russian logistics company, UniTrans. She graduated with honours from the Moscow State University of International Relations (MGIMO).

In April 2014 the seventh annual survey was conducted via online and paper interviews with top managers of AEB member companies operating in Russia. The results reflect the current perception of the investment climate in Russia from the point of view of European companies doing business in the country, the problems they are facing and their strategies.

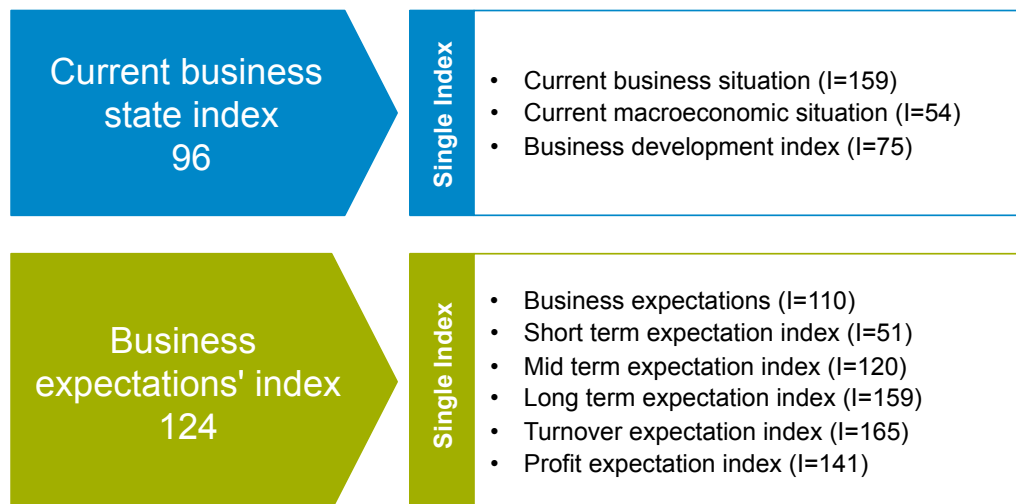
Summing up their business results of 2013, the top managers of the companies that participated in the study, report a decline in their performance. In April 2014, 69% of respondents claim that the turnover of their companies grew over the past year, while in the previous wave of the survey, which was conducted in April 2013, 78% indicated revenue growth.

Compared to the previous year, in the more severe macroeconomic circumstances of 2014 the share of those who said that the economy and business in the first three months of the year had developed below expectations increased considerably. As a result, in 2014 a significant reduction in investment can be expected. Representatives of AEB member companies are quite pessimistic about the development of foreign investment in Russia over the next 2–3 years. The percentage of those who believe it will grow steadily has been declining from year

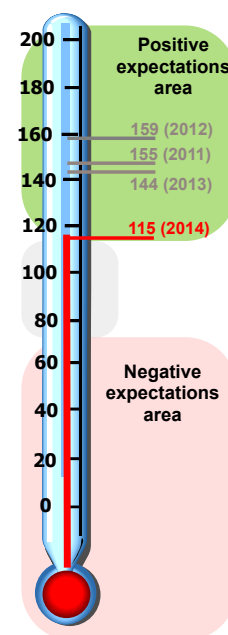
Due to the slowdown of economic growth in Russia and the escalation of the Ukrainian crisis, European companies with business in Russia have cut their investments and feel less optimistic. These

are the findings of the current wave of the survey “Strategies and Prospects for European Companies in Russia”, which is conducted annually by the Association of European Businesses (AEB) in Russia in cooperation with GfK Rus.

Figure 1 ▶ Integrated index



▶ AEB-GfK Index, 2014



to year (2012 — 70%, 2013 — 59%, 2014 — 31%). In 2014, the percentage of those who believe that the investments of foreign companies in Russia will decline increased sharply (2013 — 12%, 2014 — 40%).

Against the background of the negative start to the year, respondents have also become less optimistic about the expected turnover and profit of their companies. While in 2013 89% of companies expected turnover growth within the next three years, in 2014 the share of “optimists” significantly decreased — to 72%. The situation is similar in terms of profit. Fewer companies expect profit growth over the next three years (2013 — 72%, 2014 — 52%).

Reflecting this mood is the integrated AEB and GfK Rus Barometer Index¹ which, in 2014, dropped by 29 points compared to 2013 and amounts to 115 points out of 200 possible (in 2013 — 144 points, in 2012 — 159 points). Thus, the Index has almost moved to the bottom line of the positive expectations

area and is on the verge between the negative and the positive zones. (1 ▶)

Nevertheless, there is an important positive aspect in the answers of the respondents. Despite of a rather substantial decline in a number of indicators and worsening expectations for growth in the Russian economy in the short (1—2 years) and medium (3—5 years) terms, in the long term (6—10 years) the participants of the survey expect steady growth. While in 2013 58% of study participants expected growth in the long term, in 2014 already 69% of respondents believe that in 6—10 years the Russian economy will recover and start growing again. (2 ▶)

Regarding the social and political developments that have taken place since the previous wave of the survey in 2013, more than a half of the respondents (52%) think that the Olympic Games in Sochi improved the image of Russia. Answering the question about the impact of the crisis in Ukraine on their business

in Russia almost a half of the companies’ top managers, who participated in the April survey (45%) noted that the crisis in Ukraine was having a negative impact on their activities in Russia. The decrease in a number of indicators that we register in the current wave of the survey is in all probability caused by the complication of the political and economic environment and the crisis in Ukraine.

Each year more companies say that entry into the WTO in 2012 hasn’t affected their business. Prior to that, most companies positively evaluated the potential effect for the Russian economy (75% of respondents believed that the Russian economy would benefit from WTO entry, while 59% thought it would have a positive impact directly on their own companies). Since Russia joined the WTO, most AEB member companies participating in the survey claim that they have not felt any changes, and the percentage grows from year to year (in 2013 — 66%, in 2014 — 71%). Almost a half of the respondents (45%) believe that the current economic situation in Europe affects

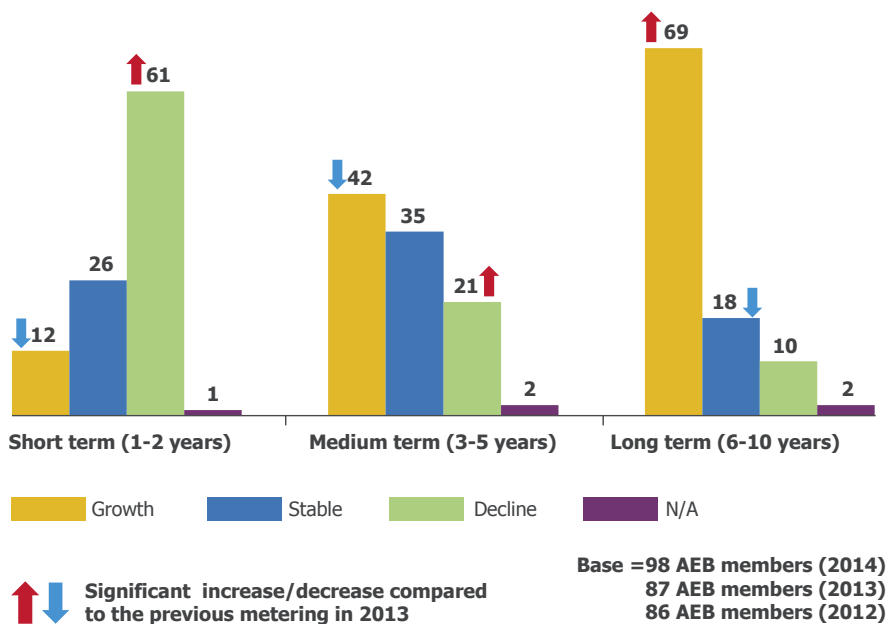
their business in Russia positively. The main reasons for entry into the Russian market remain high market potential, positive market development as well as the size of the market (95%, 93% and 91% of top managers respectively mentioned these reasons as the most important).

A positive trend has emerged in connection with the “break-even” point. In 2014, 56% of companies claim that they reached “break-even” within 1–3 years (in 2013 — 44%; this share has been growing from year to year). 15% of companies have spent 4–5 years to reach “break-even”, 11% — more than 5 years. 11% of companies still have not reached “break-even”. The financial environment for AEB members’ businesses is still quite acceptable: normally, less than 20% of payments are overdue, the overdue periods mostly do not exceed one month. 33% of companies have never had bad debts. These indicators haven’t changed much in recent years.

Almost half of the companies participating in the survey (46%) went to court in order to collect debts, and almost all won their cases. As in previous years, the main problems for financing are high interest rates (36%) and lack of financing (25%). The unwillingness of institutional investors to provide loans has grown sharply (from 2% to 12%) over the past year.

European companies doing business in Russia still estimate the business environment and culture in the country modestly. The interaction with state authorities, especially customs and tax authorities, is still evaluated rather negatively, and this situation hasn’t changed much in recent years. On the other hand, participants of the survey noted that the business culture of their cus-

Figure 2 ▶ Economic outlook for Russia over the next 10 years, %



tomers and contractors has improved. Legislative restrictions are the main obstacle for business activity (62% of the companies mentioned regulatory restrictions as the major obstacle). Another important problem is the lack of qualified personnel.

As in previous years, most participants in the survey don’t expect any positive changes in terms of corruption and bureaucracy in the short term (within 2 years). Moreover, the share of sceptics regarding corruption has increased during the year. In 2014, the top managers of European companies in Russia also have more negative expectations regarding taxes and duties, customs regulations and legal constraints on their activities. Interaction with the Russian state doesn’t inspire much optimism.

To sum up: the results of the 2014 wave of the survey reflect the general complication of the economic and political situation in Russia. The Russian economy has been slow-

ing down this year. There has been a significant decline in a number of indicators, which is most likely connected with the deteriorating political and economic situation. AEB member companies are feeling the impact of that on their own businesses. They expect to make fewer investments in the near term and are less positive in terms of profit growth. On the other hand, the expectations for the long term remain positive. Participants in the survey expect steady growth in 6–10 years, and the share of these optimists has grown since the previous year. Successful business development is still severely hampered by high levels of bureaucracy, corruption, inefficiencies within state institutions and the lack of qualified personnel. Taking into consideration the rapid development of the crisis and the possible further extension of sanctions by the European Union and the USA, it will be interesting to see how the economy and business react in this time of political and economic turbulence. ■

Special Economic Zone Alabuga



**Таможенный
пост**

—
Customs post



**Контейнерная
площадка**

—
Container yard



**Распределительная
подстанция**

—
Distribution
substation



FOR SALE
НА ПРОДАЖУ

0%
Таможенные пошлины и НДС
Customs duties and VAT

0%
Налог на имущество
Property tax

2%
Налог на прибыль
Corporate tax



Железная дорога
Railway branch line



Электричество
Electricity



Внутриплощадочные дороги
Inner-site roads



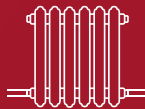
Оптоволокно
Optical fiber



Ливневая канализация
Storm sewage



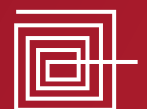
Газ
Gas



Тепло
Heating



Дренаж
Sewerage



Бесплатное подключение к инженерным сетям
Free connection to utility lines

Localization — “pro” and “contra”



MICHAEL AKIM
Vice-President, ABB Russia,
Member of the AEB Board

Michael Akim is Vice-President of ABB in Russia, Member of the Board of Directors at the Association of European Business (AEB), Chairman of the working groups on Innovation and Modernization at FIAC (Foreign Investment Advisory Council) and the AEB. He graduated from the Leningrad Technological Institute in 1986 and in 1991 from Latvian Academy of Science IWC with PhD in Chemical Engineering. In 2000 he graduated from IONA (USA) with an MBA. In 1992 Michael moved to the United States where he worked in R&D, Technology and Product Development, at Rexam, and subsequently with Champion International's Corporate Technology Group. In 2000 he joined Troy Chemicals as a Regional Manager for Eastern Europe. In 2006 he joined Emerson Process Management as a Director of their European Pulp and Paper Business. Since 2008, he has worked with ABB in Russia.

Localization: politics or economics?

The topic of localization was a high priority for many years. It was crucial

to improving the situation with the limited diversification of the economy, the continuous growth of imports of manufactured and innovative industrial goods and limited domestic development. But suddenly it has become an even more important issue due to recent political developments.

Local Content Requirements (LCRs) are prohibited under the WTO rules of Trade-Related Investment Measures (TRIMs). Some countries have nonetheless used LCRs as part of their policies relevant to state procurement and customs regulations. The TRIMs Agreement forbids the imposition of “performance requirements” and among the prohibited measures on the “illustrative list” are local content requirements.

The multilateral trading system is based on the concept of economic efficiency. The prohibition on local content requirements is based on the perception that it is an economically inefficient mechanism to protect or promote domestic industry, and that is against the spirit of free trade. This philosophy promotes the idea that investors in any country should be free to source components for their manufacturing processes abroad if foreign inputs are cheaper and better than local ones. It definitely supports investors' interests. TRIMs, “Subsidies and Countervailing Measures” and some other WTO regulations restrict developing countries' governments from using local market leverage with in-

dustrial policy as a tool for economic development. The idea of these agreements is in opposition to the purpose of an active industrial policy.

To achieve economies of scale, government should prioritise infrastructure investment to reduce costs and provide favourable conditions for manufacturing. Russia has few competitive advantages in major economic areas and is short on the cost benefits of local production when compared with European countries and, especially, with the Low Cost Countries or LCCs. Particular limitations are the growing cost of transport due to the enormous distances in Russia, labour, raw materials and the northern climate that translate into high energy cost. The previously low energy costs in Russia were due to local power production and subsidization, but current increases are particularly sensitive for industry due to low energy efficiency and high energy transmission costs.

There are numerous questions about the scope of trade restrictions, such as those concerning finished goods and foreign parts and materials, and the actual import or the customs release of goods. According to some consultants, current circumstances suggest some localization alternatives as a way of finding legal and sustainable way of overcoming trade restrictions. Among them are: localization of manufacturing operations in Russia or the localization in Belarus or Kazakhstan of the assembly of finished goods made from

foreign materials; establishing production in Russia and then increasing the market presence by adding Belarus and Kazakhstan; establishing production in Belarus and Kazakhstan and then distributing the goods in Russia without customs formalities utilizing the Customs Union's benefits; or using local materials for Customs Union production, thus saving on customs payments.

Localization by segments: "bellwether" and "old hat"

The automotive segment was the most successful case of localization in Russia. Russia remains one of the most important and attractive automotive sales markets in the world

with a high share of larger vehicles (according to industry consultants, with a 60% share of "C-segment" vs. 30% in Brazil and India), that typically provide higher margins. However, international consultants also say that the Russian automotive industry has the lowest level of localization in the BRIC countries, partly because the international automotive industry began entering the Russian market even later than it did elsewhere, along with unclear, repeatedly changing regulations. More than 40% of foreign brand volume is currently produced locally. However it is at risk of being imported in the future. The advantages of local production vs. imports could diminish due to the expiration of preferential

terms for local manufacturers (decreed 166) and a decrease in import duties in accordance with WTO regulations. Despite the optimistic view of the future, however, according to industry experts and particularly Roland Berger strategy consultants, there are serious concerns about the decreasing sales and production volumes in the recent past. Continuous challenges are being faced by international OEMs in fulfilling their localization obligations. Limitations on further localization in the industry are relevant to the diminishing cost/benefits of local production in Russia which has already resulted in putting several production sites at risk of being downsized. The overall economic environment is not



Реклама

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competitive, which limits the attractiveness and cost benefits of local production. According to a BCG report: “companies are generally paying a premium of 5–15% to manufacture in BRIC countries, mainly because of diseconomies of scale and higher quality-assurance costs. Only in Brazil do they actually save money on manufacturing.”

According to some industry analyses, a number of OEMs could stop production in Russia by 2020 which would have a negative impact on supplier localization and contract assemblers. Production is at risk due to overcapacity. Particular concerns about Russian automotive production have increased further due to weak overall cost competitiveness,

exacerbated by inflation. The challenges are familiar in other industries and segments: limited localization of suppliers, and growing labour, transport and energy costs. Another major challenge is that Chinese brands are likely to be completely imported in the future, using the great cost advantages coming from economies of scale, low labour costs and productivity improvements. The business model of contract assemblers could be in jeopardy due to limited production volumes as they face imports from Less Developed Countries (LDCs), but especially China.

A completely different situation exists in the localization of renewable power generation equipment. For Russia, the localization of renewable power tech-

nologies was not a priority in previous years due to its enormous oil and gas resources. Russia, like other developing countries, has a limited financial capacity to subsidise green technology, and particularly renewable energy. Additional measures to encourage renewable energy adoption require the political capacity to impose carbon taxes. The introduction of new technology and the rapid increase in production capacity in renewable energy have made them more competitive against conventional energy technologies. Policies such as feed-in tariffs (FITs) and other incentive mechanisms are commonly implemented in other countries to stimulate investments in renewable energy. They should be continued and enhanced

as long as they also help to ensure a healthy growth of renewable deployment that will further provide attractive returns to investors.

Targeting all portions of the energy value chain aimed at domestic manufacturers could be a way of expanding output in the green energy sector and would have the added benefit of creating associated green jobs. However imposing an LCR, which is a common condition for government support, particularly as presented in the decree № 449 which is currently being implemented by the Russian government to support renewable energy, could significantly influence the implementation of the green energy technologies developed by global players. LCR requirements are commonly irrelevant to the specifics of renewable energy. Therefore, the use of this policy tool might result in a refocusing of WTO disputes on LCRs even outside the renewable energy sphere.

Technological innovations are costly. Considerable government support is required to catch up with the implementation of sustainable development technologies, renewable energy and ecological transport. To sustain a permanent shift towards renewable energy and green industry, positive and well-directed incentives are needed to align Russia with global developments.

Developing an optimal localization profile

The goal for each company is to achieve an optimal balance between taking a market-specific approach to decentralization and achieving global synergies. It is necessary to decide which functions to localize, and to what degree. Companies need to ad-

dress certain core issues relevant to each function: sales, manufacturing, sourcing, R&D. It is essential to benchmark their profile with competitors' profiles in order to identify areas where strategic changes may be needed.

According to consultants, there are three approaches, depending on whether the primary goal is to secure volume-related cost advantages, maximize localization, or achieve high quality at low cost. They are "The Global-Scale Network", "The Broken-Chain Network", and "The Isolated-Empire Network". A major difference between those approaches is where a company should consider establishing plants to supply markets locally and globally, and how many of them there should be. For example, "The Global-Scale Network" is a scenario targeted to secure volume-related cost advantages. In accordance with this scenario, a company should consider establishing one to three large plants in the BRIC countries to supply markets worldwide. "The Broken-Chain Network" approach, however, aims to maximize a company's localization advantages, so it should consider distributing assembly in different countries, close to the market. "The Isolated-Empire Network" approach focuses on achieving high quality at low cost. A company should consider serving world markets from several regional hubs. This approach ensures the maintenance of strict quality standards at competitive prices, while keeping production at high-cost plants competitive due to a high level of sophistication, productivity and personal skills.

Localization principles are not universal, but specific. Nevertheless, they face the same difficulties in different

regions. Taking into account the actual size of the market in the longer perspective, the cost structure, the presence of Russian suppliers and the transport component should be able to combine to create favourable conditions for the successful localization of industrial production in Russia and its regions.

Localization of innovation

Given fierce international competition in the field of high technology, special attention should be given to R&D localization. The development of R&D (including process engineering centres, laboratories, centres of pre-clinical and clinical trials in the pharmaceutical industry) that meet the requirements of international standards for infrastructure is critical for attracting the R&D departments of leading international corporations, as well as for the development of domestic high-tech companies.

Developing countries often lack the financial capacity to subsidise the development and implementation of new technologies, or the political capacity to impose new taxes. Perhaps those policies are most needed in the adoption of new technologies for productive and "green" manufacturing, electric vehicles, renewable energy, new medical and other innovative technologies.

Despite a significant pool of R&D talent (with about 400,000 engineers graduating every year), the great effort made by Skolkovo, RVC (Russian Venture Company), Rosnano and other state development institutions, there is a limited number of international OEMs or suppliers that have built R&D centres in Russia. There are many reasons why they have not done so. Russian

The most promising measures for stimulating localization are tax incentives, as well as the improvement of customs regulation and administration and, in particular, solving investors' problems associated with the shipment of imported components, technology imports and the export of finished products.

consumers prefer internationally recognized brands. Russians demand virtually the same products that are sold in Europe, Japan and the United States, and will not easily accept locally-adapted versions. In the Russian market, particularly for luxury goods, the slogan "Equal to the West" is an important selling point. In the budget segment, international competitors have gained market share by selling low-cost products from other countries. Most local OEMs have not developed their relevant experience. Instead, they have focused their product-development activity on applications, or on updating existing product designs.

