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Industrial and geographical diversification of Russian foreign direct investments

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1. Introduction

Russia became an important origin of outward foreign direct investments (OFDI) only in the 2000s. At the end of 2008 Russian OFDI stock reached \$ 202.8 billion while it had been only \$ 20.1 billion eight years before (Bank of Russia, 2009b). Such a boom of Russian OFDI was mostly supported by oil, gas and metal companies, especially in the European Union and the CIS countries, as well as in the United States. However, in fact, Russian transnational corporations (TNCs) belong to a great variety of industries. Geographical priorities of some Russian companies are also very diverse. Of course, sometimes only one or two Russian significant investors can be found in some industries abroad. Several countries with notable Russian OFDI volumes are host locations only for single Russian TNCs. Nevertheless, these examples can demonstrate new ways of the Russian investment expansion or even possibilities of the whole modernization of the Russian specialization in the world economy. Thus, it is very important to investigate not only the largest Russian TNCs but also the second echelon of Russian firms abroad.

The rise of scientific interest in research on Russian TNCs is rather a new phenomenon. Although some famous Russian companies (e.g. LUKOIL, Gazprom or FESCO) owned many foreign subsidiaries even in the 1990s, there were only few articles about Russian TNCs in that period (the most well-known article was probably Bulatov, 1998). However the recent internationalization of almost all Russian largest companies stimulated a wide range of investigations. As a result, nowadays we can find several books, special reports and more than 150 articles on various aspects of Russian OFDI and TNCs.

The main attention is naturally paid to the most significant industries and countries of the Russian investment expansion even in comprehensive surveys (e.g. Vahtra and Liuhto, 2004; Kuncinas, 2006; Kuznetsov, 2007a; Vahtra, 2007; Berezhnoy, 2008; Kheyfetz, 2008; Kuznetsov and Chetverikova, 2009a). There are also several detailed articles about Russian OFDI in energy and metal sectors (e.g. Liuhto, 2001; Boyarko, 2002; Ehrstedt and Vahtra, 2008; Chetverikova, 2009a) while surveys of OFDI in other industries are very rare (for instance, in telecommunications – Lisitsin et al., 2005). However latent possibilities of the Russian OFDI development can be understood only by research on “unconventional” (at present time) investments.

A similar picture can be observed in researches on geographical aspects because only European countries (including former republics of the Soviet Union) are “popular” (e.g. Vinslav et al. 1999; Pelto et al. 2003; Zashev, 2004; Heinrich, 2005; Kilvits et al., 2005; Vahtra, 2005; Johansson, 2006; Kuznetsov, 2006; Libman and Kheyfetz, 2006; Weiner, 2006; Blyakha, 2009; Chetverikova, 2009b; Kuznetsov and Chetverikova, 2009b; Yermeyeva, 2009). Although there are few exceptions, such articles about Russian OFDI in other regions deal only with some special problems. Competition between Russian and other foreign investors in Central Asia (Kuznetsov, 2008a), state support of Russian OFDI in West Africa (Degterev, 2007) and lobbyism of Russian businessmen in the United States (Kostyayev, 2009) are among these rare examples. As a result, there is no complete picture of Russian OFDI in scientific literature.

The key task of this article is an explanation of the Russian OFDI diversification. The section 2 deals with the evolution of the Russian investment expansion abroad. Russian TNCs from various industries are described in the section 3 while new possible geographical priorities of Russian investors are analyzed in the section 4. Conclusions are given in the section 5.

2. Development of the Russian investment expansion abroad

The significant increase in Russian OFDI during the 2000s is evident. At the same time, statistical measurement of development of the Russian investment expansion abroad is very difficult. There are several main forms of Russian OFDI:

- foreign investments of Russian non-banking corporations and banks
- investments of Russian citizens in real estate abroad
- round-tripping OFDI (Russian investments in Russian companies and other objects via foreign off-shores)
- OFDI of Russian private equity funds and other minor types of foreign investors

During recent years annual and financial reports of Russian corporations have become more detailed. However even not all large companies publish sufficient information on their activities abroad. Nevertheless, it is the most productive way to survey only OFDI of Russian non-financial and financial TNCs, i.e. the Russian investment expansion abroad in the narrow sense of word. In this paper I focus my analysis on this field because Russian TNCs can play a crucial role in vitally important processes of the Russian economic modernization.

As for Russian OFDI in real estate, their statistical estimates are occasional and sometimes unreliable. We can find in newspapers some prices for residences of Russian multi-millionaires and state officials of high rank in London, Riviera towns and other prestigious foreign locations. In the 1990s these investments were the most well-known examples of “capital flight” from Russia. Nowadays such purchases are usually legal. Nevertheless, key investment motives of Russian nouveau-riches and bribers in the United Kingdom and similar countries are the same – both their inclination for luxury and their desire for comfortable place of emigration.

However in 2008-2009 the most popular countries for Russian buyers of real estate were Bulgaria (the 1st place), Montenegro (the 2nd place in 2009 and the 3rd place in 2008), Germany, Spain, the Czech Republic, Cyprus and some others. Moreover, Russians were the leaders among all foreign investors in real estate in several countries including Greece, Latvia, Cyprus, Montenegro, Egypt, Israel and Croatia. Even in 2009 Russians spent \$ 10.8 billion. An average price for an object was only \$ 210 thousand (by the way, it was a typical price for a one-room flat in Moscow). In those buildings 3/5 of all buyers planned to spend their holidays (Gordon Rock, 2010).

The significant volume of mass OFDI in real estate is a new and very specific phenomenon for Russia. Its main reasons are deformations of the real estate market of Russian cities. Extreme corruption and high monopolization in the construction industry of the Russian capital and many other regions stimulate the rapid growth of prices for flats from the side of supply. Before the modern global economic crisis Russian portfolio investors (who were connected with exporters of oil, metals and other resource-based commodities) supported this tendency from the side of demand because they were not satisfied in Russian stock exchanges. At the moment the Russian construction industry is in a deep stagnation. However prices for real estate are still high. As a result, people from not numerous Russian middle classes cannot buy large flats in Moscow or St. Petersburg even now. Instead of investing their capitals in expensive motor-cars or summer cottages in Russian provinces, they sometimes prefer to buy their “dachas” in the Balkans or Central Europe.

