

## Russia – the Credit Crunch

Every country has been affected by the economic downturn and the “Credit Crunch” and Russia is no different. It seems that every country has very similar problems. Whilst there is a “common theme” or set of problems in almost every country, each country has its own individual problems. Now I can tell you about Russia. To understand the current culture, business climate and mentality of Russia and its enterprising peoples, one has to understand some basic recent history.

Of course, most people know the recent history of Russia especially since the collapse of the Soviet Union in 1989. Until the end of this period, lasting since the revolution in 1917, it was illegal to make a profit and everyone was employed by the state. The state owned everything and everyone was strictly controlled. The population was prevented from attending church and was not allowed to travel outside the region where they lived - let alone travel overseas. Every third person was a KGB informer.

In the 1990’s directly, after the collapse of communism, the populace suddenly had their shackles taken off and the whole environment changed. It is during this period the so called “Mafia”, who are basically criminal business man, run the business scene, politics and virtually everything else. State assets were “acquired” and ended up in the hands of a few so called Oligarchs. Some 80% off the Nations’ wealth was held by some twenty people. This has recently changed. The year 2000 saw the new President Putin “elected” to the Kremlin and whilst he has his critics he did, nevertheless, bring stability and financial sense and control to the country. The people of the world’s largest geographical country started to feel very comfortable, salaries grew and jobs were in abundance. The country’s GDP started to grow at 8% - 10% per annum year on year. The Russian Government repaid debt and oil revenues flooded in. Then the “Credit Crunch” arrived!

Almost all the top Russian companies and banks borrowed heavily on foreign markets – a myriad of debt financing like Eurobonds in particular. Virtually no financing was raised within Russia. There are no Pension Funds in Russia. Private Pensions are rare in Russia as is Life Insurance. The huge exposure to foreign debt has now caused massive problems for Russian banks and businesses. Foreign debt markets have collapsed and maturing debt obligations cannot be repaid. Often the shareholders of large Russian companies have provided equity in their companies to secure foreign debt. Of course these equities have decreased by as much as 70% and the collateral is hugely inadequate. To overcome the problems of Russia’s largest brands and banks falling into foreign ownership (by default) the Russian Government has had to repay the foreign debt and take the equity pieces themselves. This means that Russia’s largest companies are, once again after 20 years, owned or controlled by the Russian Government. Just maybe the Government is not wholly unhappy about this!

It is thought that many of the 1,400 medium and small Russian Banks will not exist by the end of this year. The Government is said to be supporting the top 30 banks which, I guess, account for the vast majority of banking needs, by value and number of accounts.

The factoring industry in Russia has grown from an annual turnover of about US\$4 Billion five years ago, to about US\$ \$40 Billion today. One of the quickest and largest growth markets in the world for factoring. 80% of assignments values go through 20% of the players.

Shortly after the advent of the current economic crunch, the largest factoring company and market leader (by a long margin) collapsed, principally through debtors and clients default. Debt obligations crystallized and bingo. This is regretful. Most of the top five factoring companies, whilst not quite as bad as the ex market leader, have shut their doors for new business and now manage the defaulting clients and debtors. The second largest player has changed hands at a fraction of their market value just nine months ago - just parts of the business was purchased by one the largest Russian state owned banks. Russia's largest bank Sberbank has not yet entered the factoring market. The number three and four players are, of course, highly cautious with liquidity often making their decisions to take on new clients. A huge "manage away" process is evident across these top players.

Now is a great time to invest in a new Factoring business in Russia whilst the market is in disarray and liquidity causing such huge problems for the domestic players. There are very few foreign factoring companies in the country. The margins are huge and costs are relatively low. Expert advice from professionals is essential to enter this and any foreign market. It is my firm belief that the Russian factoring market is a great place to be as it also provides a first class "springboard" into other Eastern European markets which have great growth potential in future. We shouldn't forget that some of the world's largest banks have a sizeable presence in Russia – the main one's being Societe Generale, Raiffiesen, Citibank, HSBC, KBC and lately Barclays, through their acquisition of a small Russian Bank last year. I know of one European bank which plans to enter the market this year. Well done!

Huge progress has taken place in Russia's 20 years of market economics. This Credit Crunch is but a passing challenge.

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