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Expansion or Exodus? – The new leaders among the Russian TNCs

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To the Reader,

The current report is a part of publication series on foreign investments of the Russian companies. The series was initiated by a report by Peeter Vahtra and Kari Liuhto: Expansion or Exodus? – Foreign operations of Russia's largest corporations, published in 2004. A follow-up report by Peeter Vahtra, published in early 2006, presented the developments in the Russian outward FDI and case studies on the largest foreign investment projects of the Russian companies.

The report at hand is an update on the Russian outward foreign investments, presenting the recent OFDI trends, the largest foreign investors among the Russian companies and adjacent investment cases, and the recent policy trends of the Russian foreign investments. The industry-level focus of this report is on the Russian energy and metal sectors. While some Russian energy and metal companies have recently emerged as new challengers to the traditional MNEs in the race for globalisation, others have extended their foreign operations and investments and become truly global majors.

Throughout the 2000's, Russia has strengthened its international investment position. As indicated by Russia's recent ranking among the top 15 investor countries in the world, the country has effectively moved from the capital exporting schemes common to the 1990's, to sourcing extensive FDI projects around the globe. As Russia is strengthening its position as a leading investor among the emerging economies, its leading companies are gaining increasing momentum in the international business arena.

The increasing state ownership and leverage in the Russian enterprise sector witnessed in the last years has contributed to the changing policy dimensions of the Russian outward FDI. As the industries with the increasing state ownership and control are currently the largest sources of the Russian outward investments, discussing the policy effects of the increasing state intervention appears more topical than ever. In addition to a comprehensive overview on the recent developments in the Russian outward FDI, the current report aims to put forward a constructive policy discussion on the Russian investments abroad.

1 Introduction

During the past years, transnational companies (TNCs) from the emerging markets have risen among the leading players in the global FDI landscape. Among the leading TNCs from the emerging markets, the Russian companies have obtained a leading position in terms of the value of foreign assets, geographical scope, and coverage of international value chains.

During the past several years, the rapid rise in the Russian OFDI has begun to draw increasing attention of both Russian and international experts and academic research communities. The recent studies have extended beyond examining the massive capital flight and illegal capital transferring practices from Russia witnessed throughout the 1990s, and justifiably concentrate on the more sophisticated internationalisation practises of the Russian transnational companies (TNCs).

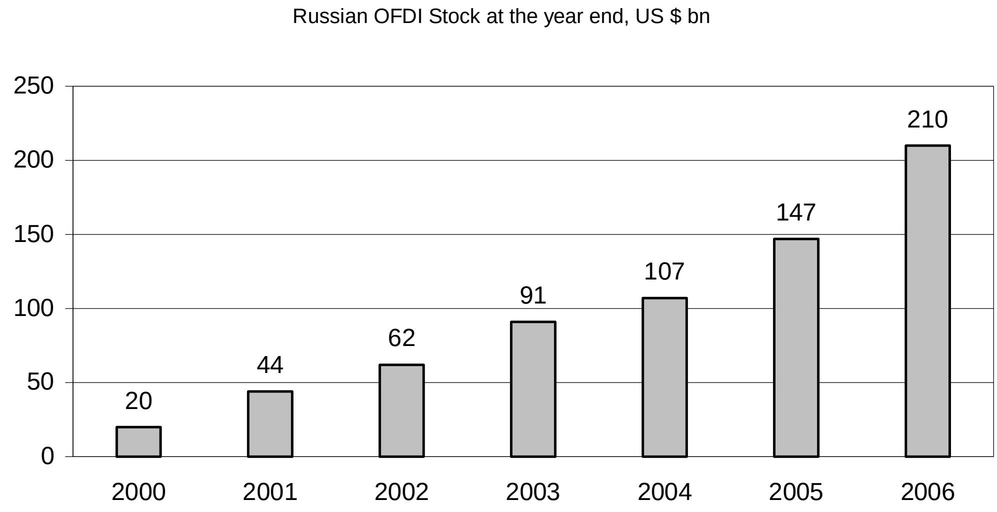
While we can already find a considerable amount of writings about the Russian investments abroad, the consensus remains to be found on several aspects regarding the Russian OFDI and internationalisation of the Russian companies. The main unsolved issues include the actual amount of Russian FDI and other capital abroad, the value of the assets of the Russian TNCs, and the motivational issues behind the Russian large-scale FDI. In our earlier writings (e.g. Vahtra and Liuhto 2004, Vahtra 2006), we have discussed several particularities of the Russian OFDI, in addition to offering classifications of the types of the Russian foreign investing companies, in order to offer a partial solution to some of the above-mentioned issues. A valuable effort of further classifying the Russian TNCs and estimating the value of their foreign assets has more recently been made by Kuznetsov (2007). In the same vein, Kalotay (2005, 2007) has contributed to solving the anomaly of Russia's remarkably high ranking among the world's leading foreign investing countries.

In the current report, I provide an analysis of some of the remaining controversial issues regarding the Russian investments abroad, including the amount, composition, and main sources of the capital flows from Russia. In addition, the recent major events on the international M&A landscape involving Russian companies are discussed. Finally, I discuss the strengthening ‘national champions’ policy in Russia and the impacts of the increasing state control over the Russian enterprise sector on internationalisation of the Russian companies.

2 Recent developments in the Russian OFDI

By the end of 2006, the Russian OFDI stock amounted to $ 210 billion, up from mere $ 20 billion in the end of 2000 (Figure 1). The substantial change in the Russian OFDI position between 2005 and 2006 ($ 63 billion) primarily reflects the amount of the actual FDI transactions by Russian investors during 2006 ($ 23 billion), and valuation changes of the existing Russian assets abroad ($ 31 billion)[1].

