



# Business Environment and the ICT Sector in Russia

<b>Full Name:</b>	<b>Russian Federation</b>
<b>Area:</b>	<b>17 million km<sup>2</sup></b>
<b>Population, 2006</b>	<b>143.8 million</b>
<b>Capital:</b>	<b>Moscow</b>
<b>Currency:</b>	<b>Ruble (RUB)</b>
<b>Head of State:</b>	<b>Vladimir Putin</b>

# TABLE OF CONTENTS

	Page
1. GENERAL OVERVIEW .....	3
1.1 Geography .....	3
1.2 Infrastructure Services.....	3
1.3 Population .....	4
1.4 Politics.....	4
1.5 International Relations .....	5
2. ECONOMIC ENVIRONMENT .....	6
2.1 Economy.....	6
2.2 Labor Market .....	8
3. BUSINESS ENVIRONMENT .....	9
3.1 Foreign Direct Investment.....	9
3.2 Taxes.....	11
3.3 Visa.....	13
4. ICT RUSSIA.....	14
4.1 Overview .....	15
4.2 Telecommunication .....	16
4.3 IT .....	17
4.4 Special economic Zones for Technology Innovation.....	21
5. PERSPECTIVES .....	23
6. BIBLIOGRAPHY .....	24
7. LEGAL DISCLAIMER.....	27

# 1. GENERAL OVERVIEW

## 1.1 Geography

With an area of 17,075,200 km<sup>2</sup>, The Russian Federation is the biggest country in the world, spanning almost half the globe from East to West and about 4,000 kilometers from North to South. The country is divided into 11 time zones and occupies much of Eastern Europe and northern Asia. Its climate ranges from the Arctic north to the generally temperate south. Although Asian Russia occupies roughly three-quarters of the nation's territory and is therefore about as large as China and India combined, it is home to less than 25% of the population.

## 1.2 Infrastructure Services

### 1.2.1 International Access

#### ▪ Roads

In 2005 Russia had 897,000 kilometers of roads, 85% of which were paved but none of which could be classified as a Western-style trunk highway. An estimated 40% of rural villages are not connected to a paved road. An Investment fund with a capacity of USD 2.6 billion was established in 2006 dealing with infrastructure improvements and projects around Moscow and St. Petersburg.

#### ▪ Railroads

In 2005 Russia had 87,000 kilometers of rail line, including 46% electrified. As of 2005 six cities had underground rail lines: Moscow, Nizhniy Novgorod, Novosibirsk, St. Petersburg, Samara, and Yekaterinburg. The Metro of Moscow is the world's largest subway system in terms of passenger rides, carrying 8 to 9 million passengers on an average weekday.

#### ▪ Sea

Russia has 102,000 kilometers of inland water routes and 43 ports were in operation in 2005. In the same year Russia's merchant marine had 1,199 ships weighting more than 1000 tonnes.

#### ▪ Air

In 2006 Russia had 616 airports with paved runway. Aeroflot - Russian Airlines is the biggest airline in Russia, operating flights to nearly 100 cities in 47 countries

### 1.2.2 Telecommunication

#### ▪ Telephone

In the 1990s, Russia's telephone system underwent a major transition, as more than 1,000 companies gained licenses to provide services. The number of private lines increased sharply during that period and the government's goal is to add 50 million land lines by 2010.

### ▪ Mobile phone

In 2005 an estimated 60% of Russians used cellular phones, about which 72% came from urban population and 47% from rural population. At the insistence of security agencies and the military, the government has postponed privatization of Svyazinvest, the state holding company that controls the long-distance monopoly Rostelkom and 89 regional telephone companies.

### ▪ Internet

Internet use has grown more slowly in Russia than elsewhere. In 2005 the number of users was estimated at 23.7 million with remarkable growth in urban centers, especially Moscow, Irkutsk, Krasnodar, Nizhniy Novgorod, Novosibirsk, Vladivostok, and Yekaterinburg. The government has provided 10,000 public terminals in most regions.

## 1.3 Population

<b>Population</b> (UN, 2006):	143.8 million
<b>Population growth</b> (CIA, 2007 est.):	-0.484%
<b>Life expectancy</b> (UN, 2004):	59 years (men), 72 years (women)
<b>Labor Force</b> (MSN, 2005):	73,229,575 people.
<b>Minimum wage</b> (Federal Statistical Service, Sept 2007):	RUB 2,300 (USD 90.36)
<b>Unemployment rate</b> (CIA, 2006 est.):	6.6%
<b>Labour force by occupation</b> (CIA, 2005 est.):	<ul style="list-style-type: none"> <li>▪ agriculture 10.8%</li> <li>▪ industry 21.9%</li> <li>▪ services 60.1%</li> </ul>

With a population of 143,8 million Russia ranks as the world's sixth largest population. The Russian Federation is inhabited by more than 160 different ethnic groups and indigenous peoples, including sizeable Tatar (3.8%) and Ukrainian (2%) populations. Although Russian is the only official language of the Russian Federation, there are several other officially-recognized languages within Russia's various constituencies<sup>1</sup>.

## 1.4 Politics

After the collapse of the USSR, the Russian Federation became an independent state in December 1991 and has adopted a new constitution and system of government. Russia is a federal and presidential republic governed under a constitution that took effect in 1993. According to the Constitution the President of the Russian Federation sets basic domestic and foreign policy. The President is also Commander-in-Chief of the Armed Forces. Vladimir Putin was re-elected president on March 14, 2004. The Federal Assembly consists of two legislative chambers: the Federation Council (upper chamber of parliament) and the State Duma (lower chamber). The majority of deputies in the State Duma are members of the pro-presidential party, United Russia. On the whole, the political situation in Russia is stable.

<sup>1</sup> Wikipedia.org (2005)

## 1.5 International Relations

The improvement of Russia's foreign trade and foreign investment positions has been a central policy of the Putin administration. Russia took major steps toward its most important foreign trade goal, membership in the World Trade Organization (WTO). Despite intensive negotiations the United States continues to block Russia's admission mainly because of copyright piracy in Russia and restrictions on US exports to Russia.

Russia is a member of numerous international organizations, among them the membership in all bodies of the United Nations with a permanent seat on the Security Council and veto rights. Russia also has signed a number of bilateral arms control treaties with the United States on the limitation of strategic arms, antiballistic missile systems, and underground nuclear weapons tests and on the elimination of intermediate-range and shorter-range missiles.