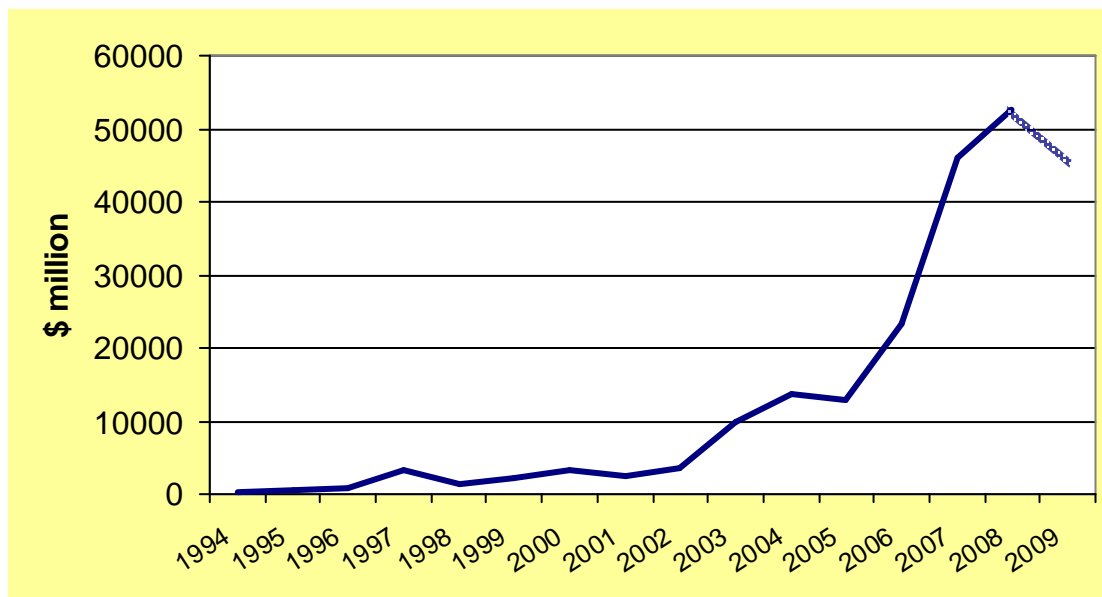
Pseudo-foreign investments can be excluded from our analysis only partially. It is possible to estimate roughly the share of Russian round-tripping OFDI in new statistics of Bank of Russia for 2007-2009, which shows geographical destinations of Russian foreign direct investment outflows. However not only classic off-shores but also the Netherlands, the United Kingdom and some other countries become the platform for round-tripping OFDI. Unfortunately, many other problems with statistics of Russian OFDI still remain (see Kheyfets, 2007, pp. 4-5; Kuznetsov, 2009b, p. 48).

The foreign investment expansion of Russian private equity funds is also a relatively new phenomenon but there is a great lack of information on this topic. Here I do not investigate other types of Russian investors abroad (for example, purchases of football clubs by Russian “oligarchs”) because their role in the Russian economy is very small.

2.1. Dynamics and structural changes of Russian foreign direct investments

There were Russian investment projects in Persia, Mongolia and some other countries even at the beginning of the 20th century. Some OFDI were made in the Soviet period. Although many Soviet enterprises abroad were closed or sold in the 1990s, some of their foreign assets became a basis for several Russian TNCs (Kuznetsov 2007b, pp. 21-23). Nevertheless, the mass investment expansion of various Russian companies began only in the 2000s (see figure 1).

Figure 1. Russian foreign direct investment outflows, 1994-2009



Source: Bank of Russia, 2009a.

Experts usually use data on OFDI stocks instead of statistics on OFDI flows. Stocks are certainly convenient for international comparisons or for estimates of the role of foreign capital in the national economy. However OFDI stocks can fluctuate without real changes in the character of the investment expansion. For example, Russian OFDI stock fell down significantly in 2008 – from \$ 370.2 million to \$ 202.8 million (Bank of Russia, 2009b). In fact, the main reason was devaluation of assets price during the global economic crisis while there were only few large divestments of Russian TNCs. Several Russian companies even made new large purchases abroad in 2008 (especially Evraz in Canada, the United States and Ukraine, Severstal in the USA, LUKOIL in Italy and Gazprom in Belarus).

We can see not only the quantitative growth of Russian OFDI but also significant structural changes. In the 1990s Russian companies usually began their expansion due to some specific circumstances (the exploitation of Soviet assets abroad, efforts of business reintegration in the CIS area, economic support of the intergovernmental cooperation in Africa and Asia and so on). In the 2000s almost all Russian largest exporters began their investment expansion abroad. Nowadays some features of a new wave appear (although the global crisis suppresses them). In fact, many Russian companies from various industries can begin their global business in the 2010s because their owners and top-managers have changed their ideology.

Some shifts in the industrial structure of Russian OFDI can confirm these processes (the most typical examples are surveyed in section 3). Changes in geographical priorities of Russian TNCs are also very interesting (see table 1). The appearance of non-European countries among the most important destinations (for instance, Canada, the United Arab Emirates or India) shows the maturity of some Russian companies. These TNCs evolve from “intra-regional” (within the CIS area) or “bi-regional” (usually the CIS plus the European Union) multinationals to global multinationals – here I use some ideas of Rugman and his colleges (e.g. Rugman and Verbeke, 2008; Sethi, 2009), but I prefer my own division of “regions” for Russian companies (see figure 5 in section 4).

Table 1. The largest recipients of Russian OFDI net-flows from non-banking corporations, 2007-2009

Destination	2007		2008		Q1-Q3 of 2009		Total	
	\$ million	%	\$ million	%	\$ million	%	\$ million	%
Total	45,211	100.0	50,740	100.0	33,497	100.0	129,448	100.0
Cyprus	14,630	32.4	7,428	14.6	11,285	33.7	33,343	25.8
Netherlands	12,502	27.7	2,618	5.2	3,550	10.6	18,670	14.4
United Kingdom	2,454	5.4	5,472	10.8	2,662	7.9	10,588	8.2
United States	974	2.2	7,676	15.1	1,114	3.3	9,764	7.5
Bermuda	2,689	5.9	4,068	8.0	269	0.8	7,026	5.4
Canada	181	0.4	6,723	13.2	17	0.1	6,921	5.3
Switzerland	1,404	3.1	2,460	4.8	1,257	3.8	5,121	4.0
Virgin (British) Islands	1,425	3.2	1,678	3.3	1,119	3.3	4,222	3.3
Luxembourg	497	1.1	2,600	5.1	1,119	3.3	4,216	3.3
Gibraltar	886	2.0	957	1.9	1,990	5.9	3,833	3.0
Ukraine	1,601	3.5	745	1.5	542	1.6	2,888	2.2
Germany	674	1.5	1,365	2.7	709	2.1	2,748	2.1
Belarus	765	1.7	671	1.3	838	2.5	2,274	1.8
Hungary	-12	0.0	462	0.9	1,787	5.3	2,237	1.7
UAE	901	2.0	240	0.5	32	0.1	1,173	0.9
Kazakhstan	103	0.2	253	0.5	788	2.4	1,144	0.9
Spain	259	0.6	458	0.9	251	0.7	968	0.7
Austria	230	0.5	254	0.5	415	1.2	899	0.7
Uzbekistan	354	0.8	387	0.8	154	0.5	895	0.7
Cayman	52	0.1	600	1.2	177	0.5	829	0.6
Bulgaria	168	0.4	388	0.8	167	0.5	723	0.6
France	257	0.6	217	0.4	234	0.7	708	0.5
Czech Republic	248	0.5	319	0.6	80	0.2	647	0.5
Serbia	44	0.1	11	0.0	534	1.6	589	0.5
Armenia	269	0.6	278	0.5	38	0.1	585	0.5
Turkey	183	0.4	272	0.5	67	0.2	522	0.4
Italy	87	0.2	295	0.6	114	0.3	496	0.4
Montenegro	188	0.4	173	0.3	59	0.2	420	0.3
India	13	0.0	401	0.8	0	0.0	414	0.3
Finland	110	0.2	150	0.3	49	0.1	309	0.2

Source: Bank of Russia, 2009c.

