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Foreign Capital in Russia:

Taking Stock after Two Years of War

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Taking Stock after Two Years of War

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Abstract

Unlike most other countries of Central, East and Southeast Europe, even prior to the war Russia's economic model was not really based on attracting foreign direct investment. On top of that, many of the Western firms announced plans to withdraw following the country's invasion of Ukraine in February 2022. However, two years after the war began, only 9.5% of foreign companies have fully exited Russia, while another 32.2% have curtailed their Russian operations. The exodus of foreign capital has slowed markedly over time, to a large degree due to the progressive tightening of the regulatory hurdles for exit. In general, foreign companies that have stayed find themselves between a rock and a hard place. On the one hand, the regulatory hurdles, the unfavourable exit terms and the non-negligible risk of nationalisation make exit a difficult, costly and potentially risky move; on the other hand, the decision to stay is fraught with risks of its own.

Keywords: foreign direct investments, regulatory hurdles for business exit

JEL classification: F21, F23

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GENERAL ECONOMIC SITUATION

According to the first official estimate, in 2023 the Russian economy grew by 3.6%, which is 0.1 percentage points (pp) higher than the earlier wiiw estimate (in our January report). Across the economic sectors, the highest growth in value added was reported in hospitality and catering and in ICT (10% each), the financial sector (8.6%), administrative and support services activities (7.8%),[1] trade (7.3%), and construction and manufacturing (7% apiece). By contrast, among the very few sectors which recorded a decline in value added last year were mining (-2%), utilities (-3%), and healthcare and social protection (-0.4%). The strong performance of many market services went hand in hand with the boom in private consumption (6.1%), while manufacturing growth was mainly boosted by military production. Interestingly, despite the ongoing war, public consumption grew by only 3.6% (probably reflecting the high statistical base of 2022), while the contribution of net exports to GDP growth was negative: -4.5 pp, according to wiiw calculations.[2]

Gross fixed capital formation expanded by 10.5% last year, partly reflecting the expansion of military infrastructure, but also private-sector investment. In January-September 2023, investments financed from the government budget, from companies' own funds and by taking out credit grew by 22%, 20% and 7% year on year, respectively.[3] According to the central bank, the main factors encouraging private-sector investment were a high level of business confidence (especially expectations), import substitution, the restarting of business activity frozen following the withdrawal of foreign firms, and the restructuring of transportation and logistics infrastructure in response to sanctions and the reorientation of foreign trade.[4] Nevertheless, the main driver behind the increase in overall gross capital formation last year was accumulation of inventories, which accounted for 4.4% of GDP – the highest level since 1995[5] – and which contributed an estimated 2.4 pp to GDP growth; without this, growth would not have exceeded 1.2%, which would have been close to the long-term trend.

Contrary to earlier expectations, the January data suggest a further acceleration of economic activity. Gross industrial production picked up by 4.6% year on year, faster than in either December 2023 (2.7%) or Q4 2023 (4.1%). The main engine of industrial growth in January was manufacturing (7.5% year on year), with computers, electronic and optical objects (54.6%), automotive production (50.2%) and furniture (34.1%) recording particularly high growth rates (albeit partly starting from a very low basis). The expansion in private consumption gathered pace in January, too, reaching 8% year on

1 According to NACE Rev.2 classification, administrative and support services activities include e.g. rental and leasing activities, employment activities, travel agencies, security and investigation activities, services to buildings, and office administration and office support activities.

2 Official statistics still do not report the dynamics of real exports and imports as part of national accounts data.

3 Central Bank of Russia (2024).

4 ibid.

5 https://www.kommersant.ru/doc/6495182?from=main

year, according to Ministry of Economy estimates.[6] It is likely that the main driver of private spending was the ongoing growth in real disposable household income: in 2023 this rose by 5.4% on average, but with a marked acceleration in Q4 (6.8% year on year).[7] Besides, retail lending – having slowed markedly in November and December 2023 (on a monthly basis), on the back of sharp monetary policy tightening – picked up again in January, bringing annual growth to 23.3%. The main transmission mechanism of policy tightening has so far been a healthy growth in household deposits, which reached 26.1% year on year in January – the highest level since 2011.[8]

