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Russia rebalances its economic focus: Opportunities and strategies to enter the market

After a decade of political stability and economic prosperity in the 2000s, Russia's economy has been hit hard by Western sanctions against its foreign policy over Ukraine and tumbling oil prices. The rouble has depreciated by half in the past 12 months and Russia is in recession, following two consecutive quarters of negative growth. Russia's new foreign economic policy is clear: Russia will continue to do business with the West while concurrently courting investors from Asia, Turkey and Latin America.

While oil prices remain low and Russia's near term economic condition will be uncertain, IE Singapore takes a long term view of the country's prospects. This insight paper examines Russia's recent economic developments, identifies niche opportunities, and lays out considerations for Singapore companies seeking to enter the Russian market.

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Driving Singapore's External Economy

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Summary

// Russia's foreign economic partners have predominantly been Western nations, particularly continental Europe. In 2014, Russia was hit hard by the combined effects of sanctions and drastic plunge in global oil prices. These events proved that Russia would be vulnerable if it depended on one regional bloc for economic development. Russia is now making a concerted effort to rebalance its economic relations with the West by intensifying its ties with Asia, Turkey and Latin America. Russia's trade with Asia is historically concentrated within China, Korea and Japan, while trade with the rest of Asia is nascent. Russian companies today are new to the Southeast Asian marketplace, and most are still uninformed about Singapore and the growth potentials of Southeast Asia. This presents significant room for growing Russia's trade with Singapore, and attracting Russian companies to base their businesses in Singapore for growing new markets in Asia.

// Many foreign companies from non-traditional trading partners of Russia are intensifying business development in Russia, including China, Korea, Turkey and Latin America. This is where Singapore companies interested in the Russian market can take opportunistic steps to deepen traction with Russia.

// IE Singapore has identified opportunities for Singapore companies in the spheres of oil and gas, supply of staple food, and urban development. To capture these, we are assisting Singapore companies to seek and cultivate good Russian partners.

// This insight paper presents a Singapore perspective on political and economic developments, key observations and opportunities, and recommends practical steps for dealing with the unique dynamics of the Russian business environment.

Recent political and **economic developments**

Russia, the 6th largest country by GDP in PPP terms[1], is one of the world's leading producers of oil and natural gas, and a top exporter of metals such as steel and aluminium. Annex A provides a snapshot of Russia and its key economic indicators.

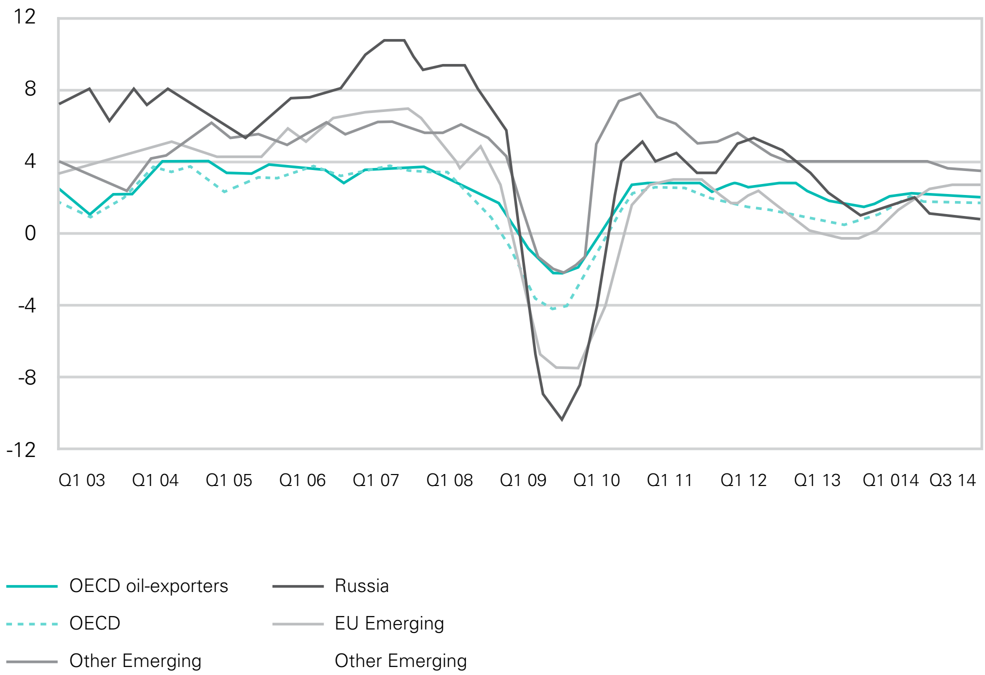
In 2014, the US and EU imposed sanctions and trade controls in response to Russian foreign policy positions in Crimea and Ukraine. Annex B summarises these sanctions. Initial Western sanctions, which banned travel visas and froze assets of individuals known to be in Russian President Vladimir Putin's inner circle and key officials in the government, had negligible economic effects. Instead, it incited a broad-based patriotic fervour within Russia. The final rounds of sanctions, however, struck with real impact. They targeted Russia's key supports of economic growth: reliance on Western financing, technology and know-how transfer from Western companies in defence, energy and dual-use technology sectors.

Russia barely had time to react before global oil prices plunged, further stressing its currency and balance of payments. By the end of 2014, foreign direct investments had fallen to US$23.6 billion, more than half below its historical annual average of over US$50 billion. Full year growth for 2014 was 0.6% for Russia, the lowest since the 2009 recession. Figure 1 shows Russia's GDP growth over the past 10 years. Interest rates has fallen from a historic high of 17% in December 2014 to 11.5% in June 2015, but are still relatively high by global standards.

In June 2015, the World Bank updated its economic outlook for Russia to reflect a stabilisation of global oil prices. Real GDP was projected to contract by 2.7% in 2015, before turning positive to reach 0.7% in 2016 and 2.5% in 2017. Consumption and investment activity were projected to increase from 2017 onwards[2].

1 "Report for Selected Country Groups and Subjects (2014 PPP valuation of country GDP)", IMF, retrieved April 8, 2015
2 "World Bank Revises Its Growth Projections for Russia for 2015 and 2016", published 1 June 2015

Figure 1: GDP Growth, 2003 – 2014, percent[3]



Russia's response to sanctions and recession

Russia's recession deepened in the second quarter of 2015, declining 4.6% year-on-year in June, from a 2.2% year-on-year fall recorded in the first quarter. Nevertheless, the Central Bank managed to avoid the need for capital controls, and the government has put in place several measures as detailed in Annex C. These include:

// **Immediate measures:** A RUB 2.4 trillion anti-crisis plan was approved on 27 January 2015, out of which 65% was earmarked for recapitalising the banking sector, 13.9% for supporting real enterprises in systemic industries and agriculture which together account for over 70% of the national GDP, 12.9% for social support and 7% in budget loans to regional governments. Concurrently, a 10% budget cut was implemented across all areas except in defence, agriculture and external debt servicing.

3 Forecast Summary, The Economist Intelligence Unit, 2015

- // **Near to mid-term economic development programmes:** Russia stepped up the pace of import substitution, and hi-tech transformation of its capital intensive heavy industries and manufacturing in sectors which complement Russia's comparative advantages, improve national security and transport infrastructure. On 31 March 2015, the Russian government announced an updated import substitution plan, intensifying efforts to attract high value-add or hi-tech investments to build up its own independent domestic capabilities and to reduce imports by 2020 for six key sectors: oil and gas equipment, services and solutions by 16.1%; equipment for food industry by 53.1%; agricultural and forestry equipment by 55.9%; light industry by 33.5%; metalworking machines and tools by 28.9%; cables, energy and electrical engineering equipment by 34.5%. This programme will cost at least RUB 2.5 trillion (US$ 50 billion) and will be partially funded by private companies.

- // **Longer term economic initiatives:** Historically and especially since the collapse of USSR in 1991, Russia's external trade and economic interests have been dominated by Europe. However, the deep impact of the 2014 EU sanctions has shown Russia the vulnerabilities of overdependence on one economic bloc. Ground observations indicate that while Russia still welcomes large Western multinationals, it is actively rebalancing its economic focus. Going forward, Russia will take definitive steps to refresh its relations with non-Western nations and regions, particularly China and Asia, including Singapore, to diversify its overseas markets and access to economic resources. This change in Russian perception of the world opens up a window for Singapore companies to secure long-term traction into the Russian market. Meanwhile, bargain hunting and in-market operations by China, Korea, Japan and Western businesses had stepped up to take advantage of reduced asset prices and operational costs. The Russian marketplace can be expected to become more crowded with more diverse competitors in the future.

