

SPECIAL REPORT

# RUSSIA'S FAR EAST

Crossing the bridge  
to the future

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## What's next for the EAEU?

Economic union expands its  
influence both east and west

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Published by  **RUSSIA BEYOND THE HEADLINES**

International projects division of Rossiyskaya Gazeta

# DOING BUSINESS WITH RUSSIA

2# | OCTOBER | 2016



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## Pfizer goes all in

Multinational benefits from  
localization of manufacturing

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## The Kremlin's Iron Lady

Central Bank head Elvira Nabiullina  
on the future of the ruble

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# Russia Direct

ANALYTICAL PUBLICATION THAT FOCUSES EXCLUSIVELY ON THE COMPLEX CHALLENGES AND OPPORTUNITIES SHAPING THE U.S.-RUSSIA RELATIONSHIPS. A UNIQUE PLATFORM FOR RUSSIAN AND AMERICAN POLICY MAKERS, BUSINESS LEADERS AND THE EXPERT COMMUNITY.



## RUSSIA DIRECT REPORT: **‘CROSSING THE BRIDGE TO THE FAR EAST’**

Russian President Vladimir Putin has stated on several occasions his commitment to make the development of Siberia and the Far East a “national priority for the entire 21st century,” including most recently at the Eastern Economic Forum that took place in Vladivostok in September. In many ways, this strategy dovetails with the nation’s pivot to the East, in the form of stronger trade and economic ties with China and the nations of Southeast Asia. But how realistic are these plans?

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## NEW POSSIBILITIES IN THE REGIONS FOR ENTREPRENEURS



We are pleased to present to you the second issue of the Doing Business With Russia magazine, a publication focused on encouraging investment in the Russian economy and supporting Russian exporters abroad. Companies from Russia continue to compete in foreign markets in a variety of industries, from food products to toothpaste.

As always, in this issue we will tell you about unique Russian companies finding success on the global market. We will also show you how Russia offers opportunities to foreign businessmen willing to take a few risks, such as Daniel Lawrence. His company, Superfood Farms, which he founded with a Russian partner, sells kale and other gourmet vegetables to health-conscious Russians.

Of course, Russia is not only interesting for small-scale manufacturers. Pfizer, one of the world's largest pharmaceutical companies, has begun construction on a huge facility in the country and is planning to transfer licenses for 40 of its products to Russian partners. In this new issue you will find interviews with some of the country's top newsmakers, including the head of the Central Bank Elvira Nabiullina, the Minister for the North Caucasus Lev Kuznetsov and many others. These leaders offer you their opinions on Russia's development and how the country's leadership is working to attract investment and benefit from international experience.

While in the past, most investment into Russia was spurred by incentives offered at the federal level, today regional authorities are playing a bigger role in attracting foreign companies and entrepreneurs. One of the most active regions in the competition for new investments is the Russian Far East. Developing the region is one of the government's national priorities for the 21st century. We have devoted a special report section of this issue to the region in which we explore the various incentives and benefits being offered there. A new tax and customs environment has been established for attracting investors to Russia's "new frontier" on the Pacific Coast, including the Free Port of Vladivostok, which is already open for business. Those who have expressed an interest in the region include Japanese car manufacturer Mazda, which is in the initial stages of building a new engine plant there.

We hope you will enjoy this latest edition and that it will encourage you to take another look at the possibilities Russia offers for doing business.

Alexey Lossan,  
Executive Editor

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# A MESSAGE FROM TRADE REPRESENTATIVE STADNIK

*Alexander Stadnik,  
Russian Trade  
Representative in the U.S.*



*Dear friends and colleagues,*

We are happy to present the second edition of Doing Business With Russia magazine, prepared by Russia Beyond The Headlines in cooperation with the Russian Trade Representation in the United States. In the past year, we have realized several important projects to support Russian business abroad.

These include the meeting of the Russian-American Pacific Partnership, which took place in San Francisco in July 2016. In this period we have become real partners, holding a whole series of events aimed at strengthening Russian-American business ties.

Despite the political contradictions, Russian companies continue entering the American market and international players under the American flag are still integrated in Russia's economy. Here I feel I should highlight the leading role of the U.S.-Russia Business Council, which represents the interests of American and Russian companies in the sphere of bilateral relations. The main USRBC event of this year is the Annual Meeting, which will focus on the topic of "Innovation and Russia's Return to Growth."

In today's world, entrepreneurs do not accept borders and impediments, which is why cooperation between Russia and the US continues regardless of political difficulties.

Just recently, the American corporation Pfizer decided to build a new pharmaceutical plant in the Kaluga Region. Then, another American giant, Ford, began exporting its Russian-produced cars to neighboring countries.

While before, foreign players came to the Russian market exclusively because of its volume and demand from local residents, now they see Russia also as a channel for entering markets of the other post-Soviet republics, primarily members of the Eurasian Economic Union. Thanks to the removal of trade restrictions, Russia is becoming a more attractive country for foreign business.

It is especially pleasant to note that the Russian Trade Representation in the U.S. played an important role in attracting foreign capital to Russia. We actively conduct business missions for representatives of entrepreneurial circles and organize business meetings, and we see that interest in Russia has never been as strong. In many respects, Russia remains the largest market in Europe and offers investors unique opportunities.

Today all the economic institutions in Russia are fully working. The independent Central Bank implements its policies, and effective mechanisms are established for supporting business.

I hope that this edition will open up new perspectives for international economic cooperation and help the foreign reader learn a bit more about Russia.

Alexey Lossan, *RBTH*

## INVESTMENT | RUSSIAN REGIONS WORK TO ATTRACT INVESTORS

**LOCAL GOVERNMENTS ARE DEVELOPING INDIVIDUAL STRATEGIES TO ENTICE FOREIGN COMPANIES TO EXPLORE OPPORTUNITIES OUTSIDE OF MOSCOW AND ST. PETERSBURG.**

**A**ttracting investment to Russia's regions was the focus of this year's Sochi International Investment Forum, held in October. Russian companies and government authorities concluded 215 agreements totaling 704 billion rubles (\$11.3 billion) during the event according to the forum's organizer, Deputy Prime Minister Dmitry Kozak.

Representatives of a number of American companies, including oil major ExxonMobil, attended the forum, according to Daniel Russell, head of the U.S.-Russia Business Council and a forum participant.

While foreign investors have long-standing relationships in several Russian regions, less well-known destinations are now upping their game, trying to encourage entrepreneurs to take another look.

"The leading regions are beginning to feel a real struggle for domestic and foreign investment on the part of regions that were previously lagging behind," said Sergei Kalendzhyan, dean of the Graduate School of Corporate Management at the Russian Presidential Academy of National Economy and Public Administration (RANEPA). "The regions create special conditions for investors, competently develop projects and train staff in order to entice investors."

According to Kalendzhyan, the realities of life in the regions are motivating governors and their teams to focus on attracting investment and creating a competitive business environment.

### DIFFERENT APPROACHES

Ivan Fedotov, director of the Association of Innovative Regions of Russia, says that each region uses a different model to attract investment. Fedotov points out that the Tomsk Region, which is located in Siberia, is based on an educational and scientific foundation.

"The region is seen as the center of scientific thought," Fedotov said. "Some of the (country's) oldest universities are concentrated here."

By contrast the Muslim-majority Republic of Tatarstan, located 600 miles east of Moscow, is a traditional center for raw materials extraction and therefore makes different incentives available to investors. In 2015, the volume of investment received by the Republic of Tatarstan from abroad amounted to about \$816.7 million — a 48-percent increase compared with the corresponding period of the previous year.

"Particularly interesting are the models of the Kaluga and Ulyanovsk regions, which are based on the effectiveness of regional development institutions," Fedotov said. According to him, the "investment results" of these regions speak for themselves.

In the Kaluga Region, located just south of Moscow, enterprises have accumulated more

228.3 billion rubles (\$3.6 billion). The Ulyanovsk Region, more than 550 miles from Moscow on the Volga River, has attracted 600 billion rubles (\$9.55 billion) in total investments over 10 years.

### ASSISTANCE FROM ABOVE

The federal government has programs in place to help Russian regions attract foreign investment, including the Industry Development Fund (IDF). This structure provides loans for specific projects at 5 percent per annum; by comparison it is almost impossible to get a loan at less than 15 percent per annum in a commercial bank. To date, the IDF has financed 85 projects in 39 of Russia's 85 federal subjects (regions, territories, republics and federal cities). The total amount of loans given has reached more than



Many Russian regions offer incentives for new investors.

than \$2.6 billion of foreign investment as of Jan. 1, 2016. From 2008 through 2016, the Kaluga Region Development Corporation invested 14.3 billion rubles (\$227.6 million) in infrastructure projects in the region's industrial parks. The volume of tax revenue exclusively for the regional budget from resident businesses of these parks totaled 26.6 billion rubles (\$423.4 million).

To put it another way, the region received more than \$3.20 in tax revenue from these residents for every \$1 spent on attracting them. During the same period, the volume of income tax and customs duties to the federal budget from the territory of industrial parks totaled

25 billion rubles (\$398 million) and the amount of private investment equals 73.9 billion rubles (\$1.18 billion).

"Our fund does not have any pet industries or regional preferences, but the largest number of loans falls on traditionally industrialized regions," said Sergei Vologodsky, deputy director of the IDF. "The explanation is simple: the more companies, the more applications. So, the percentage of approved loans is higher."

At the moment, unsurprisingly, the leading regions in attracting investment are Moscow, St. Petersburg and the Moscow Region, which surrounds the capital but has its own regional government.

INTERVIEW | LEV  
KUZNETSOV

## “OUR KEY TASK TODAY IS TO CREATE AN INVESTMENT CLIMATE”

Alexey Lossan, *RBTH*

*In an interview with Doing Business With Russia, Lev Kuznetsov, Russia’s Minister for North Caucasus Affairs, spoke about the potential for development in the area and how local officials are already working with Italian investors on projects ranging from agriculture to healthcare.*

**DBWR:** In your opinion, which sectors of the economy can become points of growth for the economy of the North Caucasus??

**LEV KUZNETSOV:** We defined them for ourselves very clearly and systemically – these are the niches where we can be objectively competitive due to climatic factors, traditions and so on. The first niche is agriculture, including the cultivation of crops that will be needed even after the lifting of the embargo on food imports from the European Union to Russia, including berries, stone fruit and vegetables. All of these projects can be implemented in remote settlements in a mountainous area. In this way we can provide income-earning opportunities for people living in difficult conditions. The second niche is tourism; this is the most effective activity for us today. It is within this area that the North Caucasus is developing ski and health clusters, based on the unique cultural and natural features of the region. A separate niche is occupied by medical tourism and the related sphere of balneology [ed: therapeutic use of mineral springs], which is actively developing in the Caucasian Mineral Waters region. In addition, the North Caucasus has its own tungsten and molybdenum deposits. The reserves of these metals in the Russian Far East are already depleted, and the development of our deposit can be a good alternative. However, we want to create a production chain for complex alloys, and this project can become the basis for the development of our region due to its capacity and importance to the country’s economy. Moreover, it will help remove socioeconomic disparities, which are higher in the North Caucasus than in the whole country.

**DBWR:** Which regions in other countries do you look to as examples in developing such a difficult region as the North Caucasus?

**L. K.:** We have thoroughly studied the experience of the Autonomous Province of Bolzano-South Tyrol in Italy. It is similar in many respects to the Russian North Caucasus. The bulk of the province’s area is covered by mountains, and only 10 percent of the land is involved in agriculture. There are the same conditions for the cultivation of apples and grapes; there the same kinds of tourism are developing: skiing and medical. However, this province is one of the richest in Italy, despite the fact that 20 years ago, there were areas where people simply starved. Now the province grows a million tons of apples and receives 6 million visitors a year. Still, this territory’s area is comparable with just one part of the North Caucasus – South Ossetia. A similar situation is developing in the Austrian Tyrol. We are actively studying this experience – it is important that people living in similar conditions are able to realize their full potential. Most of the owners of the entire infrastructure in Tyrol are people who were born and live in the land.

**DBWR:** You said that Tyrol is developing on behalf of agriculture and tourism, but there is also the Basque country in Spain, where they focused on developing industry. Do you have such plans?

**L. K.:** I believe that it is incorrect to build enterprises where there were no large-scale industrial traditions. We see opportunities for the emergence of small businesses, small eco-friendly production facilities, but no



more than that – the Caucasus is valued for its unique environmental benefits, among other things. The brand “Made in the Caucasus” ensures environmental friendliness and quality of products. Given that there are industrial regions in Russia, it would be more appropriate to leave this advantage to them.

**DBWR: A lot of new tools to attract investors have been launched in Russia lately, including a special investment contract or the advanced development territories (ADTs). Do you use them?**

**L. K.:** Yes, we want to use the tool of the ADTs as much as possible right now, and hope for the help of the state Corporation for Small and Medium Business Support in the implementation of agricultural projects. In general, we actively use the types of support that are already there, including subsidies on interest rates for loans. Today, it is necessary not to create new support tools, but to know how to use those that are there as efficiently as possible. For our part, we help all businesses in the North Caucasus to integrate into these processes. For example, the territory of the Caucasian Mineral Waters is home to one million people, and it is important that our region creates new services not only for visitors but also for locals, so we need to encourage conditions for the development of new areas of business.

