The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

State Allots $10Bln to Lure Investors

By Irina Filatova

June 07, 2011

Stanislav Voskresensky **Denis Grishkin**

The last few weeks have been busy for Deputy Economic Development Minister Stanislav Voskresensky.

His ministry is putting the final touches on a new state private equity fund that will be launched next week with the goal of improving investor confidence.

The sovereign direct investment fund, initiated by President Dmitry Medvedev, aims to reduce risks associated with investing in Russia by making the state a partner. It will primarily target "investors who haven't been here and know nothing about the country," Voskresensky said in an interview in his office.

Local investors are welcome to leverage the fund as well.

The $10 billion fund — to be officially presented by Medvedev to potential investors at the St. Petersburg International Economic Forum on June 16 to 18 — will co-invest with foreign companies, hold a minority stake in the joint ventures and is expected to yield at least 15 percent return on investment.

Another use of the fund's equity could be to invest abroad to acquire some foreign firms, which are crucial for upgrading the domestic companies' technological base, Voskresensky said.

"If the technologies needed to attract investments could be obtained only by purchasing a foreign company, such deals will be possible," he said, adding that Russia is interested in investing abroad only in order to get access to such technologies.

Priority Investors

Though the fund's detailed investment declaration will be presented only next week, it's already clear which kind of investors the country needs.

Russia counts on foreign investors, which will not only bring their money but contribute to the country's modernization and create new jobs, Voskresensky said.

"We want to see investors that bring technologies, not only money," he said. Foreign private equity funds are among those most welcome, he said.

Such funds invest in existing projects to improve domestic companies' management and technological base, Voskresensky said, noting that increasing local firms' efficiency would be a good driver of economic growth.

Among the foreign private equity funds that have demonstrated commitment to Russia is the $300 billion sovereign fund China Investment Corporation, whose chairman said at a meeting with Prime Minister Vladimir Putin late last month that his fund could partner with Russia's fund.

Voskresensky said, however, that Russia doesn't want to limit itself to foreign investors and that a favorable climate is needed to attract both foreign and local firms.

"I don't see any difference between the domestic and foreign investments. ... We compete not only for foreign firms to launch production locally but also for Russian companies, many of which have become global," Voskresensky said.

Priority sectors for investing include telecoms (domestic mobile operators are now creating fourth-generation networks) and the pharmaceuticals industry, which saw sales last year of $18.5 billion, of which $15 billion came from imported drugs.

According to Voskresensky, the agricultural sector is gaining in attractiveness as well, following the successful initial public offering of RusAgro in London earlier this year that raised $330 million.

"There are many sectors and many potential projects," he said.

One such project is SuperJet International, a joint venture between aircraft manufacturer

Sukhoi and Italy's Alenia Aeronautica that is in charge of delivering, marketing and technical support for the new SuperJet 100 — the much delayed regional airliner that Aeroflot expects to take first deliveries of later this month. Alenia Aeronautica holds a 51 percent stake in the company, while Sukhoi holds the rest.

The oil and gas industry, however, is not on the list of priority sectors because Russia is trying to diversify its economy away from natural resources, Voskresensky said. As such, the new sovereign fund won't co-invest in such projects.

"There are enough instruments to attract investors to this sector, first of all the joint ventures. ... The rules of the game are defined clearly enough here," he said.

The joint venture arrangement was initiated in 2006 by then-President Putin to encourage international energy companies to exchange assets as a measure to ensure global energy stability. The idea was approved by a Group of Eight summit hosted by Russia that year, and an asset swap between Gazprom and Germany's E.On and BASF followed the announcement.

Although a $16 billion asset swap between Rosneft and BP failed to materialize earlier this year, a recent agreement between Rosneft and U.S. oil giant ExxonMobil to jointly explore an oil field along the Black Sea coast is an encouraging example of such partnership, Voskresensky said.

Also, Rosneft holds 20 percent and ExxonMobil has 30 percent in the Sakhalin-1 oil and gas project.

Other Measures

Creating the sovereign direct investment fund is only part of the Kremlin's approach to encourage investors, many of whom still have low confidence in Russia.

Voskresensky said government efforts to improve the investment climate could be categorized in two parts. The first one includes "small measures" like improving access to infrastructure, facilitating construction procedures and easing migration for qualified foreign employees.

The second part consists of "big measures," he said, such as improving the transparency of big companies and reducing the government's presence in the economy through earlier announced plans to privatize stakes in companies like VTB, Sberbank, Russian Railways and Rosneft.

