



OPENING THE DOOR IN THE EAST TO WESTERN CAPITAL

Many companies in Eurasia are looking to the West for capital, expertise, and much more these days. But few actually have the necessary experience, contacts, and knowledge to acquire them. The rapid growth and development of Eurasia's economies and a resurgence of its domestic markets has sprawled the need for additional financial resources in the form of loans, investments, and other financial instruments.

According to the World Bank, foreign direct investment inflows into Eastern Europe & CIS went up by 56% in 2006 and reached \$62 billion compared to \$39.7 billion in 2005.¹ As foreign direct investment keeps rising and the businesses in the area keep thriving, Eurasian companies that find a way to attract relationships with Western and specifically American investors stand to reap substantial financial rewards and obtain a considerable competitive advantage in their market. A relationship with an American investor can add a lot of value to a Eurasian company, such as:

- Capital for rapid expansion, either debt or equity
- Access to global markets
- New distribution and sales channels
- Reputation and credibility
- Industry expertise
- Professional management
- Global image and marketing
- Cheaper regional financing

American organizations are willing more than ever to invest in Eurasia to take advantage of the above-average, risk-adjusted returns associated with the developing region. Eurasia presents American companies with many opportunities including the chance to:

- Gain access to a distribution network in Eurasia
- Grow top line and bottom line through acquisitions
- Capture synergies generated from collaboration
- Lower overhead costs by outsourcing to a low-cost off-shore location
- Expand geographic reach
- Diversify global risks
- Broaden an existing product portfolio

There are a number of different sources of financing Eurasian companies should understand and potentially consider. A thorough assessment of the needs of the organization must first be conducted in order to determine the type of business relationship and financial terms that would be best suited for that particular company. The actual deal structure will depend on a plethora of factors including the company's goals and the type and scope of financing it seeks.

International Banks and Government Organizations

A good source of financing that companies should consider are international organizations and government agencies. Another type of capital can be sought from Private Equity funds or institutional investors. International development banks, such as the World Bank (WB), European Bank of Reconstruction and Development (EBRD), and Asian Development Bank (ADB), all have programs in place directed specifically at financially assisting companies in the Eurasian region. These are set up as either for profit or non-profit organizations whose service offerings vary from guarantees, risk insurance, and debt financing, to investments in regional Private Equity funds and direct equity stakes in various kinds of companies.

¹ "Foreign Direct Investment Rose by 34% in 2006," Press Release, United Nations Conference on Trade and Development. Available from <http://www.unctad.org/Templates/Webflyer.asp?docID=7993&intItemID=1528&lang=1> (accessed 06/29/2007).

The largest single investor into the Eurasian region is the EBRD.² The EBRD provides project financing, lines of credit, private equity investments, and debt financing for new and existing companies from central Europe to central Asia. In 2006, the EBRD Invested 1.9 billion euros in Russian enterprises.³ It is also the largest financial investor in Ukraine, having committed to date a total of 2.4 billion euros across all sectors of the country.⁴ The World Bank's arm, the International Finance Corporation (IFC), also finances private sector projects in developing countries. It's a for profit organization that offers loans, equity financing, and other financial support for all types of companies. In 2006 the IFC committed and mobilized more than \$9 billion worth of financing for 284 projects in 66 developing nations.⁵ This included \$2.1 billion for the regions of Europe and Central Asia.⁶ Countries located in Asia can also use the ADB as a financial resource. The ADB provides direct assistance to private enterprises through equity investments and loans. These and other organizations can provide financing to companies in countries where conventional financial institutions are often reluctant or simply unable to provide financing to local companies on similar terms.

Aside from the financial resources and assistance that these international organizations can provide, the best single source to look to for investments and other business relationships is the United States. The United States is not only the largest global economy, but it is also the biggest foreign direct investor in the world.⁷ It's well developed private equity markets and supporting government agencies present Eurasian companies with the greatest opportunities to develop international business relationships. Organizations such as the Overseas Private Investment Corporation (OPIC) and the Export-Import Bank of the United States were established to support and expand the international reach of U.S. businesses. OPIC is an independent U.S. government agency whose mission is to mobilize and facilitate the participation of U.S. private capital in the economic development of less developed countries. The funds it supports are among the largest providers of private equity capital to emerging markets.⁸ It provides medium to long term funding through direct loans and loan guaranties, small business loans, large structured financing, political risk insurance, and investment funds. The primary mission of the Export-Import Bank is to assist in financing the export of U.S. goods and services to international markets. These agencies can be of assistance and provide various types of financial support to companies seeking to establish relationships with U.S. firms.

