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Positioned for growth

Ernst & Young's 2012 attractiveness survey

Russia

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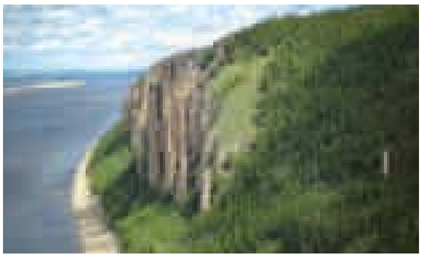

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Viewpoint

Improving investment opportunities

Igor Shuvalov, First Deputy Prime Minister of the Russian Federation

It might not be quite fair to assess Russia's attractiveness ourselves, as it is foreign investors who must have their say. Of course, international ratings show that we still have a lot to do. For example, although we have climbed up four positions in the World Bank's *Doing Business* ranking, we are still 120th. Another example is the persistent outflow of capital from Russia, with the Bank of Russia estimating an outflow of US$80b in 2011. And what is private capital outflow? It is, in fact, a real indication of the quality of the investment climate. So there is plenty of room for improvement.

The Council provides an important and useful forum to handle issues related to investment activities in Russia.

However, I can say that all these years we have remained consistent and resolute, albeit not always as fast as we would like, in removing obstacles hindering the inflow of foreign capital into our country. We have improved our laws in line with global best practices and worked to make the system for passing court rulings more transparent. Let me also mention the "humanization" of the Criminal Code, especially with regard to economic crimes, and the introduction of tax incentives for investors in a number of sectors. A most important achievement in this area is the accession to the World Trade Organization (WTO). Finally, the Customs Union significantly increased the size of the domestic market. As a result, we have a positive trend: the net inflow of foreign direct investments (FDI) amounted to US$53b in 2011.

Since the autumn of 2010, when I started working as an ombudsman, we have reviewed around 100 complaints from foreign investors. We have managed to resolve most of the issues and find positive solutions. Investors most often complain about administrative barriers.

The Foreign Investment Advisory Council (FIAC) brings together more than 40 major global companies operating in Russia. The Council provides an important and useful forum to handle issues related to investment activities in Russia.

A few examples of what it has managed to do include:

- The Council made a decisive contribution to the drafting of recently adopted amendments to the Law on Migration Registration of Foreign Citizens and Stateless Persons in the Russian Federation. The law creates favorable conditions for highly skilled foreign professionals and their families to enter and live in Russia.
- FIAC was actively involved in developing the Law on Customs Regulation, which greatly simplified customs procedures.
- FIAC took part in drafting a law providing easier access to Russia's strategic industries for foreign investors.
- FIAC working groups put forward proposals to improve administrative and customs regulations (veterinary control, food regulations and technical regulations).
- Finally, in 2011, the Council prepared a list of projects to be implemented in Siberia and the Far East.

Russia is a net exporter of capital. Last year, according to the Bank of Russia, our country – I mean the private sector, the state and households – invested US$76b in other countries on a net basis, i.e., net of investments in Russia. Money is thus not the main reason why we need foreign investors. It is no secret that, in terms of their legal status, many foreign investments are, in fact, made with money that was previously taken out of Russia. We therefore need real foreign investors to signal that the situation in Russia has improved and there are proper conditions for investment. And there is one more important thing. Foreign investments are primarily associated with innovative technologies, managerial experience, modern standards of production and market relations – and this is exactly what our economy really needs today.

Foreword

Jay Nibbe
Area Managing Partner EMEIA – Markets
Ernst & Young

Alexander Ivlev
Country Managing Partner
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The global economy faces many challenges. In Europe, recession has returned to many economies, the Eurozone crisis continues and global economic power shifts from west to east and north to south. In recent months, rapid-growth economies have slowed, in some cases notably, as a result of the financial crisis.

Despite this fact, many developing economies demonstrate robust growth, and the group of 25 rapid-growth markets (RGMs) that we monitor is expected to achieve overall GDP growth of 5.9% in 2013 and 6.5% in 2014.

Russia has proved to be resilient, experiencing growth in 2011 and 2012. An increase in consumption, a strong labor market and an increase in investments have been the prime drivers of this growth. Oil prices have supported the sustained expansion of the Russian country.

Russia, like other countries, is facing the challenges of increasing global competition, in which investment and technology play crucial roles in diversification and creating sustainable growth. Our survey shows that foreign investors are more demanding than they used to be: they now value efficiency and transparency of the operating environment as much as they do market opportunities.

Our panel of investors confirms that Russia has world-class features: an abundance of natural resources, a huge domestic market and a very skilled labor force. They also note that Russia has made a step forward in the global competition to attract FDI.

However, our survey also underlines some critical challenges for Russia: investors' confidence in the future attractiveness of Russia has declined and they repeated their concerns about the country's uncertain investment climate and innovation capacity.

This report is designed to help the Russian Government remove barriers to future growth and help business leaders make smart investment decisions. In the report, we look at the perceived attractiveness of Russia and changes in FDI behavior, and we propose actions and identify opportunities to address the challenges that our economy is facing.

Russia, with its great development potential, is now exploring new ways to compete and to lead.

As we present our second edition of the Russian attractiveness survey, we would like to thank all the decision-makers and Ernst & Young professionals who have taken the time to share their insights with us.

Executive summary

The global context

An optimistic outlook

▸ **The global economic outlook is optimistic**
The global economy started to show signs of recovery in 2011. It was weak and unbalanced, but there was optimism. As a result of the financial crisis, the growth trajectories of rapid-growth economies have declined - some notably. However, many developing economies demonstrated robust growth, and the group of 25 RGMs that we monitor at Ernst & Young should recover to achieve overall GDP growth of 5.9% in 2013 and 6.5% in 2014.

▸ **Global FDI has increased**
Despite the economic and financial crisis, global FDI increased by 16% to reach US$1.5t in 2011, exceeding the pre-crisis level. In comparison, Russia's inflow of foreign investments (FDI) increased by 22%. According to the United Nations Conference on Trade and Development (UNCTAD), investors were motivated by the continued growth of local consumer markets and manufacturing opportunities.

▸ **Investors are more demanding**
Business leaders are re-evaluating their selection criteria: at the top are now market appeal (40% of investors) and the stability of their investment destination (36%).

Reality

#1 In 2011, Russia was the most attractive destination for FDI in Central and Eastern Europe.

42% of investment projects are located in Moscow and St. Petersburg.

22% inflow in terms of value resulted in a 4% increase in job creation in 2011.

8 of the top 10 sources of FDI originate from Europe, with over 300 FDI projects between 2007 and 2011.

51% of FDI in Russia has gone into manufacturing, with over 400 FDI projects, the fourth-largest in Europe – while 9% was directed to the business services sector.

Investors' perception

Russia takes a step forward

▸ **Russia has joined the competition**
The world is converging. China's lead as the investment destination with the best image is widening and Europe's attractiveness has halved since 2006. With 19% of international investors perceiving Russia as one of the most attractive global regions in 2012, it has unquestionably joined the competition for FDI. The country's attractiveness has grown by eight percentage points over 2011, the largest increase of any region.

▸ **Russia is attractive by nature**
According to our panel, Russia's world-class features, such as its natural resources (43% of respondents), domestic market (19%) and strong labor force, all support its leading role in the global recovery.

▸ **Russia has balanced labor costs and skills**
The country's cost-competitive and skilled labor force improves its attractiveness. Nearly 56% of respondents described the availability of skilled labor as a positive factor for investing in Russia; low labor costs were mentioned by 61% of investors.

▸ **Concerns remain about Russia's operating environment**
Investors' concerns relate to the political, legislative and administrative environment of Russia, with 62% highlighting this factor as a challenge. Other factors that make Russia less attractive to foreign investors are its infrastructure and limited incentives for sustainable development.

Reality check

Russia's industrial progress

▸ **Russia attracted fewer, larger projects**

The number of FDI projects declined by 36% in 2011, even though Russia led Central and Eastern Europe (CEE) at attracting FDI. Job creation grew by 4% in 2011. Labor-intensive industrial activities increased the average number of jobs created per project to 65 in 2011 from 40 in 2010.

▸ **Manufacturing is still central to Russia's appeal**

Manufacturing activity is key to Russia's attractiveness, accounting for 51% of investment projects and 92% of job creation between 2007 and 2011. The industrial sector was another high performer, with automotive attracting 90 projects and machinery and equipment recording 62 projects. The food sector was the second-largest number of projects (86), and business services also grew in FDI.

▸ **Russia's diversification is under way, driven by expansion in business services**

FDI activity in Russia's business services sector has been growing in recent years. It accounted for 9% of the total FDI projects in 2011, higher than its 5% share in 2010 and above its average of 6% between 2007 and 2011. When financial services and the software industry are included in the business services category, this figure rises to 14% of the projects between 2007 and 2011, compared with the automotive industry's 12%.

▸ **Little change in FDI sources**

The United States remains Russia's primary investor with 122 FDI projects between 2007 and 2011 (16% of the total), but 8 of the top 10 source countries are from Europe. European countries established over 300 FDI projects in Russia from 2007 to 2011, 44% of the total. FDI into Russia from emerging countries remained low between 2007 and 2011. India and China each accounted for less than 2% of FDI projects in Russia. Brazil established just two projects in the country. These economies also made a minor contribution to employment generation.

▸ **FDI is regionally concentrated**

Russia's two largest cities – Moscow and St. Petersburg – account for 42% of the projects. The Kaluga and Nizhny Novgorod regions are also attractive investment destinations.

▸ **2013: strong plans for investment**

Investors already present in Russia continue to demonstrate their confidence in the Russian market. Nearly 80% of these investors plan to increase or maintain their operations in the country. There is a wide gap in plans between the companies that already have operations in Russia and those that are not yet established. Seventy percent of the companies that are not established in Russia have no plans to invest in the country in the next year. This is, however, 16 percentage points lower than 2011, signaling an improvement in potential investors' perceptions of the Russian economy as an investment destination.

A look into the future

How to meet investors' expectations

▸ **Expectations from investors**

Although a majority (57%) of investors remain optimistic about Russia's attractiveness in the medium term, the level of confidence has dropped from 70% last year.

▸ **Russia needs to create an investor-friendly environment**

Russia's uncertain business climate deters investment from foreign companies. Investors chose the more effective rule of law (53%), reduced bureaucracy (47%) and an improvement in the transparency of business regulations (37%) as the top three ways to enhance Russia's investment climate.

▸ **Russia's FDI portfolio is diversifying**

Nearly 39% of investors expect the mining, oil and gas sector to attract the most FDI in the next two years. Information and communication technologies (ICT) was named second-most often by investors (20%), followed by energy and utilities, agriculture, consumer goods and automotive. The country's focus on oil and gas creates a large mismatch between the attention that other strategic industries in Russia received from investors and their real potential.

Perception

8 percentage point increase of international investors who find Russia attractive compared to 2011, the largest increase of any region.

39% of business leaders expect the mining, oil and gas sector to attract the most FDI in the next two years, with 20% for the ICT sector.

62% of investors believe Russia's accession to the WTO will increase the country's attractiveness for investment.

62% of respondents consider that the country's political, legislative and administrative environment needs improvement.

78% of respondents already present in Russia plan to maintain or expand their operations in the country.

Viewpoint

Growth is not only possible, but inevitable

Kirill Dmitriev, Chief Executive Officer, Russian Direct Investment Fund

Russia has a unique opportunity to attract a record level of FDI. First, Russia really delivers: in 2011 we had a budget surplus, the lowest inflation in 20 years and one of the lowest levels of state debt (11% of GDP compared with some 80% in Europe and over 100% in the US). Russia has the fourth-largest international reserves in the world (around US$500b) and impressive 4.3% GDP growth. Such results can cause a twinge of envy in other countries, including most of the developed ones. Second, initiatives like the Russia Direct Investment Fund (RDIF) make it easier to invest in Russia. RDIF is a partner for direct investment funds, state investment funds and transnational corporations that can share risks and elucidate the finer points of the investment machinery in Russia. In addition, RDIF will attract foreign capital by showcasing real examples of successful deals made in partnership with leading financial and strategic investors. The mere presence of such investors in Russia will be very good public relations (PR) for the country. Third, Russia has a large-scale government program of investment in infrastructure under way, as well as a new wave of privatizations, targeting assets worth US$30b–US$50b, in total.

> **There are many factors that appeal to investors in Russia.**

Russia has to become more competitive in the international capital market. The Russian Government has clearly realized that it needs to improve the local business environment and is prepared to commit itself to state, corporate management and regulatory reforms. There are some real problems that the Government has been trying to solve. It is clear that we still suffer from excessive bureaucracy and red tape, and there are concerns about the reliability of the Russian judicial system, although we have recently seen some improvements in all these areas. To tackle these challenges, a special institution, the ombudsman, has been established in Russia during the transition period.

According to an Ernst & Young survey of more than 150 executives whose companies' combined assets exceed US$1.5t, foreign investors have become increasingly interested in Russia. According to the survey, in April 2012, 48% of FDI funds expressed the intention to expand their dealings in Russia and the Commonwealth of Independent States (CIS) compared with just 25% in October 2011. There are many factors that appeal to investors in Russia, including the country's strong macroeconomic performance, the threefold growth of the Russian middle class over the last five years and prospects of lowering export barriers as Russia prepares to join the World Trade Organization.

Coming to Russia primarily for high revenues, foreign investors bring unique managerial expertise and knowledge of global markets. They facilitate the implementation of advanced technology and contribute to the modernization of production in Russia. It all fits very well with the Government's agenda for attracting "smart" long-term foreign investments.

While a member of BRICS, Russia has some big advantages over the rest of the group. Russia possesses huge mineral resources and a more literate and educated population than other BRICS countries, which, unlike Russia, have to rely on either mineral or human resources. In addition, Russia boasts the highest GDP per capita, the best capitalized banking system and the lowest corporate tax among BRICS nations.

Russia's investment climate is often cited as one of this country's weaknesses in comparison with other BRICS countries (Brazil, Russia, India, China and South Africa), but, as stated above, the Russian Government intends to take some serious steps to improve it.

International experts often speak about the low competitiveness of Russian businesses. But the lower efficiency of Russian companies also has an upside, as it shows that there is growth potential, and, most importantly, where this growth may come from is clear. In spite of some pessimistic views of the current state of the Russian economy, growth is not only possible, but inevitable. Suffice it to say that the Russian middle class, which, in relative terms, is the largest middle class in the BRICS group, has emerged only in the last five years, during which time the number of middle-class Russians has tripled.

An optimistic outlook

The global context

6.5% GDP growth in 2014 forecasted for the 25 rapid-growth markets (RGMs) monitored by Ernst & Young.

