



**Installed against the Wind – New Factories of Russian Manufacturing Subsidiaries of Western Multinational Corporations**

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## Installed against the Wind – New Factories of Russian Manufacturing Subsidiaries of Western Multinational Corporations

### Abstract

Using a series of interviews with the heads of Russian subsidiaries of Western multinational corporations and a unique database registering the openings of new manufacturing plants in Russia during 2014-2015, we trace the changing demography, geography and economics of foreign direct investments in industrial assets in Russia. We demonstrate that foreign companies in general were capable of overcoming the adverse economic conditions of 2015 and were able to complete their projects of installation of new factories that were launched in 2012-2013. Importantly, such factories not only target current opportunities and market niches in consumer markets but also aim at exploring possibilities in core industrial markets, including mining equipment, transportation equipment, and other types of industrial equipment. We also highlight the emergence of a new type of industrial project known as “fenced field projects,” which are new manufacturing facilities within the existing industrial sites of successful Russian firms. This new type is particularly attractive for companies in the machine-building and chemical industries. “Fenced field projects” can be either wholly owned subsidiaries or joint ventures, but the main feature of such projects is the active use of the developed physical and business infrastructure of the “hosting” Russian company. We demonstrate not only the changes in the geographic distribution of foreign direct investments in Russia but also the impact on medium-sized industrial towns (200,000-400,000 inhabitants), the most frequent location for industrial projects by foreign multinationals.

Keywords: Russia, manufacturing, multinational corporation, new factories

## Introduction

The Russian economy is going through a very difficult period. Sanctions imposed by developed nations affect critical aspects of the local economy such as securing long-term capital by leading Russian financial and non-financial corporations and accessing sophisticated drilling technology for oilfields. Russia's self-imposed embargo on imported foodstuffs from the United States of America (USA), the European Union and other countries, in addition to the fall in oil prices and subsequent two-fold devaluation of the local currency, have led to accelerated inflation, a drop in the gross domestic product (GDP), the contraction of disposable incomes, decreases in retail sales and a sharp decline in foreign trade. More importantly, the combination of these events with the absence of a clearly articulated governmental economic policy has created a situation of extremely high uncertainty for business.

All of these factors have seriously affected Russian subsidiaries of multinational corporations (MNCs), including those that possess Russian industrial assets. The business press has recently published numerous stories about many MNCs postponing investment plans and even closing or divesting of Russian factories (e.g., Coca-Cola and General Motors). Some analysts report that foreign groups consider scaling back Russian operations (Oakley, 2015). At the same time, in 2014-2015, many MNCs have continued or even intensified their efforts to install new manufacturing facilities in Russia. Among them are leading car producers, such as Volkswagen Group, Ford Motors Corp, Toyota, Nissan; large chemical companies (Solvay); machine-building and equipment corporations (Siemens, Bombardier, Claas, Bosch, and ABB); construction materials companies (Saint-Gobain, Henkel, and Knauf Insulation); food-processing corporations (Danone, Nestle, Mars, and Mondalez International); and pharmaceutical corporations (Teva, Novartis, Berlin-Chemie, and AstraZeneka). We examine the phenomenon of investment under great uncertainty and reveal which new industrial facilities have been installed in Russia by MNCs in 2014-2015, where such facilities have been installed and why

1  
2 some MNCs have not only finalized their on-going industrial projects but also launched and  
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4 completed new projects during the current economic downturn.  
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7 The paper is organized as follows. In the first section, we provide a short overview of the  
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9 history of industrial projects by foreign MNCs in Russia in the post-Soviet period. The second  
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11 section is devoted to the methodology and data. We present the contents of a unique database on  
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13 Russian industrial projects completed by MNCs in 2014-2015 and also provide information  
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15 drawn from interviews with the heads of Russian MNCs' subsidiaries that were carried out in  
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17 2014-2015. The third section presents the distribution of the completed industrial projects and  
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19 information on the industry, size, country-of-origin of investment and investment location. The  
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21 fourth section describes various motives by MNCs that justify completing on-going projects and  
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23 launching new projects to install manufacturing facilities despite adverse economic conditions.  
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25 The conclusion section summarizes our findings and also contains some predictions about the  
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27 validity and applicability of MNCs' motives for installing manufacturing facilities in the future.  
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### 35 **Development of Manufacturing Subsidiaries of MNCs in Russia in Post-Soviet Times**

