

# The Obstacles Faced by Chinese Enterprises in Direct Investments in Russia and Countermeasures

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**Abstract:** As the largest country in the world, Russia is rich in oil, gas and mineral resources due to its vast territory, but its economy is not developed. China and Russia have a long border, which provides a natural geographical advantage for the economic and trade exchanges between the two countries. Since the end of the 20th century, with the deepening of the two countries in political, economic and cultural exchanges, investments from China are particularly important for Russia. Although in recent years, the total investment from Chinese enterprises to Russia has been increasing year by year, Chinese companies are facing a series of problems, such as financing difficulties in Russia, high cost of doing business, imperfect market and law system, lack of understanding of the Russian market. The paper closely analyses the present situation of Chinese direct investment in Russia and the obstacles that Chinese enterprises have been facing in the process of making direct investment in Russia. Under the background of 'the Belt and Road' strategy, both China and Russia should seize the opportunity and explore the cooperation in trade, investment and joint projects. At the last part, the paper proposes some countermeasure from macroscopical and microcosmic point of view to adjust investment strategies from China to Russia in the hope of strengthening outward direct investment to Russia.

## 1. Introduction

With the implementation of China's 'One Belt And One Road' strategy, Russia, as a world power, is becoming an important partner of China more than ever. The direct investment from China to Russia has been highly valued by the leaders of the two countries. Nowadays, there are both opportunities and challenges for Chinese enterprises to conduct direct investment in Russia. The two countries need to make more efforts in policy communication, improving corporate governance institutions and providing more financial support, so as to create a favorable operating environment for Chinese enterprises to invest directly in Russia and promote the sound development of Chinese enterprises' direct investment activities in Russia.

## 2. Current Situation of Chinese Enterprises' Direct Investment in Russia

As economic and trade exchanges between China and Russia have become more frequent in recent years, Chinese companies have been making more and more investments in Russia, but they still account for a small percentage of China's total outward direct investment. By the end of 2018, according to the statistics from China's Ministry of Commerce, Chinese direct investment in Russia reached us \$725 million, accounting for 0.51% of China's total outbound direct investment. China's investment in Russia is mainly concentrated in manufacturing, mining, finance, leasing and commercial services, wholesale and retail industry. With the strengthening of the political, economic and cultural relations between China and Russia, China's outbound direct investment in Russia will fully unleash its potential and enjoy steady and rapid growth. China's outbound

investment to Russia in recent years and its proportion in China's total outbound investment are shown in Table 1.

**Table 1.** The total amount of Chinese direct investment in Russia from 2003 to 2018.

(Unit:US\$100 million).

Particular year	Total Chinese direct investment in Russia	Total outward direct investment of China	Ratio(%)
2003	0.31	28.50	1.08
2004	0.77	55.03	1.39
2005	2.03	122.61	1.66
2006	4.52	211.60	2.56
2007	4.78	265.10	1.80
2008	3.95	559.07	0.71
2009	3.48	565.29	0.62
2010	5.68	688.11	0.83
2011	7.16	746.54	0.96
2012	7.85	878.04	0.89
2013	10.22	1078.44	0.95
2014	6.34	1231.20	0.51
2015	29.61	1456.67	2.03
2016	12.93	1961.50	0.66
2017	15.48	1582.90	0.98
2018	7.25	1430.40	0.51

### **3. Obstacles to Direct Investment by Chinese Enterprises in Russia**

#### **3.1. Chinese Companies Lack Understanding of the Russian Market**

The market environment in Russia is complex. Chinese enterprises often do not understand the market information and culture of Russia and know little about the investment environment, consumer habits, consumer psychology, policies and regulations in Russia, which makes it difficult to invest in Russia at the initial stage. In addition, Russian product inspection standards are stricter than those in China, which also makes it more difficult for Chinese companies to invest in Russia.

#### **3.2. Russia's Law Systems and Market Are Imperfect**

In the aspects of attracting foreign investments, Russia has made many preferential measures to foreign laws and regulations (including tax law, land law, corporate law, etc.), but in fact the effect is limited, the judicial system uncertainty, management organization of an impartial award, widespread corruption and bribery, serious damage to the foreign investor confidence in the Russian legal protection have constituted obstacles to foreign investments from all nations in the world. Russia's macroeconomic instability also brings great risks to investment companies. In addition, such issues as market access barriers, land purchase barriers, tax barriers, labor quota barriers, visa approval barriers also seriously hinder the development of China's direct investment in Russia.

