Economist Intelligence Unit

The Economist

Nothing ventured, nothing gained
Changing international perceptions of Russian business

A report from the Economist Intelligence Unit

Commissioned by UC RUSAL

RUSAL

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Introduction

Back in the middle of the last decade, international expansion was high on the agenda of Russia-based multinationals, and high-profile acquisitions were often in the headlines. Russian corporations' drive to internationalise slowed during the financial crisis of 2008-09, which hit highly leveraged companies particularly hard. But in recent years, as some Russian companies have begun to renew their foreign expansion plans, the international climate for that expansion has become an important factor as well—not only in terms of the strength of the economies that would receive those investments, but also in terms of the perceptions that the potential partners hold of doing business with Russian companies.

With this as background, the Economist Intelligence Unit has conducted a study on the climate for Russian investment abroad, looking in particular at the second issue—the image that Russian companies have in the minds of their potential business partners abroad. The study, which was commissioned by UC RUSAL, looks at the advantages and challenges of Russian investment in global markets, seen from the point of view of companies based outside of Russia.

The Economist Intelligence Unit bears sole responsibility for the content of this study. The report's findings and conclusions are those of the Economist Intelligence Unit alone. The author of this study is Paul Kielstra, and the editor is Aviva Freudmann.

About this research

This report is based on a survey of 195 senior executives from outside Russia, focusing on those whose companies have past or current experience with Russian companies as joint-venture partners, merger partners or parent companies, or plan to enter such arrangements over the next three years. Slightly under one-half (46%) of the sample consists of executives with current or past experience with Russian partners or parent companies, with the rest planning to do business with Russian partners or investors in the next three years.

Respondents are senior-level executives: 59% are C-level (CEO, CFO, etc) or above. The survey is global, with 33% based in Western Europe, 26% each in the Asia-Pacific region and North America, 11% in the Middle East and North Africa, and the balance in the rest of the world. Respondents tend to work for large companies: over one-half (52%) work for companies with more than US$1bn in annual revenue. They are also from a wide range of industries, with the strongest representation in manufacturing (21%), energy and natural resources (16%), and financial services (12%).

In addition to the survey, the Economist Intelligence Unit conducted extensive desk research as well as in-depth qualitative interviews with 11 senior executives who have experience of working with Russian partners. We would like to thank all participants in the in-depth interview programme for their time and insight; the interviewees are listed in an Appendix to this report.

Executive summary

As direct investment both into Russia and from Russia outwards starts to pick up again after a decline during 2008-09, the number of ventures between Russian and non-Russian companies is on the rise. With this as background, the Economist Intelligence Unit conducted a survey of how the Russian partners are perceived by their non-Russian counterparts, to determine the business climate for current and future ventures. In particular, the survey considered the main issues and concerns of the non-Russian partners when it comes to Russian parent companies or joint-venture partners, what such companies expect of their Russian partners, and—for those with experience of such deals—how well the partnership met their hopes and expectations. In addition, the study looked at whether foreign companies expect to do further business with Russian direct investors, and at the advantages and challenges of working with Russian companies as perceived by the non-Russian partners.

Here are the key findings of this research:

Foreign direct investment (FDI) both into and out of Russia is recovering, suggesting a continued upswing in international joint ventures, mergers and acquisitions (M&A). According to EIU forecasts, *inward* foreign direct investment will reach US$50bn in 2012, up from an estimated US$49.5bn in 2011. EIU data show that average annual outward foreign direct investment (OFDI) from Russia has grown sixteenfold over the past decade, despite downturns after the global financial crisis, and that the outflow is starting a sustained, post-crisis ascent. The EIU estimates that OFDI from Russia will reach US$41bn in 2012, making Russia the world's 14th largest source of OFDI, up from 28th in 2000. Russia's accession to the World Trade Organisation in August 2012 is likely to boost foreign investment flows. An estimated one-third of the outflows goes into productive corporate investment.

Non-Russian business executives have decidedly mixed views of their Russian partners. On the plus side, nearly three-fourths (74%) of survey respondents who have been involved in M&A deals or joint ventures with a Russian investor—where the activity took place within Russia—say the arrangement met their expectations reasonably or very well. For such dealings outside of Russia, this figure rises to 84%. Moreover, 72% say they will probably or definitely do business with Russian investors again in the medium term. On the minus side, Russian partners are the least welcome among those from major emerging markets. Respondents show a clear preference—if they had a choice—for being acquired by Indian, Chinese or Brazilian firms. Moreover, on attributes such as reliability, innovation and competitiveness, respondents give Russian companies a score of between 4.3 and 5.7 out of 10.

Access to energy and financial resources, and technical know-how, are the big pluses. Respondents most often cite access to resources as an advantage of working with Russian companies. Sixty-seven percent say that their partner's access to energy was either an advantage or a strong advantage, and 46% say the same about access to capital. The country's traditionally strong technological capacity is also valued, with 49% seeing it as an advantage.

Poor language skills, inefficient management and weak governance are the big minuses. The leading obstacle to doing business with Russian global businesses is a perceived lack of foreign-language skills—cited by 36% of respondents—although this is more of an issue below C-level. More worrying, respondents see Russian companies as too often poorly managed, inefficiently structured, or both, leading to reduced flexibility. Administrative delays and red tape are cited as obstacles to working with Russian global companies by 32% of respondents, and 21% complain of complex, hierarchical structures. Those surveyed also give Russian companies a low score for managerial quality (5.4 out of 10). Respondents cite corruption as the third-biggest obstacle to working with Russian global companies (28%), while 19% see poor corporate governance as a barrier. On average, respondents give Russian companies a score of 4.3 out of 10 for transparency, which they see as a big disadvantage of Russian partners.

Familiarity with Russian business partners reduces the perception of weaknesses. Survey respondents whose companies have actual experience of working with Russian partners are more likely than the sample average to expect to do further business with them in the future. They also tend to have a higher opinion of Russian companies' reliability, flexibility and innovation. They are less likely than other respondents to point to language barriers, administrative delays and corruption as obstacles when doing business with Russian global companies. However, these respondents still list these as the biggest problems. The difference in attitudes may be the result of a greater awareness by those in contact with Russian companies of ongoing improvements in fields such as corporate governance.

The way forward for Russian firms is to differentiate themselves from the stereotypes. Despite the negative elements of perceptions about Russian partners, most foreign companies are ready to do business with them. Nevertheless, poor transparency and corporate governance can complicate deals. Russian businesses that differentiate themselves from the commonly held perception will find it easier to form successful partnerships abroad. This includes taking such measures as focusing on ethics, ensuring their financial results are transparent to all, avoiding "insider" practices and deals, ensuring fair employment practices, respecting contracts, improving their executives' foreign-language skills, and focusing on long-term and sustainable business practices.

1 Outward bound

An investment recovery

In recent years, Russia's inward and outward foreign direct investment (FDI) flows have started to recover after downturns during the financial crisis. EIU data show that inward FDI in 2011 was US$49.5bn, with the figure forecast to rise slightly to US$50bn in 2012. This is slightly below the US$55bn that came in during 2007, although well short of the pre-crisis peak of US$75bn reached during 2008.

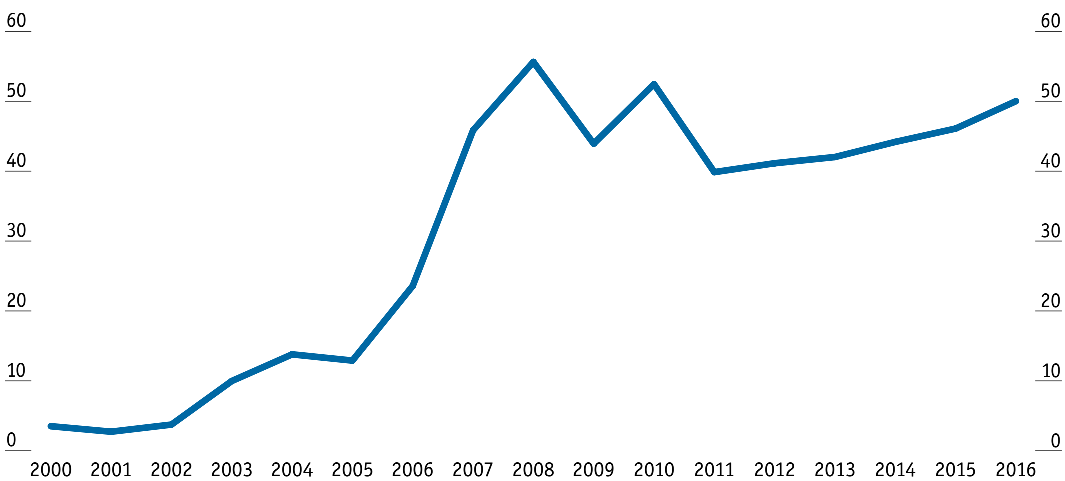
Outward foreign direct investment (OFDI) experienced a double dip during the global downturn, but is on course for a steady recovery (see Chart 1). Moreover, OFDI is expected to remain on a significantly higher plateau in the years ahead compared to the early years of the last decade. In particular, according to EIU data, average annual OFDI during 2000-02 was about US$3bn per year, rising to an annual average of US$49.2bn in 2007-10. In 2012, following a second post-financial crisis dip, the EIU expects that Russia's OFDI will rise to US$41bn, making it the world's 14th-largest source of OFDI, up from 28th in 2000. This also makes Russia one of the largest OFDI sources among emerging economies.

The data on outward investment give a good indication of the globalisation of Russian business. However, if taken at face value, these data create a misleading impression of the extent of Russia's globalisation push. These figures incorporate all outflows from the country including investment in real estate abroad

Chart 1

Russian outward foreign direct investment

(US $bn)



Note. Figures from 2012 on are estimated.
Source: Economist Intelligence Unit.

and tax avoidance. Columbia University's Vale Center on Sustainable International Investment estimates that only one-third of Russian OFDI is represented by corporate internationalisation.

That said, the Columbia University analysis and those interviewed for this study confirm that genuine corporate outward investment is increasing along with the rest of Russian OFDI. Kostas Katsoglou, the president of Dow Chemical in Russia, Eastern Europe, Greece and Turkey, notes that compared with five years ago, "Russian companies now have much broader horizons. People have started seeing them as players globally."

Expected upswing in outward corporate investment

Natural resources, energy and metals companies account for the bulk of this activity. An example is TNK-BP International's recent acquisition of a 45% interest in oil and gas deposits in the Solimoes basin in Brazil for US$1bn. But companies from other sectors are active as well. Recent high-profile deals outside the extractive industries include the acquisition by Vimpelcom, a telecoms company, of Egypt's Weather Investments for US$21bn in 2010; the US$4.6bn purchase in 2011 by Digital Sky Technologies, an Internet investment company, of stakes in various social media companies, including Facebook and Twitter, following a substantial investment in Alibaba Group, the Chinese business-to-business Internet marketplace in 2010; and Sberbank's purchase in June 2012 of Turkey's Denizbank from Dexia, a Franco-Belgian bank, for €2.8bn (US$3.5bn).

