How to explain the foreign expansion of Russian firms

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Abstract

This article explores the main features of outward foreign direct investment by Russian corporations and some of the implications of their recent rise to global prominence for the theories of international investment. Surprisingly, lower middle-income Russia is a net capital exporter, and some of its firms, such as Gazprom, Lukoil, Norilsk Nickel, and Severstal, have already leapfrogged to a global status. This article also aims to identify issues for further analysis, such as the growing role of the state in controlling natural resource-based firms and its implications for the future of the Russian multinationals. It suggests that different investment theories fare divergently in trying to explain Russian outward foreign direct investment. For example, the eclectic paradigm could be applied to Russian multinationals with its extension to home-country factors. Other theories, however, would require more radical rethinking in future research.

1 This article is an updated and abridged version of Kalotay [2008]. The views are those of the author and do not necessarily reflect the opinion of the United Nations.

In one of the reminders about the rise of Russian corporations — referred to as 'eagle multinationals' in the literature [Liuhto and Jumpponen (2003)] — the (majority) state-owned natural gas monopoly Gazprom was reported to have become in April 2006 the world's third largest company by market capitalization (U.S.$270 billion), behind two U.S. firms, Exxon Mobil and General Electric (U.S.$381 and U.S.$358 billion, respectively), and ahead of another U.S. company, Microsoft (U.S.$246 billion) [Bloomberg (2006)]. The entry of a Russian firm into the top 3 of the world shatters the hierarchy of large multinational enterprises (MNEs)[2] known so far. Gazprom and other Russian firms are indeed important outward investors, making their country one of the most dynamic sources of outward foreign direct investment (FDI) worldwide.

The rapid rise of Russia[3] to global investor status may surprise some observers. Emerging corporations from the developing world, such as China, India, or West Asia, are the ones that are typically expected to move onto the global scene, rather than firms from an economy in transition. The latter would seem to possess less experience in competing in global markets. The emergence of Russia as a major source of outward FDI hence puts to test the existing paradigms on international investment. This article suggests that while Russian corporations that expand internationally have different characteristics in terms of ownership structures, motivations, and strategies, they do share at least three key attributes. The first is their leapfrogging onto the global scene. The second is their strong link with the natural resources of their home base. Until recently, most of them have come from the oil and gas, metallurgy, and electricity generation and distribution industries. The third feature is the growing role of the Russian state (since 1999) in outward FDI.

The outward investment position of Russia

According to the data from the Russian central bank, the outward FDI stock of Russia increased from U.S.$1 billion in 1999 to U.S.$157 billion in 2006, making it the 15th most important source economy of investments worldwide and the 2nd largest among emerging economies, behind Hong Kong (China) and ahead of Brazil, China, and India (Figure 1). Moreover, if those numbers are correct, Russia's growth rate was by far the fastest, faster than other newly emerging source countries such as India, or rapidly expanding offshore centres such as the British Virgin Islands. The three-digit growth rate of the outward FDI stock of Russia is partly a statistical artefact. It may well be that in the 1990s, the outward investment position of the country was largely underreported [Bulatov (1998)]. After 1999, the Bank of Russia started receiving increasingly accurate information but was not fully in a position to

Economy	Outward FDI stock 1999	Outward FDI stock 2006	World rank in 2006	Growth per annum, 1999-2006	Ratio of outward to inward stock, 2006	GDP/capita 2006 ($)
Russia	1.1	156.8	15	103.7	0.79	6,877
India	1.7	13.0	41	33.6	0.26	784
Ireland	25.2	125.0	17	25.7	0.70	51,665
British Virgin Islands	30.1	123.5	18	22.4	2.20	46,407
Spain	125.2	508.0	8	22.2	1.15	27,913
France	334.1	1,080.2	3	18.2	1.38	35,375
Turkey	2.8	8.9	48	17.9	0.11	5,307
Denmark	51.3	150.1	16	16.6	1.08	51,074
Switzerland	194.6	545.4	7	15.9	2.63	50,491
China	26.9	73.3	25	15.4	0.25	2,055
Australia	89.6	226.8	14	14.2	0.92	37,924
Netherlands	263.8	652.6	6	13.8	1.45	40,535
Sweden	106.3	263.0	13	13.8	1.20	42,170
Germany	413.4	1,005.1	4	13.5	2.00	34,955
World total/average	**5,156.9**	**12,474.3**	**-**	**13.4**	**1.04**	**7,373**
Canada	201.4	449.0	11	12.1	1.17	39,004
U.K.	686.4	1,486.9	2	11.7	1.31	39,207
Hong Kong, China	321.6	689.0	5	11.5	0.90	26,575
Singapore	55.7	117.6	20	11.3	0.56	30,159
Italy	181.9	375.8	12	10.9	1.27	31,440
Korea, Republic	23.3	46.8	27	10.4	0.66	18 164
U.S.	1,216.0	2,384.0	1	10.1	1.33	43 294
Taiwan Pr. of China	60.0	113.9	21	9.6	2.26	15 565
Japan	248.8	449.6	10	8.8	4.18	34 661
Brazil	49.7	87.0	23	8.3	0.39	5 640
Malaysia	18.4	27.8	34	6.1	0.52	5 704
South Africa	33.0	43.5	29	4.0	0.56	5 133

