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Title:
Russian Multinational Firms and Their Investment Activities in Emerging Economies

The South Caucasus

Russian Multinational Firms and Their Investment Activities in Emerging Economies: The South Caucasus

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A dissertation submitted to the University of Bristol in accordance with the requirements for award of the degree of Doctor of Philosophy in the Faculty of Social Sciences and Law

School of Sociology, Politics and International Studies

March 2020

Word Count: 78,199

Abstract

This research explores the behaviour of Russian firms in the oil and gas, electricity, aluminium, telecommunications, insurance, financial and railway industries. Its key aim has been to analyse their investment activities in the South Caucasus emerging economies. Since the 1990s, the rise of Russian multinationals has been remarkable; they have redefined the international business landscape by continuously increasing their FDI activities as a result of political and economic changes. Individual political events have also influenced state-state, state-business and business-business relations. Thus, the study was designed to explore the main drivers of Russian firms' investments in the South Caucasus emerging economies. This research involved fieldwork and interviews with business and political elites in Russia and the South Caucasus countries between June and September 2017. In order to explain the Russian firms and their business activities, the thesis develops an 'interdisciplinary theory' which is built on Dunning's eclectic paradigm, with the incorporation of the IDP and U-model predictions, state-business and state-state relations, as well as other political factors. The findings show that there are variations in the Russian firms' ownership advantages, between the locational advantages of the South Caucasus countries, in the Russian state's interaction with the firms, in the influence of Russia's relations with the South Caucasus countries on the firms and their corporate roles in these interstate relations, and in the firms' entry strategies. The results enable a better understanding of the development of the firms' internationalisation processes and can serve as a reference and guideline for researchers and policymakers. The study shows that the interdisciplinary theory is an analytical framework that is well-suited for exploring and analysing the various kinds of determinants of the Russian firms' business and investment activities. This analytical framework could also be used to investigate other big emerging economy firms. The study contributes to the theoretical IB and IPE literatures.

Acknowledgements

My motivation for conducting this research came from my own personal background and interest. My undergraduate studies in international economic and political relations and my master's study of international political economy boosted my interest in Russia's firms and their roles in its foreign economic policy, which was later published as a working paper. I then realised that this research area had considerable potential to develop and contribute not only to knowledge but also to a region which to date had not been substantially studied in this regard.

Writing this thesis without the help, support and guidance of kind people around me would not have been possible. I would like to mention some individuals here.

This dissertation would not have been possible without guidance, critical but always stirring and inspiring comments and patience of my principal supervisor Dr Magnus Feldmann, not to mention his advice and unsurpassed knowledge of Russian politics. I also thank my former second supervisor Professor Benoit Pelopidas, who supervised me for the first two years. Besides his critical comments, his support and friendship were priceless on both an academic and personal level.

I would like to thank Ilham Hidayetov and Hikmet Nasibov who hosted me during my fieldwork in Moscow, Russia. I am very grateful for their kind help and housing support. I also thank Professor Vladimer Papava and other people at the Georgian Foundation for Strategic and International Studies who gave me a warm welcome and allowed me to use their facilities during my fieldtrip to Georgia.

Very special thanks to my friends, Dr Rodrigo Mendoza, Dr Charles Chuka Agboeze, Dr Denitsa Pencheva, Dr Alexis Bedolla, Marc Piñol and others in number 3 Priory Road for their encouragement and support over the past years.

These acknowledgments would not be complete without mentioning my sincere friends: Carlos Muñoz, Büşra Yücel and Noémie Fedon, who have joined the study group at 'my cave' to encourage each other and provide motivation over the past year. The biggest thanks go to Kimon Butzbach for listening to my complaints all the time, providing intellectual conversation, and helping me to improve my errors.

I also thank my landlady, Vanessa Evans, for her very kind and invaluable help over the past years, doing my shopping, and many other things to save me time so that I could fully focus on my PhD.

Above all, I am highly indebted to my parents for their invaluable support and financial assistance. Without them, doing and finishing my PhD would not have been possible.

Author’s Declaration

I declare that the work in this dissertation was carried out in accordance with the requirements of the University’s Regulations and Code of Practice for Research Degree Programmes and that it has not been submitted for any other academic award. Except where indicated by specific reference in the text, the work is the candidate’s own work. Work done in collaboration with, or with the assistance of, others, is indicated as such. Any views expressed in the dissertation are those of the author.

SIGNED: .... **DATE:**...

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Abbreviations

ADA	**Azerbaijan Diplomatic Academy**
bcm	**billion cubic metres**
BP	**British Petroleum**
BTC	**Baku-Tbilisi-Ceyhan**
BTE	**Baku-Tbilisi-Erzurum**
BTK	**Baku-Tbilisi-Kars**
BTS	**Baku-Tbilisi-Supsa**
B.V.	**Private company with limited liability**
CHP	**Combined Heat and Power**
CIS	**Commonwealth Independent States**
CIS EPS	**Commonwealth Independent States, Electric Power Council**
CJSC	**Closed Joint Stock Company**
CNG	**Compressed natural gas**
CST	**Collective Security Treaty**
CSTO	**Collective Security Treaty Organisation**
D-222	**Deepwater 222**
EAEU	**Eurasian Economic Space**
EBRD	**European Bank for Reconstruction and Development**
ECU	**Eurasian Customs Union**
EU	**European Union**
EEU	**Eurasian Economic Union**
EurAsEc	**Eurasian Economic Community**
et al.	***et alia***
FDI	**Foreign Direct Investment**
FGC UES	**Federal Grid Company of Unified Energy System**
FSU	**Former Soviet Union**
GDP	**Gross Domestic Product**
GUAM	**Georgia, Ukraine, Azerbaijan and Moldova**
GmbH	**Company with limited liability**
GRES	**State District Power Plant**
GSM	**Global System for Mobile**
gw	**gigawatt**

HPP	**Hydro Power Plant**
I	**Internalisation**
IB	**International Business**
ibid.	***ibīdem***
IBP USA	**International Business Publications, United States of America**
IC	**Insurance Company**
IDP	**Investment Development Path**
IPE	**International Political Economy**
IR	**International Relations**
JV	**Joint Venture**
JSC	**Joint Stock Company**
KGB	**Committee for State Security**
km	**kilometre**
km^2	**square kilometre**
kV	**kilovolt**
kwh	**kilowatt hour**
L	**Location**
L_i	**Institutional-related location advantages**
LLC	**Limited liability company**
Ltd	**Limited**
LTE	**Long-Term Evolution**
Lukoil	**Langepas, Uray and Kogalym oil**
M&As	**Mergers and Acquisitions**
MGTS	**Moscow City Telephone Network**
MNCs	**Multinational Corporations**
MNEs	**Multinational Enterprises**
MPS	**Ministry of Railways**
MTS	**Mobile Tele Systems**
NGV	**Natural Gas Vehicles**
NPP	**Nuclear Power Plant**
O	**Ownership**
O_a	**Asset specific advantages**
O_t	**Transaction cost-minimising advantages**

OCCRP	**Organized Crime and Corruption Reporting Project**
OIJSC	**Open Insurance Joint Stock Company**
OLI	**Ownership, Location and Internalisation**
OLIH	**Ownership, Location, Internalisation and Home**
PJSC	**Public Joint Stock Company**
PJSFC	**Public Joint Stock Financial Corporation**
PSHPP	**Pumped Storage Hydro Power Plant**
RAO	**Russian joint-stock company**
RAO UES	**Unified Energy System of Russia**
RSPP	**Russian Union of Industrialists and Entrepreneurs**
RUSAL	**Russian Aluminium Company**
RusHydro	**Russian Hydroelectricity Company**
RZD	**Russian Railways**
SCP	**South Caucasus Pipeline**
SOCAR	**State Oil Company of Azerbaijan Republic**
SOFAZ	**State Oil Fund of the Republic of Azerbaijan**
SUAL	**Siberian-Urals Aluminium Company**
TANAP	**Trans-Anatolian gas pipeline**
TAP	**Trans Adriatic Pipeline**
tcm	**thousands of cubic meters**
TPP	**Thermal Power Plant**
UC	**Unified Company**
UES	**Unified Electricity System**
UGSF	**Underground gas storage facility**
UGSS	**Unified Gas Supply System**
UK	**United Kingdom**
U-model	**Uppsala School of Internationalisation**
US	**United States**
USM	**Usmanov**
USSR	**Union of Soviet Socialist Republics**
WiMax	**Worldwide Interoperability for Microwave Access**
WITS	**World Integrated Trade Solution**
VTB	**Foreign Trade Bank**

WTO	**World Trade Organisation**

Chapter 1

1 Introduction

1.1 Overview

This research investigates the internationalisation of Russian firms in the South Caucasus emerging economies since the collapse of the Soviet Union. The timing of this study is significant because the rise of Russian firms and their investment and business activities have been influenced by various economic and political factors. Principally, these involve economic and institutional development of home and host countries, firm-level development, and cultural or social factors, as well as state-business and state-state relations. Russian firms have also become crucial players in the home country's economic and political relations with the host countries. Additionally, since the early 2000s Russian firms have started following aggressive investment and business policies outside the home country. During this time, non-resource-based firms became a new trend in Russian foreign direct investment (FDI). This research argues that political factors alongside economic factors are highly significant because they influence both resource- and non-resource-based firms and their internationalisation processes. These factors attest to the importance of creating a research project that explores and analyses the underlying drivers of Russian firms' investment in the South Caucasus emerging economies and the variations across firms, industries and host countries.

Since the 1990s, the number of multinational corporations (MNCs) in the global economy has increased considerably and the rise of their investment and business activities has been remarkable. In most cases, historically, MNCs from developed economies have possessed dominant, ingrained and determining positions in international business activities and marketing operations. More recently, new companies from emerging economies, especially from Brazil, Russia, India and China, have progressively become prominent and redefined the international business landscape by continuously increasing their FDI activities, mostly as a result of political and economic changes in the world system.[1] During the past three decades, individual political events have also influenced the state-state, state-business and business-business relations, also known as 'triangular diplomacy' (Stopford *et al.*, 1991).