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38 The history of developing manufacturing subsidiaries of MNCs in Russia in the post-Soviet era  
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40 has never been properly described. There are several reasons for the absence of such studies. One  
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42 of the main reasons is the lack of reliable Russian official statistics regarding foreign  
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44 investments. Unlike the countries in Central and Eastern Europe, the Russian official statistics  
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46 identify legal entities with a share of foreign ownership of 10% or more as "companies with  
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48 foreign investment". Because of the widely applied techniques of "capital round-tripping" (see  
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50 Ledyeva et al., 2015) and the popular practice among Russian corporations of keeping their  
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52 parent companies offshore (mostly in Cyprus, Luxemburg, and the Netherlands), the official  
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54 figures regarding "foreign direct investments" and the overall number of "foreign-owned  
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1 companies”, in addition to their shares in particular industries, are somewhat irrelevant. At the  
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3 same time, many studies in the fields of economic geography and international business use as  
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5 the unit of analysis the company, not particular manufacturing sites (Ledyeva et al., 2012),  
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7 which are not always incorporated as separate legal entities<sup>1</sup>. Even Dun & Bradstreet (D&B)  
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9 databases, that cover more than 43 million public and private establishments in more than 100  
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11 countries and territories, used in several very interesting studies regarding agglomeration of  
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13 industrial plants (see, for example, Alfaro and Chen, 2014), are affected by the same problems of  
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15 distinguishing between industrial facilities that belong to parents of Russian companies located  
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17 offshore and those that belong to “genuinely foreign” parents. As a result, through secondary  
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19 data, we may derive only very rough estimates of the total number of manufacturing plants that  
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21 belong to “genuinely foreign” MNCs and their total output.  
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28 Nevertheless, despite the deficiency of general data regarding Russian manufacturing  
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30 subsidiaries of MNCs, the major stages of the development of that phenomenon are quite clear.  
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32 In general, the whole history of Russian manufacturing subsidiaries of MNCs can be split into  
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34 five distinctive periods – 1987-1991; 1992-1999; 2000-2008; 2008-2014; 2014-present time.  
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38 Foreign direct investment in Russia was first permitted in 1987 after nearly 60 years of  
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40 complete prohibition. The very first instances of joint ventures between Russian and foreign  
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42 companies attracted significant research interest (Nigh and Smith, 1989; Nigh, Walters and  
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44 Kuhlman, 1990; Rosten, 1991). During the period of 1987-1991, the activities of state-owned  
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46 enterprises were closely supervised by the Soviet Union industrial ministries. Thus, foreign  
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48 MNCs established joint ventures mostly as separate subunits (shops or departments) within  
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50 already existing factories.  
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54 In 1992-1999, at the fall of the Soviet Union, the dissolution of industrial ministries and  
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56 the beginning of privatization, some MNCs dared to acquire newly privatized plants. In many  
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1 cases, they experienced a major disappointment – the local traditions of manufacturing culture  
2 and quality management varied too much from international standards. One publication  
3 describes the first impressions of foreign engineers during their initial visit to a recently acquired  
4 Russian beer factory: “Puddles of beer on the floor and hordes of cockroaches everywhere”  
5 (Jullenius, 2000). Moreover, one of the most distinctive elements of the Soviet industrial culture  
6 that contradicted the principles of modern manufacturing (i.e., robust and flexible operations,  
7 safe products and processes, and attention to detail) was “storming.” Kets de Vries (2001: 615)  
8 noted that this “...led to what by Western standards were irrational, cost-ineffective behaviours,  
9 such as maintaining extremely high inventories of finished goods, hoarding materials and labour,  
10 and accepting unconnected goods that could be bartered to obtain badly needed supplies. During  
11 GOSPLAN days, ‘storming’ - working in a mad frenzy to fulfil certain agreed-upon quotas - was  
12 part of the routine. Crash programmes became a national pastime. This fire-fighting mode is still  
13 typical of many organizations in Russia...” Thus, the period of 1992-1996 is marked by several  
14 examples of major international MNCs quickly divesting recently acquired Russian industrial  
15 plants<sup>2</sup>. Very few MNCs were capable of using the Russian capacities of “storming” in a  
16 productive manner, e.g., for quick installation and putting in motion new production facilities  
17 (see Gurkov and Kossov, 2014a).

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However, the period of 1992-1999 was not a period of total disappointment for foreign investors. Several MNCs (P&G; Knauf; Rhodia, which was later acquired by Solvay; Henkel and many others) successfully established Russian manufacturing subsidiaries. Following Leo Tolstoy’s suggestion that “all happy families are alike”, the success of MNCs with Russian industrial assets can be ascribed to four interrelated factors. *First, to achieve success, MNCs needed to consider acquisitions of Russian industrial assets as “brownfield investments”, regardless of the physical conditions of the facilities* (e.g., steadily running plants that had been using imported equipment and the recipes of the acquirer for decades in the case of the Tosno

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plant acquired by Henkel, an unfinished plant full of uninstalled equipment in the case of the Novomoskovk plant acquired by P&G, and abandoned construction sites in the cases of many other MNCs). This means that after the acquisition, major investments in both equipment and personnel were needed to achieve the desired productivity, quality, robustness of operation and “centrality of production processes”. The milestones of upgrading a flagship Russian factory of Knauf (a German company specialized in gypsum plasterboards) offer an example:

- In 1994, the production of polystyrene plates began using a cement-fibrolite production line.
- In July 1995, Italian equipment was used to start producing metal constructions for mounting modular partitions, suspended ceilings made of gypsum board, and other gypsum-based products. In 1997, a production line for metal structures was enhanced with steel-cutting equipment. In January 2002, a second production line for metal structures was installed. In 2012, the second production line was upgraded, and a module for automatic packaging was added.
- In 1997, production of dry building compounds was launched at the Akmigran factory. The equipment was supplied by German manufacturers.
- In 2000, the production volume of dry compounds exceeded the projected capacity. As a result, automated equipment was purchased and put into operation in May 2001.
- From November 2002 to December 2003, a new factory for the production of dry cement-based compounds with a production capacity of 200 thousand tons was built. In 2005, the reconstruction of the dry gypsum compounds began and was completed in February 2006. The installation of the second production line increased production capacity by a factor of 2.8 without any physical expansion of the factory area.
- In 2012, the company added new products to its portfolio: Knauf Binder dry building compound and Knauf Flisen Plus glue.

- From 1997 to 1998, an overhaul and upgrade of individual machines and plants for the gypsum board production line was completed without significant production process interruption. The upgrades resulted in an increase in the board spinning speed of up to 40 m/min (planned speed 18 m/min).
- In April 1998, a warehouse for gypsum binder was completed, and a new unit for gypsum production was added in November. Another reconstruction project was conducted in 2006 that increased production speed by 2.1 times. The company had solved the problem of gypsum binder shortages and had improved prospects for the overhaul of the gypsum board production.
- From the fall of 2002 to 2003, the reconstruction of rail infrastructure increased the rail tracks by 2.6 km, and warehouse area totaling 5,000 square meters was added. These additions facilitated the development of a new customs terminal.
- In September 2008, large-scale reconstruction of the gypsum board production line was completed; the building was expanded, a conveyor belt was installed, and a warehouse of gypsum stone was expanded. Production capacity was increased by a factor of 2.5.
- In 2009, a new production line for spackling pastes was inaugurated. In 2010, the following new products were launched: “Knauf Rotband Grund” and “Knauf Rotband Pasta” pasty plaster.
- In 2010, conversion of the heat system from a centrally supplied system to an autonomous system was initiated. An autonomous boiler for an administrative block was built in 2010. An autonomous boiler room for auxiliary buildings was delivered in 2011.
- From 2010 to 2012, a new gas distribution facility was built within the central gas supply system and transferred to the Moscow region’s government.