**DBWR: So the tools devised for the development of Russia's Far East, for example, the ADTs, can be used in the North Caucasus?**

**L. K.:** Yes, of course. Today, five special economic zones have already been established in the Caucasus, but preferential treatment applies only to companies with a specific profile of activity. The new tool – the ADTs – provides a complex set of tax and customs preferences without favoring any one segment, and from this point of view, such a tool is very preferable for us. Moreover, the essence of the creation of the ADTs was initially to try out the new format in the Far East, and then to extend it to the entire country.

**DBWR: Today, many Russian regions are competing with each other for foreign investors. What advantages does the North Caucasus have in this race?**

**L. K.:** In addition to the environment, we have an important logistical advantage – we bor-

der Iran and Asia. We are thinking about creating a transport link through the Caucasus to Asia. A powerful logistics base for the supply of food and petroleum products has already been created in the region. In fact, the Caucasus could become a gateway to the Middle East. Today, private investment is very important for us. We have our own state program for the development of the North Caucasus, but during the last few years all the money under the program were allocated to build schools, kindergartens and homes for the resettlement of people from landslide zones. Starting in 2017, we will allocate funds from the program to the real sector, and

## **WE HAVE THOROUGHLY STUDIED THE EXPERIENCE OF THE AUTONOMOUS PROVINCE OF BOLZANO-SOUTH TYROL IN ITALY. IT IS SIMILAR IN MANY RESPECTS TO RUSSIAN NORTH CAUCASUS.**

thanks to this program, we want to implement projects worth a total of about 1 trillion rubles (\$16 billion). These funds should go to industry, agriculture and the tourist sector. Our key task today is to create an investment climate, and then gradually build up the muscles in those areas where we are competitive in the long term.

**DBWR: During the St. Petersburg International Economic Forum in June 2016, you signed several agreements with Italian companies.**

**What is the essence of these deals and why have you formed an alliance with Italian companies?**

**L. K.:** We have very good, long-term relations with Italy, thanks largely to the active work of our Italian colleagues. The first niche where we began to actively cooperate was agriculture, including the supply of seedlings from Italy to plant nurseries. An Italian company supplied equipment, irrigation and storage systems. We have agreements with Italian companies for the supply of medical equipment and materials for the construction industry.

Moreover, Italian delegations regularly come to visit us, exploring the potential for cooperation in new areas. One of the areas of work is the creation of a health cluster in the North Caucasus, where the Italian side has an interest in terms of equipment supply; there are also plans for the launch of a training program. Another company proposes to build a cardiology clinic and also to become one of the residents of the health cluster. Overall, the value of our health cluster amounts to about 160 billion rubles (\$2.5 billion), and we are willing to share any piece of the pie. Moreover, the first agreements on cooperation between Russian and foreign companies have already been signed. For example, the Russian company Arnest signed a contract with an Italian company for the production and development of medical products in aerosol containers. Even despite a number of sectoral restrictions imposed on Russia by the European Union, cooperation continues.



North Caucasus is developing ski and health clusters.

## INTERVIEW | ELVIRA NABIULLINA

## 'IRON LADY' ON SETTING NEW GOALS

Kira Egorova, *RBTH*

ture of trade will change and the dependence correlation is likely to be different, too. As far as we are concerned, we need to understand what is happening in the Chinese economy. In other words we should focus on the sectors that will grow quickly. We need to adapt our production to the new reality, to find more distribution markets and so on. In a way it's an incentive for internal restructuring, for diversifying the Russian economy. We hope that our economy takes advantage of this opportunity.

**DBWR:** Have you made similar calculations of how the Russian market may be affected by Brexit?

**EN:** Firstly, the sanctions led to the increase of capital outflow from the country and Russian companies had to immediately pay off their debts. In the short term this brought about the devaluation of the ruble, in the long term this resulted in the decrease of costs for Russian enterprises.

The debt that Russian companies owed was drastically reduced and consequently, so was their exposure to external risks. This meant switching to domestic sources of financing. Before, the gap between the rate of domestic savings (30 percent of GDP) and investments (20 percent of GDP) was generally covered by capital inflows from abroad, but now this model no longer exists.

We are painfully moving toward a new model of economic development, which is significantly less risky.

**DBWR:** By 2017, you are planning to bring inflation down to 4 percent, but Russia has never had such a low inflation rate in its history. What is this target based on?

**EN:** Yes, we have set ourselves the target of bringing inflation down to 4 percent by the end of 2017. It is no less important — as I keep stressing — to further maintain inflation at this low level. It is quite easy to achieve a one-time drop in inflation, but it can then return to its previous high level. Our forecasts are first and foremost based on our monetary policy, which we design in such a way so as to meet the 4-percent target.

Importantly, all of this is happening in the current economic situation, while taking into account the state of affairs on the labor market and the situation on the currency markets. You are absolutely right: we have never had such a low inflation rate, which is why many think it is unrealistic.

However, the forecasts we make are what lead us to the results we declare. It is important for us that the market and economic players have faith in our policy.

That is why for over a year now we have been publishing our inflation forecasts a year in advance. So far we have been keeping to our forecasts. Our forecast for inflation until the end of 2016 is 5–6 percent.

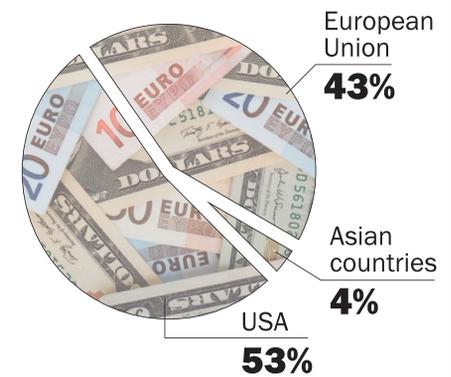
*In her address to the International Financial Congress in St. Petersburg on July 1, 2016, Russia's Central Bank head Elvira Nabiullina laid out Russia's strategy for tamping down inflation. At a briefing after the speech, Nabiullina spoke to Doing Business With Russia.*

**DBWR:** You said that an economic slowdown in China by one percentage point slows the Russian economy down by half a percentage point. In other words, if China's economy slows from 7 to 6 percent a year, Russia will go down half a percentage point. So it's clear that dependence on China poses a threat to the Russian economy. How could this dependence be reduced?

**ELVIRA NABIULLINA:** We insist on this correlation, but only if the current structure of our relations and our trade remains unchanged. The changes that have been taking place recently, including with our national currency rate, make it possible to make our goods more competitive. For example, we see that — among other things — the share of our machinery exports to China is growing. That is why the struc-



## Eurobonds were purchased by investors from:



Alexey Lossan, *RBTH*

## BONDS | RUSSIAN EUROBONDS: STILL ATTRACTIVE TO FOREIGN INVESTORS

**THE RUSSIAN MINISTRY OF FINANCE PLACED \$1.25 BILLION WORTH OF BONDS ON THE OPEN MARKET IN ITS SECOND OFFERING THIS YEAR. THE SALE INDICATES THAT RUSSIAN SECURITIES CONTINUE TO APPEAL TO INVESTORS AND SUGGESTS THAT THE GOVERNMENT IS PURSUING A SOUND ECONOMIC POLICY.**

**T**he Russian Finance Ministry has placed an additional \$1.25 billion in bonds on the global market, in order to reach its target of selling \$3 billion worth of Eurobonds by the end of 2016. It has achieved its goal according to an announcement by Russian Minister of Finance Anton Siluanov, cited by the Interfax news agency. The coupon rate for the bonds was 3.9 percent.

Siluanov said that 53 percent of the new bond issue was purchased by investors from the U.S., Europeans picked up 43 percent, with the remaining 4 percent going to Asia. There were no Russian buyers. Demand was six times the supply, exceeding \$7.5 billion. The Russian Ministry of Foreign Affairs has concluded that Russian bonds are still of interest for foreign investors despite economic sanctions.

The first part of the issue — \$1.75 billion in 10-year bonds with a 4.75-percent yield — was offered in May. That issue marked Russia's first foray into international capital markets since fall 2013. Foreign investors bought \$1.2 billion in the bonds, with private Russian banks picking up the remaining share (\$550 million). According to VTB Capital, most of the foreign investors were from the UK, followed by representatives from Europe, Asia and the U.S. In the May issue, the Ministry of Finance purposely limited the number of Russian buyers:

the Russian government sought to attract foreign players, limiting Russian investors to no more than 30 percent of the bonds.

### INCREASING THE APPEAL

In order to alleviate the concerns of potential investors, Russian authorities included some specific provisos in the bond issue prospectus, the main code of rules regulating an investment offering for sale to the public. According to that document, Russia will not use any funds received from the bond placement to help companies and individuals included on the EU and U.S. sanctions list.

Furthermore, if economic sanctions are expanded, the Ministry of Finance can pay investors in currencies other than dollars, such as pounds, euros or Swiss francs. All funds raised will go to servicing the country's foreign-currency debt or to replenishing its gold and foreign exchange reserves, the prospectus states. According to the Russian business daily RBK, in 2016 the Ministry of Finance must allocate 164 billion rubles (\$2.56 billion) to service its debts.

Experts consider Russia's move to attract foreign investors a wise one.

"It is in the government's interest to use foreign investors' funds and to preserve those of domestic investors," said Konstantin Bushuyev,

head of market analysis at Moscow's Otkrytie Brokerage. "In addition, when Russian debt instruments are bought by external investors, Russia ends up with a capital inflow, which is not the case when residents' funds are used."

The Russian economy, he continued, is preparing to move out of recession and the state could be interested in increasing levels of new borrowing.

### TAKING ADVANTAGE OF OPPORTUNITY

Ratings agency Standard & Poor's recently upgraded Russia's credit ratings from negative to stable. Meanwhile, in September U.S. Vice President Joe Biden said that as many as five EU member states were ready to lift the sanctions against Russia. It should be noted that individual states cannot take this step unilaterally — the ultimate decision rests with Brussels.

According to Bogdan Zvarich, an analyst with Moscow investment firm Finam, demand for the recent offering was six times the amount of placement and the whole issue was bought by foreign investors. Zvarich says that now is a good time for external borrowing.

Given that yields generated by the sovereign bonds of some European states are below zero, Russian Eurobonds have become an attractive instrument in terms of the risk-to-yield ratio, he said.

Alexei Lossan, *RBTH*

## TRADE | WILL THE EAEU BE THE NEXT GREAT GLOBAL ECONOMIC UNION?

IN TERMS OF CONTENT AND DEGREE OF INTEGRATION, THE EURASIAN ECONOMIC UNION HAS THE POTENTIAL TO BE A MAJOR TRADE ORGANIZATION ALONG THE LINES OF THE EUROPEAN UNION.



To gain access to markets in the post-Soviet space, new investors no longer need to negotiate with each country. Over the past two years, the Eurasian Economic Union has created mechanisms to allow economic cooperation between Russia, Belarus, Kazakhstan, Kyrgyzstan and Armenia, and it may expand further.

The EAEU is the latest alliance to emerge from the Soviet Union, but it may have more staying power. The Commonwealth of Independent States, which was created in 1991 immediately after the Soviet collapse, has few supranational powers. The EAEU, however, is aiming to be a platform for the integration of its member economies into the global system.

“The EAEU is needed to preserve and strengthen economic ties between the countries that were once part of a single state – the USSR – and substantially drifted apart after its collapse, in the economic sense,” said Yevgeny Gushchin, a researcher from the International Laboratory of International Economic Research of the Institute of Applied Economic Research at the Presidential Academy of National Economy and Public Administration.

According to Gushchin, there are three main reasons the EAEU is already effective. First, it is still much easier for countries that once were part of one state to integrate than for the coun-

### THE KEY AREAS OF THE INTEGRATION WORK IN THE UNION'S COUNTRIES WERE CUSTOMS, TRADE AND TECHNICAL REGULATION.

tries without a shared historical and cultural experience. Secondly, the members of the EAEU have the political will to work together to develop the strategic direction of economic integration in Eurasia. Thirdly, the main management body – the Eurasian Economic Commission – is a highly professional group that promotes dialogue and the resolution of conflicts between the EAEU member countries.

#### WORK PRINCIPLES

“As a supranational union, the EAEU implies a much deeper integration of the member countries in comparison with the CIS. [This level of integration] is commensurable with the depth of the EU,” said Timur Nigmatullin, an analyst at Finam investment company.

In particular, the EAEU allows member countries to dramatically reduce all sorts of trade and non-trade restrictions to facilitate the movement of capital and labor resources, Nigmatullin said.

Sergei Khestanov, macroeconomic adviser to the head of the Otkrytie Brokerage, agrees with this assessment: “The EAEU has largely formed a common market for the countries belonging to it,” Khestanov said. According to him, the main role of the organization is to remove barriers to trade, and it works for the most part of product groups.