The cost of employing engineers and researchers is rising, approaching the level of Western R&D centres. Local engineers lack relevant, up-to-date industrial R&D experience. In Russia, significant numbers of well-educated engineers focus on other areas, such as operations and production. Traditionally, many well-qualified specialists and researchers were dedicated to the military.

Conclusion. Stimulating the localization of industrial production in the Russian Federation

Economically sound policies to promote localization with a focus on the best international practices can make a significant contribution to improving the investment climate and the development of mutually beneficial cooperation between Russian and international businesses, and contribute to the achievement of strategic objectives for modernization.

The most promising measures for stimulating localization are tax incentives, as well as the improvement of customs regulation and administration and, in particular, solving investors' problems associated with the shipment of imported components, technology imports and the export of finished products.

Requirements for the localization of industry and the method of calculating the degree of localization should be tailored to specific industries and

the state of their development in Russia.

Measures aimed at providing businesses with skilled labour play an important part in ensuring the success of localization projects. Educational training sites for specialists within regional clusters of localized production sites, the implementation of housing construction programs, and the establishment of incentives for working professionals are fundamentally important measures to support the development of the regions. This is critical, as is the creation of a healthy urban environment (a higher level of comfort and security and improved education and recreational infrastructure) in order to attract high-paid, highly qualified specialists, including foreigners.

The arbitrary unjustified definition of localization levels, without careful objective analyses of industry specific conditions and requirements, may lead to excessive demands that could adversely affect investment.

Most critical for investors will be the government position on developing a long-term vision and strategy for the industry to increase competitiveness, build industry infrastructure, provide subsidies, manage the rouble exchange rate and continue to monitor the terms and conditions of WTO implementation and its impact on Russian industry. It is essential for investors to be able to reassess investment and localization levels in Russia, and renegotiate localization obligations based on current market conditions, and thereby reduce risks of future losses, and revise their long-term portfolio of locally produced models and their manufacturing footprint. ■

US and EU sanctions against Russia: impact on investors



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against which asset freezes and travel bans are imposed.

At first, the respective lists covered mostly Russian politicians and government officials but later, for the first time since the start of the crisis in the Ukraine, the US has designated an entity, namely a bank (Rossiya), as the subject of the sanctions. This was followed by a broadening of the list of sanctioned entities in the banking, mining and defence manufacturing sectors. Several of the targeted individuals have significant business interests, increasing the impact of the sanctions on those doing business in Russia. Russia responded by barring nine senior US officials from Russia.

At first, the US and the EU-imposed sanctions were primarily targeted at individuals associated with the government of the Russian Federation, citing misappropriation of state funds. So far the commercial impact of these has been more limited than, for instance, the broader Iranian and Syrian sanctions. However, as the situation in the Ukraine continues to remain unstable, the sanctions have been broadened. At the end of July, the Council of the EU imposed a limitation on a list of the Russian state-owned banks seeking to raise capital in the EU capital markets. Also, Brussels has banned the EU states from exporting to Russia any military or dual-purpose products, and products for certain types of oil drilling projects (excluding contracts already signed). Switzerland has also joined most of

The recent events in the Ukraine and Crimea have led to the most serious political crisis in Europe in recent years. In reaction to the annexation of Crimea by the Russian Federation and the

ongoing political crisis in the Ukraine, the EU and US have imposed sanctions (asset freezes and travel bans) against certain Russian individuals and entities. Furthermore, the EU and the US have expanded the list of parties



the initiatives of Europe. The US and Canada have done the same.

Russia in turn has banned imports of food products from the states which imposed sanctions on Russia.

Unless the situation around Crimea is settled, the US and the EU sanctions regime might be escalated. This raises the question of their impact on specific transactions and investment projects in Russia.

Most of the sanctions have been supported by Japan, Australia, Canada and many non-EU countries in Europe. The Baltic states announced that national sanctions aimed at all Russians, not just designated persons or companies, could be imposed. As of the writing of this article, the situation

continues to evolve, and Russia plans to declare more import bans too.

The purpose of this article is not, however, to scrutinize the detail of the sanctions as instruments themselves, but rather to consider the impact that these have had on the contractual arrangements of private businesses operating in Russia, and to offer some views on how to effectively mitigate this impact.

The sanctions are broad in scope and continue to evolve. Any breach of them carries the risk of significant penalties and reputational damage. The speed with which these politically-driven sanctions can be imposed means businesses have to react adequately and effectively. The criminal and financial penalties for breaching the legislation

are severe, and the potential reputational damage of such breaches also cannot be ignored.

It is far from straightforward for businesses to analyse the sanctions regime and respond appropriately. The occasionally ambiguous and often broad drafting of some of these instruments, as well as the complexity and overlapping nature of various regimes, makes it difficult to formulate an effective response. Businesses are faced with the time and resource-intensive challenges of either attempting to comply with the sanctions regimes on a case-by-case basis, or applying blanket policies which could lead to businesses withdrawing from Russia completely.

The first consideration for affected businesses should be to establish

whether they are exempt from the application of the sanctions. It is therefore important for any companies doing business in Russia to monitor the sanctions regimes and to carry out thorough due diligence on their contractual counterparties to ensure that they are not designated individuals or entities. Taking into consideration that in most cases it is difficult to identify the beneficial owners of the Russian counterparties due to opaque corporate structuring, this can be quite complex and may involve offshore jurisdictions.

If the current sanctions are broadened, it would also be logical to investigate any relevant sanctions legislation and to look for certain “transit provisions”, which allow businesses to adapt to a particular sanctions regime. For example, the sanctions legislation may contain “winding-down” provisions, which give parties affected by pre-existing contracts a certain amount of time to comply with the new sanctions regime.

Where the application of the sanctions and the resulting impact on their contractual arrangements cannot be avoided or resolved by counterparty discussion, businesses should consider their rights to suspend or cease performance of their contractual obligations. Thus, it is also highly recommended to consider incorporating contractual protections (such as force majeure clauses) in any future contracts, the fulfilment of which may be affected by current or new sanctions against Russia, and to investigate the scope of the protection offered by the terms of any existing contracts.

A force majeure clause will typically release a party from performing its

obligations under a contract where an event beyond the parties’ control, such as a war, riot, strike or an event described as an “act of God” has occurred, which renders the performance of the contract impossible. This provision typically allows the party seeking to rely on it to suspend performance of its contractual obligations for the duration of the event (and often for either party to terminate the contract in the event that performance cannot be resumed within a stipulated period of time).

The scope of protection afforded by the force majeure clause will depend on two aspects: how broadly it is drafted, and the law governing the contract.

Russian law (Article 401 of the RF Civil Code) provides that, unless otherwise provided by the law or a contract, the entity which in the course of its business activities has not performed or improperly performed an obligation is liable, unless it proves that the proper performance became impossible due to force majeure events, i.e. extraordinary and unavoidable, under the given conditions. Based on our analysis of Russian commercial court practice, we conclude that the international sanctions, in general, are considered under Russian law as force majeure circumstances even if they are not explicitly mentioned as such in a contract due to the fact that they meet criteria of unavailability, emergency and unpredictability.

Under English law, which is frequently used in Russia-related projects involving foreign investors, force majeure is a purely contractual matter, and there is no separate doctrine or common law

definition of force majeure. Therefore, the parties to a contract governed by English law will not automatically be relieved of their obligations if the sanctions make performance difficult or impossible.

Under English law, and separately from the consideration of a force majeure clause in a contract, the party seeking to comply with the sanctions should also consider whether the contract has been “frustrated” by virtue of supervening illegality. The English legal doctrine of “frustration” provides the parties with limited remedies, and will only apply where performance is rendered impossible. In these circumstances if governmental sanctions are imposed, which mean that it is unlawful for a party, for example, to trade in Russia, or to supply goods to the Russian government, it may be that such a party could rely on the English common law to argue that the contract has been frustrated for reasons beyond its control, and which make performance impossible.

Although legal rights to avoid performance may be available to commercial parties where their contracts fall within the scope of the new sanctions legislation, these rights are not always clear and may provide less comfort than expected upon closer analysis of the contractual terms and the applicable law. In addition to ensuring familiarity with the relevant sanctions regimes, commercial parties should also ensure that their contractual rights are protected by adequate provisions. There are also several non-legal protective measures available for investors in Russia, for instance, one should not underestimate the utility of sanctions-related risk hedging. ■

Unfinished business, Russia, WTO and accession to OECD



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Since the collapse of the Soviet Union, Russia has responded to economic crises by adopting reforms. In 1991 shock therapy was applied in which prices of goods were freed, businesses were privatised and the rouble devalued. Over the next few years a Civil Code was adopted, a joint stock company law and other reforms enacted with the support of the IMF, the World Bank and the EBRD. The 1998 crisis was followed by the enactment of a

Tax Code and a Customs Code. For several years, while GDP was growing at a 7% yearly rate, Russia's reform activity was slow. Finally, the most recent financial crisis exposed Russia's dependence on natural resource exports. GDP declined by 8% in 2009. This crisis was a major motivator for Russia's WTO accession and policy of modernization and innovation.

Russia's accession to the World Trade organization in August of 2012 was designed to minimize potential negative effects on its auto, meat and other domestic industries while stimulating other industries such as information technologies and pharmaceuticals. According to the WTO, the average final bound rate for agricultural goods will be 10.8%, compared to the applied tariff rate of 13.2% at the time of accession. Approximately 38% of Russia's tariff lines had their final bound rates implemented upon accession and over 80% will have their final bound rates implemented within 3 years of accession. Russia cannot raise the CU (Customs Union) or CET (Common External Tariff) above these rates, bringing a high degree of predictability to businesses exporting to Russia. It must be noted that because Russia, Kazakhstan and Belarus apply a common external tariff, Russia's WTO tariff is effectively binding for those countries too.

On 13 September 2013, Russia joined the Committee of Participants in

the Expansion of Trade in Information Technology Products, otherwise known as the Information Technology Agreement (ITA). The ITA is a WTO agreement that strives to eliminate tariffs on a broad range of IT products including duties on computers telecommunications products, manufacturing equipment, and data storage media and software. Before joining the agreement, Russia agreed to decrease its tariffs on IT products from 5.4% to zero in a series of equal rate reductions. This reduction in tariffs has the potential to open up Russia's growing IT market which stands to double in size from \$6.3 billion in 2012 to \$12.8 billion by 2016. IT imports increased by almost 14% in 2013. Russia's ITA membership supports its program of innovation.

Upon joining the WTO, Russia assumed all the obligations of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement) and the additional commitments on IPR issues contained in the Working Party Report. The TRIPS Agreement sets minimum standards for protection of copyright and related rights, trademarks, geographical indications, industrial designs, patents, integrated-circuit layout designs and undisclosed information. The TRIPS Agreement also establishes minimum standards for enforcement of intellectual property rights in administrative and civil actions and in regard to copyright piracy and trademark counterfeiting, in civil actions and in ac-

tions at the border. Furthermore, the TRIPS Agreement requires that, with limited exceptions, WTO members provide national and MFN treatment to the nationals of other WTO members with regard to the protection and enforcement of IPR rights. The February 2013 opening of a special intellectual property court was seen as a positive step toward enforcing the TRIPS agreement, which creates international (WTO) standards for intellectual property protection.

The WTO also required Russia's customs law to be amended to strengthen IPR protection. In December 2010 Russia adopted the law "On Customs Regulation" to provide ex officio for customs officials and strengthened the ex officio provisions contained in the Customs Union Customs Code. The law also updated procedures for registering certain intellectual property rights with the Russian Customs IPR register. Russia, however has yet to fully harmonize its IPR regime with the regulatory principles adopted under the Customs Union. These enhancements of IPR rights along with reduced import tariffs have benefited the pharmaceutical industry, which is projected to grow at an annual rate of 8.3% over the next five years.

Government procurement is another area where Russia has made progress in the past year. In May 2013 Russia became an observer to the WTO Government Procurement Agreement (GPA), which regulates the government procurement of goods and services based on principles of openness, transparency and non-discrimination. Prior to joining WTO, Russia had agreed to begin GPA accession negotiations within four years of its accession. In April 2013 President Putin signed the federal law "On the Con-

tract System in State and Municipal Procurement of Goods, Works and Services" in order to signal the country's intention to join the GPA. When Russia finally joins this organization, it will create many opportunities for foreign businesses as they will receive national treatment rights in this area.

Much emphasis has been placed on bringing Russia into the rule-based system of the WTO. Knowing what the rules are, being able to rely on the applicability of those rules, and having the means to enforce them helps to create a stable environment in which trade can flow. The terms of Russia's WTO accession underscore and strengthen all of those elements. As part of the Working Party Report Russia has embedded into its and the Customs Union's legal regime the requirement to publish new measures affecting international trade and to provide interested parties with an opportunity to comment.

Immediately after Russia's WTO accession a recycling tax was imposed on imported foreign cars. The EU, US and Japan began a WTO Dispute Resolution proceeding a few months later to protest the tax as it contributed to a significant decline in imported autos. Russia recently passed legislation to apply this tax to Russian auto producers too while granting these producers subsidies to compensate them or their additional costs. This may be enough to resolve the dispute as the national treatment differentiation would no longer apply. Sanitary and phytosanitary measures are used by many countries to protect their markets and to achieve political objectives. Shortly after acceding to the WTO, Russia imposed a ban on meat products

from the US, Canada and Germany because producers from these countries used meat additives in their production. More recently, a ban on Ukrainian chocolates, and Lithuanian and Estonian dairy products was imposed, although the ban on Moldovan and Georgian wines and water was lifted. In October, Gennady Onishenko resigned from the consumer health and safety ministry. An event that some analysts suggest is related to a move toward a WTO science-based implementation of SPS rules.

Russian combine harvesters were an industry that was severely affected by the WTO accession, with a decline in sales of 43% and a decrease in profits of 80% in the first year following accession. Antidumping duties of 27.5% were imposed on imported combine harvesters. This is allowed under WTO rules for five years after accession, which is Russia's period of transition. When concerns were raised by Kazakhstan, this antidumping duty was replaced by a quota on imported harvesters. Antidumping duties were also imposed on light commercial vehicles (LCVs) after an investigation demonstrated that increased imports of LCVs caused serious injury to Russian producers. Russia has already filed its first WTO Dispute Resolution case claiming that the EU has unfairly thwarted the attempts of certain Russian chemical and manufacturing groups to break into the European market. The EU claims that many Russian products are subsidized because of Russia's low domestic energy prices and therefore charges Russian companies expensive antidumping duties. It is estimated that Russia loses \$2 billion annually in export earnings because antidump-

ing duties in 18 markets and 73 potential cases.

A recent study by the World Economic Forum concluded that reducing supply chain barriers to trade could increase GDP up to six times more than removing tariffs — by nearly 5%, and trade by 15%. Lowering barriers is effective because it eliminates resource waste whereas abolishing tariffs mainly re-allocates resources. The recent WTO Trade Facilitation Agreement adopts some of the recommendations of the WEF. Trade facilitation boosts trade by reducing costs and delays for traders, through measures that provide predictability, simplicity and uniformity in customs and other border procedures. It makes it easier for businesses big and small to participate in trade around the world, and to support jobs through that trade. Several studies show that this agreement could increase global GDP by almost \$1 trillion. The OECD estimates that developing countries such as Russia could reduce trade costs by 14.5%. The Russians participated in the negotiations on this agreement in Bali and it is hoped that it will help Russia to reduce non-tariff barriers and increase trade.

In November of 2007 Russia established a Road Map for accession into to the OECD. Integration to the OECD requires that a candidate country fulfil a set of requirements that are defined in advance. In Russia's case, this entails a detailed 360-degree review of its public policies, above all to determine their compliance with the OECD's standards. This does not resemble WTO accession negotiations because, although WTO accession is a major requirement to enter the OECD, it

deals with trade matters while OECD accession covers a broader range of issues. Successful completion of full accession to the OECD will mean that Russia will have to cooperate with the 22 OECD committees, which scrutinize the country in various fields. Some of these are:

- Economy and Business Environment: Overview;
- Rule of Law, Public Administration and Anti-Bribery;
- Trade and Investment;
- Competition and the Role of the State;
- Corporate Governance;
- Chemical.

Since Russia assumed the presidency of the G20 in 2012, it has been actively implementing the first year of the Anti-Corruption Action Plan. Under the joint leadership of Russia and Canada, the Anti-Corruption Working Group established standards and tools to guide countries on some key commitments. In particular, it adopted Guiding Principles on Enforcement of Foreign Bribery Offences, as well as on solicitation, and High-Level Principles on Mutual Legal Assistance. The OECD, thanks to its expertise and experience with monitoring the Anti-Bribery Convention, was instrumental in assisting these efforts. In the last year, Russia has supported the OECD's plan called "The Action Plan on Base Erosion and Profit Shifting". In addition, Russia is likely to join the OECD's initiative on the automatic exchange of tax information that is establishing a new global standard. These will provide Russia with significant new tools to fight the illegal offshore tax evasion that costs the country about \$6 billion annually.

If Russia is granted OECD membership, and Jose Gurría the director of OECD

expects Russia to join by 2015, this will mean that Russian national laws and the business environment meet international standards. This will be a huge milestone for Russia and a boost to its business environment and World Bank Doing Business Ranking. OECD accession will only create a structure for an improved business environment and potential inflow of foreign direct investment. Russia and the business community must remain vigilant to ensure that the implementation of OECD standards is strictly enforced. Only then will Russia achieve the improved business climate and corresponding economic growth it so desperately needs.

The EU/US sanctions imposed on Russia have provoked retaliatory sanctions against the EU/US banning many food products, such as meat and fruit. It is interesting to note that many of the products on the sanction list represent industries that were hurt by increased competition from Russia's recent WTO accession. Some Duma members have suggested that Russia withdraw from the WTO; a vote is scheduled for September. In addition, Poland has asked that the EU file a Dispute Resolution case against Russia because of the food sanctions.

As of late August 2014, the Ukraine crisis is still getting worse and the EU and Russia may enact further sanctions against each other that will further damage Russia's business climate and economic growth. It is impossible to predict when this crisis will be resolved and normal trade relations resumed. At this point, foreign investment and economic growth will replace trade wars as a priority, and progress toward OECD accession and other reforms should resume. ■

Part II. Basic Aspects to be Considered When Investing in Russia

Before you start

Compliance and distribution



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protect the company's global interests and reputation, today the implementation of an internal control system (compliance system) is required by virtually all market participants.

1. The legislative compliance framework in Russia

The reason for this was in particular the development of anti-corruption legislation in Russia. One of main legal acts related to compliance framework is Federal Law No. 273 of the Russian Federation dated 25 December 2008 "On Combating Corruption" (hereinafter — the "Law") which has been amended in 2013 whereby the new Article 13.3 was introduced. The Article 13.3 of Law stipulates that every Russian company is required to take measures to prevent corruption, inter alia:

- Designate the subdivisions or officers responsible for preventing corrupt crimes;
- Cooperate with the law enforcement authorities;
- Draft internal regulations aimed at ensuring the bona fide operations of the organization;
- Draft a code of ethics and corporate conduct for the organization's employees;
- Prevent and resolve conflicts of interests;
- Prevent the compilation of unofficial reporting or use of forged documents.

The list set out by Article 13.3 of the Law is an example of the measures

Over the past few years compliance has been one of the most discussed topics both in Europe and Russia. Owing to numerous investigations of corruptions, companies have started organizing their internal procedures, drafting, implementing and develop-

ing internal control systems. Whereas several years ago the implementation of a compliance system was only considered a necessity in certain sectors of the economy, for example, the banking sector, or deemed desirable for the largest players in the market in connection with the need to pro-

that a company may implement to combat corruption, however, this list is not an exhaustive one.

The Decree No. 309 of the President of the Russian Federation dated 2 April 2013 "On Measures relating to the Implementation of Individual Provisions of the Federal Law "On Combating Corruption"" (see Clause 25 of the Decree) instructs the Ministry of Labour and Social Security of the Russian Federation, jointly with interested federal executive authorities, the Chamber of Commerce and Industry of the Russian Federation, the Russian non-governmental organizations the Russian Union of Industrialists and Entrepreneurs, Business Russia and OPORA Russia, to prepare methodological recommendations on issues relating to the prevention of corruption in accordance with Article 13.3 of the Law.

Prior to the inclusion of the aforementioned Clause 13.3 into the Law, a company could only be held liable for the violation of Russian anti-corruption legislation due to its culpable action (or inaction). However, as the Russian Code on Administrative Offences had not previously established a positive obligation relating to the adoption of such measures, it could be difficult to justify the fault of the company in this particular case.