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2 Similar stories of continuous upgrades and significant investments can be found in descriptions  
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4 of other successful Russian manufacturing projects of MNCs that started in the 1990s (see, for  
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6 example, Anghel, 2012; Pepper, 2012).  
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10 *The second pillar of success was the development of an efficient and effective system of*  
11 *human resource management (HRM) in the 1990s by Russian subsidiaries of MNCs* (see Fey,  
12 Björkman, and Pavlovskaya, 2000). That system has remained unchanged for 15 years (see  
13 Gurkov, forthcoming) and presents an “antipode” to the prevailing post-Soviet model of HRM  
14 (Andreeva et al., 2014) because it emphasizes such features as permanent job contracts, the  
15 dominance of the fixed part in take-home pay, numerous additional non-monetary bonuses and  
16 benefits.  
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26 *The third pillar of success was the ability learned by trial and error to distinguish*  
27 *between “corrupt” and “extremely corrupt” practices.* Dr. Gerd Lenga, Managing Director of  
28 Knauf CIS in 2006-2012, remembered the following story:  
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33 “We have ... experience. We managed to build our second plant in the Moscow region only  
34 at the third attempt. The administration of one of the cities gave us many promises. And at  
35 the first negotiation round, some people were introduced to us in the presence of regional  
36 and city officials. I asked, ‘Who are they?’ I was told they were a private firm that would  
37 help us ‘solve problems.’ I asked what sort of problems, as long as we have none in the  
38 city. Of course, we refused to invest in this city because we were immediately offered a  
39 firm that would solve problems, created by the firm itself. The same story repeated itself in  
40 another city. In the end, we built a plant in Stupino. There the city government did not  
41 offer such things” (Zhegulev, 2010).  
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2 It should be stressed that in 1990s, most MNCs also adhered to two principles in selecting and  
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4 managing the possible targets for acquisitions. First, they favored acquisitions over greenfield.  
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6 The above mentioned Dr. Lenga also stressed the following:  
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9 There are some terms as greenfield and brownfield — establishing of a manufacturing  
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11 object “from zero” or the work on the existing industrial field. As an advocate who works  
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13 in Russia more than 20 years, I prefer to work with brownfield. No matter which are the  
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15 conditions of infrastructure but it should exist. If you have to pull some pipes or to install  
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17 electivity lines, you will never be capable to calculate how much it will cost...” (Gurkov  
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19 and Kossov, 2014b).  
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22 The second organizational principle can be formulated as follows: “Regardless of the structuring  
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24 of the acquisition deal, the real investments start only after achieving 100% operational control  
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26 over the industrial object”. This principle is still largely valid today.  
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29 *The fourth pillar of success was the ability and the willingness to defend the newly*  
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31 *acquired assets against different types of local actors* who considered foreign companies to be  
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33 easy targets. For this purpose, foreign MNCs established a well-developed system of multi-layer  
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35 defense. On the top were two lobbying organizations: the Foreign Investment Advisory Council  
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37 (FIAC), established in 1994, and the Association of European Business (AEB), established in  
38  
39 1995. The 50 members of FIAC are the largest global MNCs with substantial interests in Russia.  
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41 The annually held general assemblies of FIAC bring together chief executive officers (CEOs) of  
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43 the largest global MNCs and the Russian prime minister. The AEB assembles approximately two  
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45 hundred members and consists of “sectoral committees,” which address issues common to all  
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47 industries and usually hold open meetings (attended not only by assigned members), and  
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49 “industry committees,” which address issues specific to their industry and usually hold closed  
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51 meetings (only attended by assigned members).  
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The next “layer” consists of national trade chambers (the US, German, British, and French chambers, for example) and country associations (Canadian, Japanese). Finally, specialized law firms focus on particular types of disputes (e.g., the use of land, abuse of monopoly power, trademark use, and safety control) with different authorities (e.g., local authorities, anti-trust authorities, and sanitary inspections). During the 1990s, that system was just being established, and foreign companies used many tricks to defend their Russian assets.

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The period of 2000-2008 was the zenith for Russian manufacturing subsidiaries of MNCs. The period was characterized by the spectacular rise of the Russian economy. For example, the average monthly salary increased from US\$62 in 1999 to US\$695 in 2008. As a result, the consumer market (in retail prices) grew from US\$80 billion in 2000 to US\$600 billion in 2008. Foreign MNCs rushed to explore the opportunities offered by the increase in Russians’ purchasing power. The Putin administration clearly indicated the following interests for different sectors in 2001-2003:

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• it wished to see foreign investors (in fast-moving consumer goods (FMCG), construction materials and do-it-yourself (DIY), chemicals, and industrial services);
- it wished to tolerate foreign investors as junior partners (in the oil industry);
- it did not want foreign investors to acquire large factories (such as machine-building and some other “strategic sectors”<sup>3</sup>).

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Foreign MNCs obviously concentrated their investments on the most attainable sectors and markets. During this period, MNCs largely expanded the repertoire of development methods of their Russian subsidiaries. In addition to brownfields, and despite the grim warnings of “experienced advocates”, many MNCs embarked on greenfield investments. In selecting the locations for both brownfield and especially greenfield investments, MNCs followed the pattern of *cross-sectorial agglomeration*. Successfully establishing a subsidiary of one foreign corporation served as a sign of the attractiveness of a particular industrial town and a “tolerable

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corruption level” among a regional administration. Greenfield investments were also supported by the establishment of the first “industrial parks” and “special industrial zones” including Alabuga (in Tatarstan), Kaluga and some others (e.g., Noginsk, Zelenograd, Lipetsk, Dubna, and Ulyanovsk)<sup>4</sup>. However, the most interesting case of cross-sectorial agglomeration of plants created through greenfield industrial investments is the case of the “M3 industrial strip,” a zone along the Moscow-Kiev highway (M3) in both Moscow and Kaluga oblasts that hosts greenfield investments of AVON (cosmetics), REXAM (aluminum cans), Samsung<sup>5</sup> (consumer electronics) and a dozen other recently established industrial entities.

