

# Partnership PERSPECTIVE

FALL - WINTER 2005

## IFC Improves Business Practices of SMEs in Russia's Far East

To extend the benefits to local communities from multimillion dollar Canadian investments in Russia's far northeast, IFC's Partnership works with small and medium-sized companies to raise the level of local management skills, improve business practices, and increase the knowledge base.

Fitness-class N-ERGO is an association of four female entrepreneurs who are advocating a healthy way of life and providing exercise classes to the local community in Magadan. Formed in January 2004, N-ERGO today is the most popular fitness center in the local market.

The founders of Fitness-class N-ERGO attribute a good part of their venture's success to the advice and support they have received from the IFC Partnership's Russian Far-East Business Development Project. The project is funded by the Canadian Inter-



N-ERGO founders

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## Five More Years: PEP Pledges Continuity and Innovation

Interview with Mr. Christian Grossmann, Director of IFC's Private Enterprise Partnership

This July IFC's Board of Directors approved the extension of the Partnership for another five years. That is a strong vote of confidence in the program. What has the Partnership been able to achieve in its first five years?

PEP has developed unique expertise in a number of areas of technical assistance, from financial sector development (particularly leasing) to strengthening corporate governance practices, developing communities and supply chains around large companies and projects, and improving the regulatory environment for small businesses. We have developed and proved a number of "product models" for technical assistance, particularly in leasing and corporate governance. PEP has replicated these models throughout the region, and there is growing demand for their export to other parts of the world.

We are also launching a number of new programs, which can become our core technical assistance products in the future. They include development of mortgage markets and rural finance.

The Partnership was established in 2000 to promote private sector investment, support the creation and growth of the private sector (especially SMEs), and improve the business enabling environ-

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The International Finance Corporation (IFC) is a member of the World Bank Group. IFC works to reduce poverty and improve people's lives in emerging economies by enabling and promoting sustainable private sector investment at the frontiers of economic development. IFC itself is the world's largest multilateral investor in emerging markets.

### Who We Are

IFC's Private Enterprise Partnership works to develop strong, self-sustaining economies in the former Soviet Union that serve all levels of society. Together with our donor partners, we assist private companies and governments to:

- Attract private direct investment to all areas of the economies,
- Stimulate the growth of small and medium-sized enterprises, and
- Improve the business enabling environment.

Countries we serve: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Mongolia, Russia, Tajikistan, Ukraine, and Uzbekistan.

We thank our donor partners for making our programs possible.



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**Mr. Christian Grossmann**

**Director of IFC's Private Enterprise Partnership**

### **ment. Have its objectives changed over the years?**

The overall, strategic objectives have not changed. All PEP projects target at least one, and usually two or all three of these objectives. But there are four additional criteria which shape our projects: country need and potential development impact, investment activity, IFC's core competence in a given sector, and donor support.

Naturally, the focus of our projects changes with time. For example, we began our SME program by conducting surveys of

small businesses to assess barriers to investment in a number of countries in our region. The surveys revealed key obstacles to SME development, and we have designed our subsequent SME Policy projects around their results. For example, in Uzbekistan we focus on streamlining business inspection practices and in Ukraine on improving issuance of business permits. To take another case, after implementing PEP's corporate governance program in Russia and Ukraine we added a specific program for the banking sector, because banking has special need for corporate governance improvement.

### **Will the focus of PEP programs in particular countries change?**

This depends on how the countries will evolve, what their needs will be, and of course on donor support for particular initiatives. Russia is an interesting example. Flying into Moscow, you may get the impression that Russia is a fairly wealthy country with little need for technical assistance. But the situation is dramatically different in the regions. For instance, PEP is currently working on building entrepreneurship in the Magadan region, a remote and isolated part of the Russian Far East.

In winter the temperature can reach -40 degrees and the only access is by air. Nevertheless, the region is rich in natural resources, the population has been holding steady, and there is much scope for development. It is important to reach people in such parts of Russia and the amount of work still to be done in the regions is often staggering. It is also true that while the Moscow region has seen strong development, several aspects of its private sector, and particularly financial services, still require assistance. The mortgage market in the Russian capital is a clear example.