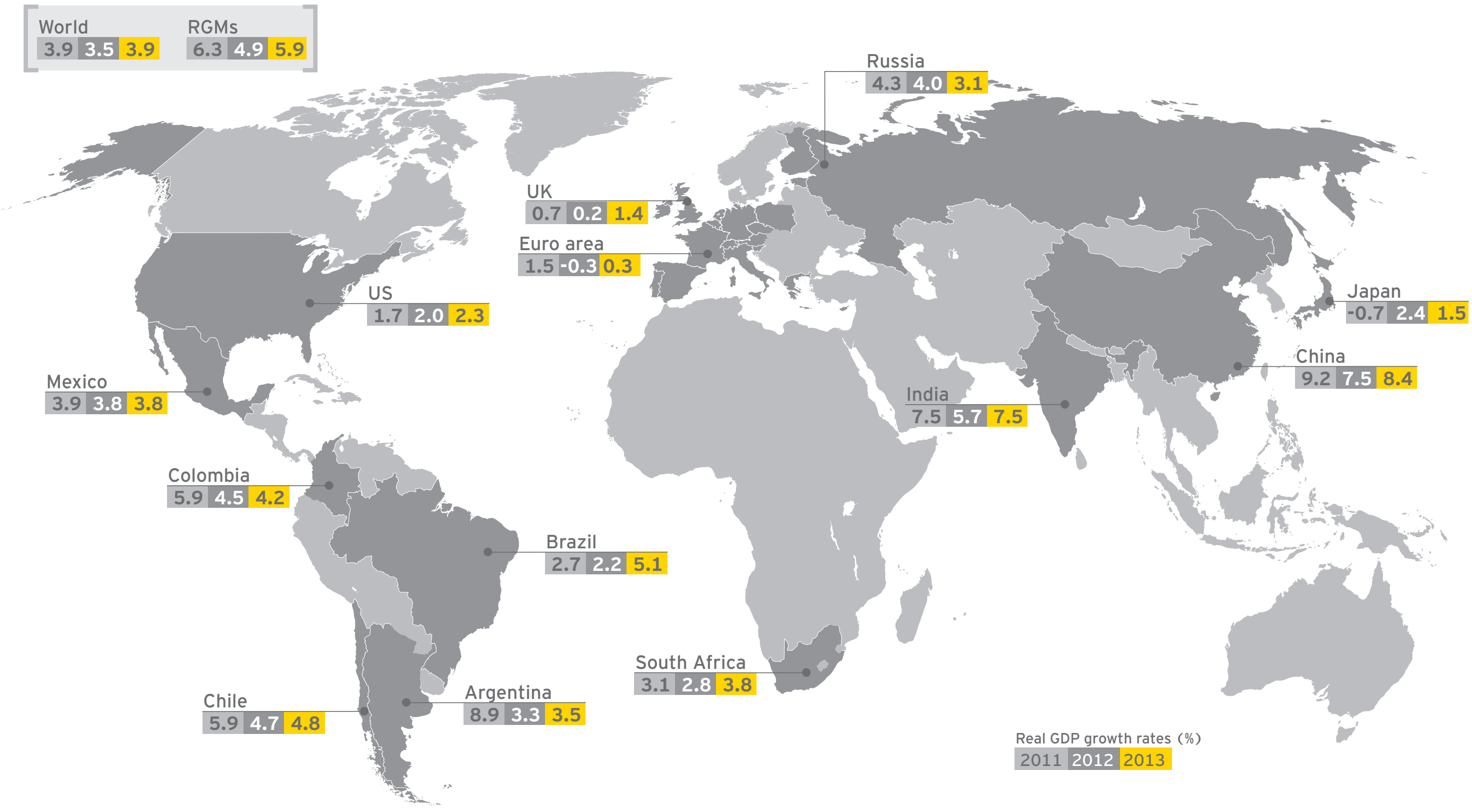
16% global FDI increase despite the global financial crisis.

US$1.5t global FDI in 2011, exceeding pre-crisis level.

22% surge in FDI inflow to Russia.

40% of investors consider market appeal as the top criterion for investment.

Global economic outlook



World Economic Outlook (WEO): Growth resuming, dangers remain, April 2012, IMF 2012.
Rapid-growth markets forecast, Ernst & Young, July 2012.

The global economy began 2011 in recovery mode. It was weak and unbalanced, but there was some optimism. However, the global recovery slowed in the second half of the year due to weakening investor and consumer confidence and sharply escalating risks during the fourth quarter. Economic growth in many developed economies decreased during the latter part of 2011 as many Western economies headed toward a double-dip recession. Increased uncertainties in the Eurozone, persistently high levels of sovereign debt and government austerity programs are all acting as a brake on Gross domestic product (GDP). They are the main forces holding back economic recovery in the West.

As a result of the financial crisis, expansion in rapid-growth economies has slowed recently, in some cases notably. Economic pressures in Europe are also leading to reduced demand for commodities and a slowdown in exports of manufactured goods. However, many developing economies continue to grow robustly, and the group of 25 RGMs monitored by Ernst & Young should achieve overall GDP growth of 5.9% in 2013 and 6.5% in 2014.

Growth in the emerging world is underpinned by the emergence of a richer middle class, favorable demographics and, as a consequence, strong and sustained growth in domestic demand. Increased trade among emerging markets will further help protect these markets from unfavorable developments in mature markets. The developing markets that rely on energy exports may see some short-term variation. However, the mid- to long-term outlook remains positive. Investments in emerging markets will remain strong as mature market companies seek to tap into their projected growth, and the emerging markets themselves use their favorable economic positioning to drive development.

National and regional differences do exist between emerging market economies, and significant growth differences are opening up this year. Asian RGMs are projected to see growth rates of 6.2% in 2012, while RGMs in the EMEIA and Americas regions can expect to register growth of 4.0% and 3.2% respectively. Strong RGM performers in 2013 are expected to be Brazil (+5.1%) and Chile (+4.8%) in the Americas; India (+7.5%), Kazakhstan (+7%) and Qatar (+6%) in EMEIA; and mainland China and Hong Kong (+8.3%), Vietnam (+6.9%), Indonesia (+6.6%) and Thailand (+6.5%) in Asia. Russia is projected to grow at a moderate rate of 3.1% in 2013.

Global FDI market: dynamic and demanding

Viewpoint

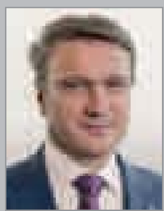
Our success will depend on us

Herman Gref, Chairman of the Management Board & CEO of Sberbank

If we assess the investment climate in Russia retrospectively, we can say that, at the beginning of this century, the temperature was around zero. The nominal tax burden was twice as large as real tax payments, with massive red tape and corruption. The macroeconomic situation was also awful, as was the nation's credit history. The only attractive features included perhaps the size of the market (and even this was no more than potentially so) and our oil and gas reserves.

By the middle of the 2000s, the investment climate in Russia had changed significantly. This climate is not only, and not so much, about figures as it is about how it feels to do business in the country. In 2006-2007, business in Russia was in a state of elation at the pace of growth we had achieved. We simplified the tax system, cut interest rates and managed to reduce red tape. We shortened the company registration process from two months to three days in accordance with the law. We amended the Civil Code and adopted the Land Code, Water Code, Forestry Code and law concerning minerals. All in all, we took a big step forward and, as a result, enjoyed a foreign investment boom.

Unfortunately, the pace of growth then slowed down, primarily because of corruption and Russia's crippled judicial system, while our competitors were marching forward. Governments in advanced economies did not simply work to accommodate the interests of their business communities; but they actually tried to anticipate their needs. Therefore, we still have a lot of hard work ahead of us. The World Bank and the International Finance Corporation have placed Russia in the 120th position in their recent *Doing Business* report, which is far from satisfying. Making a leap from the 120th to the 20th place is not easy, but the fact that President Vladimir Putin has declared this as an objective is very important.



Russia's main goal is to reform its system of federal and local government.

Russia's main goal is to reform its system of federal and local Government. It needs to improve its blatantly inefficient judicial system (all major transactions are carried out in other jurisdictions now, which is evidence of the complete lack of trust in our own system); improve the law enforcement system and customs legislation; eliminate corruption and the Government's involvement in areas where it is unnecessary; and concentrate its efforts on the priority areas of Russia's development. Corruption is our number one problem, because it, too, is a measure of the Government's efficiency.

Our second goal is to reform the system of education. The notion that the quality of education in Russia is much better than in any of the other BRICS countries is nothing but a myth inherited from Soviet times. In China, the quality of education is rising, while in our country it is falling. Education starts in kindergarten, but all we are concerned about is how to make sure our kindergartens can accommodate all the children. Nobody seems to be thinking about the quality of education – as if we were building some sort of luggage room and assigning kindergarten teachers the role of luggage security officers! In the morning, you deposit your kids at the kindergarten and in the evening you take them back home. Yet about 80% of a nation's successes rest upon the quality of pre-school education. Eighty percent of a child's potential is built during the first seven years of their life. As for the quality of Russian secondary and higher education, I would rather not speak about it at all.

The third goal is to create a system of values.

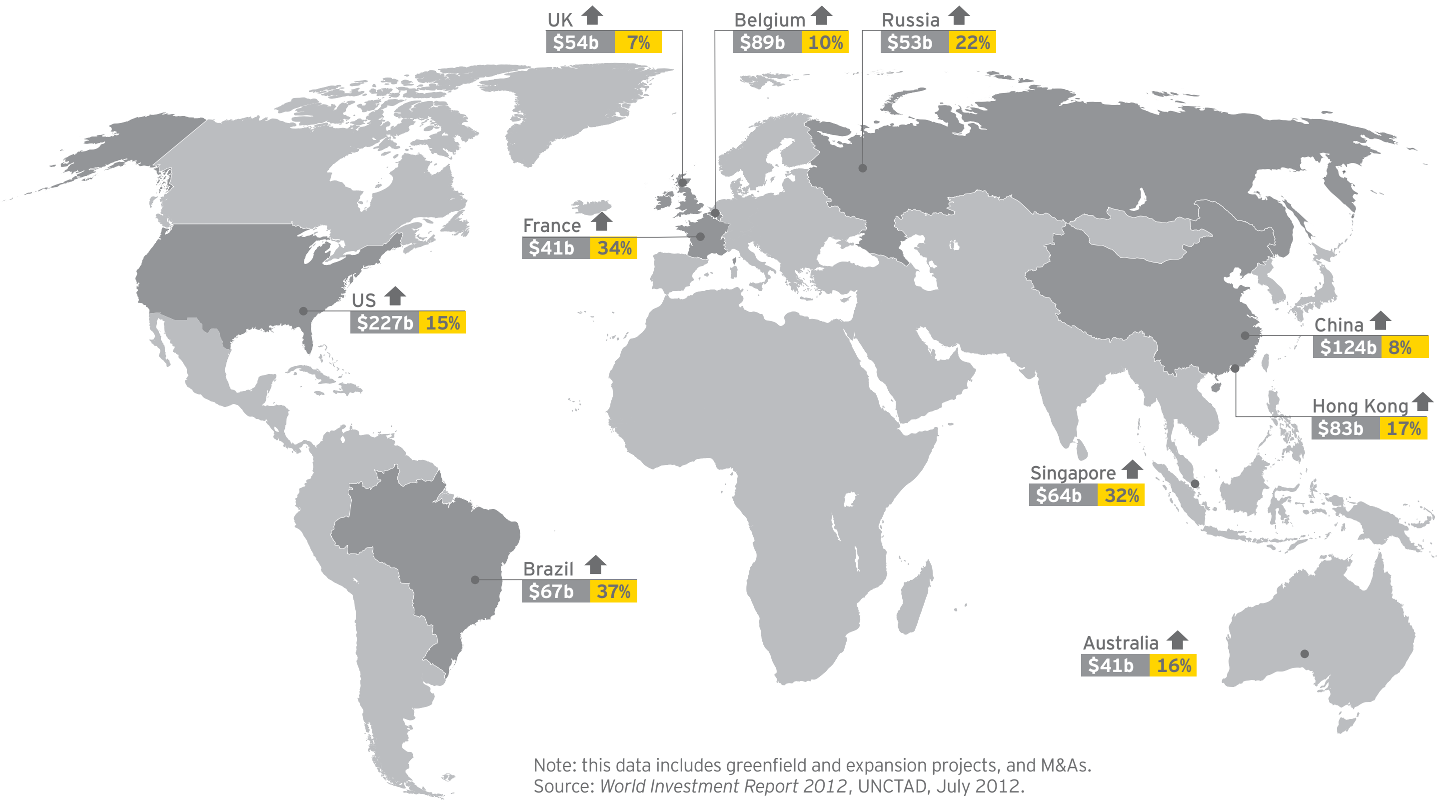
We can also mention the need to improve our infrastructure, etc. But above I mentioned the fundamental things.

Foreign capital plays a critical, though not decisive, role in the modernization of the Russian economy. And this is true for all Russian industries, without exception. At the end of the day, our success will depend on our own preparedness to move in the direction of modernization.

I do not have enough empirical data yet to make any predictions concerning the efficiency of the modernization drive in Russia in the coming years. I do hope that modernization will take place, yet I believe we need to wait for some systemic improvements from the new Government.

Top 10 destinations for FDI inflows in 2011

(in US$ billion)



Note: this data includes greenfield and expansion projects, and M&As.
Source: *World Investment Report 2012*, UNCTAD, July 2012.

Global FDI increased by 16%

Despite the economic and financial crisis, global FDI increased by 16% in 2011. At US$1t, the total exceeded the pre-crisis level. In comparison, Russia's inflow of foreign investments surged 22%.

According to UNCTAD, investors were motivated by the continued growth of local consumer markets and by a new round of privatizations in Russia.

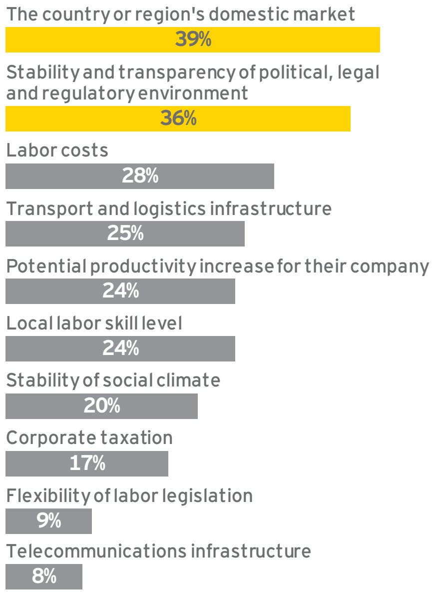
Investors look for market opportunities as much as stability and transparency

Economic volatility and lower growth prospects around the world have caused business leaders to re-evaluate their selection criteria. In our 2011 survey, investors cited transportation and telecommunications infrastructure as the top two factors in their location decisions.

But this year, executives clearly have market appeal and the stability of their investment destination at the top of their agenda. Almost 40% of investors questioned in 2012 said that, when deciding to invest, a country or region's domestic market is now their top concern. In our past surveys, this requirement was far less important. Rapidly changing circumstances around the world have triggered a radical change in sentiment. Companies want to set up operations in regions with large and strong domestic demand.

Minimizing risk is the next main goal. Stability and transparency in the political, legal and regulatory environment is listed by investors as the second-most important criterion (36%) when deciding where to invest. Labor costs, which used to be a compelling concern, still matter for 28% of respondents, but rank third overall.

Most important factors in deciding the location in which to establish operations



Source: *Ernst & Young's 2012 European attractiveness survey*. Total respondents: 840

Russia takes a step forward

Investors' perception

19% of international investors perceive Russia as one of the most attractive global regions.

8 percentage point increase of international investors who find Russia attractive compared to 2011, the largest increase of any region.

43% of respondents find natural resources to be Russia's most attractive feature.

56% of investors deem availability of skilled labor a positive factor for investing in Russia.

61% of investors are attracted by low labor costs.

62% of respondents consider that the country's political, legislative and administrative environment needs improvement.

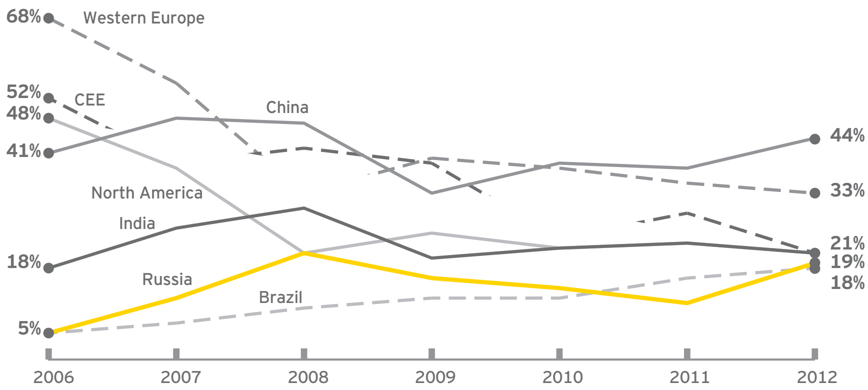
Russia in the global context

China's lead is widening

Investors are still focusing on rapid-growth markets. Business leaders see a larger role for emerging economies, particularly China, that offer greater returns on their investments. In addition to the size of its market and pace of consumption growth, China also has a broad economy, specialized clusters in key industries, easy access to international markets and an enduring image as a low-cost production base – all of which combine to make the country a magnet for investors. Consequently, in *Ernst & Young's 2012 European attractiveness survey*, China retains its position as the most attractive FDI destination. It was named as the most attractive destination by 44% of respondents – the highest level of investor confidence since 2009. Although the rankings of the most attractive destinations remain roughly similar to those of last year, there is a noticeable variation in the "attractiveness gap." The gap between China and Western Europe has increased from one percentage point in 2010 to three percentage points in 2011 and 11 percentage points in 2012. Similarly, China has extended its attractiveness lead over CEE. In contrast, competition among the pack of other leading players – Brazil, CEE, India, North America and Russia – remains keen.

