

Partnership PERSPECTIVE

WINTER 2002

New Russian Tax Code Promotes Leasing To Support New Enterprises

IFC's Private Enterprise Partnership plays a major role in improving Tax Code provisions on leasing.

Leasing has provided opportunities for many new enterprises in Russia that lacked the capital or access to credit needed to make a start. Through leasing, these enterprises can obtain essential equipment and facilities without large up-front costs they cannot afford.

The Private Enterprise Partnership's Leasing Development Group, currently funded by Canada (CIDA), has played a leading role in the development of the leasing sector in Russia, most

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This mini-bakery in Moscow was able to start production because it could lease rather than buy equipment. IFC's Private Enterprise Partnership is establishing and developing the leasing sector in Russia, Ukraine, and Central Asia to increase small businesses' access to financing.



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, Kyrgyz Republic, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

We thank our donor partners for making these programs possible.



IKEA-Domostroitel Collaboration Helps Revitalize a Russian Town

IFC, through its Private Enterprise Partnership, expands the benefits of foreign direct investment by helping Russian companies become dynamic, competitive, and responsible business partners.

Today, Domostroitel is a growing, profitable Russian furniture producer. Located 1000 km northeast of Moscow in the small town of Krasnaya Polyana in Kirov Oblast, Domostroitel is the town's largest business, employing a quarter of the town's 8,000 people, or about 50% of the workforce.

The situation was not always so bright. From the late 1980s to the mid-1990s Domostroitel was losing money producing prefabricated wooden buildings that the company had been making since 1946, when cheap housing was needed to rebuild after World War II. With the collapse of the state-controlled economy, the demand for Domostroitel's products plummeted, and the company was forced to reduce its workforce from 3,000 to 900 workers, a devastating blow to the local community.

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Building Businesses, Creating Opportunities

Interview with Peter Woicke, IFC Executive Vice President



“My personal objective has been to raise the profile of technical assistance within IFC and further integrate it with our investment work.”

Peter Woicke,
IFC Executive Vice President

IFC is an investment institution, and many are surprised to learn that IFC provides technical assistance. Could you explain what type of technical assistance programs IFC implements and their role within IFC's activities?

First of all, I would like to say that since I arrived in IFC, just over three years ago, I have felt very strongly that IFC's role is not just about making investments. Investing is certainly central to what we do, but our role of giving advice, providing consulting services, and technical assistance is just as important in the countries where we work.

I have always been thrilled by the fact that we have what we call “project development facilities” around the world and the Private Enterprise Partnership in the former Soviet Union. They provide on-the-ground advice to our clients, in particular to small and medium-size entrepreneurs, on how to build their businesses. They also provide advice to governments on creating better business environments. In the former Soviet Union IFC began its work about 10 years ago by advising the government on privatizing small businesses. Today, IFC's Partnership is getting involved in training companies on good corporate governance.

I've consistently said that these kinds of services are enormously important. And no one can provide these services better than IFC, with its private sector and development expertise in these countries. I don't think it should be a surprise to others that IFC provides technical assistance. I actually think that this is one of the most underrated services that we deliver. My personal objective has been to raise the profile of technical assistance within IFC and further integrate it with our investment work.

You have traveled extensively throughout the former Soviet countries and just recently visited Russia. What were your impressions of the progress the private sector has made in the post-Soviet economies? What are the challenges these markets face today?

When you say the former Soviet Union, it depends on which country you are talking about. I think that the attitude of the government in Russia today towards the private sector is extremely positive. But it is not just the government's attitude that has changed, it is also how the private sector itself sees its role in the development of Russia today. One of the most encouraging signs I saw during my recent trip is the growth of a new entrepreneurial class in Russia.

Until recently the private sector was very much dominated by those people who came with the first wave of privatization, those who, let me put it diplomatically, took advantage of the privatization. At the time many were questioning the issues of corporate governance, transparency, the privatization process, and how these newly privatized companies were run. What you see now is, I think, a greater concern by some of these so-called oligarchs for transparency and corporate governance. But more importantly you see a new emerging class of entrepreneurs, who did not participate in the first phase of privatization, but who see the private sector and the changing environment as an opportunity to create and manage new companies in a different way.

I think the other countries in the former Soviet Union, Ukraine and Central Asia, might be a little bit behind in this respect. But as Russia sets an example in clearly viewing the private sector as the engine of growth, hopefully it will reflect on the other newly established countries as well.

