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RUSSIA AND FOREIGN DIRECT INVESTMENT

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Foreword

The Northern Dimension Research Centre (NORDI) is a research institute run by Lappeenranta University of Technology (LUT). NORDI was established in the spring of 2003 in order to co-ordinate research into Russia.

NORDI publications have paid permanently attention to investment climate in transitional economies (TEs): several studies of the Research Centre deal with foreign direct investment (FDI) in post-communist societies. Western investors have strongly influenced the economic development in national economies which used to be guided by central planning.

LUT has a long tradition in conducting research and educating students in the field of communist and post-communist economies. From the point of view of these studies, LUT is ideally located in the Eastern part of Finland near the border between EU and Russia.

This short report deals with the interesting topic of foreign direct investment (FDI), which has been one of the most influential factors on the developments in post-communist countries. This book provides an overview of outward FDI from Russia, exploring the direction and amount of the investments made by Russian companies in foreign countries. Anna Karhu has gathered and analyzed data for the book.

I want to express my gratitude to Mrs. Tiina Tarhonen, who helped me to finalize the book.

Lappeenranta, December 2008

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1 Introduction

The historical period of the Cold War came to an end after the collapse of communist system in the Eastern Bloc comprising the mighty Soviet Union. In the early post-communist period of the formerly centrally planned economies it was questionable whether the newly created market economies will have enough capital to establish capitalism. It was widely assumed that restructuring of transitional economies (TEs) can only take place via massive inflow of foreign capital.

International capital movements involve huge sums annually. It is not the aim here to cover this topic in detail. Capital movements across national borders can be divided in two main categories, credits and risk capital movements. The former is ignored here. The latter has two subcategories, foreign direct investment (FDI) and foreign portfolio investment (FPI). In the first case, the investor seeks dominance in the foreign entity which is the object of the funding. In the second case (FPI), the investor buys sharers or stakes of foreign companies with the aim to increase the value of his/her input in a passive manner (without getting involved in management of the company, in which the investor has an equity stake).

This short report concentrates on FDI issues in post-communist Russia. In the first decade of transition, there was an extremely strong inflow of FDI into TE-region. In this capital injection Russia and other CIS countries (Commonwealth of Independent States) played a very modest role in relative terms (see Table 1.). FDIs flowed in especially in Central Eastern Europe (CEE). Estonia in the Baltic region became a favourite of Western investors already in the 1990s.

Table 1. FDI stock to transitional economies in the end of 1999

	FDI stock (Bn USD)	FDI stock/per capita (USD)
Central Eastern Europe	**68.6**	**1.033**
Czech Republic	15.2	1.481
Hungary	19.0	1.889
Poland	30.8	796
Slovakia	2.2	410
Slovenia	1.4	684
Balkans	**13.1**	**237**
Bulgaria	2.2	272
Romania	5.7	252
Baltics	**6.0**	**784**
Estonia	2.0	1.354
Latvia	2.0	818
Lithuania	2.0	538
CIS	**36.2**	**128**
Russia	19.6	135
Ukraine	3.0	60

Source: EIU Country Reports 2000

In the turn of the century, Russian post-Soviet economy started to recover amid a global oil price boom. Economic growth resumed in Russia and her current account started to show considerable annual surpluses. Thus, in the second decade of her transition, Russia has become a clear net capital exporter (for details, see Tiusanen: Development of Rouble Exchange Rate in Russia. Lappeenranta 2007. NORDI publication no. 45).

In the first decade of the 21st century, FDI business has became a two-way street in the Russian economy. Foreign companies are more and more interested in increasing purchasing power in Russia, and thus, market-seeking FDIs have plenty of attractions in her vast territory. At the same time, many Russian companies with high profitability have started FDI operations in the global market. Other TEs hardly have any outward FDI yet.

There is no universal scheme in FDI statistics. Therefore, it is impossible to cover any topic dealing with FDI issues in exact terms. UNCTAD (United Nations Conference on Trade and Development) publishes its annual investment report with extensive data material. Thus, UNCTAD's World Investment Reports are used here as a major source of information.

Traditionally, NORDI publications rely heavily on basic data provided by The Vienna Institute for International Economic Studies (WIIW). The Vienna Institute publishes permanently detailed information on FDI issues in TEs.

In this report an attempt is made to analyse Russian FDI stock with the emphasis on the outward side of the story. Relatively little is known so far on Russian FDI activity in the global economy. Therefore, it is not possible here to provide a complete picture of the topic under review.

2 Some structural features of Russian economy

Russia’s role in the global economy has increased considerably in the last ten years. The most important background factor in this positive development trend is her mighty resource base. Russia has essentially profited from the strong global demand on oil, natural gas and metals. High demand for basic materials has driven up prices bringing windfall profits to Russian companies.

However, in 2006 Russia’s share of the global Gross Domestic Product, or Gross National Income (Purchasing power parity adjusted) was only 2,5%, while the equivalent figure in the USA was about 20%, and in China about 15%. Living standard in the USA is roughly four times higher than in Russia (for details, see Tiusanen: Russia in the Global Economy. Lappeenranta 2008. NORDI publication no. 49). The investment rate (the share of investment of GDP) is relatively modest with some 21% in Russia, while the equivalent figure in China is about 40%.

In the first decade of post-Soviet era, industrial production decreased rapidly in Russia. This negative development was not surprising. In the system of Soviet planning, plenty of products were turned out without any concrete demand. After the systemic change with market pressure, it was evident that unnecessary activities were reduced radically. Therefore, GDP alongside with industrial production dropped dramatically.

In the table below, the year of Soviet Union’s collapse (1991) is marked with 100 as a base of industrial production index. In 2002, all industrial branches still had an index figure below the one hundred mark indicating that production was lower than in 1991.

Table 2. Industrial production (1991 = 100)

	2002	2006
Extraction	84.2	101.3
Utilities: Electricity, gas and water supply	81.7	90.1
Manufacturing	52.6	70.8
Food & beverages	63.1	77.6
Textiles & textile products	24.6	25.2
Pulp & paper	92.6	112.9
Fuels	64.6	75.6
Chemicals	70.1	82.3
Rubber & plastic products	53.4	75.3
Non-metallic minerals	42.3	56.4
Metallurgy	73.5	94.2
Machinery & equipment	31.4	46.8
Electrical & optical equipment	45.3	99.6
Transport equipment	38.7	53.9

Source: RosStat

Extracting activities have recovered more rapidly than manufacturing output. The index number of mining exceeds 100 in 2006, but only marginally (by 1,3%). Thus, extracting sector is virtually on the same level as in the last year of Soviet power. In the category of energy bearing materials, the index number is 114 in 2006. The main export articles, oil and gas, show therefore more dynamic production development than mining in average.

Manufacturing activity in 2006 was still almost 30% lower than in 1991. The recovery in industry shows a very diversified picture.

Food and beverage production index was 77,6 indicating that this vital branch of industry produced over 20% less than in 1991. However, recovery in this field of activity was between 1991 and 2006 better than industrial average.

Textile and clothing branch shows the most catastrophic decline in the above table. Production has dropped to one quarter of the original level. Hardly any improvement in the index figure has taken place. It can be assumed that this branch is facing harsh competition of cheap imports from Asia. On the upmarket Western branded goods are favoured in clothing. Local industry has limited demand for its products.

Pulp and paper industry has the best index figure of 2006 in the above table. Demand of paper increases rapidly amid the economic boom. Russia has ideal preconditions to develop chemical wood processing activities because of cheap energy and plentiful raw material base.

Fuels branch shows no rapid recovery, even if its index figure of 2006 is above the industrial average. Russian oil companies have bought several refineries in other transitional economies but have not expanded their capacities strongly in the home market. The big bulk of Russian oil is continuously exported in raw form.

Production of chemicals as well as rubber and plastics show similar development trends as fuels. In chemicals, the index number of 2006 exceeds already the 80% mark.

Metallurgy is one of the important pillars of Russian industry suffering less than most manufacturing branches in the post-Soviet slump. In making metals the index number was in 2006 close to 100 (94,2). There has been strong external demand, especially from China, for Russian metals in the current decade.

Production of electrical and optical equipment has more than doubled between 2002 and 2006. The production level of 1991 has been virtually reached.

