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THE PBN COMPANY is an international strategic communications, government relations and public affairs consultancy serving clients worldwide from offices in Washington, DC, London, Moscow, Kyiv, Riga, Almaty and Chisinau.

Thursday, March 10, 2005

Volume 1 Issue 24



4 March 2005 • The FIAC Working Group and the RF Ministry of Economic Development and Trade present the results of the *Russia: Investment Destination* survey conducted by The PBN Company on the perceptions of 158 investors and potential investors of the Russian investment climate.

"The decision to invest in Russia has as much to do with trust, transparency and consistency by the Government as it does with assessments of risk and return" — is one piece of the extensive counsel offered by 158 well-known foreign company CEOs who participated in *Russia: Investment Destination*, a survey conducted by The PBN Company.

The results were released on Friday, March 4, by the Foreign Investment Advisory Committee (FIAC) and RF Ministry of Economic Development and Trade, which sponsored the survey. German Gref, Minister of Economic Development and Trade,

Foreign Investors Succeeding in Russia

But Call on Government to Fight Corruption and Enact Reform
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"Investing Orange"

Foreign Investors Taking a New Look at Ukraine
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"The Baltic Tigers"

FDI Continues Strong Growth in Baltic Countries
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said that "such projects of cooperation between the government and the investment community are very important today in order to enhance investment attraction and diagnose the most acute problems which still exist in Russia's economy. This initiative gives the state an opportunity to listen directly to investors' opinions on which measures and decisions should be a priority."

The survey was designed to do just that: prompt a focused dialogue among foreign investors, the Russian government and other stakeholders on ways to advance Russia's quest for FDI. Russia last year posted \$9.4 billion in FDI, an increase from 2003 but still six times less than China.

Russia's Size and Economy Attracts Investors

"The survey had mixed results for Russia," explains PBN Chairman and CEO Peter B. Necarsulmer. "On one hand, foreign investors are attracted to the size of the Russian market, the growth and macroeconomic stability of the economy, and the quality/cost ratio of the Russian workforce.

"On the other hand, foreign investors are leery of Russia due to pervasive corruption, insufficient judicial and legal reform, excessive bureaucracy, weak corporate governance and inconsistent enforcement of the laws," says Necarsulmer.

The survey lays out a clear path for Russia to increase its share of foreign direct investment, which is critical to sustained economic growth and social reforms. Foreign investors call on the government to curb corruption, ease excessive bureaucracy, enact and uniformly enforce laws and regulations, and promote the country more aggressively with potential investors abroad.

PBN's Research Expertise

Russia: Investment Destination is the latest example of high impact, sophisticated research conducted by The PBN Company. Last fall, PBN conducted an opinion survey of 175 Russian CEOs of major companies to gain their views on corporate governance, transparency, business ethics and other issues impacting their company's and country's reputations. The firm specializes in benchmarking the views of extremely

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difficult to reach top decisionmakers in government, news media, professional services industries and the investment community.

"We have always believed in the importance of research to help drive our clients' business decisions," explains Necarsulmer.

"The firm uses advanced opinion, economic and secondary research as the foundation for all client strategic communications programs and, as important, to judge their effectiveness and value over time."

In this edition of Access PBN, we provide an overview of the results of *Russia: Investment Destination*. We also offer an analysis of FDI in Ukraine and the Baltic States — two other markets in which PBN itself is a long-time investor.

For copies of *Russia: Investment Destination*: www.pbnco.com/fiacsurvey

For more information on PBN's research and strategic planning capabilities: <http://www.pbnco.com/eng/services>

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Foreign Investors Succeeding in Russia

But Call on Government to Fight Corruption and Enact Reform

The vast majority of current foreign investors are succeeding in Russia in terms of sales, profits and realizing their business plans. At the same time, foreign investors' views of Russia as a destination for business expansion are mixed.

