

Vasily V. Vysokov

INVESTMENT APPEAL OF THE SOUTH OF RUSSIA



*To clients, colleagues
and shareholders
of Center-Invest Bank!*

*To all, who take part
in renaissance
of the South of Russia!*

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FEDERAL EDUCATION AGENCY

ROSTOV STATE UNIVERSITY OF ECONOMY "RINH"

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INVESTMENT APPEAL OF THE SOUTH OF RUSSIA

Scientific practical handbook

Rostov-on-Don

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Basing on the analysis of strategic indicators of the South Federal District this scientific practical handbook discloses main tendencies of socio-economic development and evaluates investment attractiveness of commodity and service markets of the SFD, describes line of activities to liven up investing in the region basing on experience of cooperation of JSC Center-Invest Bank with international financial organizations.

The book is aimed at public authority leaders, entrepreneurs, economists, professors and students.

PART 1. POTENTIAL OF THE SOUTH OF RUSSIA

Epigraph

Sergey Mikhalkov

An old man was selling a cow

(Russian fairy tale)

*An old man was selling a cow at the market,
But no one was interested in it.
Although many needed a cow,
But somehow it did not appeal to them.
- Chief, are you selling this cow?
- I am, been stuck with it here all morning!
- How much do you want for it, old man?
- I won't overcharge, just want to get my money back!
- Well, the cow is a bit on a slim side!
- Well, she's sick, poor thing. What a disaster!
- How much milk does your cow produce?
- Has never produced, not even a drop...
All day the old man was selling his cow in the market,
But no one was interested in it.
One jolly chap fell bad for the old man:
- Listen, Father, you can't sell it like this!
Let me stay here and have a go,
Perhaps we can sell it.
Then a thrift buyer approached the jolly chap,
And launched his bargaining campaign;
- Are you selling the cow?
- I am, if you are rich.
Just look at it, it's simply a gem!
- Really? It looks a bit slim!
- It is slim but generous in milk.
- How much milk does it produce?
- It can produce so much milk until your hands are stiff.
The old man took another look at his cow:
- Oh dear, why am I selling you?
I will not sell my cow to anyone -
I'll keep this gem for myself!*

1. INTRODUCTION. LESSONS OF SOVNARKHOZ¹

1.1. Mystery of the Demise of Sovnarkhoz

Sovnarkhozes were founded in 1957 for the purpose of increasing the influence of the regions in the country. I was fortunate enough to have among my teachers those who worked in the Northern Caucasian Sovnarkhoz. Thanks to them I know about the difference between a regional industrial plan breakdown and a comprehensive plan of

¹ - Council of National Economy usually translated as Regional Economic Council, was an organisation of the Soviet Union to manage a separate economic region. They were subordinated to the Supreme Soviet of the National Economy. Sovnarkhozes were introduced by Nikita Khrushchev in 1957 in an attempt to combat the centralisation and departmentalism of ministries

industrial development within one area. I also received other useful knowledge.

My teachers candidly revealed to me one day why and how the Sovnarkhozes were shut down. These Sovnarkhozes were established in large economic regions and their objective was to design plans and applications for allocated funds which were distributed in Moscow for the krais², regions and republics of Northern Caucasus. Initially such an intermediary between the ministries of the Soviet republics and krais was necessary due to a shortage of competent local human resources. But the economists from the krais and regions quickly learnt how to complete the forms and started directly sending their applications to Moscow. Then these applications were double-checked by the Sovnarkhozes, but their post-check arguments were less convincing than those put forward to Moscow by the regions. For the purpose of shutting down the intermediary management a new administrative reform was launched, as a result of which the regions were granted the right to independently develop comprehensive development plans.

I will always keep in mind the lesson given by my teachers: never try to give instructions from top down in Caucasus, the local government will take the initiative and implement the management's instructions better with due consideration of the local requirements.

1.2. National Character of the Competition

This lesson has proved itself on a number of occasions, when I had to deal with national-level issues in the region. The matter is that in everyday life the residents of the southern federal region consider the entire South of Russia to be their home. - We are all SOUTHERNERS, they say. And after our summer break we look suntanned like the residents of Caucasus and share common traditions of hospitality, ways of toasting, cuisine and even ambitions. At the political level the ambitions come first. If for example, the highway engineers of the Krasnodar Krai repaired the road by 10 km more than the highway engineers in the Rostov region, then at the summing up meeting either the ex-first executive secretary of the regional Communist Party committee or the present governor would express surprise in such a way that the next year Rostov region would exceed the highway engineering target by 120%. Such competitiveness is evident in everyday life too when every southerner aspires to outdoing his neighbour. This competitiveness ensures the dynamic economic development of the South of Russia.

Today the regions compete in road engineering, housing, harvest and milk yield. Attracting investments comes to the fore and every region deals with this issue differently, although it is very tempting to impose centralised decisions while employing the most modern financing packages. In accordance with the local requirements it is better to improve the investment appeal of the South of Russia by sharing experience gained within every region. Instead of setting up meetings where the audience is divided into the audience and the presidium, one can gain a great deal more in the South of Russia by having a round table discussion, where each individual will try to prove through his experience that he is the best.

There is a notion in market economy «keep up with the Joneses». Any informal discussion of a problem or problem solving in the South by virtue of its national character may cause a «we are better than the Joneses» effect.

2 - Krai is an administrative territorial unit, a term used to refer to seven of Russia 86 federal subject

1.3. Regional Structure of the South of Russia

In 1976 a remarkable book by Vodovozov S.A., the Head of the Department of the Northern Caucasus of the Institute of Gosplan (State Planning) of Russia «Development of Productive Power of Northern Caucasus» was published, where he described the region as the breadbasket, forging shop and health resort of the nation as well as forecast the development of virtually every enterprise in the Soviet economy. But at the end of the book the author hoped that his prognosis would prove to be wrong because Northern Caucasus was a unique recreational area in the whole of the Soviet Union.

In the late 1970's experts from the Siberian Department of the Academy of Science of the USSR for the first time calculated the difference in the population's incomes in various regions. According to their chart the southerners had to move to any other region of the country because of lower cash incomes in Northern Caucasus. But when they took into consideration the differentiation in the average annual temperature in various regions, it became clear that the South of Russia is the Nation's favourite place.

These two facts simply illustrate that as a result of intensive investment activities we can build autobahns, hotels and new industrial giants in the South of Russia. But in this case crawfish with beer will be served in portions: «not more than two pieces per head». There will be a supermarket in every corner, however, the strawberries there will be Australian.

Therefore, while welcoming every new investor, it will be a good idea to think over the future impact of investment agreements before they are signed, including the marketing problems as well as competitiveness of goods produced using technologies that are modern for Russian but outdated for the west.

1.4. South of Russia in the Global Economy

The catch-up game is completely useless here. In the global market one has to make the most of the region's uniqueness. Nature and climate are taken rather seriously by health-conscious Europeans. The Russian themselves might find holidaying in the South appealing, provided the service level is raised not only at holiday hotels and health resorts, but also travel arrangements for holidaymakers are improved.

In the last 10 years our fields have been exposed to very little fertilisers and as a result of this our agricultural products have become in fact organic. The only thing left to do now is to let the whole world know about it, and we could deliver organically grown produce in accordance with western standards and technologies.

The unique geographical location of the South of Russia is often mentioned. However, the reality is that the transport and telecommunications infrastructure do not meet international standards. In order to integrate the South of Russia with the world it is necessary to attract international structures. And project tenders should be held by international organisations, even for those projects that are funded by the government. Those companies that lost the tender are unlikely to leave the South of Russia, as they will seek other areas for their business. The immediate objectives in this field are to hold an international tender for restoring the economy of the Chechen Republic, infrastructure development of the city-candidate for the Winter Olympic Games 2014, residential development in large cities of Russia.

1.5. Social Implications of Investments

Our experience shows that it is the social factor that hinders investments, not lack of resources or quality projects.

The matter is that investments not only bring technological innovations but also the social structure. According to the old concept – «I am the boss and you are loser». Under the new requirement the situation may reverse. Fear before these changes hinder the investment processes.

Fortunately, we cannot conquer the investment processes but we can lead them. The directors who understood this, will push their employees through market and administrative means into producing quality projects and finding new sources of funding. At the time of Sovnarkhoz there was a method called «target plan distribution», when the Communist Party and the Government’s political directives were distributed among designated officials (implementers). This official was denied access to his director, until the target was reached. («The Plan is law, to implement the plan is a duty, to exceed it is an honour!»). For the new industrialisation of the South of Russia it is necessary to invest annually not less than 10 billion dollars for the next ten years. How to distribute these tasks among various implementers is the responsibility of the economic services of the South of Russia.

1.6. Time Factor

At the time of Sovnarkhoz the main indicator of capital investment efficiency was the payback period. For some reason this timeframe is often indicated in investment applications. But the purpose of investing is not only to recover the money within the indicated timeframe but also to continue generating income until the project is completed and the fixed assets are closed out.

In the new market conditions the main indicator of capital investment efficiency is not the payback period but the Internal Rate of Return, which is calculated for the life period of equipment. Since the equipment life period is 2-3 times longer than the payback period, the investments become viable even though the cost of attracted resources exceed the annual profitability of the new project by 2-3 times.

One of the investment problems in the South of Russia is related to the fact that high returns are ensured in all sectors of the economy. Often even a previously approved project is put off because the investor finds a new niche in the market. Our southern character is often lost in the multifaceted favourable investment potential of the South of Russia.

High returns are ensured almost in all industries of the south of Russia. It often happens that implementation of an agreed-on project is put off only because the investor discovers a new market niche. Our southern temper is getting lost in reach investment potential of the south of Russia.

1.7. Organisational Conclusions

The veterans of Sovnarkhoz taught me: «don’t say a word if you can’t complete it with a sentence». The endeavours undertaken today in order to revitalise investment activities in the South of Russia are made by in the right direction. Taking into account the Sovnarkhoz experience the following could be added to these steps:

- forecasting future investments for each subject of the South Federal District,

- creating a healthy competition between the subjects for attracting investments through introducing international tenders on projects in the South of Russia,
- arranging regular exchange of experience specifically involved in the investment processes,
- introducing retraining to learn about investment activities on the basis of high education institutions.

Another lesson learnt from the veterans defines the responsibility for implementing the formulated proposals: «instruct, teach, monitor and do it yourself». Following this legacy I present to the readers my analysis of the investment appeal of the South of Russia from the point of view of potential investors. I hope that this analysis will be of interest as well as of practical use to those who are planning to invest in the South of Russia.

2. PEARL OF RUSSIA

2.1. Climate

The foreign partners who visited Center-Invest Bank agree that if Moscow is the Center, then the South is the pearl of Russia.

Fortunately or unfortunately, they draw conclusions in their Moscow and European offices not on the basis of their colleagues' trips but the official statistics of rating agencies. If we are looked at through their eyes and taking into account the official data, then the picture looks as follows:

Table 2.1.1. Average Climate Indicators in 2004

January		July	
Temperature	Regions	Temperature	Regions
+4,3	Republic of Adygea, Krasnodar Krai	+23,8	Astrakhan Region
+1,2	Republic of Dagestan	+23,0	Republic of Kalmykia
0	Republic of Karachaevo-Cherkessia, Republic of Northern Osetia – Alania, Stavropol Territory	+22,2	Republic of Adygea, Krasnodar Krai
-0,2	Rostov region	+21,5	South Federal District, Republic of Northern Osetia-Alania, Rostov Region
-0,3	South Federal District	+21,4	Republic of Kabardino-Balkaria, Volgograd Region
-0,9	Republic of Kabardino-Balkaria	+19,8	Republic of Dagestan
-1,3	Republic of Ingushetia, Republic of Kalmykia	+19,2	Republic of Ingushetia, Republic of Karachaevo-Cherkessia, Stavropol Krai
-1,6	Astrakhan region		
-4,6	Volgograd region	+18,7	Moscow Region
-7,1	Moscow		

Table 2.1.2. Average amount of precipitations in 2004

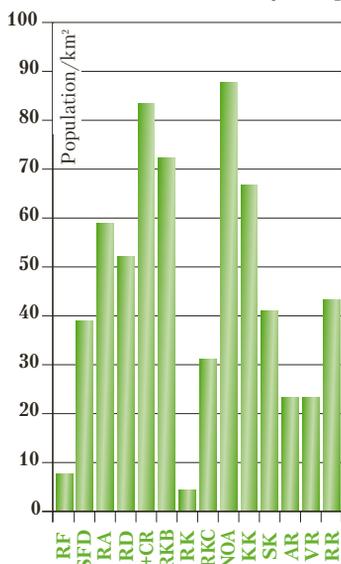
Regions	Precipitations, mm (January)	Regions	Precipitations, mm (July)
Moscow Region (including the city of Moscow)	88	Moscow Region (including the city of Moscow)	152
Rostov Region	86	Republic of Ingushetia	141
Republic of Adygea, Krasnodar Krai	62	Republic of Northern Osetia – Alania	131
South Federal District	32	Republic of Kabardino-Balkaria	109
Volgograd Region	28	Volgograd Region	78
Republic of Northern Osetia – Alania	25	Karachaevo-Cherkessk Republic, Stavropol Krai	75
Republic of Kalmykia	24	South Federal District	73
Republic of Dagestan	19	Rostov Region	58
Republic of Karachaevo-Cherkessia, Stavropol Krai	16	Republic of Adygea, Krasnodar Krai	57
Astrakhan Region	15	Astrakhan Region	55
Republic of Kabardino-Balkaria	14	Republic of Dagestan	50
Republic of Ingushetia	11	Republic of Kalmykia	40

2.2. Territory and Population

When the South Federal District (SFD) was formed, it was joined by the following republics: Adygea, Dagestan, Ingushetia, Kabardino-Balkaria, Kalmykia, Karachaevo-Cherkessk, Northern Osetia (Alania), Chechen Republic, Krasnodar Krai and Stavropol Krai as well as the following regions: Astrakhan, Volgograd, Rostov. As a result of this, the notion of the South of Russia acquired a stronger administrative significance which should be taken into account when analysing the statistical data.

Almost 16% of the population live on 3.5% of the territory. Taking into consideration the vast lands of Russia, one can call the South a highly populated region. If the average density of the population nation-wide is 8 people per square km, then this figure is 4-8 times higher in the region. The steppes of Kalmykia make an exception here though.

Table 2.2.1. Territory and population of the regions of the Russian Federation



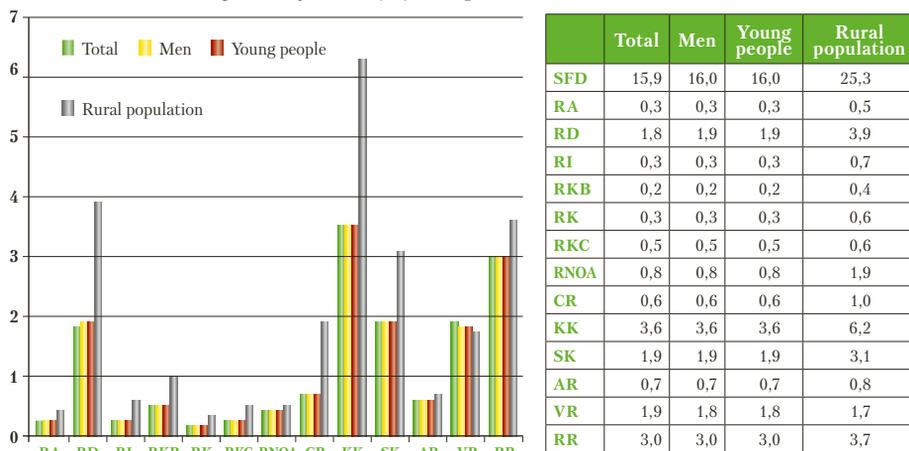
	Territory, thousand km²	Population, thousand people	Residents per 1 km²	Capital, Centers and large and cities in the regions
RF	17075,4	143474	8	Moscow'
SFD	589,2	22821	39	Rostov on Don
RA	7,6	445	59	Maykop, Adygeysk
RD	50,3	2622	52	Makhachkala, Khasavyurt Derbent, Kaspiysk
RI	19,3	482	84	Magas, Nazran, Malgobek, Karabulak
CR		1141		Grozniy, Urus-Martan, Seali
RKB	12,5	897	72	Nalchik, Prochladny, Baksan
RK	76,1	290	4	Elista, Lagan, Gorodovikovsk
RKC	14,1	435	31	Cherkessk, Ust-Dzhzeguta, Karachaevsk
RNOA	8	704	88	Vladikavkaz, Mozdok, Beslan
KK	76	5100	67	Krasnodar, Sochi, Yeysk, Novorossiysk, Armavir, Kropotkin
SK	66,5	2718	41	Stavropol, Pyatigorsk, Nevinnomyssk, Kislovodsk
AR	44,1	998	23	Astrakhan, Akhtubinsk, Znamensk
VR	113,9	2655	23	Volgograd, Volzhskiy, Kamyshin
RR	100,8	4334	43	Rostov on Don, Taganrog, Schakhty, Bataysk, Novocherkassk, Volgondonsk, Novoschakhtynsk

*In green are the cities where Center-Invest Bank has branches and representations.

RF – Russian Federation, SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia –Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

This higher density of the population in the South of Russia does bring additional advantages in terms of developing trade and consumer goods, creates conditions for a more commercially viable infrastructure, communications means for the population, and improves its structure.

The southerners account for 15.8% of the population of Russia, but the male population, particularly young people, is much higher than in the rest of the country. In spite of the all-around urbanisation more than a quarter of the rural population of Russia live in the South in accordance with their own specific lifestyle, needs and employment structure. In many ways these factors result in a higher birth rate (1.4 times higher) in the South compared to the rest of the urbanised regions of Russia.

Table 2.2.2. Population breakdown on basis of sex, age group in the regions as of 1 January 2005 (%) compared to the Russian Federation


SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia –Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

2.3. Ethnic Composition and Migration

The multi-ethnic South of Russia is very complex and presents a specific ethnographic, social and economic structure that encompasses: federal laws and local traditions, languages, dialects and slang, religions, crafts, lifestyle, cuisine and temper. This diversity creates extraordinary combinations of surnames, names and patronymic names in southern families. This also brings a variety of approaches and flexibility of mind, removes barriers in interactions between various ethnic groups as well as reflects on external appearances and beauty of young men and women.

Table 2.3.1. Ethnic Composition of the Southern Regions of Russia

	Major ethnic groups
Republic of Adygea	Adygei, Russian, Armenian, Ukrainian
Republic of Dagestan	Avar, Dargin, Kumyk, Lesgin, Russian, Lak, Azeri, Tabasaran, Chechen, Nogai
Republic of Ingushetia	Ingush, Chechen, Russian
Republic of Kabardino-Balkaria	Kabardin, Balkar, Russian, Osetian, Turk
Republic of Kalmykia	Kalmyk, Russian, Dargin, Chechen, Kazakh, Turk
Republic of Karachaevo-Cherkessia	Karachaev, Cherkes, Russian, Abazin, Nogai
Republic of Northern Osetia - Alania	Osetian, Russian, Ingush, Armenia, Kumyk, Georgian
Chechen Republic	Chechen, Russian
Krasnodar Krai	Russian, Armenian, Ukrainian, Shapsug
Stavropol Krai	Russian, Armenian, Ukrainian, Dargin, Greek
Astrakhan Region	Russian, Kazakh, Tatar, Ukrainian, Chechen
Volgograd Region	Russia, Ukrainian, Kazakh, Tatar, Armenian
Rostov Region	Russian, Ukrainian, Armenian

It should be noted that the Russians in the South are predominantly of Cossack descent – free-spirit people who never experienced serfdom, and treat any fellow-villager, chief and guest as an equal. This democracy of spiritually strong people has a special impact on the relationship with the central government, foreign investors and titled population of the national republics.

On the one hand, the peoples of the South of Russia fully appreciate the high cost of ethnic conflicts, and centuries-old traditions and cool down the hot heads who attempt to declare bloody revenge for any particular reason. On the other hand, the lower living standards (approximately 30-40% lower than in the rest of the country) often turn any everyday conflict into a national one. The wisdom of the elderly, experience of the young politicians force them to seek constantly modern means of preventing conflicts based on the golden rule of ethics: I am treated the way I treat the others. There is one more way of preserving internationalism: southern humour. For example, when the local authorities in one of the districts tried to adopt restricting immigration legislative acts, the female political activities suggested that this act should be called «On Impotency of the Native Population». The issue was immediately removed from the agenda.

Unlike other regions of Russia which are quite uncomfortable with the influx of migrants (Center) or migration of the locals (Urals), the balance of migration in the South of Russia is virtually zero. People have become more mobile, but over 3/4 of migrants change their residence within the region: rural residents move to towns, urban residents move from towns to cities. Very few residents from larger southern cities are tempted to move to the Russian capital. The clever ones are coming back to the South.

Table 2.3.2. Migration in the South of Russia: arrivals and departures

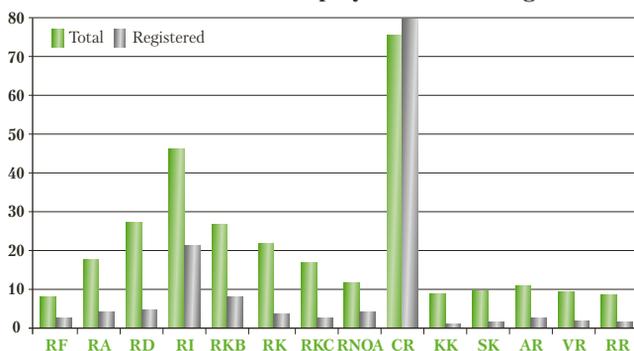
Federal District	Balance of Migration (% to Russian Federation)	Arrived in the South from (% of the arrived)	Departed the South for (% of the departed)
Central	4,17	4,88	11,40
North-West	0,26	2,70	3,30
South	-0,63	78,43	75,08
Privolzhsky (Volga)	-1,20	4,12	3,51
Ural	-10,05	3,64	3,43
Siberian	-1,32	3,70	2,02
Far-East	-1,10	2,53	1,25

2.4. Employment

In the age structure of the population of the South of Russia, the percentage of the youth has a significant weight than the national average. Consequently, the percentage of the active population in the South is much lower.