Russia is also a good place to develop and test innovative technical assistance project models, before rolling them out in countries with less developed market infrastructure. For example, PEP tested and proved our leasing portfolio in Russia in the late 1990s and then applied it successfully in other countries starting from 2002. We recently launched two new project models from our current financial markets portfolio in Russia, dealing with housing finance and energy efficiency, and if they are successful we will take them to other countries in the region in coming years.

As for the other countries where we work, donors have shown particular interest in Ukraine. This year, we started three agribusiness projects in the southern part of the country and are currently discussing several other projects. We are also planning to further expand our programs in the Caucasus and Central Asia.

### **You mentioned two new programs in Russia - the Russia Primary Mortgage Market Development Project and Russia Sustainable Energy Efficiency Finance Program. Why IFC and why these programs?**

IFC is the leading international investor in the Russian mortgage

market. IFC has invested USD 240 million to support housing finance programs at a number of institutions: Absolut Bank, Delta Credit Bank, Moscow Credit Bank, Banque Societe Generale Vostok, and Raiffeisenbank Austria. IFC's comparative advantage in this sector is clear: we know the market and have significant expertise in this sector. The point of our technical assistance project is to increase development impact of our investments. We are supporting improvements to legislation, which will help the housing market to grow, and we are helping banks to develop mortgage products, which make mortgage financing affordable to more Russians.

The Energy Efficiency Program also addresses an urgent need. Russia has one of the highest levels of energy consumption per unit of GDP in the world, and this isn't just because of the cold climate. Making industrial processes more energy efficient would increase productivity, improve product quality, and reduce spending on energy and other raw materials. That would have the double impact of making Russian industry more competitive and improving the ecological situation in heavily industrialized areas.

Many energy efficiency projects are too small for IFC direct investments, although the total market for this type of

### **Since 2000, the Partnership's projects have:**

- **enabled USD 865 million in investments, including USD 148 million by IFC**
- **helped establish 86 new businesses**
- **reached 17,017 clients with trainings/consultations on sustainable business practices**
- **provided in-depth assistance to 470 clients**
- **contributed to passage of 125 legislative acts**
- **trained/advised 2,320 of government officials**

investment is huge. IFC has therefore chosen an approach which continues our strategy of deepening Russian financial markets by enabling Russian banks to enter new market segments. IFC will provide local banks and leasing companies with credit lines and partial credit portfolio guarantees for energy efficiency projects. We will also provide technical assistance to build energy efficiency finance expertise in the financial sector and among potential clients.

Financing energy efficient technologies is currently perceived as risky and complex by Russian financial institutions, and potential clients have limited experience in preparing project proposals that meet bank requirements. So the challenge in the Energy Efficiency Program is to make more long-term capital available for financing energy-efficient technologies. The Program is supported by the Global Environment Facility together with donors from Finland, Denmark and the Free State of Saxony, and IFC's Sustainable Financial Markets Facility.

### **IFC has approved funding for a five-year extension of the Partnership. Nevertheless, donor funding remains the key to the Partnership's activities. How do you see relations between the Partnership and its donors evolving in the coming period?**

PEP has always had a strong relationship with its donors which has further strengthened over the last year. Over time we have developed a customized approach to each donor based on their regional strategies and particular objectives. Our relationship with donors is a true partnership, and we have an on-going dialog concerning projects and future plans. I would like to welcome once again the new donors, who have joined the PEP program this year: Denmark, the European Commission, the Free State of Saxony and Iceland. We are currently developing these new relationships to turn them into longer-term partnerships for sustainable development.



## Ukraine Adopts Law on Business Permits

In September, Ukraine's Parliament, the Verkhovna Rada, adopted the Law on the System of Permits for Business Activities, which was drafted by the State Committee for Regulatory Policy and Entrepreneurship in cooperation with the Partnership's Ukraine SME Policy Development Project. The project is funded by the European Commission.

The adoption of this law is a first important step in reforming the permit system and reducing the barriers to launching and operating a business in Ukraine. The current system is in dire need of comprehensive reform: there are more than 1,200 types of business permits, while their issuance is regulated by 167 statutes, 150 regulations of the Cabinet of Ministers, and more than 1,500 normative acts issued by municipalities and state regulatory agencies.