Production of machines and equipment suffered a very serious blow in the post-Soviet period when overall investment activity virtually collapsed. This branch shows some recovery in the present decade. For example, machines are demanded in the very dynamic construction branch. However, in 2006 the index number in machine building was still below 50% mark indicating that this important branch has gone through an essential restructuring in competition with Western alternatives.

Transport equipment production also suffered a severe blow in the immediate post-Soviet period. Imports of Western vehicles became possible. A huge amount of second-hand cars was imported in the 1990s. Amid the economic boom in the early years of the 21st century, an increasing inflow of Western new cars has started. Some foreign car-makers have started production in Russia. Thus, transport equipment production has started to recover. However, the index number of 2006 in this branch was only about 54%. Thus, transport equipment is only a bit more than half of its previous level of 1991.

Transitional economy in Russia experienced a remarkable turning point in 1998. At the beginning of that year, a new exchange rate regime with managed floating system was introduced. A central rate of RUB 6,2 for USD 1 was determined with a spread of ±15%. In August the same year rouble started to depreciate and the borderline of -15% was in danger. The Central Bank of Russia attempted to support the exchange rate (ER) of rouble, but run out of dollars. Therefore, the set depreciation limit of -15% (against the central rate) had to be abolished. As a consequence, rouble depreciated rapidly and ended up in a couple of months on a level of one quarter of its set central rate.

The rouble depreciation was a very clear blessing for the Russian economy. Before 1998, investment in Russia was in tailspin. The post-crisis ER of rouble was strongly undervalued, and thus, gave a strong incentive to invest especially in import-substituting branches. A new investment boom started.

The most important background factor in the Russian boom in the second decade of post-Soviet era is, however, the development of world market price of oil. Natural gas prices are closely linked with oil price trends. These two items (oil and gas) make up about two-thirds of Russian exports. Amid the oil price boom, Russian economy has earned huge windfall profits.

The world market price of oil was exactly USD 20 per barrel in 1991, the year of Soviet Union's collapse. In the 1990s, this important price had a decreasing tendency. In 1998, oil price was about USD 13 per barrel. In ten years time, oil price has grown almost by factor six.

Table 3. World market price of oil

Brent	USD/bbl
1998	12,72
1999	17,97
2000	28,50
2001	24,44
2002	25,02
2003	28,83
2004	38,27
2005	54,48
2006	65,12
2007	72,81

Bbl=barrel=159 litre

The overall economy (GDP) of Russia has grown with an average annual rate of some 7% in real terms in 2004 - 2007. In this period, export of goods increased by no less than 22% a year in average. In 2005 this growth was extraordinarily high, 33%.

Table 4. Russia: Selected economic indicators

	2004	2005	2006	2007
Gross domestic product, annual change in % (real)	7.2	6.4	7.4	8.1
GDP/capita (EUR at PPP – WIIW)	9170	10030	11070	12330
Gross industrial production, annual change in % (real)	8.0	5.1	6.3	6.3
Gross agricultural production, annual change in % (real)	3.0	2.3	3.6	3.3
Construction output total, annual change in % (real)	10.1	10.5	18.1	18.2
Consumption of households, annual change in % (real)	12.1	11.8	11.2	12.8
Gross fixed capital formation, annual change in % (real)	12.6	10.6	17.7	20.8
LFS – unemployment rate in %, average	7.8	7.2	7.2	6.1
Average gross monthly wages, annual change in % (real, gross)	10.6	12.6	13.3	16.2
Consumer prices, % p.a.	11.0	12.5	9.7	9.1
Producer prices in industry, % p.a.	24.0	20.7	12.4	14.1
Exports of goods, annual growth rate in %	22.5	32.9	24.3	6.7
Imports of goods, annual growth rate in %	16.4	28.7	30.7	23.9

Source: WIIW

In the period under review (2004 – 2007), industrial production increased by some 6% annually. Agricultural production had a clearly more modest growth of some 3% a year, while construction output has had unusual dynamism. Real annual growth rate accelerated from 10,1% in 2004 to no less than 18,2% in 2007 in building activity.

On the demand side both private consumption and investment show both double-digit growth rates in real terms. The annual average in former is about 12%, while the latter has even more dynamism. Gross capital formation growth accelerated from 12,6% in 2004 to no less than 20,8% in 2007 (in real terms).

Therefore, it can be said that the Russian boom is sustainable, and is not alone dependent on external factors. Deceleration of export growth is not decisively affecting the present boom.

There are some signs of overheating of the Russian economy. Unemployment (measured by Labour Force survey method) has gone down. Unemployment rate of roughly 6% indicates relative full employment. In many big cities, there is a shortage of labour force. Guest workers, mainly from other former Soviet republics, are flowing in. Internal labour mobility is far from perfect. Housing problems hinder migration. Therefore, unemployment rates have huge differences between various regions. Big cities and oil, gas and metal producing regions enjoy full employment.

Therefore, unit labour costs have increased extremely rapidly in the first years of the 21st century. It means that nominal increases of wages exceed productivity gains with considerable margin. Relative shortage of labour is driving nominal wages up causing “wage inflation”. As a result, Russia is losing international competitiveness.

Deteriorating competitiveness is not hurting Russian exports in the same manner as in “normal” industrial countries, because Russia is selling mainly important energy bearing materials. However, decreasing price competitiveness affects import substituting branches. For example, imported foodstuffs and construction materials have in the last years become price competitive in comparison to locally produced alternatives.

“Fortune” magazine publishes every year a list of 500 biggest companies in the global economy. In the 2007 list, the biggest company is Wal-Mart stores with USD 379 billion revenues and over 2 million employees. Three oil companies, Exxon-Mobil, Royal Dutch Shell and British Petroleum have the next ranks (2-4). This is not surprising in a period of high oil prices in the global market.

Russia had five companies in Fortune’s list, four of which are active in oil and gas branch. The fifth one is the biggest financial institution in Russia.

Table 5. Five biggest companies in Russia

	Global rank	Revenues, 2007
1. Gazprom	47	98.641,5
2. Lukoil	90	67.205,0
3. Rosneft Oil	203	36.184,0
4. Surgutneftegas	357	23.302,4
5. Sberbank	406	20.784,5
Total	**406**	**246.117,4**

Source: Fortune, August 25, 2008

Gazprom is a listed company, in which the state has a majority share. It has virtually a monopoly in natural gas production in Russia.

In global scale Gazprom is the 47th biggest company measured in revenues, which are close to USD 100 billion. Gazprom employs 436.000 persons. Annual profit (2007) is USD 19,3 billion which is the fifth highest figure in Fortune’s list.

Lukoil is the biggest Russian oil company with USD 67 billion annual revenues and with 90th rank in Fortune's list. It is a public company without state dominance. In 2007, Lukoil made a profit of USD 9,5 billion being the 44th most profitable company in the world.

Rosneft is another Russian oil company which is within the 500 largest global companies ranking 203rd in Fortune's table. This company with USD 36 billion revenues is clearly state dominated. Only a small part of Rosneft is owned by non-state shareholders.

In 2007, Rosneft had more revenues than SABIC, the Saudi-Arabia's oil giant with USD 33,7 billion turnover. Surgutneftegas is the third biggest Russian oil company with USD 23 billion revenues. A big bulk of its shares is in the hands of the company managers.

Sperbank is a traditional savings bank which collected basically all private deposits of the population in the Soviet era. In the post-communist period, this big bank has remained in state ownership with a leading position in retail banking business.

The total revenues of the five Russian companies mentioned in the above table are USD 246 billion, while the sum of 500 biggest global companies gives revenues of USD 23.618 billion. Thus, the share of Russian big five companies within Fortune's list is only about 1% of overall revenues collected by 500 largest companies in the world.

Russia is the biggest natural gas producer in the world with highest known deposits. At the beginning of the 21st century, Russia produced about 580 billion cu metres of gas. The equivalent figure in 2007 was USA with 550 billion cu metres. Third was Canada with 185 billion.

Therefore, it is no wonder that Gasprom is the most valuable company in the world with stockholders' equity of over USD 200 billion. The second one according to market capatalization is Vodafone, a mobile phone operator from Great Britain, with USD 155 billion stockholders equity.

