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KLINK & CO., INC.
Your Global Risk Management Partner

Klink & Co., Inc.

Global Risk Advisory #1 In a Series Target - RUSSIA

**Klink & Co., Inc. - Your Global Risk
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July 2009

In This Issue

[Recent Speaking Engagements](#)

[Global Due Diligence Russia](#)

Recent Speaking Engagements



April 26-29, 2009

Jeffrey Klink spoke at the GAIM conference in the Cayman Islands on Anti-Money Laundering.

[GAIM Ops Cayman 2009](#)

December 9, 2008

Jeffrey Klink was a featured speaker at the [IIR Asian Pacific Leveraged Finance Conference](#) in

Dear Client,

This is the first in a continuing series of advisories in which we will examine risk factors for multinational corporations and investment funds when conducting business in a particular country. **Russia** is the subject of this advisory.

Global Due Diligence - Russia

[Klink & Co., Inc.](#) has offices around the globe and provides specific and general information about the risks associated with doing business in mature and emerging economies. In short, we provide detailed reports on the people and countries that will make or break your investment.



THE RISKS: FOREIGN CORRUPT PRACTICES ACT, CORRUPTION, GOVERNMENT INTERFERENCE, ORGANIZED CRIME, LIKELY DEVALUATION OF THE RUBLE, CREDIT AND DEBT

LEVEL OF RISK: ** 4 out of 5 stars**

* ONE IS SAFE

** TWO IS SAFE WITH SOME RISK

*** THREE IS MODERATE RISK

**** FOUR IS HIGH LEVEL OF RISK

***** FIVE IS UNSAFE (ABSENT SPECIFIC DEMONSTRABLE CIRCUMSTANCES AND RESEARCH)

BRIEF ANALYSIS: Despite having immense natural resources (oil and gas), a fairly educated populace in pockets, and some pretty bright business people, the Russian economy is beginning to show very real signs of danger, if not

Hong Kong. He spoke about the importance of conducting due diligence investigations in the region and identifying political and business risks prior to committing capital.

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Russia faces massive contraction, a declining stock market, and other negative economic factors. With oil prices still in relative decline, increasing inflation, and the government intent upon protecting Russian interests perhaps at any cost, Russia is not a place for the timid investor. Look to the government to be forced into devaluing the ruble as well. Additionally, our analysis of mergers and acquisitions activity shows a decline of about 80% since the beginning of this year as compared to last, which reflects not only the global decline of mergers and acquisitions, but also the risks associated with doing business in Russia.

Other risk factors include a disinterested citizenry reliant upon corruption and frozen credit markets. Easy credit, which fueled recent Russian growth is now virtually unavailable from foreign sources and national entities are also reluctant to lend. Most national entities, in fact, have no idea about how much bad debt they are holding and that issue could boil up into a major crisis sometime in the near future. Note NPL's (non-performing loans) as a major risk factor for the next several years.

We therefore rate Russia as a 4 Star Risk for foreign investors at the present time. That means that Russia offers opportunity in energy plays, some retail plays, and certain niche sectors, but at high level of risk. We recommend very substantial due diligence and research prior to committing even modest amounts of capital in a Russian venture.

WHAT ARE SOME OF THE OTHER RISKS?

Private industry is beginning to look suspiciously like government run business, with all of the negatives associated with a state run economy. Both foreign and domestic companies are still able to operate, however, as tax rates are low (even though it is debatable how often taxes are paid) and regulation limited.

In most cases, it appears the central government is only interested in taking over, interfering with, or forcing out foreign run or owned businesses, not Russian owned companies. The likelihood of being pushed out by the Russian government is what makes investing in this country an especially risky proposition for larger multinationals. Further, bribery is necessary to maintain profitability, and foreign companies have to pay up to keep working which exposes multinationals to liability under the Foreign Corrupt Practices Act or its equivalent legislation. The Russian government recently estimated that over \$300 billion in bribes are paid to government officials and others every year and that over 200,000 corruption crimes were detected in 2008.

Russians seldom pay their share of taxes, so it is tough for foreign investors to compete on anything resembling a level playing field.

Even when bribes are paid, it takes 3-6 times as long in Russia to be able to get government approval to do even the smallest of activities. There is no historic ability to get things done in Russia, and while most Russians understand this, many foreign investors see the shining lights of Moscow without taking in the less pretty underbelly of government inefficiency. McKinsey, the noted consultancy, also recently reported that productivity of Russian workers is far less than half of Western workers and that without government subsidies, little enterprise could survive.

We have found so many instances of corruption and organized crime activities in Russia of late, that they are too numerous to count. Suffice it to say that no one appears to be safe from the threat of hacking, corruption, outright theft, or demands for kickbacks or bribes, especially since law enforcement activities in Eastern Europe, as in many places in the world, focus primarily upon protecting only national companies. Investors should not look to the Russian courts to correct any deficiencies either. They are part and parcel of the state apparatus and are loyal to their benefactors.

Worth repeating is the massive debt owed by Russians entities to foreign banks. The state will not likely honor any commitments it has made to pay for

defaults as it has problems of its own, and therefore, defaults of material size will shortly be coming down the pike. This will exacerbate current liquidity issues that are stifling the economy today.

ENERGY

Russia is sitting on massive oil and gas reserves that would be the envy of any country. Bold and sophisticated energy companies like BP have entered the marketplace, done their homework, and come away scarred and unhappy after losing control battles to the Russian government. Sure you can own the business, but not for long, and by the way, your management team will slowly but surely be replaced by Russians who have no desire to protect your company's interests.

The lessons to be learned from BP alone could fill up the syllabus for a post-graduate course on doing business in Russia, but let it be said that Russian government interference in business is a reality, not a concept. If the Russians decide that they want your business, they will make sure that they get it. All of the niceties that were resolved along the way get replaced by good old-fashioned Russian resolve to control their domestic interests and resources.

CONCLUSION

As discussed, we see great risk in Russia at the present time. Substantial due diligence in the marketplace is essential but will not guarantee a happy outcome. If you see a real opportunity in Russia, make sure that the return timetable is short term. Our belief is that long term commitments amount to gambling, due to a lack of infrastructure, corruption, nationalism, and the other risks we have identified.

For further information about our Foreign Corrupt Practices Act services, due diligence capabilities throughout the world, or pre-employment background services, please call a [Klink & Co., Inc.](#) professional at 1-800-836-8916.

Jeffrey M. Klink is the Founder and CEO of Klink & Co., Inc. and has saved clients over one billion dollars by doing the proper due diligence. He can be reached at 1-800-836-8916 or 1-412-201-9123.

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