Source: Author's calculations, based on the UNCTAD FDI/TNC database and Bank of Russia data.

Figure 1 – Outward FDI stock of selected economies, 1999 and 2006 (billions of dollars and growth in %)

2 In the United Nations terminology, multinational enterprises are called transnational corporations (TNCs) and their internationalization is called transnationalization.

3 The country is called officially 'Russian Federation.' For the sake of brevity, this article uses the more common short version 'Russia'.

revise its previous reporting. That is partly confirmed by a look at the difference between outflows and outward stock data. Between 1999 and 2006, the cumulative outflows reached U.S.$63 billion, while the outward FDI stock rose by U.S.$155 billion. Naturally, part of the discrepancy may be due to changing valuations or the fact that not all the private sector outflows of that period were correctly recorded under FDI. Nevertheless, the dynamics of flow data too indicates fast growth.

Even more important is the issue of the net investment position (outward FDI stock minus inward FDI stock) of Russia. In the sample of 26 economies presented in Figure 1, Russia is a premature net outward investor. Common sense would dictate that poor countries should be capital importers and higher-income countries should be capital exporters. One can also refer to more elaborate theories, such as the investment development path (IDP) [Dunning (1981), (1986)], which puts the common sense observation into a more elegant form. It does not, however, change the fact that Russia is expected to be a net capital importer and not a country in which the inward and outward FDI stocks are almost on parity.

In the sample of the 26 economies we selected by the size and growth of their outward FDI, a simple exponential equation can well describe the relationship between the ratio of outward to inward FDI stock in 2006 and the GDP per capita in current dollars in the same year: $O/I = 0.005 \times G^{0.5495}$ (O/I: outward to inward FDI stock; G: GDP/capita), with a relatively good R-square (0.6335) if one also considers the heterogeneity of the sample and the unevenness of the data. Beside the fact that the curve does not seem to follow the form predicted by the IDP, it is also interesting to note that the equation would predict the ratio for Russia at 0.536, and not at the actual 0.793. In other words, if Russia followed a pattern similar to other countries, its inward FDI stock would exceed its outward stock by almost two times (or its outward FDI stock would be almost two times less than it is actually). Probably both hypotheses are right: while inward FDI is still below the potential of Russia [UNCTAD (2007), p. 14], outward FDI is in many respects beyond expectations.

The largest Russian MNEs

To identify the largest Russian outward investing firms and their peers from other developing countrie, we used internationally recognized company lists, such as the Fortune Global 500 for 2005. We found 63 firms that were headquartered in emerging economies: nine in the Republic of Korea, eight each in India and Saudi Arabia, seven in Hong Kong, China (including firms from China), and six each in Brazil and Russia. Gazprom was the largest emerging-market firm, Lukoil was eighth, and Surgutneftegas ninth. We complemented that information with other national and company sources to obtain market capitalization data for Russian companies up to the end of 2007. We were also able to find some other information about these companies up to 2006. We used that data

