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Expansion or Exodus? – Trends and Developments in Foreign Investments of Russia's Largest Industrial Enterprises

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Electronic Publications of
Pan-European Institute, 1/2006

http://www.tukkk.fi/pei/pub

The author is grateful for the financial support of the Finnish Ministry of Education and the Foundation of Economic Education (Liikesivistysrahasto).

To the Reader,

The current report is a follow-up to the earlier publication Expansion or Exodus? – Foreign operations of Russia's largest corporations, by Peeter Vahtra and Kari Liuhto. The current report also initiates series of publications concerning foreign investments and activities of Russian companies. The reports will be published semi-annually in the electronic publication series of the Pan-European Institute. Whereas in the report at hand an update on overall developments in foreign operations of Russian largest enterprises is provided, along with recent data on Russia's international investment position, the upcoming publications in the series will offer in-depth insights into individual industrial sectors.

Since the beginning of 2000's, we have witnessed Russia's rise among the top foreign investor countries in the world, already leaving behind many developed economies of the European Union. The Russian companies are gaining increasing momentum in the international business arena, and many countries are hailing the newborn Russian FDI, often seen to increase stability and regional prosperity in particular in the EU and its neighbouring areas. On the other hand, it is not always without problems that Russian companies expand to foreign markets. Especially the recipient countries of Russian investments in the Commonwealth of Independent States (CIS) and the Central and Eastern European countries (CEEC), where the Russian enterprises often have a strong foothold, have expressed concerns over motivations behind the Russian investments. In particular, the recent developments in the energy dialogue between Russia and her neighbouring countries, EU, has again raised many questions on the political dimension of Russian investments abroad. The report at hand offers an insight into these and other current issues by providing updated information on recent developments in the Russian outward investments and their implications and leverage in the target countries.

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1 Introduction

Outward foreign direct investments (OFDI) from the Russian Federation have increased significantly. Russia is already a top outward direct investor among the emerging markets economies. Russian companies are indisputably the leaders among the international corporations based in the Central and Eastern European region. Recently, the Russian statistical authorities have taken steps to improve the data reporting system, providing a more reliable and consistent data series on Russian investments abroad. In addition to advancing foreign operations of Russian companies, hence, the improved data system in part explains the surge in the reported Russian outward investments in recent years.

Apart from the improved data reporting, surging OFDI from Russia indicate the increasing international experience and maturity of Russian companies with international business operations. Through foreign investments, the Russian companies have the advanced their international competitiveness by gaining increased access to resources, acquiring strategic assets worldwide, and conquering global market shares. High world energy and, consequently, commodity prices have brought in increasing export revenues, which have in large part supported or financed the international expansion of the leading Russian enterprises. The recent phenomenal increase in Russian foreign investments further suggests that Russian companies find investment opportunities abroad attractive, and often more so than at home. Also the shortcomings in domestic business environment, either in form of scarce investment opportunities or unfavourable governmental practices, have sometimes motivated Russian companies to seek for investment opportunities abroad. In addition, the recent legislative developments regarding the ownership of natural resources and increasing state control over the natural resource-based sector may have influence on investment behaviour by Russian companies.

Russian companies are investing abroad mainly though mergers and acquisitions. The recent developments in Russian foreign investments include the expansion of companies beyond Eastern Europe and to the non-traditional locations of the European Union and the United States. On the other hand, the CIS countries are again appearing among the most popular targets for Russian FDI, with purchases in the region significantly increasing in value. Various motivations can be found behind the internationalisation of Russian corporations, and a variety of investment schemes are employed. One of the most distinctive features of Russian OFDI is the widespread phenomenon of investment round tripping, where investments are made through offshore companies in third countries.

Although the resource-based companies in oil, gas, and metal sectors still top the list of Russian foreign investors measured by the value of foreign assets, the telecommunication companies are currently the most active foreign investors among the Russian corporations. Increasing numbers of Russian SMEs are engaging in OFDI projects, but several hindrances remain for most of the small companies to initiate more demanding foreign operations.

2 Trends and development in Russian outward investments

The recent statistical updates confirm the previous estimations on the massive amount of Russian capital abroad. Unlike in most of the economies in transition, capital outflows from the Russian Federation have repeatedly exceeded capital inflows. In addition, the ratio between outward and inward FDI is considerably higher for Russia than for any other CEEC. The recent years have witnessed growing variation in the overseas investment practices by Russian entities and the Russian enterprises are gradually engaging into more demanding investment schemes, compared to mainly export-supporting activities of early 1990s.

OFDI stock from Russia has risen rapidly, from 20 billion in the end of 2000 to $ more than 100 billion in the end of 2004 (table 1).

Table 1 Development of OFDI stock from Russia, *year-end, $ million*

	2000	2001	2002	2003	2004
Direct investments abroad	**20,141**	**44,219**	**62,348**	**90,873**	**103,692**
Equity capital and reinvested earnings	18,47	42,167	58,357	86,532	96,804
Other capital	1,671	2,053	3,992	4,341	6,888

Source: Central Bank of Russia (http://www.cbr.ru/eng/statistics).

With this amount, Russia is the second-largest outward investor among the emerging economies after Hong Kong, and ranks 15th in worldwide comparison. Although the Russian investments abroad are still negligible compared to these of the world's leading investor countries, such as USA, UK, and Japan, the growth in Russian foreign investments is among the highest in the world. In comparison to other CEECs, Russia's outward foreign investments are manifold to any other countries in that region (table 2).

Table 2 Outward and inward FDI stocks of selected economies, as of 31.12.2004.

	Outward FDI stock, *$ mln*	Inward FDI stock, *$ mln*	Outward/ inward FDI stock ratio, *%*
World	**9,732,233**	**8,895,279**	**109**
European Union	**5,189,738**	**4,023,935**	**129**
United Kingdom	1,378,130	771,658	179
Germany	833,651	347,957	240
France	769,353	535,201	144
Sweden	203,943	162,973	125
Finland	80,936	55,946	145
Portugal	45,555	65,213	70
Greece	13,056	27,213	48
Hungary	4,472	60,328	7
Czech Republic	3,061	56,415	6
Poland	2,661	61,427	4
Slovenia	2,450	4,962	49
Estonia	1,398	9,530	15
Slovakia	618	14,501	4
Lithuania	423	6,389	7
Latvia	226	4,493	5
North America	**2,387,982**	**1,777,678**	**134**
United States	2,018,205	1,473,860	137
Canada	369,777	303,818	122
Asia	**1,088,541**	**1,375,592**	**79**
Hong Kong	405,589	456,833	89
Japan	370,544	96,984	382
Singapore	100,910	160,422	63
China	38,825	245,467	16
South America	**115,456**	**353,969**	**33**
Brazil	64,363	150,965	43
Argentina	21,819	53,697	40
Commonwealth of Independent States	**106,561**	**169,072**	**63**
Russia	*103,692*	*114,926*	*90*
Other CIS	2,869	54,146	5
South-East Europe	**2,773**	**46,863**	**6**
Croatia	2,426	12,989	19
Romania	301	18,009	2
Bulgaria[1]	147	5,082	3

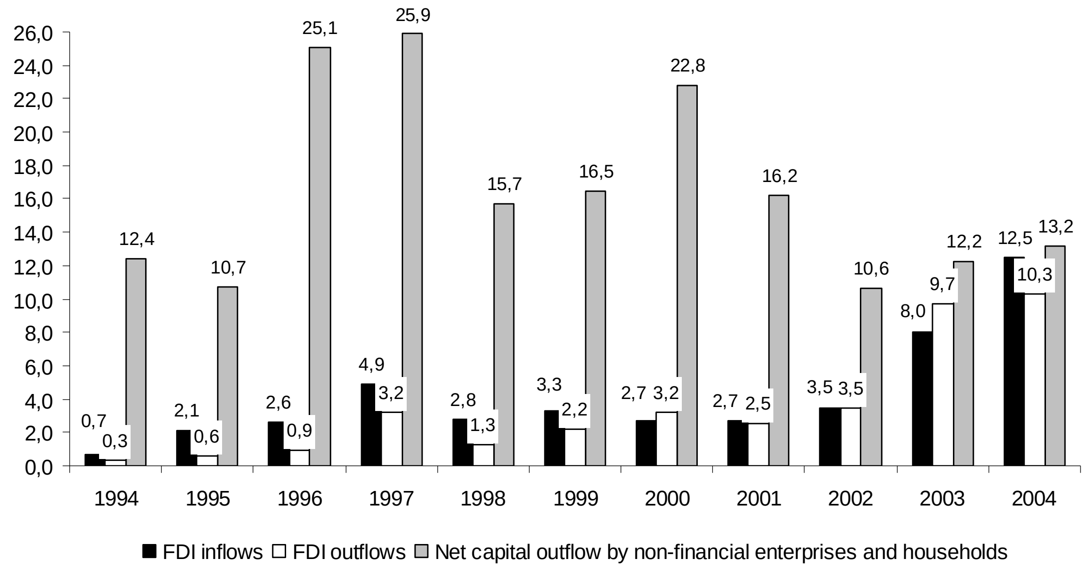
Source: UNCTAD (2005a), Central Bank of Russia (2005), author's calculations.

Recent improvements in data registering and reporting system of the Central Bank of Russia able us to draw more precise conclusions on Russian companies' investments abroad. Besides FDI, massive amount of Russian capital has flown abroad through

[1] Data from 2003.

unregistered and, in some instances, illegal channels. Although widespread controversy still exists concerning the total amount Russian investments and capital abroad, it is widely acknowledged that the actual figures are considerably higher than suggested by the official data on OFDI. Recent improvements in reporting of balance of payment data enable more reliable estimations on the capital outflows. According to the Bank of Russia, net capital outflow by non-financial enterprises and households from Russia amounted to $ 181 billion between 1994 and 2004 (Figure 1), which is largely in line with international estimations on capital flight from Russia[2]. When this total amount of capital outflow is considered, Russia ranks among the 10 largest investors and capital exporting countries in the world (Kalotáy 2005; Central Bank of Russia 2005).