It is often said that Gazprom is a state within a state. This phrase underlines the might of Gazprom. It can also be stated that in business relations between Russia and EU, Gazprom is the most important player.

It is a well-known fact that burning natural gas is an environmentally friendly way of producing energy. Unfortunately, Western part of Europe is not rich on gas. Norway produces

90 billion cu metres a year offshore gas, but other sources of gas are marginal. European OECD members bought 148 billion cu metres of gas from Russia in 2007, which is about 40% of overall demand. Thus, Gazprom is a vital supplier of energy. In 2007, Germany paid USD 10,8 billion for Russian gas deliveries, Italy USD 7,2 billion, Turkey USD 7,0 billion, Hungary USD 2,4 billion and France USD 2,3 billion.

In the early period of post-Soviet era, Gazprom had a monopoly in Russian gas sector. Oil companies were able to sell gas which was a by-product in pumping oil. In the turn of the century, gas production was allowed also for independent companies which presently produce about 15% of gas in Russia.

However, Gazprom controls the gas pipeline system and obviously allows independent gas producers to deliver only to domestic clients. Gas business within Russia is not necessarily lucrative. Domestic gas prices have been in recent past only about 20% of the world market price which means that energy bills of Russian industry and households are subsidised. In between, it has been decided that domestic gas users will have a more than doubling of the gas bill from USD 45 per 1000 cu metres to USD 110-120 by 2010 and after that, brought in line with export prices. Household gas tariffs will probably be still subsidised in the next decade.

Therefore, Gazprom, which is dominated by Russian state, has clear interest in enhancing domestic supplies by independent gas producers, because prices in export business are more lucrative. It is estimated that the non-Gazprom sector produces presently close to 100 billion cu metres a year covering about 30-40% of domestic industrial demand. It can be assumed that more freedom will be allowed in the near future in this business field, while exporting of gas will remain a monopoly or near-monopoly of Gazprom.

Several post-Soviet countries in Central Asia produce natural gas. Especially Turkmenistan is an important gas producer. Gazprom has the huge advantage of controlling the Soviet-time gas pipeline network and with that, export routes of Turkmen gas. It can be assumed that the company earns income of Asian gas transit business.

Natural gas can be liquidized which makes it transportable without pipelines. Technology for that purpose is available, but using this method contains extra costs. Therefore, controlling gas pipelines is an invaluable asset.

3 Foreign direct investment (FDI) and post-Soviet Russia

3.1 FDI trends

In the immediate post-communist period it was widely assumed that capital will be a limiting factor in restructuring and modernising transitional economies. However, capital started flowing in, especially in FDI form, in the former Eastern Bloc. Economic growth resumed in the second half of the 1990s.

In the early period of Russian transition, massive capital flight took place. Obviously, this capital movement can not be statistically counted, because a variety of means was used to get savings out of the country.

In several Russian statistics covering FDI inflow, Cypros and Virgin Islands are in prominent position among investing countries. This means that in many cases previous flight capital is repatriated from so called “tax heaven” places.

In the 1990s, FDI inflow in Russia was very modest. Some FDI outflow took place, also in small scale. In the turn of the century the FDI scene changed fundamentally.

Table 6. FDI stock in Russia
Bn of USD

	2000	2006	Growth factor
FDI inward stock	32,2	197,7	6,1
FDI outward stock	20,1	156,8	7,8
Inward stock, net	12,1	40,9	

Source: UNCTAD, 2007

Russian inward FDI stock increased by factor 6 between 2000 and 2006 to almost USD 200 billion in 2006. In the same period outward stock increased even more rapidly, by factor 8 to some USD 157 billion. Inward stock was about USD 41 billion larger than the outward stock. This figure is rather modest. Russia has in the first years of the 21st century invested rather heavily abroad, and thus, the difference between inward FDI stock and outward FDI stock is thin, only just over USD 40 billion.

The relative importance of FDI can be measured by different ways in every national economy. One way doing it is to count FDI stocks as a percentage of gross domestic product (GDP).

Table 7. FDI stocks as % of GDP

	2000	2006
Russia		
Inward	12,4	20,2
Outward	7,8	16,0
Estonia		
Inward	48,3	77,2
Outward	4,7	22,0
Latvia		
Inward	27,0	37,5
Outward	0,3	2,2
Lithuania		
Inward	20,4	36,7
Outward	0,3	4,0

Source: UNCTAD, 2007

In the above table, four former Soviet Republics are included. Estonia, Latvia and Lithuania are small countries presently members of EU. Estonia is the most successful transitional economy (TE) in attracting FDIs to its territory.

In Russia, the inward FDI stock in relation to her GDP has increased from 12,4% of GDP in 2000 to 20,2% in 2006. The latter figure is very modest in comparison to Estonian equivalent percentage of 77,2. Also Latvia and Lithuania have attracted more inward FDI than Russia in relative terms.

The most crucial figure in the above table is Russia’s outward FDI stock as a percentage of GDP in 2006, which is with 16% twice as high as the equivalent figure in 2000. Russian outward FDI stock is advancing rapidly in relative terms.

Outward FDI investing in Latvia and Lithuania is on the modest relative level, while Estonian firms, especially Swedish-owned banks, have advanced their outward FDI spree.

According to WIIW data, FDI inflow was 2004 – 2007 somewhat higher, than FDI outflow in Russia. Differences between these two flows are relatively modest.

Table 8. FDI flows in Russia
Billion EUR

	2004	2005	2006	2007	Growth factor
Inflow	12,4	10,4	26,0	38,3	3,1
Outflow	11,1	10,2	18,6	33,4	3,1

Source: WIIW

As the table above shows, there was a net inflow of FDIs in the given period (2004 – 2007). The net sum, however, is of modest magnitude. FDI inflow and outflow grew between 2004 and 2007 in unison, by factor 3,1.

It can be assumed that FDI inflows had in the current decade been considerably higher in value, if Russia had taken a more liberal attitude toward foreign investors. Russia has been reluctant to accept foreign dominance in activities, in which local natural resources are exploited. Shell had a large-scale operation in Sakhalin Island in natural gas production. This scheme was dismantled due to certain environmental issues. The only joint venture in oil business between Tyumen Oil and British Petroleum has been in the headlines in 2008. The British managing director had visa problems and was ousted from the company. However, the joint venture was kept in tact.

A new law dealing with “strategic investment” was adopted in 2008. There are some 40 sectors, in which foreign dominant investment requires permission. The aim is to provide the government with strong means to control foreign FDI activity. Sectors like telecommunication and internet providers are included in the list of “strategically important sectors”.

Thus, the investment climate is not optimal for foreign potential investors. Therefore, FDI inflows are difficult to predict.

In the outward FDI flows there are several reasons for the growing trend. Since the financial crisis of 1998 with a deep devaluation of rouble exchange rate it became profitable to invest in Russia and create import substituting capacities, e.g., in food processing industry. Some Russian companies in food and beverage have become international.

In the first years of the new century, oil and gas prices have experienced a steep increase bringing windfall profits for Russian companies producing energy bearing materials. These companies can finance their foreign operations from their cash flow.

There has been strong demand for metallurgy products because of strong economic growth in China. Thus, Russian companies operating in metallurgy branch have become rich. In this context it is important to bear in mind that Russian industry has enjoyed subsidies in the energy bill. Thus, energy-intensive metallurgy has been able to earn high profits, which can partially be used for internationalization.

Amid the global oil price boom, Russian rouble has appreciated clearly in real terms. Therefore, it is convenient to invest money outside of Russian borders.

In the 1990s, several Western retailers started invading the former Eastern Bloc. Russia was regarded as a high risk country, and thus, only a few Western retailers penetrated the Russian market via FDI. Local retailers created viable networks for their chains and have now cash for international expansion. Eldorado is a Russian company selling consumer durables with subsidiaries in Ukraine and Kazakhstan.

3.2 Russian outward foreign direct investment (OFDI)

3.2.1 CIS

In the former Soviet Union there were 15 republics in the Federation. After the collapse of the Union, three Baltic republics, Estonia, Latvia and Lithuania, refused to join any edifice comprising the former Soviet Republics.