The main engine of income growth has been strongly rising wages, on the back of widespread labour shortages. In 2023, the average wage soared by 14.1% in nominal and 7.8% in real terms – more than double the GDP growth rate. As a result, the wage share of GDP jumped by a huge 2.5 pp within just one year: from 38.5% in 2022 to 40.7% last year. Nevertheless, that is still fairly low in international terms, suggesting that strong wage growth – and the redistribution of national income from capital to labour – could continue for some years to come without unduly affecting the price competitiveness of products, provided rising production costs (resulting from wages growing faster than labour productivity) are at least partly absorbed by companies keeping a check on their profits. In poor regions (which have reportedly been the main source of contract soldiers and mobilised reservists for the war), household incomes have also likely been boosted by hefty government payments to soldiers and their families in the event of serious injury or death.[9]

The remainder of this report analyses the strategies of foreign businesses in Russia since the beginning of the war and outlines the numerous legislative and financial hurdles involved in exiting the Russian market.

FOREIGN DIRECT INVESTMENT IN RUSSIA PRIOR TO THE WAR

Unlike most other countries of Central, East and Southeast Europe (CESEE), even prior to the war Russia's economic model was not really based on attracting foreign direct investment (FDI). This rather reflected the reluctance of the country's political and economic elites to cede control over large parts of the economy to foreigners. For instance, back in 2008 the government adopted a strategic sectors law. This identified 42 types of activity of 'strategic importance to national defence and state security', on which limits were placed in terms of foreign ownership; they included aviation, mining, encryption, nuclear development, space, arms production, telecommunications, fishing, certain types of publishing activities, and television and radio broadcast media.[10]

At the end of 2021, inward FDI stock in Russia officially stood at EUR 439.8bn, making the country one of CESEE's laggards in terms of FDI penetration per capita (around EUR 3,000) – roughly on a par with Albania and Kosovo. By comparison, according to wiiw data, the FDI stock in Poland stood at EUR 6,400 per capita; in Serbia at EUR 6,800; in Kazakhstan at EUR 7,100; in Hungary at EUR 9,600; and in

6 https://www.kommersant.ru/doc/6535314?from=main

7 Having said that, real disposable incomes in 2023 were still 1.4% below the all-time peak registered in 2013.

8 https://t.me/russianmacro/18808

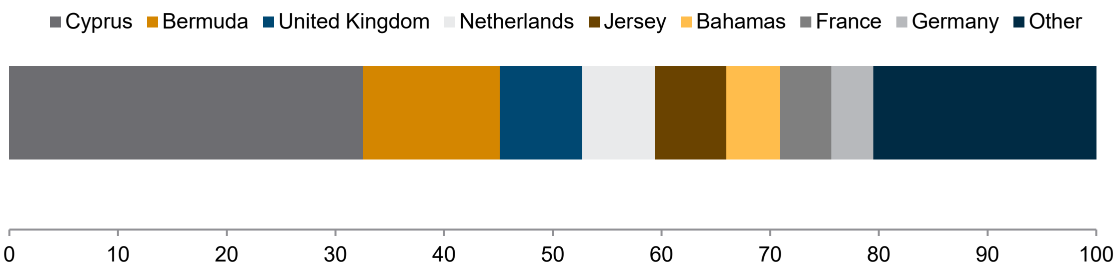
9 See Solanko (2024), who found that the share of mobilised soldiers across regions tends to go hand in hand with the growth rate of household bank deposits between 2021 and 2022.

10 See e.g. Astrov (2021).

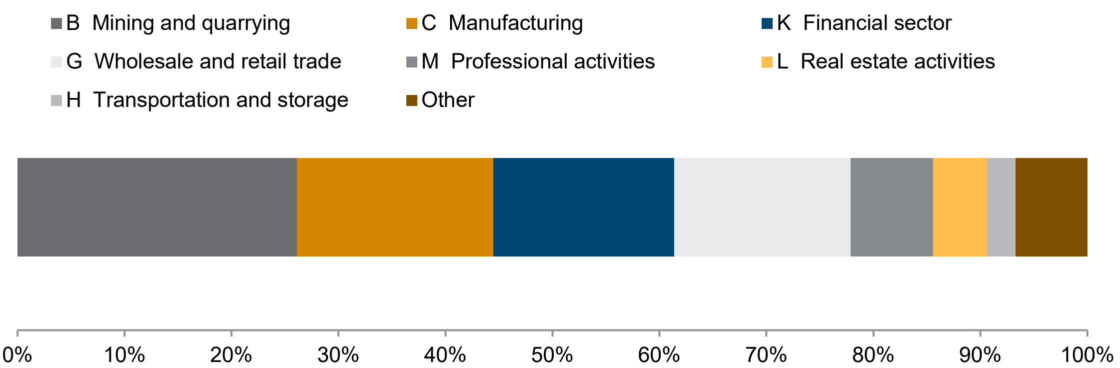
Czechia at EUR 17,000. Besides, the bulk of the FDI stock in Russia was accounted for by 'offshore' countries, arguably largely representing the 'round-tripping' of Russian capital (Figure 1a). These capital inflows hardly brought the usual economic benefits associated with FDI, such as advanced technology and integration into global value chains. Cyprus alone accounted for 32% of the FDI stock, while FDI from the UK and the Netherlands (the third and fourth biggest investing countries, respectively) were partly offshore related as well.

