Investment In Russia Essay, Research Paper

Russia

In 1991 Boris Yeltsin became the first elected leader of Russia. This was the end of Michael Gorbachev?s policy of perestroika ( radical changes in the economy) and glasnost ( the possibility of free expression) ( Gunn, 1995). The new elected president wanted some more radical changes; decentralisation, democracy and a market economy.

For Russia, transition to a market economy has been difficult because the government has been trying simultaneously to change the economic and the political system of the country. This resulted in a lot problems, but the Russian market is emerging. This brings me to the following problem statement; Is it Interesting for a multinational enterprise to invest in Russia?

I shall answer this question by first evaluating the situation in Russia, second I shall discuss the opportunities and problems of the Russian business environment, and finally I shall draw my conclusion.

The situation in Russia

The transition to a market economy

In order to achieve a correct and effective transition, the Russian government tried to achieve three main principles:

• liberalisation of prices and trade. In January 1992 Russia started the process of liberalising prices and trade. A major point in this liberalisation was establishing clear and easily enforceable property rights. Until this is done, entrepreneurs will have little faith in the market and capital will flow out of Russia. Especially in the first few years of the transition inflation was enormous

1990 1991 1992 1993 1994

Inflation in Russia 5.0 90.4 1534.0 877.0 552.0

( European economy, Special supplement, Eastern Europe, 1992 and 1994)

The government does not set five year plans anymore in which is stated what , where , and how much to produce ( Like in the communist period). The producers now have to decide themselves what ,where, and how much to produce. These decisions need a lot of licenses which the local governments have to supply. In order to adapt to these changes local governments need some radical changes, but at the moment bribery is usually the only effective way to get such a licence.

• Privatisation of state owned companies. In Russia privatising the state-owned enterprises is very difficult, because the enterprises are often monopolies which often produce all the parts they need in only one facility. This makes breaking these enterprises up very complicated, and often they had to be closed because of inefficiency and uncompetitiveness. In the first years of the transition output fell considerably (Daniels/Radebaugh,1995).

• Achieving macro- economic stability. The most concerning macro-economic problem in Russia is the inflation. A high inflation frightens investors. The most important cause of the inflation is the government deficit. The government should try to increase government earnings, for example higher taxes, or loaning money from the central bank at market rates(Welford/Presscot, 3rd edition).

The Russians put a lot effort in the transitions of their country, but it seems that the environment is being neglected.

Pollution in Russia

At the moment pollution is the largest environmental problem. Air pollution is enormous because of the emission of coal-fired electric plants, and the pollution of large industry. Soil contamination and erosion are often a effect of improper use of agricultural chemicals. Even areas of sometimes intense nuclear contamination can be found in Russia. (htpp://muhu.cs.helsinki. etc.)

It can be an advantage for a company that a country ( like Russia ) hardly pays any attention to the environment. For example, a firm can use old, more polluting but cheaper techniques, and has to pay less pollution taxes. A disadvantage for such practises is of course the bad publicity. A company can even face boycott in these cases ( for example, Shell Nigeria).

The Russian business environment

Foreign investment in Russia has increased considerably the last few years. During the first quarter of 1996 foreign investment in the chemical and petrochemical branches was 40 times the amount invested in the first quarter in 1995, non-ferrous metallurgy went up 20 times, and fuel and energy branch went up 10 times ( http//www.odci.gov/cia etc.). Although such increases can not be shown for every branch, it does show foreign interest in the Russian market. In the following part I shall discuss some opportunities of the Russian market.

• Large market. Almost 150 million people live in Russia. Now that the economy has changed into a market economy, all the consumers can decide themselves ( in the former USSR the state decided this) what products they want to purchase decide. This makes certain markets grow very fast. The telephone business for example; In 1991 and 1992 the number of telephone applications reached 11,000,000. Only 661,000 new telephones were installed( http://www.odci.gov/cia etc.). Because of this enormous booming market, the American firm AT&T agreed upon a joint venture with the Russian telecommunication company DALS (AT&T news release, R.T.Ullrich@att.com).

• natural resources. Russia is an enormous country with a lot of natural resources ( coal, gas, oil, etc.) These industries used to be in governmental hands, but the last few years most of these often inefficient companies have been privatised.

The canadian firm Black Sea Energy announced a joint venture with the Russian firm Tyumennedra. The joint venture is going to explore oil wells near the black sea which are expected to produce 1.4 billion barrels of oil (w.w.w.,Black Sea Energy).

• Technology. In the history of the USSR there have always been large investments in war and space technology. This has resulted in a group of well educated technicians and scientists. In 1995 the American company Lockheed Martin and the Russian company Khunichev, both developers of space launch systems, combined their technology in the International Launch Service (ILS). Together they developed the Atlas, a new space launcher (Rich.Waterman@lmco.com).