Holding under pressure

Economic reforms in Russia had been an ongoing process. Annex D provides a comparison with past Russian economic crisis in 1998 and 2009. Russia had since been working to improve its business environment for several years. By 2014, the World Bank announced that **Russia had advanced 49 places in three short years from 111st in 2013 to 62nd position in its 2015 Ease of Doing Business index.** This made Russia the fastest improver in its peer group. Some of the reforms implemented include making it easier to start a business by eliminating the requirement to deposit charter capital before company registration, and simplifying property registration procedures. Companies also do not need to notify authorities before opening a bank account, speeding up the overall business formation process. These regulatory simplification ranked Russia today above Vietnam (78th place), China (90th place), Indonesia (114th place), Brazil (120th place), India (142nd place), Myanmar (177th place) in ease of doing business[4].

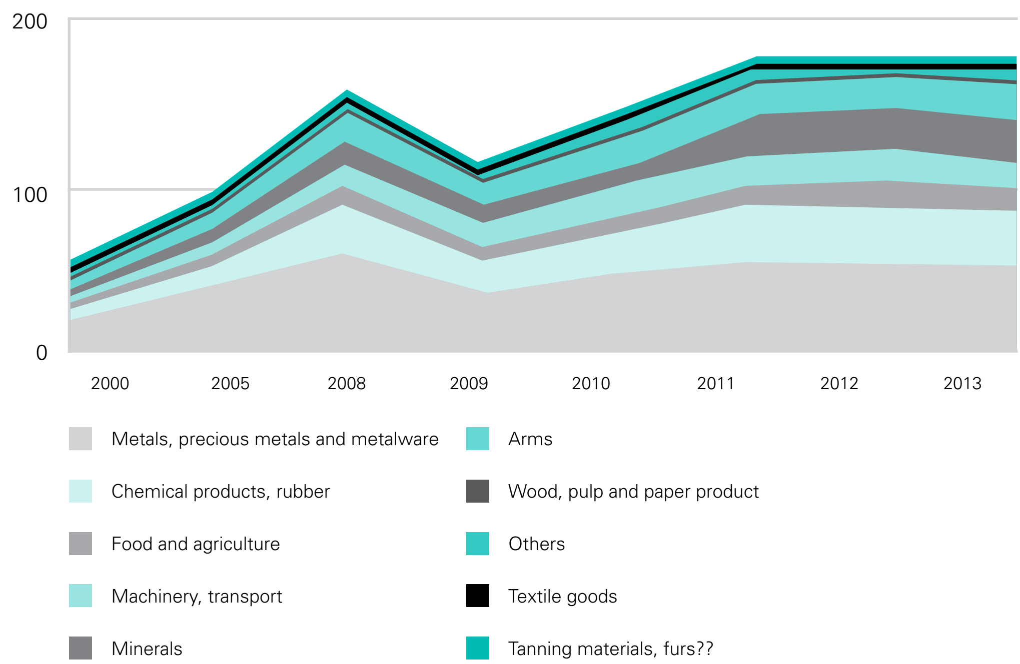
4 World Bank 2015 Ease of Doing Business Index

In addition, Russian corporate tax rate has been steadily decreasing from 43% in 2001, to 20% today, ahead of the 25% of Myanmar, Vietnam, Indonesia and China, and the 34% of Brazil and India, making Russian corporate tax the lowest of all BRIC and emerging ASEAN economies[5]. To promote dynamic industry development across industries and regions, various forms of incentives are available and profit tax rates can be reduced to as low as 0% in certain sectors like medical, R&D, high-technology activities and agricultural goods producers. Investments in regions like the Russian Far East can enjoy reduced profit tax rate of 0% for the first five years and 10% for the next five years[6].

In the last decade, Russia's key economic reform programmes of import substitution and modernisation of key industrial and manufacturing sectors with capital and labour intensive heavy models have produced upward trends. According to Russian Federal Statistic Service:

// Industrial production index rose more than 50% from 2000 to 2012
// Total structure of exports diversified more than 50% from 2000 to 2013, with marked increase in diversification in non-energy exports
// Non O&G exports grew 250% from 2000 to 2013, from US$50.4 billion to US$176 billion (Figure 2)
// Within imports, there is a clear growth over the same period of machinery and equipment needed for domestic industrialisation.

Figure 2: Non-oil & gas exports, growth 2000 – 2013, US$ billion



Source:
Rosstat, The Central Bank of Russia

5 KPMG
6 http://www2.deloitte.com/content/dam/Deloitte/ru/Documents/tax/tax_incentives_in_russia_2014.pdf

Recent political and economic developments

As shown in Figure 3, Russia entered 2015 with over US$385.5 billion in international reserves and foreign exchange liquidity, double that of Germany's and nearly triple that of the US's. With reference to Figure 4, Russia's external debt stood at US$680.86 billion, less than one-fifth of Germany's and 25 times less than the US's. As oil prices in 2015 are expected to remain half of 2009 levels, Russia has prudently tightened its Federal budget spending for 2015 and is in the process of revising its national budget to reflect a more realistic oil price, trimming budget expenditure towards 2017 to cap at RUB 15 trillion.

Foreign investors are still entering the market in niche growth sectors, with examples provided in Figure 5. Thus it appears that the potential of the Russian marketplace for foreign investors remains.

Singapore's stock of Direct Investment Abroad in Russia was S$42 million as at end-2013. Singapore investments in Russia, while small in total, are individually significant with good growth potential. For example, Changi Airports International maintains a joint venture with Russian business conglomerates Basic Element and Sberbank to develop and operate airports in the Krasnodar Region.

7 IMF

Figure 3: International reserves and foreign currency liquidity of December 2014[7]