Figure 1 Russian FDI flows and net capital outflows, *$ billion*



Sources: Central Bank of Russia (http://www.cbr.ru/eng/statistics), UNCTAD (2005b) (http://stats.unctad.org/fdi).

However, in the author's opinion, even the CBR estimation on private sector capital outflow does not serve as a reliable measure on Russian capital and purchasing power abroad. Namely, the composition of capital outflows from Russia highlights widespread

[2] Various estimates are provided on additional capital flight from Russia. According to the European Commission, the non-recorded capital flight from Russia totaled $ 245 billion in 1992-2002. One can, thus, only estimate the total amount of capital that has left the country under registered and non-registered investing and capital exporting schemes. Authors believe the actual amount of capital transferred abroad from Russia to be manifold to the registered transfers and investments.

misreporting and undervaluation of revenues from abroad. Put differently, Russian companies systematically undervalue their export earnings and report remittances against fictitious imports and transactions in securities. The value of this particular item[3] on the balance of payments sheet of the Russian Federation has an average annual value of staggering $ 25 billion, thus being more than twofold compared to annual OFDI from Russia. It appears reasonable to argue that at least part of these unregistered capital outflows has been used for investment purposes abroad by Russian entities.

Regarding the foreign investments from Russia, few other particularities should be pointed out. First, Russian companies have invested substantial amounts of capital through third countries and offshore locations. For instance, the continuously high rank of Cyprus among the investing countries to Russia and other CEE and CIS countries is widely believed to indicate the existence of investment units of Russian origin in Cyprus. In other words, Russian entities utilise investment companies registered to Cyprus, through which funds are either brought back to Russia in form of FDI, to obtain tax and other benefits offered to foreign investors, or, alternatively, reinvested in other countries especially in the CEE region (e.g. Pelto et al. 2003; Kalotáy 2003; Grigoryev and Kosarev 2000). Certainly, Cyprus is not the only country through which Russian capital returns home. One may track Russian origins in large-scale investments through the Netherlands, Luxemburg, and various tax havens and other offshore locations.

Second, besides capital round-tripping, the FDI inconsistencies root to the operations of Soviet enterprises abroad, the assets of which were often inherited by contemporary Russian companies. Understandably, reliable valuation of these assets becomes essentially problematic. In a degree, the recent improvements in the data registering system have addressed this problem, and, thus, the massive increase in Russian OFDI stock (see table 2) can partially be attributed to improved valuation practices of these existing foreign assets.

[3] The item "Non-repatriation of exports proceeds, non-supply of goods and services against import contracts, remittances against fictitious transactions in securities" appears on the asset side of the financial account of the Russian Federation, and was valued at $ 25.9 billion in 2004. The total assets of non-financial enterprises and households under financial account amounted to $ 32.8 billion in 2004.

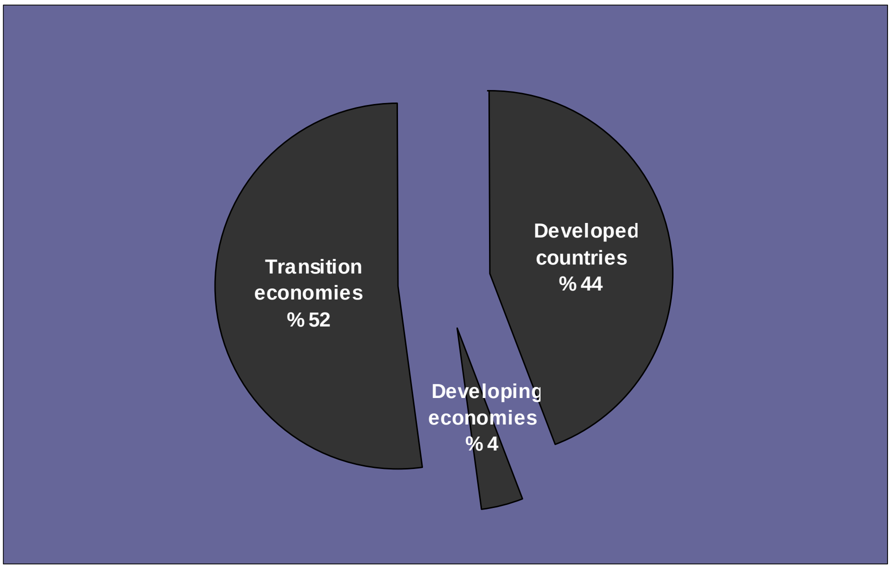
Notwithstanding the illegitimate capital exporting schemes, one must recognize the increasing international activity of Russian enterprises what comes both to exports and foreign investments. Several Russian corporations already rank among the world's leading companies in their industries, with oil, gas, and metal producers currently leading the internationalisation race. The leading Russian companies have acquired considerable foreign assets around the world, partially to support their extensive export activities, and even more so to become truly global players to cope with increasing competition on the world markets.

3. Geographical distribution of Russian foreign investments

According to the authors' estimations, the main regions receiving Russian OFDI are the EU and the Commonwealth of Independent States (CIS). Although systematic data on geographical distribution of Russian OFDI is currently not provided by any statistical institution, we estimate the EU to accommodate over one third of Russia's outward investments, and the share of CIS to stand around one fifth. Another major receiver of Russian investments is the USA with an estimated share slightly less than that of CIS[4] (Kalotáy 2003). Figure 2 roughly outlays the geographical distribution of Russian OFDI.

[4] The author express some doubts regarding the amount of Russian FDI in the USA, given relatively few large-scale investment projects by the Russian firms in the country. Similarly, we expect the actual amount of Russian investments in the CIS to be considerably higher due to the various capital round-tripping schemes and investments through third parties.

Figure 2 Geographic distribution of cross-border M&A purchases by Russian companies, 2000-2004,



Source: UNCTAD cross-border M&A database.

In general, the recent developments indicate the extending geographical and sectoral distribution of FDI projects by Russian companies. Majority of the Russian companies' foreign mergers and acquisitions have taken place during this millennium, clearly indicating the growing international activeness of the Russian firms.

2.1 Focus on the CIS

The recent investment trends by Russian companies again indicate the growing share of the CIS countries among the recipient countries of Russian OFDI. This development is also suggested by the UNCTAD (2005b) data on cross-border M&A purchases by Russian companies. Measured by the number of deals, over a half of the Russian M&A purchases have taken place in the CIS region, whereas the developed countries account for somewhat smaller share. For many Russian companies, the CIS region has been the first step on their way towards the global markets. The Russian natural resource-based companies already hold a strong grip on some particular segments of the CIS markets and have moved their focus beyond the CIS, whereas the manufacturing and telecommunication companies have more recently entered into their first investment projects in the CIS region.

However, in several instances, the CIS markets are as strategic a target for Russian companies as the Western markets. In many occasions, the assets controlled by Russian companies in the CIS countries also tend to be more controversial in nature, such as energy and infrastructure assets. In addition, the Russian companies tend to be dominant players in several CIS markets, whereas in developed economies they often hold smaller market shares and leverage in respective industries. One should give further attention to the fact that although the value of assets purchased in the developed economies has traditionally exceeded this of the assets in transition economies, the Russian companies' investments into CIS region have dramatically increased in value during the recent years.

The official statistics on Russian investments in the CIS give an essentially misleading image of the reality. According to the somewhat differing Russian and CIS statistics, the CIS region accounts for between 1 and 5 per cent of the Russia's total OFDI. In this respect, thus, one might regard Russia as a negligible investor in the region. To achieve a more realistic overview, we shall look at the following example. According to the Russian Federal State Service (Goskomstat 2005), the country's OFDI flows to the entire CIS region totalled $ 713 million in 2004 (Table 3). In contrast, the recent years have witnessed several acquisitions in the CIS by Russian energy and telecommunication majors with many of the individual transactions valued more than the total investments from Russia as reported by Goskomstat. This discrepancy can partially be explained by the fact that the major Russian companies invest abroad through offshore investment units and the investments are thus not shown on the balance of payments sheet of the Russian Federation. In addition to capital round-tripping, often the investments by Russian companies are not regarded as FDI by definition. In particular, this goes for the massive investments in the energy sector exploration and infrastructure projects, operated by existing (financial) subsidiaries. After a company or joint venture is established, the further investments in this company are not regarded as FDI. Notwithstanding the fact that these investments do not appear in the FDI statistics, we claim that they significantly add to the leverage of investing companies in the target country.

Table 3 Russian FDI flows to the CIS countries, 2000-2004.

	2000		2002		2003		2004	
	$ ´000	*%*	*$ ´000*	*%*	*$ ´000*	*%*	*$ ´000*	*%*
Total	**130,981**	**100**	**239,692**	**100**	**544,141**	**100**	**713,016**	**100**
Azerbaijan	26	0.2	92	0.0	1,613	0.3	2,379	0.3
Armenia	5	0.0	4,321	1.8	7,650	1.4	1,033	0.2
Belarus	77,238	58.9	98,292	41.0	243,355	44.7	280,193	39.3
Georgia	133	0.1	-	-	1,182	0.2	284	0.0
Kazakhstan	3,453	2.6	6,143	2.6	27,135	5.0	84,104	11.8
Kyrgyzstan	7	0.0	1,400	0.6	608	0.1	628	0.1
Moldova	31,224	23.8	192	0.1	372	0.1	6,600	0.9
Tajikistan	-	-	71	0.0	18	0.0	3,067	0.4
Turkmenistan	2,934	2.2	855	0.4	857	0.2	1,865	0.3
Uzbekistan	929	0.7	2,027	0.8	582	0.1	138,547	19.4
Ukraine	15,032	11.5	126,299	52.7	260,769	47.9	194,316	27.3

Source: Goskomstat (2005).

