



American  
Chamber of  
Commerce in  
Russia

# **AmCham Enterprise** **Development Newsletter**

# Contents

- 3** The AmCham Enterprise Development Committee:  
Focusing on SMEs
- 4** Interview with Chet Bowling, Partner,  
Alinga Consulting Group
- 6** Private Equity for SMEs: Financing  
the Development of Russia's Economy
- 10** Legislative Benefits for Small- and Medium-sized Enterprises

# The AmCham Enterprise Development Committee: Focusing on SMEs

**I**n 2009, the American Chamber of Commerce in Russia and members of the AmCham Enterprise Development Committee took important steps to ensure that the committee will meet on a more frequent basis, and that the issues involved in the development of small- and medium-sized enterprises (SMEs) in Russia become a key focus for AmCham and this Committee.

During our meetings and discussions with AmCham, we have outlined our primary goals in this regard: Members stressed that the Enterprise Development Committee should differentiate itself from other committees and focus on issues related to SME development, promotion, and growth. Themes can range from such topics as raising capital, HR issues, and taxation, but we decided that meeting topics need to focus on how these issues influence SMEs specifically – our core member target group.

Meanwhile AmCham management has pledged to be active within the committee and supportive of its goals. This includes the publishing this periodic newsletter on issues specifically related to SMEs, as well as offering case studies and success stories that will go to all of AmCham's membership.

We encourage AmCham members who are interested in SME development to attend the Enterprise Development Committee meetings (dates can be found at [www.amcham.ru](http://www.amcham.ru)). We will convene eight or nine times a year to discuss certain key issues and welcome guest speakers. These meetings can take the form of roundtables, business breakfasts, or Early Bird Networking sessions. The format of each event will be decided in consultation with AmCham and based upon the content and speaker.

We look forward to seeing AmCham members taking an active role in this committee. And we hope that you enjoy this first issue of our committee's newsletter.

Best regards,

**Eric Hansen**

Vice President, U.S. Russia Center for Entrepreneurship,  
and Co-chair of the Enterprise Development Committee

**Andrey Zelenin**

Partner, Lidings Law Firm, and Co-chair  
of the Enterprise Development Committee

# 4 Interview: Chet Bowling

Partner, Alinga Consulting Group

**Question:** *What is your experience in Russia? You helped set up a company here – Alinga – how did it come about?*

**Bowling:** My experience in Russia in now is in its nineteenth year.

I first came to Russia from Guyana to study law at the Friendship University in October 1991. Moscow made a strong impression on me. I remember driving into a city of no color: it was a dull gray day, a dull gray road, and a dull gray city. During that first ride into Moscow in 1991, I couldn't have known the colorful future in store for me here.

I began seeing Moscow as a long-term opportunity in the early 90s, when I was a student working in an upscale Mexican Restaurant, where Moscow's business elite came to dine and I could see that business opportunities were opening up. As I was completing my studies in the mid 1990s, I went to work for KRES FB, a boutique financial brokerage firm serving private American and European investors investing in the nascent Russian stock market. After the crisis in '98, when investors became timid, I started an MBA at Kingston University in the UK. I completed the degree in 2000, just as investors were starting to return and to invest in the real economy as opposed to the stock market. Seeing this, I – along with my partners – saw that these investors needed legal and accounting advice to help navigate their business activity. We began Alinga Consulting to provide legal and accounting services – and we've since added auditing to the lineup as well – and to provide these services with the level of customer service and support that we know Western customers expect.

In the almost two decades since I first laid eyes on Moscow, the drive into the city has changed enormously: the city is lit up with neon signs and activity. Alinga is proud to be part of that activity.

**Question:** *In your experience, has operating a small- or medium-sized business in Russia become easier since Alinga was founded?*

**Bowling:** It is certainly easier. The time it takes to set up a business has gone down considerably since the late 90s and early 2000s. It used to take about three-to-five months to register a business; now three weeks is usually enough. The time needed to get a work permit has also become much shorter (moving from a six months to two and a half). However, the rules have become less transparent and are constantly changing. This is still a major problem.

Since the early 2000s, as Russia has become more integrated into the world economy and a younger generation has entered the work force, Russian professionals have become attuned to what "international-standard service" means. In addition, it is generally easier to find staff with foreign language skills in addition to international accounting, audit, and/or legal qualifications. For example, in one recent case, a potential client insisted that the auditors working on a financial due diligence project would need ACCA qualifications. A few years ago we would have had to rely on expensive outside consultants, but we now have staff with these qualifications working for us.