Table 2.4.1. Number of economically active population in the regions of the South of Russia

	Population, % compared to the Russian Federation	
	Total	Active population
South Federal District	15,9	14,5
Republic of Adygea	0,3	0,3
Republic of Dagestan	1,8	1,5
Republic of Ingushetia	0,3	0,2
Republic of Kabardino-Balkaria	0,6	0,5
Republic of Kalmykia	0,2	0,2
Republic of Karachaevo-Cherkessia	0,3	0,3
Republic of Northern Osetia – Alania	0,5	0,4
Chechen Republic	0,8	0,6
Krasnodar Krai	3,6	3,3
Stavropol Krai	1,9	1,7
Astrakhan Region	0,7	0,7
Volgograd Region	1,9	1,9
Rostov Region	3,0	3,0

Table 2.4.2. Unemployment in the Regions of the South of Russia


	Unemployment Level (%)	
	Total	Registered
RF	8,2	2,6
SFD	15,4	5,9
RA	17,6	4,3
RD	27,2	4,7
RI	46,3	21,3
RKB	25,7	8,1
RK	21,7	3,6
RKC	16,9	2,7
RNOA	11,7	4,3
CR	75,6	79,7
KK	8,8	1
SK	9,6	1,7
AR	11	2,7
VR	9,4	1,8
RR	8,6	1,5

RF – Russian Federation, SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

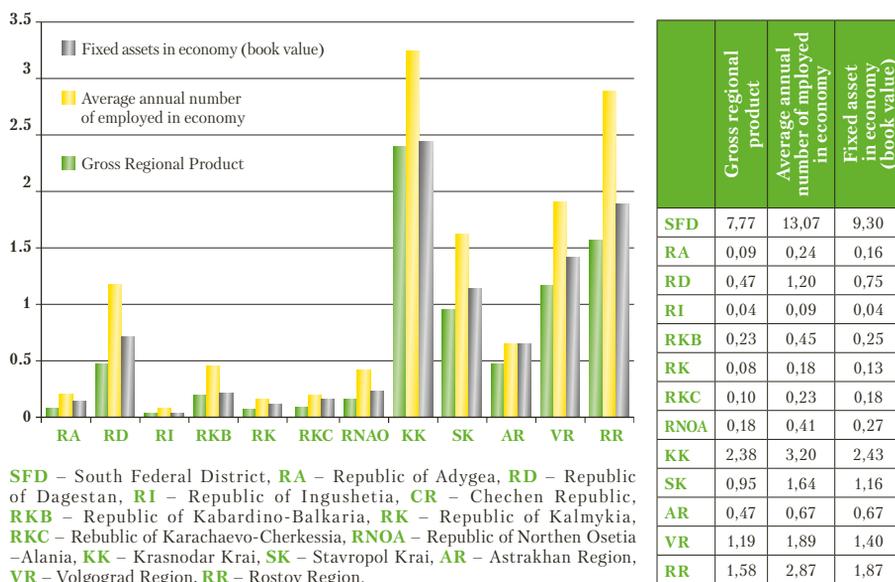
If we compare the unemployment level, then in the majority of the republics it is two-three times higher than in the rest of the country. The fact that the number of registered unemployed residents is two-three times lower than the number of those looking for jobs means that people have no confidence in government support, and are reluctant to register their unappealing status. Even in the regions with a more developed production structure (Rostov Region, Krasnodar Krai) that are comparable with the national average, the level of registered unemployment is twice as low. The Southerners are ashamed of unemployment. When you look around and see all the opportunities available, you realise why it is embarrassing to be unemployed.

3. MYSTERY OF THE SOUTH OF RUSSIA

3.1. Efficiency of the Regional Economy

Unique climatic conditions, a remarkable demographic situation, multi-ethnic, hardworking people, who deeply care for the region – this extraordinary set of conditions should produce significant economic results. However, if we look at the main economic indicators, it is hard to see the expected results: 13% of employed in economy using over 9% of fixed assets and produce only around 8% of the gross regional product.

Table 3.1.1. Main economic indicators of the South of Russia in % compared to the Russian Federation



SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, CR – Chechen Republic, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

If we take the ratio of Russia's GDP, fixed assets and employment rate as a model, then the efficiency rate of the leading production factors of the South of Russia, i.e. employment and cost of fixed assets, accounts for only 1/3 of the national average. The undisputed leader in comparison with the Russian model is the Krasnodar Krai, but we should keep in mind that the average temperature in Kuban is a bit higher than in the neighbouring areas. Krasnodar Krai is then followed by larger regions, such as Astrakhan, Volgograd, Rostov, and the Stavropol Krai. In terms of production potential return they are closely followed by Kabardino-Balkaria and Adygea. It is four times lower in other republic compared with the national average.

The interrelation between the scale and the efficiency of the economy is undoubtedly a serious argument put forward by the politicians calling for strengthening the regions. But the differences in economic performance in various regions and republics of the South

of Russia are not significant enough to provide an additional effect. The fact that it is three-four times lower than the national average may raise a very sticky question: how to divide in a fair and just way. Consequently, there is a danger of triggering ethnic-based divisionism which will completely destroy the existing potential of the pearl of Russia.

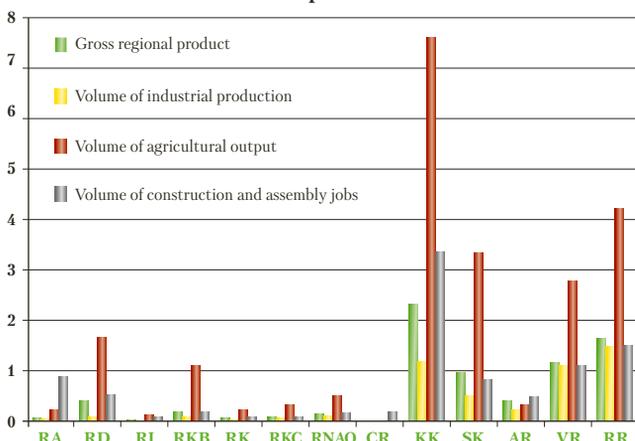
3.2. Industrial Structure of the Economy

The Gross Regional Product consists of added value of enterprises operating in the region. If these enterprises belong to the sectors of the economy with a lower degree of product processing, then their contribution to the regional gross product will not be significant. Therefore, the share of the region in the gross national product will be insignificant.

In terms of the regional division of labour the South of Russia will always be an agricultural producer. Agriculture does not have much added value and its contribution to the GDP is only 6-7%, although over 10% of the population is involved in this sector. This evidently reduces the contribution of the South to the GDP.

If we compare the performance of the areas of the South Federal District it becomes clear that even when agriculture plays a dominant role of the regional economy, this region is still capable of adding considerable value. This contribution can be increased through a more developed food-processing industry. In addition, the scale of the agro-industrial business in the South of Russia is such that it is inevitable to develop agricultural machinery, fertilisers, fodder production and other industrial services necessary for agriculture. Fortunately, this is being dealt with. However, the level of food-processing and industrialisation of the sectors that provide services to the agricultural sector should be significantly raised.

Table 3.1.1. (Cont'd) Main economic indicators of the South of Russia in % compared to the Russian Federation



	Volume		
	Industrial production	Agricultural output	Construction and assembly services
SFD	5,06	22,71	8,90
RA	0,05	0,27	0,87
RD	0,10	1,60	0,61
RI	0,01	0,15	0,09
RKB	0,09	1,12	0,22
RK	0,02	0,26	0,10
RKC	0,07	0,39	0,09
RNOA	0,13	0,59	0,19
CR	-	-	-
KK	1,21	7,55	3,42
SK	0,60	3,39	0,80
AR	0,27	0,38	0,58
VR	1,12	2,74	1,11
RR	1,40	4,26	1,41

SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia –Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

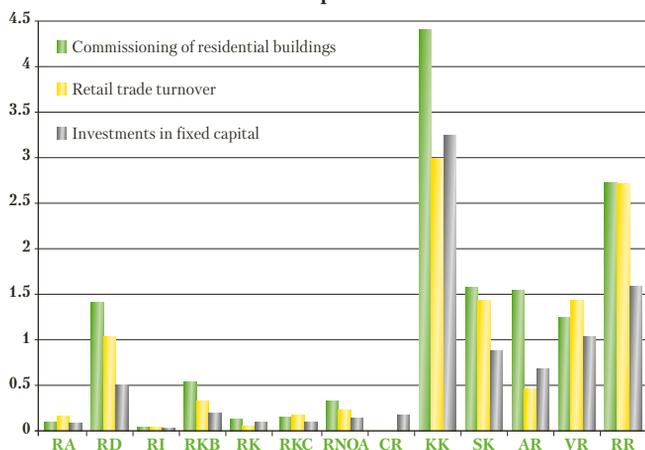
Construction is another field of specialisation of the South of Russia. This is a significant factor for potential investors who while offering their new technologies will need new buildings, roads, housing and hotels. The necessary conditions for tackling these issues in the South already exist.

3.3. Living Standards

A lower economic performance of the South of Russia may challenge one's belief that the region is indeed the pearl of Russia. But it is enough to compare the volume of residential buildings, direct investments and retail turnover with the national average to be convinced of the investment appeal of the South as well as the comfortable local living conditions. The volume of investments in the region exceeds its contribution to the gross regional product. The housing rate reflects the population rate. The retail trade turnover also corresponds to the employment rate.

Radical economists from politics argue that such a combination of indicators very much is influenced by the shadow economy. First of all, one should not forget that one fifth of agricultural products in Russia come from the South of Russia. Secondly, visitors from other parts of Russia contribute to the retail turnover who come to the South for their holidays. These two factors together define the appeal of the South for residential housing development as well as investments.

Table 3.1.1. (Cont'd) Main economic indicators of the South of Russia in % compared to the Russian Federation



SFD – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia –Alania, **CR** – Chechen Republic, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

	Commissioning of residential buildings	Retail trade turnover	Investments in fixed capital
SFD	14,19	11,05	8,74
RA	0,10	0,16	0,08
RD	1,41	1,04	0,50
RI	0,04	0,04	0,03
RKB	0,54	0,33	0,19
RK	0,13	0,05	0,10
RKC	0,15	0,17	0,10
RNOA	0,33	0,23	0,14
CR	0,00	0,00	0,17
KK	4,41	2,99	3,25
SK	1,58	1,43	0,88
AR	1,54	0,46	0,68
VR	1,24	1,43	1,03
RR	2,73	2,72	1,59

3.4. Setting for the Pearl

Comparisons of economic efficiency of production factors, field structures of the economy, and living standards among various regions of the South Federal District undoubtedly convince us that the South is the pearl of Russia. But like any pearl it needs to be set properly and looked after:

- Replacing fixed assets by more efficient ones;
- Upgrading skills of the population contributing to the regional economy;
- Thorough thinking about the natural and climatic potential and resources.

Finally, the activities of those living, working and investing in the South should be more professional. The following chapters of the book provide a more detailed analysis of the initiatives within the consumer, manufacturer, and investor markets.

4. CONSUMER MARKET

4.1. Money Income, Expenditure and Goods Turnover

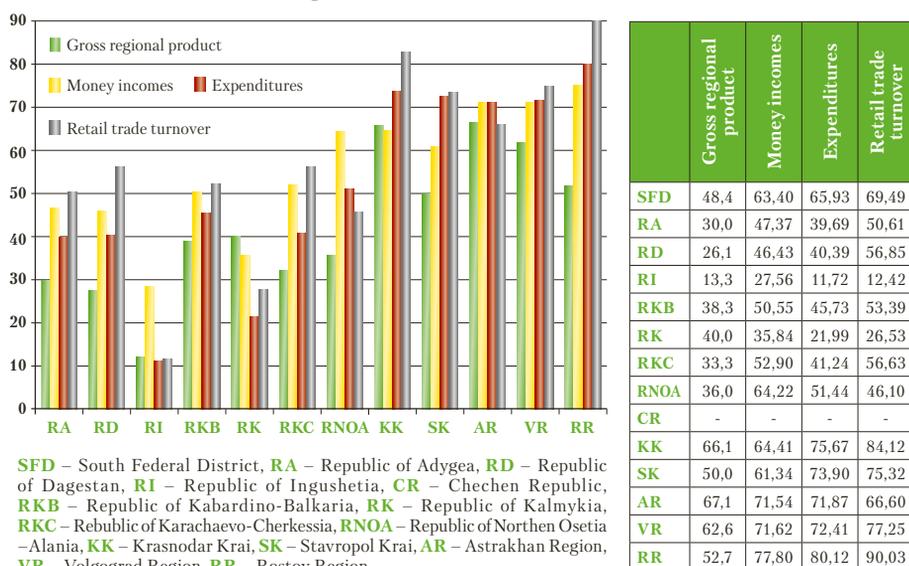
Twenty two million people live in the South which accounts for 1/4 of the population of Germany. That makes us consider the South as a serious consumer market. But in order to assess the market we need to take into consideration not only the number of consumers but also their purchasing power.

Money income of the Southern population has always been lower than the national average for a number of reasons:

- Natural economy income is of importance in addition to money income;
- Money income of the population in other regions of Russia is complimented by harsh climate bonuses.

But the important thing is that we live as good as hard we work. It has already been mentioned that the South of Russia was less efficient in using labour and fixed assets compared to the national average. Inefficient labour prevents people from having adequate money income and it is compensated by natural benefits which are used to continue production in the private farmyard. In larger regions with more goods-oriented economic structures the level of money income is much higher. In the national republics lower money income appear to be higher than labour productivity. Social guarantees and public sector wages play an important part when the labour productivity is low.

Table 4.1.1. Indicators of income, expenditures and goods turnover per capita in % compared to the Russian Federation



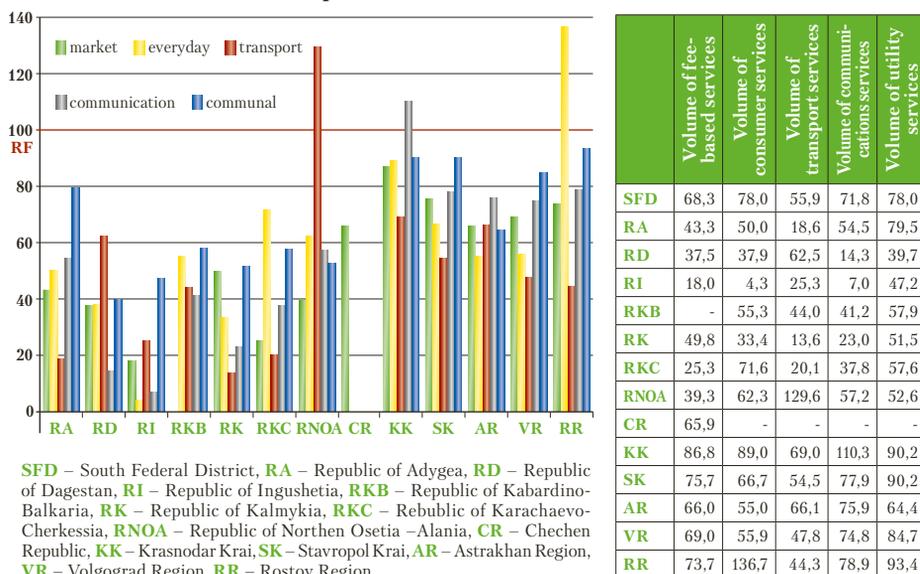
During the initial stage of reforms the gap between the income and the expenditure of the population of the South of Russia was significant: the southerners even had to

exchange their modest income for goods in the nation's capital. The restoration of the health resort areas increased the number of visiting holidaymakers and their expenditure on goods and services. Having «conquered» the relatively easy markets in the Center, trading chains and distributors gradually reached large and medium size cities.

4.2. Market of Services

Lack of cash income reduces the demand of the southerners for services. Taking into account the importance of natural economy income one can assume that the majority of services is also provided on a natural basis or within their private farms.

Table 4.2.1. Volume of services per capita in % compared to the Russian Federation



SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

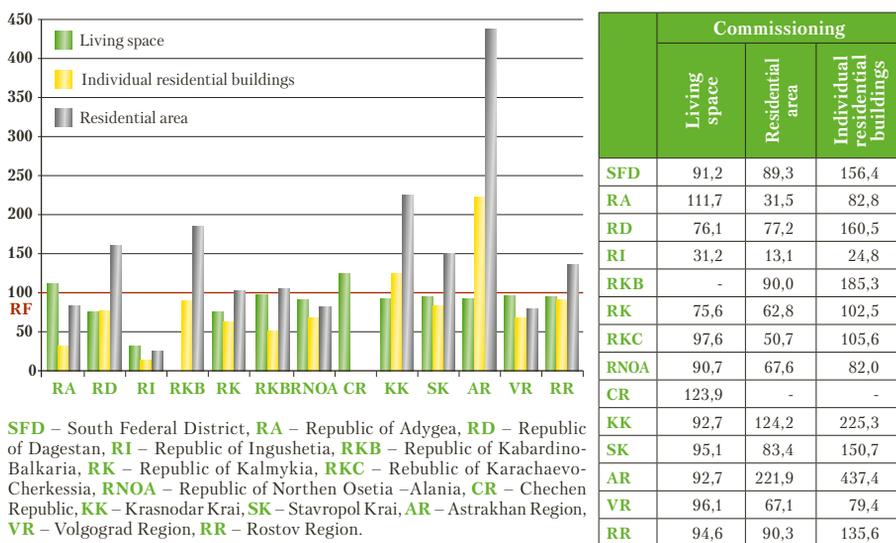
The availability of private vehicles defines the reduced demand for transportation services. A sharp increase of the average national level of communications services in the Krasnodar Krai confirms once again the growing demand for the Black Sea recreation and resort areas. The payment level for utilities in the Rostov Region, the Krasnodar Krai and the Stavropol Krai almost always coincides with the average national indicators and is evidence of the beginning of reforms in the utilities sector of the economy.

The increased level of payments for utilities in the Rostov Region goes back a long way. Back in the Soviet days the Rostov Region had a high level of expenditure for consumer services particularly for hairdressing services. Since housewives from Don region needed not only money but also time, they outsourced other domestic services too. The local authorities in charge of domestic services supported this process and took over the consumer services market in spite of all the difficulties related to the reform process in Russia and the regional economy as well as the reforms in the services sector.

4.3. Housing and Transport

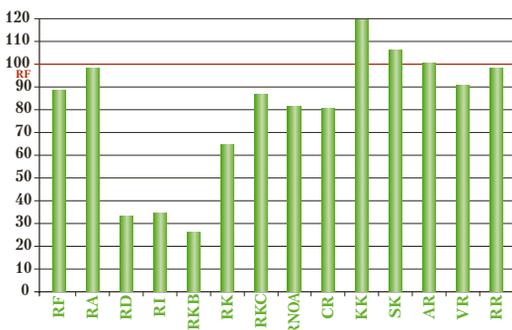
The South falls behind the rest of Russia in meeting its housing needs. The communist era top-priority projects in Siberia hindered the state-funded development of residential buildings in the South, however, it taught the people to take care of their housing needs. As a result, the southerners learnt to save money for housing, and they also prefer to build houses, not apartment blocks. One can hardly call these houses «Rublyev Towers» but they are decent houses and exist in every Cossack village. Since these houses are located in rural areas, it is difficult to differentiate them from dachas, which urban Russians are so used to. The provision of gas supplies in villages and khutors is gradually improving along with other utilities. The construction and interior design materials market is also growing.

Table 4.3.1. Provision of housing and commissioning of residential buildings per capita in % compared to the Russian Federation



SFD – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia – Alania, **CR** – Chechen Republic, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

Despite shortage of money income the southerners have taken good care of themselves in terms of private transportation means. In some areas of the South this indicator exceeds the average national. Acquiring an automobile on a barter basis is difficult but the southerners do have the money which they use purposefully for the development of their private businesses. Availability of car owners presents a demand for road construction and car servicing.

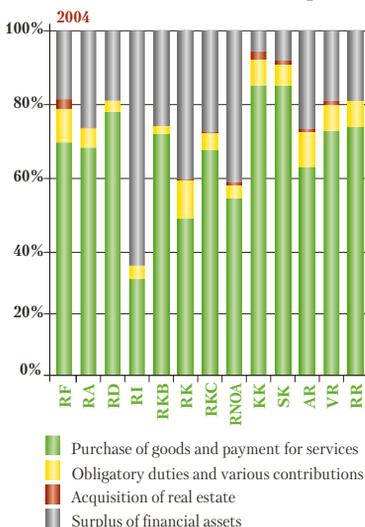
Table 4.3.2. Number of cars per capita in % compared to the Russian Federation


	Number of privately owned cars
SFD	88,39
RA	98,05
RD	33,33
RI	34,40
RKB	26,11
RK	64,53
RKC	86,94
RNOA	81,29
CR	80,60
KK	119,52
SK	106,03
AR	100,69
VR	90,90
RR	98,18

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4.4. Domestic Savings

What do the southerners spend their money on? After one pays for consumer goods, services, bills and improving one's living conditions, there is little money left to go by.

Table 4.4.1. Structure of expenditures and savings of southern residents in % compared to the Russian Federation


	Purchase of goods and payment for services		Obligatory duties and various contributions		Acquisition of real estate		Surplus of financial assets		Of which increase, decrease (-) of currency in hands	
	2000	2004	2000	2004	2000	2004	2000	2004	2000	2004
RF	75,5	69,8	7,8	9,2	1,2	2,3	15,5	18,7	2,8	1,8
SFD	79,9	76,9	4,5	6,2	0,5	1,1	15,1	15,8	4	-3,1
RA	69,4	68,6	3,8	5,9	0,1	0,2	26,7	25,3	20,5	17,6
RD	65,3	78,3	2,5	2,6	-	0,1	32,2	19	31,3	3,3
RI	48,2	33,8	4,3	3,1	-	-	47,5	63,1	47,5	61,7
RKB	72,1	71,9	3	3,2	0,1	0,1	24,8	24,8	21,4	11,2
RK	51,2	49,3	7	10,4	-	0,2	41,8	40	36,9	38,4
RKC	75,1	68	3,7	4	0,5	0,2	20,7	27,8	16,6	23,4
RNOA	76	54,1	3,6	4,5	-	0,7	20,4	40,7	14,5	20,5
KK	87,1	85,9	5,7	7,4	0,5	1,9	6,7	4,8	-5,8	-14,4
SK	89	86	4,2	6,2	0,6	0,9	6,2	6,9	-9,5	-18,3
AR	65	64,1	5,2	8,1	0,3	0,9	29,5	26,9	15,3	1,3
VR	72,8	72,5	5,4	7,4	0,5	1	21,3	19,1	7,8	0,6
RR	84	75	3,9	6,3	0,8	1,2	11,3	17,5	0,3	-1,2

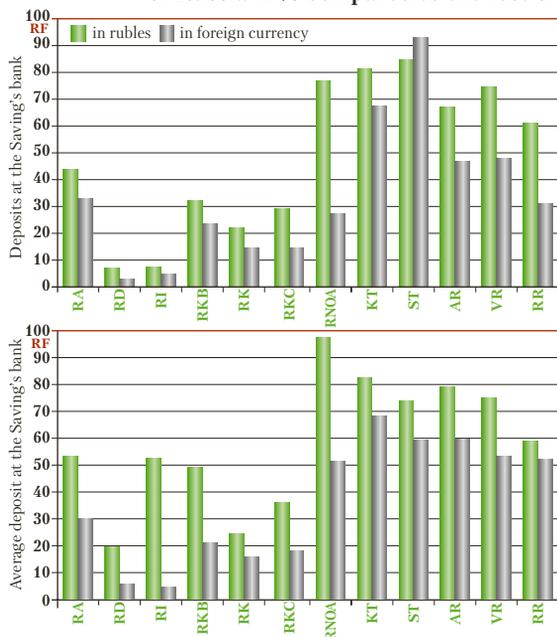
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Since the southerners have less cash income than an average Russian, they have to spend most of it on consumer goods. But as their incomes grows, their ability to acquire financial assets will improve (deposits, currency reserves, acquisition of shares). It is positive that people in the South have less cash on their hands but it is due to the growth of payments for consumer goods and services by the holidaymakers visiting the southern resorts.

Surplus of cash of the population of Kalmykia and Ingushetia is a special topic for discussion. Free economic areas with tax privileges that were established in these republics are still creating favourable conditions that stimulate payments in cash.

Low income forces the population in the South of Russia to be reluctant to the idea of «savings». People prefer to deposit money in cash. But the volume of deposits is one and a half- two times lower than in other regions of Russia. However, the residents of the krais and regions of the South of Russia have higher income and can deposit more money than the residents of the national republics.

