

Taming ~~THE~~ Wild East

New Russian Entrepreneurs
Tell Their Stories



DELTA Private Equity Partners

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Tell Their Stories



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This edition has been compiled by Delta Private Equity Partners

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Alexander Osipovich
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Twelve emblematic tales of entrepreneurial success in the new Russia,
plus a look back at the roots of pre-Revolutionary entrepreneurship.
Prepared by the investment company Delta Private Equity Partners.

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Dear Readers:



This book was inspired by our work over the last decade with Russian entrepreneurial management teams and the companies they created. That experience reinforced our conviction that the true engine of Russia's economy should be and will be the many smaller, growth-oriented companies that continue to emerge.

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In Russia today, one hears much about mega-companies and their owners and managers, the so-called oligarchs. But while the oligarchs dominate the headlines, a new class of entrepreneurs is hard at work – growing companies, taking risks, innovating, and in many cases reaping remarkable rewards for their efforts.

The new entrepreneurs are active in diverse fields, from high technology to consumer goods, from marketing to finance to media. They include men and women. They are from Moscow and other parts of Russia, from former Soviet republics and from Europe, America and elsewhere. They come to entrepreneurship often from very different backgrounds, with different ideas and aspirations.

5 As a group, these entrepreneurs are laying the groundwork for an increasingly dynamic, market-driven Russian economy. Individually, though, each entrepreneur has a highly unique story to tell.

For a decade, The U.S. Russia Investment Fund has been providing risk capital to Russia's new entrepreneurs. For a decade, we have been assisting Russia in developing the culture of entrepreneurship. As the Fund celebrates its tenth anniversary, we want to share some of these remarkable stories with you.

We thus thought it fitting now to publish a small book featuring some of Russia's ground-breaking businesspeople. The centerpiece of this book is a series of 12 candid portraits of entrepreneurs. Some of these entrepreneurs were financed by The U.S. Russia Investment Fund, others were not. We have also included a short introduction on Russia's entrepreneurs of the 18th and 19th centuries, since there are interesting and important antecedents to today's activities.

We thank all of our supporters for their assistance over these ten pioneering years. We continue to move forward, as a team, to demonstrate that your support was well-founded.

We hope you enjoy reading the book!

Sincerely,

Patricia M. O'Rourke

**Chairman and Chief Executive Officer
Delta Private Equity Partners**

THE U.S. RUSSIA INVESTMENT FUND

managed by **DELTA PRIVATE**

EQUITY PARTNERS

The U.S. Russia Investment Fund ("TUSRIF") was formed in Russia in 1995 under private management, but with the United States Government as its sole financial sponsor. TUSRIF's mission was to promote the development of a free market economy in Russia by providing investment capital – equity and debt – to well-conceived, potentially high-growth entrepreneurial companies. This was to be combined with technical assistance to management teams seeking to grow productive, transparent and valuable companies. Once such a program was established and working well, the TUSRIF

Board of Directors was to form a private successor fund. Additionally, it was to propose to the U.S. Government a plan for future use of the capital re-flows from TUSRIF's successful investments, a plan that would seek to further accelerate entrepreneurship in Russia.

2004 marks ten years since the Fund's inception. The primary mission has been accomplished. A successor private fund, the Delta Russia Fund ("DRF"), has been formed and planning for use of capital re-flows has begun.

Delta Private Equity Partners ("DPEP", formerly Delta Capital Management) has managed TUSRIF over this time. DPEP has invested approximately \$300 million in some 44 entrepreneurial businesses in Russia, including the following:

- DeltaCredit Bank, a leading mortgage bank;
- DeltaBank, a leading consumer lender;
- DeltaLease Far East, a regional equipment lessor;

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- Lomonosov Porcelain, a historic and well-known manufacturer of high-quality china;
- Saint Springs, a leading bottled water company;
- StoryFirst Communications, a leading television network;
- USP Compulink, a rapidly-growing systems integrator;
- Two SPAR supermarket chains, one in Moscow and another in the Middle Volga region.

The dynamism and increased liquidity that have characterized the Russian financial markets since 2002 have contributed greatly to the success of TUSRIF's investment program, reflected in several recent sales of investment positions at substantial capital values. These conditions also provided the necessary market momentum for TUSRIF to complete its transition to a purely private fund at this time.

Uniquely, the U.S. Government's development assistance to The U.S. Russia Investment Fund was the catalyst for DPEP's entry into, and contribution to, Russia's nascent private equity market. Now, with the private Delta Russia Fund also under management, DPEP can build in future years on that valuable foundation.

This small volume, *Taming the Wild East: New Russian Entrepreneurs Tell Their Stories*, is dedicated to those who, with imagination and great patience, first created then supported Delta Private Equity Partners and The U.S. Russia Investment Fund over the years.

INTRODUCTION

It was the best of times, it was the worst of times. On the one hand, the Russian economy was booming. Industrial output had doubled in the past decade, and Russia was the world's number one exporter of oil; Western capital was pouring into Russian enterprises, and adventurers from London, Paris and Berlin were heading east to make a fortune. On the other hand, life wasn't easy for Russia's entrepreneurs. With the nation's banking system still in its infancy, businesses had a hard time raising capital, and they faced a variety of other daunting challenges – above all, interference from a powerful and corrupt bureaucracy. "In Russia, private enterprise and capitalism confront very significant obstacles," wrote the Minister of Finance. "From the petty administrative authorities to top-level government agencies: receiving permission often depends on the personal viewpoint of this-or-that official, and it always involves a large amount of time: The entrepreneur bumps up against various rules, regulations and local

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9 decrees, and only the bravest ones, who are seduced by the promise of large profits, decide to establish new enterprises."

This might sound like post-Soviet Russia at the dawn of the 21st century. But in fact, it was the year 1900, and the frustrated Minister of Finance was Sergei Witte, writing a report to Tsar Nicholas II. In Witte's era, now heralded as the golden age of Russian capitalism, entrepreneurs had opportunities that seemed as boundless as Russia itself – and obstacles, like the state bureaucracy, that seemed equally large and immovable.

It was much like the era we live in today. Despite a century of revolutionary changes, there are remarkable echoes between Russia's golden age of capitalism and today's post-Soviet business environment. Mark Twain once wrote that history doesn't repeat itself, but sometimes it rhymes. He wasn't talking about Russia specifically, but he

could have been; from the perspective of the Western investor or the Russian entrepreneur, Russian capitalism has gone back to where it started. **10**

The purpose of this book is to provide a snapshot of Russian entrepreneurs a dozen years after the rebirth of capitalism in Russia. So why begin with a historical survey? We felt it was important not just to talk about the flowers in the garden, but about the soil in which they grew. During the Soviet period, many Western observers decided that communism had crushed the entrepreneurial spirit of the Russian soul. They even coined a term, "Homo Sovieticus," to describe this initiative-less, downtrodden shell of a human being. So after the collapse of communism, hordes of Western experts were airlifted into Russia to teach the basics of business to the ignorant natives. But slowly, a remarkable thing occurred – the natives turned out to be surprisingly dynamic and business-savvy. They

11 quickly adapted to the new conditions, creating successful businesses from the rubble of the Soviet economy. The spirit of entrepreneurship had never really died; it had just been hiding in the shadows of Marxist-Leninist ideology.

Moreover, the new breed of entrepreneurs wasn't entirely new. They had their predecessors, in the merchants and capitalists who dominated Russian life before the Revolution. Of course, there is an abyss of time and history between the entrepreneurs of today and those of tsarist Russia. But by looking at these early Russian entrepreneurs and the world they created, we can better understand the entrepreneurs of today, and where they are taking Russia.

THE DAWN OF THE RUSSIAN ENTREPRENEUR

Capitalism came late to Russia, compared to countries like England and France. There was a simple reason for this: the absolute power of the tsarist state. Up until the mid-18th century, the concept of private property did not exist in the Russian Empire. Everything belonged to His Majesty the Tsar – although in practice, it was managed by various aristocratic families. The government also held monopolies in manufacturing and trade.

Under these circumstances, the best way to enrich oneself was to get close to people with political power. One person who succeeded using this tried-and-true formula was Alexander Menshikov. Descended from a peasant family, Menshikov grew up on the streets of Moscow. He was either selling meat-pies or picking pockets (depending whom you ask) when he accidentally encountered Peter the Great. The young tsar, impressed by Menshikov's peasant cleverness, made him his servant, and thus began a strange, lifelong friendship. As Peter's right-hand

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13 man, Menshikov became a military commander, then the first governor-general of St. Petersburg, and finally an all-powerful War Minister. In the process, he became fantastically wealthy, mostly by embezzling funds from the state treasury. At one point he possessed over 90,000 serfs. Peter occasionally heard news of Menshikov's corruption. On these occasions, he would punish his friend by publicly beating him with a stick. However, the two always made up afterwards, often with a drinking binge that lasted several days. Peter even awarded Menshikov with a pompous title: "His Serene Highness the Prince of Rome and Russia, etc., etc." But when Peter died in 1725, Menshikov's joyride came to a crashing halt. His enemies forced him out of power, exiling him to northern Siberia. His Serene Highness died in poverty a few years later.

Menshikov's fall from grace illustrates an important truism of the Russian business world: if you accumulate your wealth thanks to political connections, as soon as your well-placed friends die or leave office you're likely to kiss your rubles goodbye. For a recent example, just look at Russia's oligarchs of the 1990s; after

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accumulating vast fortunes thanks to their ties to the Yeltsin Family, they now face an uncertain future under Putin. But luckily, not all of Russia's success stories are well-connected crooks like Alexander Menshikov. There have also been successful, honest entrepreneurs who made their money through hard work and wise business decisions. Consider the Yeliseyev family, the famous dynasty of food merchants.

The story of the Yeliseyevs begins in the winter of 1812, at the estate of Count Sheremetiev, a prominent Russian aristocrat. Numerous guests had gathered for a midwinter banquet. When it was time for dessert, the servants unveiled an exquisite surprise – fresh strawberries. The guests were astonished; nobody had ever seen fresh strawberries in the middle of a Russian winter. The banquet went down as a smashing social success. In gratitude, Count Sheremetiev called in his gardener, a serf named Pyotr Yeliseyev, who had been growing the berries in a special greenhouse. The count offered Yeliseyev whatever he wanted as a reward for his stellar service. The gardener replied that he wanted his freedom. His wish was granted.

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THE DAWN OF THE RUSSIAN ENTREPRENEUR

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The Yeliseyev Store on Tverskaya Street in Moscow

One year later, Pyotr Yeliseyev opened a small shop in St. Petersburg selling wine and imported foodstuffs. He could barely read, but he was organized and energetic, and the business prospered. After his death in 1825, the shop was taken over by his wife and two sons. It was Pyotr's son Grigory who took the Yeliseyev name to new heights of glory. Grigory was a skilled businessman who established excellent relations with his foreign suppliers, as well as a master wine-taster who sampled every shipment that arrived in St. Petersburg. By the 1840s, the "Yeliseyev Brothers" company owned three cargo ships that sailed regularly between Russia and Holland. By the 1850s, the company was consuming the entire grape harvest of certain regions of France. Grigory Yeliseyev finally retired in 1896, handing over the business to his son, who had the same name. The second Grigory Yeliseyev made the family business a truly nationwide brand, opening new stores in Moscow and Kiev. The Moscow store commanded special attention – located on Tverskaya Street on the site of an 18th-century palace, it took two years to build, while fantastic rumors spread about the interior design. Some said it would resemble a Hindu shrine; others expected it to be a full-fledged temple to Bacchus. The grand open-

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ing attracted a huge crowd. On entering the store, shoppers gaped at the grand crystal chandeliers, the stained-glass windows, and the lavishly decorated mahogany walls. You can still see Yeliseyev's store in Moscow today; it re-opened in 2003 after a \$3 million restoration. Once again, it offers a wide variety of luxury imported foods, wines, and (of course) fresh strawberries.

By mastering the business of international trade, the Yeliseyevs became one of the best-known entrepreneurial families in 19th-century Russia. Historically, Russia had always been a major center for world trade, lying at the crossroads between East and West. In fact, Russia was home to the world's largest market – the famous market of Nizhny Novgorod. As early as 1804, a traveler from France described the immense column of dust rising into the air from the Nizhny Novgorod marketplace; coming closer, he saw a massive, seething swarm of men, horses and carts, which dwarfed anything he had seen in Western Europe. Here, merchants from China, Persia and Central Asia rubbed shoulders with their Russian and European counterparts.

While trade was a strong point of the Russian economy, there were weaknesses that held back the growth of capitalism. Above all, Russia was an overwhelmingly agrarian country. More than 80% of the population were peasants, living off the land and participating little in the urban economy. When it came to industry, Russia lagged far behind the developed economies of Western Europe. The tsarist government recognized this problem, and responded by encouraging investment in the industrial sector – most importantly, in Russia's growing network of railroads.

Much like the American West at the same time, Russia had huge expanses of land that were poorly connected by dirt roads and river routes. Thus, a capable person could forge a brilliant career in the booming railroad business. One such person was the future Minister of Finance, Sergei Witte. Born into a family of government officials with noble roots, Witte initially wanted to enter academia, studying mathematics at the university in Odessa. But his father's death compelled him to enter government service. He started out as a cashier on the

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19 Odessa railroad. Thanks to his intelligence, he rapidly rose through the ranks, until he became the head of the government-owned network of railroads in the southwest part of the Russian Empire. When this network was privatized, Witte found himself in charge of a wealthy private corporation. He was a gifted manager; between 1880 and 1889, the company's annual profits rose from 470,000 rubles to 13 million. But the critical moment of Witte's railroad career came in 1888, when Tsar Alexander III passed through his network to vacation in the Crimea. The demanding, autocratic tsar was unhappy with the speed of his train, and he ordered it to plow ahead faster. Witte refused to execute the order – he knew that increasing the speed could cause the train to derail. The tsar was not pleased. After returning to St. Petersburg, he issued an order that raised the speed limit for trains across Russia. His sycophantic ministers praised the tsar's "wise" decision. But the order proved to be disastrous, leading almost immediately to a derailment. (Luckily, no one was killed.) Alexander reconsidered his attitude towards Witte, and invited him to work for the finance ministry. In 1892, Witte became Minister of Finance.