After the inclusion of Article 13.3 in the Law, a company is now vested directly with the obligation to draft and adopt anti-corruption measures that comply with the requirements of this article. Accordingly, if a system of such measures is not put in place at the company, this might be interpreted as inaction in the sense of Article 19.28 and Article 21 of the Russian Code on Administrative Offences and

could serve as justification for holding the company liable for the violation of Russian anti-corruption legislation.

Particular attention should be paid to the provisions of the Methodological Recommendations on the Development and Adoption by Organizations of Measures to Prevent and Counter Corruption dated 8 November 2013, developed by the Ministry of Labor and Social Protection of the Russian Federation. The recommendations contain a detailed review of the anti-corruption legislation of the Russian Federation and practical recommendations on the development and implementation of compliance systems at Russian enterprises.

Another important issue is the current reform of antitrust legislation which includes inter alia enhancing the effectiveness of controls over the actions of companies relating to the establishment of distribution networks in Russia and also improving interaction with foreign oversight agencies responsible for monitoring compliance with antitrust law in product markets. In connection therewith the Federal Antimonopoly Service of Russia (the "FAS") has drafted the Strategy for the Development of Antitrust Regulation in the Russian Federation for 2013-2024. The FAS perceives the drafting and implementation at the legislative level of norms that stimulate the implementation of a compliance system by participants on product markets as one of the most important objectives. Consequently, Russian state policy in the medium term provides for an intensification of work aimed at combating corruption and increasing the efficiency of mechanisms used to prevent violations of antitrust legislation. Furthermore, an existing compliance

system might be seen as a mitigating factor when determining liability.

2. Compliance risks arising during the organization of distribution in Russia

Market trends in Russia show that, in addition to the performance of contractual obligations (the supply of goods that comply with the requirements of the contract, subsequent warranty maintenance, etc.), organization of a supply system to the Russian market in compliance with the law is acquiring fundamental importance for successful operations in Russia.

Establishing a structure for the sale of goods or services in Russia implies first and foremost the selection of the most appropriate working arrangement:

- direct supplies of goods to ultimate buyers;
- the sale of goods through a subsidiary or representative office;
- work through a dealer network of partner companies.

The selection of the specific working arrangement is frequently predetermined by operational specifics in different sectors of the economy.

In addition to the selection of a working arrangement on the Russian market, companies also consider different legal forms for interaction with Russian partners, including:

- one-time sale and purchase agreements;
- supply agreements for the goods;
- distribution agreements;
- agency agreements;
- mixed contracts.

Each of these arrangements has its own specific advantages and disadvan-

tages. At the same time, companies tend to select from a variety of options, and it is up to the head of the company to make the selected arrangement effective and secure for the company.

2.1 Direct supply of goods

When organizing the direct supply of goods to ultimate buyers, suppliers are often confronted by the following situations:

- Offshore companies supply goods directly to Russia;
- Payments are performed by third parties, as a rule by offshore companies;
- It is impossible to control the customs clearance of goods at the time of their import into the Customs Union between Russia, Belarus and Kazakhstan.

2.2 Sale of goods through a dealer network

The establishment of a dealer network in Russia requires particularly diligent and meticulous work given the provisions of antitrust legislation, inter alia:

- determination of the company's market share in a specific product market;
- conclusion of the fixed price agreements;
- division of a product market by territory and/or participants;
- non-compete arrangements etc.

In addition, work with dealers requires the selection of the optimal legal structuring of relations: the supplier-dealer, which should consider, in addition to the terms and conditions on the supply of the goods, issues arising from the use of intellectual property (trademarks, patents, etc.); issues arising from the promotion of goods on the Russian market (market research; promotional products); the interaction of dealers.

2.3 Sale of goods through a subsidiary in Russia

If the supplier opts to sell the goods through a subsidiary, it will have furthermore to resolve specific tasks that arise for the Russian subsidiary, including:

- Audit by the state authorities;
- Tax, employment law and exchange control issues; the receipt of permits (licensing), etc.

The effective work of the established system will provide a company with a number of competitive advantages.

At the same time the establishment of Russian subsidiary allows control of the customs clearance of goods at the time of their import into the Customs Union.

3. Participation in procurement for the needs of the state authorities and companies with state participation

In 2012–2013 the system of state procurement underwent significant changes. This was attributable primarily to the fact that there tended to be a high level of corruption in the public procurement sector.

First and foremost, the Federal Law of the Russian Federation "On the Contractual System in Respect of Procurements of Goods, Work and Services to Ensure State and Municipal Needs", which introduced significant amend-

ments to the previous state procurement system, entered into force from 1 January 2014.

The procedure governing procurement by companies with state participation was governed by a special regulatory and legal act, the Law of the Russian Federation "On Procurements of Goods, Work and Services by Certain Types of Legal Entities".

Violation of legislation on procurement during the preparation and performance of measures relating to the selection of the supplier (auction, tender), including at the stage of the preparation of the terms of reference and tender documentation — at the stage of the actual tenders and the adoption of decisions on the winner — may result not only in the invalidation of the tender results, but also in the persons engaged in illegal activities being held criminally liable.

This concerns first and foremost corruption crimes: the giving and receipt of a bribe, corrupt practices, negligence, and in certain instances general crimes, for example: fraud.

Consequently, when working with state procurement, suppliers should pay the utmost attention to the selection of counterparties, the selection of the supply arrangements and control over each stage of project implementation.



4. Work in Russia — success is contingent on due preparation and control

In fact, in order to be successful, it is important to find the golden mean between the risks and opportunities offered by the market. The Russian market provides foreign investors with excellent opportunities. Naturally, however, work in this market also carries risks that are no less significant.

So management should work to minimize risk, inter alia to verify counterparties at the stage of the conclusion of the agreement, to guarantee compliance with the requirements of Rus-

sian legislation at all stages of supplies of goods to ultimate buyers, and subsequent warranty maintenance and service. In addition, management objectives should include the establishment of an effective system of interaction with the state authorities during audits of the company's compliance with legislation, so that the actions of the employees of the state authorities have the minimum adverse impact on the company's business activities.

The work of such a system necessitates both time and financial cost whose effectiveness can be hard to evaluate in the short term. At the same time, however, the long-term

economic impact of an internal control system (compliance) is self-evident. The effective work of the established system will provide a company with a number of competitive advantages. First, such a system reduces the number of breaches of statutory requirements. Secondly, it makes it possible to forecast the subject matter and scope of potential (state) audits and prepare personnel for emergencies. As a result, a compliance system will generate financial and time savings spent on the resolution of identified violations during control measures and bring you closer to the "golden mean", guaranteeing the success of your venture in Russia. ■

Key trends in Russian immigration legislation: issues to consider when engaging foreign personnel

One of the key areas that should be carefully considered by the management of international companies entering or already operating in Russia is immigration, as the requirements are subject to ongoing changes. Immigration regulations affect not only a company's activities, but also its foreign employees and the family members who often accompany them to Russia.



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Ekaterina has over 7 years of experience specializing in immigration and labour matters related to the engagement of foreign personnel in Russia, plus extensive experience in immigration health checks and audit of immigration business processes. Additionally Ekaterina specialises in the area of personal taxation of inbound and outbound assignees. She is a participant of the AEB Migration Committee work group. Ekaterina graduated from Tambov State University with honours, majoring in linguistics.

In light of the above, it is important to understand and constantly monitor the specifics of hiring foreign citizens to work in Russia in order to achieve a smooth and easy transfer of them and their families. In most cases, timely and well-organized arrangement of the required immigration and HR documentation for foreign personnel guarantees a successful start to Russian operations for the company.

Current Russian immigration legislation is developing with two main trends. The first is the improvement of the regimes that are currently in place in order to make the Russian environment more attractive for foreign investors, as well as to clarify some "grey areas" of legislation to ensure that existing mechanisms work effectively for the benefit of the companies operating in Russia. The first major step in this direction was taken in 2010, when a new simplified regime for engaging Highly Qualified Specialists (HQSs) was introduced.¹

Over the past four years, this beneficial regime for engaging foreign nationals has been available only for Russian legal entities and branches of foreign legal entities. On 5 May 2014, the President of the Russian Federation signed a law that made it possible for

representative offices of foreign legal entities accredited in Russia to employ HQSs starting from 1 January 2015.

Recently, the Government introduced an amendment regarding the annual salary requirement for HQSs who are employed by Russian companies accredited by the state in information technology (except for resident organizations of Technology and Innovation Special Economic Zones). Starting from 25 June, the salary requirement was lowered to RUB 1 million from the previous amount of RUB 2 million.

Several bilateral treaties have been signed with other countries in order to simplify the procedure for the employment of foreign nationals in Russia. The latest one is the Treaty between Russia and Tajikistan, which allows citizens of Tajikistan to obtain work permits valid for three years.

On 1 January 2014, two new methods of engaging foreign specialists came into effect. The first is designed in order to hire full-time foreign students for the period of their study at state and accredited universities. Other rules were developed for investors from member countries of the World Trade Organization who send specialists to Russia to perform activities as key personnel.

¹ HQS is a foreign specialist whose annual salary paid through the Russian payroll of a Russian legal entity or a Branch of a foreign legal entity is not less than RUB 2 million.

Additionally, the government of the Russian Federation is working to improve the existing patent system by making it possible for companies to engage foreign personnel under patents received in advance. The relevant draft law provides for a patent system which will replace the current work permit process and can be used for engaging foreign nationals from CIS countries, therefore abolishing the necessity of receiving the respective quota. Currently, only Russian citizens and individuals with permanent or temporary residence permits can hire foreign nationals from CIS countries who have patents for household duties.

Another way immigration legislation is being developed is through the tightening of control over labour migrants staying in Russia, which necessitates closer cooperation between various Russian authorities. Several measures have been taken in this respect. Starting from 1 January 2014, Russian immigration authorities are obliged to check whether a foreign specialist has a Tax Identification Number at the time of applying for a work permit. If the person does not, it will be arranged for them automatically. This is an example of close information exchange and cooperation between the immigration and tax authorities. They have the necessary information regarding the quantity of foreign labour in international companies and can verify whether a company is in compliance with the reporting requirements stipulated by current legislation, and whether the foreign specialists are paying Russian personal income tax as stipulated by law.

The clampdown on administrative control measures also affects individuals. Under new regulations, a foreign national may not be allowed to enter



the Russian Federation if he or she was held liable for any administrative offence on the territory of the Russian Federation two or more times within a three-year period. The entry ban lasts for three years, beginning from the date when the last administrative sanction came into force. Such actions as smoking in a restricted place, violating traffic or parking rules (when you are stopped by the police, it applies even in those cases when the car registered under the company name is driven by a foreign national), and crossing the road illegally are considered administrative offences and are taken into account under the aforementioned sanctions.

Moreover, a foreign citizen is forbidden from entering Russia if he or she evaded paying taxes or had an administrative fine levied against him or her during a previous stay in Russia. The entry ban lasts until the foreign citizen pays the respective tax or administra-

tive fine in full. For violation of the residency regime in Russia, the new legislation provides for an administrative fine imposed on a foreign national in the amount of RUB 2,000—5,000, along with deportation from Russia.

The new sanctions came into force in August 2013. There are already several precedents for the detention of foreign specialists at the Russian border. Some foreign specialists have been banned from entering Russia for several years due to the fact that they had unpaid administrative fines or had violated the enrolment (registration) requirements in Russia. This is yet another example of the close cooperation between the immigration authorities, police and other parties targeted at creating a unified database in which the required information regarding the stay of foreign nationals in Russia is available.

It should also be noted that in the new edition of the Code of Administrative Offences, lawmakers distinguished of-

fences performed both in the cities of Moscow and St. Petersburg and the Moscow and Leningrad regions, and stipulated individual sanctions with obligatory administrative deportation (not possible deportation as in other regions) if a foreign citizen performs labour activity in the Russian Federation without a work permit. The sanctions also apply to a foreign citizen in violation of the rules regarding entry or the residence regime of the Russian Federation.

In addition, punishment measures for employers who hire foreign citizens in labour activity in the Russian Federation without getting the respective permissions, as well as measures for non-notification concerning the employment of foreign citizens in labour activity, became harsher. Violations incurred in the areas of federal significance (Moscow, St. Petersburg, Moscow and Leningrad regions) will result in an administrative fine of up to RUB 1 million.

Another important federal law, published in May, tightens requirements for foreign nationals working in Russia. Under this law, starting from 1 January 2015, foreign nationals who apply for the approval of a work permit, patent, temporary residence permit or permanent residence permit are obliged to present a certificate confirming knowledge of the Russian language, as well as the history and basics of Russian legislation. The validity of the certificate is five years from the date of issue.

The certificate is granted by the educational organizations located in Rus-

sia, or outside Russia, included in the list of educational organizations authorized to give the examinations. The list of relevant organizations as well as sample examinations are still under development.

A diploma, granted by an educational organization located on the territory of the former USSR, as well as a document of education and qualification granted to a foreign national as confirmation of passing a state certification in Russia starting from 1 September 1991, will also be considered as a document confirming the knowledge of the aforementioned disciplines. These regulations will not be applicable for processing work permits and permanent residency permits for HQSs.

Apart from preventing illegal immigration in Russia, the government is also attempting to support the local labour market and help unemployed Russians who have priority employment rights under current legislation. For this reason, there is a so-called "quota" approval process, which was initially implemented in 2007. This mainly affects those companies which engage foreign specialists under the standard work permit procedure².

Under this process, companies must annually report the number of foreign specialists (including both actual employees, civil/legal contractors and CIS citizens, but excluding HQSs) they anticipate employing in the following calendar year, including the precise positions and citizenships of those anticipated foreign employees. This

effectively constitutes an application for a quota, whereby the quota must first be obtained before it is possible to launch a work permit application for any foreigner who is not an HQS or who occupies one of a limited list of specific quota-free jobs.

A new legislative act regulating the specifics of quota approval was published this spring. The new quota process lists a number of requirements that must be satisfied before a company can be granted a quota. Among them is compliance with the existing labour, employment, tax and immigration legislation requirements. At this stage, it is hard to predict when a company may expect to receive the requested quota for the year 2015, the application for which in Moscow had to be submitted by 1 July 2014. Based on the practice of previous years, the quota requested by many companies located in Moscow might be rejected partly or in full for several reasons, one being the possibility of employing Russian nationals in the vacant positions.

Under the new regulations, the deadline for the quota application submission is region-specific.

Taking into account the above information, companies that operate in Russia, or plan to establish a subsidiary in Russia, and for this purpose anticipate engaging foreign specialists, should seriously consider the current immigration requirements and available regimes for hiring foreign labour, and other specifics, in order to ensure their operations in Russia are successful and effective. ■

² Standard work permit is used for companies that do not satisfy HQS requirements. The process of a 1-year work permit approval can take up to 6 months or even longer, provided there is no respective quota secured in advance.



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Regional expansion: HR aspects



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ability of raw materials, good logistics, sales channels, available capacity and infrastructure. Unfortunately, the role of the HR manager is more that of an adviser than a decision-maker. HR expertise is taken into consideration only at the moment of investment, when many bottlenecks in the labour market become obvious, so for the HR manager nothing remains but to accept these risks and develop responses.

You may get a surprise when developing in a new region, for example terrible city traffic, the impassability of roads, the predominance of residents of retirement age and the situation when half the working-age population has medical problems. Also, young people leave these places for the big cities because there is nowhere to study. No one could have foreseen that. Or could they?

Evaluation of investment attractiveness of a region for new plant or LC must include the following aspects.

Overall economic performance of the region

Study the statistical materials posted on the official websites of the district or city administration, the local universities, and city news portals. Study too the population, its ethnic composition, the proportion of the working age population who are seniors, youth or people with higher education, unemployment, average wages (in comparison with the cost of living in this and neighbouring areas, as well as consumer prices). This information will be provided by the Employment Centre. Talk with specialists of

One of the most important strategic ways of development is regional expansion. In order to make the right decision, a company should analyse and take into account such fundamental things as the region and the plan of development of the region. A company should formulate the attractiveness criteria for a region — location, size, value, resources and infrastructure opportunities, level of competition — and identify possible risks.

Also a company must take into account the opinions and points of view of every manager of a future plant or LC (logistics centre) regarding a region's characteristics, and confirm it by figures and long-term business forecasts.

How can an HR manager get involved in the start-up project launch discussion?

Certainly, during consideration of a region for the launch of a start-up project, important factors are the avail-



the Employment Centre, analyse what applications come to them, and from what organizations (such information is often placed on a stand in the corridors). Talk about the complexities of employment and the type of applicants.

Also you should investigate what industries are there already, who are the main employers, which of them are your potential competitors in the workforce market. Which companies have been operating for a long time? Are they Russian or foreign companies? What is their size? Which industries are they in? Are they manufacturing or trading companies. Also it may be useful to find out about wage levels in the region and what specialists are most popular there, and the presence of, or planned reductions in, important industries.

Location of the region regarding to the transport hubs and major transportation routes

A company should think not only about international and inter-regional logistics, but also about how staff will get to their place of work. As for the relocation of top managers and key

specialists, for them the possibility to get home to Moscow or St. Petersburg will become one of the main issues during the employment negotiations.

In the case of mass recruitment of line staff with limited terms, what is the possibility of recruiting staff from nearby villages and adjacent areas through the provision of corporate transportation, housing?

The administrative factor and social responsibility factor

Decision to build a warehouse or plant in a remote village will influence the future of the whole region. It is because of taxes in favour of the region. It is the policy. Increase of investment attractiveness and attracting big companies. It is infrastructure development and possible opening of new schools. And finally, it is the cause of new jobs creation.

Professional level of local specialists

The availability of a sufficient number of managers who have technical or logistical education, with experience using the Western approach and using practical management tools.

The availability of skilled warehouse personnel (forklift drivers, data entry operators and etc.).

- Analysis of educational institutions (what kinds of specialists are trained?) centres for retraining and qualification, safety committees etc.
- Analysis of information about the proposed job, wage rates, compensation & benefits level, as well as resumes of possible applicants.
- Analysis of human resources in the region or adjacent regions (the presence of the required number of working-age people currently in the labour market).

The results of data collection, analysis and systematisation of the information received will allow an HR manager to make an informed analysis. In the future, these materials will help HR to continue to produce a clear and effective plan for search and recruitment, help create a favourable image of the employer, create attractive offers for job seekers, and provide top management with the necessary information to evaluate level of costs. ■

Facing immigration hurdles in Russia: where to start

Considering starting business in Russia? Contemplating your company's expansion to the Russian market? Then you must already be aware of some of the bureaucracy you are likely to encounter. In spite of the fact that such expansion plans are usually made far in advance and every aspect is considered and reviewed in detail, it is still often the case that when everything is long set up and clients are eager to receive products and services,

the key personnel are still not in place. In order to avert many operational as well as legal problems and avoid finding yourself disappointed right from the start, immigration issues have to be considered as central to any international move.

Planning an international move

Normally, in order to legally perform work activities in Russia every foreign national except citizens of Belarus and Kazakhstan has to obtain a work permit. Citizens of countries which do not belong to the CIS have also to apply for a work visa.

This exception is also granted to foreign employees of manufacturers and suppliers of equipment imported into Russia, so they are allowed to enter Russia and participate in works related to the installation of such imported equipment without a work authorization. However, it should be noted that such employees are granted one of the types of business visa and general "business visa" rules still apply — for example that one's stay can't exceed 90 days in each 180 days period. This means for employers that all the works should be planned for the term not exceeding three months, or a "substitute" team should be planned and if necessary hired in advance.

Otherwise there are two main procedures available for engaging foreign labour in Russia. First is the old "standard work permit" procedure which involves multiple stages and in practice can be completed in 4–5 months. In spite of

the fact that Ministry for Labour and Social Development has recently approved quite an extensive list of job positions for which quota for engaging foreign labour is not required, in order to deploy this process the company has to have an approved quota for engaging foreign labour for the year in question, which is extremely rare for recently established companies.

The other option is to make use of the procedure for highly qualified professionals, introduced in 2010. Though the Russian legislation does not contain any specific requirements concerning educational qualifications or other professional qualities of such employees, it is required that the salary for this type of staff is set at the benchmark of not less than 2,000,000 roubles gross per year (approx. 42,000 EUR). This option can be beneficial for most international companies considering moving their employees to Russia due to the shortened processing time — approximately six weeks for the completion of all steps.

With regards to both options described above it should be noted that according to Russian labour legislation a labour agreement should be signed irrespective of whether the assignee in question remains on the host entity's payroll or not.

One of the other important points for consideration is assignees with family or partners willing to accompany your employees on assignment. It is well known, for instance, that Russian migration legislation does not recognize



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civil partnerships. What is more, there are problems with such categories as children over 18, gay couples, children from previous marriages who were not adopted by the assignee or, last but not the least, nannies, nurses or other domestic staff.

As can be seen from the above there are a lot of questions to be considered before it is possible to start planning an international move. Many issues need to be resolved, such as what work permit option will apply, whether assignee will be able to travel with his family members or partner, whether he will require to make any additional arrangements for his children, etc.

