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Foreign Direct Investment in a Stagnant Economy: Recent Experience of FDI in Manufacturing Facilities in Russia

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ABSTRACT

This study presents a snapshot of investment projects in manufacturing that were implemented by foreign investors in Russia during 2017–2018. We assemble a unique database of all new plants opened by foreign companies in Russia during 2012–2018 to clarify the distribution of investment projects implemented during 2017–2018 across industries and territories with different tax regimes. We also identify the most interesting individual investment projects, interrelated investment projects, and elements of collective actions. In general, foreign investors in manufacturing demonstrate high ingenuity in discovering and exploiting the remaining emerging growing market segments and promising niches in consumer and professional markets and express significant persistence in realizing investment projects. We also demonstrate the methods applied to decrease the uncertainty of the project costs by establishing partnerships with local foreign- and domestically owned companies and the attempts to correct the government's decisions and regulatory measures that are uncomfortable for foreign investors.

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Introduction

A plethora of empirical evidence and theoretical research exists on the behavior of foreign investors when host countries in which they have invested face economic downturns. Depending on the severity and expected length of an economic downturn, foreign investors can select between low profile strategies (see Meyer and Thein 2014), retrenchment (see Forbes and Warnock 2012; Gurkov and Saidov 2017; Gurkov, Kokorina, and Saidov 2018a), divestments (see Arte and Larimo 2019), or a complete exit from a selected country (see Tan and Sousa 2019). Paradoxical behavior may also be exhibited when foreign investors opt to complete their previously launched investment projects despite a host country's negative

economic dynamics to improve the liquidity of investment expenses that have already been incurred (see Gurkov 2016).

However, much less research was done on foreign direct investments in countries that experience prolonged periods of economic stagnation. Meanwhile, prolonged economic stagnation (defined as a period in which the annual growth rate of the nominal gross domestic product is slower than one percent for three or more consecutive years) has occurred in many small and large countries. Examples include Brazil during 1981–1993 (see Luna and Klein 2014), Japan's the so-called "lost decade" of 1991–2000 (see Koo 2009), and Russia's experience since 2016. Slow growth is also predicted for many countries for the next 20 years, including Italy, Spain, Germany, and France (Fidelity Investments 2019, 3).

Any particular case of prolonged stagnation is unique as a macroeconomic situation, and economic policy in a stagnating economy can be quite diverse given the potential for high inflation or deflation, high or low external embeddedness, high levels of protectionism or a liberal trade policy, and other contradictory elements. In this respect, Russia presents a particularly interesting case given its stability of state finances (including negative debt) and moderate inflation, coupled with foreign sanctions¹ that, by some estimates, did not seriously affect the dynamics of its gross domestic product (see Pestova and Mamonov 2019) but largely affected the performance dynamics of particular companies and industries and forced the government to bear significant expenses for "import substitution."²

Theoretical and empirical studies devoted to strategies in stagnant industries are scarce. Most publications on strategies in stagnant industries are from the 1970s and suggest that companies seek growth segments, maintain operational efficiency, and do not compromise on quality (see Hammermesh and Silk 1979). A similar recent article devoted to multinational corporations' current strategies in Russia (Bozadzhieva 2016) repeats the old advice for businesses in stagnant industries and adds a few additional elements, such as "gaining access to government procurement" and "building strong true partnerships." Certainly, such general advice cannot present the entire range of truly implemented individual and collective actions by foreign investors in a stagnating economy.

In view of the paucity of the relevant academic literature, we took a phenomenon-driven research approach (see Hambrick 2007; Alvesson and Sandberg 2011; Schwarz and Stensaker 2014; von Krogh, Rossi-Lamastra, and Haeffliger 2012; Doh 2015; Schwarz and Stensaker 2016). Whereas von Krogh, Rossi-Lamastra, and Haeffliger (2012) stated that phenomenon-based research is inherently proto-theoretic, Doh (2015, 609) argued that phenomenon-based research is any research that "takes as a principal focus the ability to accurately and insightfully inform a real-world phenomenon or

phenomena.” Schwarz and Stensaker (2016, 245) agreed with Doh (2015) and stated that “phenomenon-driven research (PDR) is problem-oriented research that focuses on capturing, documenting, and conceptualizing an observed phenomenon of interest in order to facilitate knowledge creation and advancement.”

Because a single article could not accurately and insightfully reflect a diverse phenomenon, such as the strategic actions of foreign investors in Russia, *we concentrate on the creation of new or further developments of installed manufacturing assets*. Investments in manufacturing are the focus because manufacturing subsidiaries are largely formed from highly specific assets; changing the product mix or development of new technologies usually requires substantial additional costs. Thus, decisions regarding the installation of new or the further development of existing manufacturing assets often present strategic choices of corporationwide importance and are usually made at the very top of the corporate management hierarchy. Therefore, we assumed that the general criteria for selecting investment projects of corporate-wide importance (NPV rank, project manager’s reputation, project manager’s confidence, cash flow timing, market share, “gut feel”; see Graham, Harvey, and Puri 2015, 463) are applicable universally for foreign investment projects in both high- and low-growth countries. That assumption gives us a key to assessing the reasons for creating new or further developing installed manufacturing assets.