TAMING THE WILD EAST: NEW RUSSIAN ENTREPRENEURS TELL THEIR STORIES

Witte was a talented individual with a solid understanding of modern capitalist economics. In private, Kaiser Wilhelm II of Germany called him the smartest man in Russia. And considering the rest of the tsarist government, it is easy to see why Wilhelm made such a claim. The other ministers were largely preoccupied with praising the tsar at every opportunity, persecuting Jews, and upholding the interests of the fading nobility. Witte would have none of this. Instead, his primary goal was to modernize Russia, lifting the Russian people from poverty and thus preventing the possibility of revolution. To accomplish this, he took dramatic, controversial steps like stabilizing the ruble and encouraging foreign investment. Amazingly, Witte had no sentimental attachment to the nobility, even though he had noble blood himself. He wrote in his memoirs, "Politically speaking, the majority of nobles constitute a band of degenerates who are concerned solely with their own interests: [they] direct their efforts at extracting favors from the government at the expense of the people." Instead, Witte saw the future of Russia in another class of people – Russia's new breed of entrepreneurs.

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Sergei Witte

STARS OF THE GOLDEN AGE

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ho were these entrepreneurs driving Russia into its golden age of capitalism? The historical record can't always be trusted. Like the "New Russians" of today, their success aroused a great deal of public resentment; the left-leaning *intelligentsia* condemned them as bloodsucking capitalists, while conservatives, who were nostalgically attached to the *ancient regime*, regarded them as dangerous agents of Western liberalism. After the Revolution, Soviet textbooks inevitably portrayed them as villains, overlooking their impressive accomplishments.

One thing that is clear, however, is that most entrepreneurs emerged from the poor, disenfranchised classes of Russian society. Very few members of the nobility went into business. Accustomed to the easy life, and disdaining enterprise as an activity for "common folk," they left the job to Russia's poorest class: the peasants. At the dawn of the 20th century, many of Russia's wealthiest entrepreneurs

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had peasant backgrounds. Some, like the Yeliseyevs, were the descendents of liberated serfs. There were also a disproportionate number from religious minorities – most notably, the Old Believers.

At first glance, the Old Believers might seem like a strange group to spearhead the modernization of Russia. The sect broke away from the Russian Orthodox Church in the 17th century, over an obscure liturgical dispute that involved, among other things, crossing oneself with two fingers instead of three. Originally, they were best known for massive acts of self-immolation and for predicting the Apocalypse. Persecuted by the tsarist authorities, they fled to faraway villages in Siberia and the Russian north. But as it turned out, the qualities that made them unwanted refugees in the 17th century made them successful businessmen in the 19th. Having lived for generations outside the reach of the tsarist bureaucracy, the Old Believers were an independent, hard-working bunch who saved up their capital and reinvested it in their communities. Their religious lifestyle gave them another competitive advantage – they refused to drink alcohol.

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Without a doubt, the most celebrated family of Old Believer entrepreneurs were the Morozovs. The founder of the dynasty was Savva Morozov, a devout, hard-working peasant from the Vladimir region. Morozov established a small workshop making silk and lace; he used to walk hundreds of kilometers to Moscow to sell his goods. By 1812, he had made a small fortune selling his fabrics. In that year, Napoleon occupied Moscow, and the city burned down, destroying its textile mills. The government adopted a protective tariff to rebuild the industry. Morozov took full advantage of the opportunity; he moved to the capital, opened a factory for the production of cotton cloth, and rapidly became one of Moscow's richest entrepreneurs. To the end of his days, he remained thrifty, despite his wealth. He also remained completely illiterate.

But despite his lack of schooling, Morozov spared no expense in educating his children. And thus, when his grandson (also named Savva Morozov) came of age, the new standard-bearer for the family was a refined, high-society gentleman. The young Savva Morozov studied chemistry at Cambridge and traveled to Manchester to see the English textile industry. In 1887, his father fell ill, and Savva, who was only 25, took

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Savva Morozov

over the family business. It was a bad time for the Morozovs. The market was depressed, and a nasty strike had just crippled their factories, leading to political attacks against Savva's father and ruining his health. Savva Morozov planned an aggressive response to the crisis. He launched an expensive modernization of the factories, importing the latest equipment from England over the strenuous objections of his father. The gamble paid off. By the late 1890s, Morozov's fabrics were outselling their English competitors in Persia and China; his factories employed over 13,000 people, producing two million square meters of cloth every year. As a multimillionaire, Morozov became famous for his contributions to charity. He opened schools, nurseries and hospitals near his factories, and he also became a patron of the arts, donating the money to establish the legendary Moscow Chekhov Art Theater. Sadly, Morozov's love for theater proved to be his undoing. He committed suicide in 1905, driven to despair by a hopeless love affair with a beautiful actress.

Meanwhile, a number of entrepreneurs were foreigners who came to Russia as youthful adventurers and ended up setting down roots. Henri Brocard, the perfume king

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of Moscow, was one such foreigner. A Frenchman by nationality, Brocard actually grew up in Philadelphia, where his father and older brother ran a cosmetics store. When his brother died, Brocard left the U.S. and moved to Russia. An expert chemist, Brocard dreamed about starting his own cosmetics business, but he had no money and little experience. He started out as a laboratory assistant in a Moscow perfumery. There, he invented a technique for making concentrated scents, and sold it to a French company for 25,000 francs. This gave him the capital to launch his own business. In 1864, Brocard opened a tiny workshop. He and his two employees produced 100 bars of soap every day. Dressed in his best suit, Brocard himself walked around Moscow selling his soap to shopkeepers. He succeeded thanks to savvy marketing; he presented his product as "children's soap," and each bar of soap looked like a toy block, featuring a letter from the alphabet. The gimmick caught on. In less than ten years, Brocard was running a full-fledged factory with 30 employees, and his products had won several awards. The Frenchman ran a tight ship. He always woke up at six in the morning and began to work immediately, often tinkering in the lab with new recipes and procedures. But it wasn't chemistry that made "Brocard & Co." a

prestigious, nationwide brand – it was an innovative, and sometimes shameless, approach to marketing. During the Russian-Turkish war of the 1870s, Brocard made a lipstick called the "Bouquet of Plevna," named after the site of a major Russian victory. The firm had legions of loyal customers. When Brocard & Co. opened its first boutique, there was such a stampede that the police showed up to maintain order.

Of course, there were also entrepreneurs who were 100% Russian, and equally capable of innovation and success. One of them was Ivan Sytin, the son of a country clerk who became the biggest publisher in pre-Revolutionary Russia. Sytin started out as the apprentice of an elderly, childless bookseller in Moscow. The bookseller took a liking to the boy, giving him books to read and teaching him the tricks of the trade. When Sytin reached adulthood, he decided to start his own business. His idea was to start a network of door-to-door salesmen, offering small, printed pictures of religious subjects. The bookseller approved, and gave him the money to buy a printing press. It turned out to be a profitable idea. Ordinary Russians – who were predominantly devout, but illiterate peasants – snapped up the inexpensive pictures.

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In 1884, Sytin was approached by Vladimir Chertkov, an aide to the renowned author Leo Tolstoy. Chertkov had been trying to find a publisher to print cheap, mass-produced editions of books by great Russian writers, but so far, he had failed to convince anyone. Nobody believed that such a project could be profitable. To Sytin, however, it sounded like a great opportunity. His small publishing house began printing the books, with Tolstoy himself providing editorial services. Sytin viewed the effort as a sacred duty – but it was also a profitable one. Within six years, his profits had doubled. In addition to the Russian classics, Sytin began to publish translations of foreign bestsellers, such as "Uncle Tom's Cabin" and "Robinson Crusoe." In 1902, he entered the newspaper business. His newspaper, *Russkoye Slovo*, became one of the biggest in Russia, with a print run of 700,000 copies on the eve of the Revolution. One reason for the newspaper's success was the new technology of telegraphs and telephones. At the Ministry of Finance, Sergei Witte complained that *Russkoye Slovo* learned about events faster than the government did.

Entrepreneurs had an immense influence on life in pre-Revolutionary Russia. They were the dominant force in philanthropy, responsible for over 90% of the money given to Russian charities. Schools, orphanages, hospitals and soup kitchens all depended on their donations. Russia's entrepreneurs were also a major force in culture. One man alone, industrialist Savva Mamontov, made an incalculable contribution to Russian art – his pet projects included the famous retreat for painters at Abramtsevo, the influential journal "The World of Art," and Russia's first private opera house. And if you visit Moscow's most famous art museum, the Tretyakov Gallery, you can thank merchant Pavel Tretyakov, who gave his collection to the city in 1892.

Russia's entrepreneurs understood the modern world far better than their despot, backward-looking government. So not surprisingly, many of them craved political change. One of these was banker Pavel Ryabushinsky, the founder of Russia's first stock exchange. Ryabushinsky published the liberal newspaper *Utro Rossii*, and together with industrialist Alexander Konovalov, he

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led a faction called the Progressive Bloc in Russia's pre-Revolutionary Duma. Both men were millionaires, and both were descended from Old Believer families. When war broke out in 1914, the duo played a key role in supplying the Russian army with food and clothing. This experience gave Konovalov and Ryabushinsky a valuable insight – entrepreneurs, they realized, could fulfill certain functions of the state better than the state itself. So when the tsarist regime collapsed in February 1917, it seemed like their moment had arrived. Konovalov became the Minister of Trade in the short-lived Provisional Government. For a few turbulent months, it seemed like Russia might develop on liberal, democratic principles. But then came October 1917. The Bolsheviks stormed the Winter Palace, plunging Russia into the Red Terror and kicking off seven decades of communism. It seemed like the age of the Russian entrepreneur had ended.

REVOLUTION AND REBIRTH

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According to Marxist-Leninist ideology, the central evil of capitalism was private ownership of the means of production. Thus, the Soviet Union outlawed all forms of private enterprise. From farms to factories to food stores, all enterprises came under the control of an omnipotent state. In theory, this was supposed to lead to a fair distribution of wealth. In practice, it led to a grotesquely inefficient economy that could barely fulfill the basic needs of Soviet consumers.

Thanks to the shortcomings of the command economy, there was always a role for entrepreneurs in the Soviet Union. The regime (which never quite achieved its promised socialist utopia) grudgingly allowed the existence of private enterprise, within strict limits, when there was no other way to satisfy people's needs. For instance, after the massive starvation of 1921 and 1922, Lenin instituted the New Economic Policy, or NEP. The NEP allowed farms, shops and small factories to function under private ownership. The result was a resounding success; com-

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merce revived and starvation ended. But to the Bolsheviks, the NEP was nothing more than a "temporary retreat" along the road to socialism. Their propaganda portrayed the NEP's entrepreneurs as scheming, antisocial criminals. For many Russians, this period is embodied in Ostap Bender, the hero of the satirical novel "The 12 Chairs" by Ilya Ilf and Yevgeny Petrov. Bender is a cynical conman searching for hidden treasure; at the end of the book, he is killed as punishment for his greed. Unfortunately, a similar fate awaited the petty entrepreneurs who flourished under the NEP – especially if they were private farmers. In 1928, when Stalin ordered the collectivization of Soviet agriculture, millions of peasants died resisting the brutal process, or else they starved in the ensuing famine. The failure of collectivization forced Stalin to make a major concession: he allowed the peasants on collective farms to have private plots. For the lifetime of the Soviet Union, these tiny, productive plots coexisted side-by-side with the enormous, unproductive fields of the collective farms. According to one estimate, private plots took up 2% of the nation's farmland, but produced 26% of the nation's agricultural output.

In the late Soviet period, the shortage of goods led to the emergence of a **34** gigantic, thriving black market. Underground entrepreneurs could make vast, unofficial incomes in this shadow economy, usually by selling rare goods to the Party elite. In fact, one of Moscow's biggest black marketeers was the manager of the old Yeliseyev food store (which had the uninspired name "Gastronom No. 1"). He was ultimately arrested for the crime of caviar smuggling. Black marketeers could take advantage of the absurd distortions of the Soviet economy. For instance, because of subsidized air travel, one could buy a bag of oranges in Georgia, get on a flight to Moscow, and sell them at the airport for a handsome profit.

When Gorbachev came to power, the Soviet regime began to consider the unthinkable – legalizing private enterprise to revive the stagnant economy. In 1988, the Law on Cooperatives gave individuals the right to start private businesses. It was in this period that many future capitalists of the 1990s got their start. Mikhail Khodorkovsky, the future oil billionaire, opened a cafe. Vladimir

35 Gusinsky, who would later become an all-powerful media mogul, quit his job as an obscure theater director and started a small business making copper bracelets. Mikhail Fridman, who would later establish the Alfa banking group, started out by reselling theater tickets. One of his early, less-successful ventures involved breeding white mice for use in scientific laboratories.

Due to price controls and other restrictions, private enterprise didn't really flourish until the USSR collapsed and Yeltsin began his radical reforms. For example, retail sales were only liberalized by a presidential decree in January 1992. The effect of this decree was astounding. Literally overnight, thousands of traders appeared in the streets and squares of Russian cities. Unfortunately, there was a dark side to the boom; criminal gangs preyed on the fresh flock of street traders. For the post-Soviet entrepreneur, it became an unwritten law that one had to pay protection money to the local mafia. In return, they would supply your business with a *krysha* – a sort of insurance policy against their own thugs, literally translated, a "roof."

And that wasn't the only problem that entrepreneurs faced. Other challenges were abundant. The list included high taxes, police harassment, bureaucratic interference, changing laws, hostile takeovers, inflation, a lack of bank loans, an immature market, an absence of know-how, impoverished consumers and the skepticism of the general public. Moreover, even as the business climate improved, it also suffered some ferocious setbacks – most infamously, the financial crisis of 1998.