Table 4.4.2. Deposits of the population to the Savings Bank in the southern regions of Russia in % compared to the rest of Russian Federation



	Deposits at the Savings' Banks		Average deposit at the Savings' Bank	
	Rubles	Foreign currency	Rubles	Foreign currency
SFD	57,78	42,97	68,51	45,99
RA	43,74	32,84	53,22	30,19
RD	7,03	2,91	19,74	5,64
RI	7,60	4,90	52,71	4,59
RKB	32,10	23,61	49,20	21,13
RK	22,18	14,57	24,54	15,66
RKC	29,04	14,58	36,19	18,12
RNOA	76,67	27,33	97,45	51,27
KK	81,48	67,40	82,67	68,07
SK	84,90	92,88	73,77	59,35
AR	66,95	46,66	79,29	59,46
VR	74,51	48,04	74,84	53,35
RR	60,94	31,09	58,88	52,28

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Foreign currency is not very popular with the southerners. The foreign exchange turnover per capita is twice as low as in the rest of the country with the exception of the Chechen Republic. Savings (sale and purchase) in foreign currency are significant in Dagestan and Northern Osetia, although the level of these savings is twice as low as the national average.

Table 4.4.3. Sale and purchase of foreign currency through credit companies in the regions of the South of Russia per capita in % compared to the Russian Federation.

	Money income	Purchase of currency	Sale of currency
South Federal District	63,40	53,31	38,71
Republic Adygea	47,37	17,72	21,24
Republic of Dagestan	46,43	53,13	3,01
Republic of Ingushetia	27,56	3,67	8,98
Republic of Kabardino-Balkaria	50,55	22,62	10,50
Republic of Kalmykia	35,84	14,66	15,84
Republic of Karachaevo-Cherkessia	52,90	11,48	6,68
Republic of Northern Osetia – Alania	64,22	82,25	32,41
Chechen Republic	-	318,22	355,30
Krasnodar Krai	64,41	41,30	21,15
Stavropol Krai	61,34	19,72	12,42
Astrakhan Region	71,54	77,54	65,99
Volgograd Region	71,62	103,69	78,78
Rostov Region	77,80	63,52	48,26

4.5. Combating Poverty

The reforms mean a very tough process that require people to adapt to new realities. The subsistence minimum level is significantly smaller than the established norm in Russia, and the Population with money incomes below subsistence minimum level is higher than the national average. Without disregarding these problems, it should be noted that the income here are lower than the norms established by the local laws. However, as the economy of the South is being revitalised the number of people that belongs to this group decreases. This process is taking place simultaneously at the federal and the regional levels. Combating poverty is a common task for the whole of Russia, and the success of this process will depend in many ways on the reforms in general.

Table 4.5.1. Subsistence minimum level established in the Russian Federation and federal districts for the 4th quarter of 2004 in Rubles per month.

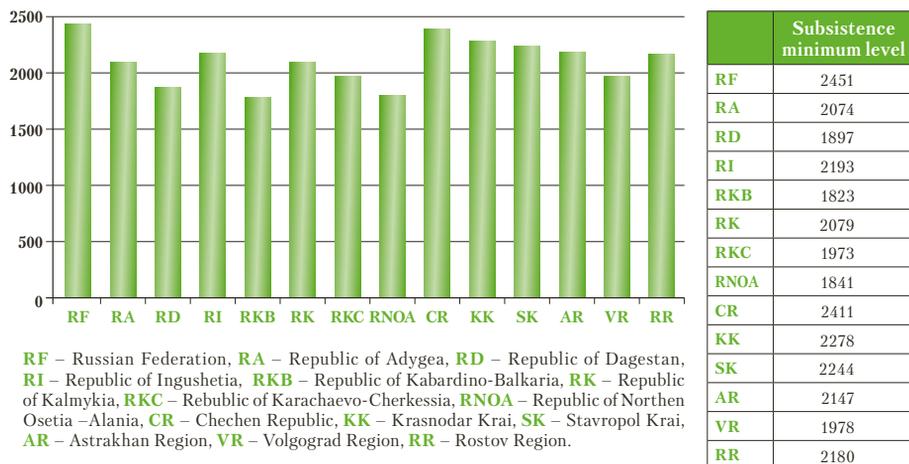
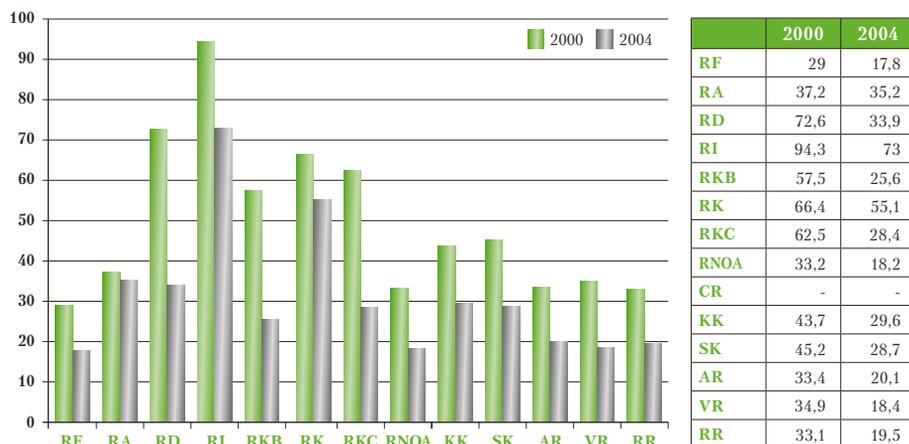


Table 4.5.2. Population with money incomes below subsistence minimum level in regions of the Russian Federation in % of total population



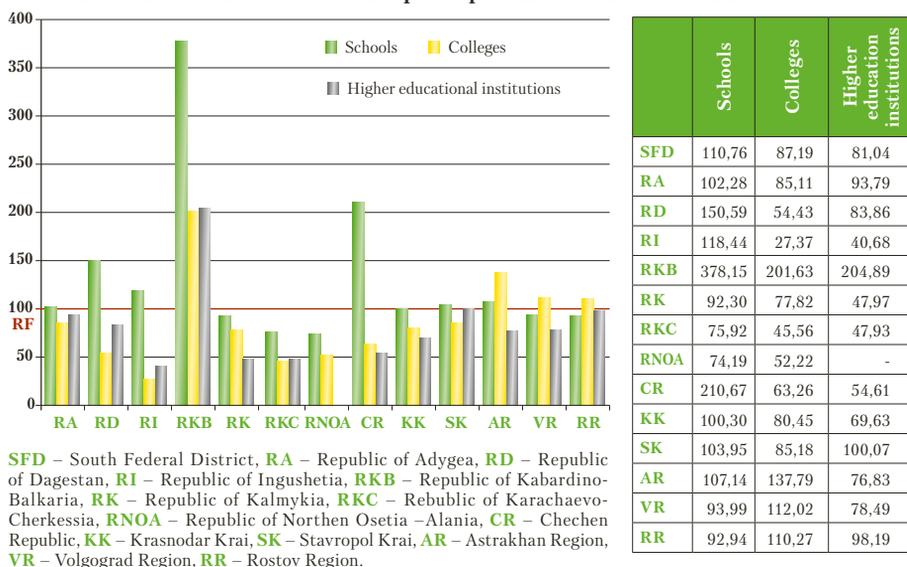
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4.6. Market of Education Services

Despite the challenges of the reform process, a great deal of attention is paid to education: taking into account the demographic differences, the number of schoolchildren (per capita) in the republics is higher, and in the krais and regions the number of college

students is higher. Higher education is limited by the income levels, as the young people have to earn a living. Therefore, young people receive secondary education and vocational training first and only then think about higher education. Taking into consideration the current situation numerous colleges entered into agreements with higher education institutions for continued education when the exam results are taken into account when accepting students at universities.

Table 4.6. Number of students per capita in % of the Russian Federation



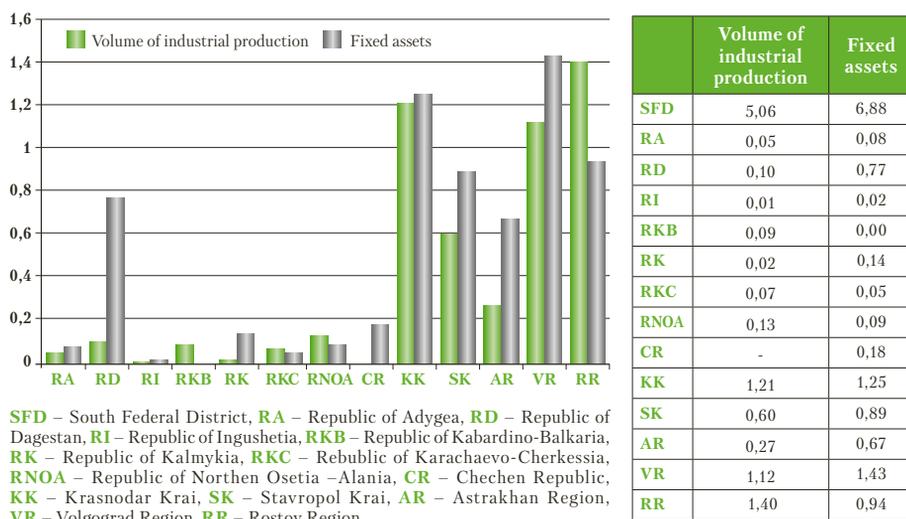
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5. PRODUCER MARKET. INDUSTRY

5.1. Industrialisation of the National Republics

The industry of the South of Russia is rather modest compared to the rest of the country. In addition, over 90% of the industrial output of the South of Russia is produced in the krais and the regions: Krasnodar, Stavropol, Rostov, Volgograd and Astrakhan. The fixed assets of the industry are also concentrated in these regions. The situation is even worse in the national republics which have significant industrial fixed assets (Dagestan, Kalmykia) but are used inefficiently.

Table 5.1.1. Volume of industrial production and fixed assets in the South of Russia in % of the Russian Federation



SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia –Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

A distinctive character of the nation prevents industrial development of the national republics. During the early stages of the Soviet industrialisation the concept of accelerated industrialisation of the remote regions was introduced and in many ways implemented. Today at this time of economic globalisation, this principle is becoming more and more relevant:

- Limited demand for local markets;
- Focus on local markets preserves inefficient and uncompetitive production;
- Inefficient production prevents from increasing income levels;
- Low income leads to social division, corruption and terrorist threats.

Unfortunately, the creation of the offshore tax facilities in the 1990’s did not lead to the industrial growth in the national republics. The special economic zones declared by the Russian government provide a chance of balancing the development level of certain regions, including the national republics. The national elite has to realise that the development of their republics can only rely on their own initiatives and requires thorough thought about development strategies based on the global trends.

As for the dynamics of industrial output of the developed territories – the pace of industrial development, although with a bit of delay, exceeds the development pace of the industrial output of Russia. The industrial revitalisation of the South of Russia after the crisis of the 1990's is still based on old production capabilities, which should also be upgraded and adopt new and more efficient technologies.

Table 5.1.2 Industrial production structure in % of total

	Russian Federation	South Federal District
Electric power industry	10,7	15,6
Fuel industry	21,7	10,1
Oil extraction	14,7	3,8
Oil refining	3,1	1,9
Gas	2,4	3,6
Coal	1,5	0,7
Ferrous metallurgy	11,8	7,8
Non-ferrous metallurgy	7,3	2,8
Chemical and petrochemical industry	5,9	7,5
Machine-building and metal working	18,9	16,5
Logging, woodworking and pulp-and-paper industry	3,9	1,9
Building materials industry	3,1	5,2
Glass and whiteware industry	0,5	0,8
Light	1,1	2
Food	12,5	26,6
Flour-groats and mixed forage industry	1,2	2,1
Total	100	100

5.2. Industrial Diversification

If fuel and energy resources dominate the Russian industry, then in the South it is the food industry. The recommendations of the international financial institutions on the necessity to diversify the structure of the Russian economy have been implemented de facto in the South of Russia. However, the food products of the South of Russia have to be internationally recognised and to achieve that - new technologies for production, packaging and distribution are needed.

While analysing the industrial structure one cannot but note that in addition to the food industry, the South of Russia has favourable conditions for sustainable, comprehensive and balanced development of its industry as well as other sectors of the economy:

- Availability of own adequate diversified fuel and energy resources;
- Energy power production;
- Developed production potential for ferrous and non-ferrous metals, machinery and metal processing;
 - Large chemical and petrochemical enterprises;
 - Significant production of construction materials;
 - Light industry enterprises.

During one of the meetings at the World Economic Forum the topic of Russia's economic development was touched upon. The group headed by the President of the European Bank

for Reconstruction and Development – Jean Lemierre discussed the diversification of the Russian economy. On behalf of this group I was instructed to inform other participants of the outcome of our discussions. My colleagues supported our viewpoint that the Russian economy has to be diversified based on the regions, economic sectors and types of ownership. This statement simply reflected the processes underway in the South of Russia.

Table 5.2. Share of the regions of the South of Russia in industrial production, % of total industrial production of the Russian Federation

	SFD	RA	RD	RI	RKB	RK	RKC	RNOA	CR	KK	SK	AR	VR	RR
Electric power energy	7	0	1		0	0	0	0	0	1	2	0	2	2
Oil, incl. gas condensate	3	0	0	0	-	0	-	0	0	0	0	1	1	0
Initial oil refining	9	0		0	-	0	-	0	-	3	0	1	5	-
Natural gas	3	0	0	-	-	0	-	-	0	0	0	2	0	0
Black coal	2	-	-	-	-	-	-	-	-	-	-	-	-	2
Iron rolled products	1	-	-	-	-	-	-	-	-	-	-	-	1	-
Synthetic ammonium	9	-	-	-	-	-	-	-	-	-	9	-	-	-
Synthetic resins and plastics	12	-	-	-	-	-	0	-	-	0	8	-	3	0
Tires for motor vehicle, agricultural machines, motorcycles and scooters	7	-	-	-	-	-	-	-	-	-	-	-	7	-
Metal cutting machines	7	0	0	-	-	-	-	-	-	1	0	5	0	-
Passenger motor cars	3	-	-	-	-	-	0	-	-	-	-	-	-	3
TV sets	0	-	0	-	-	-	-	-	-	-	-	-	0	-
Refrigerators and freezers	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Round wood removals	0	0	-	-	0	-	0	0	-	0	-	0	0	0
Sawn wood	1	0	0	-	0	0	0	0	0	1	0	0	0	0
Cellulose	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Cement	17	-	-	-	-	-	4	-	-	7	-	-	6	-
Bricks	15	0	0	0	1	0	0	1	0	5	2	0	2	4
Woven	8	0	-	-	0	-	0	-	-	0	-	-	7	0
Foot-wear	34	-	0	-	0	-	0	0	-	28	2	0	0	4
Granulated sugar	42	2	-	-	-	-	0	-	-	38	1	-	-	-
Bread and bakery products	16	0	2	0	0	0	0	0	0	5	2	1	2	3
Meat (incl. 1 category sub products)	13	1	0	-	0	0	0	0	-	5	2	0	1	3
Vegetable oil	56	-	-	-	-	-	-	-	-	25	-	-	-	21
Canned products	13	0	0	0	2	0	0	0	0	7	0	1	1	1
Diary products (in milk equivalent)	10	0	0	-	0	0	0	0	-	6	1	0	1	1
Groats	35	0	0	-	0	0	-	0	-	23	3	1	3	6

0 = less than 0.5%

SFD – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia – Alania, **CR** – Chechen Republic, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

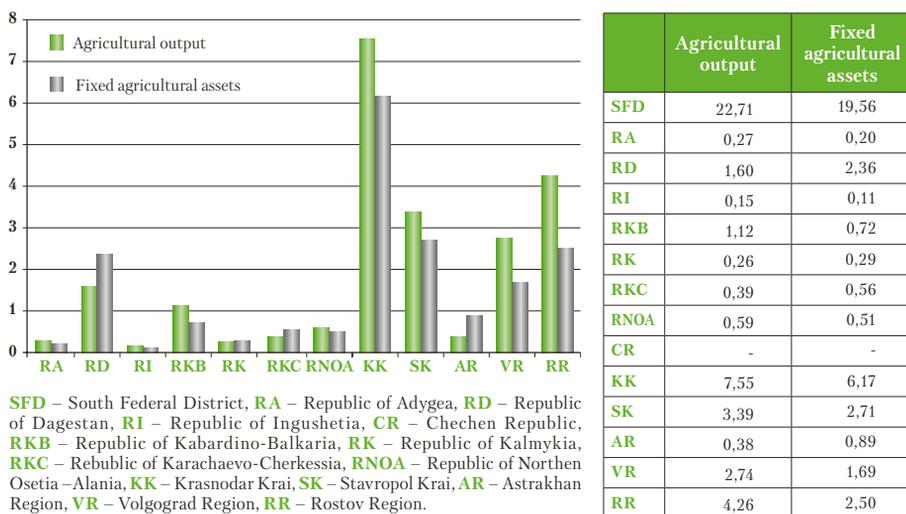
Production of vegetable oil, sugar, groats, shoes (Krasnodar Krai, Rostov Region) plays an important part in the territorial division of labour in the South of Russia. Cement and construction material production (Krasnodar Krai, Rostov Region, Karachaevo-Cherkessk), synthetic resin, ammonium (Stavropol Krai) and refined oil products (Volograd Region) are of significant importance for the Russian economy. However, machinery manufacturing, including agricultural machinery lost its positions during the reforms to the point that their performance is no longer recorded in the state statistics database. Consequently, it is becoming harder to notice the revival of certain industrial sub-sectors in the South of Russia.

6. PRODUCER MARKET. AGRICULTURE

6.1. Competitive Advantage

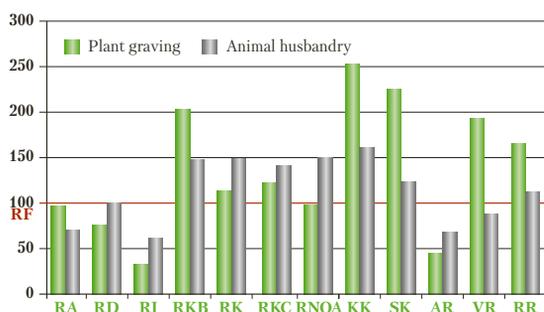
The natural and climatic factors predetermined the agricultural orientation of the South of Russia which is responsible for 1/5 of agricultural output of the country and 1/4 of Russia’s plant-growing. The bulk of agricultural output is produced by the Krasnodar and Stavropol Krairs, the Rostov and Volgograd Regions. It should be specifically mention that Krasnodar Krai has the highest level of agricultural assets which is evidence of the beginning of technical upgrading of the Kuban villages.

Table 6.1.1. Production volume and fixed agricultural assets in the South of Russia, % to the Russian Federation



SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, CR – Chechen Republic, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

Comparison of the agricultural indicators per capita more clearly demonstrates the influence of the natural and climatic factors on agricultural output: these indicators are significantly higher in the Krasnodar and Stavropol Krairs, Volgograd and Rostov, Kabardino-Balkaria compared to the average per capita indicators in the rest of Russia. However, one should not ignore the fact that the yields of main agricultural crops in European countries are two-four times higher than they are in the South of Russia. In addition, modern agricultural technologies also have an impact.

Table 6.1.2. Agricultural output per capita in % to the Russian Federation


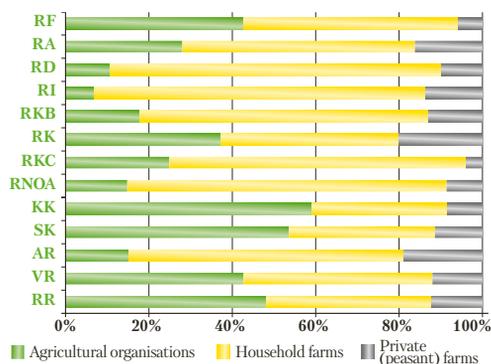
SFD – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia – Alania, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

	Agricultural output		
	Total	Plant graving	Animal husbandry
SFD	142,75	165,10	113,80
RA	86,74	97,65	72,62
RD	87,48	77,94	99,84
RI	45,66	34,51	60,10
RKB	178,95	202,59	148,33
RK	128,12	112,21	148,73
RKC	129,83	120,09	142,44
RNOA	121,10	98,57	150,27
KK	212,36	252,96	159,77
SK	178,81	223,22	121,30
AR	54,80	45,69	66,59
VR	148,23	193,52	89,59
RR	140,99	164,10	111,05

6.2. Masters of the Land

The land management issue is of great importance in agriculture. Despite the fact that the land legislation is far from being perfect, and certain elements of the shadow economy are present, the attitude of the owner of the durable means of production has provided a powerful impetus for increasing agricultural output.

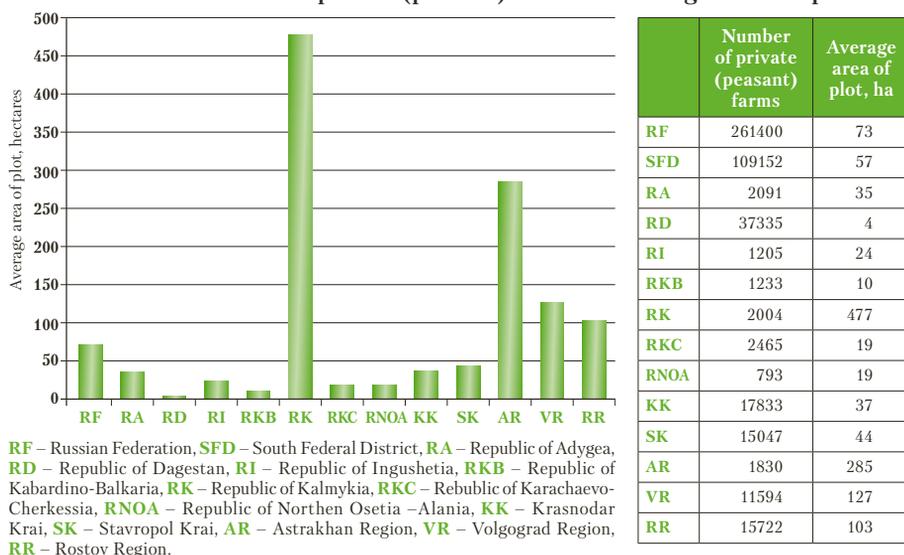
One should always bear in mind that the South of Russia has been and will remain to be the region of large agricultural commodity production. In the context of economic globalisation marketability means competition not only at the local market but also at the world markets.

Table 6.2.1. Agricultural output structure by economic sectors


RF – Russian Federation, **SFD** – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia – Alania, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

	Agricultural output		
	Agricultural organisations	Household farms	Private (peasant) farms
RF	42,8	51,3	5,9
SFD	44,8	44,4	10,8
RA	28	55,8	16,2
RD	10,6	79,6	9,8
RI	6,9	79,5	13,6
RKB	17,7	69,3	13
RK	37,2	42,8	20
RKC	24,9	71,1	4
RNOA	14,8	76,6	8,6
KK	59,1	32,4	8,5
SK	53,6	35	11,4
AR	15,1	66	18,9
VR	42,7	45,3	12
RR	48,2	39,5	12,3

Table 6.2.2. Number of private (peasant) farms and average area of a plot



RF – Russian Federation, **SFD** – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia –Alania, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

In the regions that typically take a leading position in agricultural output, the contribution of farms is lower than the average national. Almost 42% of farms are located in the South, but their understanding of farming differs in certain areas of the South of Russia: average plots of land account for between 30 and 470 hectares.

Romanticism or fetishism of the role of farmers is not acceptable when we talk about competing at the global markets. Farms can only survive in the global market:

- As structural divisions in large global companies;
- If there is availability of infrastructure for storing, supplying, processing;
- If farms are expanded to the size of corporations.

As for the farm population, their potential in many ways depends on the rational utilisation which used to be irrationally. As the farms are becoming privatised, there is more order and fewer resources are wasted. The social factor also plays a part, when a rural resident has to deal with his main job and private business. In this situation one of the jobs suffers as the rural resident carries a double burden. Ideally it is necessary to have highly developed agriculture so that the rural residents are paid a decent salary which allows them to lead a modern quality life and not to undertake a second job in his backyard. These factors have to be taken into account when analysing the agricultural product structure of the South of Russia.