Figure 1 Russian OFDI Stock at the Year End, 2000-2006

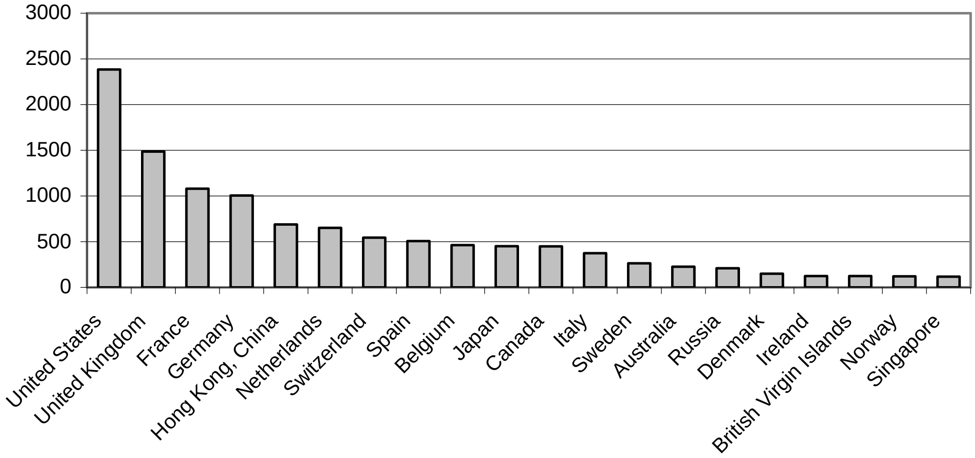


Source: Central Bank of Russia 2007.

The substantial growth in Russian OFDI in 2006 contributed to the country's improved ranking among the world's largest outward investors (Figure 2). While the Russian OFDI merely amounts to one tenth of that of the world's leading investor, the USA, Russia is by far the largest investor in the Southeast Europe and the CIS. Among the emerging markets of the world, Russia is second only to Hong-Kong, China[2].

[1] The remaining $ 9 billion is reported by the Central Bank of Russia to originate from statistical adjustments.
[2] The East-Asian financial hub hosts mainly financial TNCs, making it more of a financial intermediate rather than an actual home base for TNCs.

Figure 2 OFDI stocks of the world's largest foreign investing countries in 2006, *$ mln*



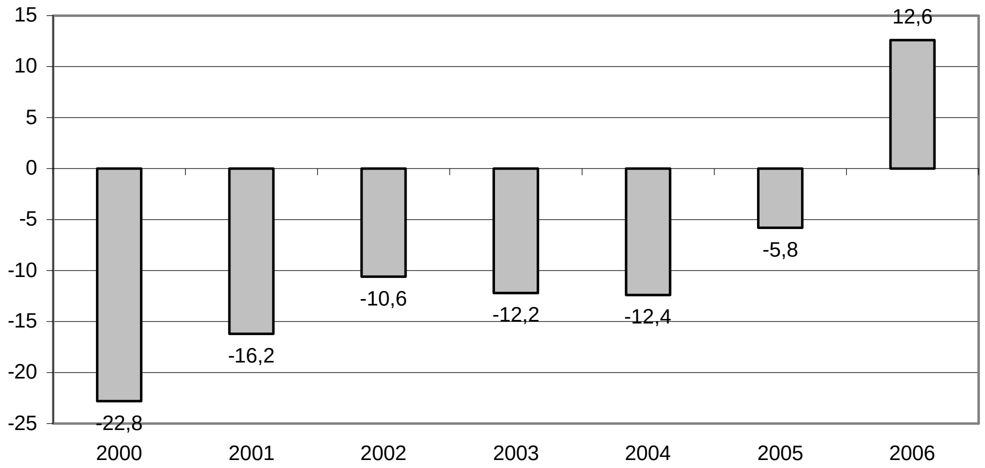
Sources: UNCTAD 2007a/b; Central Bank of Russia 2007.

Estimations on the value of the Russian investments abroad have varied significantly in recent years from one data source to another. Representational of the problem of estimating the actual volume of Russian outward FDI is the huge discrepancy between Russia's own data sources[3]. In the absence of an ultimately reliable measure for the actual FDI from Russia, we have chosen to rely on the figures provided by the Central Bank of Russia as the source for the most coherent data available[4].

During 1990's, Russia emerged as a major capital exporting country, with its capital outflows repeatedly exceeding the inflows. This unusual trend for an emerging economy was broken only in 2006, when the net capital flows turned towards Russia (Figure 3).

[3] According to the Federal State Statistics Service, Rosstat, the Russian OFDI stock totaled $ 6 billion by the end of 2006, compared to the estimation by the Central Bank of Russia (CBR), $ 158 billion. The data by Rosstat are based on (evidently insufficiently) reported transactions by the companies, whereas the CBR bases its estimations on the balance of payments data.
[4] This is due to the fact that the CBR produces the most extensive set of longitudinal data on FDI enabling a conditional comparison over time. In addition, the CBR has made significant improvements in its data collection and reporting system in recent years, its reported figures now being largely in line with previous international estimations on the Russian capital outflows. Further, based on the extensive database on FDI projects by the Russian companies, compiled by the author, the estimations by the CBR on Russian (legal) FDI are the closest to the aggregate of the values of individual FDI projects carried out by the Russian companies (see Chapter X for an elaborated discussion)