Tips for the employer

When opting for the highly qualified professional scheme described above, employers should bear in mind that any part-time employment for specialists hired using this procedure is possible only if the full salary is paid. Many questions also arise with regards to maternity and other types of leave, considering the fact that Federal Migration Service officials always stress the importance of following the requirement that such employees are paid not less than 2 million roubles per year gross, irrespective of any leave they take, including maternity and sick leave. If any type of unpaid leave is granted for more than 1 month the Federal Migration Service should be notified.

Tips for the employee

When you are on an international assignment in Russia yourself you should consider that part of the responsibility for compliance with immigration legislation will be imposed on you.

Thus, you should be aware that foreign nationals entering the territory of Rus-



sian Federation should register with the local migration service office. Those with a business visa (unless you are staying in a hotel which will take care of the registration requirement) and with "standard work permits" referred to above should do so within 7 business days, and those holding work permits procured under the highly qualified professional scheme, within 90 calendar days.

In this regard it is important to be aware of the fact that non-compliance with the address registration requirement can, according to the Administrative Code, lead to deportation for employees based in Moscow, St. Petersburg as well as those residing in Leningradskaya and Moscow regions.

In addition to being extra careful with the immigration-specific matters one

has to be aware that even administrative offences — road traffic violations as well as different sorts of public order disturbances — can endanger your assignment. Recently there has been a rise in bans from entering Russia in accordance with Section 4 art. 26 of the Federal Law 114 on the procedure for entering and leaving the Russian Federation which allows a ban to be imposed on a foreign national who has committed two or more administrative offences in 3 years.

Not only is it a quite challenging to plan and execute flawlessly an international assignment in the first place, but successfully relocating an employee is not the finishing line. Management of international assignments requires the constant attention of specialists with specific experience in the area. ■

Import to Russia. Practical solutions to the challenges of the early stages

The first steps are always the most important as they affect the whole process of your business in a new country. It is vitally important to foresee all possible advantages allowed by the laws of the Russian Federation. Today the new economic crisis brings a lot of challenges to existing business communication and ways of doing business.

Like many other countries, Russia is starting to protect its local markets and border trade. New restrictions are affecting the Russian economy and changing its structure. An example is



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the new Federal order on government purchases, № 44 dated 5 March 2013, which on the one hand gives foreign companies the right to become suppliers but on the other requires them to comply with criteria which may be applied only to a Russian one. That means that you should first consult legal or customs representatives to assess all the risks before you participate in a tender.

Since Russia joined the WTO in 2013, the expected reduction of customs duties has been partly compensated by the erection of new barriers. Many of those are already a subject of the international trade disputes.

Most industrial companies are forced to localize their production units inside Russia if they want to be able to participate in financial support programs, to sell their goods in the Customs Union and to be able to present their goods in government tenders. Moreover, there are some minimum limits on production amounts. If your volumes do not fit them the company can be excluded from the preferential list.

Signing a purchase contract is not as easy it might seem. It is important to put the correct descriptions of the goods and of the import/export process. Equipment can be imported in two different ways, either saving money or facing extra costs. Many forget to mention the possible changes in the rates and

the export/import of spare parts. When those are not clear in the contract, it may bring extra costs at customs clearance.

Not all the equipment can be loaded within one day. Sometimes it takes more than 6 months to transport it from the factory to the customs post. The customs classification decision is usually applied in this case to clear the goods as equipment and not as spare parts. The decisions can also be applied to those goods for which the importer cannot find the proper code themselves.

The INCOTERMS matters a lot. It is important to remember that each type of delivery requires its own set of documents. DDP deliveries to Russia are also possible.

Since 1 January 2014, e-declarations have been the only officially accepted system in Russia. But in practice, there are still some documents which must be presented on paper. Also there is little exchange of documents between the services. It is easier for the importer to have all the papers on hand. The situation is much the same when the importer wants to be registered at the customs post. The documents must be provided each time, though the procedure was changed by the legislation.

As soon as you have started importing, you may face the customs value correction challenge. There is a statistics

“price” attached to each customs code. It is calculated in the US dollars. The difference in duties to pay (if any) should be paid in full or the importer should prove that the duties declared are correct. Normally, at least thirty documents need to be presented, and they are specified in the orders of the Federal Customs Service. They generally include the trade contract, the accompanying import documents, domestic and foreign accountants’ documents, and last but not the least documents and information giving proof of the value of the goods.

All that might be exacerbated by different approaches of the companies concerned and by misunderstanding between the importer and the exporter.

In Russia only 340 companies (Federal Customs Service statistics, May 2013) out of 67,000 are authorized economic operators, though in Europe this correlation is almost 60% of the total figure. Today the criteria and the benefits are again under discussion. The authorities try to make the procedure easier and broaden the benefits.

Your customs clearance process might be delayed because of the difference in customs codes of the goods. That leads the company to extra costs and penalties. Russia is a sovereign country, and though it is interested in a harmonized coding system it still takes into account only the national ones. You should get the correct codes long before you start the process. If the code change has led to a legal case, the company will be debarred from applying for the green corridor program.

The other challenge in Russia is the absence of a smooth procedure for legalizing excess quantities of imported goods



if they were found out (only after the truck was unload at the warehouse of the consignee) in the warehouse after the customs clearance was finished. There are two ways of solving the problem. The first one is to make changes in the declaration. The declarant will have to pay the penalties as appropriate and, in parallel, a legal case will start. The other option is to destroy the items. In either case it leads to extra cost.

Russian customs officials are very cautious about the weight and the quantity of goods. Be careful when declaring NETTO/BRUTTO weight, especially for packages. The approximate difference between the two must not be more than 30%. The difference in quantity of pieces usually results from a misunderstanding of the term “set”. A “set” may include several items. In such a case, one should write that there is this amount of sets consisting of that amount of items. Otherwise the consequences might be a legal case for incorrect information in the declaration.

Last but not the least is the case of items which constitute intellectual property. Last year, a separate Ministry for Intellectual Property was established. It is increasingly important to get your brand in the customs register list. Then

only accredited companies will be able to import goods.

In conclusion, it is important to underline the recent changes in the attitude of the customs officials. They have started to listen to business and accept some proposals. The implementation of the electronic preliminary information has saved time at the border. There is an e-database of certificates. A transaction document from the bank (for deals less than \$50,000) is no longer needed for the customs clearance. Other changes prescribed in the road map of the development of the customs legislation will be made faster than was originally envisaged. Russia has a long way to go to move from 92nd place in the survey of Ease of Doing Business 2014 to the target of being in the top 25 countries in 2015.

The development of the customs business in Russia will be much affected by the economic and political situation in the world. Most companies hope that there will be changes towards loyalty and tolerance, but they worry about the risks of the broadening of the Customs Union and the need to review such documents as the technical regulations, certification and the idea of the single window to provide the documents. ■

Customs benefits for foreign investors localizing manufacture in Russia

The effective customs legislation of the Customs Union of Russia, Belarus and Kazakhstan (Customs Union) envisages, in particular, the following customs benefits for foreign investors planning to localize manufacturing in Russia:

1. an import customs duty concession in respect of goods imported as in-

kind charter capital contribution of a foreign investor into the charter capital of a Russian legal entity;

2. an import VAT concession in respect of the technical equipment, components and spare parts, for which substitutes are not produced in the Russian Federation;

3. an import customs duty concession in respect to (1) technical equipment, components and spare parts, as well as (2) raw materials and components, imported for the exclusive use on the territory of the state-member of the Customs Union in connection with an investment project, falling under the type of the priority activity (sector of economics) of the state-member of the Customs Union in accordance with the legislation of such state-member of the Customs Union;

4. exemption from import customs duty and taxes provided by the customs procedure of Free Customs Zone;

5. exemptions from import customs payments provided by the customs procedures of Processing on the customs territory and Processing for internal consumption.

Below we provide brief comments on each of the customs benefits.

Customs duty concession for goods imported as an in-kind charter capital contribution of a foreign investor

The import customs duties concession may be provided under the condition that the goods refer to the main production assets (e.g. production equipment), are not be excisable goods (e.g. passenger motor vehicles) and are imported within the time period of the charter capital formation. If all these conditions are met, the importer may enjoy full exemption from import customs duty.

The main disadvantage of this customs concession is the complicated procedure involved in the importation of the goods as an in-kind charter capital contribution. These complications are caused by the significant management and administrative input required due to the time frame requirement. The import of the goods as an in-kind contribution to the charter capital and within the period of charter capital formation should be duly documented. The provision of security for customs payments for the period of the charter capital formation may be required under the placement of the imported goods under the customs procedure. The importer who is given a customs concession should comply with the restrictions on usage and disposal of the goods within a 5-year period from the date when the goods were released by the customs authorities. During this 5-year period, if the goods need to be repaired, the respective customs formalities may be required to be performed in respect of this equipment and its parts which are out of order. If the goods are subject to sale or lease to a



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third party, or in case of withdrawal of the foreign investor from the founders (participants) during the above 5-year period, the customs duties that were exempt will have to be paid by the importer.

Please note that the effective Customs Tariff of the Customs Union envisages zero import customs duty rates in respect to majority of types of technical equipment. The rate of import customs duty depends on the classification code applied to the equipment according to the Commodity Nomenclature of the Foreign Trade Activity. Therefore, it is advisable to specify the classification codes under which the particular equipment should be classified, and the possibility of applying these codes taken into account in its shipping schedule, including by obtaining a preliminary decision on classification, before making the decision on the application of any customs concessions.

Import VAT concession for the technical equipment, components and spare parts, substitutes for which are not produced in the Russian Federation

This concession may be applied in respect to the types of the equipment included in the List approved by the Resolution of the Government of the Russian Federation dated 30 April 2009 № 372. If the type of equipment is not included in this List an interested party may initiate the procedure of amending the List.

If the equipment is shipped to Russia in disassembled mode, it is advisable to obtain a preliminary classification decision which may be issued by the Federal



Customs Service of Russia or its regional customs departments.

Investment project

The customs legislation of the Customs Union¹ envisages import customs duty concessions in respect to the following goods:

“Technical equipment, including components and spare parts for it, raw materials and/or materials, imported for the use on the territory of the states-members of the Customs Union in connection with the implementation of investment projects which correspond to the priority type of activity (sector of economics) of the states-members of the Customs Union in accordance with the legislation of such states-members of the Customs Union.”

The indicated concession concerns the raw materials and/or materials, if such raw materials and/or materials are not produced in the states-members of the Customs Union or if the materials or if raw materials and/or materials, produced in the state-members of the Customs Union do not correspond to the technical characteristics of the investment project applied.

Please note that currently this concession is not applied in the Russian Federation (such exemptions are applied in Belarus and Kazakhstan only). Consequently, in Russia there are no normative acts which determine the procedure for rendering the indicated exemptions.

The perspective for the application of such exemptions in Russia is not clear. There is no direct prohibition or clear guarantees that such exemptions will not be applied in Russia. At the same time, following the Decision of the Court of the Eurasian Economic Community on application of this customs concession the Secretariat of the Eurasian Economic Commission should prepare the general rules of enjoying the tariff concession in the Customs Union, including the procedure of provision of the concessions for the importation of the goods connected with investment projects. Based on the above it is recommended to monitor the situation, and if following the resolution of the Eurasian Economic Commission the possibility to apply this customs concession in Russia arises, try to implement it.

¹ Sub-clause 7.1.11 of the Decision of the Commission of the Customs Union № 130 dated 27 November 2009 “On the single customs tariff regulation in the Customs Union of the Republic of Belarus, Republic of Kazakhstan and the Russian Federation”.

Special Economic Zones

Four Special Economic Zones ("SEZs") are being established in Lipetsk oblast, Republic of Tatarstan, Samara oblast and Sverdlovsk Oblast. Besides tax benefits, these SEZs envisage the possibility of applying the customs procedure of a free customs zone. The goods (i.e. the technical equipment, components and spare parts required for the manufacturing process as well as raw materials and components) customs-cleared under this procedure may be used within the territory of SEZ without paying import duties and VAT, and without the application of non-tariff measures². No export customs duty should be paid in respect to the products manufactured from the imported components. If such products are released for free circulation, the import customs duties and taxes to be paid may be calculated based on the rates related to either the imported components or to the manufactured products based on the choice of the manufacturer, provided that the respective criteria for processing and identification requirements are met.

To enjoy the above customs benefits the Russian legal entity should be registered in the respective SEZ and it cannot have a branch outside the SEZ. The resident performs its activity in accordance with the Agreement on the Production Activity (production and/or processing of the goods (products) and their sales)³ which should be concluded with the Ministry of Eco-

nomics Development of Russia. The resident of the special economic zone is obliged to make capital investments in roubles in an amount equivalent to USD 4.5 million, at least 1.5 million of which should be invested within the first year after the date of signature of the indicated Agreement⁴.

Customs procedures of Processing on customs territory and Processing for internal consumption

The customs procedure of Processing on Customs Territory (inward processing) provides for full exemption from import customs duties and taxes levied on the imported goods, provided that the goods produced from the imported goods (the Processed products) are exported from the customs territory of the Customs Union and other conditions are met.

The Customs procedure of Processing for Internal Consumption stipulates that the imported goods are used for the refinery (processing) operations without paying import duty. The Processed products should be released for free circulation on the customs territory of the Customs Union after paying import duties at the rates applicable to the Processed products. Consequently, in cases where the customs duty rate with respect to the Processed products is zero, the application of the customs procedure of the Processing for internal consumption allows a decrease of the import customs duty expenses significantly.

However, this customs procedure may be applied only in respect of goods which are included in the List approved by the Government of the Russian Federation⁵. The effective Resolution of the Government № 565 of 12 July 2011 envisages the list of components required for assembling units of passenger cars and train. Therefore, for the purpose to enjoy it, the respective amendments should be introduced into the Resolution of the Government. The maximum period of Processing of the goods for Internal Consumption is 1 year from the date when the first shipment of goods was placed under the customs procedure. The Commission of the Customs Union may establish a longer or a shorter period for separate types of goods⁶. Special permission should be obtained, and reporting should be provided, to the customs authorities for applying this customs procedure.

Please also note that products manufactured in Russia, owing to the creation of the Customs Union, may be supplied to Belarus and Kazakhstan without the need for any customs formalities. If such products are supplied to other CIS countries (e.g. Ukraine, Moldova, Uzbekistan, Kirgizstan and etc.) tariff preferences (i.e. full exemption from import customs duties) may be applied in the respective CIS country, subject to compliance with relevant conditions (for example, the resident rule, direct supply rule, criteria for processing, certificate of origin ST-1, etc.). ■

² Article 10 (Clause 1) of the Agreement on the issues of the free (special) economic zones on the territory of the Customs Union and on the customs procedure of free customs zone dated 18 June 2010.

³ Article 10 (Clause 1) of Federal Law "On special economic zones in the Russian Federation".

⁴ Article 12 (Clause 2) of Federal Law "On special economic zones in the Russian Federation".

⁵ Article 265 of the Federal Law "On the Customs Regulation in the Russian Federation".

⁶ Article 268 (Clause 1) of the Customs Code of the Customs Union.

Vital legal issues to consider when investing in technology-based projects in Russia

Foreign companies are looking to expand technology investments in the Russian market, targeting software development, IT, medicine, energy and other technology-based spheres.



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Advocate, IP/IT, 1 Forma

Ekaterina Tilling is recognised in Russia for her experience in the IP field. She is highly skilled at solving IP disputes in Russian courts at all levels, including the Supreme Arbitration Court. She has significant experience in handling complex investment projects involving different IP assets, as well as in negotiating and advising on various IP/IT transactions.

Ms. Tilling is recommended among the European legal experts for IP matters (Chambers Europe, 2008–2014, Chambers Global 2010–2014, The Legal 500 EMEA, 2007–2014 and others).

Ekaterina is a Deputy Chairperson of the IP Committee of the AEB in Russia and is actively involved in the Committee's work.

The base models for a standard investment project may be described as follows:

- the investor acquires the rights to an off-the-shelf technology in Russia;
- the investor comes with its own technology;
- a technology is developed from scratch in Russia.

Irrespective of the model selected for an investment project, the investor needs to evaluate existing and potential risks. This is why investors need an instrument enabling them to check the legal status of a target technology and determine its value. IP due diligence serves to protect the investor.

The goal of IP due diligence is to analyse how well the technology fits the investor's business objectives, whether it provides exclusivity within the market and may be effectively enforced against others.

In the case of an off-the-shelf technology, the goal of the investor may be either to purchase or invest in a company holding a certain technology or purchase individual rights to a technology of interest in order to set up its own manufacturing. If the investor comes with its own technology, it will want to save its background IP rights for this technology and duly determine the rights of all

participants in the project for future developments.

In all of these cases, it is particularly important to conduct IP due diligence before purchasing technologies. Where the goal of the investor is to buy a company, financial and corporate due diligence may be needed, too. Due diligence helps generate a model for the creation and use of technologies that is risk-free to the maximum possible extent. The three key guidelines for creation of such a model are:

- **Structuring of IP and Perfection of Rights** — identification of IP, definition of the form of its protection and understanding how to make a "product" of IP for subsequent commercial purposes.
- **Territory** — regions of presence (national and international protection of IP).
- **Protection** — this means the form of IP protection and the regions of presence. Two key stages are implied - primary protection (title documents) and subsequent protection (against unauthorised third-party use — both extra-judicial and judicial).

While a technology transaction may involve different intellectual property rights, it mostly relies on know-how and patent



rights to inventions, utility models and industrial designs. This is why in this article we will focus on basic rules for dealing with know-how and patent rights.

As to Patent Rights IP due diligence should first of all address the existence and strength of patent rights. When properly protected and used, patents can increase revenue, bar competitors from certain markets or technologies and serve as an in-kind contribution to corporate capital. If a technology is not properly protected by patent rights, the value, future competitiveness and even the survival of an investment project may be at risk.

In checking patents one needs to take into account that patents are protected on the principle of territoriality, i.e. they are valid only on that territory for which protection has been claimed and in which it was issued. In particular, for a technology to be granted with a patent protection in Russia, a patent for it should be issued by the Russian Patent Office (Rospatent).

If an investor comes to Russia with its own technology or develops it specifically for the Russian market, to establish the rights to such a technology one may either secure its patent protection in Russia or satisfy the necessary conditions for it to be protected in Russia as know-how. The same general rule applies where an investor establishes the right to an off-the-shelf technology in Russia, i.e. the investor needs to satisfy itself that the technology is duly protected in Russia. For example, in Russia, unlike the U.S.A. and Japan, business methods are not patentable.

Patentability

Irrespective of the model for an investment project, IP due diligence may establish whether technical results developed in other countries, as well as patents issued abroad, are patentable in Russia.

If they are, patent applications will need to be filed, which means that information about a technology being

patented will need to be disclosed. If due diligence uncovers certain problems that may potentially result in denial of patent protection, it may be worth considering updating the technical solutions before filing an application, or keeping proprietary solutions secret and protecting them as know-how.

Coverage

In checking patents, one would closely investigate whether a technology, or products to be made using it, is/are sufficiently covered by existing patents and know-how. Legal due diligence often shows that existing patents or know-how do not cover a technology completely, or that patents are weak and may be challenged, in full or in part, by interested persons for a failure to match the patentability criteria.

In such a case, the investor may run the risk of being unable to prohibit third-party use of the technology in Russia.

Freedom to operate

A significant risk can arise when the use in Russia of a technology that is not completely covered by patents or know-how results in an infringement of the rights of other persons who may, for example, hold patents for any of the technology's component parts. Besides the fact that infringement actions are time-consuming and expensive, there is the risk that the use of the technology may be prohibited.

Accordingly, due diligence should involve a check on freedom to operate, i.e. for potential infringement of third-party rights by the use of a certain technology not yet protected by patents.

Such a check may cover both Russia and other countries where the technology is intended to be used. A check for the freedom to operate in other countries may be needed, in particular, when the plan is to make products in Russia, but distribute them abroad.

Effective term

Due diligence may also reveal that the effective term of the rights being purchased is short and might not be extended. If so, the technology will become available in the public domain. This may also significantly impact on decisions made by the investor.

Know-how is a very important part of any technology. There is a balance between patents and know-how. While a patent provides the exclusive right, it may in some circumstances be beneficial to protect information as know-how rather than seeking its patent protection. In particular, new developments before the date on which patent applications are filed, when their

completion requires time, may be protected as know-how. Besides, developments not patentable due to their failure to meet the patentability criteria may still have commercial value for their rights holder when protected as know-how.