The reasons behind the globalisation push are as varied as the companies themselves, but they share some common elements. Dmitriy Kolomytsyn, senior metals and mining analyst at Morgan Stanley in Moscow, notes that large Russian companies want "to spend cash that is accumulating on the balance sheets, and want to diversify their holdings to reduce risk." In addition, some firms are trying to find cheaper assets than they can at home, or simply to realise their international ambitions. Ivan Tchakarov, chief economist for Russia and the CIS at Renaissance Capital, a Russia-based investment bank, says that the increased corporate outward investment "is definitely a trend that has been increasing in strength since 2008." Part of this is capital flight brought on by fears over political risks, such as the risk of arbitrary application of regulations, but he says part is also "a natural evolution of big Russian companies," which are diversifying their bases and becoming more international.

This trend is likely to continue despite current concerns about the business environment within Russia, which ultimately affects the prospects of any international business venture involving Russian partners. "Russian outward FDI will increase," predicts Carl Fey, professor of international business at the Nottingham University Business School in China and formerly with the Stockholm School of Economics in St Petersburg. "Historically they haven't done much, but there are some very interesting companies that are starting to move abroad."

Russia's economy: The good, the bad and the ugly

The ability of Russian companies and investors to pursue foreign opportunities will depend in part on the long-term strength of the Russian economy and whether it can generate investment capital. And when it comes to the Russian economy, the outlook is decidedly mixed.

In some ways, the prospects are bright. The market is already substantial. The economy—which will surpass US$2trn in 2012, according to Economist Intelligence Unit estimates—is already among the world's ten largest. For certain industries it is an essential location. For example, Andrey Lavrinenko, regional vice-president for Russia and the CIS at Alstom Power, the French energy company, says his business is there "because Russia has one of the biggest energy networks in the world. For us, this is a very strategic market."

Russia's high GDP is partly a function of its large population, currently about 142m people. But its GDP per head, forecast to be US$14,200 this year, is the biggest of the BRIC countries (Brazil, Russia, India and China), and more than double that of China. The EIU sees substantial scope for growth in domestic, particularly household, spending. Its index of market opportunities ranks Russia sixth out of 82 countries—developing and emerging—and first for Central and Eastern Europe. Byron Smith, strategy and transformation director at Sweden-based AkzoNobel Pulp and Performance Chemicals, notes: "Russia is potentially a great market. It's the only really big market in Europe with strong expansion potential."

Survey respondents agree that the Russian economy has great potential. They tend to believe that the country will become Europe's largest market in volume terms (39% agree compared with 24% who disagree). They also expect that Russia will become a key export platform for both Europe and Asia (37% agree; 23% disagree).

That's the good news. The bad news is that many business barriers remain. For example, companies complain that interest rates remain too high for enterprises which might otherwise borrow to expand their businesses. Moreover, our survey respondents tend to see Russia as less promising than other major emerging markets. Slightly more agree than disagree that it will lag behind these (40% compared with 37%). As for China, 38% think that Russia will not rival it as an investment magnet, compared with 27% who believe that it will. Perhaps more striking is the level of uncertainty about these questions. Forty percent of respondents simply are unsure if the country will become an export platform, and 35% are unsure whether Russia will become the largest European market. Despite Russia's undoubted potential, reservations clearly abound.

"The real challenge in Russia is that [its legal environment] is unpredictable," says Carl Fey, professor of international business at the Nottingham University Business School in China and formerly with the Stockholm School of Economics in St Petersburg. This is particularly true with the political environment, where Russia sometimes follows an approach of extremes of legal enforcement to keep people and firms in line. "A better approach would be predictable, consistent enforcement of laws at less extreme levels," he adds.

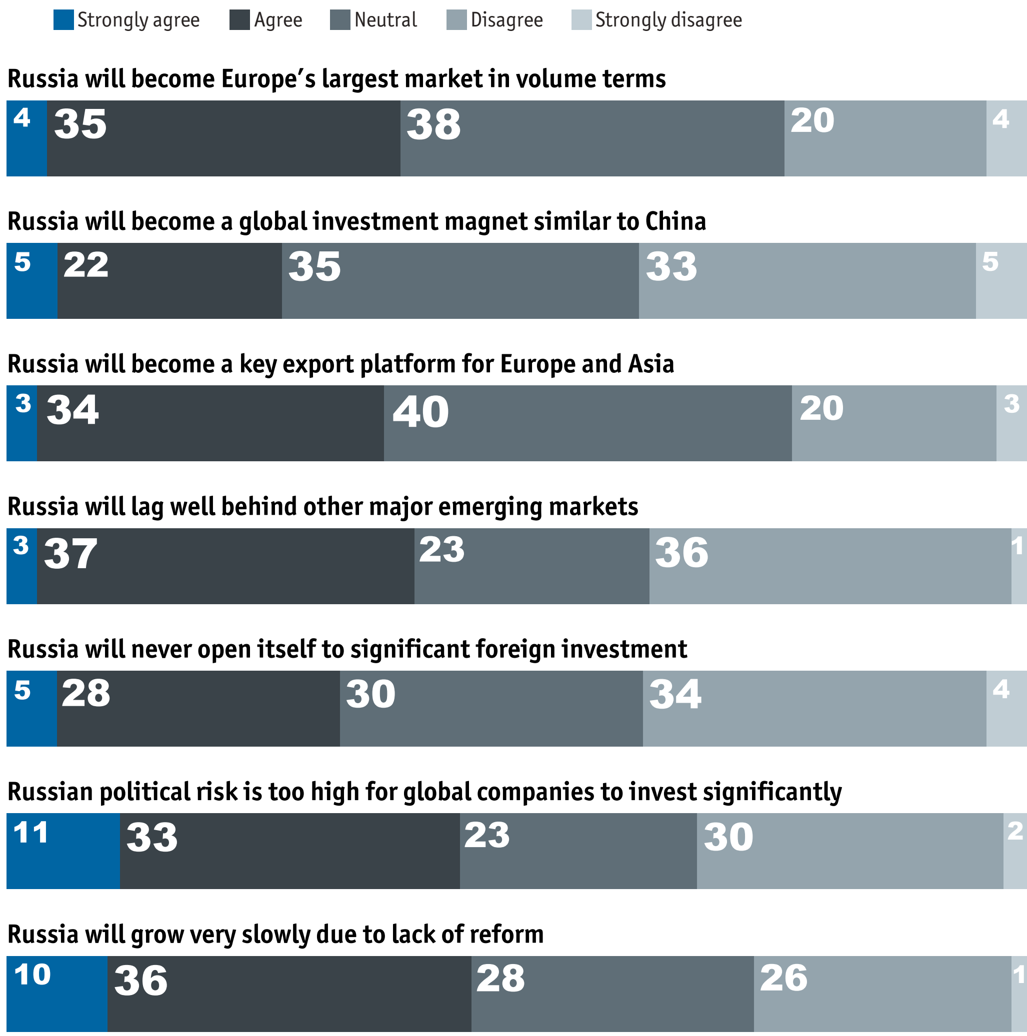
Survey respondents agree: 44% believe that current levels of political risk are too high to allow significant investment (compared with 32% who disagree). Similarly, 46% agree that Russia will grow slowly because of a lack of reform (compared with 27% who disagree). Nearly one-third feel that the authorities will never open Russia to significant outside investment. EIU analysts see the political risks as almost as substantial as the economic opportunities. In the EIU's business environment rankings, Russia's political environment comes in 73rd out of 86 countries globally and 15th out of 16 in the region.

This does not make doing business impossible—Russian GDP is projected to grow at around 4% per year for the next four years—just a lot harder. Greg Thain, CEO of Agriculture Infrastructure Management Company, a property company, describes the situation succinctly: "The biggest problem in Russia is the complete dominance of the state. The barriers [to business] are official ones. But there are huge opportunities as well. Companies are making money there."

Chart 2

Thinking about Russia in general, how strongly would you agree or disagree with the following statements regarding business opportunities within Russia over the next decade?

(% respondents)



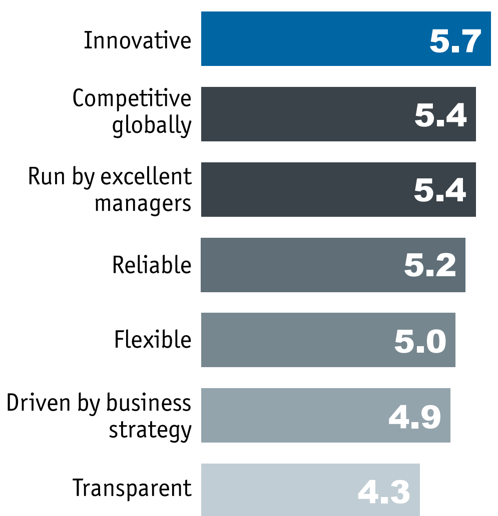
2 Perceptions and realities

A deep ambivalence

More than anything else, the survey reveals a deep ambivalence among foreign executives about working with Russian investors and companies. On the one hand, respondents, if they had to choose, would much prefer to be taken over by, or merge with, a company from any of the other BRIC economies. Nearly one-half (45%) see a Russian purchase as the worst or a bad option, and only 15% see it as good or best. They would much prefer to deal with Indian investors (51% called this the best or a very good option) or Chinese ones (45%)—see Chart 4. Similarly, respondents are unenthusiastic

Chart 3

Q How do you respond to the following general descriptions of Russian companies?
Weighted average score out of a maximum of 10.
(% respondents)



about the management attributes and abilities of Russian companies in general. As the table indicates, on a range of important attributes, respondents rank Russian firms between 4.3 and 5.7 out of 10. Clearly, foreign companies have some reservations about Russian firms.

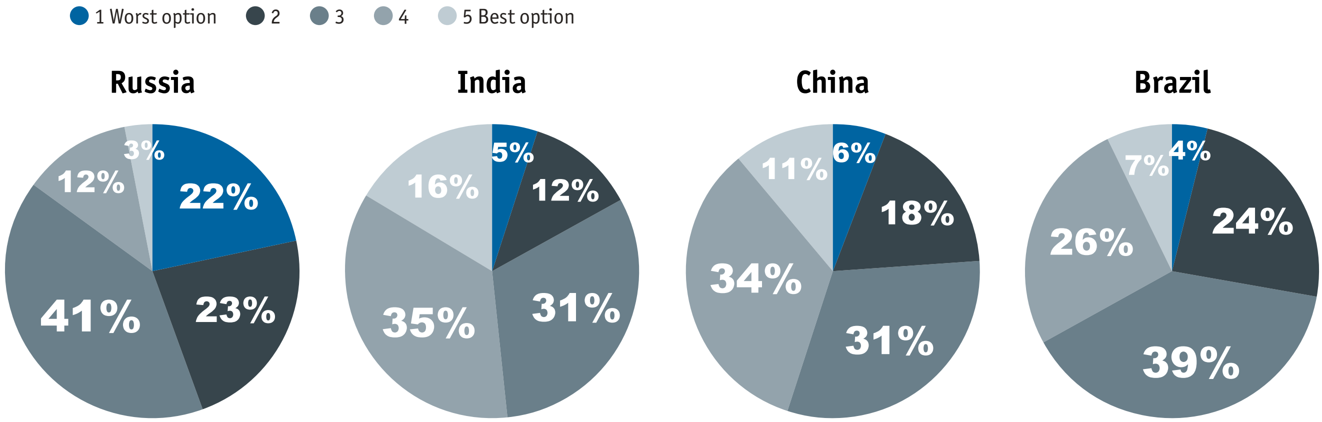
On the plus side, when asked specifically about their own joint ventures or M&A involving Russian partners, respondents are far more positive, as the pie charts show (see Charts 4-7). Seventy-four percent of those who have conducted such activity *within* Russia say that the venture met their expectations reasonably or very well. For ventures with a Russian partner *outside* the country, the figure rises to 84%. Mr Katsoglou of Dow Chemical regards these results as more significant than respondents' views on the preferred country of a partner. The latter is "very subjective, [but] we've had one joint venture [in Russia] and it was a very good experience." Alexander Ivlev, country managing partner at E&Y in Moscow, observes that, although in the past the situation was sometimes problematic, now "foreign companies on the ground [working with Russians] are happy."

