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Russia's New Horizons
DELIVERING GROWTH CAPITAL TO RUSSIA'S ENTREPRENEURS
Panel

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11:45–13:00, Pavilion 5, Conference Hall 5.1

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Moderator:

Simon Nixon, Chief European Commentator, The Wall Street Journal

Panellists:

Sergei Borisov, Vice President for Small Businesses Development, Sberbank

Sir Suma Chakrabarti, President, European Bank for Reconstruction and Development

Mark Haefele, Global Head of Investment, Chief Investment Office of Wealth Management, UBS

Vladimir Miklushevsky, Governor of the Primorsky Krai

Andrei Sharonov, Deputy Mayor for Economic Policy, Moscow

Pekka Viljakainen, Chairman, All Capital

S. Nixon:

Good morning, everybody, and welcome to this session on Delivering Growth Capital to Russia's Entrepreneurs, an important topic all over Europe at the moment, but obviously a particularly important topic here in Russia. We have a very distinguished panel. Unfortunately, Andrei Sharonov, the Deputy Mayor for Economic Policy in Moscow, has been delayed. I hope he will join us during the course of the session, but we will carry straight on.

To open our discussion, I am going to ask Pekka Viljakainen to speak first. Pekka, who is better known in Russian financial circles as 'the Bulldozer', a name he was given by President Medvedev himself, is an advisor to the Russian government on investing in growth companies and an advisor to the Skolkovo Foundation, and he has recently completed a trip around all of Russia's regions where he visited a very large number of small and medium-sized companies to try to understand the problems of financing. I ask him to speak first.

P. Viljakainen:

Good morning, ladies and gentleman. I am here in two roles: AI Capital, of which I am a Chairman, is my small investment company in the private sector, but today, in this particular session, I am sharing some views about what we have learned about the Russian investment climate. My focus is mainly and only on start-ups, small and medium-sized companies. Of course, raising capital for infrastructure projects, for airports, streets, roads, and that kind of stuff is also extremely important, but let us say it is a traditional task that is very capital intensive. My focus is on new businesses and high-tech.

I am an advisor for Mr. Vekselberg at Skolkovo and, as a 'Bulldozer', I wanted to push a survey analysing what is happening not only in St. Petersburg, not only in Moscow, not only in Skolkovo, but across Russia's regions. We took a great team, bringing together Russian venture companies, the Federal Agency for Youth Affairs, the Agency for Strategic Initiatives, and all the key ministries, and we organized a 16-city tour. The first thing I want to highlight for all the foreign guests here is that Russia is a really big country: we covered 24,000 kilometres

by plane, visiting 16 cities, and about 7,000 people joined in on those sessions. This is a really big country.

However, from the investment standpoint, even Russians were asking me, "Why are you going to Vladivostok? Why are you going to Novosibirsk? Why are you going to Rostov? Why are you going to these different cities? The big opportunities are in Moscow and St. Petersburg." After the tour, my Russian colleagues who joined me changed their views. I was really positively surprised by the fact that, not only these 16 cities, but most of the regions have, in the past five years, not only started to change but have already achieved big changes in their ways of working, in how they develop new businesses. The motivation is pretty clear: Russia needs tens of thousands of new companies over the coming 10–20 years, to compensate for the inevitable fact that they will not be able to be so dependent on oil and gas production in the future. The drivers are clear, and that is something.

Now I put my investor hat on. When we talk about capabilities, I think that Russia needs more than just money. Americans call it 'smart money'. Russia has a lot of money and a lot of capital, but what these start-ups, these SMEs, and these new companies need is more advisors. They need board members. They need active executives. The 'bandwidth', I would call it, of companies is really high. If anybody in the room is planning to invest in Russia, Russians or foreigners, I would not invest on a portfolio basis. But if you have a team, a Russian team, if you have people who know Russia to support these entrepreneurs, I think that investments can be extremely fruitful here. Also, valuation levels, which are key to success, are, at least for me, much, much more tempting in the other Russian regions, not in the overheated areas.

The last point that I want to make in this introduction is that the biggest barrier to investment in Russia for these companies is not corruption, not bureaucracy, and not the lack of companies. Yes, all of these exist to a certain extent, but these never prevent me as an investor from investing in Russia. The problem is the lack of trust, and I am not talking about politics or governmental issues now. The problem is that when you talk to a young entrepreneur in any city, and he or she needs USD 1 million, by definition, he or she is afraid of me as an investor. He

thinks, "What is his motivation? What is his plan? Is he here to take my business? Why do I need his money?" It is not like when you invest in Silicon Valley or in Finland, where the entrepreneurs give you a big hug and they want your money. Here, you have to sell yourself. This is about a lack of trust, and I would like to hear this panel also highlight the importance of this fact: that Russia is about personal relations. It is about trust between friends – not so much the vodka-drinking any more – and without that trust, no investment should be made here.

Last but not least, every single investor knows that in Russian trade law and federal law, there is one weakness, and it is guarantees for minority shareholders. I always remember when I made my first investment in Russia, I asked my legal team, "What does it mean if I own less than 50% of the shares?" The lawyers said, "Do you want the short version or the long version?" The short version was: "Pekka, you will be screwed!"

The point is, this is partially a historical thing, because most of the companies which I have invested in operate in Russia and their teams are here, but they are incorporated in Luxembourg; they are incorporated in Cyprus; they are incorporated in Helsinki. You can therefore do deals based on European trade law, so even that has been overcome.

All in all, to summarize, if I want to triple my money over the next 5–10 years – as a minimum requirement – I see Russia's SME market and high-tech sector as extremely, extremely attractive.

S. Nixon:

Thank you very much, Pekka, for that introduction to the issue. Before we turn to the providers of finance, I thought we would go next to Sir Suma Chakrabarti, who is President of the European Bank for Reconstruction and Development (EBRD). The EBRD has recently done its own study into the supply of finance in Russia which has raised some interesting issues, so I will ask him to speak next.

