

EBRD strategy for the Russian Federation 1996-97: a summary

Overall priorities

The EBRD will continue to focus on the following priority areas:

- To achieve a *transition impact* by participating in institutional development and acting as a strong catalyst.
- To continue a *regionally focused approach*. The EBRD has achieved significant impact in St. Petersburg and aims to achieve similar impact in Ekaterinburg and Vladivostok. It also proposes to increase its efforts to identify project opportunities in Moscow and to be reactive to bankable investment proposals in other regions in Russia.
- To continue with a proactive effort in *stand-alone financing of major Russian companies* in key industries in Russia even without Western strategic partners.
- To continue to focus operations on *banks making progress under the Financial Institutions Development Project (FIDP)* and to strengthen capital markets by initiating investments in Russian mutual funds and exploring the possibility of investing in brokerage companies and pension funds. The financing of the aerospace sector will continue to be a priority area, and in the natural resources sector a shift is to be made towards areas such as refinery and transportation. A considerable increase in activities is envisaged in the telecommunications sector, and both public and private sector transportation projects will be undertaken. The EBRD aims to open up the power sector to private sector financing, and intends to make a special effort to increase the role of the Bank in the agribusiness sector and in the field of energy conservation.

Achieving transition impact

The EBRD aims to achieve a broad transitional impact by:

- participating in key *institutional developments*, the benefits of which will last long after the Bank's involvement (for example, the national

share registry and St. Petersburg municipal financing);

- acting as a *path breaker* for new types of financing, helping to remove obstacles and increasing the *demonstration effect* of the Bank's operations (for example, private sector power projects and financing of satellite launching);
- being a *catalyst* for attracting new lenders and investors, both foreign and local (for example, boosting trade finance through the Trade Facilitation programme);
- using the experience that the Bank has gained to provide *constructive feedback* to its partners - government and business - on how to improve the business environment and practices.

The EBRD will continue to emphasise the importance of strict compliance with relevant law, of respect for the rights and interests of minority shareholders, and of ethical conduct on the part of managers and directors, and insist on compliance with such standards. Good corporate governance is a main priority and a prerequisite of the Bank's involvement in industrial companies.

Cooperation with the government and business

The EBRD's strategy emphasises the importance of building a strong relationship with key players and institutions in both government and business. The establishment of the Interdepartmental Working Group, dealing with issues strictly related to the EBRD, has provided the Bank with a regular opportunity to discuss strategic and operational issues with representatives of the government. This will also be the forum for seeking an early indication of the availability of sovereign guarantees. The EBRD also participates in the work of the Foreign Investment Advisory Council, which aims to improve the general investment climate in Russia.

Regionally focused approach

The EBRD will continue to take a regionally focused approach. Significant impact has been achieved in St. Petersburg, and some progress is being made in the area around Vladivostok, two of the regions

where the Bank is working proactively with a long-term commitment. The Bank also expects to have a similar impact in a third region - the industrial area of the Urals, in and around Ekaterinburg. The selection of this third region was based on specific criteria, such as degree of privatisation, direct foreign investment, local banking capability and the potential for benefits to surrounding regions.

In the three selected regions the local presence of the EBRD will be maintained through the Bank's local representatives and through a range of wholesale Bank products, such as Regional Venture Funds (see below) and FIDP banks. Resources will be applied proactively, utilising the expertise of the EBRD teams working in Russia. Particular emphasis will be given to involving local banks in the EBRD's activities.

In those regions where the Bank has already built up important relationships, such as in Krasnodar, Kaliningrad and Samara, as well as in all other regions where the EBRD presently has only a limited presence, the Bank will continue to be reactive to bankable investment proposals. Throughout the country the EBRD will continue to be responsive to requests for financing from strong Russian and Western sponsors who are developing large, high-quality projects with a substantial financing requirement.

In Moscow, which remains the centre of economic activity in the country, the EBRD will increase its efforts to identify project opportunities and will prepare a specialised credit line to finance bankable projects in the city. The EBRD's priority will continue to be the provision of support to the central institutions of government.

Reducing reliance on central government guarantee

The EBRD is exploring the credit-bearing capacity of selected local governments. As a pilot case, work is already under way to help the municipality of St. Petersburg establish its creditworthiness. The Bank is assisting the local authorities find better ways to run their municipal services, helping to formulate the city's investment programme and defining the steps needed for a credible municipal budget and borrowing programme. The aim is to develop the existing relationship into a wholesale approach to municipal finance which could result in new investments in the municipal services sector, with a focus on utility restructuring and the move towards more revenue-based financing.

Financing major Russian institutions and enterprises

The EBRD will continue its effort in stand-alone financing of major Russian companies in key industries in Russia - even without Western strategic partners. Through these operations, the Bank can achieve strong transitional impact.