We expect that during 2017–2018, multinational companies developed a set of country-specific solutions to increase net present value (NPV) ranks and shorten the period of the appearance of positive cash flows from investment projects in manufacturing.

The remainder of this article is organized as follows. In the first section, we present the data sources and methods. In the second section, we provide an overview of significant investments by Western multinational corporations in Russia during 2017–2018 and present the major forms and peculiarities of investment projects in different sectors (food and kindred products, construction materials, and chemicals and pharmaceuticals) and territories of different tax regimes. We also outline several new forms of organizing foreign investments in manufacturing, including leasing ready-to-use industrial premises in foreign- or locally owned companies in non-related industries. We also present some elements of collective actions and lobbying the specific interests of foreign investors of manufacturing facilities in Russia. The discussion section relates our findings to debates on strategic actions related to foreign direct investments in manufacturing. The conclusion outlines the limitations of this study and suggests directions for further research.

Data and methods

This study is based on four types of information. The first type is data from 2012–2018 on plant opening ceremonies for newly installed or extended facilities of foreign multinational corporations, which we collected from secondary sources, including local newspapers, regional TV news, and, in particular, a special Web resource – www.sdelanounas.ru – a social network devoted to the successes of the Russian industries. This technique, which is used to detect investments in manufacturing facilities, was initially applied in Gurkov (2016) and was found to be extremely reliable and accurate. Because a public plant opening ceremony is mandatory for *new* production facilities of foreign multinationals in Russia (see Gurkov and Kokorina 2017; Gurkov, Kokorina, and Saidov 2018b), using public opening ceremonies as points of observation enable us to detect *all* factories opened by foreign multinationals in Russia from January 2012 to December 2018 and identify their locations, parent companies, main production types (according to two-digit Standard Industry Codes (SIC)), and, in many cases, the amounts of investments in projects. We also collected information on public opening ceremonies for significant extensions of the existing facilities. Because such ceremonies are not mandatory, we cannot claim that we have identified all significant extensions of the existing facilities that occurred during the study period, but we have identified all publicly revealed extensions. Finally, we collected information on some large acquisitions undertaken by foreign multinationals in Russia during 2017–2018.

Using these data, we compared the installation of new factories and extensions of existing facilities that occurred during 2012–2013 (a period of economic growth and normal political and economic relations between Russia and the West³) and 2017–2018 (a period of economic stagnation, economic sanctions, and political tensions between Russia and the West).

The second set of information is closely related to the first set. Approximately 50% of all public opening ceremonies are presented in publicly available videos. Typically, such videos present in full the speeches of the main participants of public opening ceremonies, including high-ranking officials of parent companies (such as CEOs of U.S. companies and managing owners of German companies) and local governors. We used the texts of speeches delivered at public opening ceremonies as a substitute for interviews; these speeches by foreign participants delivered at such ceremonies during 2017–2018 were an average of 9 minutes long and contained detailed reasons for such projects in general and for selecting a particular location for an industrial investment project.

The third set of information is based on data on specific corporate actions undertaken during 2017–2018. We attempt to identify the different

interconnected investments from various corporate partners related to the execution of a single project or a series of projects. Here, we use the Russian business press and government publications because several projects were supported by government-backed programs.

The fourth source of information relates to various foreign business associations in Russia. We attempt to find “traces” of collective actions related to foreign firms’ access to government procurement. Materials from the Foreign Investment Advisory Council and the Association of European Businesses, which – despite its name – includes hundreds of investors from the European Union, the United States, Canada, Japan, and South Korea, were invaluable sources of information.

This information enables us to develop a general overview of the recent investment projects of foreign multinationals in Russia to observe the peculiarities of investment projects within four groups of industries (food and kindred products, construction materials, chemicals, and pharmaceuticals) to discover some important “chains of investments” related to the same project and to identify some elements of the collective actions of foreign investors in their relations with host country authorities.

Findings

Overview of investment projects implemented during 2017–2018

We collected information on 106 significant investment projects implemented during 2017–2018: the opening of 62 new factories, significant extensions of 43 factories, and one large acquisition. A total of 58 investment projects were implemented in just three industries: food and kindred products (one large acquisition, installation of 11 new factories, and nine significant extensions of existing factories); chemicals and pharmaceuticals (11 new factories and nine significant extensions); and industrial and commercial machinery and equipment (eight new factories and nine extensions). During 2017–2018, eight corporations (German BASF, Knauf Gips KG, Tonnies Fleisch, Swiss Sika, Norwegian Kverneland Group, Belgian Drylock Technologies, and Danish Vestas) implemented more than one significant investment project in Russia.