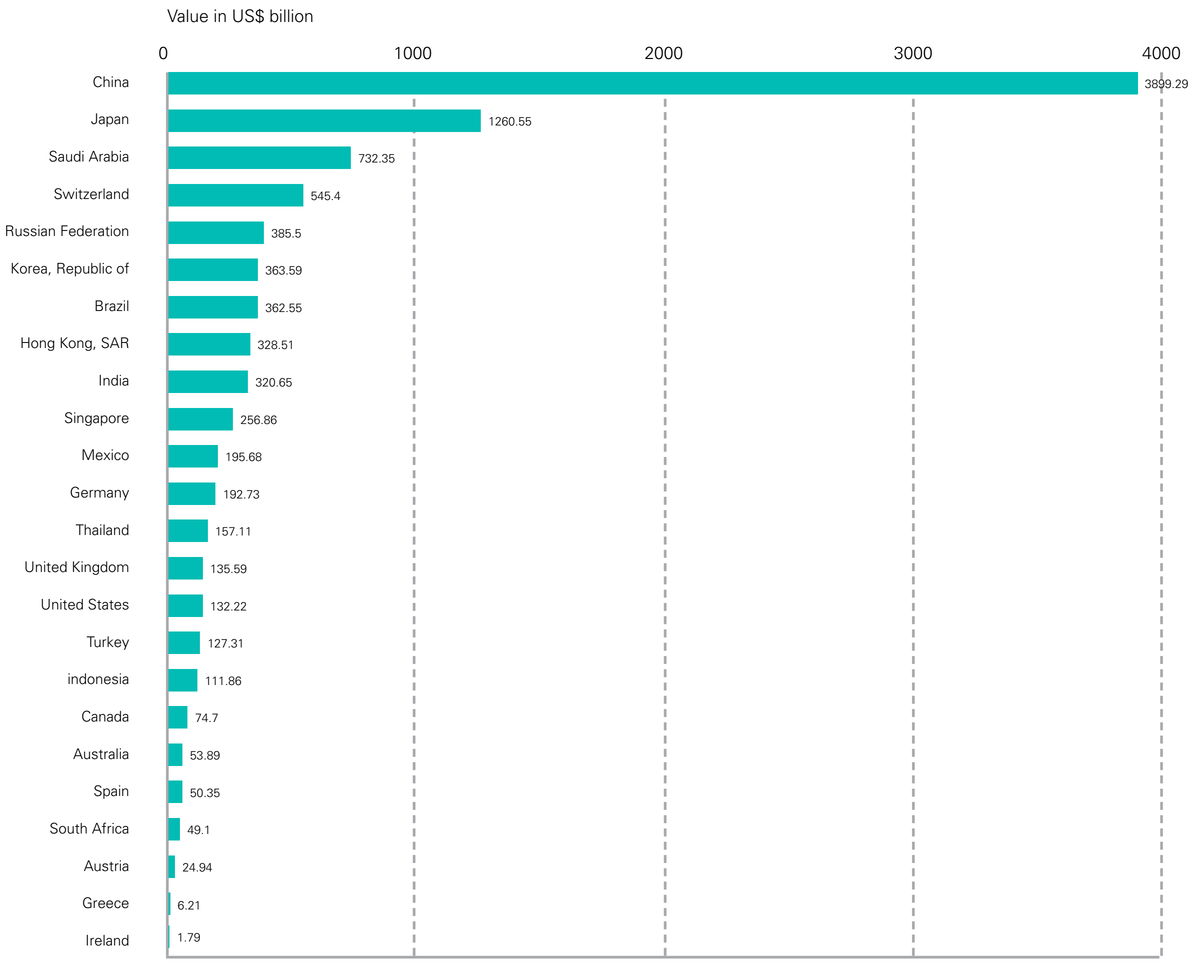
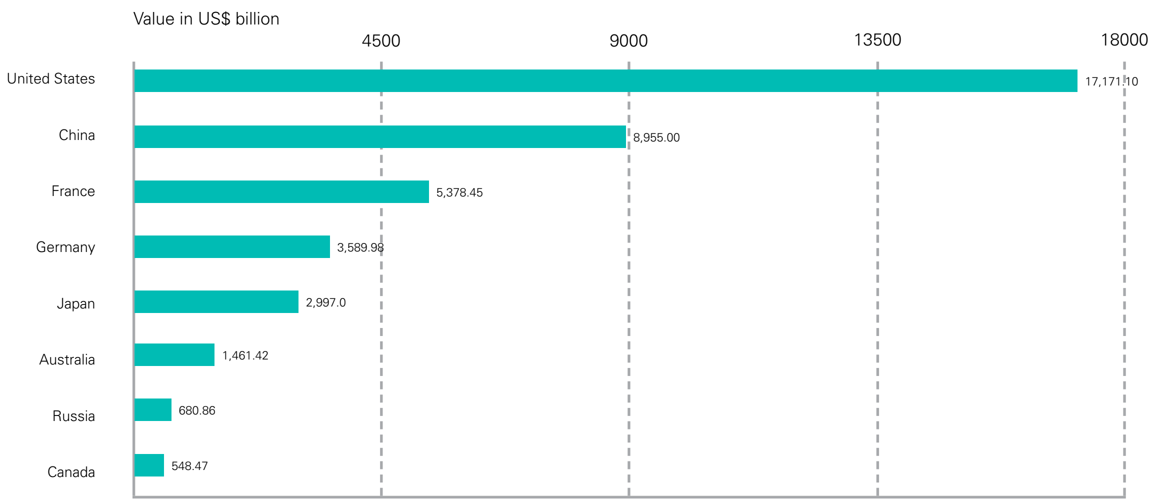


Figure 4: Comparing Russia's total external debt to developed nations as of 2014[8]



8 IMF

Figure 5: Highlights of new investment projects into Russia from September 2014 to March 2015[9]

2014	2015
September	January
// Agriculture Thai company CPF (Charoen Pokphand Foods) launched a new stage of the industrial pig-breeding farm in Moscow Region at a total investment of US$27 million. http://sdelanounas.ru/blogs/53258/	// Hi-tech components American conglomerate Emerson Group expanded its production of various hi-tech sensors (pressure, temperature, etc.) in Chelyabinsk Region (in the Urals). http://sdelanounas.ru/blogs/57290/
October	February

// Mining machinery
German company Becker Mining Systems co-invested with Russian coal extraction giant SUEK in a joint production facility for high-voltage commutation machines used in mining.
http://sdelanounas.ru/blogs/55824/
 	
// Automotive
Germany company Schaeffler opened a new production plant for automotive components in Ulyanovsk Region (European Russia) at a price of US$35 million.
http://sdelanounas.ru/blogs/53721/
 	
// Pharmaceutical
Israeli pharmaceutical company Teva Group opened a new production facility in Yaroslavl Region (next to Moscow Region) at a total investment of US$45 million.
http://sdelanounas.ru/blogs/54031/
 	
// Automotive
Swedish company Bulten and Russian company GAZ (car producer) opened a new joint facility for production of fastening equipment at an investment of US$10 million.
http://sdelanounas.ru/blogs/54294/
	// Construction
	French company Saint-Gobain launched its eight production plant for construction materials in Moscow Region at an investment of US$9 million.
	http://sdelanounas.ru/blogs/58132/
	
	Mass market personal care
	Swedish cosmetics company Oriflame inaugurated its production facility in Noginsk, Moscow Region. Total investments were US$165 million.
	http://investors.oriflame.com/index.php?p=press&

December	March

// Automotive
American company Ford Sollers through its Russian joint venture invested US$ 400 million to expand its existing plant in the Republic of Tatarstan with a new production facility to produce mass-market cars.
http://sdelanounas.ru/blogs/55653/
 	
// Real estate
Vietnamese investment company Incentra invested about US$ 250 million in a new multifunctional center in Moscow comprising office space, hotel, hypermarkets and malls.
http://sdelanounas.ru/blogs/56111/
	// Hi tech components
	Japanese conglomerate Furukawa group through its American subsidiary opened a fibre optic cable production plant in Voronezh Region (European Russia) at a total investment of US$160 million.
	http://sdelanounas.ru/blogs/60225/

9 Information compiled from http://sdelanounas.ru/

Russia turns towards Asia for new trade flows

Prior to 2014, China's economic growth attracted the attention of Russian companies across broad sectors, mostly in resource and energy sectors. At the beginning of 2014, Russia's total trade with Asia reached US$144.4 billion, catching up to second place behind Russia's trade with Europe and the UK which stood at US$318.2 billion. However, over 75% (or US$110.8 billion) of Russia's Asian trade is concentrated in the North Asian markets of China, Japan and Korea, while only 11% (or US$15.8 billion) of trade is conducted with Southeast Asia. As such, Russia's trade flow with Southeast Asia is still nascent which spells a high potential for growth.

Bilateral trade agreements serve to promote cross-border trade and investment between countries. Russia and Singapore's Double Taxation Agreement was ratified in 2009, resulting in lower withholding tax rates imposed on dividends, interest and royalties. Tax credit is also available for residents earning foreign sourced income[10]. This contributed to the healthy growth of bilateral trade in the past 6 years. Between 2008 and 2014, trade between Russia and Singapore grew at a compound annual growth rate of 19.0%, from S$3.8 billion to S$10.8 billion. Today, Russia is our 21st largest trading partner worldwide. In 2H2014, Russian Federal Statistics Service recorded a jump of 152.2% in Singapore and Russia's trade turnover, ranking Singapore as Russia's fastest growing foreign trade partner overall for that period. Singapore's main exports to Russia were in electrical circuits, machinery parts, and cocoa butter fat and cocoa oil, while imports from Russia are dominated by crude oil, nickel and copper.

Since 2014, Russian conglomerates that want to tap markets outside Russia, have found Singapore's competitive and efficient financial ecosystem to be a vibrant business hub. For example, Russia's largest gas company, Gazprom, and second largest oil company, Lukoil, have operations in Singapore while notable IT and retail companies Acronis and Sportmaster have chosen to situate their regional office here. This presents an opportunity for Singapore companies to partner Russian conglomerates to create new business and trade flows in the Asia Pacific region.