Sir S. Chakrabarti:

Thanks, Simon, and thanks to Pekka as well for what he said. I agree with much of what he said. I think, from our point of view, what our studies show is not going to surprise anyone here. The biggest killer for new Russian entrepreneurs is the concentration of economic power in three areas.

One is at a sectoral level. We know this; we all know that oil and gas still dominate the economy. Everyone knows that. Oil and gas make up 70% of Russia's exports, and the government budget completely depends on this sector as well, which leads to all sorts of problems in terms of volatility at the macroeconomic level. So there is a good case for diversification there.

Second is the concentration of economic power geographically, which Pekka has talked about. We have the same experience: too much economic power lies in a certain part of Russia. It is not very well spread out.

Thirdly, the state still controls too many industries, and this is also well-known. The need for the state to 'let go' is part of the issue. Concentration of power in these three spheres is, I think, a big issue.

It seems to me that there are a number of things one has to do, and they are not new, but they need to be repeated and repeated, because obviously when you have concentration of power in those three spheres, you have vested interests. This is true for any country which depends on that concentration of power. The first thing is to tackle some of the investment climate issues. Now, Russia has been doing quite a lot of work on that; I think the Foreign Investment Advisory Council (FIAC) has been working quite closely with the Russian administration on some of those issues. But the red tape and bureaucratic hurdles are still seen as a real problem. This is quite an interesting thing: if I market Russia to those foreign investors who are already operating in Russia, such as many of you here who already have investments in Russia, it is actually quite an easy sell because you know how to navigate the system. But if I market Russia to new foreign investors, they do not know how to navigate the system and they are incredibly frightened of it, so at the moment, it is incredibly difficult for the EBRD to persuade new foreign investors to come to Russia. It is quite easy for us to do repeat business with existing investors, but Russia needs new foreign investors as well, not just the same old people.

I think the importance of this is that the more Russia is interlinked with the global economy, with new foreign investors, the more some of the entrepreneurial skills will be transferred automatically as companies establish themselves here. One of the things I notice quite often in Russia is that it has great education levels compared with many other countries, but the management skills in many companies are below what you might see in other BRICS countries, for example. I think that is partly because Russia is not as integrated into the global economy yet as it should be, and with more integration, with more new companies coming into Russia, more management skills and entrepreneurial skills will be transferred.

I strongly agree with Pekka about the importance of innovation and the IT sector, but I think there is quite an interesting debate here. When I talk to Israeli entrepreneurs or British entrepreneurs who want to come to Russia because of the education levels in the ICT field, the knowledge economy sector, what most puts them off is the top-down approach to this sort of area. They do not think ICT – the knowledge economy – is nurtured by a top-down approach. They think it is much better to have a more bottom-up approach, generally, and that is, again, something about the state and its willingness to let go. Another area where I very much agree with Pekka is that SMEs are an under-resourced area. The EBRD ought to be doing a lot more on SMEs throughout Russia, and outside of the advanced regions, in the much more under-developed regions. We are, with our new strategy which we have just started to implement, moving much further east and south – on purpose. It is much harder, but much more worthwhile in the long term in building those small and medium-sized enterprises, which will have the entrepreneurs and will grow. I will leave it there, Simon.

S. Nixon:

Thank you very much indeed. We can turn now to a supplier of growth capital. I am going to ask Sergei Borisov, who is Vice President for Small Business Development for Sberbank, and also an ex-President of the Russian Federation of Small Businesses, to talk about some of the things that Sberbank is doing to help support Russian growth.

S. Borisov:

Thank you very much, Simon. It is true that I am quite familiar with the small and medium-sized business sector. For ten years, I was the head of OPORA RUSSIA, the biggest Russian organization of small and medium-sized businesses. Now I am the Head of its Advisory Board, and the President of the organization is here in this room. I have my own impression of what small and medium-sized businesses need today in order to develop, move forward, and open up new niches. For big businesses, everything is more or less clear, and access to capital here is fairly evident: they have something for collateral; they have a business plan; some companies (but not that many, by the way) have worked out business plans not just in terms of primary inputs, but also for the development of manufacturing. But small businesses have a whole set of problems. To avoid basing this purely on words and emotions, I want to bring in some facts.

Traditionally, every year, we ask our entrepreneurs, 6,000 respondents, one question: "What are your most significant problems today?" To comment on Pekka's thesis about trust, I agree that that is problem number one, and I would put it at the top of the list. Nevertheless, the entrepreneurs answered that today what they lack most of all is knowledge: they lack skills. Do you understand what a lack of skills means? It means business plans not put into practice, loans not paid off. It means tragedy and disillusionment. In second place is taxes, but they are on the list only because of an unsuccessful experiment with social welfare payments, new requirements for which have pushed us far backwards. And in third place is access to capital and insufficient credit. The year before last, 30% of our respondents mentioned a lack of access to capital. Since then, competition among banks has intensified, and today only 22% say that it is hard for them to get a loan. It is true that competition to attract small business is growing, and that is gratifying. New credit products are emerging. Sberbank has a very expansive line of credit products, around 20. We are responding to all the fundamental demands entrepreneurs are making. Unfortunately, those demands are not very great, and in order to understand them, you need to know the structure of a small

business. Our criteria for defining a small business, and the legal one, coincide with the European criteria: 100 employees is a small company. So among small companies, around 40% are in commerce, or retail, and among individual entrepreneurs, of which there are approximately 3.5 million in Russia, that figure is 80%. Now try to imagine how the banking community is distributing its efforts. About 10–12% is targeted at manufacturers in small business, 10% at shipping and transportation, and only 1.5–2% at healthcare and social services, with another 1.5–2% perhaps going to innovative businesses, which is very little and extremely insufficient for Russia. Small business comprises around 23% of GDP, and around 25% of jobs. President Putin stated in his orders and articles before the election that by the year 2020, we must reach a rate of 50% employment in small business, which would correspond to around 40–45% of GDP.