At the same time, in the 2000s, Russian manufacturing subsidiaries of MNCs started to face stronger competition from Russian-owned companies that had also managed to acquire and revitalize Soviet-era industrial factories. Several local companies in FMCG also developed successful brands that appealed to the domestic clientele. Thus, shortly before and especially after the financial crisis of 2008, a wave of acquisitions of local companies by MNCs began: Unilever, Coca-Cola, PepsiCo, and Danone Industries acquired large Russian companies. In many cases, these deals led to portfolios of overlapping global and local brands and an excess of production facilities. Thus, Russian subsidiaries had to quickly learn how to make the operations of newly acquired production facilities compatible with corporate standards, how to streamline production between sites, and, in some cases, how to manage business in a completely new sphere. In addition to acquisitions of local companies, the period of 2008-2012 is characterized by further expansion of greenfield investments, including implementing new projects in “special economic zones” and in “industrial parks” (especially in Alabuga and in Kaluga). In this period, it was possible to see the arrival of latecomers (such as Peugeot-Citroen, which installed its new car assembly plant in 2012-2013 near the car assembly plant of Volkswagen) and the expansion of established Russian subsidiaries beyond brownfield investments (see Gurkov and Kossov, 2014).

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As a result of brownfield investments, greenfield investment and acquisitions of local competitors, many Russian subsidiaries of MNCs own numerous plants – six corporations own individually more than a dozen plants in Russia. Approximately 30 corporations own three or more plants each. Estimating the total number of plants and total volume of production by Russian manufacturing subsidiaries of MNCs is not easy. Gurkov (2014) estimated the total volume of production of Russian manufacturing subsidiaries of MNCs at approximately US\$100 billion and the total number of factories at approximately 1,000.

Since 2012, many local consumer markets have gradually stagnated. The first markets that stagnated were local juice and beer markets, and in 2013, the number of new cars sold in Russia decreased by 5%. The first round of economic sanctions imposed on Russia in March 2014 did not affect most Russian subsidiaries of MNCs because such sanctions primarily targeted the oil sector. The more serious impact was felt from the self-imposed Russian embargo on foodstuffs. This caused many Russian subsidiaries of MNCs to review their supply schemes because many types of products sold in Russia by MNCs were imported. Finally, the sharp devaluation of the local currency in November-December 2014 (on the 1<sup>st</sup> of January 2014, the Ruble was 32.66 per US\$; on the 1<sup>st</sup> of November of 2014, the exchange rate was Ruble 41.96 per US\$; on the 18<sup>th</sup> of December 2014, the exchange rate was Ruble 67.78 per US\$; on the 31<sup>st</sup> of December of 2014, the exchange rate of the Ruble was 56.26 per US\$) harshly affected both Russian and foreign-owned firms. As the panicky storming of shops by the Russian customers expecting further devaluation quickly ended, managers of Russian subsidiaries had to design new plans to work in a new economic reality. As the Russian financial director of one of the leading world FMCG corporations recalled:

“On December 24<sup>th</sup> we took our nice strategic plan for 2015, looked at it for the last time and put it into the litter bin. Next we spent the whole Christmas week in designing new

1 strategic estimates and operational measures. We finished a new plan an hour before the  
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4 New Year jingle bells. Almost 70% of those estimates were confirmed through 2015”.

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6 In addition to designing new operational plans, it was equally important (at least for listed  
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8 companies) to prepare annual reports and to explain to shareholders why the Russian assets lost  
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10 45% of their value in one year.  
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## 12 13 14 15 **Data and Methods**

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17 In the present study, we rely on two sources of information. First, shortly after the first round of  
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19 economic sanctions, we started a series of interviews with the heads and/or other top executives  
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21 at Russian subsidiaries. Among the major topics in these interviews were the strategic and  
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23 tactical measures of adaptation to new economic realities. In May 2014 through October 2015,  
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25 we were able to interview heads of Russian (Eurasian) operations of Air Liquide (which was  
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27 regularly installing new Russian plants), Alstom (which recently gained operational control over  
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29 several Russian plants), Bunge (which built new facilities in 2013-2014), MAPEI (which  
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31 expanded its Russian production facilities in 2014), Lactalis (which acquired a new plant and  
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33 quickly expanded it in 2014), Nestle (which opened a new plant in a very promising market  
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35 segment in 2014), ROCKWOOL (which was rapidly expanding its 3rd plant in Russia), Solvay  
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37 (which finished the largest Russian industrial project of the 2010s), Unilever, and the heads of a  
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39 few corporations that did not wish to be named. In addition to the above-mentioned (and  
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41 unnamed) corporations, we performed an in-depth study of ORIFLAME S.A., a Swedish beauty  
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43 and cosmetics company that opened its largest production facility in Russia in February 2015. In  
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45 preparing that study, we interviewed the CEO and Vice-Chairman of the parent company and  
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47 other executives at the parent company in addition to the key executives of ORIFLAME’s  
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49 Russian subsidiary; we were present at the official opening ceremony for the new plant and  
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51 studied company records related to the installation processes. The major rationale for this in-  
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depth study was to reveal the motives for investments and the of capital allocation within an international corporation.