Compared with 2012–2013, a surprisingly similar number of new factories and extensions of existing factories occurred in 2017–2018 – in 2012–2013, foreign companies installed 70 new plants; in 2017–2018, foreign investors installed 62 new plants

Among the 62 new plants opened in 2017–2018, 40 (i.e., 65%) were opened by “novices,” that is, corporations for which these plants were their first in Russia. During 2012–2013, the proportion of “novices” was lower (50%). The very high proportion of “novices” that invested in 2017–2018

was the result of stronger demand for the “localization of production” in Russia. We should stress that for the absolute majority of “novices,” establishing a manufacturing facility in Russia was not a market entry (because the products were presented through imports into the Russian market, sometimes for the past two decades) but just the extension of a subsidiary mandate toward manufacturing.

Location and accommodation of new foreign-owned plants in Russia

Existing factory extensions are determined by location choices that could have been made a decade ago. The choice of location was made after 2014 for most factories opened during 2017–2018 and during 2009–2011 for those opened in 2012–2013. We examined the distribution of new factories from three perspectives: the region, the status of the territory, and the degree of independence of a production facility (standing alone or incorporated into existing industrial premises).

In general, multinational corporations continue to explore various Russian regions; 70 new factories were built in 33 different regions during 2012–2013 and 62 were built in 28 different regions during 2017–2018. The location preferences were found to have changed between the pre-sanction and sanction periods; during 2012–2013, the favorite new plant locations were Leningrad Oblast (the region around the second largest Russian city, St. Petersburg), Kaluga Oblast (150 km southwest to Moscow), and Nizhny Novgorod Oblast (approximately 400 km east of Moscow). Moscow Oblast became the favorite destination during 2017–2018 (12 plants were established during the period). Kaluga Oblast remained among the favorite destinations for new plants of foreign investors during 2017–2018 (seven new factories opened during that period in Kaluga Oblast). Lipetsk Oblast (450 km south of Moscow) also became attractive (five new plants were opened there during 2017–2018).

At the same time, the locations of foreign-owned plants became more concentrated. Three leading regions accommodated 20% of new plants during 2012–2013, whereas three leading regions accommodated almost 40% of new plants during 2017–2018.

The concentration of new investment projects in the Moscow and Kaluga regions is quite easy to understand. The Moscow agglomeration, with a population of 20 million (14% of Russia’s total population), is the largest market for consumer goods, including 22% of national new car sales, 20% of national drug sales, and more than 20% of national baby and kindred products sales, among others. Moscow is also the largest market for construction equipment and materials, partly the result of the large volumes of residential and office construction and partly the result of the

rapid development of the Moscow subway system. During the past few years, industrial parks in Moscow regions developed rapidly, with more than 20 new industrial parks opened during 2017–2018, raising the total number of industrial parks to 51 (Government of Moscow oblast 2019). Industrial objects in the Kaluga regions are mostly oriented toward the Moscow markets. The success of the Lipetsk Oblast at attracting foreign investors was explained in an extended speech delivered by a managing owner of a German company at a plant opening ceremony of a new manufacturing facility in Lipetsk:

- proximity to suppliers;
- proximity to customers;
- presence of qualified workforce;
- tax advantages of a special economic zone; and,
- quickly established personal contacts with the local governor.⁴

Here, we proceed to the question of selecting the status of the territory in which foreign investors will install new industrial projects. Currently, Russia possesses numerous special economic zones (see Kuznetsov and Kuznetsova 2019) and “territories of accelerated development” that offer tax preferences⁵ and other investor benefits (e.g., simplified procedures for attracting a foreign workforce). In addition to these areas whose creation coincides with the global trend (see UNCTAD 2019), numerous industrial parks exist. Industrial parks are separate legal entities (most are private, but some are state-owned) that do not offer tax preferences but, instead, guarantee (although not always inexpensive) connections to electricity and other necessary elements of the industrial infrastructure. Russia recently moved higher in the World Bank’s index of doing business regarding obtaining construction permits (48th place in 2019) and electricity (12th place in 2019; see World Bank Group 2019), partially thanks to the development of industrial parks.

In academic research, selecting the type of territory with different tax regimes and modes of installation of manufacturing facilities (lease or purchase of ready-to-use premises, lease or purchase of existing premises that require further repairs, and modifications for the installation of a particular industrial object) and “pure greenfield” (purchase or leasing free land with subsequent investments in manufacturing and auxiliary facilities, such as storage space, electricity and water supply facilities, sewage systems, and others) are regarded as separate processes. In real corporate decision-making processes, when the NPV and timing of cash flows are the most often used criteria for new projects (see Graham 2015, 463), the mode of installation of manufacturing facilities and the tax status of territories are

considered together because the mode of installation determines the overall volume and, in particular, the accuracy of the initial estimates of investment expenses and the timing of cash flows, whereas a territory's regime affects the amount of estimated cash flow.

Table 1 presents the distribution of new plants according to the mode of installation of manufacturing facilities and type of territory during 2012–2013 and 2017–2018.