Will that be difficult to do? Yes. It will be especially hard to establish good connections between the banking community and small business, to reduce risks, and to significantly change the regulations. At Sberbank, we have introduced a collateral-free loan called *Doverie*, which is Russian for 'Trust'. It is very popular, but, as you will understand, it also carries a great deal of risk, so the interest on it is around 19.5%. That is incredibly high. But there are some banks that assign rates of 20–25%. Right now we are racking our brains over how to lower rates like those. That is being done by the Government Commission on Competition and Development of Small and Medium-Sized Businesses, headed by Igor Shuvalov. I am his deputy on that commission. There is a major problem having to do with beginning entrepreneurs. Sberbank is running a successful experiment that is continuing to gain momentum: *Business Start*, a product operating on the franchising principle, through franchising companies. Obviously, the likelihood of failure for small businesses is significantly lower if they take advantage of the experiences of those who have already gone down that path. Whole sector-wide associations are now joining *Business Start* and setting up their own franchises: the Russian Union of Beauticians and Cosmeticians, the Russian Guild of Bakers and Confectioners, the Federation of Restaurateurs and Hoteliers of Russia, and so on. The President of the Federation of Restaurateurs and Hoteliers, Igor Bukharov, is

here, and they are also currently working through these issues. This is the future; this is real.

But here is the problem we have run up against. An entrepreneur has money; he has a good company; a franchiser has approved his project and business plan; people have been trained, but in 60% of cases it is impossible for him to open his business, because there is not enough infrastructure. There is a lack of the kind of premises that would meet the franchiser's standards. Sometimes there are difficulties with access to electricity. On the one hand, you have startup capital; on the other hand, you have no way to open a business. I am going to stop here for now and am ready to continue later.

S. Nixon:

Thank you very much indeed, Sergei, for that. I am now going to turn to Mark Haefele from UBS. He is the Global Head of Investments in the Chief Investment Office of the Wealth Management Division and, in that capacity, he is a provider of finance on a global basis, including investments in Russia. I will hand over to him. Thank you.

M. Haefele:

Thank you. Just in terms of opening remarks, I would like to tell you a little bit about where UBS works in the capital structure in Russia – not as an advertisement, but hopefully because it will raise some questions and give you a view of the different markets that we try to serve. Then I will tell you a little bit about my view as an asset allocator. We have about USD 1.6 trillion under advisement and USD 130 billion in discretionary capital that we deploy into asset allocation. I will give my view on SME lending globally to put this discussion into context.

With UBS, we touch a lot of different levels in the capital structure and in different markets. We have been in Russia since 1997. As the number one global wealth manager, we have a dedicated capital advisory team that deals with mid-markets. In UBS, we bank for one out of two billionaires, so when you talk about 'smart money', we have this pool of people that love to get involved and be

advisors on deals. We, of course, as an international, global investment bank, bring billions of dollars every year to Russia's banks, which then, in a follow-on way, provide lending to SMEs.

We see things from different perspectives in the markets and the capital structure although, for me, it comes from an international perspective. What I would say is that Russia has done a lot, including hosting this entire Forum and this panel specifically, and in its lending efforts, to bring attention to this issue, because SME lending is difficult globally.

Let me give you some examples. The UK, according to the World Bank, is ranked number one in terms of countries where it is easy to provide credit into the SME space, yet the government is desperate to get loan growth up in the commercial space. They have launched a Funding for Lending scheme; it has attracted less than GBP 20 billion of the GBP 80 billion that is available. When you look at the euro zone, taking a slightly wider view, the difference in lending rates for small companies between Germany and Spain, within a few hundred miles of each other, is two percentage points, and this is at a time when the rates in these countries are at historic lows.

This is a problem that extends well beyond Russia. It is important to think about it in that context, that everybody is looking to address these factors.

S. Nixon:

Thank you very much, Mark. Finally, I am delighted that Andrei Sharonov, the Deputy Mayor for Economic Policy in Moscow, has arrived. He will give a slightly different perspective on this issue, no doubt.

A. Sharonov:

Thank you, Simon. If you do not mind, I will speak Russian. Sorry for being late. I would like to begin with a thought that, I hope, is obvious to everyone here in this room: access to capital is not a job for the government – much less for the regional governments – but for market institutions. Very often, in the old Russian tradition, we try to attack a problem all together, not splitting up functions, not dividing up areas of expertise. Nothing good ever comes of that. Of course, the

government influences access to capital; it influences it very strongly, but nevertheless, capital should come out of the appropriate market institutions, and the state should not be standing in for those. The government, in the broad sense of the term, certainly should be responsible for macroeconomic stability and the overall economic conditions that in large part determine how accessible capital is: the notorious cost of money, over which small businesses so seriously criticize both the banks and the government. Although in this case I would sooner agree with the banks' point of view, with their assessment of the macroeconomics and risks that go into the cost of money, of how those fall on small business owners. The second thing for which the state is responsible is the condition of the institutional environment. That is also extremely important. And the third job, in which the regional governments also have an enormous role to play, is facilitation, cooperation with small business in access to capital.

I will remind you of what Sergei Borisov said: very often the entrepreneurs themselves, and, following their example, government agencies, put down all problems to a lack of capital. It seems to me that the lack of education, of mentorship and tutorship, has enormous importance here. When knowledge and know-how emerge later than money, and the money runs out sooner than success arrives, that, as a rule, is the result of errors, of incompetence. This concerns mainly, but not exclusively, beginning entrepreneurs. On closer inspection, entrepreneurs most often need precisely that knowledge, precisely that training and that connection with people who have already gone down the same path several times and can protect them from obvious mistakes and from having to learn everything on their own.

