

European Investment Bank (Ed.)

Research Report

Small and medium entrepreneurship in Russia: Luxembourg, 7 November 2013

Regional Studies and Roundtables

Provided in Cooperation with:

European Investment Bank (EIB), Luxembourg

Suggested Citation: European Investment Bank (Ed.) (2014) : Small and medium entrepreneurship in Russia: Luxembourg, 7 November 2013, Regional Studies and Roundtables, European Investment Bank (EIB), Luxembourg

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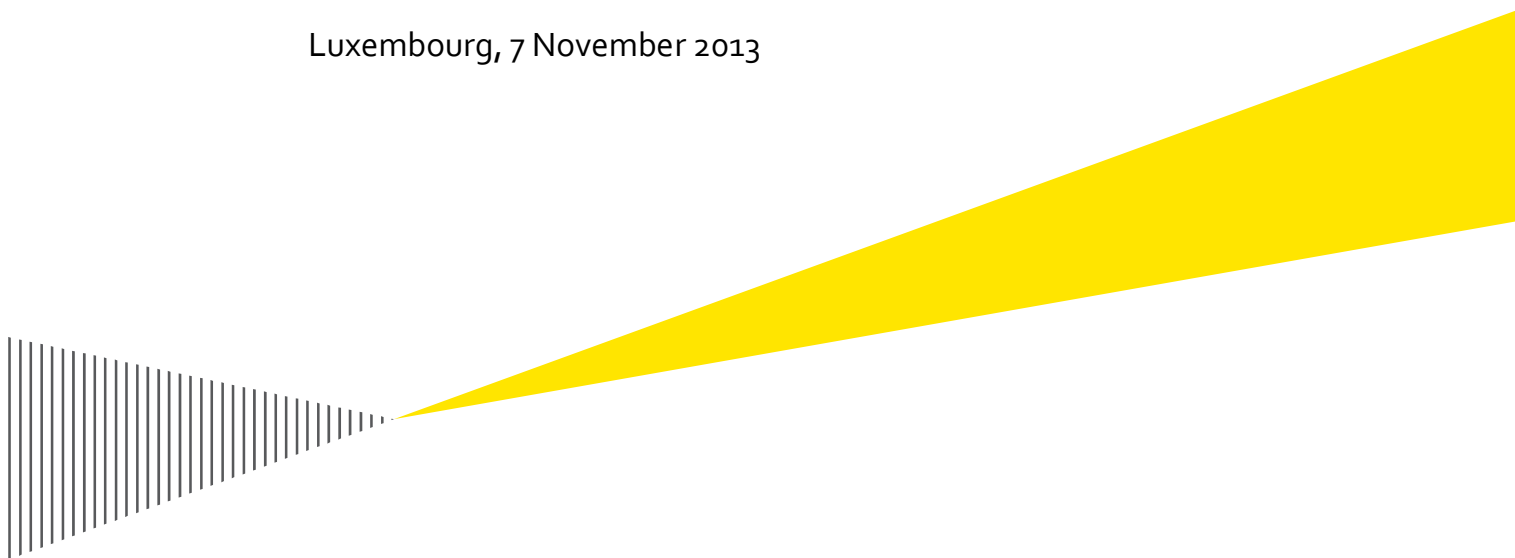


Small and Medium Entrepreneurship in Russia

November 2013

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This Report was prepared for the purposes and financed by the European Investment Bank. Ernst & Young (CIS) B.V. (Moscow branch office) takes responsibility for the content of this Report solely towards the European Investment Bank.

1. Objectives of the study

The main objectives of this study are to describe the current position of small and medium entrepreneurship in Russia, to show the market for SME financing and to define the ways European Investment Bank can influence it.

The current position of small and medium entrepreneurship includes:

- involvement of legal status of SME in Russia
- contribution of SME to socioeconomic development of Russia
- SME sector dynamics with respect to different indicators

The market for SME financing includes:

- demand for financing from the borrowers side, including key obstacles
- supply of financing, including instruments, major players and projections
- state support and activities of international development institutions

The ways European Investment Bank can influence SME financing market include

- hypotheses and scenarios of possible positioning in the market
- assessment of those hypotheses/scenarios

2. Executive summary

This study was prepared for the European Investment Bank (EIB). The objective of the study is to assess the financing needs of SMEs in Russia and identify the market failures. In addition to senior debt, which is the main instrument currently available to the EIB in Russia, the study also examines the needs for risk-bearing instruments (including subordinated debt and risk capital) as well as SME loan guarantees and other financial instruments, and the contribution of capital markets.

The study is based on the best available and actual data from the following sources: state statistics, state SME full coverage review 2010, reviews of analytical agencies, industrial surveys, surveys of non-state SME associations, companies' financial reports, national enterprises database SPARK, EY research studies and proprietary data bases on banking and SME sectors.

The SME sector in Russia has steadily grown since 2005, both in terms of SME number and turnover. Nevertheless, the current share of SME in GDP is estimated at 20-25%, which is not only significantly lower than in developed countries, but incomparable to developing ones as well. This fact, as well as the SME regional and industrial structure, shows the underdevelopment of the sector.

Industrial structure of Russian SME segment indicates the underdevelopment of certain industries: more than half (57%) of SME turnover falls within the trade sector. Manufacturing accounts for 11.5% of total turnover, construction – 11.0% and real estate – 9.7%. Together these four sectors amount to approximately 90% of SME turnover. The share of every other sector does not exceed 5%.

Regional structure of Russian SME segment demonstrates uneven distribution of SME turnover: approximately 80% of SME turnover is located in the European part of Russia, with 48% of total SME turnover coming from the Central and North West Federal Districts. Additionally, SMEs located in Moscow and Saint Petersburg generate 18% and 7% of total turnover, respectively.

One of the key constraints to SME development is low availability of financing. Further analysis identified key groups of SME requiring financial support with total number of SMEs in these groups being over 1 mln.:

- mature industrial (including innovative) SMEs
- un-bankable developing SMEs¹
- beginner individual entrepreneurs²

¹ SME's which have no access to bank financing due to various obstacles, for example, high borrowing cost, lack of collateral etc.

² Persons who commence their own business - start-up project

Key financial instruments available on the Russian SME market are: bank loans, leasing, factoring, microfinance, private equity. The most popular source of SME financing is bank loan (27%). Second and third by popularity are borrowings from relatives and friends (19%) and trade credit (17%). Leasing, factoring and others are not widely popular. Most common purposes of using external financing are investment purposes (equipment, transportation vehicles, etc.) and working capital - 55% and 47% respectively. None of the other purposes exceeded 10%.

The share of total SME financing by institutional investors and total number of SME organizations will increase in the future. The main driver of this is the political will of the state. SME business in Russia is one of top priorities for the Russian government. Doing Business research was chosen as an indicator of SME sector development. According to the most recent report *Doing Business 2014*, the Russian government measures implemented in 2012-2013 helped Russian Federation to move up 20 positions, one of the top-5 biggest improvements in 2013. The goal set by the government is to reach the top-20 by the year 2018.

State support for small and medium businesses is conducted through a variety of channels: SME Bank (total support of EUR2.3 bln.), regional guarantee funds (EUR1.1 bln. guarantees), regional governments (EUR451 mln. of support in 2013), etc.

The significance of SMEs for the Russian economy also attracts international players to the sector. Key international development institutions acting in this field in Russia are European Bank for Reconstruction and Development (investment portfolio of EUR9.7 bln), International Finance Corporation (invested EUR7.6 bln since 1993) and KfW Bankengruppe (targeted loans of EUR200 mln)

Despite steady growth of SME financing market recently, the comparison of SME financing market figures of Russia with Europe shows considerable potential for growth of banking and nonbanking financing to SMEs. The majority of SME financing markets in Russia are in the developing or emerging stage and there is potential for international financial institutions to make a considerable impact on the economy by enhancing financial services to the SME sector.

Accordingly, EIB faces a set of scenarios, which imply various degrees of involvement and commitment to the SME sector in Russia. The chosen scenario will also define the degree of impact EIB will ultimately have on the Russian SME sector.

3. Methodology and assumptions

The report is based on the desk research and analysis of information and data available from open sources, EY project experience as well as the opinion expressed by EY internal and external experts. The following sources of information were used for different sections of the report:

- Legal framework: federal laws on small and medium entrepreneurship, mortgage-backed securities and bill on securitization of financial assets; information on volumes of issued MBS is taken from www.rusipoteka.ru, data on new mortgage loans – from www.cbr.ru; information provided by the Association of regional banks
- SME sector development: the information is taken from annual statistical observations “Small and Medium Entrepreneurship in Russia”, including the complete statistical observation of 2010
- SME financing – demand: the information is taken from 2012 OPORA Regional Index (this report assesses conditions of SME development)
- SME financing – supply: the information is taken from Russian analytical agencies and Russian Venture Capital Association
- Information on key players in the Russian SME lending market is taken from publicly available sources, including the Central Bank of Russia (CBR) and IFRS reports of these organizations
- Information on state support to SME is taken from research agencies and the state-controlled SME Bank, subsidiary of Vnesheconombank (VEB)
- Information on support of international development institutions is taken directly from these institutions

All currency values in the document are given in euros and sometimes in rubles. In places where values are given not in originating currency the conversion factor RUB/EUR= 40.0 was used.

4. Legal framework

4.1 Description of government policy objectives and instruments for the SME sector

The starting point of the development of state support to small business was 1989, when the Unity of Small State Enterprises in USSR was created. In the modern history of Russia the state support for SME received its legal framework in 1995 with the adoption of Federal Law No. 88-FZ on *State Support for Small Business in the Russian Federation*. This law set the framework for state support to small business in Russia, forms and methods of state stimulation and regulation of small business activity. It also set criteria for enterprises to be considered small-sized companies (for more details please see the Appendix 1).

Federal Law No. 209-FZ on *Developing Small and Medium Scale Entrepreneurship in the Russian Federation* replaced the previous 88-FZ, entering into force on 1 January 2008. It was mentioned in the bill's explanatory note that law 88-FZ became outdated due to the conditions of the Russian economy and current state of the Russian legislation. Moreover, a number of articles were eliminated from the earlier law that made it almost unenforceable and substantial limitations on the development of small business were applied. Besides, the previous law regulated only the development of small business, but international (including European) experience also devotes attention to medium-sized companies. Thus, a new law needed to be proposed to regulate not only small, but medium entrepreneurship also.

One of the most important innovations in the law was a conceptually new definition of small business (see Section 4.2). For the first time the terms "medium entrepreneurship", "microenterprises" and "infrastructure for support to SME" were introduced, defining methods of support to various forms of SME.

Among the main objectives of governmental policy in the field of SME development are:

- creating a competitive environment in the economy
- fostering favorable conditions for SME development
- increasing the number of SMEs
- supplying jobs for the population and developing self-employment
- increasing the share of SME in GDP
- increasing the share of taxes paid by SMEs in tax revenues

The law specifies measures that may be envisaged by federal laws and other legal acts for the purpose of implementing state policy in the area of SME development:

- special tax regimes, simplified tax record-keeping rules, simplified tax return forms for specific taxes and fees for small enterprises
- a simplified bookkeeping system for small enterprises pursuing certain types of activity
- a simplified procedure for SME when drawing up statistical reports
- a privileged procedure for settlement of accounts for state and municipal properties privatized by SME
- the details of participation of small businesses as suppliers (performers, contractors) for the purpose of placing orders for the delivery of goods, performance of works and provision of services for state and municipal needs
- measures for safeguarding the rights and lawful interests of SME when state regulation (supervision) is performed
- measures for the provision of financial support to SME
- measures for the development of an infrastructure for supporting SME

An application-only procedure should be used by SME subjects in order to receive support from federal or local bodies. The following organizations are excluded:

- credit organizations, insurance organizations (except for consumer cooperatives), investment companies/trusts, non-state pension funds, professional participants in the securities market or pawn-shops
- parties to production sharing agreements³
- pursuing entrepreneurial activities in the gambling business
- non-residents of the Russian Federation, except for the cases specified by international treaties of the Russian Federation

³ In accordance with Federal Law of December 30, 1995 N 225-FZ "Production Sharing Agreement" is a contract under which the Russian Federation provides business entity (the investor) on a reimbursable basis, and for a certain period of exclusive rights for exploration, extraction of minerals in the subsoil and to conduct related activities, and the investor undertakes to conduct these works at his own expense and risk.

Moreover, financial support cannot be rendered to small and medium businesses that manufacture and sell excisable goods (such as tobacco and alcohol), and also mine and sell mineral resources.

Support to SME and to organizations constituting the infrastructure for supporting SME includes:

- financial support in the form of subsidies, budget investments, state and municipal guarantees for the obligations of SME and the organizations constituting the infrastructure for supporting SME
- property support
- information support
- consultative support
- support in the area of training, re-training and upgrading employees qualifications
- support in the area of innovation and industrial production and craft
- support of export-oriented SME
- support of agricultural SME

4.2 Definition of SMEs

According to Law 209-FZ, legal entities, individual entrepreneurs and peasant farms are deemed to be small or medium businesses if they meet three criteria regarding ownership structure, workforce and volume of revenue. Key components of SME classification in Russia are similar to those used in EU (please see figure 1):

1. **Ownership structure:** SME's stake held by one or several legal entities, which are not small or medium businesses, should not exceed 25%
2. **Workforce:** Number of employees should not exceed **250 people**
3. **Volume of revenue:** Annual turnover should not exceed **25 euro mln**

Figure 1. SME Segmentation

SME Segmentation				
	Russia		EU	
	Revenue (eur mln)	Number of employees	Revenue (eur mln)	Number of employees
Medium	10-25	101-250	10-50	50-250
Small	1.5-10	15-100	2-10	10-50
Micro	<1.5	<15	<2	<10

These limits (regarding revenue only) are set by the Government of the Russian Federation once every five years. The most recent decision came into effect from the beginning of 2013 (please see figures 2-3 for details).

Figure 2. SME definition: workforce

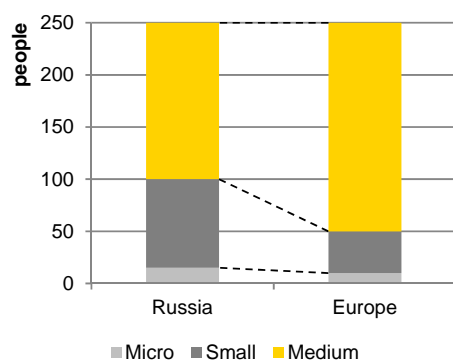
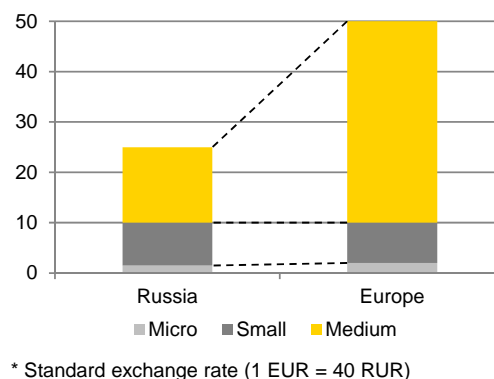


Figure 3. SME definition: revenue, EUR mln*



The law (209-FZ) also specifies the frequency of observations of SME activities. There are two approaches:

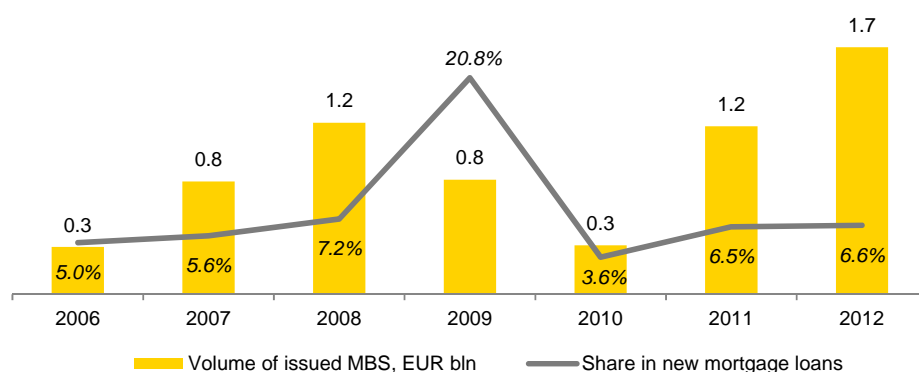
- **complete statistical observation** is carried out once every five years
- **selective statistical observation** is carried out on the basis of representative sampling
 - monthly and/or quarterly for small (except micro) and medium enterprises
 - annually for microenterprises

4.3 Legal framework for securitization

Currently in Russia securitization issues can be backed only by mortgages. The corresponding law, No. 152-FZ on *Mortgage-Backed Securities (MBS)*, was passed in 2003. However, due to a number of defects, the first securitization occurred only in 2006. Since then, the total volume of issued MBS is equal to approximately RUB300 bln (EUR7.5 bln).

Except for a short decline in 2009-2010 (see figure 4) this market continues to evolve rapidly. While in the early stage, the main issuers of bonds were the state-owned Agency for Housing Mortgage Lending and VTB Bank, now among them there are also private and even foreign-owned banks in Russia such as Unicredit, Raiffesen and Societe Generale.