By 2005 trade with several states of the Commonwealth of Independent States (CIS), had declined steadily to less than 15% of the total as trade with the countries of the EU increased to more than 50% of the total, based on increasingly favourable conditions. In 2006 Russia raised gas prices for Ukraine, whose democratic government Russia disfavoured, by about 100%.

## 2. ECONOMIC ENVIRONMENT

### 2.1 Economy

#### ▪ Key Statistics

##### Monetary unit

(Yahoo Finance, Aug. 20, 2007): 1 ruble (RUB)= 100 kopecks = USD 0.03883

##### Main exports:

Oil products, natural gas, wood products, metals, chemicals, military equipment

#### ▪ Evolution of Key indicators

	Population (mn)	Population Growth (%)	GDP per capita (USD, current prices)	GDP real growth rate (%)	Current account balance (USD bn)	Inflation Rate (annual % change)
<b>2003</b>	145.00	-0.50	2,975	7.30	35.41	13.70
<b>2004</b>	144.20	-0.51	4,104	7.20	58.59	10.90
<b>2005</b>	143.50	-0.47	5,323	6.40	83.34	12.70
<b>2006</b>	142.80	-0.37	6,856	6.70	95.60	9.70
<b>2007e</b>	142.10	-0.48	8,209	6.40	72.90	8.10

Source: IMF, OECD, CIA

Russia's macroeconomic performance in recent years has been impressive. Whereas the Moscow region has a tenth of Russia's population, it contributes to one-third of the country's GDP. The country has been able to reduce its formerly huge foreign debt. From 2000 through 2005, Russia's federal budget showed surpluses each year due to the high price of oil, large capital inflows and the combination of strong growth in productivity, real wages, and consumption.

Russia has the world largest known natural gas reserves, along with the second largest coal reserves, and the 8th largest oil reserves. It is the world's 2nd largest oil producer.

#### ▪ Inflation

	Inflation Rate (consumer prices, 2006)
<b>Russia</b>	9.7%
<b>China</b>	1.5%
<b>United States</b>	2.5%
<b>Brazil</b>	3.0%
<b>India</b>	5.3%

Source: CIA (2007)

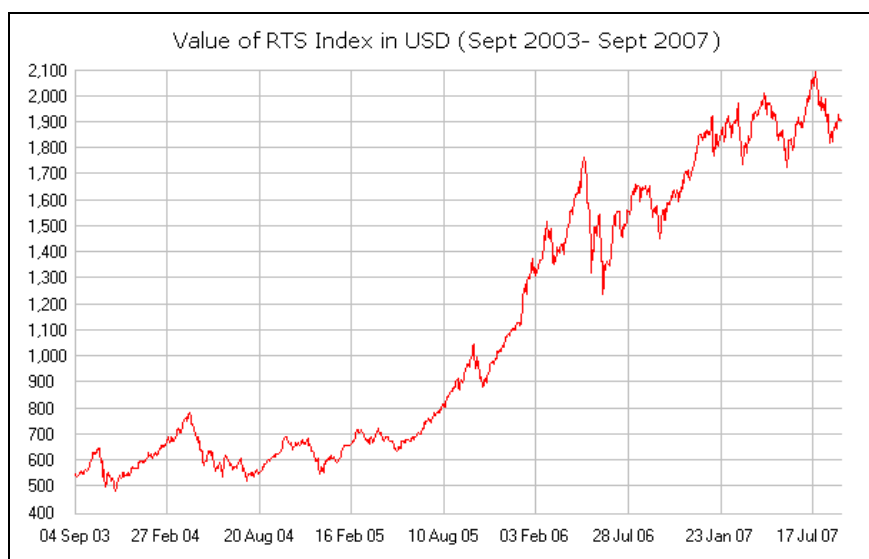
In 1992, the inflation rate in Russia reached a level above 2000%, due to the expansion of the money supply by the central bank of Russia. With a prudent fiscal policy price stabilization was reached in 1995. The financial collapse of 1998 and subsequent currency devaluation raised inflation that year to 84.5%. Since that time inflationary policy has become a major issue for the government. A stabilization fund was created in January 2004 to reduce inflationary pressure and to protect the economy from volatility of raw material export earnings. Russia has the third-largest foreign exchange reserves in the

world (close to USD 301 billion at the end of 2006) which should shelter it from commodity price shocks.

#### ▪ Interest Rates

The central bank of the Russian Federation is responsible for the country's monetary policy and is at the same time the main regulator of the banking industry. While the interest rate<sup>2</sup> reached a level of 91% p.a. in 1995 the Central bank changed his policy and was able to increase the gross international reserves, to ensure a stability of the national currency and to decrease the interest rate. Since 2003, the average short term interest rate is fluctuating between 2.7% and 3.7% p.a.

#### ▪ RTS - Russian stock exchange market<sup>3</sup>



Source: RTS (2007)

Established in 1995 in Moscow the Russian Trading System (RTS) consolidates various regional trading floors into one exchange. The RTS Index consists of 50 stocks issued by leading Russian companies. At the present time it is one of the most dynamically developing emerging markets in the world. Currently the RTS Index has a market capitalization of USD 186.6 billion and surged 686% from 2001 through 2005 - and another 66% in 2006. On September 3, 2007 the RTS Index closed at 1926.5 Points.

The RTS Telecom Index (RTStI), one of the 5 sector Indexes of the RTS stock exchange has an actual capitalization of USD 8.2 Billion and increased 326% in the last 5 years. On September 3, 2007 the RTS Index closed at 269.6 Points.

<sup>2</sup> Average Interbank rate per annum

<sup>3</sup> RTS (2007)

## **2.2 Labor Market**

### **2.2.1 Labor Force**

Russia's labor force generally is considered well-educated and skilled, due to the free and compulsory schooling introduced from the former Soviet government. As a result, Russia has an extremely high literacy rate. More than 99% of the population over age 15 is literate. In spite of that, the labor force in Russia is shrinking by as much as 1 million workers per year, due to low birth rates and a likely rise in mortality rates caused by the spread of AIDS and other diseases. The country's total population is projected to decrease to 128,180,396 by 2025 and to 109,187,353 by 2050<sup>4</sup>.

### **2.2.2 Wages**

The average income across the country was RUB 13,810 (USD 535.86) in June 2007, according to data from the federal statistics service. Wages are climbing by 20-27% annually and have jumped 750% in the past eight years. Russia still trails other Eastern European countries. In Poland, average wages are USD 862 and in Hungary USD 873<sup>5</sup>.