The EBRD has expanded its investment with companies serving primarily the domestic markets. The experience to date indicates that this requires a different approach from the traditional project financing (including a shift to corporate finance and stronger emphasis on equity financing).

Sectoral priorities

The EBRD will continue to focus on well-defined sectoral priorities.

The financial sector

Banking

In the banking sector, the EBRD continues to focus its operations on the larger private sector banks, which are making progress under the FIDP.

The Russian Trade Facilitation Project is being implemented. Recognising the rapid progress that has been made towards the commercialisation of the two most active State banks (Rosvneshtorgbank and Sberbank), relations were developed with each of them, and stand-by and credit line facilities (respectively) were approved to a total of US\$ 200 million. Consideration will be given to developing similar relations with the remaining public sector banks (Agroprombank and Roseximbank). This approach will broaden the EBRD's ability to deliver finance to a range of enterprises, including many smaller, individual investment requirements.

The EBRD will undertake discussions with a few of the strongest and most professional Russian banks, which will act as "informal" partners rather than as targets of technical cooperation projects or specific credit lines. Such a partnership could include: the local banks' assistance in identifying good projects and clients from existing pipelines; establishment of joint operations teams for the appraisal of the project once initial interest has been confirmed; project implementation arrangements, including an increased role for the local bank in performance monitoring, covenant compliance checking and the analysis of financial information; the establishment of escrow accounts to capture revenues in local currency; and co-financing.

Capital markets

The Bank will continue to undertake proactive work in strengthening capital markets. It will seek

underwriting opportunities in public offerings of privatised enterprises, initiate investments in Russian mutual funds, and explore the possibility of investing in brokerage companies and pension funds.

Enterprise development

Among the projects approved or in the pipeline, there is a concentration in specific sectors, such as shipping; automobile production; metallurgy; wood processing and the pulp and paper industry; and the aerospace industry. This concentration is likely to remain, as it reflects factors such as the country's comparative advantages, the interests of foreign investors and the perceived market prospects. Only a limited number of new sectors will be exploited.

There is already a shift towards a wholesale approach in the EBRD's Russia portfolio. A number of multi-project facilities are expanding into Russia and there has also been a significant expansion in the range of financial intermediaries.

The role of the Bank is to enable Russian companies to fulfil orders from creditworthy foreign buyers by providing each company with working capital or by providing the foreign buyer with performance guarantees.

Agribusiness

A priority is to provide intermediary financing for the abundance of small-scale projects, typical in agribusiness, and to support the infrastructural projects, like the pilot seed potato programme initiated by the government. Since the number of major Western investors in this sector is likely to be limited, emphasis should be on financially strong Russian partners, with a willingness to incorporate best Western management practices.

Regional Venture Funds

The EBRD will explore the possibility of establishing further RVFs with less technical cooperation funding and greater initial investment from the private sector. The Bank is currently developing a RVF - with private investors and technical cooperation support - for investments in the automotive sector, covering central and eastern Europe and the Commonwealth of Independent States, with at least half of its capital likely to be invested in Russia.

TurnAround Management

The first TurnAround Management (TAM) programmes in Russia have been established, and

many more enterprises are due to be supported by the TAM programme, sponsored by the Russian Privatisation Centre. These enterprises will be selected in groups of 10 to 12 in geographical areas where the EBRD has one of its RVFs.

Support of small businesses

The EBRD is continuing to implement the Russia Small Business Fund (SBF), which is supported by the G 7. More than 1,700 small and micro loans have been granted so far. As an example of the integrated support packages tailored to the needs of the EBRD's clients, the SBF offers small and micro credits, equity participation and equity-related investments in combination with business advisory services provided by the Business Training Centres (BTCs) of the Morozov project.

Natural resources

Natural resource projects will continue to be of great importance to the stabilisation of the economy, through the supply of oil, gas and minerals, the generation of hard currency, technical know-how transfer, improvement in the environment and employment.

Oil and gas

The EBRD will continue to participate in financing oil projects if these ventures have the strong support of a Western oil company or if a financially sound Russian oil company is involved. An important corner stone for these very large investment decisions is the recent approval of the Law on Production Sharing Agreements, which is intended to form a basis for the long-term economic viability of these projects for investors. Transportation of the oil and gas inside Russia and to export locations will continue to be a major focus of the EBRD. This will include not only the improvement of parts of the existing pipeline system in critical areas, but also the participation in financing new important pipeline routes.

The EBRD will also continue to be active in the gas sector. The two-year extensive technical co-operation study (total cost US\$ 8.6 million) on the reconstruction of the Gazprom gas supply and transport system was completed during 1995. Building on the outcome of this cooperation, the EBRD has continued to process high-priority reconstruction investments for financing and has signed a first corporate loan with Gazprom to this effect.