Structural changes in Russian OFDI, especially geographical aspects of foreign activities of Russian TNCs give new arguments for theoretical explanations of the Russian investment expansion.

2.2. Explanation of the spatial expansion of Russian investors abroad

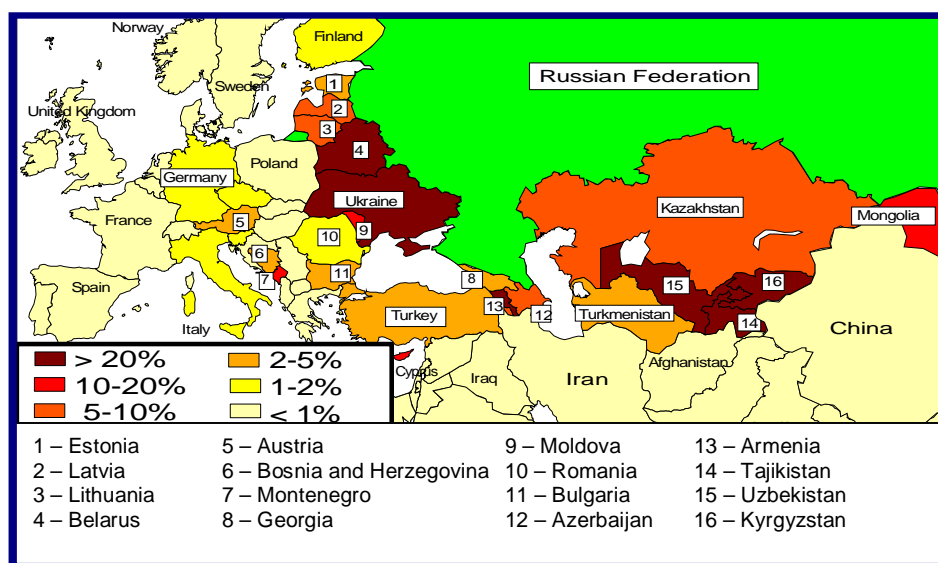
A tardy start of the mass OFDI expansion of Russian companies gives many facts for development of the Uppsala theory of internationalization (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977; Kuznetsov, 2007b; Kalotay, 2008; Kuznetsov, 2008b). In fact, many companies can internationalize their business only through stages because of their limited experience in the initial phases and the uncertainty of foreign markets. Moreover, companies usually try to conquer a significant part of the inner market for guarantees of their sustainable development within their home country. Only then firms begin to export their goods or services. Mainly successful exporters start their investment expansion abroad.

Of course, real schemes of internationalization are usually not so primitive. The state can substitute strong market positions for companies at the beginning of their expansion abroad. Such examples can be found not only in Russia but also in many other countries (including some members of the EU and China) where the state supports OFDI in resource exploration (Kuznetsov, 2002, p. 15-16). Top-managers can develop their experience of the OFDI expansion not only by export activities but also by import activities or by their previous work in other companies (Kuznetsov, 2007a, p. 52). Two extreme types of investors are international new ventures (chiefly in modern services where we can find already examples of Russian OFDI) and re-internationalized companies (e.g. Oviatt and McDougall, 1995, Welch and Welch, 2009). Cases of political disturbance of internationalization are the most interesting examples for the second type (e.g. German TNCs after 1945 as well as Soviet “red” multinationals after 1991). Second stages of foreign expansion often merge because many service companies can “export” their “production” only after the establishment of subsidiaries in foreign countries (Kuznetsov, 2002, p. 15-16).

The second key idea of the Uppsala school of internationalization of the firm is connected with the spatial diffusion of OFDI. Both physical distance and cultural barriers (from languages to whole systems of institutions) determine a neighbourhood

effect in OFDI geography. Political ties can be an additional factor for this effect. The neighbourhood effect is most evident for newly internationalized countries, especially for Russia (see figure 2). Russian companies play the most important role among all foreign investors in Belarus. It can be easily explained because this Russian neighbour state tries to build a union with the Russian Federation and all people in Belarus speak Russian (it is the second official language).

Figure 2. The Russian share (including trans-shipping OFDI) in foreign direct investment stocks of various countries, end of 2008



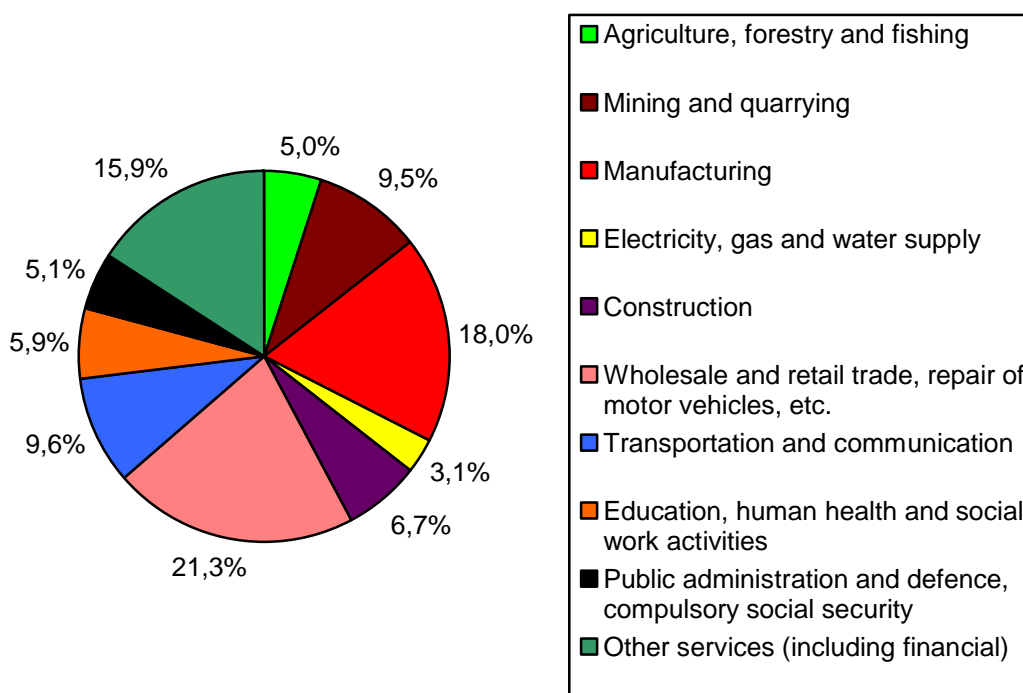
Sources: Bank of Russia, 2009c; UNCTAD, 2009, pp. 251-254; Eurostat, 2010; State Statistics Committee of Ukraine, 2010; National Bank of the Republic of Belarus, p. 11; Central Bank of Montenegro, 2010, p. 67; National Bank of Serbia, 2009; Kuznetsov, 2008a, websites of Russian transnational corporations.

