How to do Business in Russia: Strategic Intelligence and Risk Management

Eduard Malygin | General Manager
Rosie Hawes | Associate Director
Agenda

- Control Risks: about us
- Russia is not a bad place to invest
- Main risks for foreign investors in Russia
- Day-to-day threats to your business
- The DOs and DON’Ts of living and doing business in Russia
- Q&A
About us
About us

Since 1975 we have worked in over 130 countries for more than 5,000 clients

An international consultancy with 34 offices worldwide

National and multinational clients in a wide variety of industrial and service sectors, governments and NGOs
What we do

- Integrity Risk
- Political Risk
- Security Risk
“If you do business in Russia or with a Russian business partner, you will lose all your money because your Russian business partner will steal it from you because he or she is a thief and you will die because the Russian mafia will murder you in your hotel bedroom when you visit Moscow or they will reach you in your own house”.
The Russians are coming
The Russians are coming
Why Russia can be a good market for your company

• If a company has a global strategy, it needs Russia. If a company has a European strategy it needs Russia even more. Russia is one of the few GDP and business growth markets left in Europe!

• Is Russia a BRIC market? Yes, it is the European BRIC

• GDP per capita in Russia is 4-8 times that in China and India

• Western company sales are 8-15 times larger than in China and India

• Russia will be the biggest European auto market in 2012-13

• It will be the biggest consumer products market in 2023
Russia as a growth market

• Russia is a very good profit market for the majority of companies

• Russia is profitable because consumers and government understand quality and are willing to pay premium prices for quality

• Russia has the ultra wealthy and also the developing middle class, providing an excellent customer base

• Russian sales across all sectors are holding up very well in 2012-13 and Russia is one of the strongest sales markets in Europe

• Most companies are growing at 8-25% and most in the IT industry are seeing sales rise at 30-40%
More good news

• GDP in 2013 looks set at about 3.6% and then will be about 3.5% for the next two years

• Profits are tight in China and India; the Middle East has seen risk rise sharply; the Eurozone will be flat or more likely negative … so Russia remains attractive

• Companies which left the market 5-10 years ago are returning

• Public debt is 10% which is lower than the Eurozone average of 100% and about the same figure in the US

• FX reserves are still the third highest in the world at $520bn and the country has another $120bn in rouble-denominated reserves

• Inflation is trending downwards well to 5.5% at end of 2012 and about the same in 2013
So why the street protests?

- Corruption at most layers of society is frustrating and angering the majority of people
- Small, petty corrupt actions by junior officials and police officers irritate people daily
- The educated middle class are dissatisfied when they see manifest corruption; they want something better from the state than daily graft and malpractice
- After the “job swap” between Putin and Medvedev people and society felt they had been treated like fools and children
- More positively, an anti-corruption campaign is gathering speed
So there are risks: economic/corruption

- The economy is vulnerable to any major downturn in the oil price. Russia is performing relatively extremely well because while global confidence is down, the oil price is still at $105.

- But in any moderate scenario the Russian government with a small budget surplus in 2013 has money to spend which other governments do not have.

- Corruption, bribery and malpractice exist a lot but is little worse than in China or India. Perceptions are distorted. Transparency International gave Russia the same ranking as Sierra Leone. This is not true or accurate and Russia has no monopoly on corruption.
Main risks: security threats and organised crime

- Russia of the 1990s no longer exists
- State reasserted control over organised crime, but line between police and criminal groups is now blurred
- Organised crime in Russia now more sophisticated, often involves state officials, and law enforcement officers
- Violence still used to solve business disputes.
  - Usually between local businesses
  - Contract killings still occur, but are unlikely to target foreign companies
  - ‘Corporate raiding’ (prevalent in the 1990s) does not tend to target well managed foreign companies
  - Local managers could be subject to intimidation if companies were to become involved in a dispute with a shadowy business
  - Thorough investigation to avoid bad partners, suppliers, customers, associations
Main risks: terrorism

**Where** - the North Caucasus (Moscow?)

**Targets** - law enforcement and government personnel
Nevertheless: Then & Now

Then: Can I live safely in a private apartment?
Now: *Can I pay my rent by bank transfer?*

Then: Should I drive a car?
Now: *Which car gets stolen the most?*

Then: Where can I find a decent supermarket?
Now: *Where is the best restaurant for my CEO?*

Then: Is Aeroflot safe to fly?
Now: *Which Russian airline should I fly?*
Doing business in Russia

A few short stories…
- Know your partner
- Understand what you are agreeing to
- Don’t expect everyone to be as thorough as you
- Keep an eye on your sales team
What does this mean for you? Grey practices

- **Black cash** (off-book salaries, small bribes)
- **Shell companies** (in Russia, and abroad)
- **Tax evasion** (everyone wants more money)
- **Bribery and facilitation payments** (where your black cash may end up)
- **Murky political links** (who really owns your partner?)
- **Criminal involvement** (who really owns your partner?)
- **Payment risks** (cash, paperwork, arbitration)
- **Why is this important?** (FCPA, UKBA, Russian laws etc)
- And ultimately, because you want to keep hold of your hard earned money!
What is black cash?
The complex world of Russian shell companies

When you business partner is registered at an address that does not exist, with 600 other companies. And the CEO died 5 years ago in Vladivostock.