3 Foreign investments by Russia's largest industrial corporations

As elaborated above, outward investments from Russia are driven by large industrial conglomerates especially in the natural resource-based industries. Up to date, the majority of Russian OFDI has been carried out by relatively few industrial giants, whose significant export revenues have played a key role in supporting and financing the growth of their overseas business expansion and acquisitions. In estimation, oil & gas sector covers nearly 60% of the value of OFDI by Russian companies, thus, following the country's export structure. The ferrous and non-ferrous metal companies are currently the most active international expanders among the traditional industrial sectors, accounting for around one fourth of Russian companies' investments abroad.

Apart from traditional natural resource-based industries, the Russian telecommunication companies have started aggressive foreign expansion and race for assets especially in the neighbouring CIS countries. The foreign acquisitions by Russian telecom companies have dramatically increased in value; a recent example of such development is the reported $ 3 billion-bid by Altimo (formerly Alfa Group) for a Turkish mobile operator in late 2005.

Table 3 outlines the leading Russian companies ranked by their foreign assets. In many occasions, valuation of such assets is highly problematic due to numerous shortcomings in the companies' reporting practices, especially what becomes to non-publicly-traded or closed joint stock companies. The problem is often further alleviated in case of state-owned companies, and Gazprom in particular[5].

[5] The vast holding structure comprises close to one hundred foreign subsidiaries and affiliates around the world, most of which are controlled by offshore financial units of Gazprom. In the absence of corporate reporting on the value of such asset collection, we are often obliged to make rough estimations on its present value. Hence, despite the actual figures at hand, we rank Gazprom number one among the Russian transnational corporations, given the considerable extent of the company's foreign energy and infrastructure assets.

Table 4 Russian top 10 companies ranked by foreign assets, as of 1.1.2005

Company	Industry	Assets		Sales	
		Total	*Foreign*	*Total*	*Foreign*
Gazprom	Oil and gas	104 982	…	36 422	16 149
Lukoil	Oil and gas	29 761	10 663	33 845	26 428
Norilsk Nickel[6]	Non-ferrous metals	13 632	2 618	7 033	5 968
Russian Aluminium[7]	Non-ferrous metals	11 500	2 165	5 450	4 440
Mobile TeleSystems	Telecommunications	5 581	1 214	3 887	995
VimpelCom[8]	Telecommunications	4 780	852	2 147	45
Severstal	Ferrous metals	5 919	666	6 648	3 954
Yukos[9]	Oil and gas	18 514	607	16 566	12 546
Rosneft	Oil and gas	25 987	319	5 275	3 438
OMZ	Heavy engineering	901	347	524	272
UES of Russia	Electrical energy	40 613	211	24 493	441

Sources: Company information, author's calculations.

3.1 Oil and natural gas

The Russian oil and natural gas sector continues to grow on the back of high global energy prices. Despite the somewhat modest expectations of many industry experts, the year 2005 show decent growth of 6.6 percent in the country's oil production, if not considering the Yukos factor. The continuing probe against Russia's once-largest oil producer left its mark on overall performance of the industry in 2004-2005, but the revival of the oil sector is expected in 2006, once the reconsolidation process of the former Yukos subsidiary, Yuganskneftegas, into the state-owned Rosneft's holding structure is completed.

Although the oil and gas sector remains the backbone of Russian foreign investments, two single companies, Gazprom and Lukoil, are responsible for over 90 percent of the sector's investments abroad. Above all, Lukoil is strengthening its position as Russia's number one oil producer and the most international company, measured by the ratio of foreign assets and sales to the company's total assets and sales. Although we currently estimate the value of Gazprom's foreign assets slightly to outperform those of Lukoil, the latter is clearly set to take over the leading position in the near future. As the most recent sign of such

[6] Foreign assets include the estimated value of 20 percent of Gold Fields Ltd, to be incorporated in the 2005 financials.
[7] RusAl is not a public company and does not disclose its financial data in a consistent manner. The figures are based on scarce company information and the author's calculations.
[8] Foreign assets include the estimated value of two Uzbek mobile operators acquired in early 2006.
[9] As of September 2003. Yukos Oil Company has not provided financial statements after 9/2003.

development, we consider the takeover of Canadian-based Nelson Resources by Lukoil in the largest-ever foreign acquisition by a Russian company, valued at $ 2 billion.

As a whole, we see the Russian oil and gas sector characterised by strong consolidation tendencies. Whereas the gas sector remains in strong grip of Gazprom, the oil sector is increasingly being split up by two entities only – the fast-growing and increasingly global-minded Lukoil, and the state-owned Rosneft, now the country's number-two producer. When adding to the picture the recent takeover of Russia's fifth-largest producer, Sibneft, by Gazprom, consequently putting the Russian State in control of over one third of the country's oil production, further sectoral dynamics appear increasingly limited. Among the other vertically-integrated oil companies, the Russian-British joint venture, TNK-BP, has shown impressive production and export growth in 2004-2005, but is unlikely to considerably expand beyond the Russian borders. In the BP's global strategy, the Russian joint venture primarily serves the role of upstream subsidiary, and, thus, active internationalisation of the company seems unlikely.

In the following, the recent internationalisation tendencies of the leading Russian oil and gas companies are laid out.

Gazprom is the largest Russian corporation and taxpayer, and the world's largest natural gas producer and exporter. The company is the most transnationalised Russian corporation in terms of foreign assets, foreign sales and the spread of its international operations. Gazprom has operations in 17 countries in the European Union, involving natural gas distribution and processing activities. In addition, Gazprom has operations in nearly all of the CIS countries (table 5). Foreign acquisitions by Gazprom largely follow its natural gas export markets. In the Baltic States, Finland, and several CIS countries, Gazprom is the sole provider of natural gas. The main motives behind Gazprom OFDI activities are to strengthen its market position in its traditional export markets, tap new market opportunities and internalise its value chain business activities. OFDI has helped the company achieved a strong international presence, which has provided Gazprom with substantial leverage, both economically and politically, in several of its key markets and in the CIS region in particular.

In September, 2005, Gazprom signed an agreement on the construction of the North-European Gas Pipeline (NEGP), running from Russia through the Baltic Sea to Germany. Gazprom holds a 51%-share in the joint German-Russian venture, established for the construction of the pipeline. The estimated $ 4-billion project is expected to improve the reliability of Russian gas deliveries to Europe and to cover the rising demand for natural gas especially in Germany. The NEG pipeline also strengthens Gazprom's position as an energy supplier to Western Europe. Currently, the Russian giant provides around 25 percent of the gas consumed in Europe; the share is expected to rise to one third after the completion of the pipeline project.

Table 5 Gazprom's foreign subsidiaries and affiliates

Country	Company	Type of operations	Gazprom's share, %
Armenia	Armrosgazprom	Gas distribution	45
Austria	Gas und Warenhandelsgesellschaft	Sale of gas	50
Bulgaria	Overgaz	Gas distribution	23
	Overgaz Incorported	Investing	50
	Topenergo	Gas distribution	100
Cyprus	Leadville Investments Ltd.	Investing	100
Czech Republic	Gas Invest	Investing	n.d.
Estonia	Eesti Gaas	Gas distribution	37
Finland	Gasum	Gas distribution	25
	North Transgas OY	Gas transportation	50
France	Fragaz	Gas trading	50
Germany	Wingas	Gas distribution	35
	WIEH	Gas distribution	50
	ZMB	Gas distribution	100
	GWH	Gas distribution	100
	ZGG	Gas distribution	100
Greece	Prometheus Gas	Foreign trade	50
Hungary	Panrusgaz	Sale of gas	40
	Borsodchem	Petrochemical production	25
	DKG-EAST Co. Inc	Gas trading	38
	TVK		14
	General Banking and Trust	Investing	26
Italy	Promgaz	Gas distribution	50
	VOLTA S.p.a	Gas trading	49
Kazakhstan	KazRosGaz	Gas distribution	50
Latvia	Latvijas Gaze	Gas distribution	34
Lithuania	Lietuvos Dujos	Gas distribution	34
	Stella Vitae	Gas distribution	50
	Kaunasskaya power station	Electricity	99
Moldova	Moldovagaz	Gas distribution	50
Netherlands	Gazprom Finance B.V.	Investing	100
	Blue Stream Pipeline Company	Construction, gas transportation	50
	West East Pipeline Project Investment	Construction, inversting	100
Poland	EuRoPol GAZ	Gas distribution	48
	Gas Trading	Sale of gas	16
Romania	Wirom	Gas distribution	25
	WIEE	Gas distribution	50
Serbia-Montenegro	Progresgaz Trading Ltd.	Gas distribution	25
Slovakia	Slovrusgas	Gas trading	50
	Slovenský Plynárensky Priemysel	Gas distribution	16
Slovenia	Tagdem		n.d.
Turkey	Turusgaz	Sale of gas	45
UK	Gazprom Marketing and Trading Ltd	Gas distribution	100
	Gazprom UK Ltd	Investing, banking	100
	Interconnector (UK) Ltd	Gas trading	10
	HydroWingas	Gas distribution	50

Source: Company information.

Lukoil is the most international Russian corporation, measured by its foreign assets and sales in relation to the company's total assets and sales. Lukoil possesses substantial foreign assets around the world (table 6) and more than 80% of the company's revenues were generated abroad in 2004. In upstream production activities, the company has strong presence in resource-rich Middle-East region and the CIS countries, whereas the company's downstream assets are concentrated near its main export markets of the European Union and the United States. Lukoil operates extensive petroleum retail chains in the Baltic States, several of the CIS countries, CEEC and in the United States. In addition, the company operates three updated oil refineries in Eastern Europe, which supply the key export markets of European Union and other CEEC. In upstream activities, Lukoil's foreign production ventures serve to extend the company's hydrocarbon resource base and to partially cover the depletions of its domestic resources. The main motivations behind Lukoil's foreign investments are extending the resource base and internalising the value chain internationally. The international acquisitions have provided the company with strong positions in several of the CEE countries, and more recently in the United States, thus, considerably advancing its global competitiveness.