Note: The Russian share is usually underestimated by official statistics. For example, due to the Ukrainian statistics, the share of Russian OFDI was 5.2% at the end of 2008, but the leader was Cyprus (21.5%) with the evident dominance of Russian trans-shipping OFDI.

3. Industrial diversification of Russian foreign direct investments

It is well-known that Russia specializes in exports of oil, gas and some other resources. However the place of the country in the global economy does not reflect its industrial structure (see figure 3). Although the Russian inner market is rather underdeveloped, companies produce considerable value added in various branches without significant sales abroad. Moreover, it is difficult to explain such a situation only by the high level of protectionism in the case of low competitiveness of Russian companies (one of the rare examples is construction) or by the dominance of foreign multinationals (in fact, global leaders do not control many branches of the Russian economy). Sometimes Russian companies struggle successfully against their foreign competitors (for instance, in retail trade) but with rare exceptions they still do not try to conquer markets abroad.

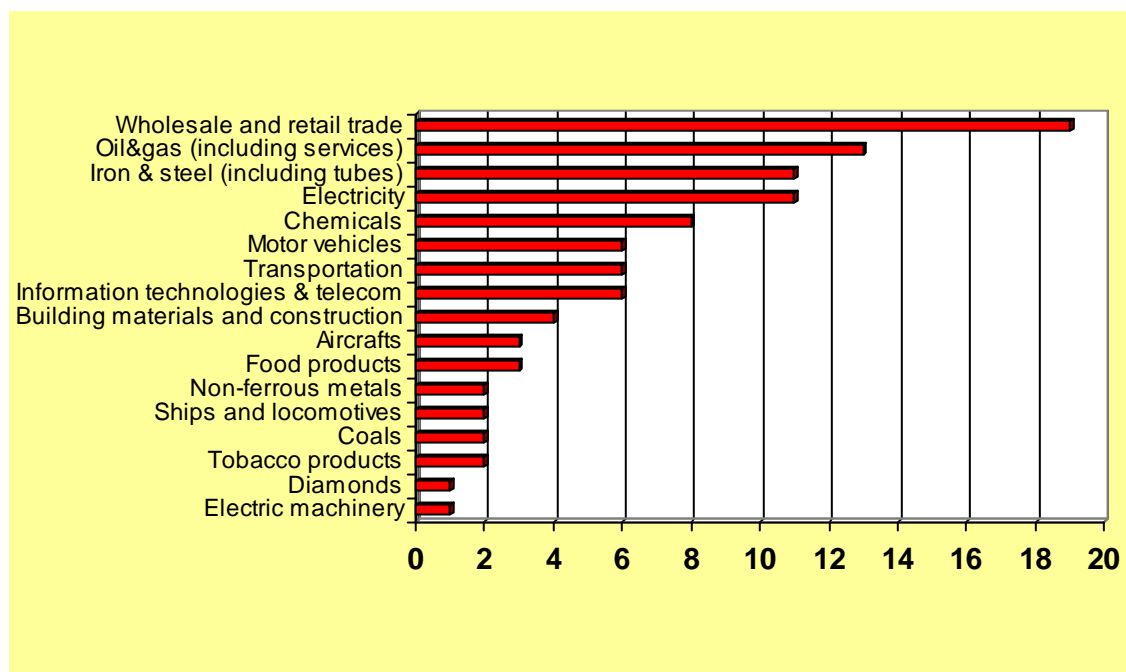
Figure 3. Industrial structure of the Russian value added, 2008



Source: Rosstat, 2009, p. 305.

There are many large oil and gas companies in Russia but they also do not dominate in the top list of non-financial companies (see figure 4). There are many Russian companies in various industries of manufacturing and services which have real or latent possibilities for the investment expansion abroad.

Figure 4. Industrial distribution of 100 top Russian non-financial companies, ranked by turnover, 2008



Source: Expert-400, 2009, p. 116-121.

Of course, not all companies from the top list of Russian companies can become TNCs but recently many new investors abroad have appeared among them.

3.1. Changes in the top list of Russian transnational corporations

There are no Russian companies in the global top lists of transnational corporations which are regularly published in World Investment Reports (e.g. UNCTAD, 2009, pp. 225-227). However LUKOIL and probably Gazprom should appear in the list of world's 100 largest non-financial corporations, ranked in 2008 by foreign assets. Despite a significant decrease in foreign assets of many TNCs worldwide, Russian oil and gas giants show some growth in their foreign assets even during the global crisis.

It is incorrect to compare total foreign assets with OFDI (as some experts did) because direct investments have a long-term character while assets consist of both fixed and current components. The share of current assets in total assets varies significantly in different companies – it is very small in telecom TNCs and more than 1/3 in some resource-based companies. However we can usually find only total foreign assets

statistics in annual reports of large Russian companies. Moreover, these data is the base for global rankings of TNCs. That is why I use total assets statistics in this paper (the comparison of 25 leaders by total and fixed foreign assets among Russian firms at the end of 2007 can be found in Kuznetsov, 2009b, p. 50).

Although the composition of the top list of Russian non-financial TNCs shows insignificant changes, the structural shifts are large (see table 2). LUKOIL is the leading Russian investor abroad since the middle of the 1990s. At the end of 2005 its share in the list of 10 largest Russian owners of foreign assets was 42.4%. In 2006 LUKOIL's share decreased to 31.5% and became only 22.0% in 2007 and 23.2% in 2008. At the same time, Russian steel and non-ferrous metal companies accelerated their investment expansion abroad. In 2005 there were only 3 metal TNCs in this top list and their share was 21.5%. After three years metal companies (Severstal, Evraz, NLMK and Norilsk Nickel, as well as conglomerate Basic Element with its main company RUSAL) formed a half of the list and their share was 38.5%. Moreover, metal giants suffered consequences of the global crisis stronger than Russian oil and gas companies.

