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Russia Goes Global — Southeast Asia

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Russian companies moving into Asian markets are often attracted to China primarily for its growth and size. But increasingly they are finding that investment opportunities in Southeast Asia are too good to be ignored and making the move. This makes a thorough understanding of the investment environment vital, and at the Goltsblat BLP "Russia Goes Global" conference in Moscow, guests heard from BLP's regional experts about the attractions and the pitfalls.

Taking the global step

The future of Russian business will depend not only on Russia attracting international players to its markets, but also on Russian companies making greater inroads internationally. Russian corporates are increasingly taking this step. Only a decade ago it was only Russian energy giants, or resources producers, that had moved into the global marketplace. But more and more, they are being joined by infrastructure and construction companies, machinery and equipment manufacturers and lessors, and Russian mobile telecommunications operators. More Russian corporate players can be expected to follow.

When Russian companies step into a global marketplace, they find many of the same challenges and issues that international players coming to Russia find. The laws and customs and systems are different, and they can be quite daunting. The Russian companies looking to move into markets in Asia and Europe, and in emerging markets, will need to understand a different business culture and legal framework, and ensure they have good advice on how best to work in that marketplace.

Southeast Asia

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The attractions of Southeast Asia are the rapidly growing economies of the region, which have posted strong economic growth as the major developed economies have remained mired in debt and weak demand following the global financial crisis of 2008. According to the OECD, Southeast Asia is projected to grow at a robust 5.5 percent, supported by strong national savings rates, a focus in domestic demand, and an increasingly sophisticated workforce. Beyond the traditional leading regional economies of Singapore, Malaysia and Thailand, Indonesia, which is setting ambitious infrastructure investment as the cornerstone of its economic growth plans, and Myanmar, which is coming in from decades of economic isolation, are getting increasing attention.

The experience of companies moving into the Southeast Asian market, regardless of the country, has demonstrated the value of developing a very nuanced understanding of the market. Having supported numerous clients who are contracting and investing in the region, BLP knows that one of the most important first steps is to get good local advice. Not only legal advice, but general advice to assist in navigating the applicable country, political and legal risks. Many businesses and clients try to replicate their business models from home in Asian markets, and sometimes it doesn't work. So potential investors have to do a lot of research into the way things work in the relevant jurisdiction and not just try to use the same business models that have been successful elsewhere.

One part of the knowledge acquisition process is about getting effective advice from legal and other advisers, but obviously it also includes making an effort to meet as many people as possible, and conducting due diligence on prospective target companies and the people behind them — not just legal advice, but getting into the market and understanding. Japanese companies often open a representative office in the country and spend quite some time just meeting people, talking to people and finding out what the legal climate is, as well as who might be a suitable local partner.

For most investors looking at the region for the first time, the key questions are where to locate a regional headquarters, and choosing which market or markets to enter. For the first question the answer is often Singapore or Kuala Lumpur, as new regional markets are attracting investor attention, or specific projects may take an investor to a country in the regions such as Indonesia.

Singapore

Singapore is the leading individual destination for Russian companies moving into Southeast Asia, reflecting an economy that has long been a key cornerstone of global capital in the region, a strategic location astride one of the world's major trade routes, a trading culture that has encompassed a diverse range of peoples, and a legal and administrative system strongly influenced by a long period as Britain's major Southeast Asian outpost. It has a per capita GDP of about $60,500 (2011 estimate), and has the largest number of millionaires per square mile in the world — largely due to real estate costs. In global ranking, it comes in 25th for quality of life, and 8th for personal safety. English is a national language, and the language of courts, business and even taxi drivers.

One of the world's busiest ports on a small island at the end of the Malayan Peninsula at the end of the Strait of Malacca, Singapore has a very open, free, stable environment for business in all respects, with no restrictions on foreign ownership of business in Singapore.
The corporate tax headline rate is a reasonably low 17 percent, and there are exemptions from capital gains tax, with income sourced and retained overseas not taxable.

Singapore also provides significant incentives for global companies, both financial and operational, to establish regional head offices there, meaning it is the home to numerous regional headquarters including Russia's Gazprom and LUKoil. Repatriation and import of capital is freely allowed in Singapore, and it is also the center for a large region servicing investment banking and the professional advising sector. Singapore has also made a significant effort to cultivate positive business relations with corporate Russia.

Malaysia

The other major choice for Russian companies looking to establish themselves in Southeast Asia is often Kuala Lumpur, the capital of Malaysia. KL, as it is widely known, is like Singapore in that there are no restrictions on foreign ownership of business. The headline rate for corporate income tax is 25 percent. Capital gains tax is paid but it's quite a complex indirect tax system, and applies only to gains from real property, which does not affect most corporates. Generally, it has a lower cost base than in Singapore, and for that reason some companies who find a balance between Singapore and Kuala Lumpur will opt for KL.

One of the major factors to consider for global companies moving to Malaysia is the Malaysian language, Bahasa Melayu. Bahasa Melayu is the national language and is now the language of the courts. This means that although dispute resolution may take place in English, litigation will be in Bahasa Melayu.