Commonwealth of Independent States (CIS) was created in the early period of post-Soviet time. Russian Federation is far the biggest state in this commonwealth. Ukraine, Belarus and Moldova are European CIS-countries. Georgia, Armenia and Azerbaijan are in Caucasus. Kazakhstan, Turkmenistan, Uzbekistan, Kyrgystan and Tajikistan are CIS-countries situated in Central Asia.

Ukraine is the second largest post-Soviet republic with a population of about 46 million. In the 1990s Ukrainian transition was extremely difficult. In the Soviet period, Ukraine hosted a lot of military-industrial production units. After the collapse of the communist superpower, conversion of this branch to civilian purposes was awkward.

Assets were privatised reluctantly and slowly. For a rather long period of time, stability was neglected in economic policy making. Ukraine is relatively rich on natural resources (coal, iron ore, fertile soil, etc.), but she has no abundant oil and gas deposits to earn easy export income. Therefore, it is no wonder that the population of the country decreased rather rapidly in the early transitional period (for details, see: Tiusanen, Ivanova & Podmetina. EU's New Neighbours: The Case of Ukraine. NORDI publication no. 6. Lappeenranta, 2004.).

Ukraine has not been able to attract plenty of FDIs into her territory. The FDI stock was only USD 22,5 billion in 2006 according to UNCTAD figure. However, there has been an increasing FDI inflow in recent years in Ukraine. According to WIIW data, FDI inflow grew form USD 1,4 billion in 2004 to USD 7,2 billion in 2007, a fifefold leap upwards.

It is obvious that Ukraine as a neighbouring country is potentially interesting for Russian resource-based companies. Enterprises active in metallurgy have had a dynamic period in the early years of the 21st century because of increasing demand from China.

Russian Aluminium (Rusal) became the largest unit in its branch in the early period of transition. It merged with its domestic upstream competitor Sual and with Switzerland-based Glencore's Aluminium business in 2007. This merger has created a world leader in aluminium production (by tonnage). This international giant has production in 17 countries.

Table 9. Main assets of Rusal, Sual and Glencore

Rusal	Sual	Glencore
In the Russian Federation - Achinsk alumina refinery - Boksitogors alumina refinery - JSC Bratsk aluminium plant - Krasnoyarsk aluminium smelter - Novokuzneck aluminium smelter - Sayanal - Sayanogorks aluminium smelter	**In the Russian Federation** - Bogolovsk aluminium plant - Irkutsk aluminium smelter - Kandalaksha aluminium smelter - Nadvoitsy aluminium smelter - North Ural bauxite mine - Pikalevo alumina refinery - Sual-PM Ltd. - Ural Silicon - Urals aluminium smelter - Urals Foil - Volgograd aluminium smelter - Volkhov aluminium smelter	- Alumina Partners of Jamaica (Jamaica) - Aughinis Alumina Ltd. (Ireland) - EurAllumina Spa (Italy) - Kubikenborg Aluminium Sundsvall AB (Sweden) - West Indies Alumina Co. (Jamaica)
In other countries - Armenia foil mill (Armenia) - Bauxite Co. of Guyna Inc. (Guyna) - Cathode plant (China) - Compagnie de Bauxite de Kindia (Guinea) - Friguia alumina refinery (Guinea) - Nikolaev alumina refinery (Ukraine) - Queensland Alumina Ltd. (Australia) 20%	**In other countries** - Zaporozhye aluminium combine (Ukraine)	

Source: UNCTAD 2007

Ukraine is traditionally the largest alumina producer in the CIS region. Nikolaev alumina refinery in Ukraine belongs to Rusal. Sual owns Zaporozhye aluminium combine in Ukraine. Rusal has surplus bauxite in its supply chain but is short of alumina, while Sual and Glencore have excess refining capacity, and will benefit from Rusal's bauxite surplus. Thus, the merger of these three units aims at controlling the entire value chain in aluminium production. Alongside with Ukraine, Rusal has assets also in Armenia (within CIS), where it owns an aluminium foil mill.

As pointed out above, Gasprom is one of the biggest and also one of the most profitable companies in the world. Gasprom is not a “normal” publicly traded company. It’s majority owner, Russian Federation, obviously participates actively on international affairs made by Gasprom.

At the end of 2005, Gasprom was for several days in headlines when Russia announced price hikes of natural gas deliveries to Ukraine. The official reason for price revision was the cheap (subsidized) price Ukraine paid for Russian gas (USD 50 per 1000 cu metres). In the international press it was pointed out that gas was used as a political weapon. There were rumors that Ukraine diverted for its own needs deliveries sold to Germany. Eventually, a new (higher) price was agreed on for Russian gas deliveries to Ukraine.

After this dispute, Gasprom developed a new pipeline route connecting Russia with Germany through “Nord Stream” underwater alternative. The final destiny of this giant project is unclear. The aim is to transport 55 billion cu metres of natural gas from Russia to continental Europe per annum.

Alongside with Ukraine, Belarus received a notice of gas price hikes. This dispute was settled in December 2006 via an agreement, according to which Gasprom will be able to raise its stake in the Beltransgaz pipeline. This company is vital in allocating Russian gas in Belarus.

Armenia is a small landlocked CIS country with scarce natural resources. Gasprom is the main supplier of gas in Armenia and owns three-quarters of the local gas distribution company, ArmRosGasprom.

Lukoil is the biggest oil company in Russia. In 2005, Lukoil purchased a Canadian-based company with substantial assets in Kazakhstan’s oil business. In addition, Lukoil has petrol stations in Azerbaijan and an oil refinery in Ukraine (Odessa). Tatneft (the oil company of Tatarstan) is the majority owner of Kremenclingsky refinery. TNK (Tyumen oil) has a decisive stake in Krersousky refinery (both refineries located in Ukraine).

In the former Eastern Bloc, Lukoil owns two refineries Neftokhim Burgas (Bulgaria) and Petrotel Ploesti (Romania).

In Russian food processing industry plenty of mergers took place in the 1990s. Rouble devaluation in 1998 improved essentially price competitiveness in import substituting branches, including food industry.

Wimm-Bill-Dann Foods (WBD) is a real success story among the de novo enterprises in post-communist Russia. It is the market leader in the dairy and juice products in Russia. In the turn of the century it started to become an international player in her own branch. In 2002, WBD became the first Russian consumer good company ever to be listed on New York Stock Exchange (NYSE) via ADRs (American Depository Receits).

In the second half of the 1990s, WBD started a rapid acquisition spree in Russia. In 2000, WBD bought a 60% share of Kiev City Milk Plant. The company advanced rapidly on her acquisition path in Ukraine and had some 12% of the dairy product market of the country in 2007. This company also acquired production units in Kyrgystan and Uzbekistan. In 2007, WBD had annual revenues of USD 1,5 billion.

Unimilk, Russia’s second-largest dairy producer, has a rather similar history as WBD. However, it is not listed in New York. After acquiring several units in Russia, also Unimilk entered the Ukrainian market via an acquisition spree. In 2007, Unimilk had even a higher market share of Ukrainian dairy branch (14%) than WBD.

In food and beverage branch, two Russian breweries have become international, Baltica and SUN. Both of them have large-scale operations in Russia and Ukraine.

Baltika brewery was acquired by a Scandinavian holding company (BBH) in 1990s. When this brewing unit had huge success in the post-Soviet market, it was acquired by the British company Scottish & Newcastle. This British owner sold Baltika to Carlsberg (Denmark).

SUN brewery was established by an Indian trading house. After a very rapid growth, the major owner sold its stake to Inbev, which is the biggest brewery in the world after acquiring Altheuser-Busch in America. Thus, these two international Russian breweries are actually owned by Western players.

Alfa Group is one of the leading conglomerates in the post-communist Russia. The core of this group is Alfa Bank, which was founded already 1990. Alfa has also an insurance arm (AlfaStrakhovanie). Alfa’s financial activities cover commercial and investment banking. The group has equity investment in a variety of industrial branches.

Alfa Bank was registered in Ukraine in January 2001. The company created rapidly a rather tight network of offices throughout the country. Alfa Group has bought equity stakes in a multitude of Ukrainian industries, including mass media. It is involved in TV and radio business, as well as in printed media branch.