Table 2. 10 top Russian non-financial transnational corporations, 2005-2008

No.	2005		2006		2007		2008	
	Company	Foreign assets, \$ million	Company	Foreign assets, \$ million	Company	Foreign assets, \$ million	Company	Foreign assets, \$ million
1.	LUKOIL	14,361	LUKOIL	18,921	LUKOIL	20,805	LUKOIL	23,577
2.	Gazprom	5,445	Gazprom	15,452	Gazprom	16,769	Gazprom	21,408
3.	Severstal	4,161	Severstal	5,252	Norilsk Nickel	12,843	Severstal	12,198
4.	Sistema	2,062	Basic Element	4,600	Evraz	9,824	Evraz	11,196
5.	Sovcom-flot	1,845	Norilsk Nickel	3,855	RENOVA	8,700	RENOVA	8,500
6.	Norilsk Nickel	1,600	Sovcom-flot	3,646	Basic Element	8,300	Basic Element	6,200
7.	Basic Element	1,500	Evraz	2,836	Severstal	6,411	NLMK	4,985
8.	Vimpel-Com	982	Sistema	2,290	Sovcom-flot	4,214	Sovcom-flot	4,642
9.	PRISCO	976	Vimpel-Com	2,124	Sistema	3,572	Norilsk Nickel	4,600
10.	TNK-BP	904	INTER RAO UES	1,116	Vimpel-com	3,067	Vimpel-Com	4,386
Total		33,836	Total	60,092	Total	94,505	Total	101,692

Sources: Kuznetsov and Chetverikova, 2009a, p. 49; Skolkovo, 2008, p. 19.

It is also important to stress that even many largest Russian TNCs began their expansion only in the first decade of the 21st century:

- Only Gazprom has some foreign subsidiaries established at the end of the Soviet period.
- LUKOIL began its foreign oil production abroad (in Azerbaijan) since 1994, while the start of its business outside the CIS took place in 1995 in Egypt.
- Severstal and Basic Element began their investment expansion outside Russia in the early 2000s.
- Sistema group (the 11th place in 2008) began its OFDI expansion in 2002 when its mobile phone company MTS established a subsidiary in Belarus and its telecom producer Sitronics took over STROM telecom in the Czech Republic.
- INTER RAO UES (the 15th place in 2008) made first acquisitions abroad in 2003.
- VimpelCom went with its direct investments outside Russia in 2004 but crossed the border of the CIS only in 2008.
- Evraz made its first significant foreign acquisitions only in 2005 in Italy and the Czech Republic.
- RENOVA started its OFDI expansion also in 2005 but its key acquisitions of European machinery firms took place in 2006-2007.
- NLMK bought the first plant abroad in 2005 too (in Denmark) but its rapid investment expansion began only in 2006-2008.

If we broaden a little the list of Russian TNCs we will see more beginners of internationalization. Metal firms TMK and Mechel began their foreign expansion at the beginning of the 2000s, while Koks bought several plants in Slovenia only in 2007. Metalloinvest began a construction of its first foreign steel plant in the UAE in 2006. Another Russian steel company MMK made several unsuccessful attempts at acquisition of foreign subsidiaries and in 2007 it began a greenfield construction of two steel works and infrastructural objects within a joint company in Turkey.

The largest Russian producer of fertilizers Eurochem bought 94.8% of the leading Lithuanian producer of phosphoric fertilizers in 2005. Another Russian agrochemical firm Acron started the biggest Russian OFDI project in China in 2002. Significant Russian acquisitions of foreign machinery plants were also made only in the middle of the last decade.

3.2. Prospects of the Russian investment expansion in machinery

Companies usually begin OFDI when three groups of advantages exist, including various forms of ownership advantages, as well as localization and internalization advantages. In other words, 1) competitive or monopolistic advantages of companies must be sufficient to compensate for the costs of establishing and operation a production subsidiary in foreign country, in addition to those faced by indigenous producers; 2) companies prefer engagement in foreign production if they can combine spatially transferable intermediate products from their home country with at least some immobile factor endowments or other intermediate products in another country; 3) it must be in the best interests of enterprises that possess ownership-specific advantages to transfer them across national boundaries within their own organization rather than sell them or their right to use to foreign-based firms (Dunning, 1988, pp. 2-4). Nevertheless, companies can also use OFDI to overcome their disadvantages, mainly by purchase of foreign companies with advanced technologies and/or significant possibilities in research and development (Moon and Roehl, 2001). I can add that sometimes investors take into account not real but only possible future advantages. Although they often make mistakes, in a case of success an investing company receives additional profits from its position of the pioneer in a new market.

Cases of Russian OFDI in machinery illustrate all these theoretical ideas very well. The share of machinery (including electric equipment and motor vehicles production) exceeds 5% in Russian foreign assets, both total and fixed (Kuznetsov, 2009a, p. 6-7). The branch takes place among Russian leaders (side by side with telecommunications and transportation, but after oil and gas industry, steel and non-ferrous metal industry). Nevertheless, prospects of further Russian foreign investment expansion in machinery are rather modest. Russian producers of machines and equipment with high competitiveness work chiefly in weapons, nuclear power and aerospace sectors where both localization and internalization advantages are rare:

- OMZ specializes mainly in the engineering, production, sales and maintenance of equipment and machines for the nuclear power. This industry does not have many places of localization worldwide, especially with companies for sale. That is why the only foreign country with OMZ production facilities is the Czech Republic (since 2004), although in 2008 company's foreign assets were \$ 714 million (the 19th place). Only diversification of the company or a probable boom of nuclear power electricity in the 2020s can radically change the situation.

- Foreign assets of S.P. Korolev Rocket and Space Corporation Energia exceed \$ 100 million. Since the middle of the 1990s the firm owned 25% in international Sea Launch Company from Cayman Islands with main assets in the United States and in the Pacific Ocean. In 2009 Sea Launch Company became bankrupt and at the beginning of 2010 the US and European partners decided that Energia would be a key actor in this technologically prospective project. Another foreign joint company with participation of Energia is Aelita in Kazakhstan. It is difficult to imagine that more than several new aerospace companies with participation of Energia will be established during next decade.
- Foreign assets of Military-Industrial Corporation NPO Mashinostroyenia also exceed \$ 100 million. Its only joint company abroad is BrahMos in India. It was founded in 1998 for production of cruise missiles. There is a real problem of further investment expansion of the Russian company because there is a factor of non-proliferation of modern weapons as well as a threat of counterfeit production after plants with Russian participation stop their activities in some countries. The best example of unfair competition is Kalashnikov sub-machine guns production which continues illegally in many former Soviet satellites. Nowadays the only legal producer Izhmash controls less than 1/5 of the global market. As a result, this large Russian company very cautiously develops new international projects.
- RTI Systems from Sistema Group has key interests in defence-related segments of missiles and aerospace technologies. In 2008 it acquired 74.9% of Austrian electric motors producer Watt Drive. By the way, the foreign expansion within conversion or double technologies development will be the most productive for all Russian companies of defence-related industries, especially in the case of private firms.

In production of civil machinery Russian companies usually have technological disadvantages and try to overcome them with OFDI. However Russian investors often should select firms with financial problems which they cannot solve in many cases. For example, we can remember failures in Eastern lands of Germany with carriage production by Fahrzeugtechnik Dessau of Russian company Transmashholding and shipyards Wadan-Werften of Andrey Burlakov (although he sold the company to another Russian investor in 2009).