On balance, the foreign view of Russian partnerships must be interpreted as more positive than negative, since most respondents say that they would be willing to partner again with Russian companies: 52% say that they would probably or definitely do further business with Russian direct investors in the short term. This figure is dampened by current economic conditions. For companies in regions less affected by the ongoing turmoil such as

Chart 4

If you compare the prospect of your company being merged with or acquired by a Russian company, is it better than being merged with or acquired by a company from one of the other fast developing emerging-market countries?

(% respondents)

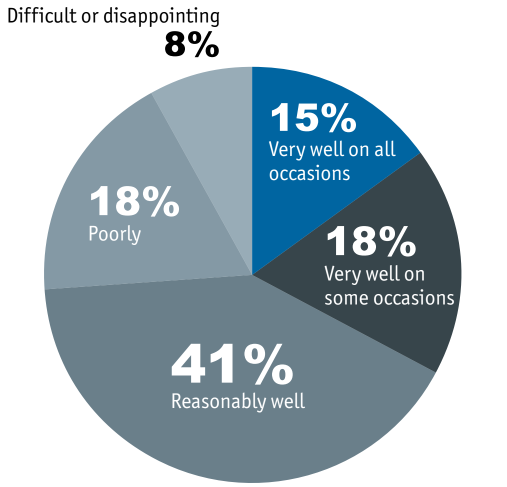


Asia-Pacific (63%) and the Middle East and Africa (62%) it is noticeably higher. Mr Thain of Agriculture Infrastructure Management Company comments: "Everything is on hold [with Western companies] at the moment.... But there are a lot of non-Anglo-Saxon businesses actively looking to start partnerships in Russia: from China, the Middle East and Turkey." Once the

Chart 5

Overall, how well have your joint ventures and/or mergers and acquisitions with Russian multinational companies met your expectations: when doing business inside Russia?

(% respondents)

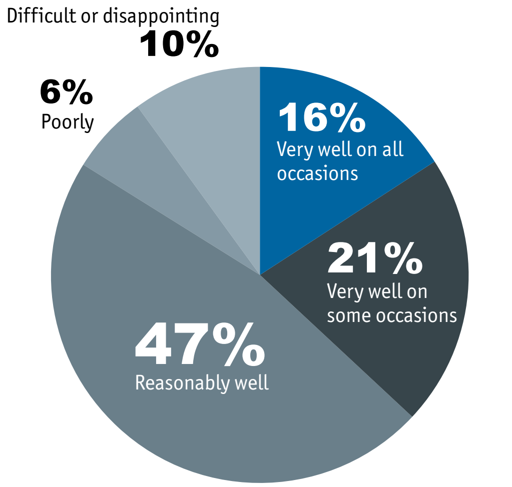


Note. Sample of companies with experience; "Not applicable" responses have been stripped out of these data.

Chart 6

Overall, how well have your joint ventures and/or mergers and acquisitions with Russian multinational companies met your expectations: when doing business outside Russia?

(% respondents)

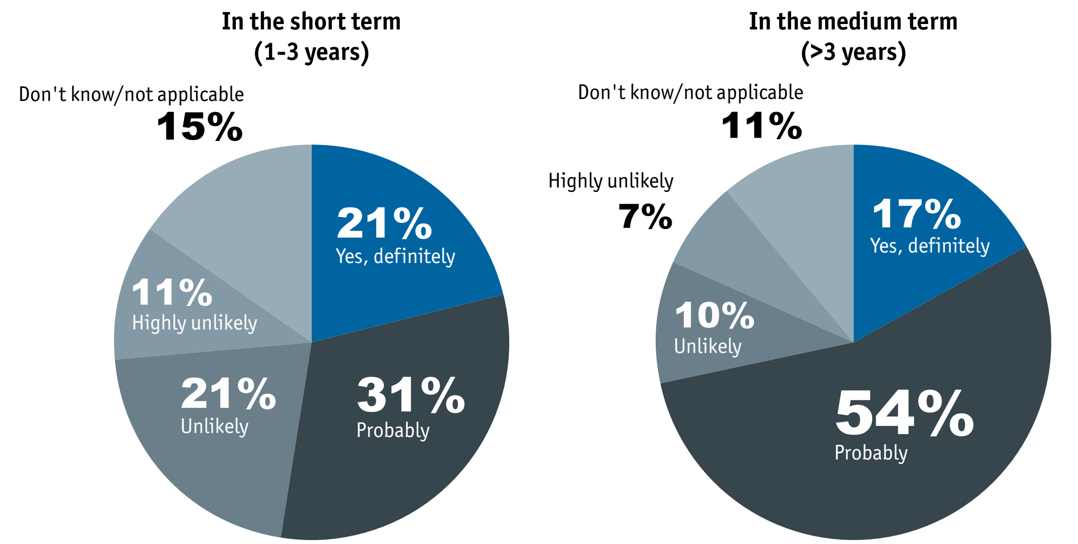


Note. Sample of companies with experience; "Not applicable" responses have been stripped out of these data.

Chart 7

Q Does your company plan to do business with Russian investors?

(% respondents)



current uncertainty fades, interest should pick up everywhere. In the medium term, 71% of respondents expect (probably or definitely) to do further business with Russians.

Russian partnerships: pros and cons

Survey respondents cite a range of advantages and disadvantages that explain their mixed views on working with Russian partners and investors.

Advantages

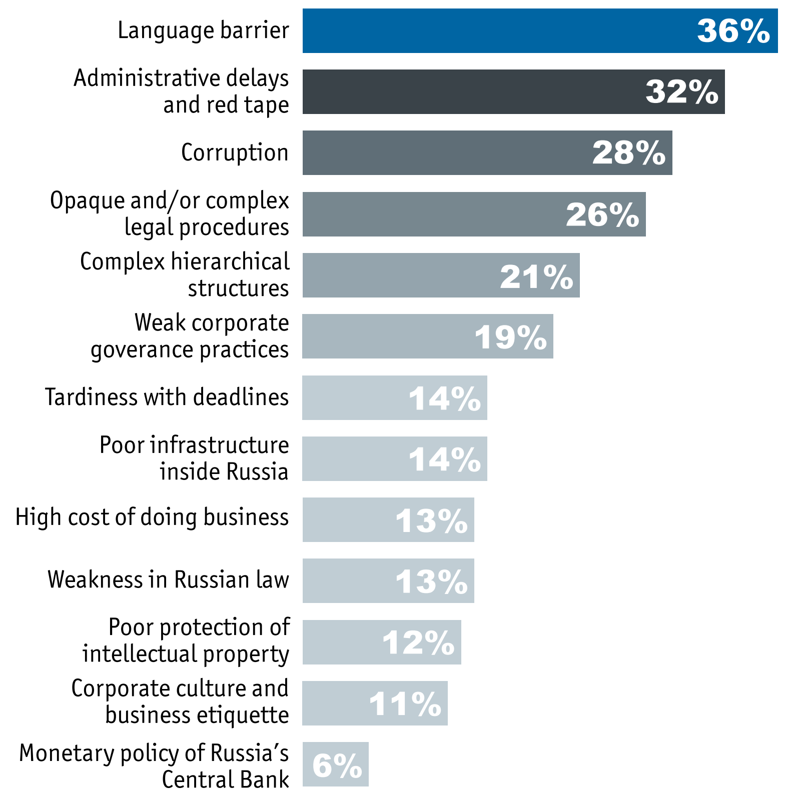
The clearest benefit that respondents see in working with Russian companies is access to resources. Sixty-seven percent say that their partner's access to energy was either an advantage or a strong advantage, and 46% say the same about their ability to access capital. Increasingly, especially as Russian foreign investment grows, it is financial resources that gets Russians a seat at the table. Mr Thain notes: "Looking at partnerships globally, the expectation is that the Russian partner will supply money."

Other factors traditionally considered strengths of Russian companies include their technical abilities and the education of the workforce. Survey respondents value the former, with 49% seeing it as an advantage and only 15% a disadvantage. Mr Fey notes that "Russia has a history of being strong in technology, and a lot of that lingers. They were bad at commercialising it, but some companies are doing that." Nenad Pavletic, president of the Russian unit of AstraZeneca, a pharmaceutical giant, adds, "Russia has a knowledgeable talent base with strong intellectual capacity." He reports that his company is successfully partnering with Russian development institutes such as Skolkovo, Russian Venture Company and Rusnano. AstraZeneca is also expanding its partnerships with Russian clinical research organisations because of their ability to deliver good clinical trials. In many partnerships, foreign companies provide the more advanced technology, but in such cases Russian firms typically have the technical know-how to use it.

Chart 8

What are the main obstacles you have faced when doing business with Russian global companies?

(% respondents)



Views on the qualifications of the workforce—both managers and employees—while still positive, are more mixed: 39% of respondents consider these an advantage but more, 44%, are unsure. Those interviewed for this study in general spoke favourably of the skills of their Russian partners. Mr Katsoglou, for example, says that Russians are "very well educated. We were impressed by the standard of [our joint-venture partner's] workforce." The country's adult literacy rate of over 99% also speaks of broadly based education. However, it is not always relevant to business needs. As Mr Fey notes: "The quality of education is very high, even in the least educated quartile, but traditional undergraduate education is far too theoretical. People have very good theoretical knowledge, but don't know how to apply it. So companies have to put a lot of effort into training." Moreover, Russia has seen deterioration in its human capital in the past two decades, in part from underfunding its education system.

Disadvantages

On the opposite side of the ledger, survey respondents see three key difficulties in working with Russian companies.

The most frequently mentioned is a lack of foreign-language skills, which 36% list as one of the biggest obstacles to doing business with Russian global companies. Although generally recognised as an issue, less senior respondents were more likely to cite it: only 33% of C-level respondents list it as a barrier, compared with 41% of other executives. This discrepancy suggests that it is a bigger issue at middle management and lower levels of companies than it is at board level. On the positive side, once language issues are overcome, cultural ones rarely arise. Badr Jafar, president of Crescent Petroleum and managing director of the Crescent Group, a diversified group of companies based in the United Arab Emirates, notes that "in business dealings, Russians are very direct and upfront." Mr Fey agrees: "There's no problem in Russia finding out what people think. They're very direct people, and that helps things to move forward."

