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*Relocation of headquarters to Saint Petersburg –
Public discussion from Russia*

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1 Introduction

1.1 *Background to the research*

In October 2004 the Governor of Saint Petersburg Valentina Matvienko first announced that the second largest bank in Russia, state-owned Vneshtorgbank, will be relocated to Saint Petersburg and similarly, with regional tax payments of about USD 60 million, become one of the main taxpayers in the city. In addition to this announcement, Governor also made an invitation for other large-scale Russian companies, mainly domiciled in Moscow city or Moscow region, to relocate and register their corporate headquarters to Saint Petersburg. One logical major incentive for this active promotion of the city could be found from the budget of Saint Petersburg, which had been running on deficit in 2003 and massive infrastructure and energy supply investment needs threatened to worsen the situation in the near future. Thus the obvious aim of these statements was to attract prosperous taxpayers for fiscal purposes and Governor Matvienko herself stated that without the presence of major Russian companies, Saint Petersburg would not have a future. In addition to conversation about corporate headquarters movement, relocation of parts of federal power from Moscow to Saint-Petersburg had also been brought up already in July 2004 when, according to the radio station Echo Moskvy, Governor Matvienko announced that the Russian government had made a decision about relocation of some parts of federal functions from Moscow to Saint-Petersburg (Внешторгбанк переедет в Петербург в первом квартале 2005 года, 8.10.2004; Правительство РФ приняло решение о переносе части федеральных функций в Петербург, 14.7.2004)

The tendency that local authorities wish to attract new taxpayers to their own region is a phenomena that tends to occur in every city or a region but what makes the case of Saint Petersburg especially interesting is the nationwide support it has received from high-level politicians and Federal government organs. As the hometown of both President Dmitry Medvedev and Prime Minister Vladimir Putin, Saint Petersburg seems to have a very favorable position in the minds of both political and economical decision makers. The idea of promoting the status and importance of Saint Petersburg is also strongly emphasized by ruling United Russia Party and related to that the party introduced the "Saint Petersburg – Sea Capital of Russia"-program in December 2006. The purpose of such act is to re-

establish St Petersburg's status as Russia's most important commercial, industrial and navy port. The objectives of the project range from developing the Greater Port of St. Petersburg to organizing an international sailing regatta but the most interesting statement was that main government authorities, related to maritime transportation, should be relocated to Saint-Petersburg (Проекты Всероссийской политической партии 'Единая Россия')

1.2 Purpose of the study

Governor Matvienko's invitation has not been accepted only by the maritime industry or government organs but also by many other private and state-owned large-scale companies. The obvious presumption is that firms, especially private ones, choose to relocate in order to maximize profit but within the observation of this study we wish to assess whether are there other, perhaps economically illogical, underlying reasons to be found.

The main purpose of this study is to assess intra-country headquarters relocation decisions in Russia to Saint Petersburg and to understand the reason and incentives affecting these decisions. In order to achieve this we will first introduce the theoretical incentives for headquarters relocation and the fundamental factors that should affect rationally behaving companies in their decision making process. Then we will assess Saint Petersburg's characteristics as a location for corporate headquarters, based on the earlier introduced factors. After that, our next aim is to go through the recent relocation decisions discussed or made by major Russian companies in order to understand whether the relocation decisions have been made because of economically viable reasons or because of other incentives, uncovered in earlier theoretical studies.

The sections of our study are organized as follows. In the next chapter we will go through the fundamental factors affecting corporate headquarters relocation decisions and the reasons identified in the earlier research. The aim is to construct a good image about relocation as a corporate capital investment, with related benefits and costs. Like in every corporate investment the cumulative amount of explicit and implicit benefits should outweigh the amount of costs generated. On the basis of this information, we will assess the characteristics of St Petersburg region as a location for major corporate headquarters

in the section 3 and thus enlighten the basis on which companies should made their decision. In chapter 4 we will introduce and explain the recent relocation or registration decisions. Finally, in the last chapter we sum up the findings of the survey and compare the reasons stated by the companies with the theoretically logical reasons derived from the earlier research.

2 Corporate headquarters relocation

2.1 Corporate HQ relocation – a capital investment decision

Company headquarters tend to be relatively sticky compared to production facilities and other company facilities such as shared service centers. The trend of relocating these to lower labor cost countries has been the strategic must-to-do action of manufacturing companies during last few decades. In the very beginning companies decided to increase their presence in other countries by relocating a part of their sales and after-sales departments to the target country in order to create a more efficient and more local customer service network. Next phase of relocation trend was to locate manufacturing and part of the logistics to low-cost countries and thus to achieve cost advantages, taxation advantages or labor flexibility. Due to these significant savings, it's relatively logical to see why the production sites have been actively relocated to emerging economies with lower cost levels, despite the obvious losses in productivity levels. These manufacturing site relocations are considered as capital investment decisions and are thus subject to thorough strategic review in order to decide whether the long-term benefits will offset the investment costs (Baaij – van den Berghe - van den Bosch – Valberda, 1991).

Like mentioned in the beginning, corporate headquarters have been left relatively untouched by these trends. They are often located in the very same place where the company was originally founded and where the manufacturing site used to be located earlier. However, according to Baaij, van den Berghe, van den Bosch and Valberda (1991) the decision of location of corporate headquarters should also be considered from the same strategic point of view as the decisions of location of manufacturing sites or shared service centers or any other corporate investment which is likely to affect it's performance and future cash flows. The underlying assumption should always be that companies choose to relocate their headquarters in order to maximize their profit. The search for higher profits may derive either from cost savings or from profitability increases. In general we could sum up that, due to agglomeration effects the headquarters are largely located in substantial metropolitan areas. However, as the cities grow the disadvantages of size may offset the economies of scale and concentration advantages. For example in the United States the share of headquarters domiciled in New York city has been steadily decreasing while main beneficiaries have been other large cities (Diacon – Klier, 2003)

In order to assess the different locations from the point of view of profit maximization, companies need to consider numerous factors related to social, economical, technical and political circumstances in the possible locations. According to earlier literature regarding relocation decisions, at least the following criteria should be taken into account when deciding on corporate headquarters location and most of them should similarly be assessed in both cross-boarder and intra-national relocation decisions (Baaij, van den Berghe, van den Bosch, Valberda).