The current economic crisis has actually helped SMEs doing business in Russia. For example, the cost of labor and the cost of renting facilities – two of the largest costs for a business – have come down significantly. In addition the SME has gained a bit more negotiating leverage. In the pre-crisis, high-growth years, landlords would raise rents at will, even beyond that allowed by the rental agreement, and simply tell the business to “take it or leave it.” Employees too had the same approach, asking for salary increases on a regular basis and often starting just a few months or even weeks after starting work – and even if they had no argument as to why they deserved the raise. The market “correction” has “corrected” this... even if perhaps temporarily.

**Question:** *What major obstacles still hamper SMEs in the Russian market?*

**Bowling:** Three things: financing, financing, and financing! Issues like corruption, administrative barriers are all relevant and do affect SMEs. However, entrepreneurs and medium-sized companies have learnt to deal with these issues – and since most of them are more flexible than bigger companies, it is easier for them to find solutions. However, flexibility does not help much when there is no finance. There is always talk about helping the SME, but few banks “walk the walk.” One of my clients – a food importer and distributor – applied to one of the banks professing to offer SME loans. He was quite surprised when the bank wanted him to lodge the goods he intended to trade as collateral for the loan.

A second issue is transparent financial reporting. Even if the company wants to be completely transparent, finding specialists that can prepare IFRS-complaint accounts internally is difficult. They usually need to outsource to a professional service firm to help with monthly/quarterly conversion of RAS statements to IFRS, or to help them implement an IFRS-reporting module for the popular 1C accounting software.

**Question:** *What value do SMEs add to their respective economies?*

**Bowling:** SMEs play major roles in most developed economies. They help bring flexibility and resilience to the economy, especially in times of crisis. They can be an engine of growth as very often it is not a major firm that finds and commercializes the "next big thing." However, the impact of this sector is still not fully recognized or even supported in Russia. I once heard a senior government minister say that “Russia will never be a small company economy like Italy. In Russia we like big companies like Gazprom.”

The major value of SMEs, and what Russia could really profit from, is the SME's ability to empower people to make a difference in other people's lives. Allow a person to start his own business, and he can provide for not only himself and his own family, but also create more opportunities for others to provide for themselves and their families. This is the most rewarding experience for me as the managing partner of an SME – to see a young accountant from Siberia come to Moscow and join Alinga as a junior and after four or five years see him as an Audit Manager, ACCA qualified, married with a young child, and in a flat that he owns.

*Private equity could be a great resource for developing small- and medium-sized businesses, and therefore strengthening the Russian economy.*

# Private Equity for SMEs: Financing the Development of Russia's Economy

**By Richard Sobel, Chief Executive Officer,  
Alfa Capital Partners**

**T**here is a sense of déjà vu in Russia as the country again finds itself in the midst of an economic crisis. The Russian economy has achieved impressive growth since the early 1990s, and especially since the 1998 crisis, exceeding many expectations; however, the country's continued dependence on commodities and foreign capital is contributing to heightened cyclicality and volatility, and has resulted in a love-hate relationship with foreign investors. The challenge is clear. To reduce its vulnerability to external shocks, Russia needs to diversify away from commodities and build a "value-added" economy. To facilitate this, it needs to develop long-term domestic sources of private sector debt and equity capital that also reduce its dependence on short-term international capital flows.

President Medvedev and Prime Minister Putin have outlined the country's economic goals, which include diversification away from a dependence on resources, increased employment in value-added sectors, the improvement of Russia's long-term industrial competitiveness and an increase in the average standard of living. These worthy and ambitious goals are not new to post-Soviet Russia, and while they have been widely and rightfully lauded, they require time, resources, and commitment. Unfortunately, the path to achieving these goals is not clear, and the necessary programs and resources are not yet in place. The growth of small- and medium-sized enterprises (SMEs) offers the most effective means to achieve sustained GDP growth, job creation, and economic diversification. The current crisis affords Russia a wonderful opportunity, which it should not waste, to speed SME development. As a veteran private equity investor active with SMEs in Russia since 1991, I encourage the Russian government to introduce financial programs to promote the development of SMEs and the domestic private equity industry, as well as to improve overall conditions for economic growth and diversification.

