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# Russian Territories of Outrunning Development in Mono-Cities: Current and Prospective Opportunities for Foreign Investment into Manufacturing

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## ABSTRACT

The paper describes a new form of investment attraction recently introduced in Russia—territories of outrunning socio-economic development (TOSEDs). These initiatives provide tax and other benefits to 20 territories in the Far East and to 90 cities in which a considerable number of jobs are concentrated in a single factory (mono-cities). Using secondary sources and interviews, we present the initial legislation for TOSEDs, the evolution of the initial legislation, and the functioning of TOSED residents. We also identify several opportunities for foreign investors who have installed or intend to install their new manufacturing facilities in TOSEDs.

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## Introduction

On December 29, 2014, the President of Russia signed the Federal law concerning “territories of outrunning socio-economic development in the Russian Federation” (Federal Law 473-2014) (The Russian Federation 2014). The law stipulated creating two types of territories of outrunning socio-economic development (TOSEDs) during the period 2015 to 2018—in the Russian Far East and in mono-cities—cities where a significant share of jobs (20% or more of all jobs in a particular territory) are concentrated in a single factory or “the core enterprise.” Mono-cities are a legacy of the Soviet system of industrial development, when large enterprises were established in greenfield areas, and subsequently surrounded by newly built cities which were fully dependent on the “core enterprises.” These enterprises were responsible for providing not only jobs but also housing for their employees. They owned sanatoriums for the employees and their families, conducted summer camps for their children, and financed the factory’s sports teams (usually soccer, hockey, volleyball and cross-country skiing). They also supported a “house” or a “palace of culture” (a cultural center

comprising a concert hall, a library, and different facilities to accommodate various hobby groups). With the end of communism, most of these facilities disappeared or were transferred to the local authorities, but the performance of the “core enterprise” continued to guarantee the prosperity (or decline) of a mono-city.

A TOSED offers benefits to its residents such as lower taxes on wages, lower taxes on profits, low or zero tax on land and property. The major provisions of the law are equally applicable to both local and foreign investors, but there are a few points especially appealing for foreign investors, including the absence of any restrictions on attracting foreigners as temporary or permanent employees. The tax benefits of TOSEDs are offered for 10 years with a possibility of their partial prolongation for an additional 5 years. The core enterprise cannot be a resident of TOSED.

In addition, since 2016, it has been possible to create TOSEDs in closed administrative territories—small and medium-size cities where formerly secret enterprises producing weapons and armaments are located. TOSEDs in closed administrative territories received the status of a free custom zone in addition to the standard preferences and benefits of TOSEDs.

Federal Law 473-2014 took effect 90 days after its signature; that is, at the end of March 2015. Overall, in 2015–2019, 111 TOSEDs were created including 20 TOSEDs in the Far East and Eastern Siberia, 82 TOSEDs in mono-cities, eight TOSEDs in closed administrative territories, and a free port Vladivostok. In December 2019, the 500th resident of TOSEDs in mono-cities was registered (Almakunova 2019). In addition, in 2015–2019, 422 residents were registered in 20 TOSEDs in the Far East (Far East Development Corporation 2020).

This paper explores this recently emerged new form of investment attraction and the accelerated development of particular territories in Russia with special attention on the real experience of foreign-owned companies that have opted to install their new Russian manufacturing facilities in TOSEDs in mono-cities and identifies current and possible opportunities and challenges for foreign investors in recently created TOSEDs.

The paper is organized as follows. In the first section, we present the phenomenon of TOSED and outline the theoretical frame of the study, the research approach (phenomenon-based research) and research methodology. In the second section, we introduce the legal framework for a new institution of investment attraction by comparing it with another similar institution in Russia, SEZs, to outline the peculiarities of the new institution. Additionally, we outline the evolution of the initial legislation on TOSEDs. The third section presents the field study in one particular TOSED. Using interviews with the local heads of foreign-owned residents of TOSED and an observation tour of residents' premises, we reveal the

advantages of “superposition” of an industrial park and TOSED which can be considered ready-to-use fully serviced industrial space with significant tax advantages and potential cost savings. A discussion section presents our speculations concerning the recent and possible further development of TOSEDs in mono-cities, the role of different actors including the core enterprises of TOSEDs, and the full potential use of TOSEDs for accommodating foreign investment projects in Russia. The conclusion summarizes our findings and contains some suggestions for further studies.

### **Territories of outrunning development in mono-cities—the phenomenon, the theoretical frame for the study and research methodology**

A study of territories of outrunning development in mono-cities as a newly emerged phenomenon reveals two distinctive characteristics. First, TOSEDs are special economic zones (SEZs), which are areas designated for the accommodation of local and foreign investors, offering different benefits to its residents over and above the standard legal and institutional conditions, for different types of economic activities. The first special economic zone (SEZ) appeared in the late 1950s in Ireland,<sup>1</sup> but the real expansions of SEZs has been in developing and later, since 1979, in emerging economies, especially China (see Yeung, Lee, and Kee 2009; Wang 2013) and in the lesser extent, in India (see Jenkins, Kennedy, and Mukhopadhyay 2014). There are currently approximately 5,400 SEZs worldwide (UNCTAD 2019, p. 128). Although the forms of SEZs are highly country-specific (including location, size, types of permitted activities, taxes, and other incentives) as is their intended and real impact on local and global economic development (see Narula and Zhan 2019) the World Bank attempted to make a typology of special economic zones (see Table 1).

Russian TOSEDs have some similarity with one type of special economic zones, distinguished by the World Bank—urban zones, with development objective of “urban revitalization,” and with typical location in “distressed urban or rural areas.” Meanwhile, the second specific feature of TOSEDs is that they stipulate by definition, collocation of their residents with large established industrial enterprises, which may be locally—or foreign—owned.