The second source of information was secondary data (companies' press releases, publications in local newspapers, and information from specialized internet portals) regarding ceremonies at new plants' openings. Using this type of data, we compiled a database that contains detailed information about *all plants* officially opened by foreign MNCs in Russia between January 1, 2014 and December 31, 2015. The database includes data on the exact location of the plant, the major type of production (4-digit Standard Industrial Classification, or SIC, code), corporate parent(s), the amount of investments made, and the number of personnel employed<sup>6</sup>. The fact that Russian subsidiaries of MNCs inherited the Soviet-era tradition of public plant opening ceremonies enabled us to identify all such events because the participation of government officials in such festivities was mandatory<sup>7</sup>. We also recorded approximately 50 public ceremonies devoted to openings of new production lines in the already-established plants, but we excluded that data from further analysis because in a series of interviews, we were assured that only a small fraction of the facts pertaining to opening new production lines is revealed (primarily because of considerations about commercial secrecy).

### **Demography of New Industrial Plants**

In 2014-2015, MNCs opened 109 factories in Russia, consisting of 94 completed new objects and 15 "first stages" of new industrial entities. Although the number of opened plants varied largely across particular months of 2014-2015, the overall number amounted to 54 new plant openings in 2014 and 55 in 2015. The smallest size of a new facility was Ruble 100 million (mln.) in investments and 20 employees, whereas the largest industrial plant commissioned in 2014-2015 (RusVinyl plant) was estimated at Ruble 6,000 mln. and listed 1,800 employees. The

1 median size according to financial investments was Ruble 1,000 mln. and the median size  
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4 according to employment -- 136 employees.  
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6 Regarding the country of origin of corporate parents, the most prolific (in terms of the  
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8 number of plants installed) was Germany (30 plants), followed by the USA (13 plants), France (9  
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10 plants) and Japan (8 plants) (see Table 1).  
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21 Regarding the industry distribution, the most popular type of production for new plants  
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23 was "transportation equipment" (22 plant), followed by "industrial and commercial machinery  
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25 and computer equipment" (19 plants), "chemical and allied products" (16 plants) and "food and  
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27 kindred products" (9 plants) (see Table 2).  
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41 Examining the industrial distribution of new MNCs' plants more deeply, we should  
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43 further explain the wide variety of production in Russia. For the aforementioned 109 plants,  
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45 there were 59 unique 4-digit SIC code descriptions of the main type of production, ranging from  
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47 "candle making" to production of "explosion-proof high-voltage switchgear and switchboard  
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49 apparatus". In addition to 22 plants related to car and truck production (that included new car  
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51 assembly and engine factories opened by Volkswagen, Ford, Volvo Group, and Isuzu; car  
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53 component factories opened by Nematik, Fujikura, Continental and Bosch), other popular  
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1 categories were “oil field machinery and equipment” (SIC 3533) - 5 plants; “construction  
2 machinery and equipment” (SIC 3531) – 5 plants; and “farm machinery and equipment” (SIC  
3 3523) – 5 plants. There were also 5 plants in “pharmaceutical preparation” (by Novartis, Teva,  
4 Berlin-Chemie, AstraZeneka and Novo Nordisk) (SIC 2834) and 4 plants in “paints, varnishes,  
5 lacquers, enamels, and allied products” (SIC 2851).  
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12 We also noted that the unwritten ban from the 2000s on foreign companies’ investment in  
13 machinery and equipment was lifted in the 2010s. Among the types of new factories that foreign  
14 companies built in Russia, we found such “sensitive” products as “production of emulsion  
15 explosives” (a new factory opened in December 2014 in Murmansk Oblast by the Australian  
16 company Orica, located on the territory of a large mine owned by the Russian mining group  
17 “Apatite,” is the largest European factory for products needed for surface and underground  
18 blasting).  
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28 Assessing the size of the industrial projects, we simultaneously take into account three  
29 types of parameters – the absolute size of investments, the size of investments into a particular  
30 Russian plant relative to other realized and on-going investment projects of the parent company,  
31 and the importance of a plant for a particular Russian industry (markets). Using the  
32 amalgamation of those criteria, we identify several industrial projects that can be assessed as  
33 “really large”:  
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- 42 • RusVinyl, a joint venture of Solvay (Belgium) and SIBUR (Russia) that officially opened  
43 in September 2014, is a complex for production of polyvinylchloride (PVC) and caustic  
44 soda at best available technologies (BAT). This investment project of Euro 1.5 billion is  
45 the largest investment project of both parents, and the project completely changes the  
46 local PVC industry.  
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- 52 • A new cement factory with a planned capacity of 2 mln. tons was opened in May 2014 by  
53 Lafarge. The total costs of the project were Euro 500 mln. This was a large (albeit not  
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1 unique) project for the parent company, and this plant added 3% to the total output of  
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4 cement in Russia.

- 5  
6 • Two engine plants were opened in September 2015, by Volkswagen Group and by Ford  
7  
8 Motors Corp. (in cooperation with the local Sollers group). Although the plants were not  
9  
10 unique for the parents in terms of their sizes, each plant absorbed more than Euro 250  
11  
12 mln. and also contributed more than 10% to the local capacities of car engine production.
- 13  
14 • We also should mention a Euro 150 mnl. plant by Oriflame AG., a Swedish beauty and  
15  
16 cosmetics company. This plant was the largest industrial investment project in the  
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18 parent's history and added more than 5% to the total local capacity in beauty and  
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20 cosmetics.  
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### 26 **Geography of New Plants**