## **The Growth of Private Equity**

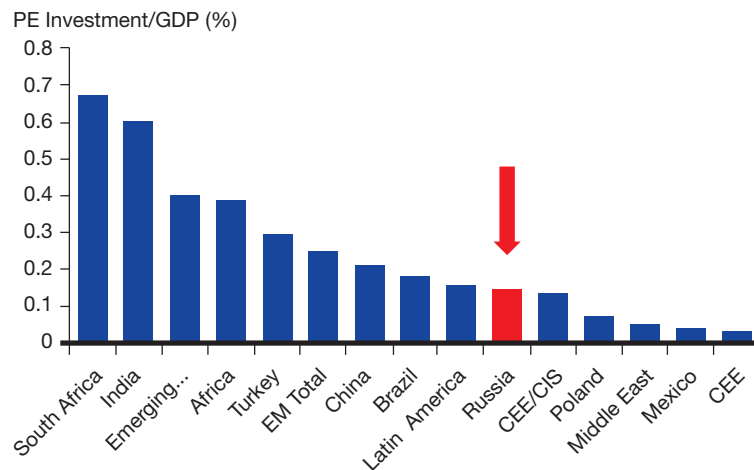
Over the past fifty years, private equity has evolved and matured into an important asset class in developed and emerging markets. Private equity (PE) refers to a range of investment strategies from micro-finance, seed finance, venture capital, growth capital, buyouts, real estate, and infrastructure. Sophisticated investors appreciate that a portfolio of private equity funds can deliver above-average returns, with reduced volatility. Since the collapse of the Soviet Union, the young Russian PE industry has experienced waves of growth and contraction, emerging as a respected, value-added source of equity funding for small- and medium-sized businesses. Beyond the long term equity capital, private equity managers typically support portfolio companies and their owners and managers in a variety of ways, including management recruiting, improved transparency, governance and accountability, strategic planning, M&A, budgeting, and arranging additional debt and equity.

International capital plays an important role in an emerging market's development. Foreign investors act as catalysts, demanding transparency, accountability and attractive risk-adjusted returns. In both portfolio and private equity investing, foreign investors bring valuable experience, know-how and credibility. Over time, the role of these investors in an emerging market is taken over by local investors, who learn, come to understand the opportunity, and ultimately dominate the market. Indeed, in Russia during the recent period of economic expansion, local financial groups came to play the largest role in private equity deals, albeit often by using borrowed foreign capital. As a result of the economic crisis and tightening credit markets, however, most Russian financial groups suddenly find themselves once again with sharply reduced resources for new private investment.

Around the world, government sponsored initiatives in support of the private equity industry have had a powerful development impact. These initiatives are important for the capital and economic incentives they provide, and for the commitment that they demonstrate, which bolsters investor confidence. Small business investment company initiatives (SBIC) in the U.S., as well as micro-finance programs and other private equity fund initiatives in emerging markets by the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC, part of World Bank) and the U.S. Overseas Private Investment Corporation (OPIC) represent a few of the successful programs. These programs have demonstrated a powerful ability to scale up and mobilize institutional capital, with a large multiplier effect. For example, every dollar of direct, government-related financing or financial guarantees can attract from three-to-ten dollars of additional private capital into fund-investment vehicles. Some OPIC fund programs provided debt financing to PE funds, which bolster investor confidence and enhance returns to the equity investors, while protecting and ultimately repaying OPIC's capital with interest and a small profit share if the fund is successful. Additionally, fund performance has generally been positive, due to the fact that the capital is awarded through a transparent, commercial process, with risk sharing, profit sharing, transparency, and accountability. Equally, the money that pours into private equity quickly trickles down to the local economy in ways that other government economic initiatives fail to do. It turns job seekers into job creators. Employment growth, training and creation of successful businesses encourage a virtuous cycle of entrepreneurship and new business formation.

Since 1994, many Russian private equity funds have been formed with some of the capital from the EBRD, IFC, and OPIC. International investors rely on these institutions to screen and carry out due diligence regarding the fund manager, to provide seed or anchor capital, to participate in governance, and to generally give a good housekeeping stamp of approval. Alfa Capital Partners, an affiliate of Russia's Alfa Group, manages or co-manages \$655 million in three private equity funds, targeting growth capital and buyouts, real estate, and infrastructure. We receive valuable support from OPIC, EBRD, and IFC in forming and managing these funds. EBRD, and IFC both remain active in Russia. The Russian govern-

## Private Equity Penetration in Russia vs. Other Emerging Markets, 2008



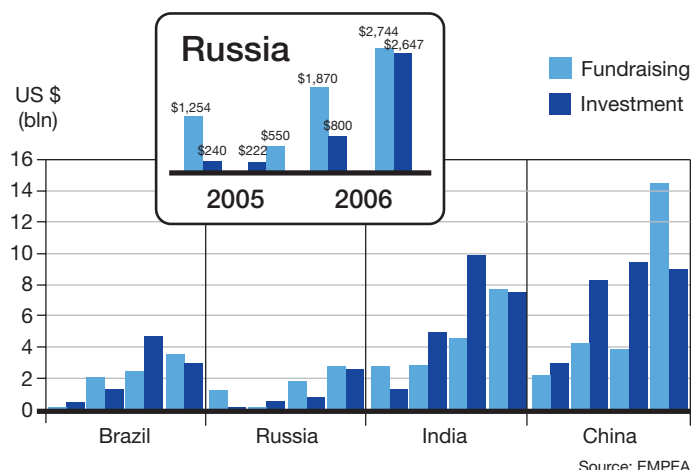
ment has also supported various private equity related efforts, including the EBRD-sponsored Regional Venture Funds, Russian (government) Venture Funds (RVFs), and RusNano, demonstrating its recognition of the importance the PE industry plays in national and regional economic development.