Recently, Lukoil has made a number of strategic acquisitions abroad, which have helped the company secure prominent presence in some of its key markets. In 2004, Lukoil expanded its retail network in the United States by purchasing 795 petroleum stations from ConocoPhillips for $ 266 million. In the beginning of 2005, the company announced the acquisition of 100% of the second-largest petroleum retailer in Finland, Teboil, and its sister company, Suomen Petrooli. The deal is valued at $ 270 million and provides Lukoil with a strong foothold not only on the Finnish, but also on the Scandinavian petroleum markets. Through the acquisition, Lukoil is capable of considerably altering the competition structure on the Finnish market with its own petroleum products. In 2005, Lukoil further strengthened its ownership in Bulgarian refinery of Burgas, and acquired additional petroleum stations in Hungary. The acquisitions are in line with the corporate program stipulating intensive development of the downstream sector in Central Europe.

In the end of 2005, Lukoil considerably strengthened its position in the Kazakh oil industry, by acquiring a Canadian-based Nelson Resources, operating several exploration and production sites in Kazakhstan. The deal is thus far the largest FDI in Russian corporate history, amounting to impressive $ 2 billion. Once completed, the acquisition is to considerably enhance Lukoil's position in the Kazakh oil industry, characterised by fierce competition between the international oil majors. Besides the acquisition, Lukoil has recently reported having further interests for asset purchases in the country. The claims are strongly backed by the ambitious investment plans for 2006, published recently.

Table 6 Overview on Lukoil's foreign assets

Type of assets	Countries
Oil & gas production and exploration	Azerbaijan, Colombia, Egypt, Iran, Iraq, Kazakhstan
Petroleum retailing	Bulgaria, Cyprus, Czech Republic, Estonia, Finland, Greece, Kazakhstan, Latvia, Lithuania, Moldova, Poland, Romania, Serbia-Montenegro, Turkey, Ukraine, UK, USA
Petrochemical production	Bulgaria
Investing & services	Bulgaria, Canada, Columbia, Cyprus, Denmark, Egypt, Kazakhstan, Lithuania, Netherlands, Saudi-Arabia, UK, Ukraine, USA, Yemen

Source: Company information.

Yukos, the formerly Russia's largest oil producer, is currently on the verge of collapse, hammered by the massive tax evasion and fraud charges, initiated by Russian authorities in 2003. In the late 2004, Yukos lost its main production outlet, Yuganskneftegas, auctioned off by the State authorities to cover the enormous tax debts of the parent company. For the time being, Yukos remains to control considerable foreign assets in the neighbouring countries. We expect the market value of Yukos' foreign assets to exceed $ 1 billion.

Yukos emerged as a notable actor in the global oil business during the early 2000s and has foreign operations in the Baltic States, the CIS, and CEE region. In the beginning of 2002, the company acquired 78% of an oil and gas exploration block in Kazakhstan. In the same year, Yukos acquired a 49%-share in Transpetrol, a Slovak pipeline operator, through which the company controls the Slovakian sector of one of Russia's main oil export outlets, the Druzhba pipeline. In mid-2002, Yukos obtained a controlling stake in a Lithuanian oil refining and seaport complex Mazeikiu Nafta. Pursuing active internationalisation strategy, Yukos was among the most transnational Russian enterprises before the crisis. However, the deprival of Yukos' main domestic production outlets is likely to be followed by asset losses abroad as well. Several Russian producers, including Lukoil, TNK-BP, and Gazprom, have already expressed strong interests towards acquiring Yukos' foreign subsidiaries, and Mazeikiu Nafta in particular. The company is the only oil refinery in the Baltic States, holding considerable strategic value due to its location and capacity. The market value of Yukos' 54% stake in the company is estimated to amount to $ 1 billion.

Table 7 Main foreign affiliates of Yukos

Country	Company / venture	Type of assets	Yukos' share, %
UK	John Brown Hydrocarbons Davy Process Technology	Oil drilling & refining equipment	100
Slovakia	Transpetrol	Pipeline operator	49
Kazakhstan	Federovsky block	Oil & gas exploration	78
Lithuania	Mazeikiu Nafta	Oil refinery, pipeline system, and seaport	54

Sources: Company information.

Rosneft is Russia's largest state-owned oil company and the second-largest oil producer in the country, following its purchase of the main production subsidiary, Yuganskneftegas, of the embattled oil giant, Yukos. Rosneft's experience in international operations dates back to the Soviet era and up to date, the company is engaged in various foreign ventures based on intergovernmental agreements. Besides its extensive export activities, Rosneft participates in several foreign upstream ventures, including oil & gas production in Algeria, Colombia, and Kazakhstan. In addition, the company controls upstream assets in Afghanistan.

The strengthening of Rosneft's position in Russian oil industry and the consequent increase in state control over the sector may have further implications on the motivations and transparency of internationalisation processes of the Russian oil companies. However, it appears unlikely that Rosneft would take over any significant Yukos' foreign assets. Firstly, the current Yukos assets do not fall well into the asset portfolio of Rosneft, concentrating on upstream ventures in its foreign activities. In addition, there is growing opposition in the host countries' governments, to sell the assets of a strategic importance to a Russian state-owned company. Hence, the private Russian producers Lukoil and TNK-BP appear as more likely buyers of Yukos' foreign assets.

The **Itera Group**, the second-largest natural gas distributor in Russia and the CIS, has headquarters in the United States. The company has acquired shares in gas distribution companies and several production facilities throughout the Baltic States and the CIS. Through its acquisitions of distribution and infrastructure assets in the region, Itera has emerged as a major gas supplier especially in the Baltic States. In addition, some of Gazprom's supply contracts in the CIS have been transferred to Itera. In the United States, Itera owns a 70% share in an oil and gas field development company. The Itera International Group of Companies comprises some 150 enterprises in Russia, the CIS, Western Europe, and the United States. Apart from the production, distribution, and manufacturing outlets (table 8), Itera has acquired or established several financial units in Cyprus and Switzerland. Itera does not appear on the list of largest Russian investors (table 3) due to the fact that the company does not disclose any financial information nor a detailed corporate structure or asset valuations.

Table 8 Foreign ventures of Itera Group

Country	Company / venture	Type of assets	Itera's stake, %
Armenia	Armrosgazprom	Gas distribution	10
Belarus	Itera-PET	Plastic manufacturing	100
	Belpak	Production of PET granules	n.d.
Estonia	Eesti Gaas	Natural gas operator	10
Georgia	Azot	Production of fertilisers	n.d.
	11 gas distribution firms	Gas distribution	majority stakes
Latvia	Itera Latvia	Gas delivery and marketing	100
	Latvijas Gaze	Natural gas operator	25
Moldova	Moldovan Metal Works	Metallurgic production	75
	Moldkarton	Cardboard manufacturing	majority stake
Turkmenistan	Zarlt	Oil and gas field development	37
USA	Itera International Energy Corp.	Headquarters of Itera Group	100
Uzbekistan	Gazli-Kagan	Gas pipeline reconstruction	n.d.

Source: Company information, authors' estimations.

3.2 Electricity

Russian electrical energy monopoly, UES of Russia, is a powerful bearer of Russian influence near abroad and in the CIS region in particular. UES is preparing to launch several energy projects in the CIS, including expansion of electricity exports and operation of national energy companies. Exports to CIS countries are the priority of UES' foreign economic activities and one of the primary sources of funding of the investment projects.

In the former Soviet territory UES has established a single energy area and operates parallel with the energy systems of nearly all the former Soviet Republics. The expansion of the Russian energy giant in the CIS has been controversial in many occasions. On one hand, the system considerably increases the reliability of our CIS countries' energy systems maintaining high quality of electricity based on common technical standards. On the other hand, the arrangement offers UES indisputable access to neighbouring countries energy networks making many of the countries in the region subservient to Russia's energy policy interests. In several instances, political motivations are seen to have driven the expansion of UES in the neighbouring countries.

Since 2003 UES has enhanced the activities of its subsidiaries directly operating on the foreign markets, enabling UES to switch from wholesale electricity sales to foreign energy companies to supplying electricity to end consumers. The subsidiaries of UES act both as retailers of Russian electricity and as organisers of electricity supplies to third countries, exports to which directly from Russia is inefficient due to high electricity transit tariffs.

In Georgia, UES purchase of shares in several energy facilities in 2004. The acquisitions include a 75 per cent stake in a power grid company, AES Telasi; sole ownership of the energy supplier to Georgian capital Tbilisi, AES Mtkvari; 50 per cent stake in energy exporter AES Transenergy; and management two hydroelectric power plants owned by AO Khramesi. Altogether, the deal puts UES in control of 20 per cent of Georgia's power generation capacity and some 35 per cent of electricity supplies to domestic consumers. Besides the prominent position in the Georgian market, the arrangement provides UES with possibility to expand its electricity exports to Georgia's lucrative neighbouring markets of Turkey.

Among UES' further interests in Georgia are the updating and management rights of the Inguri HPP hydroelectric plant in the country. In addition, UES has been reported of eyeing the possibility of restoring power plants in Abkhasia, requiring dozens of millions USD in investments. According to industry experts, resuming the operation of these facilities would provide further options for feasible electricity exports to Turkey and Azerbaijan.

In Armenia, UES manages several power facilities, including Razdanskaya TPP, Armenian NPP, and five hydroelectric plants part of Sevar-Razdansky HPP chain. In addition, UESis eyeing the possibility of gaining control over cross-border transmission lines linking Armenia with Georgia, Iran, and Turkey, all operating on common technical standards. The transmission lines would make it economically feasible to sell excess electricity from Armenia's energy system to the above-mentioned countries.