HQ site selection criteria
-Corporate tax advantages
-Investment incentives
-Investment climate
-Company law
-Operational costs
-Quality, availability and costs of the workforce
-Quality of living
-Level of infrastructure
-Level of high-level business services
-Sufficient representative office space
-Presence of other major corporations

One of the most obvious and significant factors to be considered in headquarters relocation decision is the taxation advantages or disadvantages possibly achieved as a result of this decision. Taxation, like company law, is distinctively related to cross-boarder relocations because the corporate taxation does not traditionally vary much across the country but since the Russian corporate taxation system offers facilities for some taxation flexibility also between different regions, this factor should certainly be taken into account. Investment climate is also among the factors that the regional government may affect when willing to do so. Since a relocation of a headquarter is a long-term decision and since the investment climate is often related to the political will of the city authorities, the companies should also take possible changes in the political situation into account.

Availability of high-level business services and presence of other major corporations are typically closely related. Headquarters need to be located close to the essential business service suppliers such as law firms, advertising companies and especially to their financial markets. Thus, headquarters tend to agglomerate to large cities where these service

suppliers are located, and on the other hand suppliers tend to home in to centers where a lot of headquarters are located. Related to this, Burns (1977) divided the headquarters location decisions to either vertical or horizontal moves. Vertical relocation was considered to mean a move from the major city centre to the suburbs and a horizontal relocation was relocation from one central city to another one. The reasons for corporate headquarters relocation different in horizontal and vertical move. Companies relocating vertically tend to look for lower expenses like rents or labor costs whereas horizontally moving companies are aiming to be situated in a close proximity to city centers offering a high density of company services. The same applies to the labor factors as well. High density of corporate headquarters attracts qualified workers to the region and simultaneously companies wish to locate any of their facilities, including headquarters, to locations with a decent supply of skilled labor. Due to higher competition, costs of the workforce also tend to increase on these high-density areas but since headquarters are not extremely labor-intensive by nature, costs of other crucial inputs, such as office space and services, are likely to become most important direct-cost related factors that are considered (Baaij et al, 1991; Davis, James C. – Henderson, Vernon, 2008).

Level of infrastructure is naturally one of the key factors which relocating companies have to consider. In case of headquarters relocation, the most important aspects to consider are availability and costs of high-class premises, telecommunications logistics as well as availability of decent housing for employees relocating with the company. In addition to these crucial factors, companies should also consider the explicit and implicit cost they face from this capital investment decision of relocation corporate headquarters. Explicit costs means the ones derived from the physical moving operations, staff relocation expenses as well as the underemphasized opportunity costs associated with the loss of staff not willing to relocate. Implicit costs derive from e.g. disturbances in operations during the actual relocation (Alli et al, 1991).

Even though the previous factors should be similarly considered in all corporate HQ decisions, we should separate the relocation decisions which have been made as a consequence of a merger or acquisition and pure “organic” relocations since in the later ones, the decision is often obligatory by nature (Diacon – Klier, 2003)

2.2 *Effects of relocation decisions*

However, it is not sufficient to only consider what location-related factors companies should assess when making the decision, but it's also necessary for them to understand how these decisions affect company value, i.e. how will the shareholders of the company react to the reasons and incentives stated by the relocating company. In addition, when companies are assumed to relocate in order to maximize the profit, it also applies that they make these decisions to maximize shareholder wealth. Thus like in any other capital investment decision, the discounted net future cash flow must be positive. The decision can be judged from the shareholders' point of view in two different ways. Firstly, we can analyse the abnormal returns on the stock market in order to find how shareholders have reacted to these relocation announcements. Secondly, we may assess the changes in the operating profits of the companies, which have implemented their relocation decision. Basically, it is more complete to use the first method since the share price reactions are considered to take all the public information available into account and thus to reflect all known benefits and all explicit and implicit costs.

In earlier research, related to stock market reactions to relocation decisions, the scholars have found out that the abnormal returns are very closely related to the nature of the relocation decisions. First the reasons should be separated between the relocation decisions that have been made as a consequence of a merger or acquisition and pure "organic" relocations (Diacon – Klier, 2003). In our case we will concentrate on the former. Alli, Ramirez and Yung (1991) have found out that the relocation announcement has affected the stock market returns positively when the target location has better availability of labor and negatively when the level of cost of living is higher. This suggests that the shareholders value vertical relocation decisions higher than horizontal ones and also supports the factors that we have chosen for our research. The similar evidence was also found by Ghosh and Chinmoy (1995), according to whom the market reaction is significantly positive when relocation decisions are related to cost savings, thus indicating that from the investors' point of view the cost savings outweigh the close proximity to agglomerate of services. On the other hand, decisions based on managerial self-interest will be subject to adverse reactions from investors. This would be also supported by the above mentioned real-life tendency of companies moving their headquarters out of New York.

To conclude, we could note that the earlier research of stock market reactions supports the importance of the same crucial factors that were listed above and thus it justifies us to use them as our assessment factors as well. However we should also bear in mind that even despite the positive shareholder reaction, the expected benefits may fail to realize. This is also supported by research conducted by Gregory, Lombard and Seifert (2005). They investigated the impact of corporate headquarters relocation on the operating performance of the firm and opposite to the studies concentrating on the abnormal stock market returns, they found little evidence of improved operating performance after headquarters relocation. This would suggest that we should pay even more attention on the non-monetary incentives of relocating companies. These are covered mainly when considering the overall investment climate and atmosphere in the region, like we aim to do in the next section of this study.

3 Saint Petersburg as a location for corporate headquarter

3.1 *Investment climate and incentives*

On February 2008 in the 5th Economic Forum in Krasnojarsk, then deputy prime minister of Russia Dmitry Medvedev announced the four-year development plan for Russia and simultaneously introduced his “4-I’s” program. These four development principles were institutions, infrastructure, innovations and investments. In order to fulfil the Dmitry Medvedev’s other plan, idea of Saint Petersburg becoming the locomotive of economical development of Russia, the Governor Valentina Matvienko already in May 2007 created almost similar guidelines for the regional government actions. These guidelines dealt with investments: creation of stable conditions for investment inflows, with innovations: stimulating economical innovation, with infrastructure: optimal utilization of the infrastructure potential of the city, and with institutions: activate and mobilize all the sources to replenish the city budget (Об итогах социально-экономического развития Санкт-Петербурга и районов Санкт-Петербурга за 2007 год).