In conclusion, I will name a few specific tools that the Government of Moscow is using to enhance access to capital and to stimulate small business activity in the city. Small business has an extremely large role to play, most of all as a source of jobs, income for citizens, and taxes, but not least as a way of life for that class of active citizens that is so notable in any country. We are still growing in that direction. So I want to name a few tools. First, there are subsidies. Let us not forget that credit is the business of special market institutions – banks, for example – and here the state should be reactive, in the good sense of the term.

We must not take upon ourselves the function of discovering and analysing projects when there are people who are specially trained for that on the markets. The role of the state in this case is complementary with respect to the activity of market institutions: we share risks with them and rely on their expertise. If they make a mistake, it would be best if they were the first to lose money, and we the second. That rule must absolutely be in effect. Therefore, I believe that practically everywhere that government money is involved, it should be accompanied by private funds, private risks, in order to avoid a moral hazard.

I would like to name two Moscow institutions here. One has already made a good name for itself: a Moscow guarantee fund called the Small Business Credit Fund, which takes on 50% of the risk in the case of a default. This policy is a popular one. Over the years the fund has been in operation, several thousand companies have received bank loans. It is not at all certain that they would have received those if not for that guarantee. Fortunately, cases of default are rare, and apparently the idea of risk sharing is working. Our task is to increase the leverage, increase the scale of activity, and make it possible for a large number of both entrepreneurs and financial institutions to make use of the mechanisms of the guarantee fund.

One new tool, created just in the past year, is the Microfinance Development Facilitation Fund. It is also based on risk sharing. We are working not with the end beneficiaries, but with market institutions that use our money and their own people to select the end beneficiaries. They have special scoring techniques for that, specially trained employees whom we should not have to, and cannot, retain as members of our staff. That kind of support – and here we are talking about startup, collateral-free loans up to RUB 1 million for beginning entrepreneurs – is targeted at the earliest, most vulnerable stage of entrepreneurship.

For the state, it is extremely important not just to make capital more accessible, but also to facilitate cost reduction. We can hand out government money too, but with that, the company risks running up against an enormous number of overhead costs connected with administrative procedures, corruption, and so on. By eliminating administrative barriers, the government, including regional

governments, helps to reduce costs and at the same time indirectly reduces the demand for financing.

And the last thing I wanted to talk about is the need to choose a focus. There are hundreds of thousands of small businesses operating in Moscow, and we are in no condition to cover them all. Hence our attention to institutions, which to a greater or lesser extent makes it possible for us to connect with them all. At the same time, we are trying to focus on those business sectors that interest us the most in terms of various criteria. For us, those sectors are innovation, innovative entrepreneurship, and venture companies. This is not a matter of taste. We are proceeding from the idea that Moscow is a post-industrial megalopolis with enormous scientific potential. About 40% of all the science workers in the country are concentrated in Moscow, as is about the same percentage of scientific institutes, of varying qualities, to be sure, but nevertheless. Moscow has over a million students, and of course, our task is to create attractive possibilities for the most talented, so that they will stay in Moscow and not move away, as citizens of the world, which they essentially are on the strength of their high level of competitiveness. We want to fight for them, and we can. Therefore, our focus of attention is on the creation and support of innovation infrastructure in the form of special economic zones, techno-cities, techno-parks, and business incubators. We are not discovering America here; we are just announcing that we are ready to conscientiously direct our money and our efforts along precisely that route. Thank you.

S. Nixon:

Thank you very much indeed. Now, I know that before we move to questions, Pekka wants to come back to something that Andrei just said, so I will pass straight back over to Pekka.

P. Viljakainen:

I just want to share one view that I have learned here in Russia, and not only in Russia but also in Finland, where I am originally from. With these grants, giving support to companies, there is also a tendency for many entrepreneurs to

become lazy if these grants are not always supported by private funding or co-funding. I must say that, on behalf of Skolkovo, we have actually made it a very strict policy that we no longer fund companies which have received a grant and which are not able to attract private funding from the very early stages. It also underlines what was stated here about management skills, leadership skills, and so forth.

The other point I was making about the banks is that when I was on this tour, I was in the city of Astrakhan, where, at the end of the day, there were about 400 start-up companies. I asked, "Okay, ladies and gentlemen, boys and girls, how can I help you?" One guy raised his hand and said, "Can you tell Mr. Gref at Sberbank that my company is good?" I said, "Okay, thank you. What is your next wish?"

The reason that I am telling you this story is that I come from Finland, which is only 20 minutes by helicopter from here. It is a small 'Mickey Mouse' country. There are a lot of start-ups and it is really booming there. I have invested personally in 20 start-ups there, and none of them got a single euro from the banks, ever. The Finnish banking system is in good shape. There are not too many bad loans and there are triple As, but the negative side of it is that you cannot get any money from the bank if you are a start-up or an SME because you have to have not just 80% in guarantees; nowadays you have to have 125% in guarantees. What start-up company can have 125% of their assets to cover themselves if everything goes wrong?

What I am saying here is that, yes, I am aware of the governmental things and government-owned banks' support programmes. I highly appreciate those, but I am saying that, for me, the only way to really boost the situation is to get the business angels, venture companies, and funds that provide the 'smart' element, not just the money, involved, and to make that happen faster in this region. I believe in banks; all my money is in banks. But I do not believe that they will solve the problem here. In a way, it would be like a turnkey solution.

S. Nixon:

Thank you, Pekka. For me, by far one of the most interesting things, or the most shocking thing to come out of this discussion, was Sergei saying that the cost of loans for businesses is 19.5%. Mark talked about the debate and the issues within the euro zone and in the UK over SME financing, but in the debate in Italy, where 90% of the economy and employment is in the SME sector, we are talking about 6–7% on SME loans there, versus 3–4% in Germany. How Russian SMEs can compete in the economy with rates of 19.5% for their bank loans – and goodness knows what returns the venture capitalists and the angel financiers would require, if the banks themselves are requiring 19.5% – seems to be a very serious structural issue for the economy.