As the chart below shows, from 2005-2008 roughly \$6 billion was raised for Russian private equity funds. While this amount represents a large increase over previous years, when compared to developed markets, and especially when compared to China and India, funds raised for Russian PE partnerships lag far behind in both absolute terms and as a share of GDP. This low amount can be attributed to a combination of misperceptions and concerns on the part of many international investors about Russia and the relatively small role of Russian investors to date.

## Rewarding Investors

The current demand for private equity capital in Russia is large and pressing. In recent years, excess liquidity, inexpensive bank debt and the ruble bond market reduced the attractiveness of private equity financing for SMEs. With the sharp reversal in economic conditions, and a sharp decrease in domestic liquidity, debt is either not available or too expensive and short-term. Many Russian SMEs are now under severe pressure to refinance short-term debt at a time of declining earnings and reduced availability of equity capital. Private equity is needed to fill the funding gap, and the resulting dynamics for investors are much more favorable. EBRD tracks the performance of PE funds in Russia and Eastern Europe. According to EBRD data, many of the best performing PE deals and the best performing funds since 1992 were those which were formed and invested in the years following a major crisis. With private company valuations now off sharply and the cost of doing business moderating, investments made in the next two years are likely to find better value and lower risk, rewarding investors for their courage and market timing.

In 2008, private equity fundraising and investment continued to grow for Russia, while other BRICs saw investment activity slow.



The case for investment in Russia remains sound and is based on strong long-term fundamentals, as well as the fact that Russia is again one of the cheapest emerging markets in the world. An abundance of natural resources, a large consumer market, and a talented human resource base contribute to the coun-





try's potential. Analysts expect Russia to return to moderate GDP growth in 2010, and the recent rebound in oil prices has led to growing signs of stabilization, namely the strengthening of the ruble and a rebound in the stock market. Russian private equity has certain advantages over public-market investment, including broader access to the domestic economy, generally lower valuations, better transparency and governance, and the ability for PE managers to add value and manage risks through board participation. Most PE funds in Russia are focused on consumer-related industries, targeting the surge in disposable income and spending. Our experience indicates that private company valuation multiples are down from 8-11 times EBITDA at peak to 4-7 times at present, although relatively few PE investments have taken place recently. While many of the best companies remain reluctant to sell control, it is becoming easier to secure favorable governance rights.

The best time to invest is often the hardest time to raise capital. The next one or two years are expected to be extremely challenging to raise PE capital for Russia, amidst growing capital flight and an overall slowdown in fund formation globally. Unfortunately international investors are scaling back commitments to alternative investments, including PE, and are increasingly comparing investments in Russian private equity, real estate, and infrastructure funds with comparable, lower risk partnerships in developed markets in which valuations are also sharply reduced and risks are lower. Investors typically demand a premium in expected annualized returns of 5-10 percent for investing in Russian PE relative to similar investments in developed markets. In the current crisis, many investors are so severely capital-constrained that they will not invest in emerging markets PE under any circumstances. A recent survey of leading international investors by the Emerging Markets Private Equity Association (EMPEA) and Collier Capital ranked Russia the lowest among the four BRIC countries for new LP commitments to PE in the next 1-2 years. Some international investors will come, but greater attention must be paid to raising PE capital from local investors. Over the long term, the real potential for Russian PE lies in developing the domestic funding base. The Russian government's support for PE fund formation will be particularly essential for success in the near term. Fortunately, Russian PE is attracting growing interest from local high net worth individuals, pension funds, insurance companies, and corporations. A number of Russian investors became disillusioned with Russian public equity, following the 80 percent decline in 2008, however, as a result, Russian institutional and private investors are once more starting to explore Russian PE, in search of better returns with reduced volatility.

The relatively small amount raised for Russian PE is also due to the significant challenges involved in raising Russian PE funds, and the volatility many first time funds have experienced over the past fifteen years. Many PE funds raised in the 1990s fared poorly due to the crisis of 1998, with losses forcing some to exit, while deterring others. While two of the oldest Russia-dedicated PE firms recently succeeded in raising their third and fourth funds, most PE firms in Russia are still on their first or second fund. During the recent economic boom, Russian private company valuations surged. It became challenging to acquire stakes in good companies at reasonable valuations, and many investments made in the last two years now appear over-priced. EMPEA tracks investment levels in emerging markets and reported that PE investment in Russia surged from \$0.6 billion in 2006 and \$0.8 billion in 2007, to \$2.7 billion in 2008. Many funds invested most or all of their capital; some Russian PE partnerships are even undergoing restructuring, due to a combination of bad deals, staff turnover, and failure of LPs to fund their capital commitments. Those Russian PE groups that have capital to invest are reviewing deals, seeking to acquire good companies with stable cash flows, at reduced valuation multiples.

