

BISNIS Bulletin



Facilitating
Commercial Success in Eurasia

April 2003



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U.S. Department of Commerce
International Trade Administration

U.S. Exports to Eurasia Beat Worldwide Performance

by Tanya Shuster and Michael Considine

U.S. exports to the 12 Eurasian countries in 2002, while roughly equal to 2001 levels, nonetheless indicate a significant performance considering the nearly 5-percent contraction in U.S. exports worldwide. Factors contributing to this relative high spot include several aircraft sales throughout the region and comparatively robust machinery export growth at 10 percent, against an almost 10-percent drop for the rest of the world. The United States continues to be a leading supplier to the region, particularly of machinery and technologies. Russia continued to hold a dominant position for U.S. exports to the region in 2002, with Ukraine, Kazakhstan, and Uzbekistan next in importance.

Russia

Russia is the United States' chief trading partner in Eurasia, accounting for three-quarters of exports to the region in 2002. Total U.S. exports to Russia declined 12 percent in 2002 compared with 2001, to roughly \$2.3 billion. However, poultry exports alone—which were cut nearly in half following Russia's late winter imposition of quotas on all poultry

imports—accounted for all but a small share of the decrease. Although the performance of remaining U.S. exports was mixed, the net effect on overall U.S. exports was neutral.

According to Russian data, the United States ranks third as a foreign supplier to Russia, after Germany and Ukraine and just ahead of China, followed by Italy, then France. The value of German exports to Russia in 2002, which grew by 12 percent, was more than double U.S. levels (\$6.1 billion), while Ukraine's exports exceeded U.S.

U.S. Exports to Eurasia, 2002 (F.A.S.) (millions of U.S. dollars)

	2002	2001	2000
Eurasia total	\$3,837.4	\$3,816.5	\$3,324.7
Russia	\$2,398.5	\$2,716.0	\$2,318.2
Kazakhstan	\$604.6	\$160.2	\$124.4
Ukraine	\$254.9	\$200.0	\$186.1
Uzbekistan	\$137.9	\$144.8	\$151.3
Armenia	\$111.8	\$49.8	\$57.0
Georgia	\$98.8	\$105.9	\$108.8
Azerbaijan	\$69.6	\$64.2	\$210.3
Turkmenistan	\$47.1	\$248.4	\$72.5
Tajikistan	\$33.1	\$26.6	\$12.7
Kyrgyzstan	\$31.1	\$27.6	\$24.4
Moldova	\$30.6	\$35.5	\$27.4
Belarus	\$19.0	\$34.9	\$31.1

Source: U.S. Dept. of Commerce, Bureau of the Census

levels by about half a billion dollars. The U.S. ranks first among other countries in the supply to Russia of oil and gas equipment and poultry, second as a supplier of medical equipment, third for tractors/trucks, fifth for perfumery/cosmetics, autos/parts, and computers, sixth for construction materials, and

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Upcoming U.S. Commercial Service Catalog Shows!

Boat Show St. Petersburg, Russia June 4–8, 2003

The U.S. Commercial Service (CS) at the American Consulate General in St. Petersburg will help U.S. companies identify market opportunities in the rapidly growing pleasure boats and accessories market in St. Petersburg and Northwest Russia by showcasing U.S. products at a leading pleasure boats industry trade show. Participation in the CS product literature center is a low-cost way to test market U.S. products and receive contacts and trade leads.

For more information, contact: *Eva Astakhova, CS St. Petersburg*, at email: eva.astakhova@mail.doc.gov or tel: +7 (812) 326-2574.

11th International SIA 2003 Kyiv Motor Show Kyiv, Ukraine May 28–June 1, 2003

The U.S. Commercial Service in Kyiv will assist U.S. companies to promote their products at the major Ukrainian automotive exhibition for vehicles, spare parts, accessories, and repair. CS will manage an official business information office and catalog show at the show (see www.autoexpo.com.ua/eng/sia.html).

For more information, contact *Oleksandr Zavorodniy, CS Kiev*, at email: oleksandr.zavorodniy@mail.doc.gov or tel: +380 (44) 490-4018.

2003 CIS & Eastern Europe Business Forum November 1–2, 2003 Tucson, Arizona

The University of Arizona announces the 10th annual "CIS and Eastern Europe Business Forum."