What is IFC's role in addressing the challenges facing the former Soviet countries?

We will continue to play our role as a catalyst for increased investment by financing private sector companies and projects in those sectors where private sector investors are still somewhat reluctant to go in. In Russia we are focusing increasingly on developing the domestic financial sector. We support newly established private banks with advice. We have also recently made an investment in a bank. I am sure more investments in the domestic financial capital markets of the region will follow.

I think another important role for IFC to play in these markets is to expand the development benefits of its investments. This is particularly important with some of our bigger projects. For example, in Russia we are currently looking at a coal project. We can maximize the benefits of our projects by combining our investment expertise with what we talked about earlier – through our advisory and consulting services. Integrating our investment and advisory expertise will not only ensure that our projects are financially viable and meet strict environmental standards, but more importantly, that local communities derive benefits from these projects.

And this is where I think the Partnership can be of a tremendous value – leveraging our considerable expertise to develop new projects. A combination of financial sustainability, environmental soundness, and local community involvement make us unbeatable in providing the services to our partners to build businesses and create opportunities.

IFC's Private Enterprise Partnership is:

Technical assistance to the private sector in the former Soviet Union

10 years of IFC's hands-on investment and technical assistance experience in the former Soviet Union

Seven permanent country offices staffed with more than 200 local professionals and a central management team in Russia and Ukraine

Serving 10 countries: Armenia, Azerbaijan, Belarus, Georgia, the Kyrgyz Republic, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan

Funded jointly by donor governments and IFC



U K R A I N E

New Ukrainian Land Code Secures Private Ownership of Agricultural Land



The Ukraine Agribusiness Development Program played a major role in drafting the Land Code and worked for its passage. The program is administered by IFC's Private Enterprise Partnership and has

"The Land Code is a victory for Ukraine, which now has a proper legislative base to support the ownership of land. This will have positive effects on economic reforms in Ukraine."

President of Ukraine Leonid Kuchma

been funded by Canada (CIDA), Denmark, Japan, the Netherlands (Senter), Norway, Sweden (Sida), and the United Kingdom (BKHF) since its inception as the Land Privatization Project in 1995. The new Land Code was signed into law by Ukrainian President Kuchma on November 13, 2001. The law replaces the outdated Code of 1992,

permits the sale of agricultural land, and expands farmers' rights by allowing greater freedom in operating private businesses.



R U S S I A

Russia Stabilizes Legal Base for Leasing by Passing Amendments to Leasing Law

The Partnership's Russia Leasing Development Group, with funding from Canada (CIDA), has worked intensively with the leasing sector and Russian government officials to draft amendments to the Law on Leasing and gain their passage. These amendments bring the existing Law on Leasing into line with the Civil Code and eliminate ambiguities in current leasing regulations. The amendments were passed by the Parliament in January 2002 and signed by President Putin on January 29, 2002 (also see the story on amending Russia's Tax Code provisions on leasing, pg. 7).

For more information on Russia Leasing Development Group, visit our web site: www.ifc.org/russianleasing



K Y R G Y Z R E P U B L I C

Kyrgyz Government Takes First Step to Develop Leasing, Submits Draft Legislation to Parliament



The Partnership's newly established Central Asia Leasing Project – funded by Switzerland (seco) – worked closely with the Central Bank and the government of the Kyrgyz Republic to develop a draft Law on Leasing. The law will lay the foundation for the development of

The development of leasing will increase finance options available to Kyrgyz businesses, particularly start-ups and small companies.

the leasing sector in the Kyrgyz Republic, which will increase the finance options available to businesses of all sizes. The Kyrgyz government has approved the draft Law on Leasing and presented it to Parliament for consideration in early 2002.



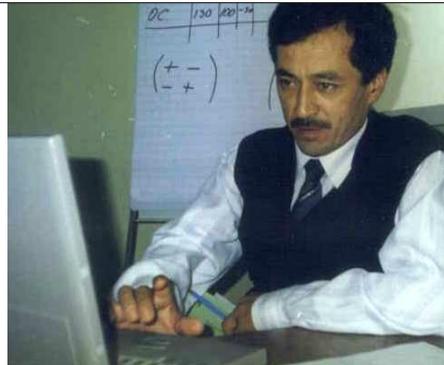
CENTRAL ASIA

New Swiss-IFC Central Asia Partnership

In Central Asia, IFC's Private Enterprise Partnership has begun a program to promote foreign and domestic investment, support the growth of small and medium enterprises (SMEs), and improve the business enabling environment.