## Broadening Focus

The focus of private equity in Russia continues to broaden, mirroring the development of the economy, with increased demand for equity to finance businesses in a wide range of consumer and industrial industries, both manufacturing and services, including food and beverage, technology, transport, media, and in recent years real estate and infrastructure. Real estate and infrastructure represent large segments of the economy which require enormous investment for modernization and expansion, although both segments have raised relatively limited partnership capital to date, and are more dependent on cost-effective debt to achieve target returns, so are likely to experience more moderate growth in the near term. Successful private equity backed companies are involved in many other industries, including specialty retail, movie theaters, auto and home security, agribusiness, software, and business process outsourcing. Other private equity backed companies target new, relatively underserved sectors in the economy, including, elder care, health care, waste management, supply chain services, and document storage. Others include: fitness, food processing, casual dining, auto retail, consumer finance, oil field services, multi-modal transport, logistics services, and real estate.

Many leading Russian economists continue to lobby for further liberalization of the economy and for structural reforms as a means to aid new business formation, job creation, economic growth and diversification. Empirical studies in the U.S. and Russia show that industries in which the government played an active role and where greater regulation existed lagged in growth, profitability and overall competitiveness.

Structural reforms have advanced slowly in Russia in recent years and the Russian government must determine the timing and pace of any further reforms. Investors and entrepreneurs watch closely for substantive policy initiatives that demonstrate Russia's commitment to reform and to developing its economy to its full potential, and the degree to which property rights are protected. Meanwhile, the delay of Russia's WTO accession sends a mixed signal to domestic and international businesses and trading partners regarding its commitment to promoting free trade, open markets, and long-term competitive development.

## Russia's Image Problem

Regrettably, Russia also has an image problem with global investors. While misperceptions cloud the picture, real challenges exist that impede raising both international and local capital for Russian PE and SMEs. Legitimate concerns include a weak judicial system, corruption, and the large role which the government continues to play in the economy. Investors, owners and entrepreneurs would welcome the introduction of stronger legal measures to protect against aggressive raider activities, which hinder the development of successful businesses, harm the country's reputation, raise the risks and cost of capital and impede the flow of funds to SMEs. Taken together, economic liberalization, structural reforms, and stronger measures to protect property rights would bolster investor confidence, increase entrepreneurship and competition and stimulate economic development.

A key event in the development of Russian SMEs and the Russian private equity industry was the Vimpelcom IPO in November 1996. Originally backed by a group of private investors and PE funds, Vimpelcom was the leading mobile phone operator in Moscow at the time. The Vimpelcom IPO demonstrated to local owners, managers and investors the powerful wealth creation which can be derived from the market capitalization of a successful, transparent business, which is many times the wealth which can be made by owners and



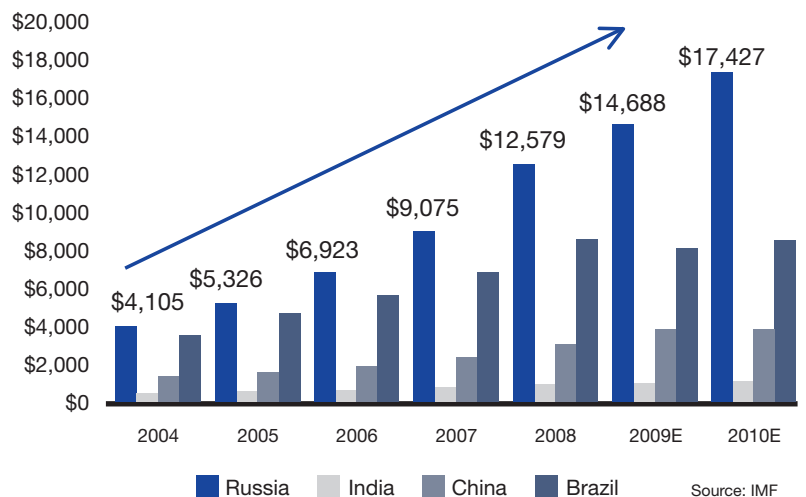
managers who seek to maximize short-term cash flow and stealing.