Firm	Industry	State ownership	Major foreign shareholder	Report on outward investment	Market value ($ mil)	EBITDA 2006 (%)	Sales 2006 ($ mil)	Growth of sales 2007 (%)
Gazprom	Oil & gas	50.01%	E.ON (6.5%)	Yes	334,726	44.4	79,122	10.0
Rosneft	Oil & gas	50.01%	Petronas (5%), BP (4%), CNPC (2%)	Yes	98,139	21.9	33,099	48.7
Sberbank	Banks	60.25%	-	Not	95,132	67.8[a]	9,863	44.1
Lukoil	Oil & gas	-	ConocoPhillips (20%)	Yes	73,302	18.1	68,109	20.4
UES	Electricity	52.70%	-	Yes	56,064	16.1	32,780	13.6
Norilsk Nickel	Mining	-	-	Yes	50,554	65.9	11,550	39.0
Surgutneftegas	Oil & gas	-	-	Not	49,860	38.9	18,401	14.1
VimpelCom	Telecom	-	Telenor (26.6%)	Yes	40,389	50.4	4,868	47.3
MobileTeleSystems[b]	Telecom	-	-	Yes	38,192	53.3	6,384	29.3
VTB Bank	Banks	50.01%	EADS (5%)	Yes	34,629	40.1[a]	3,252	30.9
TNK-BP	Oil & gas	-	BP (50%)	Yes	34,371	33.5	22,166	9.0
Gazpromneft[c]	Oil & gas	50.01%	-	Yes	30,382	25.6	20,172	2.0
Evraz	Iron & steel	-	-	Yes	27,684	31.6	8,292	54.5
Novolipetsk Iron & Steel	Iron & steel	-	-	Not	22,894	43.0	6,046	27.6
Severstal	Iron & steel	-	-	Yes	22,673	24.0	12,423	22.7
Novatek	Oil & gas	-	-	Yes	22,226	46.7	1,782	34.7
Sistema[b]	Holding			Yes	19,059	37.0	10,863	22.9
Magnitogorsk Iron & Steel	Iron & steel	-	-	Not	14,423	31.2	6,424	27.6
Tatneft	Oil & gas	-	-	Yes	13,152	15.7	11,702	8.5
Mechel	Iron & steel	-	-	Yes	12,963	21.0	4,398	43.7

Source: Author's calculations, based on company reports.
a Net interest income.
b Sistema owns 52.8% of Mobile TeleSystems, as well as other telecom companies (i.e., Comstar), a microelectronics firm (Sitronics), an insurance company (Rosno), etc.
c Formerly called Sibneft; acquired by Gazprom in September 2005, and renamed Gazpromneft.

Figure 2 – The 20 largest Russian firms, ranked by market capitalization, end 2007

to compile a list of the 20 largest Russian firms, ranked by market capitalization (Figure 2).

The universe of large Russian firms, as measured by market capitalization, is also dynamic in terms of new entries. For example, in June 2006, the previously 100% state-owned oil firm Rosneft completed a U.S.$10.4 billion international initial public offering (IPO) for 49% of its shares, making it the second largest Russian firm measured by market capitalization. In another case, the combination of a tripartite merger in 2007 between Russian aluminium giants RusAl and Sual and of the Swiss commodities trader Glencore's alumina business, plus a proposed international listing of the merged entity, resulted in a firm that would have a market capitalization of in excess of U.S.$30 billion [UNCTAD (2007)].

However, large is not necessarily the synonym for multinational. On the one hand, the majority of the 78,000 MNEs of the world [UNCTAD (2007), p. 218] are small and medium-sized firms. On the other hand, there are some very large firms that are uninational, lacking the basic requisite of transnationality, i.e., a structure of a parent enterprise located in the home country and affiliates located abroad. On the list of the 20 largest Russian firms (Figure 2) there are four (Magnitogorsk Iron & Steel, Novolipetsk Iron & Steel, Sberbank, and Surgutneftegas) that have seemingly no affiliates or branches abroad and hence have to be considered uninational. The situation of the newly emerging players (Rosneft and United Company Rusal) is somewhat clearer: even before their IPOs, they used to own assets abroad, already making them MNEs at that time. As for the aluminum giant, the acquisition of Swiss assets will further enhance its international character.

An additional caveat is that some of the firms on the list are not necessarily independent MNEs in the strict sense. Sibneft has become the affiliate of Gazprom and was renamed Gazpromneft. Sistema holding owns the majority of Mobile TeleSystems. We also have to consider those cases where foreign strategic investors have acquired more than 10% of voting rights in a company: BP controls 50% of the BP-TNK joint venture, Telenor controls more than one quarter of VimpelCom, while ConocoPhillips owns 20% of Lukoil. In a very narrow sense, these foreign investors would be the ultimate parents, and these firms would not qualify as MNEs in their own right. However, if that ownership is short of majority and the relationship with the foreign owner is closer to an equity-based strategic alliance than control/hierarchy, these firms, too, can still be considered MNEs in a broader sense.