These are the bottomline results of an unprecedented survey of 158 well-known foreign companies of various types and industries that participated in a survey conducted by The PBN Company for the RF Ministry of Economic Development and Trade and Foreign Investment Advisory Council.

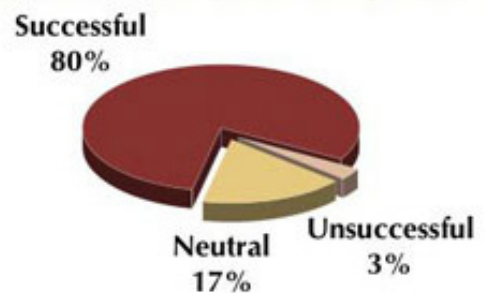
The surveys were completed from January 18 through February 21, 2005, and included 107 companies that are currently investing in Russia and 51 that are not. It was designed to determine factors that influence decisions on foreign investment and to provide substantive, actionable recommendations to the RF Government on ways to improve the country's investment climate.

Almost nine in 10 current investors reported that sales had increased more than 10 percent in the past year in Russia, and three-quarters said that their profits went up more than 10 percent. Two thirds of the companies not currently invested in the country said they have plans to invest in the next three years.

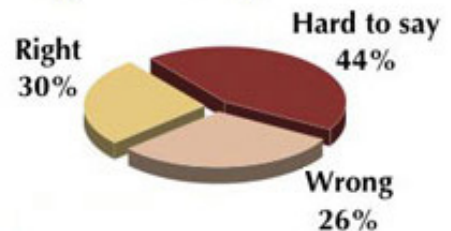
The size of the market and the country's sustained economic

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Achieved business plans in Russia over past two years?



Is Russia headed in the right or wrong direction?



Three top advantages to investment?



growth are the main features attracting investors to Russia. High-quality and low-cost human resources, macroeconomic stability and the government's fiscal policies and solvency are other positive factors for foreign investors.

Corruption Top Deterrent to Investment

But investors also pointed to a number of factors that make them apprehensive about the Russian market, with pervasive corruption being the number one barrier to investment.

Almost nine in 10 foreign investors called on the authorities to fight corruption at all levels of government to improve the business environment and attract foreign investment.

"Corruption is a pernicious problem, undermining all government and private undertakings," said one foreign investor. Deputy Minister of Economic Development and Trade Andrei Sharonov said that the survey "speaks to the wide scale of the corruption problem and requires government to concentrate efforts to resolve it."

Administrative barriers (66%), selective interpretation and application of laws (56%) and inadequate and inconsistent laws (51%) are other disincentives to investment cited by the foreign companies participating in the survey.

"Clear laws that are consistently and fairly enforced are crucial to foreign investors," explains PBN's Chairman and CEO Peter B. Necarsulmer. "Russia is under a spotlight. Failure to enact substantive reforms and any examples of real or perceived selective application of laws will severely undermine the country's quest for FDI."

Russia Viewed as Riskier than Other Markets

Foreign investors are uncertain about Russia's progress in attracting foreign investment. Less than one third said that Russia is on the right track in terms of economic policies and laws to encourage foreign investment, while almost an equal number (26%) said it is heading in the wrong direction. At the same time, more than half (54%) said they expect the investment climate and opportunities to improve in Russia in the next two years.

Despite this optimism, Russia is still viewed as riskier and less

Four top barriers to investment?



profitable than most other markets, including China and India. Only other CIS markets rated lower than Russia in terms of both return on investment and risk levels.

Russia Urged to Promote Market to Foreign Investors

The majority of CEOs who participated in the survey believe Russia should do a better job of promoting the country to foreign investors. Almost nine in 10 agreed with the statement, "Investment into the Russian economy will increase significantly if government authorities do better at informing and communicating with foreign investors."

Current non-investors, in particular, said they need more information about investment opportunities in Russia. Only 41 percent of non-investors said that they had enough information to make informed investment decisions about Russia, compared to 7 in 10 current investors. Data on Russian companies, market statistics, legal foundation and tax regulations are issues which non-investors say they require more credible information.