Government reforms and policies have been necessary for firms' internationalisation and influenced their performance and behaviour. However, the role of states from developing

[1] These new firms are also described as latecomers (Bessonova & Gonchar, 2015; Bonaglia *et al.*, 2007; Mathews, 2006; 2002).

economies, such as China and Russia, and their various forms of intervention, including state ownership, management, personal connections, finance, government regulations and policies, ministries and business associations, in certain industries and firms has gone far beyond the encouragement of sectoral development and the stimulation of companies' internationalisation (Rodrik, 1997: 412; Sáez & Chang, 2009: 266). These types of direct and indirect government involvement may shape and influence the when, where and how of both state-owned and private firms' internationalisation. These interactive relations between states and firms can also shape both governments' political and economic objectives and firms' strategies and goals. Because of this exchange relationship it may also be hard to distinguish firms' business interests from government interests. Moreover, resource-based firms from large emerging economies have conducted a significant share of FDI (Rosen & Hanemann, 2009: 9), and their governments, especially China and Russia, may therefore have strategic considerations in resource-based firms which are key vehicles of country's economic growth that also produce political benefits (Chen, 2008; Lane, 2001; Pleines, 2009). Unlike resource-based firms, especially since the early 2000s, the internationalisation of non-resource based firms has become a new trend, although their FDI has been relatively small (Filippov, 2008: 9) and has followed the home country's resource-based firms to serve their international operation (Collins, 2013: 109-110; Goldstein, 2009: 99). All this raises important questions: whether there is a mixture of political and economic considerations behind these mechanisms, and whether interventions or state-business relations vary from industry to industry or from firm to firm.

In recent years, MNCs have become central organisers of economic activity, drivers of international trade, influential actors in international political economy and international relations, and more powerful vis-à-vis states. Firms and their investments have been primary means of accomplishing growth in these large developing economies, as well as political affirmation at a regional or global level. Considering this, firms have become political actors to maintain and maximise their home country's political and economic power, and their investment and business activities can be also influenced by the home country's political and economic relations with host countries. Firms as 'corporate lobbyists' (Barron & Hultén, 2014) have begun to support their governments and to play an active role as 'diplomats' (Stopford, 1994: 64; Strange, 1992: 10) in building or developing political and economic relations between countries. Given both state-business and state-state relations, firms may use this political advantage in their favour and simultaneously fulfil their home government's tasks. In other words, their investment and business operations can be perceived as necessary supplements to the home country's foreign policy (Dicken, 2015: 230) or as corporate tools with which to accomplish political objectives (Feklyunina, 2012: 454).

Taking all this into account, in order to discover the main drivers of Russian firms' investments in the South Caucasus emerging economies this research aims:

- to investigate several Russian companies from resource- and non-resource-based industries and their dynamic interactions with the Russian state;
- to examine the role of these interactions in firms' investment and business operations;
- to explore the role of interstate political and economic relations in firms' investment decisions;
- to identify firms' role in interstate relations and home country's foreign policy;
- and to analyse whether firms' investment and business operations are economically and/or politically driven and whether there is variation across industries, firms or host countries.

Given the institutional environment of Russia, the policies and reforms implemented by the Russian state, its relations with firms and host countries, and foreign policy objectives, the internationalisation of Russian MNCs has been noticeably different from other large developing economy firms (Filippov, 2013; McCarthy *et al.*, 2009; Tepavcevic, 2015). The context of state-business relations, especially in the case of Russia, has attracted the attention of scholars of international business (IB), international political economy (IPE) and international relations (IR). However, a review of the available literature on the emerging economies and their firms has identified several gaps in the research. Despite the remarkable development of Russian firms and their international business operations, there is still a need to undertake solid and in-depth empirical investigations or/and provide theoretical justifications.

Several scholars have undertaken a range of country- or region-specific, firm- or sector-specific, firm-country-specific and selected sector studies (Heinrich, 2001; Kilvits *et al.*, 2006; Kuznetsov & Anisimov, 2013; Lisitsyn *et al.*, 2006; Panibratov & Verbá, 2011; Yeremeyeva, 2009). Others have claimed that Russian companies have pursued similar expansion approaches in the former Soviet Union (FSU), but different strategies in the West (Hedenskog & Larsson, 2007; Heinrich, 2003; Vahtra & Liuhto, 2006; 2004). However, not enough attention has been paid to exploring and analysing variations between firms, industries and countries, and the studies are primarily focused on the oil and gas industries. Yet others (Crane *et al.*, 2005; Kuznetsov, 2012a; Kuznetsov & Kvashnin, 2015; Vahtra, 2005) have attempted to explain Russian companies and their investment activities in the FSU, which comprises the three South Caucasus emerging economies, but only in a very broad sense. Scholars from IR (Huotari, 2011; Kazantsev, 2010; Perović *et al.*, 2009) and IB (Liuhto, 2010; McCarthy *et al.*, 2009; Tepavcevic, 2015) have studied Russian firms, predominantly oil and gas, and often seen their relations with the Russian state, including their investment and business activities, as political considerations. However, some IB scholars (Filippov, 2008; Johnson, 2004; Kuznetsov, 2010a; Panibratov & Kalotay, 2009) have denied this claim, although they do acknowledge state-business interests. A few Russian scholars (Kheifets & Libman, 2008; Libman & Kheifets, 2007) have begun to explore the role of investments in regional integration, which was later studied by Balakishi (2016) and Kuznetsov (2016a). However, they have neither used appropriate theory nor provided any theoretical contribution and their studies have remained descriptive.

All this reveals the need to study the political factors in more detail, and shows that there is also a need to develop a single integrated theoretical framework to explore and analyse the internationalisation of firms and their business and investment activities. Considering the facts above, not enough attention has been paid to exploring and analysing these processes either empirically or theoretically. This research is also the first study to investigate the internationalisation of Russian companies in the South Caucasus emerging economies and one of very few studies to explore in depth the expansion process of Russian companies.

To study firms and their internationalisation, several theories have been developed by business, economics and IPE scholars. These theories have been used by others to attempt to explore firms from emerging economies – including Russia, as a large emerging economy – and their expansion strategies. Given all the facts and considering the limitations of the various theories, in this research I have examined the determinants of the Russian firms' investment decisions and their internationalisation strategies in the South Caucasus emerging economies, and analysed whether there are variations across industries, firms or countries. In answering this, the study shows that a political economy approach is helpful to understand Russian MNCs and useful to explain their investment and business activities. Economic and business factors offer a poor explanation for the investments of large developing economy firms in emerging markets, but this explanation can be improved by including political economy factors, such as state-business and state-state relations, alongside the macro- and micro-economic factors. Given firms' intentions to maintain and develop strong ties with their home country, which has least interventions in firms' investment and business operations, the political economy approach has a limited ability to explain this phenomenon. This study shows that political factors are highly important and that there are several determinants of Russian firms' investment decisions which vary across industries, firms and countries. Furthermore, Russian state-business relations vary from industry to industry and from firm to firm. Considering the inadequacy of existing FDI theories for explaining Russian firms' investment and business activities in the South Caucasus, in this study I develop an 'interdisciplinary theory', as illustrated in Figure 5, by drawing on the theories of IB, international economics, IPE and IR. This research contributes both empirically and theoretically to the IB and IPE literatures and existing knowledge.

1.2 Outline of the Chapters

Chapter 2 develops and sets out the theoretical framework by reviewing the existing literature on firms and their business activities. The chapter explains at the start why Dunning's OLI was selected as the framework for this study. Then, I discuss firm-specific determinants and identify other determinants associated with the home-country economic and institutional and firm-level development which can determine why a firm decides to internationalise. I then discuss the literature on the locational factors associated with the economic, institutional, social and cultural factors that have determined the firms' decisions about where to invest. Following that, I critically engage with the literature on the political economy of investments. Here, I identify the mechanisms through which the state influences firms and their internationalisation processes and explore how and why states use corporations to pursue their political objectives. In this section, I also discuss state-state relations and states' 'foreign policy' interests, and explain both their influence on firms and firms' roles in these as 'diplomats'. By examining the literature on firms' motivations for their expansion, I discuss traditional and other types of investment motive. Drawing all these factors together, the chapter continues with a discussion of how firms enter host counties and what entry modes they choose. Finally, after developing and setting out the theoretical framework, I propose a theory and set out the analytical framework for this study.

Chapter 3 presents the research methodology. As a powerful research tool, I chose a multiple case studies method, allowing me both to test theories, and to unearth where particular theories are limited for theory building. I discuss here what sort of cases I was looking for and explain how I identified and later grouped them which is reflected in my central empirical chapters 5-8. I explain here the process of sorting the cases into four groupings. The chapter then explains the range of data sources which were used, and how they were gathered and analysed. Following that, it elucidates ethical issues.

Chapter 4 provides an insight into the political economy of Russia and the South Caucasus countries. I explore macroeconomic changes and development in Russia. The discussion starts with a brief explanation of the Soviet era which will be helpful for understanding the characteristics of modern Russian firms, their internationalisation, and whether there is change or continuity. This is followed by a consideration of macroeconomic changes and development in resource- and non-resource-based industries in the 1990s and 2000s. I then analyse political and economic relations between Russia and the South Caucasus countries and discuss political and economic integration in the region.

Chapter 5 deals with Russia's largest resource-based firms, including Gazprom, Lukoil and Rosneft in the oil and gas industries; I analyse the variations in their investment activities in the South Caucasus emerging economies. First, I explore their resources and capabilities, and show how the home-country's economic and institutional development and their own development have influenced Gazprom's, Lukoil's and Rosneft's internationalisation strategies and business activities. I then identify the locational attractiveness of the South Caucasus countries in terms of their economic and institutional infrastructure and other social and/or cultural factors and investigate the locational choices of the Russian oil and gas companies about where to invest and why. I subsequently explore the Russian state's relations with Gazprom, Lukoil and Rosneft, and with the South Caucasus states. I then look at the other political factors involved, analyse their influence in the investment activities of the Russian oil and gas companies, and identify these firms' roles in interstate relations as corporate players. Given the firms' competencies, locational determinants in the South Caucasus countries and political economy factors, I analyse how Gazprom, Lukoil and Rosneft have entered the markets, what entry strategies they have preferred and the reasons behind their choices.