A second and more deep-seated problem is that, according to respondents, too often Russian companies are poorly managed, badly structured, or both, leading to lower efficiency and flexibility. After language, administrative delays and red tape are the biggest obstacle to working with Russian companies, cited by 32% of respondents. In addition, 21% of respondents complain of complex, hierarchical structures. Similarly, administrative efficiency is more often cited as a disadvantage than an advantage in working with Russian companies (32% compared with 22%), and respondents rank Russian firms low on flexibility (assigning a score of 5, on average, on a 10-point scale) and on managerial quality (5.4 out of 10).

Mr Smith of AkzoNobel sees these difficulties as something that foreigners need to accept. "The main obstacle to joint-venture agreements with Russian firms is mind-set: companies go into it thinking that they can do it in six months. You have to realise that business-culture and authority-wise, it will take longer. The hard part is the bureaucracy, but you can wade through it." Mr Thain adds: "What is missing in Russia is real management knowledge. It is the big obstacle. It's still a thin pyramid and all decisions have to be referred upwards. That slows everything down." This is not, of course, a problem for every company. Mr Fey notes that "Russian elite managers can stand up to any in the world," but says that there are not enough of them at this quality level.

The third serious drawback for foreign executives concerns governance and transparency. Respondents cite corruption as the third-biggest obstacle to working with Russian companies (28%). Opaque legal procedures (26%) and poor corporate governance (19%), both of which can aid corruption or give rise to suspicions of it, are also leading issues. Similarly, the quality of corporate governance is much more often seen as a disadvantage than an advantage (45% compared with 17%), as is the level of legal transparency (45% compared with 14%). Indeed, Russian companies score worst on transparency of any attribute covered in the survey (4.3 out of 10).

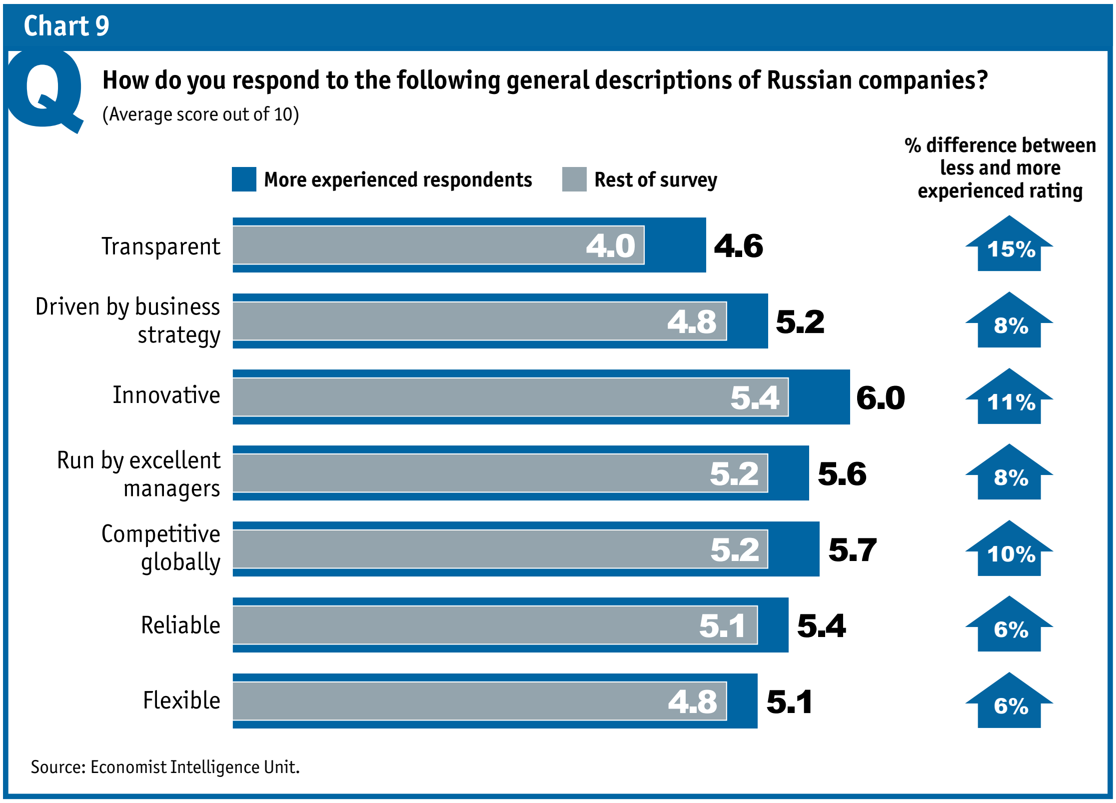
The issue is well known. The Transparency International (TI) 2011 Corruption Perception Index ranks Russia 143rd out of 182 countries. Although this index measures perceived levels of public sector corruption, Russian companies do not come off any better. In last year's TI Bribe Payer's Index—which measures perceived likelihood of companies from a given country to offer bribes—Russia scored worst among 28 major economies.

Corporate governance has been a concern since the 1990s. The details of high-profile struggles over control of joint ventures—such as those between Russia's AAR and BP over TNK-BP, an oil joint venture, or between Alfa Group and Telenor over Vimpelcom—do little to reassure foreigners about the risks of operating where legal clarity and protection can be problematic. In some cases, Russian business culture can also add to the difficulties. Mr Jafar observes: "The general perception is that once a contract is signed, it is only as strong as the partners decide or want it to be. In one instance there didn't seem to be any sense of regret or embarrassment when one of our partners informed us that they had made a mistake when they signed a particular clause, and now they wanted to remove it."

This set of issues has become of increasing significance to business globally. Corruption in particular is a growing concern, with the United States Department of Justice becoming ever more aggressive in enforcing the Foreign Corrupt Practices Act (even for non-American companies acting well beyond that country's borders) and the extraterritorial provisions of the UK's Bribery Act—the two leading drivers of heightened risk in this area. A poor reputation here is likely to make any firm less welcome as a partner or investor. Dietrich Moeller, president of Siemens Russia, notes that, for potential partners of his company, "adherence to legal and ethical norms and fighting corruption at all levels in the company is an unconditional priority."

Getting to know the Russian partners

Although the survey shows that foreign executives have some positive views about the Russian corporate sector, many of their opinions are lukewarm or decidedly negative. This comes as no surprise to many interviewees for this study. As Mr Tchakarov puts it, "Russia has a lot of perception problems. Clearly, it has real problems in terms of corruption, corporate governance and treatment of minority shareholders, but these are to a large extent exaggerated." Mr Fey adds that Russian companies "are not viewed [abroad] as



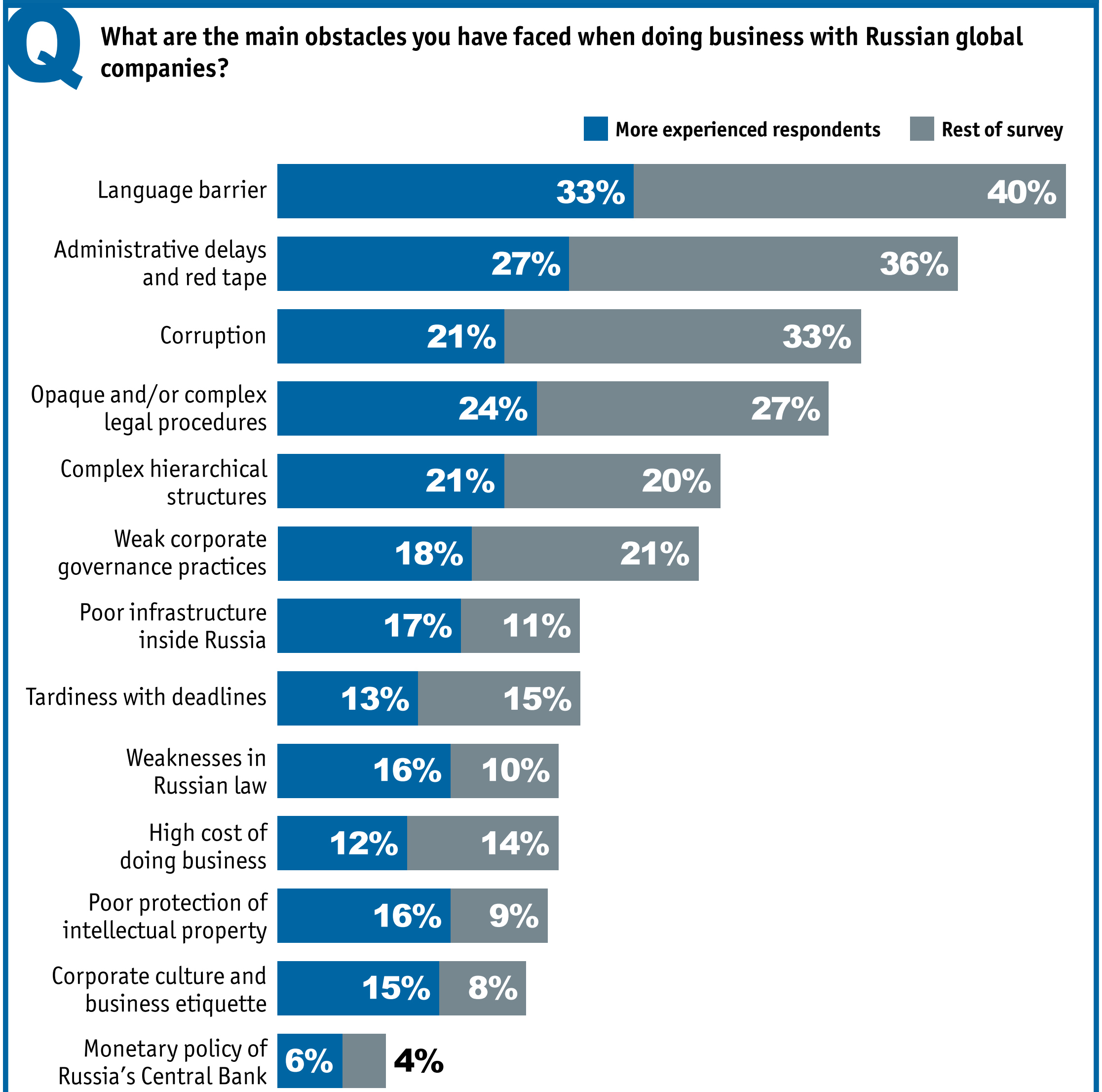
world class and yet, in Russia, you see some really great examples of companies doing good things. But the world is largely oblivious to that, as the horror stories make better press."

A closer look at survey figures confirms that negative perceptions of Russian companies as a whole are probably excessive. Forty-six percent of those surveyed—here called "more experienced respondents"—are from companies that have had experience with Russian investors and firms. Their views differ in important ways from those whose businesses do not have experience so far and only plan to engage with Russian firms in the near future.

As noted above, a large majority of the more experienced respondents say their joint-venture and M&A activities with Russians have met expectations reasonably or very well. Equally striking, more experienced respondents are more likely to plan to do further business with Russian direct investors: 67% say they definitely or probably will do so in the short term (compared with 40% of less experienced respondents), and 75% say the same of the medium term (compared with 70% of the less experienced respondents).