Private-Equity

The decisions of Private Equity funds are driven solely by their pursuit of medium-term economic profit. This is in juxtaposition to most government entities mentioned above, that are generally willing to accept much lower rates of return in exchange for accomplishing certain political and foreign policy objectives, such as promoting U.S. exports, for example.

Private Equity funds can exist in a variety of forms such as venture capital firms, hedge funds, investment banks, and other groups or pools of private investors. The recent surge of private equity investments into the CEE/Eurasia region is expected to continue to increase in the future as the region's

² European Bank for Reconstruction and Development homepage. Available from <<http://www.ebrd.com/about/index.htm>> (accessed 6/29/07).

³ EBRD 2006 Annual Report, 2006: p11. Available from <<http://www.ebrd.com/pubs/general/ar06.pdf>> (accessed 6/28/07).

⁴ European Bank for Development and Reconstruction, Press Release: September 28, 2006. Available from <<http://www.ebrd.com/new/pressrel/2006/132Sept28.htm>> (accessed 6/29/07).

⁵ Highlights of IFC's 2006 Annual report, International Finance Corporation. Available from <[http://www.ifc.org/ifcext/annualreport.nsf/AttachmentsByTitle/AR2006_ExeSummary/\\$FILE/AR2006_ExeSummary.pdf](http://www.ifc.org/ifcext/annualreport.nsf/AttachmentsByTitle/AR2006_ExeSummary/$FILE/AR2006_ExeSummary.pdf)> (accessed 6/28/07).

⁶ Ibid.

⁷ James K Jackson, "U.S. Direct Investment Abroad: Trends and Current Issues," CRS Report for Congress. (April 26 2006). Available from <<http://italy.usembassy.gov/pdf/other/RS21118.pdf>>. (accessed 6/29/2007).

⁸ "Investment Funds," Overseas Private Investment Corporation. Available from <<http://www.opic.gov/investment/index.asp>> (accessed 6/29/2007).

economies continue to thrive, producing some of the highest risk-adjusted rates of return in the world. Earlier this year, the Emerging Markets Private Equity Association (EMPEA) reported that of all private equity groups surveyed, 61% intended to invest in CEE/Russia in 2007, and as much as 87% by 2012.⁹

US venture capital firms are continuing to expand to a more global investment focus and are now more willing to invest into promising companies in Eurasia than ever before. Venture capital firms usually invest in rapidly growing industries and into young, promising companies within those industries that have the potential to return 30 to 40 percent or more on the initial investment.¹⁰ Professionally managed venture capital firms provide seed, start-up, and expansion financing, as well as management/leveraged buyout financing. Venture Capital firms usually invest money for an ownership stake in the company, as well as some control over the decisions the company makes via seats on the board of directors. Venture capital is highly sought after, not only for its capital, but also for the many intangible resources and benefits that often accompany such a relationship. These can come in the form of important contacts in the industry, marketing abilities, and managerial expertise. Venture capital firms actually invest in a very small percentage of all the businesses they consider. Companies that are in the high-tech, biomedical, and information technology fields, which have the potential for high growth, offer a unique product, and utilize an original business model, have the best chance of obtaining such financing.

Another source of private equity is hedge funds and investment banks. Although these institutions are predominantly involved in trading securities and other financial instruments, the scope of their operations and investments has expanded considerably over the last decade. Many of them now allocate certain percentages of their funds to investments into promising companies in emerging markets.

Private investors are yet another source of potential private equity. They are often referred to as Angel investors and are usually wealthy individuals who are former entrepreneurs or executives, who invest in entrepreneurial companies.¹¹

Strategic Alliances

Another type of business relationship that a Eurasian company can seek out is a strategic alliance. This kind of arrangement is typically entered into between companies in the same or complementary industries that should ideally create synergies that neither company would be able to capture alone. In other words, a strategic alliance is a partnership between firms whereby resources, capabilities, and core competencies are combined to pursue mutual interests. Strategic alliances can take a variety of different forms, from a majority ownership stake in which the 'foreign' (U.S.) company has the controlling share of the Eurasian company, a 50/50 split of ownership, to a minority stake by the 'foreign' player in which the Eurasian company retains most of the control. Strategic alliances enable participants to grow and expand quickly, efficiently, and benefit from each other's established channels of distribution, marketing, and developed brands.

