

ANALYSIS OF THE IMPACT OF FOREIGN INVESTMENT ON THE COMPETITIVENESS OF RUSSIAN COMPANIES

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Abstract

The article analyzes the impact of foreign investment on the competitiveness of Russian companies. Capital mobility is growing rapidly in the 21st century owing to the processes in the world economy, such as globalization, internationalization, and also due to the established single market of goods and services. The enhancement in the competitiveness of companies becomes an essential requirement of the world market. Unfortunately, it is often impossible for many companies to reach a technological progress and increase the efficiency of corporate social responsibility using only its own funding without attracting a foreign capital. Based on the analysis, conclusions are reached and practical recommendations are offered.

Keywords: competitiveness, net outflows, FDI (foreign direct investment), portfolio investment, and volatility

JEL classification: M21, O11, R11

1. Introduction

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Competitive advantages are one of the main elements of successful activity in the global market. This is relevant for the economy of any country, which in modern conditions is involved in the globalization of the world economy. World economic relations between different countries provide opportunities that can be used with varying degrees of economic success. Modern Russian entrepreneurial structures are actively trying to integrate into the world economy. This is very difficult, because all the producers in the world economy today are in the conditions of hyper competition. These conditions impose additional requirements on business, such as high quality of labor, high technologies, quality of products and competitive prices for goods and services. Entrepreneurial structures have to go to additional costs in order to provide their goods and services with high competitiveness in the global market (Khryseva, Akimova, Dneprovskaya, 2017).

Capital mobility is growing rapidly in the 21st century owing to the processes in the world economy, such as globalization, internationalization, and also due to the established single market of goods and services. The enhancement in the competitiveness of companies becomes an essential requirement of the world market. Unfortunately, it is often impossible for many companies to reach a technological progress and increase the efficiency of corporate

social responsibility using only its own funding without attracting a foreign capital (Kizilova, 2014).

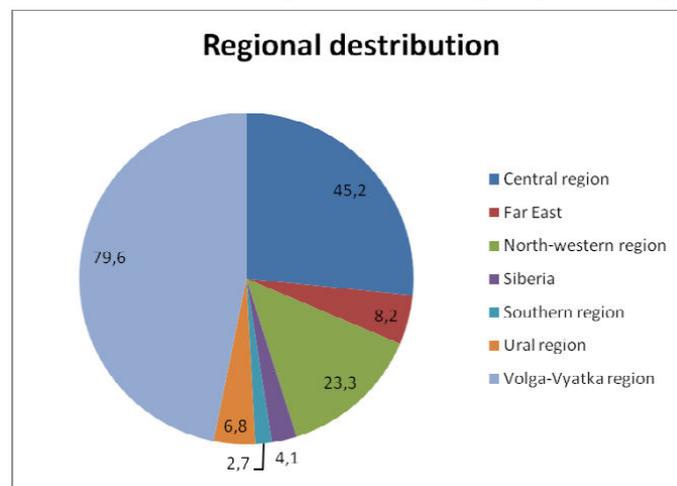
The main goal of the paper – to analyze the impact of foreign investment on the competitiveness of Russian companies.

2. Analysis

Russia is characterized by commodity-based economy, as well as the underdeveloped manufacturing industry. Moreover, despite the obvious factors of competitiveness of Russian economy, such as a high level of human capital and its technological capabilities, which attract foreign investors, the economic growth of the country is still largely based on sales of energy resources. Besides, there is an unequal distribution of foreign investment in the regions of Russia. Thus, the leaders on the attractiveness of foreign investments in the country are Central and Volga-Vyatka regions. However, only 2,7 % of Russian companies with foreign capital are in Southern region despite the favorable economic climate (Investment, 2010).

In figure 1 is presented the number of Russian companies with foreign capital among regions, %

Image 1: Number of Russian companies with foreign capital among regions, %



Source: Foreign direct investments in Russia, regional aspect, an analytical review. National rating agency (October 2015), 50. <http://www.ra-national.ru/ru/node/55128>

Net capital outflows from Russia are volatile, as shown in Figure 2, due to the decrease in the amount of external debt in 2015 and 2016. According to the analytical journal RBC, the debt of Russian companies and banks was 67 billion dollars in 2015, and it declined to 40 billion dollars in 2016. Decrease in the outflow of capital from Russia was affected by the same decline in the demand of the population for the currency (Astapovich, 2014).