A significant change has occurred in the choice of the type of territory for new factory locations: greater concentration of new foreign-owned plants in special economic zones and “territories of accelerated development” and more intensive installation of new manufacturing facilities in already existing premises (redevelopment). Thereby, foreign investors attempt to save on initial investment costs, shorten the period of the appearance of positive cash flows, and maximize expected cash flows. We should stress the broader use of leasing “ready-to-use” industrial premises for new manufacturing projects that can be labeled as “accommodations” of new manufacturing facilities. The growing number of new production facilities is now accommodated within fully operational factories, both locally and foreign-owned. Such accommodations are not necessarily found in factories in the same industry.

For example, in May 2018, the Danish corporation Vestas opened its production of gondolas for wind turbines within the Liebherr factory (a producer of construction equipment that opened its plant in Nizhny Novgorod Oblast in 2011). In December 2018, Vestas opened its facility for the production of composite blades for wind turbines in the production premises of the locally owned company AeroComposite in Ulyanovsk. In total, during 2017–2018, almost 20% of companies decided to use “accommodation agreements” (to lease space for the installation of new equipment and storage space, and to obtain the right to use auxiliary facilities (electricity and water supply, sewage systems, security and surveillance services, and employee canteens)) with other industrial companies to install their new Russian production facilities. This form usually allows for accelerated installation and putting in motion production facilities because the supporting infrastructure already exists, and new production can sometimes use free space in existing buildings (constructions).

We also present the truly unique case of an industrial accommodation that combines well-prepared production and office premises and supporting infrastructure (lifting mechanisms, tools maintenance, supply of electricity, water, natural gas, technical gases, and parking, and even a first-aid medical point and a canteen for employees of tenants) with the tax benefits of an accelerated development zone (no taxes on profits for the first five years of operations instead of the standard 20%; no income tax instead of

Table 1. Opening of new Russian factories of foreign multinational corporations in territories with different tax regimes and in different types of installation of new manufacturing facilities in 2012–2013 and in 2017–2018 (percentages).

	Type of installation of new manufacturing objects							
	Leasing/purchasing the premises of existing factories for installation of the new equipment ("industrial accommodation")				Leasing/purchasing the land with guaranteed supply of electricity, water, access to sewage systems, etc. for installation of new structures, and facilities (industrial parks)			
	2012–2013	2017–2018	2012–2013	2017–2018	2012–2013	2017–2018	2012–2013	2017–2018
Type of the tax regime								
Territories with significant tax preferences (special economic zones and 'territories of accelerated development'*)	0	5	1	0	9	23	10	28
Territories with some limited tax preferences	1	0	20	18	1	2	22	20
Territories with no tax preferences	8	18	34	10	26	24	68	52
Total for territories with different tax regimes								

Note: *—"territories of accelerated development" are establishing since 2014.

the standard 2.2%; no land tax instead of the standard 1.5%; and a social security tax of 7.6% for the first 10 years of operation instead of the standard 30%).

Our study refers to the AvtoVAZ industrial park, which was created in October 2016. AvtoVAZ is not officially an industrial park because it is not a separate legal entity but an organizational unit of AvtoVAZ, the largest Russian carmaker and that is controlled by Renault (AvtoVAZ 2019a). All premises (176,000 sq. m. of industrial and office space) are located in a “zone for accelerated development.” As of July 15, 2019, the premises had 10 tenants (AvtoVAZ 2019b), among them three foreign companies. Six received the status of resident of a zone for accelerated development because an internal unit has no status as a profit or revenue center. The industrial park’s main task is “creating jobs through development of small and medium-size business” (AvtoVAZ 2019a, 4). The only restriction for tenants is that they should not be involved in car production (see Government of Russia 2016).

Individual, networked, and collective actions of foreign investors during 2017–2018

Individual investment projects

Because we possess a significant amount of information about particular investment projects implemented in different regions and territories with different tax regimes, we attempt to avoid simply presenting a report on the installation of particular new plants. We highlight several of the most interesting investment projects as well as general trends in direct foreign investments in various industrial segments, which absorbed more than half of the industrial projects completed by foreign investors during 2017–2018:

- food and kindred products;
- construction materials;
- chemicals and pharmaceuticals; and,
- commercial machinery and equipment.

In the ***food and kindred products industry***, the most interesting deal was the acquisition of Donskoy Tabak, the last locally owned tobacco company, by Japan Tobacco Inc. (JTI). The deal was announced on March 16, 2018. JTI was ready to pay RUB 100 billion (around US\$1.76 billion), including US\$170 million to cover the debt of the acquired company (Sinitzina 2018). A unique aspect of this deal is that the tobacco market in Russia has steadily declined, from a total production of 412 billion cigarettes in 2012–336 billion cigarettes in 2016. Through the acquisition, JTI obtained

two tobacco factories representing approximately 7% of the Russian market for cigarettes and several relatively strong brands. This example of purchasing a share in a declining market is rare.⁶

Another large individual investment project in the food industry is the opening of an oil extraction factory by Cargill in Volgograd Oblast. The cost of the project is approximately RUB 10 billion (US\$150 million). The total capacity of the enterprise will be 280,000 tons of unrefined sunflower oil and 260,000 tons of forage meal per year. The launch of the plant will allow 100% of the sunflower seeds produced in the Volgograd region to be processed. The region currently processes 80% of the sunflower seeds produced and produces 5% of the total Russian sunflower oil production. The new enterprise will improve the position of the region in this market.