In the Soviet era, all banks were owned by the state and run according to the central plan. It meant that banks had no “normal” spontaneous actions on the market. Deposits collected by the banking system were invested in projects determined by Gosplan, state’s planning unit.

Sberbank (Savings Bank) was the only bank in the Soviet Union able to deal with savings of individual citizens.

After the collapse of the Soviet Union, Sberbank remained in state’s ownership. It has traditionally the biggest bulk of savings accounts of households.

In the second decade of transition Sberbank started its internationalization by acquiring 80% of Texakabank in Kazakhstan in 2006. One year later Sperbank bought NRB Bank in Ukraine.

In the Soviet era, currency deals were tightly concentrated in Vneshtorgbank (Foreign Trade Bank) which was part of the state’s monopoly of foreign trade. In the early period of transition it was decided that Vneshtorgbank, or VTB, will remain state-controlled via majority stake of government. Presently, VTB controls two banks in Ukraine, and one in Belarus, Armenia and Georgia.

In the early period of Russian transition, a new company generating electricity was created (United Energy System, or UES). Virtually all power stations of the vast country were functioning under the umbrella of UES, except nuclear power stations, which were managed by state-run Atomenergo.

A couple of years ago it was decided to create competition on the electricity market by dissolving UES. A number of power stations were put on sale. The aim is to establish market-oriented prices for all users of electricity.

UES has been active in several CIS countries. The resource-poor Armenia, which is highly dependent on Russian energy deliveries, made a special deal with Russia in 2003. Virtually all electricity generating units in Armenia went to Russian ownership in a debt-for-equity swap worth about USD 100 million. In Georgia, UES controls about 20% of the country's power generation capacity. In Belarus, UES owns and operates a thermal-power plant.

In all communist countries telephone operating was a state-run utility. The state ran a fixed-line system, which took very badly care of individual clients. Households had a long waiting time before getting their telephones connected. In the post-communist period a revolution in telecommunication has taken place. A handful of big operators is available in every TE. Western involvement in this business has been remarkable.

In the second decade of the Russian transition, there are three major telecom operators, the largest one of which is Mobile Tele System (MTS). MTS was listed in New York in 2000. In 2007, MTS had almost 60 million customers in Russia. It also provides GSM services in Ukraine, Belarus, Armenia, Turkmenistan and Uzbekistan.

VimpelCom is the second biggest operator in Russia with over 40 million customers. Telenor (Norway's main tele-operator) has a 30% stake in VimpelCom, which operates in Ukraine, Armenia, Georgia, Kazakhstan, Uzbekistan and Tajikistan.

MegaFon is the third major teleoperator in Russia with 36 million customers. TeliaSonera (the Swedish-Finnish operator) has a 44% stake in this company, which operates also in Tajikistan.

These three Russian mobile phone operators have entered CIS countries via FDI. MTS and VimpelCom have been especially eager to expand their operations in CIS countries outside of Russia.

It is not the aim here in this chapter to cover all possible details of Russian OFDI in the other CIS countries. Altogether, the sums invested directly by Russian companies in the former Soviet republics are relatively modest.

It is obvious that economic influence moves alongside FDI flows. Therefore, it is understandable that Russia has set very clear limits for FDI inflow in branches it regards as strategically important.

Russian OFDI gives her potential leverage in "near abroad" as CIS-countries are called in Russia. This leverage is rather limited in the light of examples mentioned above.

However, Russia's dominance in the Armenian electricity market contains clear leverage. Gasprom's strong position in gas pipeline business gives plenty of concrete leverage, e.g., in case of Turkmenistan which is an important factor in global hydrocarbon business. Exporting Turkmen gas without Russian pipeline routes is virtually impossible. This leverage, however, does not originate from Russian OFDI, because Gasprom controlled transit routes are inherited from the Soviet time.

International expansion of Russian banking sector gives potential leverage in "near abroad". Alfa Bank's strong position in Ukraine obviously is linked with economic influence. However, Russian banking sector is not yet an important factor in global financial markets, not even post-communist part of it.

Russian food processing and beverage branch has become more and more international via FDIs in neighboring countries. From the strategic point of view international operations of dairy firms and breweries are harmless.

In this sphere, Western capital is involved. Baltika brewery, as well as its rival, SUN brewery, is in Western ownership. VimpelCom in telecommunication is expanding internationally earning supplementary profits for its Norwegian shareholder. Internationalization of Russian firms have thus a multitude of aspects to be observed.

3.2.2 Russian OFDI outside of CIS

In the first years of the 21st century Russia has earned permanent substantial current account surpluses. The cumulative surplus between 2000 and 2007 was about EUR 400 billion. This high figure illustrates the wealth Russia has been able to collect from the oil and gas price boom in the world during her second decade of post-communist transition.

With the windfall profits from the energy bearing exports Russia is in a good position to go shopping in the global acquisition market. Shopping objects can be in the rich part of the world, as well as in the emerging markets.

However, a big part of the windfall profits of the oil and gas bonanza has been diverted to the state via heavy taxes levied especially on oil exports. The state owns the oil pipeline system (Transneft), and earns substantial income via transporting exported oil.

In 2004, Russia established a special fund for petro-dollars it acquires. This Oil Stabilization Fund (OSF) was originally created to reduce the vulnerability of Russian economy highly dependent on raw material exports. The original aim of OSF was to even out business cycles.

As the world market price of oil kept on increasing, and thus, OSF expanding it was decided that the accumulated money was converted into foreign currencies. The reserves were invested in sovereign bonds of 14 developed countries.

In 2008 it was decided that the Oil Fund will be divided into two parts. One of them is called “Reserve Fund”, and the other “National Welfare Fund”. The latter one is supposed to invest its money into highly profitable assets, probably including equity stakes in the global market. It is not clear what kinds of risks the management of the welfare fund is ready to take in the present turbulence of international financial markets.

In the early years of the 21st century it became clear that certain parts of the emerging world is gaining economic strength via dynamic growth scene. A new abbreviation, BRIC, came into being (Brazil, Russia, India, China). Two first ones are resource-rich and two others extremely populous and fast growing. BRIC countries accumulate wealth. Alongside BRIC countries, members of OPEC have become extremely rich.

In several newly-rich countries there is oligarchic and state-led capitalism which differs essentially from traditional entrepreneurial capitalism. If countries belonging to the former acquire assets in the latter, the situation is awkward. In 2006, as Dubai Ports World attempted to buy some American ports from their British owner (P & O), the deal was delayed in Congress. Abu Dhabi Investment Authority bought a stake in Citigroup with USD 7,5 billion in 2007, which made headlines.

There are obvious fears in the developed part of the world that sovereign-wealth funds or state-dominated companies from emerging markets acquire decision-making power via investing in corporate sector in the rich part of the world. Obviously, every investor is looking for the best possible return on the invested money, which will not necessarily include meddling in politics. However, a combination of these two aspects can not be excluded which seems to worry especially Western financial media.

Obviously, emotions can not be kept separate from business. In 2006, Mittal Steel (India) made a bid for Arcelor, a European steel firm. Fierce opposition came from the governments of France, Luxembourg and Spain, which preferred to Arcelor’s merger with Severstal

(Russia). The deal was finalized when Indian government interfered and threatened a trade war. Mittal became the biggest steel-maker in the world.

In this context it is interesting to note that Arcelor's shareholders favoured a potential owner from Russia. Normal shareholders on the market usually prefer an acquirer who pays the highest price for shares.

Complete and up-to-date information on Russian multinationals is still rather difficult to come by. As Russian OFDI is increasing, destinations of investment is changing. CIS is declining in relative terms, while developed world is increasing in importance. Africa becomes a more interesting destiny, while Asia (excluding CIS-countries in Central Asia) is hardly a location for Russian OFDI.

Table 10. Russia's top 15 multinationals
USD million, 2006

	Foreign assets	Sector*
Lukoil	18.921	1
Gazprom	10.572	1
Severstal	4.546	2
Rusal	4.150	2
Sovocomflot	2.530	3
Norilsk Nickel	2.427	2
AFK Sistema	2.290	4
VimpelCom	2.103	4
Novoship	1.797	3
TNK-BP	1.601	1
Evraz	1.322	2
FESCO	1.074	3
PriSCo	1.055	3
Novolipetsk Steel	964	2
RAO UES	514	5

*1 (Oil/Gas), 2 (Metals/Mining), 3 (Transport), 4 (Telecoms/Retail), 5 (Electricity)

Source: Deutsche Bank Research. April 30, 2008.