Another example of the successful fusion of entrepreneurship, SME and PE in Russia is World Class (now also referred to as Russian Fitness Group). In 1993, Olga Sloutsker founded World Class, Russia's first modern fitness company. In 2006, Alfa Capital Partners made an investment in World Class and her chain of ten clubs. Over the last three years, it has expanded to thirty clubs, with roughly 100,000 members and nearly 3,000 employees. For fifteen years World Class has promoted fitness and in so doing, pioneered a new industry to develop. Unfortunately these entrepreneurial successes rarely get the same amount of publicity as the problems in Russia. Meanwhile, my own personal involvement with successful Russian SMEs has exposed me to the tremendous skill, passion, and determination of Russian entrepreneurs and informs my own confidence in the great potential for SMEs and PE in Russia.

Russia must determine for itself its economic priorities and its model for economic development, including the role of SMEs, free trade, and private equity funds. While many informed observers remain skeptical as to whether Russia can achieve sustained high growth through entrepreneurship and SMEs, as has occurred in many countries around the world, I believe the potential is great and depends mostly on creating favorable conditions and providing some catalytic support. There is significant international experience that the Russian government can tap into to develop its own strategy for how best to promote development of SMEs. Government support for the private equity industry and development of a domestic funding base play an important role. The United States is indisputably the most advanced market for private equity in the world, and venture capital, private equity, and SMEs have been an engine of U.S. innovation, growth, wealth creation, and national competitiveness. The United States has

### Russia's GDP per capita is rising and outperforming other BRICs

GDP per Capita (US\$)



unmatched experience to share regarding entrepreneurship, management training, and the cross fertilization of academia, research, capital markets, and investment institutions. During July's presidential summit in Moscow and its parallel business summit, both Presidents, their advisors, and invited guests shared experiences and explored the many opportunities for closer economic cooperation. If President Medvedev signals continued interest, President Obama can encourage experienced U.S. VCs and PE managers and entrepreneurs to explore partnership and investment in Russia, bringing valuable capital, know-how, contacts, and credibility. Closer cooperation offers benefits to all participants. Strengthening business and commercial ties between the U.S. and Russia could improve relations, broaden and deepen mutual interests, and serve as a shock absorber to soften the bumps from periodic political differences. Most importantly, it can be a big boost to advancing Russia's economic priorities.

*This article reflects the personal views of the author.*

*At the federal level and within the business community, there is growing focus regarding the need to support small- and medium-sized enterprises in Russia. Here, experts from Lidings Law Firm examine special legal benefits that already exist for this category of business.*

# Legislative Benefits for Small- and Medium-sized Enterprises

**By Andrey Zelenin (Partner, Lidings Law Firm, and co-chair of AmCham's Enterprise Development Committee) and Dmitry Pavlov (Associate, Lidings Law Firm)**

# 10

**T**he primary statute regulating activity of the subjects of small-sized and medium-sized enterprises (SMEs) is the federal law "On the Development of Small-sized and Medium-sized Enterprises in the Russian Federation," dated June 24, 2007, No. 209-FZ (Statute). The Statute introduces several criteria which can be used to identify enterprises as small- or mid-sized:

1. SMEs can only be commercial organizations or entrepreneurs.
2. The overall amount of participation in the enterprise's charter capital of Russian state, regional and municipal governments, foreign legal entities, foreign citizens, public and religious organizations (unions), charitable and other funds of legal entities cannot exceed 25 percent (except for assets of joint-stock investment funds and closed share investments funds); participation in the charter capital of one or several legal entities that are not SMEs themselves can not exceed 25 percent as well.
3. The Statute regulates the requirements for the average amount of employees for SMEs:
  - From one hundred to 250 inclusive employees for mid-sized enterprises
  - Up to one hundred employees for small enterprises
  - Up to fifteen for micro enterprises
4. According to the Statute, the Government is empowered to set the maximum amounts of profit received from the sale of goods (works or services) or the balance cost of assets for each category of enterprises.

The Decree of the Government of the Russian Federation, dated July 22, 2008, No. 556, sets forth the following thresholds of income from the sale of goods:

- For mid-sized enterprises: 1000 million rubles
- For small-sized enterprises: 400 million rubles

- For micro enterprises: 60 million rubles

The category of the SME is subject to change if the maximum threshold of the SME is higher or lower than the stated maximum during two calendar years in a row.

The Statute provides that the newly created organizations or newly registered entrepreneurs are entitled during the year in which they were registered to be recognized as SMEs, provided that the average threshold of the number of employees, amount of profit received from sale of goods, or the balance cost of the assets for the period left from the state registration will not increase.