More experienced respondents are also less worried about the obstacles of dealing with Russian companies. They tend to think more highly than do their less experienced peers of Russian firms across a range of criteria, such as competitiveness, innovation and flexibility. In our survey, the scores given by the experienced companies were on average 9% higher than the scores given by less experienced companies (see Chart 9). Although even the assessment of the more experienced respondents is not very enthusiastic, this difference is important given that Russian firms are not alone in having problems. As Mr Thain notes, "It's very difficult doing business in all emerging markets, [including] all the BRIC countries." The Chinese are not paragons of transparency, nor the Indians of efficiency. From a relative standpoint, the higher assessment of more experienced respondents is therefore significant.

Chart 10



Source: Economist Intelligence Unit.

The view of more experienced respondents on the obstacles to doing business with Russian firms is also more nuanced. Language, administrative delays and corruption remain among the leading issues, but they are cited much less often by the more experienced respondents than by others. Instead, the more experienced respondents have a greater appreciation for the difficulties both they and the Russians face in common, such as a weak infrastructure when operating within Russia, and differences in business etiquette. Mr Smith of AkzoNobel, for example, says, "creating joint ventures takes longer in Russia than elsewhere. There's a lot of detail—things that you see as bureaucracy, but they don't, because they're essential to their process. Don't be surprised if unexpected rules and regulations crop up: they may surprise your Russian partners as well." He adds that in dealing with Russian businesses, "you need to learn the culture. The process for making changes is different."

The harsher opinions that less experienced companies hold of Russian firms may simply reflect a lack of current information. Interviewees point to ongoing, steady improvement in areas of concern to outsiders, such as corporate governance. Mr Ivlev of Ernst & Young believes that significant change has occurred over the last decade. “In the 1990s, conditions were more challenging. Now corporate governance has become much better. Russian companies are not as bad as many foreigners think.” Similarly, Mr Smith notes that, in his experience, “all the Western companies [involved with Russian ones] think that things are better these days.”

This is not just taking place inside Russia. As Dr Moeller of Siemens says “in the past five years, the reputation of Russian companies abroad has improved,” as they entered global markets and have started investing in foreign countries, noting in particular their activity in Germany.

Corporate governance codes and standards have improved at many companies, their profile raised by ongoing discussions on Russian membership of the Organisation for Economic Co-operation and Development (OECD). Annual surveys in the last decade by the Russian Institute of Directors (RID) found continuous, steady improvement in corporate governance practice. Compliance with the RID’s governance recommendations among Russian joint-stock companies rose from 56% in 2004 to 68% in 2009 (the last year with comparable figures before a new survey format). Similarly, a 2011 RID survey of governance disclosure by Russian listed companies found that in some areas—notably financial transparency and ownership structure—they were above average for emerging markets. The report mentioned a need to create awareness of the obligations and benefits of transparency among corporate directors.

The campaign against corruption, too, may be seeing progress: in 2011 Russia passed a new anti-bribery code with stricter penalties, and in February 2012 Russia signed the OECD’s anti-bribery convention. Moreover, Mr Kolomytsyn of Morgan Stanley stresses the importance of not conflating the situation in Russia with the behaviour of Russian firms abroad. “If we are talking about Russian companies that have assets outside of the country, these are completely different. They are internationally oriented companies.” If anything, the current internationalisation of Russian companies is likely to speed their improvement as partners. As Mr Katsoglou of Dow Chemical explains: “Russian businesses were used to dealing with local issues and processes. Now they’re in a period of trying to open up, so they will increasingly have to expand their horizons to the whole world. That will affect the way they do business. The World Trade Organisation accession will help with that process.”

In summary, while the problems that respondents see with Russian companies are real, for many the worries are exaggerated. It is not always easy to overcome the barriers to fruitful interaction with Russian partners, but those who have done so think it is worth the effort. According to Mr Smith of AzkoNobel, “once in, you’re really glad you put all that effort in. All the companies I’ve spoken to that have done it are looking at more investment.”

PepsiCo: A long journey

PepsiCo, the giant US food and drinks company, offers a good example of a company that has moved beyond stereotypes in learning to deal with its Russian counterparts. PepsiCo—maker of Pepsi-Cola, Gatorade, Tropicana, Quaker Oats and Frito Lay products, among others—began its history in Russia somewhat inauspiciously, with a Cold War publicity stunt. In 1959, after their famous "kitchen debate", the US vice-president, Richard Nixon, steered the USSR premier, Nikita Khrushchev, towards PepsiCo's kiosk at the American National Exhibition in Moscow. On tasting two batches of the fizzy cola, one made in the US and the other in Russia (to show that the product could be produced there as well), Khrushchev declared: "Drink the Pepsi-Cola made in Moscow. It's much better than the Pepsi made in the US."

It would take another 15 years before Pepsi was allowed to sell its products in the USSR. Today, however, Russia is a key market for the American giant, and PepsiCo is a key player in Russia's corporate scene. In December 2010, PepsiCo became Russia's biggest food and beverage company through its 66% acquisition of Wimm-Bill-Dann (WBD), a Russian juice and diary producer, for US$3.8bn. By September 2011, PepsiCo had acquired the remaining 34% of the shares, giving it full control of the business.

The reasons for buying WBD are clear. The takeover made PepsiCo the biggest player in Russia's food and beverage business. WBD's products buttress PepsiCo's global revenue from sales of nutritious and functional foods. And the acquisition gave PepsiCo a foothold in the country's expanding dairy category, as well as in key emerging markets in Eastern Europe and Central Asia. As Ekaterina Kvasova, director of communications at PepsiCo, put it: "For PepsiCo it was a no-brainer—the investment was a perfect fit."

But what about the experience of taking over a local company? According to Ms Kvasova, it was quite a smooth process: "there is nothing we would do differently if we had to do it all again." That is not to say that everything was effortless, she adds. "Integrating two different companies with different histories and culture is never easy, but I would say we have a perfect understanding and working relationship with our [WBD] colleagues."

PepsiCo's long history in the country helped things along. It already had the right people with the necessary skills on the ground and thus understood the local market. "For us, there was no 'before' and 'after'," says Ms. Kvasova. "In some ways we are now a Russian company. We have over 40 factories and employ over 25,000 people in the region."

Yet even for a company with a long-standing local presence, doing business is not always straightforward. Bureaucratic red tape and inefficient business processes can make companies less nimble than they should be. For example, says Ms Kvasova, "in the West you just have to send an e-mail and that's enough. But in Russia sometimes that's not enough, because you may also need to get papers signed to get things moving. But we do see these things improving all the time."

As for the notion that Russia poses insurmountable difficulties to foreign investors, Ms Kvasova demurs. "There are negative stereotypes of Russia as a place where nothing can be done, or that it takes ages and there is corruption. To be honest, Russia has been really good to PepsiCo and we've never had these problems."

As PepsiCo's history in Russia shows, doing business in Russia, like many emerging markets, is not always a smooth process. However, the opportunities more than make up for the difficulties, making a local presence vitally important, says Ms Kvasova. She explains: "There are new opportunities everywhere; because disposable incomes have doubled over the last decade, there's a growing middle class, and there is low consumption within key categories."

Conclusion

The task ahead

How far these perceptions matter is difficult to quantify. Many foreign companies are willing to partner with, or receive investments from, Russian companies. Sometimes, however, says Mr Fey of Nottingham University, "negative perceptions are a huge obstacle." The efforts of Surgutneftegaz to invest in MOL, the Hungarian oil company, is a case in point. Surgut's private purchase of a 21% stake in MOL from an Austrian company was strongly resisted by the Hungarian government, which blocked Surgut from voting at MOL meetings and eventually bought the stake from the Russian company. Whether a reason for Hungarian unease or an excuse, Surgut's lack of transparency on its ownership structure and its political ties—typically described in the press as "murky"—did nothing to promote acceptance of the deal. Instead, they prompted accusations of Cold War-like plots to undermine Hungarian energy independence.

For Russian companies planning an international acquisition or joint venture, the best chances for success lie in accentuating the positive perceptions that attach to Russian partnerships—including the positive assessment of Russia's technological capabilities—and trying to allay fears associated with the negative perceptions. As Mr Fey notes, "Russian companies looking to expand abroad need to show that they are ethical, have good employment practices, and are interested in the long term—the whole list of best practices." Mr Ivlev of Ernst & Young comments that foreign partners look for the same things from Russians that they do from businesses of any nationality: "They always look for clear, understandable, predictable interaction, good corporate governance and normal business ethics."

The same applies to joint ventures. Mr Smith explains that AkzoNobel felt comfortable entering a joint venture with Ilim Paper not only because it had the appropriate size and capabilities. Even more important to success in such a partnership, he says, is "making sure you are dealing with a company with a sound reputation and ethics. We had known Ilim for many years and had a feeling for the kind of company they were. Their ethics and compliance had to map ours. It's not just a question of values but also of philosophy: if you're at opposite ends of the spectrum on that, the joint venture would fail."

For some Russian firms, this will involve addressing failings in governance and management, while for others it will mean making clear that they already abide by international standards. As Russian companies become more active in the global economy, the specific challenges for each company will become clear. Mr Kolomytsyn notes that many of the largest businesses with operations abroad "are internationally oriented companies. I don't think anyone who works with them abroad will say that they are corrupt." Similarly, Mr Tchakarov notes that "the key fear [of foreign partners] may be the level of corporate governance, but the big Russian companies have international management and good people."

Ultimately, says Mr Tchakarov, "it is up to Russia to change its perception problem. International investment is a chance for Russian companies to run decent business in a decent way that will help to change the perception. They should look at this as a great opportunity." Mr Fey adds: "The good news is that some Russian companies abroad are showing that they follow best practice, and are succeeding. That will attract attention."

Moving beyond the stereotypes

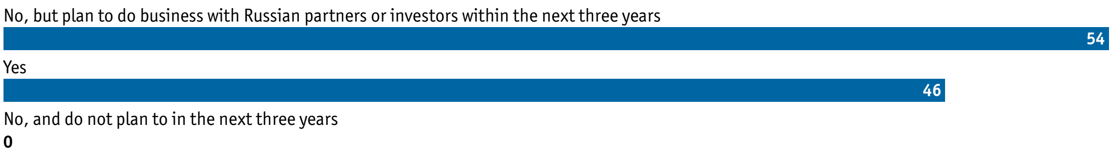
Russian firms that manage to separate themselves from the stereotypes held about their country and its business practices will find it easier to form successful partnerships abroad. Our research suggests nine ways that Russian companies can put the stereotypes to rest—or at least differentiate themselves from the commonly held perceptions:

- Focus on promoting business ethics at all levels of the company.
- Ensure that financial results are released in a timely fashion and are transparent to all.
- Avoid "insider" practices and back-room deals.
- Ensure fair employment practices and clear decision-making processes.
- Respect contract terms.
- Improve executives' foreign-language skills.
- Focus on long-term and sustainable business practices.
- Develop anti-corruption processes that are robust enough to meet not only the requirements of Russian law but also those of foreign legislation with extra-territorial reach, such as the US Foreign Corrupt Practices Act or the UK Bribery Act.
- Follow international best practice in terms of corporate governance, including protection of minority shareholder rights and developing codes of ethics.

