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Further Reading
Richard Connolly: Financial vulnerabilities in Emerging Europe: An overview, BOFIT Online Paper 3/2009, http://www.bof.fi/NR/rdonlyres/BA4C9028-D69D-45CB-ABF1-140ECB129E4C/0/bon0309.pdf

Analysis

Russia's Outward FDI Rise Amidst the Global Fall

By Peeter Vahtra, Turku

Abstract

Despite the global economic recession, Russia's outward foreign direct investment is increasing. Energy companies are seeking new resources and downstream assets. Companies are also seeking larger markets in the former Soviet Union. In some cases, the purchases have political rather than economic motivations. Although some investors, like Oleg Deripaska, have had to sell off some of their assets, many companies are still in expansion mode. Germany is one of the more popular target countries.

Ever Increasing Investment Flows

During the past year, the global economic boom has turned into economic gloom, bringing immediate and adverse consequences for multinational corporations. After nearly a decade of steady growth, global foreign direct investment (FDI) has entered a period of recession. Multinational corporations have put many new international investment projects on hold and have even sought to extricate themselves from existing projects and international subsidiaries in order to adjust to the changing business environment.

Amidst the general drop in global FDI, only a handful of countries stand out as sources for new investments. Most notably, Russia and China have posted growth in outward FDI (OFDI) over 2008 and early 2009, a notable exception to the current trend. Despite the faster growth in Chinese OFDI over 2008, Russia still outpaces the Asian economic giant both in OFDI stock and flows. Although the world's multinationals have seen the values of their international assets contracting in 2008, and the Russians are no exception, annual FDI outflows and the number of new transactions by Russian companies have increased despite the global economic downturn. The continuously increasing OFDI flows indicate a growing urge among Russia's multinational companies for further internationalization.

Since the beginning of its economic reforms, Russia has stood out among transition economies as a net capital-exporting country and the economy with the highest outward/inward FDI ratio. After a steady, yet relatively modest, average annual growth of some 10 percent throughout the 1990s, Russian OFDI flows took off in the 2000s, growing more than tenfold during 2000–2007. Despite a slowdown during 2008, Russia remained among the few economies in the world still posting growing figures in OFDI amidst the global economic crisis. Russia's outward direct investment flow grew to $53 billion in 2008, with the most recent statistics indicating a further rise during the first half of 2009. In addition to the officially registered OFDI, observers estimate extensive capital flight from Russia that by far exceeds the official OFDI figures. In fact, 2006 was the first year that Russia became a net capital importer, indicating a notably large amount of capital outflows by Russian commercial entities and residents.

Key Drivers of Russian OFDI

There are several stimulants driving Russia's outward investment flows. First, through OFDI, Russian companies seek to establish additional control over foreign natural resources in order to complement their domestic reserves. The Russian natural resource-based multinationals generally seek upstream investment targets that can be developed more readily and cost-effectively than untapped domestic resources, which are often geographically isolated and require vast investments and years to develop. These resource-seeking investments make up a relatively modest share of Russia's total OFDI compared to those of China. Second, the Russian multinationals increasingly seek downstream assets in order to build up their value chains internationally and reach end customers. In particular, this strategy is popular with the natural resource-based companies that are responsible for the lion's share of Russia's OFDI. Third, Russia's leading telecommunication and financial service providers, among others, increasingly are seeking targets for strategic acquisitions in order to establish control over markets in the former Soviet republics. Among these strategic acquisitions, one may also include purchases of assets granting easier access to certain protected markets, such as the acquisitions by Russian companies in the US steel and automotive industries. Finally, Russia's state-owned enterprises make purchases that seem to serve the purposes of Russia's foreign policy rather than commercial logic. While these investments are often speculative, they generally attract considerable attention.

Traditionally, Russian OFDI has focused on the nearby CIS region. However, recent years have marked a clear turn in this respect. According to current estimates, some 75 percent of Russian OFDI goes to Europe (including the CIS), with the share of Western and Southern European countries continuously rising. As the Russian multinationals have gained experience in international business, they tend to look beyond the CIS for new acquisition targets. Beyond Europe, Russian companies are increasingly active in the USA, with several strategic investments in the metal and machinery sectors, as well as in Africa with large-scale resource-seeking investments. In considering the geography of Russian OFDI, one should, however, note that the statistics are often somewhat biased due to a large share of offshore investments and investment round-tripping. The continuous ranking of countries such as Cyprus, the Netherlands, and the British Virgin Islands among the most popular destinations for Russian OFDI serve as an indicator of these common practices.

Russian OFDI and the Economic Crisis

On the surface, the economic crisis has hit Russia's economy and some of its leading multinationals hard. Not only does the global credit crunch cause increasing troubles for the already overleveraged Russian enterprise sector, but the collapse in global demand for energy and raw materials, the key source of Russia's export and federal budget revenues, has had dire consequences for the export-oriented companies. For instance, the Forbes 2009 list of the world's billionaires indicates a 70 percent drop in the combined net worth of Russia's wealthiest industrialists. In other words, many of Russia's leading businessmen, or oligarchs, who first obtained their wealth during the privatizations of the 1990s, have seen the value of their assets contract during the global economic downturn. In addition, several top businessmen have been forced to seek state loans in order to protect their assets.