Official income statistics are skewed because many Russians underreport their incomes to avoid taxes. The economic condition of many Russians is ameliorated by earnings from additional jobs or by access to private plots of land. The minimum wage was increased from RUB 1,400 (USD 54.98) to RUB 2,300 (USD 90.36) on September 1, 2007. Deputies hope that an increase of the minimum wage will stimulate creation of special salary tariff scales in different industries.

### **2.2.3 Unemployment**

The growth of unemployment has been the bane of many of the Central and East European countries in the transition from centrally planned to market economies. Russia's unemployment rate has been hard to measure accurately because many firms unofficially furlough workers but leave them on company rolls. The CIA Fact Book estimated the unemployment rate at 6.6% (9.4 million people) for the year 2006.

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<sup>4</sup> MSN Country Profile

<sup>5</sup> Conor Sweeney (2007)



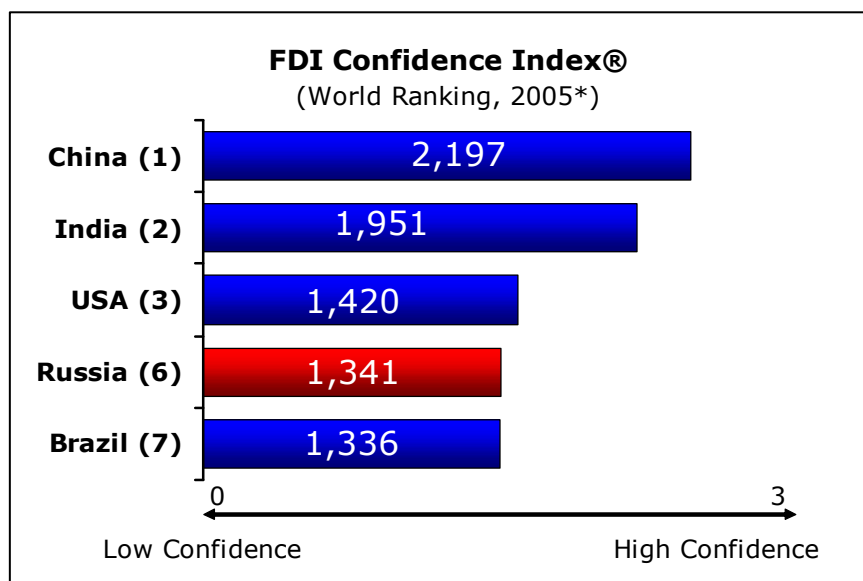
## 3. BUSINESS ENVIRONMENT

### 3.1 Foreign Direct Investment

<b>Inward FDI</b> (OECD, 2005, USD bn):	Flow: 14.60	Stock: 132.49
<b>Outward FDI</b> (OECD, 2005, USD bn):	Flow: 13.12	Stock: 120.41

"Foreign direct investment (FDI) is defined as a long-term investment by a foreign direct investor in an enterprise resident in an economy different than the one in which the foreign direct investor is based. In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate. The United Nations defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm".

In the last few years FDI has become a global phenomenon, with FDI stocks now constituting over 20% of global GDP. Emerging countries such as China and India have become the most favoured destinations for foreign direct investment, according to the latest FDI Confidence Index®, an annual survey of executives from the world's largest companies conducted by A.T. Kearney<sup>6</sup>:

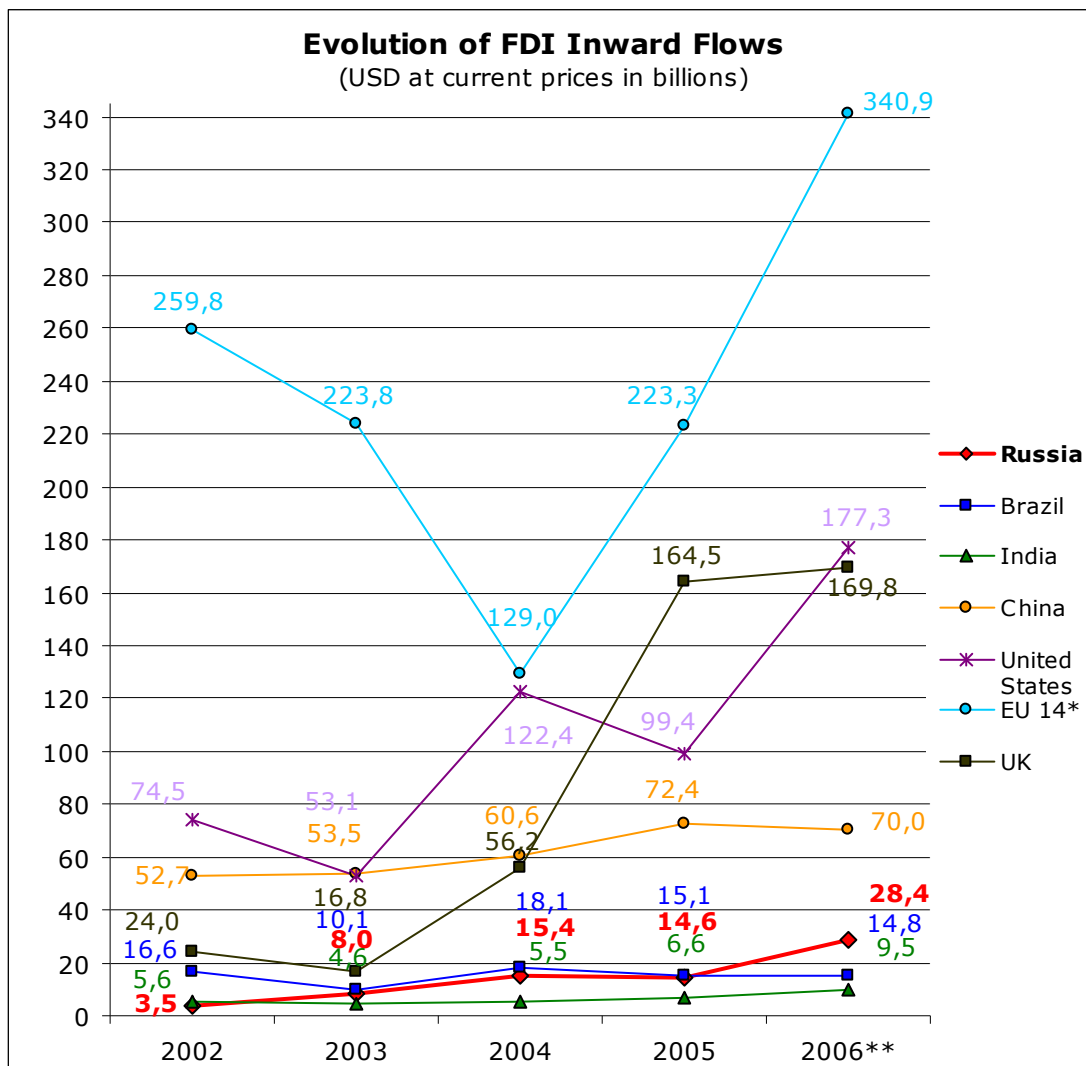


\*Values calculated on a 0 to 3 scale  
Source: A.T. Kearney

Among the emerging and transition countries of both Europe and Asia, the fastest growing ones are the biggest recipients of FDI.