Until very recently Saint Petersburg has also de-facto acted at least as one of the growth locomotives of Russia, since the economy of the city has grown with a very rapid and stable pace, surpassing constantly country averages in terms of gross regional product growth. In 2007 the GRP of Saint Petersburg grew 9.1% whereas GDP of Russia grew 8.1% during corresponding period. Coinciding with the guidelines set by the City Hall, especially the investments have been in focus lately. In 2007 fixed investments in the city grew by 38.8% while in 2005-2006 the growth had been on a single-digit level and in 2004 the fixed investment actually contradicted by 6%. In addition to attracting private companies to invest to Saint Petersburg, the regional government has also been actively participating the investment projects. In 2007 public investments accounted approximately for one fourth of city’s budgeted expenditures, which is five-times the country average, and as a result of massive investments to e.g. infrastructure projects in 2008 the share of investments is supposed to grow to 31.5% of all expenditure. Fastest growing sector in the region was passenger car production, which in the first half of 2008 increased 8.2 times compared to corresponding period in 2007. This growth was boosted by numerous foreign investments to the industry, such as openings of car manufacturing plants of Nissan and

Toyota (Biannual Economic Review, BRE, Об итогах социально-экономического развития Санкт-Петербурга и районов Санкт-Петербурга за 2007 год).

Earlier the growth has mainly been based on consumer and infrastructure based investments and growth but in 2007 and during the first half of 2008 large automotive and shipping industry investments enhanced the industrial production of Saint Petersburg also to above country average year-on-year growth of 10% (average 6.7%). This achievement is especially remarkable when taken into account that still in previous year the industrial production in the city declined by 7 %. Thus the city authorities have managed relatively well in developing decent conditions for investments. In addition, and in order to stimulate creation of new innovations, regional government has also an increasing interest towards increasing the amount of small and medium size enterprises in the city. The government of the city has formulated a plan to achieve this target and as a part of this they are e.g. committed spend at least 27 billion rubles the situation of SMEs by creating a necessary infrastructure for them to operate and to create a venture capital fund to invest in SMEs. Already in 2007, the amount of SMEs increased by 27% y-o-y to 228 thousands (Об итогах социально-экономического развития Санкт-Петербурга за 1 полугодие 2008 года; .

Other attempts to enhance the investment climate in the city have included setting up a special economical zone with a purpose to develop both innovative high-tech and processing industries. The area consists of about 200 hectares of land situated in two different locations, which are Novo-Orlovskiy park north of the city centre and Neudorf, south of the city. The residents of the are subject to numerous tax benefits and reliefs. In addition to President Medvedev emphasising the need of the city to become the locomotive of economical growth in Russia, the political elite has also encouraged investments to the city and has stated that the role of Saint Petersburg as the second capital of Russia should be also de-facto increased. Former President of Russia Vladimir Putin has been arguing that some of the Federal functions traditionally belonging to capital cities should also be relocated to Saint Petersburg. This emphasis was also taken into account when Putin decided to hold the G8 meeting in Saint Petersburg in July 2006 instead of in Moscow (Ivannikov; Путин: Петербург де-факто обретает столичные функции).

However, despite the continuous attempts by authorities of every level, occasionally too fast and uncontrolled growth also causes severe problems, such as with lacking infrastructure or labor shortages, in the region that cannot be solved only by presenting ambitious plans. Simply, as cities grow the disadvantages may offset the economies of scale and concentration advantages. At least partly as an evidence of that both Samara and Krasnodar regions ranked above the traditional leaders such as Moscow and Saint Petersburg in the latest study regarding the competitiveness of Russian regions, published by Institute of Regional Politics on October 2008. The rating is based on the study that takes into account 130 financial, economical, social and economical factors and as well as opinions of 35 thousand in people interviewed. Samara and Krasnodar received the highest absolute overall rating but Moscow and Saint Petersburg still surpassed the in terms of competitiveness and economical development. Main weaknesses identified for Moscow and Saint Petersburg included ecological and infrastructural problems as well as homogeneousness of local economy i.e. high dependency on few major industries (Москву и Санкт-Петербург лишают надежд на лидерство, 13.10.2008).

Overall, we could conclude that the investment climate in Saint Petersburg is relatively positive due to the special attention paid to investors by regional authorities as well as federal decision makers. The city hall has made and partly implemented strategic plans for enhancing the conditions of both large-scale as well as small- and medium size enterprises. It's also important to bear in mind that the regional government itself is actively taking part in the investments and thus ensuring that the most crucial infrastructure and energy investments will be carried out. In addition, their own participation is likely to increase the understanding that the city authorities have about the investment conditions of the city.

3.2 *Infrastructure and related costs*

Infrastructural problems were among the most severe negative factors related to Saint Petersburg in the study conducted by Institute of Regional Politics. However, compared to Moscow, the city offers comprehensive connections to Europe both by sea and road. The ports of Saint Petersburg have got special attention both in regional level decision making but also on the federal level. The United Russia-party's Saint Petersburg – Sea Capital of Russia project aims also to enhance the maritime infrastructure of the city. New

investment are constantly planned, even though facing some postponements in implementation, and e.g. by 2010 there should be more than 32 million tons of freight going through the new Ust-Luga port. Relatively good international flight connections via Pulkovo airport have also been brought up as one of the key logistical characteristics of Saint Petersburg. In 2007 investments accounted approximately for one fourth of city's budgeted expenditures but as a result of massive investments to different infrastructure and electricity supply projects, in 2008 the share of investments is supposed to grow to 31.5% of all expenditures (Ход реализации:"Санкт-Петербург – морская столица")

Prices of real estate reflect the certain status difference between Moscow and Saint Petersburg. According to Vedomosti, the average real estate price in the primary market in Moscow in the October 2008 was more than 160 thousand rubles per square meter, while in Saint Petersburg, according to Adveks company, at corresponding moment the price was almost 50% cheaper, accounting for 85,5 thousand rubles per square meter. This should be among one of the most crucial factors considered by the company when making a relocation decision, especially when taking into account that headquarters are likely to be located in relatively expensive high-class premises (Недвижимость в Москве; Стоимость жилья в Санкт-Петербурге снизилась в октябре 2008 года на 0.7-1.3%).