While the situation described above largely remains the public face of Russia's big business today, many of the country's leading foreign investing companies are, however, far from surrendering their international assets. For instance, the leading Russian steel manufacturers Evraz and Severstal allegedly plan to hold on to their US assets despite the recent sellout rumors, while the country's number one private oil producer, Lukoil, actively seeks oil refining and retail assets in continental Europe and beyond. Adding to this, the world's leading natural gas producer, Gazprom, is planning several multi-billion-dollar infrastructure projects in Europe and Eurasia, including the Nord and South Stream gas pipelines. Currently, one may even claim that, in many instances, increasing economic protectionism in the West poses the greatest challenge amidst the current crisis to the expansion plans of Russian (and also Chinese) multinationals.

Russian Investment Projects in Germany

Of the more recent targets of Russia's OFDI, Germany has been among the most popular host countries for Russian investments. Apart from the Russia's gas giant, Gazprom, which has ownership interests in the German natural gas retailing and transportation sector, other Russian investors have recently entered the German markets. In 2007, one of the Russia's leading industrial conglomerates, BasEl, owned by the then-wealthiest businessman in Russia, Oleg Deripaska, bought a 10 percent share in the construction giant Hochtief. The stake was sold a year later, however, as the Russian company and its primary owner faced a severe financial crisis. Hochtief is engaged in several large-scale construction projects in Russia, which are claimed to continue uninterrupted despite the ownership changes. On another business front, the German luxury clothing maker Escada recently filed for bankruptcy protection after the contraction of the global market. The largest single owner of the German company is Russian businessman Rustam Aksenenko, who controls slightly more than 20 percent of the stock.

Despite the above examples of failed investment projects, there is increasing interest among Russian investors in the German companies. During their recent meeting in August, German Chancellor Angela Merkel and Russian President Dmitry Medvedev backed two investment projects with the involvement of Russian capital. They gave their support to the ultimately successful efforts of Canadian–Austrian car maker Magna and Russia's Sberbank in taking control of Opel, the troubled German car manufacturer once owned by the American General Motors. The Russian bank now controls a 20 percent share in the company. The other investment project targets the German shipbuilding industry as Igor Yusufov, a member of the board of Russia's Gazprom and the former Energy Minister of Russia is due to take over the insolvent Wadan shipyard. The €40 million investment is bound to guarantee jobs for the majority of the yard's current workforce of 2,500.

As the above examples indicate, both the scale and scope of Russia's foreign investments are currently widening, despite the obvious setbacks presented by the global economic crisis. Russian investors beyond the traditional energy and mining industries are growing increasingly active on the international arena and are bound to target the more developed markets in their acquisition spree, once the immediate effects of the economic crisis wear off.

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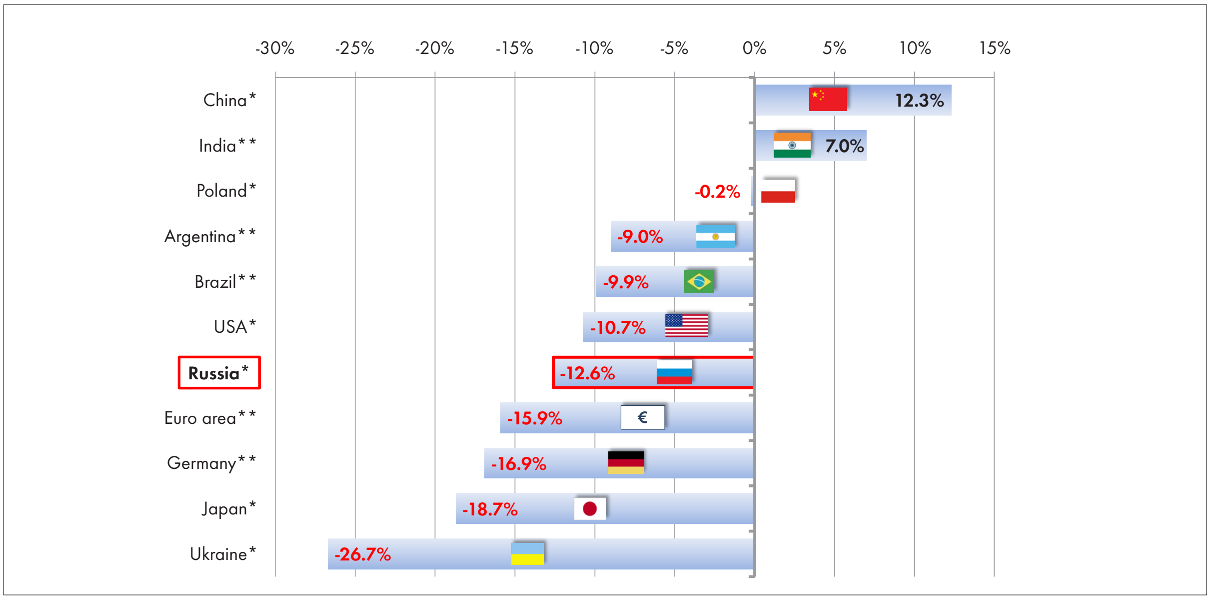
Statistics

Russia's Current Economic Indicators in International Comparison

Diagram 1: Industrial Production (July or August 2009) (Change Compared to August or July 2008 in %)



** August 2009, ** July 2009.*
Source: Economist, http://www.economist.com/markets/indicators/