

RESEARCH NOTE

Foreign operations of Russia's largest industrial corporations – building a typology

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Russia's outward foreign direct investment (FDI) has grown rapidly during the past decade. This note discusses outward FDI from Russia through developing a typology of Russia's largest outward investing industrial corporations. We base the typology on two specific features of Russian companies' foreign operations, namely the relatively low level of transparency and disclosure and, the strong involvement of the Russian State. We have delineated four typological groups of Russia's foreign investing industrial corporations. *Non-transparent Patriots* refers to large state-controlled conglomerates with a low level of transparency often serving the interests of Russian economic policy overseas. The *Transparent Patriots* category consists of large and transparent state-controlled companies employing effective internationalization strategies but which conform to government policy due to their strategic importance. *Transparent Independents* consist of private corporations whose overseas activities are not unduly influenced by political considerations. They employ transparent and business-oriented internationalization strategies and have developed their managerial practices accordingly. The *Non-transparent Independents* category comprises privately-owned enterprises with a relatively low level of transparency.

Key words: Russia, outward FDI, transnational corporations, internationalization

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1. Introduction

Foreign direct investment (FDI) has proven to be one of the most effective means of integrating Russia into the world economy. While trade rapprochement via Russia's accession to the World Trade Organization is an utmost necessity for further integration, it is not sufficient on its own in this process. Hence, even more emphasis should be placed on improving the conditions for integrating the economy through FDI, and particularly outward FDI by Russian enterprises. The expansion of Russian firms outside their domestic market is perhaps one of the fastest means of improving the international competitiveness of Russian firms.

The outward foreign direct investment (FDI) stock from the Russian Federation increased significantly from a mere \$3 billion in 1995 to nearly \$140 billion in 2005. With this amount, Russia is the second largest outward direct investor among the emerging market economies after Hong Kong (China), and Russian companies are indisputably the leaders among the transnational corporations (TNCs) based in South-East Europe (SEE) and the Commonwealth of Independent States (CIS). Through FDI, Russian companies have enhanced their international competitiveness by gaining increased access to natural resources, acquiring strategic assets worldwide and obtaining segments of the global market. High oil and raw material prices have yielded increasing export revenues, which have, in turn, supported the international expansion of Russian enterprises.

The rapid increase in Russian FDI suggests that Russian companies often find overseas investment opportunities more attractive than domestic ones. Additionally, the shortcomings of the domestic business environment in the form of scarce investment opportunities and unclear government policies have sometimes motivated Russian companies to seek investment opportunities abroad. Furthermore, recent legislative developments regarding the ownership of natural resources and increasing state control over natural resource-based industries may have influenced the outward FDI behaviour of Russian companies. In some instances, FDI by Russian companies is

reminiscent of an exodus rather than true expansion. This was particularly the case in the earlier phase of the transition period when investing abroad was seen as a safeguard against the unfavourable treatment of assets by the Russian authorities.

In this article, we aim to add to the knowledge of Russian business expansion abroad by building a typology for the foreign operations of Russia's largest industrial corporations. While earlier research has identified some motivations behind Russian corporations' foreign expansion, the literature lacks a systematic classification of Russian companies' internationalization. We contribute to filling this gap in the literature by considering the specific features of Russian business expansion abroad and assisting policy makers and scholars in assessing the implications of this phenomenon.

We proceed with an overview of the development of Russian outward FDI in section two and a review of literature on Russian business activities abroad in section three. Section four provides a methodological basis of the study. We present brief descriptions of company cases of Russia's OFDI in the framework of the designed typology in section five. In the concluding section, policy implications are discussed.

2. The development of Russia's outward FDI

The origin of Russian outward FDI dates back to the late nineteenth century. At the time, capital was exported primarily to neighbouring China, Mongolia and Persia. During the period 1886-1914, Russian capital outflows amounted to about 2.3 billion roubles (equivalent to \$33 billion at 1996 prices). Between the two World Wars, FDI by the Soviet Union diminished radically (Bulatov, 1998). Even after the Second World War, foreign operations of Soviet firms remained rare. Soviet firms had around 30 affiliates in developing countries and 116 foreign affiliates in the OECD countries at the end of 1983. Soviet companies were not particularly active overseas even within the Council for Mutual Economic Assistance (CMEA) area. In 1990, only 175 Soviet-owned joint ventures were registered in the European CMEA countries (Zaleski, 1986; McMillan, 1987; Matejka, 1988; Cheklina, 1991).

The overwhelming majority of Soviet foreign affiliates were engaged in the marketing of oil, raw materials and machinery. In addition to the intermediary activities, Soviet firms provided services to the foreign trade activities of the Soviet Union, as they operated in transportation, the insurance business and international banking (Hill, 1986). Despite the small number of Soviet foreign affiliates abroad, Sokolov (1991a, 1991b) argues that these affiliates sold around a half of Soviet commodities abroad. However, when evaluating the role of Soviet enterprises abroad, one should not forget that the foreign operations of these Soviet firms were not driven by business logic alone, but that Soviet firms abroad also served the goals of Soviet foreign policy (Hamilton, 1986).