In the first stage, the key areas of the integration work of the Union's countries were customs cooperation, trade and technical regulation. The main task of the Union's members was to develop a common legal framework in the key areas of work and to create conditions for the beginning of the harmonization of national legislations. In 2010, the Customs Code entered into force, and a unified system of regulation in this area started to operate in three countries – Russia, Belarus and Kazakhstan. The regulations on customs administration were adopted, including common rules for the declaration of goods, customs payments and common customs regimes. These common regulations seriously reduced the number of documents required for registration of customs declarations, and customs control was removed on the borders of countries participating in the treaty. In 2015, Armenia and Kyrgyzstan joined the organization.

In January 2012, 17 basic international agreements forming the Common Economic Space



were adopted and the next month, a single management body for the union was established – the Eurasian Economic Commission. The formation of the Common Economic Space was meant to ensure the “four freedoms”: movement of goods, services, capital and labor.

Work on deepening integration between the participants of the Eurasian economic project, which was undertaken during the Common Economic Space stage, allowed the states to create conditions for the establishment of the Eurasian Economic Union, which began operations on Jan. 1, 2015. Among other things, the new treaty defined the legal basis of a single services market and common principles for technical regulation. These included mandatory requirements for products and related processes – from design and manufacture to disposal. Today the common services market includes 43 sectors of economy, around half of all the services available in the EAEU.

By November 2016, the list of the technical regulations adopted by the Eurasian Economic Union should include 39 documents, 34 of which

have already come into force. “The EAEU managed to create conditions for strengthening and development of trade and economic cooperation between the member countries,” said Yevgeny Gushchin. According to him, this can be seen by looking at Russian foreign trade statistics in 2015 – in the context of a general drop in exports and imports, foreign trade decreased less with the EAEU partners than with the other countries of the world.

**A SECOND EUROPEAN UNION?**

In terms of its content and degree of integration, the Eurasian Economic Union has become a second example of a global economic union, after the European Union. Experts note, however, that it is important to consider the age of the EAEU when making comparisons with the European Union.

“The EU has a very long history of integration, which originates from the European Coal and Steel Community, formed after World War II,” Gushchin said. “The EAEU countries still lack that depth of integration achieved in the united Europe.”

Alexander Yegorov, a senior analyst with the TeleTrade group of companies, agrees: “In general, the process of implementing such a large transnational project as the EAEU cannot be called unambiguously successful or vice versa. During the initial integration of the participating countries, economic and political interests affecting the spheres of influence of national elites were intertwined.”

Experts also agree that compared to the CIS, the Eurasian Economic Union is a much more viable organization, since the association is founded on the economic interests of the participants.

“In contrast to the CIS, the EAEU is, first and foremost, not a political, but an economic union,” Georgy Vashchenko, head of Russian stock market operations at the Freedom Finance investment company, said. “Without tight integration with other economic blocs, the EAEU will develop quite slowly, because the economy of other countries is very small in comparison with Russia (less than 10 percent in terms of GDP).”

Nevertheless, the organization has established its viability and potential for growth. About 40 different states have expressed interest in working with the EAEU. In October 2016, negotiations began on trade-economical cooperation between the EAEU and China, which could lead to further Eurasian integration.



INTERVIEW | VERONIKA  
NIKISHINA“BETTER TO STOP USING DEFENSIVE  
TACTICS”Alexey Sergeyev, *RBTH*

*EAEU Trade Minister Veronika Nikishina spoke with Doing Business With Russia about the benefits of the Eurasian Economic Union and its plans for the future.*

**DBWR:** What were the main reasons for establishing the EAEU? How strong is the integration between the association's members?

**VERONIKA NIKISHINA:** The creation of the EAEU is the third phase of the process of strengthening integration, after the Customs Union and the Single Economic Space. In general, this is a translational integration — a change to a single market of goods, services and capital. One of the main reasons for establishing the Union, which is fixed in the EAEU agreement, is the need to guarantee economic progress through mutual actions directed at meeting the challenges facing the EAEU countries concerning stable economic development, comprehensive modernization and strengthening competitiveness of the national economies within the global economy. In the process of forming the customs, and then the economic, union, we did serious work to clearly determine the integration's legal foundations. In general, we can say that the current level of integration is not the Union's final destination of development. We are forming and realizing programs for removing

the existing restrictions in the EAEU internal market — in particular, for separate types of services such as in the sphere of pipeline transportation or finance. But we can already see that integration among the EAEU countries is very profound and that this was accomplished in a limited amount of time.

**DBWR:** What are the advantages that a foreign investor receives from working with a single institution such as EAEU rather than the individual countries constituting it?

**V.N.:** Issues related to investment conditions with the EAEU are still part of the national competencies of the Union's countries. However, the projects that are of interest for two or more member countries are obviously discussed at an EAEU level. This subject matter is becoming more and more important in light of the expansion of the scale of cooperation, which in the current reality concerns not only various regions but also entire continents. Thus, with this principle in mind, we are developing our work within the framework of uniting the EAEU and the Silk Road Economic

ALEXANDER KABANOV



Belt. In our work, we strive to reach an optimal level of liberalization of foreign trade that does not limit the advantages of investing in EAEU countries and creates additional premises for it. The issue of strengthening investment, as well as technological, cooperation with our external partners is a big part of the EAEU'S current agenda.

**DBWR:** Can a foreign producer use the advantages of the single customs regime on EAEU territory?

**V.N.:** Of course. The functioning of a single market with more than 180 million people is one of the key factors that attract foreign producers. [It operates] on two levels at the same time. First, having gone through all the necessary procedures for distributing the goods on the market of one country, the markets of four other countries automatically open up for the producer. This helps producers examine possible regions where products can be marketed with more foresight and without additional expenses for customs procedures and certification. Secondly, various producers combine the export of goods with the localization of production. Vivid examples of this are the car and electronics industries. It is important to stress that in such a scenario, and with a sufficient level of localization in



PRESSPHOTO

The producers combine the export of goods with the localization of production in the EAEU.



one EAEU country, there is the possibility to view such production as “a point of entrance” not only into the single EAEU market but also the markets of the other countries. For example, producers can use preferential conditions within the CIS free trade zone agreement or optimize the supply logistics, and sometimes even receive both of these advantages simultaneously.

**DBWR:** With whom have free trade zone agreements been already made?

**V.N.:** The first and for now only partner with which the EAEU has made a free trade agreement is Vietnam. The agreement went into effect recently – Oct. 5, 2016. Obviously it is too early to made conclusions, but we expect that in the not distant future, the agreement will help us substantially increase, if not even double, mutual turnover to \$8-10 billion annually. It is pleasant to note that representatives of the real sectors of the EAEU countries’ economies are very interested in this agreement. This can be observed by the attention with which the agreement’s entry into force date was followed, by the amount of offers that the Commission representatives received to explain the agreement’s substance and the practical aspects related to using the advantages that it provides. On our part, we

have prepared a series of informational material that is available on the Commission’s site in the Trade section. We also held the first EAEU-Vietnam business forum in Hanoi.

**DBWR:** With whom does the EAEU plan to sign such an agreement in the near future?

**V.N.:** In relation to the current agenda on free trade, it should be divided into three parts. The first part concerns the countries with

## **WE PLAN TO ASK THE PRESIDENTS OF THE EAEU COUNTRIES TO DECIDE WHETHER OR NOT TO START NEGOTIATIONS ON SIGNING FREE TRADE AGREEMENTS WITH EGYPT, INDIA, IRAN AND SOUTH KOREA.**

which negotiations have already begun: Israel and Serbia. At the same time these negotiations are very different. While Belarus, Kazakhstan and Russia already have bilateral agreements on free trade with Serbia and the process of creating a single preferential trade regime between Serbia and the EAEU has basically already begun. [However,] we along

with our partners have to write the agreement with Israel from scratch. Moreover, by the end of this year, we plan to ask the presidents of the EAEU countries and members of the Higher Eurasian Economic Council to decide whether or not to start negotiations on signing free trade agreements with another series of countries: Egypt, India, Iran and South Korea. This year we also plan to begin cooperation with Singapore on the study of the future expediency of signing a free trade agreement. In the near future, we will undertake extensive and time-consuming work to construct an effective network of preferential trade agreements between the EAEU and countries that differ in the structure of their economies and their geographical positions.

**DBWR:** Why is it necessary to sign such agreements with new countries? What does this offer Russian companies and their foreign partners?

**V.N.:** We see this work as the most effective instrument for supporting export-oriented producers and the unification of the EAEU countries’ efforts to enter and strengthen their positions on foreign markets. Currently, goods from the EAEU countries often lose in price competitions on foreign markets, however, the competitive advantage of goods from third-party countries is often based on the fact that when they are exported, their producers do not have to pay customs duties since a free trade regime already exists between the target market countries and the third-party countries. We expect that the formation of free trade zones will solve this problem. At the same time, we obviously take into consideration the fact that various sectors of Russia’s production are still not ready for competition with imported goods within the free trade regime. Here it is important to note that contemporary free trade agreements provide a solid selection of instruments to protect them – from the full exclusion of separate goods from the agreements’ scope to the possibilities of using the protective measures in the event imported goods increase as a result of the removal of the tariffs and damage certain sectors. We expect the EAEU countries’ producers to participate in the formation of positions during the negotiations.



50%

The share of drugs produced in Russia for domestic use by 2020 (projected).

\$340

MLN

Total export of drugs produced in Russia in 2015.

45%

Growth in export of drugs produced in Russia in 2015.

Kira Egorova, RBTH

## PHARMA | PFIZER GOES LOCAL

THE AMERICAN PHARMACEUTICAL CORPORATION IS BUILDING A NEW FACILITY SOUTH OF MOSCOW TO CAPITALIZE ON SUPPORT FROM GOVERNMENT INITIATIVES

### TOP-20 drug producers by volume of drugstore sales in the Russian market in 2015

| Ranking 2015 | Producer             | Sales, mln \$, 2015 | Share % |
|--------------|----------------------|---------------------|---------|
| 1            | Sanofi               | 433                 | 5,0     |
| 2            | Bayer                | 409                 | 4,7     |
| 3            | Novartis             | 400                 | 4,6     |
| 4            | Servier              | 301                 | 3,5     |
| 5            | Glaxosmithkline      | 280                 | 3,2     |
| 6            | Tekeda               | 276                 | 3,2     |
| 7            | Teva                 | 261                 | 3,0     |
| 8            | Berlin-Chemie        | 247                 | 2,8     |
| 9            | Отисифарм            | 241                 | 2,8     |
| 10           | Gedeon Richter       | 223                 | 2,6     |
| 11           | Stada                | 214                 | 2,5     |
| 12           | Abbott               | 209                 | 2,4     |
| 13           | Pfizer               | 187                 | 2,1     |
| 14           | Johnson & Johnson    | 186                 | 2,1     |
| 15           | KRKA                 | 179                 | 2,1     |
| 16           | Astellas             | 162                 | 1,9     |
| 17           | Actavis              | 159                 | 1,8     |
| 18           | Фармстандарт         | 155                 | 1,8     |
| 19           | Valeant              | 140                 | 1,6     |
| 20           | Boehringer Ingelheim | 134                 | 1,5     |

Source: DSM Group

ALYONA BERKINA (2)

In July 2016, the U.S. pharmaceutical giant Pfizer became the first foreign company in its sector to localize its business in Russia with a Russian partner. Pfizer and the Russian-American company NovaMedica, whose shareholders include the Russian state-owned company Rusnano, decided to jointly invest in the construction of a plant in the Kaluga Region, 125 miles southwest of Moscow.

By constructing a production facility in Russia, Pfizer is eligible to take advantage of Pharma 2020, a large-scale Russian government program offering subsidies to local manufacturers that produce medicines from the essential drugs list (EDL). All state hospitals and clinics are required to look to the EDL first for medicines for their patients. In addition to supporting local producers, the state program aims to increase the share of Russian drugs to 50 percent of the domestic market by 2020. During the first year that Pharma 2020 was in effect, the share of locally produced drugs in the domestic market doubled in value terms from 13 percent to 26 percent, according to the DSM Group marketing agency.

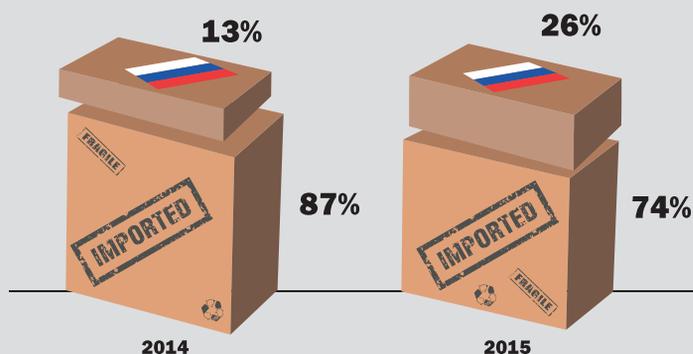
#### HIGH-TECH PRODUCTION

According to Pfizer's press service, the portfolio of high-tech medicinal products planned for the new plant in the Kaluga Region includes essential drugs for the treatment of severe bacterial and fungal infections, inflammatory diseases, cancer and for use in anesthesiology – more than 30 INNs (international nonproprietary names for active pharmaceutical ingredients).