Figure 1 / FDI inward stock in Russia at the end of 2021

(a) By investing country, in % of total



(b) By economic sector (NACE Rev.2 1-digit level), in % of total



Source: wiiw FDI database, based on Russian central bank data.

Nevertheless, some economic sectors – such as the automotive industry and mining – recorded a high level of FDI penetration by Western firms. Foreign investment in car manufacturing (largely car assembling, destined for the Russian market) was fostered by the prohibitively high duty on imported cars and rapidly growing demand for cars in Russia. In the case of hydrocarbon mining, the need to develop production in remote and climatically challenging regions (such as Eastern Siberia, Sakhalin and the Arctic shelves) and to produce liquefied natural gas (LNG) also required Western technology and know-how. Many of these projects were implemented as production-sharing agreements (PSAs) between Russian and Western companies. These are the sectors that are likely to suffer disproportionately from the exodus of foreign companies and the related disruption to the flow of technology and know-how, although the negative impact (especially in the case of hydrocarbon mining) may only be felt in full in the longer run.

An arguably more accurate picture of the extent of foreign capital in Russia is provided by alternative data sources, such as the SelfSanctions/LeaveRussia database compiled by the Kyiv School of

Economics (KSE). According to KSE, at the outbreak of the war there were 3,769 foreign companies present in Russia, with a combined turnover of around USD 316bn.

ONLY A FEW FOREIGN FIRMS HAVE LEFT RUSSIA SINCE THE WAR BEGAN

Following Russia's invasion of Ukraine in February 2022, many of the Western firms present in Russia announced plans to withdraw from the country. Early surveys generally suggested that the prime motivation for leaving was the risk to the company's public image; that said, other factors also played a role, such as sanctions, logistical and payment difficulties, and fears of asset nationalisation.[11]

However, two years after the war began, only 359 foreign companies (9.5% of the total) have fully exited Russia, while another 1,214 companies (32.2% of the total) are in the process of 'leaving', i.e. have curtailed their Russian operations, according to KSE data. This implies that nearly 60% of foreign companies have chosen to stay, at least for the time being (although many have reduced the scope of their Russian activities). Other data sources come up with similar figures. For instance, using a smaller sample of 1,589 foreign firms active in Russia on the eve of the war (as well as a somewhat different classification), the Yale School of Management has found that 538 foreign companies have fully withdrawn from Russia, while another 504 have suspended their activities there, keeping their options open for a return.[12] Similar conclusions have been reached by the online newspaper *Novaya Gazeta Evropa*, which analysed the strategies of 110 of the biggest foreign investors in Russia and found that 91 had stayed (see Box 1).

Having said that, the KSE data suggest that 9.5% of the companies that have left accounted for 29.6% of the total revenue generated by foreign businesses in Russia in 2021 (Table 1). This implies that the true extent of foreign capital exodus is greater than the relatively small number of exiting firms would suggest.

As a result of company withdrawals and economic recession,[13] in 2022 the total revenue generated by foreign companies in Russia dropped by 25% (in US dollar terms) compared to 2021. However, the revenue of companies that chose to 'stay' *went up* by 6.7% (Table 1). Most probably, this partly reflects the reduced competition after other foreign players left Russia, allowing those who stayed to expand their market share and/or their profit margins. Besides, some foreign companies present in Russia took advantage of not being targeted by Western sanctions (unlike some of their Russian competitors). A case in point is the Russian subsidiary of Austria's Raiffeisenbank, which – unlike some big Russian banks – was not disconnected from SWIFT after the start of the war and has become a major channel for cross-border payments to and from Russia.[14]