There is a considerable need to upgrade refineries in order to produce products of a higher environmental standard and to be competitive. The EBRD

will concentrate on financing refineries with a strong market position and significant environmental improvements.

Mining

Building on experience gained in the Omolon project, the EBRD will continue to be active in the mining sector, especially in gold mining, to support the development of a technically competent and efficient mining industry.

Power sector

The EBRD's strategy continues to be to open up the power sector to private sector financing without sovereign guarantee and to enhance nuclear safety. The EBRD will continue therefore to develop power projects for generation and possibly transmission. It will support the demonopolisation of the sector through the financing of independent power producers, particularly in regions where the shortage of power has already driven electricity prices to levels compatible with private financing, and where the demand is projected to be stable in the long term.

Nuclear safety

The EBRD will continue to promote nuclear safety both directly through the activities of the Nuclear Safety Account and indirectly by supporting the development of replacement power generation and transmission capacity in areas where replacement is needed to permit the shutting down of unsafe reactor units. The Bank is ready to finance non-private sector new or rehabilitated generation capacity to the extent that such projects will enhance nuclear safety.

The EBRD is also maintaining close contacts with the Russian authorities on nuclear liability legislation and is encouraging the Russian Federation to become a party to the 1963 Vienna Convention on Civil Liability for Nuclear Damage.

Energy conservation

A special effort is to be made to build up a pipeline in the area of energy conservation by originating financing mechanisms which will enable the EBRD to finance energy-saving projects.

Transport

In the transport sector the EBRD will focus on projects where it can help create innovative, limited-recourse project-financing packages with beneficial environmental impact. It will also seek to involve other private sector foreign and local lenders or investors.

Public infrastructure projects will be prepared only if they clearly fit into sovereign borrowing priorities of the government and if the EBRD has a comparative advantage compared with other international financial institutions. The EBRD has agreed with the World Bank that in the railways sector the EBRD will take a lead role, while the roads and highways are left primarily to the World Bank to finance.

Telecommunications

The EBRD aims to increase considerably its presence in the telecommunications sector. A wide array of new projects - in mobile telecommunications, overlay networks and local systems - is under consideration.

Property development

The EBRD has identified Moscow and St. Petersburg as priority areas for property development as both cities suffer from a lack of modern office, industrial, retail and hotel accommodation. The Bank is seeking to increase its portfolio through the support of all types of commercially viable and well-structured projects.

In Moscow the EBRD will continue to consider the most urgent needs for office space and modern warehousing and distribution facilities as well as support for retail and mid-range hotel projects on a case-by-case basis. In St. Petersburg the EBRD is looking for opportunities in all areas of the market and is also seeking to expand into Russia's secondary cities.

Cooperation with other international financial institutions

International Monetary Fund

The EBRD has been invited to participate in the preparatory phase of the proposed IMF Extended Fund Facility, which is worth US\$ 9 billion over three years. The EBRD was asked to make proposals on how to improve the business environment and current business practices in Russia.

World Bank

The key area of the EBRD's cooperation with the World Bank is the joint identification and financing of projects. Practically all of the EBRD's sovereign operations so far in Russia have been co-financed with the World Bank. Coordination of the approach to economic policy-making is an important part of the working relationship. In the transport sector, for example, there is an agreed division of labour

between the two institutions. There is also coordination in the regional approach - in St. Petersburg, for example, the World Bank is concentrating on improvements to the centre of the city while the EBRD is pursuing a wider approach in helping the city to establish its overall creditworthiness.

International Finance Corporation

The EBRD has been working with the International Finance Corporation (IFC) on a number of operations. During 1995 the Bank sought in particular to cooperate with the IFC in the area of capital markets development in Russia. The first example of this is the joint shareholding in the National Registry Company. The EBRD has also discussed an investment in the Depository Clearing Company, once the technical assistance phase (provided through the EBRD privatisation loan) has been completed.

European Union

The European Union is the largest provider of technical cooperation funds for project preparation and implementation work related to EBRD-financed projects. At the local level, the Bank's Moscow Office is seeking to work more closely with the Tacis Moscow Office and to channel Tacis funds available for local allocation towards project development and due diligence activities for EBRD projects. This initiative is under consideration by the EBRD and Tacis management.

The EBRD welcomes the initiative of the European Commission to reserve part of the funds under the Tacis programmes for cross-border investment projects. It is expected that the Commission will broaden the use of Tacis funds for investments to cover the whole area of Tacis recipient countries in the future. This would enhance co- and parallel financing opportunities with the EBRD.

This document is based on the EBRD's Strategy for the Russian Federation, approved by the Board of Directors at its meeting on 19/20 March 1996.