“Most of these INNs that are to be produced in Kaluga are on the EDL and several are also in the federal reimbursement programs Population Drug Coverage [ONLS] and one called 7 Nosologies [7N],” said a representative of Pfizer's press service. “Based on our estimates, these med-

### Sales volumes of foreign and domestic drugs in Russia

\*Volume-based pricing



Source: DSM Group

AP



The shareholders of Pfizer's partner Novamedica include state-owner Rusnano, headed by former Deputy Prime Minister Anatoly Chubais (center).

icines are in high demand on the Russian market. Following the priorities denoted by the Ministry of Health and the Ministry of Industry and Trade of the Russian Federation, Pfizer strives to provide a maximum amount of Russian patients with access to Pfizer medicines.”

Pfizer will provide NovaMedica with technology licenses for the production of more than 30 drugs. The construction of the plant will begin this year and its launch is scheduled for 2020.

“We do not disclose the size of Pfizer’s investment, but we can say that this is a significant amount,” said Alexander Kuzin, the managing director of NovaMedica. “The remaining funds will be invested in the construction of the plant by NovaMedica’s shareholders.”

In an interview earlier this year with the Russian business daily *Vedomosti*, Leonid Melamed, a member of NovaMedica’s board of directors, estimated the cost of the project at \$60–100 million.

Kuzin says that the joint Pfizer–NovaMedica project is taking a different approach to production than is typical in Russia.

“In Russia, new pharmaceutical facilities are often built without focusing on specific drugs,” Kuzin said. “We sought to form the portfolio first and then build the plant, taking into account the specifics of the portfolio of the products that will be produced there.”

Kuzin said he considers this to be a cost-effective method of development, providing a strong foundation for the commercial success of the project.

The Pfizer–NovaMedica project also has a different concept for localization than past joint ventures. International pharmaceutical companies used to practice one of two localization strat-

**“WE DO NOT DISCLOSE THE SIZE OF PFIZER’S INVESTMENT, BUT WE CAN SAY THAT THIS IS A SIGNIFICANT AMOUNT.”**

egies in Russia: they either built their own production facilities or bought an existing one. Instances of this latter example include U.S. company Abbott’s purchase of Russia’s Veropharm in 2014, France’s Sanofi acquisition of a local plant in 2009 and Germany’s Stada ownership of the Russian plant Nizhpharm since 2005.

#### MARKET DYNAMICS

Over the past six years, the Russian pharmaceutical market has become very popular among investors. It has also shown resilience to the country’s crisis, the devaluation of the ruble and the reduced purchasing power of Russians.

“Indeed, since 2010 investors have invested more than \$2 billion in the Russian pharmaceutical industry and, perhaps this figure will double by the end of the next decade,” said Vasily Ignatiev, the CEO of the R–Pharm group of companies.

According to the Federal State Statistics Service Rosstat, the volume of production of medicines increased by nearly 27 percent in 2015 compared to 2014, totaling 231 billion rubles (\$3.6 billion).

“There are positive dynamics in national pharmaceutical manufacturing,” Ignatiev said.

Growth in the sector along with the ruble devaluation has encouraged international players to invest in large-scale projects in the region.

“In Russia, several key production centers have appeared,” said Ignatiev. “These are pharmaceutical clusters in the Yaroslavl and Kaluga regions – not far from Moscow. The historically developed industrial base in the Moscow Region continues to evolve.”

Given the growth in the domestic market, the Russian government, led by Prime Minister Dmitry Medvedev, has become interested in the possibility of exporting Russian medicines. At the end of July, Medvedev instructed the Ministry of Trade and Industry to study the issue of funding clinical trials abroad on a returnable basis. A report is expected in September.

Exports are already the fastest growing segment of the Russian pharmaceutical market. In 2015, total exports amounted to \$340 million, which is 45 percent more than in 2014 according to data from the analytical firm RNC Pharma.

NovaMedica and Pfizer did not confirm the possibility of exporting pharmaceuticals from their new plant. However, NovaMedica stressed that the plant will be built in compliance with international GMP (Good Manufacturing Practice) and FDA (U.S. Food and Drug Administration) standards, leaving the option open.

“The plant will have the opportunity to expand as new products appear in NovaMedica’s portfolio for localization,” Kuzin said.

Victor Dmitriev, the CEO of the Association of Russian Pharmaceutical Manufacturers, acknowledged that the possibility for export exists.

“It would be logical for Pfizer and NovaMedica to offer part of the Kaluga plant’s products for export,” he said, noting that the international players working in Russia have long been looking to export their products. Sanofi has already announced its plans to export insulin to Europe, while Germany’s Stada is already sending a number of drugs it produces in Russia to Germany.

Another U.S. company – Abbott, which produces high-quality affordable medicines for cancer and chronic diseases at its Veropharm plant in Russia – is also considering the possibility of export.

“Our program aims at transforming Veropharm into a world-class manufacturer that could at some point export to other countries” besides former Soviet ones, said Irina Gushchina, the public affairs director of Abbott Russia.



Kira Egorova, *RBTH*

## COSMETICS | RUSSIAN COUPLE'S FIRM MAKING THE WORLD A LITTLE CLEANER AND GREENER

Elena Demina, Co-founder

**SPLAT CARVES OUT A NICHE FOR ITS UNIQUE, HIGH-QUALITY TOOTHPASTES AND CLEANING PRODUCTS**

Evgeny Demin, CEO



**E**vgeny Demin and Elena Demina moved from the Krasnodar Territory in southern Russia to Moscow with a small idea and big ambitions. In 2000, when they were not yet 25 years old, they founded SPLAT, a company that today supplies personal care and household chemical products to 50 countries around the world.

"In the beginning, the company specialized in the production of biologically active additives and cosmetics based on *Spirulina platensis* seaweed — thus the company name," explains Evgeny Demin.

They quickly decided to target their efforts in another direction: on the production of next-generation toothpaste.

"From the very start, we agreed to create the best toothpaste in the world, so that it would surpass all expectations," he said.

The couple first rented a factory for their operations near Moscow and in 2009 they opened their own plant 300 miles northwest of the Russian capital in the Novgorod Region. Today it employs more than 350 people. A total of 1400 people work for the company, including in sales and marketing offices abroad.

### THE RIGHT SEGMENT

From the very beginning SPLAT toothpaste was priced about twice that of its supermarket rivals. Some of its exclusive offerings include black toothpaste made from Karelian coal and golden toothpaste featuring extracts of diamond and colloidal gold.

Entering the premium segment, where there were practically no competitors, was one of the factors of the brand's success, says Alexander Yeremenko, managing director of the Brand-Lab marketing agency. According to Yeremenko when SPLAT debuted, two major international players, Procter&Gamble and Colgate, had claimed the middle segment of the Russian market, while the lower end was dominated by Russian producers selling very cheap toothpaste.



By 2015 foreign sales made up 17 percent of Russian company's revenue.

"In the high-price segment, there were no important players," Yeremenko said.

In 2008 the company began exporting its products and by 2015 foreign sales made up 17 percent of its revenue. One of its most successful foreign markets is Turkey, where SPLAT was able to sign an exclusive contract with one of the country's leading perfume and cosmetics chains.

The company has opened a subsidiary and hired a local team in China and is now looking forward to working with Chinese partners, according to the press service. The company's premium products are particularly popular in Germany and SPLAT has also started to sell its products in France. The company currently owns more than 10 Russian and foreign patents.

### A PERSONAL APPROACH TO CUSTOMER LOYALTY

The company has not divulged any financial indicators, but SPLAT holds 17 percent of the Russian market, says Timur Nigmatullin, an analyst at Finam Holding.

Nigmatullin attributes SPLAT's success in part to its unusual marketing strategy. The company does not employ TV advertising on principle and focuses its energies on repeat sales to loyal customers. Each SPLAT toothpaste pack-

age contains a letter from Evgeny Demin himself, the firm's general director. At the end of each letter, he provides his personal email address noting that he responds to all messages himself.

Yeremenko believes that SPLAT's marketing efforts were appropriate for a product in the high-end segment of the market where consumers value innovation and are ready to pay for it.

Today SPLAT has diversified and it produces more than 200 different products from its 50,000 sq. ft. plant in the Novgorod Region. The company's offerings include toothpastes, brushes, foams and mouthwashes, the BioMio housekeeping products, the LALLUM Baby organic cosmetics for children and mothers and the HEYA series of natural shampoos and conditioners.

HEYA is one of SPLAT's latest developments, made exclusively from natural ingredients without silicon or parabens.

The company spent 5 years developing the HEYA series components, but Yelena Demina says she is very happy with the result.

"We do not compete with other hair care producers because, all modesty aside, we believe that our products are unique and unrepeatable," she said.

Kira Egorova, *RBTH*

## STARTUPS | SUPERFOOD FARM LAUNCHES A KALE REVOLUTION

THE AMERICAN-RUSSIAN JOINT VENTURE HOPES TO CAPITALIZE ON THE GROWING INTEREST IN HEALTHY LIVING WITH RARE ORGANIC VEGETABLES FROM THE MOSCOW REGION.



Daniel Lawrence and Olga Korogodina launched their business growing unusual vegetables in 2014.

APART FROM TWO VARIETIES OF KALE, CURLY AND TUSCAN BLACK, SUPERFOOD FARM GROWS 30 VARIETIES OF TOMATOES, PEPPERS, LETTUCES, EGGPLANT AND HERBS.

**K**ale, the leafy green superfood that has taken over salads from Los Angeles to London, is making inroads into the Russian diet thanks in part to Daniel Lawrence and Olga Korogodina.

The pair founded Superfood Farm in 2014 and today supply kale and other niche vegetables to a number of Moscow restaurants and retail chains, including the upscale Azbuka Vkusa supermarket and the farmers' cooperative Lavka-Lavka. The U.S. Embassy in Moscow is also a client.

Lawrence did not set out to become a farming pioneer in Russia. An American investment banker specializing in financial markets, Lawrence came to Russia in 2010 intending to stay no longer than six months.

However, he found life in Moscow "thrilling" and decided to explore long-term opportunities in Russia, supporting himself through business consulting and teaching English.

During a trip home to the U.S. in 2013, Lawrence came up with the idea of growing kale in Russia. The vegetable's popularity had exploded in the U.S. and Europe, but was virtually unknown in Russia.

"When I googled kale in Russian just a dozen links came up and that included forums," Lawrence said.

He decided to plant an experimental plot at his friend's dacha to see how the vegetable would grow in the Russian climate.

About this time, Korogodina, who worked in real estate, decided to brush up on her English and started taking lessons with Lawrence.

In addition to the language lessons, she began helping him find commercial real estate for another one of his projects, but she found the idea of introducing kale to Russia an exciting possibility.

### LOCATION, LOCATION, LOCATION

Korogodina and Lawrence decided to launch a farming business together and in 2014 they began looking for a plot of land in the Moscow Region for their first large-scale planting.

"It was essential for us to find land with greenhouses already on it," Korogodina said, "However, finding anything from ads was virtually impossible, so we just opened Google Maps in landscape mode and searched for greenhouses."

Eventually Korogodina and Lawrence found a two-hectare plot of land in the Dmitrovsky district of the Moscow Region.

"It was an abandoned farm with half-ruined metal rigging for greenhouses erected back in Soviet times," Lawrence said. "But it had two advantages: good soil - black peat - and a good location just an hour's drive from Moscow."

To prepare the land, the budding farmers had to remove piles of industrial plastic and bits of concrete that had been buried there by the previous owners.

#### A TOUGH MARKET

By opening their farm, Korogodina and Lawrence joined a fairly exclusive club. According to Ivan Rubanov, head of analysis at the State Duma's Agriculture Committee, official statistics show that there are about 250,000 private farms in Russia.

However, private farms account for only about 10 percent of Russia's agricultural production and there is little growth in the industry.

"The number of new farms is not that big," Rubanov said. "The segment is developing mainly through the expansion of existing successful farms, most of which were set up in the 1990s and have already grown into big businesses."

Lawrence says that part of the problem is that the profit margins for individual farmers in Russia are very small.

"If you walk into any Russian supermarket, you will see only three or four varieties of tomatoes or cucumbers," he said. "There is a reason for that and the reason is that agricultural companies pick these varieties because they offer the lowest risk of disease or insects and the highest and fastest return with the producer."

Rubanov noted that prices on the vegetable market are set by large retail chains and processing plants, which often enjoy a local monopoly that in turn drives profit margins down.

"As a rule, farmers are subordinated to them because farmers are numerous, whereas distributors and processing plants are distinctly less so," he said.

Korogodina said that offering a unique product gives Superfood Farm the opportunity to charge more for their vegetables.