In Moldova, UES controls the power plant of Moldavskaya TPP. The current upgrade of the power plant will make it possible to export up to 5 TWh of electricity to Romania and Bulgaria.

In Ukraine, UES is reportedly seeking potential targets for acquisition. Currently, UES operates a trading company in the country. According to industry experts, Ukraine would offer UES business opportunities not only in bilateral trade operations and electricity transit, but also in implementing joint projects to export electricity to European countries.

In Belarus UES operates a power facility, Berezovskaya TPP, supplying electricity to Poland. The ongoing upgrade of the facility is to considerably increase its capacity.

Table 9 Foreign subsidiaries of UES of Russia

Country	Company	Nature of business
Armenia	MEC	Energy trading
Austria	Terawatt	Energy trading
Bulgaria	RAO UES International Bulgaria	Energy trading
Finland	RAO Nordic	Trading and holding company
Georgia	Telasi	Power supply
	Mtkvari Energetika	Power supply
	Khrami HPP-I and HPP-II	Power supply
	Power Grids of Armenia	Power supply
	Armenian NPP	Power supply
Moldova	Moldovan GRES	Power supply
Netherlands	Gardabani Holdings B.V.	Holding company
	ES Georgia Holdings B.V.	Holding company
	Silk Road Holdings B.V.	Holding company
	Interenergo B.V.	Holding company
Serbia and Montenegro	RAO UES International Balkans	Energy trading
Ukraine	RAO UES International Ukraine	Energy trading

Source: Company information.

3.3 Non-ferrous metals

Norilsk Nickel is the world's largest producer of several strategic metals, including nickel and palladium. The company is one of the largest industrial producers in Russia and the largest mining company in the country. Norilsk Nickel has established representative and sales offices in Europe and the United States to strengthen its market position and export and distribution channels. The company is set to further strengthen its position as one of the world's leading producer. Norilsk Nickel has reported the analysis and effective exploitation of new strategic opportunities in Russia and abroad to be among the most important areas of the company's activities. Given this, the company recently set up a structure that deals exclusively with mergers and acquisitions. The recent two large-scale investments by Norilsk Nickel are mainly resource-seeking in nature. The company controls a majority stake in **Stillwater Mining** (United States), which is the world's fifth-largest producer of platinum group metals (PGM). The acquisition considerably strengthened Norilsk Nickel's position in the world PGM market. In 2004, Norilsk Nickel acquired a 20%-share in one of the world's largest gold producers, South Africa's **Gold Fields Ltd.** At the time, the $ 1.2-billion acquisition was the largest individual FDI by a Russian company. (table 8). The acquisition, along with the consolidation of the Norilsk

Nickel's domestic gold mining assets, is in line with the company's strategic objectives of becoming a world-class gold producer.

Table 10 Principal foreign subsidiaries of Norilsk Nickel

Country	Company	Nature of business	Norilsk Nickel's Share, *%*	Esimated value, *$ mn*
Belgium	Norgem SA	Market agent	51	n.d.
China	Norilsk Nickel Asia	Market agent	100	n.d.
Great Britain	Norimet Ltd.	Market agent	100	320
	Norilsk Nickel Europe Ltd.	Market agent	100	n.d.
Luxembourg	Norilsk Nickel Finance	Bond issuer	100	n.d.
South Africa	Gold Fields Ltd.	Mining	20	1 100
Switzerland	Norilsk Nickel Holding SA	Investment holding	100	30
	Metal Trade Overseas SA	Market agent	100	220
USA	Stillwater Mining Company	Mining	55	540
	Norilsk Nickel USA	Market agent	100	n.d.

Sources: Company information.

Russian Aluminium (RusAl) is the country's largest non-ferrous metal producer and the third-largest aluminium producer in the world. In the author's estimation, the company ranks among the top Russian companies measured by foreign assets. RusAl is the flagship entity of Russia's largest financial-industrial holding, Basic Element. RusAl controls an extensive network of production outlets worldwide, from the neighbouring CIS countries to Australia and Africa. Due to limited domestic raw material reserves, RusAl has expanded its raw material base by acquiring two bauxite mines in Guinea. In 2005, RusAl finalised the purchase of a 20%-stake in the world's largest alumina refinery, Queensland Alumina (QAL) of Australia. The value of the deal amounted to $ 460 million. The acquisition is extremely strategic in nature, strengthening not only the RusAl's raw material stock but also the company's position in the world aluminium markets. The acquisition is to expand RusAl's raw material base by more than 20%, and further expansion of QAL is expected in near term. RusAl possesses two additional giant alumina refineries in Ukraine. Besides expansion of the raw material base, the foreign acquisitions have fuelled growth in the company's value-added aluminium production. The foreign operations of RusAl are additionally targeted to outsourcing of service functions and, thus, increased rationality in the company's worldwide operations (table 11). The largest foreign investments of RusAl have thus far mainly been resource-seeking in nature, strengthening the company's position among world's leading aluminium producer.

Table 11 Major foreign affiliates of RusAl

Country	Company	Type of assets	RusAl's share, %	Estimated value $ mn
Armenia	Rusal Armenal	Foil mill	100	n.d.
Australia	Queensland Alumina	Aluminium production and refining	20	475
Guinea	CBK	Bauxite mining complex	100	250
	Alumina Company of Guinea	Aluminium production	>50	200
Kazakhstan	Eurasian Aluminium Company	Alumina refinery & smelter (under construction)	50	1 000
Romania	Cemtrade	Alumina refining	n.d.	n.d.
Ukraine	Nikolayev Alumina Refinery	Alumina refining	100	75

Sources: Company information, Rustocks.com (http://www.rustocks.com), author's calculations.

3.4 Ferrous metals

The major Russian steel holdings rank among the most active Russian companies regarding foreign investment activities. The two largest Russian steelmakers, Evraz Holding and Severstal, are aggressively bidding for production outlets across Europe. Severstal has already expanded to North America through its acquisition of a local steel producer. Gaining an increasing foothold on the international markets, the Russian steelmakers are pursuing more aggressive internationalisation strategy than what has been witnessed among the former success stories in the industry, such as that of Mittal Steel. Instead of gradual production expansion approach, starting from relatively undeveloped markets, the Russian manufacturers are straightforwardly seeking assets in developed Western countries nearby their main export markets. Whether the aggressive strategy will pay off, remains to be seen; financial experts have expressed some concerns over increasing indebtedness of the Russian companies caused by massive foreign takeovers. In addition, the quality of foreign assets acquired has been questioned by some analysts, given the usually weak financial conditions of the target companies. Developments over the next years will show whether the expressed concerns appear relevant; the developments in world steel industry will be further affected by the global awakening of vast Chinese producers, which are increasingly seeking foreign markets for their growing production.

Severstal is one of the largest steel producers in Russia and pursues one of the most aggressive internationalisation strategies among the Russian industrial majors. Apart from several representative offices and marketing units abroad, in 2003 Severstal acquired an US steel producer, **Rouge Industries,** for $360 million. The acquisition provides Severstal with efficient means to circumvent the US steel import restrictions and considerably strengthens the company's position in the world steel market. According to the company statement, the acquisition of Rouge Industries, Ford Motor Company's largest steel supplier, would allow it to boost sales to the United States and give Severstal access to the U.S. market for a long time. Also in other fronts, Severstal pursues aggressive internationalisation strategy and has recently bid for several steel producers in the CIS countries, Europe, and North America.

In the beginning of 2005, Severstal acquired a 62%-share in a major Italian steel producer, **Lucchini Group**. The reported value of the deal totalled $ 574 million. The Lucchini Group, which comprises over 20 factories across Europe, went through a serious financial crisis and the sell-out of the majority share was a part of the corporation's financial restructuring program. The acquisition seems to be in line with Severstal's strategy aimed at boosting its production capacities. In addition, the acquisition of the European company will enable the Russian company to gain a stronger foothold on the European market, bypass the EU import quotas, and increase its output and sales of high value added products.

Severstal's recent international expansion through strategic asset-seeking investments is aimed to strengthen the company's position among the world's top steel producers. Acquisitions of underperforming production assets on strategic markets of the United States and European Union provide Severstal with cost-efficient opportunities to increase its production capacities and gain market access through local production outlets. The internationalisation strategy of Severstal, thus, contradicts that of many other Russian TNCs, which have started their expansion from the neighbouring markets of CIS. Instead, Severstal is pursuing aggressive expansion strategy in developed markets. In addition, the company has not pursued a traditional stage model approach to internationalisation but has rapidly engaged in foreign acquisitions.

Evraz Holding is the largest steel producer in Russia measured by combined output of the plants in the holding structure. The recent strategy of the holding appears to comprise international acquisitions, and during 2004-2005, Evraz has participated in several privatisation tenders across the CIS and CEE. At the time of writing this report, Evraz has completed successful takeover of the largest steel producer in the Czech Republic, Vitkovice Steel. According to the company source, the price of the acquisition totalled $ 287 million.

3.5 Telecommunications

In recent years, the Russian leading telecommunication service providers have conquered markets throughout the CIS region. For the Russian mobile operators, the CIS represents a relatively unsaturated and rapidly growing market area. With the domestic mobile penetration rate nearing 80 per cent, the Russian operators are eagerly eyeing the lucrative neighbouring markets. The largest Russian telecom companies have already expressed their further interests to expand beyond the CIS markets and to India and China in particular.

Currently, the CIS mobile telecom markets are almost exclusively dominated by the Russian companies. In the top of the list is Ukraine, where the Russian operators hold a combined market share of nearly 75 per cent. In future developments, the Russian companies are looking to establish strong positions in the undeveloped mobile markets of Uzbekistan, Tajikistan and Turkmenistan in particular.