Working closely with IFC's Southern Europe and Central Asia Department and the World Bank Group's SME Department, the Partnership recently established regional offices in the capitals of Uzbekistan and the Kyrgyz Republic to launch and manage projects in these countries and in Tajikistan and Turkmenistan. The Government of Switzerland (seco) is providing funding for these projects.

A pilot project in Uzbekistan is improving local business consulting services. Last September seven Uzbek consultants participated in a 16-day training program organized by the Ukraine Consulting Network – a group of 11 self-sustaining consulting companies established by IFC with support from the Governments



At the workshop, Uzbek consultants developed their skills in writing business plans, conducting market research, and performing financial analysis. At the end of the training program, the consultants developed a business plan for their own company, UzInvestProject, to attract new clients. The consultants will implement this business plan over the next year.

of the United Kingdom (BKHF) and the United States (USAID). The program will be repeated in 2002 and, if it continues to prove successful, may be expanded to other Central Asian countries.

Other projects underway or planned include:

A project to develop leasing sectors in the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan, launched in October 2001. Working with the Kyrgyz Republic officials, the project team has drafted a law on leasing, which has been submitted to Kyrgyz Parliament (see pg.3).

A survey of Uzbek SMEs to identify obstacles to business development

at both the company and country level. The findings will be used to advise Uzbekistan officials on improving regulatory, administrative, and economic policies affecting the growth and development of small and medium-sized enterprises.

The establishment of a pilot farmer-owned company and advising it on technical and environmental aspects of production, on modern irrigation practices to improve the yields and quality of cotton produced, and on establishing a marketing capability for the company's products. IFC will work to increase the farmers' access to financing for new technology and working capital, and ultimately may invest in the company itself.



R U S S I A

Russia Corporate Governance Program Launched

IFC's Partnership launched the Russia Corporate Governance Program in Spring 2001 with funding from the Netherlands (Senter) and Switzerland (seco). The goal of the program is to improve the investment climate in Russia by strengthening corporate governance practices at the company level, refining regulation at the national level, and introducing corporate governance coursework at universities and business schools in the Russian regions.

In its first nine months, the program has:

Developed Model Company Charters and By-laws and begun work on a Corporate Governance Manual. These model documents, which

include shareholder protections and incorporate corporate governance best practices, will be adapted by the Project's consultants for adoption by client companies at their annual general meetings of shareholders.

Advised Russia's Federal Securities Commission on developing a Code of Corporate Conduct. The Code, approved by the Russian Government late last year, promotes corporate governance best practices and aims to increase the transparency of Russian companies.

Opened regional offices in St. Petersburg and Samara and started training and advising managers of medium and large enterprises in these regions on internationally accepted corporate governance practices and compliance with local legislation. The project conducted its first seminar for regional companies in St. Petersburg in December 2001.



"Krasny Oktyabr" (Red October), Russia's most famous chocolate factory, is one of the companies working with IFC's Partnership to improve its corporate governance in order to build investor confidence and gain access to capital.

The program also seeks to raise public awareness of the importance of good corporate governance and the protection of shareholders' rights by conducting comprehensive public education campaigns through specialized publications and the media.



Building Supply and Distribution Chains

IFC's Partnership Spurs Local Economic Development by Linking Companies to Major Investors

Direct investment – particularly foreign direct investment – has an enormous impact in emerging economies. It is an important source of capital, and brings with it new technologies, management techniques, and market access.

To help capture these benefits for the post-Soviet markets, IFC's Private Enterprise Partnership is launching innovative technical assistance projects, designed to complement investments by multinationals and enable local companies to become suppliers and distributors for these

major investors. The Partnership works with local companies to improve the quality of their products and services, to help them meet global environmental and corporate standards of business practices, and to assist them in obtaining financing.