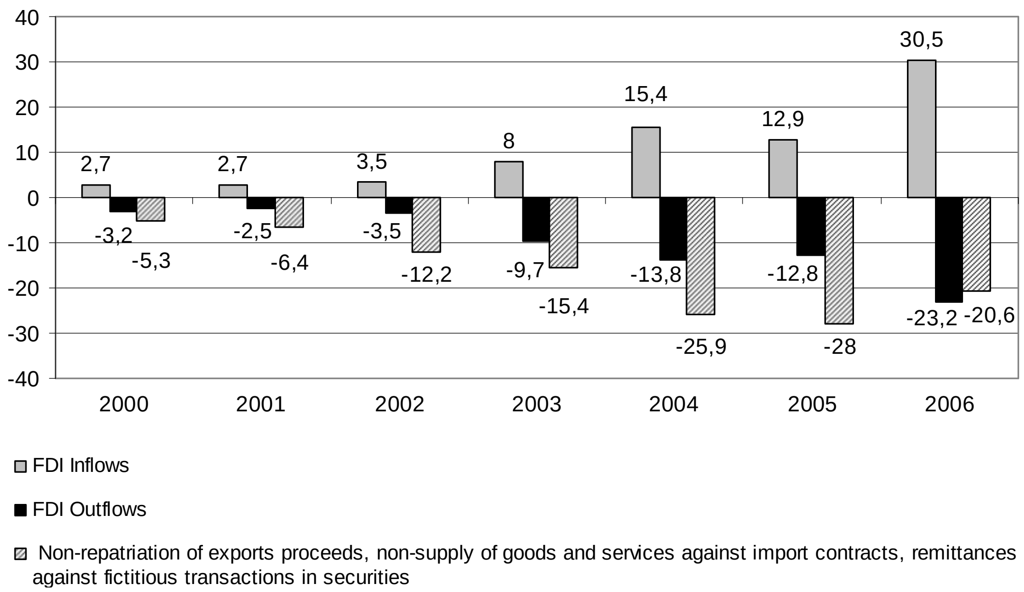
Figure 3 Net capital flows to and from Russia by private sector, 2000-2006, *$ bln*



Source: Central Bank of Russia 2007.

As presented by the Figure 4, the registered foreign direct investments (FDI) form only a part of Russia's capital outflows.

Figure 4 FDI flows and unregistered capital exports from Russia, 2000-2006, *$ bln*



Source: Central Bank of Russia 2007.

Besides FDI, the Central Bank of Russia includes on the balance of payments an item “non-repatriation of export proceedings…”, which represents the estimated the unregistered capital outflows (or illegal capital exports) from the country. Since the beginning of transition in 1991, the unregistered and illegal capital exports have formed a sizeable share of the total capital outflows from Russia. Until 2006, the value of these “grey” capital exports has surpassed that of outward FDI from Russia, at worst being more than twice as large as the legal OFDI (Figure 3). The sheer size of the unregistered capital outflows suggests that they originate not merely from the transactions by the resident individuals but also from the hidden transactions of the Russian companies operating abroad. Hence, I argue that when discussing the amount of Russian capital abroad, one should not limit the analysis to official (although substantial) FDI only, but take into account the vast amount of Russian capital abroad accumulated through “grey” transactions by the Russian resident individuals and enterprises. Although capital flight is a global phenomenon and not only typical for Russia, the enormous value of unregistered capital outflows is what makes Russia a special case in this respect. In the light of the recent data from the Central Bank of Russia, even earlier estimations on capital flight from Russia by the European Commission ($ 200 – 300 billion between 1992 and 2002) and World Bank ($ 300 billion by the end of 2003), seem rather optimistic.

Despite the unusually high share of unregistered capital flows from Russia, the share of FDI in total capital outflows has grown notably in the recent years. While in the beginning of 2000’s the FDI covered merely a third of the country’s estimated total capital outflows, by 2006 its share had grown to over a half of total outflows, indicating improved investment practices and transparency of the Russian enterprises and resident individuals. In 2006, the annual registered FDI flow from Russia reached its new high, amounting to over $ 23 billion, according to the Central Bank of Russia (2007). This accounts for more than 96% of the total FDI flows from the South-East Europe and CIS in 2006 and marks a spectacular 80% year-on-year growth in FDI flows from the country (Central Bank of Russia 2007, UNCTAD 2007b).

2.1 Recent trends: The breakthrough of Russian IPO

Since the beginning of 2005, there has been a considerable breakthrough on the Russian equity capital markets as the Russian companies initiated a wave of initial public offerings (IPOs) both on domestic and foreign stock exchanges. In 2006, Russia was the fifth-largest source economy for IPOs in global comparison. Altogether, Russian companies raised around $ 17.5 billion in 2006 through domestic and foreign IPOs (see Table 1). According to recent estimations, the value of Russian IPO market will have doubled in 2007, reaching $ 30-40 billion (RIA Novosti 2007a, b).

Table 1 The largest Russian IPOs in 2006

Issuer	Sector	IPO value, *$ mln*	IPO %	Stock market
Rosneft	Oil and gas	10 400	14.8	LSE, MICEX, RTS
TMK	Metals	1 070	23.0	LSE, RTS
Severstal	Metals	1 063	9.1	LSE
Komstar-OTC	Telecommunication	1 060	35.0	LSE
OGK-5	Utilities	459	14.4	MICEX, RTS
Sistema-Gals	Real estate	420	18.0	LSE
Magnit	Consumer retail	368	19.0	RTS
STS-Media	Media	346	16.4	NASDAQ
Raspadskaya	Mining	317	33.0	MICEX, RTS
Chelyabinskiy	Metals	281	18.0	LSE, RTS

Sources: Troika Dialog 2007, numerous media sources, author's calculations.

As many Russian companies have exhausted their traditional sources of financing and, in addition, remain highly undervalued, their engagement in global equity markets appears rather logical. There is a wide range of dynamic private Russian companies looking to increase their market value and raise capital for further domestic and foreign investments projects. The recent IPOs of private Russian companies include the floatation by Polymetal, the largest silver producer in Russia, raising $ 600 million in London and Moscow, and the one by Sitronics, one of the fastest-developing Russian high-tech companies, raising $ 350 million.

Apart from its explosive growth, what distinguishes the Russian IPOs from those of other emerging markets, is the role of the state in the process. Two thirds of the total value of the Russian IPOs during 2006-2007 was raised by the state-owned companies. In addition, the three leading Russian companies by market value, Gazprom, Sberbank, and Rosneft, are majority-owned by the state. Gazprom alone is responsible for nearly a third of the Russian stock market value (see e.g. Lazareva et al. (2007)). The two leading share issuances in 2007 were carried out by major Russian state-owned banks, Sberbank and VTB, raising more than $ 8 billion each on Moscow and London stock exchanges.