Figure 4. Evolution of mortgage-backed securities market



It is now clear that other types of assets, such as consumer loans, car loans and loans to SME can be considered collateralized and then sold to the market. In order to run this mechanism, certain changes in legislation should be adopted. This work started in 2009 when the bill on *Amendments in Certain Statutes of the Russian Federation (in part of regulating financial assets securitization)* was introduced to the State Duma. It was passed in the first reading, but the further steps were postponed.

Now that President Putin has set as an objective reducing interest rates for small- and medium-sized companies, the bill has been recalled and it will likely be passed in autumn session. The Ministry of Finance has noticed that it will be possible to collateralize different types of assets, but loans to SME are of most importance. The Ministry also believes that there will be a demand for such securities in the market, noting that from 1 January 2014 foreign investors will gain access to Russian corporate bonds through familiar international depositories Euroclear and Clearstream.

In June 2013, Chairman of the Central Bank Elvira Nabiullina considered the mechanism of refinancing banks under security of SMEs loans. But in this case, it would be necessary to use the mechanism of state guarantees or warranties of regional funds.

5. SME sector development

5.1 Number of SMEs and contribution to employment

Development of the SME segment is one of the key elements in the sustainable economic development of Russia. Currently, the share of SME in GDP is estimated at 20-25%, which is not only significantly lower than in developed countries, but in comparable developing ones as well. The number of SMEs per 1000 people is 2.5 times lower on average than in Europe (as represented by EU-27 countries, see Figure 5). Employment in the SME segment is 1.7 times lower on average than in Europe (measured as a share of total employment, see Figure 6). All these factors support the considerable growth potential of the SME segment in Russia and its strengthening role in the economy. Due to these factors, we also anticipate increasing demand for financing in the SME segment.

Figure 5. Number of SMEs⁴ per 1 000 of population (2011)

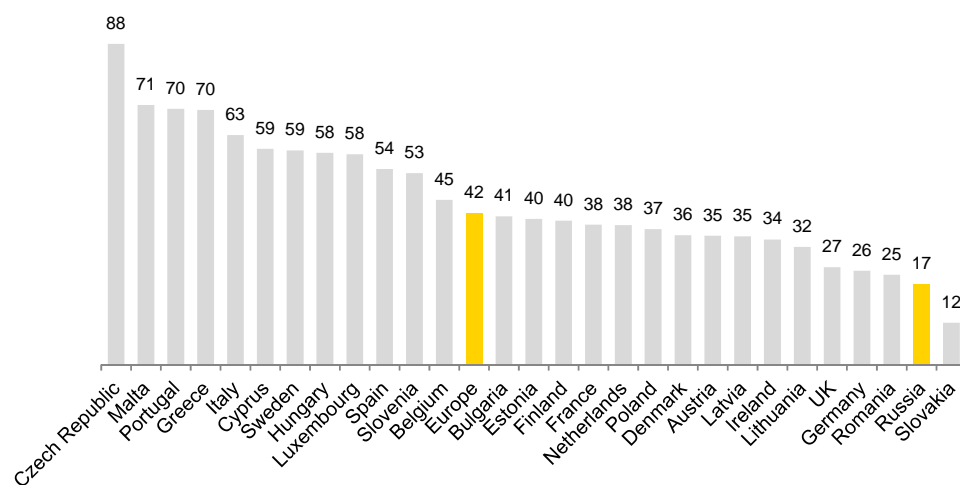
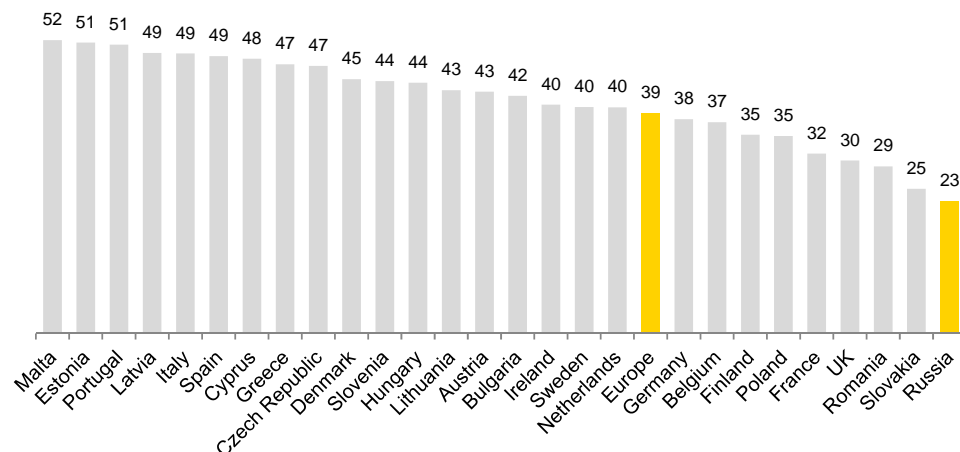


Figure 6. Employment in SME (% of total employment, 2011)



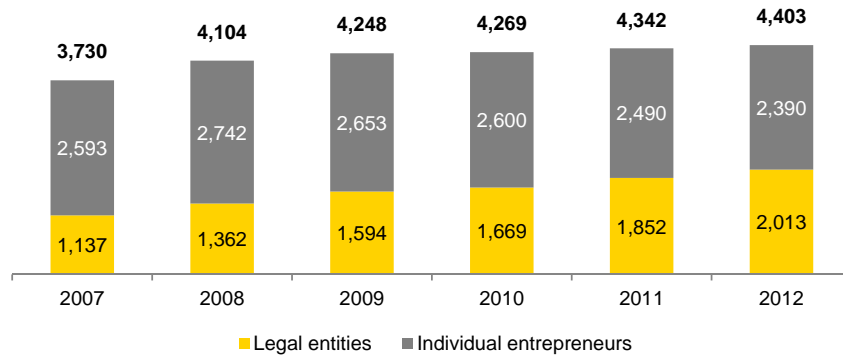
⁴ The number of active SMEs in Russia is taken from EY survey (conducted in partnership with SME Bank).

The Federal State Statistics Service carries out both observations of SME activities mentioned before – complete and selective. The last complete statistical observation was conducted in 2010 and its results were published in 2012. These observations form the basis for analysis of SME activities and landscape.

5.2 SME sector dynamics

Starting from 2004, the total number of small and medium enterprises has grown by almost 30% from 3.4 mln to 4.4 mln (see Figure 7).

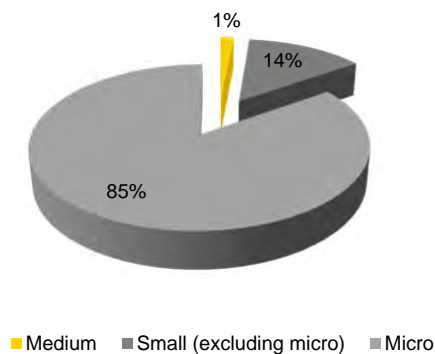
Figure 7. Number of SMEs, in thousands



After adoption of a law (effective from 1 January 2013) that doubled obligatory social tax (contributions to Russian pension fund and to obligatory medical insurance fund), from RUB17,208 (EUR430) to RUB35,665 (EUR892), more than 500,000 individual entrepreneurs have cancelled their registration with authorities. This reduction will significantly affect the statistics for 2013. A new law that decreases the social tax amount for individual entrepreneurs has been passed and is waiting for President's signature. It will come into effect from 1 January 2014. These turbulent changes make it difficult to project the dynamics even for the near future.

In contrast, the number of legal entities has steadily grown and nearly doubled for the period 2007-2012. It should be noted that before 2008 the data include only small-sized companies. After adoption of 209-FZ, from 2008 it also includes medium enterprises. As can be seen from Figure 8, the proportion of medium-sized companies is about 1%. The majority of SMEs are microenterprises (85%). The rest, 14%, constitute small-sized companies that are not considered microenterprises.

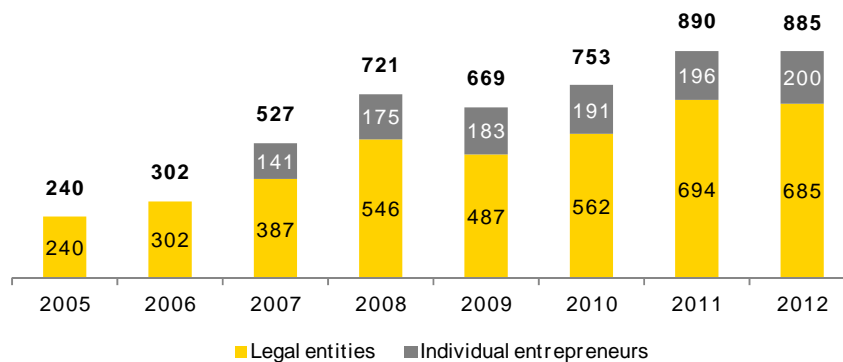
Figure 8. SME structure: legal entities



5.3 Turnover

Turnover of small and medium enterprises has steadily grown during the post-crisis period (starting from 2010). Stagnation was indicated in 2012 (figure 9). We still need to see whether or not the results of increasing government support will lead to increased SME turnover in 2013.

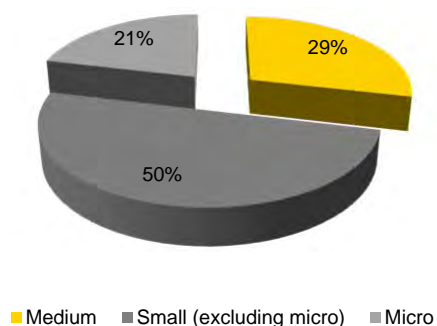
Figure 9. SME turnover, EUR bln*



* Standard exchange rate (1 EUR = 40 RUR)

Although microenterprises comprise the majority of SMEs, their proportion in total turnover is only 21%. Half of total turnover is coming from small (excluding micro) enterprises. Another 29% of turnover falls within medium-sized companies (please see figure 10 for details). It is largely due to the high proportion of inactive enterprises of the total number of SME; it is approximately 23% for legal entities and 34% for individual entrepreneurs⁵ in 2010 and now share remains on high level.

Figure 10. SME turnover (legal entities): structure

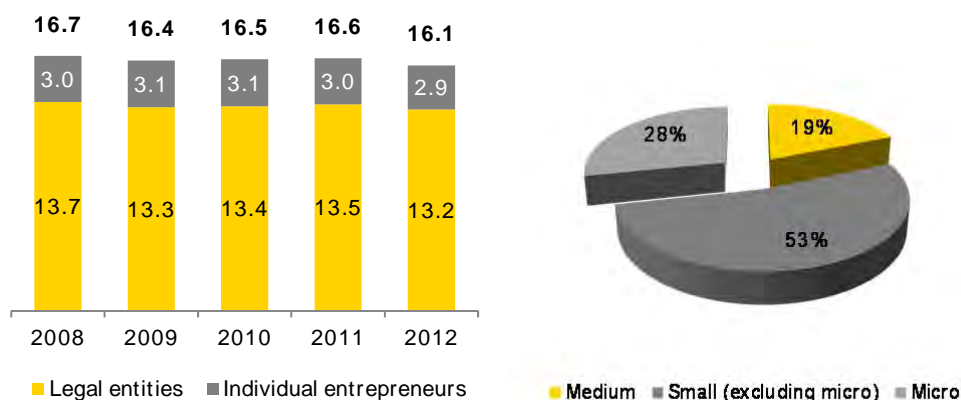


⁵ According to the report of the Rosstat (the Russian Federal State Statistics Service) "The complete federal statistical observation of the activities of small and medium-sized businesses" which was published in 2012 for the year 2010.

5.4 Employment

In 2012 approximately 13.2 mln people were working in SME (only in legal entities). Taking into account individual entrepreneurs with 2.9 mln employees, the total employment in Russian SMEs is 16.1 mln people, which is 23% of the total number of employees in Russia (please see figures 11-12 for details).

Figure 11. Employment in SME, millions of people Figure 12. Employment in SME (LE): structure in 2012



5.5 Breakdown of SMEs by sector

More than half (57%) of SME turnover falls within the trade sector. Manufacturing accounts for 11.5% of total turnover, construction – 11.0% and real estate – 9.7% (please see figure 13 for details). Together these four sectors amount to approximately 90% of SME turnover. The share of every other sector does not exceed 5%.

Figure 13. Breakdown of SME turnover by industry

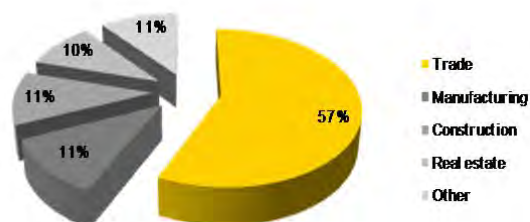
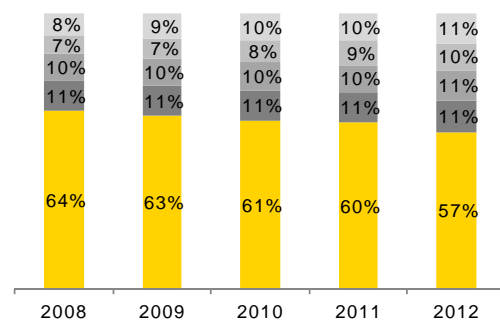


Figure 14. Industry turnover structure dynamics



As it can be seen from Figure 14, the share of the trade sector has decreased since 2008 from 64% to 57%. In the meantime, the share of real estate has increased by 3 percentage points. The share of other sectors did not change by much. In terms of revenue growth, real estate revenue has grown by 85% since 2008, transport and communication – by 56%, agriculture – by 49% and construction – by 44%.

As for the number of active SMEs, the majority of them are in the trade sector (but the share is lower than in terms of turnover). Fifteen percent of medium-sized companies come from agriculture, but their turnover is not high enough. Real estate is the second most popular sector for small and micro enterprises. The service share (including tourism) of total entities is about 20%.

Table 1. Number of active SMEs per sector (2010), thousands

Sector	Medium	Small	Micro
Trade	4.7	180.9	786.1
Manufacturing	3.1	45.0	166.6
Construction	1.8	50.4	201.1
Real estate	1.4	106.6	452.6
Agriculture	2.3	16.9	62.7
Transport and communication	0.7	28.6	119.8
Other	1.2	47.2	190.2
Total	15.2	475.6	1985.2

In terms of number of employees, the real estate sector is among the leaders – total growth of 29% in the period 2008-2011. The number of employees in transport and communication grew by 9% in the same period. At the same time, in trade, manufacturing, construction and agriculture the number of employees has decreased in this period with construction being the less attractive (-13%).

According to state statistics, 5.37% of small- and medium-sized companies implemented technological innovations in the manufacturing sector. The leading subsectors are presented in Table 2. Also, the research study "Indicators of innovative activities" performed by the Higher School of Economics shows that medium-sized companies innovate more (10-13%) than small-sized companies (3-7%) in relative terms.

Table 2. Percentage of companies that implement technological innovations in manufacturing

Electrical and optical equipment	13.51%
Chemicals and chemical products	13.01%
Transport equipment	6.72%
Refined petroleum products	6.56%
Rubber and plastic products	6.43%
All manufacturing	5.37%

The expenses of small companies spent on technological innovations are estimated at RUB10 bln (EUR238 mln). The majority (93%) of expenses on new technology are in the manufacturing sector, including RUB1.9 bln (EUR47.5 mln) in production of electrical and optical equipment, RUB1.5 bln (EUR37.5 mln) in food and beverage products and RUB1.1 bln (EUR27.5 mln) in chemicals and chemical product manufacturing.

State support for innovation is set in Federal Law 127-FZ from August 1996 *On Science and State Scientific-Technical Policy*. The forms of support are tax allowances, education services, information support, financial support and others. Financial support for innovative SMEs is done mainly through the state-owned SME Bank (VEB Group). While the share of loans to innovative SMEs in total lending volume is estimated at 5% (and the share of investment loans – at 18%), the share of loans from SME Bank to SMEs implementing innovation, modernization or energy efficiency solutions is 43% (in 2012). Currently, the state also draws attention to the borrowing costs of innovative SMEs. The near-term target is states that innovative SMEs should receive loans with an interest rate of no more than 10% in RUB, which is below current market interest rates for SMEs.

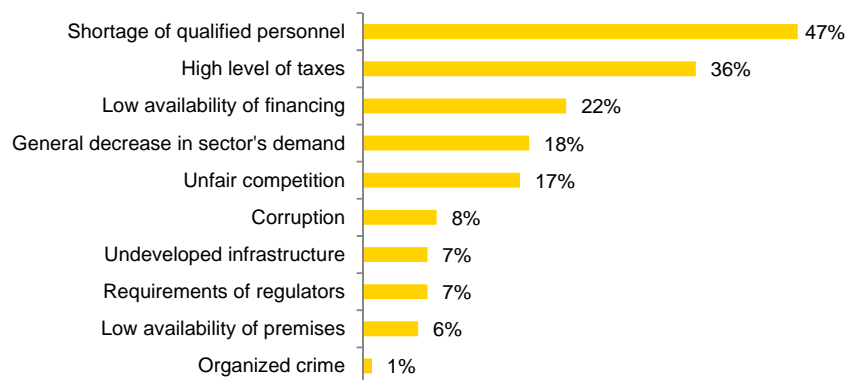
The main problem for company development in the manufacturing sector is a shortage of qualified personnel (indicated by 47% of respondents). The labor market cannot satisfy companies' demand, neither in qualified engineers and technical specialists nor in qualified workers.