Yet amazingly, some entrepreneurs succeeded in this punishing business environment. And contrary to the stereotype, not all of them were well-connected bankers who cashed in on shady privatization deals; some of them were honest, courageous entrepreneurs who built profitable enterprises while sticking to the rules. In this book, we present the stories of twelve men and women who fall into the second category. By fighting for the right to run a legitimate business, they did far more than enrich themselves – they became the model for a new way of doing business in

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Russia. Because today, the values of having a sound strategy, transparent finances, and a long-term vision are becoming increasingly clear among the Russian business community. If Russia is no longer the Wild East, then these are the men and women who tamed it.

Thus, this book is more than a how-to guide for aspiring Russian entrepreneurs; it is an attempt to capture history in the making. After all, the people in this book may soon become the Savva Morozovs and the Grigory Yeliseyevs of the 21st century.



nikolai zinoviev

GIVING RUSSIAN BUSINESS A NEW LEASE ON LIFE

"When you're talking about financial services, you have to have very strong people. People are everything."

Nikolai Zinoviev is living proof that Russia is full of opportunities for young and motivated entrepreneurs. The 30-year-old businessman is the president and founder of Europlan (formerly known as DeltaLeasing), a leading small- and medium-sized business leasing company with 100 employees and a portfolio worth over \$50 million. But Zinoviev came late to the world of business – while he was growing up, he wanted to be an English teacher like his mother.



NIKOLAI ZINOVIEV:
"Initially, everybody laughed because nobody believed that leasing could work in Russia."

He entered the State Pedagogical University in his native city of Rostov-on-Don with the goal of studying English literature. But his university years were a time of dramatic change in Russia. The Soviet regime collapsed, and Russia entered its turbulent transition to a free-market economy. Zinoviev

became interested in business. He took a job at a local commercial bank, where he traded in foreign currency.

Quickly, Zinoviev realized that the bank could improve its foreign-currency business by upgrading its technology. He approached the bank's president and asked for 20,000 deutsche marks to install a state-of-the-art, satellite-based trading system. The president balked at the expense and refused. But Zinoviev persisted. Finally, the president changed his mind, after learning that banks in Moscow were using the new technology. Once the system was

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installed, Zinoviev's prediction came true – the bank saw a huge increase in its foreign-currency business, with added profits of hundreds of thousands of dollars a month. Zinoviev did what any young, ambitious employee would do under the circumstances – he went to his boss and asked for a raise. But the bank's president refused.

Today, Zinoviev laughs when he recalls the situation: "I sat down and thought, 'Hmm. Maybe I need to look for another job.'" At that point, Zinoviev had a stroke of luck. He met an American who was starting a new regional branch of

The U.S.-Russia Investment Fund in Rostov-on-Don. The American was impressed by the young, articulate Russian trader, and in 1995, Zinoviev became the Fund's vice president for the region. He spent the next few years overseeing loans to small- and medium-sized businesses in southwest Russia.

In doing so, Zinoviev realized several things. First of all, he perceived that the Russian financial sector was woefully underdeveloped, and there was a great, pent-up demand for banking services. Secondly, he realized that Russia's small- and medium-sized businesses



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were good borrowers – especially compared to Russia's large businesses, which were often poorly managed enterprises, acquired as the result of shady privatization deals. So Zinoviev had the bright idea of starting a leasing company. He approached Delta's management with his plan.

"Initially, everybody laughed," says Zinoviev, "because nobody believed that leasing could work in Russia." Nonetheless, he persuaded Delta's president to support him. In 1999, Zinoviev left his comfortable, well-paid job as vice president to become an entrepre-

neur, with three employees and \$200,000 in seed capital. And thus, DeltaLeasing was born.

It was a strange time to be starting a business in Russia. As a result of the 1998 financial crisis, hundreds of banks had gone under, and foreign investors were fleeing in droves. But paradoxically, the crisis proved to be a huge gift for DeltaLeasing. Because of the massive devaluation of the ruble, the price of imported goods had quadrupled, and Russian customers were turning en masse to domestic goods. To keep up with the increased demand, domestic manufac-

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43 turers needed to modernize their equipment – everything from beet harvesters to printing presses. To modernize their equipment, they needed to finance their purchases. And to finance their purchases, they turned to DeltaLeasing.

"The demand was just crazy," recalls Zinoviev. In fact, the first few months were so successful that Zinoviev won over the remaining skeptics at Delta Capital. He persuaded Delta to give him a new infusion of capital. This time, the goal was to turn his regional company into a nationwide brand. Zinoviev left Rostov-on-Don to launch the Moscow office of

DeltaLeasing. After 12 months DeltaLeasing had offices covering virtually all of western Russia.

But the company's rapid growth, combined with the uncertainty of the Russian market, was often a recipe for stressful situations. In fact, the first lease that Zinoviev booked in Moscow nearly ended in disaster. Working from a temporary office, without a secretary, he leased some equipment to the owner of a supermarket chain. As part of the deal, the equipment was insured against theft or damage. Then Zinoviev took a few days off – he needed to prepare for the imminent



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arrival of his wife and eight-month-old daughter. But while sitting in his new Moscow apartment, surrounded by unpacked boxes, he got a call from the insurance agent. She informed him that the supermarket owner had taken out a second policy on the equipment. What was going on? Was he planning to destroy the equipment, collect on the two policies, and flee to Cyprus? Zinoviev canceled his vacation, told his wife and baby to stay put, and rushed to the scene of the crime. It turned out that the supermarket owner – not knowing the basic rules of leasing – had pledged the equipment as collateral for a bank loan. He wasn't a

crook; he was simply uninformed. Relieved, Zinoviev went home and finished unpacking.

Such crises were typical of the early days of DeltaLeasing. Looking back, Zinoviev says he worked during most weekends for the first five years of the company. But thanks to a sound business model, DeltaLeasing grew steadily and attracted new investors. In 2003, it was acquired by Baring Vostok Capital Partners, a Moscow-based private equity fund. The deal marked a success story for Delta Capital, Zinoviev's original employer. "It was a win-win-win situation," he says, "for

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the management, for the old shareholder, and for the new shareholder." The company, renamed Europlan after the deal, now serves clients in 32 regions of western Russia. Its equipment vendors include some of the world's industrial giants, such as Ford, Volvo, MAN, Daimler Chrysler, etc.

So as a successful entrepreneur, what does Zinoviev consider the most important ingredient in starting a business? The founder of Europlan wastes no time

in answering the question: People, he says, can make or break a company. Zinoviev urges budding entrepreneurs to pay close attention to their partners. At Europlan, he takes great pride in the team he has assembled, and in the low rate of staff turnover – less than 5% every year. "When you're talking about financial services," he says, "especially in an emerging market like Russia, where things change on a daily basis, you have to have very strong people. People are everything."





charles ryan

BANKING ON THE FUTURE OF RUSSIA

"After the crisis, even oligarchs valued competence over loyalty. It was gratifying to see this independent streak we had stuck with eventually bear fruit."

When Charles Ryan first arrived in Russia, not long after the failed putsch of August 1991, there was a man waiting to meet him at Pulkovo Airport in St. Petersburg. He was "a diminutive fellow," recalls Ryan. The man took him to his car, and together they drove to a meeting downtown. The purpose of the meeting was to discuss an impending project of huge importance – the privatization of the St. Petersburg economy. At the time, Ryan was working for the European Bank of Reconstruction and Development (EBRD), and top officials from the city



CHARLES RYAN:
**"It's so clear
that Russia's
not going to revert
to communism.
But it really was
a fear at the time."**

government were gathered around the meeting table. So Ryan was surprised when his driver sat down at the table too. "What the heck is he doing here?" wondered Ryan.

It turned out that the diminutive fellow was more than a driver. He was Alfred

Kokh, who would later become the architect of Boris Yeltsin's privatization effort. And he wasn't the only future bigwig at the table. There was Anatoly Chubais, who would later lead the SPS political party; there was Boris Fedorov, who would later become the Minister of Finance; and last but not least, there was a deputy mayor named Vladimir Putin. The meeting became a lively, intellectual discussion of how game theory could be applied to privatization. For Ryan, a young banker from Philadelphia, it was a stimulating experience that set the tone of his future career. "I got kind of addicted to the

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49 whole process of thinking so fundamentally about why you would privatize, and how you would privatize," says Ryan. "And I was impressed by the intelligence of the people that we were dealing with."

From that moment on, Ryan enjoyed a front-row seat to the transformation of the Russian economy. Starting out as the EBRD's representative in St. Petersburg, he soon left to become a pioneering entrepreneur. In 1994, he and Boris Fedorov started United Financial Group, one of Russia's first investment banks; over the next ten

years, UFG evolved into a major player on the Russian stock market. But when he first arrived in Russia, Ryan never thought he'd stay for more than two years. In fact, like many expats, he came to Russia in search of adventure. "A bit like John Reed coming over during the Revolution," he quips.

Ryan grew up in Philadelphia. His father was a cardiologist and his mother taught biology in a local high school. There was a deeply conservative streak in his family – especially on his father's side, which came from Kansas. "For example," he says, "when I got into



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Harvard, everyone in my family was a little disappointed that I wasn't going to Notre Dame: I remember my grandmother from Kansas City calling and saying, 'What are you doing? You're going to go up there and study with all those communists?'"

Contrary to his grandmother's expectations, Ryan didn't meet any communists at Harvard. But he did develop an interest in communism – at least in the academic sense. While majoring in political science, he specialized in Soviet foreign policy. It was the beginning of a lifelong fascination that ultimately led Ryan to Russia.

At Harvard, Ryan also developed an interest in finance. But his financial career had a strange origin – it began while he was running a homeless shelter in Cambridge, Massachusetts. The shelter had a peculiar financial situation. It was officially run by the state government, so the staff earned salaries from the state; however, it was staffed by student volunteers who didn't actually cash their government paychecks. Instead, they donated their salaries to Philips Brooks, a student-run body that managed an endowment for various charities. As the director of the shelter, Ryan found himself on the board of

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Philips Brooks. There, he got his first taste of finance. But more importantly, he discovered that he liked it.

After graduating from Harvard, Ryan took a job with Credit Suisse First Boston. The job was a useful learning experience, but he still felt that something was missing. So when he learned about the formation of the EBRD, he knew he had to get involved. The EBRD was a London-based bank with \$12 billion in starting capital, and all of it was destined for private equity investments in Eastern Europe. Ryan joined it in June 1991, although he had no experience in private equity.

"I felt a little bit like a fraud," says Ryan, "in the sense that here I was, about to go out to Eastern Europe and Russia, and I was going to talk to people about private equity, who would probably think that I actually knew something about it. So I felt a little bit insecure." There was only one way to address his insecurity; it was to get some practice. So Ryan decided to make a private equity investment that was 100% sure to succeed: selling Coca-Cola in Poland. At the time, Poland was one of the most financially stable countries in Eastern Europe, and Coca-Cola was a proven success in every market it had entered. Ryan went to



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Poland to find the company that held the rights to sell Coca-Cola. He had found it, and he was about to make his deal, when history intervened. The August putsch happened in Moscow, Yeltsin came to power, and Russia opened up for foreign investment. The EBRD sent Ryan to St. Petersburg.

Working with the future leaders of the Russian reform effort, and getting hands-on experience in privatization, was an exciting ride for Ryan. He also fell in love with Russia's northern capital – to this day, St. Petersburg is his favorite Russian city. But as the pivotal

year of 1992 rolled on, working as an EBRD go-between for Mayor Sobchak's government lost some of its appeal. "The reality of privatization advisory work is that it's very fascinating at the beginning, when you're setting up the framework," he says. "When you get to the level of auctioning off a bread shop for the 50th time, it's not as intellectually stimulating."

Ryan relocated to Moscow and went back to private equity investment. Over the next two years, he gained valuable experience in the strange, murkily privatized business climate of

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early-1990s Russia. So when Boris Fedorov approached him with the idea of starting an investment bank, Ryan was interested. Of course, they had one big problem – a lack of starting capital. Luckily, they knew an experienced banker named Luqman Arnold who worked for Banque Paribas. Arnold arranged a deal where Banque Paribas gave them \$1 million in exchange for a 25% stake in the new investment bank. Thus, United Financial Group was born. In October 1994, UFG got its brokerage license and began trading shares on the Russian stock market.

There was one slight complication for the would-be traders: the Russian stock market didn't really exist. Today, Ryan laughs when he recalls the primitive conditions of trading shares in 1994. "Effectively, there were about ten of us," he says, "that is, firms in town who were trying to be investment banks. And we were all scattered in various apartments. Our office was a little apartment on Tverskaya Street. Because there was no market, there was no way to know what the price of something was, or who was buying or selling. Each of us had a scratch pad, a little piece of



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graph paper. The way it worked was that you'd come in the office around nine in the morning and try to catch up on the news. Then around 10 or so, we'd start calling each other. And throughout the day, you'd sort of go through a loop – you'd call Brunswick, Troika, and all these other firms. They would tell you what they were buying and selling, and you would tell them what you were buying and selling. By the time you got through the loop, a picture would emerge... little by little, throughout the day... It was very, very chaotic. And kind of fun, too."

Ultimately, the firms decided that the situation was intolerable, and they banded together to create a real stock market. This led to the RTS, which started up in June 1995. Ryan recalls that there was a vigorous debate over a seemingly simple issue – when the stock market should open. Some people argued it should open at nine and close at four, in order to overlap with Vladivostok; others argued that it should open at eleven and close at six, in order to overlap with New York. In the end, they decided it should open at eleven, since New York was more important as a finan-

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55 cial center. "It was an intriguing part of the early market," says Ryan, "thinking about such fundamental things as when you're going to open."

Another strange aspect of doing business in the early years was the fear, now largely forgotten, that communism would make a sudden return. "It's hard to remember today," says Ryan, "because it's so clear that Russia's not going to revert to communism. But it really was a fear at the time. There were literally conversations back then about how we'd all be swinging from lampposts if the Communists came back."

