RUSSIA, TIMBER!
Watch out for the Fall…
A CASE STUDY

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Executive Summary

Russia, February, 1993, one year after the cold war has ended. President Yeltsin is trying to work magic by taking a country that has been shrouded in mystery, an allied to very few, and turn it into a democratic, market economy. In order to do this, Yeltsin needs the help and support of those who were considered the enemy. From the foreign business person's perspective, suddenly a country that has unlimited, untapped resources that had been virtually entrenched in communism, within a closed economy, is striving to create a market economy. The unlimited, untapped resources are ripe for the taking. All that is required, is capital and an honest, hard working Russian partner. Simple, right? Not really. Doing business in a foreign country where you as the foreign investor are afforded very few rights, with lack of knowledge of the culture and business requirements, and an ever changing taxation structure, can cost more than capital investments.

Natural Resources

As the world moves toward a global economy, the lure to foreign business opportunities is powerful, especially, when the possibility of untapped opportunity is coupled with the promise of tremendous rewards of unbelievable wealth. Russia is currently one of the largest emerging markets that if tapped, hold the prospect of huge wealth, and endless opportunities. Opportunities, that for the average business person, are generally, not attainable in the United States. The wealth in Russia lies in the fact that it is the world's largest country, that holds some of the largest sources of untapped resources. Russia has a wide natural resource base, including major deposits of oil, natural gas, coal, and many strategic minerals, and timber. However, there are a number of formidable obstacles of climate, terrain, and distance that hinder the exploitation of these natural resources.

Whether the resources are natural in the form of timber, or human in the form of human capital, Russia is a country sitting on the brink of discovery. Russia also possesses the availability to produce any and all products. However, the Russian population does not currently posses the technical knowledge, initiative, and corresponding technology to develop their natural resources. It is this knowledge and technology that they must get through U.S. capital investment. Unfortunately for the U.S. business person who strikes blindly out to discover, hoping to make their fortune in opportunity promised by the Russian government, or their Russian partners who will help "walk you through" the maze of the tax process, joint-venture legalities, or the Russian Mafia, misery may be the only thing discovered by the U.S. business person.

The Dilemma

This dilemma has faced 90 percent of the investors who have ventured into Russia. After having pored millions of dollars into hopes and dreams of both helping a country discover itself through democracy, and unbelievable return on investment, companies have found themselves holding the bag, so to speak, empty handed.

This is what happened to us when we decided to scale down operations at our busy, thriving home building, land development company in Arizona, for the greater opportunity offered in Russia in the form of Russian/American joint-ventured sawmills. Sawmills that were desperately needed to harvest some of the untapped natural resources that as of now, have been left to die because of the lack of available technology.

> After researching available sawmills in the United States, we purchased a mill, dismantled it, shipped it across the ocean, and reassembled it in Central Siberia, Russia. From the very first container of equipment to arrive at port in Russia, the problems began. The expected problems of doing business in the United States don't scratch the surface of what the unsuspecting business person in Russia can expect. The problems in Russia run the spectrum from equipment too large to travel the rail line without special arrangements, to theft of the equipment at the port, to theft of the containers after emptying the equipment. (In Russia, due to the lack of adequate housing, 40 foot containers are stolen at port and used for housing. Shipping companies generally require the

original user to purchase the 40 foot containers instead of leasing.)

Once the equipment did pass through the port, surviving both the long voyage by ship, and then being shipped by train to the interior of Russia, there was the problem that the equipment would not meet with Russian specifications for power requirements, that the equipment would not be allowed to be transported to the mill, or that the equipment would need repair that was not available in Russia. This required skilled personnel to be available on sight, in Russia, from the United States who could not only take care of the equipment, but train the Russian workers on the workings of the U.S. equipment, and Western production methods.

Human Resources

Russia claims a population of over 149,000,000 (July 1995 est.), and although the Russian population is generally, very well educated, the country continues to experience the difficulty of moving the country from its old centrally planned, "taken care of", economy, to that of a modern market economy. Because of this, the average Russian worker is having trouble adapting from the role of dictated to, to one of motivational achievement. This, coupled with the runaway drinking problem of the general population who is served Vodka at commissaries across the country as a staple with breakfast, lunch, and dinner, make the U.S. business person, who tries to create a safer working environment, by cutting off the Vodka, and training personnel to think for themselves, very unpopular. On the surface, given Western standards and expectations of work force knowledge and skill level, this sounds easier than it is. To retrain a population used to being told what to do, to think for themselves means the entire thought process must be adapted. This situation, one unfamiliar to the U.S. business person, is frustrating at the very best, and can be terminal to the emerging joint-venture.

The Russian Partner

A well connected partner is essential when choosing the profitable path in a foreign country. This partner must be knowledgeable on the inner workings of the government, taxation obligations, who to contact to get things done, and how to work through the Mafia, if applicable. In Russia, the Mafia connection is certainly a big issue. Crime runs rampant. The Mafia is currently very involved in the business development of the country. Time and time again stories are told of business persons being blackmailed, robbed, and killed due to their confrontations with the Russian Mafia. Because of the strength of the Mafia in Russia, it is best to work with them, and not against them. This is one area that the Russian partner is so important. The best Russian business partner is a rare blend of honesty, hard work, and being well connected. Being well connected runs the path on both sides of the road. The connections must be with both government workers, and the Mafia. To walk that thin line satisfying both sides, is a valuable asset in a foreign country.