Moreover, sometimes Russian firms meet protectionism, especially in Europe. For instance, in the middle of the first decade of the 21st century RENOVA Group began to change its main specialization from resource-based to high-tech. The Russian company started numerous purchases of high-tech firm Oerlikon shares from stock exchange in Switzerland. The share of Russian investor grew from 10% in 2006 to 56.8% in 2008. In October 2007 RENOVA tried to repeat its strategy and acquired more than 30% of famous Swiss machinery company Sulzer. The main aim of the Russian investor was technological transfer into the Russian Federation. However RENOVA's actions were met with irritation by other key owners and the conflict was solved with difficulties. Another bright example was a deal with Opel when Russian Sberbank failed to become its significant shareholder and then transfer technologies for Russian national producers of motor vehicles.

At the same time, there are many rather successful stories of Russian OFDI in machinery. Despite problems with competitiveness, even some Russian producers of motor vehicles have small assembly plants abroad, especially in the Third World (AvtoVAZ produces jeeps while KAMAZ specializes in trucks). Three companies are among 50 top Russian multinationals:

- The leading Russian TNC in traditional civil machinery Concern Tractor Plants began its expansion in 2003 within the CIS. Then it acquired Silvatec in Denmark in 2006, 74% of Luitpoldhutte in Germany and IHB Beteiligungs in Austria in 2008. Concern Tractor Plants also received informal control over Malaysian engineering company Dunham-Bush with plants in several countries.
- Telecom equipment producer Sitronics from Sistema Group (the conglomerate owns 71% of its shares) took over STROM telecom in the Czech Republic in 2002, bought 51% of Kvazar-Micro in Ukraine in 2004 and 51% of Intracom Telecom in Greece in 2006.
- Machine-tool firm of conglomerate Borodino acquired its main foreign subsidiaries in Italy three years ago. Its subsidiary SBC Bottling & Canning specializes in packing equipment and Jobs produces milling machines.

3.3. Diversity of Russian transnational corporations in manufacturing industries

There are several main manufacturing industries of the Russian OFDI expansion: petrochemicals (especially LUKOIL), agrochemicals (Eurochem and Acron), steel

(about 10 significant investors), non-ferrous metals (first of all RUSAL and Norilsk Nickel) and machinery. However we can find many examples in other industries with OFDI. Their volume exceeds at least \$ 25 million in following companies:

- INTER RAO UES – electricity. Its OFDI expansion started in 2003. Its main subsidiaries are situated in the CIS but the company also tries to develop its business in Finland, Turkey and Lithuania.
- Investlesprom – paper industry. Its subsidiary Segezha Packaging acquired a producer of paper sacks in Sweden in 2006 with plants in Spain, Italy, Germany, Denmark, the Netherlands, the Czech Republic, Romania, Ukraine and Serbia. It also took over two plants in Turkey in 2007.
- Eurocement – building materials. The company acquired cement plants in Ukraine (2005) and Uzbekistan (2006).
- LSR Group – construction and building materials. The firm bought Aeroc with aero-concrete plants in Estonia and Latvia. It also began to build new plants in Ukraine (finished in 2008) and Lithuania.
- Vostok-service – special clothing. It took over Eastern European company Červa in 2006.
- Kalina – perfumes and cosmetics. This leader of Russian market controls Dr. Sheller in Germany (since 2005) and some other foreign subsidiaries (the oldest one is in Ukraine).
- WimmBillDann – milk and juices. During the whole 2000s it acquired plants in Ukraine, Kyrgyzstan, Uzbekistan and Georgia.
- Russian Solod – brewing. It bought several plants in Germany in 2006.
- Russian Wine Trust – alcohol. It took over a company in France in 2007.
- SPI Group – alcohol. This private company failed to struggle for famous vodka trademarks with the state Soyuzplodimport. Then it decided to establish vodka production in Latvia and bought famous Latvijas Balzams in 2001. SPI also acquired a wine company in Italy in 2006.

There are many other companies with small foreign plants but well-known market reputation in Russia (Unimilk with several plants in Ukraine; Gloria Jeans with a Ukrainian factory and service subsidiaries worldwide; ice-cream producer Alterwest with a plant in Germany; etc.). It is difficult to predict their development but it is evident that some of them can also evolve into real transnational corporations.

3.4. New Russian transnational corporations in retail, banking and other services

On the one hand, retail, banking and many other services became a field of the mass Russian investment expansion abroad only several years ago. On the other hand, it is incorrect to say that these branches show absolutely new way of diversification for Russian OFDI because the majority of foreign enterprises under Soviet control was in these sectors, especially in developed countries. Moreover, state-run foreign trade organizations dominated among Soviet multinationals (Andreff, 2003). Usually they were hardly profitable or even loss-making and their objective was to collect hard currencies in order to finance the Soviet imports. Nevertheless, some foreign subsidiaries could survive in the market environment of the 1990s. Nowadays several modern Russian TNCs still have foreign subsidiaries which were established in the Soviet period, especially bank VTB (former Vneshtorgbank) and insurance group Ingosstrakh (Kuznetsov, 2007a, pp. 176-182).

Thus, the real novelty is the process of internationalization of almost all leading Russian service companies. It began later than the start of the OFDI expansion of Russian industrial plants. The main reason is relatively low competitiveness of Russian service TNCs. Probably it can also explain the dominance of the CIS countries among locations of their subsidiaries but it can also be a consequence of initial stages of their internationalization. For instance, Russian mobile companies MTS (from Sistema Group) and VimpelCom began their foreign expansion in the 2000s from the CIS countries but in 2008 Sistema started its business in India while VimpelCom in Vietnam and Cambodia. The first countries with OFDI of Ritzio Entertainment were Latvia (1994) and Ukraine (1995) but in the middle of the 2000s it had subsidiaries not only in many European countries outside the post-Soviet area but also in Peru and Bolivia.

Such examples can be found in banking sector too. Almost all Russian leading banks under state or private national control have foreign subsidiaries or affiliates in several countries:

- Sberbank – in Kazakhstan (2006), Ukraine (2007) and Belarus (2009)
- VTB – in Austria, Germany, the United Kingdom, France, (former Soviet assets, although VTB received them in 1992-2005), Cyprus (1992), Armenia (2004), Georgia and Ukraine (2005), Namibia, Vietnam and Belarus (2006), Angola (2007), Azerbaijan, Kazakhstan, Singapore, India and China (2008) and the UAE (2009)

- Gazprombank – in Belarus (1997), Armenia (2007) and Switzerland (2009, but it was a subsidiary of VTB since 1992)
- Alfa-bank – in the Netherlands (1994), Kazakhstan (1994), the United Kingdom (2000), the United States (2001) and Ukraine (2001)
- The Bank of Moscow – in Belarus (2000), Latvia (2002), Ukraine (2006), Estonia (2003) and Serbia (2008)

The same tendencies can be seen in the Russian insurance. The largest state company Rosgosstrakh began its tardy expansion in the CIS and bought companies in Ukraine in 2006 and Moldova in 2008. Ingosstrakh reduced its Soviet networks (now it owns subsidiaries only in Austria, Finland and Switzerland) but it bought or established companies in Belarus, Ukraine, Armenia and Kyrgyzstan. Another Russian large insurance firm RESO made its OFDI in Belarus, Ukraine, Kazakhstan, Armenia and Lithuania.