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11 For instance, according to the Moscow-based Centre for Strategic Research, which surveyed the 600 biggest foreign companies active in Russia at the beginning of September 2022, for more than half of the firms 'subjective reasons' (such as concerns over their public image) were the main motivation for withdrawing: https://www.rbc.ru/economics/07/10/2022/633e94809a79475aa5d84f00

12 https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain

13 Russia's real GDP declined by 1.2% in 2022, according to the newly revised data.

14 Raiffeisen is by far the biggest foreign bank in Russia and in 2022 reportedly accounted for up to half of all cross-border payments to and from Russia carried out via SWIFT, https://www.ft.com/content/1cea1f08-83ac-4471-9fa4-1cdfcc86fcb0. Partly because of this, it saw its Russian profit soar by 3.6 times (in RUB terms) between 2021 and 2022, https://www.kommersant.ru/doc/5876263. The profit from Russian operations reportedly reached EUR 2bn in 2022 and EUR 1.3bn in 2023, https://www.derstandard.at/story/3000000205520/eingefrorene-milliarden-so-will-raiffeisen-an-ihr-geld-in-russland-kommen.

Table 1 / Status of foreign firms in Russia, as of 18 February 2024

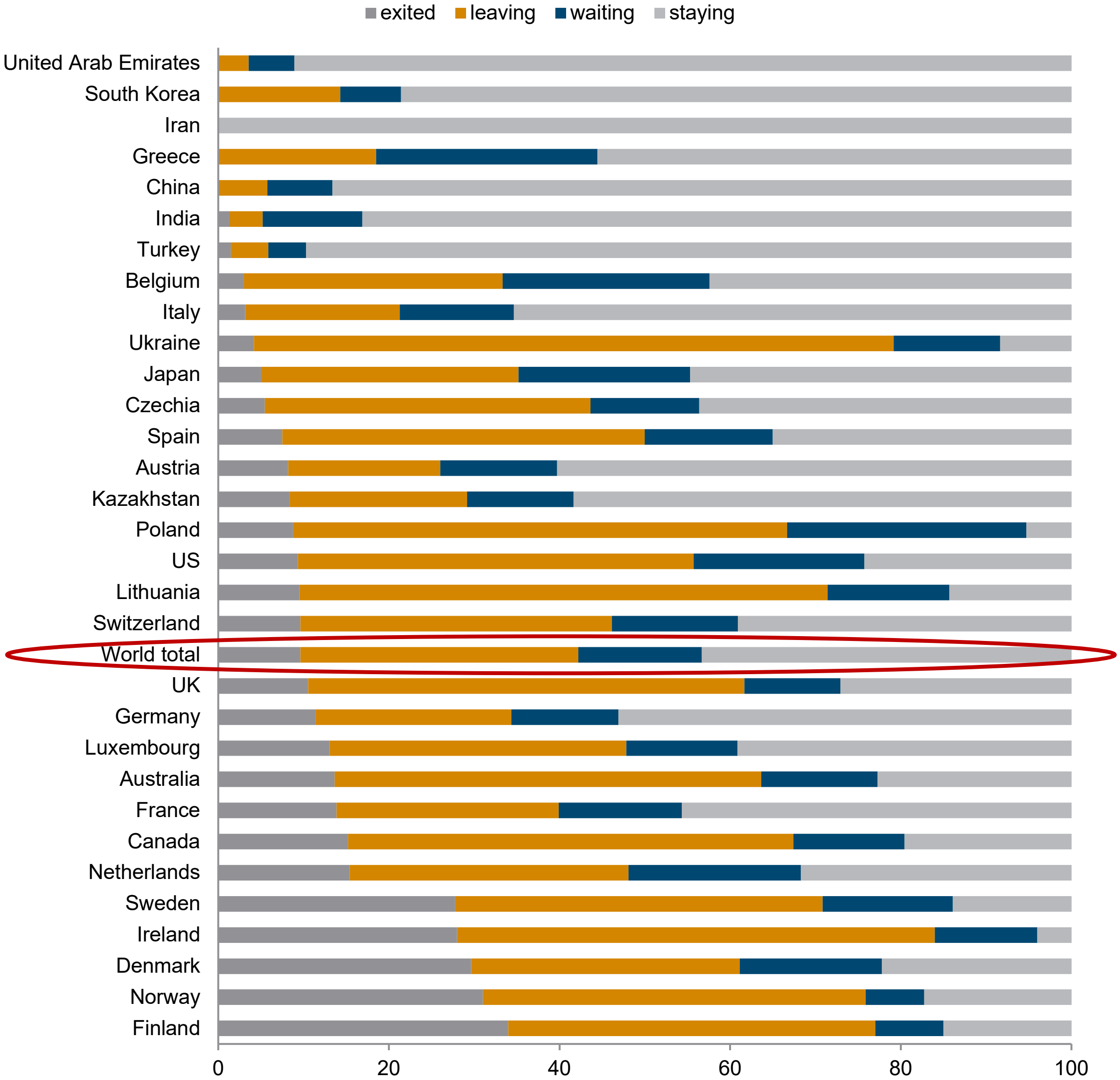
Status	Number of firms		Gross revenue in Russia in 2021		Gross revenue in Russia in 2022	
		% of total	USD million	*% of total*	USD million	*% of total*
Exited	359	*9.5*	93,350	*29.6*	65,402	*27.8*
Leaving	1,214	*32.2*	73,571	*23.3*	38,079	*16.2*
Waiting	540	*14.3*	55,642	*17.6*	32,451	*13.8*
Staying	1,615	*42.8*	93,058	*29.5*	99,372	*42.2*
n/a	41	*1.1*	.	.	.	.
Total	**3,769**	***100***	**315,621**	***100***	**235,304**	***100***