I know Sergei wanted to come back to some things Pekka said, so maybe you could discuss why the cost of funding is so high. Is it all credit risk or are there other structural issues? And could you also address the points that Pekka made about venture capital?

S. Borisov:

It is interesting that Pekka mentioned his meeting with entrepreneurs, who told him angrily, “Convince Herman Gref that I am a reliable person so he will give me a loan.” Pekka, you are not going to believe this, but I, as a vice president, periodically try to convince my colleagues at the bank who are responsible for decision-taking on the loan committee that they should give a loan to one entrepreneur or another whom I have known personally for ten years, who I know is a good, reliable borrower, a capable entrepreneur. It does not always work. There are complex patterns in play, complex risk management laws in all banks, and there is no getting away from them. Sberbank is responsible for ordinary people’s savings, and that is a very serious moral and material limitation. When we asked small business owners their opinion about the size of interest rates, 48% said they were unmanageable. If you can imagine it, we are in fact cutting off half the risk. In the EU, around 20% of entrepreneurs also complain about high interest rates, but theirs are incomparable to ours.

Nevertheless, I believe that there are some reserves. Those reserves are connected not just with our banking community, but with the regulator, the

Central Bank of the Russian Federation. In particular, we are using a risk assessment method proposed in special Central Bank documents. But those methods are intended for any type of entrepreneur, regardless of the size of his business. We need to learn from the EU countries that have significantly reduced their risk requirements for small business owners, which is a definite boost for them. Right now we have a high refinancing rate of 8.25%. That is the cost of the money going into business here. If we reduce that rate to 5%, for example, and create a special small business fund out of the National Welfare Fund, then we will significantly change the threshold for inclusion in the portfolio of homogeneous loans. Right now that is one million, but we want to raise it to five million, and then the lending rate will go even lower, and so on.

You might ask me what else Sberbank is offering, as a powerful, major bank, and as the biggest in the country. A little over a year ago we launched a programme to create small business services. The first area of focus was on specialized divisions within Sberbank: Business Development Centres. These are not simply bank divisions where they give you loans. They also offer consulting on finances, tax consulting – in a word, knowledge. If you do not have your own infrastructure, you can hold B2B meetings there. These are genuine business development centres. We have already opened 140 of these centres, and we plan to bring their number up to 450. Yesterday a seventh centre was opened in St. Petersburg, at 7 Bolshaya Morskaya Ulitsa. Business owners love working in our centres.

The second area of focus is our unique Business Environment portal (dasreda.ru), a subsidiary of Sberbank. There are around 60 educational courses posted there. We select the best courses in order to generate some insurance for entrepreneurs who want to get a loan. First the user is asked to undergo some testing to ascertain whether he is capable of running a business. Unfortunately, some people choose work that is not right for them. Then we give them knowledge.

About trust. Our portal has over a million users in total, of which around 200,000 are so-called verified users: that is, people who Sberbank is confident are creditworthy. The network of verified users we are building could be of real use to

everyone, both inside this country and as Russian businesses leave for markets abroad. We are actually starting to build these commercial bridges with China, Austria, Germany, and Finland. I think that the Business Environment portal will be a very important boost. The portal also has other services, but I can talk about them later. Thank you.

S. Nixon:

Thank you, Sergei. I can see hands going up in the audience, people wanting to come back to you on that, but before we go to the audience, I just want to bring Mark and Sir Suma back into this conversation, as they both also wanted to follow up on some points. Mark first.

M. Haefele:

Thank you. I just felt like Sergei was taking some criticism there for his bank's rates and approval process, and I wanted to say, from our perspective, as we look at the Russian banking system, there are over 1,000 banks in Russia. The 30 largest banks provide 60% of SME funding, and it is actually the smaller, regional banks where credit is even tighter, so we should give Sergei a break. His bank is actually one of the more generous lenders towards this sector that is out there.

S. Nixon:

Thank you, Mark. And Sir Suma?

Sir S. Chakrabarti:

Thanks very much. On the cost of credit, which Sergei mentioned, I agree with Mark. I think the problems in Russia are much more at the regional bank level in terms of SME lending, and there seem to be a few problems. One is their own credit assessment. The risk assessment within these banks, I think, is overly conservative for the types of business that they are trying to do, and I think there are some issues here about the training of their risk officers in the specifics of their lending.

Secondly, it seems to me that many of these regional banks have yet to develop tailored products for the regions they are working in. If you look at the comparative advantage of different regions in Russia, too many of these regional banks are just offering generalized types of lending, whereas I think focusing on agriculture products or other products which are really tailored to the region would bring down cost.

Thirdly, one of the reasons the cost of lending is high is because, frankly, credit officers in banks are not specifically trained to do SME lending. Moreover, they do not work sufficiently with the businesses to which they are lending to develop their capabilities, so the business plans that come into banks for financing are not well enough developed. Unless one, as part of the whole process, really builds up the capability of SMEs to actually put forward good business plans that can be financed, that you can have confidence in, the cost of lending is going to remain high. I think there are a number of things we need to do with the regional banks; it is not really a Sberbank problem. I think it is much more the regional bank level that we need to worry about.

S. Nixon:

Thank very much for that. Of course, Pekka mentioned earlier this issue of trust, and of course SME lending is ultimately a trust business, and an expensive business too, because to build the relationships at a grassroots level is an expensive business.

I want to bring in some people from the audience. I know various people are very keen on entering this discussion.