It is important to point out that the confidence index has yet to state anything about the size of the FDI flows. According to the data of UNCTAD the United States attracted the largest capital inflows in 2006, followed by the United Kingdom (USD 165 bn) and France (USD 64 bn).

<sup>6</sup> China Daily (2006)



\* Percentage Composition of FDI inward flows in EU14 (without UK): 28% France, 20% Netherlands, 15% Germany, 11% Belgium, 10% Spain, 9% Italy, -10% Ireland, 17% Rest.

\*\* Preliminary estimates

FDI includes the three following components: equity capital, reinvested earnings and intra-company loans. FDI flows with a negative sign indicate that at least one of the three components of FDI is negative and not offset by positive amounts of the remaining components.

Source: UNCTAD 2007

While there was a sharp increase in FDI inflows in European countries and the United States over the past few years, the level of inflows remained stable in China, Brazil and India. Russia represented the greatest percentage of growth among the emerging countries, with an increase of almost 100% in just one year!

### ▪ FDI in Russia

In the last few years Russia has received far less FDI than it could, both relative to its economy's size and in comparison with other emerging markets. Adjusted for population size, cumulative FDI in Russia was USD 15, compared to USD 84 for Poland, USD 118 for the Czech Republic and USD 221 for Hungary in 2000. This result implied, in part, a flawed policy strategy regarding FDI in past years<sup>7</sup>.

Not only the countries natural resources, but also its technological capabilities and labour skills hold considerable potential for foreign direct investment, as long as foreign investors are allowed to take equity shares and are not confined to production. One of the most damaging elements for the Russian FDI market was the Russian Tax system, in which instability, a heavy burden, and arbitrary enforcement were the major hindrances to foreign investors. The new tax code helped in this regard, but more needs to be done. Putin administration is trying to increase inflow of FDI in country and the government is making reforms in this sphere. In the first quarter of 2007, foreign investment in Russia amounted to USD 24 billion according to the Federal State Statistics Service, almost three times more than the same period in 2006 (USD 8.8 billion), which in turn, was twice the level for the same period in 2005. Still less than half of all capital came in 2006 into the country (43%) was direct foreign investment<sup>8</sup>. The Vienna Institute for international economic studies estimates an FDI Inflow of 25 billion Euros (USD 34.12 bn) for the year 2007, an increase of more than 20% in one year.

## 3.2 Taxes

### 3.2.1 Overview

The Russian tax system has undergone significant changes in the last years, aiming at improving the investment climate and stimulating business development. Russian taxes are listed and regulated by the Russian Tax Code. The Tax Code consists of Part 1, dealing with administrative and procedural rules, and Part 2, containing 17 chapters on specific taxes. Russian Taxes are subdivided into three levels of taxation: federal, regional and local:

#### Federal taxes

- |                         |                          |                       |
|-------------------------|--------------------------|-----------------------|
| ▪ Profit tax            | ▪ Personal income tax    | ▪ Water tax           |
| ▪ Value-added tax (VAT) | ▪ Unified social tax     | ▪ State duty          |
| ▪ Excise taxes          | ▪ Mineral extraction tax | ▪ Several other taxes |

#### Regional taxes

- Corporate property tax,
- Transport tax
- Gambling tax

#### Local taxes

- Land tax
- Individual property tax.

<sup>7</sup> Bergsman, Broadman, Drebenstov (2000)

<sup>8</sup> Financial Laboratory of the London Stock Exchange (2007)

While all taxes are legislated at the federal level, the regional and local governments have the power to set rates and establish procedures for those taxes but they can reduce the original profits tax rate by no more than 4 percentage points for certain groups of taxpayers.

The main government bodies are:

- **The Federal Tax Service:** Federal executive body responsible for collecting taxes.
- **The Ministry of Finance:** Overall responsibility for taxation, taxation policies and funds transfers to state budget
- **Federal Service for Economic and Tax Crimes:** Subunit of the Ministry of Internal Affairs responsible for investigating tax crimes

The Russian tax system continues to be in a state of transition. The following gives a general overview of the actual legal status of the three main taxes in Russia.

### 3.2.2 Profit tax

Corporations and their shareholders are taxed separately. The maximum tax rate for all companies is 24%, which includes 6.5% for the federal budget and 17.5% for the regional budgets. The regional authorities have the power to reduce their regional profits tax rate by 4%. Therefore, the overall tax rate can vary from 20% to 24%.

Profits tax can be paid on monthly or quarterly basis. Monthly payments are based on actual profits and quarterly with monthly advance payments are based on the profits of the previous quarter.

A taxpayer can deduct documented business expenses if they are incurred to generate income and if they are economically justified with documents. Deduction of certain types of expenses like costs for business entertainment or medical insurance for employees is subjected to restrictions.

#### ▪ Dividends

The tax rate for dividends received by Russian residents from Russian companies is set at 9%. Dividends paid by Russian companies to foreign shareholders are subject to a 15% withholding tax. Russia has an extensive network of double tax treaties with 65 countries, which can enable the reduction of the withholding tax rate on dividend income to as low as 5% and 0% withholding rate on other income like interest, royalties or capital gains.

#### ▪ Profit tax for foreigners

The general rate is 20% with a reduced rate of 10% on profits received from freight income (rent of vehicles, aircraft and other transport facilities). Foreign legal entities operating in Russia through a permanent establishment do not make monthly advance payments and pay profit tax on a quarterly and annual basis only.

### 3.2.3 Value Added Tax

*Value Added Tax (VAT) is tax on exchanges. In this specific case it is imposed on sales of goods, works and services within Russia, and all goods imported into Russia.*

The standard VAT rate is 18% on most goods and services. A reduced rate of 10% is applied for some basic food items and children's goods, as well as medicines, printed matter, educational and scientific goods and books. Exports are not subject to VAT, except oil and gas exported to CIS countries and exports of any goods to Belarus. Certain types

of goods, work, and services are exempt from VAT (i.e. circulation of securities, land plots, certain medical goods and services...)