The new law will significantly decrease the number of permits required for business activities in Ukraine. It will also diminish the scope for government agencies and other institutions to create new permits and will greatly

simplify the procedures for obtaining permits for business activities that do not pose heightened risk to society or the environment.

Through its fundamental provisions, the new law:

- prohibits issuance of permits that are not directly established by laws of Ukraine;
- introduces the application principle for issuance of permits, making issuance nearly automatic for business activities that do not pose heightened risk;
- renders permit issuing agencies responsible for any violations of the laws governing their operations.

The President of Ukraine, Viktor Yushchenko, designated adoption of the law on permits as a priority for the country's parliament. In his opening remarks at a recent forum, "Regulatory Policy - Guaranteeing the Openness and Transparency of Power," he underlined that upon the adoption of this law over 1,000 unnecessary regulatory documents would lose their force in a single day.

## ProgramLaunch



## IFC Supports Farm Business in Southern Ukraine

In September 2005, the Partnership launched its Southern Ukraine Vegetable Supply Chain Development Project. The three-year initiative will work with farms in the Mykolayiv Region of southern Ukraine to help them improve access to markets and finance and in this way improve the long-term viability of their operations. The project is funded by the Swedish International Development Agency (Sida).

The project mentors farms that produce vegetables on business management, product quality, modern sales and marketing techniques in order to help them become consistent suppliers to food processors and other markets in the region. Sandora Juice Company, Ukraine's number one producer of fruit juices and nectars, and an IFC investment client, is a key partner in the project. The project also provides legal support to farms in resolving land tenure and ownership issues, and in structuring supply contracts with markets.

Ukraine is a country of priority for Swedish development cooperation. Sweden plans to double its cooperation with Ukraine by the year 2008. Current annual support amounts to approximately USD 9.0 million to fund expert assistance in democracy, social development, economic development, security and environment.



## IFC to Help Develop Russian Mortgage Market

In October, IFC officially launched its three-year initiative to spur development of the Russian mortgage market. The Russia Primary Mortgage Market Development Project is funded by governments of the Netherlands, Switzerland, and by IFC.

The project will work closely with pilot banks in Moscow and other regions to implement standardized, world-class practices in mortgage origination, underwriting, portfolio analytics, risk management, and servicing. The project will

also deliver trainings and consultations to financial institutions and mortgage-related service providers on modern practices of housing finance, including borrower-oriented programs and standards. Another important aspect of the project will be work with Russian government agencies and active involvement in the regulatory and legislative process. The outcome should be creation of a modern residential mortgage lending infrastructure and growth of the Russian mortgage market.

## Building Business Partnership

IFC's Private Enterprise Partnership is implementing programs in four core areas:

1. Improving the regulatory environment for small and medium-sized businesses (SMEs)
2. Building business partnership between small and large companies
3. Developing financial markets
4. Improving corporate governance practices and regulations.

In the last issue of the Partnership Perspective we began to review these program areas in detail starting with our SME Policy program. In this issue we are reviewing the Partnership's linkages and supply chain technical assistance work.

### The Challenge

Direct investment, both foreign and domestic, can have a powerful positive impact on local communities and economies. Large investment projects create business opportunities for companies up and down the supply and distribution chains, as well as jobs for local communities. To ensure greater benefits for local economies, the governments of the CIS countries are increasingly adopting policies that require investors to have a high level of local content in the production process and to source services locally. Often, however, local small and medium businesses are poorly positioned to take advantage

of these opportunities because of inadequate product quality, a lack of management and production know-how, and limited access to market information and financing. The requirement to work with local partners whose product quality does not meet investor standards increases the risk of projects and could discourage investors from working in these markets.

### IFC's Solution

To help local communities and companies benefit from new business opportunities and to promote investment, IFC builds local small and medium companies and farms into competitive and reliable businesses. It also links them to investors and partners who can help them expand and strengthen their businesses. We:

- Work in partnership with existing or potential investors to identify their local supply and product needs.
- Survey local companies to identify those best positioned to become reliable business partners to larger companies and outside investors.
- Conduct thorough reviews of the business and management practices of selected local companies to identify the main factors preventing them from attracting business partners.
- Help selected local companies introduce modern quality systems,

technical standards, and productivity skills, and improve environmental practices and customer service in order to reach investors' standards and form business partnerships.