As the multi-billion share floatations by the state-owned companies have coincided with increasing state control over the Russian economy, the international investment community has grown increasingly vary about the effects of such a combination. The most notorious example of the controversial effects was the flotation of 14% of the shares of state-owned Rosneft on London and Moscow stock exchanges in 2006. The IPO raising nearly $ 11 billion is the largest in kind by a Russian company and the fifth-largest in the world. As the IPO coincided with the conclusion of predatory acquisition of the remains of the embattled Russian oil company Yukos by the state-owned behemoth, the IPO was surrounded by a notably high level of controversy and proclaimed unethical by many domestic and international reviewers.

3 Geographical trends of Russia's foreign investments

In the recent years, the Russian transnational companies have also discovered new geographical pathways. Besides the 'traditional' locations of the CIS and the CEE, the Russian companies are eager to expand their activities in Western Europe and in the USA. Since many attempts by the Russian companies to acquire assets in the Western EU have been met with reservation, if not with outright suspicion in the host countries[5], the current level of the Russian investments does not reflect the actual interest of the Russian companies to invest in these countries, but remains significantly lower. Especially in the natural gas sector, Gazprom has expressed its interest to considerably increase the downstream presence in the EU. One may assume that the inevitable deepening of the EU-Russia energy relations, for instance through the Nord Stream gas pipeline, would yield increasing Russian investments in the energy sector of the EU.

The Russian steel companies have been particularly active in acquiring assets in North America. Both Severstal and Evraz Holding have made strategic investments in the USA, adding to both their production value chains and providing the means to circumvent the US steel import quotas. In addition, a leading producer in the world of several strategic metals, Norilsk Nickel, has acquired production assets in the USA. By the time of writing this report, the company had recently finished the ever largest foreign acquisition by a Russian company, purchasing 100% of LionOre Mining, a major Canadian-based producer of gold, copper, cobalt and platinum for $ 5.2 billion. Besides the Russian metal giants, Lukoil has expanded its operations to the USA already in 2003, and currently runs a network of over 1000 service stations in the country.

The nearby CIS region has traditionally been a major target for the Russian FDI. The essential problem of estimating the value of the Russian investments in the region is that hardly ever these investments are made directly by the parent (holding) company, but rather through an offshore financial subsidiary. Although not a unique practice in the global M&A landscape, the investment trans-shipping from Russia to the CIS is

[5] According to Epsilon Corporate Finance, a London-based market watch agency, altogether 12 attempts by Russian companies to buy shares in Western European companies fell through in 2006. The combined value of the attempted acquisitions was $ 49 billion. Five of the deals, with a total value of $ 33 billion, involved Gazprom (Transitions Online 2007).

pronounced due to the fact that for one reason or another, the ultimate beneficiary is often reluctant to reveal its identity. In the official FDI statistics of the CIS countries, Russia hardly ever ranks among the top investors in a country, but the leading positions are acquired by countries such as the UK (including the tax haven of British Virgin Islands), Netherlands, and Cyprus, all known to host countless financial subsidiaries of Russian companies. In addition, in many instances, the acquisition of assets in a given country does not produce any injection of capital to the host economy, but is rather a financial transaction invisible in the balance of payments of a particular host economy. As an example, one may take the $ 2-billion acquisition by Lukoil, of the Canadian-based company Nelson Resources, the assets of which are in the Kazakhstan's oil sector. In this particular instance, there is neither any capital inflow to Kazakhstan, nor are there any other visible benefits present, often associated with FDI. Thus, one may conclude that in many such cases of investment round-tripping from Russia to the CIS (or any other countries in that matter), the potential benefits of FDI (technology transfer, managerial know-how, financial inputs etc.) are not realised.

Increasingly, Russian companies have also found their way to the developing markets of Africa, Asia, and Latin America. Among the developing markets, African countries are the most popular destinations for the Russian FDI. The acquisitions by the Russian companies in these regions have been almost entirely resource-seeking in nature. The Russian oil companies have extended their resource bases by acquiring exploration and production licenses from the oil-rich countries such as Iraq, Venezuela, Nigeria etc. while the Russian metal companies have targeted the South-African producers of gold and other strategic metals. Among the Russian metal companies, RusAl has established the strongest presence in the African continent having operations in Angola, Guinea, Nigeria, and South Africa.

Overall, one may conclude that the scope of the Russian foreign investments already covers the whole globe, while still being concentrated in the neighbouring regions of the CIS and CEE, and, more recently, in the Western EU.

4 Motivations and obstacles for Russia's foreign investments

Besides their wide geographical scope, what distinguishes the foreign investments by the Russian enterprises from these often pursued by the other emerging markets' TNCs, are the motivations behind the investments. Unlike the TNCs from other emerging economies, the Russian companies increasingly seek to acquire strategic assets from established markets of the EU and the USA, attempting to increase their downstream presence (energy sector) and value-added production activities (metal sector). In comparison, the main motivation for foreign expansion of most of the Asian TNCs is to establish upstream presence abroad and to secure the supply of raw materials. Seeking natural resources, these companies mostly invest in developing countries of Africa and in Latin America. Hence, the foreign investments by the Russian companies differ from these of other emerging market TNCs both in their motivations and locations.

As the Russian natural resource-based companies tend to have an abundance of raw materials in their use, the motivations for their foreign expansion become notably different from those of the Asian TNCs aiming to increase the supply security of natural resources through foreign investments. In the case of many Russian TNCs, the recent motives for foreign investments include acquiring control over the entire value chain internationally, to secure positions on strategic markets, and to increase their global competitiveness through growing outside the domestic market (particularly in the metals sector, characterised by strong global consolidation tendencies).

The seek for control over downstream assets is undoubtedly among the main triggers of political resistance towards the Russian investments in many countries and their energy sectors in particular, as foreign control over upstream assets is often more acceptable to the policy makers and the public than foreign ownership of downstream assets, through which one has a direct control over supplies to the end users.

5 Largest foreign investors from Russia

Traditionally, the financial-industrial groupings (FIGs) and individual companies owned by the groupings have been the most active foreign investors among the Russian enterprises. The recent strengthening of the state control over the Russian large enterprises is, however, bound to leave its mark on internationalisation of the Russian companies.