Mudambi, Narula, and Santangelo (2018) defined collocation based on three distinct perspectives: international business, economic geography, and innovation studies. They found that “the nexus of the three literatures is surprisingly thin, in particular with regard to the conditions under which collocation is an advantage or a disadvantage” (Mudambi, Narula, and Santangelo 2018, p. 229). At the same time, they highlighted the newly

**Table 1.** Types of special economic zones.

Type of zones	Development objective	Physical configuration	Typical location	Eligible activities	Markets
Free Trade Zone	Support trade	Size < 50 hectares	Ports of entry	Entrepôt and trade-related activities	Domestic, reexport
Traditional Export-processing zone (EPZ)	Export manufacturing	Size < 100 hectares, total area is designated as EPZ	None	Manufacturing, other processing	Mostly export
Hybrid EPZ	Export manufacturing	Size < 100 hectares, only part of the area is designated as an EPZ	None	Manufacturing, other processing	Export and domestic markets
Freeport	Integrated development	Size > 100km <sup>2</sup>	None	Multi-use	Domestic, internal and export markets
Urban Free Zone	Urban revitalization	Size < 50 hectares	Distressed urban or rural areas	Multiuse	Domestic
Single Factory EPZ	Export manufacturing	Designation for individual enterprise	Countrywide	Manufacturing, other processing	Export markets

Source: adapted from World Bank (2008, p. 10).

emerging research stream of “microgeography” (Feldman 2014). This approach specifies that the location effects operate at a much smaller scale than suggested by previous research. The “local” scale had previously been specified to be the city, city region, industrial district, or cluster. However, microgeography studies have documented local advantages arising from within very small city neighborhoods, based on co-ethnic ties and even ties formed due to the particular location of offices within buildings (Catalini 2018). Thus, this research stream suggests an entirely new unit of analysis for location that provides, in the opinion of Mudambi, Narula, and Santangelo (2018), a rich avenue for both theory development and empirical investigation. Following this suggestion *we attempt to explore the benefits offered by the TOSED regime and the “cohabitation” of residents with a large established manufacturing enterprise in the same town, to reveal how they affect foreign industrial investors with various motives of investments (asset-seeking, market-seeking, efficiency-seeking, knowledge-seeking or different combinations of these)* (Cuervo-Cazurra and Narula 2015). Our research question has both theoretical and practical importance. From a theoretical point of view, it brings about a transition in the research on international industrial investments from a bird’s-eye view (usually based on quantitative secondary data) to more down-to-earth issues that include costs of initial investments in particular types of industrial properties, uncertainty surrounding the process of investments in manufacturing assets, variability of design of newly created industrial premises, and specifics of technical requirements of industrial investments with regard to supporting infrastructure. Most of these issues are missing from the discussion on location advantages compiled from previous academic studies (Narula and Santangelo 2012).

From a practical point of view, colocation with the large established manufacturing enterprises might be a necessity for “returnee investors” (companies re-shoring their manufacturing activities, i.e., bringing them back to their home countries). In many developed countries, especially in Western Europe, free land available for industrial development is highly scarce; hence, “returnee investors” will have to establish their new enterprises in close proximity to existing enterprises or by leasing their premises. Therefore, TOSEDs in Russia can be viewed not as a unique country-specific phenomenon, but as a model of investments in industrial clusters dominated by large established enterprises.

In order to explore this new phenomenon not sufficiently described in academic literature, we adopted for our study, a phenomenon-driven research (PDR) approach (see Hambrick 2007; Alvesson and Sandberg 2011; von Krogh, Rossi-Lamastra, and Haefliger 2012; Schwarz and Stensaker 2014; Doh 2015). Doh (2015, p. 609) argued that PDR involves

any research that takes as its principal focus, the ability to accurately and insightfully inform a real-world phenomenon or phenomena. Reiterating this definition, Schwarz and Stensaker (2016, p. 245) stated that phenomenon-driven research (PDR) uses a problem-oriented approach that focuses on capturing, documenting, and conceptualizing an observed phenomenon of interest in order to facilitate knowledge creation and advancement.

Given the proposed definition of PDR, we used mixed methods for the present study. First, we assessed the legal framework of the recently emerged form of special economic zones from the point of view of its “potential users,” and second, we tried to reveal the real experience the “early real users”—foreign-owned companies which had dared to become residents of TOSED. While exploring the experiences of the “early real users,” we carried out double-check interviews, wherein the experience of a resident was presented by the head or by another top executive of the resident, and also by other persons—executives of other companies that offer services to the TOSED residents. We also made observational tours of the production premises in the TOSED, following the principle of “walking the talk” (see Gioia, Corley, and Hamilton 2013). For the field study we choose TOSED Togliatti. This TOSED has a unique feature—its core company (AvtoVAZ) is controlled by Renault, which is itself a foreign company. In addition, TOSED Togliatti is one of the largest mono-city TOSEDs in Russia in terms of the land area (314 sq. km) and the largest in terms of the number of residents (75); among them, we easily recognized several subsidiaries of well-known foreign companies. The core enterprise of TOSED Togliatti is the car maker AVTOVAZ, which opened in 1970 with the strong support of the Italian car maker FIAT (Fava 2018). The company had a planned production capacity of 600,000 cars per year (at its height (in 2008), the company produced 800,000 cars). The factory is well-known in Eastern and Western Europe for its brand LADA, which was popular in many countries (including Finland, Norway, and Sweden) in the 1970s and 1980s.

### **Initial TOSED legislation and its evolution from 2015 to 2019**

Federal Law 473-2014 on TOSEDs in the Russian Federation is a technical document that does not contain a preamble explaining the reasons for its adoption and the expectations for the newly introduced institutional form. However, Article 2 of the Law defines a territory of outrunning socioeconomic development as

a part of the territory of a subject of the Russian Federation, including closed administrative-territorial formations and (or) water area, in which, according to a decision of the Government of the Russian Federation, the special legal regime for

carrying out entrepreneurial and other activity for creating favorable conditions for investment attractiveness is established, securing accelerated socio-economic development and creating comfortable conditions for ensuring the livelihoods of the population.<sup>2</sup>

Most other articles of this Law are devoted to mechanisms for the creation and functioning of a newly created institution form. Each TOSED should be created through an application to a regional body of the Government of Russia, and the subsequent special decree of the Government of the Russian Federation determines:

- the borders of a new territory (usually the whole territory of the city district that, for the largest mono-cities, may measure 300–600 square kilometers);
- the types of economic activities permitted for residents of a particular TOSED<sup>3</sup> (usually 20–30 economic activities);
- the minimal amount of capital to be invested by a resident of this particular territory, in general, and in the first year after registration as a TOSED resident;
- the number of new jobs created by a resident after registration as a TOSED resident.