Trade-secret regime

As far as know-how is concerned, we note that unlike in many other countries, as a general rule which exists under Russian law rights over know-how do not arise until its owner introduces a trade-secret regime (or so-called "confidentiality regime"), with regard to such know-how. This regime involves a set of measures to be taken that is quite complicated and is, therefore, rarely complied with properly by companies. Recent changes to the Russian Civil Code relating to the IP rights, which are effective starting from 1 October 2014, allow any "reasonable" confidentiality measures undertaken by a know-how holder as sufficient for proving the rights to a know-how (but the trade-secret regime is provided as optional). However, the criteria for such "reasonability" are still uncertain. Accordingly, we would recommend following the general rule on a trade-secret regime until authoritative criteria are established by court practice.

Accordingly, the central risk normally identified in checking know-how is that because the statutory measures for applying the trade-secret regime are not complied with, the rights over know-how do not exist. Moreover, even if the investor wishes to use in Russia know-how created outside Russia, and is protected under a foreign law, the mandatory provisions of Russian law still require proper application of the

trade-secret regime for such know-how to be protected in Russia.

Confidentiality

The specifics of know-how under Russian law are that preservation of title over know-how does not always depend on the rights holder's will. Thus, the key test for the title over know-how is that the rights exist until information in question has not been disclosed to third parties. Accordingly, the main risk to title is that a disclosure of know-how to third parties may occur, for instance, without the knowledge of the rights holder.

Thus, the exclusive rights over know-how may be vulnerable if no proper steps to protect it under Russian law are taken. Besides, if a technology is disclosed in any public source anywhere in the world, including by publishing a patent application, then this information is no longer secret and the technology cannot enjoy risk-free protection in Russia as know-how. In this case, the risk is that any company will be able to use such a technology in Russia and the rights holder will most likely be unable to prevent them from doing this.

As a result, IP due diligence helps the investor to decide if it is appropriate to proceed with a particular technology-based project, and if so to estimate its value. The scope of due diligence depends on the specific project. An experienced lawyer may advise the investor on the best approach to due diligence for it, based on both the primary objective of asserting rights and the prospects for the further use of a technology, including the further sale of products which are manufactured using that technology, or in which it is used. ■

Overview of various strategies: pros and cons

Car fleets in Russia: lease vs purchase

The Russian fleet of passenger and light commercial vehicles amounts to some 41 million units, while corporate fleets make up about 6.1% or 2.5 million vehicles.

The larger portion of company cars today are owned by companies, with

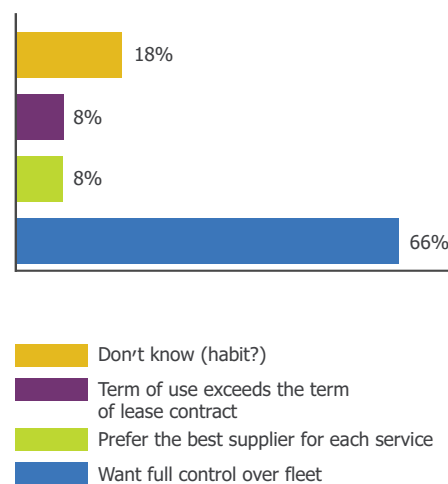


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Sergey, who was born in Moscow, holds a Master of Engineering degree from the Moscow Aviation University (1988) and a Professional Diploma in Management from the Open University of Great Britain (2001). He started his career as design engineer in the aircraft industry in 1988. In 1992–2001, he worked in management positions in FMCG and pharmaceutical companies. In 2001, he moved into the automotive finance industry, working as Managing Director at ROLF Leasing until its merger with Europlan. In 2005, he headed the start-up of ARVAL in Russia, bringing it to one of leading positions in the market. Since October 2012 Sergey works as the Managing Director of LeasePlan Russia.

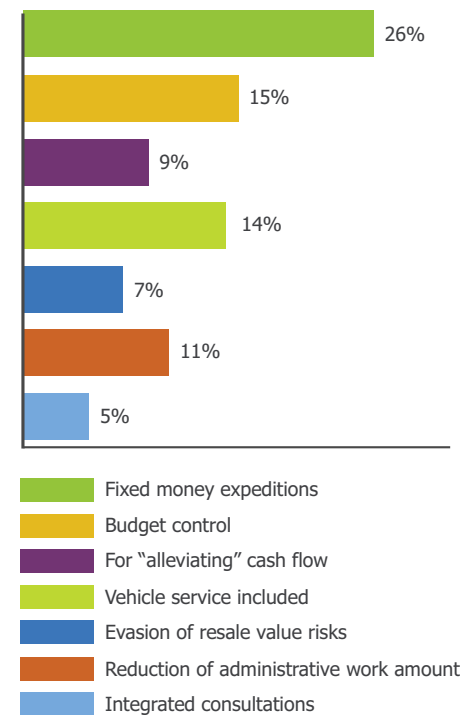
the share of finance lease of about 10% and operating lease slightly exceeding 1% (comparing to share of full service leasing of over 30% in the EU). Car allowances are rarely used as taxation makes them costly. Such methods of fleet building can be explained by history and habit, as purchase and ownership were the only options before 2000. Full service leasing appeared in the Russian market less than 10 years ago, reaching an awareness level of about 8%. It is presented by three global providers and a few local players. Finance leasing is growing at 5–10% per year, strongly supported by development in the SME segment. Full service leasing is growing at 15–20% per year, mainly in the corporate segment, while outright purchase is losing market share.

► Main motivation for choosing purchase and ownership



Why companies make the choices they do. Russian fleet managers give the following reasons:

► Main motivation for choosing operational leasing with full service



"Having full control over the fleet" originates from the strong emotional link of a person to a vehicle or fleet, the desire to possess, to own. Lack of knowledge about other possibilities helps.

What to expect in Russia? The total cost of ownership (TCO) of a vehicle in Russia is higher than in Europe or USA, the Economist Intelligence Unit and PricewaterhouseCoopers say. Why?

Vehicles are 15–25% more expensive because of custom duties of 25–35% of invoice price and higher logistical costs. Local production depends on imported parts and targets higher ROI.

The next important component is the interest rate, with Russian average annual rates of 12–15% being much higher than the European 4–5% and the American 2–3%.

Regular maintenance intervals are shorter in Russia (every 10,000–15,000 kms vs 20,000–40,000 kms in Europe) due to climate and roads conditions. The higher cost of spare parts (20–30% higher than Europe because of custom duties and logistics) pushes the TCO up further, even though it is partly compensated for by lower labour costs.

All the above certainly is reflected in insurance costs making insurance premiums 50–100% higher than European ones. Higher accident rates also make a contribution.

Finally, the enormous geographical size of the country, with more than 17 million sq. kilometres, the inefficiency of systems of paper-based local tax and accounting processes, and the level of service infrastructure development are all reflected in higher logistic, management and administrative costs.

Does this mean you can't afford a fleet in Russia? Not at all! You just need to take it all into account in your business model, define your fleet objectives and priorities, make accurate analysis and comparisons, and to decide which way to go.

But how to decide? What is the base for the decision? Cost and price? Comfort and convenience for drivers? Ecology? Availability of resources? Efficiency?

Answering these questions will give you a good base for the next steps and helps you to define your fleet strategy.

Now, buy or lease? What and how to compare? What to take into account and how to take it into account?

Let's take five fleet-related areas and put them onto the scales:

- Financing;
- Insurance;
- Repair, maintenance and tyres;
- Risks;
- Fleet management, administration and reporting.

Financing is the most important and, perhaps the most interesting part of the comparison.

As already noted, interest rates for the Russian rouble (RUR) and the Euro are very different. However, you should not just compare 4% and 12%. Let's go a bit deeper.

For a start, let's recall one rule of risk management: "Match currency of your cost to currency of your revenue. If mismatched, bear the risk and estimate its cost."

How to estimate the cost of FX risk in this case? And how to compare interest rates?

Let's assume:

- you have a loan in Euro, 4% interest rate;
- term of vehicle use is 36 month;
- your revenue is in RUR.

Assume that spot exchange rate is 49.0 RUR/Euro and the 3 years forward rate is 54.8 RUR/Euro. This means hedging the FX risk would cost you 11.8%.

Calculating effective interest rates for a 3 years loan in Euro, including FX risk, we get an annual interest rate of 12.2% on the real cost of funding.

Do lower interest rates make contracts in Euros more attractive? Yes, if we neglect FX risk; however, correct analysis of associated FX risk proves it is wrong. A contract in Euros is more attractive only if the Euro devaluates against the rouble by more than 10% in three years. The history of FX Euro/RUR rates suggests this is unlikely.

Certainly in a country like Russia, where the local currency demonstrates high volatility, it is worth taking FX risks into account. Look what happened at the end of 2013—early 2014: every cost evaluated in Euros (or USD) grew more than 12% just in three months.

The next important part of financing relates to the term of a loan and the corresponding interest rate. Short-term loans vs long-term loans. Is it correct to compare the cost of a three month loan to thirty-six month one?

Let's remember another rule of risk management: "Match maturity of loan to term of use of vehicle. If mismatched, bear the risk and estimate its cost."

Here we speak about the risk of availability of liquidity at the moment when you need refinancing, and the risk of the changing cost of this liquidity. This is applicable for either currency.

Basics? Yes, basics, but see how many companies neglect these basics!

The next part of our comparison is own funding vs funding from a leasing company.

Many companies and people working in Russia assume their own capital costs nothing. Are they right?

Imagine you are a shareholder of a company and your investment brings you a 20% return (ROI). You hear someone in the company say, "I buy a fleet because financing from my shareholders costs me nothing." Would you be happy if the company didn't want to pay you dividends?

In fact, the expectations of shareholders, expressed as objectives for ROI or ROE, are much higher than the interest rates of a leasing company. These expectations and objectives for Russia are usually higher than for Europe, as a reward for higher risk.

You could say, "Agreed. That is why I borrow money, but I do it at lower rates than leasing company proposed me."

Well, then I ask you, "What is the target structure of your Balance Sheet? What is your targeted debt-to-equity ratio?"

If you really manage your debt-to-equity ratio, you will use a "blend" of equity and debt to buy a fleet. In this case the cost of such blended funding should be calculated as weighted and must take into account the expensive equity part. Thus, a blend of 25% of capital at a cost of 20% and 75% of loans at interest rate of 7% gives the total interest rate of 10.25%. Leasing provides off-balance sheet financing which makes balance sheet management easier.

Another point to consider is the situation with capital expenditure in your organization. Leasing is an "allowance" when CAPEX is restricted. The negative side of leasing is that it increases your operational expenses.

You need to define your funding and risk strategies to make a correct "buy vs lease" comparison and decision.

What about insurance? Usually insurance coverage consists of three parts: Obligatory Third Part Liability (OSAGO), voluntary Third Part Liability, and Damage and Theft Liability (CASCO).

The obligatory TPL (OSAGO) is quite cheap and amounts in average to 10,000—12,000 RUR (200-250 Euros). The low coverage reflects the low premium and is limited to:

- 160,000 RUR (~3300 Euro) for life and health of each injured person,
- 160,000 RUR in total if property of several persons is damaged,
- 120,000 RUR (~2500 Euro) if property of one person is damaged.

Obligatory TPL (OSAGO) premium and coverage are both regulated by the law.

Due to the low coverage provided by OSAGO, companies usually extend it by adding voluntary Third Part Liability coverage where they are free to increase the coverage up to the required level.

As already said, insurance rates for damage and theft (CASCO) in Russia are higher than in Europe. The premium is calculated on a base of vehicle cost and expressed as a percentage of the price of the vehicle.

Comparing insurance costs in the cases of purchase or lease we can see that OSAGO part is exactly the same, due to regulations, while CASCO could differ. Usually you can get the best of both options and utilize premiums of your company or lessor's, whichever is lower.

As a conclusion, the insurance cost is same or better when car is leased.

Next come repair, maintenance and tyres.

Let's start from availability of data. Ensure all your costs are booked and allocated properly to the fleet but not to employees' personal expenses or departmental operating expenses. This will ensure you have the full picture. How can it be that cost is allocated in to the wrong article or cost centre? Here is an example. An employee based in a remote location makes a car repair and reports it as a personal cost. This expense is charged to the employee's or department's expense but not to the fleet. This is only one example from hundreds.

After you have recorded and properly allocated all the costs, you start the analysis. How to estimate repair costs over the full life of the car? Take a sample of vehicles which are not in use anymore because the term and mileage have expired. That gives you full life-cycle cost. Don't take your fleet expenses for the last year (or few years) divided by the number of cars in fleet. This gives you half of the picture, as the fleet consists of vehicles of different ages (from new to the maximum age allowed by car policy) and of vehicles of different mileages (from zero to the maximum allowed by car policy). A leasing company will always give you a proposal assuming full age and full mileage as per your car policy.

We made two steps and got two figures: the full cost of repair, maintenance and tyres and budget proposed by leasing company. Now we have to bring these figures up to present value. Why?

Because your statistics reflects the past while the proposal of the leasing company reflects the future. One of key factor here is inflation, which in Russia is about 6% a year.

Now the risk part is coming. Do you want to bear the risk of breakdown and associated expenses or to outsource it to the leasing company? Do you prefer having flat and predictable budgets or managing volatility and zigzag cash flow? You decide.

Certainly we also have to take into account the scale effect and purchase power in every geographical location.

We mentioned the word risk; let's discover a bit more about risks.

There are two major technical risks associated with any vehicle: the risk of its future value (residual value) and the risk of break-down.

Technical risks depend on so many factors and defining them is too complicated try here. You need to decide if you want to become an expert in the technical risk area and bear these risks or you want to outsource them.

Other risks are country risk, political, economic, market, geographical, legal, tax, social, administrative, ecological, process, technological, finance, inflation, currency exchange, liquidity, cost of liquidity, credit, supplier and operational risks.

Probably it is too much, but in a country with such a vast territory, uneven level of development and cultural differences, operational risks are certainly of huge importance. They apply to all aspects of the fleet: procurement, sourcing, order, delivery, registration, logistics, maintenance



and repair, sales of used vehicle, invoice management, payments, suppliers, etc.

In the case of leasing, you have another very important risk, one associated with your supplier, its processes, quality of its services, its capabilities and capacities. You are dependent on your supplier.

The final part of our comparison is comparison of Fleet Management and Administrative costs. In fact it is a comparison of efficiency: internal vs external.

How to estimate or to understand what resources are involved in fleet management directly and indirectly? Resources directly involved in fleet management usually are fleet managers, fleet coordinators, fleet assistants, drivers and technical specialists based in the local HQ and/or regions. Don't forget to include the full cost of these employees, not just their salaries.

Resources involved in fleet management indirectly aren't always obvious, but include procurement, finance, controlling, reporting, accounting, tax, legal, compliance, HR, management of a company and global functions.

What share of their activity should be allocated to fleet issues? What is the real cost? This can be difficult to calculate. One example: every car generates at least 8—9 events per year. Each event generates an invoice. Each invoice, according to Russian Accounting Standards, requires from 4 to 6 documents. Each document must be in two hard copies, signed, sealed, stored. Cost of one invoice proceeding is estimated at 570—780 RUR or 12—16 Euro.

This is not a problem for the leasing company as all of its staff are dedicated to fleet management. All management and administrative costs are included in the leasing proposal.

Finally, some other areas to take into account and to compare, less quantitative and more qualitative: flexibility, scalability, convenience and comfort for drivers, convenience and confidence for company, quality of services and ecology.

You make your choice based on the balance of your business needs and available resources, the balance between cost and convenience, the balance between efficiency and habit. ■

Entering Russia — the JV ‘to be or not to be’

Introduction

As Prince Hamlet so elegantly puts it in Shakespeare’s *The Tragedy of Hamlet, Prince of Denmark*: “To be or not to be, that is the question”, this is also the question that many companies ask themselves when considering entering the Russian market by means of a joint venture.

A joint venture can take the form of a contractual arrangement in which the

rights and obligations of the parties are spelt out. Alternatively, the joint venture may be structured through a corporate vehicle where the rights and obligations of the shareholders (the joint venture partners) are regulated by a shareholders’ agreement. For the purpose of this article, when using the term “joint venture”, we mean a contractual arrangement where two or more shareholders have agreed to execute a particular business undertaking structured in the form of a corporate vehicle.

Many stories can be told about Russia-related joint ventures and long essays can be written about the pros and cons of joint ventures involving Russia. This article does not purport to be exhaustive on the subject, but aims simply to give some guidance.

Why a joint venture — can’t we do it on our own?

An answer many lawyers give when being asked a legal question is: “It depends on the circumstances.” Although such an answer sometimes creates justifiable frustration among clients, it is particularly true when a lawyer is asked to give a recommendation on whether a joint venture should be established and, if so, how it should be structured. Generally, the following pros and cons can be mentioned about a joint venture:

Pros

- Sharing the cost of the set-up — the cost of incorporation, notaris-

ation, lawyers etc is larger than I can afford and I need someone to share it with.

- Improving the financial resources for the joint venture going forward — undoubtedly, two pockets are larger than one.
- Reducing the risk — if it all goes bad, we only owe X % of the venture.
- Local management style and cultural differences — it’s Russia, so let’s have a Russian partner with a foot on the ground.
- Vital domestic connections — connections play an important role in countries like Russia.

Cons

- Reduced profit — your equity stake (and profit) will remain the same regardless of whether you are the most active party and take most steps to increase the productivity of the joint venture.
- Reduced level of control — it is always dangerous not to have control over the business (increased costs, law suits, undesired outcome of the quality of the product or project etc).
- Liability for doubtful business methods of the partner running the joint venture on the ground — anti-corruption legislation and regulation have a global reach and you do not want to be part of a joint venture that is involved in bribery or other illegal activity.
- Legal disputes with your partners — what happens if you suddenly disagree with your joint venture partner?



FREDRIK SVENSSON

Partner, Mannheimer Swartling,
Sweden’s representative, AEB
Council of National Representation

Fredrik is resident partner in Moscow and has devoted a substantial part of his career working on matters relating to Russia, Ukraine (and other CIS countries) and the Baltic countries. His specialisation is general transactional work, joint ventures and compliance-related questions. He is often engaged early in the process and regularly takes part in the strategic discussions that lead to investment or financing. He is today an advisor to a number of large Nordic and European companies and banks and is often engaged as a speaker regarding investments, financings and corporate governance issues relating to Russia and the CIS.

Now, what about the Russian specifics?

If you are an industrial company with large resources, then we would opt for a wholly-owned subsidiary in Russia rather than a joint venture. You can invest in employees with relevant experience and networks, you can grow organically, and, most importantly, you are in control of your legal structure in Russia and are not running the risk of a shareholders' battle.

The above applies also to companies seeking to set up sales companies in Russia (which import goods and then sell them on the Russian market). There is no reason, at least in our view, to be charmed by someone who claims to possess indispensable contacts, or friends in so-called high places, and in exchange for "connections" wants an equity stake.

In some industry areas — particularly in the oil & gas sector — a joint venture may de facto be a necessity since the industry is dominated by a number of players who possess the necessary licenses and permits (which are difficult, and in some cases legally impossible, to obtain on your own). Furthermore, in some other contexts, it could also be a good fit to form a joint venture. One example is if a Russian raw materials producer enters into a joint venture with a technically skilled foreign company in order to produce certain goods in Russia.

One of the most important things to consider when entering into a Russia-related (or actually any) joint venture is to assess "who are you going to bed with". It is always wise, in particular when it comes to Russia, to do a detailed background check on the people you are entering into the joint

venture with. There are a number of well-respected service firms in Moscow that can assist with this.

It's decided — we'll go for a joint venture. So what do we do now?

One of the first questions you should ask yourself is what level of ambition you have with the joint venture. This may be illustrated by flying an airplane: (a) do you wish to be the pilot and thus have full control of where you are going, (b) do you wish to be the co-pilot and know what is going on and to have some means of influence, or (c) do you wish to sit as a passenger in the airplane with no possibility of making any decisions or having any influence?

Another important question is to select a jurisdiction which is "joint venture friendly". Some of the driving (legal) factors when selecting a suitable jurisdiction for a joint venture are:

- Developed, flexible and predictable legislation;
- Corporate governance considerations;
- Insignificant currency control rules;
- A favourable tax treaty between the two relevant countries;
- An internationally-recognised venue for dispute resolution.

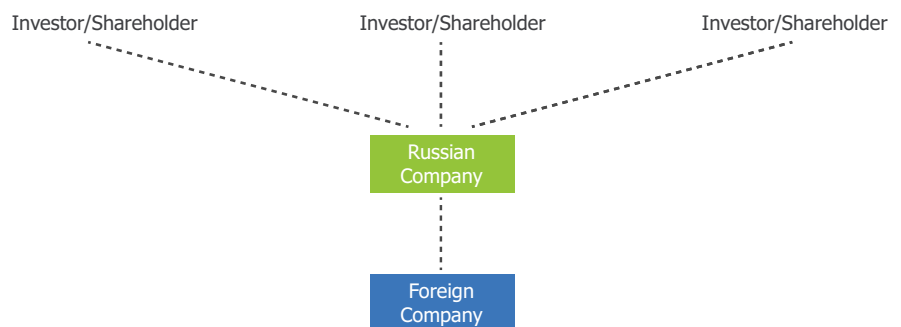
Other (perhaps less legal but more "soft") factors when selecting a suitable jurisdiction are for example:

- The political and economic situation;
- The legal and accounting infrastructure;
- A reliable banking system;
- Language.