Russia has joined the competition

What are the three most attractive regions in which to establish operations?



Source: *Ernst & Young's 2012 European attractiveness survey*. Total respondents: 840

According to our *2012 European attractiveness survey*, Russia's attractiveness as an investment destination (19%) increased by eight percentage points over the previous year, the largest increase of any region. In last year's survey, Russia ranked far behind India, North America, CEE and Brazil. However, this year, the "attractiveness gap" between these regions closed substantially. While Russia overtook Brazil in terms of its attractiveness profile, it is also in very close competition with India, North America and CEE.

Since 2006, Russia's investor appeal has increased nearly fourfold. Its profile for investors has been improved by its growing consumer market, expanding industrial base and recent government efforts to reduce the country's over-reliance on oil and gas. In 2011 particularly, there was a boost in investors' confidence in the country as a result of its sustained consumer demand, its agreement to join the WTO from mid-2012 and a new round of privatizations.

Europe's attractiveness has halved since 2006

Europe continues to appeal strongly to investors. Western Europe is ranked as the second-most attractive investment destination for global FDI (33%), followed by CEE (21%). These results, which were achieved during a period of extreme uncertainty in the Eurozone, confirm the continent's fundamental appeal.

Yet the number of investors who rank Europe as the most attractive destination for an FDI project has fallen by more than half since 2006. In this year's *2012 European attractiveness survey*, Western Europe's attractiveness slid by two percentage points to 33% and CEE's attractiveness suffered a steep decline of eight percentage points to 21%. This decline, coupled with a simultaneous rise in the attractiveness of other rapid-growth economies, means that CEE is now competing with North America and emerging markets such as India and Brazil. It is clear that the global economy has a growing number of attractive destinations in which to invest. Western Europe, however, is still ranked far ahead of these markets and is challenging China, the leading investment destination.

Mixed messages between Central and Eastern Europe

Investor confidence in CEE has declined. In 2006, 52% of respondents ranked the region as the most attractive place in the world for investment. In 2012, this figure is just 21%. Many factors explain this decline. A few years ago, CEE benefited from Western Europe's success. It was seen as a low-cost location to serve free-spending Western consumers. Today, Europe's problems have hit CEE hardest. A rise in non-performing loans, a very high dependence on exports to Western European economies and a weak and largely foreign-owned banking system – which contributed to the credit crunch in the region – are among CEE's problems. Given the region's strong trade and financial links with Eurozone economies, it is no surprise that the International Monetary Fund (IMF) expects CEE to be hit the hardest by adverse knock-on effects of the Eurozone crisis.

In addition, debt levels in some CEE countries are high and economic growth prospects low. Banks have cut their net aggregate lending to the private sector across CEE. Also, many of the region's banks have foreign parents. Labor costs have risen too, making manufacturing in CEE less attractive. With the increasing appeal of BRIC countries and other rapid-growth economies, CEE now finds itself competing with North America and emerging markets such as Brazil and India. Nonetheless, some CEE countries and regions, including the Baltic States, the Czech Republic, Hungary and Poland, continue to attract good FDI inflows from investors who seek relatively favorable labor costs and availability of skills.

Viewpoint

Russia on the way to liberalization

Yaroslav Lissovolik, Member of the Management Board, Chief Economist, Head of Research Department, Deutsche Bank Russia

Russia's investment appeal has been largely understated because of its controversial image in the world, and the Russian Government should do more to improve it. The market has overlooked some important factors that have become visible in Russia in recent years. For example, Russia is the only BRICS country that does not have any capital flow restrictions. This makes the Russian market more open to foreign investment. Progress made by Russia while preparing for accession to the World Trade Organization has not received due appreciation either. However, it is very important not only for the liberalization of the Russian economy, but also because international standards are playing an increasingly significant role in this country (though legal matters and the rule of law are still a matter of concern to many foreign investors).

Furthermore, we have recently seen some major improvements in corporate governance, which has never been Russia's strong suit. In this respect, Russia has always been behind other countries, including other BRICS nations. But Russian companies have recently taken some important steps to modify their dividend policies, thus becoming more open in many respects, including their financial reporting.

Other advantages of Russia include a stable macroeconomic situation; good quality human capital (in terms of the quality of education and human resources, Russia is still ahead of all other BRICS nations, and Russia must learn how to capitalize on this); and abundant natural resources. If used in the right way, these resources could help Russia address numerous development challenges instead of weighing down on the country like the so called "resource curse," which is only too often the case with developing markets.

A nice cushion for the Russian economy would be a stable inflow of long-term foreign capital, direct foreign investment.

Speaking about Russia's weaknesses in comparison with the other BRICS nations, demographics are one of them. Notwithstanding the recent years' improvements in this area, population decline is still a formidable challenge for Russia, as many investors regard demographic growth as a crucial prerequisite for long-term sustainable development. Russia's other issues are the low efficiency of production and labor, as well as inadequate investment. These issues are partly caused by the nation's underdeveloped infrastructure.

Foreign capital plays an important, though not decisive, role in the development of the Russian economy. Key decisions must be taken by Russia to move ahead with institutional reform, create a better investment environment, reduce red tape and fight corruption. Meanwhile, foreign capital may be critical for large-scale infrastructure projects such as the Sochi 2014 Winter Olympic Games or the 2018 FIFA World Cup. Such undertakings are simply too large a claim on the Government's purse to be financed by the state on its own, considering their cost inefficiency and the possible decline in oil prices in the next six to eight years. A nice cushion for the Russian economy, which remains heavily dependent on oil prices, would be a stable inflow of long-term foreign capital and FDI.

Incidentally, saying things like, "We don't need any short-term investment – give us only the long-term capital in the form of FDI instead" will hardly help Russia in achieving its goals. Russia must improve the local environment for portfolio investment, which will help attract long-term investment. According to our analysis, there is a connection between these.

In general, although there is still a lot to be done in Russia, I am an optimist. However, given the inertia in perceptions regarding the changes in Russia's economy, our country, in certain cases, may have to put in more effort than other nations to persuade investors that the positive changes in Russia are viable and will continue.

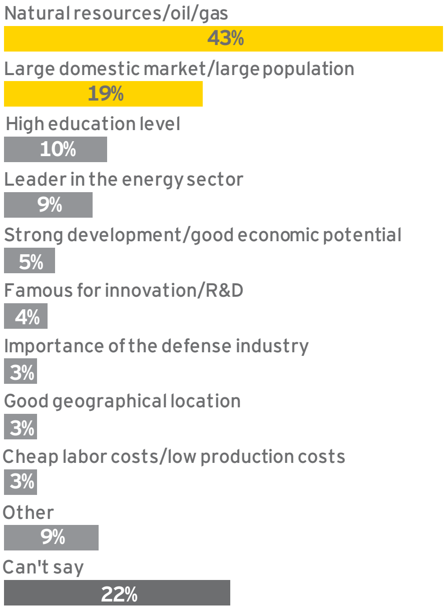
Russia's world-class natural resources

An abundance of natural resources continues to be Russia's most globally competitive feature, according to 43% of survey respondents. Russia's domestic market comes a distant second (19%).

Investors recognize Russia as a key global energy player and a large market.

Two-thirds of Russia's export receipts come from the oil and gas sector. Extractive industries thus remain key contributors to the Russian economy. The country holds the world's largest natural gas reserves and second-largest coal reserves. Over half of respondents (56%) expect Russia to still be an energy sector leader in 2020. Although energy dominates the country's economy, the Russian Government is trying to reduce its reliance on revenues from the volatile oil and gas sector, while looking for a more balanced economic growth model for the future.

What are Russia's world-class features?



Source: *Ernst & Young 2012 Russia attractiveness survey*. Total respondents: 208.

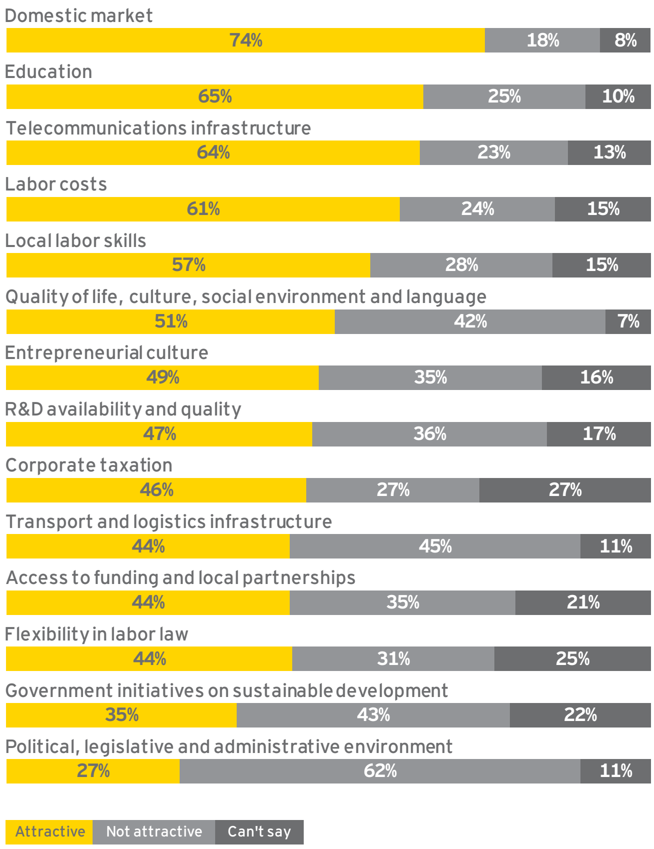
Russia's attractiveness: strengths and areas for improvement

According to our *2012 European attractiveness survey*, in the current environment, a country or region's domestic market is foremost in the mind of investors when they consider an investment location. Stability, labor costs, skills and infrastructure are some of the other key factors they consider when deciding on an investment location. In the *2012 Russian attractiveness survey,* investors highlight Russia's domestic market as its key strength. Education, telecommunications infrastructure, labor costs and skills are also recognized as some of Russia's most attractive features.

In terms of weaknesses, investors remain concerned about Russia's political, legislative and administrative environment; its transport and logistics infrastructure; and limited incentives for sustainable development. The country's leaders continue to emphasize the need to improve, while holding mixed views in terms of innovation and an entrepreneurial environment in Russia.

Investors already present in Russia have more confidence in its economy. First, they like Russia more because they understand the market better and are aware of the elements that make the country attractive. Second, investors have already crossed the preliminary hurdles to enter the Russian market.

What are the most attractive features of the Russian economy?



Source: *Ernst & Young 2012 Russia attractiveness survey*. Total respondents: 208.

Viewpoint

Russia will become a more balanced economy than India or China

Alexei Kudrin, Chairman of the Committee for Civil Initiatives, Minister of Finance 2000-2011

Why are foreign companies that are already doing business in Russia more optimistic about its investment climate than those who haven't yet entered the Russian market? We don't meet a number of standards that investors are used to in other countries. They have to accommodate themselves to the specific working styles of local and federal government bodies, and even individuals. They have to allow for the specifics of the tax system and financial reporting, and adjust to sometimes unaccustomed inspections. They don't always understand the mentality and motivation behind decisions that are made here. But those who go through this "school" acquire an ability to resolve the issues facing them and, most importantly, earn a good income. Investors simply have to learn to manage and avoid specific risks; and to devote a little more time to this than usual. I understand that big Western companies don't like to deal with such fine points or with country specifics. They want everything to operate the way it does at home. Since they're bringing money with them, they think everything should be done for them. But Russia doesn't work that way yet. Even businesspeople who go through this "school" don't always make everything work. But half, or even more, do make it work and are quite successful.

If we talk about Russia in the context of the BRICS, it should be noted that these countries are all very different and hardly comparable. We lag behind in a number of respects. Although China isn't a market in the direct sense of the word, but an imitation of one dominated by state regulation, many procedures there are set up better than in Russia. Take investment projects, for example. In China, after reaching an agreement with the central authorities, an investor will face minimal problems. An investor can't count on that in Russia. Here, unfortunately, problems can arise at any stage. In Brazil, there is probably no less economic crime than there is in Russia, but some market institutions function better there than they do in Russia. India is a very closed country. Building a business there is even harder. As in Russia, obstacles can be encountered after a project has been launched. But its colonial past and the English language bring India a little closer to Western business in terms of mentality and the legal system. Still, as strange as it may seem, I believe most of all in Russia. Russia will develop a more classical market model than China or India. In this sense, we're closer to Brazil. But we still have a lot to do to make the political and economic climate more competitive; to give market players a feeling of greater freedom and confidence, so that they feel freer to appeal to state institutions for support and have greater trust in the judicial system. Russia will follow this path and ultimately, I think, become a more balanced market economy than India or China.

Investors simply have to learn to manage and avoid specific risks; and to devote a little more time to this than usual.

For any BRICS country – Russia included – foreign investments are important. But they are not decisive for successful economic development, although advanced technologies come along with the money, which is also very important. In recent years, China had fixed capital investments of 30%–40% of GDP and higher, and the contribution of foreign investors accounted for approximately 4% of GDP. In 2011, these figures were 48% and 1.5% of GDP (22% and 3% in Russia). A few countries have foreign investments totaling well over 10%, but I wouldn't say that these are stable countries in terms of their macroeconomic indicators. The main source of investment is personal savings, deposits made by the population – and Russia is no exception.

Russia's strengths

▶ **Market opportunities**

Three-quarters of all respondents, and 85% of those already present in Russia, continue to be impressed with Russia's domestic market. With a population of more than 142 million,[1] Russia is the ninth most populous country in the world and the largest in Europe. It also enjoys the highest GDP per capita (US$16,700) among all BRICS countries. As a result of rising wealth levels over the past decade, 25% of Russia's population (nearly 40% of its workforce) is now part of the "middle class." And this percentage is growing. According to the Ministry of Economic Development of Russia, the middle class will grow to 37% of the population by 2020 and 48% by 2030.

The expansion of Russia's consumer base was displayed in 2011 when it became the largest internet market and the largest milk market in Europe.[2] Therefore, many international and domestic firms are now investing in manufacturing and selling their products in Russia. According to industry estimates, the country is poised to become Europe's largest consumer market by 2018.

1. IMF World Economic Outlook, April 2012.
2. Anna Krachenko, Ben Aris, "Russia's baby boom boosts children's goods sector," accessed via *www.telegraph.co.uk*, 12 June 2012; "Europe's great exception: Why local firms dominate the Russian internet," accessed via *www.economist.com*, 14 November 2011; "Overview of European Internet Usage in September 2011" press release, accessed via *www.comscore.com*, 12 June 2012.

▶ **Higher education advantage**

Two-thirds of the respondents cited education as one of Russia's competitive advantages. The country's population is relatively well educated, with a near 100% literacy rate and an exceptionally high tertiary enrollment rate of more than 75%. Russia also produces one of the highest proportions of science and engineering graduates in the world, well above the Organization for Economic Co-operation and Development (OECD) average. Expenditure on higher education has more than tripled since 2005, reaching RUB390b (almost US$14.5b) in 2011. However, overall education spending still remains low compared with OECD levels. There is also a need to renew university curricula to respond better to the skill requirements of a market economy.

▶ **Balanced labor costs and skills**

Investors come to Russia to find the right balance between labor costs and skill levels. Russia has the eighth-largest labor force in the world. In 2011, the average monthly wage in Russia was US$806.40. Although this is higher than in other emerging markets such as China, India and Mexico, it remains substantially lower than Brazil and the developed economies.

Fifty-six percent of investors are attracted to the availability of skilled labor in Russia. However, some respondents feel that there is a need to upgrade the skills of the Russian labor force in order to take steps toward a knowledge-based economy. While outlining Russia's long-term economic policy objectives earlier this year, President Vladimir Putin promised to create 25 million jobs for highly skilled workers by 2020.