If you are interested in being a presenter at the forum, contact Roza Simkhovich at email: roza@dakotacom.net, or call or fax at 520-298-6599.

For more information about the conference, visit last year's conference Web site at <http://russian.arizona.edu/business>.

BISNIS

Facilitating Commercial Success
in Eurasia

BISNIS is the U.S. government's primary market information center for U.S. companies exploring business opportunities in Eurasia. Operated by the **Market Access and Compliance** unit of the **International Trade Administration**, BISNIS disseminates information in print form, electronically, and through consultations by its staff of trade specialists. For more information, please contact:

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Articles by non-U.S. government employees express the views of the authors and should not be construed as a statement of U.S. government policy.

ISSN 1544-1121

Franchising in One of the World's Few Growing Markets

by Jeffrey Kamins and Andrei Chursov

Franchising as a business model is capturing interest throughout Eurasia, but it has only recently started to develop. In a world experiencing declining economic growth, Eurasia offers opportunities for U.S. franchisors seeking to compete in fast-growing, less saturated markets. Eurasian countries have shown between 4 and 13 percent annual economic growth (on average 2000–2002), constitute a 220 million-person consumer market, offer educated and affordable labor, and have plenty of skilled entrepreneurs seeking proven models of success. Despite these incentives, U.S. companies must be well prepared to tackle the unique challenges that this region can bring.

Retail Growth, Hypermarkets Open Opportunities

To understand the potential for franchising in Eurasia, it is important to examine the current dynamics of the retail sector. In Russia, the consumer market is estimated to be worth \$220 to \$250 billion, according to several sources. The Moscow region consumer market is growing at 6 percent to 12 percent annually. Other areas of Eurasia where retail growth and volumes grew strongly in 2002 include Omsk (23%) and Novosibirsk (17%) regions in Siberia, Sverdlovsk region (21%) in the Urals, Sakhalin region (18%) in the Far East, and Ukraine (17%). It should be noted, however, that some of these areas began from a very low retail sales base.

The development of hypermarkets (i.e., megastores that include grocery stores), which is accompanying and spurring retail growth, is opening up new opportunities for franchisors. For example, IKEA (Swedish furniture manufacturer/retailer) recently invested \$200 million in the development of Eastern Europe's largest mall—the 150,000-square-meter MegaMall located in Moscow. Ramenka (Turkey), a real estate developer, also announced plans to invest \$60 million in three large hypermarkets in St. Petersburg. Such retail chains as Eldorado and M-Video (Russia's largest household appliance retailers), Pyaterochka (discount stores similar to Rite-Aid), and Seventh Continent (grocery stores) all have aggressive plans to open dozens of stores throughout Moscow and are looking to expand

to other high growth regions in Russia, as well as Ukraine and Kazakhstan.

U.S. franchisors should focus marketing efforts on the growing middle class, estimated to be as high as 25 percent of the Russian population and responsible for nearly 50 percent of consumption. Out of average Russian yearly income (\$3,900 based on purchasing power parity), less than 20 percent is estimated to be allocated toward rent and utilities, only 9 percent toward savings, 12 percent on apparel, 14 percent on daily consumables, and 23 percent on food. Lower interest rates, mortgages, and more flexible downpayment terms than existed previously are starting to open up the durable goods market. Multibillion dollar investments by oil companies in Azerbaijan, Kazakhstan, and on Russia's Sakhalin Island are creating a retail market for locals employed in the energy and related services sectors, as well as for the growing expatriate communities.

Developing Vast Networks

Fast food is the most actively franchised sector in Eurasia. Baskin Robbins, Yum! brands (KFC, Taco Bell, and Pizza Hut), Subway, and T.G.I. Friday's are present. Established franchisors are expanding rapidly out of Moscow and St. Petersburg. Franchisors such as Grillmaster (Germany), Rostiks (Russia), Baskin-Robbins, Econika (footwear), and 1C (with more than 2,000 franchisees of software sales-technical support) have developed vast networks across Russia, with some also present in Ukraine and Kazakhstan. Other viable sectors for franchising include automotive care, home improvement, language/educational services, fitness centers/health food, cleaning services, film developing, office supplies/printing centers, and apparel.