10 https://www.iras.gov.sg/irashome/News-and-Events/Newsroom/Media-Releases-and-Speeches/Media-Releases/2009/Singapore-Russia-Avoidance-of-Double-Taxation-Agreement-Ratified/

Current sectoral **opportunities in Russia**

Provision of oilfield service, equipment, machinery and parts

Based on published information, the EU and US sanctions on Russia's energy sector are crafted very specifically to prohibit EU or US entities from very specific activities against "Designated Parties":

// **Transacting or dealing in new debt** (>30 days (EU), >90 days (US)), or equity instruments for the following Russian energy companies:

1. Rosneft
2. Gazprom (US sanctions only)
3. Gazprom Neft
4. Transneft
5. Novatek (US sanctions only)

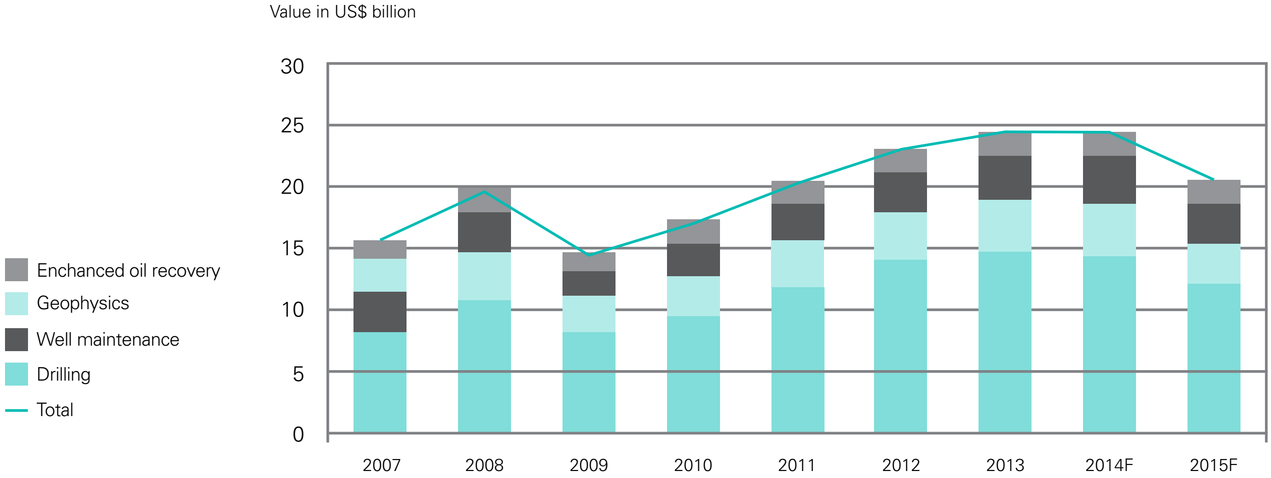
// **Supplying goods, services and technology*** to conduct well testing and **deep-water** (>150 m), **Arctic offshore and shale projects** to major Russian oil E&P companies:

1. Gazprom
2. Gazpromneft
3. Lukoil
4. Rosneft
5. Surgutneftgaz

The specific carve-outs in the sanctions rules appear to leave only onshore, shallow water and conventional exploration and production activities available for EU and US entities. However, non-sanctioned oil and gas services and supply companies are not restricted from participating in the entire Russia's oil and gas sector. Interested companies are advised to conduct proper due diligence before engaging in transactions or procurement activities. Law firms with a specialised sanctions team will be able to offer their professional services to Singapore companies.

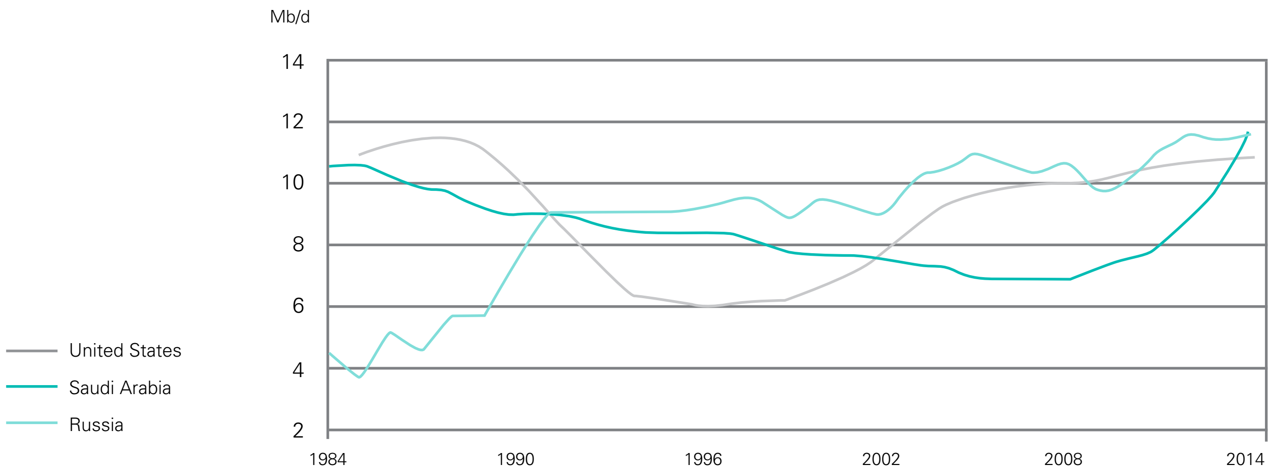
At current estimates, Russia's total oilfield services market is worth more than US$20.4 billion in 2015, about 16.8 percent of the world's oil field services market which is believed to be about US$ 149 million, as shown in Figure 6.

Figure 6: Russia's oilfield services market (2007 – 2015F)[11]



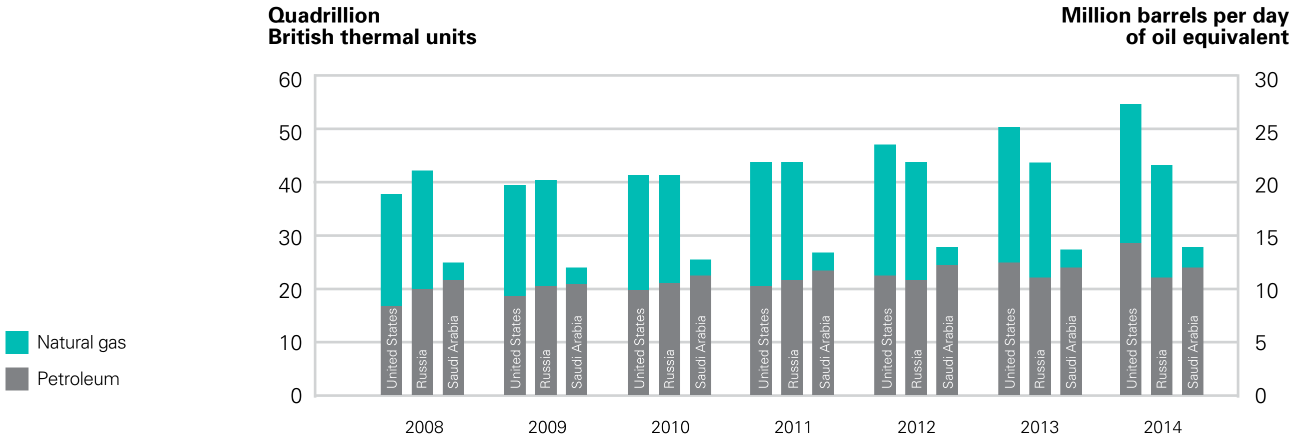
Furthermore, in March 2015, Russia's new daily record of oil production was 10.7 million barrels, ranking Russia as the world's third biggest oil producer after US and Saudi Arabia and the second largest energy producing state in the world after US. Figures 7 and 8 compare Russia's oil production against the other two top oil-producing nations.

Figure 7: World's largest oil producers[12]



11 "Russian State and prospects of Russian Oil & Gas Market", Deloitte, October 2014.
12 Rosstat, BP Statistical Review of World Energy 2015, US Energy Information Administration

Figure 8: 2008-2014 estimated US, Russia and Saudi Arabia oil and gas production[13]



As about 50% of Russia's Federal budget revenues is derived directly from hydrocarbon production, the Russian government aims to maintain oil production at current levels for the foreseeable future. This assures a positive near to long term outlook for Russia's oilfield services sector.

Currently, Russia's oilfield service sector enjoys two immediate drivers of growth:

// **Rising depletion rates of onshore oil wells spells accelerated well stimulation in the next three years:** Onshore oilfields form the bulk of Russia's oilfield services sector. Continued stimulation have deepened wells by 10% since 2007 at higher rate of cost increase by 15%. Experts assess this trend to continue through to 2018.

// **Requirements for exploration and production of tight resources in deep water, Arctic and shale reserves:** The EU and US sanctions have barred Russian oil companies from directly purchasing Western equipment and services for drilling, well testing, logging and completion services for these areas, creating an immediate demand for alternative suppliers.