Russia is not (at least not yet) regarded as a "joint venture friendly" country. For example, shareholders' agreements were, until 2009, not recognised by Russian law. This means that the vast majority of all Russia-related joint ventures were established abroad where the joint venture company then owned 100% of the Russian operating subsidiary.

Popular jurisdictions for Russia-related joint venture companies are typically Cyprus, the Netherlands, Luxembourg, Austria and Sweden. All these countries offer favourable tax treaties with Russia. Although popular with certain investors, we would generally not advise setting up joint ventures in Bermuda, the British Virgin Islands, Seychelles, the Isle of Man, etc., since these jurisdictions are on the black list of the Russian Ministry of Finance.

One of the main reasons for selecting a non-Russian joint venture company is also that you can select another law than Russian law on the shareholders' agreement. Although Russian law now allows for shareholders' agreements, it is unclear whether certain provisions which are typically found in a sharehold-





ers' agreement are enforceable under Russian law. For example:

- **Governing law and dispute resolution:** A shareholders' agreement involving a Russian joint venture company needs to be governed by Russian law, and any disputes between the shareholders arising out of, or in connection with, the agreement needs to be referred to a Russian commercial court.
- **Drag along and tag along:** Russian law has not developed the concepts of drag along and tag along, and it is unclear how a Russian court would treat such.
- **Voting arrangements:** Voting arrangements in a shareholders' agreement (e.g. that a resolution needs to be passed by a certain majority) that are contrary to mandatory provisions in Russian law, or the charter of the joint venture company, are unenforceable.
- **Actions taken by the joint venture company:** Russian law does not specifically allow for the joint venture company to be a party to the shareholders' agreement and thus the terms of the shareholders' agreement will not be binding on it. This will lead to the effect that any actions taken

by the joint venture company in violation of the shareholders' agreement cannot be invalidated on the basis of such violation provided that the third party contracting with the joint venture company is acting in good faith.

- **Non-competition undertaking:** An undertaking by a party to a shareholders' agreement not to compete with the joint venture company (or any other shareholder) is unlikely to be enforceable in Russia and may also have implications from a Russian competition law point of view.
- **Indemnities:** The concept of "indemnity" is not recognised under Russian law and thus not distinguishable from a right to damages under Russian law. There is no assurance therefore that an "indemnity" will give any greater right than would arise under a normal claim for damages.
- **Penalties:** A contractual arrangement to pay, e.g. EUR 5m in case of breach of a confidentiality provision in a shareholders' agreement, can be substantially reduced by a Russian court.

Russian law and Russian court practice deviate in this respect from many other legal systems where the above clauses would be recognised and enforceable. A joint venture should always be regulated by a detailed shareholders'

agreement drafted by a legal counsel well-accustomed to the particularities of Russia.

Looking in the crystal ball — are structures with a foreign joint venture company holding 100% of the Russian company about to change?

The structure described in this article with a foreign joint venture company holding 100% of the Russian company is, at the time of writing, the most common on the Russian market and the preferred structure among investors. But might things be about to change when it comes to Russia-related joint venture structures?

Yes — most likely. What is being discussed intensively in Russia today is so-called "de-offshoreisation". This is a drive from the Russian government which seeks to create more transparent business structures on the Russian market. This may have an effect on how joint ventures relating to Russia will be structured in the future. For example, if you are to enter into a joint venture with a Russian state-owned company, you may have to establish the joint venture company in Russia and thus be a shareholder in a Russian company, rather than e.g. in a Cypriot entity owning 100% of the shares in a Russian company. There are also discussions about the introduction of rules for so-called "Controlled Foreign Companies" (CFC rules) in the Russian Tax Code which will make it less tax-efficient to have non-Russian holding structures.

The development and potential effects of the "de-offshoreisation" process and the CFC rules is perhaps something for next year's publication!*

* With the assistance from Evgeniy Tarasov, Senior Associate.

Outsourcing vs hiring. It's all about finding the right provider

Starting a business in Russia can be pretty expensive and risky. Although the Russian market offers foreign companies many opportunities, it remains a complicated one, characterized by strong state regulations, a lack of well-educated professionals (especially with an international background) and a rapidly changing business environment. These are good reasons for any

foreign company contemplating entering the Russian market to ask itself whether it should hire its key service personnel (lawyers, accountants and IT personnel) or outsource these tasks.

The question of whether outsourcing is more advantageous than a hiring is not a simple one. In theory, outsourcing could even look more expensive than hiring one's own staff, as outsourcing hourly rates, for example for well educated and experienced lawyers in Moscow, can easily reach €100 or more. But such prices are not exorbitant if one compares them to the cost of hiring in-house, full-time staff. An international company establishing its own representative office or a subsidiary in Moscow urgently needs well-educated professionals who speak several languages and who are skilled in very specific areas. As a typical salary for such people in Moscow easily reaches levels of about €3—4,000 nett per month, plus another €1,500—2,000 in taxes and state fees, hiring an in-house lawyer, for example, can be pretty expensive.

As long as outsourcing bills do not exceed this price, it is still a cheaper option. Moreover, if a company outsources legal services, it has access to large pools of lawyers with very different competences, and does not need to rely only on one or two of its own lawyers, who cannot be expert in all areas. When outsourcing, a company gets full access to a wide range of highly experienced lawyers who normally stay in close contact with many ac-

countants, and tax and financial experts, as they are able to efficiently exchange opinions on every problem, which few in-house lawyers can.

What is very important for companies is that outsourcing their legal and other services significantly reduces the financial risks of making wrong decisions, as reputable outsourcing providers assume liability for their mistakes. In particular, smaller and middle-size companies entering the Russian market should think seriously about outsourcing their legal, financial and IT functions. At RUSSIA CONSULTING, we know many mid-size companies who outsource all their services, having only the General Director of a subsidiary as a hired, in-house professional. This works very well especially for the first two or three years, allowing a company to significantly cut its costs and to focus on business development and core competencies. This leaves technical issues to the outsourcing provider, and frees the company from the chores of creating their own complicated legal, financial/tax and IT structures.

But even bigger companies can outsource legal issues when confronted with specialist topics like M&A regulations or antimonopoly laws. These subjects are not familiar to every lawyer, and even a good in-house legal department may need support from an outsourcing provider when having to deal with the complicated Russian regulatory environment.



SERGEJ SUMLENNY
Head of Public Relations,
RUSSIA CONSULTING

Sergej Sumlenny is Head of Public Relations at RUSSIA CONSULTING, a leader in the Russian consulting market with over 400 employees in Russia, Ukraine, Kazakhstan, Belarus, Poland and Germany. From 2006 to 2013, Sergej Sumlenny worked as Germany Correspondent and Chief of the Berlin Bureau at the leading Russian business weekly, *Expert*. Before that, he was Chief Editor of the daily news programme at the Russian business TV station, RBC, and was a producer at the Moscow bureau of the German TV and radio station, ARD. Sumlenny has a degree in political sciences.



Another aspect that makes outsourcing very attractive in Russia is the Russian labour law which permits employees to leave their company within two weeks after giving notice. What makes it even worse is the fact that there is no legal prohibition on employees beginning work with a direct competitor immediately after leaving his or her former company. Actually, it is even not prohibited to work part-time for two competing companies. Such regulations make companies very vulnerable to the loss of professional staff who are crucial for the business as they can leave suddenly, disturbing the business processes dramatically. From this point of view, outsourcing is a much more reliable and secure way to run your business, especially as outsourcing providers must comply with trade secrets legislation.

Of course before outsourcing its legal, financial or IT services, a company needs to be sure it has found the right provider. Not every provider offers every outsourcing service and not every provider is reliable. As in every market, one can find cheaper offers and more expensive ones. The problem one can encounter when cooperating with a cheaper provider is the need to supervise the provider's activities. Moreover, you cannot always be sure if the cheaper outsourcer will meet strict compliance procedures, has a secure IT system and can really prevent security breaches. In other words, outsourcing to a cheaper provider requires several in-house professionals to check and control the work of the outsourcing provider. This

makes the cheaper outsourcing provider less attractive.

It is good news for smaller and mid-size companies coming to Russia that the market has turned out to be significantly more customer-friendly than it was six or seven years ago. Before 2008, there were not many providers in Russia offering outsourcing services, and they preferred to focus on projects with a specific duration rather than on day-to-day business. This made the market very hard for foreign, mid-size companies who wanted to outsource their day-to-day work because providers simply declined to cooperate with them. After many projects were aborted during the financial crisis of 2008/2009, providers became much more cooperative and are now willing to

work with smaller clients. Nowadays, the Russian market has turned into a normal one with nearly equal supply and demand.

Together with the outsourcing of legal tasks, the outsourcing of financial services remains an attractive area. As Russian financial laws are very strict, and technically subordinate to tax laws, Russian in-house staff working on financial issues can often be an obstacle for business development. For example, a Russian, in-house employee, working in a financial department, may decline to execute certain transactions as he or she believes that it would create unnecessary tax complications. This is a not rare situation, as the in-house financial department tries to literally dictate to the General Director

what contracts should be signed and in which form, just to make their own job "easier" — as they believe.

For this reason, a company should decide whether it wants to hire expensive financial staff with international experience and knowledge of foreign languages or just outsource these tasks to experienced providers. A good provider can offer experts who are competent in dealing with the typical challenges that foreign companies face in Russia. At the same time, an outsourcing provider may report directly to the head office in Europe, helping the management to maintain control over their financial situation within a subsidiary or a company's representative office. This could be extremely important in the Russian market as some in-house employees

in the financial department may not inform the head office about the whole situation or even try to deliver incomplete or false information, trying, as they believe, to "protect" the subsidiary from external influences.

What is very important regarding financial and tax outsourcing is that a company with only one in-house financial expert can be in serious trouble if that person falls ill, goes on vacation or simply quits the company. When outsourcing financial services, a company not only neutralizes these risks, but also cuts costs for software licenses, software maintenance and seminars for professional staff. A competent and serious outsourcing provider regularly sends their employees to seminars to improve their skills and keep

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their knowledge up-to-date. On the other hand, the single in-house professional will seldom have enough time for this and the risk of using outdated knowledge and processes grows.

Outsourcing financial services also cuts IT security costs, such as the cost of backing up data and taking other security measures. A single in-house financial expert seldom works on a fully backed-up and secured notebook. But, that is customary for any good outsourcing provider. The loss of a computer with sensitive data on it can be a real disaster if you are working with a single, in-house professional.

provinces, to find an advertisement promising financial/tax outsourcing for €150 or €200 for an entire package of quarterly reports. In every case, a company should decide whether this offer is a reliable one. Unreliable companies often will not properly prepare your balance sheet, and will not guarantee to send your papers to the tax office — and might even not inform you of the fact.

IT is another common area for outsourcing. As with legal or financial outsourcing, IT outsourcing is mostly used by smaller companies, or when the tasks are either too complicated or too routine

On the other hand, IT outsourcing requires complete trust in your provider, as its programmers will have full access to all your data. A system administrator can access your company's bills, your e-mails, your internal documents, your employees' salary data, your financial reports and even your customer data — without you even noticing it. You must be prepared to trust your IT outsourcing provider, or to forget about the idea of outsourcing your IT. Of course it is always a question of preference, whether a company wants to hire a less-skilled, in-house system administrator whom they can control or to outsource the IT to a professional company they trust. Maybe the best solution would be outsourcing to a provider on whom you first conduct a full security check using an independent auditing company.

In the end, the decision to outsource legal, financial or IT services is always an economic one. If your outsourcing bills will be lower than the cost of hiring in-house staff, you will probably decide to outsource. This option is especially attractive for the smaller and mid-size companies that are being established in the Russian market, as outsourcing allows them to have full access to a large pool of highly-qualified professionals that they could hardly hire for a full-time position. Outsourcing significantly reduces the risk of losing your key personnel during vacations, because of illness or because they leave your company. Outsourcing also increases quality and control, as good outsourcers apply sophisticated control measures and have very strict compliance guidelines. Of course, like any significant business decision, outsourcing requires full trust in your provider — but you could say the same about hiring a professional in Russia. ■

What is very important regarding financial and tax outsourcing is that a company with only one in-house financial expert can be in serious trouble if that person falls ill, goes on vacation or simply quits the company.

Such a situation is much less likely when a company works with a reliable outsourcer. What is also very important in Russia is that an in-house financial expert might disclose sensitive information such as payroll data to his friends within the company and seriously damage team spirit, a nearly impossible situation if you work with an outsourcer, as no private relationships between the accountant and the company's staff exists.

As with legal outsourcing, a company should be careful in deciding what outsourcing provider it should rely on. It is not uncommon, especially in the Russian

and simple. In a typical situation, an IT outsourcer oversees for a wide range of services, including e-mail, financial software, call centre technology and other IT solutions. The goal of outsourcing is most visible in IT outsourcing. A company has access to programmers and system administrators of a very high level, but which cost much less than an in-house system administrator in a mid-size company which needs only a few hours per month of IT support at that level. In the end, this creates huge savings for the company, allowing it to have access to a high level of professional services for much less money.

Part III. Regional Aspects of Investing in Russia

Krasnodar Region is the region of mega-projects and a comfortable business climate



ALEXEY SHEYAN

Minister for Strategic Development, Investments and Foreign Economic Activity of the Krasnodar region

Mr Sheyan graduated from the Kuban State University with the qualification "Lawyer" in 1998 and the qualification "Economist" in 2001. In 2007, Alexey was awarded the degree of Candidate of Legal Sciences.

In May 2014, Mr Sheyan was appointed Minister for Strategic Development, Investments and Foreign Economic Activity of the Krasnodar region.

Earlier he was the Head of the Department of the Krasnodar region which was tasked with implementing the powers in preparation of the Olympic Winter Games in 2014, worked in the federal government and judicial authority of the Russian Federation.

One can hardly find a spot in the world where people have not heard about Krasnodar Region and the city of Sochi, where the XXII Winter Olympics and XI Paralympics took place.

Implementation of a large-scale mega-project, the Olympic Games in Sochi, was unique in the history of modern Russia. It has become an additional powerful impulse to the socio-economic development of the Krasnodar Region, as well as a vector for the further dynamic development of the region.

It is Krasnodar Region that, within the next years, will become a platform for implementation of a number of landmark projects in Russia.

Primarily, this includes efficient use of the Olympic heritage.

The ambitious project of building a racing track for Formula1 is also being implemented in Sochi. The first Russian GrandPrix for Formula1 will be held on the track in Sochi Olympic Park on 12 October 2014.

Another landmark project in preparation is the World Football Championships in 2018. The Krasnodar Region is represented by the city of Sochi, one of 11 Russian cities where the games will take place.

As a result of that, Sochi will obtain the status of a resort and a world-level sports centre.

Krasnodar Region is one of the leaders of investment development among the regions of Russia

In recent years Krasnodar Region has confidently maintained its positions in the first three most attractive regions of Russia in which to invest.

National rating agency Expert RA in its "Rating of investment attractiveness of regions of Russia-2013" included Krasnodar Region (along with Moscow, the Moscow Region and the Republic of Tatarstan) in the group of leaders which combine minimum risks for investors with maximum potential for capital in-

Krasnodar Region

Area: 76 thousand sq.km

It is the southern-most region of Russia, bounded by the warm Black and Azov Seas.

It borders on Rostov Region, Stavropol Region and Abkhazia.

The transportation infrastructure includes: 9 seaports, 5 airports (including 3 international ones), federal railway and motor routes

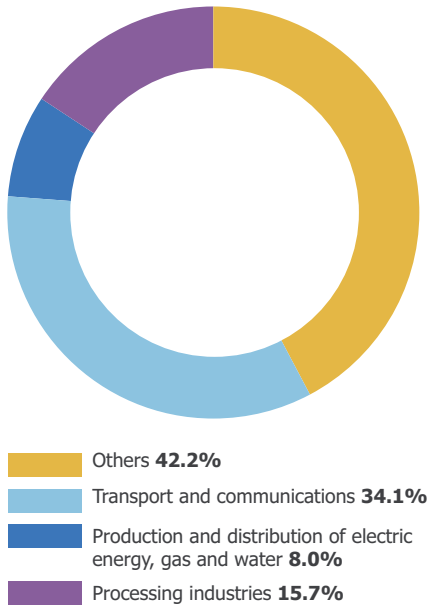
The length of beaches is more than 1,000 km

Labour resources: population is more than 5 million of which 50% is economically active

Leading industries are construction, transportation, agro-industrial, fuel, energy sectors, resorts and tourism

Natural resources: oil, gas, natural minerals, fresh water reserves, finewood, 3.9 million hectares of fertile black soil, 18 resorts and recreational areas.

► **The most attractive branches for investments based on results of 2013**



vestment. In 2013 alone the volume of investments in the regional economy accounted for more than RUR 907 billion with the growth rate of more than 107 percent. For its part, foreign investments in 2013 accounted for more than USD 1 billion.

agriculture were the most attractive industries for investments based on the results of 2013.

Currently there are about 800 enterprises in Krasnodar Region involving companies from more than 70 coun-

PricewaterhouseCoopers and Ernst & Young, world leaders in consultancy services, are in active cooperation with our region.

The investment achievements of Krasnodar Region are in many respects the result of a consistent investment policy, the mechanism of implementation of investment projects and a well-organized system of state support of investors established by legislation.

General Director of the plant OOO CLAAS Ralph Bendish:

Back in 2000, the CLAAS company decided to build a plant to produce agricultural machinery in Russia. From the very beginning, I was involved in the process of selection of the region for future production. The modern investment approach of the Krasnodar Region Administration involves the attraction of foreign investment and, of course, that influenced my decision. Last year, we started the project of the plant extension with an investment about 6 billion roubles. This points to the fact that we consider our cooperation with the regional administration to be very positive.

Transportation and communication, processing industries, production and distribution of electric energy, gas and water, as well as healthcare, rendering of social services and development of

tries. The strategic partners of the region are world-famous firms such as Knauf, Claas, Philip Morris, Nestle, Bonduelle, Cargill, Lafarge, Anadolu Cam, Metro and Auchan.

The city of Krasnodar

the administrative centre of Krasnodar Region
It is located on the bank of Kuban River, 1,342 km from Moscow
Area: 841.4 sq. m

The transportation infrastructure includes: Krasnodar international airport, Krasnodar-1 railway station (the largest railway station of the North-Caucasus Railway), motor roads of federal and regional importance M4 "Don", A-146 "Krasnodar-Novorossiysk", R-268 "Krasnodar-Yeisk"

Labour resources: population is more than 871,000 of whom 442,000 are economically active

Leading industries are construction, agriculture and the consumer sphere

The main natural resources: construction materials, curative natural mineral waters.



The region possesses a sound set of state incentives. Those investors who have taken a decision to work in the region can make a claim for benefits.

Investment vector

Industry, construction and energy complexes; information and communication technology fields and also agro industrial, transport, resort and tourist complexes are the basis of productive power of the Krasnodar Region.

The last three branches (agro industrial, transport, resort and tourist complexes) answer the priorities of social and economic development of Russia and determine the special status of the Krasnodar Region in the economy of the country.

The strategy of socio-economic development of the Krasnodar region till 2020 involves further economic structure diversification.

Regional authorities will make a special focus on industry, energy, transport, information and communication infra-

structure development, and also development of building complex, process industries and tertiary activity.

The strategic aim of the Krasnodar Region development is realization of political, geostrategic and social-economic priorities of Russian Federation in the south of the country.

There are also plans to implement such large investment projects as the construction of a dry-cargo zone at Taman Seaport, the development of Novorossiysk transport hub, the construction of the South Stream main pipeline, the construction of a bypass round the Krasnodar railway junction and the creation of an alpine climatic resort in Lagonaki.

On the whole, our region is ready to offer more than 1800 investment proposals to potential partners virtually in all spheres of the regional economy.

For the maximum convenience of investors this database is available in free access in Russian and English on the

website "Investments and investment projects of Krasnodar Region", at www.investkuban.ru.

Indeed, the development strategy of the Krasnodar Region is an up-to-date document, which is always being improved, depending on world-wide and Russian economic trends. One of the main platforms for discussing actual directions of economic development is the International Investment Forum "Sochi", which has taken place annually since 2002.

In 2014, the Forum will be held from September 18 to 21. The main themes of discussion are the new regional policy in present-day conditions.