Note: Status is defined by the KSE as follows. 'Exited' – companies that have sold their business/assets, or a part thereof, to a local partner and subsequently left the market. This information is based on data from the Uniform State Register of Legal Entities in Russia. 'Leaving' – companies that have officially announced their temporary reduction of operations in Russia. 'Waiting' – companies that are reducing only part of their business operations, while continuing to work on other aspects, or that may have reported delays in future investment, development or marketing, while maintaining their core business (as announced on the company's official website or in a foreign publication such as the *Financial Times*, *New York Times*, etc.). 'Staying' – companies that are either ignoring exit or downsizing requirements in Russia or have officially stated their intention of remaining in the country (or no news of their exit has been found). 'n/a' (not available) – companies are present in the dataset, but there are no data on them.
Source: SelfSanctions/LeaveRussia database of the Kyiv School of Economics, https://kse.ua/selfsanctions-kse-institute/, as of 18 February 2024, wiiw calculations.

Figure 2 shows that the share of a foreign nation's companies that have exited the Russian market tends to correlate with the political stance of that country's government towards Russia and its war in Ukraine. For instance, 20-30% of companies from the Scandinavian countries have already left Russia; the inclusion of companies that are 'in the process of leaving' would bring the figure to 60-80%. At the opposite end of the spectrum, one can typically find 'friendly' countries (in Russian official terminology, denoting countries that have not imposed sanctions). For instance, not a single company from China, Iran or the United Arab Emirates has exited Russia since the outbreak of the war (and the same goes for Greece and South Korea, for example). Across economic sectors, the greatest shares of the withdrawals by foreign firms have been reported by advertising and PR (25%) and hospitality and real estate (21.7%) – see Figure 3.