Among the most recent developments is the acquisition of the Kazakhstan's second-largest mobile operator, Kar-Tel, by the number two Russian mobile service provider, VimpelCom, for the price of $ 425 million. The subscriber base of Kar-Tel currently nears one million, representing the market share of over 30 per cent in Kazakhstan.

As elaborated above, similar developments have been witnessed in many CIS countries. In Ukraine, the Russian largest operator, MTS, controls the majority share of Ukraine's leading mobile operator, Ukraine Mobile Communications (UMC), with a subscriber base of 2.5 million. In addition, MTS controls 75 per cent of the largest mobile operator in

Uzbekistan, Uzdunorbita. In Belarus, MTS holds a 49 per cent share in MTS Belarus, currently the leading mobile operator in the country.

Adding to the list, Altimo (formerly Alfa Group), a Russian holding company and the majority owner of VimpelCom, controls 40 per cent of the second-largest mobile service provider of Ukraine, KyivStar. In 2004, Altimo also bought the only mobile operator in Turkmenistan, Bashar Communications Technology, for the price of $ 55 million. Additionally, in late 2005, Altimo announced its readiness to pay as much as $ 3 billion for one of the largest Turkish mobile operators. Should the acquisition be realised, it were the largest-ever foreign takeover by a Russian company.

Mobile TeleSystems (MTS) is the top non-natural resource-based company among the Russian companies ranked by foreign assets. MTS is Russia's largest mobile operator. The company has successfully entered the CIS markets in recent years with substantial investments. MTS currently pursues aggressive market-seeking strategy having operations in virtually all the countries in the CIS region. The company's presence is the strongest in Ukraine, where it has a sole and fast-growing subscriber base. MTS owns the majority share in Ukraine's largest mobile operator, **Ukraine Mobile Communications (UMC)**. In 2004, MTS acquired a 74%-share in Uzbekistan's leading operator, **Uzdunorbita**, for the price of $ 121 million. With its recent acquisitions in the CIS region, MTS has successfully entered one of the fastest-growing and most unsaturated mobile market areas in the world, strengthening the company's leading position among the Russian mobile operators. MTS further controls a 49%-share in the largest operator in Belarus.

In addition to the shares in local telecom operators, MTS has substantial infrastructure assets in the region. The growing and unsaturated CIS markets provide vast possibilities for Russian telecom operators and, thus far, MTS has outperformed its domestic competitors in the race for these lucrative markets. The company statements (Mobile TeleSystems 2005) emphasise further acquisitions in the region, which would strengthen the company's position given the low mobile penetration rates and huge growth potential in CIS countries.

An active market-seeking strategy has granted MTS the position of a market leader both in Russia and the CIS region. Apart from rapid economic growth in the area, the reasons for internationalisation towards the CIS markets mainly include the geographical proximity and historical ties, which have in many cases led to close political relations and similar business practices, especially what comes to the markets of Belarus, Uzbekistan, Tajikistan, and Kazakhstan. In addition, the OFDI by MTS partially indicate the "follow you consumer" strategy, since several large corporate clients of MTS have already entered the CIS markets.

VimpelCom is currently the most active international expander among the Russian telecom companies. Similar to other Russian mobile operators, the CIS region is the initial target for VimpelCom's outward expansion.

In early 2006, VimpelCom announced the acquisition of the second- and fourth largest mobile operators in Uzbekistan, **Unitel** and **Buztel**, together for around $ 275 million. With the acquisition, VimpelCom follows its main competitor, MTS, in the relatively promising and unsaturated Uzbek market.

In September 2004, VimpelCom acquired the second-largest mobile operator in Kazakhstan, **Kar-Tel**, for $ 350 million, and took over the company's $ 75-million debts. VimpelCom bought the Kazakh company through its Cypriot-based subsidiary, Limnotex, which is in turn owned by a Dutch-based company VimpelCom Finance B.V., wholly owned by VimpelCom.

Kar-Tel is the fastest-growing operator in Kazakhstan, with its current subscriber base nearing one million, representing a market share of 31 per cent. Given the strong domestic economy and low mobile penetration rate of 13 per cent, Kazakhstan is considered one of the most promising mobile telecom markets in CIS.

In April 2005, in accordance with its business development strategy to find a partner in Kazakhstan with local market knowledge, VimpelCom agreed to sell a minority share of 50 per cent minus one share in Limnotex, the parent company of Kar-Tel, to shareholders of the fourth-largest bank in Kazakhstan, ATF Bank. As reported by VimpelCom, the company believes the agreement to provide support and local knowledge that would add value to VimpelCom's operations in Kazakhstan. According to VimpelCom, its mid-term strategy includes becoming the number one operator in the country.

More recently, VimpelCom took another and more controversial step in its foreign expansion strategy. In November 2005, the company announced consummation of the purchase of Ukraine's fourth-largest mobile operator, **Ukrainian Radio Systems (URS)** for the price of $ 231 million plus $ 23 million in debts. The acquisition sparked serious controversy between the two largest shareholders of VimpelCom, the Russian Altimo and Norwegian Telenor. The former strongly favoured the purchase, whereas the latter opposed the transaction, claiming it to lack business sense. The acquisition is complicated mainly due to the fact that Altimo and Telenor already control the second-largest mobile operator in Ukraine, KyivStar, through a joint venture. The Norwegian parent claimed that the purchase of URS by VimpelCom would bring the company in direct competition with KyivStar.

Despite the recent decision to move forward with the acquisition, there are several other challenges related to VimpelCom's expansion to Ukraine. The mobile network of URS is relatively limited and the estimated costs of necessary expansions reach hundreds of millions. In addition, the mobile penetration rate and wireless use is relatively high in Ukraine, forcing VimpelCom to battle for existing customers. The main competitor of VimpelCom in Ukraine is its domestic rival, the number-one Russian mobile operator MTS, controlling the largest mobile company in Ukraine, UMC.

3.6 Machine building

There are currently relatively few truly international Russian machine building companies. In terms of foreign assets, OMZ is the most international of Russian machine-building corporation. Another major enterprise in the sector, Russia's largest automobile manufacturer, **AvtoVaz**, has recently divested itself from several of its foreign assets, concentrating on its domestic joint ventures.

OMZ is the largest heavy engineering corporation in Russia. It has established strong international presence through foreign investments in possessing, production, marketing, and financial units overseas. OMZ has affiliates and subsidiaries in the CIS countries, Western Europe, and the United States (table 12). The largest and most recent acquisitions include three units bought from the Czech company Skoda Holding. The price of the units (**Skoda JS** division and **Skoda STEEL** consortium including **Hut** and **Kovárny**) amounted to $ 200 million. According to the statement by OMZ, the acquisition provides the company with an improved access to the Eastern European markets of strategic business opportunities (Power Engineering International 2005). OMZ has a strong position in the international markets in highly specialised product segments. In equipment for atomic power stations, the company controls a 25% share of the world market.

Table 12 Major foreign affiliates of OMZ

Country	Company	Nature of business	OMZ' share, %
Armenia	OOO OMZAR	Investing	100
British Virgin Islands	UHM Investments Ltd.	Investing	100
	Shipley Trading Ltd. BVI	Investing	100
Czech Republic	Skoda Kovarny	Steel production	100
	Skoda Hute	Steel production	100
	Skoda JS	Nuclear equipment production	100
Netherlands	Friede Goldman Marketing	Engineering services	75
	United Heavy B.V.	Investing	100
	UHM Investments NV	Investing	100
Romania	UPET S.A.	Production of metal equipment	66
Ukraine	OAO CBK Korall	Services for shipbuilding industry	94.3
USA	BioLink Technologies Inc.	Biometric products	39
	FGL Buyer LLC	Naval architecture	75
	OMZ Investments Co.	Investing	100
	Friede Goldman United Ltd.	Financial services	75

Sources: Company information.

3.7 Soaring value of foreign acquisitions

As the current section has put forward, the leading Russian enterprises are becoming increasingly engaged with foreign investments, the value of which has soared during the past years. Increasingly, the times of stripping cheap assets in the nearby CIS and CEE regions, are over and the value of recent acquisitions by Russian companies in the region is manifold compared to that of 1990's. Simultaneously, the improved financial situations have fuelled the acquisitions by Russian companies in established markets of old EU member states and the USA. Increasingly, we witness the Russian companies evenly bidding for foreign assets against the world's largest industrial conglomerates. During 2004 and 2005, the combined value of the ten largest foreign acquisitions by the Russian companies exceeded $ 6 billion. Table 13 outlines the largest foreign acquisitions in value by Russian companies during 2004-2005.

Table 13 The largest foreign acquisitions by Russian companies, 2004-2005.

Acquiring company	**Target company**	**Country**	**Nature of business**	**Share,** *%*	**Value,** *$ mln*
Lukoil	Nelson Resources	Kazakhstan/ Canada	Oil exploration & production	100	2 000
Norilsk Nickel	Gold Fields Ltd	South Africa	Gold mining	20	1 200
Severstal	Lucchini Group	Italy	Steel products	62	574
RusAl	Queensland Alumina Ltd	Australia	Alumina refinery	20	460
VimpelCom	Kar-Tel	Kazakhstan	Mobile telecommunication	100	425
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	795 petroleum stations from ConocoPhillips	100	266
VimpelCom	Ukrainian Radio Systems	Ukraine	Mobile telecommunication	100	254
MTS	Uzdunorbita	Uzbekistan	Mobile telecommunication	74	121

Sources: Numerous company and media sources; author's calculations.

4 Drivers and motivations of Russian OFDI

The recent years have witnessed considerable improvement in investment practices by Russian companies. In the initial stage of transition, weak domestic business environment caused the surge in capital flight from the country. The motivations behind investments in early 1990s often stemmed from scarce domestic investment opportunities and weak ownership protection.