On the eve of the disintegration of the Soviet Union, its outward FDI stock was modest, amounting to less than \$1 billion in 1990. The transformation from a centrally planned system towards a market economy has resulted in a considerable increase in outward FDI. Recent statistical updates by the Central Bank of Russia confirm the previous estimates of the massive amount of Russian capital abroad. Unlike most economies in transition, the capital outflows from the Russian Federation have repeatedly exceeded capital inflows. The ratio between outward and inward FDI is considerably higher for the Russian Federation than for any other SEE and CIS countries or the new EU Member States (table 1).

Russian enterprises are now investing abroad for diverse strategic reasons, compared to the early 1990's when their foreign activities were mainly for supporting their exports. Rapidly expanding overseas activities of Russian enterprises have resulted in a considerable increase in outward FDI. Russia's outward FDI stock, which stood at \$20 billion at the end of 2000, reached almost \$140 billion at the end of 2005. With this amount, Russia ranks as the sixteenth largest investor country in the world, accounting for 1.3% of the world's outward FDI stock.

Although the estimates of the total amount of Russian capital invested abroad vary, it is widely acknowledged that the figures are considerably greater than the outward FDI stock (e.g.

Loungani and Mauro, 2000; Buiter and Szegvari 2002). According to the Central Bank of Russia, net capital outflows from Russia by non-financial enterprises and households between 1994 and 2004 amounted to \$181 billion. If this total amount of Russian capital abroad is taken into account, the country ranks among the 10 largest capital exporting countries in the world (Central Bank of Russia, 2005; Kalotáy, 2005). This is still a conservative estimate and others have suggested much greater figures. For instance, according to the European Commission (2004), non-recorded capital outflows from Russia totalled \$245 billion during the period 1992-2002.

Table 1. Outward and inward FDI stocks of selected CEE and CIS economies, as of 31.12.2005

	Outward FDI stock \$ mln	Inward FDI stock \$ mln	Outward/ inward FDI stock ratio, %
Hungary	6 604	61 221	11
Czech Republic	4 239	59 459	7
Poland	4 671	93 329	5
Slovenia	3 607	8 064	45
Estonia	1 968	12 274	16
Lithuania	708	6 461	11
Slovakia	538	15 324	4
Latvia	294	4 783	6
Romania	242	23 818	1
Bulgaria	127	9 173	1
<i>Russia</i>	<i>138 845</i>	<i>168 950</i>	<i>82</i>
Azerbaijan	3 686	13 876	27
Ukraine	466	17 209	3
Kyrgyzstan	60	522	11
Armenia	32	1 225	3

Source: UNCTAD (2006), Central Bank of Russia (2006).

The neighbouring regions, including the SEE and the CIS, are the main recipients of Russian outward FDI. However, in recent years, outward FDI to non-traditional locations, such as Africa, Latin America and the United States, has become increasingly visible, indicating the expanding geographical spread of Russian companies' FDI. About a half of Russian outward FDI stock is believed to be in the European Union, while the CIS and the United States accounted for about a fifth each (Kalotáy, 2003). However, due to the large amount of

round-tripping investment from Russia through a third country, the authors believe the actual share of the CIS to be considerably higher than what is indicated by the recorded FDI data. The majority of FDI by Russian enterprises has taken place during the past five years, which suggests a growing interest of Russian firms in internationalizing through outward FDI.

UNCTAD (2005) provides a list of the largest non-financial TNCs based in the SEE and the CIS in 2003. Eight out of the ten listed companies are of Russian origin, including Lukoil, Norilsk Nickel, Russian Aluminium (RusAl), Mechel, Alrosa and three shipping companies. Since the authors find the UNCTAD list incomplete in some parts, a slightly different list is provided in table 2, which is based on an extensive set of updated company data.

Table 2. Top 12 Russian companies ranked by foreign assets, as of 1.1.2005

Company	Industry	Assets		Sales	
		Total	Foreign	Total	Foreign
Gazprom	Oil and gas	104 982	...	36 422	16 149
Lukoil	Oil and gas	29 761	10 663	33 845	26 428
Norilsk Nickel	Non-ferrous metals	13 632	2 618	7 033	5 968
Russian Aluminium	Non-ferrous metals	11 500	2 665	5 450	4 440
Evrast Holding	Ferrous metals	4 253	813	5 933	2 645
Mobile TeleSystems (MTS)	Telecommunications	5 581	1 214	3 887	995
VimpelCom	Telecommunications	4 780	852	2 147	45
Severstal	Ferrous metals	5 919	666	6 648	3 954
OMZ	Heavy engineering	901	347	524	272
Rosneft	Oil and gas	25 987	319	5 275	3 438
United Energy Systems (UES)	Electrical energy	40 613	211	24 493	441
Alrosa	Precious stones	4 630	162	2 037	923

Source: Company information, authors' calculations.

As indicated in table 2, leading Russian industrial companies possess a substantial amount of foreign assets. The top two Russian foreign investors, Gazprom and Lukoil, control a variety of strategic assets in Russia's neighbouring region, whereas the Russian telecommunication companies are expanding rapidly in the CIS, controlling the mobile

communication industry in Belarus, Kazakhstan, Ukraine and Uzbekistan. Following a similar pattern, Russian metal and mining conglomerates are establishing a considerable presence around the world, strengthening their global market positions through foreign acquisitions.