Resource-based firms dominate the above list of Russian multinationals which are listed according to their foreign assets. Three of the companies in the list are active in transportation. These three firms are not covered below.

Acquisition deals made by Russian multinationals abroad in 2005, 2006 and 2007 are listed in Appendix 1. The list covers only deals, in which the acquisition price is USD 100 million, or more.

Lukoil is the most international company of Russia according to asset ownership abroad. It acquired Nelson for USD 2 billion in 2005. The target was registered in Bermuda Islands. This case was mentioned above. Nelson was active in Kazakhstan's oil business. Therefore, the acquisition price was rather high.

In the same year Lukoil acquired Teboil and Suomen Petrooli in Finland for USD 160 million. These two companies have their own history in post-war Finland. Both companies were owned by the former Soviet Union. Suomen Petrooli imported oil products, especially gasoline from Soviet Union to Finland. Teboil was running a retail network for Soviet oil products in Finland. In the deal mentioned above, Lukoil acquired the Teboil filling station network.

Severstal is the biggest steelmill in Russia. It bought a dominant share (62%) of Lucchini Steel Mill in Italy 2005 for USD 560 million. In the meantime, Severstal has increased its share in Lucchini to 79,8%.

VimpelCom entered the Ukrainian market via acquisition of WellCom for USD 231,3 million. As mentioned above, VimpelCom has a very strong foodhold in telecom operating in CIS-countries.

RAO Nordic acquired a power station in Moldova in 2005 for USD 100 million. As a small CIS country, Moldova has hardly been able to attract Russian FDIs in its territory.

Two acquisition deals in the billion dollar category were signed in 2006 (Appendix 1), both of which are in metallurgy branch. The far biggest one comprises the merger of two Russian aluminum producers, Rusal and Sual, plus Glencore's business in the same production branch. The total value of this amalgamation is over USD 10 billion.

Evraz is one of the big metallurgy companies in Russia. The firm acquired Oregon Steel Mills (USA) in 2006 for USD 2,3 billion, which is one of the largest sums in Appendix 1. The same company acquired a dominant share of 73% in Strategic Minerals Corporation (USA) for USD 110 million also in 2006. In 2007 Evraz bought Highveld Steel and Vanadium (South Africa) for USD 238.

Norilsk Nickel (NN) is another Russian metallurgy company, which has expanded its asset ownership abroad. In 2006, NN bought OM Group's Nickel business with activities in Finland and Australia for USD 408 million. The same company acquired LionOre Mining

(Canada) for USD 5,2 billion in 2007, the highest sum mentioned in Appendix 1 concerning deals signed in 2007.

Severstal seems to be the most international metallurgy company alongside with Rusal in Russia. The company bought a dominant share (81,1%) of Celtic Resources Holding (Ireland) in 2007 for USD 315 million. Severstal foreign operations take place especially in the USA.

Severstal International was established in April, 2008 to manage the holding's foreign assets. It integrates Italian Lucchini (79,8% belongs to Severstal) and the range of assets in the USA: Severstal Columbus (former SeverCorr) in Mississippi and the incorporated company Severstal North America (SNA) that consists of Severstal Dearborn in Michigan (former Rouge Steel), Severstal Sparrows Point in Maryland (Sparrows Point), Severstal Warren in Ohio (WCI Steel) and Severstal Wheeling in Western Virginia (Esmark Inc.), as well as several joint ventures. The total production capacities of all division's enterprises attain 12,5 million tons of steel products. SNA alone occupies the 4th place by the volume of the produced steel in the USA among the full integrated works. (www.severstal.com.)

Lukoil is obviously interested in expanding her retail operations by acquiring gasoline stations. In 2007, the company bought Network Jet with filling stations in the Czech Republic, Slovakia, Belgium, Poland, Hungary and Finland for USD 560 million.

Appendix 1 contains several deals in telecom branch outside CIS. Sitronics bought a majority share (51%) of Intracom Telecon (Greece) for USD 152 million. AFK Systema bought Ashyam Telelink (India) for no less than USD 4,3 billion. Renova Group bought a 50% share of Everest Beteiligungs GmbH in Switzerland for USD 720 million.

One big deal in the chemical industry branch is included in the acquisition list (Appendix 1). TransCentralAsia Petrochemical Holding Consortium bought a majoritys share (51%) of Petkim Petrokimya Holding in Turkey for USD 2,1 billion in 2007. This is one of six cases in the list comprising three years (2005 - 2007), in which the acquisition (partial or complete) exceeds USD 2 billion. The same list contains only two deals in the branch of machine-building. GAZ International bought LDV Holdings (100%) for USD 130 million in 2006. In the following year Rostsilmash bought an 80% stake in Buhler Industries (Canada) for USD 152 million.

Russian service sectors are not yet heavily involved in internationalization process. Telecom operators are an exception, not a rule. As pointed out before, some Russian banks are active in other CIS countries.

Mirax Group bought Hotel Sungate Port Royal in Turkey for USD 340 million. This deal in the sphere of tourism is relatively high in value terms.

Gazprom is a special case among Russian internationally active companies. This gas giant has its own bank (Gazprombank), which has its daughter company in Belarus (Belgazprombank). Gazprom UK is involved in banking.

In the early period of Russian transition, freedom of the press started taking shape. Relatively soon the media world changed radically. Especially TV and radio branch experienced a “consolidation phase”. NTV, one of the major TV companies became a part of Gazprom conglomerate. Obviously, this arrangement did not advance the freedom of speech.

Gazprom has a number of wholly owned daughter companies, especially in gas distribution business: Topenergo in Bulgaria, Northtrransgas in Finland (gas transportation), Gazprom Germania in Germany, WIEE in Romania and Gazprom Marketing and Trading in Great Britain. In addition to these wholly owned subsidiaries, Gazprom has stakes in gas distribution firms situated in several EU-countries.

It is often pointed out in the Western financial press that Gazprom’s activities are not always transparent. In the early years of the 21^{st} century there were rumors that some of Gazprom’s export deliveries were made via intermediaries, one of which was called Itera. Gazprom bought gas cheaply from the internal market and sold it with hefty mark-up abroad. Itera’s shareholders thus collected extra profits from export business, while Gazprom’s shareholders did not benefit from the intermediary link. Itera was eventually dismantled. However, several observers maintain that Gazprom’s business activities are still not entirely transparent.

According to UNCTAD’s “World Investment Report 2008”, Russian inward FDI stock had a total value of USD 324 billion in 2007, or about 64% more than one year earlier. The outward FDI stock in Russia is estimated to be USD 255 billion in 2007, which is about 63% more than in 2006. It means that the former (Russian inward FDI stock) increased roughly by USD 125 billion, while the latter (outward FDI stock) grew by almost USD 100 billion. The UN report does not contain complete information on how these remarkable growth rates in inward and outward FDI stocks have taken place in one year only.

The 15 deals listed in Appendix 1 concerning the year 2007 have a total value of USD 15,4 billion. Each one has a value of USD 100 million, or more. These big deals cover thus only about 15% of the increment in Russian OFDI stock in 2007.

The Russian economy is traditionally, in Soviet and post-Soviet era, dominated by big companies. A significant share of the Russian enterprise sector consists of 839 large corporations with combined sales of USD 740 billion in 2006. This group covers almost all significant Russian listed firms in the Russian stock exchange (RTS). The private sector's share reached the level of 70% of Russian GDP in 1997, but declined to 65% in 2005 – 2006 indicating growing government involvement in the economy. (For details, see: Juha Väätänen: Russian Enterprise Restructuring – the Effect of Privatisation and Market Liberalisation on the Performance of Large Enterprises. Acta Universitatis Lappeenranta, 2008. Doctoral Thesis.)

There are some de novo enterprises in Russia which are listed in RTS or abroad. Some of them, like WBD, in dairy business have become international by acquiring firms in neighboring countries. However, the SME-sector (small and medium size enterprises) is not yet very international.