To manage a newly created TOSED, a special managing body—a state-owned managing company—is created. The managing company has a supervisory board responsible for some strategic issues, for example, setting the desired share of foreigners attracted by residents of a TOSED. Federal Law 473-2014 devotes two Articles (Article 8 and Article 10) to the functions of the managing company of a TOSED. While Article 8 describes the general administrative duties of the managing company concerning the territory and its residents, Article 10 pays special attention to the functions to be performed by the managing company in the supervised territory regarding its amelioration. The Law stipulates that the managing company of a TOSED:

1. prepares proposals for amendments to the general settlement and master plans of urban districts, territorial planning schemes of municipal areas within whose borders where priority social and economic development is located, and the rules for land use and development of these municipalities;
2. organizes the construction and operation of roads;
3. organizes the placement of infrastructure facilities of the territory of priority social and economic development;
4. organizes transport services in the territory of priority social and economic development<sup>4</sup>;

5. organizes electricity supply, heat supply, gas supply, cold and hot water supply, and water disposal in the territory of priority social and economic development;
6. organizes the collection, transportation of municipal solid waste, the construction of facilities used for the disposal and disposal of these wastes, and the improvement of the territory of priority social and economic development;
7. creates conditions for the provision of persons located in the territory of advanced social and economic development with communication services, public catering, trade and consumer services, and the organization of leisure of such persons;
8. carries out other functions to ensure the livelihoods of persons located in the territory of advanced social and economic development.

The Law also specifies that residents of TOSEDs may lease land to build the necessary production structures and, later, to buy-out the land under such structures; lease the ready premises owned by managing companies and by other firms located in the TOSED, or lease the land and premises of industrial parks to be created in TOSEDs through subsidies of the federal government and local authorities, private investment, or a combination of both types of financing.

Federal Law 473-2014 does not specify in detail the benefits to residents of TOSED in terms of taxation or easier access to foreign workers. These specifications appeared later in specific Government decrees and from the decisions of lower ranking authorities. Additionally, Federal Law 473-2014 placed no restrictions on the types of economic activities performed by TOSED residents. Federal Law 254-2019, signed by the President of Russia on the July 26, 2019, amended the text of Federal Law 473-2014<sup>5</sup> and excluded the following from the list of permitted economic activities for TOSED residents (1) oil production, (2) production of natural gas and (or) gas condensate, (3) timber harvesting and its sale, (4) banking, (5) insurance, and (6) clearing activities. In addition, organizations in the TOSED regime could not participate professionally in the securities market or non-state pension funds.

However, the most serious amendment for TOSED residents came not from laws but from the Ministry of Finance. In a letter dated May 11, 2017, the ministry informed TOSEDs that the lower taxes on salaries (low payments for mandatory pension insurance, lower social security tax, and lower payments for obligatory medical insurance) applied only to residents registered during the first 3 years of a particular TOSED's existence (Ministry of Finances 2017). During 2019, 11 TOSEDs created in 2016 ceased to offer such benefits to its new residents (for residents registered

during the first 3 years of a particular TOSED's existence, the period of lower taxes on salaries remained unchanged—10 years after obtaining resident status).

### **TOSEDs in mono-cities versus other forms of special economic zones in Russia**

Besides TOSEDs, there are other forms of special economic zones (SEZs) in Russia—technological zones, industrial zones, recreational zones. Currently, in Russia, there are 10 industrial zones, five technology zones, five tourist zones, and one free port zone. The total number of residents in industrial zones is 230<sup>6</sup> (Russian Special Economic Zones 2020), but this number represents the total number of registered residents and includes both the residents that have already initiated production and the residents that are still in the production facility installation or design phase. We decided to compare TOSEDs in mono-cities to industrial SEZs in terms of the location, size, resident requirements, taxation and other benefits, the services offered to residents, and ease in terminating residency.

#### ***Location and size***

The first most visible differences between TOSEDs and industrial SEZs in Russia are their locations and their size. While SEZs should be established in close proximity but *outside* the borders of the cities whose names they bear, TOSEDs *embrace the whole territory of the mono-city*. This leads to different size areas occupied by SEZs and TOSEDs. The maximal land areas to be occupied by an industrial SEZ is legally set at 40 sq. km, and the largest SEZs (Alabuga and Lipetsk) occupy territories of, respectively, 39 and 23 sq. km. Other SEZs are much smaller. At the same time, the TOSEDs built in large industrial cities (Togliatti, Novokuznetsk, Naberezhny Chelny), for which the borders coincide with the city borders, have territories, respectively, of 314, 424 and 171 sq. km. In addition, the territory of industrial SEZs should not include any housing that requires daily commuting of all employees of an SEZ to and from the neighboring cities or villages. As in most SEZs the managing companies and local authorities do not pay attention to the development of the public transport serving newly created industrial areas, the residents must own (or rent) the fleets of buses and mini-vans used to transport shift workers to and from the enterprise (residents must also manage the building of large parking lots for employees who prefer to use their own cars to go to and from work). In TOSEDs, the plots occupied industrial residents can be surrounded by residential areas, and the employees of TOSEDs' residents can use the existing established public transportation. Moreover, Federal Law 473-214 stipulates

“organization of transport services in the territory of priority social and economic development” as one of the mandatory functions of a TOSED managing company.