"At the same time, investment promotion can never be a substitute or smoke screen for government action to resolve serious barriers to investment," warns Necarsulmer. "Foreign investors who participated in the survey laid out in very candid terms what the Russian government needs to do to attract more foreign investment. Combat corruption, curb bureaucracy, enact reform, and fairly enforce laws and regulations are the top recommendations offered by foreign investors to the Russian government to increase FDI."

Top Foreign Companies Participate in Survey

The survey went directly to those responsible for making decisions — chief executives and top investment officials of major foreign companies that are currently investing in Russia and those that have yet to enter the market. Most of the companies are headquartered in either Europe or North America.

Among the current foreign investors participating in the survey were oil and gas giants such as BP, Royal Dutch Shell and Total; consumer goods producers including Unilever, The

Coca-Cola Company, Nestle and Mars; technology leaders such as Siemens, United Technologies, Microsoft and Intel; and, banking and financial institutions like ING Bank, BNP Paribas, Citigroup and Raiffeisen. Non-investing companies included Air Products, Anheuser-Busch Companies, Bank of America, British Telecom, E&J Gallo, Kingfisher, Lexis/Nexis, Nokia, Rio Tinto, Statoil, Thales and Woolworths, among many others.

For English or Russian copies of the *Russia: Investment Destination* survey: www.pbnco.com/fiacsurvey

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Visit the FIAC and Ministry websites: www.fiac.ru and www.economy.gov.ru



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"Investing Orange"

Foreign Investors Taking a New Look at Ukraine

Leading Ukrainian investment banker, Concorde, calls it "Investing Orange," which aptly sums up the foreign investment enthusiasm in Ukraine since the election of President Viktor Yushchenko, whose Orange Revolution brought him to power late last year.

Significant international investment conferences, attended by hundreds of foreign investors and organized by companies such as Renaissance Capital and Alfa Capital, have already taken place in Ukraine. Next week, an Adam Smith Conference, Ukrainian Investment Summit, will take place in London, where PBN's Senior Vice President and Board Member Myron Wasylyk will speak about the investment opportunities in the country.

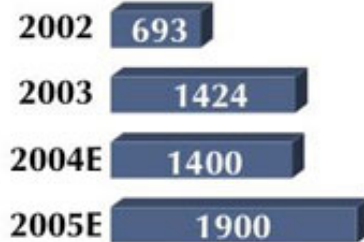
"Not a week goes by without a delegation of foreign investors, fund managers and investment bankers checking out the Ukrainian market," says Wasylyk. "The enthusiasm for the Ukrainian market is contagious, but new investors are largely taking a 'wait and see' attitude to make sure that the economic and political reforms promised are actually delivered."

"Meanwhile, existing investors in Ukraine are reaping the benefits of a rising stock market, growing GDP and increasing consumer spending," explains Wasylyk.

Ukraine has long been one of the most overlooked markets in

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UKRAINE Foreign Direct Investment (million USD)



Source: The Economist Intelligence Unit

terms of foreign investment. Since the collapse of the Soviet Union, total FDI in Ukraine has amounted to only \$8.35 billion — or just \$176 per capita, far behind, for instance, Poland's FDI of \$1,880 per capita. Last year, FDI reached \$1.4 billion. Official estimates put FDI at \$1.9 billion in 2005, but some experts predict it could be closer to \$3 billion.

Investment in Consumer Goods

For the past several years, the country's debt on the London and New York markets has performed well, but there has been little investment in equities. This is despite the fact that the Ukrainian stock market was one of the world's fastest-rising last year, albeit with small volumes and low liquidity.

One organization that has understood and managed successfully the potential of investing in Ukrainian companies is the Western NIS Enterprise Fund (WNISEF), a longstanding PBN client. For the past decade, WNISEF has invested more than \$100 million in 28 mid-cap companies in Ukraine and Moldova. Two recent exits brought WNISEF an internal rate of return of 20-25 percent with an average two times cash-on-cash return. The Fund is filling its pipeline of new investment opportunities quickly.