A. Brechalov:

Thank you. Alexander Brechalov, President of OPORA RUSSIA. First, I would like to say a couple of words about what we have achieved. Mr. Borisov was discussing cooperation between OPORA RUSSIA and Sberbank. I would like to say that Sberbank is not the only organization with which our organization is working successfully. Along with Promsvyazbank, we founded the first fund for direct small business investment at USD 10 million, not just and even not so

much in IT and innovation as in the non-financial sector. There are several applications being reviewed right now. In conjunction with Uralsib, we completed a very big project for the social welfare business and an unprecedented product, the interest rate of which will be 8.25%, at the level of the refinancing rate. I will note that we imposed some absolute conditions on our joint project with Promsvyazbank – in this regard, Andrei Sharonov is correct, as is Pekka – the investment absolutely must be accompanied by training.

Now I would like to ask a question and express my point of view. In discussing Russian entrepreneurs' access to capital, we are talking mainly about the cost of funds loaned, and we are missing one very important thing. I mean the role of the regional governments.

I would like to ask Pekka and Mark about this. When you invest in a Russian business, you are putting money into a business operating in a specific territory. Probably you have your own ranking system for the regional authorities, depending on whether they are helping to develop business, including small business, and attract investment. This is very important: OPORA's index and other research we conduct show, unfortunately, that the leaders of most territories are not interested in developing small business. There is money on the market; if the project is interesting, if investors consider it ready to expand, then the money will be there at a decent price. But no matter what kind of money the entrepreneur attracts, if he spends six months getting connected to the gas supply, if technical connections cost 80% of the money he has attracted, then it is very difficult to imagine this project being carried out successfully. I will repeat my question. Do you rank the territories? And how, from your point of view, does a regional government impact investment? Thank you.

S. Nixon:

I think, in order to use the time well, we will just take a couple of questions and then we will come back if you do not mind, for some comments.

S. Smysnov:

Good afternoon. I want to thank you all for an interesting discussion. My name is Sergei Smysnov. Returning to the question of venture capital investment over USD 10 million, I can mention my own company as an example. We are building a new operation in Nizhny Novgorod, which is 400 km from Moscow. We have invested about USD 20 million in it, and we have a separate package especially for an investor who will purchase it for USD 10 million. The problem is that the banks, for their own reasons, are unanimously refusing to participate in projects such as these, including Sberbank, and working with the funds is a fairly long process. So here is the question. What would you recommend as far as how to set up work with Russian venture funds that are investing not RUB 1 million, not RUB 5 or 10 million, but sums on the order of USD 10 million? Thank you.

S. Nixon:

We will just take one more question before we go to some other answers. Yes, in the front row.

S. Strzhenko:

Hello, colleagues. My name is Sergei Strzhenko. I was born here but I live in Australia. What I found in Australia is that 19% is not that bad when you think about. In Australia we get 19% from the bank as well. My question was, coming back here, what I found in Australia is that it is very simple to open up a company, very simple to do anything. But in terms of funds, it is very difficult in Australia as well. I assume that at the moment it is very difficult here, too. Now, the easiest thing so far for a couple of my start-ups which have a lot of traction is to go to Dubai or Saudi Arabia. There is no bureaucracy, not that much bureaucracy, so you just set up your company, and if you can get a seed round, then you can get round A nice and simple. Is there anything or anyone I can talk to here to maybe discuss that? Thank you.

S. Nixon:

OK. Let's get some answers to those points, and we go back to the Q&A. So, well, Pekka, do you what to start? There was one question that was particularly for you.

P. Viljakainen:

In the Russian tradition, there is a tendency to focus on big things – big houses, lots of square meters, a lot of big construction issues. The financing of SMEs, small businesses, is not very attractive because nobody cares about issues which are less than a hundred million dollars, in the media, for example. I think that the wind is changing in this, and we are doing a lot to change this whole thinking because no company becomes a hundred million dollar company from day one. It takes, even in optimum conditions, several years to do that. And also the question was – can I rank the regions? In every single interview, in every single TV station in Russia, they always ask me, as a Finn, can I rank the regions, can I rank the governors, can I rank everything. And I always say “nyet” because I'm not here to do ranking. However, what we are definitely doing, not only at Skolkovo but also in federal-level government structures, is we are making it so that in future the success of building new businesses is not measured by who has the biggest techno-park, who is building the biggest infrastructure, but actually how much of the VC money, the private money in the region, is guided to the companies. If I could decide only one thing, I would make that into a federal law. That would be the only ranking. There are differences between the regions. Without ranking anybody, I must say, for example, in Novosibirsk, Krasnoyarsk, Kazan, Rostov, Kaluga, you can feel it when you talk with companies, that there is interest in starting new businesses, and it does not happen only with the big banks. You need government support and funding. Of course, there is also Moscow, but Moscow is almost its own country within Russia. So, there are these parts.

Then, I think, a very quick comment about this fast-track to Russia. I am a very simple guy, a proper simple Finn, so I had to see it for myself. I have tested this fast-track by starting new companies here in Russia. For example, how easy or how difficult is it to start a business. I did it the first time six years ago, and there

were a lot of all kinds of documents, permissions, and stamps required, all kinds of things. We did it for a new company this February. Admittedly we did it using Skolkovo's services. But anyway, it was done in the Moscow area, in Skolkovo, in 42 days. We have a company, book keeping, bank accounts – all that kind of thing in 42 days. OK, so this is more than in Australia, it is more than in Finland, but it's still OK, it went extremely well. So, I am saying, that it is possible to start a business here, and there have been a lot of improvements in in the system, and I hope that it will continue. For money, the answer is regional VCs, regional venture companies, because nobody from Moscow can evaluate the capability of guys and girls in Vladivostok. They are sleeping when we are awake, and so forth. So, you have to be, the VCs need to be in those regions, otherwise it will not fly.

S. Nixon:

Thank you, Pekka. I am now going to make a plea to the panel and to everybody else to try to keep comments and questions reasonably brief so that we can get many points of view across. I am now going to ask Sir Suma whether he will rank the regions of Russia.