But as history proved, communism was dead. Ryan and Fedorov pursued their capitalist dreams in peace. UFG stuck to a business strategy of staying independent – despite numerous proposed buyouts by Russian oligarchs – and providing unbiased research and analysis for its clients. This strategy was vindicated after the 1998 financial crisis. With all the big Western firms leaving the market, and oligarch-controlled banks failing in droves, UFG was one of the strongest survivors left standing. "After the crisis," says Ryan, "even oligarchs valued competence over loyalty. It was gratifying to see this independent streak we had stuck with eventually bear fruit."



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The strategy has born its juiciest fruit in the past few years. UFG advised British Petroleum on its colossal \$6.3 billion investment in the Russian oil sector, and in 2003, Deutsche Bank bought a 40% stake in the firm. Ryan doesn't view the German investment as an opportunity to retire. "The point of it wasn't to exit," he says. "The point of it was to organize a dominant player in our industry."

Ryan is optimistic about the future of Russian stocks – in part, because he believes in the agenda of President Vladimir Putin. Having known Putin

for over ten years, he can offer some insight into the president's character. "In private, he's very much like he appears in public," says Ryan. "He's very reserved. He's a very good listener, which is rare among Russian officials: and he's very professional." Ryan dislikes the perception, often conveyed by the Western media, that Putin is an uncaring KGB spymaster determined to crush democracy. Ryan feels Putin's main goal is thoroughly understandable: he wants Russia to take its rightful place among the world's great powers, and part and parcel of being a great power is maintaining the correct bal-

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ance between big business and politics. Thus, he understands why Putin felt the need to rein in Mikhail Khodorkovsky, who was widely believed to be attempting to influence the Russian political process in order to advance his own interests. "That investors have understandably become jittery as a result is unfortunate," says Ryan. "I put this down to the perception that Putin has chosen to act through selective prosecution, rather

than implementing regulations on campaign finance across the board." Ryan has a long perspective; for him, the Yukos affair is just the latest twist in the ongoing drama of Russian capitalism. After thirteen years in Russia, with ten of them as an entrepreneur, he has seen the Wild East become the more or less civilized world of Putin's Russia. It's no coincidence that he compares himself to John Reed – after all, both men witnessed a revolution.

CHARLES RYAN BANKING ON THE FUTURE OF RUSSIA



albert gusev

BUILDING SUPERMARKETS FOR THE RUSSIAN SHOPPER

"You'll always find people who will tell you that your business is going to fail. You shouldn't listen to such advice."

Guidebooks to Russia often warn foreigners about the "Russian system" of shopping for food. In this bizarrely inefficient system, which dates back to the Soviet era, food stores are divided into various sections; in order to do their daily shopping, customers must obtain a fistful of receipts at the all-powerful central cashier. Often, it seems that the system has only one goal: to employ as many surly babushkas as possible.



ALBERT GUSEV:
"Everything was hard in the early 1990s! There was only one good thing: a wide-open market."

In recent years, however, Western-style supermarkets have appeared all over Russia. Consumers have flocked to them because of the more efficient service, the higher-quality goods, and – perhaps surprisingly – the better prices. Like many trends, the supermarket revolution began in Moscow

and St. Petersburg and gradually spread to the provinces. When it came to Nizhny Novgorod, Albert Gusev seized the opportunity. Gusev is the president and founder of SPAR Middle Volga, a chain of seven supermarkets in Nizhny Novgorod and the surrounding region.

In his youth, Gusev was drawn to a military career. He joined a military academy in 1988, hoping to become an officer in the Soviet Army. But he became disillusioned when he realized that advancing in the Army depended on many factors beyond his control. So

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in 1991, with Russia turning into a free-market economy, he went to work in the local marketplace. Together with some friends, he opened a small business selling candy. It was so successful that other storeowners began to use him for their candy supplies. Thus, Gusev moved up the food chain – he and his friends turned their business into a wholesale food distributor. Within several years, it was offering thousands of food items, and not just candy.

At first, Gusev and his friends called their business Aisa – a name they

invented by combining the first letters of each of their names. But one day, they printed an advertisement with a catchy slogan: "Sladkaya Zhizn" (The Sweet Life). The tasty slogan proved to be a hit with customers. Gusev recalls their reaction: "People started calling us and asking, 'Hello, is this Sladkaya Zhizn?' And we'd say, 'Well, no, this is Aisa.' And they'd reply, 'OK, sure, but we're trying to reach Sladkaya Zhizn.'" In other words, you could say that people really endorsed the new name. Of course, that was back in 1994, which was sort of a weird time. I remember that when my friends came to me and



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said, 'Hey! Let's change our name to Sladkaya Zhizn!' I replied, 'Are you crazy? Then the Tax Police will come for us, and they'll give us a taste of the sweet life.' But in the end, we changed the name to Sladkaya Zhizn because people liked it. Against the background of all the negativity that was happening in Russia, with things getting worse all the time, people wanted something positive."

The negativity of the early 1990s was especially acute in Russia's regions. Compared to Moscow, which was saturated with Russian and foreign capital,

the economic crisis of the Yeltsin years was much more profound in the provinces. Incomes were low, unemployment was high, and Western-style businesses, such as supermarkets, were unknown. But compared to other cities, Nizhny Novgorod had some advantages. It was large, with 1.3 million residents. It had a historic tradition of entrepreneurship – before the Revolution, it was home to the world's largest seasonal market, which drew merchants from China, Persia and Western Europe. But most importantly, Nizhny Novgorod had a reformist, business-friendly government. Under

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63 their leadership, the city became a pioneer in Russia's transition to a free-market economy. "I think we were lucky," says Gusev. "The local government tried to create an atmosphere that was friendly for entrepreneurs. They didn't interfere with us: We were also lucky that we didn't have any monolithic oil companies that crushed everything underfoot. You read about this sometimes in other regions: if some oligarch wanted a factory, he took it. It didn't matter if an entrepreneur had spent five years developing it – tough luck, the oligarch wanted it. Well, we didn't have that."

ALBERT GUSEV BUILDING SUPERMARKETS FOR THE RUSSIAN SHOPPER

In this environment, Sladkaya Zhizn continued to grow. Gusev made a number of international contacts, and his business became one of the leading food distributors in Nizhny Novgorod. His clients included the city's first supermarkets, which appeared in the mid-1990s along with a handful of Western-style shopping centers. Gusev saw an opportunity – to open a chain of supermarkets geared towards a wide segment of the population. At that time, only the wealthiest Russians bought their food in supermarkets; most consumers shopped at old, Soviet-style food stores, while the



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lowest end of the market was served by large, chaotic marketplaces. The supermarket format, coupled with a good distribution network, could compete effectively with the old, Soviet-style food stores, offering lower prices and better service. Furthermore, once incomes began to rise in the late 1990s, the share of retail trade that took place in marketplaces began to drop. The time was ripe to open a chain of supermarkets in Nizhny Novgorod.

However, Gusev faced one major problem: a lack of starting capital. Opening

a supermarket is immensely expensive; it can cost anywhere from three to 20 million dollars, and typically, the investment only pays itself off after four or five years. Sladkaya Zhizn didn't have enough money to build a supermarket. So Gusev and his friends began to look for an investor. With the help of a local consulting firm, they drafted a business plan and pitched their idea to Russian and Western investors. One of those investors was The U.S.-Russia Investment Fund. In 1999, Gusev met Paul Price on the sidelines of a Deloitte & Touche investment conference. Price was the

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65 vice president of Delta Capital, which managed the Fund; he saw that Gusev was a young, energetic entrepreneur with a solid grasp of the retail sector. It was the beginning of a fruitful collaboration between Albert Gusev and Delta Capital.

Together, Gusev and Price approached the management of SPAR International, a Dutch-owned supermarket chain. This was a major step, because SPAR was a giant in the food retail business. Founded in 1932, it ran the world's largest chain, with over 17,000 stores around the world; there were SPAR

supermarkets in five different continents, in countries as far apart as Argentina, Australia, South Africa and Japan. Most recently, SPAR had begun to expand across Eastern Europe. So when Gusev and Price proposed launching a SPAR franchise in Nizhny Novgorod – Russia's fourth-largest city – the supermarket giant expressed interest. Gusev came under intense scrutiny. Above all, SPAR wanted to be certain that Gusev could provide an effective, well-managed food distribution network. Sladkaya Zhizn fit the bill; having operated successfully for nearly ten years, it proved acceptable

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to the SPAR management. The franchise agreement was signed, and SPAR Middle Volga was born. In 2002, Delta Capital announced that it would invest \$6 million to build SPAR supermarkets in the Nizhny Novgorod region.

Today, Gusev manages seven supermarkets under the SPAR brand name. Not all of them are in Nizhny Novgorod itself; there are also stores in the regional cities of Dzerzhinsk and Yoshkar-Ola. Gusev has an aggressive expansion plan; by 2006, he plans to open 13 more stores in the Middle Volga region. In fact, the region is in the middle of a full-fledged supermar-

ket boom. Gusev faces competition from Metro Cash & Carry, a German chain, as well as a number of Moscow-based chains that are expanding into the regions now that the Moscow market is approaching saturation. One of those chains, Perekrystok, bought a controlling stake in SPAR Middle Volga in December 2003. The deal marked a successful exit for Delta Capital.

Looking back on thirteen years in retail, Gusev sees tremendous changes in the Russian business climate. "Today the biggest problem is large barriers to entry," he says. "Back then, the biggest problem

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was – well, it's hard to say. Everything was hard in the early 1990s! There was only one good thing: a wide-open market. Now things are the other way around. People have experience, people have access to capital, but the market is getting smaller and smaller. Just getting onto the market is the hardest part."

Nonetheless, Gusev thinks that there are plenty of opportunities for Russia's next

generation of entrepreneurs. He has the following advice for them: "First, you need to have a very strong sense that the thing you're offering is something people want. Second, don't listen to anyone. You'll always find people who will tell you that your business is going to fail. You shouldn't listen to such advice. If these people had the same sense that you do, then they'd go into business themselves, and be successful at it."





sergei borisov

GIVING THE BOOT TO BUREAUCRACY

"The destiny of Russia is not just to drill for oil and gas. It also rests on our heads: in the education, the traditions, and the good culture of our people."

In Russia today, small business is locked in a life-and-death struggle with the "bureaucratic mafia." This is the opinion of Sergei Borisov, who started the Hermes-Moskva chain of gas stations in Moscow. As an entrepreneur, Borisov had plenty of experience with bureaucracy – to open a single gas station, he had to obtain 150 different permits from a variety of government officials. And since each official had a month to issue his permit, the process could have



SERGEI BORISOV:
"The greatest resistance to small business today comes from our bureaucracy. Our government officials have no motivation, of any sort, to help entrepreneurs."

stretched out to a mind-boggling twelve years. Borisov and his partners were lucky; he admits that they had well-placed friends who intervened on their behalf. But for most businessmen, the only way to cut through the red tape was by paying bribes. Thus, Borisov has no problem comparing Russian bureaucrats to the chain-wielding thugs of La Cosa Nostra.

"The greatest resistance to small business today comes from our bureaucracy," declares Borisov. **70**

"Our government officials have no motivation, of any sort, to help entrepreneurs. For them, having control is a much higher goal than encouraging development."

Yet this 50-year-old businessman does more than complain; he also plays an active role in fighting for the rights of small- and medium-sized businesses. Borisov is the president and co-founder of OPORA Rossii, an advocacy group that lobbies the government to lower taxes, reform Soviet-era laws, and reduce the bureaucratic burden on entrepreneurs. OPORA has soared in visibility since its founding in 2001. Today, Borisov meets

SERGEI BORISOV GIVING THE BOOT TO BUREAUCRACY

71 regularly with President Vladimir Putin and his cabinet ministers. The organization has branches in 67 regions of Russia, and its members come from a variety of sectors, including retail, tourism, agriculture and industry.

OPORA assists businesses that are under attack by regional bureaucrats. According to Borisov, the biggest offenders are the local police, along with health and fire-safety inspectors; often, such officials will suddenly arrive and threaten to shut down a business unless the owner pays a hefty bribe. OPORA has a creative way of dealing with this kind of corruption – among its other activities, the group gives out the "Golden Brake" award to regional officials. The winners of the

award are bureaucrats who are deemed to be the worst enemies of small business; the award itself is a gold-plated statuette of a boot, pushing down on a brake pedal.

Borisov himself has no golden boots. Instead, his office is decorated with miniature models of antique gas station pumps; if prompted, he will gladly discuss how gas-pump design has evolved since the early 1900s. Likewise, Borisov is always ready to discuss the dire state of small business in Russia. And here, he has another large collection – of facts. In 1994, he explains, there were about 850,000 small- and medium-sized businesses in Russia; ten years later, this number has not changed significantly. Furthermore, such



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businesses play a very minor role in the Russian economy, accounting for less than 12% of GDP. (In Germany, by comparison, the same number is close to 70%.) Such figures indicate that Russia's small- and medium-sized businesses are not performing to their full potential, and this, in turn, is holding back the Russian economy. "These are critically small numbers," says Borisov. "Only the most undeveloped countries in the world can rival these statistics."

In a nation where the government is unfriendly to entrepreneurs, and the population is skeptical of anyone involved in business, Borisov plays the role of a small-business evangelist. He argues that small- and medium-sized businesses, if properly

encouraged, could play a critical role in reducing poverty. Moreover, he believes that the goal of doubling Russia's GDP by 2010 – the stated goal of the Putin government – is only realistic if small businesses are allowed to flourish. Borisov has no patience for the mentality, often expressed by Russian oligarchs, that the wealth of Russia lies in its natural resources. "The destiny of Russia is not just to drill for oil and gas, and to pour ingots of aluminum," he says. "It also rests in our heads: in the education, the traditions, and the good culture of our people."

