# Dancing with the bear

Feb 1st 2007 | MOSCOW
From *The Economist* print edition

## Want to make money in Russia? Here are some ground rules

AS A parable of the quirks of doing business in Vladimir Putin's Russia, the tale of the confiscated mobile phones is hard to beat. Last year 167,500 Motorola handsets were seized on arrival at a Moscow airport. They were variously alleged to be smuggled and counterfeit; to violate a Russian patent; and to be a danger to public health. Around 50,000 phones were supposedly destroyed by the interior ministry—though some were later said to have turned up on the black market.

Eventually, most of the handsets were returned: evidence of progress or chaos, depending on your point of view. But the moral of the story lies in the fact that Motorola's enthusiasm for Russia is undimmed. Sergei Ovcharenko, the firm's country boss, says Russia is now the world's third-biggest handset market, after America and China. Since they "tend to spend more on demonstrating what they can afford", many Russians opt for snazzy models. Motorola's sanguine attitude is shared by many multinational companies. For all the risks, there is a striking dissonance between the growing Russophobia of politicians and the enthusiasm of investors.

Bullying foreign policy and human-rights abuses are not all that have tarnished Russia's reputation. Under Mr Putin, the Kremlin has scored an unfortunate hat-trick of business scandals. Most of what was once its top oil company, Yukos, has been expropriated, its founder dispatched to a Siberian labour camp and its other shareholders cheated. Bill Browder of Hermitage Capital Management, the boss of the biggest portfolio investor in Russia, has been shut out of the country, ostensibly because he is a threat to national security, but probably because of his scrutiny of Russia's murky corporate governance. And state-backed racketeering has helped Gazprom take charge of an oil-and-gas project on Sakhalin Island, Russia's largest foreign direct investment (FDI) scheme. TNK-BP, an Anglo-Russian oil firm, may be the next big victim.

Yet alongside these high-profile scandals, Russia's economy has grown strongly for eight years, and by just under 7% last year. The Russian contingent at the World Economic Forum in Davos last week bragged that their country's GDP would soon overtake that of France. Rising oil and gas production and sky-high prices have driven that growth, but sound macroeconomic management—Mr Putin's most unequivocal achievement, which has seen debt paid off and much of the oil windfall stashed in a rainy-day fund—will insulate the economy from a falling oil price, for a while. Salaries are rising fast, most Russians save little and consumer credit is increasingly available even for small purchases, such as flashy mobile phones.

All that, plus the rouble's strength against the dollar, means big profits can be made in financial services, construction, and especially consumer goods and retail, where sales last year grew by 13%. Top money-spinners include groceries, beer and cars. PricewaterhouseCoopers, a consultancy, says new foreign cars (many assembled in Russia) outsold domestic brands for the first time last year. Russians have learnt that foreign brands can offer better value even at high prices, as well as conferring status. And they are demanding as well as aspirational: Erik Sandberg, formerly of Cadbury Schweppes, a confectionery and drinks firm, says its Russian call centre receives the most sophisticated questions anywhere.

Consider the experience of that global totem of middle-class consumption, IKEA, which has spent $2.4 billion in Russia. It now has eight stores and runs eight mega-malls. “Russia is a bit of a rollercoaster,” says Per Kaufmann, its local boss, with Scandinavian equanimity. “You don't know exactly what will happen tomorrow.” Like many others—PwC was accused of tax evasion this week—IKEA has had run-ins with the authorities. Its Nizhny Novgorod mall recently had to close for ten days, allegedly for fire-safety infractions, but possibly for murkier reasons.

Yet the widespread and lucrative Russian urge to trade up from Soviet furnishings evidently justifies the hassle. Sofa-beds, slippers and vodka glasses are local favourites. Mr Kaufmann says his Russian staff are quick learners: half his store managers are locals. Reflecting the spread of prosperity beyond Moscow, five of IKEA's stores are outside the capital, and three more are to open this year. Mr Ovcharenko reckons Moscow now accounts for around a quarter of Motorola's Russian sales, with three-quarters elsewhere: a reverse, he says, of the situation a few years ago.

Last year, even as Mr Putin and his Western counterparts became ever more estranged, the Russian stockmarket boomed, and FDI reached around $30 billion—twice as much as in 2005, and less concentrated than before in oil and gas. Big risks such as political upheaval, which might deter investors, seem reasonably remote. One of the economic braggarts at Davos was Dmitry Medvedev, a deputy prime minister who is the favourite to succeed Mr Putin in 2008, and whom many investors regard as the least bad candidate. Even if they are sometimes obliged to make “voluntary” contributions to the local community (for example, by paying for new fire engines), multinationals are less vulnerable to the everyday risk of extortion by corrupt officials and police, which many Russian businessmen say has worsened under Mr Putin. Multinationals also stand a better chance of defending themselves in Russia's dodgy courts. The main worries at the moment concern crazy red tape, counterfeiting and rising wages.

So what are the rules for safe success in Russia? First, avoid industries that the government considers “strategic”, such as natural resources—but remember that the government is liable to change its mind. (A long-awaited set of new laws may soon define the rules for foreign firms in these areas.) Second, avoid the wrong sort of partner: steer clear of the “oligarchs” who made shady fortunes in the 1990s, and anyone too close to Mr Putin, since his fortunes may change after 2008.

Third, make the right friends, which in the regions means buttering up the local governor. Mr Ovcharenko says it's important not to appear to be a fly-by-night profit-stripper. “The more you invest, the safer you are,” he says. Be big enough to defend yourself against bureaucratic attacks, but avoid irking rivals with better connections. Finally, be ready to hold your nose when elections are rigged and political opposition is crushed.