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IGOR GURKOV

Foolishness, obstinacy or wisdom? Recently opened Russian factories of Western MNC

Expert article • 1926

The current business life of Western MNCs in Russia is full of paradoxes. For example, in the first nine months of 2015, the local production of cars decreased by 24% comparing to the same period of 2014, but in 2015 Western MNCs opened in Russia nine new factories related to car production (engines, care parts etc.). The list of such “absurd” actions – expansion of production facilities of Western MNCs in Russia during the stagnation or decline of particular local markets can be continued.

We decided to have a closer look at the picture of industrial investments of Western MNCs in Russia and concentrated on new plants (as new production lines in the existing plants are often hidden from the eyes of outsiders). In the first 11 months of 2015, Western MNCs opened in Russia 56 new plants (in 2014, they opened 54 plants). The distribution of industries where new plants have been opened is presented in Table 1.

Table 1. New plants opened in Russia by foreign multinational corporation

Industry	Year	
	2014	2015
Transportation Equipment	12	11
Chemicals and Allied Products	7	10
Industrial and Commercial Machinery and Computer Equipment	11	8
Food and Kindred Products	3	5
Fabricated Metal Products except Machinery and Transportation Equipment	3	4
Stone Clay Glass and Concrete Products	3	2
Others	15	16
Total	54	56

We cannot see any significant changes in industry distribution between 2014 and 2015 – industrial and commercial machinery, transportation equipment and chemical and allied products are the major spheres of new industrial investments. While the median size of a single industrial investment remained roughly the same in the local currency (Ruble 1,455 mln. in 2014 and Ruble 1,555 mln. in 2015), it decreased by two times in US\$ terms.

Many “chains” of industrial investments look quite reasonable. For example, Volkswagen opened in September 2015 a new engine plant to supply its already installed assembly lines in Russia. In the same month, Nematik (a Mexican firm) opened its first plant Russian for the production of aluminum automotive components - cylinder heads and engine blocks, targeting Volkswagen’s new engine plant as the major customer, and Canadian Magna opened its sixth Russian plant of auto components, targeting Volkswagen as one of the major customers. A few months earlier Bosch opened its second Russian plant of car electronics etc.

The same connected or just coinciding movements can be found in other industries. Anticipating restrictions on purchase of imported drugs by state-owned clinics and hospitals, AstraZeneca, Novartis, Novo Nordisk, Teva and Berlin-Chemie opened in 2014-2015 their plants in Russia. Moreover, in 2014-2015 some really unique industrial projects were realized in Russia by Western MNCs. Belgian Solvay, Swedish Oriflame, Australian Orica opened in Russia not only the largest plants in their portfolios, but, in some cases, the largest plants of the kind in Europe.

However, all the projects realized in 2015 were designed 2012-2014. The twofold devaluation of the local currency in December 2014 was far beyond sensitivity analysis of any investment project and thus radically changed the whole economics of the industrial investments in Russia (the prices for imported machinery and equipment followed the exchange rate while the prices for industrial products increased in January-November 2015 in average by merely 12%). Although in 2015 the local wages remained stable even in the local currency, this cannot compensate for the raise of the costs of imported components as in most manufacturing industries in Russia labor costs occupy 8-15% of the total operating costs.

Thus, two interconnected issues arise. First, what can be the delay in reaching the break-even point for newly opened plants taking into account the changing economics of production and possible working at sub-optimal levels of capacity utilization due to the insufficient demand.

Second, how the experience of industrial investments of 2014-2015 would affect further industrial projects of Western MNCs in Russia. Here, the first task of the corporate parents is to find safe “market niches” with more chances for the proper return on investments. However, more important is the complete redesign of the architecture of new industrial projects. We mean here both the technical side aimed to suppress costs of new projects (relying on local contractors for installation of production facilities and on local suppliers for raw materials and components, using lower level of automation of production lines) and the institutional side aimed to lower risks of projects. In order to minimize risks several MNCs (including Bombardier Transportation and Siemens) have already reestablished the 1990s’ practices of joint ventures with successful Russian companies which are maintaining good connections with particular large customers. The move from stand-alone greenfield investments to joint ventures can become the leading trend in structuring of Russian industrial projects of Western MNCs for the years ahead. ■

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