Education has always been important to Borisov. While he was growing up in Serpukhov, a provincial town in the Moscow region, both his parents

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SERGEI BORISOV GIVING THE BOOT TO BUREAUCRACY

taught at local schools; his mother was a Russian literature teacher and his father taught physics. As a young man, he dreamed of being a diplomat. But he ended up choosing a more accessible career path – engineering. In 1973, he entered the prestigious Bauman institute in Moscow, one of the USSR's top technical schools. There, he became the leader of the student wing of Komsomol. In those days, this was a serious responsibility; Komsomol was the youth organization for aspiring members of the Communist Party. Today, Borisov claims that he was never fully sold on Soviet ideology. He did, however, enjoy the managerial aspects of Komsomol, which included organizing student construction brigades, and even producing musical stage

shows. In any case, Komsomol gave him some valuable career connections. In 1981, he took a job at the Ministry of Higher Education, where he worked with foreign students who were studying in the USSR.

Working with foreigners was an eye-opening experience, exposing Borisov to different cultures and points of view. The experience led him, in 1988, to enter the Academy of Foreign Trade. This elite institution, accessible to a select group of students, was in the throes of change due to perestroika and the end of the Cold War. Taking full advantage of the opportunity, Borisov took a course from Harvard business professor Douglas Coulter. The course marked the first time that



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the case-study method, familiar to any American MBA, was used in the USSR. As a result of this course, Borisov caught the entrepreneurial bug. "It absolutely changed me," he says. "It taught me the importance of making decisions myself, and not waiting for my superiors."

After completing his studies at the Academy, he became a consultant to the United Nations Industrial Development Organization. Stationed in Vienna, Borisov had the diplomatic job he had always dreamed of. But it came at a moment when Russia was abandoning the Soviet system, and embarking on a radical experiment in free-market economics. When he learned about a potential business opportunity in Russia, he quit his job in

the placid UN bureaucracy, and returned to Moscow to become an entrepreneur. His new mission was to launch a chain of gas stations.

"Never in my life did I think I'd end up selling gasoline," says Borisov, who started Hermes-Moskva in 1993. At the time, there were only about 200 gas stations in Moscow, and most of them were foul-smelling, Soviet-era dumps with long lines and lousy service. There was clearly room for growth and improvement – but it was also a marketplace that was rife with danger. In the early 1990s, the gas-station business had a reputation for being run by organized crime. Often, owners paid protection money to the local mafia, and many were gunned down after deals went bad. Luckily,

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Borisov escaped this fate. He categorically refused to deal with gangsters. Instead, he relied on dependable ex-agents from the Soviet secret services to protect his business. Ultimately, the chaotic situation of the early 1990s subsided, and Borisov emerged as a prosperous, legitimate businessman. He became the president of two trade associations – first the Moscow Fuel Association (MFA), a local group, and later the Russian Fuel Union, a nationwide network. Today, the gas-station market in Moscow is consolidated and mature. The MFA includes almost 1000 stations around the city,

offering state-of-the-art service, in a largely stink-free environment.

Borisov retired as the president of Hermes-Moskva in 2002. He is now focused on solving Russia's political and economic problems. As the president of OPORA, he lobbies on behalf of entrepreneurs who face many of the same challenges that he himself confronted in the 1990s. While they don't have to dodge bullets, dodging the Russian bureaucracy is still a day-to-day task. "Today the bandit mafia doesn't exist," says Borisov. "Instead, we have the bureaucratic mafia."



mikhail lyashch

RACING AHEAD IN THE RUSSIAN I.T. SECTOR

"I would advise our young people to follow the advice of our great leader Lenin. 'Study, study and study!'"

Mikhail Lyashch started a company that is now one of the dominant players in the Russian IT market – in fact, with a string of high-profile contracts and over \$77 million in annual turnover, Compulink could soon be headed for an IPO.



MIKHAIL LYASHCH:
"Choosing the right partner is probably the most important thing in business. You need to do business with competent, honest people."

Standing behind this phenomenal growth is Lyashch, an articulate, feisty entrepreneur who clearly understands both business and computer technology. Yet amazingly, he has no formal training in either field. As a matter of fact, he had never seen a personal computer before 1991.

Lyashch tells the story with a wry sense of humor. At the time, he was working as a junior administrator in a Soviet electronics factory. One day, the director of the plant got a computer. The factory boss didn't know how to use it, but he was jealously proud of his acquisition. Lyashch could only use the computer when the director was gone. Luckily, he got permission to use it at night. Together with a friend, he taught himself how to program; they often started at five in the afternoon, as soon as the director went home, and worked until midnight or one in the

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79 morning. Working with out-of-date manuals, they didn't know about modern programming languages like C or BASIC – instead, they programmed in Assembler, a difficult, low-level language where they had to manipulate bits and bytes directly on the computer's processor. But on the plus side, it was a solid introduction that taught them the ins and outs of computer technology. Eventually, they wrote a small copy-protection program that was good enough to sell. By promoting it at software fairs, Lyashch got his first taste of the computer business.

In 1993, Lyashch and his friends started Compulink. At first, they assembled computers and sold them at a stand in the Biblio-Globus bookstore in Moscow. They gradually opened a chain of retail stores, and at the same time, they began providing computers to medium-sized businesses. A major turning point came in 1997, when Lyashch decided to refocus the company on services. Because of his experience selling hardware to companies, he saw that there was a clear demand for services like system integration. In the rush to modernize their operations, companies often purchased



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large amounts of computer hardware; but then, without having well-designed networks or useful software, the computers would sit uselessly on employees' desks. Compulink, along with a host of competitors, began to offer services on the emerging IT market.

However, it was a bumpy road to success. "Honestly, for all our successes, we made a lot of mistakes too," says Lyashch. "With what I know now, I would have done many things differently – especially in the first seven years." The company often spread

itself thin by initiating projects outside its core business. For example, Lyashch invested a large amount of money in a software development project. The venture, called BioLink, made a biometric security program; although it was an innovative product, it failed to catch on with customers, and the venture fizzled. Another failed venture was the computer superstore. In 2000, Compulink opened Europe's largest computer store on the outskirts of Moscow, along with a distributor called Verysell. Modeled on CompUSA, the store had over 2,000 square meters of

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MIKHAIL LYASHCH RACING AHEAD IN THE RUSSIAN I.T. SECTOR

shopping space. But it proved to be too ambitious for Moscow's computer market. As customers stayed away, the partnership between Compulink and Verysell went sour. Today, Lyashch accuses his old partners of dishonest dealings. "Choosing the right partner is probably the most important thing in business," he warns. "You need to do business with competent, honest people."

Meanwhile, Compulink established a solid reputation in IT services. By providing a strong mix of system integration and consulting services, the com-

pany developed an impressive client list, including corporate giants like MTS and Sberbank. But Lyashch's biggest client is just over the horizon – the Russian government. Compulink has won several tenders in the federal government's ambitious, ten-year "Electronic Russia" program. The program's daunting goal is to make the Russian bureaucracy efficient. While some might consider this an impossible task, there is no doubt that computerizing the paper-based bureaucracy could cut waste and improve efficiency. For example, according to the Ministry of Trade and Economic



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Development, the Moscow city government loses \$25 million a year by sending pensions to dead people. The reason: it takes six months for all the necessary departments to process death certificates.

By routing out inefficiency in corporations and the government, Compulink became one of the fastest-growing IT companies in Russia. Between 2002 and 2003, its sales grew by a whopping 46%. This rapid growth, together with all the news-making deals, drew the attention of Western investors. In November 2003, The U.S.-Russia Investment Fund bought

a major stake in Compulink. Lyashch has big plans for the newly acquired capital; he wants to improve his company's range of services and expand geographically into Russia's regions. He believes that eventually, Compulink will become a publicly traded company. Such a step, he argues, wouldn't just be good for him personally; it would also be good for Russia as a whole. "The reason that we have a gigantic, realistic chance of having an IPO is that the market badly needs companies like us," he says. "Everyone is sick of the current situation with blue-chip stocks. When you only have ten companies, and something bad happens to one or two of

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MIKHAIL LYASHCH RACING AHEAD IN THE RUSSIAN I.T. SECTOR

83 them, the whole market suffers. But when you have a critical mass – let's say 500 companies, and not just oil or gas giants, but also normal companies like Compulink – then you can have a real market situation."

Although the market today is far more developed than it was in the early 1990s, Lyashch believes that there are still huge, untapped opportunities for young entrepreneurs – especially in Russia's undevel-

oped service sector. But he has one piece of advice for them: get an education. He feels that his own example – that of a self-taught man who built a large, successful company – would be virtually impossible to duplicate today. To make his point, he cites a slogan that was familiar to generations of Soviet schoolchildren: "I would advise our young people to follow the advice of our great leader Lenin. 'Study, study and study!' After all, not everything he said was completely silly."



olga slutsker

BLAZING A TRAIL FOR THE FITNESS INDUSTRY

"I have an entrepreneurial gene. I was never a passive participant in the process of life."

RUSSIAN

Sometimes an entrepreneur can introduce an idea that changes society. Olga Slutsker did that in 1993 when she opened Moscow's first Western-style fitness club, single-handedly bringing the fitness movement to Russia. Today, signing up for a gym membership is all the rage among Moscow's middle-class professionals, and the city has a thriving fitness-club market with over \$200 million in annual turnover. Despite numerous competitors



**OLGA SLUTSKER:
"I had to explain
to people what 'fitness'
meant, and how
it was different from
the obsolete system
of physical education
which had existed
in the Soviet Union."**

that have arisen over the past ten years, the market leader is still World Class Clubs, Slutsker's pioneering chain. But Slutsker is more than a groundbreaking entrepreneur: she is also a celebrity on the Moscow party scene, an occasional fashion model, and a dedicated mother of two.

Fitness was always a big part of Slutsker's life; before going into business, she was a champion fencer. She started training at age 11, and after completing the rigorous Leningrad Academy of Physical Education, she fenced for several years on the USSR's national team. But even in her youth, she showed a flair for organizing projects and making deals. In fact, with two great-grandfathers who were prosperous merchants in pre-Revolutionary Russia, Slutsker jokes that she has business in her DNA. "I have an entrepreneurial gene," she says. "I was never a passive participant in the process of life."

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87 In 1988, she married businessman Vladimir Slutsker and moved to Moscow. While accompanying her husband on an international business trip, she visited her first Western-style fitness club. Although she had trained for years as a professional athlete, using the best facilities in the Soviet Union, it was unlike anything she had ever seen. So upon returning to Russia, she was determined to start her own world-class fitness club. She envisioned something that was still unknown in Russia; while there were many old, Soviet-style training centers, like the gritty "kachalki" weightlifting rooms, there were no fitness clubs that measured up to

OLGA SLUTSKER BLAZING A TRAIL FOR THE RUSSIAN FITNESS INDUSTRY

international standards. In 1993, Slutsker's husband bought the rights to the name "World Class," and gave her the starting capital to open a club.

The new club received a skeptical reaction from the Moscow public. "The word 'fitness' was absolutely unknown," recalls Slutsker. "I had to explain to people – above all, to the press – what 'fitness' meant, and how it was different from the obsolete system of physical training which had existed in the Soviet Union." Some reporters questioned the idea of charging fees for fitness-related services. Others mocked her club as an elitist



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hangout for New Russian bandits who were obsessed with bizarre American fads like aerobics and exercise bikes. Still others attacked Slutsker personally; they portrayed her as the spoiled wife of a wealthy banker who had been given a small business to occupy her time. But Slutsker was determined to defy this stereotype. In fact, once World Class began to turn a profit, she returned the starting capital to her husband. For her, this was a point of honor. "He wasn't expecting me to return the money," admits Slutsker. "But it was important for me, on principle, to return it. I didn't want to look at it as a gift, or as some kind of fancy bauble which he had bought me."

Slutsker began a campaign to change the Russian attitude towards fitness. In 1995, World Class sponsored Russia's first annual international fitness convention, bringing athletes and trainers from all over the world to discuss the latest trends in the industry. Meanwhile, she personally invited Moscow's trendsetters – including politicians, businessmen, actors and singers – to join her club, giving it the reputation of a hip, fashionable hangout. Slutsker also put her own personality on the line. She appeared at all sorts of glamorous, high-society events to plug the benefits of fitness, and she even became a fitness consultant on the "Star Factory"

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OLGA SLUTSKER BLAZING A TRAIL FOR THE RUSSIAN FITNESS INDUSTRY

89 TV show (Russia's equivalent of "American Idol"). Most recently, she sponsored a series of "fitness marathons" in Russian schools. For Slutsker, teaching children the benefits of fitness isn't just a wise marketing strategy; it's also a victory for public health. "These aren't people who are going to come in today and sign up for a membership," she says. "But we're getting these kids used to the culture of contemporary life. We're showing them the latest trends and giving them goals to strive for."

The result has been a boom in the fitness industry. Moscow now boasts over 100 clubs, and the market is growing at an

estimated 30-40% every year. Public opinion has also changed; reporters no longer ask Slutsker whether it's fair to charge for fitness, and working out is perceived as a normal, healthy activity for the young professional. Also, clubs are beginning to appear in cities outside Moscow. "One could say that we've won the battle," says Slutsker. "We have a colossal number of followers, and fitness is becoming more popular around the country."

One indicator of Slutsker's success is the number of competitors nipping at her heels. Besides Planet Fitness, there are also R-Fitness, Gold's Gym, Olympic



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Star, Kimberly Land and others. While some of these are fancy mega-clubs that offer every imaginable service from landscaped aqua-parks to motorized rock-climbing walls (usually at oligarch-like prices), others are small, unpretentious franchises that cater to middle-class clients. But all of them have one thing in common: they attempt to mimic the success of World Class. Slutsker welcomes the competition. "Whenever any fitness club opens today," she says, "you can read in different interviews that the club's managers are always competing with World Class. This is very healthy, because it gives my team the chance to stay alert and keep developing."

The industry's latest trend seems to be the growth of middle-range clubs, since the premium market is approaching saturation. World Class recently announced that it would open three new clubs, under a new brand name, that would offer memberships for almost half the price of the existing facilities. It also seems that World Class might be moving towards a franchise model. The firm now offers consulting services to new club owners, which could help the expansion of the fitness industry into regions outside Moscow.