The more than 2 million private cars in Moscow have annual maintenance costs averaging \$1,000, thus making that market a \$2-billion opportunity. Despite stable growth in franchised fill-



The Grand Opening of MegaMall in Moscow in December 2002.

ing stations, only Bosh Service (Russia) provides a large network of 54 car-servicing shops in Russia, concentrated in Moscow.

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seventh for telecommunications equipment, but provides very little of the country's pharmaceuticals, beef, or pork (other top Russian imports).

Food processing and agricultural equipment also play a noticeable role in U.S. exports to Russia. Additionally, a number of U.S. consumer items—including gym and certain other types of recreational equipment, some toiletries, and vitamins—are finding niche markets in Russia, where disposable incomes have been rising steadily.

Central Asia

U.S. exports to Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan) for 2002 were valued at \$853 million, up \$237 million (40 percent) from last year. Aircraft sales and launch of satellites in Kazakhstan contributed heavily to this apparent surge. Machinery and equipment, including for the oil and gas, telecommunications, and agricultural sectors, also featured prominently among U.S. exports to the region.

Kazakhstan received \$604 million worth of U.S. goods and services; roughly half of this value was for aircraft. Oil and gas machinery related to Caspian basin oilfield development and telecommunications equipment were the two next most important U.S. export categories. Uzbekistan was the second-largest recipient of U.S. exports in the region (\$137 million), obtaining mainly agricultural machinery and telecommunications equipment, as well as some grains and feed. The three remaining Central Asian countries each brought in between \$30 and \$50 million in U.S. products in 2002. Turkmenistan, after purchasing \$181 million in U.S. aircraft in 2001, largely refocused on agricultural machinery (combines), while Tajikistan received above all medical donations and grain, and Kyrgyzstan bought a small range of U.S. machinery as well as medical supplies.

The Caucasus

The Caucasus (Armenia, Azerbaijan, and Georgia) increased U.S. imports to \$280 million in 2002. Like Central Asia, aircraft featured prominently among U.S. sales growth in the region. Armenia's purchase of U.S. airplanes worth \$63 million pushed it to the top of the U.S. buyer list in the Caucasus. Armenia also received some precious stones/metals, as well as agricultural products such as meats and grains. Georgia overall saw a slight decrease in its imports from the United States in 2002 over 2001, to just under \$100 million. However, a number of U.S. products experienced export growth, including machinery, telecommunications equipment, pharmaceuticals, and poultry.

New Resource!

The Armenia Export Catalog

Funded by the **U.S. State Department's** Educational and Cultural Affairs Bureau via the **Cambridge-Yerevan Sister City Association**, the Catalog is the latest resource for U.S. companies on trade and investment with Armenia.

This catalog was produced on a CD and contains profiles of Armenian companies open to trade opportunities with the United States. The profiles are concentrated largely in the food, manufacturing, and services sectors. It also details information on Armenia's market reforms, banking system, investment incentives, corporate development, trade regulations, and customs and tariff guidelines.

*A limited quantity of CDs is available for \$10. To request a CD, please send an email to **CYSCA** at arthurqueenan@yahoo.com.*

Western Eurasia

U.S. exports to the western part of Eurasia (Ukraine, Moldova, and Belarus) totaled over \$304 million for 2002, up modestly from 2001. The growth is attributable to an increase in exports to Ukraine, which totaled \$255 million, up 27 percent from 2001. Ukraine's purchase of U.S. aircraft in 2002 (\$63 million) was matched in dollar value by its purchases of U.S. machinery (mostly industrial, but also computer-related). Ukraine also bought telecommunications and medical equipment, as well as some vehicles (cars, tractors, and parts) and some consumer goods (including vitamins and toiletries). Exports to neighboring Moldova totaled just over \$30 million, with poultry topping the list and medical donations second. U.S. shipments to Belarus dropped to a bare \$19 million for the year, led by charitable aid and some pharmaceuticals and machine parts.

Eurasia, despite being a market that remains challenging to U.S. exporters and that is dominated in some sectors by European and Asian competitors, remains a viable market for the future. Moreover, it is a market that has recently shown signs of stability and growth, while several other world markets are experiencing contraction.