Krasnodar Region is open for cooperation with Russian and foreign partners. We are ready to consider any methods for attracting capital, advanced technologies and managerial experience, and can guarantee the most favourable regime for implementation of investment projects. ■

Siberia — it's near and it's prosperous

On 14 August, 2014 Tyumen region celebrated its 70th anniversary. Today there is a construction boom, agricultural expansion and industrial production growth. The Region has changed from being the “capital of villages” to one of the main points of economic growth in Russia.



VADIM SHUMKOV

Deputy Governor, Director of the Department of Investment Policy and State Support of Entrepreneurship of the Tyumen region

Born on in the Kurgan region, Vadim graduated as a lawyer in 1996 from the Tomsk State University. He had already started his career in 1994 as an economist at Tyumenprofbank, in Nefteyugansk. In 2004 he joined the Tyumen region Administration as Deputy Director of the Strategy Development Department. From 2006 to 2012, he worked as Director of the Department of Investment Policy and State Support of Entrepreneurship of the Tyumen region. Since then he has been Deputy Governor of the Tyumen region, and Director of the Department of Investment Policy and State Support of Entrepreneurship of the Tyumen region.

About the region

The Tyumen region has an area of 160,100 square kms, and a population of 1.4 million. The population growth in 2013 was about 30,000 people. The capital of the region is the city of Tyumen, with a population of about 700,000.

The Tyumen region is located at the intersection of major transport routes, including the Trans-Siberian Railway and federal highways, going from west to east and connecting the regions of European Russia and the Urals, Siberia and the Far East, and, from north to south, linking north autonomous regions (Yamal and Khanty-Mansiysk), which are major

Russian oil and gas areas, with other regions of Russia, and providing access to Central Asian countries. In the south the region has a 170 km border with the Republic of Kazakhstan.

There is an international airport, called Roshino, in Tyumen. It has direct international flights to Munich, as well as 9 daily flights to Moscow, three of which are operated by Aeroflot.

About the regional economy

The GRP of the Tyumen region is growing by 7—10% per year. From 2006 to 2013 the GRP in absolute figures almost doubled. The industrial production index for the last





4 years has risen by an average of 19% per year. Over seven years (2006 to 2013), the index of industrial production also doubled. According to official statistics, from 2006 to 2013 the number of small and medium-sized enterprises also doubled.

The main reason for such high growth rates is the active work of the government of the region in developing industry and entrepreneurship, as well as boosting investment.

The main tools for encouraging investment are:

- complex and systemic tax benefits;

- subsidies, including state support in three most important directions for investors: interest rate subsidies on loans taken for new enterprises and equipment; subsidies for the cost of purchase of new production equipment, subsidies for expenses on infrastructure for industrial enterprises;
- complex administrative support for investors, including simplification and cost reduction procedures associated with the allocation of municipal sites, engineering infrastructure, and obtaining construction permits and commissioning certificates. Help is also provided to investors for staff selection and training, and solving any other problems within the com-

petence of the government of the region.

At the present moment, the "portfolio" of the regional government includes 287 investment projects with a total investment of 1.3 billion roubles. As a result of these projects, 33,816 jobs will be created.

So, for example, in the second half of 2013 and the first half of 2014, 21 new large-scale production plants were opened. There will be 4,000 new high-skill jobs created by these factories alone. All these projects have received comprehensive state support (tax benefits, subsidies, administrative support).

Five of these 21 projects are being implemented by companies with foreign capital: Baker Hughes, Schattdecor, DynaEnergetics, Knauf Insulation, MC-Bauchemie.

One of the CEOs of these companies, Wilhelm Sonnenberg, who is the General Manager of DynaEnergetics CIS, explained the choice of the Tyumen region as the location for the company's plant: "It's no secret that Tyumen is the oil capital of the Russian Federation, so we considered Tyumen

new 15 large-scale industrial projects starts in 2014.

It should be noted that the most actively developing industries of the regional economy are:

- hydrocarbons deep conversion;
- petrochemical industry;
- oil-and-gas machine building;
- agriculture and food industry;
- production of construction materials;
- wood-working industry;
- property development;
- tourism and recreation.

According to our forecasts, the economy of the Tyumen region has a good chance to double its indicators again between 2014 and 2020. And your business has a chance to grow with us.

as the first place to put our plant. Another important factor was the transport criteria, since the geography of our consumers is quite extensive."

At the moment, a few dozen big international companies work in the Tyumen region: Schlumberger, BENTEC Drilling & Oilfield Systems, Halliburton, KCA Deutag, Aushan, Leroy Merlin, Metro Cash & Carry, McDonald's, Air Liquide, KFC, Accor Group and others.

Today, the Government of the region has successfully negotiated with a number of large international companies about new investment projects in the region. The implementation of

About the practice of applying the mechanism of support of investment projects in the Tyumen region

Regulation of investment projects on the principle of "one window" was developed and adopted by the Government of the region (Decree of the Government of the Tyumen region from 21.02.2013 №248, "Approval of the Regulations of complex support for investment projects, implemented and (or) to be implemented in the Tyumen region").

The regulation lays down the terms and sequence of actions in order to assist investors with registration of

sites, obtaining permits, connection to engineering communications, cooperation with federal and regional authorities, local authorities and resource providers.

Support systems for investment projects have already proved their efficiency. For example, the CFO of Schattdecor AG Harald Purainer described the practice of project support in the Tyumen region: "Nowhere in the world have we seen such a professionally organized environment for investors. From the beginning, we were provided with easy access to the administration and department of investment policy. The Governor of the Tyumen region, Mr Yakushev, repeatedly found time to meet with us and regularly expressed interested in our situation, although we have just 70 employees and a total investment of only 15 million EUR, which represents a very small company."

In July 2013 an agreement on cooperation in improvement in the local investment and business climate between the Government of the Tyumen region, the municipal administrations and resource providers was signed. This agreement is another step forward in improving the efficiency of comprehensive support for investment projects in the region.

About labour

In the Tyumen region there are:

- 9 state universities, 9 branches of universities of Moscow, Yekaterinburg, Novosibirsk (about 84 thousand students);
- 19 institutes of professional secondary-level education (30 thousand students).



There were close links with all investors and training of specialists during project implementation in the Tyumen region — today a “turn-key” labour training system has been introduced.

Tyumen Region in the ratings:

- 1) 1st place on the growth of industrial production in Russia. In five years, the volume of industrial production doubled; the average annual growth rate was 19%.
- 2) Rating of the happiest cities in Russia. 1st place according to the survey of recruitment web-site Superjob.ru in 2013. Research Center found in a survey of residents of Russian cities that residents of Ty-

men are more than other Russians satisfied with life in their native city: 88% of the population are fully satisfied.

- 3) In 2010, the Tyumen region took 2nd place in Russia after Moscow in the human development index (from a report drawn up in accordance with the United Nations Development Programme in the Russian Federation).
- 4) In 2013, Tyumen region took the 2nd place among the subjects of the Russian Federation for effectiveness of its government authorities.
- 5) According to one of the leading consulting companies in the world, McKinsey & Company, Tyumen will be among the top 600 cities in the world in 2025, which will together account

for 70% of global GDP. There were 5 Russian cities listed in the City 600 survey: Moscow, St. Petersburg, Yekaterinburg, Krasnoyarsk and Tyumen.

It should be noted that the Government of the Tyumen region is ready for any new project, not only in the industries already mentioned but in others according to the investor’s choice.

According to our forecasts, the economy of the Tyumen region has a good chance to double its indicators again between 2014 and 2020. And your business has a chance to grow with us.

We are waiting for you in Siberia, nearby and prosperous. ■

Part IV. Facilitating Entrepreneurship in Russia

Emerging ecosystem for venture companies and innovative small and medium-sized enterprises (SMEs) in Russia: vibrant regional and sub-sector niches



AGRIS PREIMANIS

Lead Economist for Central Asia,
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Agris helps governments, regulators and private sector formulate economic policies, strategies and structural reforms. Previously, he held the position of Senior Economist for the financial, VC and PE sectors. Before joining the EBRD, he spent ten years with Oxera, a UK-based advisory firm, advising financial services firms and regulators in the UK, Europe and US. Agris holds a DPhil in Financial Economics from University of Oxford, MSc in Finance from Birkbeck College, University of London, and BSc in Economics and BA from Stockholm School of Economics in Riga.

Against the backdrop of a challenging business climate and a struggling SME sector, a dynamic ecosystem for venture compa-

nies and innovative SMEs is beginning to emerge in Russia. Although, this process is covering only some regions and cities, and sub-sectors, rather than being broad-based, it is nonetheless a positive development. These improvements in the ecosystem are making venture companies and the SME sector more dynamic, and improving the commercial environment for large domestic and international companies in sectors that rely heavily on venture companies and innovative SMEs in their supply chains or as their customer base. These developments are also enhancing opportunities for companies that form part of this ecosystem, including providers of advice and legal services, venture capital funds and B2B and B2G platforms.

Ecosystem for venture companies and innovative SMEs in Russia

The state-funded and prolific science and technology infrastructure and network in Russia entered into a period of decline following the collapse of the Soviet Union in 1991. However, the recovery of the Russian economy after the 1998 financial crisis fostered new developments in the innovation sector, and kick-started building of the ecosystem

for venture companies and innovative SMEs. The regional and sub-sector niches is where a lot of this development is taking place, often getting lost in the overall, still underdeveloped, ecosystem for venture companies and innovative SMEs in the country.

Before discussing the ecosystem, here are some basic facts about the venture capital and innovative SME sectors. These sectors indeed remain relatively small. Whilst the venture capital data needs to be treated cautiously, the level of annual institutional venture capital investment in Russia stands at around 0.02% of GDP, compared to 0.02%, 0.04% and 0.16% of GDP in Germany, Finland and the USA respectively. At the same time, while more than 90% of companies and around 25% of employment in Russia comes from the SME sector, the sector contributes only around 20% of GDP. Although consistent data on the size of innovative SMEs is not readily available, the share of enterprises introducing innovations in 2012 was estimated at 9.1%, with a share of innovative goods and services in total standing at 8.0%.

Against the backdrop of relatively small venture companies and innovative

SMEs, a strong ecosystem supporting them is beginning to emerge. This ecosystem consists of such elements as:

- Business incubators and accelerators;
- Venture capital funds;
- Market interface platforms (B2B, B2G platforms);
- State innovation institutions (Rusnano, Skolkovo, etc.);
- Research institutes and universities;
- Large companies that apply an “open innovation” approach;
- Legal, judicial and regulatory frameworks for innovation and commercialization.

However, it is important to note that, while it is difficult to speak of a highly developed ecosystem at the federal level, in some regional and sub-sector niches, the ecosystem is becoming comparable to what is observed in countries that are highly developed in terms of venture companies and innovative SMEs (e.g. Finland, USA).

Effectiveness of ecosystem for venture companies and innovative SMEs

Given the complexity of the ecosystem for venture companies and innovative SMEs, comprehensive measures of its quality or effectiveness are not available. However, some proxies related to the overall R&D system in the country and the so-called “Knowledge Economy Index” can be considered.

In Russia, significant R&D amounts are being spent, with an overall annual R&D of around 1.1% of GDP and annual business R&D of around 0.7% of GDP in 2011. This ranks Russia 30th among the OECD countries. How effectively is this R&D spent being converted into outputs such as new technologies and high-tech exports?

- On a number of simple R&D “commercialisation” effectiveness indicators Russia seems to rank around average among the OECD countries. For example, in terms effectiveness with which business R&D is transformed into high-tech manufacturing exports (defined as the ratio of high-tech manufacturing exports as a percent of GDP to business R&D as a percent of GDP), Russia is close to the median level. Countries like Chile and Singapore score highly on this particular measure.
- The World Bank’s Knowledge Economy Index (KEI) can also be usefully used to gauge the quality of ecosystem. The Index is calculated based on the four pillars: economic incentive and institutional regime, education and human resources, ICT and the innovation system — with the first three arguably being most closely related to the quality of ecosystem for venture companies and innovative SMEs. At the country level, in terms of KEI in 2012, Russia ranked 55th out of 146 countries surveyed. It ranked 116th on economic incentive and institutional regime, 44th on education and human resources and 44th on ICT. Historically, Nordic countries have led these rankings.

Whilst overall, Russia generally ranks close to the median level among the OECD countries, there is a very significant variation in the quality of the ecosystem across regions and sub-sectors. In terms of R&D spend per unit of gross regional product, for example, Nizhny Novgorod region (3.92%), Kaluga region (3.28%), Moscow region (3.27%) and Ulyanovsk region (3.25%) rank highest (total in the country is 1.26%). Also, in terms of R&D-related employment as percent of total employment, Moscow (3.57%) and St. Petersburg

(3.19%) dominate; however, there are regions — including Moscow region (2.94%), Nizhny Novgorod region (2.4%) and Kaluga region (2.12%) — where R&D-related employment is considerably higher than the total in the country (1.07%).

Also, historically, quality of education has varied across specialisations. For example, education relevant to the energy and metals sector has been some of the best in the world, suggesting that Knowledge Economy readiness (and therefore the basis for a strong ecosystem) in this sector is likely to be stronger than elsewhere in the country.

It is clear, however, that these statistical measures do not provide an adequate picture of the dynamic development of the ecosystem that has taken place. Indeed, there are specific individual platforms and clusters that form particularly strong sub-regional and sub-sector ecosystems.

For example, in the Tatarstan region, the innovation and production technopark “Idea” provides an illustration of the type of development of local ecosystem that is taking place across regions and sub-sectors. The technopark was established in 2004, with the objective of providing support to innovative companies with R&D, including commercialisation of ideas and other activities. The technopark consists of such elements as incubator, business park and nanotechnology centre. To date, more than 400 companies have graduated and more than 7,000 jobs been created. The Technopark partners include Rosnano, Tatneft, and Tatarstan Venture Fund.

There are a number of other success stories across the regions and sub-sectors, including the Kazan IT park, a



high-technology technopark which supports entrepreneurs focused on IT, and Academpark, a technopark in Novosibirsk that specializes in instrumentation and research-intensive equipment, ITC, biotechnologies, new materials and nanotechnologies.

These initiatives are beginning to help venture companies and innovative SMEs. And whilst the full extent of the dynamism can only be observed when visiting the regions (which I would wholeheartedly recommend to anyone with an interest in the venture company and innovative SME sectors in Russia) and sub-sector clusters, some of the data trends are telling. Whilst in Russia overall, the share of enterprises introducing innovations has increased from 7.7% in 2009 to 9.1% in 2012, some regions have seen much more significant increases. Over this period, in Kamchatskiy Krai region the share has increased from 7.0% to 23.5%, in Altai Respublika region from 5.5% to 18.5%, in Chuvashskaya Respublika

region from 13% to 20.1% and in Tatarstan region from 12.5% to 16.9%.

Why does a strong ecosystem matter?

Building competitive federal and regional economies critically depends on being able to nurture successful venture companies and innovative SMEs. In Russia, this notion has been recognized by the federal and regional authorities and the private sector, and significant effort has gone into developing relevant ecosystems. Clearly, a venture company operating in the ecosystem of Silicon Valley has a better chance of succeeding than a similar company operating in Irkutsk. Similarly, an innovative SME that is plugged into a technology ecosystem, with connections to centres of excellence in Finland, will have a better chance of success than a similar company based in Moscow.

At the same time, in some sectors, large companies depend on venture companies and innovative SMEs as their suppliers of goods and services or as their

client base. This is important in such sectors as high-tech manufacturing, pharmaceuticals, polymers, and the automotive sector, as well as, often, in less high-tech sectors. The more effective the ecosystem of venture companies and innovative SMEs in the relevant region or sub-sector, the more competitive will be the large company that engages them as suppliers or clients. Improvements in the ecosystem therefore help not only venture companies and innovative SMEs, but also directly help make larger companies more competitive. On the macro level, this development of the ecosystem helps re-balance the Russian economy towards non-extractive sectors.

Large state-owned companies can benefit in a similar way as large domestic and international private companies. Currently, venture companies and innovative SMEs do not form an important part of the supply chain of state-owned companies, and hence the ecosystem does not matter to any significant degree. However there are some exceptions. For example, Kamaz

The more effective the ecosystem of venture companies and innovative SMEs in the relevant region or sub-sector, the more competitive will be the large company that engages them as suppliers or clients.

has adopted an innovation program for 2013–2020, intending to spend 0.7–1.6% of revenue on R&D. This program provides the basis for cooperation with research institutes, as well as an opportunity for innovative SMEs. Kamaz has already supported the creation of an industrial park in the past and entered production outsourcing agreements with the park's residents.

It should be noted that the importance of the ecosystem for state companies is going to increase. Indeed it can facilitate the more effective opening up of the state companies' procurement, which is being targeted to increase from around 10% to 25% by 2018. Such elements as B2B and B2G platforms like Gruzobzor, which connects transport companies to customers, and zakupki.gov.ru, a government procurement platform, increasingly form an important part of the venture company and innovative SME ecosystem, and could play an important catalytic role.

How is the ecosystem going to develop?

Instead of seeing any significant developments of the federal ecosystem for venture companies and innovative SMEs, enhancements will continue to take place at the level of regional and sub-sector niches. Often well-developed already, these niche ecosystems will continue to improve as a result of efforts

that have been put in by the private sector and authorities over recent years.

The existing ecosystems will be enhanced, new ones will be created, and networks among entrepreneurs and their commercialisation capacity will improve, etc. Both large private and state companies are also increasingly likely to open up their supply chains to innovative local content, and pro-actively work on enhancing relevant (often, highly localised) ecosystems for these companies. Whilst material improvements in the federal legal, judicial and regulatory framework governing innovation and commercialisation in short-run cannot be expected, these niche ecosystems will increasingly provide a safe and conducive (legal and regulatory) environment for companies to operate in.

The connectedness of the ecosystems in Russia to those of the USA, Europe and Asia is also likely to gradually improve. However, perhaps even more importantly, it will be critical to work on improved connectedness between the niche ecosystems within the country, which will not only help create bigger networks of entrepreneurs but also act as a mechanism to share best practice among private sector and regional authorities. This is one of the developments of which there has not been enough in recent years.

Conclusions

Russia is becoming a more attractive investment destination for activities that involve or rely on venture companies and innovative SMEs. The improvement of niche ecosystems is going to continue, and increasingly start paying off in terms of the emergence of successful venture companies and innovative SMEs, and positive growth stories from larger companies that rely on venture companies in their supply chain or as their customer base. This will in turn create more investment opportunities in the ecosystem itself, including in accelerators, venture capital funds and companies providing market interface platforms.

Recognizing the fundamental structural weaknesses in Russia, especially in terms of the business environment and the legal, judiciary and regulatory basis governing innovation, it is perhaps not surprising that particular success in terms of the ecosystem development is being achieved at the regional and sub-sector levels. This path of development of the overall venture capital and innovative ecosystem in Russia seems suitable and realistic for the country.

The framework discussed here provides a basis for assessing how each particular sector and regional niche could develop in future, and what improvements in the ecosystem would be needed to facilitate effective development. A more comprehensive analysis of specific clusters could be beneficial in order to inform companies and authorities. This might help improve strategies and enable better policies targeted at regions and sub-sectors which could in turn provide the basis for creating better connectedness between these regional and sub-sector ecosystems. ■

SMEs doing business in Russia — getting started



CHETWYND R.F. BOWLING
Managing Partner,
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Chetwynd Bowling is Managing Partner and founder at Alinga Consulting. Chet holds a BA and MA in Law from the Russian People's Friendship University and received his MBA from the Business School of Kingston University in the UK. Since 1999, he has played a leading role in managing service delivery and consulting with major clients. Chet also specializes in the taxation of foreign companies doing business in Russia and his experience includes advising a large US industrial gas company on a multi-million dollar equity and debt investment in Russia, and providing transaction support to a French food manufacturer acquiring a factory in the south of Russia.



ALEX MEDLOCK
Regional Director CIS, TMF Group

Before joining TMF Group, Alex worked for a number of banks active in Russia and other CIS countries. He is a leading expert in debt capital markets and structured finance, and has also played leading roles in debt capital markets, syndicated loans and corporate finance. Alex is based in Moscow as Managing Director of TMF Group Russia and is Regional Director for TMF offices in the CIS region. He participates in the global management of TMF's structured finance services business as Chairman of the Supervisory Board, EMEA region. He has a degree in economics and accounting and has been a member of the Institute of Chartered Accountants of Scotland since 1985.



ORLIN EFREMOV
General Director, Performance
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Orlin has devoted his career to international sales and management, being CEO of the Moscow subsidiaries of the French companies William Pitters (2003—2004) and Manutan (2007—2013). He has a successful entrepreneurial track record in France and Russia. He has been Chairman of the Small and Medium-Sized Enterprises Committee of the Association of European Businesses since 2011, and holds an MBA degree.