### **Requirements for residents**

For SEZs, special status is applied only to newly built enterprises while the potential residents of TOSEDs can be already established enterprises located anywhere within the borders of the city. In addition, the requirements regarding the volume of investments made by a resident differ for residents of industrial SEZs and for residents of mono-city TOSEDs. An industrial SEZ resident should invest at least 120 million Ruble (US\$1.7 million); 40 million Ruble (US\$500 thousand) should be invested within the first 3 years after the conclusion of the investment agreement between the managing body of an SEZ and its resident. The highest amount of investment for TOSED residents in mono-cities was set in the case of the first established mono-city TOSED, namely, Naberezhny Chelny (50 million Ruble (US\$700 thousand). In other TOSEDs, the amount is lower (for example, in TOSEDs Togliatti and Dorogobuzh, the mandatory minimum investment for residents is 20 million Ruble (US\$300 thousand), and the number of additional jobs to be created is 20). For many TOSEDs, particularly for those established in 2018–2019 in smaller mono-cities, the minimal capital investment requirements for residents are not specified; only the number of additional jobs is specified (usually 10–30 jobs should be created). In addition, if the resident wishes to gain access to a desired plot of land (for its lease or purchase), without any competition it must invest 2.5 million Ruble (US\$30 thousand).

The range of permitted economic activities for TOSED residents in mono-cities is much larger than that for industrial SEZs, even after Federal Law 254-2019 came into force, which excluded financial services as a permitted activity for TOSED residents.

Some restrictions to TOSED residents in mono-cities are imposed by local authorities and not by government decrees. Such restrictions typically address two areas of concern—the destination of residents’ sales and the share of the foreign workforce in a resident’s total headcount. While residents of SEZs have freedom in their business contacts, TOSED residents are restricted by the share of sales that has the core enterprise of the mono-city as its destination. Typically, TOSED residents cannot direct more than 50% of their total sales toward the core enterprise of a mono-city. With respect to the use of a foreign workforce, residents of SEZs must adhere to regional quotas for attracting foreigners and perform complicated bureaucratic procedures to obtain work permits for both permanent and

temporary foreign employees. However, SEZs have no overall limit to the share of foreigners in their total headcount. TOSED residents have no legal restrictions and do not require permission to attract foreigners as temporary or permanent workers. At the same time, TOSED residents should indicate in the initial application for residency the desired share of foreign citizens they hope to attract. This share is approved taking into account the decision of the TOSED managing company's supervisory board (Federal Law 473-2014, Article 14, point 3).

Finally, both TOSED and SEZ residents cannot establish branches (separate organizational units that are not separate legal entities) outside the point of residency, and they cannot transfer (to lease or sell) a resident status to other legal persons or physical persons (individual entrepreneurs).

### ***Resident benefits***

Finally, we address the subject that is believed to be of the utmost importance for potential residents of any SEZ—tax and other benefits for residents. Here, we compare the benefits offered to residents of SEZ Togliatti with the benefits offered to the residents of TOSED Togliatti as both zones are located in the same region (Samara Oblast) with the same supervising local administration (see Table 2).

Table 2 shows that the tax and custom preferences offered (or not offered) to residents of SEZs and TOSEDs imply two different models for residents' business activities. For SEZs, the desired resident is a large capital-intensive enterprise necessarily importing a significant share of spare parts and components and oriented toward export activities. Thus, exemptions from value-added tax and custom duties are applied to SEZ residents. The design of tax preferences for TOSED residents is based on interests smaller labor-intensive enterprises. These enterprises should be oriented toward local sourcing and the exploration of opportunities in the Russian markets and, in some cases, the Eurasian Economic Union (Russia, Belarus, Kazakhstan, Armenia, and Kirgizstan).

### ***Opportunities for established enterprises located in TOSEDs***

The previous section described the benefits for newly built enterprises. As SEZs are just free plots of land to be used for the installation of new enterprises, there by definition cannot be already established enterprises. However, as TOSEDs cover the whole territory of a city, this territory may include many existing enterprises besides the "core enterprise of TOSED." Such existing enterprises may apply for a status of a resident of TOSED that causes some organizational complications together with some possibly

**Table 2.** Comparison of SEZ and TOSED tax regimes for newly created enterprises (Samara oblast).

Tax type	Special economic zone "Togliatti"	Territory of outrunning social and economic development "Togliatti"	Without benefits and preferences
Profit tax	2% of gross profit during the first 5 years of residency, 13.5% during the 6th–10th years of residency	2% of gross profit during the first 5 years of residency; 10% during the 6th–10th years of residency	20% of gross profit
Value added tax (VAT)	0%	18% charged	18% charged
Customs payments (duties)	0%	0%	1.5% of the cadaster value of land owned by the company
Land tax (paid to municipalities)	0%	0%	2.2% of the book value of "immobile property" of a company
Company property tax	0%	0%	30% of the gross employees' wages and monetary benefits
Insurance contributions to state extra budgetary funds (total), including Contributions to the Pension Fund	30% of the gross employees' wages and monetary benefits	7.6% of the gross employees' wages and monetary benefits	22%
Contribution to Social Insurance Fund	2.9%	1.5%	2.9%
Compulsory Health Insurance Fund	5.1%	0.1%	5.1%

significant additional benefits. In order to become a resident of TOSED the existing enterprise must present an investment contract stipulating the amount of investments and the number of new full-time jobs to be created. After obtaining the status of a resident, the established enterprise must establish separate accounting for its existing operations and for operations resulted from implementation of the investment contract as all tax benefits of TOSEDs (low profit taxes, low land tax, low property tax) are applied not to the whole enterprise, but to additional land purchased, additional property created and additional profits originated from the separate investment project presented in the investment contract. This forces to establish within the established enterprise which became the resident of TOSED a separate organizational unit with profit and loss (P&L) accountability. However, there is one exception from general rule—*low taxation of salaries and monetary benefits is applicable to all employees of a resident of TOSED*. This means the economy of the total labor costs by 22.4%. We should remind that that benefit is valid only if a resident obtains its status within 3 years after creation of a particular TOSED, thus such a “hole” in taxation is still available to use for companies located in TOSEDs established in 2017–2019. Local-owned enterprises usually have the share of labor costs in total costs between 10% and 30% (Gurkov and Zelenova 2011, p. 74; Gurkov and Settles 2013). The majority of manufacturing subsidiaries of foreign corporations has the share of labor costs in the total costs below 20% (Gurkov, Kokorina, et al. 2017). *Low taxation of labor expenses presents the general savings in total costs between 2 and 6% depending on the share of labor costs in the total costs*. These savings can be used at complete discretion of the management of an enterprise—to be channeled into profits, to be used to increase wages and benefits of employees or to be transferred to other types of current expenses (like expenses on equipment maintenance or on advertising).