3.3 Availability and costs of labor, quality of life

In 2007 Saint Petersburg had 4.6 million inhabitants of whom more than 3 million are considered as possible workforce. The demographic development in the city has also been positive compared to general Russian trends, since during the year 2007 the number of births increased by 7% whereas number of deaths decreased by 3%. Theoretically this massive labor market, with an average monthly wage of only 609 euro, should provide companies a tempting target city for relocation from the pure labor market point of view. In addition, the available workers in Saint Petersburg is at least academically relative skilled due to proximity of many nationally highly appreciated universities and academies. This tends to be important factor especially for headquarters relocations, since they are mainly hiring skilled academically educated employees. However, on the the negative side of the labor markets, the unemployment rate in the region has been falling as low as to 2%, considered to be clearly below the non-accelerating inflation rate of unemployment (NAIRU), in both 2007 and in the first half of 2008. This low unemployment has naturally

affected and twisted the labor market in general and makes finding qualified employees difficult for companies. In 2007 there were approximately five free vacancies for every registered unemployed. The pace of average wage growth has also been very rapid. Despite the relatively low current average wage, the number has more than doubled between 2004 and 2007. Other negative aspect is the lack of presence of other major companies which is likely to attract skilled workers and thus to affect the labor market. (Ivannikov, Baltic Rim Economies 5/2008, Saint Petersburg in 2007)

However, despite the rapid growth in average wages the growth of real income of the residents has slowed down considerably during 2008, even before the crisis intensified. In the first half of 2008 the real monetary income grew only by 2.6%, compared to 6.7% during corresponding period in 2007. The main reason for this was the rapid inflation, especially the price growth of foodstuffs. In addition to high inflation, the residents are facing severe problems related to the accommodation. However these problems apply both to Saint Petersburg and Moscow. From the point of view of companies relocating to city, the housing questions are still very crucial, since in order to attract employees to relocate with the headquarters, there has to be decent accommodation available. However, the current situation in Saint Petersburg is relatively difficult. The official queue of people waiting for regional government supported accommodation in Saint Petersburg still in the end of 2007 consisted of 12,6 thousand families. The difficulties related to the real estate and housing sector have also caused concern on regional government level and as a consequence in 2007 Governor Matvienko wrote a proposal in order to enhance the accommodation problems. The most noticeable action was that the city started to actively take part in real estate construction and mortgage business. In 2007 almost 7.2% of all the housing market construction was paid from the budget of Saint Petersburg. This tendency is significantly in line with the active investor profile that the city has followed since 2007 and could be likely to enhance the position of Saint Petersburg from the housing point of view in the eyes of companies considering to relocate (Сепреева А.И., 2008).

3.4 Taxation

Taxation is one of the key issues affecting corporate headquarters relocation decisions. It's very influential factor especially in cross-boarder relocations, due to heterogeneous corporate tax burdens in different countries, but it also plays a crucial role in intra-country relocations or registrations. The later one is highly important to take into consideration particularly in Russia, since the corporate taxation system allows some regional flexibilities and thus intra-country registration or relocation decisions between different regions may affect companys' total tax burdens relatively significantly.

Most important taxes imposed to companies include corporate profit tax, unified social tax, value added tax and different types of asset taxes. Out of these taxes, value added tax is paid to Federal budget while unified social tax goes to Federal budget, Social Insurance Fund and Medical Insurance Fund and thus they do not leave flexibility for regional governments under normal circumstances. However, to rest of the tax types mentioned the regional government may make some amendments for example in order to attract investments and taxpayers to the region (Налоговая система, действующая в Санкт-Петербурге).

The rate of corporate profits tax in Russia is currently 24%. Of this amount, 6.5% is payable to the Federal budget, 17.5% is payable to the regional government. Regional governments have the power to reduce the regional element by up to 4%, giving a minimum regional rate of 13.5% and thus to minimum overall rate of 20%. This flexibility is given for the regional governments in order to attract investments and taxpayers to their regions. Currently, both in Saint Petersburg and in Moscow the regional rate is set to the maximum. Exemption to this rule is the Special Economical Zone of Saint-Petersburg, whose residents are subjects to the minimum regional rate of 13.5%. From January 2009 the Federal budget rate will be decreased to 2.5%, thus setting the maximum and minimum overall rates to 20% and 16% , respectively. This tax relief was a responding action to the suggestion made by the Prime Minister Vladimir Putin and was intended to enhance the situation of local companies suffering from the financial crisis. However, since the decision only affects the Federal rate, it has no direct effect on intra-country relocation decisions (Налоговая система, действующая в Санкт-Петербурге; Налог на прибыль

организаций; Госдума экстренно приняла пакет глобальных поправок в Налоговый кодекс, 21.11.2008)

While considering the Russian corporate profit taxation from the relocation decision point of view, it is also important to recall that Russian companies do not directly pay all the taxes going to the regional budget directly to the region where the headquarters of a company are registered. In fact, if a Russian company has registered offices in more than one tax district, it has to separate taxable profits between each district and pay regional taxes based on this allocation. Allocation calculation should be based on either net book value of fixed assets or to the number of employees on payroll in the each separate tax district.

Other taxes leaving flexibility for the regional government are asset taxes, advertisement tax and transportation tax. Asset taxes consist of property tax and land tax. Property tax applies to property belonging to Russian legal entities and representative offices of foreign legal entities and it is based on the current balance sheet values. The maximum rate for property tax is 2.2% p.a. and currently the rate is set up to the maximum level both in Saint Petersburg and Moscow. The land tax has a maximum rate of 1.5% but in general the rate varies within the regions and thus also in Saint Petersburg it depends on the exact location of resident. However, the residents of Special Economical Zone of Saint-Petersburg are exempt from all property, land and transportation taxes as well as from transportation taxes for the first five years (Налоговая система, действующая в Санкт-Петербурге; Особая экономическая зона; Ставки региональных и местных налогов в Москве)

	Saint-Petersburg	Moscow
Corporate Profit Tax	24%	24%
Property Tax	2.20%	2.20%
Land Tax	<i>Depending on location, up to 1.5%</i>	<i>Depending on location, up to 1.5%</i>
Transportation Tax	<i>Depending on usage</i>	<i>Depending on usage</i>
Advertising Tax	5%	5%

Sources: Налоговая система, действующая в Санкт-Петербурге; Ставки региональных и местных налогов в Москве

Overall, when assessed solely from taxation point of view the city of Saint-Petersburg doesn't seem to offer any significant tax benefits compared to the other regions of the country. The corporate overall tax burden is relatively identical to the one in Moscow and as all the major regional budget tax rates are set to the maximum, it is not likely that headquarters from any other regions would be registered to the city entirely for tax reasons. However, in case that the relocating company fulfils the Special Economical Zone requirements, becoming a resident of this zone would offer significant possibilities for legal tax avoidances and thus create also economically viable incentives for the move.

4 Companies that have made the relocation decision

Overall, ten major private or state-owned companies and two government organs announced their intention to relocate to Saint Petersburg between October 2004 and January 2008. Both government organs were domiciled in Moscow during the time of their announcement, as were seven out of ten companies. Other places of origin were Omsk, Samara region and Oryol. In addition to these relocation announcements, numerous largest Russian companies have decided to register their subsidiaries to Saint Petersburg during this time. Based on earlier research, according to which companies make relocation decisions in order to maximize profit and on the characteristics of Saint Petersburg as a location for corporate headquarters, we could assume that positive investment climate and lower costs would be the main underlying reasons for these decisions. In the following chapter we will go through these announcements in a timely manner in order to create an image about the phenomenon.