Recent developments in OFDI from Russia suggest increasing variation in investment motivations between industries. Whereas the initial stage of internationalisation included export-supporting activities for many companies, numerous Russian enterprises have engaged in more demanding operations abroad in recent years. Especially foreign acquisitions have become notable. Russian companies are acquiring assets abroad to strengthen their market positions, expand their global reach and access natural resources.

An important motivation of foreign investments by Russian oil companies is to internalise or control the whole value chains internationally. By acquiring refineries and sales outlets abroad, Russian companies have achieved better control over foreign demand, processing oil in their own refineries and selling the products via their own petroleum stations. In the oil sector, the infrastructure assets are of vital importance and Russian oil companies have gained control over several strategic infrastructure assets in CEEC, including seaports and oil pipelines delivering crude oil and products to the European and the US markets.

Russian companies are expanding their global market shares and strengthening their global market positions by acquiring assets abroad. The recent large-scale acquisitions by Russia’s leading non-ferrous metal companies serve as examples of resource-seeking investments. Henceforth, the acquisitions provide companies with significant additions to their resource bases and assets, and add to the companies’ global scope of activities.

Examples of market-seeking acquisitions by the Russian firms can be found from the telecommunication sector. Through active expansion, Russian telecom companies have strengthened their positions in the neighbouring CIS region. In that particular market, Russian companies lead the race for market shares, pioneering the expansion of foreign companies to this lucrative market area.

Examples of strategic asset-seeking expansion by Russian firms relate to the specifics connected to the target markets. For instance, Severstal's acquisition in 2003 of US-based Rouge Industries effectively helped to solve the problem of US steel import quotas and provided the Russian producer with an access to the largest and most protected steel market in the world.

Yet another specific dimension of Russian business expansion abroad is connected to the international activities of the state-owned enterprises. In several instances, the Russian energy resources may serve as a considerable foreign policy tool especially in the Russia's neighbouring areas highly dependent on Russia's energy supplies. By supporting the active expansion of the state-owned energy giants, Russia effectively manages its interests in the region. The recent energy dispute between Russia and Ukraine alleviates the strong leverage of Russian energy companies in the CIS region and the possibility of using economic and natural resources as means to advance political objectives.

Although the large TNCs inevitably control the Russian business expansion abroad, the role of small- and medium-sized companies (SMEs) is increasing. The investment motivations essentially differ between the large enterprises and SMEs due to the incomparable operational and financial resources. Whereas the large Russian enterprises are engaged in cross-border mergers and acquisitions to improve their global market positions, the Russian SMEs predominantly seek for niche markets abroad. Market- and technology-seeking investments dominate the international expansion of Russian SMEs. Due to the relatively low experience level and scarce financial resources, the Russian SMEs have thus far mainly targeted the assets in the CIS and CEE markets.

Very few Russian SMEs publicly announce their foreign acquisitions and their operations abroad remain largely unknown for the media, authorities, and researchers alike. The SMEs responsible for OFDI from Russia often include leaders in narrow market segments, such as some particular electronic appliances. Estimating the total scope of international activities of these companies becomes extremely complicated due to low public coverage of the operations. However, despite the low level of publicity of the foreign asset purchases by Russian SMEs, the development is highly positive and numerous Russian SMEs have already entered the CIS and the EU markets.

Table 14 Motivations of Russian OFDI

Motivations	Corporate examples
Efficiency-seeking motivations (e.g. compulsion to control the entire value chain)	E.g. the oil companies' acquisitions of retail assets in the CEE and Baltic countries
Strategic asset-seeking motivations (e.g. securing infrastructure functionality abroad)	E.g. acquisitions by Yukos of Mazeikiu Nafta in Lithuania and Transpetrol in Slovakia, Severstal's acquisition of Rouge Industries in the USA
Resource-seeking motivations (e.g. accessing to natural resources)	E.g. the oil companies' upstream acquisitions in Middle East, South America and CIS, acquisition by RusAl of Queensland Alumina, Norilsk Nickel's acquisition of Gold Fields
Market-seeking motivations (market expansion in neighbouring countries and far a field)	E.g. telecommunication companies' acquisitions of mobile operators in the CIS

5 Obstacles towards Russian outward investments

Despite the impressive growth in Russian OFDI, the internationalisation of Russian enterprises is not nearly always without problems. Foreign investments from Russia are in most parts carried out by large natural resource-based companies, and are supported or financed largely by their growing export revenues. Russian SMEs seldom possess the capital and market knowledge needed for extensive foreign expansion. Their relatively weak financial positions and limited access to financing facilities are among the main hindrances for OFDI. Russian SMEs also lack the experiences associated with international business operations. The additional risks for operating abroad, in unfamiliar environment, have also contributed to the limited OFDI by Russian SMEs. The domestic market size and growth potential are factors that encourage Russian SMEs to invest and operate at home rather than abroad.

Additionally, the lack of international networks remains a discouraging factor for many Russian companies especially in the manufacturing sectors where the networks are traditionally build around large domestic conglomerates. Historical dependency on such industrial networks in the domestic markets often discourages companies seeking growth from abroad.

Despite its large OFDI flows and stock, Russia does not have specific policy promoting outward investments. In this regard, the Government passively discourages international investments by Russian companies. In Russia, the foreign investments by the home-based companies are often regarded as unwanted capital outflow and the government policies tend to discourage these investments. The situation, thus, inevitably calls for effective separation measures, between the non-legal capital transfers and the asset purchases advancing the global competitiveness of Russian firms. The future governmental policies towards OFDI by Russian companies play an essential role in development of these investment flows, the transparency of which is most likely to increase once a coherent investment policy framework is set. In addition, the government eventually holds no means to stop Russian investment flows abroad. Building a more supportive investment regime would not only strengthen the competitiveness of Russian companies internationally but would also help increase the transparency of OFDI flows in general.

Apart from the investment policy issues, the receptiveness of host countries towards Russian investments has sometimes posted obstacles for Russian business expansion abroad. Especially in the Baltic States and the former socialist countries of Eastern Europe, Russian ownership over strategic energy assets has occasionally been perceived as a politically sensitive issue. For example the privatisation of Lithuanian oil refinery, Mazeikiu Nafta, in 1999 resulted in long-term dispute between Russia and Lithuania[10]. Similar events were experienced in case of Ventspils oil port in Latvia[11]. The controversy has sometimes led to questionable investment schemes pursued by the Russian companies. Several examples can be found in aforementioned countries, where a Russian investor has been detected behind an investment from a third country. An example of such politically controversial transhipped investment was the acquisition of Hungarian chemical producer, BorsodChem, by Gazprom in 2000[12]. Here, the distinction between cause and effect often becomes complicated, meaning that the reluctance towards Russian FDI may have engendered suspicious investment schemes, whereas the questionable investment practices themselves have partially caused the reluctance at the first place.

Other than CEE and CIS, companies that Russian firms have bought in the old EU member states or in the USA, for instance, are often underperforming or experiencing financial difficulties. Thus far, the Russian entities have seldom managed to purchase successful companies in Western markets. On the other hand, some Russian TNCs, such as Severstal, successfully use the strategy of acquiring troubled enterprises at favourable prices. In addition, the attitudes towards Russian business expansion are most likely to change along with the rise of successful and business-oriented Russian corporations abroad.

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[10] In 1999, after a long dispute in Lithuanian government, Lukoil's bid for 33% stake in Mazeikiu Nafta was turned down and the US-based Williams International was preferred as a buyer over the Russian company. The dispute resulted in Lukoil cutting off all deliveries to the refinery.
[11] After Latvian authorities turned down the offer by Russian pipeline monopoly, Transneft, to buy a share in Ventspils seaport in 2002, the Russian pipeline exports were cut off and have not been restored since.
[12] Gazprom was detected behind an investment offer made by an Irish offshore company, Milford Holdings, to acquire altogether some 40% of BorsodChem shares. The takeover was described as hostile in nature since no intention of the buyout had been delivered to Hungarian company in advance.

The lack of specific outward investment policies in Russia serves as a further discouraging factor. The low level of real sector investments in Russian economy coupled with massive capital outflows remains among the main troubling issues for the Russian Government. Thus far the Government has mostly been struggling to curb the capital outflow from the country, which is hindering the development of supportive investment policies. The new regulative framework regarding the capital exchange is expected to ease the problem by increasing transparency and legitimacy of capital movements. Consequently, advancements in investment policies can be expected in the medium term.

Apart from the currency and investment regulations, the legislative and taxation issues especially in the natural resource-based sectors have an influence on OFDI by Russian companies. The increased state dominance in the energy sector coupled with mounting taxation on the oil industry are likely to affect investment behaviour of Russian companies in the longer run. For instance, the company representatives blame slowing production and decreasing revenues on increasing export taxes and transportation costs (Petroleum Argus 2005), which foresees increasing urge by Russian companies of finding additional production outlets abroad. In addition, the uncertainty around the new subsoil law of Russian Federation may shift in investment focus of international consortiums including Russian partners, and, thus, affect the investment behaviour of Russian companies[13].

[13] The anticipated amendments to the Subsoil law would ban foreign entities from participating in development of certain strategic natural resources. As developments of oil and gas fields usually require forming a large consortium due the huge size and costs of the projects, the consortiums including the Russian companies may be forced to turn for projects outside Russia, thus causing a shift in investment behaviour of several Russian companies.

6 Outlook and policy implications of Russian outward investments

Future prospects for foreign investments from Russia remain highly promising despite the somewhat discouraging domestic policies. The large natural resource-based conglomerates will most likely expand their global market shares and continue foreign asset purchases as recently witnessed on several fronts. Increasing international asset diversification provides Russian companies with capabilities to match the moves of their global competitors.

The internationalisation of non-natural resource-based companies is a more recent phenomenon in the Russian economy. Led by the mobile operators, the Russian non-natural resource-based companies are rapidly catching up in acquiring foreign assets. Domestic economic growth, large human potential and closing ties with global economy are likely to continue to drive Russian business expansion abroad.

