

The Analysis of Development of Russian MNEs in The Context of Imposition of Sanctions Against Russia from The West

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Abstract— The article focuses on the current geopolitical situation in Russia, which arose due to the conflict in the Ukraine. As a result, the Russian economy is in decline. Consequences of economic situation and geopolitical circumstances have impact on the Russian MNEs. But every industry, in which leading MNEs operate, bears the consequences differently. Mainly the energy companies suffered. Therefore, this situation should give rise to them to start to act independently, to adapt their policies under new economic realities, rather than wait passively for changes from outside.

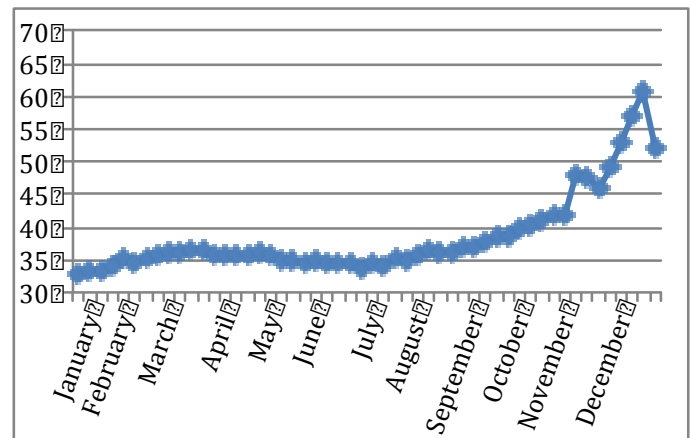
Keywords— Collapse of Russian currency, crisis in the Ukraine, decline of the Russian economy, decline of world oil price, energy industry, foreign trade reorientation, geopolitical situation, metallurgy industry, political and economic sanctions, Russia, Russian economic situation, Russian MNEs, telecommunications industry.

I. Introduction

Today Russia has quite strained relations with many countries due to the geopolitical situation, which has arisen as a result of the conflict in the Ukraine. The United States accused Russia of violating international human rights and integrity of the Ukraine as a state. As a result, political and economic sanctions were introduced against Russia from the United States, the EU and some partner countries in order to influence the policy of Russia.

Due to this situation in the Russian economy GDP growth slowed down to 0.8% (in the second quarter of 2014, compared to the corresponding period of the previous year)¹, the net capital outflows increased by 85.2 billion dollars for the first three quarters of 2014 (i.e. 48.2% higher compared to the same period in 2013)², capitalization of Russian MNEs fell (on MICEX it valued at 62.5 billion dollars), the Russian currency depreciated (*Fig. 1*), the inflation rate increased by 7.15%. Moreover, there is a decline of world oil price (*Fig. 2*). It is because of an increase in supply (due to surplus production in Iraq and Iran; besides Libya restored production and returned to the market after it was curtailed since June 25

due to the riots in the country)³ and a decrease in demand (as there were reduced oil purchases in China because of the problems in the economy⁴ and decreased consumption of foreign oil in the United States, as domestic production reached a maximum level for the last 30 years⁵). In addition, the drop of oil price was affected by the position of OPEC. At the meeting on June 11, 2014 a decision to reduce production quotas was not taken, although it might neutralize the surplus supply and stop the fall in price. The hope was the meeting arranged on November 27, 2014 but the members of OPEC made the decision to keep current oil production quotas. It seriously affected Russia as a net oil exporter. Decrease of oil price led to a negative balance of payment of the Russian Federation and it further weakened the national currency, reduced purchasing power, cut imports.