It is well accepted that Small and Medium-sized Enterprises (SMEs) play a major role in most economies, both in terms of the economy itself and also social infrastructure. However, this sector has not received the required investment and resources in Russia. But attitudes in Russia are changing and we see this in terms of increasing pronouncements of support from top politicians and government officials. We in-

vited a top executive to talk to us about his own experiences of establishing and running his business in Russia.

By way of introduction to what we feel are some of the most important issues to consider for SMEs investing in Russia, we would point out that the general lack of attention and support for SMEs means that owners or managers of smaller operations are often shocked

by the cost of entry into the market, both in time and money. One low-cost market entry strategy is to use a Professional Employee Service whereby a local service firm hires your Country Manager or Sales Rep onto their books, saving you the time and cost of setting up shop. This Employee without Establishment model is not free of risk, and one should also consider the relevant tax aspects. Local service providers are

JSC (ZAO)	LLC (OOO)
The charter capital is divided into shares (aktsii). This makes it easier to transfer or assign shares as there is a perception of separation of investors from management of the company.	The charter capital is divided up into percentages of membership interest (dol'), i.e. there is an assumption of the members' active involvement in the company's activities.
If a shareholder decides to exit a ZAO then he can do so via the sale of his shares either to the other shareholders or to a third party. The value (selling price) of the shares is determined by the parties and is not linked by law to the net asset value of the company.	If a member decides to exit an OOO he can either sell his membership interest to another member or third party, or he can choose to sell to the company and demand that the company pay him his share of the current net asset value of the company. Such a provision must be set out in the charter of the company.
Share issues must be registered with the Federal Securities Commission (FSC). Additional start-up cost and time.	No need to register with the FSC.

now offering package solutions tailored to SME start-ups.

We highlight below what we consider to be the 6 most important recent changes to the Labour and Tax codes that entrepreneurs should be aware of:

- Maximum base for accrual of obligatory insurance contributions increased in 2014 to 624,000 roubles;
- Since 2013 powers of attorney can be granted for any period — previously limited to 3 years;
- The rules now allow the Head of a foreign Rep or Branch office to issue a Power of Attorney without visiting a notary public to have it certified;
- Since 1 January 2014 companies have been prohibited from opening a new bank account in the event that one is blocked;
- Starting from 1 Jan 2014, electronic filing for VAT returns is now compulsory;
- Starting mid-2013 the registrar of companies (Tax Office) started to release incorporation document based on a Power of Attorney. Previously

this was only possible if the CEO himself visited the office for filing.

Below, based on our more than 15 years of experience in the outsourcing market, we highlight some of the issues that we consider important for SMEs doing business in Russia.

1. The Basics: Setting up a legal presence: Limited Liability Company (LLC); Joint Stock Company (JSC); Rep Office; Branch

Limited Liability Company (LLC)

The easiest way to go is to set up an LLC, or OOO as it is known in Russia. Russian law allows for a single shareholder and a single executive, the General Director. Both corporate and individual shareholders are allowed. In order to complete the registration process, it is necessary to have a General Director, and this brings us to often one of the first challenges the company may not have identified: someone to fill the role. As an interim solution, until a suitable candidate is

found, it may be desirable to outsource this function to a reputable third party. Also, at the incorporation stage, it will be necessary to specify a registered address and again, as an interim measure, an out-sourcing specialist can provide a solution until premises have been found.

For a corporate shareholder, the process is more complicated as the Chief Executive Officer (CEO) of the corporation must sign the application for incorporation. This can be done in his or her home country and be sent to Russia for translation and filing. Another option is for the CEO to come to Russia to complete the process. If this is not possible, then a nominee shareholder (this would be the local manager, if he is trusted or one provided by the legal firm handling the registration) is appointed and he can sign all the application documents.

Joint Stock Company (JSC)¹

While the process is similar, there are some differences in the incorporation process of a JSC, known as ZAO by its Russian acronym (see table of comparison below). For example, it has the additional requirement of having its shares registered by the securities commission at incorporation. This legal form is most suitable if the company is getting into a joint venture with non-affiliated partners.

Representative Office and Branch Office

Representative and Branch Offices are not independent legal entities, but rather "sub-divisions" of a parent company. A Rep Office should not engage in commercial activity, but a Branch may.

The "accreditation" process as it is called in Russia can take much longer

¹ It should be noted that there is intense discussion about removing this form of incorporation from the law. As of the date of writing the law has not changed.

► **Comparison of Legal, Financing, and Tax Aspects: Russian Legal Entity (RLE) vs. Branch or Rep Office**

RLE	Branch/Rep Office (B/R O)
<p>Legal A separate legal entity that bears its own liabilities.</p>	<p>Liability is borne by the Head Office or Parent company.</p>
<p>Accounting Compliance and Tax Filing In general the accounting requirements are bit more burdensome for RLE as quarterly financial statements must be prepared as well as full tax accounting, including VAT.</p>	<p>B/ROs are allowed to file and pay quarterly profit taxes. This is an opportunity for tax planning. No value added tax (VAT) accounting is necessary if there is no commercial activity and VAT is recognized as a cost.</p> <p>It should be noted that if a BO or RO engages in commercial activity then full tax accounting and reporting is mandatory. The accounting requirements are not as burdensome; there are no quarterly financial statements, but an annual report on activities (includes quasi-financial statements) is made.</p> <p>Rep Offices which do not carry out commercial activities are exempt from VAT on their rent payments.</p>

for a Rep/Branch Office compared to a LLC or JSC, typically 6 to 8 weeks, but there is the possibility of opting for a “fast track” process.

There are some advantages of doing business via a Rep/Branch Office, such as the ease of moving currency out of Russia and obtaining work visas for staff. However, some activities may be limited or more troublesome such as the import of goods or certain licensed activities.

2. Funding your operations

Once you have made the decision to set up in Russia, some thought should be given to funding your start up and ongoing expenses. There are a few options to consider: share capital, loans, parent-subsidiary financing, or cost+ arrangements.

The statutory **share capital** for a Russian legal entity is rather small (approx.

220 Euros). This type of funding is not very attractive, as your funds are stuck in Russian roubles with all the related currency risk.

A loan is a popular option because it allows for better cash-flow management. Cash can be sent in tranches when needed and can be re-paid if there is an excess of cash in the subsidiary. In addition, if structured properly, interest on the loans can be charged to profits, reducing your taxes payable.

Parent-subsidiary financing is a non-taxable contribution to the capital of the subsidiary by a parent owning more than 51% of the equity of the subsidiary. Apart from the benefit of managing cash-flows and currency risks as with loans, this form of financing does not require statutory registration of the increased capital and increases the equity side of the balance sheet.

Cost+ arrangements are becoming more popular as a means of financing a local subsidiary, which is not trading locally. Basically, the subsidiary “charges” the Head Office for all costs (rent, salary, marketing) plus a mark-up based on their internal corporate practice and local market practice (5 to 25%). Taxes are paid to the local budget based on this “profit”.

3. Finding a manager — local or expat?

Should you hire a local (Russian) manager with a clear understanding of the local culture and business ethics? He or she may be well connected, making it easier to solve problems when they arise. The disadvantage of this option is that the talent pool for managers is still relatively small in Russia, and as an SME, you will be competing with the big firms and be expected to pay top dollar to good managers.

Another option is to find an expat already settled in Russia, ideally, with a Russian family and looking to stay for a while. These candidates usually speak Russian and have a good understanding of the Russian culture and values. They may have good connections and have worked for start-ups before, and so understand the needs of SMEs on a tight budget. The downside of this group of candidates is that they tend to be entrepreneurial and looking to set up their own business and may not be a long-term solution.

One option that has become more popular is bringing a young expat over from the home country. Usually unmarried, ambitious, and looking for international experience, they are generally willing to give 2—3 years with relatively low pay to gain this type of experience.



4. HR issues in Russia

Twenty years ago staffing was not a problem; instead the issue was a shortage of skills. Now we almost have the reverse situation where in today's market there is generally not a problem with skills but there is an issue in finding available staff.

It is generally accepted that Russia has a very well-educated work force and that many young people are innovative. One successful owner told us recently that in his view "Russia is a laboratory of ideas." We therefore find that many SMEs succeed in attracting good people by offering a good working environment, consensual decision-making, attention to training and development, and maybe some form of ownership participation. What we have also been told by successful owners of SMEs is not to underestimate the importance of treating people well, being appreciative and having a good working environment. Also, be open with people and let them know what is happening and treat them with the respect that they deserve. With regard to talent retention and motivation,

salary is still the biggest factor. However, job satisfaction and career growth are becoming more significant. With regard to additional employee benefits, private medical insurance has become the norm, even for SMEs.

One peculiarity about compensation in Russia is that all employees think in terms of "net salary". Therefore if a potential candidate says he is looking for 100 roubles in salary, that means 100 roubles in his pocket, with the tax grossed up and paid by the employer.

5. Accounting and Taxation

There are several systems of taxation in Russia. The most frequently encountered include the following:

- a) General system of taxation — may be applied by all types of legal entities. All taxes and appropriate tax rates will be applied.
- b) Simplified system of taxation — was implemented specifically for SMEs and can be applied by legal entities where the total annual revenue does not exceed RUB 60 million (this number is not fixed

and may vary from year to year). There are several other limitations including one that prevents a corporate shareholder from owning more than 25% of the shares (i.e. a 100% subsidiary of foreign legal entity does not qualify). The tax rate is 6% (if tax basis is revenue) or 15% (if tax basis is profit). Revenue and expenses are to be calculated on a cash basis.

Taxes and tax rates applied under the General system of taxation are:

- a) VAT. General tax rate is 18%; for certain groups of goods 10%; export operations 0%.
- b) Corporate Profit Tax. Tax rate is 20%.
- c) Property tax. Tax rate depends on the region of Russia, but cannot exceed 2.2%.
- d) Personal Income Tax. This is the employee's personal obligation; tax rate is a flat 13% for residents and 30% for non-residents.
- e) Social insurance payments. This is the employer's only obligation; the rate is 30% for 2012. There is also an additional 10% for employees that earn over a certain threshold.

6. Practical experiences of setting up an SME — interview with a Russian business owner

We recently conducted a short interview with Mr Orlin Efremov, Founder and General Director of Performance Partners, Russia who established a legal entity in Russia during 2013.

Q. Mr. Efremov can you please summarize the main business activities of your company in Russia, and the form of legal entity that you have established?

A. "Performance Partners" was created on 26 July 2013 as a limited liability company ("OOO"). Its purpose is to provide consulting, training, and coach-

vice from friends, partners, embassies or associations. After finding the lawyer it takes about a month or even just three weeks to obtain the registration.

Q. Can you describe how the whole process went and whether you experienced any particular difficulties or delays?

A. The main difficulty for me has been to find complete information about the process of registration and subscribing to the full range of state insurances and tax institutions. That's why I addressed a lawyer, instead of doing it all myself as I had done several years before in France when I established a company there. There weren't any delays in the

all. One of the main secretarial tasks is to deal with the post! And it takes time!

Q. What is your advice to anyone wanting to set up their own business in Russia?

A. Well you mentioned before (in this article) that one need is time (and money) to set up a company here. This is true and I would like to stress that the time and efforts of the company's highest executive is needed as well. Without this, the odds are that the daughter company will not adapt the product features, business processes or organizational culture to the Russian specificities. I have 3 managerial experiences at CEO level and this is the first and main conclusion I found.

Nearly all aspects of start-up and ongoing compliance (legal and tax/financial) require either hiring one or more individuals, or out-sourcing. Either way, it is a real cost when it comes to Russia and it doesn't wait for your sales revenue to come in.

ing B2B services in the field of personal leadership, communication, and strategic culture.

Q. What were the key steps that you needed to take to form the company and how long did the whole process take?

A. In terms of a company's registration process the first thing to do is to find a reliable lawyer, who will guide you through the information and paper work. I don't think there is a need to look for a big attorney firm, one could find suitable assistance by following ad-

procedure. In fact I was positively surprised by the ease of handing over the registration documents in the respective offices. It was all done in 15 minutes!

Q. Now that the company is established, what are the main requirements to keep the company compliant?

A. First of all, of course there is the book-keeping, and second, surprisingly, is to arrange for the secure receipt of state authorities' correspondence. The post does not working correctly, letters are delayed, and often not delivered at

7. Closing down your business in Russia

Before investing in setting up a legal presence, be aware that closing down a legal entity or rep office can take from 6 to 12 months and can be quite expensive. The main problem is reconciling your tax records with the tax office. As mentioned, the tax administration is still quite bureaucratic and records may not be easily accessible due to technical difficulties.

Nearly all aspects of start-up and ongoing compliance (legal and tax/financial) require either hiring one or more individuals, or out-sourcing. Either way, it is a real cost when it comes to Russia and it doesn't wait for your sales revenue to come in. For some businesses, working initially via a distributor or other partners, using a Professional Employer Service, or simply working directly from the home office for a period, until business revenue can be more clearly projected, may be a sensible first step. ■

A SME's successful business case

An interview with the founder, owner and general director of ALPE consulting.



ALEXANDER SCHACHNER
General Director, ALPE consulting

Alexander is responsible for ALPE's day-to-day-operations, as well as leading the company's growth strategy and fostering the partnership with SAP AG. Before founding ALPE consulting in 2006, he was the Head of Sales at Siemens Business Services for five years, being responsible for the company's corporate clients. Alexander first came to Russia in 1994 and started a company in the tourism industry which later became one of the leading Russian tourism operators, UTE Megapolis Group. He holds a Diploma in Economics from the Wirtschafts- und Fremdsprachenakademie in Salzburg, Austria.

Alexander, you are an Austrian national who has more than 15 years of experience living and working in Russia. Please tell us more about your company and business:

My company is a SAP Service and Channel Partner offering SAP implementations and roll-outs, trainings and consulting, and support & maintenance.

We have approximately 80 employees of which 60 are SAP consultants. While we manage projects for Russian enterprises, such as Russian Railways (RZD), Kalina, or Skolkovo Foundation to name a few, our main focus and specialty is working with international clients and assisting them with their SAP Roll-Outs in Russia. Our clients are mostly from Europe, the US and Canada.

You started your company back in 2006. Why did you choose the IT industry and why focus only on SAP?

My background is not in the IT industry but actually in tourism. I first came to Russia in 1994 after completing my military service in Austria and started a company in the tourism industry. It later became one of the leading Russian tourism operators: UTE Megapolis Group. In 1997, I moved back to Austria to continue working in tourism, this time being responsible for the development of some of the largest tourism operators in Austria. Only in 2001 did I move back to Moscow to work for Siemens Business Services as the VP for Sales. That was the first time I came into contact with the IT industry.

Regarding SAP, the answer is quite simple. SAP is the clear market leader with a market share of well over 50% (by revenue), followed by 1C with about 30% and only then Oracle, Microsoft Business Solutions and others, with not

more than 8% market share. 1C is the popular Russian accounting software which is designed specifically for Russia. It is simple and affordable. However, as soon as a company achieves a certain size, it is required to implement a more powerful ERP system.

If a Russian company wants to attract foreign investors or even increase its credibility it will have to use an internationally accepted and trusted system such as SAP. We have several examples where this has already happened. On the other hand, most international companies use an ERP system which is implemented globally, in a lot of cases SAP, and decisions come directly from the IT headquarters in conjunction with local management.

And why Russia? And also what was the start-up phase like?

This was for personal reasons. After completing my military service in Austria I went on a long journey through the Himalayas and eventually ended up in Russia. My motivation back then was pure and simple adventure. Everyone and anyone could have gone to London or New York, but Russia, and especially Moscow, in the 90's was pure adventure and filled with many challenges.

Starting to live and work in Russia once, you cannot leave again (laughs). Either you love it or you hate it. Seems that I love it...



In the start-up phase the most important thing is that you hire a Russian or international law firm who can take over the entire registration process. The difference between these companies is mainly the price tag as it is not rocket science to get a company registered. What is really important is that you need to be present once or twice and be at the tax authorities for signing some official papers. That's more or less it, actually. The registration process is therefore quite simple and relatively quick - around a month give or take.

What was a bit more challenging was the "human factor". When I started ALPE consulting, we were initially only working with freelancers. However, this was very expensive and ultimately the consultants lacked a sense of loyalty to the company. So over the years we built a team of competent and internationally versatile experts, most of who are very loyal and have

been with ALPE consulting for many years.

Were there many hurdles in starting your business? Lots of times we hear of the "red tape" in relation to doing business in Russia.

As I mentioned before, when starting up my business there weren't too many hurdles and the registration or start-up was quite easy and quick. In terms of red tape, one has to differentiate. My company deals to a large extent with international companies and here we experience almost no problems. When doing business with Russian companies, there might be profound differences however. With commercial companies a business owner should simply make sure he is dealing with legitimate and reputable owners and managers. Make some inquiries; speak to business associations, like the AEB for example. Ask them for feedback on the Russian company. Secondly, plan your cash

flow properly and insist on certain pre-payments to avoid possible losses. Regarding Russian State companies this is a different matter altogether and quite frankly it will be very difficult for any foreign newcomer (without any profound "connections") to enter into business dealings here. Overall, if you equate bureaucracy with "red tape" you can be sure that Russia is very different to the West, ask anyone about acceptance acts, stamps, paperwork for anything like business trips for example, and much more. Russia can be very bureaucratic and has a paper-based accounting system which does not make our work easier.

If you can pin-point a handful of the most profound challenges or difficulties for foreign businesses and entrepreneurs coming to Russia, what would they be?

1) Cultural Issues: Every country and region in the world has its unique culture. When you start your business in Russia,

you must be sensitive and open to the Russian culture. It is as simple as that. Lots of things can be different here compared to your culture back home, but then again lots of opportunities can and will present themselves. Don't expect Russians to behave the same as western Europeans, just because we look similar.

2) Social Skills and Communication: this is very much related to cultural issues, but deserves a separate mention. With all my respect, admiration and affection for my Russian friends, I regret to inform the reader that Russians are not the world's best communicators. Once you work here and get to know Russians, you will understand the differences, intricacies and possible pitfalls in doing business here. Be aware of them by speaking to people who have been here for many years and get advice and feedback. This will make your life much easier.

3) Competent and Reliable Employees: I mentioned this topic above with the words "human factor". My experience shows that it is quite difficult to get a competent SAP consultant for a similar salary as in Europe or the US. What we take for granted back home is simply not the case here yet. As I also mentioned before, Russia and the CIS is a key market for SAP and it is already the 4th largest market unit in the world within SAP. Equally fascinating, but worrying at the same time, is the forecast that by 2015 Russia will require approximately 20,000 specialized consultants — but there will only be around 14,000. How this gap of around 6,000 experts will be managed is still unclear.

4) Decision Making Process: Especially when dealing with Russian businesses, this process can be a very long and tedious one. Money is not nearly as free flowing as it was before 2008.

5) Financing: This is a very complex undertaking. If you approach state banks, even the large ones, and attempt to

get credit lines specifically designed for SMEs you will be confronted with the argument that "you are not an SME because you are a foreigner" or "because a foreigner is a major shareholder". So be aware of this and preferably secure financing when starting your business beforehand. By the way, it's not easier with foreign banks operating in Russia, especially when you are in the consulting business.

Going back to your industry expertise in the IT world: we have heard that Russia is one of the 3 most complicated countries for SAP Projects. What are some concrete examples that make Russia so "special"? Why is it so difficult to adapt SAP here?

With commercial companies a business owner should simply make sure he is dealing with legitimate and reputable owners and managers.

Quite frankly there are too many to mention, but we can name a few. My expertise is SAP so I will mention SAP examples so your readers can still get an idea of the various complexities of starting a business in Russia:

- Russian Accounting Standards (RAS) are fundamentally different from the international standards GAAP or IFRS. No matter whether your company is using GAAP or IFRS, your entire accounting system in Russia needs to run in parallel according to RAS, which is obvious since you are operating in Russia.
- Russian accounting is based on paper documents. Any action by the com-

pany requires a paper document, with a stamp (preferably round!) and the signature of the responsible person, to be issued and confirmed. Therefore, almost all transactions, whether they are financial or logistical in nature, require an output in the form of a paper document. It is getting better slowly as there is now a law about electronic signatures in place which allows the electronic exchange of official accounting documents.

- Profit Tax Accounting: Profit Tax (PT) concerns a very wide range of issues because there are many gaps between RAS and PT Accounting. Some examples of the differences between the two are cost of goods sold, depreciation, definition of financial results involving fixed asset

retirement, different approaches for expenditure accounting, to name just a few.

- Value Added Tax (VAT): One example is export VAT where it is impossible to recognize VAT immediately because of the legal requirement to gather a wide "package" of paper documents for the Tax Authorities.
- Different aspects of production, the calculation of production costs and semi-finished goods, which implies in SAP the activation of a functionality which is called Material Ledger, which is hardly used by any international company. ■

For notes

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