Chapter 6 examines another group of large Russian resource-based firms, including the electricity companies Inter RAO UES and RusHydro and the aluminium company RUSAL, and differences in their approaches to expansion into the South Caucasus countries. I explain their firm-specific competencies and investigate the influence of home-country and other firm-specific factors on these Russian electricity and aluminium companies' decisions to internationalise. I then explore the effect of various economic, macroeconomic and psychic distance factors of the South Caucasus host countries on the investment decisions of Inter RAO

UES, RusHydro and RUSAL and their reasons for deciding where to invest. This analysis is followed by a consideration of the interaction of the Russian state with its electricity and aluminium companies and its role in their internationalisation. In addition to the role of Russian state-business relations, I also explore Russia's relations with the South Caucasus countries, as well as various political factors in determining Inter RAO UES's, RusHydro's and RUSAL's investment and business activities across the South Caucasus emerging markets, and analyse these firms' roles in state-state relations. After that, I analyse the firms' choices of entry strategies, the reasons for their preferred entry modes and whether there was any variation.

Chapter 7 follows almost the same analytical interests but explores non-resource-based Russian firms and their investment activities in the South Caucasus. I first examine the resources and capabilities of the MTS, VEON and MegaFon telecommunications companies and Ingosstrakh as an insurance company and analyse how home-country macroeconomic factors and firm-specific microeconomic factors affected their internationalisation. I identify the South Caucasus host countries' determinants and the decisions of the Russian telecommunications and insurance companies on where invest, and then examine whether the variations in the level of institutional and economic development of the South Caucasus emerging economies determined these companies' locational choices. The analysis continues with a discussion of the Russian state's role in these firms' business activities. I then investigate the role of political and economic interstate relations and the impact of other political factors on these firms and their investment decisions. I end the chapter by studying the firms' strategic entry decisions on how internalise their investments and the motivations behind their choice of entry modes.

Chapter 8 investigates another group of non-resource-based firms – the financial company VTB and the railway company RZD – and analyses their expansion into the South Caucasus emerging markets. I identify the firms' ownership advantages and explain how home country economic and institutional development as well as firm level development determined their resources and capabilities. I next explore the South Caucasus countries' location advantages as host-countries, associated with economic, institutional and other non-economic factors, and examine VTB's and RZD's choices of location. The analysis is followed by a discussion of the Russian state's relations with these financial and railway companies through various mechanisms and its influence on their investment and business operations. Alongside state-business relations, the chapter studies the impact of intergovernmental relations as well as other political determinants, analyses how they have influenced VTB's and RZD's internationalisation processes and examines the economic and political relations between these firms' home country bases and the South Caucasus countries. Given the firms' ownership advantages, the South Caucasus host countries' location advantages and political economy determinants, the chapter ends by identifying these firms' entry strategies in the host countries and the reasons for them.

In **Chapter 9**, I conclude the thesis by identifying its contribution at a number of levels. This starts at the empirical level, identifying its links with studies in other countries of how firms and their strategies are influenced by their home country government. The findings and results of this study show that there are not only variations across the South Caucasus emerging economies in determining Russian firms' investment decisions, but that there are also variations across industries and between firms from the same or different industries. I then discuss the theoretical contribution of the thesis to the IB and IPE literatures, revisit systematically the mechanisms through which the Russian state has exercised its influence on both resource- and non-resource-based companies, and compare the levels of Russian state involvement with each company. The chapter continues with a discussion of state-state relations, Russia's broader foreign policy goals, and the characteristics of the South Caucasus countries in terms of their capabilities to resist. I also analyse political factors in these firms' investment activities as well as their roles in interstate relations as corporate players. Finally, I discuss why states are engaging in this process and whether this is specific to certain sorts of large developing economies or authoritarian regimes. I end the thesis by considering the limitations of this study and offering some suggestions for future research that can be undertaken independently and build on this study.

Chapter 2

2 Theoretical Framework

2.1 Introduction

In this chapter I develop a theoretical framework using a synthesis of economic – home- and host-country economic and institutional development, firm-level development and cultural or social determinants – and political factors – state-business and state-state relations as well as other political determinants (*see* Figure 2). These factors have rarely been studied together. Before doing this I briefly explain why Dunning's eclectic theory has been selected as the framework for this study and whether there are missing variables to complement his theory.

Internationalisation is the process of increasing a firm's involvement in international business activities and market servicing outside its home country (Hitt *et al.*, 2002: 67; Karlsen *et al.*, 2012: 117; Welch & Luostarinen, 1988: 36), and allows companies to reach new markets, achieve economies of scale and scope, and consequently increase their business profitability and security (Prioste & Yokomizo, 2012: 301-302). Since the 1960s, the internationalisation of firms has been studied by many researchers (for example, Hymer, 1960; Penrose, 1960; Vernon, 1966).[2] But these classical theories were focused on the national aspect of the internationalisation process rather than on the firms themselves.[3] In subsequent years, a new internalisation theory of firms attempted to explain the micro- and macro-economic, as well as behavioural aspects of international expansion. However, these theories, developed by Aliber (1970), Knickerbocker (1973), Rugman (1980) and Kojima (2010; 1982), can only explain the investment activities of a particular type of firm.[4]

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[2] The theoretical foundations of FDI theories stemmed from Hymer's theory of industrial organisation (1960), and Vernon's product-cycle theory (1966), which identified firms' main ownership advantages. These studies have significantly contributed to the IB field by explaining companies' growth and providing greater understanding of the motives for investing abroad.

[3] Hymer's (1960) and Vernon's (1966) interpretations of firms' ownership advantages remained less straightforward. In line with the application of their theories, firms in most advanced countries possess competitive advantages, which they exploit through international expansion.

[4] For instance, Aliber's theory (1970) was only concerned with different currency areas in explaining firms' business activities. The 'oligopolistic interaction' or 'follow-my-leader' theory of Knickerbocker (1973) for explaining firms' activities was completely based on the existence of a particular kind of market structure. Furthermore, neither the normative macro-economic theory of Kojima (2010; 1982)

The above-mentioned scholars have played a significant role in the emergence of Dunning's eclectic paradigm (1980; 1977), known as the Ownership, Location and Internalisation (OLI) paradigm, and its predictions and content stem from economic theories (2002a; 2000). In the international business context, the eclectic paradigm has been widely recognised as the leading and most encompassing theory and has been referred to as an analytical framework for the analysis of firms' international expansion and business activities (Cantwell *et al.*, 2010: 568; Demirbag *et al.*, 2010: 212; Rugman & Verbeke, 2001: 160). Dunning's eclectic paradigm (2003; 2001a) explains 'why' firms decide to internationalise (O advantages), 'where' they are more likely to invest (L advantages) and, given O and L advantages, 'how' firms enter the markets (I advantages).

Firms have become the central organisers of economic activity and the driving force of international trade in the global economy (Hart & Prakash, 2000; Jensen, 2006: 24; Strange, 1996: 45). Their FDI is a primary tool for achieving economic growth and for integrating developing economies into the world economy, as well as for gaining political affirmation at the international level (Kalotay, 2010a: 57; Luo *et al.*, 2010: 69). In determining the geography of firms' investments and their success in host-country markets, the importance of political economy factors, including state-business and state-state relations, has been recognised and widely discussed both in the IPE literature (Eden, 1993a; 1993b; Stopford *et al.*, 1991; Strange, 2004; 1992; 1970; Yeung, 2004) and in several IB studies (Berg & Guisinger, 2001; Chen *et al.*, 2010; Cui & Jiang, 2012; Rugman & Verbeke, 1998).

The drivers of firms' internationalisation may be different in emerging economies, given the expectation that the state may play a greater role. It is therefore not totally clear whether Dunning's framework can explain firms, especially those from large developing economies such as Brazil, Russia, China and India, and their internationalisation processes. For instance, the nature of state-business relations and the implications of this relationship for economic development have been highly contentious in IPE studies (Aaron, 1999; Clark & Chan, 1996a; 1996b; McMillan, 1999). The case of the internationalisation of Russian companies has been significantly different (Gammeltoft *et al.*, 2010: 261) and Russia has its own model of corporate

nor the risk diversification approach of Rugman (1980) were capable of easily covering intra-industry or most strategic asset-seeking investments, respectively.

governance,[5] due to the conditions in its unique institutional environment (Guriev *et al.*, 2004; McCarthy & Puffer, 2003; Nikolova & Bhar, 2013). Over time Dunning developed and redefined his paradigm, in which political and economic events affected the configuration of OLI advantages, but its focus remained economic (Dunning, 2001b; 1998a; 1995; 1988). Companies' firm-specific development and home- and host-countries' economic and institutional development as well as social and cultural factors have been considered as necessary determinants in firms' internationalisation (Brouthers, 2002; Drogendijk & Blomkvist, 2013; Narula, 2012; Stoian, 2013). However, IB literature treats internationalisation issues from a business or economic perspective and generally underestimates the political considerations behind firms' internationalisation.