- Broker long-term contracts between investors and local businesses.
- Increase local businesses' access to market information by working with large companies to make their procurement requirements for products and services more accessible and transparent.
- Establish financial intermediaries and work with local financial institutions to fund new production equipment, technologies, and working capital for local companies and farms.
- Work with local consultants throughout the life of a project to provide them with hands-on training and build local capacity.
- Distribute training materials to help local companies introduce improvements.
- Disseminate case studies on quality improvements to illustrate the benefits local companies stand to gain by investing in product quality.
- Work with local government authorities to remove systemic constraints to business development and investment.

## The Result

IFC's program to build business links has transformed local companies into more successful enterprises, laid the foundation for increased investment, and brought economic benefits to local communities. For example, IFC has:

### *Facilitated Investment*

In the forestry sector, IFC works with European investors to match them with Russian partners. For example, Botnia, one of the largest forest industrial companies in Europe, is building a €50 million sawmill in Podporozhie, Leningrad region. Recently Botnia announced plans to invest €1.7 billion in construction of a new pulp and paper mill in the European part of Russia.

IFC worked with 18 Russian farms to help them introduce modern technical and management know-how to boost the quality and quantity of their milk production. The improvements in the farms' operations laid the groundwork for a USD 50 million investment in a dairy plant south of Moscow, operated by Campina, a Dutch dairy processor. IFC helped finance the plant with a €9.4 million loan. This new factory created dozens of jobs, and Russian farmers concluded long-term supply contracts with Campina and other dairy processors.

### *Increased Access to Financing for Farms*

The joint project with Campina led to the creation of the Agri-Industrial Finance Company, the only commercial leasing company in the country that lends to the primary agricultural sector. It was established with technical assistance from IFC and financed by IFC, Rabobank, and the Netherlands Development Finance Company (FMO). After the first year of operation, the company's lease portfolio reached USD 7 million in outstanding and approved leases. IFC continues to provide technical assistance to Russian farms—the company's existing and potential clients—on increasing productivity and quality.

In Ukraine, IFC worked with Ukrsofsbank and Hromada Credit Union

to help them develop and expand their rural credit programs. As a result, Hromada started lending to farmers for the first time; its agribusiness portfolio now amounts to USD 470,000. Ukrsofsbank's rural credit portfolio grew more than tenfold, from USD 1.5 million to USD 18 million. IFC has also trained and advised farmers and banks on agribusiness risk management and helped both parties understand each other's requirements. The project helped nearly 400 farmers in the Kherson region in southern Ukraine obtain over USD 3.4 million in loans from local banks.

### *Introduced International Quality Standards to Local Firms*

IFC worked with Russian manufacturers of automotive components to improve their quality to meet international standards. Two of the companies have signed long-term supply contracts worth over USD 1.5 million annually with the Ford assembly plant outside of St. Petersburg. IFC trained Russian consultants on quality certifications issues. These consultants now work with other local manufacturers of spare parts for the automotive industry. Additionally, IFC produced an educational film on the Kaizen methodology to improve production quality at enterprises. Over 40 Russian producers of auto components purchased the film.

### *Matched Local Companies with Business Partners*

We worked with Russian information and communications technologies companies to help them meet the re-

quirements of international business partners and investors by improving software development process quality, strengthening project management, and improving certification procedures. IFC's project facilitated two commercial contracts between Finnish and Russian companies. More contracts are under discussion. In addition, we created a database of over 400 Russian software development companies to facilitate their search for potential partners. This database was created in partnership with a Russian information technologies association RUSSOFT, which now maintains the database.

In the automotive sector, IFC conducted a survey of Russian manufacturers of spare parts to identify those who are in the best position to become partners with outside investors. Over 1,300 copies of the survey's findings were distributed globally to manufacturers of automobiles and auto components.

### *Extended Benefits of Multimillion Investments to Local Communities*

In Russia's remote region of Magadan, which is heavily dependant on mining to drive its economy, we have been working with 46 small businesses to help them benefit from opportunities stemming from IFC-backed investments in the local gold extraction industry. Five of these IFC partner companies improved their operations to the point of being able to win supply contracts with the region's mines. The annual sales of these five companies have increased by more than USD 640,000 due to the new cooperation.