Tanya Shuster is deputy director and Michael Considine is a trade specialist at BISNIS in Washington, D.C.

Russian Beauty and Health Products Market Flourishing

by Ludmila Maksimova

The beauty and health products market is one of the fastest-growing sectors in Russia. According to Staraya Krepost Association, which unites leading Russian cosmetic manufacturers, in 2001 the Russian cosmetic market was ranked sixth among the world's fastest-growing cosmetic markets. The annual growth rates of the market in the last several years until 2001 amounted to 20 percent, in comparison to 2 percent in Western Europe. It is also one of the most advanced and mature industry sectors in Russia. Both well-established and new manufacturers of health and beauty products are represented. The total volume of the Russian beauty products market, according to a number of independent beauty industry analysts, is estimated at \$4 billion.

Domestic Production

Domestic production of beauty and health care products is concentrated in 120 enterprises, with 15 leading plants accounting for 80 percent of the total output volume. Most leading cosmetics manufacturing plants have modern equipment and use the latest technologies and high quality raw materials. Most enterprises produce local mass-market and middle-market brands. Recently, a number of new enterprises producing well-known foreign cosmetics brands have opened in Russia based on contract relations with foreign manufacturers. Several Russian manufacturers have begun to produce high-end, skin care products whose quality is very close to Western standards. The competition between foreign and local manufacturers in the mass-market segment is very high. Foreign producers outpace local ones by higher rates of new technology commercialization and they control the mass-market segment. As for the middle-market niche, local producers play a significant role and market more middle-market brands than foreign manufacturers.

Fastest-Growing Segments of the Market

The popularity of cosmetic products has been growing rapidly for several years. Cosmetics are viewed not only as a means to achieve beauty, but as a tool to combat the damaging effects of pollution and to achieve a general improvement of

health. The demand for individualized cosmetic products has grown. As a result, beauty salons and professional cosmetic products are becoming more and more popular. According to *Ekspert* magazine, selective high-end skin and hair care products constitute 10 percent of the market. COMCON research agency reports that beauty salons are currently used by 10 percent of Russian women, but the volumes of professional cosmetic products purchased by beauty salons are growing at rates of 40 percent a year.

In the selective and professional beauty products segment, Western manufacturers totally control the market. Here, the leading role is played by such well-established brands as Christian Dior, Chanel, and Lancome. Market analysts expect that in 2003 the selective market will be complemented by relatively new European brands such as Erera and Payot. It is expected that, in the next 5 years, U.S. and Japanese companies will be more widely represented in this market niche.

Professional beauty operators and hairdressing shops and salons are continuing to develop strongly, and they use exclusively imported cosmetic products. In Moscow alone there are 1,500 hair salons, about a third of which offer higher quality services and use well-known brand name products, such as Wella, Schwartzkopf, L'Oreal, and Revlon. There are about 500 hairdresser shops and beauty salons in St. Petersburg, and approximately 150 in Novosibirsk.

The high-end professional market segment is dominated by French, Spanish, and Swiss products. Only a few local products have managed to enter the professional cosmetic market. High-end U.S. professional cosmetic products, including hair, skin, and nail care products and equipment, are already represented and have good potential in the Russian market.

Another modern trend is the rapid growth of beauty products for men and children, especially teenagers. Major Russian cosmetic manufacturers target cosmetics toward men and children. Curative and health-oriented cosmetic products are another growing segment.

According to Euromoney market research company, the bulk of the Russian cosmetic and health products market is formed by hair care products (20 percent of the market); make-up products (19 percent); and soaps, bath gels, and foams (18 percent). Significant shares belong to toothpastes (13 percent) and perfumes (11 percent). The remainder of the market consists of skin care products, deodorants, and cosmetics for men and children.

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The do-it-yourself concept is not new to this region, where most people are accustomed to performing home improvement projects themselves. This Russian market is estimated to be worth \$8 billion per year, which is nearly as large as the French market and expected to grow at 30 percent annually. Obi, Germany's largest home improvement retailer, is partnering with Russian retailer Projekt Russia, and plans to open 14 Obi stores. Other competitors like Maksidom and Starik Hottabych have up to 10 stores and growing. (See "Matrix of Franchising Development" for Eurasia at www.bisnis.doc.gov/bisnis/isa/franchisematrix.htm.)