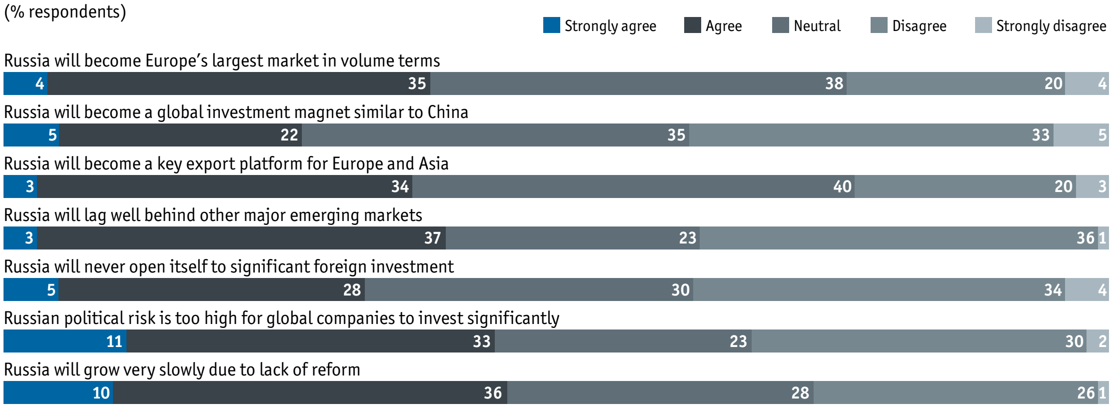
Appendix 1

Survey results

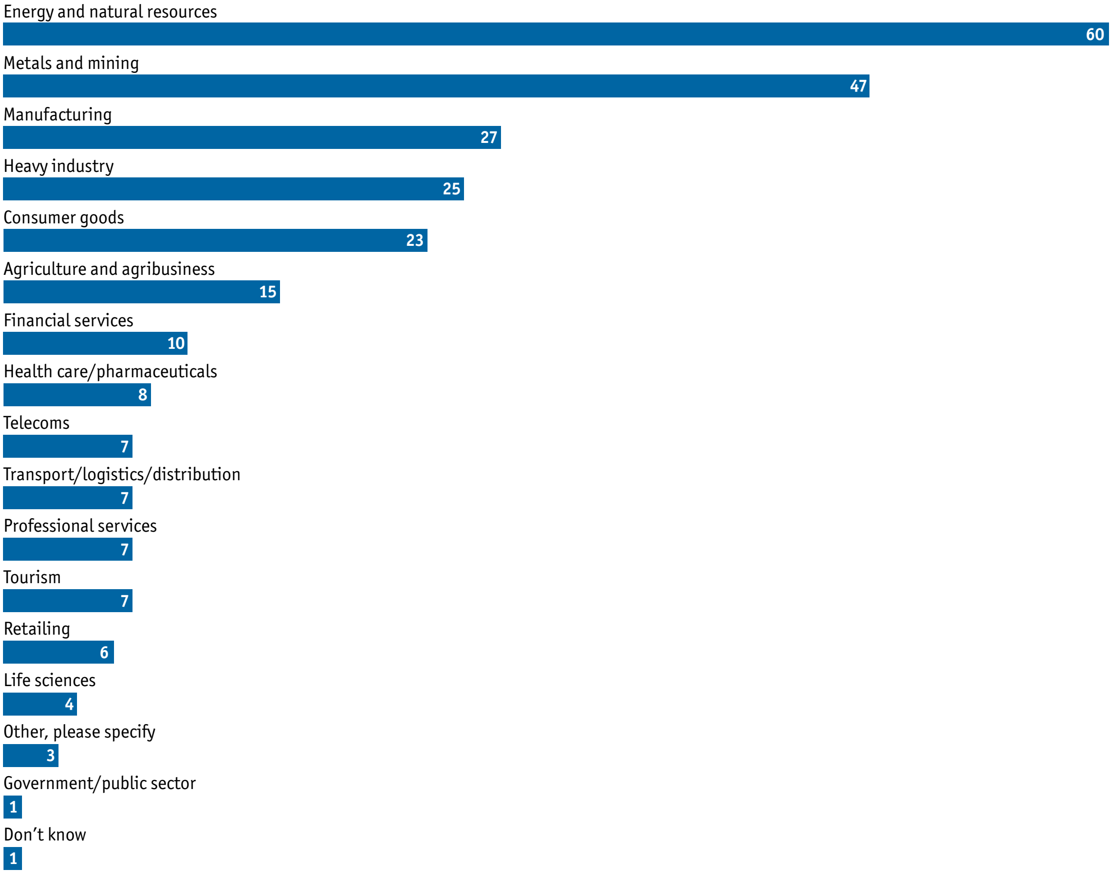
Does your company have experience (past and/or current) with Russian companies as joint venture partners, merger partners, or parent companies as a result of an acquisition?
(% respondents)



Thinking about Russia in general, how strongly would you agree or disagree with the following statements regarding business opportunities within Russia over the next decade? Please select one answer for each row.
(% respondents)



In which sector(s) do you see the greatest potential for international expansion on the part of Russian companies?
(% respondents)

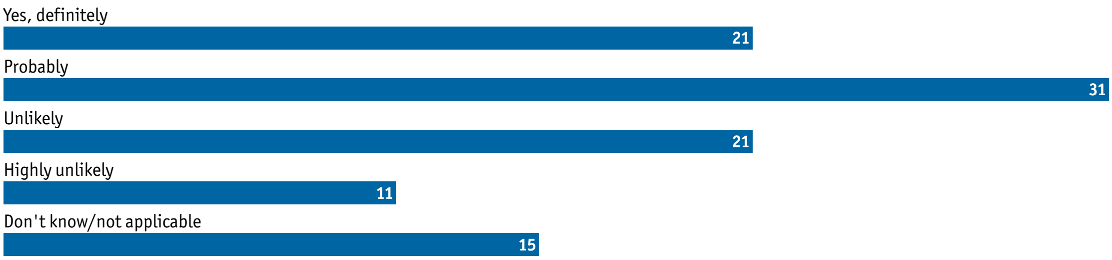


Have your company's current or planned joint ventures or mergers with Russian partners involved doing business inside Russia, outside Russia, or both?
(% respondents)

Overall, how well have your joint ventures and/or mergers and acquisitions with Russian multinational companies met your expectations: a. when doing business inside Russia?
(% respondents)

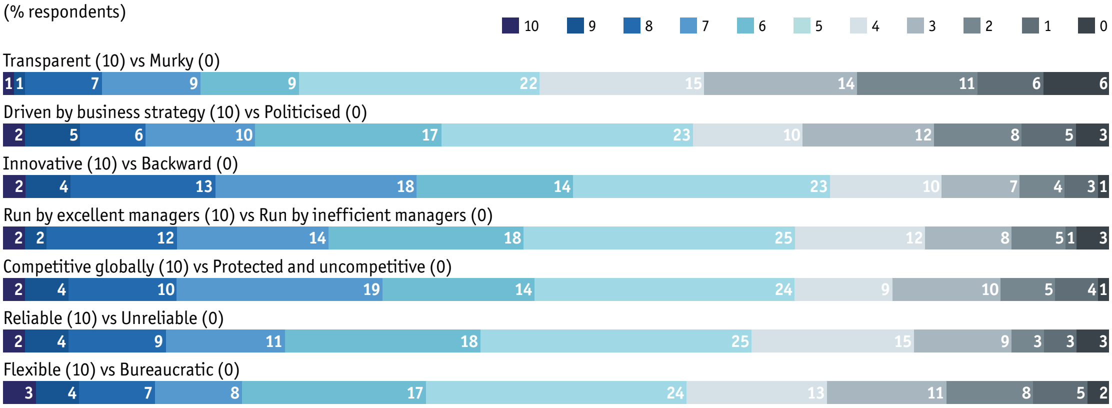
Overall, how well have your joint ventures and/or mergers and acquisitions with Russian multinational companies met your expectations: b. when doing business outside Russia?
(% respondents)

Does your company plan to do further business with Russian direct investors a. in the short term (1-3 years)?
(% respondents)



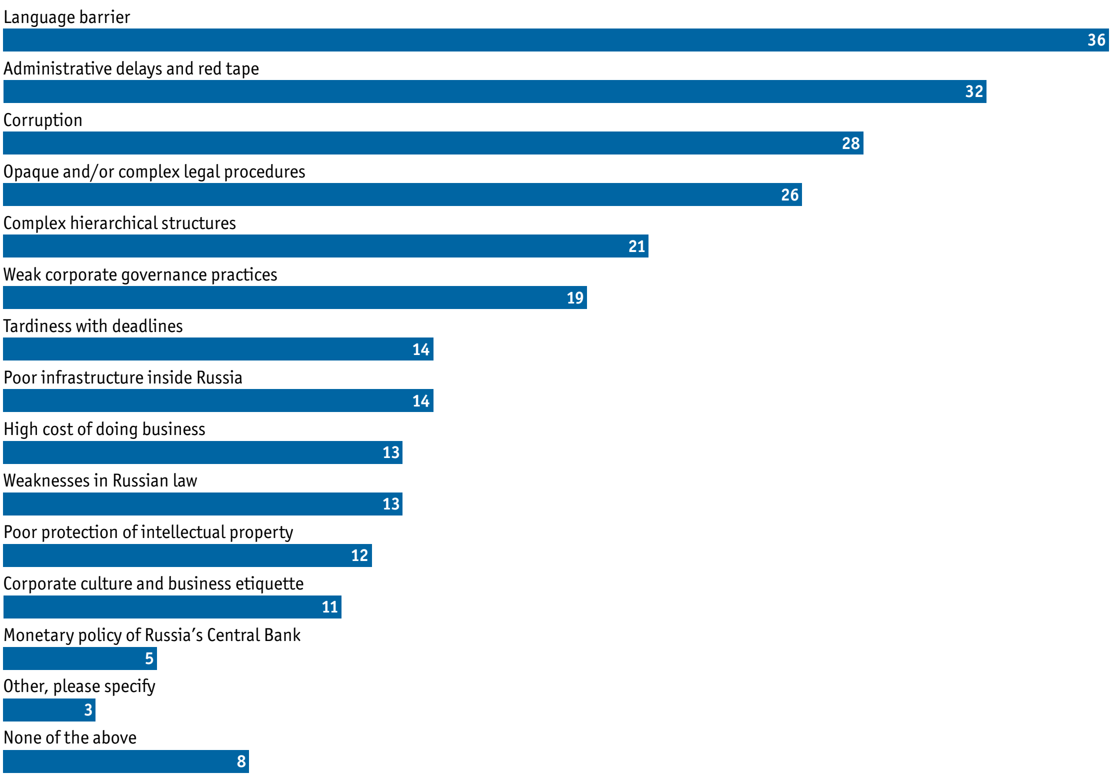
Does your company plan to do further business with Russian direct investors b. in the medium term (>3 years)?
(% respondents)

How do you respond to the following general descriptions of Russian companies? For each row, please choose the column closest to your views of Russian companies.
(% respondents)