## IFC Project Brings Finnish Investments to Russian Forest Industry

There can be few more obvious matches between foreign direct investment and local potential than in Northwest Russia, where timber resources stretch for thousands of kilometers just a stone's throw from Finland, which is home to some of the world's best forest-product companies. But Finnish investors, who want to produce on the other side of the border, have been challenged to find in Russia ongoing timber supplies of required quality and quantity.

The Northwest Russia Forest Investment Project was launched in 2001 by the IFC with funding from the government of Finland to address the problem, and three years of studies have borne fruit. Suppliers for the sawmills opened by Finnish companies in 2004-2005 in Novgorod and Leningrad regions were located with IFC help, and the project is now beginning supply studies for a massive new pulp mill facility, to be built with Finnish money.

UPM-Kymmene, the second largest forest company in Europe, opened

its €50 million sawmill at Pestovo in Novgorod region last year. The project successfully sourced the required inputs of high-quality spruce logs ("a challenging task" as UPM's deputy CEO described it). The project team surveyed huge areas of Northwest Russia for the Finnish company and provided a list of suitable suppliers and details of their capacity. Pestovo sawmill is now up and running with 100 employees.

Another €50 million green-field sawmill held its roofing ceremony at Podporozhie in Leningrad region in August 2005. The project proposed Podporozhie to Botnia - Europe's second largest pulp producer - as a suitable location due to good spruce log resources and presence of a large local wood harvesting company. Now the project is helping Botnia to arrange timber supplies.

The project also assessed and verified operational data given by Botnia to the Leningrad regional administration in support of an application for investment privileges, which were granted. The sawmill will employ 120 people and create 40 more jobs



in companies providing outsourced services.

Mr. Erkki Varis, Managing Director of Botnia, emphasized at the roofing ceremony that the present mill is only a first step. Botnia's planned investments in wood processing in Russia, possibly at Podporozhie, including construction of a pulp and paper mill, will total €1.7 billion. In September the Northwest Russia Forest Investment Project began scanning huge forested areas of European Russia to locate supplies for the future mill.

The Project has facilitated about USD 184 million of investments in Russia to date, far exceeding the initial target of USD 50 million.





## IFC Improves Business Practices of SMEs in Russia's Far East

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national Development Agency (CIDA).

The founders did not have any business experience, but possessed professional skills and considerable vocational training. N-ERGO's relationship with IFC dates to April 2004, when its founders requested the Partnership's help in developing the company strategy to raise external financing and attract new clients.

As a result of a program tailored by IFC for the company, N-ERGO raised nearly USD 10,000 from an angel investor at an annual rate of 3 percent (far lower than the prevailing bank rate of 23 percent) to purchase new equipment. If not for the angel investor, a local bank, Bank Vozhrozhdeniye—in a move unprece-

ded in the case of a start-up company in the area—was prepared to extend a bank loan to N-ERGO, after reviewing its business plan.

With IFC support, N-ERGO performed a market survey of the availability of local fitness services. Following an IFC recommendation, the company changed its pricing policy, resulting in an increase in clients.

The Partnership helped N-ERGO organize a presentation aimed at the corporate sector. Several companies



signed contracts and bought membership for their employees.

Since IFC's Partnership started working in Magadan in April 2002, the project has provided over 300 consultations to local SMEs not involved in the mining supply chain, to improve their business practices and knowledge base. The SMEs have received more than USD 440,000 from local banks and the non-banking sector.



## IFC Shows that Farming is Good Business for Banks in Ukraine

**IFC's ability to work with all key players in the agribusiness supply chain has helped to change perceptions, improve risk management, and enable farmers to access bank financing. The result has been a substantial increase in bank loans to agriculture in Kherson Region of Ukraine.**

Agriculture is traditionally an important part of the economy in Ukraine and a significant source of rural employment. Following privatization in the 1990s the sector has however presented relatively few opportunities for commercial bank lending because of perceived high risks.