"When everybody is growing and selling the same thing, it is difficult to explain to people that your products are the best and get them to understand why they have to pay more," Korogodina said.

"To be the best for us means offering unique varieties, vegetables that you don't usually see. That is why we decided to grow such rare vegetables as Italian varieties of tomatoes or the world's hottest chili pepper habanero. Nobody else grows them in Russia."

Korogodina and Lawrence invested \$100,000 in Superfood Farm, mostly from Lawrence's

savings. Income earned from their regular jobs in Moscow also went into the farm.

"In the end we had to buy a bytovka [Ed: a small cabin temporarily installed at construction sites] and set it up at the farm," Korogodina said. "We would work in it in the evenings and then sleep there before going to Moscow in the morning."

"That lasted for two years," Lawrence added. "Had somebody told me earlier that one can work so hard, I would not have believed him."

#### ON A MISSION

Superfood Farm is an organic operation because Korogodina and Lawrence believe that the best quality and best tasting vegetables can be produced only by using organic farming methods.

"In the U.S. everybody knows what 'organic' means," Lawrence said.

"There are dedicated shops selling organic products and people choose for themselves whether to buy organic and pay slightly more or opt for regular shops with more affordable prices."

In Russia, the trend of buying organic began only in the late 2000s and today farms with organic certificates account for only 0.1 percent of all farms in Russia, according to the International Foundation for Organic Agriculture (IFOAM).

Rubanov says that the main stumbling block for the development of organic farms in Russia is the lack of national standards and independent certifying bodies.

Andrei Khodus, the founder of the national certifying organization Eco-Control, seconded Rubanov's assessment.

"At the moment, the title of an organic farm in Russia can be officially obtained as part of the existing voluntary certification systems, for instance that of the environmentally-friendly and biodynamic agriculture called BIO," Khodus said, adding that in order to add eco-, bio- or organic to the name of a farm, its operations first need to be examined by bio-certifiers.

Organic farmers agree that the lack of clear rules for certifying produce as organic is a major obstacle.

"There are many unscrupulous producers in Russia who label their products as eco-, bio- and organic, but in fact they are nothing of the sort," said Roman Gurov, executive director of the Organic Farming Union.

To address this problem, the state should get involved to support organic farmers and to stipulate clear rules set in laws, he adds.

High labor costs and smaller harvests also pose major challenges for organic farmers. The small scale of the farms makes organic produce from 30 to 200 percent more expensive to grow than non-organic produce, Rubanov said.

Lawrence is convinced the interest in organic food will continue to grow.

"We are at the very start of this trend and our task is to promote it, to make it really fashionable," he said.

"We even have a section on our website called 'Summer/Autumn Harvest 2016,' similar to what fashion houses have with their seasonal collections," adds Korogodina.

"We want to stress that organic means modern. We want to be trendsetters for other organic farmers in Russia."

"Modern" is also a word that could be used to describe their marketing philosophy—Korogodina and Lawrence are turning online to get the word out about their produce and their brand.

"Most farmers in Russia simply do not use such instruments as websites or social networks," Korogodina said.

In addition to the website Superfoodfarm.ru, the company has Facebook and Instagram accounts.

Today, in addition to Korogodina and Lawrence, the farm employs 10 people.

Apart from two varieties of kale (curly and Tuscan black), Superfood Farm grows 30 varieties of tomatoes, peppers, lettuces, eggplant and herbs. They harvest produce nine months a year.

Currently, all proceeds are being invested back into the business. Korogodina and Lawrence expect to start turning a profit in 2-3 years.

While Korogodina and Lawrence are in it for the long haul, they admit that the work is far from easy.

"If we knew it was this complicated I don't think we would have started this," Lawrence said.

"Sometimes," Korogodina adds, "it is easier to start a business when you have zero understanding of all the problems."

But they love the challenge of building the farm and look forward to seeing what the future will bring.

Kira Egorova, *RBTH*

## AGRICULTURE | RUSSIAN AGRIBUSINESS SETS ITS SIGHTS ON EXPORTS

**THE VOLUME OF NON-SEASONAL VEGETABLE PRODUCTION HAS INCREASED DRAMATICALLY IN THE LAST THREE YEARS, BUT THE DOMESTIC MARKET IS LIMITED.**



Agribusiness investors hope the greenhouses will produce enough vegetables to allow for export.

**T**he increased demand for vegetables year-round, partly as a result of Russia's ban on food imports, has led to a boom in the construction of winter greenhouses.

Major Russian agroholding companies hope to produce enough food to meet domestic demand and even expand for export.

Thanks to unprecedented state support for agricultural projects and the ban on imports of fresh food from abroad, year-round greenhouses have become one of the fastest growing and most profitable investment opportunities in Russia's agricultural sector.

The volume of non-seasonal vegetable production has increased by 18 percent in the last three years according to the Russian Ministry of Agriculture.

The ministry has promised that 1,500 greenhouses will be built in Russia by 2020, which should almost cover the nation's entire demand for vegetables during the colder months.

Investors in the sector hope the greenhouses will produce more than enough to cover domestic demand, however – they are hoping Russia can become an exporter of fresh vegetables.

### LOOKING TO THE FUTURE

"In our long-term planning, we are developing a product strategy that can suit the fast-

changing vegetable market in Russia and its neighbors," said Alexei Skvortsov, general director of the vegetable division at Russian agricultural major Rusagro Holdings.

In 2015, Rusagro, which belongs to billionaire Vadim Moshkovich, announced plans to invest in non-seasonal vegetables. The company intends to build more than 90 hectares of greenhouses in the Tambov Region.

Sergei Adoniev, one of the creators of Russia's Yota mobile provider, moved into the greenhouse market in 2013 with the launch of the company Technologies for Greenhouse Growth (TGG). It has already built greenhouse complexes around Moscow and the Tyumen Region and is currently involved in building another facility.

Ilya Gamov, TGG's sales director, said that his company is planning to export its vegetables to the Chinese market.

This year the Russian-Japanese company JGC Evergreen, which owns greenhouses near Khabarovsk in Russia's Far East, sold its first harvest on the domestic market and announced plans to export to China. Japanese companies are actively developing the greenhouse business in Russia's Far East as part of the state Territories of Priority Development program, which gives tax incentives to businesses in certain regions of the country. Another Japanese company, Sayuri, has invested \$21 million this year in

the construction of a year-round complex near Yakutsk.

Planning for export is a good business strategy according to experts. "Greenhouse holdings are forming export strategies for various reasons.

## THE GOVERNMENT IS NOT ONLY SUBSIDIZING CHEAP LOANS FOR ENTREPRENEURS, BUT ALSO COMPENSATING FOR PARTIAL LOSSES

The volume of the domestic market is limited and it is always necessary to understand the prospects of export," said Mikhail Borisov, a portfolio manager at Leon Family Office Investments.

Skovortsov also noted the role of uncertainty in driving the market.

"A lot depends on foreign policy, the stagnation of the vegetable market, the offset price segment and consumer consumption priorities," he said.

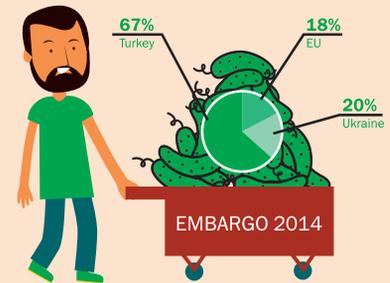
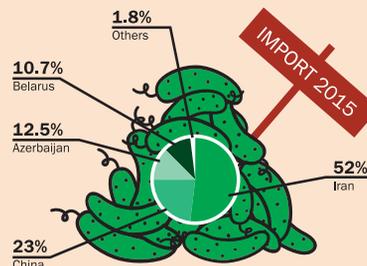
Oleg Remyga, the director of the China Laboratory at the Skolkovo Research Institute for Developing Markets, thinks there is a chance for Russian vegetables to capture the Chinese market for eco-produce.



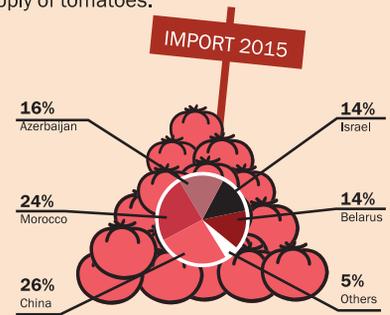
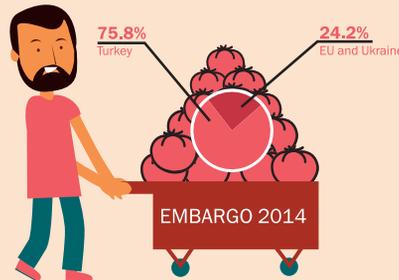
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## Russian imports of vegetables drop after implementation of embargo in August 2014

Due to the embargo, there was a **44%** deficit in supply of cucumbers.



Due to the embargo, there was a **58%** deficit in the supply of tomatoes.



Source: Technologies for Greenhouse Growth

ALYONA REPKINA

“The Chinese perceive Russian food, just like any foreign food, as ecologically clean products,” Remyga said. Russian producers must realize, however, that they will face high price competition from local producers and even the devaluation of the ruble will not help them, he noted.

Ivan Rubanov, head of the Agricultural Committee of the Russian State Duma, agrees with Remyga on one point.

“In Russia on average 30–40 kilograms of fertilizer is used for a hectare of land, while in China the amount is twice as large,” Rubanov said. “It is not surprising then that in China our production is indeed considered more natural.”

However, Rubanov is skeptical about the idea of exporting vegetables to China.

“There is a deficit in the Russian domestic vegetable market,” he said. “We import greenhouse products in large quantities from Turkey and Israel. In such conditions it is unclear what exactly companies will export to China, as the south [of the country] is located in a tropical zone.”

He added that the great distance and the enormous time required for delivery could become a big impediment, having an effect on the vegetable’s quality and price.

### STATE SUPPORT

Borisov pointed out another important reason to target the export market – a project with ex-

port potential could receive state support more easily than one without it, and today the Russian government is providing unprecedented support for the greenhouse business. The government is not only subsidizing cheap loans for entrepreneurs, but also compensating for partial losses resulting from the construction and modernization of greenhouses and surrounding property. In 2015, the Ministry of Agriculture allotted one billion rubles (\$15.6 million) towards the compensation of capital losses in the greenhouse business and in 2016 it promises to allot three billion rubles (\$47 million).

“The government provides about 20 percent of the capital investments for the construction of greenhouses,” said Yakov Lubovedsky, a project director at the Russian Fruit and Vegetable Union. Rosselkhozbank, which carries out the state program of covering capital expenses for investment in agriculture, has recorded a substantial growth in credit allotted towards the construction, modernization and reconstruction of necessary agricultural infrastructure.

“In the first half of 2016, the volume of such a loan was about 19.2 billion rubles (\$298 million), while in the same period a year earlier, the figure was 15.2 billion rubles (\$236 million),” said the bank’s press secretary.

At the end of 2015 and during the first half of 2016, the number of applications seeking financ-

ing for greenhouse construction projects aimed at year-round production of vegetables increased significantly, the bank confirmed.

Rubanov says that the big players are benefiting the most from government programs and they are squeezing out small agriculture companies.

“In the agrarian business, it is the big enterprises that dominate, those that actively use their administrative resources and obtain the best land. And private farmers are left with nothing,” said Rubanov. “About half of all state aid is destined for subsidizing the key rate, which is why banks, primarily Rosselkhozbank and Sberbank, actively work with agriculture companies, but mainly with large companies. This is easier than dealing with thousands of projects proposed by small farmers.”

The expanding possibilities offered by the industry have attracted a number of wealthy investors. In addition to Moshkovich of Rusagro and TGG’s Adoniev, Sergei Galitsky, owner of Russia’s largest retail network Magnit, and Alexander Varsahvsky, who owns car dealerships, have recently invested in greenhouses. In January 2016, Vladimir Yevtushenkov’s financial-industrial group Sistema bought the Yuzhny greenhouse complex, one of the largest in the country. To top off the list, oligarch Roman Abramovich’s son Arkady is also looking for a suitable site for a greenhouse project.

## OPINION | OLEG REMYGA



Project director at the Skolkovo Institute for Emerging Market Studies

## WILL RUSSIA BE ABLE TO FEED CHINA?

Economists like to note that the Russian Empire was a leading agricultural power in the early 20th century. The country was the world's number one grain exporter and held leading positions in the production and export of meat products and butter. In the mid-1980s, the Soviet Union was also a world leader in the production of wheat, rye, sugar beets, potatoes, milk and livestock.

However, during the transition from a command economy to a market economy Russia lost much of its agricultural capability. Additionally, in the 1990s, the government focused its domestic economic development on other sectors. As a result of these challenges, in 2010 the contribution of agriculture to Russia's GDP was just 4.8 percent. At the same time, competitors in both the West and the East ramped up production. In 2012, the country ranked only fifth in the world in terms of the amount of wheat produced, with a gross figure of 16.1 million tons.