As for Slutsker herself, she is now busy

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OLGA SLUTSKER BLAZING A TRAIL FOR THE RUSSIAN FITNESS INDUSTRY

with a new project: her family. She and her husband, who is now a member of the upper house of the Russian parliament, have two young children, a boy and a girl. But she still finds time to run her business and exercise daily. If there has been any impact on her schedule, it is that she has given up mingling with high society; she is no longer a fixture at the parties, balls and fashion shows beloved

by the Moscow glitterati. And she doesn't regret it one bit.

"Giving up the glamorous life for the sake of my kids was actually a very easy decision," she says. "It wasn't a sacrifice at all. The opportunity to teach your kids something, to enjoy their company, to be proud of them: These are feelings that can't be compared to anything else in the world. Even success in business."



peter gerwe

TUNING INTO PROFITS ON RUSSIAN TV

"Now people understand the value of transparency."

Peter Gerwe has an accomplishment that few entrepreneurs can rival. He has stared down a Russian oligarch – and won.

It was 1997, and Gerwe got a call from Russian media mogul Vladimir Gusinsky. Gerwe, an American entrepreneur, had spent the past few years building the STS television network; Gusinsky, who owned the rival NTV network, announced that



**PETER GERWE:
"We would make decisions based on what was profitable for the network – rather than spending a lot of money for some documentary that was critical of the governor, to get him unseated in the next election."**

he wanted to buy STS. Gerwe agreed to meet the billionaire executive, but when the two met, it became clear that Gusinsky was offering only a tiny fraction of what STS was worth. "It wasn't even close," says Gerwe. Then Gusinsky dropped a bombshell – he said that if Gerwe wouldn't sell STS, Gusinsky

would hire away all of Gerwe's top managers, and STS would lose its regional broadcasting licenses. Like Don Corleone in "The Godfather," Gusinsky was making an offer that Gerwe couldn't refuse.

Nonetheless, Gerwe refused to sell his network. It didn't take long for the consequences to strike. The next day, all of the top management at STS resigned – Gusinsky had already made a secret deal with them behind Gerwe's back. And soon enough, STS licenses came under attack from regional governments throughout Russia. Gerwe went

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95 into damage-control mode; he spent the next three years fending off the legal attacks, while trying to rebuild his management team. "We ended up keeping the company together," says Gerwe, "and I think we actually strengthened it." As for Gusinsky, he was ultimately chased out of the country in a politically charged court case. And despite their clash, Gerwe is gracious to his vanquished rival. "Actually, he's a very talented man," says the 45-year-old American.

Gerwe's career has been a long, strange trip from producing rock concerts in

California to managing the number-three TV network in Russia. After graduating from the University of Santa Clara with a degree in communications, he went to work for Steve Wozniak, one of the co-founders of Apple Computer. Wozniak had started a music festival, with a brand-new feature for concertgoers – giant video screens above the stage. Part of Gerwe's job was to put filler content on the screens when nobody was performing. Working with satellite technology and the fledgling MTV channel, Gerwe made a name for himself as the vice president of a small production company.



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In 1982, Gerwe contacted the Soviet authorities. At the time, the Kremlin was interested in live TV contacts between the US and the USSR; it seemed like a good way to promote a positive image of the Soviet Union. So Gerwe got an invitation to Moscow. When the 22-year-old college graduate arrived at the airport, he was met by three stodgy Soviet officials. "It took me thirty minutes to convince them I actually was the vice president," recalls Gerwe. "You could see the disappointment on their faces when they saw this kid, with hair too long, and dressed a lit-

tle too informally." Eventually, they took him outside to the waiting limousine. It was the beginning of Gerwe's Russian career.

Gerwe produced a number of satellite TV exchanges throughout the 1980s. In doing so, he made numerous contacts in the world of Soviet broadcasting. So when Gorbachev took some tentative steps towards economic liberalization, Gerwe was ready to take advantage of the opportunity. In 1989, he started StoryFirst Communications. The company's initial goal was to manage his dream

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PETER GERWE TUNING INTO PROFITS ON RUSSIAN TV

97 project – launching Radio Maximum, an FM radio station, at a time when no FM radio stations existed in Russia. It took two years to negotiate the licenses. Radio Maximum was supposed to start broadcasting on January 1, 1992, but Gerwe decided to start one week early, with an unbroken, week-long series of Beatles songs. Thus, the station played its first song on December 25, 1991 – the same day that Yeltsin and Gorbachev officially dissolved the Soviet Union. That first song was "All You Need Is Love." The second was "Back in the USSR."

With an FM radio station, StoryFirst had the credibility to move on to bigger and better things. Gerwe and the other investors wanted to start a Russian TV network. Of course, this was a massive undertaking that required political finesse, because they had to get licenses from regional authorities. So Gerwe decided, early on, to make his network entertainment-only. This way, he could present it as a reliable partner with a transparent business model and no political agenda. "Our most important advantage was that we were always focused on the business side of it,"



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says Gerwe. "We would make decisions based on what was profitable for the network – rather than spending a lot of money for some documentary that was critical of the governor, to get him unseated in the next election."

STS came into existence in 1996. But the fledgling network was battered by Gusinsky's takeover attempt, and then by the 1998 financial crisis. Since then it has recovered steadily. It recently surpassed NTV in the ratings, making it the number-three network in Russia among viewers between the ages of 6 and 54. The only two networks with

bigger ratings are the state-controlled giants Channel One and Rossiya. StoryFirst, which owns 100% of STS, has made a fortune as the TV advertising market has boomed, rising from \$300 million in 2000 to \$1.3 billion today. As for Gerwe himself, he is no longer the president of StoryFirst. He is now married with two children, and he has made investments in other ventures, including a publishing house and a cable-TV provider.

Gerwe has witnessed huge changes in the Russian business climate since the early days of StoryFirst. The biggest

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PETER GERWE TUNING INTO PROFITS ON RUSSIAN TV

99 difference, he feels, is that more companies are coming out of the shadows. "Now people understand the value of transparency," he says. A major reason for this change has been the success of tax reform. "In the early days," he recalls, "Russian taxes were so punitive and hard to understand that you really couldn't pay your taxes honestly."

But life hasn't just improved for large corporations – things have also

gotten better for Russian TV viewers, says Gerwe. They can now choose from a variety of slickly produced, Russian-language shows which were filmed at local studios. This is a far cry from the early 1990s, when Russians were fascinated by any second-rate Western show that appeared on their TV screens. "Viewers got over that quickly," says Gerwe. "Now, it's basically movies and Russian serials. Good Russian series do just great numbers."





sergei kalugin

BETTING ON THE FUTURE OF RUSSIAN CABLE TV

"Any Western investor who wants to invest here needs to first understand the Russian mentality."

Sergei Kalugin is a man with a mission: bringing cable TV to the masses. With this goal in mind, he founded National Cable Networks (NCN) in 2000. The company's ambitious goal is to provide cable TV to middle-class Russian households. Unlike many of his competitors, Kalugin sees cable as a mass-market,



SERGEI KALUGIN:
"When you start a business now – a real business, and not just a project for short-term gain – you have to decide whether you're going to be a real citizen of this country."

democratic commodity; he expects that eventually, between one-third and one-half of urban Russians will sign up for his services.

What's more, Kalugin wants his network to have a distinctly Russian character. Instead of the simple

solution – providing translated versions of Western channels like MTV or The Discovery Channel – he hopes to develop original, Russian-language cable channels in partnership with Russian TV producers. Kalugin is secretive about his exact plans. But he drops hints that we can soon expect a channel geared toward women, another one for showing blockbuster movies, and perhaps another one dedicated to old Russian documentaries.

"When a person buys cable TV, he's really buying a couple of channels

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SERGEI KALUGIN BETTING ON THE FUTURE OF RUSSIAN CABLE TV

that he's interested in," explains Kalugin. "The cable audience is very segmented: The challenge for the cable operator is to give each group the channel it wants."

Growing up, Kalugin had no idea he would enter the cable TV business, which didn't even exist in the Soviet Union. His parents were engineers at a Moscow factory. After serving in the army, he entered Moscow State University to study economics. In 1991, he got his first job at a bank and began a successful career as an investment banker. As a vice presi-

dent at Inkombank, he handled mergers and acquisitions in a variety of sectors, including oil, metals and aviation. One of his best-publicized deals was the 1995 takeover of a Moscow chocolate factory.

Kalugin got his first taste of the TV business in 1996, when he was chosen as the general director of RTR-Signal. Partly private and partly controlled by the state, RTR-Signal had been created to handle an enormous task – upgrading the technology used by Russia's broadcast TV networks. The networks used an analogue



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transmission system that dated back to the 1960s and was often falling apart. Kalugin's job was to rebuild this system using state-of-the-art digital technology with financial help from private investors. Unfortunately, RTR-Signal was paralyzed by bureaucratic infighting between different government agencies. Furthermore, due to the involvement of certain controversial businessmen, it was investigated by the Audit Chamber and the Prosecutor General's Office. The end result was that nothing happened. Kalugin left RTR-Signal in 2000, and Russia's broadcast TV net-

works are still using the same old analogue system.

However, the experience gave Kalugin a valuable insight – he saw that the Russian cable TV market was undeveloped, and the existing regional operators could benefit from consolidation. So in November 2000, he founded NCN along with some associates from RTR-Signal. NCN's goal was to construct a nationwide cable network through acquisitions. Today it owns shares in seven regional operators; its biggest single operator, TKT of St. Petersburg,

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SERGEI KALUGIN BETTING ON THE FUTURE OF RUSSIAN CABLE TV

has over one million subscribers. After every acquisition, NCN performs a technical upgrade, bringing each operator up to the same nationwide standard. Often, it is also necessary to shake up the management team and clean up their non-transparent financial practices.

Clearly, such an undertaking requires a significant amount of capital, and this was where Kalugin's financial background proved useful. NCN was initially financed by private Russian shareholders. But in 2003, it got its first Western investor when Delta

Capital purchased a 10% stake. Kalugin recalls that it was a long, arduous process to transform NCN into a company transparent enough to attract Western capital – but it was an effort that paid off, in both the millions of dollars that NCN raised, and in the prestige of having an American investor.

Kalugin has strong opinions about the role of Western investment in Russia. "The main role which Western investors should play is a civilizing role," he says. "In order to change and become more presentable



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to the outside world, we need to have people inside companies who can watch over this process. From this point of view, Western money is very helpful. On the other hand, Russia has plenty of its own money now, and you can find money for a project without looking to the West."

While Kalugin is happy to see Western capital flowing into Russia, he also has a warning for the Western investor. "Russia is a very strange country," he says. "On the one hand, we are Europeans. On the other hand, we have our own unique men-

tality and our own system of values. This is a basic fact of life that you have to deal with. I think that any Western investor who wants to invest here needs to first understand the Russian mentality. If you understand it, you can be very successful. If you don't, doing business can be very difficult. For example, people in Russia aren't as pragmatic or cynical as people who live in the West. With us, people who do business together don't just treat each other as friends; they treat each other as relatives. So when a Western investor makes a decision that affects his partner based on very pragmatic

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SERGEI KALUGIN BETTING ON THE FUTURE OF RUSSIAN CABLE TV

motivations, then he often loses in the end. Why? Because he loses the trust of his Russian partner."

But Russia is gradually becoming friendlier to the Western investor, says Kalugin. The president of NCN believes that the current trend towards transparency is going to continue. The reason, he says, is that after reaping short-term rewards in the 1990s, Russia's corporate leaders

have finally become interested in building enterprises with real, lasting value. "Earlier, people weren't especially concerned with this," he says. "But when you start a business now – a real business, and not just a project for short-term gain – you have to decide whether you're going to be a real citizen of this country. I mean that in the full sense of this word: a person who is willing to look after his partners and his customers."



dmitry agarunov

MAKING SLICK MAGAZINES FOR HI-TECH TEENS

"I prefer to evaluate someone based on their personal qualities – not based on pieces of paper."

Dmitry Agarunov has built a publishing company that makes over thirteen million dollars every year. And it's all thanks to hackers and hooligans.

(game)land, which Agarunov started from scratch, is the only publishing house that primarily targets Russian youth. Its eleven magazines are bursting with colorful information about high-tech gadgets, movies and music. Two of the best-known titles are "Hacker," which offers advice for computer geeks, and "Hooligan," which covers a variety of topics, from rock climbing to dance music to sex. Besides



DMITRY AGARUNOV:
"I had worked for six years and now I was one million dollars in debt, with no assets to speak of. I didn't buy clothes, I didn't buy a new apartment, and I didn't have a car."

these flagship brands, *(game)land* publishes an impressive array of specialized magazines, such as "Computer Gaming World," "Total DVD," and so on. The list grows longer every year.

Agarunov is a boisterous, outspoken man in his mid-30s. He comes to work in business-casual clothing, his head crowned with a kippah; he

recently embraced the Jewish faith after a lifetime of hardcore atheism. When talking to him, it quickly becomes clear that he is a man of passionate beliefs – in business as well as in religion. The self-made millionaire argues that Russia doesn't need handouts from the West, that MBAs make lousy employees, and that the ideal schedule is a 30-hour work week.

Growing up in a working-class family, Agarunov dreamed of becoming a big shot in the Soviet defense industry. He spent his summer vacations working in construction, while he excelled in school at science and math. After a stint in the army, he entered the prestigious Bauman Institute in Moscow, where he studied

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DMITRY AGARUNOV MAKING SLICK MAGAZINES FOR HI-TECH TEENS

probability theory. But he never felt at home in the abstract world of mathematics; he quickly left for the tangible world of business. In 1991, he started buying video game consoles in China and reselling them in Moscow. Five years later, he was managing a chain of five stores in Moscow and St. Petersburg.