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28 The geographic spread of new plants opened by foreign corporations in Russia is rather limited  
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30 (see Figure 1).  
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44 More than a half of all new plants were installed in just seven regions: Moscow Oblast  
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46 (12 plants), Kaluga Oblast (11 plants, including 6 plants in Kaluga city), Tatarstan Republic (10  
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48 plants, including 7 plants in the Alabuga special economic zone), Leningrad Oblast (9 plants),  
49  
50 Ulyanovsk oblast (7 plants), Samara oblast (7 plants) and Lipetzk oblast (6 plants, including 3  
51  
52 plants in the Lipetzk special economic zone). We should note that Ulyanovsk is a relatively new  
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54 destination for foreign direct investment that has enjoyed the recent establishment of an  
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1 industrial park special economic zone (“Zavolzhiye”). Another feature of the geography of new  
2 plants in 2014-2015 is a new wave of penetration by foreign corporations into old industrial  
3 cities that were previously largely neglected by foreign investors. Examples of these include the  
4 following:  
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- 10 • In Engels (Saratov Oblast), Bosch (Germany) established a production complex  
11 comprised of four different factories (producing radiators, car engine parts, industrial and  
12 domestic boilers, and professional power tools), and Bombardier Transportation also  
13 established a joint venture for production of locomotives;  
14  
15 • Japanese companies opened two plants in Tver: one for assembly of excavators under the  
16 Hitachi brand, and the second for production of components and parts for those  
17 excavators.  
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19 • In Bryansk in January 2015, Siemens established a joint venture with a local company to  
20 produce equipment for high-speed railways.  
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### 33 **Economics of New Plants**

34 Regarding the economics of the new plants, we should distinguish four essential elements of the  
35 investment processes:  
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- 39 • Making the decision about the investments.
- 40 • Financing the investments.
- 41 • Accounting for the investments.
- 42 • “Tuning” the initial investment projects.

43 In 2014-2015, all of those elements experienced serious alterations due to the changing political  
44 and business conditions in Russia.  
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### *Making the Decision to Invest*

Making the decision to invest in a new plant in Russia is usually a long process. At the very best, negotiations with local authorities prior to all real design and installation works can take a year; design and construction of a factory takes one-two years or even longer; thus, all of the factories opened in 2014-2015 were realizations of decisions made in 2012-2013 or earlier<sup>8</sup>.

There are two ways to initiate a decision about a new plant. When a corporation has already established its presence in Russia, its Russian subsidiary usually takes the initiative and prepares a “case” justifying the necessity of a new industrial object (see Gurkov, 2015). When serious investments in Russia represent an entry into a new market for the corporate parent, the headquarters assess the existing portfolio of corporate production capacities and justify the necessity of its adjustment (expansion). The decision goes smoothly if a clear and reliable market opportunity that can be exploited only by new industrial investments is apparent. As an example, we consider the story of Nematik factory in Ulyanovsk, which opened in September 2015. Nematik is a manufacturer of automotive components, namely precision parts made of cast aluminum, such as cylinder heads and engine blocks. The list of its clients includes nearly all big car manufacturers in the world. For its Russian entry, Nematik followed the plans of one of its major customers, the Volkswagen group, to build an engine plant in Russia to supply its own and contracted Russian car assembly facilities with locally made engines. Thus, in 2011, Nematik asked the German Chamber of Commerce in Russia to indicate the possible locations of a new plant. The negotiation with Ulyanovsk authorities started in May 2012, when other alternative locations were considered: Kaluga (where the Volkswagen engine plant should be located), Nijny Novgorod (the location of the major contract car assembly plant for Volkswagen), Tatarstan (with its famous Alabuga industrial district), and Samara Oblast (the major Soviet-era car producing cluster built around Lada factories). In October 2013, an investment agreement was signed with the regional authorities, and in May 2014, the construction of the plant started;

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in September 2015, the new plant was officially opened. At present, the entire output of the plant is shipped to the Volkswagen engine plant in Kaluga, which opened in October 2015 (Belov, 2015). The distance between Ulyanovsk and Kaluga (the place to where the plant output is delivered) is exactly 1,000 km using major (usually highly congested) highways or 1,046 km by alternative local roads.

In 2015, the smooth process of designing “cases” by local subsidiaries or building the investment projects by headquarters was dramatically amended. Already in November 2014, Magnus Brannstron, CEO of Oriflame AG, publically admitted that because of unpredictable changes in the exchange rate, a “gut feeling” is among a few remaining parameters to be used in justifying industrial investments in Russia (FMCG Conference, 2014).

### *Financing the Investments*

Financing the investments also became more problematic in 2014-2015. Previously, some large projects could be financed through credits from international development corporations (for example, RusVinyl was financed through credit from the European Banks of Reconstruction and Development) or by Russian state-owned banks (such as the case of Bombardier Transportation’s joint venture financed through “Vnesheconombank”). After the beginning of economic sanctions in 2014 and especially in 2015, the possibility of relying on bank credits for new industrial projects by foreign MNCs decreased dramatically. Thus, MNCs have to use additional equity financing for new industrial projects or provide their Russian subsidiaries with “internal credits” to finance the completion of the launched projects

### *Accounting for investments*

1 Accounting for investments in Russia in 2014-2015 was exposed to highly augmented currency  
2 risks. The worst happened in December 2014, when the sharp devaluation of the local currency  
3 virtually annihilated the US\$ or Euro-denominated balance sheets of Russian subsidiaries of  
4 MNCs that made investments during the second half of 2014<sup>9</sup>.  
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### 10 11 12 13 14 *Tuning of Initial Investment Projects* 15