As the leading Russian enterprises become increasingly engaged in foreign activities, the value of their outward FDI has soared in recent years. While the value of recent acquisitions by Russian companies in the SEE and the CIS is many times greater than that of the 1990s', the improved financial situations have also fuelled their acquisitions in established markets of the EU15 and the United States. During the period 2004-2006, the combined value of the ten largest foreign acquisitions by Russian companies totalled nearly \$10 billion. Table 3 lists the largest foreign acquisitions by Russian companies in this period.

**Table 3. The largest foreign acquisitions
by Russian companies in 2004-2006
(planned and realized)**

Acquiring company	Target company	Country	Nature of business	Share, %	Value, \$ mln
Altimo	Turkcell	Turkey	Mobile telecommunication	13	3 200
Evrax Holding	Oregon Steel Mills	United States	Steel production	100	2 300
Lukoil	Nelson Resources	Kazakhstan/ Canada	Oil exploration & production	100	2 000
Norilsk Nickel	Gold Fields Ltd	South Africa	Gold mining	20	1 200
Evrax Holding	Highveld Steel	South Africa	Steel products	79	678
Evrax Holding	Palini & Bartoli	Italy	Steel products	75	650
Severstal	Lucchini Group	Italy	Steel products	62	574
RusAl	Queensland Alumina Ltd	Australia	Alumina refinery	20	460
VimpelCom	Kar-Tel	Kazakhstan	Mobile telecommunication	100	425
Evrax Holding	Vitkovice Steel	Czech Republic	Steel products	100	287
VimpelCom	Buztel and Unitel	Uzbekistan	Mobile telecommunication	100	275
Lukoil	Teboil and Suomen Petrooli	Finland	Petroleum marketing	100	270
Lukoil	-	United States	795 petroleum stations from ConocoPhillips	100	266
VimpelCom	Ukrainian Radio Systems	Ukraine	Mobile telecommunication	100	254
RusAl	Alscon	Nigeria	Aluminium production	78	250
MTS	Uzdunorbita	Uzbekistan	Mobile telecommunication	74	121
Evrax Holding	Strategic Minerals Corp.	United State	Steel production	73	110

Source: Company information; authors' calculations.

3. Literature review on Russian business expansion abroad

So far, a relatively limited number of studies have been conducted on Russian enterprises' strategies and motivations for investing abroad. Earlier research largely concentrated on describing the operations of Russian corporations in specific countries, such as Cyprus (Pelto *et al.*, 2003), Finland (Jumpponen, 2001; Vahtra and Lorentz, 2004; Johansson, 2005), Lithuania (Zashev, 2004), Poland (Liuhto, 2002) and the CIS (Vahtra, 2005). Some other studies deal with individual company cases (e.g. Heinrich, 2001b; Kobyzhev, 2001; Liuhto, 2001a, 2001b; Peregudov 2001; Rybakov and Kapustin, 2001; Survillo and Sutyryn, 2001; Trofimenko, 2001). In addition, scholars have investigated why Russian companies go abroad. In particular, academic interest has focused on the foreign activities of Russia's energy and metal companies (e.g. Väättänen and Liuhto, 2000; Liuhto 2001a, 2001b; Peregudov, 2001; Trofimenko, 2001; Heinrich, 2003) and, more recently, on the expansion of Russian telecommunications companies (Sutyryn *et al.*, 2005). Apart from the case studies mentioned above, we only identified few studies that discuss the motivations and underlying settings of the Russian business expansion in a broad manner (Efimova *et al.*, 1996; Bulatov, 1998; Pchountelev, 2000; Vahtra and Liuhto, 2004; Vahtra, 2006).

Previous research on the outward expansion of Russian TNCs has stressed the limited applicability of existing internationalization theories to the understanding of foreign expansion by Russian companies (Efimova *et al.*, 1996; Bulatov, 1998; Pchountelev, 2000; Heinrich, 2001a). The main reason for this inapplicability arises from the institutional differences between Russia and mature market economies for which the existing theoretical framework in international business has largely been developed (e.g. Peng, 2000, 2004, 2005).

Previous research has identified several unique features of Russian organizational settings and the internationalization of Russia's enterprises in particular. Tikhomirov (1997), Loungani and Mauro (2000), Mulino (2002) and Kalotáy (2003,

2005), among others, have pointed to the vast amount of unregistered capital flows and trans-shipped investments from Russia. Consequently, Russian business presence abroad is believed to be considerably greater than what is indicated by outward FDI data. Even though Russian outward FDI is increasingly noticeable, the unregistered capital flows from the country remain far greater than officially recorded investment.¹ According to somewhat differing estimates by the European Commission (2004) and the World Bank, \$250-350 billion of unregistered capital has fled from Russia since the beginning of the 1990s.

Capital flight can take various forms and the origins of capital can be perfectly legal, making the phenomena difficult to deal with. Illegal capital transferring schemes are highly diverse and include the misrepresentation of export earnings, the overstatement of import payments, fake deals and a variety of capital account transactions through non-resident banks and offshore locations. In particular, as the importance of the energy and raw materials industries in Russian exports increases, the problem of non-repatriation of export earnings has been highlighted (e.g. Tikhomirov, 1997; Loungani and Mauro, 2000). Hence, unregistered capital transfers from Russia include both illegal and unregistered economic parties as well as legal exporters and investors. The widespread non-repatriation of export proceeds, the overvaluation of imports and payments against fictitious transactions in securities together totalled almost \$26 billion in the financial account of the Russian Federation in 2004. This is one of the primary source of unregistered capital outflows.