6.3. Industrialisation of the Agri Business of the South of Russia

Table 6.3.1. Agricultural output in 2000-2004 in % compared to the Russian Federation

	Grains	Beet sugar	Sunflower	Potatoes	Vegetables
South Federal District	29,5	27,5	58,9	8,2	21,0
Republic Adygea	0,4	0,1	0,7	0,1	0,3
Republic of Dagestan	0,4	-	0,1	0,6	4,8
Republic of Ingushetia	0,1	-	0,1	0,2	0,1
Republic of Kabardino-Balkaria	0,8	-	0,5	0,5	2,2
Republic of Kalmykia	0,4	-	0,3	-	0,1
Republic of Karachaevo-Cherkessia	0,2	0,7	0,1	0,5	0,4
Republic of Northern Osetia-Alania	0,3	-	0,1	0,3	0,3
Chechen Republic	0,1	0,1	-	-	0,2
Krasnodar Krai	9,4	22,5	17,6	2,0	3,1
Stavropol Krai	6,6	3,6	6,2	0,9	1,0
Astrakhan Region	0,1	-	-	0,3	1,7
Volgograd Region	3,7	-	9,3	1,3	2,7
Rostov Region	7,2	0,6	23,9	1,5	4,1

The South of Russia is a strategic sunflower producer in Russia. The main facilities for vegetable oil production are concentrated in the South. But it is necessary to move to more advanced agricultural technologies for growing and processing sunflower. The same requirements should be applied to growing virtually all other agricultural products in the South of Russia: grains, beetroot sugar, vegetables.

Cattle breeding has always been dependent on availability of fodder supplies. Inefficient, expensive technologies in plant growing made the cattle-breeding industry of the South of Russia uncompetitive and resulted in importing of milk and meat. A sharp decrease of livestock completely refocused underutilised meat-processing facilities in the region to imported raw materials. Restoring the cattle-breeding industry in the South should start from scratch but at the same time it should provide an opportunity to produce organic goods using modern technologies.

Table 6.3.2. Agricultural output in 2000-2004 in % compared to the Russian Federation

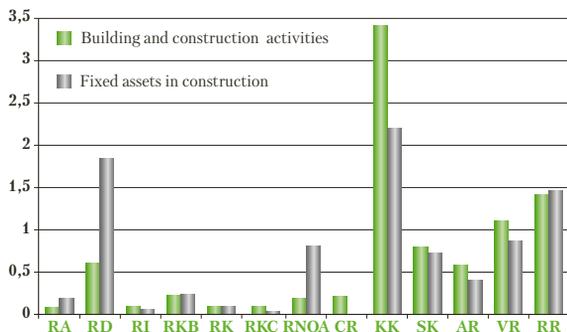
	Meat	Milk	Eggs
South Federal District	18,4	14,2	13,8
Republic Adygea	0,3	0,3	0,1
Republic of Dagestan	1,2	1,0	0,8
Republic of Ingushetia	-	0,2	-
Republic of Kabardino-Balkaria	0,6	0,8	0,4
Republic of Kalmykia	0,3	0,2	0,1
Republic of Karachaevo-Cherkessia	0,4	0,4	0,2
Republic of Northern Osetia – Alania	0,5	0,5	0,3
Chechen Republic	0,1	0,2	-
Krasnodar Krai	6,0	4,2	4,1
Stavropol Krai	2,7	1,7	2,2
Astrakhan Region	0,4	0,4	0,6
Volgograd Region	2,4	1,6	1,8
Rostov Region	3,4	2,8	3,2

7. INFRASTRUCTURE MARKET

7.1. Construction

Construction can also be reviewed as an element of infrastructure. The scale of the construction industry in the South of Russia makes it one of its specialised sectors. The share of the South of Russia in the construction industry of Russia is larger than it is in industrial production. This trend has remained over many years. Most of the construction activities take place in Krasnodar Krai and are virtually equal to the average indicators per capita.

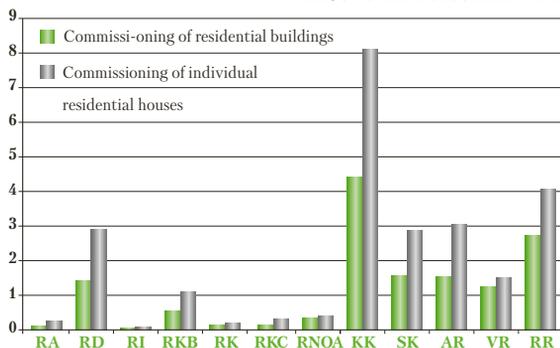
Table 7.1.1. Volume of building and construction activities and fixed assets in construction in % to the Russian Federation



	Building and construction activities	Fixed assets in construction
SFD	8,90	8,71
RA	0,08	0,19
RD	0,61	1,85
RI	0,09	0,06
RKB	0,22	0,24
RK	0,10	0,09
RKC	0,09	0,04
RNOA	0,19	0,81
CR	0,21	-
KK	3,42	2,20
SK	0,80	0,73
AR	0,58	0,41
VR	1,11	0,87
RR	1,41	1,46

SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

Table 7.1.2. Commissioning of residential and individual residential houses in % to the Russian Federation



	Commissioning of residential buildings	Commissioning of individual residential houses
SFD	14,21	24,87
RA	0,10	0,25
RD	1,41	2,89
RI	0,04	0,07
RKB	0,54	1,11
RK	0,13	0,20
RKC	0,15	0,32
RNOA	0,33	0,41
KK	4,41	8,11
SK	1,58	2,86
AR	1,54	3,06
VR	1,24	1,51
RR	2,73	4,07

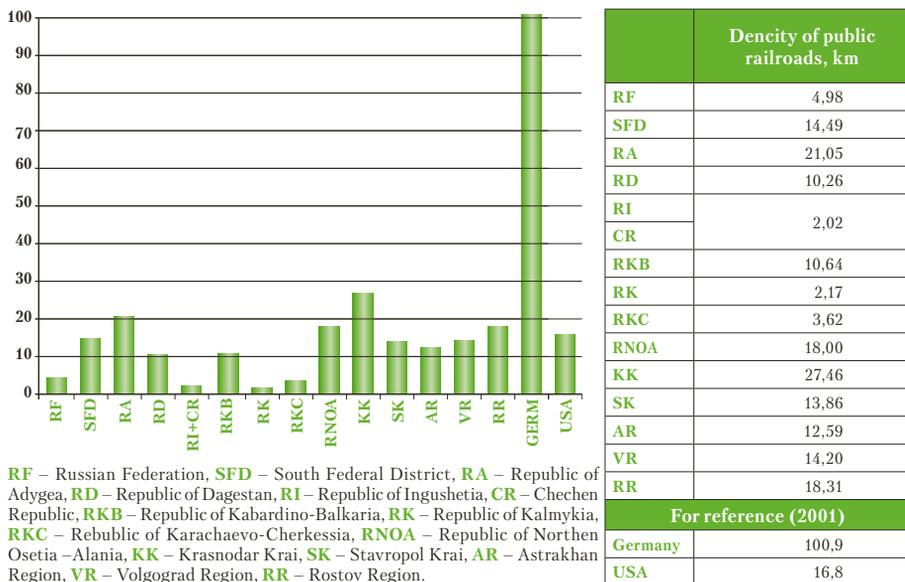
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Comparing the figures for construction, assembly works and housing shows that the residential development, particularly individual residential development dominates the construction industry in the South of Russia. Native residents and immigrants try to create comfortable living conditions in the South of Russia. Owning a house with a small plot of land ensures adequate living standards during this difficult time of reforms in Russia.

Despite of the existing potential, the construction industry of the South of Russia needs to be technically upgraded. Intensive construction requires that correct and rational solutions are found for accommodating residents, building infrastructure and roads. Since the construction of individual residential houses dominates the construction industry in the South, there is a special demand for facilities that provide gas, water, electricity and heat for residences.

7.2. Transport and Communications

Table 7.2.1. Density of railroads in the regions of the Russian Federation, in km, per 1,000 square kilometres



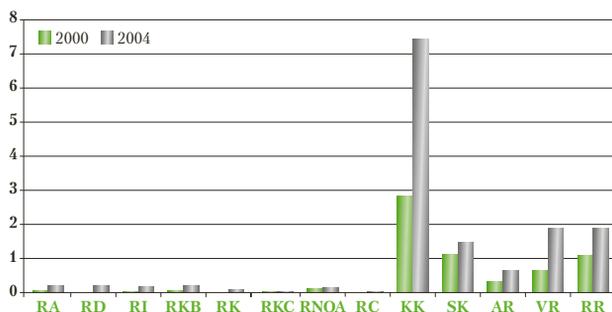
RF – Russian Federation, SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, CR – Chechen Republic, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

The South of Russia has a developed railway network and its density is three-six times higher than the national average. If we take into account the strategic directions, such as Center-Caucasus, Urals-Ukraine, then it becomes clear that the Southern stations are attractive for developing logistical Centers. Railroads are connected to the sea and river ports of the Caspian and Black Seas, navigable rivers of the European part of Russia flowing into the Baltic Sea and the Arctic Ocean.

Table 7.2.2 Hard-surfaced auto-motor roads, the number of buses and automobiles used in regions of Russia

	Density of auto-motor roads in km, per 1,000 sq. km	Buses per 100,000 persons	Automobiles per 1,000 persons
Russian Federation	32	60	159,3
South Federal District	110	49	140,8
Republic Adygea	208	34	156,2
Republic of Dagestan	148	30	53,1
Republic of Ingushetia	189	47	54,8
Republic of Kabardino-Balkaria		54	41,6
Republic of Kalmykia	237	52	102,8
Republic of Karachaevo-Cherkessia	38	58	138,5
Republic of Northern Osetia – Alania	134	50	129,5
Chechen Republic	286	60	128,4
Krasnodar Krai	143	57	190,4
Stavropol Krai	113	53	168,9
Astrakhan Region	61	31	160,4
Volgograd Region	78	67	144,8
Rostov Region	123	43	156,4
For reference (2001)			
Germany	646	109	539
USA	682	245	779

In comparison to the national figures, the South of Russia has the highest quantity of motorways (three times higher) and simultaneously the highest number of privately owned vehicles and public buses. The density of the population is five times higher in the South than the national average. The volume of automobile transport per 1 km of hard-surfaced road is 1.3 times higher than the national average. This is particularly strongly felt by the Russian drivers during the holiday season. Expansion of the existing roads and the construction of the new motor ways in the South of Russia is not a regional but national objective.

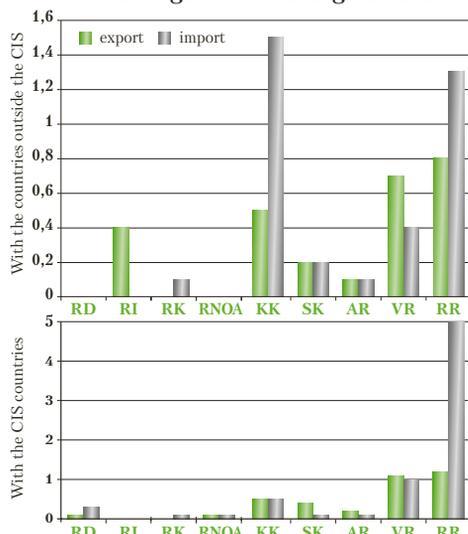
Table 7.2.3. Number of registered mobile telecommunication terminals in % to the Russian Federation


	2000	2004
SFD	6,29	14,44
RA	0,06	0,21
RD	-	0,21
RI	0,02	0,18
RKB	0,06	0,20
RK	-	0,08
RKC	0,03	0,02
RNOA	0,11	0,14
CR	-	0,04
KK	2,84	7,44
SK	1,13	1,46
AR	0,31	0,66
VR	0,65	1,90
RR	1,09	1,89

SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

The mobile telecommunication in the South of Russia is developing at a gigantic pace and its figure virtually equals the national average. If other disparities could be eliminated so quickly, then the South of Russia could not only reach the average national figures but also improve its living standards to match those of the capital.

7.3. Foreign Trade

Table 7.3. Foreign trade of the regions of the South of Russia in % to the Russian Federation


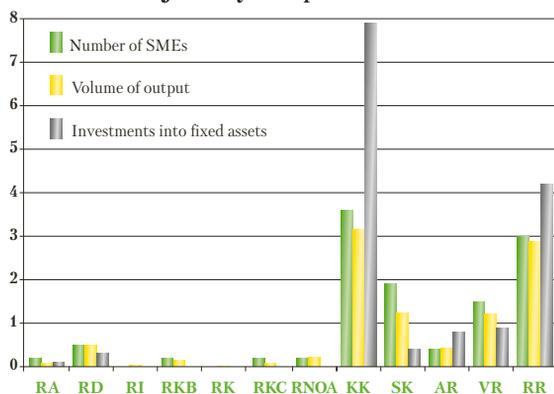
	With non-CIS countries		With the CIS countries	
	export	import	export	import
SFD	2,8	3,7	3,6	7,3
RA	-	-	-	-
RD	-	-	0,1	0,3
RI	0,4	-	-	-
RKB	-	-	-	-
RK	-	0,1	-	0,1
RKC	-	-	-	-
RNOA	-	-	0,1	0,1
CR	-	-	-	-
KK	0,5	1,5	0,5	0,5
SK	0,2	0,2	0,4	0,1
AR	0,1	0,1	0,2	0,1
VR	0,7	0,4	1,1	1,0
RR	0,8	1,3	1,2	5,0

RF – Russian Federation, SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

The contribution of the South of Russia to the country’s foreign trade turnover is more modest than its population density or production output. In many ways this is due to the fact that foreign trade deals are handled through the head offices of Russian and foreign companies based in Moscow. Therefore, the connections of the old southern Russian enterprises with the CIS countries become particularly valuable. Production collaboration which was formed back in the days of centrally planned economy has a good chance of being revived in these new market conditions when the CIS countries need to access foreign markets: experience of interaction and transport routes create an objective basis for joint activities at the global markets.

7.4. Small Business of the South of Russia

Table 7.4. Main indicators of small-size enterprises for the period of January – September 2005 in % to the Russian Federation



	Number of SMEs	Number of employees	Volume of output	Investments in fixed assets
SFD	11,7	10,1	9,98	14,7
RA	0,2	0,2	-9	0,1
RD	0,5	0,5	0,49	0,3
RI	-	-	-4	-
RKB	0,2	0,3	0,15	-
RK	-	-	-2	-
RKC	0,2	0,1	-7	-
RNOA	0,2	0,2	0,22	-
CR	-	-	-	-
KK	3,6	3,4	3,16	7,9
SK	1,9	1,3	1,24	0,4
AR	0,4	0,6	0,42	0,8
VR	1,5	1,3	1,22	0,9
RR	3,0	2,3	2,88	4,2

SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, CR – Chechen Republic, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

One can say without any exaggeration that small businesses are a specialised sector in the economy of the South of Russia. If in the Central and North-Western federal districts the development of small businesses is predetermined by the impact of the economy as a whole, then in the South of Russia it develops not due to, but despite the development of large businesses. The entrepreneurial spirit and southern Russian temper are the driving force of small businesses which always played an important part in the development of private sector and «workshop» that produced scarce goods.

As a result of the steps undertaken by the local authorities, small businesses were legalised: the number of small-size enterprises is growing along with their role in total production output as well increasing investments in fixed assets. This shows that despite the difficulties and obstacles, small business are coming out and beginning to believe in their future in the South of Russia.

8. INVESTMENT MARKET

8.1. Fixed Assets

Table 8.1.1. Fixed assets by the regions in the South of Russia per capita, in % to the Russian Federation

	Total	Industry	Agriculture	Construction	Transport and communication
South Federal District	58,95	43,25	122,96	54,74	55,45
Republic Adygea	54,72	25,34	65,67	62,54	58,74
Republic of Dagestan	44,39	42,02	129,35	101,45	21,26
Republic of Ingushetia	22,19	7,18	31,70	19,02	19,71
Republic of Kabardino-Balkaria	109,96	68,50	355,01	117,81	61,52
Republic of Kalmykia	39,23	15,92	95,27	30,82	29,76
Republic of Karachaevo-Cherkessia	35,24	17,33	114,78	7,55	9,98
Republic of Northern Osetia – Alania	33,15	23,10	64,41	101,83	17,50
Chechen Republic	0,00	0,00	0,00	0,00	0,00
Krasnodar Krai	72,37	35,29	173,68	62,03	76,92
Stavropol Krai	59,68	46,96	143,22	38,36	54,46
Astrakhan Region	91,54	96,42	128,16	58,85	92,18
Volgograd Region	72,84	77,02	91,57	46,83	73,35
Rostov Region	61,45	43,07	114,13	48,28	66,82

Low capital productivity of the South of Russia was already mentioned earlier. The other side of the coin is that this available capital is not enough. In the South of Russia the volume of these assets is 30-40% less per capita than the national average. The Krai and Regions of the South of Russia have a higher volume of assets than the national average, including the republic of Kabardino-Balkaria. The bulk of these assets are available in the agricultural sector of the South of Russia. It is in the service industry of the South of Russia that the fixed assets are limited.

Table 8.1.2 Fixed assets in the region of the South of Russia

	Wear and tear	Renewal ratio	Liquidation ratio
Russian Federation	45,1	8,4	0,9
South Federal District	43,2	10,0	0,9
Republic Adygea	33,1	19,5	0,4
Republic of Dagestan	42,3	3,7	0,7
Republic of Ingushetia	38,8	1,1	0,7
Republic of Kabardino-Balkaria	36,5	8,0	0,8
Republic of Kalmykia	47,5	5,3	1,2
Republic of Karachaevo-Cherkessia	43,2	5,4	1,0
Republic of Northern Osetia – Alania	44,3	8,3	1,6
Chechen Republic	-	-	-
Krasnodar Krai	35,0	15,2	1,1
Stavropol Krai	50,9	7,7	0,9
Astrakhan Region	52,0	6,6	0,6
Volgograd Region	53,6	8,9	0,7
Rostov Region	40,6	8,0	1,2

Fixed assets are taken into account in statistics at their book-keeping value. The introduction of new assets which cost significantly more than the book value of the old assets impact the wear and tear as well as the renewal of the fixed capital. The Krasnodar Krai, Adygea, Ingushetia and Kabardino-Balkaria are in the lead in terms of renewing the fixed capital. Rostov Region and Dagestan also have high figures in renewing their fixed assets.

8.2. Investing in the Fixed Assets

Table 8.2.1 Investments in fixed capital in the regions of the South of Russia

	Volume of Investments in fixed capital		Investments by industries of RF
	as % of investments into an industry of RF	as % of total in SFD	
Total	8,0	100	100
Agriculture, hunting, forest industry	20,6	8,5	3,3
Fishery, fish breeding industry	9,6	0,1	0,1
Mining operations	1,6	3,5	16,8
Manufacturing industry	5,6	12,2	17,4
Electric power, gas, water generation and distribution	8,6	9,1	8,4
Construction	15,6	6,2	3,1
Wholesale and retail trade; repair of motor vehicles, motorcycles, household equipments	11,5	3,8	2,7
Hotels and restaurants	20,6	1,0	0,4
Transport and communications	10,7	33,8	25,1
Finance activities	6,2	1,2	1,6
Real estate activities, rent and services rendered	6,2	9,7	12,6
Public administration and military security, obligatory social provisions	13,8	3,2	1,8
Education	8,6	1,9	1,8
Public health and social services rendering	14,0	4,1	2,3
Rendering of other utilities, social and personal services	5,0	1,7	2,7

If the investments in Russia are directed into transport and communications, exploration and production of minerals, provision of electricity, water and gas as well as real estate transactions, the investments in the South are associated with the development of the specialised sectors within the context of the Russian labour division. The contribution of the South accounts for 1/5 of all Russian investments in agriculture, hotel and restaurant businesses, and almost 1/6 of investments are spent on healthcare, trade and construction. In terms of the comprehensive development of the South of Russia itself, the investments are distributed not only on the basis of specialisation but also infrastructure, including transport and communications, food-processing industry, provision of electricity, water and gas. As the infrastructure develops the property prices will grow too. We can see this happening based on the statistical data.

From the point of view of the investor it is important to bear in mind that the main advantages of the South of Russia are the natural and climatic conditions. Their utilisation for the development of the recreational and agricultural industries is a strategic investment

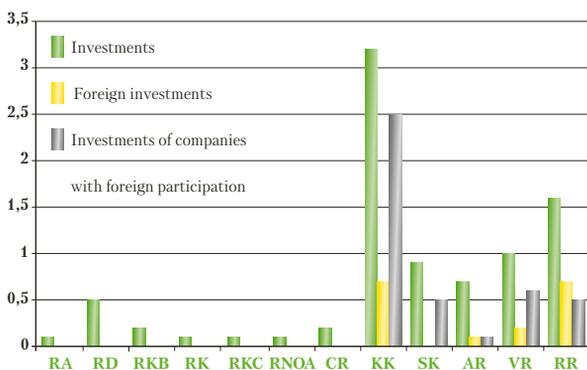
decision. Other factors related to the utilisation of the production, energy, transport infrastructure, construction, and labour resources create additional benefits in order to increase the appeal of strategic investments.

As a result of the infrastructure development, the South of Russia is becoming more attractive for the development of other sectors of the economy. But under any conditions it is vital to preserve the natural potential of the South of Russia.

If we review the territorial distribution of investments in the South of Russia, in Krasnodar Krai a half of those investments go into the agro-industrial complex of the South of Russia. Approximately the same volume of investments goes to Stavropol Krai, Rostov and Volgograd Regions. Investments in the fishery are also important in Rostov Region, Dagestan, the Astrakhan Region and Krasnodar Krai. The construction industry is receiving investments in Krasnodar Krai, Chechen Republic, Astrakhan, Volgograd and Rostov Regions. A bulk of investments is directed at the hotel business and healthcare of the Krasnodar Krai.

Virtually in all the federal districts of the South of Russia the bulk of investments in 2004 were used for the transport and communications development with the telecommunications sector in the lead.

Table 8.2.2 Volume of investments in fixed capital in % to the Russian Federation



	Investments	Foreign investments	Investments of companies with foreign participation
SFD	8,7	1,7	4,2
RA	0,1	-	-
RD	0,5	-	-
RKB	0,2	-	-
RK	0,1	-	-
RKC	0,1	-	-
RNOA	0,1	-	-
CR	0,2	-	-
KK	3,2	0,7	2,5
SK	0,9	-	0,5
AR	0,7	0,1	0,1
VR	1,0	0,2	0,6
RR	1,6	0,7	0,5

SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia –Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

Foreign investors have not yet assessed the investment potential of the South of Russia. In many ways this is because the southerners themselves and the Russian oligarchs aspired to only skimming the cream off this potential. The positioning in the global market as well as the necessity of new industrialisation in the South of Russia requires not only foreign capital but also foreign technologies, including management technologies. Investing in joint ventures is a step in the right direction in terms of combining the interests of local and foreign investors.