Next Steps

Interested U.S. franchisors should consider the following factors and resources in pursuing franchising in Eurasia.

- Analyze the top performing retailers and consumer-spending trends. Identify insufficiently met needs. The industrial B2B sector merits consideration. It accounts for about 30 percent to 60 percent of GDP in Eurasian countries, and is in need of modernization and technical support, which can be franchised through service providers. After-sales service is vitally important.
- Do some research to determine if the region is a strategic fit for your company and for your franchise concept.
- Find the right partner. In Eurasia, it is often the case that the most successful companies rely on effective local management, heavily augmented by relationships with regional authorities, which are critical for resolving tax, customs, and certification issues. An ideal partner will often be a well-connected master franchisor with experience working as an "operator" with a large distribution reach. An investment in proper due diligence is critical to knowing the real connections your prospective partner has, and avoiding costly mistakes in the future.
- Playing an active role. Monitor and support your partner. Develop fees and royalties that not only reflect the market value of your brand and concept, but also adequately support the extra training, financing, and marketing you will need to provide. Since franchising is not yet well understood, it is important to invest extra efforts in explaining the costs behind the fees.
- Quality control. Visit the country and assess suppliers for their ability to meet your standards and delivery requirements. Over reliance on imported items can be costly unless your partner has strong experience with customs.

Additional Resources

Russian Franchise Association
www.a-z.ru/raf/index_en.shtml

Kazakhstan Franchise Association
Mr. Andrey Zaharov, email: kazaf@mail.ru

Stiles & Riabokobylko Russian Real Estate
www.snr-realty.com

Franchising in Russia - Oganek Sarkisov, U.S. Commercial Service, Moscow, www.bisnis.doc.gov/bisnis/country/020930RusFranchise.htm

Financing your franchisees—tools available:

- The Overseas Private Investment Corporation provides direct loans up to \$4 million either to the U.S. franchisor to on-lend to the franchisees in eligible developing countries, or to its local franchisees in developing countries. For more information, visit www.opic.gov/finance/products/franloan.htm.
- DeltaLeasing in Russia works with small and medium-sized Russian businesses and directly with U.S. equipment exporters-leasers. For information, see www.deltaleasing.ru/eng. Additional information on leasing in Russia and Central Asia is available from the International Finance Corp. at www.ifc.org.
- BISNIS FinanceLink—circulates your finance proposal electronically to over 1,000 financial service providers. Go to www.bisnis.doc.gov/bisnis/finlin3.cfm.
- Small Business Credit Bank (KMB Bank) of Russia, established by the European Bank of Reconstruction and Development (EBRD), renders micro credit to small and medium-sized businesses. Its 2001 portfolio amounted to \$97 million. Open lines of credit are available for approved franchisees. For more information go to www.kmb.ru/en.

Jeffrey Kamins is a trade specialist for BISNIS in Washington, D.C. Andrei Chursov is an independent consultant and former BISNIS representative in Almaty (email achursov@specialolympics.org).

NOTE: This article was reprinted (with some changes) from the April 2003 issue of *Franchising World* magazine, published by the International Franchising Association (www.franchising.org).

BISNIS Hosts Governor Titov of Samara Region



The Samara delegation at BISNIS offices. Left to right: Pavel Ivanov, head, Samara Dept. of Finance; Tanya Shuster, BISNIS deputy director; Philip de Leon, BISNIS trade specialist; Konstantin Titov, Samara Governor; Trevor Gunn, BISNIS director; Valerii Putko, chairman, Samara Regional Social Movement for the Dev. of Entrepreneurship; Benjamin Hanson, coordinator, U.S. State Department's Regional Initiative in Samara; and Galina Gusarova, head, Samara Dept. of Health.

by Philip H. de Leon

In March, BISNIS hosted Samara Governor Konstantin Titov and a 10-member delegation that included the heads of the Samara Oblast international relations, finance, agriculture, and health departments. Samara region is located 600 miles southeast of Moscow, and is known for its favorable investment climate and progressive leadership. **Coca-Cola**, **Pepsi-Cola**, **Corning**, **Nestle**, **Danone**, and **Delphi Automotive** have already invested there. Moreover, **General Motors** and the European Bank for Reconstruction and Development have invested \$330 million in a joint venture with AvtoVAZ, Russia's leading automaker.