The lack of transparency in Russian companies' investment behaviour is exacerbated further by the poor transparency and disclosure record of Russian enterprises. According to Standard & Poor's (2005), the organizational transparency of Russian companies remains low in comparison

¹ Detrimental effects of such capital flights include the loss of production capacity, tax and budget revenues, missing control over monetary aggregates and access to international financing (e.g. Mulino, 2002).

to internationally accepted practice. In particular, Russian companies rank low in disclosing their ownership and affiliate structures. Although the aforementioned study shows an improvement in transparency and disclosure performance in 2005 over the previous years, most Russian companies constantly underperform in comparison to their Western counterparts.² Of Russia's top 12 foreign investors (see table 2), only the telecommunication companies, MTS and VimpelCom, achieved the international standard of transparency and disclosure, reaching a score of around 80%.

Apart from the non-transparency of foreign operations, the relationship between Russian TNCs and the Russian State has attracted much attention from researchers. Since the companies in the strategic oil and metal industries have been responsible for a large part of Russian outward FDI, scholars have found economic motives alone insufficient for explaining the international activities of Russian corporations. It has been pointed out by several researchers that companies in strategic industries may be operating abroad to serve the interests of Russia's foreign policy (e.g. Heinrich, 2003; Liuhto and Jumpponen, 2003a, 2003b; Vahtra and Liuhto, 2004; Vahtra, 2005). Therefore, the role of the Russian State should be taken into account when discussing the internationalization of Russian firms.

The majority of Russian exports and FDI are made by natural resource-based groups. Raw materials account for two thirds of Russian exports and Russian energy and metal companies have a strong leverage in many of their target markets. As the natural resource-based industries form the backbone of the Russian economy, the leading enterprises in the oil, gas and metal industries are the subject of national strategic interest and are often powerful bearers of Russia's political influence abroad (Liuhto and Vahtra, 2004; Vahtra, 2005). Russia's vast energy resources provide the country with

² In 2005, Standard & Poor's Transparency index among the largest Russian companies increased to 53% from 43% in 2004. The composite transparency score for United Kingdom companies for 2005 was 71%.

a substantial political leverage, not only in the CIS countries but also throughout Europe. Recently, Russian energy companies have been repeatedly drawn into political disputes between Russia and its neighbouring countries. As the key energy supplier to the CIS and the EU, Russia effectively uses its leading enterprises to manage its foreign policy interests. Further, the recent consolidation of state ownership in the country's energy industry enhances Russia's influence in her neighbouring countries.

To conclude, two features can be identified in the existing literature that separate Russian enterprises' foreign activities from those of companies based in mature market economies: the control and leverage of the State and the relatively poor transparency record of their foreign operations. These dimensions are used in the following sections to build a typology of Russia's largest TNCs.

4. Constructing a typology: the methodological basis

Organizational typology often provides an appropriate framework for describing organizational settings and explaining their outcomes (Doty and Click, 1994). It provides an effective data storage system and a means for theory development by classifying the complex field of organizations into discrete categories (Rich, 1992). A typology can serve as a useful classification of the complex organizational reality, combining information content with simplified information retrieval. Furthermore, it is argued that a typology provides a "general set of principles for scientifically classifying things or events" and serves as an analytical tool to stimulate understanding on the underlying phenomenon (Mills and Margulies, 1980). In developing a conceptual typology, the number of variables considered is limited to just a few so as to clarify the phenomenon under classification (Rich 1992).

In this study, the authors construct a typology by categorizing the Russian TNCs using two dimensions – the level of transparency and State control. These dimensions are selected in line with earlier research findings on distinctive features

related to the internationalization of Russian companies. No systematic classification that takes into account these distinctive features of the Russian business environment could be found in earlier literature, justifying the current research approach.

For the purposes of the current study, we have examined a large number of instances of FDI by Russian companies. We base our findings on an extensive set of secondary data, derived from company reports, the reports and databases of the central banks and statistical offices as well as numerous business reviews and Internet sources. The authors have observed in earlier research projects that the primary data are not always the most reliable source of information since Russian companies can provide, deliberately or otherwise, misleading information to researchers.³

We base the definition of four typological categories of the foreign operations of Russia's largest TNCs on the level of transparency and State control. As a measure of the transparency level, we use the ratings from Standard and Poor's Russian Transparency and Disclosure Survey.⁴ The extent of State control is measured by direct and indirect state ownership of the company.⁵ In what follows, the dominant characteristics of each group are discussed in relation to the two dimensions forming the basis of the classification.

The Non-transparent Patriots category refers to the companies that are controlled by the Russian State, comprising

³ The reluctance to give information to outsiders may stem from the fear of data ending up in the hands of their competitors, tax authorities or even organized crime.

⁴ The Standard & Poor's annual Transparency and Disclosure Survey analyses disclosure from the international investor's perspective. The checklist method of the survey consists of 89 items relating to ownership structure and investor relations, financial and operational information, and board and management structure and processes.

⁵ We use state ownership as an indicator of state control and leverage over companies due to the absence of any other systematic measure. We recognize the resulting bias in estimating actual state leverage through indirect means of control, and elaborate on this issue in the following section.

mainly the industrial majors in the natural resource-based or strategic manufacturing industries. The companies in this category have a rather poor transparency record. The purpose of the international operations of these companies is to serve the interests of Russia's foreign policy, at least as much as to enhance their own economic performance. While Russian foreign policy interests are an inseparable part of the activities of these state-controlled companies, political intervention is not limited to this category only.