In following, the term ‘transnational corporations’ (TNCs) is used interchangeably to refer to both private and state-owned industrial companies and FIGs alike, depending on their organisational and ownership structure. With the exception of Gazprom (a vast state-owned holding comprising the world’s largest natural gas production company and enterprises in construction, utility, media, and transportation sectors, among others) and Altimo (the telecommunications unit of the financial-industrial holding, Alfa Group, in turn comprising several telecommunication companies in Russia and abroad), the term TNC is used in following to refer to an individual company inside a FIG[6].

The value of foreign assets of the largest Russian TNCs has soared in the recent years. The combined value of the foreign assets of the top-10 Russian companies has grown from $ 20 billion in the end of 2004 (see Vahtra 2006), to around $ 55 billion by the end of 2006 (Table 1).

[6] For instance, RusAl is part of a leading Russian FIG, Basovij Element, and the Severstal steel company belongs to the Severstal Holding, inclusing also transportation and car making companies. Similarly, the Russian leading telecommunication service provider, Mobile TeleSystems, is part of the Sistema holding company. For an elaborated discussion on the Russian industrial ownership structure, see e.g. Vahtra & Lorentz 2007.

Table 2 The 10 largest Russian TNCs, *ranked by the value of foreign assets, as of 31.12.2006*

Company	**Foreign assets,** *$ mln*	**Principal host countries**
Lukoil	19 221	Baltic States, CIS, Finland, Iraq, USA, Venezuela
Norilsk Nickel	8 265[7]	Botswana, South Africa, USA
Gazprom	6 232[8]	Nearly all the EU and CIS countries, Turkey
Severstal	4 546	Italy, USA
Evraz Holding	4 261[9]	USA
RusAl	3 550	Armenia, Australia, Guinea, Kazakhstan, Nigeria
Altimo	3 202[10]	Armenia, Georgia, Kazakhstan, Tadjikistan, Turkey, Ukraine, Uzbekistan
Mobile TeleSystems (MTS)	2 000	Belarus, Ukraine, Uzbekistan
VimpelCom	1 350	Armenia, Georgia, Kazakhstan, Ukraine, Uzbekistan
Novolipetsk Steel and Metal Kombinat (NLMK)	900[11]	Belgium, France, Italy, USA

Sources: Company information, author's calculations.

During the past years in particular, the leading Russian TNCs have pursued an aggressive strategy of acquiring foreign assets. Besides the increased number of foreign acquisitions, the value of asset purchases by Russian companies abroad has soared. During 2005-2007 alone, the value of the 20 largest acquisitions by the Russian companies exceeded $ 20 billion in value (Table 2).

[7] The figure includes the asset values generated by two major acquisitions in 2007 – LionOre Mining in Canada and OMG Harjavalta Mining in Finland.
[8] The figure includes the combined value of the assets of less than 10 subsidiaries of Gazprom, on which the information was available. The author estimates the total value of Gazprom's foreign assets at $ 10-12 billion.
[9] The figure includes the total asset value of Oregon Steel Mills (USA). Evraz completed the acquisition of 100% of the common stock of Oregon Steel Mills in January 2007 for a purchase price of $ 2.3 billion.
[10] The figure includes the asset value of the stakes owned directly by Altimo in Cukurova Telecommunications Holding (Turkey) and Kyivstar (Ukraine). The figure does not include the value of the foreign assets controlled by the subsidiary of Altimo, VimpelCom.
[11] The figure includes the estimated value of the NLMK' share in a joint venture with Duferco, for which the Russian company pain $ 805 million, and the value of the US-based Winner steel INC., acquired by the NLMK-Duferco joint venture in 2007 for the price of $ 211 billion.

Table 3 The largest foreign acquisitions by Russian companies in 2005-2007

Acquiring company	Target company	Country	Nature of business	Share, %	Value, US $ mln
Norilsk Nickel	LionOre Mining	Canada	Mining of strategic metals	100	5 234
Altimo	Turkcell	Turkey	Mobile telecommunication	13	3 200
Gazprom	Beltransgaz	Belarus	Natural gas distribution	50[12]	2 500
Evraz Holding	Oregon Steel Mills	USA	Steel production	100	2 300
Lukoil	Nelson Resources	Kazakhstan/ Canada	Oil exploration & production	100	2 000
Norilsk Nickel	Gold Fields Ltd	South Africa	Gold mining	20	1 200
Evraz Holding	Highveld Steel	South Africa	Steel products	79	678
Evraz Holding	Palini & Bartoli	Italy	Steel products	75	650
Severstal	Lucchini Group	Italy	Steel products	62	574
VimpelCom	ArmenTel	Armenia	Fixed-line and mobile telecommunication	90	485
RusAl	Queensland Alumina Ltd	Australia	Alumina refinery	20	460
VimpelCom	Kar-Tel	Kazakhstan	Mobile telecommunication	100	425
Norilsk Nickel	OMG Harjavalta Nickel Oy	Finland	Mining and metallurgy	100	408
Evraz Holding	Vitkovice Steel	Czech Republic	Steel products	100	287
VimpelCom	Buztel and Unitel	Uzbekistan	Mobile telecommunication	100	275
Lukoil	Teboil and Suomen Petrooli	Finland	Petroleum marketing	100	270
Lukoil	-	USA[13]	795 petroleum stations from ConocoPhillips	100	266
VimpelCom	Ukrainian Radio Systems	Ukraine	Mobile telecommunication	100	254
RusAl	Alscon	Nigeria	Aluminium production	78	250
Sitronics	Intracom	Greece	Telecommunication equipment	51	160
MTS	Uzdunorbita	Uzbekistan	Mobile telecommunication	74	121
Evraz Holding	Strategic Minerals Corporation	USA	Steel production	73	110
NLMK	DanSteel	Denmark	Steel products	100	104

Sources: Company information; authors' calculations.

[12] Gazprom will gradually acquire 50 percent of the company by 2010.
[13] In late 2006, Lukoil purchased additional 376 petroleum stations in six European countries from ConocoPhillips. The value of the deal was not disclosed.