However, after Russia imposed its ban on the import of foreign food products in retaliation for sanctions against its financial sector and created the policy of import substitution, the development of agriculture in the country exploded. At the same time, Russian agricultural products became more competitive in terms of price due to the sharp devaluation of the ruble.

China has the world's largest agricultural market. In 2015, the country's population consumed 120 million tons of wheat (almost as much as the European Union), 150 million tons of rice (a third of global consumption) and 57 million tons of pork (first in the world). Additionally, as the Chinese population grows, the area of arable land shrinks, while, according to unofficial data, the level of urbanization has reached 55 percent. Incomes are also increasing in China. Average wages in China are already higher than in Russia and a middle class that demands higher-quality foods is forming in the country.

The institutional framework for cooperation in this sector is already being developed. For example, the recently established Russian-Chinese Agricultural Development Fund is aimed, among other things, at the development of agriculture infrastructure projects in the Russian Far East, including the Amur Region, the Jewish Autonomous Region and the Primorye Territory. The Fund's investment in such projects could total 200 billion rubles (\$3 billion).

However, there are still some hurdles that must be overcome. Chinese regulators are traditionally very cautious about allowing foreign businesses access to their market. For example, the negotiations on admitting Russian meat to the Chinese market took more than a year; Russian meat products should start arriving in China by the end of 2016. China also imposes a great deal of phytosanitary bureaucracy on food imports. Chinese manufacturers, however, have a reputation for sacrificing the quality of manufactured food products for the sake of higher levels of productivity and Chinese consumers consider Russian foods environmentally friendly products.



### READ MORE:

Russia looks to flood Asia with soya, wheat and fish

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INTERVIEW | DANIEL  
RUSSELL"ECONOMIC DOWNTURN  
NOT AS BAD AS MANY  
OBSERVERS THOUGHT"Alexey Lossan, *RBTH*

*Daniel Russell, the president and CEO of the U.S.-Russia Business Council, spoke to Doing Business with Russia about what the Russian market can offer foreign investors.*

**DBWR:** A lot of people say that the chill in U.S.-Russia relations is moving to the local level. Do you agree with this, and if so, what do you see as the main reason for such a change?

**DANIEL RUSSELL:** I think that the biggest impact on the business community has come from the drop in oil prices. Clearly sanctions and countersanctions contributed to that, but to understand the impact, you have to look at two different groups. First are companies that already have operations in Russia. These companies have adapted to the new circumstances much like the Russian private sector has, and I think that's something that we need to deal with. But at the same time since the crisis started if you look at potential investors or new investors, the volume of their investment is way down. I don't expect that the situation will change dramatically until we see some change in the economic circumstances. One of the things that I would add to that is that certainly the economic downturn has not been as bad as a lot of observers thought. I think part of the credit for that goes to Russian government policies and U.S. business is recognizing and appreciating this. I would note particularly the Central Bank's decision to let the ruble float freely and not to impose capital controls and the Russian government's continuing efforts to work on improving the investment climate. We all know about the improvements in the World Bank Doing Business ratings over the past several years, but we also know that the World Economic Forum rating has improved Russia's position this year. So that's something we like and would like to encourage.

**DBWR:** Speaking about American companies that are still active in the Russian market, are

most of them oil companies or technology companies?

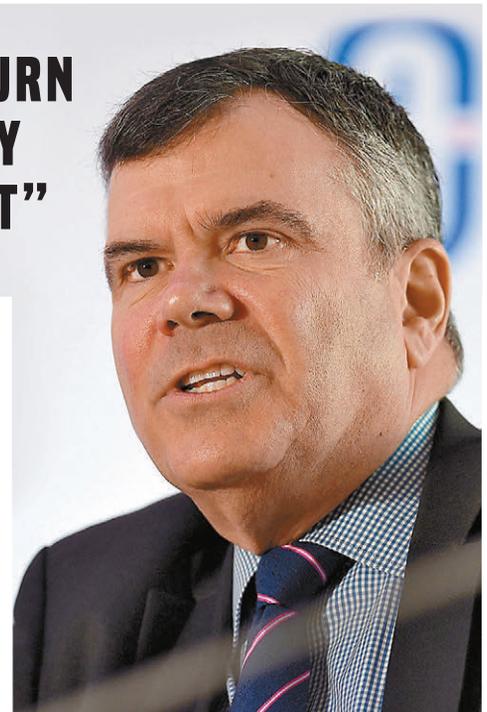
**D.R.:** I think international companies, including American companies, are present in pretty much every sector of the Russian economy and again I think business, both Russian and international, has been affected in the same way. So, whether you are working in the consumer goods sector or you're working in another sector, things are difficult. For example, if you're in a sector where you can take advantage of the lower ruble exchange rate for export, you're doing pretty well. But the Russian market is not just about oil and gas.

**DBWR:** What is it about? Pharmaceuticals? Medical devices?

**D.R.:** Well, we have companies certainly in pretty much every sector. You mentioned pharmaceutical and medical devices – certainly that is an area where international investors have been active and will continue to be. Aerospace is clearly another area of cooperation. The weak ruble presents opportunities.

**DBWR:** Recently the company Pfizer decided to open a manufacturing plant here in the Kaluga Region. Do you think that some companies are still interested in going into the Russian market despite the sanctions?

**D.R.:** Yes, I think that localization isn't anything new. Companies localize because the market conditions encourage them to do so. And so you've seen U.S. companies that localized in Russia more than 10 years ago and I think you are going to see that trend continue where it makes economic sense to do this. In terms of opportunities, export-led growth is



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**YOU HAVE SEEN U.S. COMPANIES THAT LOCALIZED IN RUSSIA MORE THAN TEN YEARS AGO AND I THINK YOU ARE GOING TO SEE THAT TREND CONTINUE WHERE IT MAKES ECONOMIC SENSE TO DO THIS.**

going to be part of the future in Russia, and I think international companies have a role to play there. If you're an international company and you have invested in Russia, you have a production facility, you have highly trained staff and you see a downturn in internal demand, the obvious business play is to export. We hope the Russian government will encourage that and we hope that international companies will start the trend in exports. Again, this is a strategic long-term view, which is my approach to this market and the approach of many companies that have been here for a long time.

Yes, we have recession, we have geopolitical turbulence absolutely, but at the same time, the basic calculation that brought international investors here in the first place hasn't changed. You've got the world's largest country, natural resources, you have a highly trained workforce – particularly in mathematics and engineering.

Alexey Lossan, RBTH

## DEVELOPMENT | HOW THE RUSSIAN AUTHORITIES PLAN TO DEVELOP THE FAR EAST

THE RUSSIAN GOVERNMENT HAS MADE THE DEVELOPMENT THE COUNTRY'S FAR EAST A PRIORITY IN NATIONAL POLICY. THE CREATION OF ADVANCED DEVELOPMENT TERRITORIES AND THE FREE PORT OF VLADIVOSTOK ARE THE FIRST STEPS IN THIS INITIATIVE.



Vladivostok hopes to become a business bridge between the Russian Far East and Asia.

**W**e have set ourselves an ambitious and large-scale task to make the Far East one of the centers of development of our country, a powerful and advanced center,” said Russian President Vladimir Putin in his keynote address at the Eastern Economic Forum in Vladivostok in September 2016. “This is one of our most important national priorities, and we are seeing encouraging results.”

According to Putin, the growth of industrial production in Russia’s Far East amounted to more than 5 percent in the past year, whereas this figure for the whole country is just 0.3 percent. During 2015, more than 300 projects were launched in the Far East, which shows that the mechanisms put in place to support business and encourage investment are working, Putin said.

The increasing appeal of the region is also indicated by emerging positive demographic dynamics: for the first time in a quarter century, the Far East saw a rise in its population, with the birth rate exceeding the death rate for the third con-

secutive year. Moreover, in the first six months of 2016, the outflow of population from the Far East declined by more than a third. “We have to catch this trend and make it irreversible,” Putin said.

The Russian authorities have created extremely favorable conditions for attracting foreign investors to the Far East, including establishing the Free Port of Vladivostok and the Advanced Development Territories — both of which feature preferential tax and customs regimes.

The government also plans to simplify the procedure for issuing visas to foreign citizens working in the far east and to start issuing electronic visas. Other ideas include creating an international educational and research center in Vladivostok to attract Asian investors and entrepreneurs to Russia and creating a platform to encourage technological development and support of startups.

### ASSESSING INCENTIVES

The first tools used to attract investors to the Far East were ADTs and the Free Port of Vladivostok.

ADTs are economic zones that feature extensive tax incentives for business and government support in constructing infrastructure. The Free Port, for its part, covers 15 municipalities around and including the city of Vladivostok, which are home to about 1.4 million people. The Free Port and ADTs offer similar tax and customs incentives: The total amount of insurance premiums in the areas is 7.6 percent instead of 30 percent in other parts of the country, while income, land and property taxes are zero. Residents of the ADTs and the Free Port of Vladivostok are entitled to a shorter period of reference checks — up to 15 days — and a reduced time for receiving permits for capital construction — no longer than 40 days. Residents of both the Free Port and ADTs can use a duty-free and tax-free customs regime starting from October 2016.

Residents of the ADTs are entitled to a fast-track environmental impact assessment — no longer than 45 days, while the residents of the Free Port are eligible for a simplified visa regime

billion). The investors hail from China, Japan, Singapore, Australia and Lithuania.

“It is too soon to assess the results: the ADTs and the Free Port of Vladivostok started to operate just this year, so it is premature to expect any results from them,” said Dmitry Baranov, a leading analyst with Finam Management. According to Baranov, creating a stable level of in-

the problems that arose during the implementation of special economic zones in other parts of the country.

“The only precedent for the successful development of these territories is the Alabuga zone in Tatarstan,” said Sergei Khestanov, macroeconomic adviser to the head of the Otkrytie Brokerage in Moscow. “In all other cases, the ADTs preferential tax treatment was de facto used to create domestic offshore companies. That is why the establishment of such zones is quite actively opposed by the Ministry of Finance.” According to Khestanov, it is too early to tell if the ADTs in the Far East will have similar problems.

The government has already acknowledged the creation of the Free Port as a success and expanded the Port’s boundaries in June 2016. Several new areas were incorporated at that time, including the Vaninsky municipal district in the Khabarovsk Territory, the Korsakovsky city district in the Sakhalin region, Pevek in the Chukotka Autonomous District, the Lazovsky municipal district in the Primorye Territory and the city of Petropavlovsk-Kamchatsky.



The residents of the Free Port are eligible for a simplified visa regime.

GETTY IMAGES

terest in the Far East and the establishment of the first residents in the projects is the main achievement of these initiatives to date. “It is also possible to mention a definite improvement in the mood of the population, since the intention was firmly stated to not just work with the district, but also to improve its socio-economic status, the well-being of residents,” Baranov added.

Concrete results can be seen in the level of funds already attracted to these special tax zones. For example, the Amur Timber Company has built a plant for the production of veneer sheets in the Komsomolsk ADT, investing more than 6 billion rubles in the project. Additionally, Techniconal Far East, a resident of the Khabarovsk ADT, built a factory for the production of thermal and sound insulation with a total investment of 2.8 billion rubles (\$44.6 million). In the Priamurskaya ADT, the company S Tekhnologiya has built a processing plant for cement clinker at a cost of 1.6 billion rubles (\$25.5 million), while the company JGC Evergreen built a year-round greenhouse using modern technologies for growing vegetables for 500 million rubles (\$7.96 million). Part of this investment was provided by Japanese investors.

#### PROCEEDING WITH CAUTION

Experts say, however, that potential investors in the ADTs are cautious about taking advantage of the opportunities they offer because of

that allows foreigners to obtain an eight-day visa at the border. Free Port residents can also rent plots of land based on its cadastral value without going through a bidding process. There is, however, a considerable difference in the volume of investment needed for potential residents in each of the areas: 5 million rubles in the Free Port and at least 500,000 rubles (\$8,000) in the ADTs. Investors in the Free Port cannot engage in the production of oil and natural gas, administrative activities, except for the rental and leasing, or the production of excisable goods, except for the production of cars, motorcycles and fuel. In contrast to the Free Port, each ADT has a clearly defined set of permitted activities – about 40 types for each territory. For the most part, these include agriculture, logistics, tourism, manufacturing, shipbuilding and mining.

According to the press service of the Far East Development Corporation, about 20 foreign companies have become the residents of the ADTs or the Free Port to date with a total investment for these applications of 200 billion rubles (\$3.18

## ABOUT TWENTY FOREIGN COMPANIES HAVE BECOME THE RESIDENTS OF THE ADTs OR THE FREE PORT TO DATE WITH A TOTAL INVESTMENT FOR THESE APPLICATIONS OF \$3.18 BILLION.

“We’ll add more if needed,” Putin assured the delegates at the Eastern Economic Forum.

Essentially, this is an attempt to extend the special economic zone to the widest possible area. This strategy is similar to one used by China: the entire province of Pudong, where Shanghai is located, is now a special economic zone that extends benefits to all businesses located in this area. Additionally, even individuals who are resident in the area receive benefits, including reduced import duties on cars.