▶ **Solid telecommunications infrastructure**

Sixty-four percent of respondents list Russia's telecommunications infrastructure as an attractive feature. Russia has the fourth-largest number of operational land lines and cellular phones in the world. In 2011, Russia also surpassed Germany to become the largest internet user in Europe.

Russia's areas for improvement

Political, legislative and administrative environment

Sixty-two percent of respondents consider that Russia's political, legislative and administrative environment needs improvement. Russia's ranking of 120 out of the 183 economies in the *World Bank's Doing Business 2012 report*[3] confirms the operating and administrative challenges faced by investors in the country. Getting electricity, dealing with construction permits and trading across borders continue to be complex and costly activities in Russia. Uncertain property rights, red tape and corruption still pose a huge challenge for investors in the country.

Russia's agreement to join the WTO and a new round of privatizations could provide partial reassurance, helping to open up Russia's huge energy sector to foreign investors. Also, internal tensions that arose after the elections now seem to be easing, and Russia is also changing its system of civil laws in September 2012. The new draft law is designed to introduce fundamental changes to property rights, obligations, contracts, security instruments and intellectual property. Finally, although the Russian Federation ranked 120 in the *World Bank's Doing Business 2012 report*,[4] it was still ahead of Brazil (126) and India (132).

3. *Doing business in a more transparent world*, World Bank, 2012, p. 14.
4. *Doing business in a more transparent world*, World Bank, 2012, p. 14.

Infrastructure

Respondents have mixed views on the current state of Russian infrastructure. While 45% do not find Russia's infrastructure attractive, 44% consider the transport and logistics infrastructure to be an advantage. According to the OECD, more than 60% of federal and regional highways do not meet regulatory standards. *The World Economic Forum's (WEF), Global competitiveness report 2011-2012*[5] ranks Russia 130 out of 142 for the quality of its roads. An adequate transportation infrastructure is only available in urban areas such as Moscow and St. Petersburg. Russia also ranks low (94) on the *World Bank's overall Logistics Performance Index*.[6] Russia's current level of containerization is approximately 4%, compared with the emerging markets' average of 15%. Russia has the second-largest railway network in the world. Its railroad infrastructure also fares well in the *WEF Global competitiveness report*,[7] ranking at 29 out of 142 countries.

Government spending on road and railway infrastructure is growing. The need to renew transport and logistics infrastructure has now become a political priority at the highest levels. Infrastructure spending is expected to increase further in light of the upcoming 2012 Asia-Pacific Economic Cooperation (APEC) summit, the 2014 Winter Olympic Games and the 2018 FIFA World Cup, all to be held in Russia.

5. *The Global Competitiveness Report 2011–2012*, World Economic Forum, p. 307.
6. "World Bank overall Logistics Performance Index: Russian Federation," accessed via *www.worldbank.org*, 11 June 2012.
7. *The Global Competitiveness Report 2011–2012*, World Economic Forum, p. 307.

Innovation and a culture of entrepreneurship

Russia's performance on most of the innovation performance indicators is mediocre overall and poor when it comes to indices that involve technical achievement or economic incentives. According to the recent *OECD Innovation Review of the Russian Federation*,[8] innovation in the country suffers because of very low levels of R&D and relevant activities in corporations; weak framework conditions for innovation; and inadequate infrastructure. According to *Ernst & Young's G20 Entrepreneurship Barometer report*, respondents face a dilemma with respect to the country's culture of entrepreneurship. Half (50%) of the Russian respondents did not agree that their culture encourages entrepreneurship, while the other 50% agreed that Russia's environment for entrepreneurs is supportive. The same report also highlighted that access to funding continues to be one of the most significant challenges for the creation, growth and survival of small and medium enterprises (SMEs), particularly innovative ones. Entrepreneurs also complain about the lack of tax incentives to start a business.

8. *OECD Reviews of Innovation Policy: Russian Federation 2011*, p. 1.

Viewpoint

Foreign capital enhancing Russia's competitiveness

Alexander Shokhin, President, Russian Union of Industrialists and Entrepreneurs

What should be done to improve the investment climate in Russia? The question is far from simple. The acutest problems are the insufficient protection of property rights; administrative barriers; inconsistent legislation; difficulties in connecting to the power grid and obtaining construction permits as well as complicated and costly customs procedures.

Foreign investment provides access to new production and management technologies, which are essential for further progress.

Human resources are an even trickier issue, as foreign investors believe that Russia has enough of a qualified labor force, while Russian entrepreneurs take the opposite view.

The key to improving the business environment is a balance between specific and universal measures. Some specific measures have either already been taken or are currently being implemented (special economic zones, Skolkovo). But this approach cannot be applied to the challenges involved in developing the financial market or be used to simplify the complex procedure of connecting all Russian regions to the power grid at once. Large-scale modernization requires universal measures, and exempting new equipment from assets tax is only the first step.

The priority measures to be taken right now include the following:

- Reducing the state's involvement in the economy and leveling the playing field for private and public companies
- Reducing the fiscal burden on businesses
- Continuing efforts to improve the efficacy and independence of judicial procedures
- Eliminating excessive administrative barriers
- Promoting a formalized expert examination procedure for all draft regulations governing entrepreneurial activities

Of course, this is not a complete list of priority measures. But even implementing only these, will make it possible to dramatically improve the business climate in Russia.

A question that comes up periodically is how impartial our judges are when considering disputes between domestic and foreign companies. According to the Russian Union of Industrialists and Entrepreneurs, there is no deliberate bias here. Eighty percent of companies believe their chances of defending their rights are high and the results of a survey of Russian and foreign companies are virtually identical. As regards disputes with control and oversight bodies (including the tax authorities) or regional administrations, foreign companies are even more optimistic. But we are now speaking exclusively about courts of arbitration.

Foreign investors are very important for economic modernization, but it is the national companies that have a key role to play. If the latter do not invest in their "native" economy and prefer to take their capital out of the country, foreign investors will either stay out of Russia or limit themselves to short-term investments of a speculative kind. We can now see this in our own case. Last year, direct foreign investments accounted for less than 10% of total investment, while "other credits" accounted for over 70%. And even the Federal Statistics Service and the Bank of Russia cannot say what the proportion of foreign investments is.

Alas, we have not yet become a quiet harbor for a crisis period in the world economy, and the situation is unlikely to improve in the near future.

Meanwhile, a lack of foreign investments could make Russian economic modernization too slow. Foreign investments provide access to new production and management technologies, which are essential for further progress.

Here, it is enough to look at the auto industry. Foreign investments changed the rules of the game. As it turned out, it was not enough to make cheap cars to remain in the market; you also had to think about quality, design and maintenance costs. The next leap forward should be in the production of auto parts, for which the foundations have already been laid out. Some new producers have appeared in Russia, who make auto parts based on international standards, although the number of such companies is still smaller than we would like it to be.

Success stories like this emphasize the importance of foreign capital in enhancing Russia's ability to be competitive.

Russia's industrial progress

Reality check

#1 FDI destination in Central and Eastern Europe.

4% increase in job creation in 2011.

36% decline in the number of projects in 2011 – but their value has increased.

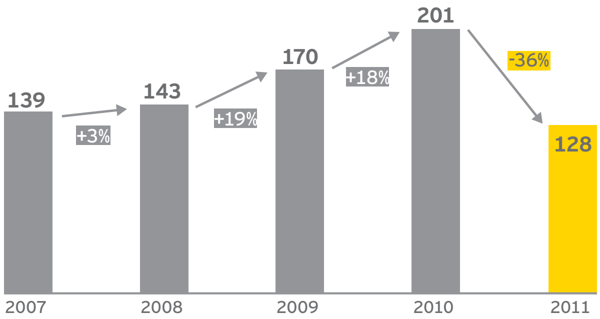
92% of job creation between 2007 and 2011 was due to manufacturing activity.

78% of respondents already present in Russia plan to maintain or expand their operations in the country.

42% of investment projects are located in Moscow and St. Petersburg.

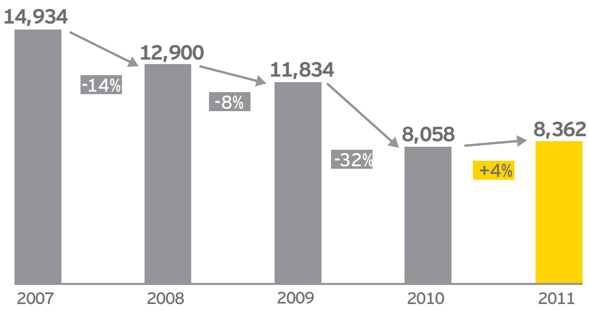
FDI in Russia in 2011: larger projects

FDI projects decline but are still close to the pre-crisis level



Source: *Ernst & Young's European Investment Monitor 2012*.

FDI jobs increase in 2011 after a continuous decline since 2007



Source: *Ernst & Young's European Investment Monitor 2012*.

In 2011, Russia attracted 128 FDI projects, a decline of 36% on the previous year. Political uncertainty caused by the electoral cycle, coupled with concerns arising from the escalation of the Eurozone debt crisis, made companies think carefully about investment in the country.[9]

Russia remained the most successful nation in CEE at attracting FDI, and its average project size continues to increase. This is mainly due to the comparative advantage of Russia over the other CEE countries.

After a continuous decline since 2007, FDI job creation started to pick up in 2011, mainly due to a rise in labor-intensive industrial activities. FDI projects in 2011 generated 4% more jobs than the previous year. The average project created 65 jobs in 2011, up from a low of 40 jobs in 2010.

9. Oksana Teplinskaya, Kate Ryzhkova, "Russia Business Report – EU leaders' informal summit took place in Brussels," accessed via *english.ruvr.ru*, 12 June 2012; Carol Matlack, "Country report: The Peril and Promise of Investing in Russia," accessed via *www.businessweek.com*, 12 June 2012.

Russia's performance in the enlarged Europe

Seventh-largest for projects, sixth for jobs

In 2011, Russia was the seventh-largest recipient of FDI projects in Europe, having been the fourth-largest in 2010. In terms of FDI job creation, Russia was the sixth-largest in Europe.

According to the WEF, Russia is among the world's fastest-growing economies in terms of domestic market size. This is one of the key reasons for its increase in FDI. Russia's proximity to other European markets and Asia encourages international firms to set up their operations in the country.

Investors have also been driven by a desire to gain access to the country's large repository of natural resources.[10]

Highest average jobs per project in Europe (in top 10 countries by FDI projects)

While the number of projects declined in 2011, the average size of projects by number of jobs created in Russia was the largest in Europe. This has largely been on account of the concentration of manufacturing activity in Russia. In 2011, manufacturing accounted for 48% of the total FDI projects, meaning Russia was the second-largest in Europe's top 10 FDI recipient countries list, ranking only behind Poland. In the same year, the automotive industry accounted for 14% of the total FDI projects in Russia, the largest share in this list.

10. *The Russia Competitiveness Report 2011*," World Economic Forum; "Global Consumer Confidence Report Q4 2011, Nielsen.

FDI inflows in Europe by destination country

Rank	Country	FDI projects				Number of jobs (2011)	Average jobs per project (2011)
		2010	2011	Change (2011 vs. 2010)	Share of FDI (2011)		
1	United Kingdom	728	679	-7%	17%	29,888	44
2	Germany	560	597	7%	15%	17,276	29
3	France	562	540	-4%	14%	13,164	24
4	Spain	169	273	62%	7%	9,205	34
5	Netherlands	115	170	48%	4%	2,229	13
6	Belgium	159	153	-4%	4%	3,599	24
7	Russia	201	128	-36%	3%	8,362	65
8	Poland	143	121	-15%	3%	7,838	65
9	Ireland	114	106	-7%	3%	5,373	51
10	Switzerland	90	99	10%	3%	1,546	16
	Others	916	1,040	14%	27%	59,344	57
Total		3,757	3,906	4%	100%	157,824	40

Source: *Ernst & Young's European Investment Monitor 2012*.

Activites: manufacturing

FDI projects by activity

Rank	Activity	FDI projects (2007-11)	Share of total (2007-11)	Jobs created (2007-11)
1	Manufacturing	402	51%	51,445
2	Sales and marketing	259	33%	1,472
3	Logistics	46	6%	287
4	R&D	25	3%	297
5	Testing and servicing	20	2%	642
6	Headquarters	12	2%	930
7	Education and training	8	1%	15
8	IDC	4	1%	1,000
9	Shared services center	4	1%	-
10	Contact center	1	0%	-
	Total	781	100%	56,088

Source: *Ernst & Young's European Investment Monitor 2012*.

Production units account for 51% of projects and 92% of job creation.[11] Investors come to Russia to manufacture goods for the local market, but also distribute globally. Over the past five years, 51% of FDI in Russia has gone into manufacturing, with 402 FDI projects, the fourth-largest in Europe. Between 2007 and 2011, manufacturing projects created 51,445 jobs, accounting for 92% of total job creation. Moscow, St. Petersburg and Kaluga are the top three regions for manufacturing in Russia, between them accounting for 21% of the Russian manufacturing projects in the last five years.

11. "Russia to Attract More Foreign Investment," accessed via *www.russia-briefing.com*, 12 June 2012.

Viewpoint

Russia needs an "image-lift"

Alex de Valukhoff, Chief Executive Officer, Lafarge Russia

We started our operations in Russia in 1996. We bought an old, decayed asset which had the advantage of being close to Moscow. Today, it's a very different country.

Among the world's large economies, Russia was the most hurt by the crisis — but it was also the fastest to recover.

Back then, the construction industry was at a third of what it was during the Soviet times in terms of volume, prices were so low that it was not possible to turn a profit and it was also plagued by a bartering system (more than 90% of the trade was non-cash).

After Russia's 1998 default, many investors moved away from the country, but we chose the opposite. To stay and grow was indeed the right thing to do: the 1998 crisis helped the Russian industry resurrect, as it was not strangled by an overpriced currency and scarce liquidities any more. Then came the "period of stabilization," with regular growth, only being dented by the 2008 crisis, which led to a collapse in both prices and construction volume. 2012 sees the return of the pre-crisis volumes, and prices should follow soon.

As we predicted, among the world's large economies, Russia was the most hurt by the crisis — but it was also the fastest to recover. This explains why, in 2009, Lafarge decided to invest in a new greenfield plant — considered to be a bold move by other players but, here again, we think that we are going to be proven right.

Compared to 1996, Russia has:

- A proven potential and a record of high returns on investment
- A much more stable and predictable environment
- Huge reserves for growth

But :

- Has not been able to convert its economy from oil dependence, and therefore is still prone to volatility
- Has possibly the highest entry ticket price among the 64 countries where Lafarge operates
- Is an over-expensive country by all standards, which reflects the cost of corruption and inefficiency
- Has an image problem, which makes our jobs particularly difficult when it comes to convincing boardrooms

Within Vladimir Putin's new presidential term, we expect to see the implementation of what has been started and/or promised, such as:

- The 2020 Strategy for the construction industry, which promises true innovation that has yet to be seen
- The improvement of the economy's energy efficiency by 40%
- The financing of infrastructure development through innovative means, including Public–private partnerships (PPPs) and project financing

Also, intensive work needs to be done on the country's image — to which we are ready to participate in, as we have also done in the past.

The sales and marketing function attracted 259 projects, 33% of the total FDI projects in Russia. More than 80% of these sales and marketing projects were concentrated in the two largest Russian cities – Moscow and St. Petersburg.

Projects in the services sector and R&D, however, have remained low in number. R&D accounted for only 3% of the total investment in terms of FDI projects; shared services centers constituted 1% and contact centers 0.2%. For the 43 countries in Europe, excluding Russia, the average for R&D in the last five years stands at 7%, and 3% for contact centers. This highlights the need for the Russian Government to introduce measures to diversify its economy by promoting innovative and more value-added services. President Vladimir Putin has said that the Government will encourage major international companies to cooperate with Russia in the area of innovative technology, and will encourage foreign firms in various industries to set up production lines and establish technological centers in the country.

Approval of the Government's long-awaited privatization plan is expected to bolster the country's investment prospects. The reduction in state ownership will create a more competitive environment and lead to an increased inflow of funds to develop the privatized enterprises.