Source: URL: <http://www.banki.ru/products/currency/usd/>

Fig. 1. Dynamics of the dollar against the ruble, 2014

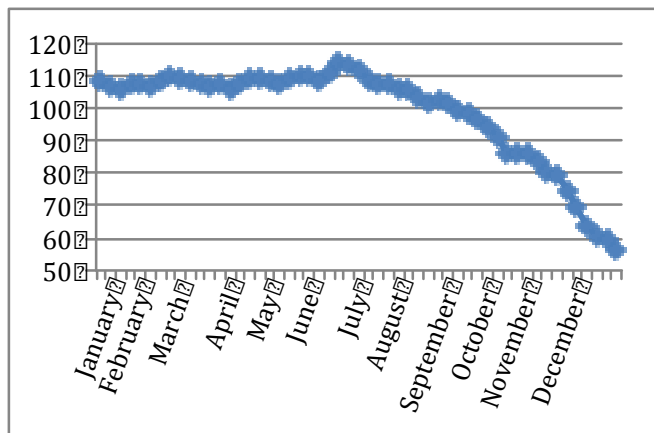
¹ URL: http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/accounts/

² URL: http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/capital_new.htm

³ URL: <http://www.vz.ru/economy/2014/10/7/709325.print.html>

⁴ URL: <http://www.vz.ru/economy/2014/10/7/709325.print.html>

⁵ URL: <http://www.vestifinance.ru/articles/48627>



Source:

URL: <http://www.marketwatch.com/investing/future/crude%20oil%20-%20electronic>

Fig. 2. Dynamics of oil price, dollars/barrel, 2014

II. Analysis

It is obvious that the geopolitical situation affected the Russian MNEs, in terms of both economic and political sides. But in order to get a clear picture of their impact, it is necessary to divide leading companies by industries. For this we take the Russian companies, which are included in the list of the largest MNEs among developing countries in terms of foreign assets and transnationality index. These are: VimpelCom, Lukoil, Gazprom, Eurasia, Severstal, Mechel, System and Rusal.⁶ These companies operate in three sectors: energy, metallurgy and telecommunications.

A. Economic influence

Of course in such economic situation, first of all, the energy companies suffered. Firstly, because of falling oil price, which had a direct impact on revenue. Thus, the net profit of Lukoil fell 12% in the first half of 2014 and amounted to 4.1 billion dollars.⁷ Secondly, because of the collapse of the ruble, as there are companies that use payment in rubles for export with certain countries. For example Gazprom, whose net profit in the first half of 2014 fell at an annual rate of more than 20% - from 593.41 billion to 465.23 billion rubles.⁸

A decline can also be seen in the telecommunications sector. The reason for this is the internal problems of the companies, the overall industry decline and fall of the Russian currency. Thus, the net profit of the company System in the third quarter of 2014 amounted to 379.2 million dollars, which is 950 million dollars less than in July-September 2013.⁹ The decrease was mainly due to the increase of foreign currency loss. Also, the net profit of the holding Vimpelcom Ltd (owned by the Russian VimpelCom, Ukrainian Comstar and

Italian Wind) in the third quarter of 2014 amounted to 104 million dollars against 255 million dollars a year ago. Decrease in net income is primarily due to the depreciation of the ruble, Ukrainian hryvnia and euro against the US dollar. In addition, the contribution to the net profit drop made the refinancing costs of the Italian subsidiary which was the operator Wind.¹⁰

In metallurgy industry, on the contrary, the situation is favorable, even there is an increase in financial performance. This is due to the fact that export prices are stable, and the actual revenue from exports became higher because of the currency exchange rates (export in dollars). Thus, the EBITDA of Severstal increased by 24.2% compared to the same period last year and amounted to 534 million dollars.¹¹ Indicator EBITDA of Eurasia in the first half of 2014 amounted to 1.080 billion dollars compared to 925 million dollars in the same period in 2013 - an increase of 17%.¹² In 2014 net profit of Mechel rose to 25% up to 1.140 billion dollars. The net profit of the company Rusal in 2014 increased by 93.8% - up to 250 million dollars.¹³

B. Geopolitical influence

Besides the economic situation, the geopolitical components directly impact on the activities of Russian MNEs. Namely, the sanctions imposed by the West and limited investment. But again every sector bears the consequences of geopolitical situation differently.