Russian trade companies are not active abroad. However several retail firms acquired or established their first subsidiaries in the CIS countries several years ago. For instance, the Seventh Continent has supermarkets in Belarus, Eldorado owns networks of shops in Ukraine and Kazakhstan, Perekrestok (X5 Retail Group from Basic Element) has a subsidiary in Ukraine while Vester controls supermarkets in Belarus and Kazakhstan.

We can find new features in Russian OFDI in transportation too. Side by side with pseudo-investments of shipping companies, the Russian real expansion in various segments of transportation began abroad. The Russian Railways received an affiliate in Kazakhstan as a result of the split of the USSR because the Trans-Siberian railroad crossed town of Petropavlovsk. The Russian Railways also established subsidiaries in Finland and Germany for development of high-speed railroads from European Russia to the EU countries. In 2008 the Russian Railways began to control railways in Armenia and in 2009 it received the former Soviet share in Ulan-Bator Railways in Mongolia. One of the largest private Russian transport multinationals N-Trans group realized its reorganization in 2008 and established two companies – Globaltrans (transit services of railways in Estonia, Latvia and Ukraine) and Global Ports (sea terminals in Finland and Estonia). It is also useful to say that shipping company FESCO began its diversification into railways.

There are several examples of Russian OFDI in absolutely new branches of the Russian foreign expansion. For instance, the leader of the Russian business information market RBC founded its subsidiary in Ukraine in 2006. It is natural because Russian companies have indisputable competitive advantages in Russian-speaking area. There are several reasons of such a situation:

- the majority of people who are interested in Russian economic, social and political problems are Russian-speaking people
- the great part of information about processes in the post-Soviet area are available only in Russian because it is too expensive to publish English versions for many journals and magazines in Russia and other countries of the CIS
- with rare exceptions only texts in Russian can influence the state policy in Russia and Belarus (usually they do it in Ukraine and Kazakhstan too)

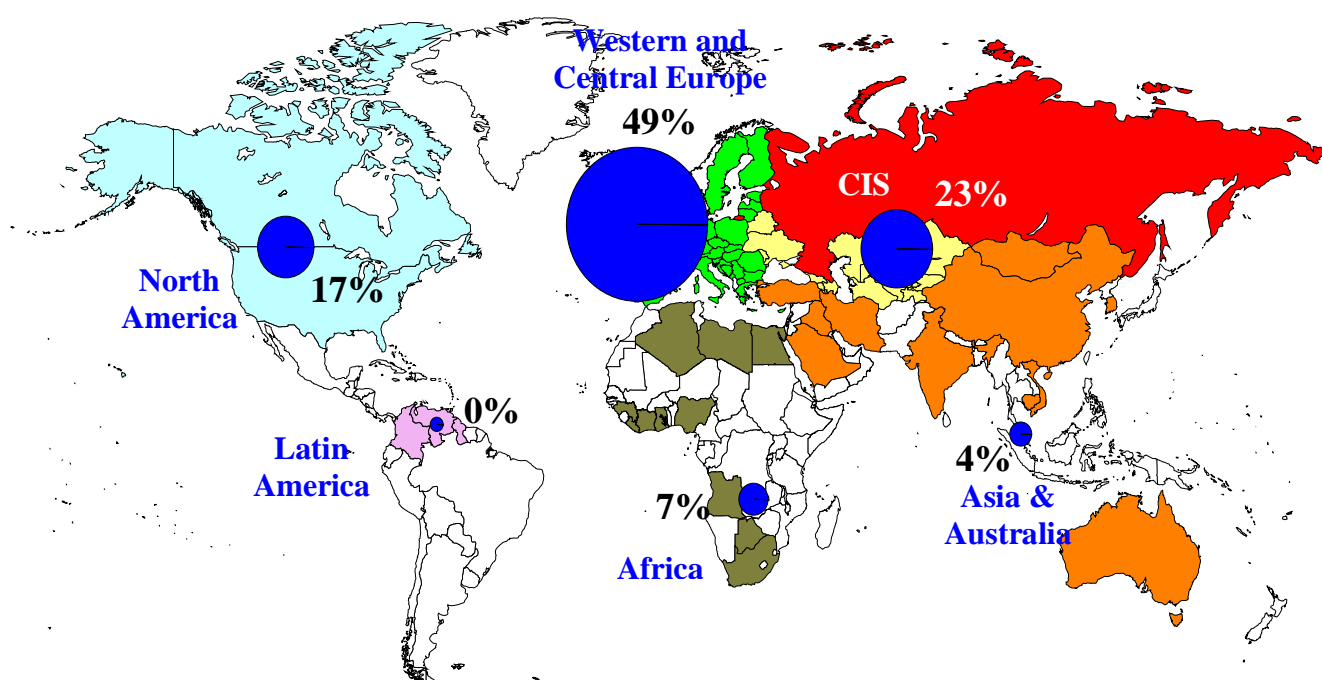
Another example is connected with mass media. In 2007 CTC Media acquired TV-company in Kazakhstan and established new broadcasting firm in Uzbekistan. In 2008 this Russian media TNC with minor Swedish participation (39%) bought Teledixi and Music Ramil broadcasting groups in Moldova.

It is also well-known that Russian programmers are very highly skilled specialists. As a result, many leading Russian system integrators began their foreign expansion. For example, Tecnoserv founded offices in Ukraine and Uzbekistan in 2007, in Armenia and Azerbaijan in 2008 and in Belarus in 2009. In 2008 the company also acquired 74% of Reksoft with offices in some countries of the European Union. Some other Russian large system integrators have foreign affiliates in the CIS too (Croc owns them in Ukraine, Uzbekistan and Kazakhstan while LANIT owns them in Kazakhstan and Ukraine). There are some Russian companies with OFDI in other IT-segments (e.g. the leading international provider of wireless entertainment Playfon).

4. New countries of the Russian investment expansion

Russian TNCs prefer to make OFDI in the countries of the CIS and Western and Central Europe (see figure 5). There are many well-known reasons: attractive markets, good possibilities for productive and technological cooperation, small physical and cultural distance and so on (e.g. Kuznetsov, 2006; Kuznetsov, 2008b). However in some countries the dominance of Russian transnational corporations has reached its limits by current investment climate (first of all in Belarus, Armenia and Tajikistan). In other countries the competitive pressure of other foreign multinationals will become too high under further Russian expansion.

Figure 5. Geographical distribution of foreign assets of 20 top Russian transnational non-financial corporations, end of 2008



Source: Kuznetsov and Chetverikova, 2009a, p. 16.