The main measures of state support of SMEs are provided in the Statute as well. They include, among others:

1. Special tax regimes, simplified rules for tax accounting, and simplified forms of tax declarations on certain taxes for small-sized enterprises;
2. A simplified accounting system for SMEs that conduct certain types of business;
3. A simplified procedure on compilation of statistical accounts by the SME;
4. A preferential procedure of calculations for the privatization of state and municipal property by SMEs;
5. Peculiarities in procedure of participation of SMEs as suppliers (performers, contractors) in the placement of orders for the supplement of goods, performing of works, or rendering services for state and municipal needs;
6. Measures for ensuring the rights and legal interests of SMEs during the execution of the state control (supervision);
7. Measures on ensuring the financial support of SMEs;
8. Measures on the development of the support infrastructure for SMEs and

9. Other measures that are aimed at ensuring the implementation of goals and principles set forth in the Statute.

### Tax Regimes

SMEs are entitled to convert from the ordinary tax regime into Simplified Tax Regime (STR). STR is a combination of profit tax, property tax, and a unified social tax into one single unified tax calculated on the results of the business activity of the organization – either 6 percent from overall income or 15 percent from net profits, as the taxpayer chooses. Organizations that pay STR are not obliged to pay the Value Added Tax (VAT) except for the cases where VAT must be paid when importing goods into Russia.

The Tax Code of the Russian Federation provides a list of organizations that cannot pay according to STR. It includes, among others:

- Organizations that have branch offices or representative offices;
- Banks;
- Insurers;
- Non-government pension funds;
- Investment funds;
- Professional participants on the stock market;
- Organizations operating in the spheres of extraction of mineral resources and
- Foreign organizations.

The maximum amount of overall profit for STR eligibility is set at 20 million rubles. However, recent court practice suggests that amount shall be indexed according to inflation and currently equals approximately 60 million rubles. Also, the government has initiated a draft law to increase this threshold. Importantly, a conversion back to STR can be implemented no earlier than one year after the taxpayer has last exceeded this limit.

Another special taxation regime available to companies engaged in a limited list of customer-related activities (dry cleaning, repair services, technical services, car washes, small retail shops, and restaurants) is the Uniform Tax on Inputted Income.

### Simplified accounting rules

According to Article 4 of the Federal law “On Accounting,” SMEs that use STR are not obliged to implement general accounting rules except for rules on accounting of the main assets and non-material assets. However, our practice shows that businesses do not generally use this exception because standard accounting may be required for reviews in banks and other partnering organizations, as well as if the company switches back to a normal tax system.

The measures mentioned above are well known to Russian entrepreneurs: they help lower the amount of paperwork, cut tax accounting expenses, and, in some cases, decrease the tax burden. However, there are some other benefits available to SMEs.

### Preferential procedure of privatization

The current legislation provides a preferential procedure for settlement for the privatization of state and municipal property by SMEs. Clause 5 of Article 3 of the Federal law “On Privatization of State and Municipal Property” sets out that the peculiarities on participation of SMEs in privatization of the leased state and municipal real property may be regulated by the statute.

At the present time, the Federal law “On Peculiarities in Disposal of the Real Property Owned by the Regions of the

Russian Federation or Municipal Governments and Leased by SMEs and on Amending Particular Legal Acts of the Russian Federation” dated July 22, 2008, No. 159-FZ, provides that the lessee has the preemptive right to acquire the leased property owned by the regions of Russia or municipal governments if certain conditions are implemented.

Article 5 of the previously mentioned statute is named “The Procedure of Payment for the State and Municipal Property, Acquired by the Lessees Upon Exercising the Preemptive Right on its Acquisition.” It stipulates the installment of payment for the property, providing that the right to choose the order of payment (in a lump sum or by installment) belongs to the SE upon exercising the preemptive right to acquire the leased property.

The Russian Government, in Decree No. 961, dated December 18, 2008, introduces the maximum area of the premises owned by the regions of Russia or municipal governments that are leased by SMEs for the purpose of exercising their preemptive right in order to acquire such property. The limit is 1,000 square meters; and the longest term of installment is three years. The decree took effect on January 1, 2009.

### State and municipal orders

Federal law No. 94-FZ, “On Settling of Orders on Supply of the Goods, Performance of Works, Rendering Services for State and Municipal Needs,” dated July 21, 2005, contains the provisions related to particularities of the participation of SMEs as suppliers (contractors).

Part 1 provides that: “State customers, excluding the cases of making the orders on the supplying of goods, performance of work, rendering services for the purpose of the country’s defense and security of the state, and the municipal customers shall make orders to SMEs in an amount no less than 10 percent and no more than 20 percent of the total annual value of supply of the goods, performance of work, or rendering of services in compliance with the list of goods, work, or services stipulated by the Government of the Russian Federation, by means of holding tenders, inquiring about quotations, participants being SME, and the state customers in cases of making orders on the supplying of goods, performance of work, or rendering of services for the purpose of the country’s defense and security of the state, are entitled to make such orders.”