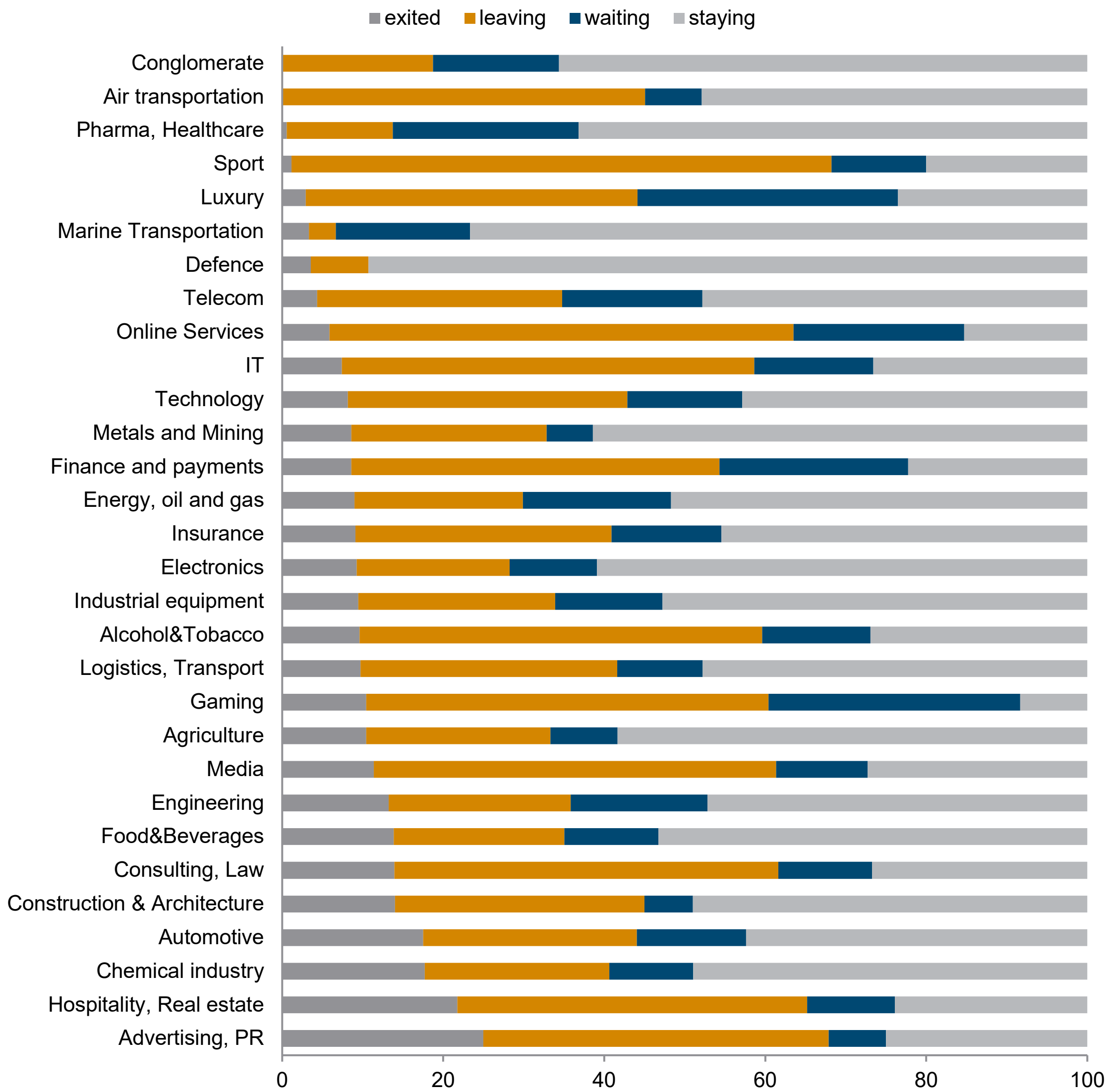
With some 11% of its companies having withdrawn fully from Russia at the time of writing, Germany ranks close to the global average. However, if one takes into consideration the *size* of the companies that have exited, the true extent of the withdrawal of German business from Russia is far greater: the 11% of companies that have exited account for as much as 37.5% of total revenue of German businesses in Russia in 2021. The companies that are 'leaving', 'waiting' and 'staying' account for 18%, 14% and 30%, respectively, of the total revenue of German businesses in Russia in 2021.

Figure 2 / Status of foreign firms in Russia, by country of origin, in % of total



Note: Countries are ranked by the share of companies that had withdrawn fully from Russia by 18 February 2024. Country of origin is defined as the country where the company's headquarters is located. Only countries with more than 20 companies operating in Russia at the start of the war are included. For the definitions of individual statuses, see the note to Table 1.
Source: wiiw calculations, based on the SelfSanctions/LeaveRussia database of the Kyiv School of Economics, https://kse.ua/selfsanctions-kse-institute/, as of 18 February 2024.

Figure 3 / Status of foreign firms in Russia, by economic sector, in % of total



Note: Top 30 economic sectors (by the number of foreign firms at the start of the war) ranked by the share of firms that had exited by 31 January 2024. For the definitions of individual statuses, see the note to Table 1.
Source: wiiw calculations, based on the SelfSanctions/LeaveRussia database of the Kyiv School of Economics, https://kse.ua/selfsanctions-kse-institute/, as of 31 January 2024.