Strategic alliances can be structured in many different ways and are often combined with other arrangements, such as licensing agreements. A licensing agreement is a great way for Eurasian companies to take advantage of already developed products, designs, and brands by acquiring the right to use, manufacture, market, or distribute products that belong to another company. In exchange for such rights, the other party usually pays a fee, either in the form of a royalty on its sales or a flat fee.

⁹ Survey of Limited Partner Interest in Emerging Markets Private Equity. EMPEA, May 2007: p5. Available from http://www.empea.net/docs/EMPEA_LPSurvey2007_ESFinal_web.pdf (accessed 6/26/2007).

¹⁰ "3 keys to obtaining venture capital," 10th Ed. PriceWaterhouseCoopers: p 4. Available from <http://www.pwc.com/images/tech/3Keys2006.pdf> (accessed 6/26/2007).

¹¹ "Beyond the Three Keys," Price Waterhouse Coopers homepage. <http://www.pwc.com/Extweb/industry.nsf/docid/2C9CA8A7F060404A85256AC5007A86B8> (accessed 6/26/2007).

What it takes to solicit investors

Although many different sources of capital are obviously available to Eurasian companies, determining the option that best fits the needs of the company and actually soliciting the investment requires many resources and is often beyond the ability of most small and midsize Eurasian companies. All projects or transactions considered for institutional financing must be commercially and financially sound. They must be within the demonstrated competence of the proposed management with a vested financial interest and commitment to the enterprise.

American investors will require any company that seeks financial assistance from them to provide a set of complete documents that thoroughly describe the nature of the company's operations. Western investors will only consider doing business with companies whose operations and financials are transparent. These companies must have a strong sense of professionalism, report their earnings in GAAP or IAS accounting standards, provide detailed financial statements, and have a clean working history (with no criminal, bankruptcy record, or current legal proceedings, as would be evidenced by a thorough due diligence and financial audit). If the company is looking for direct investment in exchange for an equity stake, then it will also need to provide the parties of interest with an updated copy of its enterprise valuation. Potential investors will also want to see information regarding the company's corporate governance, management structure, and the proposed uses of funds being sought, which should all be described in detail in a well developed business plan, written in English.

Aside from developing a business plan, soliciting investors in the U.S. obviously requires English language abilities, connections, and a cultural awareness of American business practices, understanding of capital markets, trends, and procedures. Conducting the necessary research and developing a business plan in-house often leads to strong bias on behalf of the preparer and is thus insufficient to impress potential investors. Therefore the complete document package should be prepared, or at least thoroughly reviewed by a professional firm. Even after the proper documents are in place, the lack of business connections in the private equity world and sub-par knowledge of the programs available through international and government agencies is still likely to lead many potentially great Eurasian companies to failure without the right support team or experienced consultant on the ground in U.S.

However, there are a number of professional organizations that can provide Eurasian enterprises with assistance in business planning and capital procurement. One of the resources companies can turn to are established Eurasian government agencies who work to assist domestic companies in getting financing from sources abroad. Another source are professional firms which have the expertise, experience, connections, and know-how that can help to select the best approach to take and locate an appropriate investor based on the needs of the company. Accounting, law, PR, and consulting firms are all great sources to turn to for help with your expansion and capital fundraising efforts.

Given the current Eurasian economic conditions and a positive American investment climate, today is the best time for American and Eurasian companies to work closer together in order to achieve tremendous benefits for both sides. Eurasian companies that effectively pursue such relationships stand to position themselves for success not just in their domestic markets, but on the global front.

This article was co-authored by Mr. Alexander Aginsky and Mr. Andrey Arbuzov who work at a globally recognized boutique management consulting firm - AGINSKY CONSULTING GROUP (ACG - www.aginskyconsulting.com). Staffed almost entirely with multi-lingual MBAs from top schools, ACG provides a wide range of services to companies around the globe. For questions pertaining to this article or any other comments you can contact Mr. Arbuzov directly at a.arbuzov@aginskyconsulting.com.