"It's the biggest privatization in Russia's history, with about $30 billion to be raised from selling the assets," Voskresensky said.

Medvedev announced 10 key measures to improve the country's investment climate at a meeting of his modernization commission in March. He ordered, among other things, to replace government ministers on the boards of state-owned companies with independent directors by Oct. 1 and to appoint investment ombudsmen in the regions.

The ombudsmen will work in each of the eight federal districts to reduce red tape for foreign and local investors. Such ombudsmen will fulfill functions similar to those of First Deputy Prime Minister Igor Shuvalov, who was appointed federal investment ombudsman last August to address complaints filed by local firms and foreign companies alike.

Voskresensky said the office of federal investment ombudsman — which is part of his ministry — has proved effective, resolving 46 of 67 complaints filed by foreign companies. He singled out a conflict involving Swedish furniture giant IKEA as one of the best examples of addressing foreign investors' issues locally.

In 2009, IKEA decided to freeze some investments in Russia due to the unpredictability of the country's bureaucratic procedures. A year later, the company fired two executives in Russia for tolerating corruption.

"The problems were successfully solved. The [company's] trust in the market has been restored in full," Voskresensky said.

Problems to Solve

Russia was ranked a lowly 123rd late last year on the World Bank's annual list of 183 economies that provide the most favorable conditions of doing business, including starting a business, getting construction permits and protecting investors' rights.

Indeed, the most frequent challenges that foreign investors face are administrative barriers and discrimination in resolving conflicts with the local firms, according to the Economic Development Ministry's web site.

Voskresensky said the government has no illusions about the problems that scare off investors and much work remained to be done to win their trust.

"We realize that we have the problems we're being criticized for — the poor implementation of laws, the shortcomings of the judiciary system and corruption. We're working on tackling these problems," he said.

Voskresensky said, however, that he has not noticed a decline in investor interest connected to the cases of jailed former Yukos CEO Mikhail Khodorkovsky and Hermitage Capital lawyer Sergei Magnitsky, who died in custody in late 2009 after accusing police of fraud.

He said investors were more interested in economic issues like profitability, tax policy, the federal budget and a foundation of macroeconomic stability.

But U.S. Vice President Joe Biden, who visited Moscow in March, said cases like Khodorkovsky and Magnitsky hinder U.S. companies from investing in Russia because they raise concerns about whether investors' rights are protected.

Not so, Voskresensky said. The reason for the lack of foreign confidence, he said, is that some investors are not aware of the business environment in the country. He said companies already operating in Russia are "propagandists" for the attractiveness of the market. "Those who don't work in Russia often have the wrong information about the real situation here," he said. "That's the reason for the lack of trust."

2012 and Beyond

Voskresensky expressed confidence that the stability of the domestic economy and the potential of the overall market will encourage investors in the near future to spend up to $70 billion in foreign direct investment annually — a goal voiced by Putin in a report to the State Duma in April.

The volume of foreign direct investment has exceeded $220 billion over the past five years, Voskresensky said.

Russia has single-digit inflation, low state debt and a comparatively low tax burden, which makes it attractive to investors, Voskresensky said. The country's expanding middle class ensures increasing domestic consumption, with the number of households with an annual income exceeding $10,000 more than doubling in the past five years to reach 36 percent last year, he said.

The results of the 2012 presidential election are unlikely to significantly influence Russia's economic development because the long-term economic course has been determined, Voskresensky said.

Medvedev said at a news conference last month that Russia had "chances and energy to conduct modernization at a faster pace," while Putin sees it as "a calm, gradual process."

Voskresensky said foreign companies were concerned about the conditions of investing in Russia after the election rather than about the candidacy of the next president.

Frank Schauff, chief executive of the Association of European Businesses in Russia, confirmed that foreign companies believe that Russia's economic course will remain unaltered after the elections.

"When I talk to potential investors, as well as the companies that already operate in Russia, my impression is that they don't expect any dramatic changes. Their general outlook in terms of political risks remains stable," he said by telephone.

But there are those who prefer to wait. "Why invest now when you can have clarity after the election?" said one Moscow-based investment banker.

Some investors are concerned about the election process itself. "I'd like to be able to adjust my sales plan, since the dust won't settle until at least summer 2012," the local general manager of a Fortune 500 company told The Moscow Times, speaking on condition of anonymity. "And there is always a slowdown at election time, since decision makers are unsure whether their networks will remain in place."

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