#### **3.3. Chinese Companies Have Difficulty in Raising Money in Russia**

With few financing channels and high costs in Russia, it is difficult for Chinese enterprises to raise funds. First of all, from the perspective of financing guarantee, most of the Russian enterprises cooperating with Chinese enterprises are small in scale, so it is difficult to issue loan guarantees or provide collateral recognized by Chinese commercial Banks, and they cannot make loans in China. Second, Chinese banks are regulated by the Russian central bank. The central bank has clear regulatory limits on bank lending, such as limiting commercial Banks (including Chinese ones) to lending no more than 25 per cent of a bank's capital to a single customer. Finally, there is a very

large exchange rate risk between the RMB and the Ruble, which directly affects the trade and investment between China and Russia.

### **3.4. The Geographical Relationship Between China and Russia Has Caused Transportation Obstacles**

Russia's largest industrial centre, mainly in the Russian Urals and the European part of west Siberian, is located in a remote location far from major global sea lanes. China's largest industrial centers are mainly located along the southern and southeastern coasts of China, directly facing the warm ocean and close to the world's major trade routes and coasts. Such geographical distance means that the industrial centers of Russia and China are very far apart (more than 7,000 kilometers), and transportation costs are high. (Research by the Brookings institution in the United States shows that temperature can affect economic activity and work efficiency. For example, reducing the average temperature by 1 degree Celsius can reduce GDP by 1.5 to 2.0%.)

### **3.5. Chinese Companies Suffer High Operating Costs in Russia**

Since the light industry in Russia is weak and its service sectors are underdeveloped, many Chinese companies cannot guarantee the repair and maintenance of machinery and equipment in Russia, and many spare parts need to be shipped from China.

### **3.6. Labor Shortage in Russia**

As Russia's population continues to decrease, the number of people of working age reached about 80.4 million in 2016, accounting for 59.9 percent of the total population, according to the Russian national statistical commission. The huge labor gap will pose some obstacles to attracting direct investment from China. Labor-intensive enterprises also face the problem of local labor quotas, and their costs remain high.

## **4. Investment Strategies of Chinese Enterprises in Russia under the Background of 'One Belt and One Road'**

### **4.1 Investment Strategies to Russia from Macro Level**

#### **4.1.1. Strengthening Policy Communication and Building an Inter-governmental Coordination Mechanism**

We should seek the common ground between the 'One Belt And One Road' strategy and Russia's foreign economic policy, realize the effective docking of national policies, reduce interest friction and policy instability, which are conducive to reducing risk of investment projects. China can take the initiative to share with Russia its experience in reform, opening up and economic development, and give priority to the planning and implementation of a number of major projects to promote regional economic development based on the common interests of both sides.

#### **4.1.2. Attaching Importance to Legal Risks and Constantly Improving the Corporate Governance Structure**

Relevant government departments and agencies should provide legal investment support for Chinese enterprises in Russia to avoid tax, finance, environmental issues. Chinese enterprise may entrust overseas agencies or hire intermediary institutions to conduct research, in order to obtain the information about investment environment, investment project feasibility and risk so as to improve the ability of risk prevention and control.

#### **4.1.3. Enhancing Sustainable People-to-people Interactions and Mutual Trust Based on People-to-people Connectivity**

When Chinese enterprises make investment in Russia, they should abide by local laws and customs, establish a good image of Chinese enterprises with products of high quality, and win the recognition of the local people. To dispel the doubts of the Russian people about Chinese

enterprises' investment, it is necessary to win the hearts and minds of the Russian people through multi-level, multi-angle and sustainable exchanges and cooperation.

#### **4.1.4. Increase Financial Support and Innovate Investment Model of Russian Enterprises**

China should play the role of the Silk Road Fund, the Asian Investment Bank and the Shanghai Cooperation Organization Unionpay to provide financing services for Russian investment enterprises, and try to solve the financing problems, increase the long term, high quality, high return on investment, in order to promote the development of the investment project. Chinese enterprises should adopt a variety of ways of cooperation, continuous innovation investment model.

### **4.2 Investment Strategies to Russia from Micro Level**

#### **4.2.1. Correctly Positioning the Investment Industry in Russia**

Chinese enterprises should transfer the design, research and development and other major technical links of traditional Chinese industries with mature and applicable technologies such as textiles, clothing, leather and home appliances to Russia, promote mature and applicable Chinese standardized technologies in Russia, and participate in the upgrading and transformation of traditional Russian industries. We should select potential investment areas to expand the Russian market. (agriculture, machinery manufacturing, finance, tourism).