### **Discovering a superposition of TOSEDs with other forms of investment attraction through the field study**

Making the preliminary investigation of the field before the entry, we immediately discovered a close-knit and diverse network of institutions designed to attract both domestic and foreign investors to the city of Togliatti and its surrounding territories. First, there is a special manufacturing economic zone, Togliatti, created in 2014. Currently, this SEZ has 22 residents; among them, 10 companies had already started manufacturing activities. The resident companies include several foreign-owned companies—a subsidiary of US. Praxair, a subsidiary of the German company

Edscha, a joint venture of two Japanese companies—Toyota Tsusho Corporation and Atsumitech Co., Ltd—a subsidiary of the Japanese company Hi-Lex, and several other foreign-owned companies mostly involved in the manufacturing of car components and systems. The total output of SEZ Togliatti was around 4 billion Rubles (US\$70 million) in 2017–2018; this is expected significantly increase in 2020. In December 2019, a large locally owned factory (which produces various composite materials for car manufacturing and road construction) opened.<sup>7</sup> Some residents of SEZ Togliatti, for example, a subsidiary of Spanish CIE Automotive are active exporters. Moreover, on August 6, 2019, the government of Samara Oblast decided to create an industrial park encompassing all of SEZ Togliatti's territory. The aim of the new institution within the larger institution is to construct industrial buildings for subsequent lease offerings to existing and potential SEZ Togliatti residents.

SEZ Togliatti and its newly organized industrial park are located outside the borders of Togliatti city. The whole area of the city is within TOSED Togliatti, which has other rules and requirements for its residents. A TOSED Togliatti resident has the right to lease any available and suitable land or buildings (premises) designated for industrial, storage, or office use for any legal or physical person (individual entrepreneur). TOSED Togliatti can engage in 33 types of economic activities ranging from agriculture to telecommunications, information technologies, and research and development. Residents may perform almost all possible types of manufacturing activities, from food processing to producing electronics. At the beginning of 2020, TOSED Togliatti had 75 residents involved in such activities as manufacturing car parts, materials, and tools used in car manufacturing, the production of construction materials (reinforced concrete panels, window glass, bricks), furniture production, bakeries, medical services, software engineering, and the construction of one three-star and one four-star hotel, among other activities.

Following the preferred types of economic activities, four industrial parks were created inside TOSED Togliatti:

1. AvtoVAZ Industrial Park (engineering and related industries) (170,000 sq. m of production, storage, and office facilities).
2. Open joint stock company Volgatsemash (mechanical engineering and related industries) (220,000 sq. m of free production and storage space, the production and engineering facilities for contracting or assisting in new product development for machine building).
3. Technopark Zhiguli Valley (innovative and IT companies) (64,000 sq. m of production, storage, office, exhibition, and conference facilities).

4. Industrial Park Tolyattisintez (chemical industry and related industries) (50,000 sq. m of production and storage facilities, 8,000 sq. m of office facilities, and 320,000 sq. m of free land).

All the mentioned parks have different legal status and ownership structure. Technopark Zhigulevskaya Dolina (Zhiguli Walleye) is a state-owned recently built facility. Open joint stock company Volgatsem mash is a large established factory involved in metallurgical production, mechanical assembly, and welding equipment. Industrial Park Togliattisintez is a subsidiary of one of the largest Russian chemical companies (SIBUR-Holding) which develops its own facilities at the site and also offers facilities, and particularly land, to other chemical companies for brownfield and greenfield development. Finally, Industrial Park AvtoVAZ is an internal unit of AvtoVAZ—a large car maker currently under the total control of Renault Group.

Despite the differences in legal status, all the mentioned entities correspond to the official Russian standard (P56301-2014) of an industrial park, which is defined as “a complex of real estate objects managed by a managing company composed of land plot(s) with production, administrative, warehousing, and other buildings and structures providing engineering and transport infrastructure necessary to create new industrial production as well as having the necessary legal regime to implement production activities” (Standardinform 2015, p. 21).

### ***Industrial Park AvtoVAZ***

We decided to study the superposition of TOSED with industrial parks. We contacted the President of AvtoVAZ, Yves Caracatzanis, and he kindly allowed us to visit the AvtoVAZ Industrial Park and to interview its managers and the heads of some of its residents, which were also residents of TOSED Togliatti. The series of interviews was conducted in December 2019. Prior to our visit to Togliatti, the managers of AvtoVAZ Industrial Park supplied us with specially prepared presentations (AvtoVAZ 2016, 2019a, 2019b) that contained information on the park and on each resident of AvtoVAZ Industrial Park. The information included data on both TOSED Togliatti residents and the residents of AvtoVAZ Industrial Park that had decided not to apply for TOSED resident status or who were unsuccessful in obtaining that status. In addition to interviews, we were able to visit the production sites of several foreign-owned residents of TOSED Togliatti. In mid-January 2020 we received from the managers of AvtoVAZ Industrial Park an update on the situation in AvtoVAZ Industrial Park.