FDI sectors: diversification is underway

A strong industrial base

Russia's industrial sector attracts more FDI projects than any other sector. Business services and machinery and equipment are the two sectors in Russia that recorded a rise in their number of FDI projects in 2011 compared with the previous year. Other sectors in the top 10 have seen a decline in investment over the same period.

Heavy industries[12]

Automotive has been the key sector attracting FDI in Russia over the last five years, with 90 projects and 16,787 jobs created. Investor focus on the automotive sector increased further this year, with 14% of the total FDI in Russia coming into the sector, compared with an average of 12% between 2007 and 2011. Russia is the second-largest automotive market in Europe, and the fourth-largest in the world after China, the US and Germany.

The country's light vehicle density stands at a moderate 250 cars per 1,000 people, compared with more than 500 cars in France, Germany and the UK and more than 640 in the US. So there is further growth potential in Russia's automotive industry. A surge in consumer spending and readily available car loans has helped stimulate the country's auto industry. Striving to attract FDI, in February 2011, the Government reduced import tariffs for foreign corporations on components in return for investment agreements to produce cars locally. A new industrial assembly regime was established, which aims to augment localization in the automotive sector, and encourage enterprises to construct or enlarge their production facilities and set up R&D centers in Russia.

The Russian people's preference for foreign brands has lured almost all the major international car manufacturers to establish and expand their manufacturing base in the country. Players such as Japan-based Nissan, Honda and Toyota; French carmaker Renault; US-based General Motors; South Korean giant Hyundai; Italy's Fiat; and German auto manufacturers Volkswagen and BMW are all present in Russia.[13]
On the back of rising investment in the sector, regions including St. Petersburg, Moscow, Nizhny Novgorod and Togliatti have emerged as leading auto manufacturing hubs. Other areas, such as Kaluga, Rostov, Izhevsk and Kaliningrad are also becoming centers for the automotive industry.[14]

FDI projects by sector

Rank	Sector	FDI projects (2007-11)	Share of total (2007-11)	Jobs created (2007-11)
1	Automotive	90	12%	16,787
2	Food	86	11%	9,958
3	Machinery and equipment	62	8%	3,682
4	Chemicals	57	7%	3,218
5	Non-metallic mineral products	57	7%	3,035
6	Business services	50	6%	341
7	Other transport services	49	6%	457
8	Financial intermediation	40	5%	263
9	Plastic and rubber	32	4%	1,297
10	Software	25	3%	1,918
	Others	233	31%	15,132
	Total	**781**	**100%**	**56,088**

Source: *Ernst & Young's European Investment Monitor 2012*.

Machinery and equipment emerged as the third-largest sector in Russia in terms of FDI projects (62 projects) and the fourth-largest in job creation (3,682 jobs) between 2007 and 2011. The share of the machinery and equipment industry increased to 11% in 2011, up from an 8% average over the previous five years, highlighting the increase of FDI activity. Rising demand for new machinery is fueled by infrastructure modernization, power sector construction and growth of industrial sectors – and has attracted foreign investors to Russia. Moscow and the Kaluga region are the two main locations for machinery and equipment investment, accounting for 32% of FDI projects between 2007 and 2011.[15]

Various leading equipment manufacturers including Alstom, Danieli, Deere & Company, General Electric, Siemens and Toshiba Corporation have established operations in Russia.

12. "Prime Minister Vladimir Putin chairs a meeting at AvtoVAZ (Togliatti) on the development of the automotive industry in the context of Russia's accession to the WTO," accessed via *www.premier.gov.ru*, 12 June 2012.

13. An overview of the Russian and CIS automotive industry, Ernst & Young, February 2012; Dave Leggett, "Analysis: Russia car industry set for investment wave as market rebounds," accessed via *www.just-auto.com*, 12 June 2012; "Automobile industry in Russia," accessed via *www.oxbridgewriters.com*, 12 June 2012; *Getting up to speed: Russian economy and automotive industry*, Ernst& Young, April 2011; Doug Palmer, "U.S. hunts for exports in Russian auto parts market," accessed via *www.reuters.com*, 12 June 2012; Ekaterina Shatalova, "Russian Car Market May Grow 6% This Year, Industry Ministry Says," accessed via *www.bloomberg.com*, 12 June 2012; "Russia April auto sales up 14 pct y/y – AEB," accessed via *www.reuters.com*, 12 June 2012; "World's 10 Largest Auto Markets," accessed via *www.cnbc.com*, 12 June 2012; "Renault-Nissan to Take Control of Russian Automaker," accessed via *www.nytimes.com*, 12 June 2012.

14. "Kaliningrad To Become New Autos Hub With Magna-Avtotor Investment," *Industry News*, April 2012, BMI Industry Insights – Automotives, Emerging Europe.

15. "Construction machinery market in Russia 2012: Development forecasts for 2012-2014," accessed via *www.pmrpublications.com*, 8 June 2012; "Demand for new construction machinery rising in Russia," accessed via *www.oxstones.com*, 9 June 2012; "An analytical review by Pavel Gagarin," accessed via *www.business-money.com*, 8 June 2012; "Government Initiatives to Promote General Purpose Test Equipment Market in Russia and the CIS," accessed via *www.frost.com*, 9 June 2012; "Shelf projects to attract 500 bln dollars to Russia-Putin," accessed via *www.itar-tass.com*, 10 June 2012; "Siemens to grow steel-intensive production in Russia by €1bn," 4 January 2012, via Factiva © 2012 Steel Business Briefing.

Viewpoint

Stability: Russia's biggest advantage

Laurent Kleitman, Chief Executive Officer, JSC Concern Kalina (Unilever)

I always personally believed that the Russian market would be highly attractive for Unilever and foreign investment in general. The appetite for consumption, the attractiveness of brands, the desire to access high-quality consumer goods — all these trends were already apparent in the early 1990s.

At that time, the Russian consumers were already very demanding, knowledgeable, educated and savvy in their choices. They expected quality, consistency and superior value when consuming branded goods. Since then, we have seen the explosion of the consumer goods market.

The attractiveness of Russia has never really been questioned, despite its growth rate being lower than China's.

Today, Russia is essential to our strategy. Twenty years ago, Unilever became one of the first movers into the Russian market when it bought its first business in St. Petersburg, Severnoye Siyanie. Twenty years later, Unilever purchased Concern Kalina, one of the best and most successful Russian companies. While demonstrating consistency in developing a solid, long-term presence in Russia, we also continue to show our determination to serve the needs of Russian consumers across a wide range of brands and categories.

I believe that Russia will continue to grow steadily in the coming years and remain attractive to Unilever and other foreign investors.

As a foreign investor, I would welcome progress toward more transparency in conducting business.

The biggest advantage of Russia is its stability. I am confident that the country is going to continue its slow but steady modernization. Patience and resilience have always been strong qualities of the great Russian people! The other big plus of Russia is the excellent quality work force, and increasing global mindset of the younger generations of managers.

On the downside, infrastructure is not developing as fast as it should and legislation is often still complex and somewhat bureaucratic.

However, I firmly believe that there is no fundamental obstacle that a company like Unilever cannot overcome, as the desire to win in Russia is bigger.

As a foreign investor, I would welcome progress towards more transparency in conducting business. A further simplified process for obtaining work permits for foreign employees would also be welcome, as would simplification of visa legislation and continuous reduction of imports tariffs in line with World Trade Organization membership. These measures will help integrate Russia into global trade, and will also enable foreign investors to contribute to the economy's growth and the development of a solid local market.

▶ **Consumer products driving growth**[16]
The food sector accounted for the second-largest number of FDI projects (86) in Russia. The industry created employment for 9,958 people between 2007 and 2011. Rising levels of disposable income among consumers in Russia has led this growth. The development of modern infrastructure including malls, specialty suppliers of frozen foods and drive-through establishments in many cities have further paved the way for the food sector's growth. This has been particularly prominent in Moscow, St. Petersburg and Novosibirsk. Major global food and beverage giants present in Russia include Burger King, Carlsberg, Coca-Cola, Heineken, McDonald's, Nestlé, PepsiCo and Yum! Brands.

16. "Russia's food industry to be opened to foreign investors," accessed via *www.telegraph.co.uk*, 10 June 2012; Andrew E. Kramer, "Russia Becomes a Magnet for U.S. Fast-Food Chains," accessed via *www.nytimes.com*, 11 June 2012; "Timeline: Wal-Mart eyeing Russian market," accessed via *www.reuters.com*, 11 June 2012.

Business services

Russia's business services sector has seen a growth in FDI activity in recent years. It accounted for 9% of the total FDI projects in 2011, higher than its share of 5% in 2010 and above the average of 6% between 2007 and 2011. FDI projects have been primarily directed at areas including sales and marketing, data centers, laboratories, headquarters, representative offices, and technology and innovation centers. This represents a slow but gradual sign of services sector-led growth, in a country that has primarily had a manufacturing-driven economy.

The growing strength of the services industry is also shown by the increase in the share of financial intermediation and software sector projects. Financial services FDI has mainly gone into development of new offices and branches, and expansion of subsidiaries in the areas of banking, insurance and financial leasing. The software industry has seen growth in development centers, programming facilities, IT training centers and R&D centers. Along with business services, these sectors accounted for 17% of all the FDI projects undertaken by investors in Russia in 2011, much higher than their contribution in 2010 (11%) and over the last five years (14%).

Moscow has developed as a hub for business services in the country. The capital city alone attracted 75% of FDI projects in the sector between 2007 and 2011. The city also acted as the prime location for financial services and software sector projects in the last five years. The Russian Government's plan to expand Moscow as a financial center is expected to boost foreign investment in the city.[17]

17. *Growing opportunities Russia FDI report*, Ernst & Young, 2011.

Little change in FDI sources

The US continues to be the largest source of FDI

The US remains Russia's leading investor with 122 FDI projects (16% of the total) that created 6,043 jobs. The Overseas Private Investment Corporation, an organization that aims to promote American companies overseas, has been providing financing to US companies for them to undertake projects in Russia, thus supporting the investment climate between the two countries. Leading US multinationals are present in various sectors such as automotive, IT, food and oil and gas. These include Boeing, Cisco, ExxonMobil, Ford, Hewlett-Packard, Intel and Kraft Foods.

Viewpoint

In many ways, Russia is already a free market

Andrew Somers, President & Chief Executive Officer, American Chamber of Commerce in Russia

I arrived in Moscow at the end of 2000 and I must say that the quality of the investment environment has been improving here, year in year out. Since then, the attitude of the Russian Government to foreign investment, particularly American investment, has changed significantly for the better.

Russia needs to diversify its economy and, hopefully, the Russian Government will continue to work upon it.

Russia's recent drive for modernization has attracted a number of American Chamber of Commerce (AmCham) member-companies, including large companies but also global leaders in their niche, aiming, for example, to improve the extraction of oil or the processing of steel. It's a new trend of the last two to three years. A second positive trend is the changed tone in relations between the US and Russia. When companies, whether Russian or American, feel that geopolitical issues are being solved in a quiet way, there is a better environment for long-term strategic deals, like the one signed by Rosneft and ExxonMobil. Hopefully, recent differences on some issues will be resolved or discussed privately between the two Governments.

In many ways, Russia is already a free market. Yes, there is a lot of state influence in some strategic sectors, which is not unusual around the world. But some of the fast-growing sectors in the last 10 years, like consumer goods retail and, in a certain sense, automobile, are basically left alone by the state. We do sometimes run into bureaucratic hurdles but are able to resolve the problems in an open way.

I expect that Russia's WTO entry will nudge those American companies who refused to even look at the market to at least start to study it. There are very few opportunities for growth in the world, certainly few in the US and Europe. Russia is one of those places that offer significant growth. If the Russian Government continues to try to modernize the economy, as I believe it will, there are many sectors where US companies can play an important role. So, I feel pretty positive about the growth going forward here in the short and medium term.

The only challenge I would consider concerning the rapid economic development of Russia is its dependence on oil. Russia needs to diversify its economy and, hopefully, the Russian Government will continue to work upon it.

In terms of Russia's advantages in comparison with other emerging markets, I see, first of all, that the level of the population's education is pretty high, relative to other BRICS countries. That is very important. One can find a very well-educated population throughout the country and that gives companies a platform on which to train people. You don't have that same magnitude of education in Brazil, China or India. The second big advantage is, of course, the mineral wealth. Third – the amount of arable land for agriculture. Russia is going to play a key role in feeding the world population by 2050 or even earlier. The disadvantages are well known: image, corruption and bureaucracy. In some American and Russian circles, you can still see the hangover of the Cold War. But I am confident that the greater the economic relationship between Russia and the US, the shorter this old view will last.

Eight of the top 10 source countries are from Europe

Europe continues to have the largest number of realized FDI projects in Russia. This region has provided 8 of the top 10 source countries in the last five years. European countries originated 343 FDI projects between 2007 and 2011, 44% of the total in Russia.[18] The European Union (EU) and Russia have the Partnership and Cooperation Agreement (PCA) in place, which forms the basis for bilateral trade and investment relations. The EU plans to advance its relations with Russia by replacing the PCA and signing a new agreement with substantial provisions related to trade and investment.[19]

Germany[20] emerged as the second-largest investor globally and the largest from Europe in terms of FDI projects (99 projects) in Russia, although it was the largest creator of jobs in Russia (6,254) between 2007 and 2011. Germany's relationship with Russia has primarily been built on Russia supplying Germany with a huge proportion of its energy needs. Several German companies are established in Russia in industries ranging from oil and gas to banking and consumer goods. Leading German companies that have invested in the Russian market include adidas, Bayer, Bosch, Deutsche Bank and Siemens.

18. Russia offers French cos to expand participation in Baltic nuke proj," Prime Energy Service, 18 November 2011, via Factiva, © 2011 Prime ZAO. "UK Trade & Investment and Russian Direct Investment Fund Host Joint "Invest in Russia" Conference," accessed via *www.prnewswire.com*, 12 June 2012.
19. "Countries: Russia," accessed via *ec.europa.eu*, accessed 11 June 2012.
20. George Friedman, "Germany and Russia Move Closer," accessed via *www.stratfor.com*, 12 June 2012; "The Bavarian Representative Office in Russia," accessed via *www.invest-in-bavaria*, 12 June 2012; "More German companies come to Russia," accessed via *english.ruvr.ru*, 12 June 2012.

FDI projects by country of origin

Rank	Country	FDI Projects (2007-11)	Share of total (2007-11)	Jobs created (2007-11)
1	United States	122	16%	6,043
2	Germany	99	13%	6,254
3	United Kingdom	46	6%	1,125
4	France	45	6%	2,070
5	Finland	43	6%	1,700
6	Switzerland	38	5%	1,238
7	Japan	35	5%	3,443
8	Austria	25	3%	620
9	Sweden	24	3%	2,010
10	Denmark	23	3%	2,399
	Others	281	34%	29,186
	Total	**781**	**100%**	**56,088**

Source: *Ernst & Young's European Investment Monitor 2012*.

The UK created employment for 1,125 people in Russia through 46 projects (6% of the total), making it the third largest country of FDI origin between 2007 and 2011. The Russian economy has been collaborating more closely with the UK to assess investment opportunities in Russia and invite British corporate and financial investors to set up businesses in the country. More than 600 UK firms are doing business in Russia; including AstraZeneca, BP, GlaxoSmithKline, Pilkington and Shell, all of which have a strong presence in the Russian economy.[21]

Other leading investing countries from Europe include France and Finland, with 45 and 43 FDI projects, respectively. Russia has been increasing its cooperation and dialogue with France to encourage French investment into Russia. French investment is centered in sectors such as retail, energy, construction, automotive, insurance and banking. Several French companies have established a presence in Russia, such as Accor, Auchan, GDF Suez, L'Oréal, Louis Dreyfus, Peugeot, Saint-Gobain, and Sanofi-aventis.[22]

21. "UK Trade & Investment and Russian Direct Investment Fund Host Joint "Invest in Russia" Conference," accessed via *www.prnewswire.com*, 12 June 2012.

After Russia's formal accession to the WTO, the Russian economy should push toward attracting a larger share of investment from its leading source regions such as the US and Europe.