5.1 Oil and gas

As indicated by Tables 1 and 2, the oil & gas and metal companies are the largest Russian investors abroad, judging by the accumulated value of their foreign assets. In addition, it should be noted that very few companies are responsible for the bulk of foreign investments from Russia. For instance, the combined value of foreign investments of the two leading Russian oil and gas companies, Lukoil and Gazprom, exceeds $ 25 billion, which is roughly equivalent to the combined value of the foreign assets of the remaining 8 companies on the top-10 list. In addition, the two companies are responsible for nearly 90% of OFDI from the oil & gas sector. Judged by the recent development, no other Russian oil and gas companies have the sufficient will or resources to become truly global players.

Lukoil, the second largest oil producer in Russia after the state-owned Rosneft, holds the largest foreign assets among the Russian TNCs, with a total value of nearly $ 20 billion. An extensive overview on Lukoil's foreign operations may be found in the earlier reports by the author (Vahtra & Liuhto 2004, Vahtra 2006). More recently, Lukoil's foreign expansion has been targeted towards the Western EU and the USA, with a particular aim of establishing control over retail networks. In the end of 2006, the company acquired 376 petroleum stations in six European countries from ConocoPhillips, including 156 in Belgium and 49 in Finland. The acquisition was reported by Lukoil's management to envisage the company's seek to move into segments with greater value added.

The state-owned natural gas giant, Gazprom, has recently mulled heavy expansion in the European downstream sector. During the past two years, Gazprom has made a considerable effort to strengthen its market position in the EU and Western Europe in particular. Apart from being the single largest supplier of natural gas to Europe, Gazprom is seeking to become a direct gas supplier in some of the largest national markets. The recent attempts to acquire national gas distributors in Poland, Serbia, and the UK, among others, aim at establishing a dominant position in Europe, both as a supplier and distributor of natural gas to the end users. In the author's view, further strengthening of the EU-Russian mutual energy ties inevitably open new doors for Gazprom, for increasing its downstream presence in Europe (see also Box 1).

Box 1 Gazprom going for the European downstream

Gazprom is the world's largest natural gas producer and the third largest company in the world by market value. It supplies 20% of the global gas demand and controls over a quarter of world gas reserves. The company is majority-owned by the Russian government (51% of shares). Gazprom has the most extensive network of foreign affiliates among the Russian TNCs, consisting of more than 60 foreign subsidiaries mainly in the EU and the CIS and Southeast Europe. Gazprom has established strong downstream presence in the nearby CIS region in particular and controls gas export pipelines in Belarus and Ukraine. In addition, the company is the sole supplier of natural gas in many of eastern EU, countries and Southeast Europe. Currently, the Russian natural gas giant is aggressively targeting the Central and Western Europe for stakes in the national gas distribution networks and domestic retailers.

During 2006-2007, Gazprom has either bid for or expressed interest in the national gas distributors in Belgium, France, Poland, Serbia, and the UK, to mention but a few. So far, the success has been minimal, with the likely exception of Belgium, where Gazprom has far-sighed co-operation plans with the two major national companies. Belgium has recently expressed explicit wishes to become the storage and transit hub for the Russian gas in Western Europe, a development that is likely to lead to deeper penetration by the Gazprom in Belgium's downstream sector.

The UK is another key European market for Gazprom. In 2006, Gazprom attempted to acquire the British national gas distributor, Centrica, supplying more than half of the domestic market. Despite the failed acquisition attempt, which triggered substantial politically-minded opposition, Gazprom apparently views the British market as a key source for growth in Europe. As its own gas production on the North Sea has gone into steep decline, the UK has become a net importer of gas. While in 2006 the imports stood at the level of around 12% of the total consumption, the predicted figure for 2015 is around 75%. Addressing the rapid consumption growth in the UK, Gazprom has reportedly allocated a substantial share of the capacity of Nord Stream pipeline under construction to the UK markets.

The key issue determining the Gazprom's future presence on the European market is the construction of the Nord Stream gas pipeline in the Baltic seabed, planned to run from the Russian Baltic Sea coast to Germany. Designed for direct natural gas supplies to the European market, the Nord Stream pipeline is likely to add to the economic and political security of gas supplies from Russia by advancing mutual dependency between Russia and the European Union. Given the recent political tensions between Russia, Ukraine, Belarus, and Poland, the current transit countries of the Russian gas the EU, the pipeline can be seen as an effective means to increase the reliability of Russian gas supplies to Europe. In addition, the new pipeline is likely to provide the economically most viable route for transit of Russian gas. Whether the economic benefits will be delivered to the European customers remains a key point in the issue.

On the turn side for Europe, the construction of the Nord Stream pipeline essentially means increasing dependency on the Russian gas, instead of serving the EU's long-term objective of diversifying between the energy suppliers. A direct control over the key supply route, significantly adds to Russia's leverage on the European market. In terms of increasing the long-term energy security for Europe, building of gas supply infrastructure from other regions remains the key challenge. Before the diversification of supplies to Europe is extended to supply sources instead of merely to supply routes, Europe is bound to remain an underdog in energy dialogue with Russia.

5.2 Metals and mining

The foreign investments by the Russian metals and mining companies have grown substantially during the past two years. For the first time, the Russian metal producers overtook the oil and gas companies in terms of value of the new acquisitions in 2006. The combined value of the foreign assets of the two leading Russian steel companies Evraz Holding and Severstal, is nearly $ 9 billion, the majority of which has been raised during the past few years (see also Box 1). To this one might add the $ 1 billion foreign asset worth of another major Russian steelmaker, NLMK.

Box 1 The expansionist strategy of Evraz Holding

Since 2006, Evraz Holding has become a leading Russian steelmaker to expand overseas, challenging the peak position of Severstal. The recent high-profile acquisitions in the EU, USA, and Africa total nearly $ 5 billion in value, making Evraz one of the leading steelmakers in the global M&A landscape.