It is a global tendency that despite high unemployment in the labor market, it is hard to recruit the right talent, including such EU countries actively struggling with skill shortages like Germany. Global shortages exist in areas such as engineering, energy production, infrastructure development and healthcare. It is highly unlikely that these shortages in Russia will be globally resolved with foreign workers due to language and other obstacles⁶. From the other side, the quality of such workplaces is not

⁶ According to the report "The Hays Global Skills Index 2013", prepared by the recruiting worldwide experts "Hays company" in partnership with Oxford economics.

high enough: low productivity does not allow companies to pay worthy salaries. High taxes (36%) and low availability of financing (22%) are the next major problems, which are also common to most small- and medium-sized companies in Russia (please see figure 15 for details).

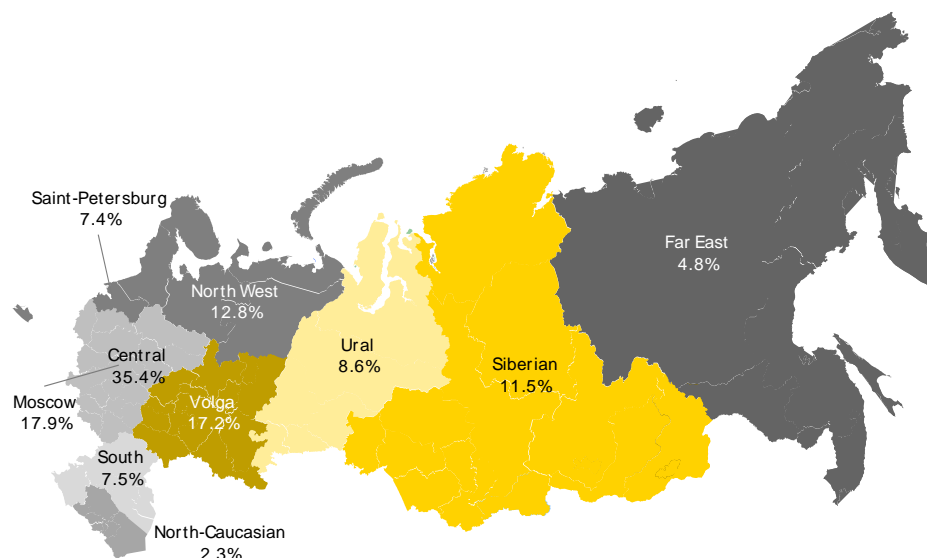
Figure 15. Key obstacles for companies' development in manufacturing sector



5.6 Breakdown of SMEs by region⁷

Approximately 80% of SME turnover occurs in the European part of Russia, with 48% of total SME turnover coming from the Central and North West Federal Districts (please see figure 16 for details). Additionally, SMEs located in Moscow and Saint Petersburg generate 18% and 7% of total turnover, respectively.

Figure 16. Breakdown of SME turnover by region



As can be seen in Table 3, in half of federal districts SME employment has fallen since 2008. The regions where it has increased are North-Caucasian (this region is under special state supervision after the war in Chechnya) and eastern (Asian) regions (which are also developing regions). The share of SME employment when considered against total employment is approximately 20% across all regions, except the North-Caucasian (where it is 9.2%).

In 2013 subsidies from the federal budget to regional budgets, with focus on support to SME, were RUB18 bln (EUR451 mln). The system of regional guarantee funds works in 79 Russian regions. The main goal of these funds is to assist small- and

⁷ The more detailed information regarding regional difference of SME is provided in Appendix 2

medium-sized companies in obtaining financing by providing guarantees with respect to loan agreements. More detailed information is given in Section 10.2.

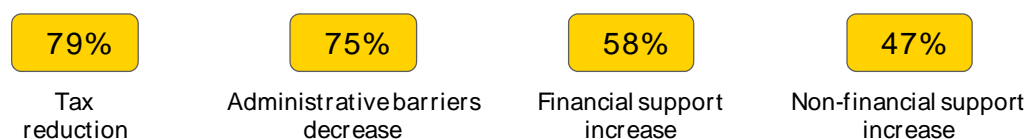
Table 3. Changes in SME: regional outlook

Region	Change in SME turnover (2008-2011)	Change in SME employment (2008-2011)	Employment in SME as a % of total employment in region (2011)
Central Federal District	+30.3%	-10.8%	20.2%
<i>particularly in Moscow</i>	<i>+28.4%</i>	<i>-30.2%</i>	<i>23.5%</i>
North West Federal District	+6.8%	-0.2%	22.2%
<i>particularly in St. Petersburg</i>	<i>+3.5%</i>	<i>-2.4%</i>	<i>27.9%</i>
South Federal District	+16.8%	-4.6%	17.7%
North-Caucasian Federal District	+80.5%	4.4%	9.2%
Privolzhsky (Volga) Federal District	+29.8%	-1.8%	19.7%
Ural Federal District	+18.5%	26.4%	19.5%
Siberian Federal District	+34.9%	9.1%	18.6%
Far East Federal District	+53.3%	8.9%	17.3%

5.7 Constraints on SME development

Small and medium business faces many problems that hinder its development. According to a recent survey by SME Bank, four main expectations of SMEs are presented in figure 17.

Figure 17. What do entrepreneurs expect from the government?



Tax burden is becoming a major obstacle for entrepreneurs. A doubling of the social tax for individual entrepreneurs from the beginning of 2013 resulted in 20-30% of entrepreneurs ceasing business operations in the first half of the year. Tax legislation fluctuates widely and tax administration is unduly difficult. Administrative barriers and corruption are the next obstacles for business. This is also confirmed by the 133rd place (among 176 countries) ranking in the 2012 Corruption Perceptions Index⁸ and 112nd place finish in the 2012 Doing Business ranking⁹. According to the latter, the most challenging procedures in establishing a new business are dealing with construction permits (178 place), getting connected to the gas and electricity grid (184 place) and trading across borders (162 place). The only positive side is enforcement of contracts (11th place).

More than half of entrepreneurs are calling for an increase of financial support to the SME segment. The current situation in this field can be characterized by limited access to finance, high costs of such financing and predominantly short-term loans available to business. About 20% of entrepreneurs use financing from relatives or friends. Meanwhile, banks remain the key source of financing for the SME segment. In turn, the key sources of cheap long-term financing to commercial banks are VEB and international development institutions. VEB provides financing to small and medium businesses through its subsidiary SME Bank. As of 1 January 2013, the volume of SME Bank's financial support to SME was approximately RUB90 bln (EUR2.25 bln), which is only 2% of all loans to SME provided by banks (and 5% on the market of long-term financing above 3 years). **Thus, there is strong potential for international development institutions to influence the development of the SME segment in Russia by providing financing.**

⁸ See <http://cpi.transparency.org/cpi2012/results/>

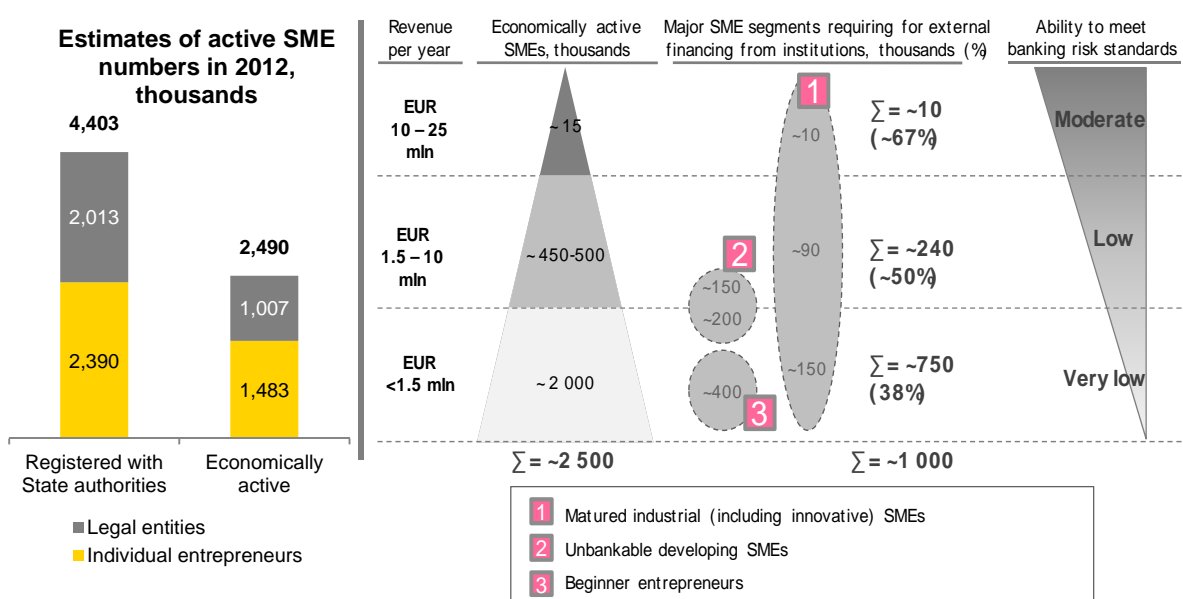
⁹ See <http://www.doingbusiness.org/rankings>

5.8 Need for financial support

Limited access to finance is not a problem for many small- and medium-sized companies due to the difference in the nature of business, stage of development, etc. Based on active SME distribution by size, sector, financial and business needs we identified key groups of SME requiring financial support and estimated the number of SME in each group. According to the analysis the key groups are (see Figure 18):

- **mature industrial (including innovative) SMEs (250 thousands):** primarily companies whose business is not related to trade. This segment has access to all types of financing, but the priority is given to long-term loans
- **un-bankable developing SMEs (350 thousands):** companies that are not able to obtain bank loans for different reasons (inability to provide high-quality collateral, need to submit financial statements, etc.). This segment is looking for sources of short- and long-term financing
- **beginner entrepreneurs (400 thousands):** microenterprises from all sectors of economy at the initial stage of development. They have limited access to funds, thus requiring financing

Figure 18. SME segments requiring external financing from institutions (current estimates)

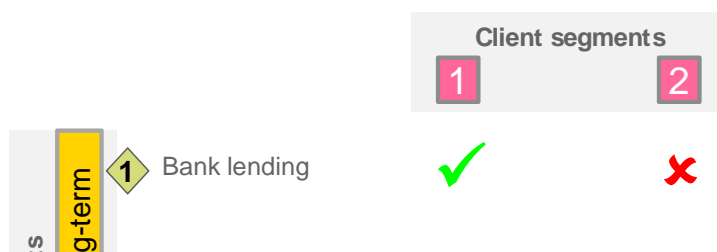


According to our estimations, about 1 million SMEs currently require external financing from institutions. The main financial instruments that can be used to address the needs of each category of SMEs are (please also see figure 19 for details):

- for mature industrial and especially innovative SMEs the primary instruments are long-term loans and equity financing
- for un-bankable developing SMEs the primary source of long-term funding is leasing and short-term financing, e.g., factoring, trade credit etc.
- for beginner entrepreneurs – microloans, i.e., small-sized, short-term loans

Figure 19. Key development opportunities

- 1 Matured industrial SMEs – Boosting long-term financing**
- 2 Emerging/ developing SME (all sectors) – Providing short-term financing opportunities**

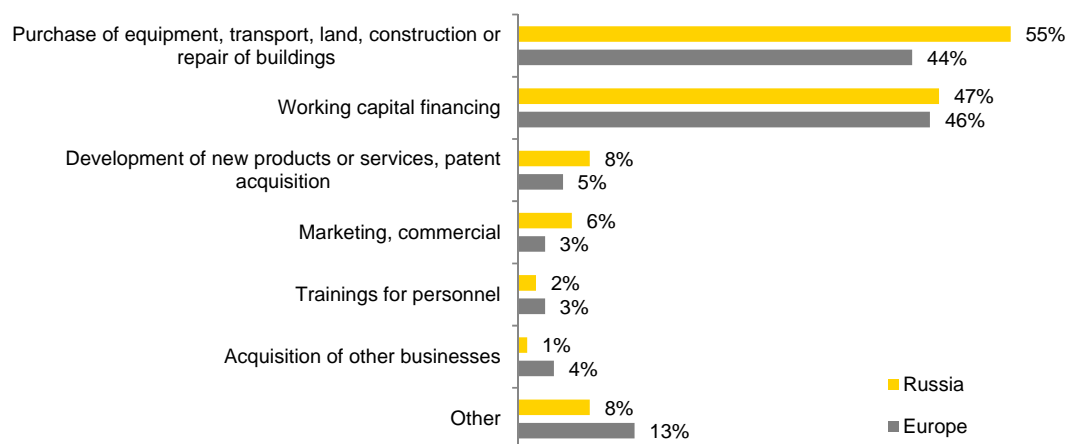


6. SME Financing: Demand

As it was mentioned earlier, limited access to finance is one of the major problems in the SME segment. Moreover, the problem has grown since the SME sector emerged in Russia, despite the government's efforts to increase the availability of financing.

OPORA Russia, a non-governmental organization for small and medium entrepreneurship, devoted close attention to the problem of SME financing in its recent OPORA's Index 2012. It surveyed more than 6,000 respondents from the manufacturing sector. According to the results of the survey (see figures 20, 21), 55% of SMEs use financing for investment purposes: purchase of equipment, transport, etc. Forty-seven percent of respondents finance their working capital. None of the other purposes exceeded 10%.

Figure 20. Purposes of financing usage, %¹⁰



The most popular source of SME financing, according to the analysis, is bank loan (27%). Second and third by popularity are borrowings from relatives and friends (19%) and trade credit (17%). Leasing, factoring and credit lines are not popular. A large share of financing from relatives or friends indicates the high potential for financial institutions to expand their activities into the SME sector.

Figure 21. Sources of financing, %



In 2012, only 25% of active SMEs applied for a bank loan at least once. More than 60% of entities did not apply because of sufficiency of internal funds or other reasons (please see figure 22 for details).

Fifty-nine percent of companies received a positive decision from banks and got the requested amount in full. Another 15% received less than they requested. Four percent of companies decided not to take a loan because of high interest rates. About 17% of requests were rejected by banks (please see figure 23 for details). In comparison with Europe, Russian banks reject requests for financing 1.5 times more often. Among possible reasons are stricter lending rules, stricter methods of claims selection (due to higher risks in the SME segment) and lower quality of requests (please see figures 25-25 for details).

Figure 22. Requests for bank loans (Russia)

- At least one request
- No request because of potential reject
- No request because of sufficient internal funds
- No request because of other causes
- Reject to answer

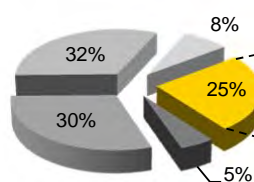


Figure 23. Bank decision (Russia)

- Obtaining of full requested amount
- 75-99% of requested amount
- Less than 75% of requested amount
- Rejection because of high borrowing costs
- Request is rejected by bank
- Reject to answer

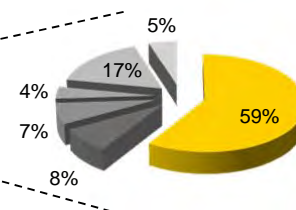


Figure 24. Requests for bank loans (Europe)

- At least one request
- No request because of potential reject
- No request because of sufficient internal funds
- No request because of other causes
- Reject to answer

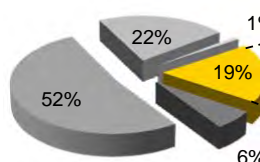
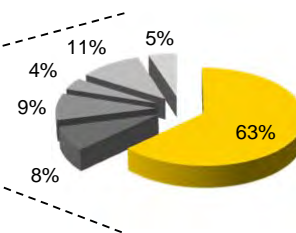


Figure 25. Bank decision (Europe)

- Obtaining of full requested amount
- 75-99% of requested amount
- Less than 75% of requested amount
- Rejection because of high borrowing costs
- Request is rejected by bank
- Reject to answer

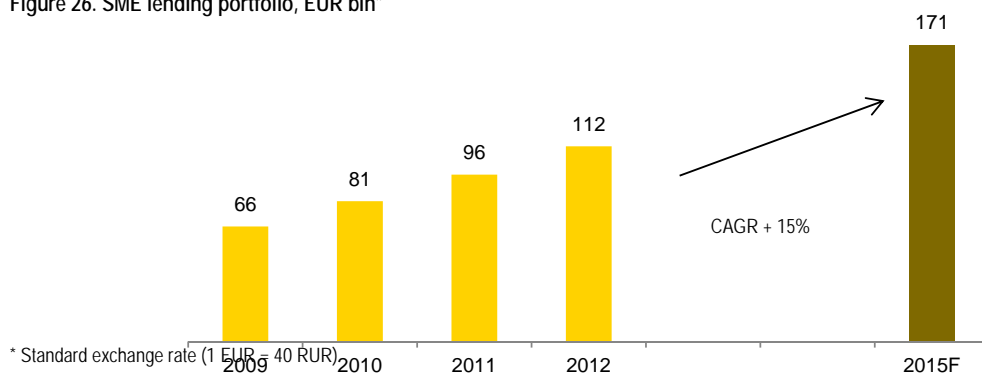


7. Supply of financing to SME, potential market growth and constraints¹¹

7.1 Bank loans

In 2012 the loan portfolio of Russian banks in the SME segment grew by 17% to RUB4.5 trln (EUR112.4 bln), which is lower than 19% in 2011 and 22% in 2010 (please see figure 26 for details). However, this growth rate is still higher than in large cap corporate business (11%), but significantly lower than recent growth rates in retail lending (39%).