Agarunov stumbled into magazine publishing almost by accident. As his chain grew, it bothered him that there were no high-quality, specialized publications where he could run ads for his stores. Moreover, he noticed that customers were always asking the same questions: what was new? what were the best games? Except for word-of-mouth, they had no place to

turn for information. So in 1996, Agarunov launched a magazine called "Strana Igr" (Land of Games). The first issue, with a print run of 5,000 copies, sold out within several weeks. The magazine tapped into a mother lode of pent-up demand; just one year after its launch, "Strana Igr" was selling 80,000 copies a month. In fact, it was bringing in far more money than Agarunov's stores. Because of competition from pirates, it was hard to make a profit selling video games. So Agarunov decided to close down his stores and focus on publishing. He launched a second magazine, dedicated to Playstation games and officially licensed by Sony. It became the first magazine in Russia to bundle a CD along with each issue.



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Yet this rapid growth came to a crashing halt with the 1998 financial crisis. After the sudden devaluation of the ruble, Agarunov found himself stuck with nearly a million dollars' worth of debt to suppliers in the US and Hong Kong. To make matters worse, his bank collapsed and *(game)land's* account disappeared into the pockets of shady Russian financiers. By September 1998, Agarunov was virtually out of cash, hounded by his creditors, and unable to sleep at night. Was it "Game Over" for *(game)land*?

As it turned out, not quite. The plucky publishing house rallied its troops and produced a new issue of "Strana Igr." It was printed on cheap paper at a local Russian printing press (unlike

previous issues, which had been printed in Finland) and its price in rubles was the same as the pre-devaluation price. "We called it the 'war issue,'" recalls Agarunov, "because we decided the situation in our country was something akin to being at war."

The "war issue" was a success with readers, who demonstrated their loyalty by buying it up within two days. The reinvigorated staff produced a new issue two weeks later, and two weeks after that – even though nobody knew if they'd receive their next paycheck. Agarunov made some painful decisions. He slashed salaries, laid off workers, and crafted a plan to pay off his debts over the next three years. But most impor-

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tantly, he came to terms with the new reality. "By December we realized that life would go on," he says. "Of course, it was unpleasant to know that I had worked for six years and now I was one million dollars in debt, with no assets to speak of. I didn't buy clothes, I didn't buy a new apartment, and I didn't have a car."

Slowly but surely, Agarunov began the process of rebuilding *(game)land*. One of the first signs that *(game)land* was back in action was the launch of "Hacker," a magazine that glamorized the underground world of Russian hackers. Combining a subversive sense of humor with detailed technical information, "Hacker" was a hit with young, hi-tech readers. Agarunov made

some missteps too. In 2000, *(game)land* launched a fantasy-fiction journal called "Phantom," which had to be cancelled due to poor sales. After the failure of "Phantom," Agarunov placed more emphasis on market research. *(game)land* now conducts a steady stream of surveys and focus groups – an all-important task as it tries to stay on top of the youth market.

After the crisis, the company racked up impressive growth statistics, which made it attractive to Western investors. Initially, Agarunov was reluctant to work with them. He knew little about the investment process, and he was skeptical of any deal where he would have to share ownership of *(game)land*. But thanks to the efforts of a persistent

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investment banker – Oleg Bystranov of Altium Capital – Agarunov overcame his doubts. He realized that Western capital could pave the way to truly humongous growth. "Even without investment, we were growing 30% a year," he says. "But we could have been growing 300% a year." So with Bystranov's help, he wrote a business plan and pitched it to a number of investors. In March 2004, he cut a deal with Mint Capital, an international investment fund. He sold them a 20% stake in *(game)land* for two million dollars – the first time that a Western financial investor had bought into a Russian publishing house. The influx of fresh cash is supporting an aggressive expansion plan. *(game)land* is launching 12 new magazines this year, while

expanding its presence in the Russian regions, as well as in Ukraine, Kazakhstan and Israel.

One thing that impressed investors was Agarunov's devotion to team-building. At *(game)land*, human resources has been elevated to a science. It begins with hiring; all job applicants take detailed personality tests, and in the second round, they are interviewed by a professional psychologist. The goal is to hire employees who share the company's values. Somewhat controversially, Agarunov only hires religious believers – they can be Christian or Jewish, but they can't be "militant atheists," he says. To some people, this might seem like discrimination, but to Agarunov, it's a matter of social responsibility.

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"Look at the effect that atheist emptiness had in the 20th century, in places like Germany and the Soviet Union," he says. "I don't want to support this at all. Since we have a media company, with a million or more readers, we don't have the right to influence them in a way that promotes atheism."

The hiring process may seem brutal. But for those who survive it, Agarunov offers a wide degree of latitude in the way they do their job. His publishers are free to set the directions of their individual magazines; Agarunov stays away from editorial decisions. Instead, he has a results-oriented management style based on

trust. For this reason, he plans to introduce a 30-hour work week; he feels it will spur his employees to greater productivity.

You won't find many MBAs at *(game)land*; Agarunov believes that most business-school grads are overpaid careerists, more interested in padding their resumes than adding value. "I prefer to evaluate someone based on their personal qualities, and not based on pieces of paper," he says. "When people come here after finishing business school, they say, 'I have an MBA, so I need a salary that's twice as big.' And I say, 'Sure – then bring me twice as many results!'"



marina malykhina

SOLVING THE ENIGMA OF THE RUSSIAN CONSUMER

"A person is either professional or not. Whether they're a boy or girl doesn't matter."

In the 1984 comedy "Moscow on the Hudson," a recent Soviet emigre – played by Robin Williams – faints in shock in a New York department store upon seeing the enormous collection of consumer goods on sale. Today, of course, it would take a lot more to shock the Russian consumer. Stores in Moscow carry a dazzling array of goods,



MARINA MALYKHINA:
"In these past eight years, we could have done a lot of things: advertising, PR, and so on... But instead, we decided to do one thing, and to do it well."

from toothpaste to beer to DVD players. But what does the Russian consumer want? How does the average Russian behave when confronted with 19 different kinds of candy bars? These are the types of questions that Marina Malykhina helps answer.

Malykhina is the president and founder of MAGRAM Market Research, one of the leading market research companies in Russia. Magram's clients have included such multinational corporations as MARS, General Motors and GlaxoSmith-Kline; the company's annual revenues add up to several million dollars. Malykhina oversees about 60 permanent staff members, along with 2,500 part-time researchers scattered throughout the country. Her success is all the more remarkable considering her age – she is only 25.

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MARINA MALYKHINA SOLVING THE ENIGMA OF THE RUSSIAN CONSUMER

In fact, Malykhina was still a teenager when she started the company. It began when a representative from Proctor & Gamble asked her to translate for a focus group. Afterwards, he suggested that she moderate focus groups herself. Malykhina followed his advice and became a freelance market researcher for Western corporations. Starting out with \$500, she rented rooms by the hour, conducting focus groups and reporting on the results to clients. The clients were pleased with her work, and they recommended her to other Western

firms doing business in Russia. Within a few months, there was too much work to continue being solo. So Malykhina went to the next level – she registered MAGRAM as a legal entity, hired several friends as employees, and found a permanent office. By the end of 1996, the company had earned over \$100,000. Malykhina was 17 years old.

"Not everyone is meant to start a business," she says. "You can't be afraid of risk. Either you have this characteristic, or you don't." Clearly, Malykhina has the fearlessness and



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self-discipline required to start a company. But she was also influenced by a pivotal, life-changing experience – spending a year in the US as a high school exchange student. It was her first trip outside of Russia, and Malykhina found herself on a farm in a small town in Oregon. Her host mother was an artist, and her host father was a software developer. Malykhina spent the year studying economics and practicing the 1500-meter run for her school's track and field team; one of her favorite aspects of American life was the high value

placed on sports. But there was something else that impressed her even more: Americans seemed to respect working hard and taking initiative. It was a perfect training ground for the future entrepreneur.

Back in Russia, of course, the Cadillac of her American-influenced ideals hit the bumpy road of Russian reality. For example, she learned that the Western approach to market research was impractical with Russian subjects. The difference is subtle, explains Malykhina. "If you ask a Westerner, 'What do you want?

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What type of product do you need?' you'll get a useful response," she says. "They'll start suggesting ideas, and in the course of this discussion you'll get the insights you were looking for. But with Russians, such an approach is absolutely worthless: Instead, the key is to ask them what's wrong: 'Tell us what's bad. Tell us what you dislike about this product.' Then they'll start complaining, and you'll get a tremendous number of honest, heartfelt responses."

Like other entrepreneurs, Malykhina faced difficulties during the 1998 finan-

cial crisis. Many of her Western clients closed down or drastically scaled back their operations in Russia. But the crisis had a silver lining, because it created a new type of client – Russian companies who wanted to sell their goods on the domestic market. Such companies were often new to the world of market research. Unlike their long-established counterparts in the West, they were unaccustomed to studying their consumers with focus groups and surveys. "With Russian clients," says Malykhina, "we had a sort of proselytizing mission. We had to explain what market research was, and why they needed it."



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Today, the latest trend in Russian market research is consolidation; almost all of the major firms are now owned by or affiliated with large Western companies. In this respect, MAGRAM stands out from the crowd – it is still independent, despite several offers to buy it. Malykhina takes a certain amount of pride in this fact. "The people who sold their businesses most quickly," she says, "were the ones who were worried that they couldn't stand on their own."

But MAGRAM continues to stand on its own. Malykhina says that the

main reason for the firm's success is its experienced managers, who have grown with the firm over the past eight years. In addition, she has always kept Magram focused on its core competency – primary data collection. Other would-be entrepreneurs should follow her example, argues the 25-year-old CEO. "The Russian entrepreneur is a little bit chaotic," she says. "It's hard to stay focused here, because there are so many emerging markets. But staying focused is important. In these past eight years, we could have done a lot of things: advertising, PR, and

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so on... and people advised us to try them. But instead, we decided to do one thing, and to do it well."

After eight years at the helm of her company, Malykhina still retains the bubbly enthusiasm of a Russian teen; she clearly hasn't forgotten the days when she started her business. Interestingly, she says that she has never

encountered problems because of her age – clients were never concerned about her youth, once they saw that she behaved professionally and delivered her results on time. Likewise, Malykhina says that being a woman has never caused problems either. "A person is either professional or not," she says. "Whether they're a boy or a girl doesn't matter."

MARINA MALYKHINA SOLVING THE ENIGMA OF THE RUSSIAN CONSUMER



andrei korkunov

ENJOYING THE SWEET TASTE OF SUCCESS

"If I had listened to all the consultants, then I never would have built this factory, and none of this ever would have happened."

During the Cold War, Andrei Korkunov built rockets for the Soviet defense industry. Working in a top-secret factory, he developed weapons that were used by the USSR's allies throughout the world. But once the struggle between communism and capitalism came to an end, he went over squarely to the other side. Today he is a wealthy, successful entrepreneur engaged in a purely peaceful pursuit – making chocolate.



ANDREI KORKUNOV:
"When I learned that I had to get forty-odd permits, agreements, and other pieces of paper, I got scared... But there was no other way. I just had to pass through all the barriers."

Yet even in his new profession, Korkunov carries on a key tradition of the Cold War: he shows no mercy for the competition. Since the opening of his factory in 1999, his "A. Korkunov" brand of chocolates has conquered the premium segment of the Russian candy market. It now accounts for nearly two-thirds of sales of expensive

chocolates, beating the combined market share of foreign competitors like Ferrero and Cadbury, while other Russian candy-makers are stuck in the low end of the market.

At Korkunov's factory, just outside Moscow, it's easy to see the reasons for his triumph. The building hums with the sound of ultramodern, Italian-made machinery; the factory floor is spotlessly clean, with workers dressed in white, surgeon-like uniforms. As for the chocolates themselves, they are made with all-natural ingredients from around the world. A single chocolate can include ingredients from three different continents – Europe, Africa

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and South America. The factory has a rigorous system for quality control, while expert confectioners develop and test new product lines.

So how did a Soviet defense engineer become the new chocolate king of Russia? The story begins in the late 1980s, when the Cold War ended and perestroika began. As orders for military hardware plummeted, the USSR's once-powerful defense industry ground to a halt. Korkunov found himself with little to do – a frustrating situation for the young engineer. "By nature I'm an energetic person," he says. "When you sit at work doing noth-

ing for hours at a time, playing computer games, after a month or so you begin to go crazy. I realized that my life couldn't go on like this."

Korkunov quit his job. Many of his friends thought he was crazy; in the economic freefall of late perestroika, it seemed like sheer madness to leave a cushy, stable job in the defense industry. But Korkunov made the leap into private enterprise. He got involved in a cooperative (the Gorbachev-era version of a private company) that sewed clothing. It wasn't as glamorous as building rockets, but it gave him valuable experience in managing a business.



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After the USSR collapsed in 1991, he started a company that imported goods from Western Europe. The imported goods were a motley assortment of hard-to-get items, ranging from hi-tech office equipment to fancy food products. Among the food products were expensive Witor's and Ferrero chocolates from Italy. It was Korkunov's first taste of the chocolate business.

The idea of building a factory first arose when Korkunov and his Italian suppliers had a realization: it would be cheaper to package the chocolates in Russia than to import boxes of pre-packaged chocolates.

At first, their discussions centered around a packaging plant. But the idea developed into something larger – building a full-fledged chocolate factory for the Russian market. The Italians promised to provide the equipment, while Korkunov promised to find a site and begin construction. However, the deal fell through under shadowy circumstances. Korkunov accused the Italian side of wildly overcharging for the equipment, and his chief partner backed out of the deal. Nonetheless, Korkunov carried on. The hardest part of building the factory, he recalls, was navigating through the Russian bureaucracy. "When I learned that I had to get forty-odd permits,

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agreements, and other pieces of paper, I got scared," he says. "At one point, I thought it would never happen. I mean, I had to get approval from a whole array of organizations that I'd never even heard of! But there was no other way. So in the end, I just had to pass through all the barriers."