The 15 MNEs that remain on the list (excluding the three uninational firms, as well as Gazpromneft), fall into 3 categories. The largest, and probably most important, is the oil and gas industry, with Gazprom and Lukoil as examples of fully-fledged international players, and Novatek, Rosneft, Tatneft, and TNK-BP with more limited MNE activities. The second is iron and steel, with Evraz, Mechel, and Severstal all having important international presence. Norilsk Nickel, a leading producer of nickel and palladium, shares various common characteristics with this group. The third group is telecommunications, with Sistema (including its affiliate Mobile TeleSystems) and VimpelCom both important MNEs. The electricity monopoly UES is a case apart from the three categories: it has huge operations at home but limited presence abroad. So is VTB Bank, which has foreign-trade supporting affiliates in London, Paris, Frankfurt, Zurich, and Limassol.

Information on Gazprom's international activities is relatively limited. It is, nevertheless, not just the largest Russian firm but also the second largest outward investor in terms of assets controlled abroad [Skolkovo-CPII (2007)]. It is believed to be in control of more than 93% of Russia's natural gas production and about a quarter of the world's gas reserves[4]. Its operations are spread globally: on the European continent alone, it has operations in at least 19 countries, involving natural gas distribution and processing activities [Heinrich (2005)]. Lukoil's strategy is better documented both in its own corporate communications and through the UNCTAD lists of largest MNEs [UNCTAD (2005)]. By foreign assets, it is the largest Russian outward investing firm. It carries out international exploration and production in at least 9 countries, refining in Bulgaria, Romania, and Ukraine, and downstream distribution in at least 15 countries. The other Russian oil and gas firms are less transnationalized. Privately owned gas producer Novatek registered its first foreign affiliates only in 2005. Rosneft, despite its large size, also has limited presence abroad (exploration projects in Algeria and Kazakhstan). TNK-BP owns a petroleum refinery affiliate, as well as gas stations in Ukraine. Tatneft, Russia's 5th largest oil producer (measured by reserves), also has limited presence abroad.

In metallurgy, Norilsk Nickel is considered to be the largest Russian MNE in terms of assets abroad [UNCTAD (2005)]. It is a world leader in the production of several strategic metals, in particular, palladium, platinum, nickel, cobalt, and copper. Stillwater (U.S.) and LionOre (Canada) are its largest affiliates abroad. Evraz, the second largest MNE in metallurgy, also has large assets abroad, despite its late start in foreign expansion. It acquired Palini e Bertoli (Italy) and Vitkovice Steel (Czech Republic) in 2005, and Oregon Steel Mills (U.S.) and Highveld Steel (South Africa) in 2007. The third largest Russian MNE in this group, Severstal, has also internationalized by acquiring assets in developed countries. It made its first foreign acquisition in the U.S. in 2003, by taking over Rouge Industries, followed by the takeover of Lucchini Industries (Italy) in 2005. It also entered into a coke producing joint venture and started to build a greenfield steel plant in the U.S. Mechel opted for a different kind of internationalization, based on low-cost specialty steels and alloys. It owns coal operations in Kazakhstan, two steel mills in Romania, and a steel product manufacturer in Lithuania.

4 www.hoovers.com/globaluk/sample/co/factsheet.xhtml?COID=52477, accessed 10 January 2006.

In telecommunications, Sistema, a holding company owning electronics, insurance, banking, real estate, retail, and media companies, derives most of its revenues from its telecommunications branch, and controls more than 50 operators in fixed and mobile telephone and other communication services. Most of the Sistema Telecom firms are uninational, while the holding's largest company, Mobile TeleSystems, is the market leader in wireless communication in various CIS countries. VimpelCom, the second largest operator in Russia and the CIS (founded in 1992 and co-owned by Russia's Alfa Group and Norway's Telenor) focuses on Kazakhstan, Tajikistan, and Ukraine. In addition, Alfa holds shares in a Ukrainian and a Kyrgyz operator, and purchased in 2005 a 13% minority share in Turkish Turkcell, itself a major competitor in various CIS markets.