Figure 26. SME lending portfolio, EUR bln*



Among the factors that contributed to slower growth were the decreasing risk-appetite of banks, increasing tax burden on small entities and general economic slowdown. Moreover, new rules on banks' obligatory normative calculations introduced by the Bank of Russia shifted the focus to retail lending.

Two main trends in the SME banking segment are "credit factories" and the provision of complex services to the client. "Credit factories", i.e., short-term low amount loans to SME, which are often non-collateralized, gave an advantage to the top banks in comparison to other banks.

Since net income from lending is decreasing due to net interest margin decrease, large banks are implementing complex services to the SME segment in order to increase non-interest income (i.e., commissions). While small banks can offer an individual approach to clients, large banks can provide individualized relationship based approach only to large businesses, thus the introduction of services with complex tariffs to help them compete in this environment.

A breakdown of disbursements by industry almost repeats the pattern in the SME segment. Half of the loans fall within the trade sector. More than 60% of loans were given with a maturity up to one year and this share has grown by 7% since 2011. Loans with a maturity of more than three years constitute 17%, and they were primarily issued by state owned banks (please see figures 27-28 for details). In 2012 banks focused on providing simple products to the SME segment while lending, which required a thorough analysis of business plans and industrial markets was sent to back. This happened because of banks' fears in anticipation of a liquidity crisis and stagnation in the economy. Development of credit factories further shortened the maturity of loans.

As the smallest part of banks' loan portfolio, the SME segment is characterized by the high proportion of non-performing loans in comparison to large business and retail lending. Moreover, since 2009-2010 the share of NPLs in large business and retail lending dropped by 40%, while in the SME segment it increased (from 7.6% in the end of 2009 to 8.4% in the end of 2012). This dynamic explicitly shows that banks still cannot properly estimate risks associated with the SME segment (please see figures 29-30 for details).

¹¹ The overview of the Russian banking market and trends are available in Appendix 4

Figure 27. Breakdown of disbursements by industry



Figure 28. Breakdown of disbursements by maturity

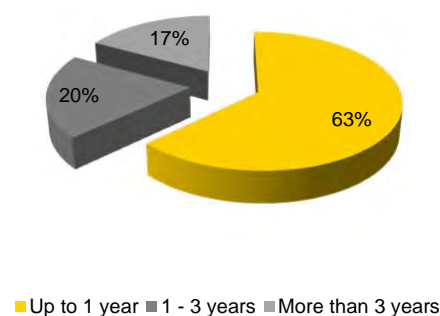


Figure 29. Non-performing loans in different segments

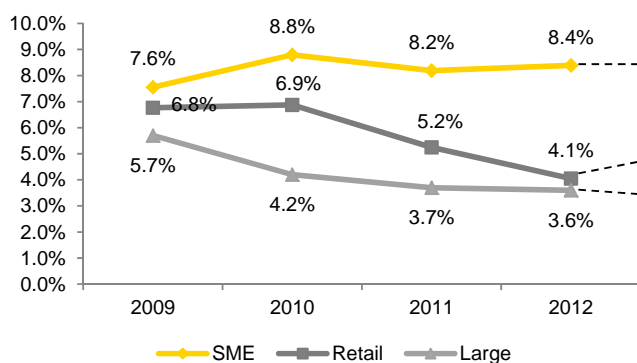
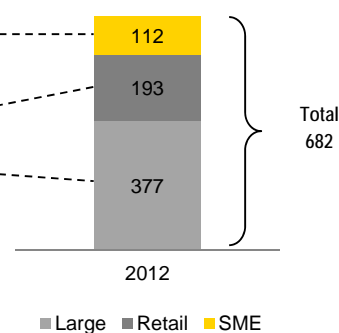


Figure 30. Loan portfolios of banks, EUR bln*



* Standard exchange rate (1 EUR = 40 RUR)

Significantly higher risks in SME sector (compared to retail and corporate) drive the interest rates of the SME loans. Table 4 demonstrates minimum and maximum interest rates (average market numbers). Vast majority of loans is provided in RUR (95.4%).

Table 4. SME loans average interest rates

Currency	Interest rate	
	Min.	Max.
RUR	12%	19%
USD	7%	13%
EUR	7%	14%

Table 5. SME loan volumes by currency

SME loan volumes in 2012	Volume, EUR bln*	Share, %
RUR	107.2	95.4%
USD	4.8	4.3%
EUR and other currencies	0.3	0.3%
Total	112.3	100%

Key loan types on the Russian market are: working capital loans, unsecured loans, overdrafts, investment loans and others. Table 6 shows the average range for loan tenor, amount and interest rate in the market.

Table 6. Key characteristics of SME loan types (market average)

Loan type	Loan tenor, months		Loan amount, EUR thousands*		Interest rate, %	
	Min.	Max.	Min.	Max.	Min.	Max.
Working capital financing	5.1	33.4	65	3338	12.8	18.1
Unsecured loan	3.9	25.6	58	330	15.9	20.1
Overdraft	4.1	12.3	58	973	12.3	15.6
Investment loan	13.7	78	285	4068	13.3	18.1
Other loans	18	45	10	900	12.6	17.5

* Standard exchange rate (1 EUR = 40 RUR)

At the same time certain banks offer loan terms, which significantly vary from the average. For example, Investment loans in certain banks have the highest maximum tenor of up to 10 years; other loan types have maximum tenor of 2-3 years; lowest minimum tenor for all types of loans is 1 month. Lowest minimum loan amount can be 2.5 EUR thousands (unsecured loans), while maximum is 250 EUR mln. (Investment loans). Interest rate for all types of loans is similar and can vary from 7.75% to 35%.

One of the key barriers for a SME to obtain a loan is the absence of proper collateral. It is also one of the key factors defining loan interest rate. The most commonly used type of collateral is real estate - it is accepted by 100% of banks. Goods for sale and miscellaneous assets are accepted by 87.5% and 70.8% of banks. Only 5% of banks accept guarantees as collateral, these are the top players in the market (please see figure 31 for details). "Other" types of collaterals are movable assets and receivables pledging. For example, Uralsib bank (top-5 by SME portfolio) takes following types of collaterals: goods for sale, equipment, vehicles, real estate and land, sea and river transport, bank debts.

Figure 31. Types of collaterals in SME loans

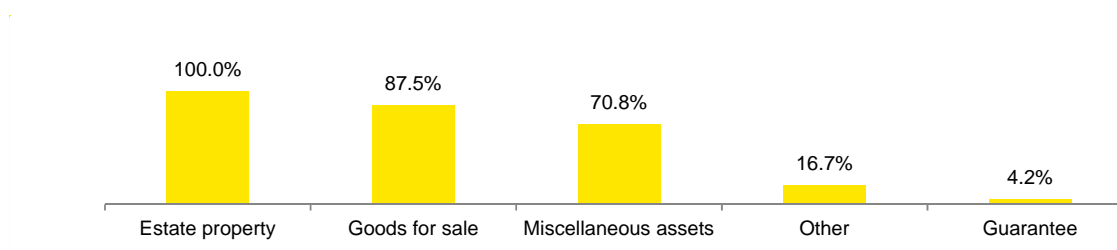


Table 7. Top 20 banks by loan portfolio to SME segment

Rank	Bank	SME loan portfolio, EUR mln		Change*	Bank type	SME loan value per client, EUR thousands****
		01/01/13	01/01/12			
1	Sberbank of Russia	29,706	25,033	+18.7%	State owned	37.1
2	VTB 24**	4,607	2,792	+65.0%	State owned	19.2
3	Promsvyazbank	2,537	2,345	+8.2%	Private	36.2
4	Bank Uralsib	2,216	2,044	+8.4%	Private	24.6
5	Moscow Industrial Bank	1,770	1,426	+24.1%	Private	29.5
6	Bank Vozrozhdenie	1,726	1 680	+2.7%	Private	32.0
7	Nomos Bank Group***	1,019	717	+42.2%	Private	11.9
8	Transcapitalbank	945	724	+30.6%	Private	21.0
9	Uniastrum Bank	941	941	-0.0%	Foreign	37.6
10	Bank Intesa	910	970	-6.1%	Foreign	33.7
11	Investorgbank	851	784	+8.6%	Private	31.5
12	Ak Bars Bank	720	640	+12.4%	Private	16.0
13	Bank Otkritie	719	765	-5.9%	Private	24.0
14	Bank of Moscow	709	531	+33.5%	State owned	14.2

15	SKB-Bank	614	444	+38.5%	Private	20.5
16	Raiffeisen Bank	578	511	+13.1%	Foreign	19.3
17	Rosbank	566	331	+70.7%	Foreign	9.4
18	Center-Invest	546	498	+9.6%	Foreign	13.7
19	LockoBank	517	407	+27.1%	Private	12.9
20	Bank TRUST**	511	414	+23.3%	Private	20.4

*Green color means growth higher than market, Yellow – growth less than market, Red – decrease of SME loan portfolio

**Data are for small enterprises only

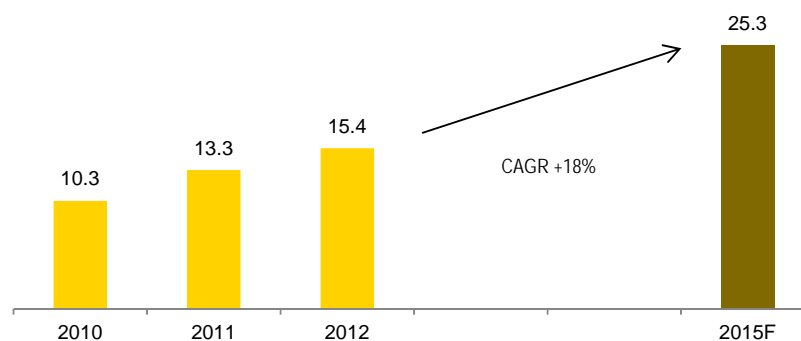
***Nomos Bank Group consists of Khanty-Mansiysky Bank, Nomos-Regiobank, Nomos-Bank-Sibir, Novosibirsky Municipal Bank

**** Standard exchange rate (1 EUR = 40 RUR)

7.2 Leasing

The SME segment accounts for about 35% of the total leasing market in Russia. In 2012 this share grew by more than 6%, reflecting the desire of leasing companies to diversify their portfolios. The demand for leasing from SME also increased because of several factors. One of them is the tightening of banking law. The other is the rising competence of lessees. Finally, the court practice in this field has also increased.

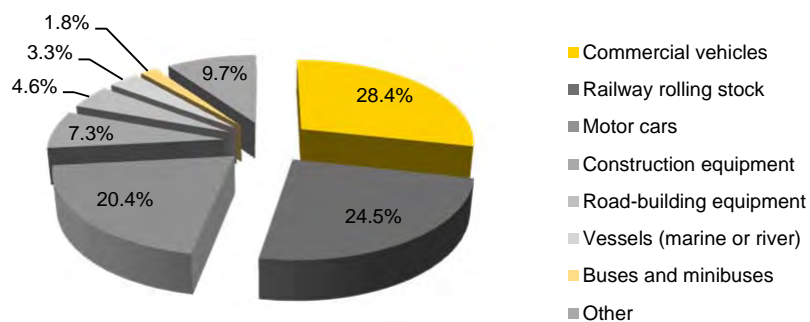
Figure 32. SME leasing market, EUR bln*



* Standard exchange rate (1 EUR = 40 RUR)

The leading type of leased property in the SME segment is commercial vehicles. Its share is 28.4%. Despite being the most popular in the whole market (41.3% of all deals), railway rolling stock accounts for only 24.5% of the SME segment. Automobiles and construction equipment are other types of property which the SME segment is interested in (please see figure 33 for details). A regional breakdown shows that 33% of all new deals are settled in Moscow. Together with the rest of the Central Federal District and Saint Petersburg it accounts for one half of the leasing market in the SME segment.

Figure 33. Breakdown of new deals (2012) by type of property



More than 100 leasing companies are working with the SME segment. The top 10 companies constitute half of the market (in terms of newly established deals).

Table 8. Top 10 lessors working with SME

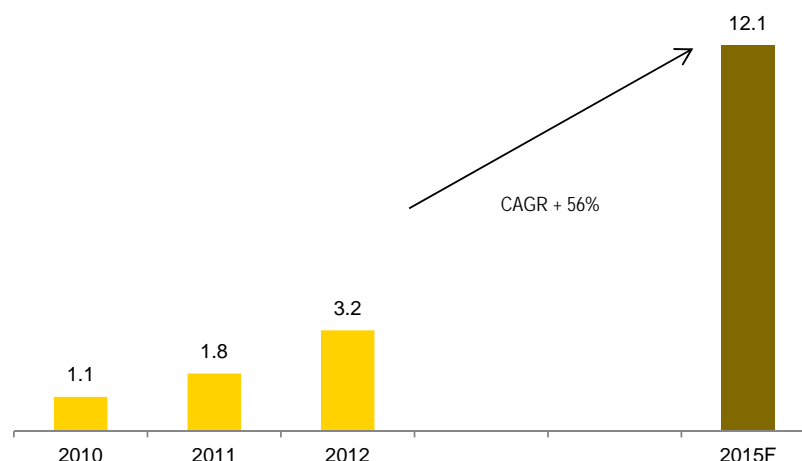
Rank	Company	New deals, EUR mln*		Change
		2012	2011	
1	Europlan	1,102	793	+39.0%
2	VEB-Leasing	859	384	+123.3%
3	State Transport Leasing Company	758	564	+34.5%
4	TransFin-M	632	-	
5	Sberbank Leasing	572	1,304	-56.1%
6	CARCADE Leasing	526	450	+17.0%
7	Baltiisky Leasing	429	306	+40.0%
8	Gazprombank Leasing	384	170	+125.9%
9	Uralsib Leasing Company	302	246	+22.9%
10	Element Leasing	251	180	+39.2%

* Standard exchange rate (1 EUR = 40 RUR)

7.3 Factoring

The factoring market is the fastest growing financial market in Russia. In 2012 its share of GDP grew to 2.3% (from 1.6% in 2011). Last year the major trend in the market was client segmentation of factors. They started to work individually with large, medium or small enterprises. The share of the SME segment in new deals (2012) is approximately 40%.

Figure 34. SME factoring market, EUR bln*



* Standard exchange rate (1 EUR = 40 RUR)

Alfa Bank has been the leader in the SME segment for two consecutive years. The top 10 companies occupy 73% of the market (in terms of volume of ceded money claims).

Table 9. Top 10 factors working with SME

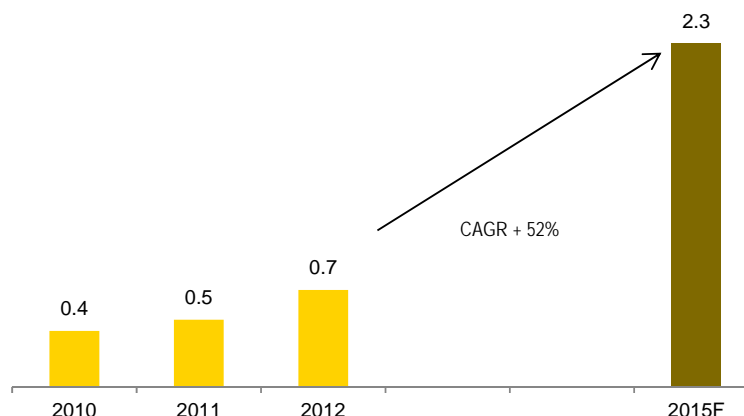
Rank	Company	Volume of ceded money claims, EUR mln*		Change
		2012	2011	
1	Alfa Bank	3,443	2,065	+66.8%
2	Promsvyazbank	2,106	1,569	+34.3%
3	NFC	1,439	1,173	+22.6%
4	VTB Factoring	1,359	792	+71.6%
5	FC Life	699	493	+41.8%
6	Metallinvestbank	651	732	-11.0%
7	UniCreditBank	558	318	+75.7%
8	FC Saint-Petersburg	208	108	+92.7%
9	Russian Factors Company	156	106	+48.0%
10	Bank Petrocommerce	140	197	-29.1%

* Standard exchange rate (1 EUR = 40 RUR)

7.4 Microfinance

In 2012 the total portfolio of microfinance organizations (MFOs) was about RUB48 bln (EUR1.2 bln). Its annual growth was 30%. Commercial companies are the main driver of growth due to its flexible decisions regarding microloans. MFOs with state participation were bounded by law requirements and showed slow growth. The share of SME segment in portfolio is 54% with RUB26 bln (EUR0.65 bln) in absolute terms.