The Transparent Patriots category includes companies with a relatively good transparency record and a strong foreign presence in their overseas target markets. The companies are majority-owned by the Russian State, obliging them to balance business rationale on the one hand and governmental interests on the other. The level of political conformity is also highly dependent on the strategic significance of the industry. In particular, the companies in the strategic oil, gas and metal industries are often obliged to play according to the state's goals. As the size of the company largely defines its political leverage, companies in this category include the major natural resource-based corporations that have gained a strong foothold in international markets. Conformity to state policy often secures these companies unrivalled access to production assets, such as the exploration licences of natural resource sites and pipeline infrastructure.

The Non-transparent Independents category includes companies with little or no state control and a poor transparency record. The companies may be strong performers internationally, employing active internationalization strategies. However, the low level of operational transparency often makes their foreign expansion problematic. The companies with a low level of transparency may be regarded as a source of unregistered transfers of capital abroad. At the same time, the companies may face negative attitudes in host countries and hence, are often investing through offshore locations. Transferring capital abroad and then moving it back home through a third country used to be a common practice throughout the 1990s, but the recent

measures taken by the state indicate a radical change in the policy. The measures taken by Russian authorities in recent years to curb the influence of the country's leading business groups and oligarchs indicate tightening state policy in the matter.⁶ In future, it is likely that the State will exert stronger control over these companies, which are often controlled by only a few industrial magnates and have roots in the controversial privatization schemes of the 1990s.

The Transparent Independents category comprises private companies whose overseas activities are not particularly influenced by political considerations. Often, these companies are operating either in less strategic industries or have retained relative independence from state authorities. The companies have a relatively good transparency record, often employing westernized business practices and seeking strategic growth through foreign expansion.

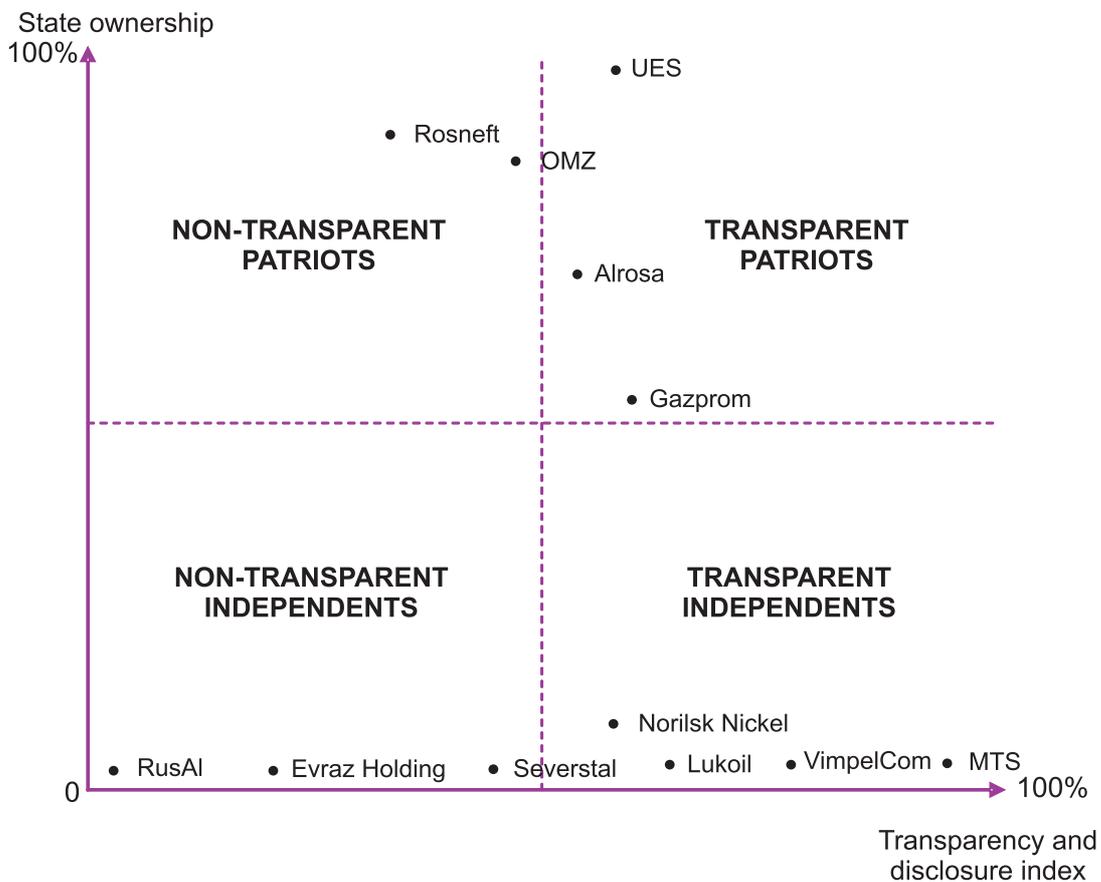
5. Placing Russia's largest TNCs in the proposed typology

Based on the level of state ownership and the transparency and disclosure rating, the largest Russian foreign investing companies (see table 2) are placed in four typological groups defined above. Figure 1 depicts the positioning of companies along the two axes. In the following, we provide a brief overview of selected companies' FDI activities followed by a consideration of the utility of the proposed typology.