The universe of Russian MNEs goes beyond the group of leaders analyzed here. One of the MNEs not making the list is the majority state-owned diamond producer Alrosa, which is already important globally. Others, such as the largest shipping companies of the country (Novoship, FESCO, and PriSCo), are "born multinationals." There is also some case study evidence that Russian medium-sized, small, and family businesses are also investing abroad [Johansson (2006)]. However, the market leaders analyzed here continue to dominate the outward investing landscape.

Sources of competitiveness

The rise of the Russian MNEs on the global scene raises a number of questions, such as where do these firms derive their competitive strengths from, how do their expansions abroad further enhance their competitiveness, and in general, to what degree do they resemble the MNEs we see in the developed world? The answer is that once we consider the specificities of the three industries in which Russian outward FDI is particularly important (hydrocarbons, metallurgy, and telecoms), the resemblances with Western MNEs are quite important.

It is important to note that these companies were created through a very rushed process, during the privatization programs that were instituted during the 1990s. As a result, they are different from many of their peers overseas. With the change from centrally planned to market economy, the country needed private property, and fast. Given the heritage of 74 years of communist ownership, the transition to private property took place in the 1990s at a very quick pace. However, "international investors were almost totally excluded from the mass privatization in 1992 and later from Loans for Shares in 1995 (which allowed the companies' capital to be transferred to a number of oligarchies at greatly reduced prices). Not until 1997 were the restrictions on their participation in Russian companies' capital lifted" [Locatelli (2006)]. While interpretations on the reasons why FDI did not play a major role in Russian privatization may differ, it remains a matter of fact that for the Russian governments of the early 1990s, the creation of a national capitalist class seemed to be the most evident way of building capitalism. It was estimated that by 1998, 49% of former state properties had been privatized to insiders, compared to 3% in Hungary and 5% in the Czech Republic. Conversely, only 3% of former state properties had been sold to foreign buyers in Russia, compared to 48% in Hungary and 15% in the Czech Republic [Kalotay and Hunya (2000)].

Once large industrial groups were created in Russia, these firms started consolidating their competitiveness through oligopolistic or monopolistic advantages, first at home, and then abroad. In 2001, the Russian investment bank Troika Dialog calculated that around 70 large financial and industrial groups controlled 40% of the Russian GDP [Shekshnia (2001)]. It is true for both the natural resource-based industries — such as oil and gas and metallurgy, in which international prices of key products largely affected the profitability of future MNEs — and the telecoms industry, where partnership with foreign MNEs in obtaining technological know-how and oligopolistic behavior played important roles. These oligopolistic advantages resulted in a high concentration of wealth, facilitating the global expansion of the largest firms. Moreover, following the textbook cases of using oligopolistic advantages created at home as a stepping stone for international expansion, the newly capitalist Russia is the scene of merger talks and hostile takeover bids in its newly privatized industries [Radygin (2002)]. These talks are then sometimes called off, just to be restarted later on[5]. The result is that, according to Figure 2, in 2006, as expected, the EBITDA of Russian MNEs, enjoying oligopolistic benefits, was particularly high in natural resources and somewhat lower in telecoms. Sales also grew rapidly between 1999 and 2004: more than 60% per annum for Mechel, more than 50% for TNK-BP, and more than 30% for Severstal [Expert (2005)].

Once the right conditions were created, the expansion of Russian MNEs abroad was fast. Most preferred the mergers and acquisitions (M&As) route rather than organic expansion. Russian firms have special methods for overcome their foreignness. In certain members of the former Eastern bloc, Russian firms have strong business links and familiarity with local conditions. It is the political sensitivities of those locations that affect the strategies of Russian MNEs. In Western markets, it is the cultural distance from the unknown Russian firms that can complicate the life of Russian entrepreneurs. In both cases, these constraints have given birth to a peculiar 'Russian' way of doing business and acquiring assets abroad, which takes place through shadow (offshore) firms instead of purchasing shares up front in the MNEs' own names. These strategies of proxy-based operations, however, can have the opposite impact on outward FDI from Russia in the short and long terms. In the short term, they are increasing outward FDI. In fact, some business people would argue that this is the sole, or the fastest way, to access assets abroad. In the longer term, however, they can reduce the readiness of host countries to accept Russian FDI. The strategy of using proxies such as privately owned Western firms to acquire

5 In the latest, and potentially the largest, bid, United Company Rusal bought 25% of Norilsk Nickel in May 2008, and aimed for a full takeover, which would have resulted in the world's biggest metal company so far [Smirnov and Asker-zade (2008)].

assets abroad are usually seen as low-transparency transactions that raise concerns in host countries about intentions, although Russian experts insist that the funds used for those transactions are of legal origin [Livshits (2001)].