The main articles of capital outflows (inflows) in the Russian Federation include: FDI, portfolio investment and trade loans. In figure 2 is presented the net capital outflows from Russia, billion dollars.

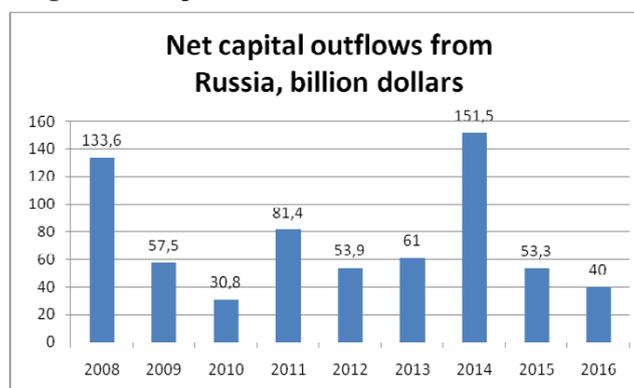
In 2012, Russia was included in the list of 25 attractive countries for foreign direct investment. The country took the ninth place in the list and the third place among the BRICS countries. Nevertheless, Russia has lost its position in the rating due to the economic sanctions. Thus in 2015, Russia did not get on this list at all.

We believe that FDI is the most appropriate investment for Russian economy in the modern conditions of global financial and economic crisis. The reasons of that are presented below (Balatsky, 2012).

Profitability of the project, preservation of the property and a payback period are necessary for foreign direct investors who provide not only financial resources for the development of the company, but also innovative technologies and administrative resources. In addition, foreign direct investors create a competitive environment in a specific region, whereas portfolio investors are motivated only by the factors of profitability and riskiness of investments, without offering any other factors for development of the company. Moreover,

portfolio investments are fundamentally more speculative and short-term (Balatsky, Pavlichenko, 2013).

Image 2: Net capital outflows from Russia, billion dollars



Source: Tomashuk I.O. 2015. "The influence of foreign investment on the activities of Russian companies – recipients". Higher School of Economics, report: 251-260

There are examples of positive and negative experience of absorption by a foreign company of Russian company.

- In December 2010, the American food company PepsiCo acquired the Russian dairy company Wimm-Bill-Dann. The Russian company was valued at 5,4 billion dollars which is 32% higher than its market value. This transaction was the largest takeover of a foreign company in a non-primary sector in Russia. As a result, Wimm-Bill-Dann acquired the status of a foreign subsidiary and became the first Russian company to conduct an IPO on New York Stock Exchange. During the placement of shares, the company valuation was 830 million dollars, and French company Danone was the largest buyer of shares.

- The largest manufacturer of cars JSC «AvtoVAZ» entered into a scientific and technological alliance with Renault. Later, in 2009, an agreement was signed between these companies, according to which Renault made an asset contribution, which included the transfer of production technologies, expertise and experience of experts in the amount of 240 million euros. However, this cooperation has become less profitable for the Russian company. In mid-2014, the alliance Renault-Nissan bought a controlling stake in AvtoVAZ, which meant inter-firm integration or takeover (Yaskova, 2013).

Therefore, it is necessary to outline the main advantages and disadvantages of the influence of foreign investment on the development of Russian companies and growth of their competitiveness.

There are some advantages:

- foreign investment is a source of innovation, modern technological equipment, which raises significantly labor productivity and production efficiency and which makes the quality of products higher;
- FDI is an additional source of capital. They help Russian companies become more prosperous in the world market;
- FDI provides jobs to employees and promotes skills development for employees;
- FDI is a substitute for foreign loans, but it does not raise the level of external debt.

The main disadvantage for domestic companies in attracting foreign investment is that FDI hinders the development of firms in the long term. This happens due to the fact that most of the income is transferred to foreign investors. Moreover, foreign companies also benefit from the usage of innovative technologies by Russian companies (Berzon, 2014).