Figure 35. SME microfinance market, EUR bln*



* Standard exchange rate (1 EUR = 40 RUR)

Besides active marketing and up-to-date risk measurement methodologies, major private MFOs have the advantage of access to different sources of market financing. In contrast to small companies and MFOs with state participation whose business in fact is bounded by the size of owner's equity, major private MFOs are able to attract bank loans and loans from individuals (in amounts not less than RUB1.5 mln (EUR37,500)). In 2012 there was a first issue of bonds by MFO "Domashnie den'gi" in the amount of RUB1 bln (EUR25 mln).

Concentration in the market continues to grow. The share of the top eight private companies grew to 20% (from 14% in the previous year). The share of top five companies (in the size of loan portfolio) grew by 4 percentage points to 18%. The further growth in the market of microfinance will be accompanied by growth in the concentration rate. Small companies will go out of business. One of the reasons for this is the lowering quality of loan portfolios. Small companies do not have much experience in the financial sector and they can't afford investments in automated risk management systems. Thus, some players will leave the market by selling their portfolios to larger players. This trend will help to make the market more transparent for borrowers, investors and regulators.

Table 10. Top-10 MFOs by volume of total loan portfolio

Rank	Company	Total loan portfolio, EUR mln*		Change
		2012	2011	
1	Domashnie den'gi	90.8	38.2	+137.8%
2	GK Microfinance Center	54.9	46.5	+18.1%
3	Microfinance	28.9	20.0	+44.3%
4	Finotdel	27.6	13.9	+97.8%
5	MigCredit	13.8	5.2	+165.4%
6	Kreditny Soyuz	11.6	3.7	+209.4%
7	Small business development fund of Republic Sakha	10.1	8.0	+27.3%
8	Microfinance Fund of Khanty-Mansiisky autonomous district	6.9	5.7	+21.3%
9	Narodnaya Kazna	6.8	0.4	+1537.3%
10	Srochnoden'gi	6.6	2.0	+236.3%

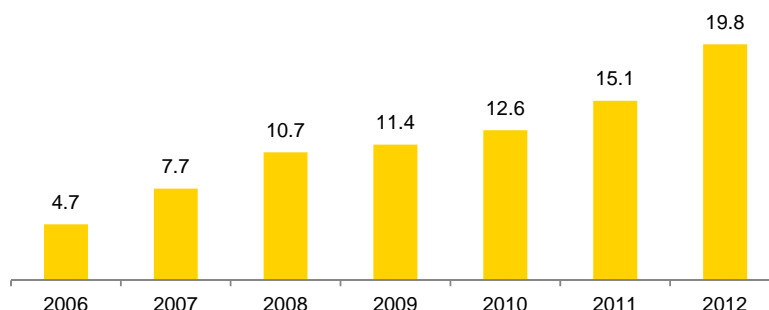
* Standard exchange rate (1 EUR = 40 RUR)

7.5 Private equity

Venture capital grew steadily over the period from 2006 to 2012. At the end of 2012 the total capitalization of venture capital and direct investment funds was approximately EUR19.8 bln (see Figure 36), which is 30% higher than in the previous year. There

are 155 active venture capital funds with a total capitalization of EUR3.4 bln and 92 private equity funds with a total capitalization of EUR16.4 bln.

Figure 36. Venture capital and direct investment funds capitalization, EUR bln*



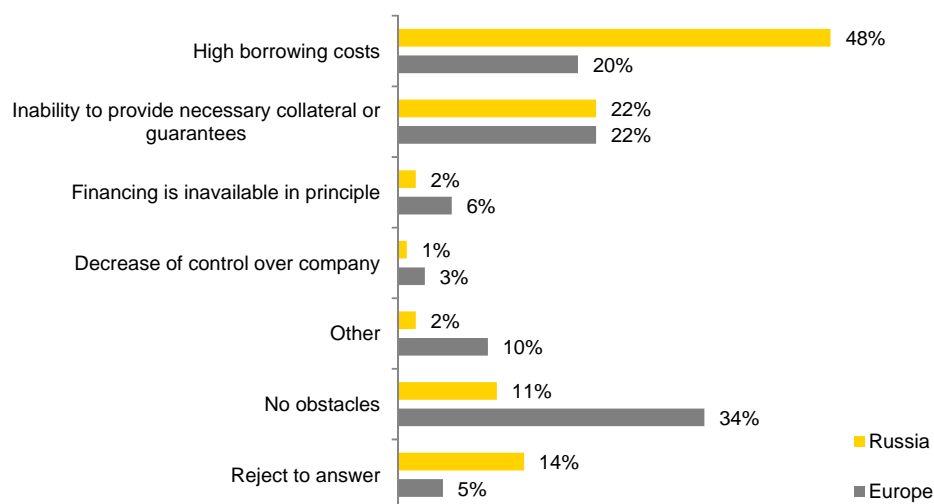
* Standard exchange rate (1 EUR = 40 RUB)

In 2012 both types of funds invested about EUR3.1 bln in 194 companies. More than one-quarter of all investments were made in companies in the telecommunications sector, 21% - to financial services and 16% - to the energy industry. About 90% of investments were made at the "mature" stage of development (enlargement, restructuring and late stage), but according to the number of companies – more than two-thirds of investments were made at the "venture" stage (seed, start-up).

7.6 Constraints

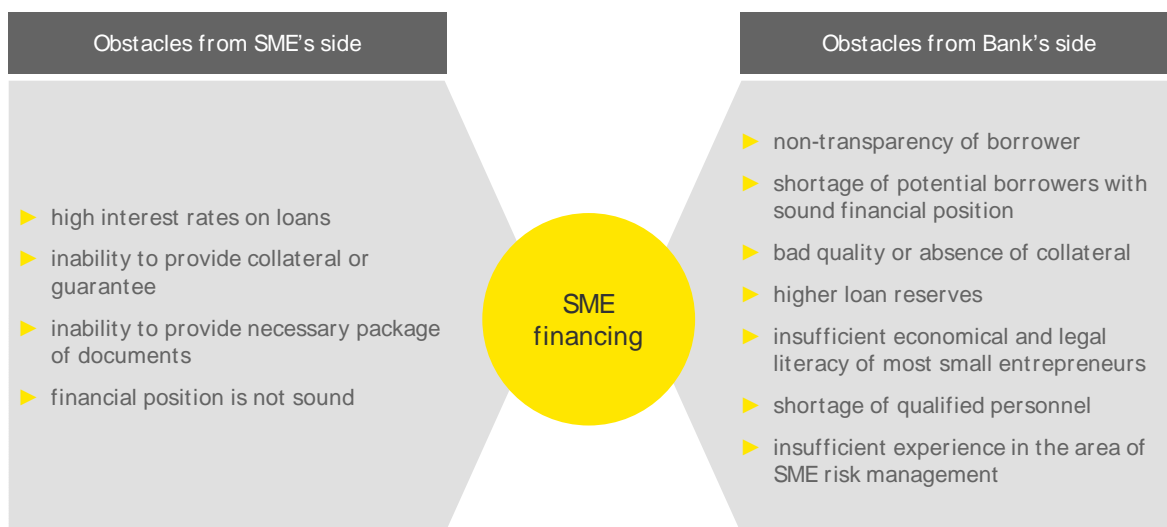
High borrowing costs are the major obstacle for obtaining financing in the SME segment. About half of all respondents indicate this reason (please see figure 37 for details). The next significant obstacle is the inability to provide collateral (22%). Surprisingly, in Europe this reason is dominant and high interest rates are second. On the other hand, only 11% of respondents in Russia said that there are no obstacles for obtaining financing and this is three times less than in Europe.

Figure37. Key obstacles to obtain finance



To sum up, there are a number of constraints that hinder the development of the SME financing market. These limitations can be seen from both sides: demand and supply (see Figure 38).

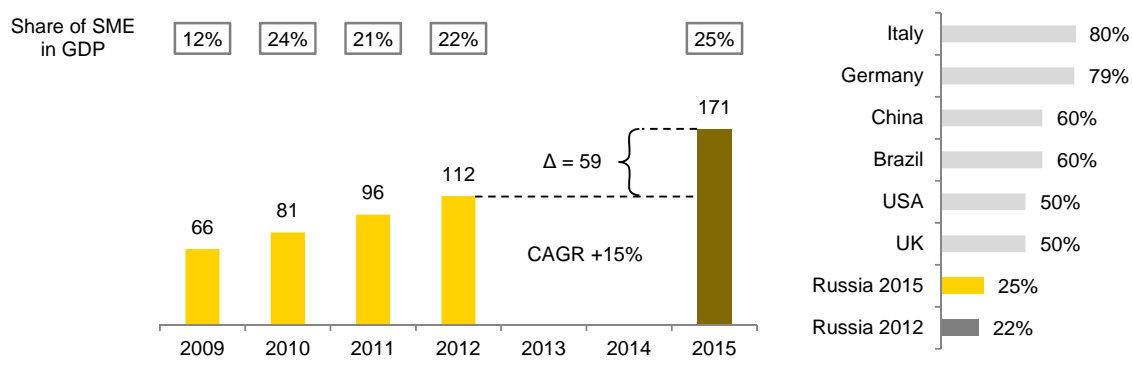
Figure 38. The obstacles from SME's and Bank's side



8. Modeling of the resources available to bank lending to the SME sector

The total SME lending portfolio is estimated to grow at an average rate of 15% to approximately EUR171 bln in 2015 (please see figure 39 for details). That year small- and medium-sized companies are projected to produce a quarter of Russian GDP, which is still significantly lower than in other developed and developing countries.

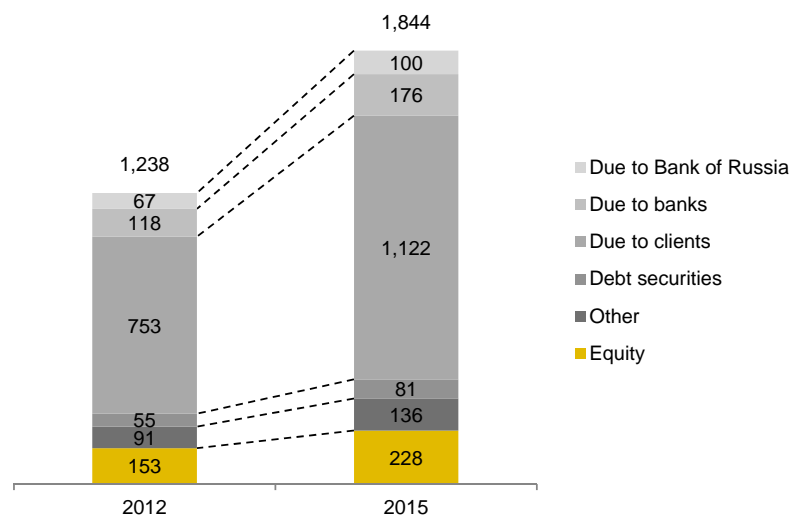
Figure 39. SME lending portfolio, EUR bln* and benchmarks for share of SME in GDP



Standard exchange rate (1 EUR = 40 RUR)

According to the strategy of development of the Russian banking sector through 2015, the share of total banking assets to GDP is estimated to grow to more than 90% (from the current 79%).

Figure 40. Structure of liabilities and equity of Russian banking system, EUR bln*



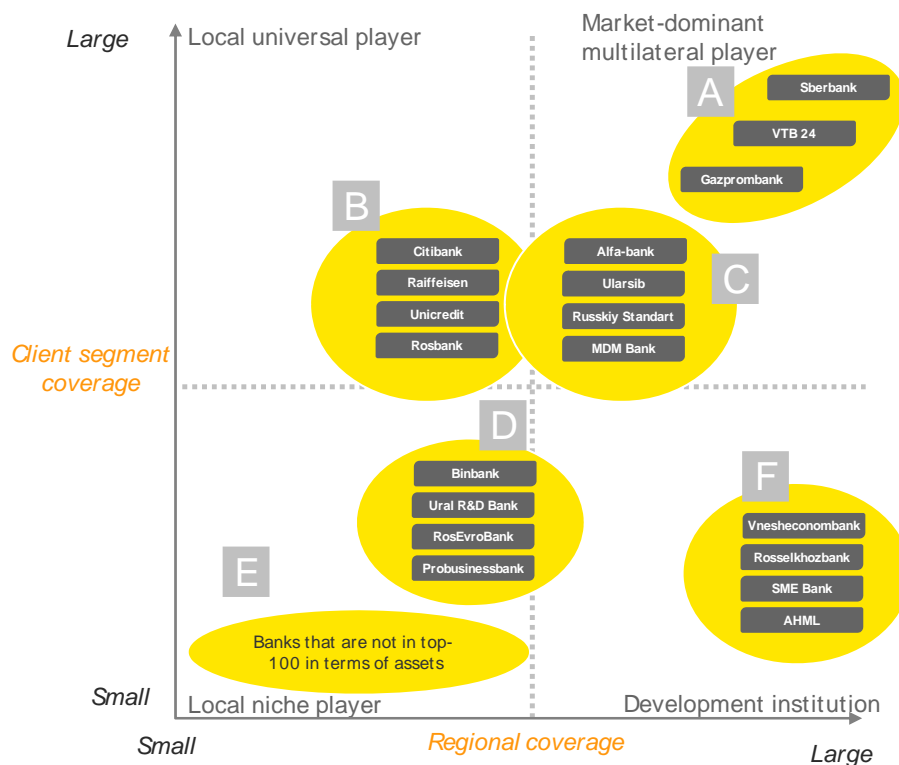
* Standard exchange rate (1 EUR = 40 RUR)

9. Description of key players/potential partners for EIB

The banking system in Russia consists of approximately 950 banks. These banks can be divided into six groups (see figure 41):

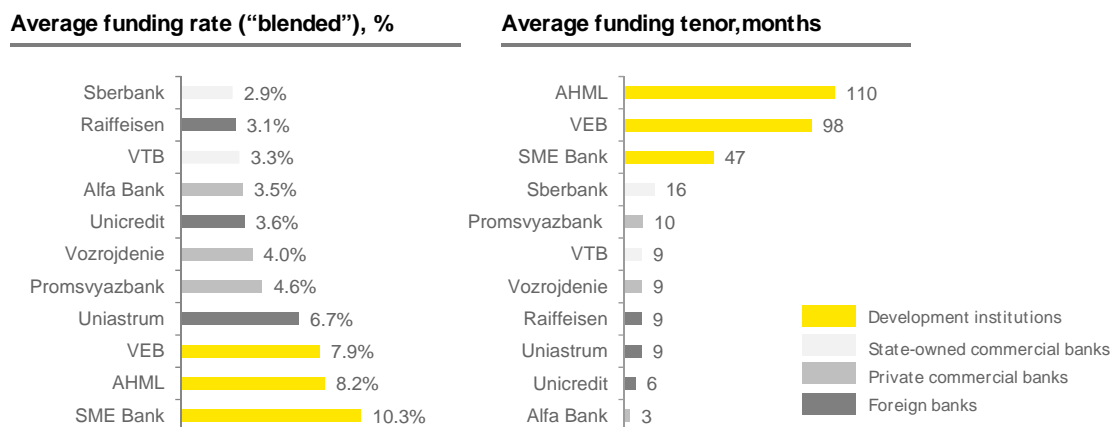
- A: State-owned commercial banks – dominate markets nationwide, headed by Sberbank of Russia
- B: Foreign banks – service and efficiency leaders with average regional coverage
- C: Large private commercial banks – above average regional coverage with growing service and efficiency
- D: Second-tier private commercial banks – below average commercial coverage seeking for product or channel differentiation
- E: Local players – invisible on the national level, but may be leaders in some regions
- F: State-owned development banks – focus on special segments or products. Price leaders in search of golden mean between profitability and development

Figure 41. Major banking clusters in Russian market



Local development institutions have about 10 times higher average funding tenor than commercial banks, while funding rates of commercial banks are significantly lower (please see figure 42).

Figure 42. Average funding rates/tenor



Development institutions do not have access to funding sources available to Commercial banks (e.g. deposit portfolio, current accounts), which affects both average funding rate and funding tenor. An overview of 12 selected banks is provided below. All selected banks, except SEB Bank, are key players in SME lending (Top-20 by loan portfolio in SME segment) representing 3 major groups:

- State-owned banks
- Major local privately-owned banks
- Leading foreign banks in the Russian market

SEB Bank was added at specific request from EIB during a meeting in Moscow.