While recent geopolitical tensions and sanctions have reduced foreign investments in Russia, the country remains an important market for international oilfield services firms such as Schlumberger, Haliburton and Weatherford. This is due to Russia's sizable oil and gas reserves. By the end of 2014, Russia possesses almost 103.2 thousand million barrels of proved oil reserves equal to 6.1% of the world's total proven oil reserves.

Under the import substitution plan, all energy sectors are slated to receive support from a state budget pool of RUB235 billion (US$4.19 billion) to localise foreign production with private co-investments. In the meantime, Russia is allowing the substitution of Western equipment with the Asian equivalents until domestic production can close the gap. Foreign companies are invited to partner with Russian companies to localise production, and will be incentivised with state support.

13 Russian Federal Statistics Service, BP Statistical Review of World Energy 2015, US Energy Information Administration

Potential food trade as Singapore is unaffected by Russia's import ban

In response to the Western sanctions, Russia imposed an import ban on food items (Figure 9) originating from the EU, US, Norway, Canada, Australia and Japan for 12 months from August 2014. In August 2015, Montenegro, Iceland, Liechtenstein, Albania and Ukraine were added to Russia's list. These bans were announced to stay in place until 2016. The banned food items are mostly staples in the Russian diet which are slated for future domestic production as part of the import substitution drive. However, raising domestic production will take several years before current demand gaps can be met, and with a population of 143 million, the Russian food market has considerable scope for growth. Companies whose product origins are not subject to Russian sanctions[14] therefore enjoy an immediate window of opportunity to export these food items to Russia as first steps towards penetrating this market, with the potential for eventually localising production to reap greater economies of scale.

Figure 9: Russia's Food Imports[15]

Pork & Pig fat	$1,645 Million	European Union
Pig offal	$166 Million	European Union
Cheese	$1,314 Million	European Union
Milk yogurt & cream	$246 Million	European Union
Butter	$192 Million	European Union
Eggs	$151 Million	European Union
Beef	$147 Million	European Union
Chicken	$246 Million	United States
Prepared Food	$84 Million	United States
Fish	$1,100 Million	Norway
Pork	$449 Million	Switzerland
Meat	$287 Million	Australia
Fruit	$34 Million	United States
Fish	$83 Million	United States
Nuts	$172 Million	United States

14 "Russia: Russia threatens to ban Serbian fruits", Black Sea Agro, 8 April 2015 (http://bs-agro.com/index.php/57518-russia-russia-threatens-to-ban-serbian-fruits). The critical learning point for Singapore exporters is to ensure that the origin of the exports must not be any of the Russian sanctioned countries, i.e. the EU, Norway, the US, Canada, Australia, Japan, Montenegro, Iceland, Liechtenstein, Albania and Ukraine.

15 http://capreform.eu/russian-food-sanctions-against-the-eu/

Keeping in mind that Russia's food import and retail industries are highly complex and price sensitive, the rate of success for first time exporters increases where export offerings match the most immediate import demand as follows:

Figure 9: Russia's food shortage as at end 2014[16]

Staple food item	Shortage (tonnes)
Fruits and nuts	1,599,570
Vegetables	914,730
Fish and seafood	457,190
Pork (fresh, chilled and frozen)	450,790
Milk and dairy products	428,790
Poultry	338,730
Beef (fresh, chilled and frozen)	59,050

16 Federal Custom Service, RBC magazine

Current sectoral opportunities in Russia

To enter the Russian market, companies are advised to invest resources to establish a representative office in Russia. In addition, they will need to work closely with Russian importers and distributors, to clear the rigorous certification requirements by Russia's Federal Service for Veterinary and Phytosanitary Surveillance, especially for fresh meat, fish and dairy products. Companies can also attend promotional food events and trade shows in Russia to market their products and blend it to match local tastes, such as World Food Moscow, Prod Expo and Moscow Halal Food.

Companies will also need to pay attention to export logistics. Thus far, the sea route is still the most cost efficient mode of delivery from Singapore to Russia. This may take up to 50 days. While most exports enter Russia through St Petersburg, they can also enter Russia via the Baltic ports and then be shipped by truck or rail to St Petersburg or Moscow. As such, exporters need to ensure proper delivery of their perishable goods under temperature-controlled supply chains and factor in these necessary costs.

In all these endeavours, IE Singapore has available assistance schemes for setting up of representative offices overseas, and our Moscow Overseas Centre is able to facilitate business matching meetings with reputable importers and supermarket chains.

Aspiring exporters can be inspired by the example of a Singapore brand that has successfully penetrated into the Russian market through exports. Singapore company Teh Yih Jia's export success was developed over the years by working closely with reliable distributors such as Australia Trade House. Today, Teh Yih Jia's Spring Home brand of frozen dim sum is now available in most major Moscow supermarkets.

Companies with in-market ambitions can glean valuable learning points from the examples of Food Empire and Olam International Ltd.

Food Empire directly entered Russia in 2006 by setting up a 7,800 square metre production plant in Moscow Region to have a first mover advantage in 3-in-1 instant coffee in Russia. By producing locally and supply directly to the market, Food Empire reaped substantial cost savings over the years by doing away with costs of exporting and reducing transport costs. Being present in the market enabled Food Empire to build up deep market expertise and react quickly to consumer and price trends . Today, Food Empire's MacCoffee range of 3-in-1 coffee products is a household name in Russia.

Olam International Ltd first tapped on Russia's enormous potentials in upstream grain production in 2009 by setting up grain procurement, trading and export offices in Moscow and Krasnodar Region. By 2012, Olam had built up market strength and familiarity to diversify into upstream dairy farming as a new income stream. Through persistence, and the agility granted by being present in-market, Olam today is the largest single owner and operator of dairy farms on the European continent. Olam is Russia's third largest grain exporter in 2014, and well positioned to take advantage of Russia's impending import substitution programmes.

Development of new urban and industrial zones to spur domestic production

In recent years, special economic zones (SEZs) in Russia had become a strong economic development strategy amongst Russian regions, with technology parks being the most popular strategy. With the advent of sanctions, SEZs development in Russia rose in national priority as a means of stimulating domestic production to build up domestic capabilities for producing oil and gas equipment, services and solutions, equipment for food industry, agricultural and forestry equipment, light industry, metalworking machines and tool, and cables, energy and electrical engineering equipment. At least RUB 2.5 trillion (US$ 50 billion) is required by this programme and is to be partially funded by private investments. As such, other than clear opportunities for Singapore masterplanners, there is also a good pipeline of potential downstream opportunities for Singapore SEZ builders and operators in creating SEZs in Russia.

As not all sites in Russia are ready for foreign participation, IE Singapore has identified two strategic areas whose framework for building SEZs are at a more advanced level of development:

Decentralisation of Moscow City: To date, the area most ready for interests by Singapore companies is in Moscow City itself. Long infamous for its traffic jams, Moscow City suffers from an overburdened city infrastructure mostly due to the daily commute by Russians staying in the Moscow region moving into the city centre for work, as well as inward migration of regional Russians in search of higher paying jobs and work opportunities. Figure 11 provides a comparison of Moscow and Moscow Region.

In 2014, Moscow City Government announced an ambitious decentralisation plan aimed at creating new spaces for work, leisure and business. A total of 192 new transportation hubs will be constructed, to connect to the outskirts by 61km of new subway lines and 200km of new railway lines. In addition, 1,480km2 of territory adjacent to Moscow City is slated to be developed into new business, industrial, residential and entertainment districts. The addition of this new territory will increase Moscow City's total geographical area by 59% from 2,511km2 to 3,991km2. Coined "New Moscow", the additional new territory alone is twice the size of Singapore.

Figure 11: The Moscow Transport Hub is the largest transport hub in Russia

	Moscow	Moscow region
Population Millions of people	11,6	7,2
Area Square km	1090 (-2600 with annexed territories)	46,000
Motorway length Km	3700[17]	14,800
Railway length Km	395	2700
Number of registered cars per 1000 people Units	303	312
Number of main transport stations (railway and subway) Units	379	506

Development of the Russian Far East territories: At 6.2 million km^2, the Russian Far East covers over one-third of Russia, yet is driven by a mere population of 6.3 million. Measuring 3,645km, the border between Russia Far East and China is Russia's second longest international border, making the Russian Far East a strategically important hinterland for Russia. From 2013 onwards, Russia made a concerted effort to develop its Far East regions, through SEZs called Advanced Development Territories (ADTs). A new Federal law on ADTs was signed on 29 December 2014 and took effect in March 2015. The first sites identified are in the most-populated regions of Primorsky, Khabarovsk and Kamchatka. To support the development of ADTs, a Federal investment fund and manpower agency are concurrently being set up.