22. "MAP: French Investments in Russia's Regions," accessed via *www.themoscowtimes.com*, 11 June 2012; "Ties at the Top," accessed via *www.themoscowtimes.com*, 12 June 2012; Kumaran Ira , "Russian President Medvedev signs strategic, business deals in France," accessed via *www.wsws.org*, 12 June 2012; "UK in Russia: Business strengths – The UK's economic and business strengths," accessed via *ukinrussia.fco.gov.uk*, 12 June 2012; Damion Potter, "Supporting UK companies doing business in Russia," accessed via *www.modernrussia.com*, 12 June 2012.

In search of new investors from emerging markets

FDI activity into Russia by emerging economies remained low between 2007 and 2011. China and India each accounted for under 2% of FDI project creation in Russia. Brazil originated just two projects in the country in the same period. These countries remained minor contributors on the employment generation front too.

However, Russia has recently started negotiations with China to develop a mutually beneficial investment climate. During President Vladimir Putin's recent visit to China, the two nations began negotiations for opening a joint investment fund worth approximately US$2b – with the RDIF and the China Investment Corporation contributing US$1b each to the fund.

These entities would also seek to raise another US$1b to US$2b from third parties. More than 70% of the fund's capital would be targeted at projects across Russia and other CIS members, with the rest focusing on China. In June 2012, a few Chinese companies provisionally agreed to invest US$2.5b to US$3b in construction projects in southern Russia.

Russia's top regions for FDI

The two largest cities attract most of the projects

FDI projects by destination city/region

Rank	Region	FDI Projects (2007-11)	Share of total (2007-11)	Jobs created (2007-11)
1	Moscow (Federal City)	231	30%	3,735
2	St. Petersburg (Federal City)	92	12%	9,843
3	Kaluga (Region)	39	5%	7,260
4	Nizhny Novgorod (Region)	14	2%	550
5	Kazan (City)	13	2%	416
6	Yekaterinburg (City)	13	2%	630
7	Voronezh (Region)	12	1%	1,462
8	Novosibirsk (City)	10	1%	753
9	Krasnodar (City)	9	1%	880
10	Togliatti (City)	9	1%	2,105
	Others	339	43%	28,454
	Total	**781**	**100%**	**56,088**

Source: *Ernst & Young's European Investment Monitor 2012*.

Forty-two percent of FDI projects are concentrated in the Moscow and St. Petersburg regions. Investors see Moscow, the biggest city in Russia, as a key destination for FDI. The capital city has attracted 231 projects that have led to the creation of 3,735 jobs in the last five years. FDI in Moscow has been concentrated in sectors such as business services, financial intermediation, machinery and equipment, and software.

Moscow's surge in FDI is based on a highly qualified workforce, supportive local authorities, subsidies and tax benefits and convenient residential options for foreign nationals. Moscow's attractiveness to foreign investors is further enhanced by the presence of special economic zones within the region: Zelenograd and Dubna are located in the Moscow area and offer investors an appealing combination of corporate tax incentives, easy access to real estate and lower VAT on imports.[23]

St. Petersburg, Russia's second largest city, is another prominent FDI location. Between 2007 and 2011, the largest number of FDI jobs were created there (9,843) by 92 projects. St. Petersburg is a major financial and industrial center in Russia. Its convenient proximity to Europe, modern transport infrastructure and educated workforce have led numerous international corporations to set up their business in the city. St. Petersburg has attracted more companies from European neighbors, including France, Germany and the UK, as well as from countries in the Middle East.[24]

23. *Growing opportunities Russia FDI report*, Ernst & Young, 2011.
24. "Business Guide: Investment Laws," accessed via *petersburgcity.com*, 13 June 2012; "Business Guide: Investment Laws," accessed via *petersburgcity.com*, 13 June 2012; "Advantages," accessed via *www.doingbusiness.ru*, 13 June 2012; "New strategy: Department is a gateway for all foreign investors," accessed via *www.investinmoscow.ru*, 12 June 2012.

The Kaluga and Nizhny Novgorod regions are increasing their appeal

The Kaluga region is becoming established as a hub for international enterprise in Russia.[25] From 2007 to 2011, Kaluga was the third-largest region in terms of FDI projects (39), which created the second-highest number of jobs in the country (7,260). Sectors that received major investment include automotive, machinery and equipment, transport, food and pharmaceuticals.

25. Alexander Bratersky, "L'Oreal Adds a French Face To Kaluga's Business Hub," accessed via *www.themoscowtimes.com*, 12 June 2012; Maria Antonova, "The Kaluga region in Russia offers economic opportunities," accessed via *www.telegraph.co.uk*, 12 June 2012.

Foreign corporations that want to establish themselves in Russia have been drawn to the region's favorable business climate, tax reliefs and close proximity to Moscow. Also, business and industrial parks in the region such as Grabtsevo, Rosva and Vorsino have amenities, which make them popular locations for foreign business operations.

Nizhny Novgorod is another developing area for foreign investment. It recorded 14 FDI projects from 2007 to 2011. These projects have primarily been directed at the automotive, metals, financial intermediation, food and non-metallic mineral products sectors. The region is also one of the main centers for IT and software, and boasts the presence of players such as Auriga, Intel, MERA Networks and Teleca.

Supportive government policies on tax benefits and the decision to allow the implementation of investment projects using the "single window" mechanism to reduce waiting periods are among its appealing features.[26]

26. "Outsourcing to Russia: Nizhny Novgorod," accessed via *goaleurope.com*, 12 June 2012.

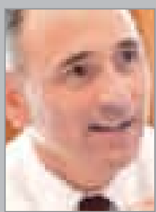
Viewpoint

Huge long-term potential

Joseph Jimenez, Chief Executive Officer, Novartis

Novartis' predecessor company, Geigy, first established trade relations with Russia in the middle of the 19th century, on the eve of Russia's first leap into industrialization. In 1890, Geigy rented a site with production buildings in Karavayevka, close to Moscow, where it began to manufacture dyewood extracts. The company also sold products directly from Basel, Switzerland, through its subsidiaries. At that time, government reforms attempted to stimulate inflow of foreign capital, and growth of domestic industrial production made Russia's market attractive for many foreign companies, especially from Europe.

Since that time, our interest in expanding operations in Russia has significantly increased. At Novartis, we believe that today's Russia will remain a fast-growing country with huge long-term economic potential. Moreover, Russia's Government has announced an ambitious economic modernization agenda, which encompasses the pharmaceutical industry. This is reflected in the Pharma 2020 strategy. We are committed to helping Russia to achieve those aspirations, particularly in the health care sector. We are currently building a new full-scale pharmaceutical manufacturing plant in the special economic zone in St. Petersburg. This facility is part of the company's US$500m, five-year strategic investment plan in Russia. The investment will address three core areas – local manufacturing, R&D partnerships and public health development.



One of the biggest competitive advantages of modern Russia is its economic stability and a growing professional workforce capacity

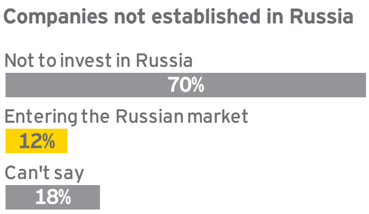
One of the biggest competitive advantages of modern Russia is its economic stability and a growing professional workforce capacity. Together with increased government effort to improve the investment climate and create a friendly business environment, this will become an important stimulus to attract foreign investments to Russia. Obstacles are similar in all fast-growing countries – unpreparedness and cost of infrastructure, bureaucratic hurdles and often the absence of transparency in the regulatory sphere.

We stand ready to support the new Presidential Administration and Cabinet in their actions to establish a regular and transparent two-way dialogue between the Government and business community. We believe this will help overcome current obstacles and create new, mutually beneficial PPP opportunities.

2013: plans for investment

What are your plans for the next year in Russia?

Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 135.



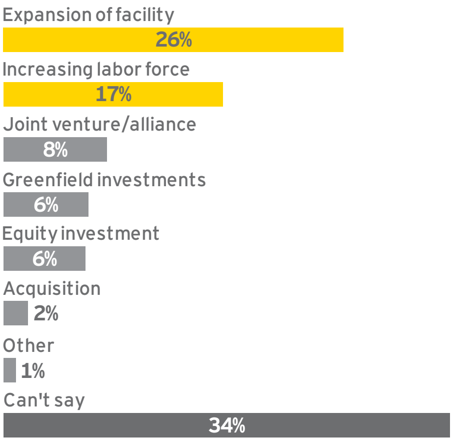
Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 73.

Despite the wave of negativity around the Eurozone crisis, investors continue to display confidence in the Russian market and optimism about the future. Nearly 80% of investors that are already present in Russia plan to increase or maintain their operations in the country. Only 3% of these respondents are not optimistic and plan to relocate or withdraw their operations from the country.

There is a discrepancy between the plans of companies that already have operations in Russia and those that are not yet established. Seventy percent of the companies that are not established in the Russian market have no plans to invest in the country in the next year. This is, however, 16 percentage points less than in the previous year's survey. This reinforces the belief that the number of leaders who view Russia as one of the key markets to invest in are, in fact, increasing. The percentage of respondents looking to enter the Russian market also increased from 7% in our 2011 survey to 12% this year.

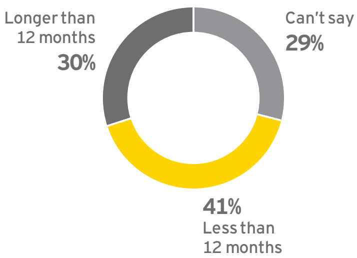
More than 40% of the investors that are keen to establish or increase operations in Russia plan to do so in the short term. Twenty-seven percent plan to invest within 6 months and 14% in 6 to 12 months. They chose organic growth as the preferred mode of investment, given their familiarity with the rules and regulations of the Russian market. Twenty-six percent of leaders plan to expand their existing facilities while 17% will increase their employee numbers in Russia. However, only 2% of respondents have acquisition plans in Russia, highlighting the country's difficult and lengthy approval process.

How do you plan to invest?



Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 113 (considering maintaining, establishing or developing activities in Russia)

When do you plan to invest?



Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 113 (considering maintaining, establishing or developing activities in Russia)

How to meet investors' expectations

A look into the future

57% of investors remain confident about Russia's future.

53% of respondents suggest improvement in the effectiveness of the rule of law.

47% of respondents would like to see bureaucracy reduced.

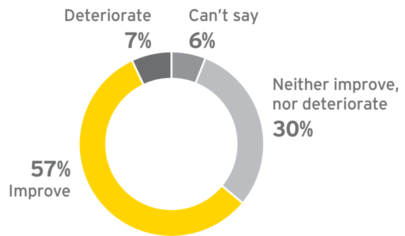
62% of investors believe Russia's accession to the WTO will increase the country's attractiveness of investment.

Expectations from investors

Confidence has declined this year …

The majority of investors continue to believe that Russia's attractiveness will improve in the medium term. However, only 57% are optimistic about Russia's future attractiveness, compared with 70% last year. It appears that confidence has fallen as a result of instability in global markets and the Eurozone crisis. Thirty percent say that Russia's attractiveness will remain the same in the medium term, while only 7% are pessimistic about Russia's future.

Over the next three years, do you think the attractiveness of Russia as a place for your company to establish or develop activities will...?



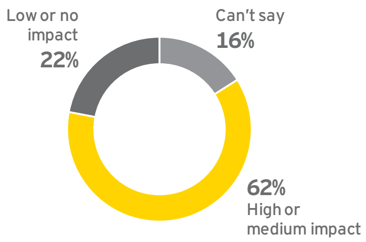
Source: *Ernst & Young 2012 Russia attractiveness survey*. Total respondents: 208.

… but remains at a comparatively high level

Russia's numbers, however, are very positive compared with Europe as a whole. In our *2012 European attractiveness survey*, only 38% of respondents said they believe the continent's attractiveness will improve, while a similar percentage believe that it will remain the same. This suggests that while the Russian economy will be affected by the crisis in Europe, the effect will be modest compared with the European economies.

WTO deal has boosted confidence

What will be the impact of Russia's accession to the WTO on its investment appeal?



Source: *Ernst & Young 2012 Russia attractiveness survey*. Total respondents: 208.

After almost 18 years of negotiations, Russia is set to become a fully fledged member of the WTO. The overall consequences of Russia's accession to the WTO are expected to be positive and to boost foreign investors' confidence in the country. More than 60% of respondents believe Russia's accession will have a medium-to-high impact on the country's investment appeal.

According to the World Bank, in the medium term, the gains should be about 3% of GDP per year, with wages rising 4%-5% and more than 99% of households gaining income. In the long run, the gains should be about 11% of Russian GDP per year, with wages rising 13%–17%.

To ensure that Russia maximizes the benefits of its accession to the WTO, the Government should take urgent steps to restructure uncompetitive Russian industries. Measures should first and foremost be taken to achieve a shift in manpower from uncompetitive industries and enterprises to regions and industries that have the capacity to develop.

The past experience of nations that have acceded to the WTO, and the assessment of the likely consequences of Russia's accession, show that FDI in Russia's liberalized services sector may eventually deliver growth in production of up to 11% of GDP. To enhance that effect, Russian authorities, at all levels, should regard an improvement in the investment climate as a key policy priority.

Accession to the WTO, renewed privatization and Government initiatives to reduce reliance on energy exports are all reasons why we expect investor confidence in Russia to rise.

WTO opportunities?

According to a recent Ernst & Young report,* the following measures should be taken in order to exploit the opportunities that stem from Russia's accession to the WTO:

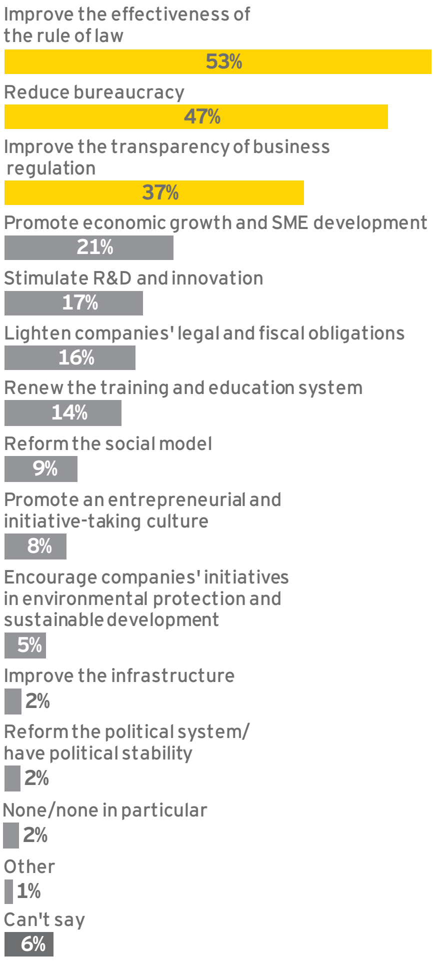
* *Russia's success in the WTO: What The Opportunities*, Ernst & Young, April 2012.

- **Restructure the town-forming enterprises** in the Russian monotowns (towns with only one industry) that are in the high-risk zone of reduced production. This can be done with the withdrawal of non-core assets and their privatization.
- **Develop transportation, postal and communications infrastructure** to reduce the costs of connecting cities and towns in the heightened risk zone with other regions and countries.
- **Offer incentives** to draw major investors into regions, towns and cities in the heightened risk zone. Big businesses that operate on the basis of state order should be obliged to acquire goods and services from small- and medium-sized companies in distressed regions, towns and cities.
- **Allow small and medium-sized companies** in the distressed regions, towns and cities to receive financial support.
- **Improve tax administration and the procedure** to reimburse VAT for exports.
- **Train and retrain the residents** of distressed towns, cities and regions. Human capital should be developed substantially to make those cities, towns and regions more attractive for investors.
- **Support exports** by extending regional programs to aid small and medium enterprises.
- **Reduce administrative obstacles** relating to customs procedures for exporters. Customs procedures can be improved by reducing the number of documents, simplifying the procedure for formalizing export permits, and optimizing the time limits for customs clearance and the issue of permits for the export and temporary import-export of goods for warranty repairs.
- **Improve the business climate** in the country and regions by reducing administrative obstacles, investing in infrastructure, counteracting corruption and creating conditions of equal competition for all businesses.