According to the press service of the regional government, agreements have been reached on the supply of products to Azerbaijan, Belarus, the Middle East, Scandinavia, and Africa. Plans are also in place to establish a plant on the site for the production of lecithin, a product derived from sunflower oil and used in the food, cosmetic, and pharmaceutical industries. This pure greenfield investment project is being pursued in agreement with the local authorities. The investor pays for the reconstruction of a sewage treatment plant, the construction of a new water conduit necessary to operate the newly installed plant, and the development of the infrastructure of a nearby city with a population of 16,000.

Most other investment projects implemented during 2017–2018 are less costly and target the so-called “sanction segments” – dairy and meat production – that fill niche markets liberated after the embargo imposed on imports of these types of products from most developed countries was lifted in August 2014. Here, we observe textbook strategies of diversification, horizontal integration, and even vertical integration. Auchan, one of the largest international retailers, also opened a meat-processing factory in 2017 with a capacity of 40,000 tons of pork and that is expected to increase to 70,000 tons by 2021. The project was launched in 2015, shortly after the announcement of the embargo on imports of meat and dairy products. Also worth mentioning is the Mexican company Gruma. In September 2017, Gruma opened a factory producing authentic Mexican tortillas and corn chips in a free economic zone near Moscow.

The **construction materials** industry faces no embargoes, but most companies are installing new production facilities of highly specialized products, such as materials for horticulture, complex mineral binders for flat ground reinforcement technologies, cold regeneration of combined asphalt concrete, moisture-resistant gypsum panels, and so on.

The same trend can be observed in the **chemical and pharmaceuticals** industries. Although pharmaceuticals remain pharmaceuticals, foreign

investors (including Abbott and Nova Nordisk) have installed new factories and production lines for the production of ingredients and for pill packaging, partially under pressure from the Russian government to make governmental purchases of only locally produced drugs made from locally produced substances. *Multinational chemical companies (including Russian subsidiaries of BASF, Sika, Mapei, Polychem Systems, and several other well-known chemical companies) are moving closer to construction materials, the production of plastic and polycarbonate panels, other construction elements, additives, paints, and other materials used in specific types of civil construction (road construction, underground construction, extra-strong or water-resistant surfaces, and others).*

Finally, in the **commercial machinery and equipment** industry, three major directions exist for the installation of new factories and extensions of existing ones: road construction equipment, oil extraction and refinery equipment, and renovation centers for overhauling old, heavy machines.

Interconnected investment projects

Interconnected investment projects of foreign investors are not new in Russia, and multinational corporations have brought their worldwide suppliers to the country. This process was especially intensive during 2005–2014 when major global automakers had to fulfill their obligations regarding “investment contracts,” which stipulated the specific amount of local sourcing for car production when installing their assembly facilities in Russia. The same was applicable for road-building equipment and some other machinery sectors. During 2017–2018, we discovered a similar deal in the production of machine tools: In October 2017 in Ulyanovsk, the Czech corporation HESTEGO opened its factory for producing telescopic and cabinet protection for machine tools. This factory supplies its products to a DMG–MORI (a joint German–Japanese company) machine tool factory, which opened nearby in 2015, as well as to local machine tool producers.

However, we were able to identify a much more complicated network of foreign investments related to the creation of a new industry in Russia: the development of wind energy stations. Since 2012, the Russian government has realized a special program for renewable energy development (Government of Russia 2019). Part of this program (currently officially labeled Program 6 of the “National Program of Energy Efficiency and the Development of Energy”) stipulates the development of wind energy stations. This program put in motion numerous Russian and foreign actors. First, the state development corporation ROSNANO together with the Russian energy generator JSC “Fortum” created an investment fund for

the development of wind energy with a total capital of RUB 30 billion (US\$460 million). In 2017, this investment fund won the competition to build wind energy parks with a total capacity of 1,000 megawatts in different Russian regions. In addition to the fund, ROSNANO planned to invest approximately RUB 1 billion (US\$15 million) in the localization of necessary equipment. The fund selected the Danish corporation Vestas as the main supplier of the necessary equipment, which triggered the installation in 2018 of Vestas' factories in Nizhny Novgorod Oblast (gondolas and cooling equipment for wind turbines) and Ulyanovsk (blades for wind turbines). Because these factories were accommodated within operating facilities of other companies, Vestas' investment projects also affected the "homeowners" – the Russian subsidiary of Liebherr and "AeroComposite" – that, in turn, are subsidiaries of the state-controlled Russian Aircraft Corporation that manages all Russian aircraft production. Simultaneously, a factory producing steel towers for wind energy stations was opened in the region in December 2018, which was among the first proposed sites for three wind energy parks (Rostov Oblast). This factory was a joint project of ROSNANO, Severstal, which supplied special assortments of steel, and the Spanish company Windar Renovables, which supplied the necessary technology and experience. Thus, a single project led to the installation of three factories in different Russian regions and directly affected several large Russian and foreign corporations (ROSNANO, Severstal, United Aircraft Corporation, JSC Fortum, Vestas, Windar Renovables, and Liebherr).