The Central Bank of Russia noted the decrease in the volume of attracting foreign investments. A significant decline began after the collapse of the ruble in the second half of 2014, when the balance of investment operations became negative. This meant that foreign investors received their funds more than they invested. This trend continued in 2015 (Petrova, 2015).

Nevertheless, there are countries, which volume of investments has grown relatively. These are the Bahamas, Cyprus, and the Netherlands, which are offshore. Meanwhile the balance of direct investment from the Bahamas island was (+2328 million dollars), Cyprus

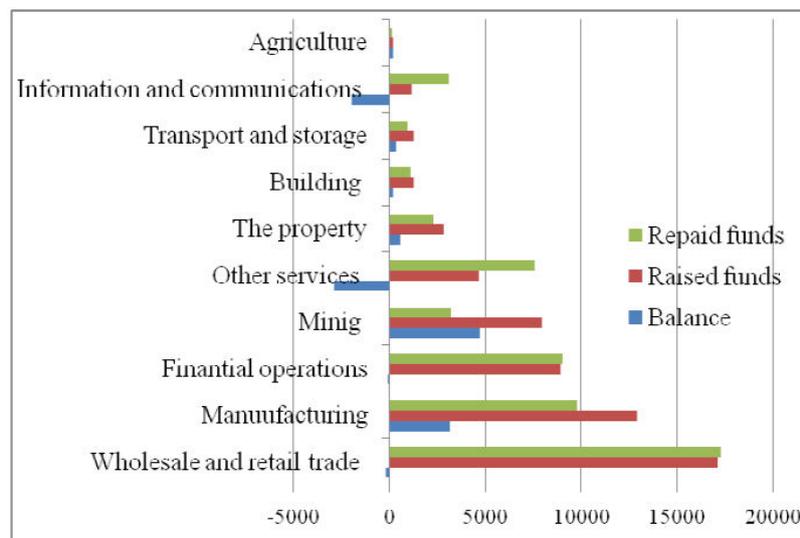
(+1156 million dollars). Obviously, such firms received revenue in currency, increasing the value in rubles.

Many Russian companies with foreign capital are being closed nowadays. This applies to industrial companies, companies of productive sector and service companies. In 2015 the production of Opel cars was stopped. Moreover, about 30 models of cars left the Russian market later. Official representatives of General Motors associated this fact with unclear market prospects.

Furthermore, some affiliated companies of information technology sector were closed such as Skype, Adobe Systems and Google. Besides, 3 Danone companies were closed in Smolensk, Novosibirsk and Togliatti (Tomashuk, 2015).

As for the sectors of foreign capital investment, according to the data of the Central Bank, most of it is invested in wholesale and retail trade, manufacturing, finance and mining. Figure 3 is presented ten sectors of the Russian economy with total leveraged investment.

Image 3: Ten sectors of the Russian economy with total leveraged investment, a first half of 2015, billion dollars



Source: Tomashuk I.O. 2015. "The influence of foreign investment on the activities of Russian companies – recipients". Higher School of Economics, report: 251-260

Over the past two years investment in the steel and metallurgical industries, building and information technology has fallen sharply. Moreover, the level of repayment investment has increased and as a result the balance has decreased and become negative. Thus, foreign investors withdraw their funds, which is not profitable for companies due to the fact that the local currency is devalued (Voronina, 2013).

UNCTAD reported that in 2016 FDI inflows into Russian companies declined due to the volatility of major currencies and the reduction in resource prices. Moreover, increased geopolitical risks are also an important factor which influence on decrease in FDI.

The main disadvantage of domestic companies in attracting foreign investment is that FDI hinders the development of firms in the long term. This is due to the fact that most of the income is transferred to foreign investors. Moreover, foreign companies also benefit from the use of innovative technologies by Russian companies.

Nevertheless Russian companies need FDI. It is necessary to increase the investment attractiveness of companies, which has decreased significantly due to the high volatility of ruble and the fragile Russian economy (Dzedzichuk, 2016).

It is necessary to explain the term of investment attractiveness. It is a specific environment where investment processes take place. It contains investment conditions and potential risks for investors. Investment attractiveness create investment climate influenced by different factors, such as economic, social, political and others. A favorable investment climate attracts foreign capital, and as a result, investor confidence is growing (Savchenko, Khryseva, 2016).