BOX 1 / THE STRATEGIES OF 110 OF THE BIGGEST FOREIGN COMPANIES IN RUSSIA

The independent Russian-language media outlet *Novaya Gazeta Evropa* has analysed the strategies of 110 of the biggest foreign companies active in Russia in the first half of 2023. It has found that 91 of them have stayed, in part because they have been unable to exit on reasonable terms. In particular, it has identified five groups of companies, depending on their chosen strategy in response to the start of the war and sanctions:

› **'Wait it out':** 51 companies that declared their intention of staying (and have not revoked that decision) or did not make any public statement: e.g. Auchan, Metro, Calzedonia, Ecco, Benetton, Ehrmann, TotalEnergies, Rockwool, Mitsui, and some leading pharmaceutical companies. In 2022, these 51 companies recorded a combined net profit of EUR 6.2bn.[15]

› **'Declared intention of leaving but did not follow through':** 40 companies which initially declared plans to reduce their operations or investments in Russia or to leave altogether, but did not subsequently follow through on this: e.g. BP, JTI, PMI, Pepsico, Mars, Nestlé, Raiffeisen, UniCredit, ABB, Bacardi, Campari. In 2022, their combined net profit reached EUR 9.2bn.

› **'Formally left but de facto stayed':** three companies – Leroy Merlin, Decathlon and Adidas – have formally left, but have de facto retained their brands in Russia through various schemes. These companies did not disclose their profits for 2022.

› **'Waited until the last moment':** eight companies left only in the second half of 2023, mostly on very unfavourable terms: e.g. Hyundai, Kia, Volvo, Ingka Group, AB InBev, VEON. In 2022, their combined net profit reached EUR 590m.

› **'Lost their assets':** there are eight companies whose assets have been de facto nationalised: e.g. Danone, Carlsberg and Fortum. In 2022, their combined profit reached EUR 670m, but they lost all their assets in 2023.

Source: https://novayagazeta.eu/articles/2024/02/06/esli-rabotat-tikhonko-nikto-za-toboi-ne-pridet. The sample includes foreign companies that were active in Russia in 2023 or had left before the second half of 2023.

15 Here and below, own calculations based on the value of net profits as indicated by *Novaya Gazeta*, using the average exchange rate of 72.5 RUB/EUR.

OBSTACLES TO EXITING RUSSIA ARE FORMIDABLE – AND ARE ON THE RISE

The exodus of foreign capital from Russia has slowed markedly over time. For instance, the 2023 M&A report by the AK&M agency[16] found that the number of transactions involving asset sales by foreign companies dropped to 97 (from 109 in 2022) and the overall value to USD 11.14bn (from USD 16.31bn in 2022). Thus, the value of asset sales (-32% year on year) declined much more steeply than the number of transactions (-11%), which means that the average transaction value dropped by 23%. The slowdown in the exit of foreign capital is also visible from the balance-of-payments statistics: whereas in 2022 the reduction in FDI liabilities (i.e. divestment of foreign capital) from Russia reached USD 39.8bn, it plunged to a mere USD 8bn in the first nine months of 2023. Thus, depending on the data source used, the extent of foreign direct capital withdrawal from Russia during the first two years of the war and sanctions can be roughly estimated at USD 30-50bn. The movement in portfolio flows shows a very similar picture: according to the balance-of-payments data, the outflow of foreign portfolio investments from Russia reached USD 32bn in 2022 and another USD 8.2bn in the first three quarters of 2023.

The divestment of foreign FDI from Russia has been mirrored by the divestment of Russian FDI from abroad. However, the magnitude of the latter has been much smaller. In 2022, Russian FDI claims on foreign countries dropped by a mere USD 13bn, while the first three quarters of 2023 saw a reversal of this trend, with Russian FDI abroad *picking up* by USD 8.7bn. Anecdotal evidence suggests that this may reflect the relocation of Russian investment from countries that have become ‘unfriendly’ (such as Cyprus and other EU countries) to neutral countries such as Kazakhstan, Türkiye and the United Arab Emirates. Unlike FDI, Russian portfolio investments abroad have been contracting throughout: by USD 10.8bn in 2022 and by another USD 2.4bn in the first three quarters of 2023.

There are various reasons for the slowdown observed in the exit of foreign businesses. One is the progressive tightening of the regulatory hurdles for exit. Apart from its obvious direct effects, the ongoing tightening trend has strengthened the bargaining power of buyers, further suppressing the value of foreign companies’ assets to be sold.[17] The most important hurdles for exit can be summarised as follows:

› Since March 2022, the sale of Russian assets by investors from ‘unfriendly’ countries has been subject to approval by a government sub-commission chaired by the finance minister. The time frame for obtaining such approval had reportedly increased by the end of last year, as the work of the commission was sometimes interrupted, which delayed a number of transactions.[18]

› Since August 2022, the exit of investors from ‘unfriendly’ countries from the financial, fuel and energy sectors – deemed ‘strategic’ – has been prohibited altogether, unless explicitly authorised by the Russian president.[19] Having said that, the exit of the UK’s HSBC, Czechia’s J&T Banka[20] and Italy’s Banca Intesa Sanpaolo[21] has been authorised by the president.