• Investing in an early stage. Investing in a rather undeveloped economy in a early stage of transition can give a company a first-in advantage ( any benefit gained in terms of brand recognition and lining up best suppliers, distributors, and local partners before competitors do)(Daniels/Radebaugh, 1995) AT&T ,for example, was first to enter the Russian telecommunication market. They where able to form a joint venture with DALS, which was the marketleader at that time. This gave AT&T a huge advantage (AT&T news release, R.T.Ulrich@att.com)

A transition of both the political and the economic system of course brings a lot of problems. In the following part I shall discuss some of the major problems of Russia.

Problems in the Russian business environment

In Russia the primary sector is relatively large compared with the average of the EU countries, as can be seen in the table below. This is because of the relatively underdeveloped economy.

agriculture and forestry industry and construction services

Russia 10.0 56.0 34.0

EUR 12 5.7 32.4 61.5

(National sources and Economist Intelligence Unit Country Report, 1995)

In the first section was shown that it is still a long way before Russia becomes a good functioning and performing market economy, and for any firm there are a lot of problems to deal with. The following points are the major problems for investors in Russia.

• political instability. In 1996 Yeltsin won the presidential election again, this meant a continuation of the transition process. At the moment it seems that more and more people are returning to the communist party because they have the opinion that the reforms have done more harm than good. A few days ago both the liberals and the communists wanted to serve a motion of unconfidence, which proves that the political environment in Russia is highly unstable.

Another problem concerning the government is the lack of laws which regulate and protect the business interest. It is rather difficult for Russia to create such laws on business, because Russia doesn?t have a history of doing business. When these laws do exist they are usually unclear and hardly applied.

• Lack of infrastructure. In Russia almost all aspects of the infrastructure ( roads, rails, airways, telephone connections) are very unreliable, and insufficient. For example; When McDonald?s wanted to open a restaurant in Moscow, they built a food processing factory only 45 minutes from the restaurant, and carried supply on its own trucks to be sure of supply (Daniels/Radebaugh,1995).

• Difficulties in obtaining supply, raw materials and employees. In Russia are often no raw materials available, this is often because of a underdeveloped distribution network, or a shortage of hard currencies for importing them. This problem counts for almost every product needed to run a business. Another problem concerning the supply of recourses is an often rather low quality of these products. When McDonald?s entered Russia they solved these problems by contracting and training their suppliers. Their Russian farmers for example were educated and trained how to grow and raise their cattle according to the McDonald?s schedules and standards (Daniels/Radebaugh, 1995).

In Russia it is very difficult to find market oriented personnel, because people where used to listen to a five year plan instead of the market. For the Moscow restaurant McDonald?s had send a few managers to the hamburger university in Chicago, and several other personnel was send on training in restaurants throughout Europe and the USA (Daniels/Radebaugh,1995).

• Lack of suitable partners. When a company wants to enter Russia though a strategic alliance, they need to find a suitable partner. In Russia it is very hard to find such a business partner, because all Russian companies are relative young. The companies have hardly any experience in making decisions concerning prices, marketing, materials, etc. This makes them rather unreliable or useless as a business partner.

• Corruption and crime. In the former USSR it was almost a custom to bribe someone if you wanted for example a license. Although the enormous bureaucratic lines of government officials seem to have diminished, it is still very hard to make a deal without bribery. The criminality has also boomed since the transition, businessman are often forced to pay money to criminals for ?protection?, this is of course plain extortion ( Economist, Nov. ?96)

Joint venture

In all the examples mentioned before, the companies entered the Russian market by making a joint venture agreement with a local company. An international joint venture is a company that is owned by two or more firms of different nationality ( Beamish, et al, 1997). Firms often want to use a joint venture to strengthen or protect their own business. A firm can for example achieve economies of scale, or share the cost of research and development in. The knowledge of culture and market, and the sharing of financial risks are also reasons for joint ventures (Beamish, et al, 1997).

Conclusion

With the transition to a market economy and the liberalisation of trade an enormous market has opened for foreign investors. Russia is very attractive for foreign investors because Russia has an enormous market ( almost 150 million people ), plenty natural resources and high quality technology. Problems like the political instability, the lack of infrastructure, the difficulties in obtaining supply and raw materials, the lack of suitable partners and the corruption are very difficult for a firm. There still is a lot to be done before these problems are solved. Because things change very rapidly at the moment , it seems very risky and uncertain to invest in Russia. A joint venture seems a suitable entry mode if a firm decides to invest in Russia. With a joint venture a firm can spread risks and lower costs. The Russian market is emerging, and with the Russians putting as much effort in as they have done until now, at least in the future Russia shall become a country worth investing in. Even though Russia still has a long way to go before it reaches the economic and political level of the most modern western societies, Russia might be very profitable and worthwhile investing in.