The purpose of this chapter is to set out the theoretical framework for this research study by drawing on Dunning's eclectic paradigm and to show how this project relates to the existing literature in other sub-fields beyond Dunning, especially political economy. My contribution lies in the synthesis of various factors that have rarely been studied together and this helps to complement Dunning's theory. I have developed an interdisciplinary theory by integrating the tenets of the IDP and U-model, state-business and state-state relation factors into Dunning's eclectic theory. In this regard, the first section explores firm-specific determinants, identifies the missing variables, such as macro- and micro-economic factors, and integrates them into the ownership sub-paradigm. The second section studies the locational (L) advantages of the targeted host countries and incorporates the predictions of the IDP (Investment Development Path) and U-model (Uppsala school of internationalisation) into the localisation sub-paradigm. The third section is an analysis of the political economy of investments, such as state-business relations and state-state relations. Given the O and L advantages, as well as the political economy of investments, the fourth section examines the motivations underlying firms' internationalisation. The final section explores and analyses firms' entry choices and strategies based on firm-specific, host-country and political economy determinants. The analytical framework used, or 'interdisciplinary theory' developed in this study, is then explained and illustrated in Figure 3. The concluding section assesses the ideas and contributions to

[5] This includes the roles played by oligarchs (Filippov, 2010; Guriev & Rachinsky, 2005; 2004; McCarthy *et al.*, 2009), and the state itself (Kuznetsov & Murav'ev, 2001; Kuznetsova & Kuznetsov, 1999; Liuhto, 1999a; 1999b; Murav'ev, 2003).

explaining the internationalisation of Russian firms, identifies the issues and presents a further contribution to existing knowledge.

2.2 Firm-specific and home-country determinants

To understand why firms want to internationalise, this section discusses the first component of the interdisciplinary framework, which is based on Dunning's O sub-paradigm, with the intention of identifying whether there are missing variables. Firms' internationalisation or expansion of international production is dependent on the possession of sets of some kind of competitive (ownership) advantages (Dunning, 2001a: 87), such as a trademark or brand, know-how, marketing and management skills, advanced technology, financial capability, market power, market-oriented assets, exclusive knowledge and specialised skills (Blonigen, 2005: 384; Chew *et al.*, 2012: 249). Such resources constitute firms' endogenous advantages (Buckley & Casson, 2002; Peteraf, 1993) and are located in the home country (Dunning, 2000: 167-174).

Firms' ownership advantages are divided into tangible assets: plants, goods, physical infrastructure; and intangible assets: access to markets, technology, organisational capacity, management and knowledge experience (Amit & Schoemaker, 1993: 38-39; Wernerfelt, 1984: 172). Intangible assets are asset-specific advantages, 'O_a'. These are different from transaction cost-minimising advantages, 'O_t' (Dunning & Lundan, 2008: 100-101). O_a are privileged income-generating assets and O_t are transaction-based intangible assets such as access to learning experiences and organisation competencies and the advantages of common governance. Firms in relatively less-developed economies lack the possession of technological competencies and their O_t would involve more management and organisation-based advantages (Kalotay, 2008a: 101; Spigarelli, 2011: 31). Caves (2007) and Dunning (2000) both showed that some firms that are monopolies possessing rich natural resources and being the only firms with access to those resources (Ramamurti, 2009: 404) can better and more easily penetrate foreign markets than the host-country's own firms and always seek to control and protect value-added activities in foreign markets.[6] In this regard, this study explores whether Russian

[6] This is in line with Hymer's (1960) explanation that some firms possess monopolistic advantages over their host-country competitors.

companies have oligopolistic or monopolistic advantages, and if they do, how they use these advantages.

To understand latecomer economies, such as Russia since the 1990s, we may need to extend the OLI (Buckley *et al.*, 2007; Kalotay, 2008b; Marinova *et al.*, 2012) because external factors (macro-level) associated with the home country's economic and institutional development affect firms' ownership advantages, and internal factors (micro-level) associated with the assets and competencies of the firms influence their internationalisation processes (Verma & Brennan, 2013: 137). Dunning's original eclectic paradigm (1980; 1977) therefore remained static, though he later proposed a dynamic approach by reconfiguring OLI with the IDP (1988; 1986; 1981). From the macroeconomic perspective, the IDP explains that the role of the economic and structural development of a country influences companies' development and competencies and intensifies their internationalisation (Andreff, 2002: 378; Dunning, 1997a: 235). Alongside home-country economic development, developing economy firms are influenced by the home-country's informal and formal institutions (Havrylyshyn & van Rooden, 2000), known as the "rules of the game" (North, 1990). Thus, the IDP is extended by incorporating institutional factors, such as transitioning from a planned to a market economy, privatisation, and overall institutional reforms (Dunning & Narula, 1996; McMillan, 1996; Stoian, 2013). In line with the IDP, countries pass through five development stages as a result of successful structural changes and transformation of the economy, affecting firms' ownership advantages, choices and desire to invest abroad (Buckley *et al.*, 2010: 87; Dunning, 2001b: 180-182).

In the first stage, the country might have an inadequate economic infrastructure and suffer from weak economic and political systems and non-existent industrial policies (Dunning, 1997a: 236; Slater, 1996: 17; Spar, 2001: 222).[7] Privatisation and industrial restructuring have been key determinants in emerging economies transitioning to a market economy (Filatotchev *et al.*, 1999: 1014; Jensen, 2002: 973-974; Perotti & van Oijen, 2001). This can be realised only through government interventions and policies (Dunning, 1994: 36) which influence firms' performance and behaviours (Wright *et al.*, 2005).[8] In the second and third stages, the

[7] including low GDP, enforced high tax rates, weak protection of property rights and the banking system (Bulatov, 2001; 1998; Tikhomirov, 1997).

[8] This can also pave the way for some companies to gain monopoly power (Buckley & Ghauri, 2004: 94; Meyer & Jensen, 2005: 129).

companies' O advantages may be increased as a result of government policies which may stimulate firms to look for market- and resource-seeking investments in less developed economies that are at earlier stages of IDP (Dunning & Narula, 1996: 4-5). But in these stages, some firms might also be undertaking strategic asset-seeking to learn and transfer knowledge. In stages four and five, home-country firms start to implement efficiency-seeking or strategic asset-seeking investments abroad and effectively compete with host-country firms (Dunning & Lundan, 2008: 355-356). Firms that emerge and gain experience in economically and institutionally weak economies (Guillén & García-Canal, 2009: 33) could also be classified as having an ownership advantage allowing them to readily and swiftly adapt their strategies to challenging new environments in other emerging economies. Even so, the IDP stages are indicative rather than categorical. It has generally been used in a broad sense as an instrument for analysing the interaction between a country's development and its influence on firms and their performance (Narula & Guimón, 2010: 17).

From the microeconomic perspective, companies must improve and develop their resources and capabilities and be financially, organisationally and technologically strong enough to invest outside the home country (Sauvant, 2005: 662; Vissak & Zhang, 2012: 143). In this respect, the U-model[9] (Johanson & Vahlne, 1990; 1977) explains firms' development in terms of passing through stages that shape firms' behaviours and locational choices. Firms in the initial stages have limited experience and lack knowledge and resources, and the initial growth in their internationalisation takes places in the home market (Johanson & Wiedersheim-Paul, 1975: 306).[10] In the early stages, firms start to look for markets to which to export their products, and to invest in adjacent countries (Batra, 1999: 28; Kalotay, 2005: 6), or to conduct resource- and market-seeking investments. These aspects of the U-model are similar to the tenets of the IDP discussed above. The U-model is more applicable to companies' initial internationalisation than to established companies (Barkema *et al.*, 1996).[11] Thus, as Dunning and Lundan stated (2008: 91-93), the U-model is appropriate for explaining the

[9] The intellectual origins of the U-model rely heavily on Cyert and March's behavioural theory of the firm (1992), and Penrose's theory of the growth of the firm (2009).

[10] Obtaining and increasing ownership advantages, and higher competition in the home market drives firms to seek out and maximise their locational advantages (Boyd, 2003: 40).

[11] Firms with greater international involvement and experience are capable of relocating their headquarters to the new country (Solberg, 2007: 212).

internationalisation of inexperienced and relatively small companies from developing countries.

In a nutshell, taking into consideration significant home-country factors in explaining the internationalisation of Russian firms, Kalotay extended Dunning's OLI and renamed it 'OLIH' ('H' signifying home-country factors) (Kalotay, 2008a: 101-102; 2008b: 59-60; Kalotay & Sulstarova, 2010: 137-138). However, the current study argues that macro-level factors associated with a home-country's economic and institutional development and micro-level factors associated with a firm's development should be incorporated into Dunning's ownership sub-paradigm to make the theory simpler and more applicable to other cases, rather than building a single or restricted theory for one particular case. Therefore, I developed the interdisciplinary framework for this study by incorporating home-country and firm specific factors, as illustrated in Figure 3, to identify various ownership advantages, and in the ownership sub-section of chapters 5-8 analyse how they both shape firms' investment behaviours and allow them to be competitive in foreign markets, and eventually to solidify their international competitiveness.

2.3 Locational determinants of the host country

This section discusses the second component of the interdisciplinary framework, which offers an analysis of firms' decisions on 'where' to locate their investments and explores various economic and non-economic locational determinants. Such determinants – physical proximity or location, export flows, customers, transportation costs, physical infrastructure, the relative costs of production, access to skilled labour, government-imposed incentives or obstacles, access to regional markets, exchange rates and tax structures – are important for the scale, location and timing of investments and offer firms great investment opportunities (Dunning, 1998a: 56; Pain & Welsum, 2003: 110; Panibratov & Verbá, 2011: 72).

A degree of physical proximity is considered necessary for a company's business activities where the costs of transportation can be higher or lower (Dunning, 1998b: 48; Eckert & Rossmeissl, 2011: 15). Territorially specific resources can be available in particular locations where geographical proximities are more markedly efficient (Storper, 2000: 43). In this regard, geographic proximity minimises transportation and communication costs and entry barriers (Dunning, 1997a: 186-187; Shenkar, 2001: 526), while greater distance brings uncertainty about doing business (Dunning, 1997b: 120; Ojala, 2015: 825-826). Physical proximity plays a significant role in transferring knowledge (Audretsch, 2000: 68) and the company's headquarters therefore should get directly involved to carry out its investment projects and operations (Keegan, 1971: 87). Moreover, the proximity of firms' home-based facilities allows them to follow their customers abroad and to perform their international operations (Porter, 1998b: 172). This is also called the 'follow the customer strategy' in host countries where firms have growing export flows and customers (especially corporate customers) (Lisitsyn *et al.*, 2006: 132; Liuhto, 2015: 9; Mihailova & Panibratov, 2012: 176). Trade effects, such as the level of trade between the countries, can be a significant factor, including low trade protection and lower trade costs (Blonigen, 2005: 391-392; Franco *et al.*, 2008: 24). All this can speed up firms' internationalisation. In this regard, this study is designed to examine how geographic location or proximity and trade effects influence firms' locational choices and business strategies and whether Russian firms' decisions vary depending on host countries' attractiveness.