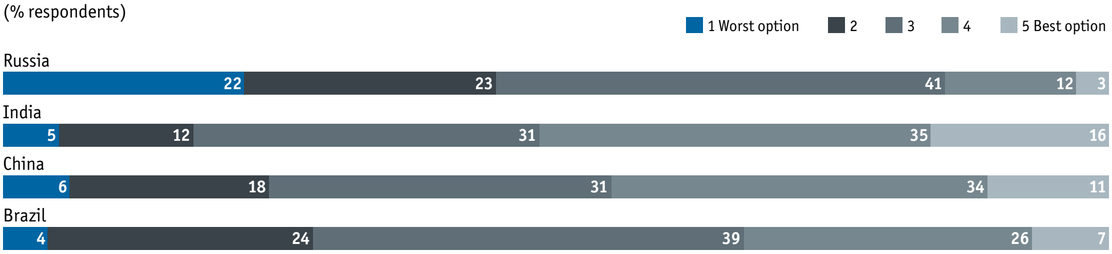


In your view, what are the main advantages and disadvantages of doing business with Russian companies? Please rate each of the following on a scale of 1-5, with 1 corresponding to strong advantage, and 5 corresponding to strong disadvantage.
(% respondents)

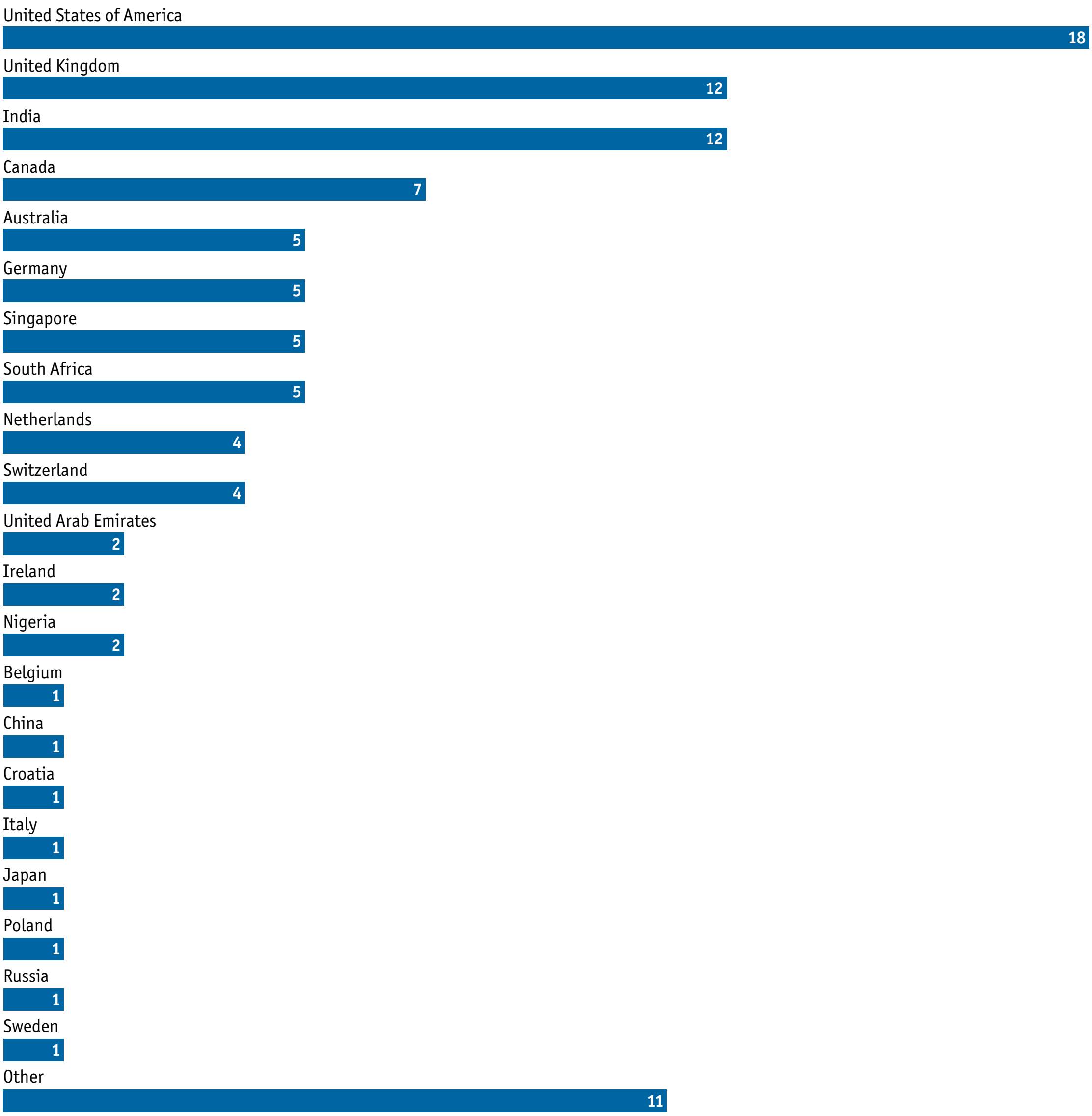
What are the main obstacles you have faced when doing business with Russian global companies? Select up to three.
(% respondents)



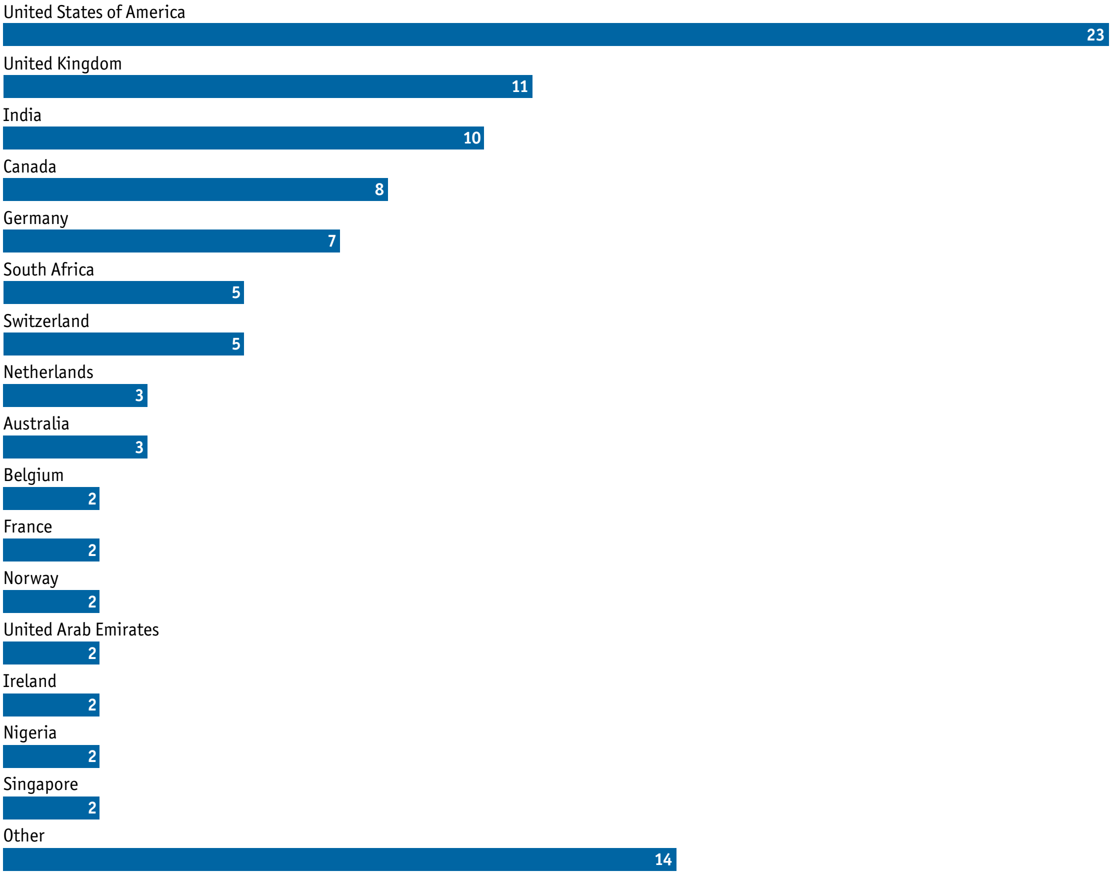
If you compare the prospect of your company being merged with or acquired by a Russian company, is it better than being merged with or acquired by a company from one of the other fast developing emerging-market countries?
(% respondents)



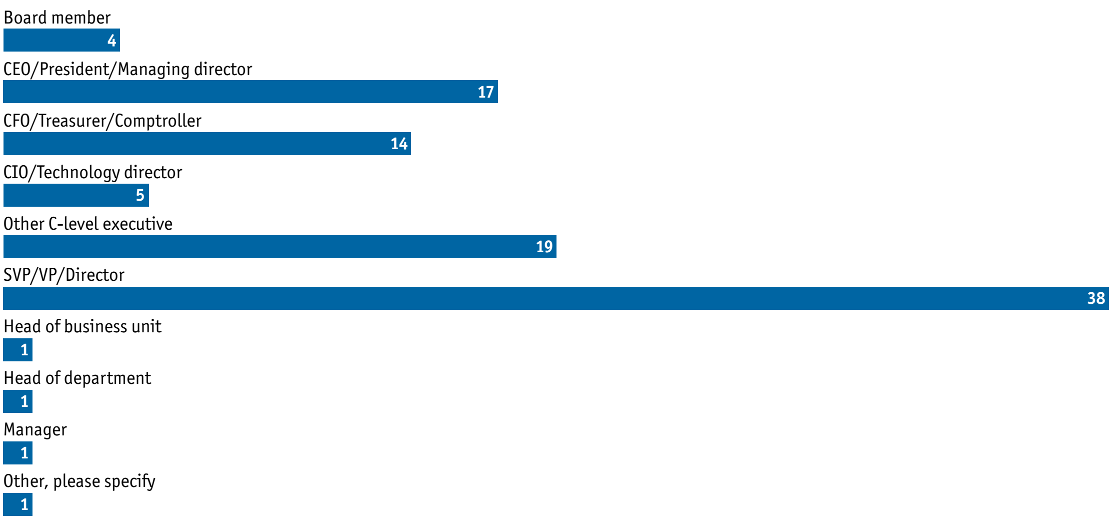
In which country are you personally located?
(% respondents)



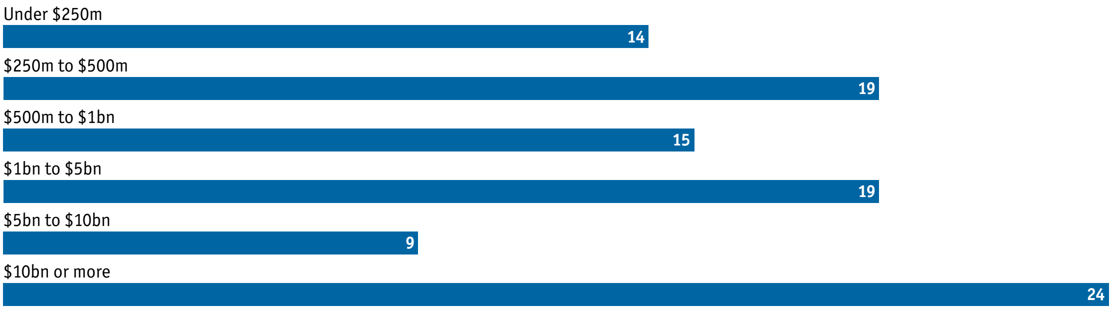
In which country are your company's global headquarters based?
(% respondents)



