Analysis

Russian Companies Expand Foreign Investments

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Abstract

While all agree that Russia has become a significant source of foreign direct investment (FDI), there is no consensus on the size of these investments. According to the author's calculations, Russian outward FDI stock exceeds $70 billion. This estimate is based on a tabulation of foreign fixed assets (property, plant and equipment, and investments in associated undertakings and jointly controlled entities) held by Russian companies outside the financial sphere and the trans-border acquisition prices of banks. The largest investors are typically Russian integrated business groups with subsidiaries mainly in oil and gas, ferrous and non-ferrous metals, telecommunications, and machinery. Nevertheless, big businesses are not the only Russian companies expanding their presence abroad. Many other companies, both in and outside the resource sector, are establishing themselves in foreign markets. The main destinations for Russian investment expansion are the CIS (30 percent of Russian FDI stock) and the European Union (almost 40 percent of FDI stock). While the role of North America is growing gradually, most Russian TNCs prefer to work in their immediate neighborhood.

The Real Scale of Russian Investment Expansion Abroad

Russia became a significant source of foreign direct investment during the last several years. Almost every month brings announcements of new large cross-border mergers and acquisitions (M&A) involving Russian participation in various regions of the world. Few Russian companies had any foreign investments as recently as the beginning of the 2000s. Official statistics have had a difficult time keeping up with this rapid growth in Russian investments abroad and now there are considerable disagreements among them (see Table 1).

The Central Bank of Russia claimed the largest figure for Russian FDI outward stock at the end of 2006. According to its calculations of the balance of payments, the volume of these investments was $209.6 billion. Unfortunately, the Central Bank could only estimate the reinvested earnings of Russian transnational corporations abroad and sometimes it was forced to apply rough econometric approximations when it lacked hard data. UNCTAD took into account these figures but compared them with the FDI statistics of other countries. As a result, this respected institution estimated Russian FDI outward stock as $156.8 billion. The sum of current UNCTAD figures (from its World Investment Reports) of annual Russian FDI outflows was "only" $72.2 billion.

Nevertheless, even according to UNCTAD estimates of FDI stocks, Russia leapt from 29th place in the world to 15th in a period of six years. I think this data was too "optimistic" because it makes more sense to exclude pseudo-Russian FDI (mainly round-tripping FDI via Cyprus and other off-shore havens), the investments of emigrants with Russian passports in real estate abroad, and de facto portfolio investments, which made up a significant share of the "capital flight" from Russia. I argue that it is more useful to calculate only the FDI stocks of large Russian companies.

We can usually find foreign asset statistics in the annual reports of large Russian companies. That is why this data is useful for ranking the transnational corporation (TNCs). However it is incorrect to compare total foreign assets with FDI volumes (as some experts did) because FDI means long-term investments, while assets consist of current and fixed components. For example, in 2006 the total foreign assets of *Severstal* were $4.5 billion, although its foreign fixed assets were only $2.1 billion. According to the first indicator, Severstal ranked 3rd among Russian companies, while, according to the second, it was only in 8th place. This situation is typical for many Russian raw material exporters. For instance, the total foreign assets of *Gazprom* exceeded $10 billion, however the share of current assets was significant. Among them were inventories (first of all gas in European pipelines and reservoirs), accounts receivable and prepayments, cash and cash equivalents, recoverable value-added taxes and so on. As for the foreign fixed assets of *Gazprom* (property, plant and equipment, investments in associated undertakings and jointly controlled entities, etc.), they were less than $8 billion at the end of 2006.

At the same time, the difference between total and fixed foreign assets for telecommunications companies was not so significant. For example, at the end of 2006 *MTS* had $2.3 billion in total foreign assets and $2.1

billion in fixed foreign assets. Sometimes the volumes of current foreign assets demonstrated significant fluctuations. For instance, the FDI of steel pipe maker *TMK* did not exceed $100 million in its two pipe plants in Romania. However its current assets rose rapidly to $490 million at the end of 2006. The main reason was the increase of inventories (semi-finished pipes) before the expansion of its Romanian production capacity at the beginning of 2007.