Sir S. Chakrabarti:

I do not have to because it has been done, in a way. All I need to do is point you to the right bit of the website. There is a thing called the Business Environment and Enterprise Performance Survey. It looked at 37 regions in Russia over the last couple of years, and identifies where it is easiest to actually get a business started and running. It has been used by the EBRD with the Russian government to try and target our investments as well.

Secondly, I do believe, like Pekka, that things are getting easier at the local level in terms of some of the administrative difficulties, the barriers to actually setting up a business. It is getting much easier than it used to be in terms of corruption. Levels are dropping, I think, in many regions, but again, this survey tells you which areas are better than others.

On your question, particularly, there is a very interesting issue around private equity, particularly on SMEs. We have invested in some 50 equity funds now which are focused on medium-sized enterprises. We have struggled to make it to the smaller ones. I think this whole private equity sector and SMEs is a sector that is untapped, and it is something that we should be pushing hard on.

S. Nixon:

Thank you. Mark and then Sergei, please.

M. Haefele:

I want to say that you do not have to listen to Mr. Bulldozer for very long to know that he has a certain way of investing and leading, and I would just throw this out there: if you are looking to attract international capital, I think you can call it 'smart money', but it is also habitual money. By that I mean they have a pattern in the way they invest. They do not think regionally. They think, "I am very interested in e-commerce, where we have interests", or, "I am very interested in healthcare." They have a sector that they are interested in; they do not look by region. Then, in terms of VC investing, they have a pattern. They say, "This is a set of assets I am going to be able to securitize," or, "This is a set of assets that I am going to be able to IPO." They look for those formulas, so the best thing I could say about attracting capital is try to speak their language as you look for help.

S. Nixon:

Thank you, and Sergei?

S. Borisov:

First I will give my thoughts on the subject of rankings. This is an extremely thankless business, but OPORA RUSSIA has been doing it for seven years now. Seven thousand respondents is a big sample of the country. When we rank the regions by how attractive they are to entrepreneurs based on the opinion of those same entrepreneurs, many governors get angry with us. They think that

they are doing everything just fine, and here we have put them at the end of the list. We respond that these rankings are done by good methodologists who participate in SPIEF and know how assessment is done in the world. Say what you will, the Dutch disease does in fact exist in Russia. Oil dollars feed us and break many of the rules of the market. Heads of municipalities, and sometimes governors or heads of regions, would sooner go to the federal capital to round up money and subsidies than work to advance their own businesses. If we change that paradigm, if we stimulate our regional leaders, the heads of 24,000 municipalities, to support their entrepreneurs, then firms will start to open quickly; they will be given the green light in terms of infrastructure and get hooked up to gas and water in a reasonable amount of time, and the money will show up.

As for venture funds, as you know, we have the Russian Venture Company, and it contains a great deal of companies; that is, it acts as the fund of funds. But they are on a starvation diet. There are not enough projects. Either you are not very convincing in presenting your product, or the venture investors see no demand for your product in the future. Demand for a small business product is actually a separate topic. We need to get our big companies used to a culture of cooperation, so that work gets done not within the walls of one enterprise, but is put out for outsourcing or subcontracted. Then we will see the gears start to turn for small, and most of all manufacturing, business development. So I would not under any circumstances dismiss the prospects of your enterprise; it is probably a vibrant and interesting one. It could be that your product will be in demand abroad and not in Russia. That is also a paradox of the present day.

S. Nixon:

Thank you, Sergei. Now, Andrei, where would you like to rank Moscow in the list of Russian regions?

A. Sharonov:

This is a favourite Russian pastime today: ranking cities, regions, and countries. In all seriousness, although the rankings cannot be trusted 100%, ignoring them is even more dangerous. We track Moscow's positions on various rankings,

national and international, and Moscow is placed well in practically all the rankings of the world's big cities, and we get some good food for thought. I can offer one example that is unfortunate for Moscow but at the same time instructive: a World Bank list in which 30 Russian cities were ranked with respect to business climate. I do not remember the exact formula – although, of course, that is important – but basically it was about the conditions for doing business in the cities. And out of 30 cities, Moscow took 30th place. Ulyanovsk and Vladikavkaz were at the top. But, despite that ranking, businesspeople are rushing to Moscow, not to Ulyanovsk and Vladikavkaz. From that, we can conclude that, yes, the costs of doing business in Moscow are high, but in terms of the total benefits of entrepreneurial activity, the capital far outperforms the other 29 cities. The total effect of doing business in Moscow exceeds the costs, which are objectively higher than they would be in another, smaller town. Returning to what our colleague from Australia said: doing business in Dubai is easier, of course, but then your product will be an import in Russia. If you produce it in Moscow, even at great expense, then, at least in certain sectors, you will have an easier time breaking into the Moscow market, with its daytime population of 15 million people.

S. Nixon:

Thank you, Andrei. So, we are getting towards the end but does anyone want to ask some questions before we summarize?

S. Borisov:

Could I offer a brief example, a response?

S. Nixon:

Very quickly, please.

S. Borisov:

Our data agrees with the results in the World Bank rankings that Andrei mentioned. We polled manufacturing companies. In Moscow, it really is harder

for them to get started; that is a fact. But, if you can imagine this, first place in our ranking is Moscow Region. Moscow is close by; the market is close by, and the attraction of Moscow, as Andrei was saying, is obvious. It is easy to set oneself up and do business in the area just outside of Moscow. This is the second year that Moscow Region is first in attractiveness to entrepreneurs.

S. Nixon:

We have got time for some very quick questions, and then I will ask the panel to quickly sum up.

From the floor:

My name is Warner and I am an entrepreneur in the biotech field. I was successful in attracting foreign investors, but there is one question they always ask and which I have a very difficult time answering: "What are my exit opportunities?" Whether that is an IPO or an acquisition. Can you address that question?

S. Nixon:

Thank you, anybody?