Indonesia

One rising economy of the region is Indonesia, whose great economic potential is only now being seriously approached by global investors. Consisting of more than 17,000 islands, including Java, Sumatra, and Borneo in an archipelago running from west of Malaysia and Singapore to south of Philippines, it has the world's fourth-largest population, with a diverse range of religions, ethnic groupings and regional administrative players.

The range of administrations can be a challenge, with some powers devolved from the central government to a regional level, which has created some issues for international investors in the mining and energy spheres. There is the Master Plan for Acceleration & Expansion of Indonesian Economic Development 2011 — 2025, which has key government objectives of boosting per capita income to between $14,250 — US$15,500 by 2025, with GDP rising to $4-4.5 trillion over the same period.

Indonesia has a civil law system influenced by customary laws and colonial Dutch laws. In effect there is what is written in the laws as supplemented by regulations, coupled with the local law in any given region or administrative area. However, the laws can be ambiguous or lack detail, and implementing regulations can take a long time to be issued.

It is vital that potential investors get quality legal advice on any proposals. Indonesia is by no means an easy country. It requires time to be spent there to get to know how the Javanese style of politics works, and how the system works. Face-to-face discussions are very important, particularly in the case of a dispute or potential dispute: often a misunderstanding can lie at the root. Issues rarely go to the courts, which are generally regarded as a last resort, with numerous allegations of corrupt practices in Indonesia. This may sound slightly intimidating, but life goes on, and there is a lot of investment there that does end up being successful.

Investors should note that historically Indonesia bankruptcy laws were used effectively to a limited extent, resulting in a very small number of bankruptcies prior to 1997. This was noticeable in the 1997 financial crisis, when many Indonesian companies ran into financial difficulty and in many cases banks threatened to put these companies into bankruptcy but found that it was virtually impossible to do so. This resulted in new bankruptcy laws in 1998 and 2004; however, effective due diligence on a potential partner is essential, and underlines the importance of having a developed relationship with a local partner based in trust, rather than relying on the black and white wording of a joint venture agreement, the courts or the bankruptcy laws.

Indonesia does not allow foreign investors to own land but it does provide generous leasing rights, and permits the repatriation of profits. The country is also a signatory to the New York Convention, making international arbitration awards recognized, notwithstanding practical difficulties in enforcing judgments against Indonesian companies on the ground in Indonesia.

Myanmar

Myanmar has only recently begun opening its economy to global investment, but in a short period of time it has come a long way and attracted considerable interest, with a genuine attempt to open up and become more investor friendly. It attracted $20 billion in foreign direct investment in 2011, with the biggest contributors fellow Asian nations in China and Korea, and South East Asian neighbors in Thailand, Singapore and Malaysia.

Its key economic drivers are currently the resources and energy sector, with Myanmar currently holding auctions for offshore energy development blocks, and with onshore blocks expected to be made available in the short- to medium-term future. Myanmar has been a known potential energy supplier for a long time, and has long been attempting to attract investment in its resources, but it has really come into its own as the recent suspension of economic sanctions has been factored in by potential investors.

The Myanmar legal system includes a mix of company and contract law based on outdated English legislation that is expected to be gradually updated or replaced. The nation is not yet a signatory to the New York Convention, making enforcement against Myanmar companies in Myanmar difficult. This has resulted in corporate structures where revenues flow through Singapore or Hong Kong based accounts. This again underlines the importance of due diligence and being careful.

The nation looks very promising for many potential investors, but there is still an element of wait-and-see for clear direction, noting that the Foreign Investment Law was recently sent back from the president to the parliament, with a clear directive to improve the investment climate. The draft law included minimum capital requirements, which the president directed be reduced. As with many global jurisdictions, there are some industry specific permits and approvals, notably with oil and gas reserved for the state, and requiring a joint venture with an approved Myanmar local entity for international companies to gain access. The new Foreign Investment law is now in place, and its implementation and development is being closely monitored by BLP lawyers.

Dispute resolution

A key factor in many companies choosing to locate regional headquarters in Singapore, and using it as their investment hub, regardless of where they may have operations, is the predominance of English law dispute resolution across the region. Many regional cross border contracts place dispute resolution under English law in Singapore. That ensures that they have neutral law and a safe arbitration hub in a country that is safe and stable, with no interference from the judiciary. This is quite widely accepted across the region and provides a lot of comfort for incoming global investors.

* Goltsblat BLP is the Russian practice of Berwin Leighton Paisner (BLP), an award-winning international law firm headquartered in London and with offices operating in major commercial and financial centres throughout the world — Moscow, Abu Dhabi, Berlin, Brussels, Dubai, Frankfurt, Hong Kong, Paris and Singapore.

The firm has a team of 100 Russian, English and US law qualified lawyers based in Moscow and over 800 lawyers in the other international offices.

Goltsblat BLP clients include over 600 companies, about 70% of them being major multinationals operating in Russia, including 23 Fortune 500 clients.