#### ▪ VAT for Foreigners

A Russian customer of a foreign company that is not registered with the tax authorities and is active in Russia must withhold either 9.09% instead of 10% or 15.25% instead of 18% reverse charge VAT from the amounts transferred to the foreign company and must itself remit such VAT directly to the state budget. Foreign legal entities having more than one representative office can consolidate all VAT accruals and offsets on a company level.

### 3.2.4 Personal Income Tax

The taxpayers of personal income tax are residents of the Russian Federation and non-residents who receive income from the sources on the territory of Russia. To be considered a Russian resident, residence must be established of at least 183 days in Russia during any calendar tax year.

There are currently 4 flat rates, applicable to different types of income:

Tax Rate	Type of Income
9%	Dividend income and certain other less common forms of investment income received by residents
13%	most types of income, e.g. salary and other earned income
30%	Russian-source income received by non-residents
35%	<ul style="list-style-type: none"> <li>Income received from gambling, lottery prizes and other events organized for advertising goods, works or services in excess of RUB 2,000 (USD 78.70) per year</li> <li>Income received from certain insurance payouts</li> <li>Interest on bank deposits exceeding the discount rate set by the Central Bank of Russia on deposits in rubles or in excess of 9% on non ruble deposits.</li> </ul>

## 3.3 Visa<sup>9</sup>

#### ▪ Travel Visa

All foreign nationals are required to have entry visas to travel to the Russian Federation. Russian entry visas can be obtained at local Russian Embassy or Consulate, The Passport and Visa Department (UVIR) of the Ministry of Internal Affairs or specially authorized travel agencies. Tourist visas allow stays of up to 30 days.

#### ▪ Business Visa

Business visitor visas are referred to as "Ordinary Visa – Purpose: Business" and are valid up to 12 month but a continuous stay of foreigners obtained multiple entry business visas in Russia may not last more than 180 days

#### ▪ Working Visa

To work in Russia, a foreigner has to obtain a work permit and work visa. A work visa is issued after a work permit is received. If a foreigner has received residency status (either temporary or permanent), then neither a visa nor work permit is needed.

<sup>9</sup> Jon Hellvig (2003)

## 4. ICT RUSSIA

### ▪ Key Statistics:

<b>Internet Users</b> (2007):	28 million
<b>Web Internet Users</b> (% of the population)	20 %
<b>Internet hosts</b> per 10,000 inhabitants (Braliev, Alzhan, 2002):	22.22
<b>PC Penetration</b> (PMR, 2006):	22% on total population
<b>Broadband Internet average monthly cost</b>	USD 50
<b>Broadband Access</b> (J'son & Partners, 2005):	1.8 million households
<b>Internet at work</b> (Waylett ,2004):	63% of Internet users
<b>Number of websites</b> (Waylett, 2004):	16,964,567
<b>ICT expenditure % GDP</b> (Worldbank, 2004):	3.7 %
<b>Number of Public Internet Access Outlets</b> (World IT report, 2003):	6,600 Outlets
<b>Level of Government Online Usage</b> (UNPAN, 2005):	25%
<b>Internet domain:</b>	.ru

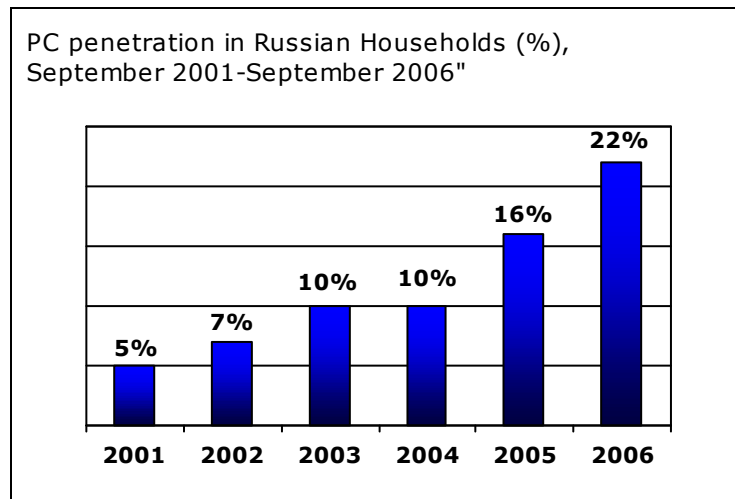
### ▪ International Comparison, 2006

	<b>Telephone main lines (mn)</b>	<b>Telephone main lines (%)</b>	<b>Cellular phones (mn)</b>	<b>Cellular phones (%)</b>	<b>Internet Users (mn)</b>	<b>Internet Users (%)</b>
<b>Russia</b>	40.10*	28%	152.00	105%	23.70*	17%
<b>China</b>	368.00	28%	437.48	33%	123.00	9%
<b>Brazil</b>	38.80	21%	99.91	53%	25.90*	14%
<b>India</b>	49.75*	5%	69.19	6%	60.00*	6%
<b>USA</b>	172.00	57%	219.40	73%	205.32*	69%
<b>EU 25</b>	238.00*	49%	466.00*	95%	247.00	50%

\*Data of 2005

Source: UNFPA State of World Population 2002- 2007, CIA, Missions Economiques (2007)

## ▪ Evolution of PC Penetration



Source: PMR, 2007

### 4.1 Overview

The Russian ICT sector has been growing very fast in recent years. The combined revenues of ICT companies in Russia reached RUB 1.1 trillion (USD 43 billion) in 2006, 20% higher than the year before, according to preliminary data from the Russian Ministry of IT and Telecommunications<sup>10</sup>.

The major driver of growth in the ICT market is the budding software outsourcing market. Russia is working hard to develop a reputation in the global outsourcing market much like China or Vietnam. There are combinations of several factors, which are favourable for the development of high-tech business in Russia: the increase of the state demand for IT-products and solutions, the insufficient proliferation of home computers, the global economic growth<sup>11</sup>. Furthermore Russia has a well-educated, well-trained, and dynamic workforce focused on science, engineering and technology. Major factors preventing Russia from fully capitalizing on its human capital strengths are software piracy, poor infrastructure, and poor image. Thomas Diffely, vice president of securities research and economics at Merrill Lynch & Co points out that Russia still must meet numerous challenges before truly competing with the likes of India. India maintains several advantages, including the lower cost of labor, more widespread use of English, aid from the government, and the existing placement of myriad executives in U.S. companies<sup>12</sup>.