16 http://mergers.akm.ru/stats/41
17 https://www.rbc.ru/finances/14/02/2024/65cb65699a7947ed01dbd76c
18 ibid.
19 http://publication.pravo.gov.ru/Document/View/0001202208050002
20 https://www.rbc.ru/finances/21/06/2023/64931b6b9a79473925de5a86
21 https://www.rbc.ru/finances/29/09/2023/65166aaa9a7947130d766b95

› Since December 2022, there has been an official requirement for a price discount of at least 50% on the independent market valuation of foreign assets to be sold. In addition, the government imposed a 'voluntary' 10% exit tax on the transaction value, which in October 2023 was hiked to 15%.[22]

› In July 2023, restrictions for exit were tightened further.[23] In particular, the government limited the duration of a possible buyback option fixed in the sale contract to a maximum of two years and stipulated that such a buyback should reflect the 'market price' and that the Russian owner should derive economic benefit from it. (The rationale behind this is probably to make exit largely irreversible and thus raise the opportunity costs for the companies leaving.)

› In addition, the buyers of the assets of exiting foreign companies are required to run a secondary public offering (SPO) for 20% of the newly acquired equity (in order to widen the scope of Russian beneficiaries of the foreign assets being sold).[24]

Finally, the assets of some foreign companies have been put into 'temporary' administration by the Russian government, i.e. de facto nationalised, making their exit virtually impossible. This applies, for example, to Finland's Fortum and Germany's Uniper (on 25 April 2023),[25] France's Danone and Denmark's Carlsberg (on 16 July 2023).[26] In the two former cases, the official justification was that a 'compensation fund' needed to be set up in response to the 'unfriendly' measures taken by foreign governments: most probably the nationalisation in June 2022 of Gazprom's assets by Germany and the unilateral withdrawal after the start of the war by Finland's Fennovoima from a contract with Russia's Rosatom for the construction of a nuclear power plant in Finland.[27] Similarly, the 27.5% stake held by UK's Shell in the Sakhalin-2 production-sharing agreement was de facto nationalised on 30 June 2022.[28] Common to all these cases is that all the companies had announced their withdrawal from Russia, but were unwilling to accept the (unfavourable) terms offered by the Russian government. Those companies that were more 'flexible' or did not announce their intention of exiting – such as Heineken (a competitor of Carlsberg), Total and BP (competitors of Shell) – have generally fared better.

On top of the regulatory hurdles, some experts argue that the sharp monetary tightening pursued during the second half of last year (whereby the policy rate was hiked from 7.5% to 16%) may also have dampened the acquisition of foreign assets – both by making the borrowed funds (often used to finance such purchases) more expensive and by suppressing the valuation of assets in question via a higher discount rate.[29]

In general, foreign companies that have stayed in Russia find themselves between a rock and a hard place. On the one hand, the above-mentioned regulatory hurdles, the unfavourable exit terms and the non-negligible risk of nationalisation make exit a difficult, costly and potentially risky move; on the other hand, the decision to stay is fraught with risks of its own. Although many foreign companies reportedly continue to earn handsome profits from their Russian operations (which is also demonstrated by the

22 https://www.rbc.ru/business/03/10/2023/651b87bd9a79476315c45f6d

23 https://minfin.gov.ru/common/upload/library/2023/07/main/Vypiska_1207.pdf

24 https://www.vedomosti.ru/economics/articles/2023/07/14/985254-vlasti-sformirovali-10-uslovii

25 http://publication.pravo.gov.ru/Document/View/0001202304250033?index=4

26 http://publication.pravo.gov.ru/document/0001202307160001?index=1

27 https://www.rbc.ru/business/26/04/2023/6448df6a9a79475b85691e6e

28 http://static.kremlin.ru/media/events/files/ru/kj25EK599KdoG3Pg0Q5AkzuwNEvABMM0.pdf.

29 https://www.rbc.ru/finances/14/02/2024/65cb65699a7947ed01dbd76c

above KSE data), the restrictions on profit repatriation to ‘unfriendly’ countries – imposed by the Russian government in July 2022[30] and still in force – place a question mark over their business model.

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