4.1 *Private/Public companies*

Already on 6th of October 2004 Governor of Saint Petersburg Valentina Matvienko expressed her desire that Vneshtorgbank (VTB), the second-largest bank in Russia, would relocate from Moscow to Saint Petersburg. According to Matvienko the decision is highly possible and the city authorities have already been in discussion about this with the company. Governor also expressed that this move wouldn't not be important only because of the significant tax income but also because it would help in turning Saint Petersburg into an important financial center. After Matvienko's comment, the company itself announced that on 21.10.2004 the supervisory board of the company had scheduled a meeting to calling an extra-ordinary shareholder meeting in order to make decision and change to the Company Charter. According to them, the relocation would be done to the premises of their current Saint Petersburg filial and there would be located at least part of the company management. As reasons for this, the company stated as a part of their strategy they want to increase their presence in North-West Russia, area which they see economically very interesting and also as a gateway to Europe. In addition, Vneshtorgbank was simultaneously acquiring a Petersburg-based Promstroibank and they stated that combining the operations in Saint Petersburg would offer significant synergies (Петербург заинтересован в переезде Внешторгбанка из Москвы в северную столицу –

Матвиенко, 6.10.2004; Внешторгбанк продолжает развитие деятельности в Северо-Западном регионе, 29.12.2005).

However according to Vedomosti, an anonymous member of the supervisory board, the act was mainly done in order to transfer tax payments to the budget of Saint Petersburg. The company management also commented that this decision would be done partly to help city authorities to build Saint Petersburg a financial center of the country. The registration and a change to the Company Charter was eventually made on 15.12.2004 and thus Saint Petersburg's budget became the beneficiary of VTB's tax payments. In the announcement year they were supposed to reach more than 60 million USD thus accounting for more than 2.5% of city's budget revenues and almost 10% of corporate profit tax incomes. Later in October 2005 VTB made an official decision about continuing the relocation process by moving the headquarters to Saint Petersburg. However, the anonymous source in the supervisory board seemed to be quite right, since as of August 2008 only the general director of the company was located in Saint Petersburg while e.g. the whole board of directors of VTB was operating in Moscow (ВТБ переезжает из Москвы в Петербург, 6.10.2004 ;Устав Банка ВТБ; Изменения No 5, вносимые в Устав Банка ВТБ, 15.12.2004)

In February 2005 the trend continued when state-owned shipping company Sovcomflot announced that it will conclude all the legislative preparations for moving its headquarters and registering to Saint Petersburg before the end of 2005. This announcement was made after company CEO Sergey Frank had met with the Governor Matvienko and the physical relocation was planned to take place in 2006, as soon as the company would find sufficient premises in the city. No key relocation factors were identified as reasons for the relocation but company management emphasized the importance of Saint Petersburg as one of the main oil and gas oriented ports in the world, mentioned that Sovcomflot wants to take part in development and of Saint Petersburg and Primorsk ports and intended to build more tankers to respond to this development. The exact amount of tax income transferring to the budget of the city was not mentioned but in 2003 (then the last published annual report) the tax payments of the company accounted for 70 million rubles. However, the implementation of registration and relocation took more time than originally announced and the registration change was finally made to the Company Charter in December 2006,

simultaneously making Sovcomflot one of the largest taxpayers in Saint Petersburg. The relocation of headquarters was also implemented by dividing the headquarter functions between Moscow and Saint Petersburg while the personnel related functions were moved to the later one (Совкомфлот ищет офис в Питере, 18.02.2005; Совкомфлот скоро переедет в Санкт-Петербург, 20.02.2006; Изменения в Устав - Совкомфлот, 05.12.2006)

The next announcement, initially made by Governor Matvienko herself, was among the most substantial ones both in terms of company size and possible tax income. In October 2005 Governor stated that the state-owned product pipeline operator Transnefteprodukt would be registered to Saint Petersburg before the end of the year. However, the company itself replied, that this decision has to be made in the shareholder meeting, which yet hadn't taken place. Eventually, the change in the Company Charter was made in February and the company was then registered as a taxpayer to Saint Petersburg. Again, business orientated reasons for the relocation were not mentioned but the fiscal importance of this relocation was brought up. In the registration year alone the increase of tax payments to the budget of Saint Petersburg was supposed to be approximately 600 million rubles or 0.5% of regional budget revenues. This decision was preceded with a key Kremlin official joining the board of directors of the company when Vladislav Surkov, deputy head of the presidential administration, was elected to the nine-member board on late 2004. Later in April 2007 the Government ordered Transnefteprodukt to merge with a state-owned Transneft and as of 15.01.2008 Transnefteprodukt has been a subsidiary of the Moscow-domiciled Transneft (Транснефтепродукт переедет в Санкт-Петербург 20.10.2005; Изменения к уставу – Транснефтепродукт, 13.02.2006; Transneft, Transnefteprodukt Ordered to Consolidate, 17.4.2007; Устав - "Транснефть")

In December 2005 the first private company Transaero, one of the largest airline companies in Russia, decided that it would register to Saint Petersburg. The announcement was again published by Governor of Saint Petersburg Valentina Matvienko. Eventually actual registration took place in January 2006 and according to the company representatives the move was part of Transaero's strategy to increase its presence in the North-Western Russia. Transaero planned to increase the amount of direct flights from Saint Petersburg to South-East Asia, China and India in order to create an important air

transportation hub to Saint Petersburg. In addition, the company mentioned its intention to do an initial public offering to the Saint Petersburg Stock Exchange as one of the reasons to locate to the region. However, according to magazine «Время», also the representatives of the company brought up the point that the decision has a multi-billion ruble fiscal effect to the budget of Saint Petersburg. Earlier Transaero had been registered to Oryol in Oryol region and in the registration year the tax payments to the regional budget were approximately 10 million rubles. Implementation of the relocation has however only occurred in terms of registration since according to the latest annual report of the company the legislative address of the company is in Saint Petersburg but the real headquarters are located in Moscow (Трансаэро переедет в Северную столицу, 29.12.2005; Трансаэро стало Питерской копанией, 20.01.2006; Годовой отчет за 2007 год).