Singapore's strength in development of urban and industrial zones lies in our proven ability to bring solutions and execute the entire value chain from master planning to management and operations. For example, Jurong Consultants masterplanned Russia's Special Economic Zone in Pskov and was responsible for developing and managing the SEZ. RSP Architects Planners & Engineers Company was chosen to design the concept masterplan of Innopolis, a new smart city in Tatarstan. Singapore companies possess a range of diverse urban and industrial capabilities ranging from power generation, waste and water treatment, metro and city rail design and operation, to traffic control and management, and airports.

17 http://www.ffue.org/wp-content/uploads/2013/08/Moscow_130829_Presentation-Transport-Council-PPT.pdf

Market entry strategies and dealing with **business dynamics in Russia**

Winning in the Russian market takes more than good strategies. Singapore companies interested in the long-term returns of the Russian market may take into account some unique considerations listed below.

Build strong relationships with business partners

Relationships with business partners are paramount. This ranks as the top success factor for doing business in Russia. The Russian marketplace has historically been dominated by large and complex Russian and Western entities with hard-forged relationships between them. With the recent economic strain, Russia is actively seeking new business partners. Aspiring foreign newcomers can expect a relatively shorter relationship building process with the Russian entities and can enjoy long term loyalties if successful.

Russia today boasts a pool of sharp entrepreneurs who are known for their pragmatism, business-mindedness and ability to move with speed and agility. Singapore companies should not be afraid to engage these businessmen with deep networks within the country and in the region.

Singapore newcomers can emulate successful foreigners who commonly invest in setting up local offices to cultivate business friendships and connections. Companies may tap on IE Singapore's Global Company Partnership scheme[18] that provides financial support for market entry costs, when expanding into new overseas markets.

Offer differentiated products and services

Russians today have not altered their expectations of quality and prefer original equipment manufacturers. This is because demand gaps in Russia has historically been filled by Western multinational brands such as Siemens, Sollers, Renault, Proctor & Gamble, Exxon and Caterpillar. To a smaller extent, this also includes Asian brands such as Mitsubishi and Samsung. Singapore companies interested in the market will therefore need to offer products of comparable quality and originality at competitive prices.

18 Qualifying criteria includes: (i) Global HQ anchored in Singapore; (ii) A annual sales turnover of at least S$500,000 per annum based on the most recent audited report, (iii) A minimum paid-up capital of S$50,000. For more details, please visit http://www.iesingapore.gov.sg/assistance/global-company-partnership

Invest in ground due diligence and hire capable Russian interlocutors

Singapore companies need to note that Russia has no equivalent of Singapore's Bizfile. The practice of buying database information on a Russian legal entity is usually costly and unreliable. Business rules, although increasingly streamlined and simplified, are also subject to Russia's unique interpretation and approach versus Western-style systems. Desktop research about the Russian marketplace mostly does not give an accurate picture. Therefore, on-the-ground business development and due diligence are highly necessary. Newcomers must be prepared for a gestation period of 12-36 months for business development in Russia, and patiently resolve the challenges of market familiarisation, identifying competitors, and cultivating potential partners. Experienced foreigners commonly set up marketing offices for a period of time during which they employ staff on the ground to physically examine potential partners, such as making cold calls, securing contacts and arranging meetings, and networking at industry events.

The vast differences of Russian cultures, languages and mentality, from Singapore, have caused many instances where misunderstandings occurred even when both parties are using English. Compounding the problem are the differences in operating environments and distorted media information. Hiring an experienced Russian interlocutor conversant with the customs and norms of the target sector will help avoid such misunderstandings.

Safeguard profits through payment protections

Financial sanctions have put Singapore exporters at greater credit risks such as payment delays or default. One of the ways of addressing this risk that has been employed by foreign exporters includes trading on full/partial pre-payment arrangements on individual shipments through direct bank transfers or Letters of Credit. There are also cases where buyers negotiate for longer payment terms. Aspiring exporters will therefore need to conduct proper market due diligence and negotiations with buyers to determine the most appropriate payment terms. This will help avoid potential disputes that can damage the hard-won relationships.

Conclusion

The Russian economy is expected to contract further in 2015 as the country ădjusts to new dynamics of lower oil prices. However, in the long term, Russia's large resource base and highly specialised technical talent pool will provide a stable foundation for developing future foreign investment and export growth. The new immediate potentials will come in the sectors of provision of oilfield services and equipment, export of food products and the development of new urban and industrial zones. Companies are welcome to attend high-level forums such as the Russia Singapore Business Forum[19], organised by IE Singapore, to keep abreast of the latest developments in the market, and at the same time connect with the top minds and managements of business owners.

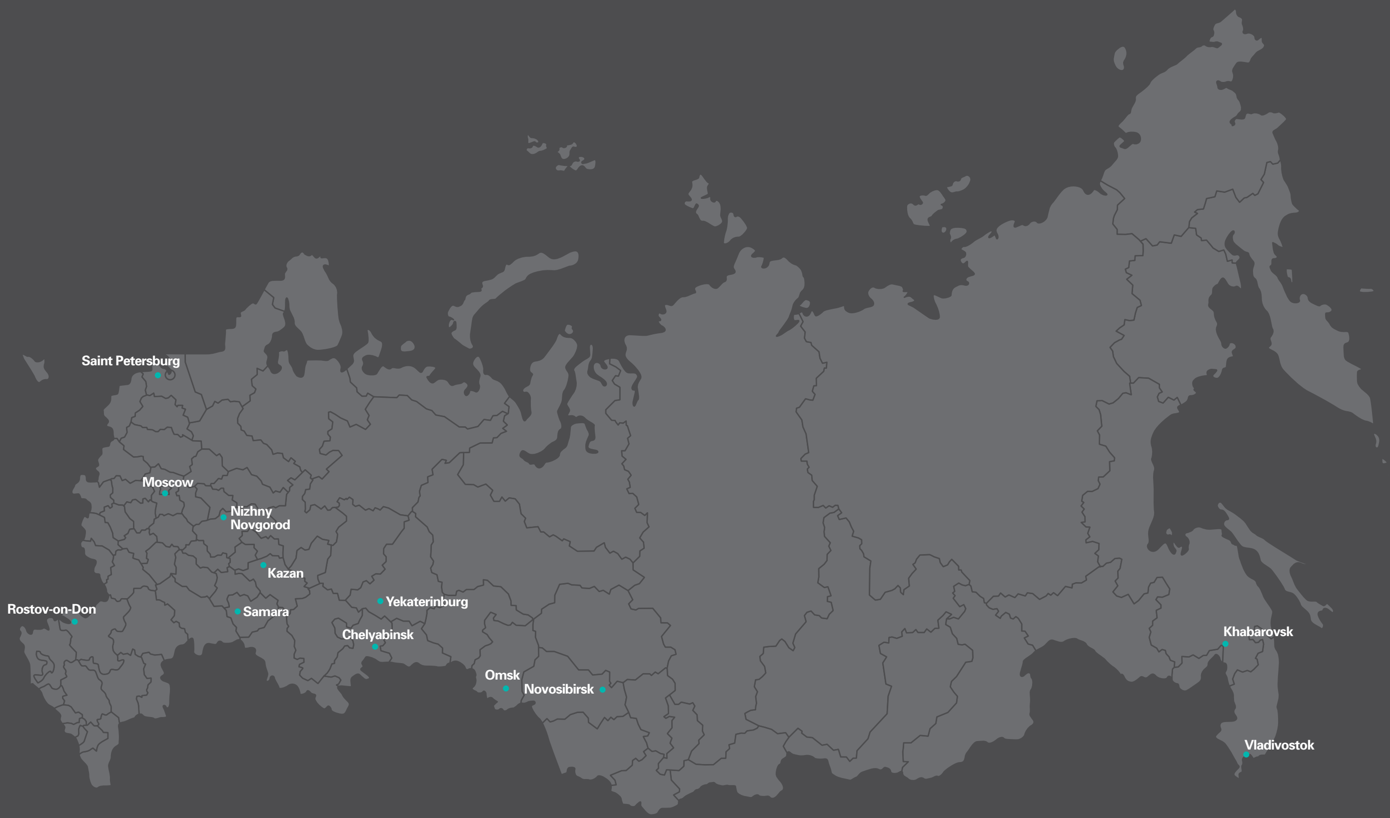
In the medium term, Russia will maintain diverse economic ties with the world, instead of being overly reliant on one regional bloc for economic development. The much-reported Russian pivot to Asia does not mean that Western investors have left the marketplace. Russia and its key economic partners are more likely to have a longer term relationships. Over time, the Russian marketplace is likely to become more, not less, diverse and competitive, offering Russian customers a wider choice of price points and quality levels.