Note: Only countries with enterprises of 20 top Russian transnational corporations (excluding trade offices and financial subsidiaries) are covered with paint.

As a result, Russian companies find new interesting markets. Although North America attracts many Russian TNCs from the beginning of the 2000s, the share of the United States and Canada began to grow rapidly in 2007-2008. However investors also try to

discover absolutely new profitable regions for Russian OFDI when their experience of activities abroad begins to grow.

4.1. Changing priorities in Europe and Asia

We can see the permanent geographical diversification of Russian OFDI within the European Union. Germany, Finland and the Baltic states traditionally attracted Russian investors from various industries, both giants and companies of middle size. Italy and France received large Russian OFDI in 2005-2006 when Severstal acquired Lucchini Group, NLMK with Duferco established Steel Invest & Finance and Evraz bought Palini e Bertoli. In 2008-2009 LUKOIL also made large OFDI in Italy when it bought 49% of two refineries in Sicily.

Some Russian companies tried to strengthen their positions in the United Kingdom. The largest acquisitions in small members of the EU took place in 2009: Surgutneftegas bought 21.2% of Hungarian MOL for \$ 1.8 billion while LUKOIL took over 45% of TRN refinery in the Netherlands for \$ 0.75 billion. However the first step for foreign expansion of Surgutneftegas did not allow this Russian large oil company to become a real direct investor because of protectionist counteractions connected with the struggle between the Russian Federation and some European countries around new gas pipelines.

Russian oil and gas companies also strengthened their expansion in European countries outside the EU. The oldest Russian oil company Zarubezhneft (the 14th place by foreign assets) took over two refineries and petrol stations in Bosnia and Herzegovina in 2007 and then began their radical reconstruction. At the beginning of 2009 Gazprom became the owner of 51% of the equity in Serbian NIS with its two refineries. LUKOIL came in the region in 2003 when it bought a network of petrol stations in Serbia. In 2006 LUKOIL opened its petrol stations in Macedonia and after two years it began its retail business in Croatia and Montenegro.

By the way, Russian investors began to play very significant role in Montenegro. This state became independent only in June 2006 and its level of economic development is relatively low (especially for Europe). The country requires foreign capital and technologies, but traditional partners of the Balkan states from the European Union are

not very active in Montenegro. On the contrary, language and historical closeness attracts many Russian investors. However Western transnational corporations become more confident in the future of this young state (which plans to join the EU) and the Russian share in foreign direct investment inflows into Montenegro gradually decreases (Bank of Russian, 2009c; Central Bank of Montenegro, 2010):

- the whole 2007 – 21.4% or \$ 188 million
- 1Q2008 – 15.1% or \$ 39 million
- 2Q2008 – 15.5% or \$ 48 million
- 3Q2008 – 25.9% or \$ 56 million
- 4Q2008 – 17.9% or \$ 30 million
- 1Q2009 – 6.2% or \$ 8 million
- 2Q2009 – 8.6% or \$ 29 million
- 3Q2009 – 3.5% or \$ 23 million

There are rare examples of geographical diversification of Russian OFDI in Asia outside the CIS. In contrast to the US and EU companies, acquired Asian firms usually cannot give new technologies for Russian TNCs. As for cutting of labour and other production costs, Russian companies do not have enough experience of activities in regions with high political and other risks. Thus, the only strong attractive factor in such countries as India or China is their huge market capacity.

4.2. Discovery of Latin America and sub-Saharan Africa

Many countries in Latin America and sub-Saharan Africa are still terra incognita for Russian TNCs. Russian investors do not have enough information about business possibilities in these regions. Institutional support (bilateral investment treaties, double taxation treaties, etc.) is at initial stages of its development. The geographical and especially psychological distance from Russia is huge, technical standards varies significantly and so on. Many political ties of Soviet period have been lost.

Nevertheless, Russia do not have a negative image of a former colonial empire in contrast to the United Kingdom or France. Moreover, there are many possibilities for Russian companies in various countries of Latin America and sub-Saharan Africa. Even in the 1990s there were three significant recipients of Russian OFDI in these

regions – ALROSA began exploration of diamonds in Angola while Russian shipping companies took advantages of “cheap” flags of Liberia and Panama.

In the 2000s LUKOIL and RUSAL from Basic Element group developed the most vast Russian networks of subsidiaries in these regions. The leading Russian TNC began oil exploration in Columbia in 2002, in Venezuela in 2005, in Ivory Coast in 2006 and in Ghana in 2007. RUSAL started its aluminium business in Guinea in 2001. After five years the company went to Guyana and Nigeria. In 2007 RUSAL became the owner of two bauxite and alumina companies in Jamaica as a result of its merge with Glencore. Several Russian TNCs began their expansion in metal industry of South Africa, including AfroAsia of RENOVA Group in 2005, Evraz in 2006 and Norilsk Nickel in 2007. In 2008 Severstal made its investments in mining companies in Liberia (iron-ore) and Burkina Faso (gold).

At the same time, the Russian share in OFDI stock of Mexico is 0.001% (Ministry for Economic Development of the Russian Federation, 2008; UNCTAD, 2009, p. 252). There are only 35 small Russian subsidiaries (mainly in tourist and trade sectors) in the most popular destination for foreign investors in Latin America. Russian economic positions in Brazil are very modest too. Biochemical holding Orgkhim realizes the only more or less significant Russian OFDI project in the country. Nevertheless, the Russian Federation tries to intensify political dialogue and mutual trade relations with various states of Latin America. These steps can stimulate OFDI in oil and gas industry, machinery and some other fields of Russian TNCs' activities.

5. Conclusions

The character of the Russian investment expansion has already changed significantly. Undoubtedly, the modern global economic crisis restrains further internationalization of Russian companies, but many large TNCs continue their activities abroad and make new OFDI. Moreover, development of Russian transnational corporations depends largely on the speed of modernization of the whole Russian economy. After this crisis plenty of countries will try to base their economies on more advanced industries. At the same time, it is a question whether Russia can change its international specialization in resources or the country cannot make necessary reforms for development of high-tech industries and services with high value added (including transformation of its institutional environment and the real struggle against corruption). The second scenario means only a short boom of Russian OFDI.

I want to stress that some important features of industrial and geographical diversification of Russian OFDI have uncertain consequences:

- On the one hand, first Russian transnational corporations in some industries can become pioneers of internationalization of these industries of the Russian economy. On the other hand, these new transnational corporations can remain rare exceptions or even will be acquired by foreign giants.
- Russian OFDI in Asia, Africa and Latin America can support further development of Russian companies activities in the European Union and North America by expansion of Russian experience in foreign business operations and so on. However localization of Russian subsidiaries mainly in the countries of the Third World can be a weak attempt of postponement of the Russian entrance to markets with normal competition (and nothing else).

Thus, internationalization of the Russian economy is a very important process but it is only a “derivative” of economic and social transformation of the Russian Federation and its inner market.

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