Different incentives made Russian car manufacturer AvtoVAZ to consider about register to Saint Petersburg. In February 2006 the company announced that it will relocate its operations, including both its headquarters and factory from Toljattia to St.Petersburg, in order to fight against corruption. However, the company representatives couldn't give more detailed information about how this registration would help with the situation. In addition, according to Kommersant, a source close to the company management said that the real intention was to redirect the tax payments to the regional budget of Saint Petersburg and de facto the development had already been ongoing since November 2005 when a factory of AvtoVAZ was registered under taxation of Saint Petersburg. Underlying reasons could also be found from the recent change in the company management after which 3 members of the board of directors of AvtoVAZ were also representatives of St. Petersburg based bank VTB. The announcement of AvtoVAZ was unordinary also because it was also unknown information for the authorities of Saint Petersburg, who normally had a tendency of being among the first ones to announce about possible relocations. In addition, only one day after the initial announcement the company made a statement denying that they would be relocating anywhere, though admitting the registration of the factory to St Petersburg (АвтоВАЗ пропицывают в Санкт-Петербурге, 16.2.2006; АвтоВАЗ передумал переезжать в Санкт-Петербург, 17.02.2006).

Most anticipated relocation decision was published in March 2006 when the head of Gazprom, Aleksei Miller, announced that Sibneft, in which Gazprom holds a majority stake, will be registered from Omsk to Saint Petersburg and will be renamed as Gazpromneft as of 13.5.2006. This announcement was preceded by continuous rumors regarding possible relocation of Sibneft, appearing since Gazprom acquired its majority stake in the company from Roman Abramovits. Earlier Gazprom and Miller stated that, despite acquiring premises for office in January 2006 and signing a cooperation agreement between Gazprom and administration of Saint Petersburg in the end of 2005, the question about relocation or registration to Saint Petersburg was not of current interest. Then the company also told that the tax payments to the Omsk region would not be affected (Сибнефть регистрируют в Петербурге и переименоуют, 31.3.2006; Колыбель нефтяной революции, 31.3.2006).

The changes to the Company Charter took place like planned and after the registration Gazpromneft became the largest single taxpayer in Saint Petersburg with annual tax payments of approximately 15 billion rubles, thus accounting for more than 7% of city's budget revenues in the announcement year. The company also committed to fund 51% of skyscraper-project Okhta Center, assumed to reach 397 meter height and cost two billion US dollars and acquired premises for its office on English embankment for approximately 400 million rubles. In spite of these massive investments, no special economical profit maximizing reasons were mentioned and in reality no reasons at all were published. The registration of Gazpromneft took place like announced but the physical move of headquarters has still been postponed. However, in November 2008 the project faced a massive drawback, when the City Hall of Saint Petersburg amended the city's budget by postponing its investments on the project (Crisis Puts Gazprom Skyscraper In Doubt, 05.11.2008). (Колыбель нефтяной революции, 31.3.2006; St Petersburg in 2007 – Biannual economic review; Устав - Газпромнефть).

In June 2006 Rostelecom, private fixed line operator in Russia, announced that its shareholders had made a decision about registering and relocating the company headquarters from Moscow to Saint Petersburg. The only factor that the company announced as a reason for the move was that the registration is 'in line with the direction of economical development of the country'. In addition to lack of economically viable

incentives for this decision, the announcement was made only a few of weeks after that Federal Tax Service announced that it was accusing Rostelecom of tax defects. In late April 2006 Rostelecom had received a tax claim for the fiscal year 2003 with a total amount of 3,474 million rubles, of which 2,181 million rubles were additional taxes and 1,293 million rubles fines and penalties. Rostelecom had earlier replied to these accusations and said that it disagreed with the Service and would be willing to defend itself in court. Later in April 2008 the Federal Arbitration Court judged these claims undue. Between these incidents, Rostelecom had made the planned amendments to the Company Charter and thus registered to Saint Petersburg. However, according to the Charter, only part of the company management is operating from the city (board of directors) whereas the CEO of the company is working in Moscow (Ростелеком переедет в Петербург, 26.06.2006; Rostelecom press release, 16.6.2006; Rostelecom press release, 23.04.2008; Устав - Ростелеком)

First major relocation announcement in 2007 was published in October when the owner of Russian Standard, banking and alcohol beverage group, Roustam Tariko stated that the group will register to the tax code of Saint Petersburg before the end of the year. Before this announcement Russian Standard had opened a new vodka factory in Saint Petersburg in 2006 and in general Tariko described Saint Petersburg as the birth place of Russian Standard to which the company wanted to stay loyal. In addition, representative of the company mentioned healthy business climate, port and transportation connections to Europe as well as their personal excellent relationships with the authorities and Governor as the main reasons for the decision. Even though the underlying incentives seem to be mainly related to the personal level relations, the company wanted also to emphasise the significance of positive investment climate and conditions in the city as a stimulus to relocate. They also gave praise to the logistical features of the city, especially to the direct road connections to company's main markets in Western Europe, Pulkovo airport and ports. In spite of their extremely positive statements, as of December 2008, the company hasn't yet relocated its headquarters or registered to the city. However, in May 2008 the company registered a filial to Saint Petersburg, thus according to Russian legislation, transferring some of its tax payments to the city's budget (Рустам Тарико перерегистрирует бизнес в Санкт-Петербурге, 22.10.2007; Изменения 4., вносимые в устав – Русский Стандарт).

The second target of relocation discussion in 2007 was X5, the largest retail chain in Russia. On 20.11.2007, after meeting with the Governor Matvienko, the director of the company Lev Khasis announced that the company would be moving its headquarters to Saint Petersburg. No reasons for this decision were mentioned and despite the statement the company is still registered in Moscow and no official decisions about the relocation have been made in neither in annual nor in extraordinary shareholder meetings of the company (Крупнейший ритейлер страны переезжает в Петербург, 20.11.2007; X5 Retail Group - Инвесторам)

The first, and so far the last, relocation decision in 2008 made by a large-scale Russian company, was announced in January when the hotel chain Azimut Management Group told via its press-services that it would be moving its entire headquarters to Saint Petersburg along with most of its other main functions, such as Food & Beverage- and Marketing & Sales-departments, while only some minor functions would stay in Moscow. Main reason for this move was the urge to guarantee good quality and management standards for the new large hotel opened in Saint Petersburg but as of December 2008 the relocation hasn't yet been implemented (Руководство гостиницами сети Азимут переедет в Санкт-Петербург, 29.01.2008).