<sup>10</sup> PMR (2007)

<sup>11</sup> Valery Kodachigov, Dmitry Kryazhev (2005)

<sup>12</sup> Ashlee Vance (2001)

## 4.2 Telecommunication

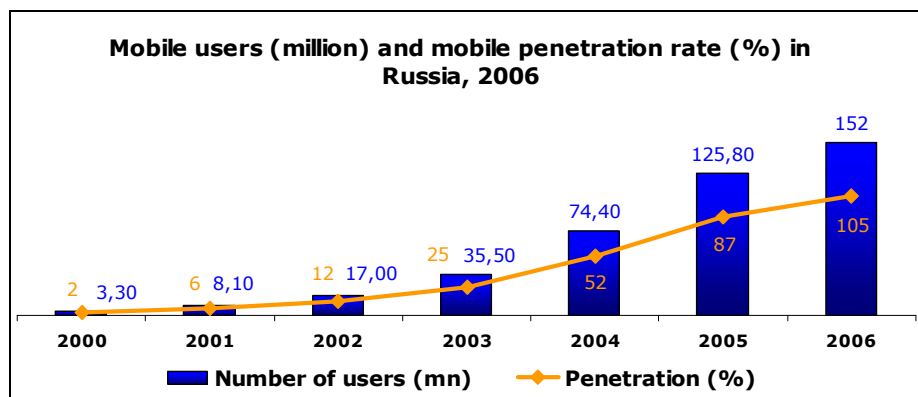
Russia is the biggest telecoms market in Central and Eastern Europe, both by value and in terms of number of users in the main segments of mobile, fixed-line and internet access services. In the 1990s more than 1,000 companies gained licenses to provide services in Russia's telephone sector.

### ▪ Fixed line market

Most of the local phone providers are only partially privatized under the umbrella of the state holding company, Svyazinvest who controls the fixed-line segment. Rostelecom, which is part of Svyazinvest, is Russia's leading long-distance telephony provider. There are 19.7 telephone-mainlines per 100 people in Russia and 6 million people on the waiting list for telephone service<sup>13</sup>. Market leaders for alternative operations, including Comstar United Telesystems, Peterstar, and Golden Telecom, are growing fast and focusing on high-margin corporate and high-income household sectors.

### ▪ Mobile handset market

In 1999 only 1% of Russians had a mobile phone, but the market began its spectacular growth in 2002:



Source: PMR, 2007

The number of mobile telephony users increased to 152 million in 2006, making Russia the world's third largest mobile market behind only China and US. While this means that statistically, every Russian has a mobile, in practice a sizeable portion of the SIM cards reported in operations statistics are inactive, and there are still segments of the population without a mobile phone<sup>14</sup>.

The mobile handset market in Russia is not dominated by network operators, like in many western European markets. All three of the largest operators VimpelCom, MTS and Megaphone have their own retail chains. The three biggest mobile operators together held 68% of the Russia mobile subscriber base. At the end of September 2006, MTS enjoyed an around 34.1% share in the market, VimpelCom had 32.4% and Megaphone had a 19.1% stake in the country's subscriber base. Other regional operators like Tele2, Smarts and

<sup>13</sup> Armen Shahverdyan (2001)

<sup>14</sup> PMR (2006)



Ouralsviazinform hold a part of 14.4% of the mobile phone market<sup>15</sup>. Megafon and VimpelCom subsidiaries in Tajikistan have UMTS licences and will use these operations to trial the WCDMA technologies. In May 2007, MTS contracted out to build a 3G network in the Moscow region. MTS plans to construct an integrated 2G/3G network in Moscow, where 3G subscribers will continue to be able to use services that are currently available within the 2/2.5G network<sup>16</sup>.

#### ▪ Satellite Systems

Satellite systems in the former Soviet Union were designed mainly for military, government, and TV broadcasting purposes; any civilian communications by satellite has primarily been for international calls. As a result, Russia's domestic communications satellites have lagged behind world standards in transmission capacities, position stability within orbit, and time of usage. Measures to support, preserve and complete existing systems have been taken and new measures for future development begun. In 2002, 30 VSAT networks and 2000 stations operated in Russia. With respect to the stations installed, the volume of the Russian VSAT market was 0.3% of the global market. The average cost of one VSAT station amounts to USD 6000 – USD 7000. Satellite communications is in relative high demand because of the country's expansive territory and the poor conditions of its landline networks. Forecasts indicate that by 2010 capacity demand will require as many as 380 transponders<sup>17</sup>.

#### ▪ CRM Market

The Russian Customer Relationship Management (CRM) market accounted USD 50 million in 2004 after surging 900% since 2001. While the market is more advanced than in other emerging countries (Chinese CRM market amounted to USD 37 million in 2004) Russia constitutes only 0.3% of the worldwide CRM market. Small projects for the financial and telecommunication sectors represent the largest segments of the CRM Industry. The implementation price for one user lies between USD 1,000 to USD 5,000<sup>18</sup>.

### 4.3 Information Technology

#### ▪ Internet

Before 2002, Internet use has grown more slowly in Russia than elsewhere, partly due to difficulties with the telecommunications infrastructure. Since that time internet penetration is growing with an average rate of 33% per year and in 2006 almost one quarter of total population had internet access. Russia's IT market is half the size of the country's telecoms market. It totalled RUB 361.5 billion (USD 14.21 billion) in 2006, up by 17.3% on the year before, according to preliminary figures from the Ministry of IT and Telecommunications.

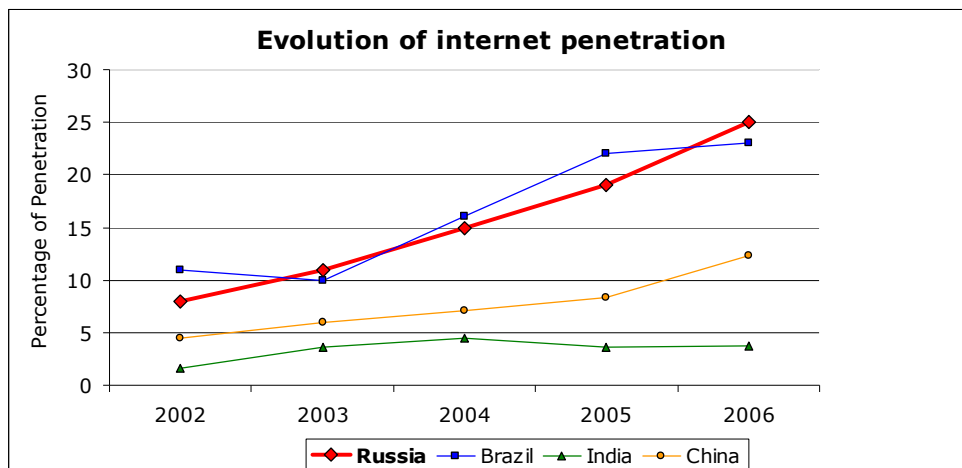
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<sup>15</sup> Missions Economiques (2007)