Is that a red flag?
Official corporate filings: **Office 3, 27 Dmitrovskoe Shosse, Moscow** (page 1)
Official corporate filings: Office 3, 27 Dmitrovskoe Shosse, Moscow (page 2)
Official corporate filings: Office 3, 27 Dmitrovskoe Shosse, Moscow (page 3)
Official corporate filings: **Office 3, 27 Dmitrovskoe Shosse, Moscow** (page 5)
Shell companies onshore: Why “one-day” companies?
Shell companies: offshore
When it gets really bad: tax evasion, money laundering and bribery
Intermediary ‘best practice’

- Conduct focused due diligence before engaging intermediaries
- Provide anti-corruption training to intermediaries
- Obtain robust contractual assurances
- Supervise and monitor ongoing relationships
- Structure compensation sensibly
Shell companies: onshore and offshore
When it gets really bad: tax evasion, money laundering and bribery
So how can you protect yourselves?

Internally, send the right message:
Choose the best people. Train them.
  - Use ethical stance as a selection criterion
  - Infuse them with the company’s ethical culture.
Choose the best agents, the best partners, the best tenders, the best…
  - Due diligence can help filter out the vulnerabilities
Understand the local context
  - But do not give into it.
  - Play by your rules, not the local rules

Externally, send the right message:
Do not be afraid to build a reputation as being intolerant of corruption
  - Helps the selection process
A reputation for honesty is a source of competitive advantage
  - (Believe it or not)
“Onshore” business v “offshore” business

Different business models, different risks

Companies that import equipment via distributors see a (spurious) benefit, but run a series of important risks.

- They believe their distributor assumes the risk of clearing customs.
- Customs clearance is highly opaque and fraught with fraud and corruption
  - And the distributor and/or broker provides little defence
- They expose themselves to price manipulation along the distribution chain

Companies engaged in direct import (sometimes irrationally) fear exposure to the sharp end of Russian business, but could actually stand to gain.

- There are honest customs brokers in Russia.
- They are following a regulatory trend – regulatory agencies want direct import
  - Easier to do business with Russian customers – business is in rubles.
Business culture. The differences

National character

Building of trust and personal relationships is of crucial importance in Russia, whereas in Europe, formal relations suffice to have successful business relationships.

Business culture

The management culture in Russian companies is usually built around a vertical power structure that allows the top management to exercise an all encompassing level of authority over even the smallest details.

Language

Most Europeans expect Russians to speak English and actually, more and more Russians do speak English in business. However in business, it is crucial to understand nuances, intentions, tactics and strategies.
Russian business culture: The DOs…

• Advice number one is …………… enjoy Russia!
• Try to understand, respect and be open to Russia and its cultural peculiarities
• Gaining some knowledge of the Russian language is also something that will help you feel comfortable in Russia
• It pays off to do your homework and know your market and your business partner
• Be committed to being in Russia for several years
• JVs is a good way to start
• Stay in control of what you are doing and keep the initiative in your business venture
And the DON’Ts

- Do not be afraid of Russia - Fear is a bad advisor
- Never underestimate Russia or Russian business people
- Never think that Russia is purely European.
- Another misconception is the idea that Russia is cheap
- Do not underestimate the importance of relationship building - or the time taken in the process
- Don't waste time trying to get decisions out of middle and junior managers - go straight to the top if possible
Some more tips

• Russian attitudes to business can vary widely from sector to sector and from region to region. Are you dealing with a new-style entrepreneur or an old-school Soviet bureaucrat?
• Russians like to think in silence before answering a question. Do not be embarrassed by the silence.
• Any overly informal behaviour could be taken as lack of respect for senior management, the company or even the country.
• Women play little part in business at the senior levels and on the whole Russian businessmen are more comfortable dealing with other men.
• It is important to dress smartly and to try to look important. If you do not appear to be a decision-maker people will quickly lose interest.
• Do not underestimate the importance of entertaining in the business world. A good meal will help cement relationships and, although, reports of the amount of drinking involved in a trip to Russia may be exaggerated, a few vodkas will also help things along.
Doing business in Russia is like driving a car

You have to know where you are, where you want to go and how to get there. You need to keep your hands on the steering wheel and your foot on the accelerator (or the brake).

You need to stay awake, pay attention at all times and understand when you are lost. It is cheap, but it can be a lot of!

Questions?
Any questions?

Thank you!