Sberbank of Russia

www.sberbank.ru

Type of ownership: State owned

Assets (01.01.2013): EUR352.1 bln* (1st place)

Profit (2012): EUR8,610 mln (1st place)

Ratings: Moody's – Baa1, Fitch – BBB

of regions covered: 83

of branches: 18,513

Number of SME clients	> 800,000				
Size of SME portfolio, EUR mln (y-o-y change)	29,706 (+18.7%)				
Share of SME over total assets	8.4%				
NPL, % of total loan portfolio	2.8%				
Loan/Deposit ratio	1.01				
Capital adequacy ratio	12.6%				
Maturity structure	< 1m	1m – 1y		> 1y	Not stated
Assets	24.3%	21.4%		50.3%	3.9%
Liabilities	32.5%	27.0%		40.1%	0.4%
Gaps, EUR bln	-17.5	-10.1		55.0	13.2
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	1.2%	81.2%	6.3%	7.1%	4.2%

VTB 24

www.vtb24.ru

Type of ownership: State owned

Assets (01.01.2013): EUR37.8 bln (6th place)

Profit (2012): EUR923.8 mln (3rd place)

Ratings: Moody's – Baa1, Fitch – BBB

of regions covered: 69

of branches: 701

Number of SME clients	~ 240,000				
Size of SME portfolio, EUR mln (y-o-y change)	4,607 (+65.0%)				
Share of SME over total assets	12.2%				
NPL, % of total loan portfolio	4.4%				
Loan/Deposit ratio	0.84				
Capital adequacy ratio	11.2%				
Maturity structure	< 1m	1m – 1y		> 1y	Not stated
Assets	14.4%	15.5%		69.4%	0.7%
Liabilities	33.0%	34.5%		32.4%	0.0%
Gaps, EUR bln	-5.8	-5.9		14.4	0.3
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	1.7%	82.5%	5.6%	6.4%	3.8%

* Standard exchange rate (1 EUR = 40 RUR)

Bank of Moscow

www.bm.ru

Type of ownership: State owned
 Assets (01.01.2013): EUR38.0 bln (5th place)
 Profit (2012): EUR205.4 mln (13th place)
 Ratings: Moody's – Ba2, Fitch – BBB
 # of regions covered: 75
 # of branches: 304

Number of SME clients	> 50,000				
Size of SME portfolio, EUR mln (y-o-y change)	709 (+33.5%)				
Share of SME over total assets	1.9%				
NPL, % of total loan portfolio	35.0%				
Loan/Deposit ratio	0.89				
Capital adequacy ratio	13.8%				
<i>Maturity structure</i>	< 1m	1m – 1y		> 1y	Not stated
Assets	25.7%	25.1%		48.9%	0.3%
Liabilities	35.4%	29.6%		34.9%	0.0%
Gaps, EUR bln	-1.9	-0.5		5.3	0.1
<i>Sources</i>	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	2.2%	44.0%	6.1%	9.0%	38.7%

Promsvyazbank

www.psbank.ru

Type of ownership: Private
 Assets (01.01.2013): EUR17.6 bln (9th place)
 Profit (2012): EUR211.3 mln (12th place)
 Ratings: Moody's – Ba2/NP, Fitch – BB-
 # of regions covered: 58
 # of branches: 302

Number of SME clients	> 70,000				
Size of SME portfolio, EUR mln (y-o-y change)	2,537 (+8.2%)				
Share of SME over total assets	14.4%				
NPL, % of total loan portfolio	4.4%				
Loan/Deposit ratio	0.86				
Capital adequacy ratio	11.1%				
<i>Maturity structure</i>	< 1m	1m – 1y	> 1y	Not stated	
Assets	33.5%	34.8%	31.6%	0.1%	
Liabilities	21.0%	57.6%	21.4%	0.0%	
Gaps, EUR bln	-2.2	-3.3	1.9	0.0	
<i>Sources</i>	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	5.3%	35.2%	28.7%	26.6%	4.2%

* Standard exchange rate (1 EUR = 40 RUR)

Uralsib

www.bankuralsib.ru

Type of ownership: Private

Assets (01.01.2013): EUR11.3 bln* (14th place)

Profit (2012): EUR58.2 mln (39th place)

Ratings: S&P – BB-, Moody's – B1, Fitch – BB-

of regions covered: 56

of branches: 455

Number of SME clients	> 90,000				
Size of SME portfolio, EUR mln (y-o-y change)	2,216 (+8.4%)				
Share of SME over total assets	19.6%				
NPL, % of total loan portfolio	6.6%				
Loan/Deposit ratio	0.89				
Capital adequacy ratio	11.0%				
Maturity structure	< 3m	3m – 1y	> 1y	Not stated	
Assets	35.4%	14.3%	34.6%	15.6%	
Liabilities	30.1%	24.5%	45.4%	0.0%	
Gaps, EUR bln	0.9	-0.9	-0.7	1.8	
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	6.0%	76.5%	0.0%	7.4%	10.1%

Moscow Industrial Bank

www.minbank.ru

Type of ownership: Private

Assets (01.01.2013): EUR4.3 bln (35th place)

Profit (2012): EUR37.0 mln (57th place)

Ratings: -

of regions covered: 25

of branches: 275

Number of SME clients	> 60,000				
Size of SME portfolio, EUR mln (y-o-y change)	1,770 (+24.1%)				
Share of SME over total assets	41.0%				
NPL, % of total loan portfolio	0.8%				
Loan/Deposit ratio	0.81				
Capital adequacy ratio	10.8%				
Maturity structure	< 1y		> 1y		Not stated
Assets	63.9%		36.1%		0.0%
Liabilities	87.5%		12.5%		0.0%
Gaps, EUR bln	-0.9		1.0		0.0
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	4.7%	95.2%	0.1%	0.0%	0.0%

* Standard exchange rate (1 EUR = 40 RUR)

Vozrozhdenie

www.vbank.ru

Type of ownership: Private

Assets (01.01.2013): EUR5.5 bln* (31st place)

Profit (2012): EUR58.2 mln (38th place)

Ratings: S&P – BB-, Moody's – Ba3/NP

of regions covered: 21

of branches: 148

Number of SME clients	> 8,000				
Size of SME portfolio, EUR mln (y-o-y change)	1,726 (+2.7%)				
Share of SME over total assets	31.2%				
NPL, % of total loan portfolio	6.7%				
Loan/Deposit ratio	0.88				
Capital adequacy ratio	12.2%				
Maturity structure	< 1m	1m – 1y	> 1y	Not stated	
Assets	30.3%	37.0%	32.7%	0.0%	
Liabilities	37.5%	33.7%	28.8%	0.0%	
Gaps, EUR bln	-0.2	0.3	0.3	0.0	
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	12.1%	70.5%	3.9%	8.3%	5.2%

Uniastrum

www.uniastrum.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR2.3 bln (63rd place)

Loss (2012): EUR24.0 mln (936th place)

Ratings: Caa1

of regions covered: 45

of branches: 194

Number of SME clients	> 10,000				
Size of SME portfolio, EUR mln (y-o-y change)	941 (-0.0%)				
Share of SME over total assets	41.6%				
NPL, % of total loan portfolio	8.5%				
Loan/Deposit ratio	1.31				
Capital adequacy ratio	12.1%				
Maturity structure	< 1y		> 1y		Not stated
Assets	50.0%		41.3%		8.6%
Liabilities	74.4%		25.6%		0.0%
Gaps, EUR bln	-0.4		0.4		0.2
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	45.5%	40.8%	0.0%	13.7%	0.0%

* Standard exchange rate (1 EUR = 40 RUR)

Intesa

www.bancaintesa.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR2.0 bln* (70th place)

Profit (2012): EUR25.1 mln (72th place)

Ratings: Moody's – Ba1

of regions covered: 25

of branches: 75

Number of SME clients	> 27,000			
Size of SME portfolio, EUR mln (y-o-y change)	910 (-6.1%)			
Share of SME over total assets	44.5%			
NPL, % of total loan portfolio	8.0%			
Loan/Deposit ratio	2.03			
Capital adequacy ratio	16.4%			
Maturity structure	< 1m	1m – 1y	> 1y	Not stated
Assets	27.0%	39.1%	28.6%	5.2%
Liabilities	34.9%	32.0%	33.0%	0.2%
Gaps, EUR bln	0.0	0.3	0.0	0.1
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt Other
Long-term (> 1y) liabilities	27.2%	3.0%	38.7%	2.6% 28.5%

Raiffeisen

www.raiffeisen.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR15.9 bln (12th place)

Profit (2012): EUR417.3 mln (7th place)

Ratings: S&P – BBB, Moody's – Baa3, Fitch – BBB+

of regions covered: 53

of branches: 199

Number of SME clients	> 30,000			
Size of SME portfolio, EUR mln (y-o-y change)	578 (+13.1%)			
Share of SME over total assets	3.6%			
NPL, % of total loan portfolio	3.1%			
Loan/Deposit ratio	0.99			
Capital adequacy ratio	13.5%			
Maturity structure	< 3m	3m – 1y	> 1y	Not stated
Assets	49.0%	14.8%	36.2%	0.0%
Liabilities	65.1%	17.8%	17.2%	0.0%
Gaps, EUR bln	-1.1	-0.1	3.2	0.0
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt Other
Long-term (> 1y) liabilities	4.9%	49.8%	0.0%	0.0% 45.3%

* Standard exchange rate (1 EUR = 40 RUR)

Rosbank

www.rosbank.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR17.4 bln (10th place)

Profit (2012): EUR334.2 mln (10th place)

Ratings: Moody's – Baa3, Fitch – BBB+

of regions covered: 70

of branches: 631

Number of SME clients	> 60,000				
Size of SME portfolio, EUR mln (y-o-y change)	566 (+70.7%)				
Share of SME over total assets	3.3%				
NPL, % of total loan portfolio	7.7%				
Loan/Deposit ratio	1.30				
Capital adequacy ratio	13.3%				
Maturity structure	< 1m	1m – 1y		> 1y	Not stated
Assets	23.8%	31.7%		40.6%	3.9%
Liabilities	21.1%	43.0%		35.8%	0.0%
Gaps, EUR bln	1.2	-1.0		2.0	0.8
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	21.7%	48.0%	16.0%	12.7%	1.7%

Center-Invest

www.centrinvest.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR1.6 bln (81th place)

Profit (2012): EUR30.8 mln (64th place)

Ratings: Moody's – Ba3

of regions covered: 5

of branches: 138

Number of SME clients	> 40,000				
Size of SME portfolio, EUR mln (y-o-y change)	546 (+9.6%)				
Share of SME over total assets	33.8%				
NPL, % of total loan portfolio	4.2%				
Loan/Deposit ratio	1.13				
Capital adequacy ratio	12.8%				
Maturity structure	< 1m	1m – 1y		> 1y	Not stated
Assets	19.5%	31.9%		43.5%	5.1%
Liabilities	28.3%	29.0%		42.3%	0.4%
Gaps, EUR bln	-0.1	0.1		0.1	0.1
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	2.2%	86.6%	1.6%	3.2%	6.5%

* Standard exchange rate (1 EUR = 40 RUR)

Unicredit Bank

www.unicredit.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR22.2 bln (8th place)

Profit (2012): EUR470.1 mln (6th place)

Ratings: S&P – BBB, Fitch – BBB

of regions covered: 30

of branches: 105

Number of SME clients	> 20,000				
Size of SME portfolio, EUR mln (y-o-y change)	117 (+39.6%)				
Share of SME over total assets	0.5%				
NPL, % of total loan portfolio	3.0%				
Loan/Deposit ratio	1.10				
Capital adequacy ratio	13.3%				
Maturity structure	< 1m	1m – 1y		> 1y	Not stated
Assets	37.2%	23.7%		37.4%	1.7%
Liabilities	54.2%	21.0%		24.8%	0.0%
Gaps, EUR bln	-2.1	1.2		3.4	0.4
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	31.8%	46.5%	21.6%	0.0%	0.0%

SEB Bank

www.sebbank.ru

Type of ownership: Foreign

Assets (01.01.2013): EUR0.2 bln (271th place)

Profit (2012): EUR1.9 mln (310th place)

Ratings: Fitch – BBB+

of regions covered: 3

of branches: 1

Number of SME clients					
Size of SME portfolio, EUR mln (y-o-y change)	12 (+14.6%)				
Share of SME over total assets	5.0%				
NPL, % of total loan portfolio	0.2%				
Loan/Deposit ratio	2.96				
Capital adequacy ratio	59.3%				
Maturity structure	< 1m	1m – 1y	> 1y	Not stated	
Assets	39.3%	25.3%	35.5%	0.0%	
Liabilities	28.4%	29.4%	42.2%	0.0%	
Gaps, EUR bln	0.05	0.01	0.01	0.00	
Sources	Due to banks	Due to clients	Debt securities	Subordinated debt	Other
Long-term (> 1y) liabilities	96.3%	0.0%	0.0%	3.7%	0.0%

* Standard exchange rate (EUR1 = RUB40)

10. State support for SME¹²

For the purposes of small and medium entrepreneurship development, increase of SME share in GDP, increase in employment and development of domestic competition, the State provides support for SMEs. This support can take different forms, where each form helps entrepreneurs to reach specific goals. Among these forms there are:

- financial support: lending of money under favorable conditions – lower interest rate, longer term, etc. This type of support is one the most popular among entrepreneurs. It will be discussed in detail below
- special tax regimes: lower tax rate for some sectors, simplified taxation and requirements for documents
- renting or acquisition of property under favorable conditions
- provision of services or delivery of goods for state needs

Since 2005 the Ministry of Economic Development has run the federal program of SME financial support. The main priorities of this program are:

- innovative companies
- mid-sized enterprises
- assistance in the development of leasing for small entities
- support for beginner entrepreneurs via grants
- creation of business incubators, industrial parks and entrepreneurship centers

Financial support for small and medium business is exercised through different channels. One way is through regional governments. In 2012 subsidies from the federal budget to regional budgets, with a focus on support to SME, were RUB19 bln (EUR475 mln). An additional RUB18 bln (EUR451 mln) is to be distributed in 2013. The volume of annual support is approximately 0.4% of the total loan portfolio of all banks to SME. These subsidies are meant to increase the volume of regional programs of support to SME that will in turn increase the number of companies which will receive financial support. The distribution of subsidies is not uniform across all regions. Regional leaders are: Moscow (7.5%), Krasnodar Krai (5.0%) and Saint Petersburg (4.6%). Regional outsiders: Jewish Autonomous Oblast (0.1%), Chukotka Autonomous Okrug (0.03%), Nenets Autonomous Okrug (0.03%).

According to the most recent Doing Business research (2014), government measures implemented in 2012-2013 helped Russian Federation to move up 20 positions being amongst the top-5 countries improving the most in the year 2013.

More detailed overview shows that this change in the country's rating resulted from a number of improvements:

- Revising electricity connection prices
- Eliminating requirement to obtain cadastral passport on land plots
- Abolishing the requirement to have the bank signature card notarized before opening a company bank account
- Eliminating several requirements for construction project approvals
- Reducing the time required to register a new building and other reforms

Though the Doing Business methodology has limitations it reveals that Russia steadily moves towards and enforces crucial and right directions in changes for better conditions in doing businesses. The goal set by the government is to reach top-20 by the year 2018.

10.1 *SME Bank*

Another way for entrepreneurs to obtain financing under favorable conditions is through an intermediary of SME Bank. SME Bank has implemented the State program of financial support for small and medium enterprises since 2004. The Bank's primary goals in SME support are:

- assurance of equal opportunities for SMEs to access mid- and long-term financing
- financial support, primarily to entities in the manufacturing sector and to those which realize innovative and technology intensive projects; thus, changing the structure of lending
- financing the building and development of infrastructure for SME support (business incubators, leasing companies, technoparks, etc.)

¹²Detailed information about legislative support to SME can be found in Appendix 5.

Since 2007 the only shareholder of SME Bank has been state corporation “Vnesheconombank” (VEB). SME Bank provides loans and other forms of support to SMEs through a two-tiered system that includes a wide network of partners – banks, leasing and factoring companies, microfinance organizations, etc. The total support for SME as of 1 June 2013 is RUB91.2 bln (EUR2.3 bln), from which RUB70.5 bln (EUR1.8 bln) are distributed through 134 bank-partners, RUB20.2 bln (EUR0.5 bln) are distributed through 140 non-banking institutions and the rest RUB0.5 bln (EUR0.01 bln) are disbursed for the creation of infrastructure objects. The share of support through SME Bank in total lending to SMEs is 2% but it can be as high as 10% in target segments for SME Bank such as long-term SME financing, microfinancing, etc. The Bank’s support programs cover all 83 regions of Russia. More than 80% of all loans are for more than two years and the average interest rate is 12.7% (compared to 15-17% on the market).

The procedure of partner selection for banks is being carried out in the following steps:

1. A partner bank should verify its compliance with the SME Lending Program terms of selection¹³
2. If a bank complies with terms, it fills out a credit application in accordance with the selected credit product, including a questionnaire, and submits it to SME Bank with the necessary documents
3. SME Bank checks to see that the partner complies with the terms, assesses its financial performance and determines the credit limit
4. SME Bank notifies the partner bank about the possibility of participating in the Program and provides information on the established limit
5. Once the partner bank accepts the offered terms, SME Bank and the partner bank sign credit and security agreements

Since support through the Program is goal-oriented, SME Bank conducts remote control of partner banks allocating credits to SMEs (based on reports and documents submitted by partner banks) and on site control.

Beginning in April 2013, SME Bank became the operator of the guarantee mechanism, which was developed by the Russian government. The purpose of the guarantee mechanism is an increase in availability of financing to medium businesses. Guarantees will be provided to certain banks that give loans for investment projects to medium-sized companies. SME Bank will guarantee 50% of an amount of a loan (but no more than RUB1 bln (EUR25 mln)) with maturity of 2-10 years. The maximum amount of guarantee fee is 1.8% per year.