The features of the Russian investment climate are instability of economic and legal systems, insufficient level of development of market infrastructure elements, as well as incomplete information from foreign investors about the possibilities of capital investment.

According to UNCTAD study of 2015 on world investment trends, Russia lost its positions in the global investment market. The total volume of investment received in the country is 1.7 billion dollars, while in 2014 this figure was 20.95 billion dollars. UNCTAD explained this recession as a decrease in investors' confidence and the complication of the geopolitical situation.

The decrease in the investment attractiveness of Russian companies is indicated by the BDO International Business Compass rating, developed every year by the Hamburg Institute of World Economics. 2015 rating includes 174 countries, where Russia is the 100th in it. The countries which are above the Russian Federation in the ranking are Vietnam, Paraguay, Nicaragua and other developing countries. The rating compilers noted that the administrative barriers have significantly increased because of the sanctions and the development of transport infrastructure and manufacturing have become worse (Savchenko, Khryseva, 2016).

International Financial Reporting Standards (IFRS) can be an instrument that increases the investment potential of Russian companies. The information contained in the reporting of companies in Russia will improve the investment climate significantly. It is necessary for companies to collect relevant, complete and objective information about the objects of investment.

Due to the sanctions, previously mentioned negative investment trends Russia cooperate closely with Asian countries such as China, which undoubtedly increases the competitiveness of Russian companies. In May 2014 about 40 bilateral agreements were concluded between Russia and China in different sectors of economy. They are energy, banking, telecommunications and others. The main factors of attractiveness of Russian companies for Chinese investors are presented below.

- A large environmental damage is caused by the usage of coal in China. Its share in the structure of energy consumption is 70%, while the share of gas is 5.9%. Therefore, China is interested in gas supplies. As a result, a contract was signed between Gazprom and CNPC companies valued at about 400 billion dollars for the supply of 1,032 trillion cubic meters gas within 30 years.

- Russia and China are geographically close and face similar geopolitical problems, which makes military cooperation within the SCO (Shanghai Cooperation Organization) attractive for both countries.

- Due to the fact that Western countries ceased to provide innovative equipment and technology to Russia, and companies began to close, there was an urgent need for high-tech equipment which China is successful at. Thanks to China, the threats of technological inferiority of Russian companies are prevented.

- The alliance of developing BRICS countries is also a factor in expanding cooperation between Russia and China, which led to the creation in 2014 of a financial institution called the New Development Bank BRICS. It was found for the implementation of joint investment projects and sustainable development" projects.

Here are examples of already implemented joint major projects created of Russia and China.

A good example of cooperation between private businesses of two countries is the gambling area «Primorje», which total investment is 2 billion dollars. By the end of this project, an international class resort will have been created. The goal of this resort is to provide jobs to the local people, which undoubtedly influence positively on economic development of the Far Eastern region.

In May 2014 an agreement was signed between RusHydro and PowerChina companies on the development and usage of small hydroelectric power stations in Russia with a capacity of 25 megawatts. 35 small hydropower plants in Russia will have been built by 2020. The total investments are estimated at 3.5-5 billion dollars (Center of Political Information, 2015).

On November 7 in 2016, an agreement was signed to establish a Russian-Chinese venture fund between the Russian-Chinese Investment Fund (RCIF) and Chinese company Tus-Holdings. The total investment is 100 million dollars. It is noted in the agreement that members of RKVF will look for Russian high-tech companies and start-ups with the prospects for further development in the markets of China. Attractive sectors include cloud technologies, biomedicine, information technology in the financial sector and others.

3. Conclusion

To sum up, the investment inflows to Russian companies will decrease until the world economic climate becomes favorable. Investor confidence in the Russian economy will be restored when the economic growth is achieved in the country. The goalposts are to improve its investment policy as well as to adopt international financial reporting standards. Nevertheless, Russia is developing cooperation with China and other countries of Asia-Pacific and Southeast Asia, which can increase the competitiveness of Russian companies in the long term.

The main aim of Russian business is the usage of one of the dominant competitive advantages of the country which is a large home market. It is necessary to fill it with top - quality goods produced by the real sectors of Russian economics. Another aim is maintaining the balance and stability in the market and in the whole economics of the country as well as caring about the consumers' needs.

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