Rosneft is a fully state-owned company and the second largest oil producer in the country, following its purchase of the main production affiliate of the embattled oil giant, Yukos. Rosneft's experience in international operations dates back to

⁶ In 2003, the Russian authorities initiated a series of court proceedings against the oil company Yukos, leading to the imprisonment of its leading shareholder, re-nationalization of the company's assets and, eventually the bankruptcy of Yukos. While the Yukos case is the most extreme example of the tightening stance towards the oligarchs during the past years, nearly all the leading private industrial holdings in Russia have experienced tightening licensing policies, back tax claims or charges on environmental violations, among others.

Figure 1. Typology of Russia's largest foreign investing enterprises



Source: authors.

the Soviet era and to date, the company has been engaged in various foreign ventures based on inter-governmental agreements. Beside its extensive export activities, Rosneft participates in several foreign upstream ventures, including oil and gas production in Algeria, Colombia and Kazakhstan. In addition, the company controls upstream assets in Afghanistan.

In the past two years, Rosneft has become one of the most significant players in the Russian oil industry. As a powerful bearer of the Government's interests, Rosneft participates in several upstream joint ventures with foreign oil majors. At 34%, the transparency and disclosure level of Rosneft remains poor even in comparison with other Russian state-owned enterprises (SOEs). However, the initial public offering of 13%

of Rosneft's shares in July 2006 is likely to improve the company's corporate governance record in future.⁷

Gazprom is the largest Russian corporation and taxpayer as well as the world's largest natural gas producer and exporter. The company is the most transnational Russian corporation in terms of foreign assets, foreign sales and the spread of its international operations. Gazprom has operations in natural gas distribution and processing activities in 17 EU countries. In addition, Gazprom has operations in nearly all of the CIS countries. Foreign acquisitions by Gazprom largely follow its natural gas exports. In the Baltic States, Finland and several CIS countries, Gazprom is the sole provider of natural gas. The main motives behind Gazprom's outward FDI activities are to strengthen its market position in its traditional export markets, to tap new market opportunities and to internalize its value chain business activities. Outward FDI has helped the company to establish a strong international presence, which has provided Gazprom with a substantial leverage, both economically and politically, in several of its key markets and in the CIS countries in particular.

Gazprom is the leader in the transparency and disclosure standard among Russia's SOEs, scoring 63% in the Standard and Poor's index. Since 49% of Gazprom's shares were made available for public trading in 2005, along with the consolidation of state ownership of the remaining 51% share, Gazprom has become the third-largest publicly traded company in the world after ExxonMobil and General Electric. This development

⁷ Raising \$10.4 billion, the Rosneft IPO ranked among the largest public offerings in the world. Surrounded by controversy, as much of the Rosneft's value was based on the assets formerly belonging to the embattled Yukos oil company, the IPO resulted in British Petroleum, the China National Petroleum Company and Petronas acquiring 21% of the issued shares. Approximately half of the remaining shares were taken by undisclosed Russian investors and the remaining one third by international portfolio investors. The relatively low share of the latter was thought to be due to the high price and, the considerable premium of Rosneft shares compared to its industry peers, rather than ethical or political concerns.

should result in further improvement in Gazprom's corporate governance practices.

UES is Russia's state-owned electricity monopoly and a powerful bearer of Russian influence in its neighbouring countries. UES has undertaken several energy projects in the CIS, including the expansion of electricity exports and the operation of national energy companies. Export to the CIS is the priority in UES' foreign activities and one of the primary sources of funding for outward FDI.

In the former Soviet republics, UES has established a practically unified electricity supply system with operations and assets in nearly all the former Soviet Republics. The expansion of the Russian energy giant in the CIS has been controversial in many instances. On the one hand, being part of the UES's electricity supply network considerably increases the reliability of the electricity supply, maintaining a high quality of electricity based on the common technical standard. On the other hand, the arrangement gives UES unrestricted access to the country's electrical grid, making many of the countries in the region subject to Russia's energy policy interests. Since 2003, UES has expanded the activities of its foreign affiliates to switch from wholesale electricity sales to supplying electricity to end consumers directly. The foreign affiliates of UES are engaged both in the retail sales of Russian electricity and in the organizing of electricity supplies to third countries.

Among the SOEs, UES has a relatively high transparency and disclosure index score (59%). Along with the ongoing restructuring of UES's holdings structure, including the creation of smaller regional power generation companies, further improvements in its corporate governance can be expected.

Lukoil is the largest oil producer in Russia and the most transnational Russian corporation, measured by its foreign assets and sales in relation to the company's total assets and sales. Lukoil possesses substantial foreign assets around the world and nearly 85% of the company's revenues in 2005 were generated abroad. In the upstream activities, the company has a strong

presence in the resource-rich Middle East and the CIS countries, whereas the company's downstream assets are concentrated near its main export markets, i.e. the European Union and the United States. Lukoil operates extensive petroleum retail chains in several of the SEE and the CIS countries as well as in the United States. In addition, the company operates three modern oil refineries in Eastern Europe that supply key export markets in Europe. In upstream activities, Lukoil's foreign production ventures serve to extend the company's hydrocarbon resource base and to cover for the depletions of its domestic resources. The main motivations behind Lukoil's FDI are extending the resource base and internalizing the value chain internationally. Its international acquisitions have provided the company with a strong position in several of the Central and East European countries, and more recently in the United States, considerably advancing its global competitiveness.