Russia needs to create an investor-friendly environment

Investors are looking for a better and more efficient operating environment

In your opinion, what should be the three priority measures to take to improve Russia's investment climate?



Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 208.

Russia offers investors a high-growth economy, a large domestic market and highly skilled labor at moderate cost. But its enduring reputation for difficult business conditions deters investors. Doing business in Russia is fraught with challenges associated with corruption, government bureaucracy, complex regulatory requirements and a lack of transparency. Investors continue to suggest that improving the effectiveness of the rule of law (53%), reducing bureaucracy (47%) and improving transparency of business regulations (37%) are the top three priority measures to enhance Russia's investment climate. However, investors' emphasis on these measures has reduced in comparison with last year (when improving the effectiveness of the rule of law scored 63%, reducing bureaucracy 53% and improving transparency 39%), suggesting some improvement in Russia's operating environment in the last 12 months. In their push to accelerate WTO and OECD membership, Russian leaders have adopted new regulations to combat the challenging business environment, and successful accessions will further improve the environment. Finally, although the goals are ambitious, the Russian Government aims to climb up the Doing Business index from the current rank of 120 to 50 by 2015, and 20 by 2018.

1. Russia is tackling corruption and increasing transparency

Currently, investment in Russia is hindered by corruption that undermines the rule of law. According to *Transparency International's Corruption Perception Index (CPI)*, Russia is perceived to be far more corrupt than any OECD country and is also the most corrupt BRICS country. The average size of bribes and commercial payoffs in reported crimes increased by approximately 250% in 2011 to RUB236,000 (US$7,866). In 2011, Russian law enforcement agencies detected 37,831 incidents of corruption against the Government, services in the public sector and local authorities. Although Russia is a member of the Council of Europe Group of States Against Corruption (GRECO), the country has fulfilled only about one-third of the anti-corruption obligations set by the GRECO.[27] However, the Government was active in 2011 to curbing corruption cases and bribery, also pledging to sign international anti-corruption treaties. Russia was ranked 143 out of 182 economies in Transparency International's 2011 CPI ranking, a huge improvement from its ranking of 154 in the previous year.

In 2011, the Russian Interior Ministry's economic security department reported a 50% increase in funds recovered from corruption cases involving government contracts awarded in the health care, utilities, construction and education sectors. The Russian Government signed a bill in February 2012 to accede to the OECD Anti-Bribery Convention. This legislation subjects Russia to peer reviews of its compliance with the convention. Under former president Dmitry Medvedev, Russia undertook a series of initiatives to deal with corruption. These included the establishment of the Anti-Corruption Council and the institution of an anti-corruption law that raises fines for officials caught taking bribes to up to 100 times the amount of the bribe. Also, in March 2012, the former President signed a bill approving Russia's National Anti-Corruption Plan for 2012-13. The bill also made amendments to certain acts of the President of the Russian Federation on countering corruption in the country. He also announced a draft law which compels public officials and members of their families to explain the origin of funds spent on major purchases.[28] Russia's current President Vladimir Putin has also affirmed his plans to tackle corruption by highlighting a need to introduce legislation to establish anti-corruption standards in the law enforcement practices. These measures and examples illustrate that Russia's fight against corruption is on.

27. "Over 37,000 cases of corruption registered in 2011 – prosecutors," Interfax: Russia & CIS Military Newswire, 28 April 2012, via Factiva © 2012 Interfax Information Services, B.V.

28. "Dmitry Medvedev's new assault on corruption in Russia," accessed via *www.telegraph.co.uk*, 5 July 2012; "Russia Signs OECD Anti-Bribery Convention," accessed via *www.themoscowtimes.com*, 5 July 2012; "Putin points out importance of public anti-corruption audit of all legal acts," Interfax: Russia & CIS General Newswire, 30 May 2012, via Factiva © 2012 Interfax Information Services, B.V.; "Executive Order on National Anti-Corruption Plan for 2012-2013," accessed via *eng.kremlin.ru*, 5 July 2012; "Russian paper details provisions of anti-corruption draft law," BBC Monitoring Former Soviet Union, 14 March 2012, via Factiva © 2012 The British Broadcasting Corporation.

2. Russia is reducing bureaucracy

Investors complain about the pervasive influence of government bureaucracy in business operations and unofficial barriers imposed by regional authorities. However, it would be unfair to say that the Russian Government is doing nothing about this. In early 2012, the "open government" project was introduced to attract outside experts to discuss government decisions, including measures to fight corruption. Russia's 2020 Strategy also details measures to reduce bureaucracy. The Russian President has proposed the creation of an anti-bureaucracy filter for business legislation as part of the country's long-term economic policy objectives.

In April 2012, Russia officially expressed its intention to join the Open Government Partnership (OGP), a global initiative that promotes transparent, effective and accountable government around the world.[29]

29. "About OGP," accessed via www.opengovpartnership.org, 5 July 2012; "Country commitments: Russia," accessed via *www.opengovpartnership.org*, 5 July 2012.

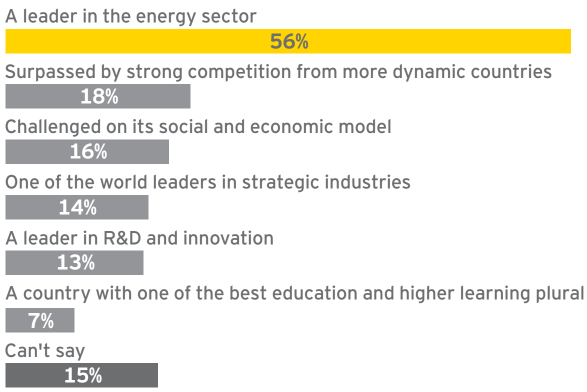
3. Building an environment conducive to SME development

Russia has an underdeveloped SME market. According to the OECD, SMEs account for about one-fifth of employment in Russia and an even smaller share of output. This is very low in comparison with most OECD economies, in which both figures are over a half. Russia ranked 111th of 183 countries in the World Bank 2012 Doing Business rankings for ease of starting a business, a drop of five places from the previous year. This low ranking explains the reason for the low numbers of new firms setting up in Russia. To make the country attractive for new SMEs a lot has to be done to improve the business environment for entrepreneurs. The Russian Government has been developing initiatives to promote entrepreneurship in the country. In 2011, the Agency for Strategic Initiatives was created to help talented people, especially young people, promote new and innovative ideas, and to help businesses overcome bureaucratic barriers. Russian banks have also shown more interest in lending money to SMEs because it is more profitable than lending to large businesses.

Reducing Russia's dependence on oil and gas

Overdependence on the oil and gas sector and an unfavorable environment for innovation and SMEs are among of the biggest challenges that the Russian economy faces today. These challenges make apparent the need for structural reforms. On the positive side, a reduced percentage of investors think that Russia will be surpassed by strong competition (18% in 2011 vs. 29% in 2010) and will be challenged because of its social and economic model (16% vs. 31%).

How do you see Russia in 2020?



Source: *Ernst & Young 2012 Russia attractiveness survey*. Total respondents: 208.

1. The diversification challenge

Fifty-six percent of respondents – compared with 51% last year – believe that Russia will be a leader in the energy sector in 2020. This indicates that Russia's dependence on the oil and gas sector has strengthened in the last year. Energy products currently account for approximately two-thirds of Russian exports. On the other hand, as a result of this focus on oil and gas, there is a large mismatch in Russia between the attention that other strategic industries receive from investors and their real potential. Although the Russian Government has recognized the need for diversification for over a decade, there has not been much action yet to balance the country's economic growth. This does not mean that focus should be shifted completely from the energy sector, which remains Russia's greatest strength. However, there should be a more balanced approach, and other key industries should be given due attention. Investors highlight ICT (20%), agriculture (13%), consumer goods (13%), and transport and automotive (11%) sectors as the keys for growth in the next couple of years.

2. The R&D and innovation challenge

While there is little or no doubt about the abilities of Russian scientists and technicians, investors are more concerned about the unfavorable environment for R&D. Inadequate infrastructure and a lack of government incentives are two of the hindrances that are holding back innovation and R&D in Russia. The country is behind Western economies when it comes to R&D and innovation expenditure (1.3% of GDP), and business openness toward innovation. Russian authorities have recently pursued a series of innovation-related initiatives, including the development of science cities, technoparks and venture capital funds. The Skolkovo Innovation Centre (also known as Russia's Silicon Valley) will benefit from innovative companies and will provide them with the necessary business and innovation support. In March 2012, Cisco signed a strategy document with the Skolkovo Foundation that outlined its R&D plans, marking an important milestone in Cisco's multi year, US$1b investment in sustainable innovation in Russia. In February 2012, Russia's Ministry of Economic Development published its revised strategy "Innovative Russia–2020," which will drive economic development. The success of these government initiatives is apparent in the *GE Global Innovation Barometer 2012 survey*. More than 87% of the top Russian managers surveyed said they had seen an improvement in Russia's innovative environment over the past five years. However, they continued to highlight weak government and private sector support for innovative companies, as well as the poor quality of the regulatory environment.

Viewpoint

Business ethics in a global world

Andrei Volkov, Dean, The Moscow School of Management SKOLKOVO

Looking at Russia's investment attractiveness from an historical perspective, it appears that we fall somewhat short of foreign investors' expectations. We are certainly moving in the right direction, but not as fast as they would have like us to do. On the other hand, the Russian authorities now have a far better understanding of how to work with these investors than they did five or ten years ago.

"Investment" is not just money that lands in a bank account. It means getting engaged with other people and working as partners in a broader sense.

Regrettably, sometimes we contribute ourselves to the investors' negative perception of Russia by breaking the rules of business ethics. Ethics and confidence that business partners follow the same code of conduct can sometimes be much more important for improving the business environment than financial indicators or prospects of returns on invested capital.

I would like to emphasize the role of foreign capital in the development of the Russian economy. And I do not mean merely financial investments, though such capital inflow is certainly very important. I mean the whole educational process, obtaining knowledge and skills for working in the globalized market. Globalization is a relatively new burden on business which has emerged during the past 25 to 30 years. However, the success of almost every company worth more than US$100m depends on how well it tackles this challenge.

If major Russian businesses do not learn how to work in the global market, they are doomed to fail within 10-15 years. It takes cooperation to avoid a fiasco: raising investments, investing abroad and successfully working on a global scale. "Investment" is not just money that lands in a bank account. It means getting engaged with other people and working as partners in a broader sense.

Foreign investment is extremely important – I would even go so far as to say critical – for the Russian economy. Either we join the big leagues of global business or become a third-rate operator, which would be a shame.

3. The education challenge

A larger proportion of Russian high school students go on to tertiary education than in any OECD economy. The country has a literacy rate of nearly 100%. Russia also produces a substantial number of scientists, technicians and other skilled workers. Yet only 7% of respondents see Russia as a country with one of the best education and higher learning systems. What explains this perception, and what can be done to improve it?

▸ **Increase government spending**
Overall education spending in Russia remains low compared with OECD standards. There is a need to increase government spending on all levels to improve the quality of teachers, infrastructure and the overall standard of education.

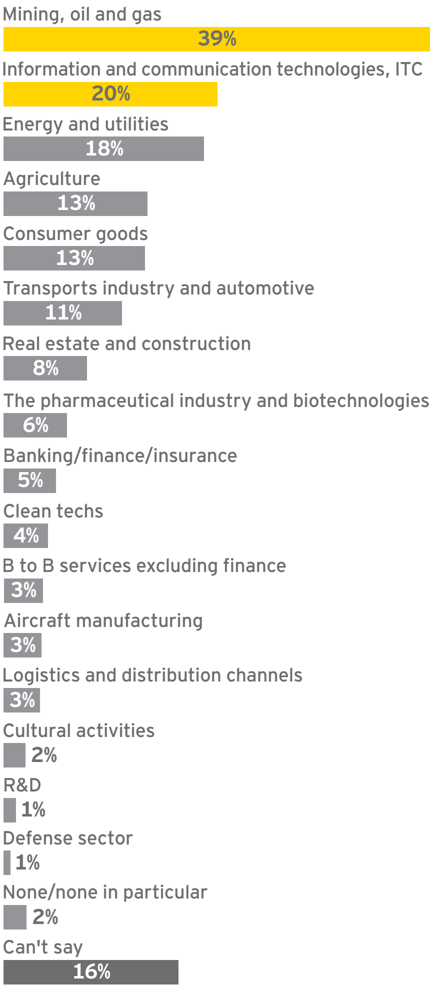
▸ **Bring industry and academia closer together by encouraging collaboration**
To ensure preparedness for the market environment, the current curricula of universities and colleges require upgrading. The new curricula should be designed in collaboration with the business sector so that the skills learned are those that business requires. The Government should also seek ways of strengthening vocational training.

▸ **Develop universities of a global standard**
According to the 2011–12 Times Higher Education rankings, no Russian university is in the world's top 200. Moscow State University is listed in the top 300 and St. Petersburg State University in the top 400. The Russian Government needs to modernize its higher education system to meet current global education standards. In 2011, Vladimir Putin announced that the Government will allocate RUB70b (US$2.4b) to build an innovative educational infrastructure in Russian universities in the next five years. However, we believe this might not be enough. More needs to be done to improve the current quality and infrastructure of Russian universities.

Sector opportunities

Extraction has the strongest potential

Which business sectors will attract the most foreign investments in Russia over the next two years?



Source: *Ernst & Young 2012 Russia attractiveness survey*. Total respondents: 208.

Unsurprisingly perhaps, a large majority of respondents view extractive industries as having the greatest potential to attract foreign investments into Russia in the next two years. According to 39% of the investors, the mining, oil and gas sector is expected to attract the most FDI in the next two years. The distant second choice of investors was the information and communication technologies (ICT) sector followed by energy and utilities, agriculture, consumer goods and automotive.

1. Strong ICT sector

Beyond the extraction industries, investors see ICT as the prominent sector that will attract most FDI in the next two years. Russia has made rapid advances in ICT in recent years. It has recorded marked growth in internet connections and cell phone usage. In 2011, the number of Russians online went up by 14% to 53 million, making the country's online population the largest in Europe. However, internet penetration is still comparatively low at 37.1%, indicating huge potential.

There is a significant demand in Russia for subsectors within ICT, such as data transfer, telephone systems and data network optimization, information security, business process management(BPM) systems and software development. The growth of some technologies has stemmed from the fact that technology-oriented applications, including process management systems, are now being implemented in various functional areas of large organizations.

2. Renewed interest in food and agriculture

Rapidly rising disposable income is driving the food and agriculture sector in Russia. Russia's membership of the WTO will have a positive impact on this sector. The WTO will give added impetus to the growth of agricultural exports, encouraging new strategic investors to enter the sector. This membership will lower tariffs and open new business opportunities for foreign companies that had been held back from entering the Russian market by high tariffs. The Government is also trying to encourage investment in the grain sector, ruling out restrictions on exports and preparing for privatization of the state grain trader.

Viewpoint

One of the best markets for local manufacturing

Irene Rosenfeld, Chairman & Chief Executive Officer, Kraft Foods

Kraft Foods entered the Russian market in 1994, at about the same time as many of our global competitors. In that way, we were pioneers in post-Soviet Russia and benefited from the positive image that foreign manufacturers' brands had at that time. In the 1990s, Russian consumers were interested in trying new things, which provided new market players like Kraft Foods vast opportunities to quickly develop and grow.

By 2023, Russia is forecast to become the largest consumer market in Europe.

Since 1994, GDP per capita in Russia has increased more than three-and-a-half times. Russian consumers have become much more demanding. But they're still open to trying something new. The market has not reached the level of maturity and saturation as that of Western Europe. All these, combined with the continued growth in consumers' disposable income, lead us to view Russia today with great optimism.

Russia has enormous potential in terms of the scale of its internal market, which is one of the largest in the world. Russia's purchasing power is four to eight times greater than in China, India and certain Eastern European countries. By 2023, Russia is forecast to become the largest consumer market in Europe. That's why Russia is such an attractive market for an investor like Kraft Foods.