### *Creating the industrial park*

The creation of the AvtoVAZ Industrial Park is demonstrative. AvtoVAZ was built from 1966 to 1970, long before the “fine slicing of the value chain” concept emerged. AvtoVAZ presented an integrated car factory that included an assembly line and all possible auxiliary production—foundry, stamping, large tools production, private employee housing, large civil engineering units, port facilities, and so on. In the 1990s, a significant part of the auxiliary units was reorganized as subsidiaries and, later, many of those subsidiaries were sold or simply liquidated. In the same way, the large tools production facility was split-off as a subsidiary in 2011, and that subsidiary was liquidated in 2016, removing the equipment and leaving the production shops in a rather dilapidated condition. At the same time, AvtoVAZ experienced a series of troubles (a sharp decrease in sales due to depreciation of the flagship models and growing competition from locally assembled budget cars—Renault Logan, Kia Rio). In 2015, AvtoVAZ incurred a net loss of US\$1 billion, and massive layoffs became inevitable. However, a newly appointed President of AvtoVAZ, Nicolas Maure (currently Senior Vice Present and Chairman of the Eurasian region of Renault Group), proposed that approximately 1,000 employees should remain on payroll to work on the repair and amelioration of the former machine tool factory building (the former subsidiary of AvtoVAZ) and other production, storage, and office facilities. The total amount of investment in the repair and amelioration of those facilities reached 500 million Ruble (US\$9 million). Those upgraded facilities became the AvtoVAZ Industrial Park.

### *Park composition*

AvtoVAZ Industrial Park is currently composed of seven buildings: one large industrial structure (111,000 sq. m), one large office building (40,000 sq. m), and five smaller buildings (one storage structure, two industrial structures, and two office buildings) (AvtoVAZ 2016).

The large office building was immediately leased by the largest Russian bank (Sberbank), where it created one of its largest contact centers (around 1,200 employees) dealing with distant bank client consultations, telemarketing, distant sales, and the support of small businesses. Manufacturing firms gradually occupied production facilities. On July 15, 2019, in addition to Sberbank, there were nine residents. Six residents received the status of TOSED Togliatti resident (AvtoVAZ 2019b).

### *Resident services*

All industrial residents pay a uniform rent per sq. m of occupied space differentiated by the type of space (industrial space, office space, heated

storage space, not-heated covered storage space, and open space). There are also uniform rates for electric energy, heat, coolant, natural gas, oxygen, drinking water, sewage, industrial wastewater, and compressed air. A resident can also rent different types of equipment: bridge cranes, beam cranes, trucks, palette trucks, loaders, machine tools, and to rent heated changing rooms for employees with individual lockers and showers. In addition to such services paid according to their use, several other services are included in the basic rate for industrial space that are not paid for separately: around the clock security control of the perimeter of the whole production area, a fire station on the territory of the industrial complex, free parking for resident employees, a cafeteria, and a medical center (AvtoVAZ Industrial Park 2019b).

Finally, there are less visible but equally important services offered to residents of the industrial park. First, is the support for resident status applications. We were assured by the managers of the industrial park that this procedure has shortened over the past years from three months to one month. The second type of service is assistance in headhunting for particular positions, including the positions that are currently in great demand in Russia (Gurkov, Morgunov, et al. 2017, p. 597), for example, setup technicians, assistant engineers, and foremen.

#### ***The situation of the Industrial Park in mid-January 2020***

On January 15th, 2020, there were 18 residents including five residents of TOSED.<sup>8</sup> Among 18 residents two residents made the leasing contracts for 10 years, one resident made the leasing contract for 7 years and one resident—for 5 years. All other residents made 1-year contracts with a possibility of extension. It is interesting that the later residents were not interested in TOSED resident status as they intended to concentrate their activities on supplies to AvtoVAZ that exceeded the share of sales permitted for TOSED residents.

As the market and financial situation of AvtoVAZ has improved<sup>9</sup> and taking into account the growing flow of residents, AvtoVAZ started to consider its Industrial Park as a real business project. Now it is considering to transfer four additional industrial buildings with to total area of 225,000 sq. m to the Industrial Park. This will increase the total size of the industrial area offered to lease by almost three times.

#### ***Resident experiences and impressions***

We performed intensive semi-structured interviews with the local heads of two residents of the industrial park from the subsidiaries of foreign companies. Both companies were residents of TOSED Togliatti.

One company is a subsidiary of a German company that produces heating radiators. The current number of employees of the Russian enterprise is 45 persons. The interviewed executive (Deputy General Director) has a biography typical for many heads of Russian subsidiaries of German and French companies. He was a translator by education and, since 1990, had worked as a translator at AvtoVAZ. During the course of his work, he learned the intricacies of managing German companies and, in 2008, he joined a Russian subsidiary of a German company. The core team of managers and engineers of the newly established production facility was assembled from Russians with experience in other Russian subsidiaries of German companies. As is also typical for Russian manufacturing subsidiaries of German companies (Gurkov and Kossov 2014), most shop-floor workers completed an internship in Germany.

The interviewed executive of the Russian subsidiary of a German company noted the main strengths and weaknesses of the location of AvtoVAZ Industrial Park in terms of production. The first, most important positive point he made is that TOSED resident status minimizes taxes. The second point was that the production space is ready for immediate use. At the same time, the production space does not have internal partitions, so the company continues to experiment with the placement of different production zones (stamping zone, welding zone, assembly zone, painting zone, storage zone) searching for an optimal design for the whole facility. The third point he emphasized in the interview referred to the invisible services that were not taken into account in the rent—security control over the entire area and the ability to receive gas and heat from AvtoVAZ (which is comfortable for the residents). The fourth point was the geographical location of the production site in the center of Russia. The company ships its products in trucks to a distance of up to 2,000 km both west and east, serving the entire European side of Russia (including Moscow and St. Petersburg), the Urals, and Western Siberia. The fifth point was the relatively low cost of labor. The savings from low taxes on wages were transferred to employees as take-home payments that allowed relatively high salaries by local standards, particularly for shop-floor workers. In return, the company could demand the willingness and capabilities to master new skills and knowledge to ensure high-performance working practices.