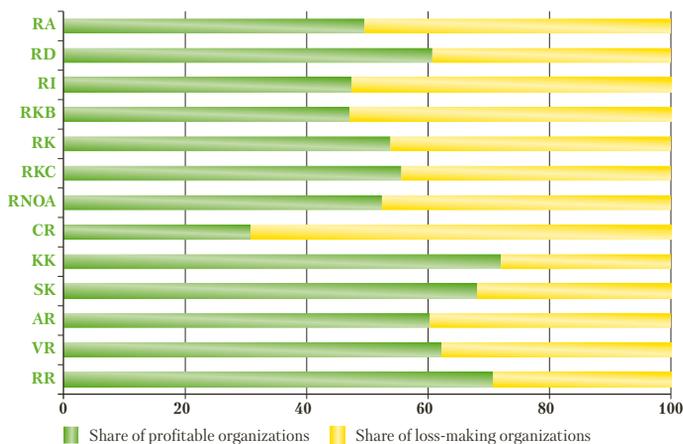
9. DEBT MARKET. FINANCIAL PERFORMANCE OF ENTERPRISES

9.1. Profit and Losses

Table 9.1.1. Financial performance of enterprises and organisations in the South of Russia in % to the Russian Federation

	Balance (profit less loss)	Profit	Losses
South Federal District	2,64	3,8	13,1
Republic Adygea	-	-	0,2
Republic of Dagestan	0,05	0,1	0,1
Republic of Ingushetia	-	-	-
Republic of Kabardino-Balkaria	-0,01	-	0,3
Republic of Kalmykia	-0,01	-	0,1
Republic of Karachaevo-Cherkessia	-0,04	0,1	0,2
Republic of Northern Osetia – Alania	-0,06	-	0,2
Chechen Republic	-0,03	0,1	0,7
Krasnodar Krai	1,21	1,2	5,3
Stavropol Krai	0,54	0,6	0,9
Astrakhan Region	0,17	0,2	0,4
Volgograd Region	0,56	0,9	1,3
Rostov Region	0,25	0,6	3,4

Table 9.1.2. Share of profitable and loss-making enterprises and organisation in the South of Russia in % to the Russian Federation for January-September 2005



	Share of profitable organisations	Share of loss-making organisations
RF	64,2	35,8
SFD	64,6	35,4
RA	49,5	50,5
RD	60,7	39,3
RI	47,5	52,5
RKB	47,1	52,9
RK	53,8	46,2
RKC	55,6	44,4
RNOA	52,4	47,6
CR	30,9	69,1
KK	72,0	28,0
SK	68,2	31,8
AR	60,3	39,7
VR	62,2	37,8
RR	70,8	29,2

RF – Russian Federation, SFD – South Federal District, RA – Republic of Adygea, RD – Republic of Dagestan, RI – Republic of Ingushetia, RKB – Republic of Kabardino-Balkaria, RK – Republic of Kalmykia, RKC – Republic of Karachaevo-Cherkessia, RNOA – Republic of Northern Osetia – Alania, CR – Chechen Republic, KK – Krasnodar Krai, SK – Stavropol Krai, AR – Astrakhan Region, VR – Volgograd Region, RR – Rostov Region.

Enterprises of the South of Russia make more than a modest contribution to the financial performance of the national economy. First of all, we should emphasise that the krajs and regions of the South of Russia bring profit to the national «money-box». The national republics

predominantly make a negative contribution to the financial performance. In addition, the number of commercially viable enterprises in the krais and regions is higher than the national average, however their viability remains to be modest compared to the national average because the economic structure of the South of Russia is dominated by low-viability sectors of the economy: agriculture, construction and transport. However, even a low number of unprofitable enterprises in the South of Russia have a profound impact on the national performance (losses). Such a ratio is due to the unprofitable activities of large enterprises, which often implement town-forming functions and are reluctant to adapt to new market conditions.

In the national republics the ratio of unprofitable enterprises and organisations is higher, and they are smaller in size but their inefficiency has a negative impact on the general financial performance.

If this non-profitability of enterprises is deliberate and related to asset stripping, initial accumulation of capital, then it explains (not justifies) why these unprofitable enterprises are supported. In all other cases one should not be afraid of the bankruptcy of large and small, town-forming, or socially important enterprises. Bankruptcy, first of all, means that the non-performing assets will change hands. Perhaps through a chain of mediators, these assets will eventually reach someone, even though at a low price, who can turn them around. Despite this negative experience in Russia, the bankruptcy mechanism has been and will remain to be the shortest way to move to more efficient management methods.

9.2. Debt of Enterprises

Table 9.2. Indebtedness of enterprises in % to the Russian Federation as of 1 October 2005

	Credit or indebtedness		Debt or indebtedness	
	total	incl. overdue	total	incl. overdue
South Federal District	6,3	9,5	4,9	7,0
Republic Adygea	0,1	0,1	0,1	0,1
Republic of Dagestan	0,1	0,3	0,1	0,3
Republic of Ingushetia	-	0,1	-	0,1
Republic of Kabardino-Balkaria	0,2	0,8	0,1	0,4
Republic of Kalmykia	0,1	0,2	-	0,1
Republic of Karachaevo-Cherkessia	0,1	0,2	0,1	0,1
Republic of Northern Osetia – Alania	0,2	0,4	0,1	0,3
Chechen Republic	0,3	1,3	0,2	0,8
Krasnodar Krai	1,5	1,4	1,2	1,0
Stavropol Krai	0,7	1,2	0,6	1,3
Astrakhan Region	0,4	0,3	0,3	0,6
Volgograd Region	1,0	1,0	0,9	1,0
Rostov Region	1,6	2,2	1,2	0,9

As it becomes evident from the above chart, the debts of the South of Russia are lower than its output. In spite of low viability, the enterprises do appreciate the threat of bankruptcy and try to keep their debt level low. Unfortunately, this is not always achievable, and the debt in arrears can be compared to the scale of production in the South of Russia. The accumulation of accounts payable with a low viability also creates additional risks for those who run unprofitable operations (threat of a takeover) and for lenders (non-repayment risk).

10. INSURANCE AND BANKING SERVICES

Table 10.1.1 Performance of insurance companies in the regions of the South of Russia in % to the Russian Federation

	Number of insurance companies	Insurance premiums	Insurance benefits
South Federal District	5,3	2,5	3,1
Republic Adygea	0,1	-	-
Republic of Dagestan	0,1	-	-
Republic of Ingushetia	-	-	-
Republic of Kabardino-Balkaria	-	-	-
Republic of Kalmykia	0,3	-	-
Republic of Karachaevo-Cherkessia	-	-	-
Republic of Northern Osetia – Alania	-	-	-
Chechen Republic	-	-	-
Krasnodar Krai	0,8	0,4	0,7
Stavropol Krai	1,0	0,5	0,7
Astrakhan Region	0,2	0,1	0,2
Volgograd Region	0,9	0,1	0,1
Rostov Region	2,0	1,4	1,3

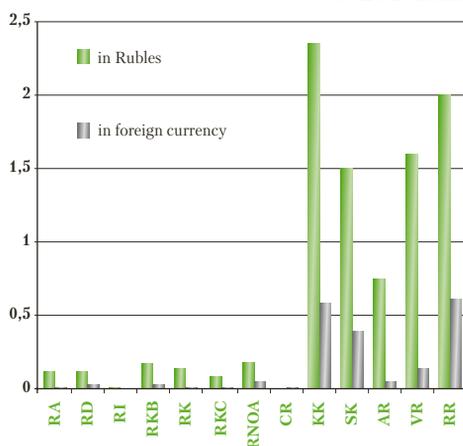
In spite of a large number of insurance companies in the region, the volume of insurance premiums and payments in the South of Russia is not high and the insurance industry is expected to grow rapidly.

Table 10.1.2 Bank deposits in federal districts in the South of Russia in % to the Russian Federation (based on places of borrowing; at the beginning of the year)

	Deposits			Consumer deposits at the Savings Banks of the Russian Federation	
	Total	Legal entities	Individuals	Ruble accounts	Foreign currency accounts
South Federal District	6,27	1,80	7,32	9,19	6,84
Republic Adygea	0,08	-	0,09	0,14	0,10
Republic of Dagestan	0,09	0,03	0,10	0,13	0,05
Republic of Ingushetia	0,01	-	0,02	0,03	0,02
Republic of Kabardino-Balkaria	0,11	0,02	0,13	0,20	0,15
Republic of Kalmykia	0,03	-	0,03	0,04	0,03
Republic of Karachaevo-Cherkessia	0,05	-	0,05	0,09	0,04
Republic of Northern Osetia – Alania	0,21	0,01	0,25	0,38	0,13
Chechen Republic	0,09	-	-	-	-
Krasnodar Krai	2,14	0,94	2,42	2,90	2,40
Stavropol Krai	0,95	0,19	1,12	1,61	1,76
Astrakhan Region	0,35	0,06	0,41	0,47	0,32
Volgograd Region	0,86	0,31	0,99	1,38	0,89
Rostov Region	1,32	0,23	1,58	1,84	0,94

The population of the South of Russia does not earn enough money to keep it in the banks. The volume of deposits per capita is twice as low as the national average. The level of savings increases as their income grows, therefore, the krais and regions of the South of Russia are becoming more and more attractive to the banking sector. In addition, the ratio of Ruble and foreign currency accounts in the Krasnodar and Stavropol Krais is approximately the same, whereas in other areas consumers prefer to keep their money in Ruble accounts.

Table 10.1.3 Indebtness of individuals of the South of Russia on loans in % to the Russian Federation



SFD – South Federal District, **RA** – Republic of Adygea, **RD** – Republic of Dagestan, **RI** – Republic of Ingushetia, **RKB** – Republic of Kabardino-Balkaria, **RK** – Republic of Kalmykia, **RKC** – Republic of Karachaevo-Cherkessia, **RNOA** – Republic of Northern Osetia – Alania, **CR** – Chechen Republic, **KK** – Krasnodar Krai, **SK** – Stavropol Krai, **AR** – Astrakhan Region, **VR** – Volgograd Region, **RR** – Rostov Region.

	Indebtness in Rubles			Indebtness in foreign currency		
	Total	Including loans for purchase of houses	Including mortgages	Total	Including loans for purchase of houses	Including mortgages
SFD	9,03	6,30	3,95	1,92	1,62	1,28
RA	0,12	0,08	0,03	0,01	0,01	0,02
RD	0,12	0,01	-	0,03	-	0,01
RI	0,01	0,03	-	-	-	-
RKB	0,17	0,07	0,03	0,03	0,05	-
RK	0,14	0,12	0,01	0,01	0,02	-
RKC	0,08	0,05	-	0,01	0,02	0,01
RNOA	0,18	0,37	-	0,05	0,06	0,02
CR	-	-	0,02	0,01	-	-
KK	2,35	1,35	1,40	0,58	0,41	0,50
SK	1,50	1,81	0,45	0,39	0,54	0,13
AR	0,75	0,31	0,20	0,05	0,04	0,06
VR	1,60	0,75	0,29	0,14	0,20	0,24
RR	2,00	1,33	1,52	0,61	0,27	0,29

The consumer lending boom is beginning to reach the South of Russia. In spite of the rigorous advertising campaigns, the local residents are not actively borrowing money even for the purpose of purchasing houses or flats. It is desirable to see the growth of lending accompany the income growth, not the growth of non-repayments and subsequent claims to debtors.

Table 10.1.4. Indebtness of legal entities on loans, in % to the Russian Federation

	Indebtness of legal entities on loans	
	In Rubles	In foreign currency
South Federal District	6,02	3,06
Republic Adygea	0,04	-
Republic of Dagestan	0,12	0,08
Republic of Ingushetia	0,01	0,01
Republic of Kabardino-Balkaria	0,10	-
Republic of Kalmykia	0,30	0,12
Republic of Karachaevo-Cherkessia	0,10	0,02
Republic of Northern Osetia – Alania	0,11	0,02
Chechen Republic	-	-
Krasnodar Krai	2,15	0,70
Stavropol Krai	0,64	0,41
Astrakhan Region	0,15	0,01
Volgograd Region	0,83	0,24
Rostov Region	1,46	1,44

The physical persons are also exercising caution. But the main influencing factors are the lack of projects that require loans, high risks related to enterprise loans, inadequate loan security. However, with the joint efforts of enterprises and banks as well as potential investors the demand for credit resources is gradually beginning to grow. Unfortunately, very few banks have access to long-term financial resources. Therefore, banks with state or foreign capital can afford to finance investment projects.

11. EFFICIENCY OF THE POTENTIAL OF THE SOUTH OF RUSSIA

The South of Russia today is:

- A region with a significant potential of human and land resources, infrastructure which can be used more effectively;
- A large market where in spite of low income the living standards remain to be high enough;
- A region which represents great interest for investments and new industrial technologies in various sectors of the industry and services.

All sectors of the economy of the South of Russia are in need of intensive industrialisation. The low capital-labour ratio (nearly 1.8 times lower than the national average) does not ensure high yields on capital investments and labour productivity.

Low income remains to be a serious social problem in the South of Russia, i.e. it lags behind the rest of Russia. In spite of entrepreneurial endeavours to increase wages, the gap in the pensioners' income remains to be 1.6 times larger. The labour productivity figures reflect the attitude: we work as much as we get paid. A more correct way of putting it is: we get paid according to how we perform, as the productivity level is lower than the national average.

The economy of the South of Russia has a significant potential, although it is currently inefficiently utilised. Like any inefficiently operated business it runs the risk of being sold out.

One should not assume that the mass process of replacing the inefficient owner during the privatisation in the South was different than in the rest of the country. Just like the foreigners were not allowed to receive a piece of the national pie, the investors from Moscow received a similar treatment in the South.

As the government and trans-national companies started to push Russian oligarchs out of the lucrative sectors where they had accumulated enough capital, this capital is gradually pushing the local elite out of the management. Only efficient managers will succeed. But they have to prove their efficiency through their ability to work with the new owners not only in the South but also in any other region. They have to be able to successfully align their business with the global economy.

The availability of modern global technologies and equipment that can offer the South of Russia solutions that would be three-five times more effective makes the region attractive to investors. On the other hand, the existing gap between the existing and potential efficiency attracts not only direct and strategic investors but also numerous mediators willing to take advantage of these opportunities. Low income of the local residents in the South force them to sell their assets to these mediators at a low price. Lack of knowledge in attracting investments and promoting investment projects also lowers the value of the Southern Russian potential.

Analysing the main macroeconomic indicators in various areas of the South Federal District it becomes clear that efficiency and high productivity can result in higher investments and financial performance.

Krasnodar Krai is the absolute leader in the South Federal District which represents a half of the consolidated financial result of the South Federal District as well as investments in fixed assets. Kuban which is traditionally considered to lead in agricultural output is catching up with the Rostov Region in industrial output, and has already gone ahead of the

region in the volume of fixed assets. The attempts to preserve the unprofitable enterprises cost the Don Region its leading position in the industry where it had always been strong. In spite of much lower income, Kuban has started playing a significant part in residential development, trade and increasing the gross regional product.

Refusal to support the enterprises on the verge of bankruptcy leads to the growth of investments and residential developments as well as improvements in the living standards of the population (particularly the employed population). Undoubtedly, one should not ignore the Black Sea Resort Area which impacts the trade turnover growth and the gross regional product as residential development. But the general economic rule remains the same: if you want to live well, you should work hard and tidy up your house on time, and get rid of unprofitable inefficient activities. As for Stavropol, it falls behind Kuban in the volume of investments and efficiency of financial performance, even though its recreation potential matches that of the Black Sea Coast.

More modest areas, such as Astrakhan and Volgograd Regions, the Republic of the South Federal District show prove through their negative experience: the connection between the flow of investments and regional performance. There is nothing new in these conclusions. Every student with minimal economic knowledge knows that: if you want to receive investments – you need to demonstrate your efficiency: if you can't, then give your place up to an efficient manager. If you are not wise and brave enough to give up power, then others will come and take it away from you.

From this point of view, it is important to assess one's efficiency parameters at the level of every separate enterprise, compare them with the competitors' performance. It will also be useful for investors to conduct a similar comparative analysis in order to have a realistic picture of what can be acquired in the South of Russia and what sort of profitability the strategic investor can expect.

12. DEVELOPING THE POTENTIAL OF THE SOUTH OF RUSSIA

12.1. Radicalism of Reforms

They say that it will require a few generations for the Russian economy to integrate with the global market system, but these pessimists disregard the fact that in the last 15 years of reforms the Russian leaders pumped so much adrenalin that it will be more than enough for 15 generations of western managers. In addition, they developed skills how to operate in a constantly changing environment. Often these changes were not friendly but rather hostile.

In connection with this, the «rules of engagement» gained by the Russian managers during the reforms become particularly valuable:

- Reforms can succeed not due to their radicalism but due to their consistency with the conducted activities;
- While destroying the existing social stability, the reforms must restore it at every stage;
- Reforms are strong only when they reach out the masses;
- Reforms are not slogans but adopted and implemented laws;
- The winners are those who are one step ahead of the others.

These statements were formulated after the meetings with the directors of enterprises and organisations in the South of Russia. Descendants of freedom loving people with a strong sense of dignity, proud and kind-hearted – the southerners promoted the Russian reforms through their words and deeds in accordance with the rules and survived in spite of ups and downs on this difficult path in the global world and at the federal level.

The summary of these rules allowed us to develop a method which identifies the key reform areas for the region or enterprises, determines the most negative consequences of the next reform, undertakes measures to make up for these negative consequences, explains to ourselves, the people and the bosses how to run the reforms locally at a minimal social cost.

12.2. Social Protection

Social stability is an important asset of the South of Russia, and its value is as important as the uniqueness of the climate and the nature of the region. Unfortunately, stagnation is also a form of social stability, and the fact that the southerners in spite of their low income purchase as many goods as average Russians, it is often used to label and create stereotypes about the South of Russia as a region with a black economy.

One can further disregard this criticism, but within the context of globalisation it becomes difficult to benefit from one's regional dignity. The international business community does not want to hear stories about the geographical, natural and climatic, social and political advantages. The investors want to know one thing: «how much are these advantages going to cost in convertible currency?»

In fact it is not a difficult question to answer. If we want to get this answer across to the public as well as the masses, then we should start with raising the income levels of the masses. High returns on investments, accumulation of funds, increase of production output and sales – all these objectives are achievable, if the most important task is carried

out, i.e. bringing up the income level of the southerners in line with the national average. Any other priority task will not only leave the population indifferent to the investment processes but also put them against the future reforms.

One can hardly count on the growth of payouts from the public consumption funds. It is more responsible and realistic to rely on raising the income levels. To reach the national average income level, the southern salaries should be increased by 40% and the production output should go up by 60%, as «the earnings must be earned». If an employed southerner does not make 7,000 Rubles per month (average salary in Russia), then everyone as well as the employee himself will have a legitimate question: how can he survive on this? The lower the legitimate income level, is the higher is the likelihood of illegitimate activities where this person himself as well as his neighbours, supervisors and officials are involved. In order to get rid of these suspicions, the person concerned, his neighbours, supervisors and officials should not only state the lack of income but also suggest a strategy for the development of enterprises, economic sectors and areas which would allow to raise or to be more precise, to legalise the income levels of the employees.

The legalisation of income, transparency of businesses encounter numerous hurdles, including ungrounded inspections from various ministries and government offices. Since very few know about the state of affairs, hidden funds and development prospects better than the inspectors, it is necessary to oblige them to prepare proposals on a quarterly basis to legalise business that they monitor. If the supervising authorities do not accept this, then the public will think that the authorities themselves are not interested in keeping the businesses transparent. But a more delicate and interesting task is the social protection of those in a privileged position at the time when the legal income levels are so low. Family and neighbour relations should not hinder but accelerate the transition to transparent commodity-money relations.

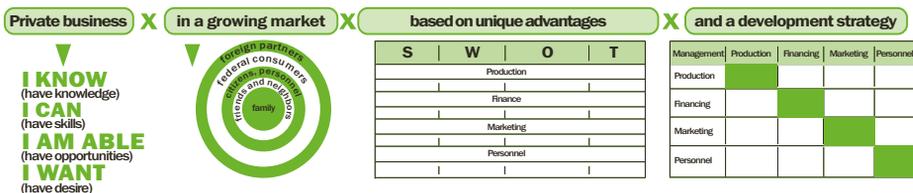
In certain areas where the level of income and living standards are so low that they cannot do without outside help, it is necessary to envisage sources of funding at municipal level, plans and strategies to increase the local income. In addition, strengthening the monetary relations will create additional financial sources for the local budgets as well funding for social projects which will in its turn increase the income of the local population.

12.3. Plans, Programmes and Strategies

Forecast is a document that describes the trends by changing proportions. The plans are developed for supporting these proportions in current activities, and the projects for preserving a balance in new directions of businesses. The programmes encompass a set of activities for implementing the plans and projects within the available resources, timeframe and designated implementers.

Regardless of the forms of presenting the documents, the main objective will always be generating ideas for future types of activities.

The following formula for success can be applied to small businesses:



Completing the proposed forms stimulates idea generation.

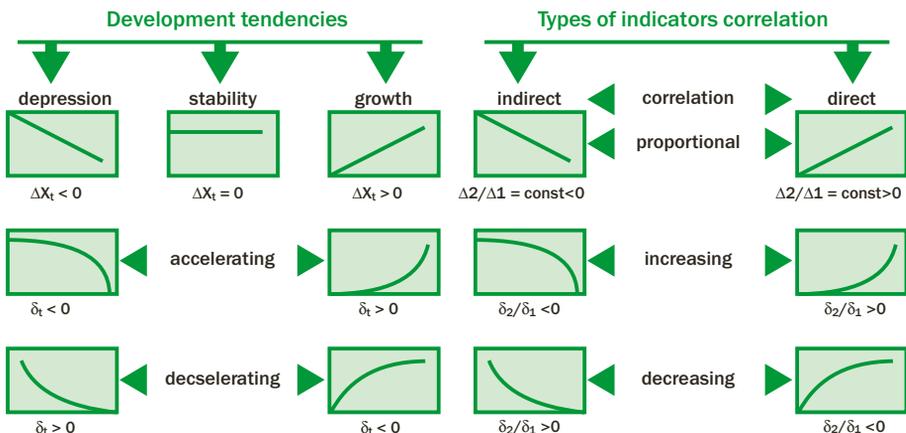
A similar approach can be applied to large enterprises and territorial level programmes based on the trend analysis in the economic performance dynamics.

The current situation analysis allows us to determine the trends and interrelations between:

- 1) Enterprises and foreign economic environment;
- 2) Elements of production, organisational, functional and product structures of the enterprise.

Analysis of trends and correlation:

Absolute value	X_t
Absolute growth	$\Delta X_t = X_t - X_{t-1}$
Growth rate	$GR = X_t / X_{t-1}$
Augmentation rate	$AR = \Delta X_t / X_{t-1}$
Change of augmentation	$\partial t = \Delta X_t - X_{t-1}$



Development of plans and programmes is an important step in terms of generating and formulating the ideas. But even after the idea is formulated, it needs to be promoted. If putting the idea into effect requires money, then you need skills to sell the idea to investors.

12.4. Promoting the South of Russia

Selling goods is possible on different markets even on the fading ones. It is important to have a clear idea about one’s marketing strategy which should encompass the following mandatory elements (Table 11.4).

Table 12.4 Marketing strategy

Market segment	Product	Price	Distribution channels	Stimulation system

The first thing, or rather the first step to take after the business strategy is developed, is to identify the markets, where this business can operate and make the most of its advantages: the local, southern Russian, federal country-specific or global.

A great deal has been previously mentioned about the advantages of the South of Russia. Now we ask a question: where can we make the most of these advantages? There are very few places in the world with such unique natural climatic potential, therefore, the South can become an international granary and a health-resort. In this case the international community should be offered higher quality products. In terms of their prices, these products can compete with the best international products. Information about the South of Russia should be distributed through the leading international information channels, and the local folk and dance groups should aid in promoting the investment projects.

Similarly in order to design and construct new facilities in the South of Russia not only the local and Russian companies but also international experienced firms should be involved. It is particularly important to develop the infrastructure of the projects that ensures the environmental protection and high ecological standards.

If every Southern Russian company positions itself in the global markets, then the South of Russia will become more recognised in the world and create more comfortable conditions for other companies to enter the world markets which will result in increasing the investment appeal of the South of Russia.