For us, Russia is also among the most favorable markets for the development of local manufacturing facilities. A large domestic market provides the justification for locating the biggest manufacturing lines in Russia, enabling lower unit costs and future expansion of capacity for export. Our freeze-dried coffee plant near St. Petersburg is on track to become the biggest freeze-dried production facility in the world this year.

We expect that many of our suppliers will also come to Russia with their own manufacturing facilities, making our supply chain even more balanced and efficient.

On the other hand, property tax is a constraint to greater investment in manufacturing facilities based in Russia. This tax, which is ultimately reflected in the cost of products, can put Russia at a disadvantage to other jurisdictions, such as neighboring Ukraine, which does not collect a property tax on manufacturing facilities.

The current Russian Government has committed to the implementation of structural reforms that will make important changes to the country's economy. The declared focus is on raising capital for the economy, the development of competition and infrastructure, and the reduction of administrative red tape. Kraft Foods supports these priorities and expects that the pace of positive transformation will be maintained.

3. Automotive flourishes

The automotive sector is already the largest recipient of FDI projects in Russia. The country's automotive industry experienced a milestone year in 2011: sales rose by approximately 40% year on year, almost reaching the pre-crisis level. Sales were driven by pent-up demand, recovery of consumer confidence, credit availability and government incentives. Sales of Russian-made foreign brands have recorded a significant increase. Recently, more and more alliances have been forged between Russian and foreign auto manufacturers. In May 2012, Renault-Nissan confirmed a US$750m deal to acquire a controlling stake in Avtovaz, Russia's leading auto manufacturer. Renault-Nissan and Avtovaz are targeting market share of 40% in Russia by 2016. In October 2011, Ford and Russia's Sollers OJSC entered into a 50:50 joint venture for vehicle and engine production in Russia. In June 2011, Volkswagen also signed an agreement with Russian carmaker GAZ to produce 110,000 light vehicles annually for Volkswagen. These alliances help foreign companies to share risks, provide immediate access to the Russian market, develop inter-market ties and gain necessary local experience. The Russian companies, on the other hand, benefit from modernization, and new and innovative technology.

Russia's accession to the WTO will see a considerable reduction of customs duties on vehicles from 2012 to 18, which will accelerate the shift in demand in favor of foreign vehicles and increase their share in overall sales.

Methodology

Ernst & Young's 2012 Russia attractiveness survey is based on a two-fold, original methodology that reflects:

- **The real attractiveness of Russia for foreign investors.**

Our evaluation of the reality of FDI in Russia is based on Ernst & Young's European Investment Monitor (EIM). This unique database tracks FDI projects that have resulted in new facilities and the creation of new jobs. By excluding portfolio investments and M&A, it shows the reality of investment in manufacturing or services operations by foreign companies across the continent.

- **The perceived attractiveness of Russia and its competitors by foreign investors.**

We define the attractiveness of a location as a combination of image, investors' confidence and the perception of a country or area's ability to provide the most competitive benefits for FDI. The field research was conducted by CSA Institute in April and May 2012, via telephone interviews with a representative panel of 208 international decision-makers.

Mapping the real attractiveness of Europe

Data is widely available on FDI. An investment in a company is normally included if the foreign investor has more than 10% of its equity and a voice in its management. FDI includes equity capital, reinvested earnings and intracompany loans. But many analysts are more interested in evaluating investment in physical assets, such as plant and equipment, in a foreign country. These figures, rarely recorded by institutional sources, provide invaluable insights as to how inward investment projects are undertaken, in which activities, by whom and, of course, where. To map these real investments carried out in Europe, Ernst & Young created the Ernst & Young EIM in 1997. The EIM is a leading online information provider tracking inward investment across Europe. This flagship business information tool from Ernst & Young is the most comprehensive source of information on cross-border investment projects and trends throughout Europe. The EIM is a tool frequently used by government and private sector organizations and corporations wishing to identify trends, significant movements in jobs and industries, and business and investment.

The Ernst & Young European Investment Monitor

Researched and powered by Oxford Intelligence, EIM is a highly detailed source of information on cross-border investment projects and trends in Europe, dating back to 1997. The database focuses on investment announcements, the number of new jobs created and, where identifiable, the associated capital investment, thus providing exhaustive data on FDI in Europe. It allows users to monitor trends and movements in jobs and industries, and identify emerging sectors and cluster development. Projects are identified through the daily monitoring and research of more than 10,000 news sources. The research team aims to contact directly 70% of the companies undertaking the investment for direct validation purposes. This process of direct verification with the investing company ensures that real investment data is accurately reflected.

The employment figures collected by the research team reflect the number of new jobs created at the start-up date of operations, as communicated by the companies during our follow-up interview. In some cases, the only figures that a company can confirm are the total employment numbers over the life of the project. This is carefully noted so that any subsequent job creation from later phases of the project can be cross-checked and to avoid double-counting in later years.

The following categories of investment projects are excluded from EIM:

- M&A or joint ventures (unless these result in new facilities and new jobs created)
- License agreements
- Retail and leisure facilities, hotels and real estate investments
- Utility facilities including telecommunications networks, airports, ports or other fixed infrastructure investments
- Extraction activities (ores, minerals or fuels)
- Portfolio investments (i.e., pensions, insurance and financial funds)
- Factory and production replacement investments (e.g., a new machine replacing an old one, but not creating any new employment)
- Not-for-profit organizations (e.g., charitable foundations, trade associations, governmental bodies)

Interviews

A series of interviews was conducted between May and June 2012, to discuss the views of a group of esteemed local leaders from Russia's business, academic and government spheres, presented in the "Viewpoint" sections of this report.

The perceived attractiveness of Russia and its competitors

An international panel of decision-makers of all origins, with clear views and experience of Europe:

- **39% Western European businesses**
- **18% Northern European businesses**
- **7% Central and Eastern European businesses**
- **2% Middle Eastern businesses**
- **20% North American businesses**
- **14% Asian businesses**

Of the companies, 65% (135 out of 208) have established operations in Russia.

We built a global panel from all business models and sectors to guarantee a representative opinion on the diversity of international strategies:

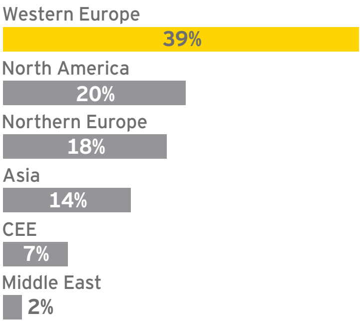
- **SMEs (small and medium enterprises)**
- **Multinationals**
- **Industrial companies as well as service providers**

Divided into five main sectors, the businesses surveyed are representative of the key European and global economic sectors:

- **Industry, automotive, energy**
- **Private and business services**
- **Consumer**
- **Chemical and pharma industries**
- **Hi-tech and telecom infrastructure and equipment**

Profile of companies surveyed

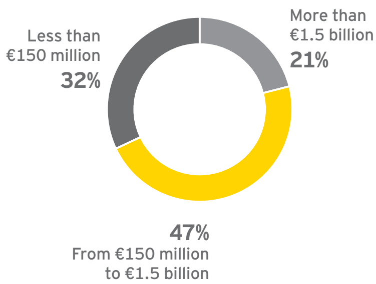
Geography



Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 208.

Profile of companies surveyed

Size of the company



Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 208.

Profile of companies surveyed

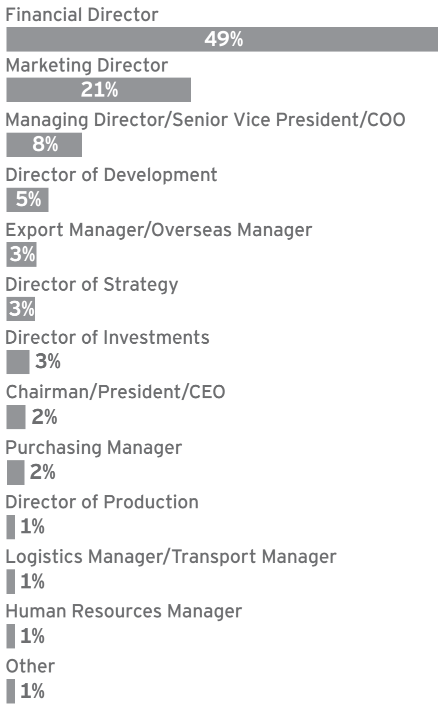
Sector of activities

Sectors	Respondents
Industry, autimotive, energy	35%
Private and business services	30%
Consumer	21%
Chemical and pharma industries	6%
Hi-tech and telecom infrastructure and equipment	4%
Others	4%
Total	**100%**

Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 208.

Profile of companies surveyed

Job titles



Source: *Ernst & Young 2012 Russia attractiveness survey*.
Total respondents: 208.

Ernst & Young in Russia

In 1989 Ernst & Young was the first professional services organization to establish operations in Russia. Our Russian practice has 2,500 employees working in nine offices located in Moscow, St. Petersburg, Ekaterinburg, Novosibirsk, Togliatti, Kazan, Krasnodar, Vladivostok and Yuzhno-Sakhalinsk.

Ernst & Young is dedicated to helping its clients identify and capitalize on business opportunities throughout Russia and the world. Our key market sectors are: financial services; retail and consumer products; industrial products; energy; technology and communications; government, real estate, transportation and infrastructure.

Our professionals are recognized for their leadership, know-how and understanding of our clients' business. In more than 20 years in Russia, we have provided critical information and resources to improve business performance and profitability.

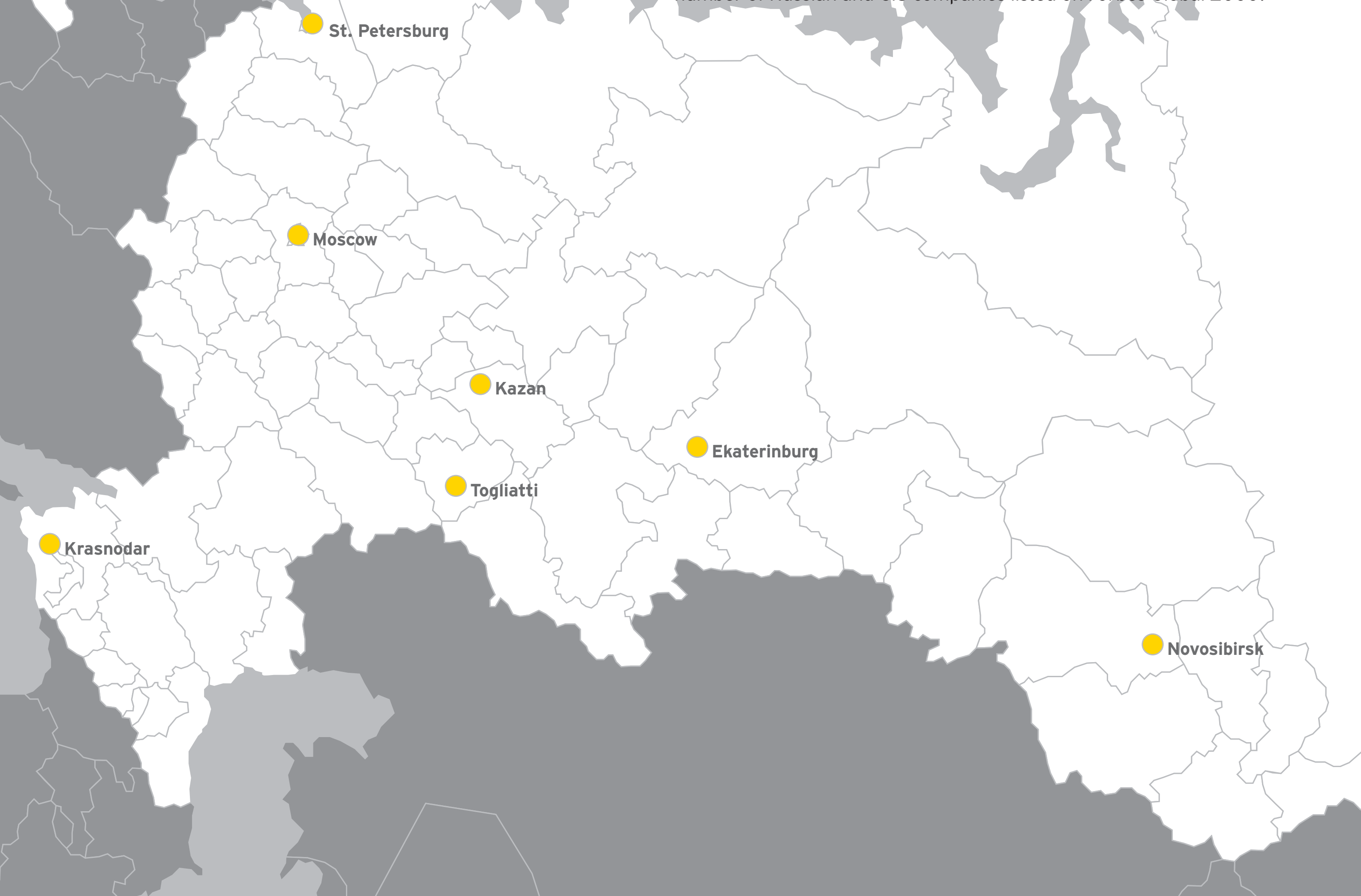
▸ Country and institutional development

Ernst & Young actively supports the development of the institutions and economics where we operate. We participate and support the Foreign Investment Advisory Councils (FIAC) in Russia, which Ernst & Young co-chairs with the Prime Minister of the Russian Government.

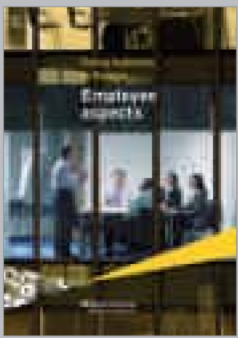
Ernst & Young also demonstrates its leadership by being involved in the Russian business community, as an active member of the Russian Union of Industrialists and Entrepreneurs, the Association of Russian Banks, the International Tax and Investment Center, the Association of European Businesses, the American Chamber of Commerce and the US-Russia Business Council. We also play an important role in the Russian legislative and ministerial processes affecting business.

▸ Our clients

We know that growing markets require innovative thinking and evolving practices for businesses to succeed. Many leading companies in Russia and the CIS have chosen Ernst & Young to advise them on the most demanding aspects of the fast-evolving business climate. Ernst & Young provides audit services to a large number of Russian and CIS companies listed on Forbes Global 2000.



Our publications



Doing business in Russia: employee aspects

In this guide, we provide an overview of employee-related issues to be considered when entering the Russian market.

Exceptional CIS magazine

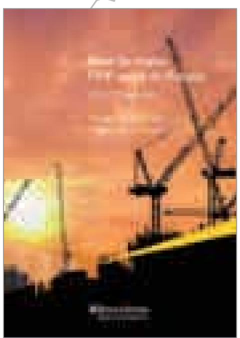
Exceptional CIS is a part of Ernst & Young's Exceptional magazine, an award-winning publication distributed to business leaders of high-growth companies. It includes inspirational interviews with the markets' top success stories.

Russian retail industry survey 2011

Our retail industry survey shows how Russian and international companies established in Russia assess the current market situation, and what plans they are making for the future. We also look at various aspects of the retail companies' activities and provide a summary of respondents' opinions on the most pressing issues retailers are facing today.

Development of industrial parks in Russia

The industrial parks market in Russia has continued to develop rapidly over the past year: the quality of projects has improved; the degree of awareness among market participants has significantly increased and professional developers, as well as management companies, have emerged.



How to make PPP work in Russia: 2012 overview

Our new survey on public-private partnership (PPP) summarizes federal and regional state officials' opinions on a variety of legal, financial and commercial issues related to PPP projects. It also promotes a better understanding of the prospects for PPP development in Russia for both local and foreign organizations.

Ernst & Young's Rapid-Growth Markets Forecast – July 2012

This edition of Ernst & Young's quarterly Rapid Growth Markets Forecast highlights that despite recession, stalling growth and high unemployment, the overall prospects for RGMs remain strong. The rise of the rapid-growth markets' middle class, with the number households more than doubling by 2020, is forecasted to boost domestic demand and transform the global economy.

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