In 2005, Lukoil became a solely privately owned company after the sale by the Government of Russia of its remaining 7.6% share in the company to United States oil major, ConocoPhillips. Lukoil's transparency and disclosure index score (68%) is the highest among Russian oil companies.

Severstal is one of the largest steel producers in Russia and pursues perhaps the most aggressive internationalization strategy among the Russian TNCs. In addition to several representative offices and marketing units abroad, Severstal acquired the United States steel producer, Rouge Industries, for \$360 million in 2003. The acquisition provides Severstal with a means to circumvent the United States steel import restrictions and strengthens considerably the company's position in the world steel market. In other markets, Severstal has recently bid for several steel producers in the CIS, Europe and North America. At the beginning of 2005, Severstal acquired a 62% share in a major Italian steel producer, the Lucchini Group. This \$574 million acquisition has given the Russian company a stronger foothold in the European market, allowing it to bypass the EU import quotas and to increase its output and sales of high value-added products.

Severstal is part of a privately owned financial-industrial holding comprising several manufacturing units, including one of the largest passenger car producers in Russia. Despite active internationalization, the company has a relatively poor transparency record (a transparency and disclosure index score of 47%) with a low disclosure level of managerial and holding structures in particular.

MTS is the largest non-natural resource-based company among the Russian TNCs ranked by foreign assets. Russia's largest mobile operator is also a front-runner in transparency and disclosure practices among Russian companies. MTS has successfully entered the CIS markets in recent years with substantial investments. MTS currently pursues an aggressive market-seeking strategy, having established operations in virtually all the CIS countries. The company's presence is strongest in Ukraine, where it owns a majority share in the largest mobile operator, Ukraine Mobile Communications and has a fast-growing subscriber base. In 2004, MTS acquired a 74% share in Uzbekistan's leading operator, Uzdunorbita, for \$121 million. With its recent acquisitions in the CIS, MTS has successfully entered one of the fastest-growing and most unsaturated mobile markets in the world, strengthening the company's leading position among the Russian mobile operators. Furthermore, MTS controls a 49% share of the largest operator in Belarus. In addition to shares in local telecom operators, MTS has substantial infrastructure assets in the region. The growing and unsaturated CIS markets provide immense possibilities for Russian telecom operators and recent company statements project further acquisitions in the region.

MTS is a leader in the transparency and disclosure standard among the largest Russian enterprises. The transparency and disclosure index score of 84% exceeds the respective figures of many of its international peers. MTS, a wholly private company, is part of Sistema financial-industrial holding, which comprises mostly telecommunication enterprises.

Russian Aluminium (RusAl) is the country's largest non-ferrous metal producer and the third largest aluminium producer in the world. RusAl is the flagship company of Russia's largest financial-industrial holding, Basic Element. The company controls an extensive network of production outlets worldwide, from the neighbouring CIS countries to Australia to Africa. RusAl has expanded its raw material base by acquiring two bauxite mines in Guinea and a 20% stake in the world's largest alumina refinery, Queensland Alumina (QAL), in Australia for \$460 million. In addition, RusAl possesses two giant alumina refineries in Ukraine. Beside the expansion of the raw material base, the foreign acquisitions have expanded the company's value-added aluminium production. In addition, the foreign operations of RusAl are targeted to incorporating key service functions and to expand the service network worldwide. FDI of RusAl has thus far been mainly resource seeking in nature, aimed at strengthening the company's position among the world's leading aluminium producers.

As a part of a large privately owned financial-industrial holding, RusAl is a closed joint-stock company and does not systematically disclose its operational or financial data. However, according to recent company statements, a restructuring process aimed at a public listing of RusAl shares is under way.

As described in section three, we base the above categorization of companies on two variables; State control and the transparency and disclosure index. Due to methodological constraints, we are obliged to use the share of State ownership as the best available measure of State control and leverage. The authors stress however, that a different outcome would have been achieved if indirect State control measures had been considered. For instance, as a wholly privately owned company, Lukoil falls in the category of Transparent Independents (see Figure 1). However, the company's operations largely conform to government interests. Oil export from Russia remains a State monopoly, giving the State authorities a strong leverage on the oil companies. Furthermore, the current licensing regime in the

oil industry leaves room for government interests in the process of licence distribution. As another example, the giant metal producers, RusAl and Norilsk Nickel, would be placed at the other end of the vertical axis, were State *ownership* replaced with actual State *leverage*, due to the strategic importance of the metals industry in Russia's economy and the size of the companies.

In addition, recent developments in Russia suggest that a considerable increase in State control vis-à-vis Russia's leading industrial enterprises is likely in the near future. In 2004, the Russian State was responsible for a mere 4% of the country's oil production; along with Rosneft's takeover of Yukos' main production affiliate in 2004 and Gazprom's acquisition of Sibneft in 2005, the State is currently in control of one third of Russia's oil output. In the same vein, Russia's largest producer of heavy machinery, OMZ, was merged in the Gazprom holding structure in late 2005. Furthermore, developments in 2006 include the creation of a State-controlled automotive holding, including Russia's largest carmaker AvtoVAZ and two other large manufacturers.