10.2 *Regional guarantee funds*

At the moment there are about 80 active guarantee funds in the regions of the Russian Federation. The main goal of the regional funds is to assist small- and medium-sized companies in obtaining loan and leasing financing by providing guarantees.

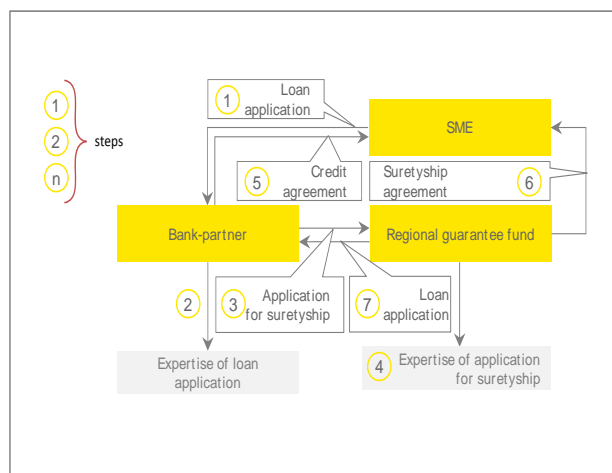
Funds’ capital is financed from both federal and regional budgets. Budget financing is provided on the ground of federal SME Support Program realized by the Ministry of Economic Development. Within the framework of this Program regions are financed from federal budget on the yearly basis for the SME support purposes. Mandatory condition for the federal financing is that the regional SME support funds are co-financed by regional budgets. Typically, co-funding proportion is 80 / 20 for federal / regional budgets respectively (but may vary in different regions). Distribution of federal budget resources to support regional SMEs with guarantees is held on an annual basis in the form of a contest organized by the Ministry of Economic Development. The Ministry’s Commission for Selection of Regions to be Provided with Subsidies for SME Support distributes federal budget money between regional funds aimed at supporting SMEs. Each request contains key areas for SME support planned to be provided in a region (guarantee funds, subsidies, education etc.). Regions’ original requests can be amended during the contest by the Commission. According to an Order of the Ministry of Economic Development, regions can be considered to receive subsidies from the federal budget for SME support through guaranty funds if they satisfy the following conditions:

- guarantee amount cannot exceed 70% of loan amount
- maximum cost to SME cannot exceed one third of the refinancing rate (which is set by the Bank of Russia and currently is 8.25%) per year applied to the guarantee amount (i.e. currently guarantee cost cannot exceed 2.75%)

Regional funds operate only in regions where they are created. Guarantees issued by the fund have credit rating of a respective region. Regional guarantee funds provide guarantees only for banks and leasing companies they have partner agreements with. The mechanism and process of issuing a guarantee by a regional fund is described on the figure 43.

¹³ Detailed requirements for banks are presented in Appendix 3.

Figure 43. Regional guarantee mechanism for SME lending



Borrower applies for a loan with a partner bank. The bank considers the application, examines documents, the financial condition of the SME and makes a lending decision. The bank then informs the SME about the possibility of attracting surety from the regional guarantee fund to ensure fulfillment of the obligations of the SME under the credit agreement. If the borrower is willing to receive suretyship from the regional guarantee fund, the bank sends application for suretyship signed by SME and agreed by the bank. Regional guarantee fund then decides whether to grant or refuse the surety application.

Overall management of activities of guarantee funds in Russia is performed by the regions and supervised by the Ministry of Economic Development.

The performance figures for guarantee funds, as of 1 January 2013:

- RUB33.6 bln (EUR0.8 bln) is a total capitalization of guarantee funds
- RUB45.0 bln (EUR1.1 bln) is a portfolio of active guarantees
- RUB96.4 bln (EUR2.4 bln) is an amount of active loans issued under guarantees by regional funds

The share of loans secured by guarantees in the total lending to SME is 2.1%. This share significantly varies across different regions but does not exceed 5%. There is strong demand for loan guarantees by regional SMEs, and guarantee funds are expected to develop further. International development institutions aimed at supporting the SME sector in Russia can potentially contribute to expansion of loan guarantees and their availability.

11. International development institution activities in Russia

11.1 International Finance Corporation (IFC)

Russia became a member of IFC in 1993. Since then, IFC invested EUR7.6 bln in 270 projects across different sectors. The current investment portfolio in Russia amounts to EUR1.7 bln, the fourth-largest country exposure for IFC globally. In 2012 IFC invested EUR900 mln in Russia, including EUR35 mln in syndicated loans.

IFC supports small and medium business in Russia with financing and advisory services. Its investment portfolio is dedicated to expanding access to finance for SME amounts to EUR628 mln. IFC's advisory services help companies improve corporate governance and become more resource efficient and competitive. Selected IFC investments in development of SME in Russia are presented in Table 11.

Table 11. IFC investments to support SME in Russia

Year	Partner	Amount (EUR mln)*	Description
2013	Transcapitalbank	116.5	A syndicated loan from a consortium of 15 commercial banks will help to support the foreign trade transactions of clients - small businesses located in Russian regions.
2013	Center-Invest	22.5	A loan to help the bank expand access to finance for small and medium enterprises in southern regions of Russia.
2012	Asian-Pacific Bank	22.5	A subordinated loan to strengthen the bank's capital base and expand access to finance for small and medium companies in Russia (primarily in Far East and Siberia).

2012	Capital markets	325	An issue of five-year ruble-denominated bonds (the largest domestic placement by an international issuer). Proceeds from bond will be used to invest in private sector companies in Russia.
2012	Elbrus Capital Fund II	15	A private equity investment to support medium-sized companies in Russia. Targeted final size of the Fund EUR375 mln.
2012	Forus Bank	3	A loan to only domestic banks specializing in microfinance to increase access to financial services for people and small businesses in central Russia.
2012	NBD Bank	7.5	A five-year ruble loan to help the bank finance small business in the small and single-company towns of central Russia to support economic development and employment.

* Standard exchange rate (1 EUR = 40 RUR)

11.2 European Bank for Reconstruction and Development (EBRD)

As of the beginning of 2013, EBRD had an investment portfolio of EUR9.7 bln in Russia. In 2012 the Bank signed for 67 projects worth EUR2.6 bln. Financing for the SME segment is provided through a range of instruments, including debt, credit lines and equity. More than 25 financial intermediaries are partners of EBRD in providing finance to SME, including state-owned, foreign and regional banks. Selected EBRD investments in development of SME in Russia are presented in Table 12.

Since 1994 EBRD has operated the Russia Small Business Fund (RSBF). The goals of the Fund are to provide finance to micro- and small enterprises and to assist institutional development of the banking sector for the benefit of SME lending. In 2011 EBRD approved an increase in the Fund's budget from USD300 mln to USD450 mln and extended its years of operation till the end of 2015. This flagship EBRD program has played a pivotal economic and social role in Russia over the last 19 years. Its new term of life will give the program a chance to help bridge what, despite the RSBF's success, remains an enormous gap between supply and demand in terms of micro and small business lending in Russia.

Table 12. EBRD investments to support SME in Russia

Year	Partner	Amount (EURmln)*	Description
2013	VEB	up to 500	The EBRD is considering signing the Deed of Guarantee and Indemnity with VEB to increase its lending capacity to selected partner banks ("PB") for on-lending to predominantly regional SMEs. The EBRD has existing SME loans outstanding to the PB's and the partnership with VEB will allow for further loans to be extended in similar size and under similar terms and conditions. The first two loans under the VEB guarantee EBRD plans to extend to Center-Invest Bank and NBD Bank.
2013	Asian-Pacific Bank	17.5	A loan aimed at enhancing the availability of longer-term local currency financing to the small and medium-sized enterprises sector in Russia's Far East and Siberia.
2012	Orient Express Bank	42	A loan aimed at providing finance to small and medium business in Russia.
2012	Banca Intesa	45	A five-year loan to provide resources to SME in Russian regions.
2011	Metcombank	8.75	A four-year loan to increase financial intermediation to SME in the regions where the bank is present.

* Standard exchange rate (1 EUR = 40 RUR)

In the 16 years leading up to March 2011, the RSBF made over 600,000 loans to Russian micro and small business borrowers, disbursing a cumulative total of nearly EUR6.8 bln through partner banks participating in the program. More than 90% of the

current portfolio volume is allocated in regions other than Moscow and Saint Petersburg. The Fund has 18 bank-partners, all of which are either specializing in lending to SME, or are major players in selected Russian regions.

11.3 KfW Bankengruppe

In February, 2009 KfW and Vnesheconombank signed an agreement on the German-Russian initiative for SME financing. The agreement was aimed at rendering assistance to Russian small- and medium-sized enterprises. It envisaged providing medium-term finance for SMEs, as well stimulation of entrepreneurial activities in the regions and support for banks that grant credits to SMEs. In accordance with the agreement, KfW Bankengruppe extended to Russian commercial banks targeted loans of EUR200 mln against the guarantee of Vnesheconombank. The loan tenor was up to 5 years. Among the banks that receive loans under this agreement were Spurt Bank (EUR30.0 mln), Promsvyazbank (EUR22.5 mln), NBD Bank (EUR11.3 mln) and others.

In the second half of 2012 KfW and Vnesheconombank entered into a Memorandum of Understanding to establish an International Fund to Promote Entrepreneurial Activity. The Fund will expand the range of instruments for funding small and medium-sized companies. Both banks intended to contribute EUR112.5 mln each. The Fund's amount is expected to reach EUR675 mln in the coming four years.

The Fund is to provide support for SMEs through target financing of Russian banks (taking into account a significant shortage of long-term liabilities in the banking system), as well as through direct financing of dynamically advancing small and medium-sized enterprises implementing investment projects in the nontrade sector with a financing volume from RUB150 mln to 1 bln (EUR3.75 to 25 mln).

At that time KfW also extended EUR82.5 mln in a credit to Vnesheconombank. These credit resources are to be used to support and promote small and medium-sized enterprises as well as public private partnership projects in the field of environmental protection, innovations and modernization in the North-West region of the Russian Federation (Saint Petersburg, the Leningrad region, Pskov region, Novgorod region, Kaliningrad region).

Besides cooperation with banks, KfW also supports SME through other intermediaries. In 2011 KfW IPEX-Bank financed a leading automotive leasing firm Europlan with a loan of EUR30 mln. The 4.5 year loan was to refinance vehicles produced by German and European manufacturers, delivered to the country and purchased by the leasing company for its lessees. The vehicles purchased by Europlan were leased to small and medium-sized Russian business customers as well as large western customers and their representative offices in Russia.

12. EIB support for SME

The EIB Group (the European Investment Bank and the European Investment Fund) support small and medium enterprises with a range of products, including loans, equity and guarantees. Support for financing SMEs is a key priority for the EIB Group, representing over 20% of the Bank's activity. Potential advantages for entrepreneurs are:

- increased amount of available funding
- reduced cost of borrowing
- longer-term loans

In 2012 EIB lent EUR11 bln to SMEs with an estimated leveraged impact of at least EUR21.4 bln (due to requirement for intermediaries to lend at least twice the amount of the EIB loan).

The European Investment Fund is a specialist provider of risk finance for SMEs. The EIF committed EUR1.4 bln of equity in 2012 and catalyzed over EUR7 bln from other investors. This amount includes:

- issuing guarantees to stimulate new loan portfolios of EUR1.2 bln
- microfinance commitments of EUR40 mln
- committing over EUR600 mln of Structural Funds

13. EIB Group possible positioning in SME sector in Russia

Process of defining EIB Group possible positioning should be started with identifying:

- Volume of Russian market for each financial instrument available for the Group

- EIB potential impact on each of these markets

Table 13. EIB Group possible positioning in SME sector in Russia

Instruments available for EIB	Potential partners	Potential impact
Loan	Banks: SME Bank (VEB Group) State owned banks Private banks (1-tier, 2-tier) Leasing companies	Low – in a whole market Moderate to high – if specialize in some sectors, e.g., innovations, research and development, long-term loans.
Guarantee	Banks	Moderate to high – the market for medium-sized companies is in the beginning stage of development.
Equity	Russian Venture Company Agency for Strategic Initiatives	High – the market of venture capital investments is estimated at US\$20 bln (end of 2011).
Microfinance	Banks Microfinance organisations	Moderate to high – the market for SME is estimated at US\$1 bln (end of 2012).
Securitisation	Banks via SPVs	High – market currently does not exist, but will evolve in the near future.

Another key factor influencing EIB future positioning is EIB risk appetite, which should be defined by its stakeholders.

14. Assessment of scenarios in terms of impact on the Russian SME sector

The table below illustrates how different scenarios may affect the SME sector in Russia. Market penetration scenario means the combination of product to ultimate client (SME) and appropriate distribution technology.

Scenario: product and distribution technology

The level of potential impact depends on two parameters: current level of market maturity and the potential market size in the medium term. The highest potential impact can be reached on currently less developed markets with considerable potential market size, and the lowest potential impact can be reached on currently developed markets or markets with small potential in terms of size.

Potential impact: current market maturity and potential market size

It is essential to consider that the potential impact can be practically reached only if the appropriate distribution technology is capable to deliver the required volume of financing with acceptable level of risk.

Real impact: potential impact and distribution technology capacity

Thus, the scenarios with high and very high level of potential impact and also with high and very high level of distribution technology capacity may reach the highest level of real impact.

Table 14. Assessment of real impact on Russian SME sector

Scenario = (1) product + (2) appropriate distribution technology					Impact assessment		
(1) Product for ultimate clients (SMEs)	(2) Distribution technology				Market	Potential	Potential
	Three-level	Two-level	Gua-	Securiti-			

	financing*	financing**	rantee	zation		maturity level	market size	impact
Short term loans	✓	✓	✓	n/a	⇒	Developed	Very large	Low
Long term loans	✓	✓	✓	✓	⇒	Developing	Very large	High
Long term loans to non-trade segment	✓	✓	✓	✓	⇒	Emerging	Large	Very High
Long term loans to innovative segment	✓	✓	✓	n/a	⇒	Emerging	Large	Very High
Leasing to SMEs	✓	✓	n/a	n/a	⇒	Developing	Medium	High
Leasing w/o railway and passenger cars	✓	✓	n/a	n/a	⇒	Emerging	Medium	Very High
Factoring	✓	n/a	n/a	n/a	⇒	Emerging	Small	Moderate
Microfinancing	✓	✓	n/a	n/a	⇒	Emerging	Small	Moderate
Equity	✓	✓	n/a	n/a	⇒	Developing	Large	Moderate

Level of technology complexity and risk exposure	Low	Moderate	High	High
Technology capacity	Very High	High	Low	Low

*Three-level financing implies work with local development institutions (e.g., VEB and its subsidiary SME Bank) which will supply financing to commercial banks (2nd level) and after that commercial banks provide loans to SMEs (3rd level). This option will give EIB the access to a broad client network without establishing direct relations with commercial banks and will significantly reduce cost and risk. This option, however, will lead to lower level of control and will limit the ability for direct SME market impact.

** Two-level financing implies work with Russian commercial banks (including State-owned, privately- owned and international banks) which will provide loans to their ultimate clients (SMEs).

15. Conclusions

- The SME business in Russia is a point of priority for the Russian economy and governmental bodies. First, it provides the potential for the diversification of the economy from the current concentration on natural resources. Second, SMEs create workplaces and, actually, about one-quarter of the employable population in Russia works at SMEs. Third, the SME sector is a potentially considerable taxpayer which can provide the state budget with a diversified income base.
- The growth rate of SMEs output after the crisis is about 19% per year, which can be treated as considerable.
- The Russian government is concentrating its efforts on providing support to SMEs and support for financial activities with SMEs, but at the moment the system of support is fragmented and not fully transparent.
- A comparison of SME financing market figures for Russia and Europe shows the considerable potential for the growth of banking and nonbanking financing to SMEs.
- Actually the share of Russian banks' loan portfolios related to SMEs is the lowest in comparison with corporate and retail loans and, at the same time, the level of overdue loans in the SME sector is the highest. This is mainly caused by the fact that the majority of Russian banks are in the beginning stage of implementing SME lending technologies, but this process is intensifying.

- The majority of SME financing markets in Russia are in the developing or emerging stage, and there is potential for international financial institutions to make a considerable impact on the economy through enhancing financial services to the SME sector.

Appendix 1. Federal law 88-FZ details

According to this law the subjects of small business should have been commercial organizations in whose authorized capital the share of participation of the Russian Federation, its subjects, voluntary and religious organizations (associations), charity and other funds did not exceed 25% and the share belonging to one or several juridical persons, which are not the subjects of small business, did not exceed 25% and in which the average number of workers did not exceed:

- 100 people – in industry,
- 100 people – on construction,
- 80 people – in agriculture,
- 60 people – in the scientific and technical sphere,
- 50 people – in wholesale trade,
- 30 people – in retail trade and domestic services,
- 50 people – in other branches and in activity of other types.

