

Stock Exchange listings of former Soviet Union companies

A Guest Article by Nigel Kotani
October 2008

Stock Exchange listings of former Soviet Union companies

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

Fund-raising opportunity

The former Soviet Union (FSU) has been suffering from a credit crunch for the best part of a decade. FSU businesses may have good products and access to enormous markets, but the loan funding required to develop businesses in the FSU is both scarce and expensive.

Over the last few years, a large number of FSU businesses have looked into the possibility of listing on a stock exchange in order to raise funds. Interest has focused on the alternative investment market (AIM), which is specifically designed for smaller, growing companies.

Low conversion rate

The proportion of FSU businesses that have ultimately decided to take the listing route, though, is tiny in comparison with the number that have looked into it. The reasons for this low conversion rate appear to be two-fold: culture and cost (or, to be more accurate, a misunderstanding about cost).

Cultural factors

Transparency of ownership

The first difficulty that FSU businesses seem to encounter when investigating the possibility of listing concerns transparency of ownership. The Disclosure and Transparency Rules require disclosure of details of all individuals who beneficially own 3% or more of a listed company.

Individuals in the FSU are often not prepared for this information to become public knowledge – sometimes for reasons of their own personal safety, and sometimes because they are concerned that such information may draw unwelcome attention from the tax authorities.

Many FSU businessmen approach stock exchange listings in the belief that they will be able to hide their identity and the identities of their partners behind offshore trusts. Often the first battle faced when trying to list an FSU business is to persuade the owners that it's not going to get off the ground unless details of the beneficial owners become a matter of public knowledge.

Stock Exchange listings of former Soviet Union companies

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

Reporting requirements

Transparency as regards ongoing reporting requirements also causes problems for a lot of businesses in the FSU. In particular, many businesses in the FSU indulge in what are euphemistically known as “grey” activities. This is especially the case when it comes to tax, with activities such as paying employees a portion of their salaries in cash not being uncommon.

It is essential in any listing that all such matters are laid out openly to potential investors as part of the listing process, but when they are they become a matter of public record, at which point such activities have to cease.

Similarly, the ongoing requirement to have the company’s accounts audited to International Financial Reporting Standards (IFRS) can cause problems, as local auditing standards are not as stringent. The requirement for the accounts for up to three previous years to be audited to IFRS can also be a problem.

Shared decision making

Another problem concerns the appointment of independent non-executive directors to the board of the listed entity. Although not a technical requirement, this has become market practice to such an extent that it has become a de facto requirement.

The owners of most businesses in the FSU are unused to explaining or justifying their decisions to anyone else, let alone sharing the decision-making process. The discovery that, after listing, decision making will genuinely have to be shared with independent, non-executive directors, who will demand total transparency as to all the activities of the underlying business, can often be the final nail in the coffin of a businessman’s interest in listing.

Internal mechanisms

Even if the willingness exists within an FSU business to achieve a listing on a Western stock exchange, and to comply with all the necessary reporting and transparency obligations, most FSU businesses simply do not have in place the internal financial and management reporting and control mechanisms that would make the underlying business suitable for listing.

It often takes two to three years for an FSU business to put all the relevant mechanisms in place and for some of the “grey” practices to have worked their way out of the system. This delay is acceptable if listing is a long-term strategy, but in most cases the need for funds is more immediate.

Stock Exchange listings of former Soviet Union companies

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

Cost factors

The second predominant reason why FSU companies frequently reject the possibility of listing concerns cost. The aggregated costs of the issuer's lawyers and accountants, of the nominated advisor's fees, of the lawyers to the nominated advisor, and of the broker's commission can be very significant indeed, and such costs are often enough in themselves to put people off an AIM listing.

The real cost

In truth though, the real cost of a listing is determined by the placing price of the shares, rather than by the administrative costs of carrying out the listing. Businessmen in the FSU often fail to understand that the real cost of the listing lies in whether, for example, in order to raise £20 million, they have to give up 20% or 40% of the enlarged capital of the group. This variable is a function of the placing price of the shares.

To ignore the effects of the placing price and simply look instead at the administrative costs is the equivalent of ignoring the interest rate on a bank loan and simply concentrating on the arrangement fees and legal costs. The best way to minimise the costs of a listing is to maximise the perceived value of the underlying business, and the real way to assess those costs is to look at the net amount raised in comparison with the number of shares issued.

Legacy of secrecy

Even for the majority of Western businessmen, the degree of control that has to be sacrificed when listing a company, together with the levels of transparency and accountability that have to be adopted, are not something they are prepared to accept.

The proportion of businessmen in the FSU who are prepared to make these sacrifices is even smaller: the legacy of 70 years of a system where secrecy and control of information were paramount takes more than 20 years to fully shake off.

Emerging generation

That said, a younger generation of business people is emerging in the FSU who do not carry that legacy, who have considerable experience of Western business practices, who understand the workings of Western capital markets, and who, in

Stock Exchange listings of former Soviet Union companies

A Guest Article by Nigel Kotani for TCii Strategic and Management Consultants

many cases, have been educated and/or have worked in the West. It seems inevitable that, as this generation comes to the fore, the number of FSU businesses that list on Western markets will increase.

Nigel Kotani
Partner – LLC Law

If you would like more information on any of the points covered in this Guest Article, please contact **TCii** on **020 7099 2621**.