Company	Private/ State	Announced	Status	Place of departure	Scale of relocation	Reasons stated
Vneshtorgbank (VTB)	State	Oct-04	Registered to St Petersburg, CEO there but the management board still in Moscow	Moscow	Headquarters	Strengthen presence in tempting region, acquisition of St. Petersburg based Promstroibank
Sovkomflot	State	Feb-05	Registered in Saint Petersburg since Dec-06, headquarter functions divided	Moscow	Headquarter functions divided between Moscow and Saint Petersburg	Location of Saint Petersburg, ports, gas&oil projects
Transnefteprodkt	State	Oct-05	15.12.2005, Change to company charter	Moscow	Headquarters	Importance for Saint Petersburg budget
Transaero	Private	Dec-05	Registered in Saint Petersburg since Jan-06 but real address in Moscow	Oryol	Not specified	Presence in N-W Russia, development of new routes, proximity of financial markets, fiscal reasons
AutoVAZ	Private	Feb-06	Cancelled but registered as a taxpayer to St Petersburg	Tolyatti	Headquarters and manufacturing	Fight against corruption
Gazprom Neft	State	Mar-06	Registration yes, headquarters not yet	Omsk	Headquarters	No reasons stated
Rostelekom	Private	Jun-06	Registered in Saint Petersburg, Headquarters still in Moscow	Moscow	Registration	Direction of economical development of the country
Russian Standard	Private	Oct-07	Still in Moscow. Filial registered to Saint Petersburg	Moscow	Headquarters	Excellent relationships with the administration, geographical location and logistics, roots of the company
X5 Retail Group	Private	Nov-07	No registration, relocation or official decisions made	Moscow	Headquarters	No reasons stated
Azimut	Private	Jan-08	Not yet implemented	Moscow	All main functions	Guaranteeing the quality and standards in new St Petersburg Azimut Hotel

4.2 Government organs

In addition to supporting the decisions of companies relocating to Saint Petersburg, Federal Government officials have also participated in the tendency by moving certain government organs to Saint Petersburg. Former President Vladimir Putin has emphasized how important it would be to strengthen Petersburg's position as the second capital of Russia by de facto moving some federal functions to the city. Thus, in December 2007 Putin signed an order about moving the Constitutional Court from Moscow to Saint Petersburg. This announcement was anticipated for a long time, since already in July 2004 Governor Valentina Matvienko had indirectly suggested it. The decision was only explained with historical reasons, with beautiful premises in Saint Petersburg and by stating that the Northern Capital of Russia deserves some functions normally belonging to a capital. The relocation was also implemented with relatively quick pace, since the physical move took place in the spring 2008 and the new premises for the Court were finished on the first quarter of 2008. However, despite the legislative changes made in order to relocate the Court, not all of the functions were ordered to relocate. This was mainly due to human reasons, since only 30 of 250 employees of the Court were originally willing to move. Neither were all the judges of the court unanimously for the relocation but eventually they all agreed to move (Конституционный суд переедет в Питер в мае, 23.12.2007; Не весь аппарат КС переедет в Санкт-Петербург, 7.5.2008; Об итогах социально-экономического развития Санкт-Петербурга за 1 полугодие 2008 года).

In October 2007 the headquarters of Russian Navy were mentioned to be relocated to Saint Petersburg and thus to a closer proximity to sea. New headquarters would have been located in historically important Admiralty building and the relocation process was supposed to start in April 2008 and to be concluded in 2009. Initially, the idea was brought up by Boris Gryzlov, speaker of the State Duma, who stated that the move would be an important part United Russia party's "Saint Petersburg – Sea Capital of Russia"- program and simultaneously the idea had also the Governor Matvienko's support. Politicians supporting the relocation explained the rationality of the decision by reminding that a majority part of the Russian naval industry was already located in the region as well as by pointing out that the accommodation costs for the staff would be 1.5-2 times cheaper in Saint Petersburg than in Moscow. In addition, direct and indirect income effects to the city's budget were seen as a positive factor, also on the federal level. Overall costs of the

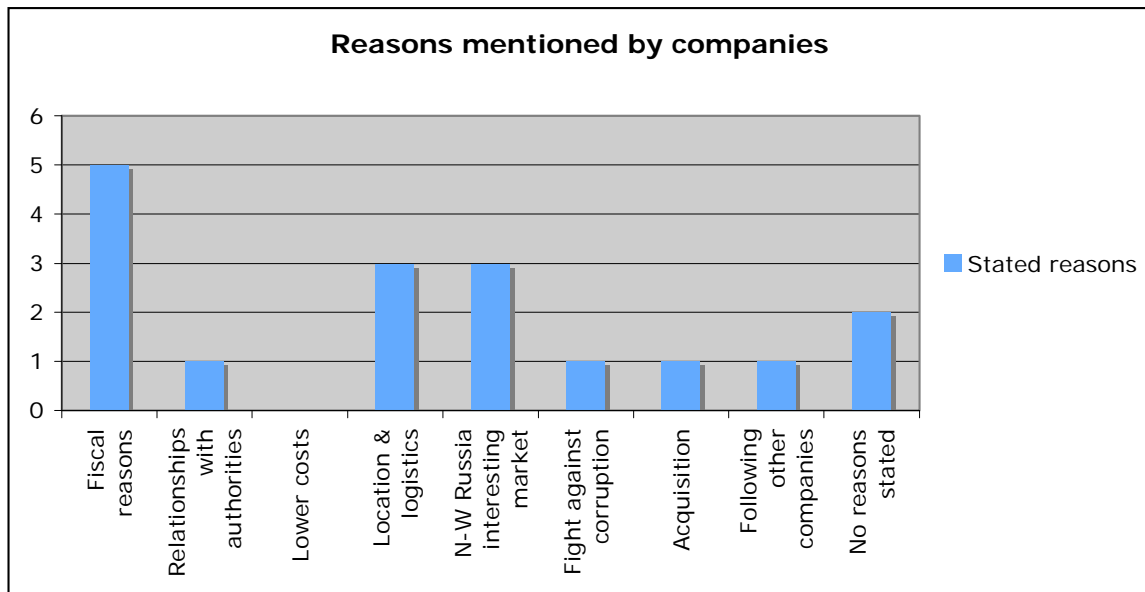
relocation were then approximated to be 15 billion rubles and many officials considered the idea to be illogical and fully political. According to the source of Kommersant in the Ministry of Defence, the idea was initially published simply due to political incentives just before the federal elections. Other speculated reason was the desire to get the thousands of square meters, currently occupied by the Navy, to commercial use. In April 2008 the representatives of the Navy denied the intention to move but the issue was again re-established in December 2008 when the new military Chief of Staff Nikolai Makarov and the Ministry of the Defence together announced that the relocation will be implemented and that it should take place within a year (Флот приказно пришпилить к Адмиралтейству, 12.11.2007; Мы в Кронштадт, 31.10.2007; Военно-морской флот, 05.04.2008; Штаб ВМФ готовится к перелету в Петербург, 17.12.2008).