“The Far East is actively attracting foreign investment,” said Georgy Vashchenko, head of Russian stock market operations at the Freedom Finance investment company. First of all, these are projects in the fields of energy, maritime and pipeline transport, oil and gas industry.

## INTERVIEW | ALEXEI CHEKUNKOV

## FAR EAST AS THE NEW FRONTIER

Alexey Lossan, *RBTH*

*In the near future, Russia's Far East will have its own stock exchange, which is designed, among other things, to attract venture capital from Asian countries. It is being promoted as "Russia's NASDAQ." In an interview with Doing Business With Russia, Alexei Chekunkov, the head of the state-initiated Far East Development Fund, spoke about the types of investment the fund and the region are hoping to attract.*

**DBWR:** Could you describe exactly what your fund is involved in using concrete examples? What projects do you support?

**ALEXEI CHEKUNKOV:** Our core competency is the provision of financing in specific investment projects in the Far East. There are 10 of them in our portfolio. Basically we are talking about the construction of transport infrastructure, but there are also industrial projects. For example, we support the construction of Russia's first plant for the production of soy protein isolate in the Amur Region. The total cost of the project amounts to 5.8 billion rubles (\$89 million); the fund's investment is 2.14 billion rubles (\$33 million). Despite being a major producer of soybeans, Russia still imports soy protein.

We will build facilities that will allow coverage of 40 percent of Russia's soy protein market. This is our first project in the field of agriculture and it is very important to us. We aim to seriously pursue [opportunities in] this direction, including jointly with Asian investors.

Recently we established the Agro-Industrial Development Fund with Chinese partners. The fund's capital will amount to \$10 billion, with 90 percent of the capital provided by Chinese investors. Another new area for us is the creation of a trading platform in the Far East, the Voskhod (Sunrise) investment system, which we call "Russia's NASDAQ." We are implementing this project in partnership with professional financial market participants - the non-profit partnership RTS.

**DBWR:** You want to create a new stock exchange in the Far East?

**A.C.:** For us, the frontier is the Far East. It is here that new business practices find application, new principles of state regulation are used and here there are no tax obstacles in the traditional sense. We are creating a new electronic trading system based on the RTS infrastructure, which for many years has been one of the pillars of the Russian financial market. We will be sure to use new technology to create it.



Moreover, more convenient and easier rules for placement for issuers from the Far East will be used on this platform. The issuers themselves will be both Russian and Asian players.

**DBWR: Why the need for a new trading platform?**

**A.C.:** I believe that collective investment is a very important tool. It so happened that after the end of the USSR, only strong players have been present in the stock and bond market and the MICEX (Moscow exchange) is now a convenient platform for the representatives of big business. However, there is a huge number of small companies in Russia that require more risk capital. Until recently, they used other platforms, including the NASDAQ or stock exchanges in Toronto and Hong Kong – so much so that one company that has business in Chukotka ended up being listed in Australia. For such companies, the Russian financial market does not offer a proper infrastructure – so far. I can say that already under consideration by our foundation are about 130 projects that have attracted a total of about 2 trillion rubles (\$30.8 billion) in loan and share capital. Many of these projects may be of interest to both Russian and international investors.

A modern platform requires not only ease of placement, but also the necessary infrastructure, which would require numerous changes in Russian legislation to create. In the near future, regulatory changes must take place in Russia allowing the opening of investment accounts without the involvement of brokers. Investing in stocks and bonds should be easy, including through an app on a smartphone. Bonds are a riskier tool, but you will also get more profitability in this case: not 8 percent, but 12–15 percent. Collective investments schemes have been practiced for 400 years already and they are much more flexible than direct institutional investments, which are important, but so far occupy a smaller portion of the market. We want the tradition to begin to change starting with the Far East.

**DBWR: Which companies will get preferential treatment in the new stock exchange? Could we say that it will be primarily IT-related companies?**

**A.C.:** The idea of preferential and easier fundraising for IT companies has long existed and it exists on the basis of an existing platform – there is a platform in the MICEX for investment in innovation. This is an alternative platform, it exists and offers its solutions. Moreover, the IT market is not an important pillar for the Far East region. However, it should be said that even in Yakutia, where people don't spend a lot of time on the computer, there are world-class companies, but

**THE FAR EAST'S POTENTIAL IS UNDERUTILIZED TODAY: IT IS HERE THAT 70 PERCENT OF FISH, 50 PERCENT OF GOLD, 25 PERCENT OF FORESTS, 20 PERCENT OF COAL AND 40 PERCENT OF SOY ARE LOCATED.**

this trend is not yet common in the region. The new platform will be designed for all businesses and there are no preferences for technology companies so far. In the future, there will be every chance for the centers of the knowledge economy and world-class technology to emerge in Vladivostok. We will offer our possibilities to all the companies that the fund interacts with, as well as to those companies that are not yet willing to take our money. Our fund has very strict conditions, including security guarantees.

**DBWR: What are your requirements for projects?**

**A.C.:** Public money should give the maximum impetus to the development, but they must go back to the treasury. We have no room for error, because the system of public investment evaluation does not allow for any risk. Everywhere where the state loses money, terrible scandals begin. Therefore, we have lowered the maximum value for money. Our yield is 5 percent per annum in rubles. This is half the price compared to the Central Bank, but our money should go back. We ask for guarantees from borrowers, like a commercial bank, so there should be additional

security for every project. This cuts off a significant layer of borrowers, but it is for them that we are creating the Voskhod investment system.

**DBWR: What main areas for the development of the Far East would you single out?**

**A.C.:** I would single out the formula “four themes plus one” – these are the main areas in which our company operates: natural resources, logistics, food, tourism and a theme not very obvious to most – industry. I'm not afraid of the so-called “resource curse” and I believe that it is necessary to squeeze the most money out of this area and reinvest it in other industries both on the part of entrepreneurs and the state, which receives taxes from the sale of hydrocarbons.

From the perspective of the resource base, the Far East's potential is underutilized today: it is here that 70 percent of [the country's] bio-resources of fish, 50 percent of gold, 25 percent of forests, 20 percent of coal and 40 percent of soy are located. All of this can be put to use.

Another important sector is logistics. The Far East has long been a transit region, beginning with the construction of the Trans-Siberian Railway, but today this function has new features. The southern border is separated from the ocean by northeast China – the provinces of Heilongjiang and Jilin, where 50 million people live and where 80 million tons of grain is produced annually. For Chinese manufacturers, the closest inland port is the port of Dalian. However, if we can direct these cargoes to Far Eastern ports, we will save them 1,000 kilometers [600 miles].

**DBWR: You said that Russia could become a supplier of food. Do you agree that we can meet the growing Chinese demand for food?**

**A.C.:** In China, the consumption of all kinds of food and water has traditionally been growing. The middle class begins to consume more protein, which is reflected in the structure of food. As a result, China has become a food importer. If we recall China uses very intensive farming with the use of aggressive techniques to increase its yield. This is a serious problem that China must solve on its own. Currently, there is an opportunity in the Far East for the creation of projects for exporting food to China.

Alexey Lossan, *RBTH*

## MEETINGS |

**BILATERAL ORGANIZATION HELPS STRENGTHEN ECONOMIC TIES**

**AT A MEETING OF THE RUSSIAN-AMERICAN PACIFIC PARTNERSHIP, OFFICIALS FROM BOTH COUNTRIES DISCUSSED POSSIBILITIES FOR FURTHER COOPERATION. THE MAGAZINE DOING BUSINESS WITH RUSSIA WAS ONE OF THE EVENT'S MEDIA SPONSORS.**

**U**.S. investors continue to occupy some of the most important places in the Russian economy, especially in the country's Far East, according to Dmitry Sazhin, head of the Department of Europe and America at Russia's Ministry of Economic Development. Sazhin made the statement at a meeting of the Russian-American Pacific Partnership (RAPP) held in San Francisco at the end of July 2016.

Sazhin added that although political relations between the U.S. and Russia have affected investment, with turnover decreasing every year, U.S. investors still play a crucial role in the Russian economy.

"We break stereotypes to become great partners," said Derek Norberg, RAPP's co-chairman from the American side. "There are not so many companies working with Russia in the U.S., but Russia holds a very important place in their work."

**MUTUAL COOPERATION**

Sazhin highlighted several joint U.S.-Russia initiatives at the meeting that were either continuing projects or those in early stages of development. In June, a joint project managed by Nauka and United Technologies to build heat exchangers for aircraft began second-stage construction in the Tver Region. In addition, Boeing has announced that it will open a new factory in Russia.

Pfizer, the global pharmaceuticals giant, has invested its own funds in the construction of a plant in the Kaluga Region south of Moscow. It has also agreed to transfer licenses for the production of 40 drugs to its Russian partners. Sazhin also noted that large Russian companies

such as TMK, Evraz Group and EuroChem maintain operations in the U.S.

**RAPP'S ROLE**

Russia's trade representative in the U.S., Alexander Stadnik, suggested that RAPP could play a bigger role in implementing deals.

"The opportunities for cooperation between business representatives of the two countries remain and the Russian side is trying to support the process," Stadnik said, adding that RAPP could help with projects in various areas, including energy, transport infrastructure and logistics. "To use the opportunities of the U.S. West Coast and Russia's Far East is an urgent task, which will allow for the creation of a metaphorical bridge between our countries."

Sazhin pointed out that Russia is trying to encourage foreign investment in ways that could appeal to U.S. manufacturers.

"Our response to the difficult macroeconomic situation is to improve the business climate in Russia," Sazhin said. It is no coincidence, he said, that Russia rose to 51st place in the World Bank's Doing Business rankings, adding that the Council for Strategic Development and Priority Projects was recently established to help encourage further development in the country.

Among the tools offered by the Russian leadership to foreign investors, Sazhin cited a special investment contract that guarantees the inviolability of a tax, customs and regulatory regime for 10 years. Several foreign firms have already signed such agreements, including Germany's CLAAS and Mazda from Japan.

Mazda plans to build its second plant in Russia in the Far East. The complex will specialize in the production of engines for the Japanese market. Foreign car manufacturers are particularly active in the Russian market. According to Sazhin, some of them are already considering the possibility of exporting their products from Russia to other countries. In particular, Ford is planning to sell cars to neighboring Belarus, while Volkswagen is considering sales to Mexico.

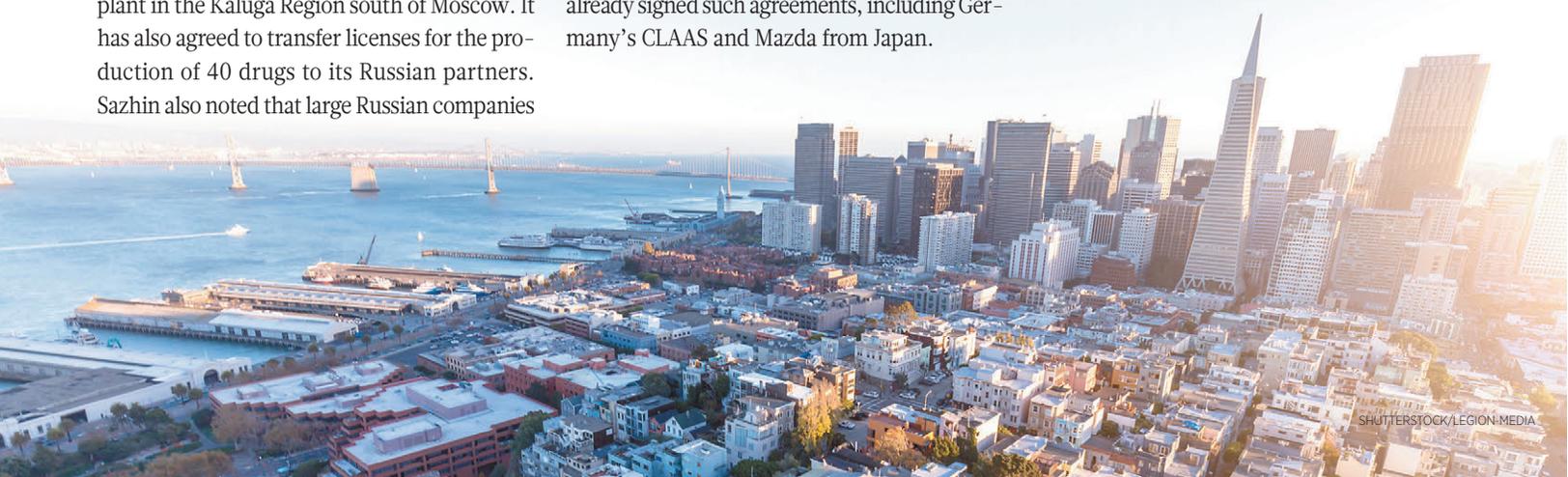
**PROSPECTS FOR THE FUTURE**

According to Sergei Petrov, the Consul General of the Russian Federation in San Francisco, some aspects of bilateral relations haven't changed despite the sanctions and the overall difficult political climate. RAPP, he says, is one such aspect.