An additional advantage is the location (in SEZ Togliatti and in Samara city) of the producers of industrial gas (both producers are subsidiaries of foreign companies) since the production processes require significant amounts of technical gas. The disadvantage of the location is the lack of local suppliers of a number of auxiliary materials. Although the steel sheeting for stamping radiators comes from Russian plants, paints, primers, and

even plastic plugs have to be imported since, in Russia, there is no production of this type of plastic.

The second interviewee was a CEO of a company for which the controlling share belonged to a French company. The parent company as well its manufacturing subsidiaries in Germany, Italy, Russia, and the United States, and partner companies in China, India, South Korea, and Brazil, are engaged in the production of sophisticated products—booster complexes, fluid temperature control systems, transverse static detection stability stands and thermally insulated capsules to simulate temperature conditions. Thanks to these devices equipped with electronic sensors, it is possible to trace the behavior of the main systems and individual parts of the car (truck). The testing covers various environmental conditions and driving regimes simulating mileage of 80 thousand km and is completed within a timeframe of three to four weeks while recording all breakdowns, exits from normal modes of operation, and so on.

The firm leases a total area of 3,500 sq. m simultaneously in two TOSED units in the AvtoVAZ Industrial Park where the assembly production is located. In the Zhigulevskaya Dolina Technopark (at a distance of 500 m), a warehouse space is leased for components, an engineering unit, and the company's office.

At the time of our visit to the production site, preparations were underway for a new, particularly large (literally and figuratively) order, a test stand for a new heavy truck model for the Minsk Automotive Plant (Belarus).

In addition to the comments from the first interview, the second interviewee (the general director of the Russian subsidiary) indicated several more reasons why the parent company chose AvtoVAZ Industrial Park and Tolyatti to establish a production site.

In AvtoVAZ Industrial Park, it was possible to lease production space that met the unique requirements of production processes at an affordable price. The density of the floor could withstand a load of 10 tons per square meter, and the ceiling was higher than 9 m, which made the use of two gantry cranes possible.

In addition, according to the opinion of the interviewee, in Togliatti, a specialized engineering culture had survived, not only among older engineers and technicians, but also among young engineers. This culture is partly due to the presence of the State University (the former Polytechnic Institute) in the city, which has a unique set of highly specialized programs in mechanical engineering (“Modern processes for the manufacture of car parts,” “Design and technological support of machine-building industries,” “Welding and soldering of new metal and nonmetal inorganic materials”

and, in industrial electronics, “Electronic devices,” and “Technical and information support of intelligent power supply systems”).

## Discussion

We made a short overview of the legal basis of a recently created new form of special economic zones (TOSED) in Russia, provided overall statistics on the number of such zones and their residents, revealed some peculiarities of this form of investment attraction (size, location, tax benefits to residents), and presented close-to-idyllic stories of two foreign-owned residents of one TOSED. In the cases described above, colocation with a large local industrial company (foreign-owned) resulted in repurposing of the newly created manufacturing facilities as ready-to-use premises capable of satisfying specific demands of tenants (in one case, a ready-to-transform space; in the other, high ceilings and extremely solid floor). Although the interviewed top executives of both foreign-owned residents discussed the uniqueness of the industrial space offered for lease, the additional services offered by the lessor (i.e., the elements of “microgeography”), they also indicated other, more traditional factors for location choice—tax benefits, the favorable geographic location of the production site, and the availability of a workforce with the desired level of professional knowledge. Thus, we can conclude that “microgeographical” factors might be important for location choice, but they usually coincide with other location advantages. In the taxonomy of location advantages proposed by Narula and Santangelo (2012) we can identify the following in the presented cases: “fundamental advantages” (profit tax holidays, the absence of complicated bureaucratic procedures when attracting a foreign workforce, and lower taxes on salaries), “knowledge assets advantages” (presence of good tertiary education and universities), and “structural advantages” (the size and attainability of the potential markets).

However, we should indicate additional location advantages of TOSEDs missed both in “microgeography” and in Narula and Santangelo (2012) taxonomy—the *low risks of industrial investments*, derived from minimal entry and exit sunk costs (short-term leasing contracts, the low level of obligatory investments, the absence of construction costs).

The low level of mandatory investment (US\$400 thousand or less) and the virtual absence of sunk costs make TOSED residency the ideal trial investment project for small and medium-size foreign companies that wish to test the efficiency of Russian subsidiary expansion in manufacturing (see Gurkov 2016) at an affordable cost and with acceptable risks.

*The major question, however, is how sustainable are these advantages? We can separate that question into two parts: how sustainable are the tax*

benefits, and how sustainable is the opportunity to save on construction costs by leasing ready-to-use facilities suitable for world-class manufacturing processes? For the first part of the question, we mentioned the letter from the Ministry of Finance that stipulated that the low taxation on salaries of TOSED resident employees would be valid only for residents that received their status within 3 years of the existence of a particular TOSED. Thus, the firms that intended to become the residents of the two largest TOSEDs (Naberezhny Chelny and Togliatti) were deprived of this tax benefit after January 28, 2019 and after August 28, 2019, respectively. This may partly explain why new residents of Industrial Park AvtoVAZ are not eager to apply for TOSED residency in Togliatti.

The availability of modern production and other spaces to lease requires investment in the repairing and upgrading of facilities built in the Soviet era. The presented example of Industrial Park AvtoVAZ, which offers well-repaired (and tuned to the needs of a particular leaseholder), perfectly serviced industrial, storage, and office facilities at an affordable rent and with many additional built-in services, can be considered an exception. The 500 million Rubles spent on making AvtoVAZ Industrial Park a place that can accommodate modern manufacturing and service operations was a component of an outplacement plan which are traditionally quite generous in Russian subsidiaries of foreign multinational corporations (see Gurkov and Saidov 2017, p. 190). The further expansion of AvtoVAZ Industrial Park requires significant additional investment.