We expect that the number of such networked projects may increase in the future. The Russian government announced the realization of 13 "national projects" during 2018–2024 at a total cost of RUB 25.7 trillion (more than US\$400 billion) using the consolidated state budget, regional budgets, and private financial sources (Government of Russia 2019). Some national projects (safe and quality roads, with a planned expenditure of RUB 4,779 billion (US\$73.5 billion)) and international cooperation and export promotion efforts (planned expenditure of RUB 956 billion (US\$14.7 billion)) may be very attractive for foreign industrial investors. To "get a slice of the pie," even more complicated networks of particular investments and larger sets of foreign and national participants will be necessary. However, when obtaining full access to both participation in national projects and current government procurement, foreign investors must undertake significant efforts and syndicate their lobbying power.

Collective actions of foreign investors

In addition to national chambers of commerce and the personnel of embassies responsible for economic relations, two major organizations represent

foreign investors in Russia: the Foreign Investment Advisory Council (FIAC) and the Association of European Business (AEB). FIAC was founded in 1994 and currently includes 53 members and four “observers” – together, 56 of the largest global corporations and the World Bank. FIAC’s activities are oriented toward the overall improvement of the investment climate in Russia; they are coordinated by EY (formerly Ernst & Young), and each particular working group (digital economy and innovative technologies; localization and regional development; improvement of tax and custom law and administration; the development of consumer market and technical regulation; health care and pharmaceutical industry development; financial institutions and capital markets; and natural resources and the environment) is presided over by two members of FIAC (FIAC 2018).

FIAC holds an annual meeting between the CEOs of its members and the Prime Minister (“the plenary session of FIAC”). Moreover, each working group presents a detailed report on the implementation of past recommendations and recommendations for recently emerged issues. FIAC recommendations address important legal and regulatory issues affecting both the overall business climate in Russia and the development of particular industries, and they are generally in tune with the aspirations and priorities of the Russian government. However, most FIAC members are large global corporations that are not too dependent on their Russian sales, which represent on average less than 5% of their global sales, allowing them to feel free to propose radical amendments to the government’s plans and programs.

For example, FIAC evaluated “Road Safety and Quality,” the enormous national program, and highlighted the need to promote the construction of cement concrete road surfaces and bases using innovative technologies to improve the useful lives of road dressings and to reduce repair and maintenance expenses during the life cycle of roads (FIAC 2018, 11). FIAC also attempts to ensure the reasonableness and effectiveness of government aspirations regarding the localization of production. For example, FIAC pointed out that “some of the requirements [for localization] are clearly excessive and fail to take into account the size of the Russian market by segment and the corresponding production volumes (a differentiated approach must be taken to regulate car and truck manufacturing, for example, because of the radically different business models involved). An example is the requirement that [truck] engines be produced in Russia. With annual sales of a few hundred vehicles, it does not make economic sense to localize engine production (which is justified when yearly production runs to tens of thousands of engines) or to adapt vehicles to domestic engines (which, in addition to technical and logistical difficulties, will inevitably result in reputation losses). Failure to comply with the requirements of Decree No. 719 effectively puts Russian-made and imported equipment

on the same level, making local production ineffective and giving an advantage to direct importers. Thus, measures designed to strengthen Russia's 'technological sovereignty' in fact [clear] out the market for Russian manufacturers, eliminating competition and perpetuating Russia's technological lag in this industry" (FIAC 2018, 14).

Despite its official name and unlike FIAC, AEB includes several hundred companies from the European Union, the United States, Canada, Japan, and South Korea. Many of these companies are largely dependent on their Russian sales, which can represent 20% and more of their global sales. AEB includes 13 industry committees (e.g., Crop Protection Committee, Seed Committee, Automotive Components Committee), 14 cross-industry committees dealing with particular aspects of foreign business in Russia (e.g., Ethics and Compliance Committee, Migration Committee), six working groups of producers of specialized products (e.g., Tire Producers Working Groups), and two regional committees (North-West and South Regional Committees). AEB is a very tough-minded organization and is active in establishing connections between foreign investors of different countries of origin within and across specific industries. Its quarterly publication monitors the most recent amendments to business legislation and regulatory practices. It issues special public statements on disputes between foreign companies and Russian regulatory and tax authorities if such cases present a risk to widely dispersed business practices, such as Russian subsidiaries paying royalties to their corporate parents for trademark use. Its major "weapon" is the annually published AEB Position Paper, which contains a description of the most acute problems of particular industries caused by the instability of regulatory practices. Part of the 2019 AEB Position Paper describing the problem of foreign investors – producers of road machinery – is provided as follows:

On 17 July 2015, the Government of the Russian Federation adopted Resolution No. 719 'On the approval of criteria for classifying industrial products as industrial products that have no analogs produced in the territory of the Russian Federation, as well as criteria for classifying industrial products as goods produced in the territory of the Russian Federation.' The Resolution should allow foreign companies investing in local production to obtain the status of a local producer ... In Resolution No. 719, the list of conditions, production, and technological activities performed in Russia was used as the basis for assessing the status of the Russian producer ... On January 17, 2017, Government Resolution No. 17 'On amendments to Resolution No. 719' was issued. In this Resolution, a number of additional mandatory technological operations were introduced, which foreign investors, for reasons of economy, had not planned to carry out at their Russian plants, for example the production of excavator cabs. Thus, foreign investors were presented with an almost insurmountable barrier for obtaining the status of a domestic producer, and the so-called 'domestic producers' using 19th century technologies and not investing a ruble in production modernization received, as a result of the interference of the administrative resource, tremendous competitive advantages over the modern enterprises of foreign investors. (AEB 2018, 24–25)

This text was signed by the following members of AEB: Atlas Copco, Caterpillar Eurasia, CNH Industrial (Russia) Commercial Operations, Doosan Infracore Co., Hitachi Construction Machinery Eurasia Sales, Hyundai Heavy Industries, JCB, John Deere Agricultural Holdings, Komatsu CIS, Liebherr-Russland, and Volvo Vostok.

Such texts are not intended to cause immediate reversals in regulatory policies and practices but serve as important feedback for the Russian government regarding the real efficiency of its policies. Additionally, these texts may be used for further negotiations with the government regarding taxation, custom regulations, and other issues.

Discussion

We presented an overview of the recent investment projects in manufacturing implemented by foreign investors in Russia. Two major trends prevailed in 2017–2018: stagnation of the major consumer markets and (despite all efforts of FIAC and AEB) strengthening of the access to government procurement. In such a situation, the general question is as follows: What were the motives to invest in Russia? Such motives should be quite strong because many “novices” – corporations with no prior experience in manufacturing in Russia – dared to install their production facilities in that country. According to Cuervo-Cazurra and Narula (2015), not a single motive but a combination of motives (market-, resource-, knowledge-, and efficiency-seeking) may exist for foreign investments. Regarding the establishment of new, fully owned production facilities, the knowledge-seeking motive is weak. Taking into account the forced nature of many investment projects (e.g., in pharmaceuticals and transportation equipment), the presence of a strong efficiency-seeking motive is also questionable. As a result, we may assume that most investment projects were conducted with the two combined motives of market-seeking and resource-seeking. The full exploration of these two motives can be clearly observed in the case of the construction of a large oil extraction factory by Cargill that accumulates local resources of sunflowers and looks toward both local and diverse foreign markets for sunflower oil. Cargill is simultaneously developing a large project in another Russian region that combines five different factories into one production site to produce starches, molasses, glucose–fructose syrups, gluten, fats and vegetable oils, cattle feed, premixes, and semi-finished products from poultry meat. In addition, many small investment projects, especially in a “frontier zone” between chemicals and construction materials, and many food processing projects can be viewed as the creation of dual-option subsidiaries that are simultaneously aimed toward local and foreign markets; this approach is officially acknowledged.

For example, FIAC presented a draft roadmap of actions to the Russian government that aimed to increase Russian exports of pet food from US\$85 million in 2018 to US\$100 million in 2020 (FIAC 2018, 20–22).

In general, most industrial investment projects implemented in Russia in 2017–2018 were designed to overcome threats of being pushed out of markets and to explore recently emerged opportunities. For example, in 2016, the Russian government introduced the disposal fee for “self-propelled vehicles and (or) trailers thereto.” This fee resulted in an increase in prices in a declining market (in 2015, the market fell by 65% relative to 2014). In 2016, the decline continued and amounted to approximately 10%, partly the result of the introduction of disposal fees. In 2017, the market experienced a strong increase but mainly the result of deferred demand. To maintain recovery and to counterbalance the disposal fee, foreign companies quickly opened two renovation centers to overhaul old self-propelled vehicles produced by foreign companies in Russia or imported. This transformation of a threat into an opportunity may be viewed as a textbook example of strategic agility.

This example also demonstrates that “speed to market” is essential in a market and with regulatory conditions that are constantly changing. In this respect, the experience of the AvtoVAZ industrial park, offering “fully serviced ready accommodation” to foreign manufacturers with high chances of receiving a preferential tax regime by obtaining the status of a resident of an accelerated development zone, could be a prototype of a new type of industrial territory that offers foreign investors investments, operating costs, and tax savings.

In this respect, we confirmed that the general criteria for selecting investment projects (NPV rank and cash flow timing) also remain valid for investments in a stagnating economy. More importantly, because stagnation presents more general uncertainty than economic downturns or rapid economic growth, a clearly observed trend exists to avoid uncertainty in investment projects, especially uncertainty related to “pure greenfield projects” (new manufacturing facilities installed established outside industrial parks or existing industrial premises) that are usually related in Russia to uncontrollable costs for electricity connections, sewage systems, and others (see Zhegulev 2010 cited in Gurkov and Kokorina 2017, 262).