12.5. Ensuring Funding for Plans and Programmes

Often the implementation of brave projects is hindered by a lack of funding. In fact, the market is never short of funds, as the demand and supply can be balanced but at a different price. The use of credit squeeze is justified if the project concerned carries higher risks, when it is not secured: in such cases the lenders take account of the price risk. If in spite of high risks and drawbacks the project has a good potential and high profitability, then expensive one should not be afraid of taking money: any delay in implementing the project often means freezing the project. Applying the market prices to the development projects and programmes for the South of Russia will create conditions for revitalising the regional financial situation:

- First of all, additional sources for the budget from increased production output, legalisation of wages, attracting substantial investors;
- Secondly, the notion of «outside of the budget» relations will become redundant, when business are put in charge of making social decisions in exchange for taking some administrative pressure off;
- Finally, the relationship between the business community and the authorities will be

more civilised.

Another twist in the Russian reforms led to the increase of the government's share in investments. The development of national projects, economic zones, investment funds, increase of funding for target programmes create a new investment environment where the government provides more funding for investment projects that were selected based of special criteria. The current regional level dialogue between the business community and the authorities in these new market conditions should be changed by increasing the volume of investments.

There are various established forms of support in the world market from government structures for investment projects:

1. Comfort letter supporting the project
2. Including the project in the government programme
3. Announcing a competition for carrying out a public contract
4. Subsidising the loan interest rate in order to implement the project
5. Government guarantees and warranties
6. Co-financing
7. Financing the project infrastructure
8. Public-private partnership for the implementation of the project

Since currently the forms and methods of support from the government for investment activities are constantly changing, then it is necessary to create a support system at the regional level that will ensure the implementation of the following functions:

1. Every enterprise, municipal office, ministry and government division should have a database of investment projects to include: volumes, timeframe, profitability, investment sources, design estimates, necessary permits and approvals.

2. Financial institutions, banks, investment companies requiring access to the database, are obliged to provide their project financing review within 10 days. This review will also be included in the database.

3. Ministries and government divisions at the regional and federal levels ensure their readiness within 24 hours to:

- Package projects in any national project
- Combine forms and methods of government support
- Provide infrastructure for any project .

12.6. Lenders

The implementation of projects that would ensure a decent level of earnings for the southerners, will require substantial funds. For the purpose of ensuring an efficient interaction with the lenders, it is important to appreciate the trends which are taking place in the world banking community and which impact the decisions to lend money to the South of Russia.

International standards. Russian banks are getting ready to make a transition to the International Accounting Standards. Russian and international standards represent two different methods of grouping banking transactions. International standards take account of borrower's high risks, immediate future reserves and the inflation rate.

Today the Russian banks have to stick to the Russian standards (for the Central Bank

of Russia) and to the international standards (for Western partners). In addition, these banks have to adhere to transposed accounting (converting the Russian bank balance to international standard balance) as well as new tax accounting. The unification of financial accounting standards would have allowed us to save time and efforts for improving the operations, and avoid triple book-keeping.

Basel principles of capital sufficiency. International experience in perfecting the system of regulating banking activities led to the development of the so-called Basel principles of capital formation which is based on the notion that banking is not a redistribution of temporarily available financial resources but taking and distributing various risk among counter parties: market, credit, operation, political, country-specific and other types of risks.

A bank should assess every asset in terms of possible risks and steps to reduce them. One's own capital has to cover not less than 8% of the value of the assets, including the risks. In addition, bank capital has to cover market and operational risks.

From the borrower's point of view the bank's adherence to the Basel principles means that the bank must work with the borrowers which have been rated creditworthy by independent rating agencies. Since the majority of Russian enterprises have not been rated like this, banks have to value their loans as high risk loans and form reserves for increased risk which leads to the interest rate increase.

Corporate governance. As the legislation on share-holding companies does not fully protect shareholder rights, various countries adopted a Corporate Governance Code in accordance with which companies voluntarily agree to fulfil their obligations to ensure the protection of the minority shareholder rights and transparency of their activities. Adhering to these obligations makes this company more attractive to the investors. If decisions were made at the local level confirming that financial assistance from the government budget can be provided only to those enterprises which carry out the requirements of the Corporate Governance Code, then such a region would gain an extraordinary status for investors. Another document that would significantly increase the investment appeal is the adoption of the Corporate Ethics Code of regional officials.

12.7. Organisational Decisions

Organisational decisions play an important part, as they determine the participants and the order of interaction between them. Any project require clear answers to clear questions: WHAT? WHO? WHEN?

The investment appeal of the South of Russia can be realised through various administrative decisions: within the framework of the existing management structures, tasks given to the ministries and government departments to develop investment projects and raise targeted investment funds. However, the existing structures had an opportunity to realise the region's investment potential. Secondly, the scale and nature of the reforms which were necessary to translate this attractiveness into specific projects go beyond the restrictions of the existing structures and require a transition to organisational mechanisms based on other principles. Every step for increasing the investment appeal of the South of Russia should be based on market, competitive and organisational decisions.

First of all, support for the implementation of investment projects should be provided to those regions which generate the most legal income for the population. I would like to emphasise not the growth but the augmentation of this level. Recently there have been cases when the government provided support to those that already performed well. Only those that have a growth potential in the South should be supported..

The selection of consulting firms, investment companies and banks for the development of projects should be competition based. In addition, proposals and projects should be tested by the public. Creating and providing exclusive rights for a narrow circle of pocket-snatching structures, invited to take part in the development of programmes and projects – is the first sign of lack of interest in legalising income of the population. By announcing competition, it is important not only to determine the winner and provide funds for him but also preserve the best ideas proposed by the contestants.

When proceeding to the implementation of the project it is necessary to involve as wide as possible group of investors, developers, contractors and other parties concerned. To achieve that - favourable conditions for attracting investments should be created: information on plots of land, development requirements, and infrastructure should be not only accessible but also genuinely interesting for those who are capable of finding solutions for the implementation of projects. One of the requirements should be: involvement of contractors, signing contracts, providing spare parts and subcontract services in accordance with the purchase terms and conditions of international financial organisations.

12.8. Prices and Pricing

If all the previous organisational decisions are implemented, then they by themselves increase the investment appeal of the South of Russia. A transparent programme, transparent implementation mechanisms, realistic (not make believe) requirements to the parties involved in the project reduce the investment risks. The main effect of this plan is that through this competition, investors and implementers propose the best ideas at a minimum price. This is how fruitless discussions can be spared on «independent evaluation» and «scientifically proved prices».

The general implementation mechanism for promoting the investment appeal of the South of Russia is given below. This general form is not final, as other options are also acceptable, besides the potential of the South of Russia intensively changes, and these changes should be taken into account in the new projects and programmes.

12.8. Correlation of Activities in the Development Programme of the South of Russia

	Social protection	Plans and programmes	Marketing	Funds	Loans	Organisational structure	Prices
Social protection	Growth of income of the population to reach the national average level	Enterprise development strategies	Consumer market growth	Funding for the programme development for the South of Russia	Consumer lending	Consumer market development	Transparent pricing for consumer markets
Plans and programmes	Growth of salary	Development strategies for economic sectors and region of the SFD	Promoting strategies and projects	Evaluation of the cost of strategy and projects	Attracting funds in an open market	Replacement of state entities by consulting firms	Reduction of regional risks in the price of projects
Marketing	«Golden parachutes» of the existing elite , training HR	Marketing strategies	Opening the investment projects market in the South of Russia	Funding marketing research	Modern banking products and technologies	Creating an investors' market	Reducing the resource price at the expense of competition
Funds	Financing budgetary projects	Stimulating non-budgetary sources	Encouraging participation in strategy development	Co-financing projects	Guarantees and subsidies for projects	Financing infrastructure development	Urgent targeted government grants
Loans	Attracting the populations incomes to investment	Bank strategies for the South of Russia	Position the South o Russia at the capital market	Return on investment	Attracting international financial resources	Infrastructure of accessing the global market	Reduction of loan interest rate
Organisational structure	Market mechanism for social protection	Infrastructure development programme	New logistics for the South of Russia	Eliminating «beyond budget» cash flow	Encouraging regulation of banking activities in the South of Russia	Economy structure focused on the global market	Competitive prices at the global market
Pricing	Income growth through price increase at the labour market	Records in price dynamics programmes	Global marketing	Taking into account price increase in the budget	Financial technologies of global markets	Technical means of access to global markets	Bridging the gap between local and world prices

PART 2

ATTRACTING INVESTMENTS TO THE ECONOMY OF THE SOUTH OF RUSSIA: EXPERIENCE OF CENTER-INVEST BANK

1. «CENTER-INVEST IS THE BEST»

A consultant's recommendations would look more convincing, if he could use his own successful experience as an example. Working with international financial organizations, Center-Invest Bank got acquainted with the best practices of the leading international companies and applied this experience in the Russia context. Gradually the western partners began to refer to Center-Invest Bank as the best practices of Russian reforms in the South of Russia. This experience is also of interest to Russian companies. Moreover, while applying the Sovnarkhoz principle «Instruct, Teach, Monitor and Do it Yourself, Center-Invest Bank offers its action plan to realise the investment potential of the South of Russia «South of Russia +».

1.1. The Laboratory of Reforms in the South of Russia.

During the first wave of the privatisation processes in Russia a team from Center-Invest Bank prepared over 300 enterprise privatisation plans in the South of Russia. At the same time the first privatised enterprises became the founders of the JSC «Center-Invest Bank» on 22 November 1992. This allows us to position the Bank as a specific outcome of economic reforms. In all subsequent years the Bank accompanied the reform processes, while finding solutions to complex problems of the Southern Russian enterprises as well as provided assistance in implementing the reforms in the South of Russia:

- 1992 – Support for privatisation processes
- 1993 – Establishing the Don regional securities market
- 1994 – Introduction circulation of promissary notes
- 1995 – Initial stage of forming the investment projects market
- 1996 – Finding solutions to non-payments
- 1997 – Programme development for Don's small businesses, first audit according to IFRS
- 1998 – New operation technologies of the bank in a crisis situation
- 1999 – Aggressive marketing strategy
- 2000 – Beginning of collaboration with international financial organisations, first issue of international type plastic cards based
- 2001 – Participation in international programmes of switching Russian banks to international standards
- 2002 – Implementation of agreements with EBRD, USAID, IFC, HERMES
- 2003 – Participation in the IFC Programme «Corporate Governance in Russia»
- 2004 – EBRD becomes a shareholder of Center-Invest Bank
- 2005 – DEG becomes a shareholder of Center-Invest Bank
- 2006 – Participation in the energy efficiency programme, developing the «South of Russia+» programme.

«The success of the reform in Russia depends on enthusiastic teams, such as Center-Invest Bank»

German Gref
Minster of Economic Development and Trade of the Russian Federation

«Center-Invest Bank, which successfully operates according to international standards, confirms again the favourable investment environment in the Rostov Region»

Vladimir Chub
Governor of the Rostov Region

«Center-Invest Bank and the support infrastructure created by it for finding generating solutions has become the laboratory of economic reforms in the South of Russia»

Yevgeny Yasin
Head of Research, Higher School of Economics

Center-Invest Bank was actively involved in various campaigns for raising the profile of the economy of the South of Russia by taking part in the activities of the World Economy Forum, UN, World Bank, EBRD, BSTDB, AEB, USCR, ERMС, USRC, Round Table Discussion of the Industrialists of Russia and the EU, ERMС.

Center-Invest Bank confirmed the image of the Russian banking system in 1996 its first audit in accordance with IFRS, from 2004 by having started the Bank was being rated by independent rating agency «RusRating» and in 2004 it introduced the Code on Corporate Governance. In 2005 the ex-President of Deutsche Bundesbank E. Welteke was elected as an Independent Director of the Board of Directors of Center-Invest Bank.

1.2. Collaboration with International Financial Institutions (IFI)

In 1999 Center-Invest Bank developed and implemented a project involving the IFI's participation in the Russian regional bank's equity (Issue of Economics Magazine, 1999, №7). In 2004 EBRD became one of the shareholders of Center-Invest Bank, and DEG became a shareholder in 2005.

Center-Invest Bank proved its credibility for the partners through active collaboration with international financial organisation, foreign and Russian banks:

 European Bank of Reconstruction and Development shareholder Credit and guarantee line for trade funding \$ 26 million Credit line \$ 5 million	 Raiffeisen Landesbank Oberösterreich shareholder Credit line € 5 million Line for Confirmation of LCs and bank guarantees € 2 million	 DEG KfW Bankengruppe shareholder Credit line \$ 7,5 million
 United States Agency for Int'l Development (USAID) Guarantor for Bank Center-invest's credits for SMEs \$ 6 million	 International Finance Corporation Credit line \$ 5 million Subordinated credit line \$ 5 million Energy efficiency programme \$ 4 million	 KfW banking group Credit line € 6 million
 Raiffeisen BANK Line for Confirmation of LCs and bank guarantees € 1 million	 SACE (export-credit agency) Guarantee Line € 2 million	 State Corporation of the Ministry of Industry of Italy SIMEST Agreement to establish SMEs € 1 million
 VTB Bank (Austria) Line for Confirmation of LCs and bank guarantees € 3 million	 BCP Banque de Commerce et de Placements Line for Confirmation of LCs and bank guarantees CHF 2 million	 International Moscow Bank Credit line \$ 7 million
 Banca Popolare di Vicenza Line for Confirmation of LCs and bank guarantees € 1 million	 Russian Development Bank Credit line \$ 10 million	 LBB LANDESBANK BERLIN Credit line € 15 million Line for Confirmation of LCs and bank guarantees € 1 million
 State Insurance Corporation HERMES Guarantor for Center-invest Bank in German equipment purchase deals € 30 million	 COMMERZBANK Line for Confirmation of LCs and bank guarantees € 5 million	 ak a export finance BANKENKONZERN AKA Ausfuhrkredit-Gesellschaft mbH Credit line € 5 million

Also, via RUR syndicated loan:

And in the international capital markets:



Center-Invest Banks is actively collaborating with export credit agencies, such as Hermes (Germany), Sace (Italy), Coface (France), Atradius (the Netherlands).

1.3. Doubling 2005: ACHIEVED!

Sustainable, dynamic development of the Bank is confirmed by international, as well as Russian, financial reporting standards.

Million Rubles

		2005	2004	2003	2002	2001	2000	1999	1998	1997
Capital	RUS	2010	1087	686	628	421	205	101	53	51
	IFRS	2221	1141	779	678	414	210	99	41	46
Assets	RUS	13058	8221	5132	3026	1605	991	540	340	234
	IFRS	13637	8493	5257	3124	1635	960	630	252	186
Profit	RUS	501	212	130	64	27	17	6	5	9
	IFRS	306	131	94	14	4	(7)	(11)	(4)	6

DOUBLING OF SCALES

- New shareholders:**
 - EBRD – 21.52% of equity;
 - DEG – 17.6% of equity.
- Center-Invest Bank is the first bank of the Rostov Region that entered the TOP100 of Russia's largest banks (www.rating.rbc.ru), occupying the following positions:
 - 87th net asset volume;
 - 80th capital;
 - 78th deposit portfolio;
 - 70th loan portfolio;
 - 68th loans to physical entities;
 - 60th loans to consumers;
 - 60th profit;
 - 44th deposits;
 - 44th capital efficiency;
 - 32th asset efficiency;
 - 26th number of branches;
 - 25th no mortgages.
- Branch network – **42 branches and sub-branches,**
- 18 operation cash desks in the Rostov and Volgograd Regions, the Krasnodar Krai.**

DOUBLING OF BUSINESS

- Loans provided to enterprises – **RUB 30.2 bln**
 - Standard loans;
 - Overdrafts;
 - Long-term loans to finance investment projects;
 - Express leasing – decision made within one day;
 - Factoring.
- Loans provided for the development of the agro-industrial complex – **RUB 9.6 bln**
 - Financing energy efficiency projects;
 - “Start up” loans to start up business;
 - Loans without collateral.
- Small business support**
 - “Hot-line” – free of charge consultations (hotline.centrinvest.ru);
 - “Center-audit” accounting and reporting;
 - “Absolut” – security agency.
- Number of clients – 20500 accounts.**

DOUBLING OF KNOWLEDGE

- Over 50 seminars** and consultations for the Bank's clients;
- Rostov's 50 best students** received the Center-Invest Bank's scholarships;
- Over 16000 pupils** of the Rostov Region visited the Treasury of Don steps Exhibition free of charge.

DOUBLING OF LIVING STANDARDS

- The Center-Invest Bank is included in the state insurance system of deposits (№283):**
 - Volume of deposits – **RUB 5 bln**;
 - Prizes for depositors: **motor car VAZ -2110, 100 household appliance set, 7 PCs,**
 - 1000 depositors-veterans** were congratulated on Victory Day.
- Loans provided to consumers – **RUB 1.7 bln**:
 - 1.2 864** consumers received emergency loans;
 - 1.888** consumers purchased vehicles;
 - 616** families acquired accommodation.
- 80 тыс. consumers received international type plastic cards**
 - 31 ATMs and 30 cash points.

DOUBLING OF WIN

- The Center-Invest Bank successfully injected € 150 million** into the economy of the South of Russia from the international financial markets;
 - RUB 1 bln** – syndicated loans from the Russian financial markets;
 - \$ 30 million** client export financing;
 - “Russian-German Day of Lending to SMEs of the Rostov Region” (expo.centrinvest.ru);
- Over 100 of Russian and foreign banks are the partners of the Center-Invest Bank;**
- Guarantees before Russia's customs authorities.**

In 2005 Center-Invest Bank put into practice the Decree of President Vladimir Putin of the Russian Federation On Doubling Russia's GDP by implementing the programme for doubling the scale of businesses, knowledge, profit and improvement of living standards of its clients.

Center-Invest Bank established a wide network of branches and offers its clients a wide range of products based on modern banking technologies.

These achievements allow us to analyse thoroughly the experience of Center-Invest Bank for:

- developing regional banks;
- involving regional banks in activating the investment processes in the regions;
- expanding international collaboration in implementing investment projects.

2. ATTRACTING INVESTMENT RESOURCES

2.1. Risks Involved while Collaborating with the IFI

Under the current conditions attracting investment resources is in many ways risk redistribution. Center-Invest Bank's experience shows that risk reduction can be achieved by applying the TPM principle (TEAM*PROJECT*MONEY). The Investor should see a TEAM of qualified experts and their interaction procedures. The minimal selection of these procedures includes: corporate governance code, risk management system, internal audit and monitoring in accordance with the laws and internal regulations. These elements enshrined in internal documents significantly reduce the investor risks and improve the chances of not only attracting financial resources but also reducing their price.

Endorsing the requirements on corporate governance code, risk management system, internal audit and monitoring along with the traditional requirements for ecologically friendly procedures significantly reduce the risks and increases opportunities for attracting funds, including co-financing from international financial institutions.

International financial institutions: World Bank Group, EBRD, development institutes – organisations established specifically for reducing risks when implementing projects with the participation of foreign partners. While they have certain differences (country-specific operations, project approval procedures, specialisation of operations), they all share common features and operation technologies:

- Equity participation;
- Mezzanine financing;
- Long-term loans and syndicated lending;
- Trade financing programmes and guarantees;
- Small business development and micro-credit programmes;
- Sector-specific programmes: agro-industrial complex, infrastructure, mortgages, energy efficiency.

2.2. Equity Participation

IFI's equity participation is a premier form of acknowledgement of the management of the company, however, the IFIs do not invest money in organisations that have a limited growth (less than 100% per 5 years) and their participation is conditioned by tough terms and conditions as well as exit dates (5-7 years):

- Management buyout or owner buyout
- Selling to strategic investors
- Selling in an open market.

Therefore, interacting with the IFIs should be based on mutual interests and envisage the company's capital growth of not less than 20% per annum.

Taking into account these restrictions, it is necessary to develop one's strategy in such a way that the business growth scales should be ahead of the requirements on shareholder capitalisation from the IFIs. Therefore, it is necessary to use their reputation for attracting investment resources as well as justify the requirements to reduce investment projects risks.

As a rule, in additional to equity participation the IFIs offer credit lines for separate programmes and technical support. It is important to choose the right credit lines accompanying equity participation based on the business development strategy:

- Micro-financing;
- Lending to small and medium size enterprises
- Energy efficiency projects;
- Mortgages;
- Consumer lending;
- Trade finance.

Each of these directions is are very good. Everything depends on the business strategy. Therefore, the business strategy (PROJECT) should be proposed to the IFIs before they become shareholders.

The IFIs equity participation conditioned by the business development requirements. These requirements, as a rule, include the enforConcrete of the corporate governance code, transition to the IFRS, risk management and international monitoring. In special cases an independent rating report or securities' market listing can be required.

One of the IFIs requirements is the participation of a foreign investor or at least a foreign consultant. However, in the emerging markets the IFIs take part as a first step and make special provisions in their agreements for involving strategic investors. Such preliminary agreements on the timeframe and terms for finding investors reduce the risks of subsequent transactions (MONEY).

2.3. Mezzanine Financing

Mezzanine financing is a provision of subordinated unsecured loans for the period of more than 5 years without the recall power. Since such loans increase bank's capitalisation, they are of interest to banks with inadequate capitalisation involving large assets. Subordinated loans assist in tackling scarcity of funds but are amortised during five years, and the unamortised part is considered to be a part of the capital.

Possibilities to increase the capital through attracting and efficient using of subordinated loans should be included in the strategy. The cost of subordinated loans is usually higher than ordinary loans.

2.4. Long-Term Lending

A long-term loans is one of the most attractive tools used by the international financial institutions and require long-term projects. Such projects usually cover mortgages, purchase of equipment, leasing operations. Higher interest rate long-term resources require highly profitable projects.

Banks' main fixed assets, receivables and first of all purpose loans can be used as a collateral for the raised funds. In more advanced markets, interbank loans are provided without any pledge (negative pledge) and the IFIs insist that other interbank loans are being provided in a similar fashion.

Syndicated loans are used by the IFI and large commercial banks for diversifying risks of the participants. The IFI or large banks Mandate Lead Arrangers check the history of the borrowing bank, prepare Information Memorandum and draft agreements with the participants of the syndicated loan. In order to diversify the risks, the borrowing bank raises vast volumes of funds, which is not the case with bilateral interbank lending. Syndicated interbank loans do not require any pledge.

2.5. Guarantees

Pursuant to the Basel principles and modern notions of banking activities for purchase and sale of risks, guarantees and letters of credit are beginning to play a bigger role in interbank collaboration.

The fundamental difference between the guarantees of the IFI and export agencies and the existing budget legislation of Russia is the absence of counter-cost recovery requirements. The important advantage of the guarantees provided by state agencies and the IFI is low risk assessment and debt provisioning norms for credit operations.

2.5.1. Loan Guarantees

Borrowers (consumers, small business enterprises) in the emerging markets are often not in a position to provide required collateral for their loan. The United States Agency for International Development (USAID) uses a guarantee programme to cover 50% of such loan. In 2000 USAID conducted independent research on the activities of Center-Invest Bank and provided a guarantee facility in the amount of 3 million dollars for small business loans. These guarantees did not require counter cost recovery. The technology of providing these guarantees was rather simple, based on receiving messages on USAID loan guarantees via Internet. In 2002 USAID provided a new guarantee facility to the Center-Invest Bank for small enterprise loan.

It is important to emphasise that small businesses receive additional guarantees through the Bank, not through the state bureaucratic structures which involve heavy paper work.

2.5.2. Bank Loan Guarantees

USAID has also programmes for credit line and bond guarantees. The IFI also have similar programmes. In such programmes the IFI act as arrangers of the syndicated loans (up to 50% of loans) and give guarantees to other participants.