Expansion or exodus

When explaining the reasons for outward FDI from Russia, one should consider not just the pull of the international markets as sources of competitiveness, but also the push factors of the domestic business environment. In other words, using the terms of the literature, outward FDI from Russia is both 'expansion' and 'exodus' [Liuhto (2005)]. Indeed, in Russia the business environment is still difficult, despite recent improvements. Russian MNEs still follow 'system-escape' motivations [Bulatov (1998)]. Recent changes to the Russian business environment have sent contradictory messages to domestic and foreign investors. On the one hand, there have been a series of impressive measures to improve the Russian business climate, including the rationalization of taxes. On the other hand, in the case of the Russian firm Yukos after 2001, tax administration has been used to reach non-economic, non-fiscal goals. And when the tax authorities approached, in November 2004, a joint venture with a foreign investor (TNK-BP) with a tax claim, it sent the message that a potential reversal of the improvement of the business climate could not be totally excluded [Ostrovsky (2004)].

An important reason for FDI outflows from Russia appears to be the investors' desire to diversify assets as a safeguard against domestic instability. This is then linked with the phenomenon of 'round tripping.'[6] One indication of the existence of round tripping in Russia, especially before the financial crisis of 1998, was the fast parallel increase of inflows and outflows itself. Another proof was the persistently high proportion of offshore companies based in Cyprus, which were involved in both inflows and outflows — a small island that otherwise has no ownership advantages for its local firms [UNCTAD (2000), Pelto et al. (2003)].

The role of the state

There is one more factor that is crucial in explaining the evolution of outward FDI from Russia: the role of the state. During the presidency of Boris Yeltsin (1991–1999), it was the Russian state that actively contributed to the creation of the large private monopolies, which gave birth to the future MNEs. The Russian state, however, did not have any particular policy for actively promoting outward FDI at that time. On the contrary, its efforts were more directed towards regularizing the unregistered part of those outflows. Even today, the state does not seem to posses any promotion policy in this area.

It does not, however, mean that the Russian state would remain passive in the area of outward FDI management forever. In recent times, the Russian state seems to have made its position clear. Increasing its share in Gazprom (it increased its stake from 38.4% to 50%-plus one by paying U.S.$7 billion in cash in 2005) is one indication of its future policies [Dittrick (2005)]. Paradoxically, it was the increase in the state's share to majority that opened the way for lifting the restrictions on foreign ownership on the rest of the shares. It also acquired some privately owned assets, such as Sibneft mentioned above, aimed at increasing its share and influence in natural resources. That influence now goes beyond the firms that it owns, and seems to affect the strategies of some privately owned companies too. Indeed, currently the balance of influence between the state and the oligarchs is changing. Until 1999, the latter occupied an undoubtedly dominant position in their relationship. Since then, the balance of power has tilted gradually in favor of the state.

The result of the growing role of the state is that the internationalization strategies of the state-owned MNEs, such as Gazprom and Rosneft, are now influenced by Russia's foreign policy [Pravda.ru (2005)]. In general, the Russian state sees these two companies as examples of how publicly owned MNEs should be developed in the future. In the literature, they have been called 'patriots' [Vahtra and Liuhto (2005)] or 'Kremlin universe' [Aton Capital (2004)]. In May 2008, when a former chairman of the board of Gazprom (2000–2001, 2002–2003), Dmitry Medvedev, became President of the Russian Federation, and a former chairman of the board of Rosneft (2004–2008), Igor Sechin, became Deputy Prime Minister with supervisory control over natural resources, the relationship between the government and its state-owned MNEs became even closer. The distinction between government and business has become quite blurred, certainly more so than it has been since the collapse of the Soviet Union in 1991 [UniCredit Aton Research (2008)].

