

“It is becoming a more competitive environment in Russia’s regions, which is prompting and pushing Russian entrepreneurs to improve their performance”



Kendrick White, Managing Principal, Marchmont Capital Partners, explains why entrepreneurs in Russia’s regions, faced with the choice ‘expand or die’, need venture capital investment

You have been focused on regional headquartered enterprises, is that correct?

I started in that direction in the early 90’s as part of a technical assistance programme to set up a business support centre for young entrepreneurs in the city of Nizhny Novgorod. Later, in 1995 I joined Price Waterhouse and set up an office for them in Nizhny and began to formally advise regionally based companies on their business planning and corporate finance restructuring. In 1998 I joined the EBRD as the Director of the Quadriga Central Russia Regional Venture Fund where I led the effort to invest funds into local enterprises such as the well known pharma producer Nizhpharm. Starting in 2001, I became deeply involved in another EBRD investment we made into a fast growing snack food producer called Bridgetown Foods, which while based in Moscow, has been focused over the last four years on expanding sales and production into the regions and CIS. Now, after forming Marchmont Capital Partners earlier this year, I am once again focused on advising regionally based companies on M&A and securing expansion financing for their de-

velopment. While it may sound odd, it seems that after so many years of working here, this must somehow be my destiny in Russia.

Are you now seeing ‘clusters of entrepreneurship’ developing in Russia’s regions?

The idea is that surrounding university towns there should be a critical mass of consultants and advisors, corporate finance specialists, VC and angle investors. If you have such a “cluster” of active market participants all located within the geographical proximity of a local university, this can clearly help to promote the commercialisation of new technologies and other businesses being developed through that university system. As an example, you can think of the typical clusters in the US surrounding such well know universities as Stanford in Silicon Valley or MIT in Silicon Alley, where you have significant brain power combined with venture capital money that brings to market new and innovative commercial investment projects.

In Russia the development of these clusters has been slow for a variety of reasons. One factor has been the

lack of local investment liquidity, but another has been the lack of local business training programs focused on generating the professional middle and top managers needed for company development. For our investment in Nizhpharm, for example, we first tried to identify managers from Moscow and bring them to Nizhny, but this proved to be very difficult to convince Moscovites to move to the provinces, so we focused instead on in-house training. Five years ago, our Quadriga Fund had financing from the German KfW which helped to finance training for our investee companies. That was very useful, but it could only be targeted to one investment project at a time. Today you are seeing a growing number of regional companies which have moved from trading to production and are now facing increasing competition and have realized that they must invest into the development of a strong management team to help develop the necessary accounting and quality control systems necessary to grow their companies. In order develop a cluster of business activity there must be an infrastructure in place to help support this process and I can

say today that this regional system of education programs, consultants, trainers and coaching is now finally falling into place. If we can now add into this equation the increased activity of angel investors, small business lending programs and venture capital financing, Russia's regional capitals such as Nizhny Novgorod, Ekaterinburg, Rostov and Novosibirsk and their surrounding regional cities, can really take off in their economic development.

Is the private sector working to fund these programmes?

I know of several MBA programs which were either recently set up over the last few years or are currently being set up. One such example is the MBA program at the South Urals University in Chelyabinsk where I have been invited as a guest lecturer. The university helped set up and sponsor the programme but the students or the companies where they work should pay for the two and half year programme. They are currently working in partnership with an American university MBA program and are offering a full curriculum of advanced business topics. Also, these are not young students in these programs, but rather professional managers such as Finance, Strategic planning and HR Directors, as well as General Directors and owners of businesses who see the value in such programs. The program is focused on such sophisticated topics as how asset pricing models work, stock market valuations and IPO preparation and how best to establish the capital structure of a company. In the class I taught, I was amazed by the advanced level of questions asked by the students. In addition to this program, I know of several new executive MBA programs which are being established in Nizhny, including the "Green City" Institute as well as a programme which is planned for next year through the local branch of the Higher School of Economics. As competition increases in Russia, it is completely logical and necessary for such commercial programs to develop across this country in order to meet the increasing needs of entrepreneurs to improve the technical competitiveness of their companies.

There are economies of scale which pushing regional companies to seek both strategic and financial partners

Which is all part of the process of Russia becoming more plugged into the global economy.

Yes, absolutely, it is becoming a more competitive environment in Russia and especially in Russia's regions, which is pushing Russian entrepreneurs to have to improve their performance and competitiveness in order to survive and grow. The fact that you have MBA programs, consultancies and support networks together with angel investor clubs and venture capitalists developing rapidly around the progressive regions, this is all helping the local entrepreneurs to access know-how and new capital and to effectively become further integrated into the global economy. These are all positive trends which I am taking advantage of in building a corporate finance advisory firm focused on linking global private equity investors together with these progressive regional enterprises. These are all trends that I intend to build on together with companies that not only need expansion financing, but are also prepared to open themselves up to international business practices and transparency which will ultimately make them more competitive and successful in their businesses.

To expand the entrepreneurs really need financing...

Today, I hear it again and again. A few years ago I worked with an attractive company in Nizhny which was very reluctant to sell shares to a foreign venture fund. Their attitude was that they would be willing to sell only a few shares to a foreign investor, but

only reluctantly and if we offered an outrageous valuation price. In the end we could not agree on a valuation and had to walk away from the project. Today the attitude of companies is much different; as artificial barriers have been dismantled which have long protected local regional business elites, natural competitive forces are changing entrepreneurs attitudes towards private equity investors.