In view of the increasingly intensified contradiction between the supply and demand of resources in China, strategic resources with a large gap between the supply and demand of the national economy and people's livelihood, including oil and gas industry, power industry, mining industry and forestry, should also be the focus of Chinese enterprises' direct investment in Russia.

#### **4.2.2. Improving the Efficiency of Enterprise Investment**

We shall expand investment in Russia. This not only includes the expansion of investment, but also includes the expansion of investment areas. This will help Chinese enterprises to avoid risks and improve investment efficiency.

It is advisable for us to cultivate professional investment talents. We will solve the problem of weak investment in human resources and cadres in Russia, and recruit and train interdisciplinary talents who are familiar with the Russian legal environment and have 'flexible' adaptability to invest in Russia so as to lay the foundation for better investment in enterprises. By relying on the Sino-Russian special economic zones and Chinese business organizations in Russia, we can understand the changes of Sino-Russian trade policies, adjust the investment strategies of enterprises and seize the investment opportunities.

#### **4.2.3 Expanding Investment Areas in Russia**

Considering the Far East and Siberia in Russia as the key investment areas, which are rich in natural resources, Chinese enterprises should focus on resource extraction and processing industry investment. By using the overseas investment and cooperation parks, we will focus on investing in the processing industry such as clothing, food and building materials, and sell the products in Russia or export them to boost the export trade between China and Russia. We will vigorously promote investment in Russia by Chinese enterprises with core technologies or intellectual property rights, based on the classified layout of Russian special economic zones and technology parks.

#### **4.2.4 Choosing Right Investment Methods**

The transnational acquisition of state-owned enterprises in China is easy to be doubted by the Russian government and the public about the real intention of the acquisition. The investment environment in Russia is relatively complex, so Chinese enterprises should employ well-known external consultants with local experience in Russia as early as possible to help bidders cope with the complex transaction situation and improve the success rate of Chinese enterprises in cross-border acquisition of Russia. We should make effective plans for cultural integration, set up a team responsible for integration, take targeted measures to develop cultural identity, strengthen cultural training for employees after merger and acquisition, and promote the integration of

employees from both sides as soon as possible.

## **Conclusion**

In the context of global economic globalization and “One Belt and One Road” strategy in China, Chinese enterprises have conducted direct investment activities in overseas countries. As a country with the largest territory area in the world, Russia conducts various trade exchanges with other countries by virtue of its natural endowment. As neighboring countries, China and Russia have a long boundary line, which provides great convenience for economic and trade exchanges between the two countries. Chinese enterprises have gradually carried out a series of investment activities in Russia, which has brought some objective economic benefits to Chinese enterprises, but we have to say, Chinese enterprises are facing some obstacles of direct investment in Russia.

Through the analysis of the current situation of Chinese enterprises' direct investment in Russia, although the total amount of investment shows an overall trend of increasing in recent years, the proportion of investment is still relatively small. The law and market in Russia are still imperfect. Chinese companies still have some difficulties in raising funds in Russia. The industrial centers of China and Russia are far from each other, so transportation costs are high. Chinese companies' operating costs in Russia are too high; Russia is short of local labour. It is these reasons that make it difficult for Chinese enterprises to invest in Russia. Therefore, how to solve these problems and make Chinese enterprises' direct investment in Russia to a higher level is an urgent matter.

In view of the above reasons, we should mainly start from macro and micro levels. In terms of investment industries, we will focus on resource extraction and processing, transfer major mature technology links from China to Russia, and upgrade traditional industries in Russia. In the field of investment, we should choose industries with great development potential to invest, expand the scale of investment in Russia and train professional investment talents. By relying on the information network established by Chinese business organizations in Russia, we can timely grasp the policy information of Russia and choose the right time for direct investment. The geographical focus of investment should be on the Russian far east and Siberia. In terms of investment mode, transnational acquisition subjects are diversified, and well-known enterprises with certain strength are encouraged to carry out transnational acquisition. Chinese companies should employ prominent local outside advisers before investing to deal with complex deals in Russia. After the acquisition, we should pay more attention to the cultural integration and promote the cultural identity of employees of both sides.

To sum up, when Chinese enterprises make direct investment in Russia, they should consider the investment industry, investment field, investment region and investment mode, choose the most advantageous one to make investment, and formulate the post-investment cultural integration plan to improve the success rate of investment.

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