The factory opened in 1999. Initially, Korkunov hadn't planned to produce chocolates for the premium end of the market; he arrived at this decision more or less by accident. With the help of his chief specialist, a chocolate-maker from Italy, he had developed a recipe with a simple goal – making a tasty product that everybody

liked. But as it turned out, the best-tasting chocolates were also the most expensive. "Then we had a dilemma," says Korkunov. "Either we had to lower the quality and sell them cheaply, or we had to maintain the quality and sell them at above-average prices." Unwilling to sacrifice quality, he chose to go with the second option.

This, however, posed a challenge in marketing. In order to persuade consumers to buy his chocolates, especially when they were faced with cheaper alternatives, Korkunov needed a solid brand. His team spent three months developing a concept. When they studied the history of the

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chocolate business, they saw that many famous brands – such as Cadbury, Mars, Ferrero and Lindt – were all named after the original owners. So they proposed naming the product after their boss. Korkunov himself liked the idea. He felt that by putting his name on the box, he would take personal responsibility for the quality of the chocolates inside. So finally, after several years in the making, "A. Korkunov" chocolates appeared on store shelves in Moscow and St. Petersburg.

Sometimes, success in business comes from a brilliant plan; other times, it's due to sheer dumb luck. In Korkunov's case, Lady Luck

played a major role. "A. Korkunov" chocolates debuted at a time when the premium chocolate market was completely empty. Because of the 1998 financial crisis, foreign brands had fled the country, while Russian chocolate makers had refocused on the low end of the market. No analyst would have predicted that the premium chocolate market was about to explode – and yet that's precisely what happened. Korkunov's factory raked in the profits; by 2003, it had annual sales of \$52 million. All of this growth took place with a minimal advertising campaign. During the first five years of its existence, Korkunov's company spent only \$1 million on promoting its brand.

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Meanwhile, it has launched several new product lines and boosted the volume of its chocolate production. In 2003, Korkunov signed a deal with German chocolate dynasty Alfred Ritter. In return for producing Ritter Sport chocolate bars at his factory, Korkunov received millions of euros in investment, allowing him to build a whole new production line. So far, the deal has worked out extremely well for both companies; Korkunov's chocolates are now sold throughout Russia's regions, as well in foreign countries such as the U.S., Germany, Ukraine, Kazakhstan and Japan.

Reflecting back on his unexpected success, Korkunov dismisses the so-called "experts" and encourages entrepreneurs to think for themselves. "If I had listened to all the consultants, if I had done a bunch of market research: basically, if I had behaved like a Western manager: then I never would have built this factory, and none of this ever would have happened," he declares with a smile. "I'd probably still be working in the military-industrial complex and earning the salary of a mid-level engineer."



david yang

PLAYING THE HIGH-STAKES GAME OF HI-TECH BUSINESS

"We didn't sleep
at night.
The entire
team worked
like crazy."

Hi-tech is a risky business. The industry is famous for its young, talented entrepreneurs who achieve mind-boggling heights of fame and fortune – but it's also famous for its long history of costly, catastrophic failures.

David Yang has experienced both extremes. In 1989, he started ABBYY Software House, which grew from a scrappy, two-man operation into one of Russia's biggest software companies, employing over 400 people and developing cutting-edge



DAVID YANG:

"Bureaucrats ask us how well the program works compared to a professional typist. The answer is very simple: the program is better. It never gets tired, and it never takes a break to drink coffee or chat on the phone."

software for Western clients. Nine years later, he started Cybiko, which briefly looked like another hi-tech success story. The company made a revolutionary product, launched a media frenzy, and attracted tens of millions of dollars in venture capital. But ultimately, Cybiko flamed out with the bursting of the dot-com bubble in 2001.

Like many other stars of Russian hi-tech, Yang has a background in physics. In his case, it goes all the way back to his early childhood. His parents, an international couple consisting of an Armenian mother and a Chinese father, were both physicists engaged in scientific research. Yang always expected that he would become a physicist too. After spending his childhood in Yerevan, Armenia's capital, he came to Moscow to study at the prestigious Moscow Institute of Physics and Technology.

Yang was still a student when he started his first software company. In 1989, he was taking a French exam when he had an idea – it would be useful, he thought, to have a multilingual elec-

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tronic dictionary. Afterwards, he spoke to a friend and they decided to go into business. They named their program Lingvo, and they named their company the ABBYY Software House. Yang's original plan was to spend two months writing Lingvo and then to sell 100 copies, which would make enough money to support him and his friend for two years. Things turned out rather differently. Like many software projects, it took far longer to complete than originally expected. Yang and his friend spent eight months writing the program, fixing bugs and making it run efficiently. Problems persisted until the last minute; just a few days before releasing version 1.0, they discovered a major bug – the dictionary was missing the letter K. This was swiftly corrected.

Once Lingvo went on sale, however, another problem turned up which was far more serious and vastly harder to solve. The problem was software piracy. As it turned out, Lingvo was too popular for its own good, selling almost 10,000 illegal copies for every licensed copy on the market. "On the one hand, this was good publicity," recalls Yang. "On the other hand, it greatly complicated our sales." Yang spoke to store owners throughout Russia, only to discover that they were already doing brisk business selling Lingvo; often, they couldn't believe that they were speaking to the original developer. At this point, Yang faced a major decision: whether to stick with physics or to go into software full-time. "Doing both things at once, and



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doing them well, turned out to be impossible," he says. On the one hand, Yang felt enormous pressure to become a physicist, both from his parents and from his well-placed advisor at the institute. On the other hand, Yang saw a ray of hope in the software business. Despite the massive competition from pirates, some customers – mainly corporations – were willing to pay for licensed software. Furthermore, the popularity of Lingvo had established a solid reputation for ABBYY. Yang decided to become a full-time technology entrepreneur.

But if ABBYY was to succeed, it needed a better product than the cheap, small and easily pirated Lingvo. So Yang came up with a grander

vision. "With our dictionary program," he says, "we realized that our clients weren't just buying a dictionary. They were trying to cross a linguistic barrier. What they wanted was a translated text. And that's why we introduced the idea of page-to-page, language-to-language translation." Yang envisioned that a client could put a page of printed text into a scanner, and then, after a few clicks of the mouse, a page of the same text, translated into Russian, would emerge from a printer. ABBYY pieced together a solution using four different programs, three of which were provided by outside vendors. The resulting package was called Lingvo Systems. Yang admits that it didn't do a great job with the translation; computer translation

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programs are notoriously poor in quality. But nonetheless, Lingvo Systems was a hit with customers. Demand for the page-to-page concept was enormous.

In 1992, Yang decided that ABBYY would redo a key part of Lingvo Systems, which, up until then, had been provided by an outside vendor. That part was the optical character recognition (OCR) program. The OCR program was supposed to interpret the scanned page of text. Unfortunately, the vendor's program couldn't do this very well, and Yang decided that his own developers could do a better job. "This was a very serious decision," he recalls. "It was almost frightening."

The project took on a life of its own. Led by Konstantin Anisimovich, Yang's development team – a crack squad of Russian scientists who had graduated from the best technical schools of the former USSR – delved deep into the theory of OCR. One year later, their program was ready. FineReader, as they called it, was a technical breakthrough in more ways than one. It was the first OCR program for Windows; it was the first such program that could recognize text in multiple languages; and it was the first one that didn't need to be "retrained" for each new font. In other words, it marked a new generation in OCR software. By version 3.0, FineReader could read English-language text more accurately than its



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Western competitors. After ABBYY opened its U.S. office in 1997, under the leadership of current CEO Sergei Andreyev, sales took off on the American market.

Today, FineReader is the company's flagship product. In terms of global market share, it is the number two product in OCR software. Scansoft, which makes the number one product, was originally a Xerox daughter company. However, ABBYY is rapidly catching up to Scansoft. In 1999, it held a 5% market share worldwide; today the same figure is over 25%, and in Europe, FineReader has broken through to the number one spot. This growth has been driven by a simple, indis-

putable fact – FineReader does a better job. Measured by the number of mistakes per page, FineReader is the best product on the market. Yang also points out that it can read text in 177 different languages, and that the industrial-strength version can process tens of thousands of pages a day. As a result, FineReader is used by some of Russia's largest government ministries. "Sometimes," says Yang, "bureaucrats ask us how well the program works compared to a professional typist. The answer is very simple: the program is better. It's more accurate. It's on the order of ten times faster. And of course, it never gets tired, and it never takes a break to drink coffee or chat on the phone."

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In the late 1990s, Yang began to consider new projects. This time, inspiration came during an extended stay in a hospital. While confined to his bed, Yang imagined a wireless handheld device that would let him communicate with other patients. He envisioned a device that could let people chat, play games and send messages. But most importantly, it would let people know when their friends were close by – a concept that later earned the name of "presence management." Such a device offered intriguing possibilities. For example, users could learn whether there were any nearby strangers who shared a mutual interest; in other words, the device could function as a "friend finder."

Yang's brainstorm became the genesis of Cybiko. His first step was to find out whether the idea was marketable. After doing research in six different countries, he concluded that his target consumer would be the U.S. teenager, who was tech-savvy, highly social, and had billions of dollars of disposable income. So Yang teamed up with an American technology executive, Don Wisniewski, and Cybiko was born. The company was truly the offspring of globalization: incorporated in Delaware, its main office was in Illinois, while its development team was in Russia and the devices themselves were manufactured in Taiwan. Yang stayed in Moscow to assemble the development team. Once again, Russia gave him a gold mine of



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technical expertise – he assembled a dream team of distinguished Russian experts, many of whom had worked in the Soviet defense industry. "We didn't sleep at night," recalls Yang. "The entire team worked like crazy." As a result, they finished a working prototype in six months. The team's speed was astonishing; when the chief technology officer of Palm paid a visit to Moscow, he told Yang that U.S. developers would have needed two and a half years to accomplish the same task. There were even more astonishing facts over the horizon. After the Cybiko's debut at a New York toy fair in February 2000, it became a runaway bestseller on the U.S. market. Americans bought over 250,000 units in the first year alone.

Newspapers wrote about "Cybiko mania," as the Cybiko became a must-have gadget for U.S. teens; in some schools, signs appeared saying "No Cybikos Allowed." Yang came under the media spotlight. He was profiled in *Time* magazine and on CNN; for many journalists, the story became the curious Russian origin of the best-selling toy. There was also another reason for the hype: large amounts of money. Cybiko raised over \$40 million in venture capital, with high-flying investors that included AOL Time Warner, Esther Dyson, SUN Capital Partners and The U.S.-Russia Investment Fund. It was the largest amount of capital ever invested in a Russian technology company.

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But the good times didn't last long. After reaching its peak during the 2000 Christmas shopping season, the Cybiko craze ended as swiftly as it had begun. With the bursting of the dot-com bubble, the U.S. economy plunged into recession, and consumers cut back their entertainment spending. Retailers such as Wal-Mart were stuck with huge numbers of unsold Cybikos. Shuttling back and forth between Moscow and Chicago, Yang scrambled to save his company. He settled on a plan where Cybiko would be divided into three separate firms. In December 2003, long after Cybiko had become a distant

memory of the dot-com boom, the company's game division was acquired by In-Fusio, a French company that developed games for mobile phones. It was a costly, disappointing exit for Cybiko's investors. Yang, however, believes that Cybiko was a breakthrough idea that was ahead of its time. Pointing out the success of Wi-Fi and text messaging, he argues that the next logical step is presence management – the concept embodied in Cybiko's device. "With presence management, humans will gain a sixth sense: a social sense," he says. "I think that people will eventually come around to this concept."

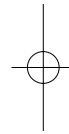
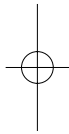
MAJOR RUSSIAN INDICATORS

Sources: Goskomstat,
Economist Intelligence Unit,
Economist Corporate Network

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
GDP (% real change pa)	-12.70	- 4.10	- 3.61	1.38	- 5.34	6.35	10.05	5.09	4.66	7.33	7.00**
GDP per head (\$ at PPP)	5,652.90	5,539.30	5,455.60	5,623.80	5,400.60	5,849.80	6,582.60	7,099.50	7,570.80	8,284.60	9,030.00**
Inflation (% , av)	307.58	197.40	47.74	17.77	27.68	85.74	20.78	21.46	15.78	13.67	10.50**
Average real wages (% change pa)	- 9.83	- 25.20	12.52	4.38	- 10.02	- 23.20	18.01	19.95	16.16	9.79	8.50**
Exchange rate Rb:US\$ (av)	2.19	4.56	5.12	5.78	9.71	24.62	28.13	29.17	31.35	30.69	29.20**
Total exports fob (US\$ m)	67,826.00	82,913.00	90,564.00	86,895.00	74,443.00	75,551.00	105,036.00	101,886.00	107,302.00	135,930.00	144,081.00**
Total imports cif (US\$ m)	50,451.00	62,603.00	68,093.00	71,983.00	58,015.00	39,536.00	44,862.00	53,765.00	60,967.00	75,437.00	89,964.00**
Trade balance (US\$ m)	16,928.00	19,816.00	21,591.00	14,913.00	16,429.00	36,012.00	60,172.00	48,122.00	46,335.00	60,493.00	54,118.00**
Current-account balance/GDP	2.81	2.22	2.77	- 0.02	0.08	12.56	18.04	11.02	8.54	8.28	6.80**
Inward direct investment (US\$ m)	690.00	2,065.00	2,579.00	4,864.00	2,764.00	3,309.00	2,713.00	2,749.00	3,442.00	1,144.00	7,500.00**
Debt-service ratio, paid (%)	4.38	6.32	6.81	6.66	12.00	13.60	9.84	14.35	11.60	8.80	9.40**
Recorded unemployment (%)	7.02	8.30	9.26	10.81	11.88	12.62	10.49	9.03	8.00*	8.47*	8.10**
Population (m)	147.97	147.77	147.37	147.35	146.85	146.27	146.16	145.80	145.30	144.65	144.15**

Notes: *estimate
**forecast

m - million
pa - per annum
ppp - purchasing power parity
av - average
fob - free on board
cif - cost, insurance, freight



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