"RAPP continues the traditions of Pacific ties between Russia and the United States," Petrov said. "We see the RAPP not just as an interregional forum, but also as an important element of cooperation with the United States, including regions located across the Pacific."

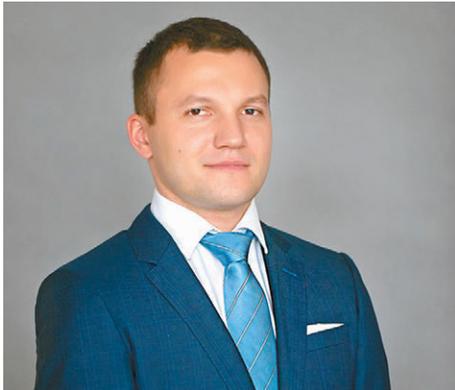
Norberg pointed out that the establishment of contacts between the countries is facilitated by air traffic between the U.S. West Coast and Russia's Far East, including direct seasonal flights between Yakutsk, Petropavlovsk-Kamchatsky and Anchorage in Alaska.

The next RAPP meeting will be held in the city of Yakutsk, the capital of the Republic of Sakha (Yakutia) in Russia's Far East.



# INTERVIEW | DMITRY KUDINOV | CREATING A MAJOR MANUFACTURING HUB

Alexey Lossan, *RBTH*



*Japan's Mazda Corporation has produced vehicles in conjunction with Sollers automotive company at a plant outside Vladivostok.*

*In an interview with Doing Business with Russia, the joint venture's CEO, Dmitry Kudinov, spoke about being located in Russia's Far East.*



**DBWR:** How many total cars have been built at your plant?

**DMITRY KUDINOV:** Today we can say that we are approaching the mark of 100,000 cars built. We managed not only to attract a partner, but also to share the investment risks that the Russian company could potentially face with them. Despite the drop in the Russian automobile market for the second consecutive year, Mazda maintains a clear focus on Russia. In 2015, we produced about 25,000 cars and we hope to achieve the same figure this year. At the same time, we realize that the population's real disposable income has fallen, and the purchase of a vehicle recedes into the background, but we are confident that the demand in the market will begin to recover within 2-3 years. In Russia, there is still a low level of car ownership – about 300 cars per 1,000 people, whereas it is 800 cars [per 1,000] in the U.S.

**DBWR:** How has your investment program changed in response to the falling demand for cars?

**D. K.:** We've radically revised it, reduced the amount of investment. But despite this, we are going to invest in production and infrastructure expansion over the next two years. In March 2016, we received approval from an interdepartmental commission to establish an engine plant in Russia's Far East. In total, we will invest about 2 billion rubles (\$30.9 million) in the implementation of this project. The latest-generation Mazda engines produced as a result of the project will be exported to Japan.

Thus, we will partially diversify the risk associated with the volatility of domestic demand.

The engines produced in our plant will be installed on various models: they can be used on the Mazda6, Mazda CX-5 and even the Mazda3. We will export engines, and they will be further distributed through Mazda Motor Corporation's domestic distribution system. At the first stage, the production capacity will be 50,000 engines per year, but we may increase production in the future. The engine pro-

duction process is more complex than the production of the car itself. Suffice it to say that there is no production at such a level in Russia's Far East.

**DBWR:** Where are your cars distributed? Do you sell some of them for export?

**D. K.:** The distribution of cars takes place only within Russia or the Eurasian Economic Union countries; we do not export them abroad. The Mazda that we produce is a car exclusively for local use. There are no legal restrictions. This is a business model adopted in many countries where there is a local user and a local manufacturer.

For example, Mazda has a Chinese plant that makes cars exclusively for China. At the same time, Vladivostok and the Primorye Territory are ready to become export centers, since foreign economic activity has always prevailed in the region. Customs and legislative frameworks meet the requirements that apply to exports. Now we need to create new production facilities for competitive products and much is being in this area. For example, there are plans to develop new export-oriented facilities in priority development areas.

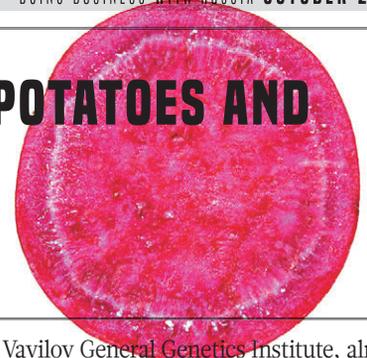
**DBWR:** Do you use the regimes of priority development areas or the Free Port of Vladivostok, which falls under a special custom and taxation system?

**D. K.:** We plan to use the regime of a special economic zone. It is a similar regime with tax preferences – we can say that we use the maximum amount of preferences that the state gives us. But legally you cannot be a resident of several preferential regimes represented in the region simultaneously. We have our own regime and it is no worse than the same priority development areas in terms of business support measures provided by the state. Moreover, our cars are directed to the local market, while the Free Port of Vladivostok is aimed at export.

Victoria Zavyalova, *RBTH*

## STARTUPS | MUTANTS ON THE MARCH: PURPLE POTATOES AND FROST-RESISTANT OYSTERS

**RUSSIA'S HIGH-TECH HUB, THE SKOLKOVO INNOVATION CENTER, IS SUPPORTING CUTTING-EDGE BIOTECH AGRICULTURE COMPANIES IN ORDER TO ENHANCE THE COUNTRY'S FOOD SUPPLY.**



In late August, the Skolkovo Innovation Center in southwestern Moscow launched a new department for agricultural biotechnology, hoping to reverse decades of decline in this field in Russia. Experts say that as economic sanctions continue to bite, Russia must develop its domestic agriculture sector in order to replace banned food imports.

### BIOTECHNOLOGY UNHINGED

Selective breeding in Russia lags behind other countries, lacking government support since the collapse of the USSR. "Most plant and animal

Nevertheless, the goal is that by 2020, Skolkovo's biomedical technology cluster will have about 200 resident startups implementing biotech projects for agriculture and industry. Investment in such projects is expected to amount to about 5 bln rubles (\$80 mln), and net earnings should total over 7 bln rubles (\$112 mln).

### RUSSIAN OYSTERS, CALIFORNIA-STYLE

Nikolsky says that Russia has an opportunity to make considerable progress in certain scientific fields, such as genome selection. "One of our residents is a company from the Russian

the Vavilov General Genetics Institute, already use genomic engineering in their work.

Skolkovo is also interested in a project to breed frost-resistant oysters, led by a California-based company founded by scientists of Russian origin. The technology, developed by Sergei Nuzhdin of the University of Southern California, could be used to produce oysters in the cold waters near Kamchatka in the Russian Far East.

"Sea organisms grow faster in cold temperatures," Nikolsky said. "Oysters and sea cucumbers grown in the northern seas are far superior in taste, size and overall quality to those that are bred in the Yellow Sea. In this sense, Russia is very fortunate."

### OTHER PROJECTS TO WATCH

In addition to the oysters, there are a number of unique agriculture projects vying for residency at Skolkovo. A plant breeding team in the city of Astrakhan on the Caspian Sea is creating a new type of eggplant that is cone-shaped, pale green in color and has no bitterness at all. These eggplants do not need to be peeled because their skin is very thin, even when completely ripe. The breed was created by accident; researchers simply noticed green fruits among the usual eggplants.

Another vegetable project with potential is the "chudesnik" or "wizard" breed of purple potatoes created by scientists in the Urals region. Wizard potatoes, which are resistant to Russia's harsh weather and contain higher amounts of antioxidants and vitamin C than a regular potato, was developed by crossbreeding an ordinary potato plant with its wild varieties.

One project that could appeal to the Instagram generation is a Novosibirsk-based experiment to breed a domesticated form of the red fox. This project, which already has been included in many textbooks on genetics, can help scientists determine which genes control aggressive behavior, psychosis and depression in animals. Domesticated foxes are not only different in their behavior, but in their appearance as well; they display spots that make them resemble dogs.



These purple "wizard" potatoes are frost resistant, appropriate for Russia's cold climate.

breeds used today in Russia's agriculture are imported," said Yuri Nikolsky, scientific director of Skolkovo's biomedical technology cluster. "Many experimental facilities have been abandoned, and many scientists emigrated or pursued careers in other areas."

Skolkovo's new agricultural biotechnology department aims to change this trend, seeking out the best experts and determine the most promising and important areas. Since early August, Skolkovo has been choosing projects that will receive resident status, which means they will get official support and investment. The precise priorities have not yet been defined, however. "Innovative companies operating in this field are so rare that there is no point in setting any precise parameters," Nikolsky said.

Far East that uses genetic manipulation to create new breeds," Nikolsky said. "Essentially, they create completely new species whose genetics have not been studied at all. It is inherent in such fields that you have to start from scratch, so Russian selection breeding specialists are on an equal footing with their Western counterparts here."

Genomic engineering is another field of opportunity, Nikolsky added. While traditional selective breeding implies changing a breed gradually by developing certain traits generation after generation, genomic engineering can modify genes on the level of stem and embryonic cells. This means that new species can be developed much faster, which could help Russia close the gap with other countries. Some Russian scientific teams, such as the genomics laboratory of

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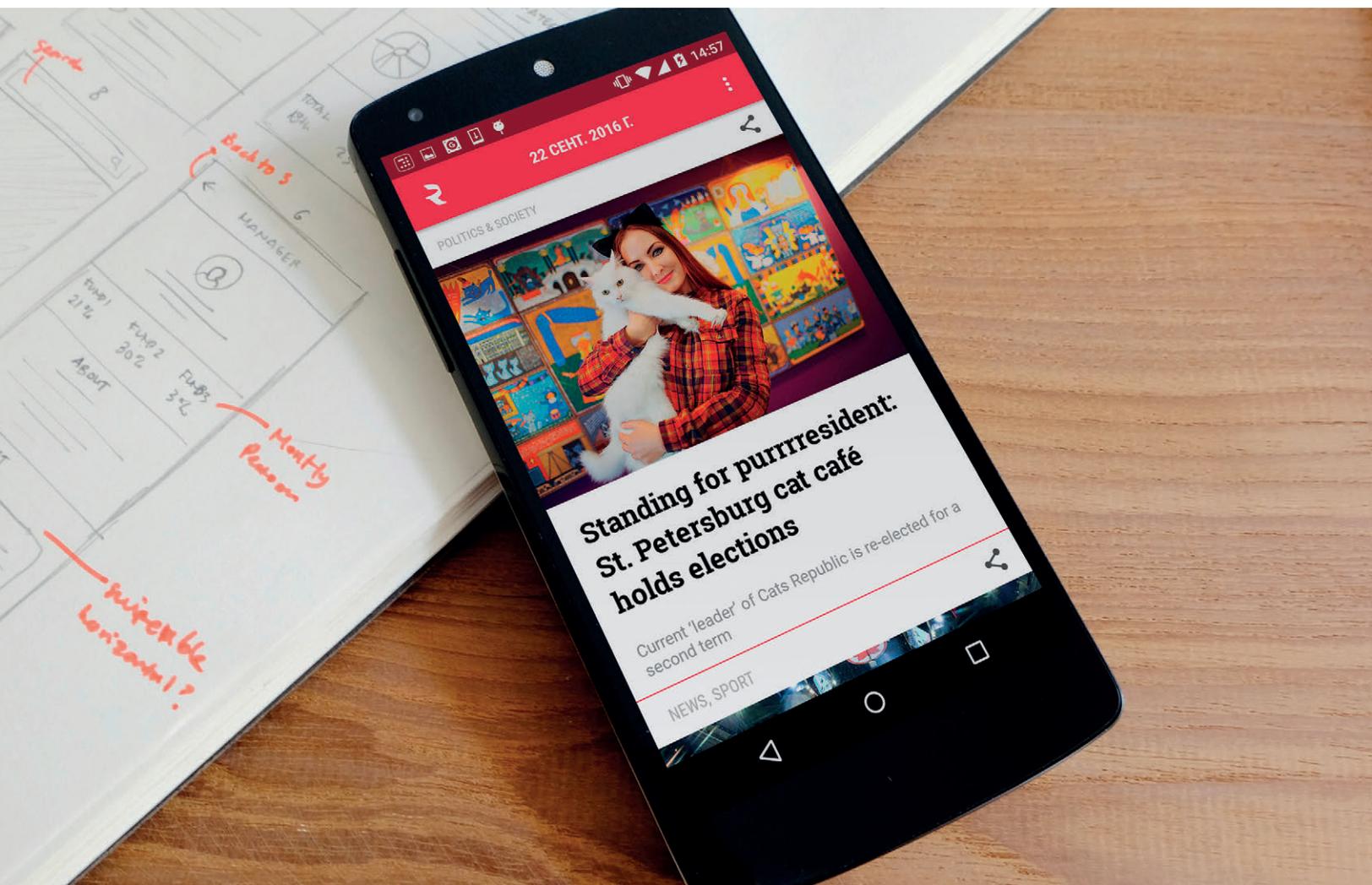
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