The main problem in making these calculations is the lack of information about foreign fixed assets owned by Russian companies. In many cases, they can be estimated only by press releases about M&A deals or expert evaluations. I estimate that the entire volume of foreign fixed assets held by Russia's 50 leading non-financial TNCs was approximately $45 billion at the end of 2006 and rose to $67 billion at the end of 2007 (see Table 1). The FDI stock of any other Russian non-financial firm was less than $75 million. Russian FDI in banks and insurance companies was less than $2 billion (*Vneshtorgbank* is the only significant investor, while fewer than a dozen companies have foreign subsidiaries in at least three countries). Thus, according to my estimates, the total FDI outward stock of Russian companies was $70-72 billion at the end of 2007.

Changes at the Top of the List among Russian TNCs

In 2007 Russian TNCs beat their record for foreign assets growth. According to my estimates, the sum of their fixed assets increased by almost 50 percent, or $22 billion. Russian integrated business groups play the leading role in this process. Some of them even try to branch out into new industries for their foreign expansion. For example, Oleg Deripaska's *Basic Element* works in seven sectors (see Figure 1) and made significant foreign investments in five of them. Its largest foreign expansion was in the aluminum industry. However, it has also invested heavily in automobiles and the construction industry. Basic Element's subsidiary car-maker GAZ bought 35 percent of *Magna* from Canada and a plant in the UK for more than $1.5 billion, while Basic Elements' investments in the construction industry included 30 percent of *Strabag*, whose assets in Austria and Germany are worth $1.7 billion, and *Sastobe-Cement* from Kazakhstan. Other Russian integrated business groups are breaking FDI records. For instance, *Norilsk Nickel* (the base of Vladimir Potanin's *Interros* group) bought nickel and gold company *LionOre Mining* for more than $5 billion. The assets of this firm are located in Canada, Australia, Botswana and South Africa.

In fact, almost all of Russia's foreign investments are made in the traditional industries where its business groups work: oil and gas, ferrous and non-ferrous metals, and telecommunications (see Table 2). Additionally, machinery has become an important industry for the foreign investment expansion of such groups. For example, *OMZ,* a subsidiary of the state-owned *Gazprom*, has assets in the Czech Republic, while *Sitronics* (a part of Vladimir Evtushenkov's *Sistema*) has foreign holdings in Greece, the Czech Republic and Ukraine. Although its main stakes are in *RUSAL* (after the merger with *Renova*'s *SUAL*) and *TNK-BP,* Viktor Vekselberg's *Renova* recently bought foreign assets in the machinery sector, including the Swiss company *Sulzer*.

At the same time, the internationalization of Russian companies continues outside the big business sector in both the resource and non-resource areas. Among the most prominent of these firms are four FDI "beginners." They did not have any foreign industrial subsidiaries before 2005, but now their FDI assets exceed $100 million. They are 1) the *ChTPZ-Group* of Andrei Komarov and Alexander Fedorov, with zinc mines in Kazakhstan and a steel plant in the Czech Republic, 2) Boris Zubitski's *Koks* with steel plants in Slovenia, 3) Alisher Usmanov's *Metalloinvest* with iron, copper and gold mines in Papua New Guinea and Australia, and 4) the legendary *Magnitogorsk Iron & Steel Works* of Viktor Rashnikov, which has set up a joint venture in Turkey.

Another interesting example is Michael Bolotin's *Tractor Plants*. Its FDI stock now exceeds $150 million. Today it owns the consolidated foreign assets of the former *KTZ* and *Agromashholding*. They consist of agriculture machinery plants in Ukraine, Kazakhstan, Belarus, and Moldova, and (since 2006) a forestry machinery factory in Denmark. In addition, *Tractor Plants'* engineering subsidiary *Iprocom* has just acquired *Dunham-Bush* with plants in Malaysia, the USA, Great Britain and China.

The well known and long-established *Rostselmash* is one of the latest Russian companies to venture abroad because in October 2007 it acquired *Buhler Industries* with tractor plants in Canada and the USA for $130 million. Another notable Russian machinery TNC is *Transmashholding*. It works in railway machinery and has only two years FDI experience. It owns plants or participates in joint ventures in Kazakhstan, Germany, Latvia and Ukraine. As a result, its FDI stock now surpasses $100 million.

A good example of FDI in the forestry and paper industry is *Investlesprom* (the former *Segezha Pulp & Paper Mill*). Its foreign investment experience is also relatively short, but the FDI of its subsidiary *Segezha Packaging* has exceeded $100 million. Due to its foreign expansion, it has become the second largest European paper sack producer. Its main assets are situated in Sweden but there are also subsidiaries in Italy, the Netherlands and some other European countries. Moreover *Segezha Packaging* recently acquired *Isiklar Ambalaj* in Turkey.