Some state-dominated companies, e.g., in banking sector, have acquired units abroad, mainly in other CIS-countries. The combined foreign ownership of these companies is still rather low.

Therefore, the UNCTAD estimate of Russian OFDI stock in 2007 seems to be rather high. The one year (2007) growth of about USD 100 billion in this stock is not clarified in the UNCTAD 2008 World Investment Report. Therefore, neither geographical distribution of Russian OFDI activity in 2007, nor industrial sectors involved can be investigated in detail.

Some pieces of information on Russian OFDI can be picked up from newsletters. Russian financial-industrial group Basic Element spent USD 1,5 billion for an 18% stake of Canadian auto-parts maker Magna International in 2007. This deal qualifies as an OFDI, because according to FDI definition the investing firm must take a stake in another company abroad above 10% (portfolio equity investment occurs when the bought equity stake is below 10%).

The same Russian company (Basic Element) acquired substantial stakes in Austrian construction company Strabag and German construction firm Hochtief in 2007. These deals were made because Basic Element is heavily involved in construction work in connection with Sochi Winter Olympic Games in 2014. (Mergers & Acquisitions in Russia in 2007. PriceWaterhouseCoopers.) It can be assumed that Strabag and Hochtief attempt to improve their chances in Sochi projects when they have a Russian investor involved in their businesses.

Even though information on Russian OFDI is far from complete, some reasons for international operations made by Russian companies can be listed. Obviously, a major background factor in this context is money: amid global oil, gas and metal price boom Russian companies have become much richer than in the 1990s. Thus, many companies have money, or access to borrowed money needed for OFDI operations.

The post-Soviet market in Russia is still far from perfect. Internal prices are still partially regulated, and thus, international businesses are potentially lucrative.

Resource-based companies everywhere in the world try to secure access to raw materials. Even if Russia is well endowed with natural wealth, Russian mining companies have interest in external sources of minerals.

Traditionally, Russian companies have been active in selling products at the lower end of the value chain, where prices are volatile. Therefore, Russian OFDIs are clearly targeting higher value-added production facilities. This seems to be especially the case in the metallurgy branch.

It is only natural that Russian corporations are trying to access end-users in external markets in order to widen their profit margins. This point is obvious in Gazprom's internationalization process.

Obviously, every OFDI by Russian companies contains potential gains in accessing to technological and management know-how. Advantages in this sphere can be taken for granted in every single OFDI which is done in the form of acquisition in the West.

Improving company governance via running foreign affiliates increases transparency of business. It can be assumed that better governance reduces capital costs. The better a company is managed, the better is its creditworthiness, which is reflected in interest rates of borrowed money.

Everywhere international diversification of a firm improves its risk profile. As a relative latecomer in OFDI business Russian companies have lately become less risky businesses via internationalization than before.

It can be assumed that in the present OFDI boom of Russian companies there is something which can be called a push factor. Investment climate in Russia is clairly suboptimal. This topic has been researched in several NORDI publications. The rather difficult institutional environment in Russia gives a potential incentive for local firms to invest abroad.

Everywhere in emerging markets local companies must be able to withstand global competition. In order to retain a strategic position in the domestic market Russian companies must consider carefully new growth potential outside their home base. Thus, Russian companies are forced to participate on the global consolidation process.

In sum, there is a multitude of reasons to believe that Russian companies will remain dynamic in the sphere of OFDI activities. It is likely that many companies in the West will be on sale for a reasonable price in the near future because of the financial crisis. Thus, Russian companies will have good opportunities when they acquire firms in the developed part of the world.

3.2.3 Russian investment in Finland

In the Soviet era, Finland and the Soviet Union had a bilateral clearing agreement in the trade between each others. In the framework of this trade, Soviet raw materials, especially oil, were exchanged for Finnish manufactured goods. Soviet oil was refined in Finland by a state-owned company (Neste).

In the post-war period, some Soviet companies (Teboil, Suomen Petrooli) were established active in oil business. In that era, it was impossible for Western companies to own shares in Soviet enterprises, which were all by definition owned by the Soviet state.

In the late 1980s, the Soviet state allowed joint ventures with Western capital involvement in her territory. Only very few Western companies, among them some Finnish ones, took this new opportunity.

Therefore, it can be stated that both inward and outward FDIs in Russia are post-Soviet phenomena. Presently, market forces determine FDI in- and outflows in Russia. As pointed out above, FDI inflows are relatively tightly regulated by the Russian state. At the same time, Russian companies are free to make outward FDIs on the basis of their own feasibility assessment.

Obviously, Finland is not a prime target of Russian outward FDIs. Finland has no extensive mineral base. However, the country has some tradition in mining and refining non-ferrous metals, for example, copper. In this branch, the most important mine is exhausted.

A copper melting unit was in the 1940s established in Western part of Finland (Harjavalta). In the 1960s a nickel producing unit was established in the same town. In 2000, an American company (OMG) bought the Harjavalta nickel unit.

OM Group sold all of its nickel assets to Norilsk Nickel in 2007. This deal with total value of USD 408 million comprised nickel production units in Finland (Harjavalta) and in Australia. This deal is mentioned in appendix 1 and 2. (It is not known what the acquisition price of Harjavalta nickel unit was in the entire deal between OMG and Norilsk Nickel).

In the last decades of the 20th century, there were certain consolidation arrangements in the Finnish energy sector. Neste Oil became a part of a big energy company (Fortum). A re-arrangement, however, gave Neste refinery an independent position.

In this re-arrangement, the state of Finland got a majority share in the oil refining unit. It can be assumed that Lukoil had interest in acquiring Neste, had majority stake been available in the stock exchange.

As mentioned above, Lukoil bought the filling station network Jet with petrol stations in Finland, Czech Republic, Slovakia, Poland, Hungary and Belgium. Lukoil also bought Teboil and Suomen Petrooli.

After these two deals, Jet filling stations disappeared from the Finnish landscape. Obviously, Lukoil acquired one of its retailing competitors in Finland and is now advancing the marketing of its own products via Teboil network in Finland.

Energy supply in Finland has never depended heavily on natural gas. There is a gas pipeline in Southern part of the country transporting imported gas from Russia. Gasprom is participating on gas transportation with an ownership stake in Finland.

There is a long tradition in making pre-fabricated houses in Finland. Amid the Russian oil price boom, demand for one-family houses has increased rapidly in Russia. One production unit in this branch was acquired by a Russian company (Appendix 2).

Industrial revolution in Finland started with the emergence of wood processing. Saw mills, pulp and paper making have lost relative importance during the last three decades. Higher raw material and energy prices are presently hurting this traditional industrial branch in the first decade of the 21st century. Especially pulp and paper industry is struggling with profitability problems. This industry is highly consolidated with only three major units left.

The bigges paper mill in the world, International Paper (USA), owns a big unit in Russia, in Svetogorsk, near the Finnish-Russian boarder. IP's Russian unit was built by Finnish companies in the Soviet era. Russian other paper companies are not important international players yet, even if they can rely on local cheap raw material and energy. Capacities were built up in the Soviet era.

It is obviously possible that some Russian wood processing companies will become internationally competitive in the near future. They can rely on strongly increasing internal demand, and thus, have reasonable cash flows.

Therefore, it can be assumed that in the next couple of decades some Russian paper mills will have interest in acquiring shares in paper-making companies in Finland. Export tariffs of raw timber have been introduced and increased in Russia. As a result, imported timber from Russia has become less and less profitable for Finnish paper-mills. At the same time, pulp and paper prices on the global market are under heavy pressure because of the relative overcapacity in the global pulp- and paper-making.

Stora Enso is the second largest forest and paper product company in Fortune's list with revenues of USD 21 billion in 2007 (the biggest one, International Paper has the equivalent figure of USD 22,3 billion). According to the same source, Stora's market value (stockholder's equity) was USD 10,6 billion in 2007. Obviously, there are no Russian companies in the same branch with enough cash to acquire the Finnish giant in the near future.

4 Conclusions

Russian outward FDI stock has according to UNCTAD increased from USD 20 billion in 2000 to no less than USD 255 billion in 2007, a growth by factor 13. This extremely high figure reflects the oil price boom and the resulting accumulated wealth of the Russian economy.