<sup>16</sup> Point Topic (2007)

<sup>17</sup> Breiter Maria (1998), RSCC (2002)

<sup>18</sup> CRM (2005)

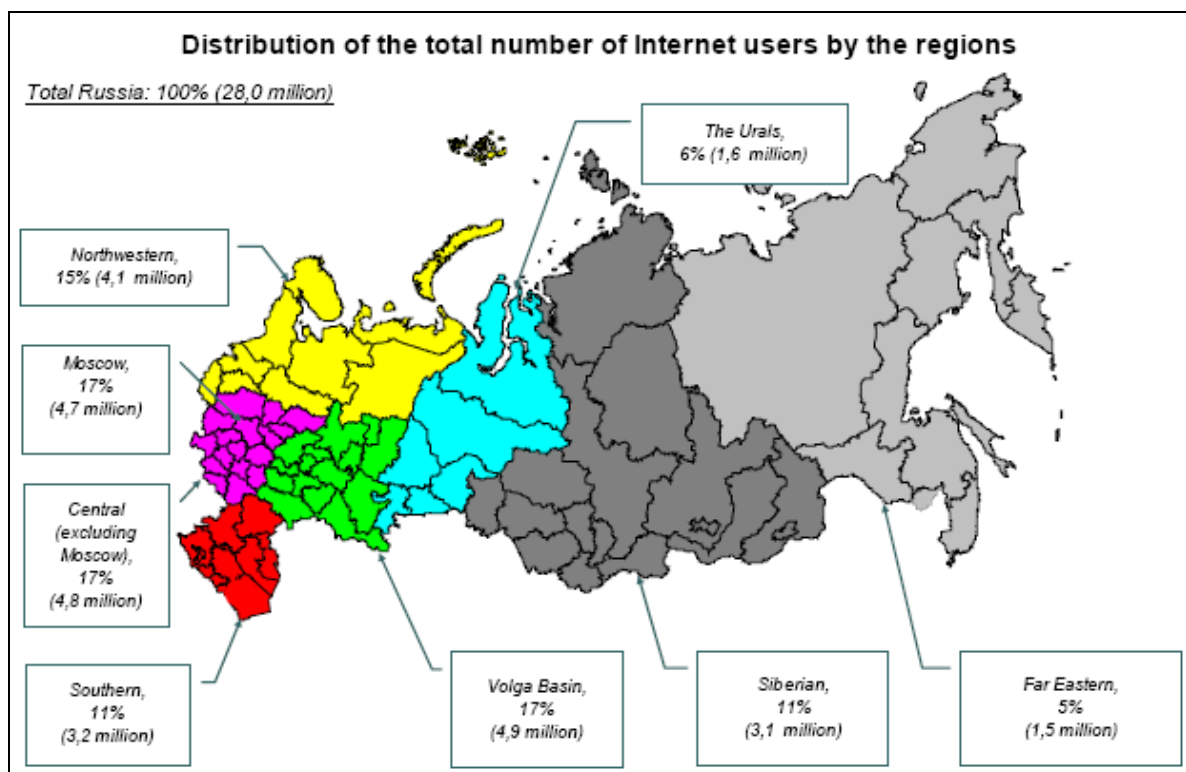


Source: FOM, 1st-18th Release, internetworldstats.com

While Google is popular with Russian-speaking users abroad, Russian residents prefer the Russian search engine Yandex which has indexed 2.8 million sites and 26,600 Gigabyte of data (July 2006). It is probably the largest Russian website with 22 million visitors in June 2006. There are 570,000 names registered in RU top level domain<sup>19</sup>.

While there were only a few Wireless Internet Hotspots in the last years the situation has changed and now there are dozens of wifi hotspots in Moscow, St. Petersburg and other major cities in Russia. Many of them are free, some charge USD 5- USD 10 per hour.

The share of Internet users in the total population has quite uneven distribution in Russia with high density in urban areas counting 83% of total internet users:



Source: FOM, 18th Release 2007

<sup>19</sup> Russian Internet Advertising Report (2006)

## ▪ Broadband

### Total Broadband Subscribers

	Q1 – 2006 (million)	Q1 – 2007 (million)	Growth 2006 – 2007	Part of Total Internet Users 2005*
<b>Russia</b>	2.08	3.21	54.5%	8.7%
<b>Brazil</b>	4.46	6.02	35.0%	17.2%
<b>China</b>	41.19	56.25	36.5%	45.7%
<b>India</b>	1.20	2.33	93.3%	2.0%
<b>USA</b>	49.43	60.36	22.0%	24.0%

\*Data from 2006 for China

Source: World Broadband Statistics Report, CIA

USA is the world leader in total number of subscribers coming top with 60.4 million subscribers, followed by China with 56.3 million subscribers. The gap between the USA and China is narrowing it is almost certain that China will be catching up with the USA very soon. The Broadband market in Russia is growing at very high rates, 54% last year. According to the Ministry of IT and Communications, the wireless broadband market shows about 61% annual growth. As the demand for broadband connections far exceeds the number of connections that can be made available, great potential for growth exist in the budding broadband market in Russia<sup>20</sup>.

## ▪ Triple play

The triple play service is a marketing term for the provisioning of the two broadband services, high-speed Internet access and television, and one narrowband service, telephone, over a single broadband connection. Triple Play focuses on a combined business model rather than solving technical issues or a common standard<sup>21</sup>. Sistema, the largest private sector consumer services company in Russia and the CIS, and an active player in the Russian telecommunications market was the first company launching triple service in Russia. Sistema holds shares in Comstar-UTS (59%), MTS (53%), Sky Link (50%), MTT (43%), MGTS (33%) and Svyazinvest (25%)<sup>22</sup>.

There are some cable TV and telephone providers who offer internet in addition to their TV or telephone packages but the triple player market is poorly developed with a great potential for growth.