The change in the balance of power between the state and oligarchy is deeply rooted in Russian political and social traditions. In Russia, property rights turned out to be more fragile and more relative than in Western societies [Litsukova (1999)]. Although former bureaucrats and managers often transformed themselves to owners with the help of 'insider' privatizations, the acceptance of such private property by a society educated for seven decades in the belief of 'social' ownership and egalitarian values has always remained very low. With the widening of social differences, the number of relative (compared to new capitalists) or absolute losers (compared to their standard of living in Soviet times) of the transition process swelled, increasing the pressure on the government to redress the power of oligarchs.

In a broader context, concern can be raised about a too strong state and too weak private property. Historically, under such phenomena Russia was heading towards sustained backwardness (in Czarist times) or stagnation (under communism). More recently (for the period 1999–2004), relatively robust proofs have been found that

6 Round tripping refers to transfer of funds abroad in order to bring some or all of the investment back as FDI and claim the tax and other benefits offered to foreign investors [UNCTAD (1998)].

state ownership of natural resources leads to a slowdown in output, exports, and GDP in Russia, while the opposite is true for private ownership [Ahrend (2005)]. A similar relationship could be detected when contrasting the performance within Russia of industries dominated by state ownership (i.e., gas and electricity) with those predominantly in private hands (oil and coal [idem]). In light of this performance, questions can be also raised about the opportunity cost of the government spending taxpayer's money to increase its participation in Gazprom, Sibneft, and Yugansneftegas.

Russian outward FDI and MNE theory

When new MNEs are emerging in unorthodox locations, it is legitimate to ask whether the FDI theories developed for traditional source countries and firms can be applied to them, or whether we need to develop new theories for the new entrants. Unfortunately, past experience in this respect is rather inconclusive. The emergence of developing-country MNEs in the 1970s gave rise to a large number of important and in-depth studies. They concluded that the existence of these MNEs did not call for the development of a new theory [Caves (1996)]. However, certain new details have emerged. An important finding in research on FDI from developing countries has been the use of leapfrogging strategies to reach a global status, documented for the case of East and Southeast Asian MNEs [Mathews (2001)]. The rise of Russian MNEs is too recent to warrant similarly definitive conclusions.

It does not mean, however, that the general theory of FDI should remain static. The experience of Russian MNEs challenges some of the conventions (i.e., the IDP and the explanations based on the standard theory of factor movements). The eclectic paradigm seems to be more 'resilient' to the specificities of Russian MNEs, although the Russian case may indicate the need for certain adjustments already indicated in the case of developing-country MNEs.

As for the Uppsala theory of MNEs [Johansson and Vahlne (1977)], it posits that the internationalization of firms takes place through stages. Because of their limited experience in the initial phase and the uncertainty of foreign markets, firms should internationalize via international trade first. That assumption holds for Russian firms to some degree, although they started establishing sales and distribution affiliates much quicker than the Uppsala theorem would predict. It is true though that some of the foreign assets of outward investing Russian firms are still in the area of trading, confirming the assumption that the nature of such affiliates is closer to that of exports than to production affiliates. However, Russian firms also possess important production assets abroad, too, although very often in socially and culturally similar countries (which is again in line with the predictions of the Uppsala school).

The eclectic paradigm describes outward FDI in terms of ownership and internalization benefits for MNEs and locational advantages for host economies (it is known as the 'OLI' theorem for the acronym of these three advantages [Dunning (1977) Dunning and Lundan (2008)]). The internalization aspect of MNE strategies (the 'I' advantages), drawing on Coase's [1937] theory of the firm, can be used as a point of reference to explain the behavior of Russian MNEs, too. As for ownership (O) advantages, originating in Hymer's [1960] and Vernon's [1966] ideas, their application is less straightforward. In principle, it should be the firms of the most advanced countries that possess those advantages and exploit them through international expansion. There have, however, been important developments in the interpretation of O advantages that make it easier to apply to other countries. For instance, a distinction has been introduced between 'Oa' advantages, consisting of property rights and intangible assets — ostensibly a strong point of very advanced MNEs — and advantages of common governance, learning experiences, and organizational competence (Ot), which can also be gained by relatively less advanced firms that do not seemingly have technological advantages, or even have disadvantages, in that area [Dunning and Lundan (2008)].