The major question is: *would the core enterprises of other TOSEDs, or the managing companies of other TOSEDs, be capable of making sufficient investments to transform the existing vacant manufacturing, storage, and office spaces into modern facilities suitable for world-class manufacturing and service processes?* The answer to that question is rooted in the size of a TOSED's core enterprise. The taxes paid by the core enterprises (particularly the tax on land), for the most part, compose the budget of a TOSED territory and thereby determine the financial resources potentially available for the managing company of a TOSED. Examining a complete list of mono-city TOSEDs, we can identify not more than 10 TOSEDs (Togliatti, Naberezhny Chelny, Novokuznetsk, Cherepovets, Nevinnomyssk, and a few others) with core enterprises large enough to spend several hundred million Rubles on the amelioration of vacant production and storage facilities and to pay sufficient local taxes to allow the city to allocate significant funds to build new modern facilities. Without sufficient ameliorated space to lease, all the existing TOSEDs will become a weaker form of SEZs at the end of 2022 with similar levels of taxation on profits, land, property, and wages but without exemptions from value added taxes and custom duties that exist in the SEZs (see [Table 2](#) above). Freedom from bureaucratic

procedures in attracting foreign workforce will remain the only advantage of TOSEDs over SEZs. The situation can be solved by providing relatively moderate subventions from the federal budget to managing companies of TOSEDs to be spent on the construction of new facilities (as mentioned in Technopark Zhiguli Valley) and low-interest credits to “core enterprises” for amelioration of existing free production and storage facilities. Unfortunately, given the current conditions (low oil prices and the coronavirus (COVID-19) epidemic), such subventions would not be feasible.

### **Conclusions and suggestions for further studies**

We have presented a new form of SEZ that has recently emerged in Russia: territories of outrunning socio-economic development (TOSED). We retraced the evolution of the initial legislation for this form of investment attraction, the spreading of that form across different regions (particularly in mono-cities), the networks of different institutions existing within or near TOSEDs, particularly the industrial parks inside TOSEDs, and the SEZs that are in close proximity of several TOSEDs. We also briefly presented the experience of two foreign firms that opted to establish their Russian subsidiaries in TOSEDs and obtain TOSED resident status.

In our opinion, the initial legislation concerning TOSEDs was a rare successful attempt to design an institution that can serve both local and foreign investors of all sizes and origins with market-seeking and efficiency-seeking motives, including combinations with these motives (Cuervo-Cazurra and Narula 2015). Moreover, the residents of TOSEDs transferred savings on salary taxes to employees ensuring a wider applicant pool, stricter selection criteria, and stronger motivation to master the knowledge and skills necessary to perform world-class manufacturing processes. Unfortunately, the ability to transfer savings on salary taxes to employees was gradually eliminated as salary taxes were restored in TOSEDs after 3 years of their existence. Foreign *industrial* investors can still explore opportunities of all tax benefits (low taxation of profits, salary and assets) in TOSEDs created in 2018–2019.

We also wish to point out that the tax preferences of TOSEDs can be applied both to enterprises to be built and to existing enterprises, so TOSED provides a window of opportunity for tax savings for several foreign investors that acquired or built their facilities or established joint ventures in the territories now transformed into TOSEDs. It is very interesting to see whatever foreign corporations will apply for the status of a resident of TOSED or there are hidden considerations and reasons behind the decision do not apply for residency in TOSED that overweight possible tax benefits. This can be a very promising direction of a separate study.

In our study, we purposely did not touch on an important subject that was behind the whole concept of TOSEDs created in mono-cities—the revitalization of old industrial cities by their re-industrialization and diversification of economic activities. As we have seen in the example of TOSED Togliatti, some revitalization does take place. However, we were unable to assess the real impact of that TOSED on new venture creation or the expansion of the existing facilities. Unlike SEZ Togliatti, the official data does not distinguish between completed, on-going, or planned projects of TOSED residents. In addition, we had to compare the number and composition of projects in that TOSED with the number of similar projects in a city of a similar size in the same region that exists without a TOSED. This could be a separate direction for a further study.

Another promising direction for a study on TOSEDs is the assessment of their overall impact on economic development, not in their own territories but in the area surrounding the TOSED. However, as most TOSEDs are only recently established, a longer period of observation is needed for such a study.

In conclusion, it is not just the offered tax benefits themselves that increase incentives for foreign industrial investors to become residents of TOSEDs. The opportunities provided by colocation, especially the possibility to lease ready-to-use premises from the core enterprises and from the other established enterprises within a TOSED, serve as a strong motive for foreign investors to use the TOSED as a location for establishing new production facilities.

## Notes

1. The first modern SEZ was in Shannon Airport in Clare, Ireland.
2. We present the currently valid definition, which was amended by Federal Law 254 and signed by the President of Russia on July 26, 2019.
3. The list of permitted economic activities is presented in decrees on TOSED according to the Russian classificatory of types of economic activities (OK029-2014, Edition 2).
4. The italics are ours.
5. Federal Law 473-2014 was amended nine times from 2015 to 2019.
6. This figure differs from that presented in (Kuznetsov and Kuznetsova 2019) (197 residents) as the authors accounted for the residents of industrial SEZs at the beginning of 2018 while we present the statistics for the beginning of 2020.
7. The formal opening ceremony of the factory was attended by the governor of Samara Oblast, who indicated the importance of that particular investment project to the region (see Gurkov and Kokorina 2017).
8. One resident left the Industrial Park and also gave up the residency in TOSED.
9. In 2019, AvtoVAZ sold 362,365 cars and increased its share in the Russian car market from 20% to 21% (VA Volzhski avtostroitel', 1 (43), January 22nd, 2020, 3). A sign of the recovery was the purchase on the 9th of December 2019 for an undisclosed amount of the stake of GM (50% of shares) in a joint venture GM-AvtoVAZ

producing light off-road vehicles under the brand of Chevy-NIVA (Izvestia, December 9th, 2019).

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