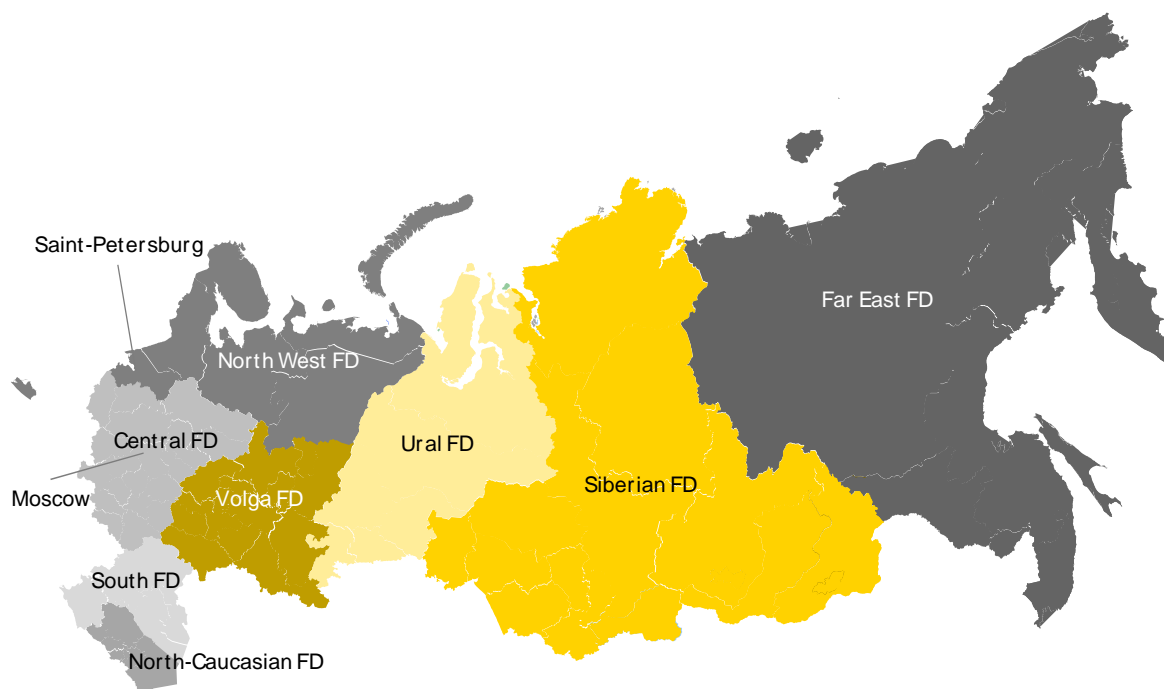
Natural persons who were engaged in business activity without the formation of a legal entity were also considered subjects of small business.

The objectives of state support were defined as:

- formation of the infrastructure of support and development of small business;
- creation of favorable conditions for the use of state financial, material and technical and information resources and also scientific, technical and information resources, scientific-technical developments and technologies;
- establishment of a simplified procedure for the registration of subjects of small business, licensing of their activity, certification of their products and submission of statistical and accounting reports;
- support of foreign economic activity;
- organization of trainings, retrainings and advanced trainings of personnel.

The law also specified the creation of funds of support for small business to realize federal programs and implementation of the law. The taxation of small business was according to active legislation. If legislation were to become unfavorable, small business could continue to operate under previous more favorable legislation (only during the first four years of operations). One of the preferences for small business was the possibility for accelerated capital allowances. Other preferences for small business were to obtain loan and to be insured on soft terms (with the compensation of the corresponding difference for credit companies from the resources of the funds of support for small business).

Appendix 2. Statistics on Russian SMEs: regional data



Region	Annual Income per capita, 2012	Total number of SMEs (2012 pro rata)		Total SME turnover (2012 pro rata)		Banks' total loan portfolio to SME (01.01.2013)	
		Number, mln	%	EUR bln	%	EUR bln	%
Russia, total	6,864	4.40	100.0%	885	100.0%	112	100.0%
Central Federal District	8,872	1.07	24.3%	313	35.4%	44	39.3%
<i>incl. Moscow</i>	14,503	0.27	6.1%	158	17.9%	24	21.0%
North West Federal District	6,905	0.46	10.5%	113	12.8%	14	12.2%
<i>incl. Saint-Petersburg</i>	8,220	0.18	4.0%	65	7.4%	7	6.1%
South Federal District	5,517	0.52	11.7%	66	7.5%	11	9.6%
North-Caucasian Federal District	5,140	0.25	5.7%	20	2.3%	4	3.3%
Privolzhsky (Volga) Federal District	5,840	0.86	19.5%	152	17.2%	18	15.7%
Ural Federal District	7,734	0.39	8.8%	76	8.6%	7	6.6%
Siberian Federal District	5,425	0.63	14.3%	102	11.5%	11	9.5%
Far East Federal District	7,530	0.23	5.2%	43	4.8%	4	3.8%

Appendix 3. Requirements to banks applying for participation in the SME Lending Program of SME Bank

Requirements to banks applying for participation in the SME Lending Program of SME Bank

General Terms

The Bank of Russia banking license

Current long-term credit ratings not lower than: S&P – B- (CCC+ if the bank provides collateral in the form of the state guarantee of the subject of Russia), Moody's – B3 (Caa1), Fitch – B- (CCC) and other ratings on national scale or from Russian rating agencies

Positive previous year audit report

Absence of the Bank of Russia sanctions in the form of the prohibition to perform certain banking operations and open branches, as well as in the form of suspending the license to certain banking operations, absence of unfulfilled orders of the Bank of Russia

Experience in lending to SMEs and a ready portfolio of SME subjects as of the date of the application; specialized technologies/programs for operations involving SMEs

Non-financial criteria

Positive business reputation

Absence of unfinished trials where the potential partner is the defendant, involving authorities, state organizations, taxation and supervisory agencies

Absence of bad credit history with SME Bank

Financial criteria

The size of equity capital not lower than RUB230 mln (EUR5.75 mln)

The capital adequacy ratio above 10.2% (15% for banks with equity capital under RUB300 mln)

Absence of unfinished client payment due to insufficient funds on correspondent accounts

Observance of compulsory requirements set by the Bank of Russia

The partner's credit portfolio arrears - under 12%

The share of 3-5 quality category loans shall not exceed 60% of the total credit portfolio; in case this value exceeds 40% the partner shall provide additional information on the credit portfolio structure with respect to quality categories

The share of non-state securities in the operating assets shall not exceed 30%

Optional criteria

Considerable SME lending potential

Support on the federal and regional levels

Successful partnership experience with SME Bank and/or Vnesheconombank in various areas of activity

Controlled risk of reputation loss to SME Bank

Appendix 4. The overview of the Russian banking market and its trends (1/5)

Decrease of the growth rates, consolidation, and focus on retail sector – are the main trends in Russian banking sector

Expected changes in Russian banking sector:

Market size and growth

- In 2013 the volume of total banking assets in Russia is expected to reach EUR 1 250 bln (at current exchange rate at year end)
- Market will continue to grow but with decreased growth rates of about 10 - 12%
- Retail banking sector growth rates are expected to slow down

Market structure

- Market consolidation will continue, the total number of banks will continue to decrease
- A tendency of the growing pressure of the large state-owned banks will preserve
- Privately owned banks will focus mainly on retail, SME and MidCap segments as local LargeCap is predominantly covered by state-owned banks

Future success factors

- Business scale, capital size and funding
- Innovative and technological business-models
- Network efficiency, right choice of product line and speed of entry in new market segments

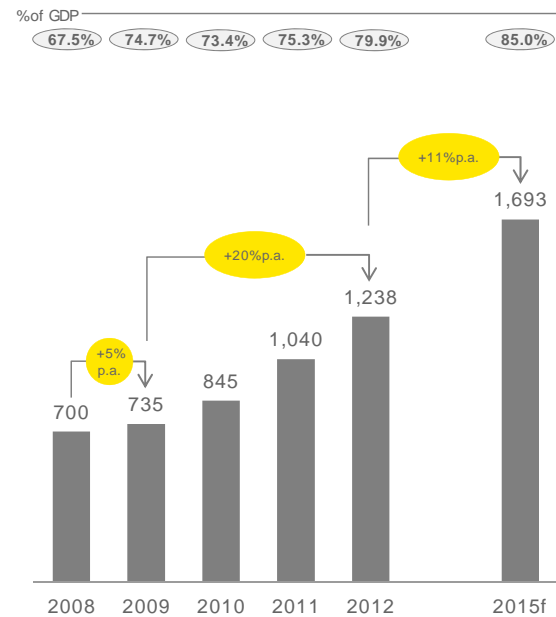
Small players without a clear focus will be squeezing out of the market

Appendix 4. The overview of the Russian banking market and its trends (2/5)

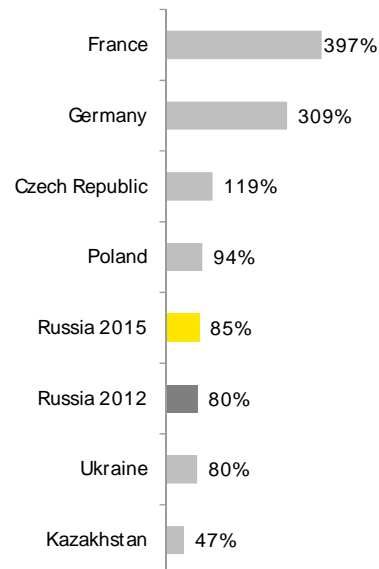
Bank assets growth rate will substantially slowdown, the volume of banking assets will reach 1 693 EUR bln by 2015

Total bank assets in Russia:

Assets, EUR bln.



Assets % of GDP, 2012 r.



Comments

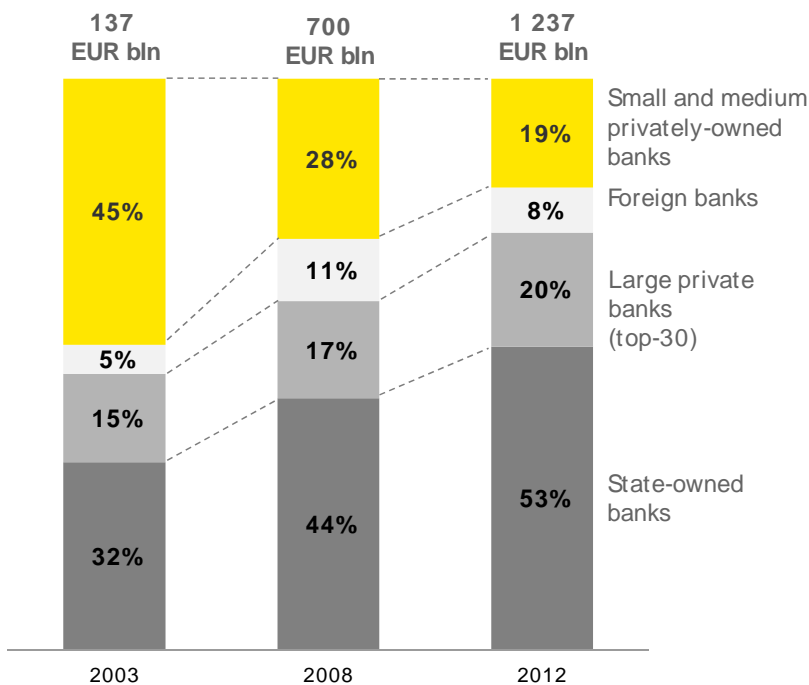
- In the next years it is expected that the current trend of GDP growth rate slowdown will preserve
- The bank assets to GDP ratio will continue to grow, however it's growth rate will slowdown
- Bank assets to GDP ratio is expected to be 85% by 2015
- Average growth rate of Bank assets in Russia will amount to 11% by 2015

Sources: EY, Bank of Russia

Appendix 4. The overview of the Russian banking market and its trends (3/5)

For many small banks without distinct positioning a survival question arises

Bank assets share in banking sector by types, %



Comments

- ▶ The structure dynamics of the banking sector indicate that state-owned banks are strengthening
- ▶ In particular it is connected with state-owned banks being preferred by consumers as their financial services providers
- ▶ This trend will increase in case of economic decline
- ▶ Foreign bank's share in Russian banking assets decreased due to the problems at their domestic markets
- ▶ A substantial decrease of Russian small banks share is observed

Sources: EY, CEE Banking Sector Report

Appendix 4. The overview of the Russian banking market and its trends (4/5)

In the coming years positive trends will persist while the economy growth rate will not exceed 3.9%

Key macroeconomic indicators

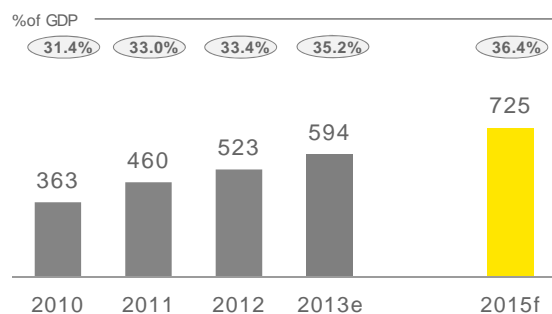
	2009	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP (% change)	-7.8	4.5	4.3	3.4	2.1	3.3	3.9	3.9	3.5
Nominal GDP (US\$ bil.)	1,222	1,524	1,898	2,014	2,129	2,333	2,604	2,841	3,047
Nominal GDP Per Capita (US\$)	8,679	10,864	13,232	14,067	14,910	16,378	18,328	20,052	21,560
Consumer Price Index (%change)	11.8	6.8	8.4	5.1	6.7	5.5	4.9	4.5	4.1
Exchange Rate (RUB/US\$, end of period)	30.24	30.48	32.20	30.37	31.75	30.50	30.00	29.82	30.10

Source: IHS Global Insight

Appendix 4. The overview of the Russian banking market and its trends (5/5)

Forecasted population income increase will assure the growth of retail sector share in credit portfolio

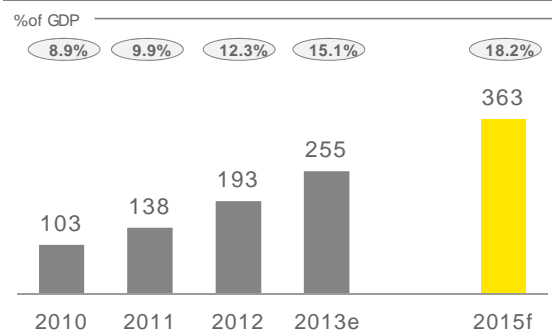
Credits to legal entities, EUR bln



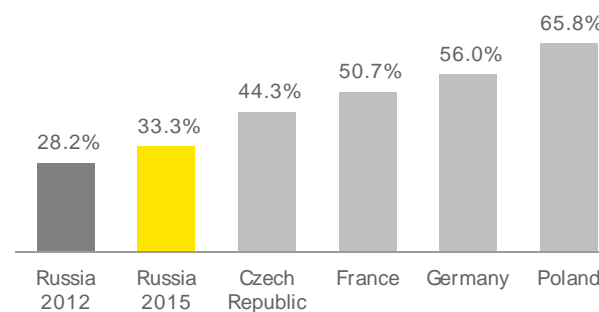
Comments

- ▶ Traditionally corporate lending significantly exceeded retail lending in Russia
- ▶ In the past years a significant growth of retail lending is observed, whereupon credit portfolio changes gradually approaching the indicators of the developed markets
- ▶ A further increase of retail credits share of 33.3% is expected by the end of 2015

Credits to individuals, EUR bln



Share of retail loan portfolio in total loan portfolio, %



Sources: EY, CEE Banking Sector Report, European Central Bank

Appendix 5. Legislative support to SME sector

State support to SME sector takes different forms (financial support, special tax regime etc.) with the focus on innovative SMEs

	LEGISLATION	DESCRIPTION
Federal Laws	<p>1 ▶ Law No. 88-FZ on State Support for Small Business in the Russian Federation (adopted in 1995)</p>	<p>Sets the framework for state support to small business, objectives, forms and methods of state stimulation and regulation of small business activity, definition and criteria for enterprises to be considered small-sized companies.</p>
	<p>2 ▶ Federal Law No. 209-FZ on Developing Small and Medium Scale Entrepreneurship in the Russian Federation (2008)</p>	<p>Replaced the previous 88-FZ. Introduced the terms "medium entrepreneurship", "microenterprises" and "infrastructure for support to SME". Defined methods of support for various forms of SME.</p>
	<p>3 ▶ Federal Law No. 82-FZ on "Development Bank" (2007)</p>	<p>Defines objectives and functions of the development bank, in particular states SME support as one of the main functions.</p>
Government measures	<p>1 ▶ State's finance program on SME support – Russian Government (2005)</p>	<p>Declares the goals such as the increase of the volume of support of the innovative SMEs, medium enterprises, leasing development, grant support of the beginner entrepreneurs, creation of SME support centers etc.</p>
	<p>2 ▶ President's Decree No. 956 on "Long-term state economic policy" (2012, May)</p>	<p>Sets measures and directions for improvement of entrepreneurship conditions, in particular through creation of mechanism of state's guarantees to secure medium-sized companies investment projects.</p>
	<p>3 ▶ The Ministry of Economic development - decree No. 143 on "Selection criteria for Russian medium entities and their investment projects" (2013)</p>	<p>Sets criterias for mid-sized entities (investment projects) selection for VEB guarantee support.</p>
<p>▶ State support of SME sector is focused on manufacturing sector with particular emphasis on innovative and technology intensive SMEs</p> <p>▶ According to the definition, innovations include modernization and energy efficiency</p>		

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