

FOCUS - Survey finds investors cautiously optimistic on Russia.

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MOSCOW, Oct 23 (Prime-Tass) - Market participants' top concerns about Russia as an investment destination are corporate corruption and the inadequate protection of investor rights, according to recent research carried out by U.S.-based consultancy LJ-Consultants. Despite these concerns, however, investors consider Russia's capital markets, especially the stock market, likely to deliver above average performance in 2004 as compared to emerging markets peers.

In a survey of 58 members of the financial community in the U.S., Western Europe, Russia and Latin America, LJ-Consultants found that 58% of respondents did not feel comfortable about the effectiveness of securities regulation in Russia. The survey also identified troubled relations between Russia's business and government structures as a major risk factor, and found that respondents initially viewed the ongoing crackdown on Yukos by the Prosecutor General's Office as the prelude to a wholesale review of the privatizations of state assets in the 1990s.

The survey respondents included 39 institutional investors, representing 13.4% of total institutional investments in Russia, according to Thomson Financial data, and 14 research analysts from leading Russian and Western brokerage firms. The responses to the survey were compiled between August 13 and September 25.

Institutional investors overwhelmingly agreed that Russia has become much more investor friendly since the late 1990s, President of **LJ Consultants**, Lev Janashvili noted. "They expect the overall credibility of the market to improve further, particularly in the areas of corporate governance and disclosure practices," he said. "At the same time, Russian corporations increasingly realize - with a sense of urgency - that they need to align their management and investor relations practices with the highest standards accepted in developed markets. These sentiments are taking root in Russia against the backdrop of impressive growth in the country's GDP, stabilizing inflation, and relative geopolitical calm. We see these developments as the pre-conditions for substantive improvements in Russia's investment merit."

The survey found that 91% of respondents rated corporate governance as "extremely important" or "very important" and 89% attached the same importance to transparency. Interestingly, factors often cited as important for Russia's investment case in the past were not judged so important, with only 58% of respondents rating the scale of the economy and its growth prospects as "extremely important" or "very important".

The drive for better corporate governance practices has resulted in increased credibility among

Russian corporations since the late 1990s, survey respondents said, but the corporate sector still gets poor or mediocre marks on management credibility, accounting, governance and disclosure practices. The quality of information issued by Russian corporations was rated as "poor" or "very poor" by 51% of respondents, and 54% rated the timeliness of information equally badly.

Respondents pointed out, however, that some Russian companies are exceptions to the generally lackluster performance of the corporate sector. Among those singled out for praise were Russia's number one oil producer Yukos, fruit juice and dairy producer Wimm-Bill-Dann, and metals giant Norilsk Nickel.

Putting the shoe on the other foot, those surveyed said the attractiveness of U.S. capital markets to Russian companies has not diminished after corporate and New York Stock Exchange scandals in the U.S. One respondent said this was because the issue at stake is liquidity, not prestige or respectability. Another argued that a more serious threat to the cachet of a U.S. listing could come from the London Stock Exchange, which has been intensifying its efforts to attract Russian listings and can also provide the requisite liquidity.

At the same time, 98% of those surveyed said American Depositary Receipt (ADR) programs and U.S. listings were "important" or "very important" for attracting Western investors. Surprisingly enough, 60% of European respondents considered an ADR "very important" compared to 43% of U.S. and Russian respondents.

However, 77% of buy-side respondents said they are willing to buy the local Russian shares of a company that does not have an ADR program.

Respondents disagreed on how the Sarbanes-Oxley Act would affect the appetite of Russian companies for a U.S. listing. Only 14% of U.S.-based respondents expect adverse consequences; 57% of this subgroup does not. On the other side of the equation, 43% of Russian respondents said the Act dampens the interest of Russian companies in the U.S. capital markets.

Discussing the findings of the survey, **LJ-Consultants'** Janashvili said he was surprised and encouraged that the overwhelming majority of respondents realized the central importance of addressing problems of corporate governance and corporate corruption to the further development of Russia's capital markets.

"But what really surprised me was that no-one said a thing about the importance of improving media independence," he said, adding, "This was really surprising because in my mind, you have investors placing greater burdens on the corporate sector, saying it needs to be transparent and accountable, and yet they do not see a link between an open corporate sector and an open government, which there cannot be without a strong independent voice for the media."

Janashvili said a crackdown on prominent voices in the media and the persecution of some journalists do not foster corporate accountability.

"People tend to view media independence in a vacuum - they believe it's good if we have it, but not too much of a problem if we don't," he said, and reiterated, "the media needs to get stronger, and I was really surprised that no-one said that."

Clearly an impressive element of the Russian capital markets, Janashvili said the stock market should nonetheless be viewed with a modicum of caution.

"It's hard to judge exactly what drives the surge in the RTS, and I think we should be somewhat cautious in reading that surge. There are not that many bona fide institutional investors active in Russia - as a percentage it is miniscule."

He said the remarkably small amount of institutional investment in Russia means the country's stock market underperforms those of some much smaller economies.

In response to some market experts' fears that the market is looking increasingly frothy, Janashvili said, "We should be concerned about valuations, but I don't think the market has reached the level of efficiency where we can treat it as an accurate reflection of asset values." Investors in Russia do not necessarily look at fundamental factors anyway, he said. "And as long as they keep buying when the market's up and selling when the market's down, they will exacerbate volatility and keep more mature investors from entering the market." End.