Today, I very often hear that entrepreneurs need venture capital investment, and increasing WC liquidity in order to grow their companies, or face falling market shares and shrinking margins. The increasing competitiveness in the regions is forcing companies to expand or die. I can also see a strong trend in consolidation, which is happening across many industries and sectors. You can see it in retail, in domestic production and in services. There is a push to take the fragmented production companies which set themselves up out of early trading operations ten years ago, and which succeeded quite nicely until now, but today face the macroeconomic pressure of larger and larger Moscow based or MNC competitors seeking economies of scale in such areas as raw materials sourcing. This pressure is now pushing companies together in order to compete. Just look at the electronics retail networks. Each city had its own locally home grown electronics retail stores which are now being converted via franchising over to members in rapidly growing national network chains. There are economies of scale in this model which can successfully solve a number of individual risks which any independent operator cannot solve on its own. This is just one example being replicated across Russia in many sectors, and is pushing regional companies to seek both strategic and financial partners.

Therefore, you would characterise this as a new 'post-privatisation' period in Russia?

Yes. This is an era of increasing competition and transparency, driven by market forces, to push companies to improve their position and to be able to compete either against Moscow

companies or multi-national companies which are entering their turn in force.

What kind of scale companies are you focused on?

We work with companies not only in Nizhny Novgorod, but also in Samara, Ekaterinburg, and Chelyabinsk and I have also been introduced to several very strong entrepreneurs in Novosibirsk and Tomsk which I would like to work with in the future. Right now, we are working with strong regional companies which are generating \$15/20m in annual sales and up, which need financing to expand the production of their branded products to reach a national market where annual sales can be increased to \$100m or more over a five year period. If we can realistically achieve this growth, it will be quite possible for us to then help the private equity investors to exit their investment via an IPO listing. Alternatively we are interested in strong regional brands that could eventually be sold via a trade sale to a MNC seeking Russian market share. Usually we are dealing with closely held or family controlled companies where the owners fully understand that it is to their advantage to sell shares to a friendly western investor whose only interest is to grow the business and make profit through value creation and a successful exit. The progressive entrepreneurs with whom we work have come to the logical conclusion that it is better to own 51% of a \$100 Mio company rather than 100% of a \$20 Mio company with falling market share, no profits and shrinking dividends.

What evidence is there that there is too much capital concentrated in Moscow and St Petersburg?

In my opinion, there are a number of Western investment funds which are operating in Moscow. These funds have been for the most part very successful historically, but the entry valuations on new projects coming from the capital cities are steadily going up. Also, there are a lot financial intermediaries in the capital cities, a lot of consultants and advisors, which are helping their local clients to develop very sophisticated and successful business plans. These business plans are often promoted via investment

tenders to the investment funds which are often competing against each other over the same set of projects and I believe that the valuations on these projects are becoming quite high as you have an abundance of funds reviewing a rather limited set of qualified projects.

Adding to the problem is the fact that many potentially attractive companies operating in the regions are not yet willing to pay the necessary consulting fees which the intermediaries

regional players, which have been strong for the last five years, are now facing competition

are seeking for their advisory work in preparing business plans and investment tenders. Regional companies are not so open to hiring expensive advisors, adding to the gap between the Moscow based investors which are seeking projects, and the entrepreneurs in the regions which are very often unprepared to provide realistic business plans which the investors are expecting to review. My experience has been that these two groups are very often missing each other as they are not able to speak the same language and find a common ground of understanding on how to develop the business going forward. Its obviously much easier for an investor in the capital to review a ready made professional business plan compared to having to travel back and forth to a provincial city over a six month period trying to build a business plan himself together with the entrepreneur.

The problem for investors right now is that the time of finding easy post privatization deals and "low hanging fruit" is coming to a close and the hard work of real VC investing is really beginning. While competition is fierce in the capital cities, there are fewer deals spread more thinly in the regions, but these to me represent significantly better valuations in the long run. This is where we stand today and as a result, I've positioned

Marchmont as an effective source of corporate finance advisory services, able to work on the ground to help regional companies to develop their business plans in such a way that they will be fully screened and qualified to secure PE investment capital from active investors.

Which is why you spend so much time on the road...

I have been working in the regions since 1993 and I like working with a certain type of entrepreneur who has a certain fire in their eyes when talking about their business and who is psychologically ready for a western partner to help them grow their business, but at the same time needs advice and coaching on how to present their business plans and ideas in a professional format and then negotiate a win-win financial partnership. Yes, this takes a lot of travel time, but the rewards of working with some of Russia's top entrepreneurs and builders of a new Russia integrated into the rest of the world are well worth it!

Are Russian regional companies now competing more intensively?

The fight between different Russian brands is already heating up. Russian consumers are very attracted to successful Russian brands. These regional brands, which are attracting financing, which are developing themselves and expanding are starting to compete against one another. There is inter-regional competition, which is heating up and will continue to do so. Added into the mix is that you have western multi-nationals which are looking at the whole of Russia as their market place. They want to become strong in all of Russia. There is a certain amount of pressure on the multi-nationals to build new green-field operations, but also there are many incentives to move quicker and buy local brands with strong marketing and merchandising teams in place. This means that the regional players, which have been strong for the last five years, are now facing competition from many angles. Eventually I believe that much of Russia's markets will be divided up and dominated by a handful of strong indigenous consumer brand producers fighting against major multi-national brands - which in the end will be quite good for the Russian consumer. 