2.5.3. Foreign Trade Agreements

The IFI serve as guarantors for trade financing programmes. An international foreign trade agreement is the first thing that is required and according to which:

- 1) The importer receives guarantees from a resident-bank, approved by the IFI, and provides this guarantee to its counter-agent which can receive a loan at any other bank;
- 2) The exporter receives the payment guarantee issued by the importer's country bank and approved by the IFI.

These two patterns can vary in various combinations with other financial tools (bills of exchange, bail-bonds). Structuring such deals is subject to structure financing.

Guarantees for the IFI's foreign trade transactions are independent. Their guarantees in the emerging markets are provided after receipt of payments from 3 months to 2 years.

2.5.4. Export Agency Guarantees

Export credit agencies provide similar facilities but their guarantees have restrictions because they are aimed at promoting their country goods for export. These agencies play an important part in forming country ratings which are used by the IFIs and commercial banks to set up interest rates for interbank market.

The most typical facilities of agencies like Hermes (Germany), Sace (Italy), Coface (France) – are guarantees to fund 85% of the loan for equipment procurement, provided the importer pays 15% of the contract. The Russian banks accredited in the agency serve as guarantors for the given contracts and can provide the initial payment to implement their obligations in monitoring foreign exchange transactions and customs payments.

2.5.5. Commercial Bank's Guarantees

Commercial banks specialising in foreign trade transactions open guarantee line limits for their banks-counterparties. In addition to limits it is important to have the client's contract for the foreign trade transaction. When choosing the guarantor bank it is necessary to take into account how much time it requires to approve a transaction.

3. TECHNICAL SUPPORT

The IFIs programmes are usually accompanied by technical support projects which are provided in the emerging markets and partially paid by the regional bank or by the technical support sponsoring country. Center-Invest Bank has a great deal of experience in technical support programmes. It should be noted that technical support programmes serve as additional sources of information for foreign partners on participating banks.

3.1. Transition to IFRS

The USAID-EU programme on adopting IFRS allowed us in 2002 to receive first-hand additional information on the IFRS contents and procedures. Starting from 1996 Center-Invest Bank has adopted IFRS, which is more transparent for foreign partners, shareholders and management accounting. From 2004 the bank's development and business plans performance have been assessed and evaluated also in accordance with international standards.

3.2. Lending Programme for Small Business Enterprises

Inspections conducted in Center-Invest Bank by the EBRD, IFC experts confirmed the high quality lending procedures for small businesses. This allowed us to set new tasks with KfW within the framework of technical support programmes for small business, which highlighted the development of international collaboration for small businesses between the South of Russia and Germany.

3.3. Sales Technologies

Important information on sale technologies of banking products and arrangement of business planning was received within the framework of technical support programmes with the IFC.

3.4. Corporate Governance

The Corporate Governance Programme was launched by the IFC along with SECO (Switzerland). Participating in this programme allowed us to significantly complement Center-Invest Bank's experience in this field through:

- Regulatory activities of the Committees of the Board of Directors and Management;
- Strengthening the protection of minority shareholder rights;
- More detailed information policy;
- Specifying the dividend policy;
- Introducing a corporate ethics code.

Updating the existing documents allowed to:

- Enhance the image of Center-Invest Bank in the eyes of the foreign partners and improve the possibilities for long-term financing;
- Significantly improve the efficiency of the existing procedures, technologies and regulatory activities;
- Clearly define and protect the rights of shareholders, managers and the Bank's clients;
- Create a positive morale and new high-quality psychological work environment.

In order to improve the Bank's investment appeal for potential investors the Bank ensures that:

- The corporate governance principles are understood;
- The implementation of the above principles is monitored;
- Staff training is provided.

The Bank, its officials and staff are guided by the existing laws and regulations as well as ethical norms accepted in the business world pursuant to the definitions of the Corporate Governance Code and the Corporate Ethics Code.

3.5. Trade Finance

The technical support programme in trade financing was organised by the EBRD along with ING. Training seminars were arranged within the framework of this programme for the Bank's departments, branches and clients. A detailed examination of various facilities allowed us to expand the scale of lending and use guarantees for foreign trade transactions for the enterprises in the South of Russia.

3.6. Business Development According to International Standards

The EBRD's technical support programme for business development (2005-2006) encompassed the following:

- Establishing a modern risk management system;
- Improving the internal control efficiency;
- Developing the Bank's information system.

Consultations on forming a modern risk management system based on New Agreement Principles of Capital Adequacy (Basel II) enabled us to create an efficient system for managing credit, market and operational risks.

Recommendations for improving the internal control efficiency system allowed us to clearly define regulate and standardise the internal control services.

Software and hardware suppliers were selected on the basis of the IT recommendations.

3.7. Training in an American Bank

Financial Services Volunteers Corps arranges trainings and courses for regional banks. In 2006 within the framework of this programme Center-Invest Bank sent one of its specialists to the USA for training. Upon the completion of the training he had to present to the American bankers the business development programme of his bank.

4. IFI EXPERIENCE IN FINANCING NATIONAL PROJECTS

Center-Invest Bank's experience of collaborating with the IFI enables it to put together recommendations on how to apply this experience to the state financial institutions of the Russian Federation for financing national projects and programmes.

The presence of the state banks in the Russian banking system puts them in a dominating position thanks to the subsidiary responsibility of the state. It is necessary to clearly define the field and scale of activities, responsibility and forms of activities of state banks in the banking market: state banks must be responsible for target financing of projects and programmes and take part in high risk lending for sub borrowers only through commercial banks-partners.

From the point of view of the modern risk assessment requirements industry-specific or regional risk concentration is not allowed. According to the IFI industrial banks or banks belonging to regional authorities make them higher risk institutions.

It is expedient to unite deferral level industrial banks with the Russian Development Bank (RDB), which should be responsible for financing all national projects with the necessary diversification of the loan portfolio. The strengthened RDB becomes the main lender for state enterprises and organisations. Therefore, when lending agreements are violated the state does not incur state property loss. To interact with the IFI, the RDB should not only apply the IFRS but also international rating of the leading rating agencies.

RDB provides loans for national projects of commercial structures through commercial banks-partners. Taking into account the high status of the RDB and efficient control of the owner, the RDB management can select banks-partners for various national projects.

RDB should interact with commercial banks based on the IFI tested practices:

- Equity participation with clearly defined exit procedures by selling the shares in an open market (listing conditions may be compulsory when becoming a shareholder) to the strategic investor or management;
- Long-term lending of commercial banks for their participation in provision of loans to client within national projects and programmes;
- Granting guarantees to commercial banks participating in national projects;
- Syndicated loans guaranteed by the RDB.

Technical support for the RDB's banks-partners should be provided in the frame of conferences and seminars.

The RDB should take into consideration the technical support programmes organised by other ministries and government departments.

As the national programmes become rich in content the RDB should develop methods of co-financing and risk structuring for participants of national projects on the basis of public private partnership.

5. SMALL BUSINESS: STEREOTYPES AND NEW IDEOLOGY

5.1. Changing the Paradigm

If the desired results are not achieved, the chief or the entire department or the whole entity is changed. If these changes have no impact, the management methods should be changed. When the new methods bring no results, the theoretical approaches should be changed.

When at the highest state and political level statements are made supporting small businesses, in reality the situation slowly changes. In this case it is the organisation or the methods that should be changed but the methodology. It is necessary to change the stereotypes of the public mind.

Traditional perception of small business is based on the following stereotypes: **small business** is 1) something small, insignificant and inefficient; 2) constantly in the shadow; 3) needs government support and 4) soon will disappear in the process of economic globalisation.

New ideology is based on other principles:

1) Unlike large businesses which become profitable after they become large scale operations, **small businesses have to become efficient from the very beginning** by using their (even if temporary) advantages in production, marketing, financing and human resources.

Small business **always** exists in any economy: «under Alexander I – the Peace-keeper, under Alexander II – the Liberator, under Nicholas II, under Kerensky» even during the Soviet times. Statements that small business is underdeveloped do not take into account the fact that in any economy small business accounts for at least 50% GDP. If we put together the «bright» (40%) and «black» (60%) part of small business, then its role in Russia's economy can be compared to developed countries. The initial efficiency and permanent nature of small business define its role in any economy: not a small but **equal partner** in business.

2) Statements that small business is shady business are irresponsible because:

- The **shadow** comes from **bad laws and civil servants**;
- Presence of shady small business – **indicates corruption**;
- There can be no contradictions between the authorities and business: **the authorities reflect the business**.

3) Small business, the **government needs small business support**. Small business guarantees social stability in a society. Absence of small business between the authorities and population leads to **change of power**. The pace of economic developments depends not on the volume of state support but on to what degree **small business is legalised**.

4) Small business adjusts to globalisation faster and makes use of **the global technological advantages** more efficiently. Global projects that disregard the interests of small businesses are doomed, as they can destroy not only the natural but also entrepreneurial environment. The complexities involved in managing global problems require that some services and subcontracts be outsourced to small businesses.

What does the new ideology change? First of all, it changes the mentality, the society's attitude to small business: the status of small business rises in the economy, social and political environment and international relations. Later on, the mechanisms of interaction

between the states, large and small businesses change. Finally, small business loses its outsider image and becomes the centre-point of economic growth.

Politicians, civil servants, corporations must always acknowledge small business in their statements and actions. Political parties should not be allowed to participate in elections if they do not clearly define their position to small business in their programmes. The civil servants involved in the development of various sectors of government activities must not only possess adequate information but must be primarily responsible for the development of small business in these sectors. The corporate ethics codes must have a separate chapter «Politics in Small Business».

To ensure that this appreciation of small business and change of the ideology are not opportunistic, it is necessary that the public monitor the developments in the small business community. Within such public monitoring should include reports from politicians, civil servants, corporations, and assessments by professional public unions, independent monitoring scientific and research organisations, mass media publications.

5.2. Support for Small Businesses

In 1997 Center-Invest Bank offered its clients a support programme for the Don Region's small business enterprises. This was the first non-government development programme of its kind by selling to this economic sector special banking products and consultative services, book-keeping, business development and protection based on Internet technologies. **The breakeven point of the programme was reached at 150 clients.** In two months' time over 400 enterprises participated in the programme.

As of 1 July 2006 at Center-Invest Bank provides services to over 1,000 small-size enterprises and 7,000 individual entrepreneurs. In 2005 over 3,000 loans worth 10 billion Rubles were provided small business enterprises.

Center-Invest Bank's share in providing loans to small businesses in the Rostov Region counts for 1/3 of the regional market.

The Bank annually participates in the traditional exhibition «Small Business in the Don Region's Economy». Along with the Administration of the Don Region and the Center-Internet LLC, the Bank introduced a programme «Partner»: a database was created that included 26,000 small enterprises of the Rostov Region (www.amb-don.ru). The database is constantly updating information on German firms seeking business partners in Russia. There are also possibilities of finding business partners in Germany and the USA.

The Bank also opened a hotline on its website to support small business which have questions (www.centriinvest.ru).

5.3. Potential of Small Business Development in the South of Russia

In 2004 the specialists of Center-Invest Bank's Department of Small Business Lending conducted research on the development of the small business potential in the South of Russia.

The assessment of the possibility to increasing the contribution of small business enterprises to the regional domestic product up to the average level of developed countries was done according to the following algorithm:

1. The scale of small business development was analysed based on statistics in the leading countries, in Russia and the South of Russia.

2. Based on the difference in the contribution of small enterprises to the gross regional product of the South of Russia and developed countries, they calculated the growth potential of production of goods and services in absolute value.

3. Based on the total volume of produced goods and services, the structure of the purchasing power of consumers, available resource potential, production base, educational level of human resources, regional characteristic features, they identified the perspective economic sectors and determined the production share of small businesses in various fields of the economy.

4. As a result of this research they received the following figures within various sectors of the economy and territories:

- Investment volume necessary for the development of small businesses in the South of Russia;
- The number of small business enterprises in the region;
- The number of people employed by small business enterprises in the South of Russia;
- Production volume of small business enterprises of the South of Russia.

Table 5.3.1. Growth Potential of Small Business Enterprises in the South of Russia

Constituent territories	Growth		Required investment volume, in billion Rubles
	Number of small business enterprises, in thousands	Production volume, in billion Rubles	
Republic of Adygea	2,2	5,4	1,9
Republic of Dagestan	1,6	17,1	6,1
Republic of Ingushetia	0,9	1,2	0,4
Republic of Kabardino-Balkaria	3,8	8,0	2,8
Republic of Kalmykia	0,6	2,3	0,8
Republic of Karachaevo-Cherkessia	1,6	4,9	1,7
Republic of Northern Osetia – Alania	2,3	17,6	6,3
Krasnodar Krai	26,4	203,0	72,3
Stavropol Krai	8,2	61,0	21,8
Astrakhan Region	4,0	28,3	10,0
Volgograd Region	15,0	57,0	20,3
Rostov Region	27,8	158,8	56,6
South of Russia	94,4	564,6	201,0

*there are no data on the Chechen Republic

Table 5.3.2. Development Potential of Small Enterprises in Various Economic Sectors

Sector of economy	Increment of growth of small business enterprises, in thousands	Increment of growth in production volume, in billion Rubles	Required investment volume, in billion Rubles
Industry	11,3	88,9	19,1
Agriculture	1,6	9,0	3,1
Transport	3,6	21,7	3,6
Trade and public catering	38,7	193,9	22,1
Real estate development	24,3	170,4	121,7
Services	14,9	80,7	31,4
Total	94,4	564,6	201,0

6. ENERGY EFFICIENT TECHNOLOGIES OF THE SOUTH OF RUSSIA

6.1. Energy Saving Programme

Center-Invest Bank became the first partner of the International Finance Corporation's Investment Support Programme for Energy Efficiency Technologies in Russia. In 2006 the programme envisages credit lines for Russian banks to finance their clients' projects which lower energy costs and carbon dioxide emissions.

The funds within this programme are provided for new projects only in the forms of loans, leasing and factoring. A borrower or lessee can be a private enterprise (government share under 50%). Funding for state or government projects can be provided as loans to private energy service companies, (ESC), contractors or equipment manufacturers. The funds are can be made available directly to energy consumers or those ESC that concluded contracts with energy end user.

Funding is allocated for the implementation of projects in the following sectors:

- Industry
- Service industry (shops, office buildings, etc.)
- Municipal buildings (educational institutions, hospitals, state administrative buildings, sports facilities, etc.) that meet the requirements put forward to the borrowers
- Residential blocks

The projects should apply the well-tested technologies, and the project documentation should include qualified energy research data / feasibility studies as well as the assessment of proposed energy efficiency and carbon dioxide emission reduction.

The main criterion for selecting projects is the cost of reduction of one ton of CO₂ emission, which should be under 6 dollars per ton. The project cost implies the total investment project value, i.e. own and borrowed funds.

The second criterion is the applied technologies. Two types of technologies are reviewed:

1. Energy efficiency technologies and renewable energy. There are certain common industrial (horizontal) technologies which are suitable for many enterprises. Energy efficiency and appropriate cost reduction are often the result of investments in such technologies. Good examples are frequency-regulated drive, combined generation of heat and electric power, heat recovery. The list of such technologies in every sector is well known: combustion systems, vapour systems, electric power systems, compressed air systems, water supply systems and production processes of sawing, drying, transporting etc. www.centriinvest.ru/ru/servicec/020304.html

2. Technologies designed to modernise energy efficiency and reduction of CO₂ emissions.

Investments in modernising the technological process are usually made in specific industrial sectors and are connected with production modernisation. In such cases energy efficiency is only one of the additional results after new technologies are introduced. Other results are reduction in use of raw material, increase of volume and quality of products, but energy efficiency and CO₂ reduction as a result of this project is considered to be a significant factors. There are recognised beneficial energy efficiency technologies available. These technologies are used in various economic sectors: production of concrete, glass, ceramics; food-processing; metallurgy; machinery; metalwork; cellulose,

paper and industrial rubber industries, timber trade, textile industry, independent electricity production, chemical and petrochemical industry, renewable energy sources. www.centriinvest.ru/ru/servicec/020304.html.

The amount of a loan should not exceed 1 million US dollars. Consultation support is also provided within the framework of the project.

From September 2005 for the purpose of implementing this programme jointly with the IFC, Center-Invest Bank has run 15 seminars with the heads of enterprises in the South of Russia, and over 50 articles were published in the regional mass media on this topic.

As of 1 July 2006 under the programme 8 loans worth about 4 million US dollars were provided, including: for the purchase of plasma cutting machine (Taganrog), chocolate machine (Krasnodar), bakery (Novocherkassk), shell-powered boiler (Kropotkin), heating facilities for pig farms (Krasnodar), publishing equipment (Aksai, Timashevsk), corrugated packaging equipment (Chaltyr).

Using other sources of funding Center-Invest Bank invested over 1 billion Rubles in energy efficiency projects, including the residential energy consumption sector (upgrading the equipments in 6 boiler-houses in the historical center of Taganrog).

6.2. Reforms in the Municipal Economy: Center-Invest Bank's Experience

With the stable growth of prices on energy carriers, it is becoming more relevant to replace the existing equipment with modern, energy efficient, ecologically safe one.

Directors of enterprises often complain about the rising tariffs, and therefore, practically all of them changed their energy facilities in their homes and gardens for more energy efficient ones. In order to introduce energy efficient technologies in the enterprises it is essential to get rid of certain stereotypes that had been formed during the Soviet days of centrally planned economy and cheap energy resources.

Center-Invest Bank has been working with «Teploenergo», a large privatised energy and heating supplier in Taganrog for five years. During this time we have managed to bring the production in order, to introduce corporate governance, to optimise financial cash flow, and to apply new management approaches. The networks used and boiler-houses used by the enterprises are in fairly good condition and they are being gradually modernised. Taganrog's Mayor's office supported by Governor V.F. Chub eventually agreed to receive the payments directly from consumers, not via the Municipal Housing Administration. The enterprise is efficient and profitable. Moreover, it set has up a management company which is aimed at introducing energy efficient technologies in residential blocks as one of its priorities.

Today the international tariffs are 3-5 times higher than those of Russia. Russia will undoubtedly reach the international level. However, the developed countries are already using energy efficient technologies. We, on the other hand are heating our streets with our lower tariffs and scream about shortage of heating but keep our hallways and windows open. An old lady with a small pension should be protected not with lower tariffs but energy efficient technologies in the municipal economy.

By the way, the gas-supply conflict that took place on the New Year's Eve in 2005 will allow Ukraine to introduce energy efficient technologies. In this case in about 5 year's time we will have to catch up with not only Portugal but also Ukraine.

7. Banking Technologies for the Agri-Industrial Complex of the South of Russia

In spite of the favourable climatic conditions, the South of Russia is in area of risk farming. As a rule every third year is lean, however two yielding years within a five-year period allow the rural residents not only to cover losses but also fulfil their loan and leasing obligations. Therefore, financial resources are needed for five years in order to upgrade agricultural technical facilities. Center-Invest Bank is in a position to attract such long-term resources in the international markets, as it has gained solid experience in providing loans to upgrade agricultural equipment in the South of Russia. Besides, international financial institutions export agencies and banks-partners offers loan and leasing guarantees for imported technologies.

Unfortunately, Russian state banks do not make use of the potential offered by the Russian regional banks-partners. For some unknown reasons, the government subsidises interest rates on credit but not lease payments, although the leasing activities in Russia do not require special licensing and Russian banks reflect their leasing transaction directly in the balance sheets. Subsidising the interest rates on agricultural technology lease payments would have allowed us to accelerate the process of new industrialisation in rural areas. The current wear and tear of the agricultural technologies is over 70%, and rural areas need new tractors and combine harvesters, old technologies cannot be accepted as collateral, and leasing was left out of the list of subsidised interest rates. The administration of Rostov managed to resolve a similar problem and agreed to subsidise the interest rates for leasing equipment and technologies for small business enterprises.

When launching the new process of industrialisation, one has to understand that rural areas need a new system of machinery, not just one tractor or harvester with special features. New technologies completely changes the way the agricultural sector operates. It is also necessary to retrain human resources as well as change the system of accounting and payment for labour. Center-Invest Bank's experience shows that it is vital to provide information and moral support for top managers who decided to switch to new industrial systems. It is similarly important for banks to set a goal and aspire to complete the transition to new technologies in rural areas. As a rule it requires three years of intensive work using the new technologies to reduce the costs by 1/3.

Agriculture in the South of Russia is not just a field of specialisation, but also an export-oriented sector of the economy. Unfortunately, the rural residents receive a small portion of revenue generated from their products in international markets. Large exporters do not attempt to support new rural industrialisation, as it is easier to buy out farms that are going out of business. Therefore, Center-Invest Bank attracts resources from international capital markets and offers its clients the facilities that enable them to create favourable conditions for selling their products within an acceptable timeframe.

The Bank's knowledge of the agricultural production, the risks involved, analysis of the international market trends, mechanisms of international trade enable it to competently structure funding for the development of the agro-industrial complex of the South of Russia.

8. SERVICES FOR THE POPULATION OF THE SOUTH OF RUSSIA

8.1 Clever Deposits

On 7 December 2004 Center-Invest Bank was included in the deposit insurance system. The total amount of deposits exceeded 6 billion Rubles and the number of depositors reached 120,000.

The Bank issued over 80,000 plastic cards, installed 40 ATM machines and 50 cash points. Using the Bank's ATM machines customers can pay for their mobile phone and Internet services. The Bank also offers individual safe deposit facilities for keeping clients' valuables.

Early 2005 a new operational hall for corporate clients was opened. The Bank's branch network has 99 offices in the regions of Rostov and Volgograd, the Krasnodar Krai as well as the Stavropol Krai.

Over 400 asset management agreements were concluded by Bank's asset management fund «Center-Invest First» in 2005. In 2006 the «Center-Invest Second» was launched.

50 best students from the Rostov high education institutions were granted scholarships from Center-Invest Bank.

8.2. Loans for Promoting Prosperity

Specialists are concerned today about the consumer lending boom in Russia. Even the Bank of Russia is worried about the fact that many banks in their pursuit to capture this fast-growing market, provide loans with no proper risk assessment. Taking advantage of the Russian consumers' naivety in banking services, Russian «sharks» offer fast loans in the regions with high interest rates or «invent» various additional payments for their loans. This tactic is aimed at skimming off the cream in the fast growing market.

Center-Invest Bank has been operating in this market for almost 15 years and is interested in long-term welfare of its clients residing in the South of Russia.

The distinctive difference in loans offered by Center-Invest Bank is that the Bank offers not just a loan but comprehensive programmes to meet its clients' needs. For example, when a customer takes a mortgage, he is also offered a loan for refurbishment and decoration of his residence. The Bank also takes into account other needs of its clients: family planning, upgrading education and strengthening the social status. Here are some of the products offered to customers.

CARTE-BLANCHE. A universal two-in-one plastic card. The user enjoys the advantages of an international plastic card, including 24 hour access to his savings, and receives interests on his deposit. The overdraft facility allows him to make large purchases even when the client does not have enough funds in his account. This product is very popular among well-to-do and economically active young customers who are financially rational.

EXPRESS CAR-LOANS. The welfare of Center-Invest Bank's clients is growing and many families think of buying a second car for their wives. Busy people have nothing to worry about: this loan is arranged during their lunch break and they pay it back within five years. This loan will not have a big impact on the family budget: the first payment is only 15% of the total sum and the monthly payment is 1.5%. Now the wife has her own means of transportation and she can be responsible for driving her husband home from a party.

MY IDEAL HOLIDAY. The Bank can offer a loan to pay for a trip or a holiday package. A client receives a bonus too: a plastic card for the loan received. The client can use the card at home too upon his return, as he becomes a «card-blanche» user. Such an opportunity is also offered to a client who opens an account with us and deposits his money required for his trip: he receives a plastic card as a present.