The consumer goods market is one of the most attractive to foreign investors. The country's gross domestic product rose 12 percent last year. Brewing, food processing, retail and construction are all sectors that hold promise for foreign investors interested in Ukraine's market of 48 million people, the largest in Central and Eastern Europe after Russia.

Other investors are attracted to Ukraine because of its low-cost production capabilities and proximity to lucrative European markets. With Europe now bordering Ukraine and President Yushchenko's vow to pry open the doors of the EU markets, many foreign investors needing low-cost, high-quality production facilities are looking to Ukraine.

Budget Changes to Promote Investment

President Yushchenko's team has already begun drafting legislative changes to the 2005 state budget, which are designed to widen the tax base and level the economic playing

field. Several new initiatives will be announced in the coming weeks to streamline government bureaucracy, deregulate and disassemble roadblocks to foreign investment, de-monopolize industry, and institute the rule of law.

He also plans to review privatizations of former state assets where widespread improprieties are suspected. Mining giant, Kryvorizhstal, is likely to be one company on the list as well as other resource companies. The President has also said that new privatizations will be open to multinational companies that can help Ukrainian industries become more competitive globally — another potential boom for foreign investment.

But with high hopes also come high, and perhaps unrealistic, expectations. Yushchenko's aggressive agenda of fighting corruption, effecting economic reform and increasing social wage payments will not be easy to realize. Nor will his efforts to unite a still divided country, particularly with Parliamentary elections scheduled for a year from now.

Foreign investors, who largely ignored Ukraine under the outgoing Kuchma regime, are now attracted to the market with new promises of curbing corruption and cronyism, and with a liberal economic presidential administration dedicated to modernizing the economy through expanded domestic and foreign investment.

"In the decade since PBN has been in the market, we've seen foreign investors get overly enthusiastic and then irrationally pessimistic with the ebbs and flows of unpredictable politics in the region," says Wasylyk. "Smart and successful investors must have a steady, long-range view of the market and a sober assessment of its risk and rewards."

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"The Baltic Tigers"

FDI Continues Strong Growth in Baltic Countries

They are small, but mighty. Combined, Estonia, Latvia and Lithuania add up to a market of just 7.4 million people. But the size of their market does not tell the whole story as it relates to foreign investment.

All three countries continue to post some of the strongest economic growth in Europe. Last year, Estonia's GDP increased by 6.0 percent, Latvia 8.0 percent and Lithuania 6.6 percent. All three also have prudent fiscal policies and low levels of debt and inflation.

This is, in part, why the countries' FDI, on a per capita basis, is also among some of the strongest in the region. Estonia's FDI per capita was EUR 4,490, Latvia's was EUR 1,340 and Lithuania's was EUR 1,270 in 2004.

But the countries' strong economic performance is only one reason explaining their ability to attract foreign investment. Their people, their location and their infrastructure are also magnets for investors. The countries have strong human capital that is still at relatively low cost. Average income levels in the Baltics are still less than half of those prevailing in Western Europe. Yet productivity and innovation are high. Forty-five percent of Estonians, for example, use the Internet, higher than other Western countries. The annual number of college graduates in Lithuania is among the highest in Europe.

The Baltics, like many of the other CEE-8 countries, are

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Foreign Direct Investment (million USD)

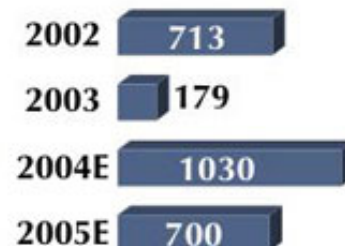
LATVIA



ESTONIA



LITHUANIA



Source: *The Economist Intelligence Unit*

central locations for companies seeking access to Pan-European markets. They are also important commercial and transportation links to Russia and the other CIS markets.