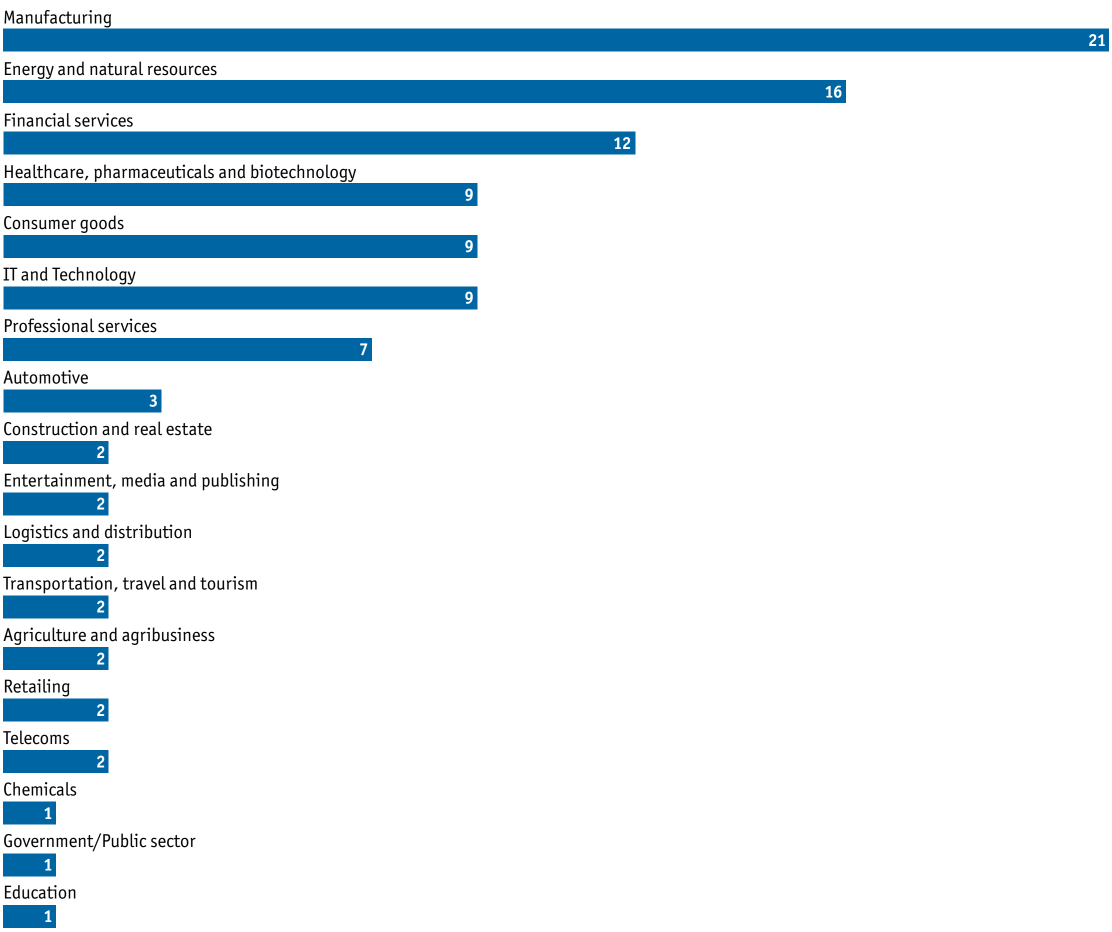
What is your title?
(% respondents)



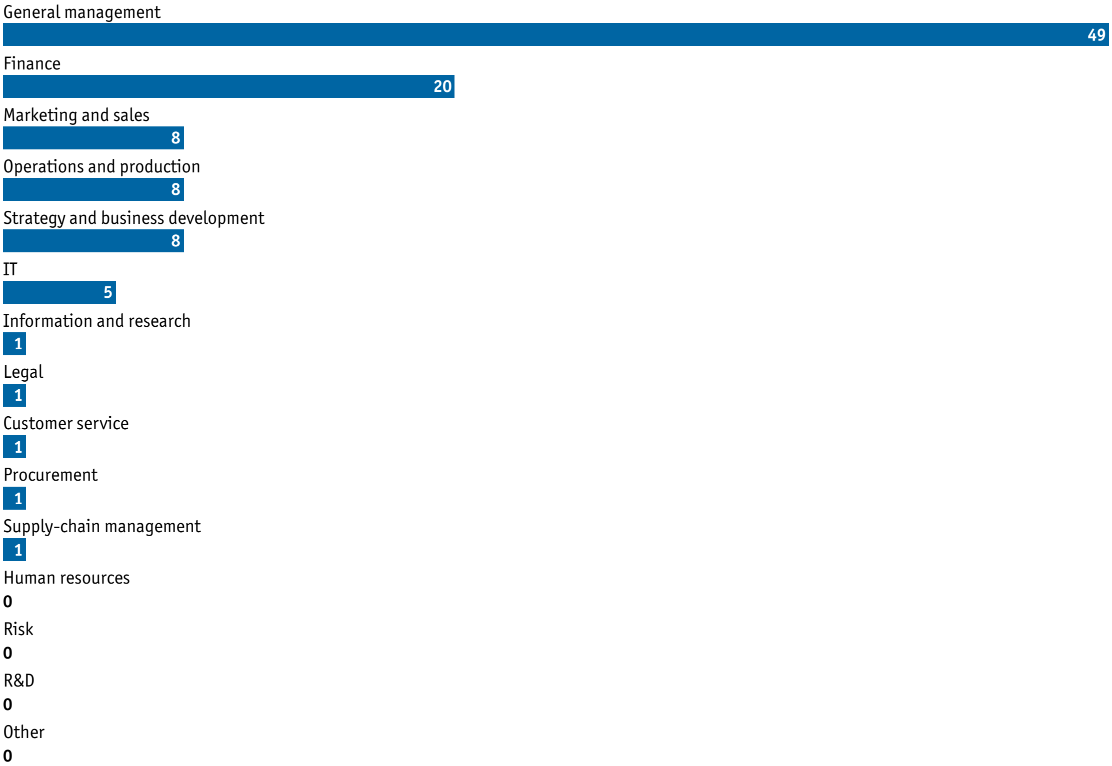
What are your organisation's global annual revenues in US dollars?
(% respondents)



What is your primary industry?
(% respondents)

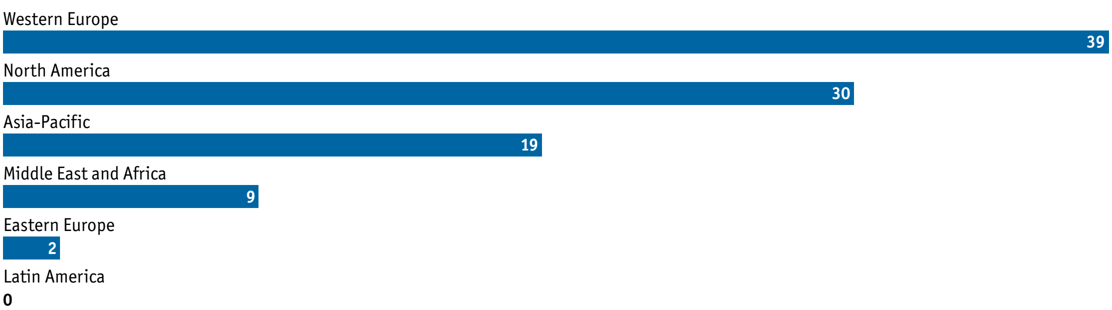


What is your main functional role?
(% respondents)



In which region are you personally located?
(% respondents)

In which region are your company's global headquarters based?
(% respondents)



Appendix 2

In-depth interview programme

The Economist Intelligence Unit would like to thank the following individuals—listed alphabetically by company name—for their insights and participation in our programme of in-depth interviews for this report:

- Agriculture Infrastructure Management Company—Greg Thain, CEO
- AkzoNobel Pulp and Performance Chemicals—Byron Smith, Director of Strategy and Transformation
- Alstom Power—Andrey Lavrinenko, Regional Vice-President, Russia and the CIS
- AstraZeneca Russia—Nenad Pavletic, President
- Crescent Group—Badr Jafar, Managing Director
- Dow Chemical—Kostas Katsoglou, President for Russia, Eastern Europe, Greece and Turkey
- Ernst & Young Russia—Alexander Ivlev, Country Managing Partner
- Morgan Stanley Russia—Dmitriy Kolomytsyn, Senior Metals and Mining Analyst
- Nottingham University—Dr Carl F. Fey, Professor of International Business
- PepsiCo—Ekaterina Kvasova, Director of Communications
- Renaissance Capital—Ivan Tchakarov, Head of Russia & CIS Economics
- Siemens Russia—Dr Dietrich Moeller, President

Foreign direct investment

	2007[a]	2008[a]	2009[a]	2010[a]	2011[b]	2012[b]	2013[c]	2014[c]	2015[c]	2016[c]
Foreign direct investment (US$ bn)										
Inward direct investment	55.1	75.0	36.5	43.3	52.9	50.0	59.0	62.0	65.0	70.0
Inward direct investment (% of GDP)	4.2	4.5	3.0	2.9	2.8	2.6	2.9	2.8	2.7	2.6
Inward direct investment (% of gross fixed investment)	20.2	20.3	13.6	13.4	13.4	11.3	12.1	11.5	10.8	10.3
Outward direct investment	-45.9	-55.6	-43.7	-52.5	-67.3	-51.0	-52.0	-53.0	-54.0	-55.0
Net foreign direct investment	9.2	19.4	-7.2	-9.2	-14.4	-1.0	7.0	9.0	11.0	15.0
Stock of inward direct investment	491.1	215.8	378.8	493.4	546.2	596.2	655.2	717.2	782.2	852.2
Stock of inward direct investment per head (US$)	3,450	1,521	2,669	3,452	3,820	4,175	4,598	5,044	5,516	6,027
Stock of inward direct investment (% of GDP)	37.8	13.0	31.0	33.2	29.4	31.2	32.0	32.3	32.2	31.6
Memorandum items										
Share of world inward direct investment flows (%)	2.86	4.99	4.48	4.82	4.88	3.99	4.26	4.10	3.89	4.18
Share of world inward direct investment stock (%)	3.34	1.51	2.43	2.98	3.09	3.15	3.22	3.28	3.33	3.66

[a] Actual. [b] Economist Intelligence Unit estimates. [c] Economist Intelligence Unit forecasts.

GENEVA
Boulevard des Tranchees 16
1206 Geneva
Switzerland
Tel: +41 22 566 24 70
E-mail: geneva@eiu.com

LONDON
25 St James's Street
London, SW1A 1HG
United Kingdom
Tel: +44 20 7830 7000
E-mail: london@eiu.com

FRANKFURT
Bockenheimer Landstrasse 51-53
60325 Frankfurt am Main
Germany
Tel: +49 69 7171 880
E-mail: frankfurt@eiu.com

PARIS
6 rue Paul Baudry
Paris, 75008
France
Tel: +33 1 5393 6600
E-mail: paris@eiu.com

DUBAI
PO Box 450056
Office No 1301A
Thuraya Tower 2
Dubai Media City
United Arab Emirates
Tel: +971 4 433 4202
E-mail: dubai@eiu.com