Another line of thought on locational choices is that strong physical infrastructure in the host countries, related to transport and communication, including railways, ports, and electricity and communication networks, is a major determinant that minimises the cost of doing business (Dunning, 1997c: 35; Khadaroo & Seetanah, 2010: 104) because the volume of trade and the cost of transport are highly dependent on a country's infrastructure (Limão & Venables, 2001: 472; Porter, 1998a: 80). As well as infrastructure, taxes and exchange rates are built into firms' investment activities. Corporate tax competitiveness and different tax rates across countries are regarded as having potentially major impacts on firms' choice of investment locations (Blonigen, 2005: 387-390; Hubert & Pain, 2002: 338). Scholars have suggested that firms should also consider exchange rates in emerging economies as an important determinant (Benassy-Quere *et al.*, 2001: 178; Franco *et al.*, 2008: 22). A devaluation of the host country's currency might force them to reduce their investment flows or exit the market (Grosse & Trevino, 2009: 280-282). Given these host-country determinants, I examine the extent to which they have influenced the location choices of Russian firms' and their business operations.

Besides all the factors discussed earlier, there is also a range of significantly important macroeconomic factors related to the host country's economic and institutional development, and non-economic factors related to 'cultural and social factors' or 'psychic distance' that determines firms' decisions about where to invest (Dunning, 1994: 32; Garg & Delios, 2007: 279). Firms invest in neighbouring countries which are in earlier stages of their IDP or less-developed and these countries are considered to be potential targets of their investment strategies aimed at accessing these markets and infrastructures (Mihailova & Panibratov, 2012: 177). There is also a growing trend for national level institutional factors (North, 1990), to determine the location advantages of a host country (L_i), and significantly influence firms' entry strategies and business activities (Dunning, 2001a: 134; Peng *et al.*, 2008: 921). This context, which has received little attention, was later referred to by Dunning (1998b) in his eclectic paradigm, as a "neglected factor".

Host country institutional-related factors, such as political stability, the absence of violence, government effectiveness,[12] regulatory quality, control of corruption, rule of law, property rights, the political dominance of the ruling elite, and tariff policies (Blanchard, 2017: 8; Cuervo-Cazurra & Genc, 2008: 963-966; Meyer *et al.*, 2009: 63) in emerging economies have had to be considered in the context of attracting inward FDI, as they can increase or decrease the costs and/or uncertainty of doing business (Benassy-Quere *et al.*, 2007: 765; Dunning, 2005: 57). Corruption is regarded as an important institutional factor for a host country's locational attractiveness (Grosse & Trevino, 2009: 276-278; Mauro, 1995) and can act as a 'grabbing hand' to lower FDI inflows, or as a 'helping hand'[13] to foster FDI inflows in the host country (Egger & Winner, 2005: 933; Petrou & Thanos, 2014: 445; Wei, 2000: 3). Consequently, I examine how and to what extent choosing a location in which to invest, and FDI inflows, are dependent on the host country's economic and institutional development stages.

Considering firms' expansion to new markets, apart from the host country's economic and institutional factors, some scholars argue that "psychic distance" (Johanson & Vahlne, 2009: 1412) and non-economic factors (Kuznetsov, 2015: 26-27) play a crucial role in their locational choices and success in foreign acquisition and operations (Nummela & Raukko, 2012; Teerikangas & Very, 2006). It should be explained that physical distance is associated with

[12] For example, in the less reformed economies, governments will continue to protect their local firms and markets or impose restrictions through trade and tax policies against foreign investors (Bevan *et al.*, 2004: 47; Lisitsyn *et al.*, 2006: 131; 2005: 12).

[13] Some companies might be in favour of 'speed money' in order to expedite bureaucratic procedures and overcome administrative and regulatory restrictions, and in order to acquire the necessary permits or licences to establish their subsidiaries or other investment projects, and to easily obtain access to publicly funded projects (Aidt, 2003; Bardhan, 1997).

transportation costs (Hutzschenreuter *et al.*, 2014: 43), whereas psychic distance[14] is associated with transaction costs (Buckley *et al.*, 2014: 180). Psychic distance acts as a mediator construct (Brock *et al.*, 2011: 384) and minimises the negative relationship between a foreign market and firms' entry sequences (Ellis, 2008: 365-366). Territorial proximity and psychic distance have together been classified, occasionally, as the "neighbourhood effect" by Russian scholars (Kuznetsov, 2017a: 41; 2008; Kvashnin, 2016: 222).

Cultural differences have profound implications on firms' entry strategies across countries (Chang & Taylor, 1999: 545; Kogut & Singh, 1988: 429) and can seriously impede the achievement of integration benefits during mergers and acquisitions (M&As) in the host country (Stahl & Voigt, 2008: 162). So in line with the U-model, it is suggested that firms should start by entering nearby and familiar markets and then gradually move to new, more distant and unfamiliar markets (Johanson & Vahlne, 2003: 90; Kuznetsov, 2011a: 40; Kuznetsov & Heinrich, 2008: 4). The U-model was developed by Swedish scholars over time (Hallen & Wiedersheim-Paul, 1979; Johanson & Vahlne, 2006; 1990) as an alternative to Dunning's eclectic paradigm (2000; 1995) to explain companies' internationalisation with a focus on the firm level (Vahlne & Johanson, 2013: 190). However, the U-model only deals with the business side of firms activities (*ibid.*: 205). Unlike the eclectic paradigm, the U-model considers a high degree of uncertainty as a part of management, not the results of complex and rapid changes in business environments. National location advantage and choice of entry mode are less important, but firms' capabilities, management, and choice of strategic partner are crucial for the U-model (*ibid.*: 203-204). The works of Cantwell *et al.* (2010), Dunning and Lundan (2008) and Peng *et al.* (2008) later led Vahlne and Johanson (2014) to understand the importance of institutions, especially in the context of emerging economies.

In conclusion, the aim of this study is to explore how economic factors in host countries, together with their economic and institutional development level, psychic distance and other locational advantages determine firms' decisions about where to invest or not to invest and their strategic entry choices during the implementation of investments and post-entry

[14] Common culture, shared language, a similar education system, similar political and economic systems, colonial links or historical ties, similar industrial and institutional levels of development, personal links, similarity of business laws and common business practices are all dimensions of psychic distance (Dow & Karunaratna, 2006; Ghemawat, 2001; Johanson & Wiedersheim-Paul, 1975: 307-308; Ojala, 2015: 827-828).

performance (Brouthers, 2002). Taking all this into account, these locational determinants have been incorporated into the localisation sub-paradigm shown in Figure 3. The extent to which variation across host countries' economic and institutional development and the similarity between home- and host-country institutional conditions and other non-economic factors affect firms' business behaviours, strategies and performance, and also the distribution of their investments will be explored in the localisation sub-section of chapters 5-8. I also examine whether firms from various or the same industries within the same host-country market can be affected differently.

2.4 Political economy of investments

The purpose of this section is to identify political economy variables, including various forms of state-business and state-state relations, and to complement Dunning's eclectic paradigm. As discussed earlier, a government plays a crucial role in the transformation or modernisation of the market (Steunenberg & Blommestein, 1994: 2), the creation of industries and the economic development of a country and its firms, particularly in the early stages (Ring *et al.*, 2005), as well as shaping its firms' strategies and investment activities by introducing and enforcing laws and regulations (Bai *et al.*, 2006: 353; Wang *et al.*, 2012a: 428). However, another angle on the explanation of firms' investments, especially from large developing economies, has focused on state-business relations by exploring how and why firms' investment decisions have been shaped by home-country government interventions (Korten, 2015: 144; Quer *et al.*, 2012a: 270) and whether the firms are fulfilling home-country political objectives (Gilpin, 1987: 241; Shleifer & Vishny, 1994: 997-998).

International economy was dominated by mercantilism during the eighteenth century when countries were trying to maximise their exports (Lake, 2000: 128). However, modern states are highly concerned about the outcomes of economic activities for economic and political gains (Gilpin, 2001: 80). Political objectives have been part of national economic policy as described by neomercantilism where a state uses regulation, assistance, and protection of its industries to attempt to foster its economic and industrial development as well as political interests (Jessen, 2016: 42; Khanna & Yafeh, 2007: 352), to increase its international competitiveness and to obtain the "commanding heights" of international economy (Gilpin, 2001: 157). MNCs, especially from large developing economies (Kumar, 1982: 397; Pedersen, 2008: 15), have become influential actors in international relations and political economy (Phelps, 2004: 342; Strange, 1992: 2). As some IPE scholars have argued, they have greatly changed the functioning and structure of the international economy (Gilpin, 2001: 290) and become more powerful vis-à-vis states (Falkner, 2009: 16). In the 1990s these changes were viewed as "state retreat" (Strange, 1996) and "power shift" (Mathews, 1997). Taking all this into account, this section explores state-business and state-state relations in firms' internationalisation processes and their roles in interstate relations.