For now, Russia's intensified spotlight on Asia gives Singapore companies a concrete opportunity to proactively promote its value propositions. This window will not last as other non-traditional competitors will step in while Western businesses continued to stay invested. Singapore companies will need to act fast, adopt a strategic long-term view and commit resources to learn the subtle market complexities and succeed in Russia.

19 Please refer to https://www.rsbf.org.sg/ for more details

Annex A

Snapshot of Russia[20]



20 http://www.un.org/depts/Cartographic/map/profile/russia.pdf

Official Name	Russian Federation
Capital	Moscow
Major Cities (population in million)	Moscow (11.6), St Petersburg (4.7), Novosibirsk (1.4), Nizhny Novgorod (1.3), Yekaterinburg (1.3)
Number of regions	83 + 2 (Sevastopol and Crimea)
Population	143.8 million
Area	17,098,242 km^2 (Crimea not included)
President	Vladimir Putin
Prime Minister	Dmitry Medvedev
Currency	Russian Rouble 1 US$ = 56.04 RUB[21] 1 SG$ = 41.84 RUB
Benchmark interest rate (Jun 2015)	11.5%
ECONOMIC INDICATORS[22]	
GDP (market exchange rate)	0.6%
Inflation	7.8%
Unemployment Rate	5.2%
Total Exports	US$520.3 billion
Top Exports	Oil, fuel & gas (70.3%), Metals (11.1%), Chemicals (6.0%), Machinery & Equipment (4.5%)
Top Export Partners	Netherlands (14.7%), China (6.8%), Germany (6.7%), Italy (6.2%)
Total Imports	US$323.9 billion
Top Imports	Machinery & Equipment (48.1%), Chemicals (14.8%), Food & Agricultural Products (13.9%), Metals (7.1%)
Top Import Partners	China (16.3%), Germany (12.1%), US (4.9%), Belarus (4.2%)

21 http://www.xe.com/currencycharts/, last accessed 22 July 2015
22 EIU Country Fact Sheet. All information reflects 2014 data unless specified.

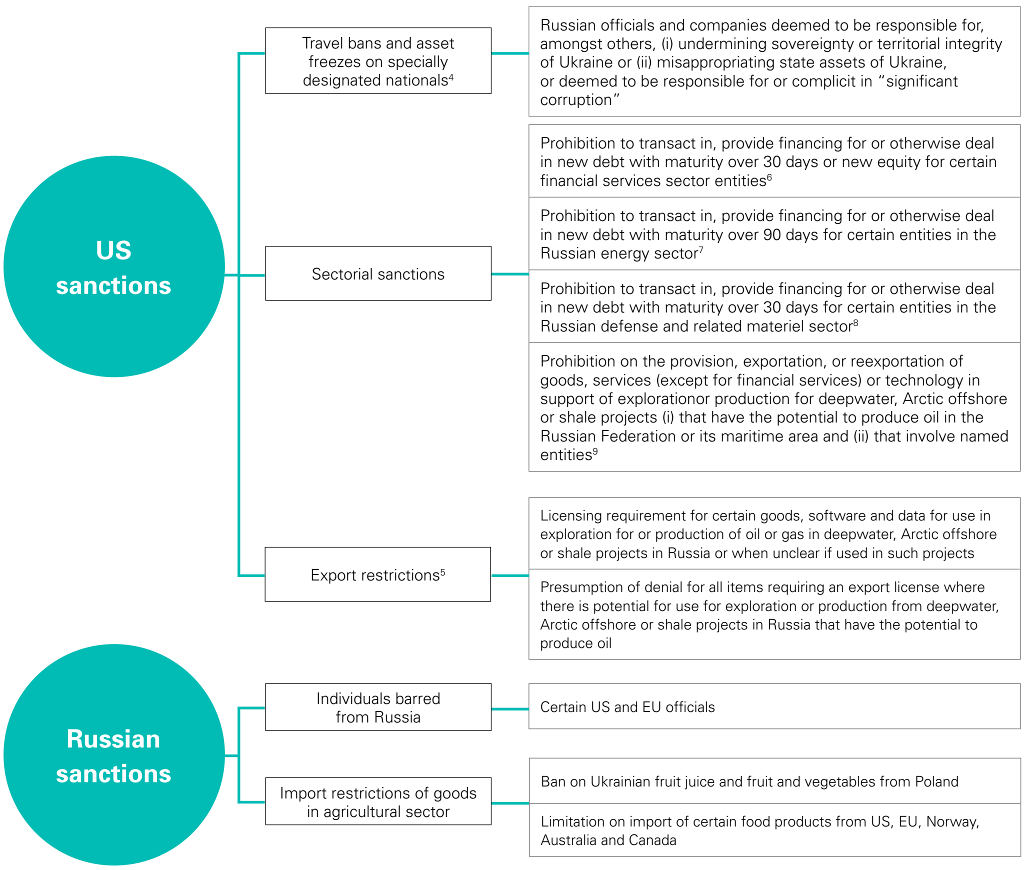
Annex B

Sanctions Summary[23]

- **EU sanctions**
  - Diplomatic measures
    - Suspension by European Investment Bank of signature of new financing operations
    - No Russian participation in G8 in Sochi and suspension of negotiations over Russia joining the OECD and International Energy Agency
    - Suspension of bilateral talks with Russia on visa matters and the New (EU/Russia) Agreement
  - Asset freezes and visa bans[1]
    - Persons actively supporting or benefitting from Russia-decision makers responsible for the annexation of Crimea or the destabilisation of Eastern Ukraine
    - Persons and entities responsible for (or associated with those who are responsible) actively supporting or implementing, actions or policies which undermine or threaten the Ukrainian territorial integrity, sovereignty and independence, or stability or security in Ukraine, or which obstruct the work of international organisations in Ukraine
    - Legal persons, entities or bodies in Crimea or Sevastopol whose ownership has been transferred contrary to Ukrainian law or have benefitted from such transfer
    - Individuals or entities conducting transactions with the separatist groups in the Donbass region of Ukraine
  - Restrictions for Crimea and Sevastopol[2]
    - Prohibition on import into the EU of goods originating in Crimea or Sevastopol and financing or financial assistance as well as insurance and reinsurance related to the import
    - Restrictions regarding (i) the creation, acquisition or development of infrastructure in the transport, telecommunications and energy sectors and (ii) the exploitation of oil, gas and mineral resources in Crimea or Sevastopol
      - Prohibition on financing of, making certain investments in and participation in companies or projects relating to such infrastructure projects or exploitation and provision of technical assistance or brokerage services relating thereto
      - Prohibition on selling, supplying, transferring, or exporting key equipment and technology relating to such infrastructure projects or exploitation to any person or for use in Crimea or Sevastopol and financing or financial assistance as well as insurance and reinsurance relating thereto
    - Prohibition to participate in activities the object or effect of which is to circumvent the prohibitions
  - Economic sanctions[3]
    - Prohibition to buy or sell, providing investment services for or assistance in the issuance of or otherwise deal with transferable securities and money market instruments by, subject to certain exceptions, (i) certain state-owned Russian banks, (ii) legal persons, entities or bodies established in Russia predominantly engaged and with major activities in the conception, production, sales or export of military equipment or services and (iii) certain subsidiaries of the aforementioned banks and persons and those acting on their behalf or under their control; and prohibition to make or be part of any arrangement to make new loans or credit to aforementioned banks and legal persons, subject to certain exceptions
    - Prohibition on import and export of arms and related materials from/to Russia and restrictions on the provision of technical assistance, brokering services, financing or financial assistance related to these materials
    - Restrictions on the sale, supply, transfer and export of dual use goods and technology subject to certain exceptions
      - Prohibition to sell, supply, transfer or export certain specific dual use goods and technology to certain specific natural or legal persons, entities or bodies in Russia, including restrictions on the provision of technical assistance, brokering services, financing or financial assistance relating to these goods and technologies
      - Prohibition to sell, supply, transfer or export dual use goods and technology to any natural or legal person, entity or body in Russia or for use in Russia, if those items are or may be intended, for military use or for a military end-user, including restrictions on the provision of technical assistance, brokering services, financing or financial assistance relating to these goods and technologies
    - Restrictions on sale, supply, transfer or export of technologies suited to the oil industry for use in deep water oil or Arctic oil exploration and production or shale oil projects in Russia or for use in Russia subject to certain exceptions
      - Authorisation by competent authorities in Member States
      - Presumption of denial if products are destined for deep water and Arctic oil exploration and production and shale oil projects in Russia
      - Prohibition to provide the following associated services necessary for deep water oil and Arctic oil exploration and production, or shale oil projects in Russia: (i) drilling, (ii) well testing, (iii) logging and completion services and (iv) supply of specialised floating vessels
    - Prohibition to participate in activities the object or effect of which is to circumvent the prohibitions

23 Linklaters, November 2014

Sanctions Summary[2,3]



The European Union and the United States introduced sanctions against Russia in March. The European Union escalated the sanctions regime at the end of July, which in turn led to a Russian blockade of food imports from countries imposing sanctions on it, and to even further sanctions in mid-September.