A Win - Win Situation

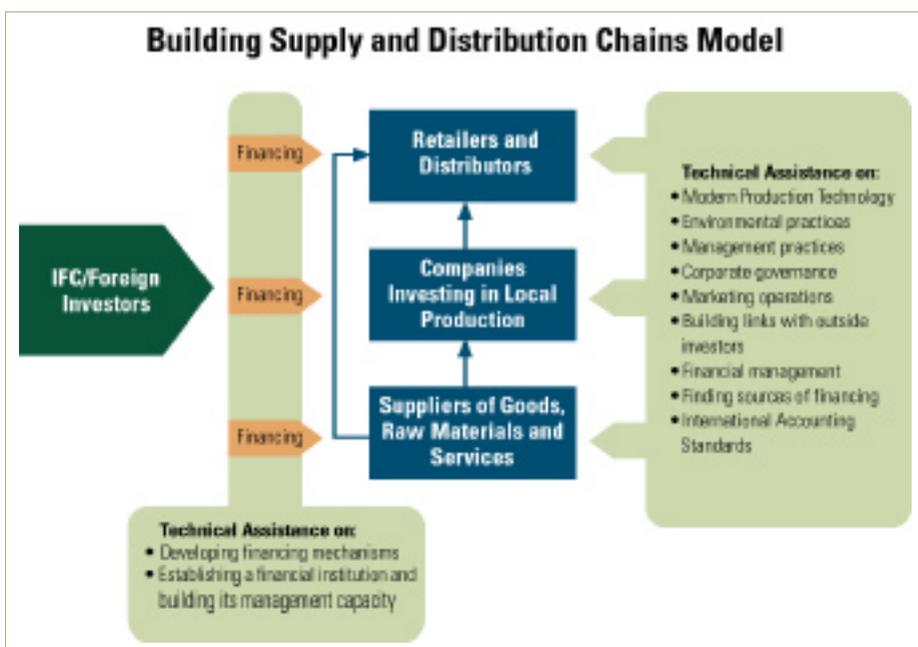
For multinationals, the benefits of forging business ties with local companies are clear – reduced costs and a positive corporate image in the local community. For local businesses the benefits of long-term partnerships with major investors are equally important. Steady demand for local companies' products stimulates their growth and helps them qualify for financing. Local business development creates new jobs in the community and increases local incomes.

Technical Assistance to Forge Business Ties

To enable local companies to become business partners with outside investors, we:

- Identify existing or potential large investors and assess their needs
- Survey local companies to identify those best positioned to become reliable business partners to outside investors
- Conduct thorough reviews of the business and management practices of selected local companies
- Help these companies introduce modern technologies and management know-how that will meet investors' standards
- Broker long-term contracts between investors and local companies
- Establish mechanisms to finance local suppliers and distributors
- Address sector-wide policy issues in cooperation with national government, local administrations, and the private sector.

Currently IFC's Partnership is working with suppliers in the agribusiness, mining, forestry, and furniture manufacturing sectors in Russia, Ukraine, and Central Asia. These programs are supported by Canada (CIDA), Finland, the Netherlands (Senter), Norway, Sweden (Sida), and Switzerland (seco).



IKEA-Domostroitel Collaboration Helps Revitalize a Russian Town

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Domostroitel's dramatic turnaround began in 1993, with its long-term partnership with IKEA, a Swedish home furnishings retailer. IKEA helped Domostroitel shift its production to furniture of IKEA's design. In the first five years of this collabora-

tion, Domostroitel increased production nearly fifty times over, and in the next two years doubled production again.

In 1999 IKEA helped Domostroitel develop a business plan, provided a loan for working capital, and leased modern equipment to the company. Today, Domostroitel is one of the 20 Russian suppliers of furniture to IKEA, exporting 80% of its product to IKEA's global network. The company has hired back more than 1,000

of the workers from Krasnaya Polyana.

IFC Lends a Hand

Despite its great progress, Domostroitel has not yet realized its full potential. The company still suffers from low energy efficiency, outdated environmental practices, and inefficient use of waste wood. If these issues are not addressed soon, Domostroitel will not be able to meet IKEA's strin-

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IKEA-Domostroitel Collaboration Helps Revitalize a Russian Town

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gent environmental criteria and will fail to qualify as a long-term global IKEA supplier. Domostroitel also faces the challenge of developing new product lines and diversifying its customer base.

IFC's Private Enterprise Partnership will work with Domostroitel to meet these challenges. The Partnership is working to improve Domostroitel's environmental practices and to introduce new market opportunities.

Leveraging the technical and environmental expertise of IFC, with support from Norway and the IFC Trust Fund, the Partnership is working with Domostroitel and other of IKEA's Russian suppliers to help assure the companies' growth and the economic stability of their hometowns. These efforts include:

- evaluating production processes and developing plans to optimize production through energy-efficient and environmentally safe technologies
- discovering new products that can be made from waste wood, providing advice on marketing new products, and helping expand the client base.