2.4.1 State-Business Relations

State-business relations are seen as a significant determinant in emerging economies and can take the form of formal and informal interactions which shape a country's economic and political policies as well as its firms' strategies and objectives (Faccio, 2006: 370-371; Shi *et al.*, 2014: 58-59), and how, when, and where they internationalise (Marinova *et al.*, 2012: 234; Tulder, 2010: 64). Scholars have argued that the state's role is crucial for developed and developing economy firms, but the role of the state and its developmental policies from developing economies,[15] such as China and Russia, and its intervention goes far beyond the encouragement of industrial development and firms' investments (Rodrik, 1997: 412; Sáez & Chang, 2009: 266), especially in particular industries that are considered strategic for the country's economy (Wandel, 2011: 406; Yiu *et al.*, 2007b: 1557), to make firms comply with the state's goals (Marinov & Marinova, 2014: 4). Developmental states have created various direct or indirect forms of bringing firms and governments together (Schneider, 2015: 40). These mechanisms are likely to be reflected in firms' corporate governance, and the expansion, timing and location of FDI (Nolan, 2001a: 14-24; 2001b: 8-15; Pinto *et al.*, 2017: 534-537), hence making it necessary to go beyond Dunning's account of narrowly economic OLI factors. The following sub-sections explore various dimensions of this issue.

Ownership structure

Ownership structure affects firms' behaviour and performance (Goldeng *et al.*, 2008), and state ownership,[16] including majority or fully controlling stakes and a golden or minority shares, plays a big role in emerging economies. In IB studies, controlling owners are viewed as crucial players in firms' investment activities, and as key shareholders through whom the state can

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[15] The state and its agencies in developing economies are also known as 'institutional entrepreneurs' (Marinova *et al.*, 2012: 233).

[16] It is also defined as a unique form of interdependence between a state and its firms (Xia *et al.*, 2014: 1344).

influence firms' strategic orientations and decision making (Beule & Bulcke, 2010: 281; Zou & Adams, 2008: 1157). Majority owned-firms in certain industries that are regarded as strategic to a country's economy can also be indirectly controlled by states through various fully or partially state-owned enterprises (Abramov *et al.*, 2017a: 5; 2017b: 153; Cuervo-Cazurra *et al.*, 2014: 924). They might be managed and used according to the state's political and economic objectives (Lin *et al.*, 1998: 425-426; Shleifer, 1998: 141-143), and their strategies and objectives have to abide by the state's requisites (Duanmu, 2012: 65; Yiu *et al.*, 2007b: 1557) which may entice them to invest in somewhere (Tsui-Auch & Lee, 2003: 512). Large firms of this sort are defined as "national champions" (Casanova & Kassum, 2013: 13; Choudhury & Khanna, 2014: 946; Vernon, 1979: 8) and in return receive strong and privileged government support (Pan *et al.*, 2014: 1030-1032; Wang *et al.*, 2012b: 659; Zhao, 2019: 28). States can also hold a 'golden' share, granting them special management rights that ensure they retain continuous control (Buck, 2003: 309; Frye & Iwasaki, 2011: 644). As a minority shareholder,[17] a state can delegate management through several direct and indirect channels to the private sector, but retain cash flow and veto power rights over strategic decisions (Musacchio *et al.*, 2015: 116); it also tends to use its ownership rights for its own political objectives (Vaaler & Schrage, 2009: 623).

According to one group of scholars, firms with state ownership are more likely to expand abroad and state ownership may have a strong positive impact on their investment and business activities in the host countries, offsetting their ownership disadvantages during internationalisation (Hong *et al.*, 2015: 49-50; Inoue *et al.*, 2013: 1795). They may also perform better than their private counterparts and have higher capabilities because of their larger sizes and possession of more resources, as well as long-term government support (Liu *et al.*, 2009: 1125; Pelikan, 1993). This allows them to be more resistant to macroeconomic and political risks, enhances their bargaining power in negotiation with foreign partners and countries, allowing them to invest and operate successfully in politically unstable markets, and ensures their survival (Hu & Cui, 2014: 752; Knutsen *et al.*, 2011: 7; O'Neill, 2014: 147). Governments in majority state-owned companies can also improve corporate governance by advising firms to recruit more independent and international board members, which would also enhance their financial reporting (Musacchio *et al.*, 2015: 115).

[17] also defined as a "residual state ownership" (Vaaler & Schrage, 2009).

However, despite the positive impact of state ownership, another group of scholars has claimed that state ownership can have a negative impact on firms and their performance (Fetscherin & Gugler, 2010: 13; Goldstein, 2009: 110; Meyer *et al.*, 2014: 1024). They say that this is because politicians tend to use firms, especially in resource-based industries (Zhang *et al.*, 2011: 230), to gain political goals. Companies of this type are described as "obedient servant[s] of government" (He & Lyles, 2008: 486) and defined as government assets (Hafsi *et al.*, 1987: 715). Therefore, state ownership in combination with a home government's political agenda may provoke negative reactions in host countries (Globerman & Shapiro, 2009: 164; Li *et al.*, 2014: 991) and as a result may be challenged by host countries' negative perceptions (Quer *et al.*, 2012b: 1090). Consequently, this study examines the role of state ownership in Russian resource- and non-resource-based firms' investment and business activities in the South Caucasus emerging economies and explores whether this varies from industry to industry or from firm to firm.

Management

Another form of state influence can be realised through board members and top management. In large state-owned companies, these are often appointed and swapped by the state (Guo *et al.*, 2014: 289; Morck *et al.*, 2008: 343-344) or can have a political relationship with the government (Fredholm, 2005: 9; Liang *et al.*, 2015: 229-235). Making political interventions through "trusted individuals" (Lioukas *et al.*, 1993: 648-649) or appointed managers (Coleman, 1996: 43; Knutsen *et al.*, 2011: 4) makes it easier for the state to internalise its control over firms and influence their decision-making behaviour. This leads to the dominance of a political orientation or combines both economic and political goals in state-owned firms' business and investment activities (Lioukas *et al.*, 1993: 659; Zif, 1983: 37-39). This may give companies a competitive advantage, with their losses covered by the government (Hennart *et al.*, 2017: 520), but in return they are required to fulfil government political objectives (Le & O'Brien, 2010: 1299) and follow state guidance when investing (Liang *et al.*, 2015: 224). Schneider (2015: 17) argued that for firms it can be worthwhile to have meetings with state officials (and even presidents, if possible), on a regular basis (Rodrik, 2011: 144-148; Rutland, 2001: 25), both to discuss their investment or business plans and to hear the president's comments and policy directions.[18] This provides firms with favourable government incentives and economic

[18] Moreover, the president may appoint businesspeople directly to the cabinet, who can then also participate in forming and shaping government policies and negotiations (Schneider, 2015: 60). Such

policies, facilitates their expansion and helps them to strengthen their international presence (Cui & Jiang, 2010: 761; Puffer *et al.*, 2007: 11). Accordingly, the political motivations behind firms' investment may outweigh their commercial motivations (Hong & Sun, 2006: 615). Considering all these, I explore how often Russian firms meet with the president, what the benefits of meeting are for them, and analyse whether there is variation across industries or firms.

Networks/personal connections

Networks are a more informal kind form of state influence. It is believed that state-owned companies are more greatly affected by the state intervention than private ones and the managers of state-owned companies are appointed for their ability to get along with government and government officials, fulfil government interests and lobby for assistance. Unlike them, private companies' managers are appointed for their capability to run firms effectively and efficiently (Barberis *et al.*, 1996: 765). But both types of companies and their CEOs consider the role of the state and its policy as significant and able to influence firms through various other mechanisms regardless of their affiliation (Frynas *et al.*, 2006: 321; Lachman, 1985: 676; Wang *et al.*, 2012b: 661). While state-owned companies are dependent on state support through state ownership, private companies or politically connected firms use their political networks to access key resources for their internationalisation and development (Seth & Yaprak, 2012: 34-35).

Given firms' inadequate resources, experience and lack of technologies, government helps them to access those resources (Boyd & Brenton, 2003: 54-55; Child & Rodrigues, 2005: 385; Khanna & Palepu, 1999: 298). This could happen only through direct or indirect government involvement (Kim *et al.*, 2004: 32), including CEOs' meetings with the president to access policymaking, especially at the initial stage of firms' internationalisation (Markus, 2007: 285). Therefore, managers recognise the importance of political connections at home when investing (Black *et al.*, 2000: 1746-1749; Liang *et al.*, 2015: 237). These politically linked firms (Faccio *et al.*, 2006: 2600) or Kremlin-friendly private investors in Russia (Milov *et al.*, 2006: 301) can directly talk to presidents or ministers and are more likely to appoint other politically connected people (Liu *et al.*, 2013: 46; Zou & Adams, 2008: 1152). This is often referred as "siloviki capitalism" in Russia (Puffer & McCarthy, 2007: 6) where executive managers of both state-

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political ties are developed and evolved through the mechanisms of career rotation and capital allocation (Shi *et al.,* 2014: 60-61).

and privately-owned companies occupy high governmental positions (Åslund, 2006: 301; Claessens *et al.*, 2000: 109; Hanson, 2011: 119; Orttung, 2009: 63-64).

Firms, especially private firms, rely heavily on personal or informal ties rather than business networks (Hennart *et al.*, 2017: 530; Luo, 2001: 407-408).[19] Close informal ties of this sort between states and firms are a feature of large developing economies, such as Russian oligarchic (Gustafson, 1999; Rutland, 2001: 19) and Chinese network capitalism (Lin & Milhaupt, 2013: 701; Xing & Shaw, 2013: 95). This is an essential instrument to control and influence firms even if they are transformed into private enterprises (Guliyev & Akhrarkhodjaeva, 2009: 3180; Yiu *et al.*, 2007b: 1562), as they receive more and greater preferential treatment from the state, such as tax reductions, subsidies and credit (Hellman *et al.*, 2003; Khwaja & Mian, 2005: 1372-1373). Moreover, politically connected people may still hold multiple positions in government agencies and other companies (Keister, 1998: 410; Windolf & Beyer, 1996: 223-225). This type of corporate network (Windolf & Beyer, 1996) or managerial elite (Pettigrew, 1992) is usually described as interlocking directorates (Cheng & Kreinin, 1996). Particularly in oil, gas and other resource-based industries, firms usually have a government relations division to talk directly with the state (Grant, 1993: 87), because these industries are substantially affected by various government policies and regulations (*ibid.*: 90).