From the Russian perspective, the outward expansion of the Russian firms is essential for both the individual companies and the Russian economy as a whole. The companies must become more international in order to survive in the global competition, which will become fiercer even on the domestic market when Russia gains a membership in the WTO. Correspondingly, the Russian economy requires a structural reform and improvement in competitiveness to transform the country from the natural resource-based economy towards a modern service- and innovation-oriented society. The outward expansion is perhaps the most efficient way to force companies to change their old patterns.

The attitudes in recipient countries towards Russian FDI continue to post challenges towards international expansion of Russian companies especially in the neighboring areas where the Russian companies have traditionally strong foothold. One can even claim that during the recent years, Russia has come close of regaining her superpower status in the nearby region, only this time leveraged by her economic resources. The Russian leading enterprises bear strong economic and political influence in the neighbouring CIS countries. At current, few countries in the world hold the leverage comparable to that of Russia in their neighbouring areas. In several occasions, Russia's leading companies have acquired control over entire industrial sectors of the CIS countries. In Ukraine, for instance, Russian oil companies' estimated share of petroleum market stands between 80 and 90 per cent. Similarly, the country's mobile telecommunication sector is dominated by the Russian mobile companies; currently four out of five leading mobile operators in Ukraine are majority-owned by Russian entities, accountable for lion's share of Ukraine's subscriber base. One can add to the list the major acquisitions of Gazprom in the CIS countries, in many of which the Russian gas giant is the sole supplier of natural gas and the majority owner of national gas companies. Whereas for many of the CIS countries, the present-day Russia is the most viable economic and political partner while others are fighting to shrug off the past dependencies on Russia.

The outward investment potential of Russian SME sector can not be neglected, but considerable policy improvements are necessary for the companies to develop more sophisticated internationalisation practices. Russian SMEs are in need for support in their outward expansion processes due to the lack of financial resources and knowledge of markets and business practices. OFDI supporting measures for the Russian companies would serve the overall development of the country's enterprise sector by encouraging the companies to develop their business practices and managerial skills. The international experience through outward investments would provide effective means to promote management and technology transfers to Russia. Through operational experience in foreign markets the domestic enterprises have to develop their business practices more actively than when operating merely from home-based locations.

In future development of investment environment, further emphasis could be laid on facilitative and investment capacity building measures. In co-operation with the private sector, it would be possible to develop for instance marketing and management techniques and put in place the structures necessary to facilitate outward investments. Providing information by bringing together the potential investors, government and financial service providers would serve as an important facilitative measure for foreign investments. Increased expertise on managing cross-border transactions and international law and investment practices are examples of the results of efficient public-private co-operation in capacity building. Additional emphasis in OFDI promotion should be laid on transferring of best practice, by linking investors directly to relevant information on investment opportunities and operating conditions abroad. Although supporting institutions for SMEs have started to emerge in Russia, further initiatives are required from public sector to facilitate the development and internationalisation potential of Russian small-and medium size enterprises in particular.

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Appendix 1 Russia's 100 Largest industrial companies by turnover

Rank	Company	Industry	Turnover *($ mn)*	Annual growth rate *(%)*
1.	Gazprom	Oil and gas	33 892.30	19.2
2.	Lukoil	Oil and gas	28 810.00	39.9
3.	RAO UES	Electrical energy	23 582.80	14.6
4.	Yukos	Oil and gas	22 100.00	--
5.	TNK-BP	Oil and gas	14 298.00	28.8
6.	Surgutneftegas	Oil and gas	10 690.90	31
7.	Sibneft	Oil and gas	8 022.90	21.4
8.	Norilsk Nickel	Non-ferrous metals	6 742.00	28.2
9.	Severstal	Ferrous metals	6 268.80	102
10.	Slavneft	Oil and gas	6 124.00	69.2
11.	Evraz Holding	Ferrous metals	5 924.60	161
12.	AvtoVaz	Machine building	5 570.30	22.8
13.	Russkij Aluminium	Non-ferrous metals	5 400.00	12.7
14.	Tatneft	Oil and gas	5 232.20	29.3
15.	Transneft	Oil and gas	5 220.00	31.8
16.	Magnitogorsk Metal	Ferrous metals	4 829.00	48.8
17.	Novolipetski Metal Works	Ferrous metals	4 538.70	72.7
18.	Rosneft	Oil and gas	4 515.10	32.3
19.	Mechel	Ferrous metals	3 636.00	68.4
20.	Alrosa	Precious metals and diamonds	2 704.70	29.9
21.	UGMK Holding	Non-ferrous metals	2 535.70	67
22.	SUAL Holding	Non-ferrous metals	2 300.00	27.1
23.	Rosenergoatom	Electrical energy	2 219.80	7.2
24.	VimpelCom	Telecommunications	2 146.60	50.9
25.	Bashneft	Oil and gas	1 993.40	45.2
26.	Trubnaja…	Ferrous metals	1 857.60	29.5
27.	SOK Group	Machine building	1 705.60	17.7
28.	GAZ	Machine building	1 618.80	27.2
29.	KamAz	Machine building	1 612.70	58.5
30.	SUEK Holding	Coal	1 559.60	579
31.	Suhoi	Machine building	1 496.90	-29.4
32.	Megafon	Telecommunications	1 480.10	70.6
33.	TVEL	Machine building	1 474.10	24.3
34.	Almaz-Antei Holding	Machine building	1 326.80	17.1
35.	Ilim Pulp	Wood and paper	1 301.00	6.8
36.	Evrokhim	(Petro)chemical	1 201.00	58
37.	Alliance Holding	Oil and gas	1 194.50	52.8
38.	Wimm-Bill-Dann	Foodstuffs	1 189.30	19
39.	Promoshlenno…	Ferrous metals	1 188.50	157
40.	Nizhnekamskneftekhim	(Petro)chemical	1 175.60	35.7
41.	Salavatnefteorgsintez	(Petro)chemical	1 169.10	81.7
42.	Ural Steel	Ferrous metals	1 024.30	186
43.	FosAgro	(Petro)chemicals	1 020.60	24.8
44.	Baltika	Beverages	994.0	26.6
45.	Russneft	Oil and gas	953.3	338
46.	Vyksunsk Metal Works	Ferrous metals	923.9	41.6
47.	Oskolsk Metal Works	Ferrous metals	899.9	66.6
48.	NovaTek	Oil and gas	874.3	46
49.	Sun Interbrew	Beverages	859.1	32.2
50.	Philip Morris Izora	Tobacco	847.2	5.9
51.	Ford Motor Company	Machine building	843.2	63.2
52.	Ural Railroad Works	Machine building	838.1	9.8
53.	Mihailovsk Metal Works	Ferrous metals	820.7	95.3
54.	Severstal Auto	Machine building	799.1	18.8
55.	TransMash Holding	Machine building	762.0	80.5
56.	Lebedinsk Metal Works	Ferrous metals	753.9	126
57.	Bashkirenergo	Electrical energy	748.5	21.6
58.	Tatenergo	Electrical energy	741.6	24.1
59.	Itera	Oil and gas	734.4	43.7

60.	MAIR Holding	Ferrous metals	712.0	-
61.	Rassguljai Ukros	Beverages	700.0	-7.6
62.	Power Machines	Machine building	662.0	76.5
63.	OMZ	Machine building	661.4	13.7
64.	Irkutskenergo	Electrical energy	636.6	25
65.	Irkut	Machine building	621.8	11.9
66.	Akron	(Petro)chemical	614.4	23.6
67.	National Computer Company	IT	613.2	22.8
68.	Golden Telecom	Telecommunications	584.0	52.1
69.	Space…	Machine building	583.0	-7.5
70.	SibUgleMet	Coal	576.1	302
71.	Obedinennie…	Beverages	571.9	16.1
72.	Mars	Foodstuffs	570.8	25.1
73.	Tseljabinsk Pipe Factory	Ferrous metals	563.0	17.2
74.	Tseljabinsk Metal Works	Ferrous metals	560.1	144
75.	Kuzbassrazrezugol	Coal	542.8	117
76.	Maksi Holding	Ferrous metals	530.7	--
77.	IBS Holding	IT	524.9	23.5
78.	Tserkisovskyi	Beverages	524.6	15.9
79.	Energomash	Machine building	519.0	15.1
80.	Izmash	Machine building	496.7	19.8
81.	Yuzkuzbassygol	Coal	483.0	105
82.	Amtel-Fredestein	(Petro)chemicals	480.6	22.8
83.	Novosibirskenergo	Electrical energy	475.6	30.2
84.	GM-AvtoVaz	Machine building	467.1	182
85.	Altai-Koks	Ferrous metals	452.7	81.3
86.	LSR Holding	Construction materials	451.9	82.9
87.	Tsaritsyno	Beverages	444.0	17.9
88.	R-Style Holding	IT	441.3	25.8
89.	Monday Business Paper	Wood and paper	438.9	20.8
90.	Coca-Cola HBC Eurasia	Beverages	434.1	31.3
91.	VSMPO-Avisma	Non-ferrous metals	431.3	31.8
92.	Nizhnekamskzhina	(Petro)chemicals	429.8	20.7
93.	Raspadsk Coal Company	Coal	427.8	--
94.	Vaneganneft	Oil and gas	421.3	32.9
95.	Petro	Tobacco	413.3	10.2
96.	Kazanorgsintez	(Petro)chemicals	413.1	33.3
97.	Togliatti-Azot	(Petro)chemicals	413.0	49.9
98.	Stinol	Machine building	405.7	19.2
99.	Uralalkaly	(Petro)chemicals	405.5	39.8
100.	Tetra Pak	Packaging materials	399.5	15.4

** The figures in Appendices 1 and 2 are provided by Expert Rating Agency. During the research process, the author has come across some inconsistencies between the figures presented by Expert RA and the company statements.*

Source: Expert (2005).