Sanctions affected 90% of Russian oil companies, and nearly all the gas sector. American companies are prohibited to deliver goods and technologies which are needed for the development of oil fields in the spongiform areas and in the Arctic shelf, as well as in shale formations. Deliveries can not even be through intermediaries. As a result, this led to the collapse of many joint projects.

It becomes obvious that the sanctions were imposed exactly against this sector because it is the most competitive Russian industry in the world market and the most important for the Russian economy in terms of profitability. Therefore, the West presumes that the pressure on Russian companies in this industry may change the geopolitical views of Russia.

As for metallurgy and telecommunications industries, the geopolitical situation indirectly impacted on them. The sanctions were not brought against them. But due to the imposition of sanctions investors' confidence decreased in all sectors. In addition, Russian MNEs have problems with repaying corporate debts and with its refinancing, as well as they have problems receiving the credits on favorable terms and generally attracting new foreign loans. Moreover, the

⁶ URL: www.unctad.org/wir or www.unctad.org/fdistatistics

⁷ URL: <http://www.lukoil.ru/new/finreports/2014>

⁸ URL: <http://www.gazprom.ru/f/posts/05/298369/gazprom-ifrs-2q2014-ru.pdf>

⁹ URL: <http://top.rbc.ru/business/27/11/2014/5476e947cbb20fd7f51d1859>

¹⁰ URL: <http://lenta.ru/news/2014/11/12/vk/>

¹¹ URL: <http://www.severstal.com/rus/media/news/document9544.phtml>

¹² URL: <http://www.steelland.ru/news/business/3521.html>

¹³ URL: <http://www.steelland.ru/news/business/3521.html>

rating agency Standard & Poor's lowered the ratings of Russia¹⁴, which itself automatically reduces investment.

economic realities, rather than wait passively for changes from outside.

C. Solution

So, the key players are at the crossroads. On the one hand, there are political restrictions on them, but on the other hand, they have an expedient desire to maximize profit. That's to say it is for them to make decision either to deepen investment activity by investing on the Russian and other markets bypassing sanctions, or to suspend investment policy due to political pressure bearing huge losses.

But here it is necessary to remember that it is very easy to impose sanctions, but it is very difficult to cancel them. And the depreciated exchange rate will never become the former. Therefore, from the above mentioned, especially the energy companies should take the former decision that is to find new solutions and deepen investment policy. There is already such opportunity. Thus western sanctions already became a "trigger" for the establishment and strengthening of cooperation between Russian and Chinese companies. On November 9, Russia and China signed agreements in the gas sector.

In addition, Japan has also shown an interest in the Russian gas despite joining the sanctions against Russia. It offered to Gazprom to build a gas pipeline from Russia to Tokyo and participate in the energy and gas distribution in Japan.¹⁵

Moreover, like Russia, Iran also takes a leading position in the oil and gas potential in the global gas market and also faced international sanctions for a long time. In these conditions there is a possibility of combining the efforts of Russian and Iranian companies to strengthen relations with the countries of Asia, especially with China, Japan, India and Korea that have a lack of oil and gas resources.¹⁶

Thus, the long term foreign trade reorientation looks very positive, as there is the diversification of business and economy, which expands the market and significantly reduces the risk of some geopolitical consequences. The new economic partners could also be used for credit lines. However, due to the current situation the Russian side is more compliant in terms of negotiations, which may result in unfavorable conditions for it. In this context, the eastern side can take advantage of Russia. Therefore it is necessary to evaluate the whole situation taking into account the percentage lost from the concluded deals, reliability of partners, increase in demand, the time needed for the realization, and the profitability of these projects.

III. Conclusion

This situation should give rise to Russian companies to start to act independently, to adapt their policies under new

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¹⁴ URL: <http://www.gazeta.ru/business/2014/04/25/6005825.shtml>

¹⁵ URL: http://polit.ru/article/2014/11/11/utro_10_11/

¹⁶ URL: <http://www.lib.csu.ru/vch/343/005.pdf>