The Partnership is conducting these initiatives in association with local Russian consultants, thus ensuring that first-rate technical and marketing expertise is developed and remains in the country.

The Partnership's broader objective is to promote modern technology and sound environmental practices throughout Russia's furniture manufacturing sector. The goal of the current project with these IKEA suppliers is to demonstrate the profitability of investing in energy-efficient technologies and efficient waste wood use. If these efforts prove successful, IFC and IKEA may develop a joint financial mechanism for Russian furniture suppliers who want to employ these technologies, thus further stimulating sustainable and responsible growth in this sector.



Building Stores, Building Communities

With IFC financing, IKEA opened its first store in Russia in Spring 2000. This 31,000-square-meter furniture store north of Moscow in Khimki is one of the largest IKEA outlets in the world, employing more than 500 workers.

IKEA opened its second store southwest of Moscow in December 2001. This store – a replica of the first – had 45,100 visitors on opening day. Adjacent to this new store, IKEA is building a 100,000-square-meter shopping center scheduled to open in December 2002.

IKEA-IFC-Russia: Troika for Today

IKEA has been investing in Russia since the early 1970s and currently exports about US\$50 million in furniture and other goods from the country for its worldwide sales organization. In comparison, IKEA's suppliers in Poland export more than US\$250 million of merchandise annually, so there is room for growth for Russia's furniture business.

Russian furniture producers have a competitive edge thanks to access to good-quality, low-cost raw materials and qualified labor. IKEA is helping manufacturers capitalize on this potential by providing financial support and technical assistance in production processes.

In support of IKEA's efforts, IFC's Partnership is helping Russian furniture manufacturers meet IKEA's environmental standards, strengthen their managerial skills, meet financial challenges, improve production practices, develop new products, and expand their revenue base. These improvements will help Russian companies become dynamic, competitive, and responsible business partners.



Thanks to the success of Domostroitel, the number of unemployed in Krasnaya Polyana, a town of 8,000, is only 87.



Fifty-two percent of Domostroitel's employees are women.



New Russian Tax Code Promotes Leasing To Support New Enterprises

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recently in the passage of Tax Code provisions that assure that leasing remains a viable alternative for new Russian enterprises.

In August 2001, Russia passed a new Tax Code adopting provisions crucial to the growth of the country's financial leasing sector.

Tachkin says the stability of the legal base will eliminate uncertainties that scare off investors. "Now leasing companies can attract capital more easily and grow more quickly. For our clients these provisions make leasing a truly viable and more accessible alternative to other types of financing."

IFC Plays Key Role

The Partnership's Leasing Development Group (see box, pg. 8) played a major supporting role in developing and advocating the new provisions.

As leasing companies learned about the draft Tax Code, they generally agreed that if it left unchanged it would stall further growth of the leasing industry, which had finally begun to recover after the August 1998 financial crisis. "The draft Code would have made leasing unaffordable to most of our clients - small and start-up companies - for whom bank financing is often out of reach. And it would give an advantage to leasing companies serving large clients. Although we were aware of these problems, what could my company do!?"



The first leasing companies in Russia appeared in the early 1990s. Russia's leasing market today is about \$1.2 billion, three times its size in 1999.

One new job is created for each \$10,000 in leased equipment, according to IFC estimates.

"These provisions, for the first time, establish a level playing field for all leasing companies, set clear terms for taxation of leasing deals, and remove contradictions between various laws and regulations," says Vladimir Tachkin, Chairman of Budget Committee of the Leasing Alliance of Perm (the Urals region).

IFC's analysis of the initial draft Tax Code revealed that the bill eliminated many of the progressive steps the government already had taken to stimulate the leasing industry. To spur discussion about the potential adverse impact of the new bill on the leasing industry, IFC's team widely publicized its drawbacks through its bimonthly publication, *Leasing-Courier* and the media.

said Lubov Galahova, General Director of the Microleasing Company in Volkhov (Leningrad region).