Evraz Group started its international expansion by acquiring two European steelmakers, Vitkovice Steel of the Czech Republic and Palini & Bartoli of Italy in 2005. The diversity of the recent acquisition targets indicates an increasingly ambitious expansion strategy by the Russian steelmaker. The acquisitions of the US-based Oregon Steel Mills and Stratcor in 2006 were primarily targeted to securing the access to and position on the US markets. Through the more recent acquisition of the South-African Highveld Steel and Vanadium (HSV), Evraz looks to enhance its raw material supplies and expand to new segments of strategic commodities. Along with the acquisition, Evraz became the world's leading producer of vanadium with around 30%-share of the global output.

The recent events indicate that there are still appetite left for future purchases. In the course of 2007, Evraz was in talks to buy a major Canadian steel producer, IPSCO, with a market value of around $ 7 billion at the time. Although the deal was never finalised, the negotiations serve as a clear indication of Evraz' eagerness to continue aggressive foreign expansion through M&A.

In the Russian non-ferrous metal sector, Norilsk Nickel is the undisputable leader measured by the value of foreign assets. Through two major acquisitions in 2007, the value of Norilsk Nickel's foreign assets rose to exceed $ 8 billion (see Box 1).

Box 2 Norilsk Nickel's acquisition of LionOre Mining – the largest foreign acquisition by a Russian company to date

In mid-2007, Norilsk Nickel, the world's leading producer of several strategic metals including nickel and palladium, acquired 100% of the shares of a major Canadian-based producer of gold and other strategic metals, LionOre Mining. The largest foreign acquisition to date by a Russian company, worth $ 5.2 billion, is considered to significantly advance Norilsk Nickel's position on the African mining sector, the key operational area of LionOre.

Through the acquisition, Norilsk Nickel entered the mining sectors of South Africa and Botswana, with the aim of diversifying its resource base and potentially engaging in new commodity sectors such as iron ore and diamonds (Mining Weekly 2007). Through the LionOre acquisition, Norilsk Nickel came to hold major shares in two separate mining ventures – 85% of Tati Nickel in Botswana and 50% of Nkomati Nickel in South Africa. In addition, the companies plan construction of a metal refinery in Francistown, Botswana.

According to the Norilsk Nickel management, the African continent is seen by the company as a promising area of operation, and preliminary plans for further expansion into other parts of the continent have already been laid down. This goes alongside with the recent announcements that the Russian company is seeking to further diversify its operations to other commodities than nickel and complementary metals.

The merger in 2007 of the leading Russian aluminium company, RusAl (part of the Basovij Element holding), with another major Russian producer, SUAL, and with Switzerland-based Glencore in 2007 created a world's leader in aluminium production. The new company has a share of over 12% of global aluminium sales and around 16% of global production. In addition, the newly-formed giant has operations in 17 countries worldwide. In addition to the pole position in the world aluminium market, the merger granted RusAl a dominant position on domestic markets, making the entrance of competitors virtually impossible. The policy of creating such powerful 'national champions' in Russian leading industries has been witnessed first and foremost in the country's oil sector over the past two years, with the other key industries evidently following the suit. Through the merger, RusAl further managed to strengthen control over the entire international value chain, something that is seen characteristic to companies from emerging markets (UNCTAD 2007b). Similar motivations have been driving the foreign investments by the Russian oil and gas majors (see Vahtra 2006).

Besides marking the rise of metal and mining companies among the top Russian foreign investors, the recent mergers and acquisitions in the sector indicate mounting domestic and international consolidation pressures in the metals industry. As indicated by the RusAl merger, the global industry trends foresee the creation of corporate heavyweights as a prerequisite for survival under the tightening competition. As shown by the recent events, the leading Russian metal and mining companies are well equipped to withstand the global consolidation pressures. Apart from the global industry trends, the major M&A deals further signal the changing domestic environment for the Russian companies. Over the past two years, there have been apparent attempts of creating a group of Russian 'national champions' , or large and politically obedient companies equipped to become the global leaders in their industries.

5.3 Telecommunications

Besides the natural resource-based enterprises, the Russian telecom companies are gaining ever stronger foothold on the CIS market. In virtually all the CIS countries, the Russian telecom operators are the indisputable market leaders. Led by MTS (AFK

Sistema holding) and VimpelCom (Altimo/ Alfa Group), the Russian companies have acquired controlling shares in local telecom operators throughout the CIS (see Box 3). In a more recent event, the leading Russian telecom holding Altimo (the telecommunications' arm of a leading Russian FIG, Alfa Group) acquired a minority share in a leading Turkish mobile operator, TurkCell, for more than $ 3 billion. In addition, the top Russian telecom holdings have voiced their interest in equity participation in the leading Scandinavian telecom companies, such as TeliaSonera and Telenor. In addition, as reported in early 2007, Altimo has voiced its interest to acquire up to 20% in the mobile giant Vodafone. Given the notably higher market value of the latter, however, the possibilities for such an acquisition remain vague.

Box 3 Altimo, VimpelCom seeking the dominant position in the CIS and moving beyond

Altimo, the telecommunications arm of a leading Russian financial-industrial conglomerate, Alfa Group, has aggressively expanded in the CIS region under the VimpelCom brand. Since 2006, the company has spent more than $ 1.5 billion on its acquisitions of leading national mobile operators in the CIS region. VimpelCom has acquired leading mobile and fixed line operators in Kazakhstan (Kar-Tel), Uzbekistan (Unitel and Buztel), Ukraine (Ukrainian Radio Systems), Armenia (ArmenTel) and Georgia (Mobitel). Besides the CIS, VimpelCom has participated in tenders for Vietnamese and Afghan state-owned mobile operators, to mark the growing urge of the Russian operators to move beyond the increasingly saturated Russian and CIS markets.

Following its most recent acquisitions in Armenia and Georgia, VimpelCom became the leading Russian mobile operator in the CIS, measured by geographical coverage. While still behind the largest Russian telecom service provider, MTS, in the number of subscribers, VimpelCom is pursuing a notably aggressive expansion strategy, which is likely to yield ever tighter competition among the Russian telecom operators in the region.