All these types of state-business relationships have been used by governments to influence firms and their business and investment activities, and to provide governments with "a free hand to decide what and how" firms should do (Hafsi *et al.*, 1987: 717). On the one hand, tight personal connections between the state and business leaders may give firms competitive advantages that are essential for their success (Aharoni, 2009: 361; Hoskisson *et al.*, 2000: 257), boost their performance, and influence their strategic decisions and choices consistent with government political objectives (Okhmatovskiy, 2010: 1025-1026). On the other hand, this may lead firms to make poor economic decisions, as their motivations tend to be politically rather than economically driven (Bremmer, 2009). So this research examines how personal relations with the government or government officials have influenced the internationalisation

[19] This is described as "blat" in Russia (Peng & Luo, 2000: 487-488) and was created during the Soviet era (Huber & Wörgötter, 1998; Okhmatovskiy, 2010: 1022), while in China these are "red hat" companies (Zhang, 2016: 20) or "guanxi" (Zhang & Zhang, 2006).

of Russian firms in the South Caucasus emerging markets, and identifies whether their motivations are politically or commercially driven.

Financial dependence

State control or influence over both private and state-owned companies can be exercised indirectly through state-owned banks (Chung, 2001: 730; Sáez & Chang, 2009: 275-276) which play a crucial role in channelling financial resources into strategic industries (Kim *et al.*, 2004: 32). For instance, the state is commonly a critical player in the financial industry of large developing economies (Dinç, 2005: 453; Rui *et al.*, 2010: 190-191), such as Russia (Chen *et al.*, 2010: 1508-1509; Filippov, 2013: 199), Brazil (Casanova & Kassum, 2013: 17-18; Hoskisson *et al.*, 2013: 1308), China and India (Rasiah *et al.*, 2010: 350), where both state-owned and private firms have loan dependence on state-owned financial institutions (Goto, 1982: 57; Leibenstein, 1968: 79-80).

Several scholars (Globerman & Shapiro, 2009: 171; Le & O'Brien, 2010: 1302) have argued that states can act as a guarantor of state-owned firms' debt, rescue them when they are financially distressed, and finance their investments.[20] Alongside state-owned companies, private firms, especially in resource-based industries (Morck *et al.*, 2008: 348; Rugman, 2009: 58), also benefit from states' financial assistance, when they are in financial trouble (Dinç, 2005: 456; Filippov, 2013: 206). The state helps them as long as they are strategically important and successfully implement government goals (García-Canal & Guillén, 2008: 1102; Kuznetsov, 2011b: 7). Moreover, financial companies with distinctive state support have invested and established their presence to support and facilitate the expansion of resource-based and manufacturing companies (Gu *et al.*, 2016: 25; Rui & Yip, 2008: 216-217; Strange, 2004: 79).[21]

By employing financial tools or taking advantage of firms' financial dependence, states can affect their locational choices and investment strategies during the internationalisation or acquisition process (Fleury & Fleury, 2009: 235; Hillman & Hitt, 1999: 825-826; Murtha & Lenway, 1994: 115). Having close ties with or loyalty to the state brings favourable credits

[20] This is often defined as a "soft budget constraint" (Kornai *et al.*, 2003; Vahabi, 2012).

[21] A similar strategy has also been followed by telecommunications and insurance companies to serve the interests of the home country's resource-based companies abroad (Collins, 2013: 109-110; Goldstein, 2009: 99).

from state-owned banks (Claessens *et al.*, 2008; Pananond, 2009: 340) and has been necessary for firms' survival and profitability (Fisman, 2001: 1097; Peng *et al.*, 2005: 624). This allows them to be more competitive in the global economy, speed up the process (Wang, 2002: 204) and engage more in M&As (Lunding, 2006: 7). However, due to their dependence on crucial government resources, large companies may take part in political strategies (Hillman & Wan, 2005: 326), pursue losing commercial practices (Yiu *et al.*, 2005: 200) and their investments and business activities can be perceived as part of home country foreign policies (Huang *et al.*, 2017: 177-178). Taking all these into account, in this study I examine how firms' financial dependence on the Russian state and its financial institutions have influenced their business and investment activities.

Government regulations and policies

Governments possess several regulatory instruments and macro-level policies, including income taxation and tax rebates, and investment guidelines that allow them to target firms in strategic industries (Finchelstein, 2017: 580; Ramaswamy *et al.*, 2002: 348), to control and influence the firms and their internationalisation strategies (Hong *et al.*, 2015: 48; Zhang *et al.*, 2011: 229). These can also help firms to involve in M&As, especially in strategic assets (Deng, 2009: 76-77). Firms' major transactions or investment projects may also require government approval (Collins, 2013: 72; Fetscherin & Gugler, 2010: 13). These instruments may be used as part of an economic and political strategy (Dicken, 2015: 188) or to bring firms' strategies into line with national strategic goals (Kalotay, 2010b: 128). In large developing economies, assets in the oil, gas, electricity, financial, transport and telecommunication industries are usually owned by the state and often controlled by state-owned entities or agencies, namely the Ministry of State Property, such as in China and Russia (Buck, 2003: 309; Li *et al.*, 2006: 559; Okhmatovskiy, 2010: 1024).

Emerging economy governments provide various industry and firm-specific investment programmes or guidelines for their firms, both to serve the countries' economic developmental objectives (Zhang, 2003: 62) and to advance firms' global capabilities (Blanchard, 2011: 96-97; Rosen & Hanemann, 2009: 20-21). Through "go global" policies in China (Hoskisson *et al.*, 2013: 1306; Wang *et al.*, 2012a: 429) and a set of firm or industry specific investment programmes in Russia (Fredholm, 2005: 3; Marinova *et al.*, 2012: 243-244) both governments have encouraged and informed their firms about investment opportunities, and investment and political risks in target host countries (Lane, 2001: 110; Xue & Han, 2010: 319-321; Yamakawa *et al.*, 2008: 71). Russia has also formulated an 'investments-for-debts' scheme with its firms in some countries (Barnes, 2003: 175; Hashim, 2010: 268; Kuznetsov, 2011b: 5). Because of this mechanism, not only can firms identify where, in which industry, and how, to invest (Lu *et al.*, 2014: 435) but the spatial and sectoral distribution of their investments can be reflected in government's political and economic considerations (Wang, 2002: 196).

Both private and state-owned firms have a different sense of loyalty to, and range of interests in their states (Mattlin & Wigell, 2016: 131). However, if they violate the government's political objectives, they will receive a lot of government pressure, will hardly be able to resist implemented or altered regulations, and eventually lose their assets (like Yukos in Russia, for example, which was acting against government strategies and policies) (McCarthy *et al.*, 2009: 174; Puffer & McCarthy, 2007: 6). Moreover, in today's developed economies such as South Korea, the development of the private sector has almost entirely relied on direct state support and regulations. Firms would not flourish if they were not loyal to their government (Buğra, 1994: 7-8). So this research explores how firms have been directed by their government, as well as where and which industries have been selected for the implementation of investments, and studies whether this varies from industry to industry or firm to firm.

Ministries and Business Associations

Ministries such as the Ministry of Commerce and Industry, the Ministry of Foreign Affairs, embassies, and other state agencies have important functions in firms' internationalisation and investment activities and have power to influence firms (Gu *et al.*, 2016: 28; Warner *et al.*, 2004: 340). They explore and report on the economic and political conditions of target markets, provide solutions, evaluate and assess firms' investment projects (Wang, 2002: 195), and facilitate firms' expansion directly by arranging bilateral and multilateral meetings with host country governments (Luo *et al.*, 2010: 72; Xue & Han, 2010: 308-309).[22] Besides this, firms may have individually signed strategic contracts with ministries (Kalotay, 2010b: 128). This type of indirect government support for large firms, especially in strategic industries, helps them engage more in acquisitions and to negotiate their investment projects in host countries (Voss *et al.*, 2014: 166). Through this mechanism a government can also act as "a supplier of

[22] These state agencies also draft specific investment policies and regulations, ratify large investment projects and coordinate loan and funding schemes (Collins, 2013: 71; Wong & Chan, 2003: 281).

information” (Aggarwal & Agmon, 1990: 170) and its goals can be reflected in firms’ investment strategies (Tepavcevic, 2015: 42-43).

Through their policies, governments in large developing economies actively encourage public-private partnership and set up interactions between private firms, state-owned firms, banks and other government agencies (Schneider, 2009: 189). Business associations are therefore perceived as an effective institutional organisation to build and stimulate public-private and intra-firm partnership (Cammett, 2007: 1890-1892; Markus, 2007: 283). They bring governments and firms together, maintain continuous close relations and solve distributional issues and trade negotiations, as well as implementing large scale investment and outreach programs (Schneider, 2015: 48).[23] Through a system of “collective representation” of all firms (Yakovlev, 2006: 1043), states can consult with “national champions” (Markus, 2007: 289) and actively intervene in firms’ management to make sure that they conform to government guidelines (Hennart *et al.*, 2017: 519). For example, the Russian Union of Industrialists and Entrepreneurs (RSPP) in Russia (Barnes, 2003: 155; Marinova *et al.*, 2012: 251), and the National Industry Confederation in Brazil (Pedersen, 2008: 150) are active players in the provision of communication channels with the president, the Ministry of Finance, the Ministry of Economic Development and Trade, the Committee of Customs and various other state bodies. Firms can also submit their proposals and documents to them (Markus, 2007: 284-289). The lobbying activities of state-supported business associations aim to fulfil long-term economic and political objectives (Guriev & Rachinsky, 2005: 145). Because of these direct and indirect political connections, firms are able to operate and do business in unstable regions (Fisman & Khanna, 2004: 619).