Four Key Problem Groups

There are four key problem groups that every business person must keep sight of, and these problem groups become all the more important when considering a foreign venture. The four key problem groups are:

- External problems – macro view relating to outside factors.
- Internal problems – controllable issues within the firm itself.
- Operational problems – micro-level problems dealing with day-to-day activities.
- Informational problems – effective, accurate, and timely information is a must.

When considering a foreign venture, the above factors become intensified. Because of logistics, many individuals keep staff on sight at the foreign location, while trying to physically operationalize the venture from a domestic sight. While this is the ideal scenario if you have very trustworthy individuals working for you, others are not usually as interested in your business as you are. Therefore, problems can become more profound, and snowball, with time and distance. Be a hands-on manager if involved in a foreign joint venture.

Imports/Exports

For the importer/exporter, Russia is a fertile market. Russia imports over $35.7 billion (f.o.b. 1994), in the form of a number of commodities, including, machinery and equipment, consumer goods, medicines, meat, grain, sugar, semi-finished metal products, and human capital

Because of the rich resource availability, the Russian markets are able to export over $48 billion (f.o.b. 1994), in items such as petroleum products, natural gas, wood and wood products, metals, chemicals, and a wide variety of civilian and military manufactures. With the development of the country’s resources, the training of the workers, and the growing income base, the import/export market continues to show growth potential.

However, studies have shown that the most successful, and profitable import/export companies are those that know their market inside and out. For the Russian population who has been cut off from the world for so long, there is a certain wariness to strangers. There is also a preference to "country of origin" imports. Simply stated "country of origin" deals with the primary country that the product was originally developed. Russian consumers have been mistreated by some of the countries that were importing goods prior to the cold war. This mistreatment of the general Russian population has come in the form of high prices in combination with inferior products. Consequently, currently, U.S. made products are more valuable that some of the others. However, if the product is claiming to be U.S. made, and it is found not to be, the importer can lose their right to import into the country.

Conversely, this theory also works in reverse for the exporter of Russian goods, specifically with natural resources. Some of Russia's natural resources are not considered to be of the same high standard as those of other countries. Timber in particular, due to the current harvesting and processing of the material, must have special treatments before being exported into other countries. Find out the requirements of the country that would receive the exported good, prior to making a large investment into the material.

Hybrid products are those considered to be made in one country for the distribution of a company from another country. Kraft foods, for example, many times utilizes subcontractors from a country outside of the United States to produce products that will carry the Kraft name for distribution to a number of different countries. Hybrid products generally are viewed as equal to the actual "country of origin" product because they carry the name of the parent product.

Summary

Because of the risk to doing business in a foreign country, prospective investors need to be prepared to do their homework. Some key things to think about are as follows:

- Know your partner - check them out thoroughly. Are they able to represent your interests efficiently and effectively? Are they honest? Are they as hard working as you are? Do they place the best interests of the joint-venture over their own?

- Be a hands on manager, or make sure you can trust your on sight manager. Remember, employees are never as interested in your investment as you are.

- Know the culture. Are they familiar with your products? Is "country of origin" an issue? Does the name of your product translate into something entirely different? How is business handled in this country? Do they get to know you socially first, or get right to business?

- Know your market. Who is your target? Are they accessible and can you reach them? Can they afford your product once they have been identified?

- Know the government and political atmosphere. If this isn't possible, make sure your foreign business partner is savvy.

- Know the economy of the country. Is the economy growing or declining?

- Hire your own interpreter. Don't rely on your foreign business partner to provide an interpreter for you. Who then does the interpreter work for, and can you trust that what you said is truly what was interpreted?

- Have a Letter of Credit drawn on a reputable bank.

- Know the country's legal regulations. How is a joint venture handled in this country? What are the rules for activity of the partnership? Is there an activity time requirement before the venture reverts back to the foreign partner? What are the taxation laws, and are they likely to change through the duration of your transactions?

- Always heed the experts advice. If more companies than not have failed in this climate, what makes you think that you can succeed?

- Realize as a foreign investor, you have no legal rights. Normally you are unable to hold property in the country, and the only legal recourse available to you is through the World Court. Even if they rule in your favor, you may never collect.

You are a foreigner completely at the mercy of your partners and host country.

In short, due your homework. Know your partners, your host country, the rules and regulations, and above all, **don't** lose your head, don't think that you are more than you are. Many foreign cultures spend more time getting to know their potential business partners, than do U.S. business persons. This is a good idea, but don't take it for granted that once the deal is done, that you can comfortably relax. Now is the time to set the wheels in motion, and to continue working hard at knowing your host country and culture. You may be a powerful, successful business person in your own country, but in a foreign country, you are at a distinct disadvantage, welcome only as long as your host country needs you, or requests you to be there.

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