At this point IFC's Leasing Development Group organized a series of consultations, roundtables, and conferences among leasing companies, small businesses, investors, government officials, and lawmakers to develop draft

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Leasing Helps Knyazev Bakery Grow and Create Jobs

As soon as entrepreneurship became legal in Russia, Oleg Shulga and Julia Chirkina began selling cookies and pastries in their native town of Voronezh. They started by selling goods produced by local Soviet-era bakeries, but quickly realized that the future was in starting their own production and introducing new recipes to the market. Lacking any credit history or collateral, Shulga and Chirkina could not get a bank loan to buy new confectionery equipment. So they began production with what they could afford - renting a small pastry kitchen furnished with an old, Soviet-era equipment. Nevertheless, within a few months the bakery, called Knyazev Bakery, began to turn a profit.

Innovative recipes soon made the bakery so popular that it could not keep up with demand. To expand production, Shulga and Chirkina turned once again to local banks and private investors, but, despite their success, they were refused financing. ReLizKom, a Voronezh-based leasing company, came to their rescue. Through leasing, the Knyazev Bakery was able to set up a new \$600,000 production line to meet rising demand. As a result of this expansion, the bakery increased its staff by nearly 80% (from 28 to 50).



New Russian Tax Code Promotes Leasing To Support New Enterprises

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amendments to the Tax Code's provisions on leasing. IFC also conducted a broad media campaign to support proposed amendments, attracting coverage of the issue in leading business publications, including *Expert* and *Kommersant*.

"IFC provided extensive legislative advice, while remaining impartial in the eyes of the participants," says Grigory Vorobeichuk, General Director of the KNK-Leasing Company, based in Moscow. "IFC's role as an honest broker ensured that the amendments to the Tax Code represented a broad range of views of different leasing companies."

During the review of the amendments by Parliament, IFC's team continued to organize additional consultations between lawmakers and Russian leasing companies and provide legislative advice.

Why Leasing?

Lack of capital is a major obstacle to private sector development in emerging markets. IFC's worldwide experience in developing financial leasing – an alternative to bank loans – has shown that leasing is an effective tool for providing needed capital and stimulating economic growth. Leasing increases the financing options for companies of all sizes, but particularly for start-ups and small to medium-sized enterprises (SMEs).

In Russia, where commercial banks remain cautious about working with the SME sector, a growing number of leasing companies are serving SMEs. In 2000-2001 the average size of a leasing deal was between \$50,000 and \$130,000, according to the IFC Leasing Development Group's survey of

the leasing market, suggesting that SMEs make up a major portion of leasing companies' client base. Development of the leasing sector in Russia also helps reduce the geographic imbalance in the availability of financing. Up to 80% of Russia's financial capital is concentrated in Moscow and St. Petersburg, while 80% of the country's industrial production is based in the regions. In response to demand for new equipment, leasing companies have been more active in the regions than other financial institutions have.

Anatoli Aksakov, a former Minister for Economy in Chuvashia region and now a legislator in the State Duma, is a strong advocate for leasing. "In Chuvashia one of the most effective means of solving the problem of financing the manufacturing sector is leasing. That is why I assisted in setting up a local leasing company. As the company began its operations, it became clear that its growth was hindered by an unstable and inconsistent legal base. So when I was elected to the State Duma [lower house of Russian Parliament], one of my top priorities was to remove the barriers to the development of leasing, starting with the Tax Code. Currently I am working on amending the Law on Leasing," says Aksakov (see pg.3).

IFC's Leasing Development Group continues to support Aksakov and other lawmakers working to improve the legal base for leasing. IFC provides legal analysis, along with expertise in developing financial leasing around the globe and a thorough understanding of leasing challenges in Russia.



IFC's Leasing Development Group has been facilitating the growth of the leasing sector in Russia since 1997. Funded by Canada (CIDA) the Group:

- Provides advice on improving leasing legislation on national and regional levels
- Trains, consults, and provides specialized information on leasing to local leasing companies, commercial banks, SMEs, and government officials across Russia
- Identifies potential investment opportunities for the private sector and IFC
- Conducts annual market surveys of the leasing sector.

In September 2001, with additional funding from the United Kingdom (DFID), the Group opened a regional office in Ekaterinburg to focus on developing the leasing sector in the industrial and financial centers of the Urals: Ekaterinburg and the Sverdlovsk Oblast, Chelyabinsk, and Perm.

www.ifc.org/russianleasing

IFC's Private Enterprise Partnership is online at www.ifc.org/pep

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A World Free of Poverty

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IFC's mission is to promote sustainable private sector investment in emerging economies to help reduce poverty and improve people's lives.

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The Partnership Perspective is a publication of the IFC's Private Enterprise Partnership.

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