These countries offer foreign investors high-quality infrastructure, including international airports, ice-free seaports, satellite-based telecommunications systems and extensive road networks linking Europe and the CIS.

"The Baltics' economy is as stable as their people," explains PBN's Vice President and Managing Director Romans Baumanis. "The region is well-grounded economically and is at the crossroads of the Euro-Asian trade routes. The people are industrious, innovative and reliable. It is a strong combination for successful business investment."

Room for Improvement

Each country, however, has areas for improvement in terms of attracting foreign investment. Corruption continues to plague each country, especially Latvia and Lithuania. Both Latvia and Lithuania are still on the U.S. government's 301 Watch List because of the pervasive nature of counterfeiting and IP infringement.

Additional legislative reform, including in the financial sectors, as well as privatization of the remaining large, state-owned enterprises are also necessary to promote investment of foreign companies in the Baltic countries.

Friendly to Foreign Investment

But overall, the Baltic countries are extremely friendly toward foreign investment. Foreign investors have equal rights with local businesses, the ability to purchase and own land and unrestricted profit repatriation. Effective corporate tax rates are also among the lowest in Central Europe. For example, the corporate tax rate in Latvia was recently reduced to 15 percent and company registration processes have been streamlined to allow a company to be established in just two days. Lithuania has one of the lowest overall tax-to-GDP ratios in the EU — just 28 percent.

This has resulted in strong recommendations from the rating agencies, with Moody's for instance giving all three countries A1 to A3 ratings. Lithuania now ranks among the World Bank's Top 20 global markets for ease in doing business, with Latvia and Estonia close behind. All three also have good economic freedom rankings, with Estonia coming in sixth worldwide in 2003.

This openness to foreign investment is underscored by each country's aggressiveness in promotions. All three countries have active foreign investment promotional campaigns. The Latvian Investment and Development Agency, Enterprise Estonia and Advantage Lithuania are all conducting comprehensive campaigns to attract and assist investors interested in establishing businesses in their countries.

These promotional efforts are particularly important as Latvia, Lithuania and Estonia along with the other CEE-8 countries confront strong competition for FDI from much larger emerging markets, most notably China and India.

"It is essential that the region leverage its core assets, like human resources and proximity to both European and Russian markets, to compete globally for FDI," says Baumanis.

The bottomline, as suggested by Thomas Laursen, the World Bank's lead economist for Central and Eastern Europe, is that "doing business in the Baltics will continue to be a winning proposition."

Email Romans (Latvia), Ignas (Lithuania) or Juri (Estonia): romans.baumanis@pbnco.com, ignas.stankovicus@pbnco.com, or juri.estam@pbnco.com

Visit the Baltic's Investment Agencies:

Latvia: <http://www.liaa.gov.lv/eng/>

Estonia: <http://www.eas.ee>

Lithuania: <http://www.lida.lt>



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News from PBN Worldwide

You Be the Judge. A new PBN client is the Furth Family Foundation, who has hired the firm to help organize the 13th annual International Judicial Conference taking place in Kyiv in May. The conference, hosted this year by the Supreme Court of Ukraine, will bring more than 100 Supreme Court chief justices and other judges to Ukraine for high-level discussions of professional development and rule of law.

Email Serhiy: serhiy.movchan@pbnco.com

Taking Stock. PBN has been retained by NASDAQ to assist them with positioning and marketing of the New York-headquartered stock exchange among Russian corporates.

Email Tanya: tatiana.nikulshina@pbnco.com

Breathing Easier. PBN was hired by the Coalition for Breathing Safety to raise awareness of the threat to the availability of disposable respirators as a result of frivolous silica litigation in the United States.

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Going Public. Russian companies considering going public might want to read an interview in the recent Russo-British Chamber of Commerce newsletter. The article interviews PBN's Peter Necarsulmer about the strategies and mindset needed to list a company's stock on an international exchange.

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