## ▪ Internet Costs

Broadband providers offering 1GB traffic with 512 Kbit speed request USD 30 – USD 50 per month. Modem Internet is cheaper and costs RUB 30 (USD 1). However, the maximum connection speed you'll get is 33600 bps. Prices for internet access in internet cafes vary between RUB 30 – RUB 60 per hour (USD 1 – USD 2). Most operators offer additional services and a reduced price is charged during the night and for students<sup>23</sup>.

<sup>20</sup> Point Topic (2007)

<sup>21</sup> Wikipedia

<sup>22</sup> Point Topic (2007)

<sup>23</sup> Waytorussia.net

### ▪ **Hard- and Software market**

The hardware accounts for around 65% of total revenues generated by the Russian IT market, with software and services being much less developed. Anyway, there is a huge growth potential in the Russian IT hardware market, which saw impressive growth last year.

The Russian Software Development market is a key player in international software outsourcing competing with the largest players in the market such as India, China, and Ireland. In Russia, its main advantage is the generally high level of education of its workers especially in the science and engineering fields. Russia's IT exports are mainly focused in the software industry. This market is significantly underleveraged. The niche packaged software companies are:

- **ABBYY Software House** - 2nd largest global optical character recognition (OCR) software producer, with 10-20% share in some European markets  
Year of Foundation: 1989  
Turnover (1998): USD 2.5 mil  
Number of employees: 600
- **Kaspersky Lab** - Top 10 global seller of anti-virus software  
Year of Foundation: 1997  
Turnover (2007): USD 80 mil  
Number of employees: 700
- **1C** - Number 1 accounting software company as well as dominant gaming developer and producer  
Year of Foundation: 1991  
Turnover (1998): USD 180,000 per person per year sales  
Number of employees: 500

Software Piracy in Russia continues to be a major inhibitor to the ICT market. The piracy rate has steadily dropped over the past ten years according to the Business Software Alliance, reporting an 87% rate in 2002. As of January 2004, piracy is down to 79%<sup>24</sup>.

### ▪ **IT Programming**

In Russia, the three main cities with concentrations of IT programming activity are Moscow, St. Petersburg, and Novosibirsk whereas software companies mainly focus on the big domestic market in Moscow. St. Petersburg has the best geographic location of the three as it is located close to several Scandinavian borders and has very little domestic market. Finally, Novosibirsk is in the heart of Siberia. Built to be a dedicated scientific town, its remote geographic location and telecommunications difficulties are hard to overcome<sup>25</sup>.

Typical Russian programmer fees run between USD 20 and USD 35 per hour in comparison to USD 35 to USD 60 an hour an American might charge. However rates are still significantly higher than most Indian programmers earn for simple computer coding.

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<sup>24</sup> Waylett (2004)

<sup>25</sup> Waylett (2004)

#### 4.4 Special economic Zones for Technology Innovation

The residents of the technical-innovative zones are entitled to engage in development and sale of scientific and technological output, its adaptation to industrial use, including manufacturing, testing, and sale of test lots, development of software and other electronic systems, as well as providing services on implementation and maintenance of such output and systems.

The Russian government in its meeting of December 8, 2005 adopted a regulation on establishing four Technology innovation areas for a period of 20 years in St. Petersburg, Tomsk, Zelenograd (Moscow region), and Dubna (Moscow region)



Source: Federal Agency for Management of Special Zones

Each zone has its own fields of specialization:

- **Dubna** will specialize in Information, nuclear and physics technologies. This zone is focused on the development of software products; information generation, processing and delivery systems; and the engineering of electronic equipment and computer parts.
- **Zelenograd** will specialize in micro and nanoelectronics. This zone is meant to boost the development of micro-system equipment, integrated optics products, optical electronics, and intelligent navigation systems.
- **Tomsk** will specialize in Industrial electronics and bio-technologies. This Special Economic Zone (SEZ) will be created to develop information and communications technologies.
- **St. Petersburg** will specialize in analytical instrument engineering. This zone will be created to promote the development of software products, multi-purpose communications equipment, and household radio-electronic equipment and automated control systems.

Besides technological zones there are several other zones aiming to improve the manufacturing, tourism and high-tech industries, production of new types of output, and development of the transportation infrastructure:

- **Industrial production SEZ:** production of consumer appliances, electronics and machinery, components for the automotive industry and petrochemicals.
- **Tourist Innovative SEZ:** provide the development of tourism, and health and recreational resorts.
- **Port SEZ:** responsible for the development stimulation of harbour equipment and the development of harbour services.
- **Tax incentives for IT companies**<sup>26</sup>
  - For the residents of the technical-innovative zones the unified social tax paid per employee is reduced from 26% to 14%
  - The residents of the SEZs are discharged of the property and land taxes for five years
  - In the event of tax changes worsening the business position of the residents, such taxes do not apply to the residents of the SEZ's (except excisable goods).
  - Goods imported to the SEZ's are not subject to customs duties and VAT.
  - VAT: In case the sales of computer programmes and databases developed in Russia are customized and modified abroad, the outsourcing business is not taxable in Russia
  - The residents of SEZ's are allowed to write off costs for R&D without limitation

To enjoy the benefits of technology zones, it is necessary to be a resident of this SEZ and to fulfil certain conditions: The company needs to generate more than 70% of its total income from IT services and have not fewer than 50 employees on its payroll. The SEZ tax regime is not feasible for companies who have already established their presence through renting offices or the purchase of property in a particular location but only to new Greenfield sites

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<sup>26</sup> Ruslan Vasutin, Ekaterina Kosheleva (2006)

## 5. PERSPECTIVES

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ICT is an important component for the growth and development of any country. In Russia it is well supported by the government through high ICT expenditures, politically stable conditions, special economic zones for technology innovation, provision of venture capital and taxation breaks.

The well-educated, skilled and cheap workforce, as well as intensive scientific and engineering expertise is the biggest advantages for competition in the global ICT market. Interest rate, inflation and exchange rate has stabilized in the last years and the Russian Stock exchange is attracting more and more foreign Investors. These led to an enormous and stable growth and enable opportunities for businesses in Russia.

While the FDI inflows in India, China or Brazil remained unchanged Russia represented the greatest percentage of growth in FDI Inflows among the emerging countries. The new Tax Code with more transparent tax laws and internationally low tax rates played a major role making Russia attractive for foreign Investors. The ICT Sector will drive the future FDI that Russia receives. Even though consumption trends in ICT vary across regions and segments, market is still far away from saturation and the industry continues to show enormous growth potential, especially in the fields of Computer production, software development, Internet and services, Broadband technologies, triple play market, 3G networks, mobile phone equipment and satellite systems.

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