6. Discussion and policy recommendations

By developing a typology of Russia's TNCs, we aim to provide a simplifying schema of a complex phenomenon and facilitate the discussion among scholars and policy makers in Russia and in the host countries receiving Russian outward FDI. In many instances, rather negative attitudes prevail towards the outward expansion of Russian firms both in Russia and abroad. While the Russian State is troubled by the unwelcome massive capital outflows from Russia, in the host countries, Russian enterprises may still be regarded as Russia's foreign policy tools.

From the Russian perspective, the outward expansion of Russian firms is essential for both individual companies and the Russian economy as a whole. The companies must become more international in order to survive global competition, which will become increasingly fierce after Russia's WTO accession.

At the same time, the Russian economy requires structural reform and an improvement in its competitiveness to transform the country from a natural resource-based economy towards a modern service and innovation-oriented one. Outward expansion is perhaps the most effective way of forcing companies to change their old management practices. International experience through outward investment would provide an effective means of promoting management and technology transfers to Russia, since the domestic enterprises would have to improve their business practices more actively than when operating merely in home-based locations.

The policy of the Government of Russia towards Russian companies' internationalization is currently not supportive enough. In Russia, FDI by home-based companies is often regarded as unwanted capital outflows and government policies tend to discourage these investments. Thus, the situation inevitably calls for effective separation measures between non-legal capital transfers and, asset purchases to advance the global competitiveness of Russian firms. Future government policy towards outward FDI by Russian companies plays an essential role in the development of these investment flows, which are bound to increase further once a coherent FDI policy framework is established. In addition, the Government has few effective means to stop outflows of investment, and building a more supportive investment regime would not only add to the competitiveness of Russian companies but eventually also to the transparency of investment flows in general.

Apart from their home country policy issues, the attitudes of the host countries towards Russian FDI have created obstacles for Russian business expansion abroad. Especially, the Baltic States and the former socialist countries of Europe may prefer Western companies to Russian ones as the owners of their strategic assets in the energy industry. This controversy has sometimes led Russian companies to adopt questionable investment schemes. Several examples can be found in the aforementioned countries, where Russian investors have channelled funds via a third country. Here, the distinction

between the cause and effect often becomes complicated; i.e. the reluctance towards Russian FDI may have prompted Russian companies to resort to dubious investment schemes, while the questionable investment practices themselves have partially caused the reluctance on the part of the host countries.

By promoting transparent and business-oriented investments abroad, Russian firms could change the attitude in the host countries. Given the deep-rooted historical resistance towards Russia's political and economic dominance in the former socialist bloc, the ultimate goal behind the internationalization of Russian companies plays a significant role in how these companies are perceived in the host countries. However, more recent developments point to the emergence of companies in the newly emerging industries. These Russian manufacturing and telecommunication companies are rapidly catching up with the natural resource-based conglomerates in the global scene.

In the future development of the investment environment, further emphasis could be placed on investment capacity building measures. In cooperation with the private sector, it would be possible to develop, for instance, marketing and management expertise and put in place the structures necessary to facilitate outward FDI. Providing information by bringing together the potential investors and government and financial service providers would serve as an important facilitative measure for outward FDI. Increased expertise on cross-border transactions, international law and investment practices is an example of what efficient public-private cooperation in capacity building could achieve. In addition, it should be emphasized that outward FDI promotion leads to the transfer of best practice by linking investors directly to relevant information on investment opportunities and operating conditions abroad. Although supporting institutions have started to emerge in Russia, further initiatives are required from the public sector to facilitate the development of the internationalization potential of Russian small and medium size enterprises (SMEs) in particular.

From the host countries' point of view, Russian firms conducting transparent and non-politically-motivated businesses, i.e. the companies belonging to the Transparent Independents category, are the most welcomed ones. The host countries' attitudes towards the companies in the Transparent Patriots category depend on the extent to which they operate in the interests of Russia's foreign policy. On many occasions, companies in the Non-transparent Independents category may be regarded as unwanted due to their non-transparent business practices.

Companies in the Non-transparent Patriots category are particularly unwelcome in those host countries that have struggled against Russian dominance. However, it should be pointed out that faced with energy supply realities for instance, the host countries are often obliged to accommodate companies in the Transparent and Non-transparent Patriots categories as their sole energy suppliers. It should also be noted that Russian companies may have a Janus-face i.e. they may employ different strategies in different regions. While a company may act as a Patriot in nearby countries, it may employ a market-oriented business strategy in other target markets.

The outward expansion of Russian companies will be dominated by strategic industries for some time to come, and hence, a widespread foreign expansion of Russian SMEs and companies in non-natural resource-based sectors could remain marginal in the near future. However, in the longer run, we can expect increasing market-oriented expansion along with the development of the Russian SME sector. The outward investment potential of Russian SMEs cannot be neglected, but considerable policy improvements are necessary for the companies to develop more sophisticated internationalization practices. In the absence of proper policy measures, vast amounts of capital will continue to flee the country through unregistered channels instead of finding legitimate routes. If the Russian economy succeeds in reducing its dependency on the export of strategic natural resources, the Russian government policy towards internationalization may become less politically oriented. If this is to happen, it is likely that host country policies, particularly

in the ex-CMEA countries, towards Russian business entry will become more neutral. ■

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