In addition to concentrating on clear market opportunities and penetrating narrow market niches through small investment projects, another aspect of foreign direct investment in manufacturing during 2017–2018 can be referred to as “strategic persistence.” Despite the high proportion of “novices,” most significant industrial projects (installation of 20 new factories and 43 significant extensions of existing factories) were done by “veterans” – companies that had already installed their production facilities

in Russia. Because we were able to identify only the extensions of existing facilities that were accompanied by public opening ceremonies, we may assume that the actual number of extensions of existing factories is much higher. Such a higher number indicates the will of a significant share of corporate parents not just to keep but to develop their Russian industrial assets against unclear general macroeconomic dynamics and volatile regulatory practices.

Conclusions and suggestions for further studies

We have presented a snapshot of investment projects implemented in Russia during 2017–2018. Foreign investors implemented several interconnected strategies and tactics to combat uncertain macroeconomic perspectives and the increased difficulties in obtaining access to state procurement, including the following:

1. concentrating a larger share of investment projects in existing and newly created territories with preferable tax regimes (special economic zones and “territories of accelerated development”);
2. saving on construction costs through the possibility of installing new production facilities within the premises of both foreign and locally owned existing factories;
3. “slicing” projects into highly specialized ones to penetrate narrow market niches;
4. staged development of new plants as new shops are opened when markets for their production are secured by newly signed contracts; and,
5. assembling the chains of investment projects to serve large, state-supported programs (the case of producing equipment for wind parks).

Such elements are supplemented by a “strategic persistence,” which may be observed at the individual companies that continue to develop their Russian industrial assets. However, another element of “strategic persistence” is the constant pressure by different foreign business associations on the Russian government to facilitate access to government procurement and to correct the most odious elements of regulatory legislation and practices toward foreign businesses.

We believe that our study may be used as a depository of cases on investment projects implemented in a low-growth country. Our findings also indicate the potential of a new method for attracting foreign direct investments in manufacturing: a combination of tax preferences of special economic zones and the rehabilitation of existing, or the installation of new, industrial premises ready to accommodate equipment of a particular

foreign direct investment project in different manufacturing industries. The most promising area for further studies is to explore the types of ready-to-use industrial premises that should be created to accommodate not only projects with established technologies but also foreign direct investment projects oriented toward Industry 4.0. We expect that such research should be interdisciplinary and combine the two currently not very closely connected disciplines of international business and industrial engineering.

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Notes

1. Among the most visible sanction and counter sanction measures implemented by Russian and Western countries are (1) restrictions on access to government-financed procurements for many types of machinery and equipment (imposed by the Russian government in July 2014); (2) licensing equipment to supply deep underwater and offshore oil extraction to Russian companies (imposed by the US government and the European Union in July 2014); (3) restrictions on imports of dairy and meat products (imposed by the Russian government in August 2014); (4) restrictions on access to government-financed procurement of imported medical devices (imposed by the Russian government in January 2015) and imported drugs (imposed by the Russian government in December 2015); (5) restrictions on long-term financing for several Russian companies; personal sanctions for several Russian individuals imposed by the United States and the European Union during 2015–2018; and (6) restrictions on operations with the Russian government’s debt and the technical assistance of international organizations imposed by the United States in August 2019.
2. For example, in 2018, the government spent RUB 637 billion (almost US\$10 billion) to finance import substitution (Vedomosti 2019).
3. We refer to the political and economic relations in 2013 between Russia and the West as “normal” and mention several facts: Russia was a member of the G8 club of advanced democratic nations; on August 22, 2012, Russia entered the World Trade Organization; in 2013, Russia was one of the main sources of foreign direct investment outflow and one of the main targets of foreign direct investment inflow throughout the world (see Liuhto, Sityrin, and Blanchard 2016).
4. In a speech by the managing owner, this factor was mentioned first among the reasons to select Lipetsk as a site for a new manufacturing facility in Russia: “The way we were accepted can be expressed as cordial, sincere hospitality ... And from the very beginning, personal contacts were very well organized.” During the speech, also stressed was that the company has been present for more than 20 years in the Russian market with six sales offices in Russia.
5. The detailed modeling of the tax conditions of special economic zones and “territories of accelerated development” found no significant differences for projects with different initial investment amounts and the timing of breakeven (see Arkin and Slastnikov

- 2017). The major non-financial advantage of “territories of accelerated development” is the absence of restrictions on the use of a permanent and temporary foreign workforce, which is especially important when a new factory is installed and put into motion with sufficient assistance from the parent’s engineering department and the personnel from foreign sister subsidiaries. The major non-financial disadvantage of “territories of accelerated development” is restrictions on the types of industrial activities allowed individually by the government for each territory of accelerated development. Such a restriction does not exist for free economic zones.
6. The Russian market is more important for JTI than to other global tobacco companies. In 2018, the Russian sales presented 24% of the global sales of JTI, while for Philip Morris International the Russian sales presented 16% of its global sales, and for British American Tobacco – merely 3.3 percent of its global sales (see Forbes.ru 2019).

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