Center-Invest Bank also offers products and programmes designed specifically for tourists. There are additional services offered as well. For example, a client can find out through his mobile phone how much money is left on his account, information on his financial transactions, top up his mobile phone, make claims and many others.

The corporate lending programme is reviewed by the Bank as a form of motivating company staff - the bank's clients. Today specialists are extremely mobile, new employees need help in finding accommodation, creating a comfortable living environment: this new employee arrived in the South of Russia!

The Bank concludes loan agreements with companies for their staff and does not focus on the form of ownership, economic sector or enterprise size. The system of motivating the corporate staff, the top management desire to expand the compensation package for staff are very important, as these loans are provided to the corporate staff of friendlier terms compared to the market terms. Arranging loans for the corporate staff on friendlier terms, with less paperwork and within a short and convenient period of time is a part of the social package of the corporate staff – the Bank's clients.

The company's interest in these services is clear: employees of large enterprises are entitled to receive loans from their employers. There are two main ways of arranging these loans: use corporate own funds (while distracting working assets) or arrange loans from a bank. The enterprise itself should undoubtedly be successful and pay decent salaries. In addition to easy receiving a loan, the employee should also be in a position to pay the loan back without putting a significant pressure on his family budget.

Therefore, the corporate lending agreements are usually signed with the long-term clients of the Bank which are creditworthy and have current accounts with the Bank.

Even in the case of corporate lending an individual approach is applied to clients because all the loans offered within the consumer lending programme are highly standardised and customised for every client.

8.3. Mortgage Programmes

The growing interest in mortgages is connected with the growing income of the population, growing demand for high quality accommodation, introduction of progressive lending products by banks and growing knowledge of the population about mortgages. Conditions of receiving mortgages are becoming accessible for a larger part of the employed population. In many cases mortgages are a family product and it is affordable for families where both spouses are employed. Usually one of the spouses pays for the mortgage and the other take care of other expenses.

The most typical mortgage borrowers today are families with spouses aged between 30 and 45, financially sufficient and their own mature perception of life. Center-Invest Bank begins discussions and debates about mortgages with students so that they became aware of the necessity to start accumulating funds for their initial deposit. Mass media

and various mortgage Centers as well as real estate agencies, surveyors and insurance companies are integral elements of the mortgage market infrastructure. Thank to their activities the awareness of the population about this products is raised and the mentality of the Russian citizen changes, who just a few years ago would not accept living on tick. Therefore, Center-Invest Bank is actively involved in explaining the meaning and characteristics of the mortgages programmers and improving living conditions.

The implementation of the national project «Affordable Housing» is supposed to create not only favourable conditions for the mortgage development and its infrastructure but also accelerate the residential development which will keep the house prices down when the consumer demand and mortgage programmes are growing.

SURPLUS IN SQUARE METRES. The Surplus in Square Metres Programme was developed by Center-Invest Bank to improve living conditions and get rid of the existing stereotypes.

Stereotype 1. «Mortgage is a loan» provided for a completed house. Center-Invest Bank also provides loans for the completion of the construction, participatory construction.

Stereotype 2. «Mortgage is a loan to buy a new house». Center-Invest Bank offers loans to improve the living conditions – to cover the difference in price when exchanging a one-room apartment for a two-room apartment or exchanging one apartment for two smaller ones.

Stereotype 3. «Arranging a mortgage loan requires a lot of paperwork». Only a passport is required to arrange a mortgage loan in Center-Invest Bank. Consultations are free.

The Surplus in Square Metres Programme includes loans to purchase or build apartments, houses, participatory construction, and completion of construction of an individual house. Mortgages are provided for the period of up to 15 years in Rubles and foreign currency, interest rates are calculated for the outstanding balance, and the amount of premiums is the same, after the first year it is allowed to pay the full loan without penalties.

DOMOSTROY is a deposit for future house-owners. Center-Invest Bank helps the residents accumulate the required 10% for the first deposit and simplify the housing problem for those who think about their future and that of their children. The loan is arranged for one year with a subsequent extension, interest rates are added at the end of the year. The amount and number of additional fees are not restricted. When the agreement is terminated earlier, the interest rates are kept the same depending on the terms of the loan. The application for **DOMOSTROY** is reviewed for free, provided Center-Invest Bank is the mortgage provider.

Parents or relatives can arrange the **DOMOSTROY** deposit for their child and keep the money in the bank until he grows and requires accommodation of his own.

9. «SOUTH OF RUSSIA +»

9.1. The Strength of Our Plans Lies in their Feasibility

Center-Invest Bank has a lot of experience in planning its activities. From the time it was launched, even when the reforms were constantly changing in Russia, the Bank developed annual and quarterly business plans. In 2002 the Board of Directors approved the five-year development strategy for the period up to 2006. Even before involving foreign shareholders the Bank implemented its strategy and adopted a new one for 2004-2009. The objective of doubling the GDP announced by President of Russia Vladimir Putin was received by the Bank management as a guide and in 2005 it doubled its performance.

Main financial indicators (billion Rubles)

	01.01.03	01.01.04	01.01.05	01.01.06	01.07.06	2009 plan
Capital	0,4	0,7	1,0	2,0	2,1	2,7
Assets	1,6	5,1	8,2	13,0	16,1	23,2
Loans	1,0	3,8	6,6	10,4	13,3	19,6
Deposits	0,4	1,6	3,2	5,0	5,9	10,0
Profit	0,03	0,1	0,2	0,5	0,3	0,8

These figures impressed the key shareholders of Center-Invest Bank, who held a meeting within the framework of the Russian Economic Forum in London and agreed upon a new strategy aimed at implementing its strategic mission:

«Rendering a wide range of services to enterprises and retail clients in the South of Russia based on international standards and modern banking technologies»

Taking into consideration the growing interest of investors in the South of Russia and the experience of Center-Invest Bank in implementing the requirements of Western banks and investment companies, the key investors approved the expansion of the Bank's activities in the South of Russia and inter-regional collaboration. This programme is called «South of Russia +», and it includes the following main directions.

9.2. Branch Network Development

Center-Invest Bank is well aware of regional risks and is planning to expand its regional network in the developing towns and cities in the South of Russia. The Bank will promote the development of inter-regional links of the South of Russia through establishing branches in other regions in order to help its clients to develop their business.

9.3. Developing a product line

9.3.1. Small Business

The Bank will expand the range of services for small business in industrial, trade and service industries, including franchising, shipping, repair and construction activities, agriculture. The Bank will assist in developing small businesses on the basis of:

- legalising small enterprises by providing legal support, outsourcing book-keeping services and consultations;
- using the Internet technologies for finding information and promoting its clients' businesses;
- promoting international collaboration of small enterprises under the programmes with

the Land Banks of Germany and Austria and programmes of international agencies.

9.3.2. Products for Corporate Clients

9.3.2.1. Collaborating with Network Companies. A well-developed network in the South of Russia allows the Bank to offer a test technology to network companies: payment collection, centralized financial management («bank in a bank»), factoring. These services are attractive to retail chains, car dealerships, telecommunication and construction companies, heating, gas and water supplying enterprises, transport enterprises. The Bank is planning to develop a branch network in order to promote its clients businesses.

9.3.2.2. Lending for Agriculture. The Bank is working with successful agricultural enterprises for introducing new technologies. Sharing this experience, collaboration with new companies, including foreign partners will increase its loan portfolio.

9.3.2.3. Implementation of Energy Efficiency Projects. The Bank mastered its activities in typical energy efficiency projects and how it is ready to spread them among enterprises and organisations in the South of Russia.

9.3.2.4. Business Development for Clients. Supporting its clients businesses, the Bank financing their technical upgrade programmes, product renewal programmes, capturing new segments of the market by the clients, using leasing, project and structuring finance, and attracting long-term financial resources of international banks and agencies.

9.3.2.5. Providing Services to Clients. In addition to loans, the Bank offers its clients unique services of co-financing within the framework of state and international programmes, including infrastructure financing support and public-private partnership (PPP).

9.3.2.6. Transactions with Securities. Experience of the Bank's asset management company Center-Invest First, one of the leaders of the asset management funds, allows it to help its clients to trade their securities, provided the Russian securities market develops in a fastly transparently.

9.3.3. Loans for Physical Entities

A well-developed branch network and experience allows the Bank to increase the volume of mortgages, car-loans and consumer loans.

9.4. Development of Service Sectors

9.4.1. Settlement and Cash Services. Up to 60% of the trade turnover of the local companies take place within the South of Russia. A well-developed network in the South of Russia allows the Bank to successfully compete in serving the inter-regional goods turnover. The new IT technology and the development of the telecommunications channels allow the Bank to accelerate the banking payment transactions between the branches, expand the range of Internet-based and customised services, and reduce the client demand for working capital. Direct marketing will allow to improve the existing

technologies and means of providing services to clients in accordance with international standards. The 2007 standardisation of the Bank's tariffs will strengthen the image of the Center-Invest as the main settlement Center of the region.

9.4.2. Direct Marketing. Center-Invest Bank will continue its assistance to its clients in developing their businesses, offering new products and services, consultations on new directions of business, new technologies. The clients will be offered adapted typical energy efficiency projects, leasing, trade finance, plastic cards, social loans. In addition to one-to-one meetings with the clients, the Bank will continue arranging informative meetings and seminars, advertising campaigns and open consultations. Within the state investment programme the Bank will offer co-financing projects, including PPP.

9.4.3. Plastic Cards. The Bank will continue developing its services based on plastic cards and it will set up its own processing center.

9.5. Developing a Range of Services

In order to reduce the operational risks related to the development of the branch network, the Bank is planning to undertake the following:

9.5.1. Standardisation of Products and Services. In 2007 the Bank will standardise its products and services in all structural divisions, including: maintaining fixed range of products and services, elaboration and implementation of standardised marketing techniques, customer care, risk management. Based on the accumulated experience, we will offer new rules on document preparation procedures and interactions with the structural divisions. By the end of 2007 the system of product and service development, marketing techniques and risk management will be improved which will allow us to reduce costs for new products and services as well as increase efficiency of risk management.

9.5.2. Introducing a New Information System. All Russian banks today face the challenge of upgrading their information systems. Center-Invest Bank started tackling this problem in 2005. Out of 16 contestants Germany's SAP AG, one of the leading international companies in software programmes for industrial technologies was selected as the IT provider. The Bank intends to use the SAP advantages: system modularity, adaptability, integration with other systems and technical platforms, readiness for further development, world best technological solutions – in order to strengthen its competitive advantage. The new IT system is installed according to the schedule and budget, as approved by the Board of Directors. The system will ensure that the Bank operates smoothly in the next 8-10 years and the operations are 3-5 times more efficient.

9.5.3. Risk Management. Thanks to the ING advisors invited by the EBRD, the Bank became one of the first Russian Banks which applied the best international practices in risk management. The monitoring procedure for managing credit, market and operational risks is changing according to the approved schedule. The received recommendations will allow the Bank to reduce risks and to increase efficiency of the operations by 2-3 times.

9.5.4. Internal Control. The internal control system was developed on the basis of the best international practices and thanks to the EBRD consultants perfected to the point which allows to control all divisions, functions and products. This work is based on the future and current plans developed in accordance with the approved instructions and standards.

9.5.5. Human Resources. The human resources policy of the Bank based on merit and training has proved its efficiency. The development of the branch network requires that the competition-based selection of the management, training and learning needs to be improved on the basis of the existing horizontal rotation practice. The Banks constantly provides training for its staff at the international level and regularly invites advisors and professionals for the required consultations.

9.5.6. Technical Support. The branch network will be developed in accordance with the business plan of each division and pay-off period not exceeding three years. Special focus will be on the «legality» of the assets to be acquired for the branch network development.

The growing role of banking technologies based on plastic cards requires that the number of ATM machines is increased.

9.6. Capital Structure

In order to implement the «South of Russia +» strategy, the Bank plans to conduct a private offering among its shareholders, to attract Tier 2 capital subordinated loan for business development and then to raise funds through IPO listing.

The precis of the «South of Russia +» new strategy does not provide specific figures of targeted programmes, as they are of confidential nature, but all the estimates and calculations were made in several versions in accordance with the mathematical model. This is exactly what give an additional + (advantage) when implementing the strategy.

If every enterprise in the South of Russia has a document similar to the «South of Russia +», the South of Russia will have a good chance of putting itself in a advantageous position not only in the Russian economy but also in the global economy.

CONCLUSION. TRADITIONS AND PROSPECTS OF REGIONAL PLANNING

1. Reviving the Traditions

Thirty years ago when I was working on my thesis on the interregional balance of Northern Caucasus, I got acquainted, for the first time, with the activities of the planning agencies and statistical offices of the krajs, regions and the national republics. As a token of my gratitude and in memory of my mentors I delivered a lecture that summer to the young staff of the Rostov Region Administration on the Traditions and Prospects of Regional Planning.

A few days later at the meeting of the State Council of the Russian Federation, the regional authorities put forward the issue of reviving the tradition of regional planning. The mass media interpreted this as the revival of the Gosplan and the Oblast Plan. If we put aside the ideological stereotypes, then in any economy, be it a centralised or a market economy, there should be a balance maintained. The differences lie only in theories that describe this balance and methods of developing plans as well as organising planning activities.

By eliminating the centralised economy, we, true to our Russian boldness, got rid of everything, including planning, which is a conscious activity to keep the economy balanced. The emerged emptiness was filled with a new idol of monetary concepts. In addition, it became very fashionable to worship just one method of fighting the inflation – reducing the money supply without proportionate increase of goods supply.

Capitalists turned out to be more tolerant. The first question asked by the IFC consultants during their inspection of the Center-Invest Bank surprised the staff with its naivety: “Have you got a five-year plan?” The foreigners were even more surprised when they were shown the Bank’s strategy for five years, annual and quarterly business plans, marketing plans, training programmes for the Bank’s staff, and even internal inspection plans. As one of the greatest minds of the past put it “one cannot work without a plan designed for a long period and long success”

2. Geographical Proportions

Any production is geographically bound. Therefore, be it within a state plan, be it within a market analysis, it is necessary to maintain a balance within the development dimensions of:

- 1) various economic sectors (sector planning);
- 2) a separate sector in various geographical areas (economics of location);
- 3) various sectors in one geographic area (comprehensive development plans of geographic areas);
- 4) various regions within the country (territorial planning and interregional interaction planning).

The necessity to support each type of the above-mentioned proportions in modern conditions is illustrated by the mass media discussions on the following issues.

1. The diversification of the Russian economy requires the development of not only the energy sector but also the responsibility of the oil and gas suppliers to develop other sectors of the economy, including the social and recreational sectors as well as the agro-

industrial complex. The outsourcing of these non-core activities should be accompanied by strengthening the market mechanism of transferring financing resources to the development of these non-cores activities.

2. Large retail chains are actively competing for opening their branches in the regions. Also, RAO UES of Russia (United Energy System of Russia) identified the locations for its generating companies. RAO Gazprom approved its investment programme within the regions. It is important that every company operating in the Russian market has a clear regional programme.

3. To ensure a comprehensive geographical development it is vital to maintain a balance in supply and demand not only within the country but also within each region. For example, imbalance in energy consumption leads to shortage of electricity in some regions and its abundance in other regions. The recreational potential of the South of Russia is underused due to the existing inadequate infrastructure.

4. It is necessary to bridge the gap in living standards in various regions so that Russia has no backward provinces and goblet places. Regional competitiveness should create conditions for accelerated development of such regions.

3. Breakdown of Business Plans by Regions

In August 2006 the Association of the European Businesses (AEB) held a round table discussion in Krasnodar “The Role of Foreign Capital in Implementing National Projects”. One of the initiators of the discussion – KNAUF – provided information on how it changed its business plans due to the launch of the national priority project “Affordable and Comfortable Accommodation for the Citizens of Russia”. This experience is very educational for foreign investors who do not fully realise all the new opportunities in the Russian market. Only the Russian management that remembers those five-year plans of economic and social development of the country was able to see something that western analysts still cannot.

First of all, foreign companies have their own strategies and business plans approved by their shareholders. To make amendments involves a long bureaucratic process. A new market entrant has to reassess its balance sheet, cash flow and profit. These estimates require marketing strategies, staff and investment portfolio management to be reviewed. Only after this analysis is complete the new business plan is approved along with the bonus systems for its implementation. The majority of Russian enterprises are starting rehabilitation of the planning system. Since these companies have no strategy or plan of their own, the management is throwing themselves at national projects as if clutching at a straw.

Secondly, while developing their strategies, western companies that have already worked in Russia, take the regions into account. For example, KNAUF indicated in its plans that the income of the population in the South of Russia is 30% lower than the national average and three times lower than in Moscow. Based on this fact the company’s investment programme offers a different product line and development of other facilities. But this development requires investments in mixed sectors, infrastructure and human resource training. Therefore, a serious company will always have regional provisions in its business strategy. Otherwise, this company cannot successfully operate in Russia.

In 2002 for the first time the European Bank of Reconstruction and Development

(EBRD)'s Strategy for Russia made regional provisions. It turned out that in the South of Russia where 15% of the total Russian population reside and 10% of the GDP is produced, the EBRD's loan portfolio accounted for only 0.2% of the Russian Federation. This imbalance was so obvious that the planned rotation of the EBRD's Russian division staff was accelerated.

Taking into account the experience of foreign colleagues, Russian companies should also make regional provisions in their business plans and strategies. If this information is confidential, then these business plans may be jeopardised because of the competitors or bureaucratic agreements. If this information is open, then it will be supported by the market participants and the state structures. Exchanging economic information allows us to push the dialogue of business power in the right practical direction. The follow-up step should be - collaboration in elaborating regional strategies of development.

4. Comprehensive Plans of the Geographical Areas

From the viewpoint of the time horizon it is necessary to reflect the sector-specific and geographical dimensions in current and future plans and take into account tactical (within the planned restrictions) and strategic (within free restrictions) perspectives.

Even the plans developed by the state bodies in the centre and the regions should allow us to group economic performance indicators based on the economic sectors (sector-specific), timeframe (time-specific), national projects (programme specific) and geographical areas (area-specific). Since recently a more flexible grouping method - cluster systems – is being implemented. Thanks to the modern technology it is easy to switch from one system of grouping to another which allows us to see the more detailed aspects of proportionality.

In 1981 the local authorities were given an opportunity to include in their plans the indicators of the enterprises of the Soviet and republican importance. In 2001 this method was used to develop the Small Business Development Programme of the Rostov Region: the programme included forecast on lending to small businesses. As a result the volume of financing for small businesses increased by 100 times and the small business programme became the largest regional programme. The publication of the results of the forecast on lending to small business enterprises intensified the competition between the banks to participate in the Regional Administration Programme.

5. Interregional Proportions

The foreign trade turnover in the economy “behind the iron curtain” did not exceed 10%. Up to 40% of total output was circulated between the regions. Like in any open economy in the process of globalisation, the regions have to be a part of the interregional exchange and position themselves in the markets of other countries.

Psychologically it is a difficult task for entrepreneurs working in the local market. Even in the developed countries the government has to undertake measures to bring its regional entrepreneurs to the international audience. I remember the speech made by one of the European regional officials before the local entrepreneurs. I do not know how accurately his speech was translated but his emotions were expressed almost in the spirit of bolshevism: “If we (local authorities) do not see you in the global economy there, then we will teach you a lesson here.” The speaker was talking about the sanctions against

those who did not develop plans to position their businesses in the foreign markets.

One can sympathise with the European entrepreneurs. In modern Russia friendlier methods are used to push our enterprises to the foreign markets. We wish that this stimulus will bring positive results, although the administrative tools may bring results faster, but for the short term.

6. Plan-Contract

Everybody knows the formula of “The Plan is the Law” but very few agree with it, although any serious company envisages not only bonuses but penalties too. It is much harder to deal with macroeconomic forecast and regional programmes. Very few officials stay in the office until the time when they can see their forecasts realised even halfway. For example, none of the government resigned for failing to respect inflation forecasts. For the same reason no one is fired for the mistakes in the the weather forecast.

In the Soviet economy the Plan was the law, therefore, it was drafted ritually as a state document. However, no five-year plan was ever met according to the approved indicators.

In addition, while drawing the plans the civil servants constantly played a game when they understated their capabilities, knowing that they would have to take high socialist obligations, and overstated their needs, knowing that they would be scaled down anyway. This interactive procedure of agreeing the plans was not too different from modern contract negotiations. It is not important who initiates the contract – the state or an enterprise, regional or federal authorities. The important thing is that the contract stipulates the responsibilities of the parties to respect the agreed proportions.

There is a slang expression used by new Russians “za bazar otvetish” (you are responsible for your words!) which can be interpreted in English as “market responsibility”. If the planning documents of the federal, regional authorities, enterprises and companies are reviewed as information commodity, then sooner or later the market will appreciate this information. It will be projected in how the business community trusts those state structures that successfully implement their plans within the economic sector, timeframe and geographical dimensions.

7. Continuity of Planning

Describing the investment appeal of the South of Russia in this book, based on the analysis of the statistical data, the author endeavoured to show the strengths and weaknesses, opportunities and risks which investors can expect in this region. The updated statistics, which came up in 2006, did not change the general picture and the conclusions drawn by the author. One can further advise on how to make investments, talk about the investment appeal of the South of Russia but it is better to recommend the reader to experience himself a sense of profound satisfaction from implementing his investment plans and the impact they might have on this vast and beautiful region.

Joint implementation of plans and strategies of the new wave of investors in the South of Russia should bring new proportions in the regional development. Future analysis of the trends and correlation in the new conditions will provide an impetus for a new investment cycle.

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VASILY V. VYSOKOV

PhD, Professor, Chairman of the Board of Directors of Center-Invest Bank (Rostov-on-Don)

Education and scientific efforts

In 1976 graduated from the Rostov State Institute of National Economy, in 1982 from the Novosibirsk State University.

1976-1991 - Assistant Professor, Senior Lecturer, Associate Professor of the Department of National Economy Planning of the Rostov State Institute of National Economy, Rostov-on-Don. In 1995 he upheld a thesis for a Doctor's degree in the Central Institute for Economics and Mathematics RAS.

Business experience

1991 - Head of the Center for Economic Support to transfer to market economy under Administration of Rostov Region.

In 1997-1998 General Director of the Federal Fund for SMEs support, Moscow.

1992-2002- Deputy Chairman of the Board of Directors of JSC Center-Invest Bank. Since 2002 - Chairman of Board of Directors of JSC Center-Invest Bank.

Vice-president of the Chamber of Industry and Commerce, member of Rostov region Governor's Council for Banking activities, member of Krasnodar Region Governor's Investment Council, Member of Rostov Region Council for Small Enterprises, member of Europe Economic Association.

Frequent participant in the World Economic Forums in Davos, Annual meetings of the World Bank, Annual meetings of EBRD and other international economic forums.

Awards

Winner in the nomination "Financial services" of competition "Entrepreneur of the Year -2003" organized by Ernst & Young Company for the first time in Russia;

Gained the lead of rating "Leader of the year" in the nomination "Successful entrepreneur-2004" organized by newspaper "Gorod N", Rostov Region.

Books and articles

Mr. Vysokov created over 200 works on problems of transition economy, privatization, post privatization development and small enterprises.

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Vasily V. Vysokov

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Bank Center-invest raised funds amounting to €200 million from international financial markets for economic development in the South of Russia.

Reliable shareholder structure*: EBRD (27,5%), DEG (22.5%), Dr. Vysokov's family (17,9%), Firebird Investment Fund (9,9%), Raiffeisenlandesbank Oberösterreich (3,6%)

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