The requirements with respect to the highest price of the contract are also stipulated in the aforementioned statute. It is set out that “upon making an order by holding tenders, inquiring about quotations that are provided in Clause 1 hereof in which the participants are SMEs, the applications for participation in the contest, auction or quotation applications submitted by the participants that are not SMEs shall be declined.”

The list of the goods, works, and services for state and municipal purposes that are ordered from an SME is approved by the Decree of the Government of the Russian Federation, dated November 4, 2006, No. 642, “On the List of the Goods, Works, and Services for the State and Municipal Purposes Ordered from an SME.”

### Measures on protecting SME rights and interests during government revisions

There are only a few issues related to measures on protecting the rights and obligations of SMEs during control (supervision) by state authorities. The federal law “On Protecting the Rights of Legal Entities and Entrepreneurs During State Control (Supervision),” dated August 8, 2001, No. 134-FZ, contains only a single provision that, with respect to SMEs, supervision may be not declared earlier than three years after the date of the state registration of the respective SME.

The Federal law No. 294-FZ, “On Protection of the Rights of the Legal Entities and Entrepreneurs During Exercising State Control (Supervision), Municipal Control,” dated December 26, 2008, which came into effect on July 1, 2009, contains another provision that: “... with respect to the one SME the total term of the planned on-site revision shall not exceed fifty hours for an SME and fifteen hours for a micro-enterprise per year.” (part 2 of the Article 13)

#### Other forms of government support

Article 16 of the Statute introduces a list of forms of government support for SME. The list includes, among other things, the following: financial; property; informational; consulting; support in the area of preparation, retraining and improvement of professional skills of SME employees; support in the area of innovations and industrial production; support of an SME whose main business is related to foreign trade; and support of SMEs that carry out agricultural activity.

#### Issues related to competition legislation

The Letter of the Federal Antimonopoly Service (FAS) of the Russian Federation, No. AK/2550-pr, dated October 17, 2008, informs entrepreneurs of new measures proposed by the government for increasing benefits for SMEs.

According to the Letter, up to July 1, 2010, the procedure of repeated tenders is not required for the prolongation by SMEs of existing lease agreements. Likewise, a prolongation of such lease agreements is possible only until July 1, 2010.

#### Financial maintenance of measures

The Decree of the Government of the Russian Federation No. 249, dated April 22, 2005, “On Conditions and Procedure of Rendering Assets of Federal Budget for the Government Support of Small Enterprises and Farming Enterprises,” provides the rendering of government grants, for example, for the creation and development of business incubators. The Decree introduces provision of grants for supporting businesses that manufacture and sell goods (works, services) for export as well as provisions of grants for the development of crediting systems of SMEs.

#### Regions of the Russian Federation

The regions of the Russian Federation are taking proactive position in adopting programs of support for SMEs. For example, there are several government authorities in Moscow that were initially created for supporting SMEs. Among them are: the Department of Support and Development of Small Enterprises, and the Commission on Financial and Property Support of Small Enterprises.

In January 2006, the non-profit organization the Fund of Assistance for the Accreditation of Small Enterprises was created in Moscow. The main purpose of its activity is to provide state guarantees regarding credit, loan, and lease agreements for SMEs.

In other areas of Russia, measures for supporting SMEs are proactively being taken as well. According to the Statute, the regions are entitled (along with already established forms of support by the federal authorities) to independently render other forms of support at the expense of their own regional budgets.

The Statute provides federal authorities, authorities of Russia’s regions, and municipal governments the right to establish lists of state or municipal property that is free from the rights of third parties (except for property rights of SMEs). The property in such lists can only be provided for SMEs and organizations that form an infrastructure of support for SMEs for use on a long-term basis (these lists must be published in the mass media and online).

It should be said that Decree No. 797, signed by the President on May 15, 2008, “On Urgent Measures for the Liquidation of Administrative Restrictions at Realization of Enterprise Activity, suggests that regional authorities should have the right to define procedures of granting premises to SMEs for rent on a long-term basis. Only those premises that were initially allocated for such purposes can be granted. Premises rented to SMEs can be bought by the SMEs if they were rented for no less than three years, without tender procedure, but with the possibility of payment in installments.

#### Crediting

Another noticeable act related to SME support is Government Decree No. 1007-r, dated July 27, 2007, which contains Section IV, entitled “Conditions, an Order and Restrictions of Financial Support of Credit Organizations and Legal Bodies in Order of SME Development.” This statute provides that the term of accrediting the SME must be more than two years. The amount of credit cannot exceed 150 million rubles. Vneshekonombank provides guarantees and credits to the credit organizations and the legal entities that are carrying out support for SMEs.

\*\*\*

Analyzing the statutes discussed above, we conclude that a trend for the development of SMEs has been set. However, not everything that has been conceived was realized. It is very likely that the government will further expand benefits and preferences for SMEs in the near future.