This overview briefly summarises the sanctions imposed by the European Union, the United States and Russia (as at 15 September); the sanctions imposed by Australia, Canada and Switzerland are not included in this summary. To support you further, our internal experts can advise on the latest developments, the key legal implications and related consequences for the current restrictions in every jurisdiction.

Notes pertaining to the sanctions overview.

1 Council Regulation (EU) No 269/2014 of 17 March 2014, Council Implementing Regulation (EU) No 810/2014 of 25 July 2014, Council Implementing Regulation (EU) No 826/2014 of 30 July 2014, Council Regulation (EU) No 959/2014 of 8 September 2014 and Council Implementing Regulation (EU) No 961/2014 of 8 September 2014
2 Council Regulation (EU) No 692/2014 of 23 June 2014 and Council Regulation (EU) No 825/2014 of 30 July 2014
3 Council Decision 2014/512/CFSP of 31 July 2014, Council Regulation (EU) No 833/2014 of 31 July 2014 and Council Regulation (EU) No 960/2014 of 8 September 2014
4 Executive Order No. 13660 of 6 March 2014, Executive Order No. 13661 of 16 March 2014, Executive Order No. 13662 of 20 March 2014, OFAC Ukraine Related Sanctions Regulations (31 CFR pt. 589), Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014, Pub. L. No. 113-95, 128 Stat. 1088
5 Russian Oil Industry Sanctions and Addition of Person to the Entity List, 79 Fed. Reg. 45,675 (Aug. 6, 2014) (to be codified at 15 CFR pts. 732, 738, 740, 742, 744, 746 and 774)
6 OFAC Directive 1 (as amended) under Executive Order 13662
7 OFAC Directive 2 (as amended) under Executive Order 13662
8. OFAC Directive 3 under Executive Order 13662
9. OFAC Directive 4 under Executive Order 13662

Annex C

Russia's Jan 2015 anti-crisis plan[24]

On 27 January 2015, Kremlin adopted an anti-crisis plan with the goal to ensure sustainable economic development and social stability in an unfavourable global economic and political environment. It announced that in 2015–2016, steps will be taken to advance structural changes in the Russian economy, provide support to systemic entities and the labour market, lower inflation, and help vulnerable households adjust to price increases. To achieve the objectives of positive growth and sustainable medium-term macroeconomic development the following measures are planned:

// Provide support for import substitution and non-mineral exports.
// Support small and medium enterprises by lowering financing and administrative costs.
// Create opportunities for raising financial resources at reasonable cost in key economic sectors.
// Compensate vulnerable households (e.g., pensioners,) for the costs of inflation.
// Cushion the impact on the labour market (e.g. provide training and increase public works).
// Optimize budget expenditures.
// Enhance banking sector stability and create a mechanism for reorganizing systemic companies.

The government aims to achieve a balanced budget in the medium term and intends to cut budget expenditures by 5% in real terms in the next three years. In 2015, the plan is to cut 10% of spending across all categories **except military, agriculture, and external debt-servicing.** The Ministry of Finance currently plans to use the Reserve Fund to optimise federal budget spending. It is expected that about RUB1.4 trillion of the anti-crisis plan will be financed this year, of which up to RUB972 billion will be financed from the federal budget and RUB550 billion with the National Welfare Fund (known domestically as "NWF").

It is estimated that the plan will cost RUB2.4 trillion, of which 67% is earmarked for bank recapitalisation, which will operate through three channels:

(1) Treasury bonds worth RUB1 trillion had already been transferred to the Deposit Insurance Agency in December 2014. In February 2015 the government approved a list of 27 banks eligible for recapitalization. Banks to be recapitalized are expected to increase mortgage loans, loans to small and medium enterprises, and loans to key economy sectors by 1% per month and increase their own capital by at least half of the amount received from the Deposit Insurance Agency.

24 World Bank - Russia Economic Report 33: The Dawn of a New Economic Era?

(2) The NWF will finance a second channel, investing RUB250 billion in subordinated deposits and bonds of the systemic banks that have capital of RUB100 billion (US$1.6 billion). The interest rate should at least cover the CPI inflation rate. On 1 October 2014, nine banks had already met the criteria. Banks that receive these deposits are expected to finance government-approved investment projects.
(3) Another RUB300 billion will be channelled through the NWF to Vnesheconombank to provide credit to the real sector.

About 13.9% of the anti-crisis plan (RUB320 billion) will go to direct support of real sectors: RUB200 billion in state guarantees for systemic companies, RUB50 billion for support of agricultural enterprises, and RUB10 billion for the transport utilisation programmes. The government approved a list of 199 systemic enterprises eligible for state guarantees, among them all major Russian companies. Companies on the list produce 70% of GDP of Russia. These steps mainly address the development of sustainable enterprises given lower domestic demand, an unfavourable global environment, and high credit costs. Some administrative measures are expected to smooth state procurement, which was hit by the exchange rate crisis.

Another 12.9% (RUB296 billion) is earmarked for social support, including pension indexation higher than the federal budget law envisaged, RUB52.2 billion for easing the labour market, RUB30 billion for payments for registered unemployed, and RUB16 billion for additional medical support.

About 7.0% (RUB160 billion) will be transferred to the regions through budget loans.

Annex D

A comparison of past Russian economic crisis[25]

// Russians have significant experience dealing with economic crises; however, the current situation is different from both 1998 and 2009, and requires and adapted response

// The permanent lesson of Russian crises is that companies that take a long-term view and remain committed to the market despite short-term performance problems tend to perform better than competitors. This remains true today, and companies should determine if their businesses are ready to commit to Russia in the face of what is likely to be a prolonged economic crisis, followed by a lackluster recovery

	1998	2009	2015f
Cause of the crisis	Unsustainable public sector debt, default on government obligations	Global financial crisis + oil price crash cause contraction in lending and external demand	Structural slowdown + oil price crash + crisis of confidence cause capital outflows
Currency	Substantial currency devaluation	Central bank defends the currency, preventing a sharp devaluation	Central bank allows currency to depreciate sharply
Government response	Institute business-friendly reforms; reform government finances	Enact large stimulus; bail out companies; protect social spending	Bail out the banking system; promote import substitution; cut government spending
Consumer demand	Contraction followed by swift recovery	Real wages continue to grow, but unemployment rises quickly	Unemployment is low, but real wages contract sharply
Business demand	Ineffective enterprises cease operations or are acquired by investors	High levels of forex debt weigh on industrial enterprises, causing bankruptcies	Ineffective enterprises go bankrupt or are acquired
Recovery curve	Growth resumes within two years on the back of reforms, rising oil prices, competitiveness gains, and higher capacity utilisation	Growth returns within a year, as capacity utilisation increases, oil prices rebound, and public spending supports consumer spending power	Global demand and oil prices unlikely to rebound, structural inefficiencies will depress growth even in favorable external environment, foreign policy hurts FDI
Business strategies	Invest in cheap assets and a build a local presence to capture recovery in demand	Scale back costs, but maintain a presence in the market to capture recovery spending, and buy local assets/compaines at a premium	Improve efficiency through localisation and restructuring to ensure profitability even with low revenue growth

25 Frontier Strategy Group, Quarterly Market Review_Russia Q2 2015

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