Many Russian companies are starting to make foreign investments in the food industry. At the beginning of 2008, the largest TNCs are *Russian Solod* (brewing), *SPI Group* (vodka and other alcoholic beverages), *Wimm-Bill-Dann* (dairy and juice), *Russian Vine Trust* (cognac and brandy production), *Mezhrespublikanskij Vinzavod* (wine) and *Nastjusha* (grain and flour). The FDI stock of each of these companies is between $30 million and $80 million.

The leading perfume company *Kalina* is also a noteworthy Russian investor. Although *Kalina* has sold its subsidiaries in the CIS (except for *Pallada-Ukraine*), its FDI stock in the chemical industry exceeds $30 million due to its German firm *Dr. Scheller*. Only tire producer *Amtel-Vredestein* with its Dutch part *Vredestein Banden*, *Akron* with its Chinese fertilizers plants and *Eurochem* with its Lithuanian and new Ukrainian fertilizers subsidiaries show more significant investment expansion among Russian chemical companies.

The Geography of Russian FDI

It is impossible to determine the geographical distribution of Russia's entire FDI stock because the routes of illegal capital flight in the form of FDI are very complicated. Nevertheless, it is possible to identify the locations of Russian companies' fixed assets and to determine the target countries for M&A deals with Russian participation. Thus, I have been able to define the geography of approximately $70-72 billion in Russian FDI.

The CIS and EU are the main recipients of Russian FDI (see Figure 2). The share of the CIS is about 30 percent, but more than 80 percent of these investments are concentrated in three neighboring countries (Ukraine, Kazakhstan and Belarus). The share of the EU is almost 40 percent. Due to the Russian fleet of ships registered under the "cheap flags" of Cyprus and Malta, these countries have as much Russian investment as Germany and Italy.

The role of North America is increasing gradually. For example, the largest foreign subsidiary of *Evraz* is situated there (the company acquired *Oregon Steel Mills* for $2.3 billion), however *Evraz* has just invested more than $2.5 billion in Ukraine. Additionally, *NLMK* has acquired plants in the EU for more than $1 billion while *Lukoil*, *Gazprom*, *MTS* and several other Russian companies are constantly making significant new investments in the CIS.

Proximity plays a significant role for Russian TNCs because they like to invest in their nearby neighborhood. They prefer to invest in the countries where they have business contacts and can easily form effective value-added chains. Moreover, in these locations, there are no information barriers for Russian firms and sometimes even the language is the same. As a result, in spite of the negative attitude toward Russian expansion in some countries, the Russian share of recipient FDI is the largest in neighboring countries (see Map 1). It exceeds 5 percent in Belarus, Ukraine, Kazakhstan, Armenia, Uzbekistan, Serbia, Montenegro, Bulgaria, and Cyprus, as well as Moldova and Lithuania, and even Georgia and Latvia, which often do not have friendly relations with Russia. Of course, the Russian share is less than 2 percent in such countries as Finland, Austria or the Czech Republic only due to their good investment climate. In these places, significant Russian investments are overshadowed by the large mass of European and American investments.

The prospects for Russian investment expansion depend on the future balance of various Russian FDI drivers. On the one hand, many Russian companies have traditional motivations to make foreign investments, namely seeking new markets (both in the CIS and developed countries), greater efficiency (especially in the CIS, but sometimes even in China), resources (in such countries as Kazakhstan, Mongolia, Vietnam, Angola, Guinea and so on) and assets (in various developed countries). On the other hand, Russia's transition economy still provides a variety of non-business motivations. For example, new laws in Russia are often contradictory and thus stimulate growing corruption. As a result, Russian companies try to insure their business against attack by making foreign acquisitions which give them the image of global players and increase their negotiating power at home. Also Russian companies seek cheap financial resources in foreign countries in response to the weakness of the Russian national bank system. In these situations, large trans-border mergers and acquisitions increase the ability Russian companies to raise money on Western markets. Insofar as the different motives determine the geography of Russian investments, it is difficult to predict the exact shares for various countries. Nevertheless, it is obvious that the EU and CIS will be main recipients of Russian FDI for a long time.

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