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17 Tuning of initial investment projects is always necessary because no plant can be designed “until  
18 the last bolt”. However, in 2015, the magnitude of “tuning” went far beyond the usual  
19 amendments to particular workplaces or adjustment of the initial schemes for production lines  
20 that were common in large industrial works in Russia (see Gurkov and Filippov, 2013). The  
21 sharp devaluation of the local currency in December 2014 dramatically changed both the cost  
22 structure of on-going industrial projects and the cost structure of their output. Regarding on-  
23 going industrial projects, the costs of imported machinery and equipment calculated in US\$ or in  
24 Euro remained unchanged, and the costs of local equipment (sometimes used in Russian  
25 industrial projects of foreign companies) slightly decreased in US\$ or Euro terms (the industrial  
26 inflation in Russia in 2015 was approximately 20% while the Ruble lost in 2015 additional 30%  
27 of its value against the US dollar), whereas all labor-intensive installation works performed by  
28 local contractors became 40% cheaper in US\$/Euro terms as the local salaries decreased in 2015.  
29 Regarding the cost structure of output, the situation was even more dramatic. The share of  
30 expenditures accounted for by manpower as part of the operating costs further decreased from its  
31 already low levels (between 9 and 15 percent in various manufacturing industries). The costs of  
32 imported components increased, whereas the share of depreciation in the total costs of  
33 production remained unchanged. Thus, industrial plants near completion received a strong  
34 impetus to redesign production schemes towards localization of supplies and to reduce the level  
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1 of automation of production processes. If it is quite difficult to change the overall level of  
2 automation in core processes, it is always possible to decrease the level of automation and to  
3 increase the labor intensity of operations in auxiliary operations (such as loading, packaging and  
4 in-site logistics) without compromising “the best available practices”. Thus, newly established  
5 manufacturing plants of foreign MNCs quickly “retuned” many production processes. In core  
6 processes, the emphasis was placed on adapting recipes and procedures to increase the  
7 possibilities of using locally sourced supplies; in auxiliary operations, the emphasis was placed  
8 on saving on expensive equipment by substituting it with cheaper labor.  
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### 23 Discussion

24 We have presented a “snapshot” of the recent investment activities by MNCs in the form of  
25 designing and opening new manufacturing plants. The installation of new plants is just the tip of  
26 the iceberg of foreign direct investments into manufacturing, which is largely based on  
27 adjustment of the existing production lines or installation of new production lines in already-  
28 established factories<sup>10</sup>. We demonstrated that foreign companies are generally capable of  
29 overcoming the adverse economic conditions of 2015 and completing their on-going projects to  
30 install new factories. More importantly, such factories not only target current opportunities and  
31 market niches in consumer markets but also aim at exploring possibilities in core industrial  
32 markets, including mining equipment, transportation equipment, and other types of industrial  
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49 The major question is not whether the flow of foreign direct investments into Russian  
50 industrial assets will continue (the combination of two-fold devaluation of the local currency  
51 with serious obstacles of local companies to finance their development plans because of  
52 economic sanctions created unique competitive advantages for Russian subsidiaries of MNCs,  
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1 both regarding their sister-subidiaries in other countries and the local competitors) but rather  
2 which forms they will take. Of course, the form of building/expanding local manufacturing  
3 facilities (greenfield projects, acquisitions, joint-ventures, and use of local firms for contract  
4 manufacturing) largely depends on particular industries and specific business conditions.  
5  
6 However, a careful analysis of the available data indicates that in 2014-2015, foreign companies  
7 in Russia began more frequently to use a specific type of industrial projects called “*fenced field*”  
8 projects. This term refers to establishing new manufacturing facilities within existing industrial  
9 sites of *successful* Russian firms. This method is especially applicable for companies in the  
10 machine-building and chemical industries. “Fenced field” projects can be executed either by  
11 wholly owned subsidiaries (such as Hitachi’s plants in Tver or the Orica plant in Murmansk  
12 Oblast) or joint ventures (such as Siemens’ plant in Bryansk or Bombardier Transportation’s  
13 plant in Engels), but the main feature of such projects is the active use of the developed physical  
14 and business infrastructure of the “hosting” Russian company. This method is in sharp contrast  
15 with the Russian practices of MNCs of 1990s, when they simply took over particular facilities  
16 (buildings) in dilapidating local factories (Gurkov, 2014, p. 237-238 presents a few picturesque  
17 examples of such foreign subsidiaries established in 1990s that are presently surrounded by the  
18 ruins of local factories).

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The use of “fenced field” investment projects clearly decreases the costs of investment projects because it facilitates solutions in terms of both physical infrastructure and access to a pool of qualified workers. The active use of “fenced field” investment projects also explains the changing geography of foreign direct investments. For such projects, MNCs target not “industrial parks” or “special economic zones” but rather medium-size industrial towns such as Engels (210,000 inhabitants), Tver (population 408,000 inhabitants), Bryansk (428,000 inhabitants), Rybinsk (193,000 inhabitants), Balakovo (193,000 inhabitants), and Dzerzhinsk (234,000 inhabitants).

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Of course, “fenced field” projects cannot be utilized in all industries. However, “fenced field” projects are the most appropriate form for urgent projects aimed at exploiting the unique current opportunities in Russia, especially in the markets for machinery, equipment, and specialized chemicals (in January-November 2015, Russian imports of machinery and equipment were 41% lower than during the same period of 2014; in January-November 2015, Russian imports of chemicals were 28% lower than during the same period of 2014; GKS, 2015).

### Conclusions

Our explorative study of industrial projects realized by foreign multinationals in Russia in 2014-2015 revealed noteworthy information about the industrial composition of investment projects, the changing geography of investments and especially, the emergence of a new type of investment project, which are casually referred to as “fenced field” projects. At the end of 2015, both the Russian subsidiaries of MNCs and the headquarters of their parent companies will design their operating plans for 2016 and perhaps some longer-term plans. Some of these plans will have modest performance targets (keeping the dynamics of Russian sales ahead of the inflation rate, i.e., to ensure the growth of sales in local currency by 15-20% per year for the coming years), whereas some plans will definitely set more ambitious performance targets for Russian subsidiaries in an attempt to explore the new opportunities in the local markets and/or export opportunities caused by devaluation effects. We outlined the changing economics of investment projects into Russian manufacturing assets are likely to continue in the years ahead. Thus, more observations are required to determine how the changing business conditions, the alterations of the mandates of Russian subsidiaries of MNCs and the outlined modifications of the forms of investment projects will result in changes in the demography and geography of new Russian industrial objects installed by foreign MNCs.