IFC's Ukraine Agribusiness Development Project started work in Kherson Region of southern Ukraine in 2001. Conditions for vegetable cultivation are exceptionally good in Kherson, but the situation on farms there when the project first began was typical for countries of the former Soviet Union: supply chains had collapsed; private farmers were emerging, but lacked knowledge

or experience of operating in a competitive economy, skills and technologies were outdated, and there was little or no access to finance.

The IFC project, funded by Swedish Sida and Canadian CIDA, worked with local farms and sought out key players in the region who saw the potential for developing farm businesses. These included: Chumak, a new Swedish investment in vegetable processing; agricultural input suppliers keen to grow their business in the region; and a progressive regional branch of commercial bank, Ukrsotsbank.

All saw the opportunity presented by emerging private farms, but it was apparent that no one could take on this development alone. Coordinated efforts were needed, and the IFC took the role of impartial broker, helping the parties to understand and manage the risks and potential inherent in the region's agriculture.

The project started work with private farms, developing business plans and

educating farmers on new production technologies and market opportunities. This soon progressed to assistance in preparing investment plans. The IFC project thus demonstrated to local banks that agriculture could offer viable business opportunities to financing institutions.

Working with Ukrsotsbank, IFC initiated a pilot program to develop effective procedures for financing farmers. The scheme brought together four parties: Ukrsotsbank as financier, Chumak as a reliable market, agricultural input suppliers, and Kherson farmers.

New drip irrigation equipment, vital for improving crop yields, was partly collateralized, and Ukrsotsbank accepted the future harvest of vegetables contracted to Chumak as collateral. This mechanism was critically important, as most private farmers did not have adequate collateral of their own, and Ukrainian law did not allow use of land as collateral. Finally, the input suppliers provided support to farmers on utilizing new technologies, creating



## IFC Shows that Farming is Good Business for Banks in Ukraine

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an additional and effective monitoring system for the bank.

The IFC project, with help from Canadian and Swedish banking specialists, subsequently developed a comprehensive training program for banks on farm financing, including farm business analysis and risk assessment. The training was followed by development of new bank credit procedures.

The central concept of IFC's approach was that a farm's creditworthiness should be assessed on the basis of business fundamentals, and not only on available security.

Ukrsofsbank's first successful customer was Estem farm, which took a loan of USD 5,000 to purchase a vehicle for transporting vegetables. Estem farm is now one of the bank's most successful clients, and has switched from borrowing from private individuals in the informal economy to an open commercial relationship with the bank. For the coming season in 2006 Estem plans to borrow USD 40,000 to invest in new greenhouses.

In the period from 2002 to 2005, Ukr-

sotsbank used its experience with IFC in Kherson to implement new procedures in its branches throughout Ukraine. Overall, IFC trained 70 account managers from Ukrsofsbank and reached over 1,000 farmers through 25 seminars and training sessions.

IFC also conducted similar training courses for other banks in the region, as a result of which the new practices were implemented by Aval, Nadra and Raiffeisenbank. The major impact of this technical assistance is improved understanding by banks of farming business and risks, and effective procedures for farm credit risk assessment, farm business analysis, farm loan monitoring and management.

Access to finance has enabled Kherson farmers to boost output and efficiency. Tomato supply to Chumak increased by over 50% between 2001 and 2004, and productivity has risen significantly thanks to new technologies financed by bank credit: on progressive farms, average tomato yields in Kherson are currently 40 tons per hectare, compared with average yields in Ukraine of 12 tons per hectare. Cost efficien-



cies have also improved significantly. Production costs at several farms have dropped from around 8 to 10 cents to 3 to 5 cents per kilogram of tomatoes as new drip irrigation leads to higher yields and higher productivity.

The pilot initiative built around Ukrsofsbank benefited other participants, too. Training conducted by the project, and one-on-one consultations with farmers, improved management skills, agri-techniques, finance management, and business planning. The project also helped farmers to become better business partners and meet new quality demands of the market, and assisted them to clarify farm ownership and contractual structures.

Most of all, the IFC project demonstrated that agriculture is good business for banks. The consequence has been growth in the overall portfolio of farm loans in Kherson region from USD 16 million in 2000 to almost USD 80 million in 2005. Improved risk management and increased competition among banks for creditworthy farms has also led to halving of interest rates over the same period.



### The Partnership Perspective

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