Organ	Military/ Other	Announced	Status	Place of departure	Scale of relocation	Reasons stated
<i>Constitutional court</i>	Other	Dec-07	Implemented in spring 2008	Moscow	Intended to be entirely relocated but some functions remaining in Moscow	Putin: Need to move some Federal functions to 2nd capital
<i>Navy</i>	Military	Oct-07	Should be take place in a year	Moscow	Headquarters	St Petersburg - Sea Capital of Russia, Navy industry and

Sources: News and articles mentioned above

5 Conclusions and public conversation

According to Ghosh Rodriguez and Shirmans most frequent reasons for corporate headquarter relocations are cost-savings and consolidations, however, with the companies announcing the decision in Russia between 2004 and 2008, this was not the case. None of the public or private companies mentioned cost-savings as their reason for relocation and only one of the companies was involved in an acquisition. However, the urge to find some cost-savings was brought up by one government organ, Russian Navy.



The fundamental principle of making relocation decisions solely to maximize corporate profit doesn't seem to apply to the companies observed. According to our earlier assessments, Saint Petersburg could offer companies cost-savings e.g. due to more affordable office space, relatively low labor costs or in case of suitable company business profile, via tax relieves applied to the residents of Special Economical Zone. However, these factors were not mentioned by any of the companies. On the other hand, some support for the profit maximization may be found from stated reasons related to logistically appealing location of Saint Petersburg and interests expressed towards North-Western Russia as a market.

Opposite to the idea of headquarters relocation as a strategic capital investment, the prevailing tendency seemed to be that even the private companies mentioned transferring regional tax payments to the budget of Saint Petersburg as one of the primary reasons. The relocation announcements of these two companies, which stated no special reasons for their decision, were also published by Governor Valentina Matvienko, thus indicating the importance of personal relationships and fiscal reasons. In general, some decisions seem to be mainly based on the will to maintain good relationships with the authorities, either regional or federal. This was directly admitted by Russian Standard group and fundamentally it also seems interesting that e.g. Rostelecom, a listed public company, announced their relocation decision only weeks after the claims from Federal Tax Agency were received, stated no reasons for their decision but was later relieved of these claims. This tendency is also supported by the fact that relatively few companies have in reality fully implemented the relocation decisions. Often only some part of the company management are moved to Saint Petersburg, in case of banks only to fulfill the requirements of the Law on Banks and Banking operations, which requires companies to register their headquarters to the same location as where their management is working. This was currently the status of relocations of at least VTB and Rostelecom. Quite similar outcome is also achieved by registering subsidiaries with taxable income to Saint Petersburg. Like mentioned earlier, according to Russian tax legislation companies with subsidiaries in different regions have to separate and pay regional taxes to those specific regions where the subsidiaries are domiciled. Thus by registering their subsidiaries to Saint Petersburg, these companies transferred a part of their tax incomes to the region (ВТБ переезжает из Москвы в Петербург, 06.10.2004).

This view is also supported by some experts like Alexander Khandurev, vice-president of Regional Banks of Russia, who commented that the underlying incentives were mainly political and related to personal favors. He stated that there are no economically viable reasons to locate headquarters of a bank to Saint Petersburg. In reality he wanted to emphasize that many regional banks like Uralsib have actually decided to act opposite way and relocate from the regions to Moscow. He also supported the view that it is possible and relatively common that companies only relocate an obligatory part of their management to Saint Petersburg and in reality operate in Moscow. This is done due to the earlier mentioned political reasons, not because of tax benefits, since they obviously don't

even exist. In addition, the anonymous sources in cases of VTB and Navy relocations directly mentioned that political reasons were strongly involved. Especially the conversation regarding the relocation of former, once already cancelled only to be republished later, seemed to be related to timing of the Federal Elections. Furthermore and related to the personal favors aspect, the announcement of registering Gazpromneft to Saint Petersburg was made only a week before Governor of Saint Petersburg Valentina Matvienko had her birthday (Поменяется ли финансовая столица России?, 7.10.2004).

Naturally, if the possible tendency of relocations continues and more major companies will also in reality physically relocate to Saint Petersburg, this is likely to attract others to join them. Also Davis and Henderson (2003) found strong evidence that there is a tendency for headquarters to agglomerate. This in turn would attract skilled labor and business services to follow. This seems to be also the target of federal authorities, who urge to relocate government organs to Saint Petersburg and thus to promote the overall status of the Northern Capital. In the near future, when the corporate profits and simultaneously corporate profit taxes are likely to decline the continuance of relocation (or at least registration) tendency would be crucial for Saint Petersburg. Particularly, since in 2007 the corporate profits accounted for 45% of all regional budget revenues of city. However, according to our analysis Azimut Management Group was practically the only company out of ten analyzed ones, which based their decision entirely on business-oriented reasons.

However, despite the recent announcement of relocation made by Azimut (which was mainly due to opening of a new large-scale hotel to Saint Petersburg and could thus be considered to be different from the other decisions) there has not been any strong evidence about continuance of the tendency. In fact, the opposite seems to be true. In 2007 only two companies indicated the willingness to relocate and eventually neither of these decision has been carried out, thus implying that the trend could have ended or at least weakened. After the federal Legislative and Presidential elections there has been no announcements (excluding Azimut). As a matter of fact, the tide seems to have turned, at least to some degree, since recently the major real estate developer PIK registered from Saint Petersburg to Moscow. The headquarters had already been located there and thus it was acting exact oppositely to the earlier trends (До лучших времен, 24.11.2008). In addition, the discussion about turning Saint Petersburg into financial center of Russia has

evaporated and authorities have concentrated on creating a world-wide financial center to Moscow. Like Mr Khandurev also pointed out, this seems to be economically more rational direction, since more than 80% of the financial industry resources and all the major stock exchanges are already located Moscow. Besides, related to the financial center status, even the President Dmitry Medvedev and Prime Minister Vladimir Putin have turned their eyes towards Moscow and in June 2008 during the 12th International Economic Forum in Saint Petersburg, both expressed their strong support for this development. (Формирование Москвы как международного финансового центра)

Nonetheless, because of the slowdown of the pace of large Russian companies registering to Saint Petersburg, the city has to also turn its hopes towards private investors. Their investments, especially when directed to infrastructure and other crucial sectors, could partly substitute for regional government investments, which are likely to slow down as a result of future corporate tax revenue decline. In order to attract these investments the city authorities have already made decisions about allowing private investors to participate to new sectors and own e.g. hospitals and pharmaceutical factors. In addition, city is looking for partners to energy supply and road investment (City Targets Private Investors, 29.2.2008). However, due to the strong personal relationships between Saint Petersburg and federal authorities, it is unlikely that the tendency of supporting the city in numerous indirect ways would cease to exist. The re-establishment of discussion about Navy headquarters and political will to organize major conferences and events in Saint Petersburg are strong proofs about that.

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