P. Vikram:

Punia Vikram, President of the Pharmasintez company in the city of Irkutsk. I have a specific question for Sberbank Vice President Sergei Borisov. I would like him to answer it directly, since the question concerns the bank's relationship with entrepreneurs in Russia. First I will provide a little bit of history. Eight years ago we began working with Sberbank in Irkutsk. Our company had sales of around USD 3 million. Over eight years, that grew to USD 120 million, and the company made it onto the list of the country's 10 biggest pharmaceutical manufacturers. We had good partners. By the way, your colleague Maxim Poletaev is now working in Irkutsk; you probably know him very well. Our credit limit was about USD 60 million. We are grateful to Sberbank for the assistance it provided us over that entire time. But recently Sberbank announced that it was improving its

operations in accordance with international standards, and that it had created a system of underwriters. When the underwriters came to us, they were unhappy with a lot of things. They do not know the client; they just see the paperwork. Thank goodness we have had good growth and have enough cash of our own. But now our credit limit at Sberbank is only about USD 20 million, even though we have plans to grow to USD 500 million by 2015, and, of course, we will do that, with or without Sberbank. But here is the question. Is it always good to have that sort of bureaucracy and to erect those sorts of obstacles, all the more so in that Sberbank is contradicting itself, advertising all over town and all over the country that they help people they know? What would you say about that?

S. Borisov:

I am prepared to sympathize with how you feel. But still, underwriting is a valid measure for Sberbank to take. I could mention a large number of cases in which a client manager, looking an entrepreneur in the eyes, has given him a loan, and the whole scheme later turns out to be fraudulent. Underwriting is carried out in order to exclude the person-to-person aspect and to make this impartial and technological. There is a price to pay, of course. For example, I do not understand why Doverie's credit scoring system gives a 40% underwriting approval rate in Moscow and a 70% rate in Tula. Underwriters reject 60% in Moscow. But today, this is a bank's holy of holies, and in this case even I have no right to influence risk management. This is a special, justified approach borrowed from international practice. Let us resolve this on an individual basis. Maxim Poletaev, who is now the First Vice President and Chairman of the Board of Sberbank, and I will review your case, and maybe we will be able to correct something. That is the only way to search out the truth.

S. Nixon:

Thank you. I am afraid we are running out of time, so I am just going to ask the panel to sum up their final thoughts on some of the points that have been raised today, and obviously a particularly interesting point raised at the back there, which gets to the heart of a lot of the issues that we have been discussing this

morning, particularly in terms of internationalizing the financial market and bringing in expertise and management. The question that goes to the heart of it is: how do you get your money out again? That is the question international investors are asking. But if you could also combine that with your thoughts on other points you want to raise, very briefly please. Mark first.

M. Haefele:

As an international investor, we do not climb out on any tree limb that we do not know how we are going to get back down from, so I agree that that gets to the heart of it. Some other things that I heard that I think get to the heart of it are this issue of trust – maybe it is all the same issue of everybody communicating in the same language and goals around how the company is structured, the culture of the company, the mind-set, etc. These are things that take time to develop, but forums like this that introduce that culture and make it more and more a part of the entrepreneurial and the SME environment in Russia are only going to make this stuff happen more quickly. If the opportunities are as great as Mr. Bulldozer says, it is going to happen very quickly. Thank you.

S. Nixon:

Pekka, would you like to speak next?

P. Viljakainen:

Very quickly about exit options. Yesterday we had an investment council meeting and the same question was asked, because the exit market in Russia is somewhat limited. Of course you mentioned pharmaceuticals as a specific industry where I think typically 99% of the exits are mergers and acquisitions by big pharmaceutical companies. I hope that there would be a healthy mix of exits, meaning perhaps 10% of, for example, Skolkovo companies in IPO; 40–50%, depending on the industry, continuing to grow; and then of course the rest will go through mergers and acquisitions.

To lighten up the discussion, I just want to tell you a joke about banking. This gentleman was asking about different policies and ways of working and changing

the structures of a bank. As a Finn, I got a call two weeks ago from my own bank. They said to me, "We would like to have a discussion with you." I said, "Why?" They said, "Because we have a new policy to talk to everybody who is listed in our records as unemployed."

I swore and said "What on earth is this? I am a minor Finnish oligarch!" But I had to go to the bank so that they would not close my credit cards. In short, there are all kinds of changing policies all over the world.

S. Nixon:

Thank you very much. Andrei, would you like to finish up?

A. Sharonov:

Thank you. I applaud Pekka: I have learned that Finland is not just the country of Santa Claus, but also of some Mickey Mouse types and some far from minor Finnish oligarchs. Thank you. I would like to conclude with a simple thought: one that I think is very important, that we are always forgetting. Any government, including the Russian one, including the regional ones, conducts two types of policies. We must explicitly prioritize one of them. I am talking about individual means of support on one hand, and on the other hand, about systemic improvements to the macroeconomic situation, reducing business risks, and making the country's business environment healthier. These two types of policies exist in parallel, but the second is fundamental. Without it, all the other measures would be less effective or not effective at all. And most importantly, nobody can conduct these systemic measures except for the federal and regional governments.

S. Nixon:

Thank you. Sergei?

S. Borisov:

Thank you. Russia requires modernization, and there is plenty being said about that. Over a short period of time, we need to learn intensively from the developed

countries. If the financial community creates the funds that will allow small and medium-sized growing, dynamic, high-potential businesses to go into the European capitals, and then bring back to Russia the knowledge, skills, improved management, investment, and technology, then that will be a path to be taken seriously. I am convinced that if a financial institution gives that some thought, then the idea of 'invest to be invested' will start working. Thank you.

S. Nixon:

Thank you, thank you very much indeed to the panel. I'd say that it is definitely a discussion that could have taken place in any country in Europe at the moment. It is taking place in Europe. But clearly there are very specific issues in Russia; I thank the panel very much indeed for illuminating them, and I wish everybody else a successful conference.