Large Russian MNEs base their international expansion plans on those newly described ownership advantages, which are less technology and more organization and management based (Ot). They possess, for example, remarkable Ot advantages in turning around ailing facilities in the iron and steel industry. In addition, the high profitability of outward investing firms (Figure 2) can be taken as an indirect proof of their organizational and common governance-type ownership advantages. Another Ot advantage is derived from excess capital. As highlighted, the bulk of Russian outward investing firms are in energy, metallurgy, and mining, and these are industries that generated large cash flows. For this excess capital, it was natural to seek investment opportunities abroad, in addition to the domestic ones. One way of interpreting this excess capital is to see it as a special case of Ot advantage. In the former Soviet Union, in the former members of the defunct Comecon, as well as in some countries that used to have traditionally close links with the U.S.S.R., Russian firms had inherited yet another Ot advantage: their familiarity with the local business and regulatory environments. They can sometimes rely on personal links developed during the times of the Soviet Union. The ease of entry is particularly high in the CIS, partly because of the common regulatory heritage and partly because the language barrier is small. Russian is often used as the business language in many former CIS countries.

From the individual cases analyzed above it emerges that the horizontal integration of production capacities and oligopolistic or monopolistic behavior in the home market are important sources of internalization advantages for the majority of Russian MNEs. In this sense, they are following Hymer's classical insight. This is partly a heritage of the Soviet times and the centrally planned economy. During that period, central planners liked to group producers of similar products into horizontal groups. But conglomeration is also driven by rivalry and competition in the post-privatization phase. As a new development, the groups of firms can also include not just production facilities but also distribution networks and banking (which used to be separated from production during Soviet times). Alfa Bank, for example, is the 'banker' of the Alfa Group mentioned above. In this case, the bank acts as the coordinator of the group. In the case of the Gazprom Group, the roles are the reverse, and the production company controls the Gazprombank.

In summary, an effort to apply the eclectic paradigm to Russian outward FDI these days provides promising results, with one major exception. Probably more than in any other country, the home country environment and other home country factors mentioned above are playing a key role in determining outward FDI. And here, surprisingly, the OLI paradigm is missing a fourth, 'home country' leg. It would seem that the successive expansions and modifications of that paradigm have tried to incorporate the home country environment implicitly under extensions of the ownership advantages, which are now becoming quite long and increasingly difficult to tackle. Naturally this article does not contend that if the OLI paradigm was extended into an 'OLIH' (with H denoting the home country) that would be applicable to Russia only.

In that sense, the possibility of crafting a separate theory for Russian MNEs, distinct from the general, or global, paradigm is small. There may be in turn various arguments raised in favor of a globally applicable 'OLIH' theorem. Firstly, is the fact that the lack of home country factors is creating problems of theoretical interpretations of outward FDI in other countries, too: for instance, they may need to factor in state-ownership as an additional factor, just like Russia. Secondly, with the incorporation of institutions and institutional factors as lead components of the locational advantages [Dunning and Lundan (2008)], the theory became one-sided, considering the role of institutions in the host countries, but not in the home countries. Thirdly, in some varieties of FDI theories, especially the ones dealing with cultural issues and cultural distance [Hofstede (1983)], home and host country factors have been implicitly included. This cultural issue is highly important for explaining Russian FDI in the CIS. Hence, unless the eclectic paradigm would disown that part of the theory, it would need to accept home country factors take their due place in the theory. In such a potential reconsideration of the theory, evidence from Russia would be important to take into account — with due consideration to the fact that its experience would need to be compared with that of the other leading outward investing countries.

Conclusion

Outward FDI from Russia is expected to stay with us and increasingly become a global phenomenon. Some of its features may change as Russian MNEs increasingly interact with their global peers. The high concentration of the outward FDI of Russia in natural resources is also expected to be a long-term feature. It is indeed a main difference with outward FDI from other emerging markets, which is more of a knowledge-seeking type. In the near future, Russian firms are expected to remain focused on controlling the upstream (exploration and extraction) and downstream (distribution) parts of their value chain, even if control of the firms may change hands. Outward FDI from Russia is also expected to remain closely related to state participation. The final format of the relationship between the state and large firms will have major implications for the future. If those firms are 'washed back' to dependent status, they will become followers of the government's foreign policy, independently of their ownership. If the rise of the state's power is contained, on the other hand, one can expect more private interest and more diverse strategies from Russian MNEs. Future research needs to keep up with new developments in this respect, and provide objective, scientific explanations for them.

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