Gasprom is not only the most valuable company in the world (measured by stockholders' equity), but also the largest energy company in global scale in Fortune Magazin's classification. The second biggest energy company in the same list is E.ON from Germany.

Fortune lists also petroleum refinering companies, the biggest of which is Exxon-Mobile with USD 373 billion revenues in 2007. Lukoil is on the 14th place in this category with revenues of USD 67 billion. Rosneft Oil is on the 22nd place with revenues of USD 36 billion. In this category crude oil production is not included.

The same source classifies also the biggest metals companies in the world with 13 firms involved. The biggest one is Arcelormittal, the Indian-owned company registered in Luxembourg, with USD 105 billion revenues in 2007. The last one in this category is United States Steel with an equivalent figure of USD 17 billion.

As mentioned above, Rusal is the biggest aluminium company in the world after a rapid expansion via acquisitions. However, Rusal is not yet in the table of 500 biggest companies in the globe, and thus, not among the 13 largest metal companies. Severstal and Norilsk Nickel have also had a remarkable internationalisation spree lately, but they are not yet real international giants.

It is not amazing that Russian companies have been very active in other former Soviet states, especially in Ukraine and Kazakhstan. In these countries of "near abroad" also some de novo Russian companies have been very active. An example is Wimm-Bill-Dann in dairy and beverage branch.

In this context, also Baltika brewery is often mentioned. It is worth to underline that this Russian company with production in other FSU (former Soviet Union) is owned by Danish company Carlsberg. Similar companies, like SUN brewery, also come up in statistics: SUN is a Russian company with production units in FSU, but the owner is InBev in Belgium.

Mobile phone operating did not take place in the communist era. Fixed line telephony was very badly taken care of by the Soviet state. Therefore, it is understandable, that this activity has grown exponentially in the post-Soviet era. Mobile phone operators have also become international players in Russia via daughter companies in other parts of FSU.

In the early period of post-communism, the banking sector expanded enormously. During the rouble crisis of 1998, several thousands of banks disappeared. Some consolidation of the branch took place.

In the first decade of the 21st century, some Russian banks have started activities in other parts of FSU. Sperbank is within the biggest financial institutions in the world. Thus, it is no wonder that this traditional savings bank has become internationally active.

The former Eastern Bloc has been entered by international companies via FDIs in massive scale. Russian firms are involved in oil refining and petrol station business, as well as in gas distribution, but the big bulk of FDIs in this region comes from the West.

Some big acquisition deals have been made in the West by Russian metallurgy companies. The internationalisation of this branch of Russia is advancing on a healthy pace. In manufacturing many deals have been clinched, but hardly any spectacular ones.

It is remarkable, that Russian companies have entered new Western markets almost only via acquisitions. There seems to be no information available on Russian Greenfield investments in the West.

Russian overall outward FDI stock figure of over USD 250 billion is rather high. If this figure is accurate, there must be thousands of Russian-owned companies in the world, many of which are obviously small. No complete information is available. This short report has dealt with the best-known cases only.

It is impossible to predict how Russian outward FDI activity will develop in the near future amid the financial turmoil in global financial markets. In October 2008, the dollar-denominated RTS stock exchange index in Moscow and the rouble-denominated MICEX index declined by some 60% since January 2008. In the same period, global oil prices fluctuated between USD 70 and USD 150 per barrel. The average oil price in 2007 was USD 73 per barrel.

It is in the light of these figures obvious that the Russian economy is not insulated from the harmful effects of the global financial crisis. At the same time it can be assumed that potential acquisition prices are now more moderate than during the two previous years. This fact may attract Russian companies to continue their acquisition spree abroad in the near future. However, as rapid growth of Russian outward FDI stock as between 2000 and 2007 can hardly be expected in the next seven or eight years.

Appendix 1. Russian investments abroad in 2007, 2006 and 2005

2007 **Buyer**	**Target company**	**Target country**	**Sector**	**Share, %**	**Value, USD million**
GMK Norilsk nickel	LionOre Mining Ltd.	Canada	Mining	100	5234
AFK Systema	Ashyam Telelink Ltd.	India	Telecommunications	100	4300
TransCentralAsia Petrochemical Holding Consortium	Petkim Petrokimya Holding A.S.	Turkey	Chemistry	51	2050
Renova Group	Everest Beteiligungs GmbH	Switzerland	Telecommunications	50	720
Lukoil	Network Jet – 376 gas/petrol stations	Czech, Slovakia, Belgium, Poland, Hungary, Finland	Oil&gas		560
Advanced Electronic Systems AG (owner Russian Holding Global Infirmation Services)	Altis Semiconductor	France	Machine-building		449
MTS	K-Telecom	Armenia	Telecommunications	80	434
Mirax Group	Hotel Sungate Port Royal	Turkey	Tourism		340
SeverStal	Celtic Resources Holding Plc	Ireland	Mining	81,1	315
Evraz Group S.A.	Highveld Steel and Vanadium	South African Republic	Metallurgy		238
Rosneft	AzEN Oil Compani B.V.	Azerbaijan	Oil&gas	50	200
Energoinvest DD	80 % - Bosanski Brod, 75,6 % - plant for oil producing Modrica, 80 % - network Petrol	Bosnia	Oil&gas		157,6
Rostsilmash	Buhler Industries Inc.	Canada	Machine-building	80	151,9
Sberbank	NRB Bank	Ukraine	Finance	100	150
Koks	Slovenska Industrija Jekla	Slovenia	Metallurgy		138

Source: Russian Journal of M&As

2006 Buyer	Target company	Target country	Sector	Share, %	Value, USD million
Russian Aluminium (Rusal)	SUAL&Glebcore	Russia, Switzerland	Metallurgy		10200
Evraz Group S.A.	Oregon Steel Mills	USA	Metallurgy	100	2300
VimpelCom	ArmenTel	Armenia	Telecommunications	90	496
Rusal Limited	Eurallumina SpA	Italy	Mining	56,16	420
GMK Norilsk nickel	Nickel business OM Group	Plants in Finland and Australia	Metallurgy	100	408
Russian Aluminium (Rusal)	Aluminium Smelter Company of Nigeria	Nigeria	Metallurgy	77,5	250
VimpelCom	Junitel (käännetty venäjästä)	Uzbekistan	Telecommunications	100	207,7
Sitronics	Intracom Telecon	Greece	Telecommunications	51	152,4
GAZ International	LDV Holdings	Great Britain	Machine-building	100	130
Gasprom	Armrosirom	Armenia	Oil&gas	15,69	119
Evraz Group S.A.	Strategic Minerals Corporation	USA	Metallurgy	73	110
Novolipetsk Steel (NLMK)	DanSteel A/S	Denmark	Metallurgy	100	104

Source: Russian Journal of M&As

2005 Buyer	Target company	Target country	Sector	Share, %	Value, USD million
Lukoil	Nelsons Resources Limited	Bermuda Islands (registered)	Oil&gas	100	2000
SeverStal	Lucchini	Italy	Metallurgy	62	560
VimpleCom	WellCom	Ukraine	Telecommunications	100	231,3
Lukoil	Oy Teboil Ab and Suomen Petrooli Oy	Finland	Oil&gas	100	160
RAO Nordic	Moldavian GRES	Moldavia	Power	100	100

Source: Russian Journal of M&As

Appendix 2. Russian investments in Finland

Buyer	**Target company**	**Target market**	**Sector**	**Share, %**	**Value, USD million**	**Year**
Lukoil	Network Jet - 367 gas/petrol stations	Finland, Czech, Slovakia, Belgium, Poland, Hungary	Oil&gas		560	2007
GMK Norilsk nickel	Nickel business OM Group	Plants in Finland and Australia	Metallurgy		408	2006-2007
Greenway Europe Oy (Owner: ХК «Гринвэй»)	Logistics terminal in Kotka (estate complex)	Finland	Transport		5	2007
Gasprom	AO North Transgas Oy	Finland	Oil&gas	50	55	2005
Lukoil	Oy Teboil Ab and Suomen Petrooli Oy	Finland	Oil&gas		160	2005
Russian group of entrepreneurs that has relations with ООО Базовый элемент	Vuokatti Hirsitalot Oy	Finland	Construction		15	2005

Sourse: Russian Journal of M&As