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**Notes:**

1. All products sold in Russia are required to identify the legal and physical addresses of production. Careful study of physical addresses is an exciting experience, especially for manufacturing sites established through greenfield investments. To date, the most intriguing physical address of a manufacturing site found by the author is “3.5 km to the northwest of the village N”.
2. For example, in 1999, Philips Royal Electronics sold for just one Ruble the Russian plant it purchased in 1995 for US\$2 mln. and subsequently spent US\$ 61 mln. to repay the plant’s debts and replenish the plant’s current assets.
3. We may recall several unsuccessful attempts by Siemens to acquire “Silovye Mahiny” (the largest Russian machine-building corporation in power equipment) or an unsuccessful attempt by Bombardier Transportation to acquire “Kolomensky zavod” (locomotives). Later both Bombardier and Siemens had to establish different joint ventures with Russian companies to develop their Russian assets in power and transportation equipment. In the same way (joint ventures with Russian government-backed holding companies), Alstom later succeeded to develop Russian manufacturing of transportation equipment.
4. The major difference between “special economic zones” and “industrial parks” is that special economic zones offer some tax and custom benefits, while industrial parks are just

1  
2 the plots of lands with the guaranteed electricity and sewage access. In reality, for  
3  
4 example, in Ulyanovsk, where both the special economic zone and the industrial park  
5  
6 exist, most MNCs prefer to install their manufacturing facilities in the industrial park, not  
7  
8 in the special economic zone.  
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11 5. The Samsung factory is located in Kaluga Oblast. The northern fence of the production  
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13 site lies exactly on the administrative border between Kaluga and Moscow Oblasts.
- 14  
15 6. The complete database in Excel and SPSS format is available from the author upon  
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17 request.  
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20 7. The rank of the official depends on the size of the investment and the persistence of the  
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22 Public and Government Relations (P&GR) department of the Russian subsidiaries. For  
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24 example, RusVinyl, a US\$2 billion joint venture of SIBUR and Solvay, was opened by  
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26 the president of Russia, and a new US\$300 million engine factory by Volkswagen was  
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28 opened by the prime minister.  
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31 8. We also checked carefully for the ceremonies of “laying the first stone” into different  
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33 production objects in 2015. We found at least 4 factories started in 2015 (Knauf factory in  
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35 Samara oblast, Mars factory in Rostov oblast, Lifan car factory in Lipetsk oblast,  
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37 KOSTAMONU factory in Kaluga oblast). However, for some of these factories the  
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39 decisions were initiated in 2013. For example, Knauf, a very experienced owner of  
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41 Russian assets (it owns almost 20 plants in Russia) signed the investment agreement with  
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43 the local authorities regarding the construction of its new plant in Chapaevsk (Samara  
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45 oblast) on August 21<sup>st</sup>, 2014, while the negotiations with the local authorities on that plant  
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47 started in November 2013. The opening of the new plant is scheduled for 2016.  
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50 9. The dollar-dominated balance sheets of MNCs’ Russian subsidiaries for the financial year  
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52 ending on the 31<sup>st</sup> of December were calculated using an exchange rate of Ruble 56.26 per  
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54 US\$, 30 percent higher than the average exchange rate of the second half of 2014. Thus,  
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1 the investments made during the second half of 2014 and accounted according to the  
2 international accounting standards at the end of six-month period just disappeared from  
3 US\$-nominated balance sheets of Russian subsidiaries. This situation also created a rather  
4 unique divergence between the return on investments (ROI) and return on assets (ROA)  
5 performance indicators for Russian subsidiaries: as accounted for the second half of 2014  
6 and the whole 2014, ROI hardly decreased whereas ROA increased (the profits received  
7 through 2014 and accounted during that year at low US\$ exchange rate were compared  
8 with the assets accounted at high US\$ exchange rate of December 31th, 2014). We wish to  
9 thank Dr. Alexander Arshavsky for noting this “accounting trick,” which caused major  
10 headaches for the chief financial officers of MNCs with substantial Russian assets in the  
11 first quarter of 2015.

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26 10. Evaluation of the installation of new production lines (new shops) in the exiting factories  
27 of MNCs can be the object of a special study (and we are currently working in that  
28 direction). Here we should note that companies in food processing industries (Nestle,  
29 Danone, Mars and some others) were quite active in expanding the production facilities of  
30 the existing plants exploring the unique opportunities offered by self-imposed Russian  
31 sanctions on imports of foodstuffs. Dairy, chocolate and kindred products (instant cereals  
32 for infants) were the major areas of expansion of the existing production facilities of food  
33 companies in Russia in 2015.

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Table 1. Countries of origin of the corporate parents of factories installed by multinational companies in Russian in 2014-2015

Country of origin	Number of factories
Germany	30
USA	13
France	9
Japan	8
Turkey	6
Sweden	6
Switzerland	4
Italy	4
China	4
Finland	4
Austria	3
Denmark	3
Belgium	3
Norway	2
Canada	1
Australia	1
United Kingdom	1
Hungary	1
Israel	1
Luxembourg	1
Spain	1
Mexico	1

Netherlands	1
Thailand	1
Total	109

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Table 2. Main types of production of the factories installed by foreign multinational companies in Russia in 2014--2015

Transportation Equipment	22
Industrial and Commercial Machinery and Computer Equipment	19
Chemicals and Allied Products	16
Food and Kindred Products	9
Fabricated Metal Products except Machinery and Transportation Equipment	7
Electronic and other Electrical Equipment and Components except Computer Equipment	6
Lumber and Wood Products except Furniture	6
Paper and Allied Products	6
Stone Clay Glass and Concrete Products	5
Rubber and Miscellaneous Plastics Products	4
Primary Metal Industries	3
Bituminous Coal and Lignite Mining	1
Construction and Mining (except Petroleum) Machinery and Equipment	1
Plastic Pipes Manufacturer	1
Miscellaneous Manufacturing Industries	3
Total	109

Figure 1. Geography of the factories installed by multinational companies in Russia in 2014-2015