As VimpelCom is going for the leading position in the CIS, Altimo is evidently seeking to expand the reach of Russian telecom operators beyond the neighbouring areas. The recent high-profile acquisition in Turkey and expressions of interest in buying into some of the leading Western telecom companies indicate that the leading Russian telecom holdings are more than ready to move beyond what used to be a heavily underdeveloped market of the CIS and digest larger companies on more developed markets.

6 Recent trends: The increased state control in the strategic sectors of the economy – implications on foreign investments from Russia?

In recent years, there has been a remarkable shift in state involvement in the Russian enterprise sector. As pointed out by the OECD (2006) *Economic Survey of the Russian Federation*, the role of the State in the Russian economy has considerably strengthened. For instance, during the past three years, there has been a visible trend of unilateral renegotiation by the State almost every major energy project in Russia with foreign control. Based on the contracts and agreements of the early and mid 1990s, marked by economic difficulties, institutional upheavals and low oil prices, many of the foreign TNCs were granted favourable terms to develop and extract the Russian energy resources. The increasing oil prices since the early 2000s and the strong economic growth that followed have given way to what some experts refer to as "resource nationalism" (see e.g. Collins 2006). During the past three years, the Russian state-owned enterprises (SOEs) have acquired major domestic and foreign energy assets from private Russian owners. Hence, the strengthening role of the State has a direct effect on not only the foreign companies' operations in Russia, but also on the foreign investments by the Russian enterprises, heavily concentrated on the sectors under the tightest state control.

Thus, while in the recent years we have witnessed the emergence of a universe of private Russian TNCs driven by entirely market-oriented motives in their international expansion, a very different picture is shaping up in what are referred to as strategic industries for the Russian economy and security[14]. As the corporate events in these sectors have unfolded, we have witnessed the creation of so-called national champions, or vast enterprise holdings under the state control designed to be competitive on the international markets and secure Russia's economic and political leverage in the target countries.

The consequences of the strengthening national champions' policy are twofold. As the vast majority of the Russian OFDI originates from the natural resources' sector, and oil, gas, and metals industries in particular, the evident strengthening of the state control in these industries raise direct concerns about the motivations behind the Russian

[14] For an in-depth analysis on Russia's strategic sectors, see Liuhto (2006).

companies' foreign investments. The state buying into the key strategic sectors of oil and gas has dramatically shaped balance of power in these industries and led to a notable concentration of resources. No doubt there is a considerable temptation to use these resources to gain economic and political leverage in the target countries. The natural gas giant, Gazprom, is a case in point. The ever increasing domestic leverage and extensive resource base have been effectively used to create a vast international energy empire, covering all the countries of the former Soviet Union and most of the EU with increasing appetite for additional downstream assets near to the end users of the Western Europe.

On the other hand, when we put aside the "natural" monopolies such as electricity, natural gas, armament exports, military aviation, etc., we find a composition of TNCs much more resembling to those in the developed economies with longer tradition of OFDI. While identified as a prominent trend in the recent years, the consolidation of the state ownership in Russia is first and foremost targeted to the industries already characterized by a relatively high rate of concentration of assets (such as oil, natural gas, strategic metals), and, consequently, accommodating very few significant foreign investing enterprises (FIE). With the notable exemption of the embattled oil giant Yukos, the consolidation of the state ownership has left untouched such enterprises with significant foreign investments and pursuing successful internationalization strategies.

Judging by their investment paths, most of the leading foreign investing companies among the Russian industrial corporations – Lukoil, Norilsk Nickel, RusAl, Evraz, Severstal, Sistema/ MTS, etc. – have retained at least most of their autonomy in investment decisions. Although it has become evident that no big business can survive in Russia without certain support from the high levels of the state administration, it does not mean that the companies receive instructions for daily operations from the high ranks of power. Thus far, Gazprom is the only state-owned company among the top Russian foreign investors. In many respects, the natural gas giant is the symbol of Russia's current geopolitical ambitions, being the most powerful bearer of the Russian economic (and often political) influence abroad. However, the author considers the creation of similar industrial behemoths in any other sector, such as oil or metals, highly unlikely if not impossible.

To conclude, I suggest we lack evidence for making conclusions on outright 'nationalisation' of the Russian OFDI. Rather, it would be more fruitful to examine the list of the Russian leading foreign investors in more detail, to discover the underlying investment patterns of the individual companies. As uncomforting as it might be, to witness the increasing state control over Russia's strategic industries, there is not enough evidence to suggest any straightforward implications on the foreign investments of the Russian companies, at least outside the energy sector. I claim that while it is impossible to separate Russia's foreign policy agenda from the overseas operations of Gazprom, it is equally impossible to claim its presence in the case of most of the other leading Russian foreign investing companies.

7 Conclusions

The Russian foreign investments are in a rapid rise. The Russian TNCs are the largest foreign investors among the companies from the emerging markets of the world and the value of foreign assets of the top-10 Russian investors has become threefold during the past two years. In addition, the Russian companies have advanced their internationalization through a wave of IPOs on domestic and foreign stock exchanges, expectedly raising more than $ 30 billion in 2007.

The steep growth of Russian OFDI originates both from the new investment projects and the increased valuation of the existing foreign assets. As the latter accounts for more than half of the total increase in the value of Russian OFDI stock in 2006, we may assume that the Russian companies are have succeeded in acquiring profitable assets overseas.

The Russian oil and gas companies' remain the leaders among Russian companies in terms of the total foreign asset value. However, for the first time, the oil and gas companies were overtook by the metal and mining companies in terms of the value of new acquisitions in 2006. As the Russian metal and mining TNCs have recently performed several multi-billion acquisitions, the author expects the trend to continue in 2007. In addition, the Russian telecommunication companies have recently undertook several large acquisitions overseas, already stretching beyond the CIS.

Involvement of the governmental apparatus in the Russian economy remains one of the key issues for both domestic and foreign operations of the Russian companies. The increasing state control over the large Russian enterprises has had a considerable effect on Russia's domestic business environment and economic power balance. In the author's opinion, the effects of increasing state control on foreign investments from Russia do not yet extend beyond the energy sector. The unceasing consolidation in the leading Russian industries are, however, likely to have consequential effects on the patterns and motivations of the Russian OFDI.

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