Governor Titov was on a 12-day tour of the United States that took him to Texas, Washington, D.C., Pennsylvania, and New York. In Washington, BISNIS hosted an event for the delegation with over 60 representatives of U.S. companies, nonprofit organizations, and government agencies. (The event was taped and will be posted on the BISNIS Web site.) In addition to promoting business opportunities in the Samara region, the delegation was interested in health care, agriculture, tourism development, small business development, mortgage lending, trade, and partnerships. Governor Titov visited the **M.S. Anderson Cancer Center** in Houston with great interest, as Samara recently opened an oncology center that will use U.S.-made medical equipment.

Among the delegates was Dr. Valerii Putko, chairman of the Samara Region Social Movement for the Development of Entrepreneurship. The movement claims more than 2,500 members, and one of its main goals is protection and representation of small and medium-sized enterprise (SME) interests. It is interested in cooperating with U.S. partners in the following areas:

- implementation of ethical standards in business practices,
- helping businesses overcome administrative barriers,
- creation and dissemination of financial credit facilities,
- education of directors of SMEs in management, marketing, finance, business planning, accounting, and
- development of cooperative high-technology manufacturing facilities using American technology.

Further information on the Samara region is available at **BISNIS Online** at www.bisnis.doc.gov/bisnis/country/volga.cfm, on the **Samara Oblast Web site** at www.adm.samara.ru, and on the **U.S. State Dept.'s Volga Regional Initiative Web site** at www.volgari.ru. Mr. Putko can be reached at email: drp@saminfo.ru.

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Although Russian women are increasingly willing to use domestic shampoos and creams, they are less willing to switch to domestic hair color, make-up, mascara and lipstick. Domestic production of these products is low and cannot compete in quality. Such products represent a good market for U.S. products.

The beauty and health products market remains one of the most lucrative consumer goods markets in Russia. It opens up wide opportunities for U.S. manufacturers in practically all of its segments: low-market, mass-market, middle-market, selective and professional. In the last several years, U.S. cosmetic manufacturers have rapidly increased their share in the mass-market, middle-market, and professional beauty product segments. However, there is still much room for increasing the U.S. share in the market through an active presence in the selective product niche and larger involvement in other segments. U.S. companies should be aware that in the mass and middle-market segments for products, such as shampoo, balms, toothpastes, deodorants, competition from local firms and foreign companies with local production facilities is very tight. At the same time, with further improvement in the Russian macroeconomic situation, prospects for U.S. manufacturers will be significantly enhanced.

For a longer report on the Russian Beauty and Health Products Market, visit <http://bisnis.doc.gov/bisnis/isa/isa-consum.cfm>.

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Trade Events Calendar

Caspian Oil & Gas Exhibition/Conference	June 3–6, 2003	Baku
Organizer:	Caspian Events Ltd.	
Web site:	www.caspianoilgas.co.uk	
Auto Services	June 3–6, 2003	Krasnoyarsk
Organizer:	Krasnoyarsk Fair	
Web site:	www.krasfair.ktk.ru	
Sectors:	Auto parts and service equip.	
Software/Automation Showcase	June 4–6, 2003	Almaty
Organizer:	ITE Central Asia	
Web site:	www.caspianworld.com	
Moscow Intl. Investment Forum: Financial Series II	June 19–20, 2003	Moscow
Organizer:	Intl. Exhibition Group	
Web site:	www.iegexpo.com	
Silk Road Symposium	June 23–27, 2003	Tbilisi
Organizer:	Intl. Black Sea Univ.	
Web site:	www.ibsu.edu.ge	
Sectors:	Tourism and recreation	
Moscow Oil/Gas Show	June 24–27, 2003	Moscow
Organizer:	ITE Group Plc	
Web site:	www.ite-exhibitions.com/og	

Two Upcoming Events from
Adam Smith Conferences

Commercial Real Estate & Construction in Russia

June 3–4, 2003

Marriott Grand Hotel Moscow

Retail Financial Services in Russia

June 17–18, 2003

Marriott Grand Hotel Moscow

Organized by:
Adam Smith Institute

For more information, visit
www.asi-conferences.com