As discussed earlier, governments from large developing economies have direct and indirect measures, such including ownership structure, management, networks/personal connections, finance, regulations, policies, ministries, embassies and business associations, to control firms and influence their investment activities (Alter, 1994: 119; Borghoff, 2013: 111; Demidova & Yakovlev, 2012: 582; Khanna *et al.*, 2005: 73; Peng *et al.*, 2004: 1111; Stan *et al.*, 2014: 480-481; Yiu *et al.*, 2007a: 524). There is a mixture of political and economic motivation behind these mechanisms or interventions (Bertoni, *et al.*, 2013: 75; Child & Tse, 2001: 16). State

[23] Business associations can also provide accurate information on investment opportunities and direct or indirect access to infrastructure, various government incentives and intergovernmental meetings (Calì & Sen, 2011: 1544-1545; Doner & Schneider, 2000: 271-272; Panibratov, 2012: 181).

intervention has boosted firms' development and helped them to speed up their internationalisation processes (P. Sun *et al.*, 2015: 1041-1043; S. L. Sun *et al.*, 2015: 235-236), and in return they must comply with the state objectives (Filippov, 2014: 229; Ramasamy *et al.*, 2012: 19-20). The state's role and the various mechanisms applied to its firms seem to be important determinants of their internationalisation processes (Taylor & Nölke, 2010: 163; Zhang, 2003: 117) and indicate that the political economy perspective is helpful to understand and explain emerging economy firms and their internationalisation. I therefore incorporate the state-business relations factor into Dunning's OLI paradigm and in the state-business relations sub-section of chapters 5-8 examine how various types of state-business relationship has been important in Russian firms' internationalisation and their investment activities and business operations, whether there is the same level of support for both private and state-owned companies or whether there is variation across industries or firms, and the extent to which the role of state ownership or involvement influences the willingness of the host country to accept the FDI.

However, firms, especially private firms, also intend to establish or have effective relations with their governments (Rugman, 2010: 77; 1993: 85) aimed at leveraging their ownership advantages, facilitating their internationalisation to catch up with their counterparts (Li & Zhou, 2010: 858; Zhang, 2014: 71), boosting their market share and maximising their sales growth and profit (Du & Girma, 2010: 543; Shaffer & Hillman, 2000: 187) through the strategy of "wearing a red hat" (Li *et al.*, 2006: 562). Political connections are a source of advantage (Cuervo-Cazurra, 2008: 149) making firms more likely to pursue M&A opportunities, maximise profits (Yakovlev, 2006: 1034) and build "empires" through investments (Liu *et al.*, 2013: 43). Taking all this into account, the political economy perspective is limited in its ability to explain why firms want to develop their relationships with governments which intervene only minimally in their business activities.

There is an exchange relationship between governments and large firms (Grant, 1993: 47; Sauvant, 2012: 27)[24] which sometimes makes it difficult to separate firms' corporate interests from state interests (Christie, 2009: 11; Grigoriev & Belova, 2009: 78; Stulberg, 2005: 14). As "corporate lobbyists" (Barron & Hultén, 2014; Frye, 2002: 1017-1018; Jensen, 2001) firms are influenced by the state, and thus strive to use the political process in their favour by lobbying their governments (Clegg *et al.*, 2016: 975; Hillman *et al.*, 1999: 67-71; Jensen, 2006: 78-79)

[24] or "big empires" (Strange, 2004: 83).

such as by signing bilateral investment agreements with host countries and strengthening their influence and bargaining power (Ramamurti, 2001: 37). In return they receive greater degrees of economic and political protection (Aharoni, 2009: 385). Moreover, MNCs can play an active role as "diplomats"[25] (Stopford, 1994: 64; Strange, 1992: 10) in building and maintaining or moderating political and economic relations between the home and host countries or searching for allies (Kubicek, 2013: 174; Kumar, 1982: 417-178; Young & Hood, 2003: 249). Given firms' important role within various economies and international economic relations, they are also described as an "official agent in bilateral trade arrangements" (Vernon, 1979: 7) and a "useful ambassadorial act of peace" (Dunning & Lundan, 2008: 639). They can explore investment opportunities through governmental meetings or meetings with government officials in target markets (Beule & Bulcke, 2010: 294) and also fulfil the home government's tasks as 'watchdogs' in projects (Vahtra, 2006: 20; Vahtra & Liuhto, 2004: 41). I explore this exchange relationship between the Russian state and its firms in the political economy of investments section of chapters 5-8 and strive to find out whether this is more significant in resource-based or non-resource-based industries, or this varies from firm to firm.

2.4.2 State-State Relations

Besides state-business relations, several scholars have argued that the dimension of interstate political and economic relations is another important determinant of firms' business and investment decisions (Buckley *et al.*, 2014: 180-183; Ramamurti, 2001: 28; Rasiah *et al.*, 2010: 347-351). One of the aims of this research is therefore to explore the significance of state-state relations, identify whether firms have political or economic driven investment or business motivations and find whether this varies from industry to industry or from company to company. According to some scholars (Ramasamy *et al.*, 2012: 24) state-owned firms rely more on state-state relationships as the basis of their investment decisions and are attracted to countries with natural resources and weak political systems, unlike their private counterparts. However, another group of scholars (Kuznetsov, 2007: 21; Lisitsyn *et al.*, 2006: 132; 2005: 14; Panibratov, 2012: 175) has argued that political and economic relations are also an important determinant in private and non-resource-based companies' decisions to enter markets. Kuznetsov (2010a: 9) defined this as an additional factor of the "neighbourhood effect". Preferential trade or investment and other various intergovernmental agreements or

[25] or "political authorities" (Strange, 1996: 45), or "state advisors" (Lioukas *et al.*, 1993: 650) or "direct representatives" of their home countries (Guthrie, 1997: 1291).

meetings can directly help firms expand into host countries, when the home country can negotiate with the host country for the protection of its firms' investments (Cuervo-Cazurra *et al.*, 2014: 933; Xue & Han, 2010: 319). Firms use this political advantage or political distance, including host countries' strong political and economic dependence on the home country, in their favour when locating their investments in host countries (Conti *et al.*, 2016: 1983; Liuhto & Vahtra, 2007: 139). If the influence of this factor is significant for both resource- and non-resource-based firms, it will be examined in chapters 5-8, which are grouped according to whether industry is resource- or non-resource-based, to compare both industries and firms.

IPE scholars have found that interstate security relations, including security alliances and military conflicts, affect investing firms and their investment decision-making (Pandya, 2016: 464-466; Stopford *et al.*, 1991: 50-51). Scholars in political science (Gowa & Mansfield, 1993; Mansfield & Bronson, 1997) and IB (Li & Vashchilko, 2010; Vahtra, 2005: 15) have argued that security alliances between home and host countries further strengthen relationships and common interests between countries and also promote trade relations and investment flows. This indicates an extra attractiveness of host countries (Li & Vashchilko, 2010: 769). On the one hand interstate conflict or political instability often brings issues of transportation, communication, market functioning, delays and direct or indirect damages to firms' assets and investment flows (Jensen, 2008; Kheifets, 2008: 74; Schneider & Frey, 1985). Thus, when making location decisions, firms examine how interstate relations may influence their investment activities and adjust their decisions and strategies accordingly by considering various political issues. On the other hand, it is possible that this might have the opposite effect on investment flows (Kononenko, 2011: 7; Li & Vashchilko, 2010: 766) and the distribution of firms' investments can be varied, according to both economic and political factors in host countries (Schneider & Frey, 1985). However, IB, IR and IPE scholars do not provide in-depth analyses of how interstate political relations, including military conflicts and security alliances, influence firms and their investment flows and distribution across host countries, and whether there is variation across industries and firms.

FDI is considered more important and influential than trade and can be used as a strategic weapon or a necessary supplement to a country's foreign policy (Dicken, 2015: 230) for a variety of motives or reasons: to gain access to foreign markets, to take over or control strategic assets (Buckley, 1998: 14, 22; Gilpin, 1987: 76-77), or to isolate host countries from others and make them dependent on the home country (Wang, 2002: 205). As scholars have argued, the foreign expansion of large developing economy firms, such as those from Brazil, China and

Russia, may fortify the general lines of a home country's foreign policy (Finchelstein, 2017: 584-586; Hurrell, 2013: 195-196; Wu & De Wei, 2014: 784). They can become political actors by strengthening both the economic and political influence of the home country (Hong & Sun, 2006: 619; Soysa, 2003: 40; Walter & Sen, 2009: 208), and their investment activities can be perceived as a "commercial instrument of achieving political aims" (Feklyunina, 2012: 454). Some host countries may regard home country firms, such as those from China and Russia, as a tool of imperial expansion that exploits the host countries and their economies (Fieldhouse, 2000: 165; Strange, 1996: 50).

In large developing economies, such as China and Russia, strategic considerations influence government diplomacies in resource-based industries, particularly oil and gas, and these generate great political benefit (Chen, 2008; Kolstad & Wiig, 2012: 29; Lane, 2001; Pleines, 2009). It is quite often argued that firms' internationalisation strategies and investments, particularly in the energy industry in Russia, are driven largely by home-country foreign policy (Durnev, 2010: 92; Kalotay, 2010b: 127-128; Tepavcevic, 2015: 33), or tools of the home-country foreign policy (Heinrich, 2003; Liuhto, 2010; Vahtra, 2009a: 160; 2006; 2005; Zhuplev, 2012: 208). In addition to IB scholars, scholars in IR (Bahgat, 2010; Balmaceda, 2008; Balzer, 2005; Cohen, 2009; Hedenskog & Larsson, 2007; Huotari, 2011; Kazantsev, 2010; Monaghan, 2007; Newnham, 2011; Orttung, 2006; Wenger *et al.*, 2006) quite often consider state-owned companies, especially in the energy sector, as tools that serve Russia's foreign policy. In contrast, other IB scholars (Filippov, 2008; Kalotay & Sulstarova, 2010; Kuznetsov, 2011b; 2010a; 2007; Panibratov & Kalotay, 2009) argue that business motives are the main drivers behind the Russian state-owned energy companies, although they do not dismiss Russian state-business interests. However, these studies (especially those by scholars from the IR field), are predominantly focused on the oil and gas sectors. They often generalise and put all state-owned energy companies in the same basket without providing facts or specific investments or business activities, count all Russian state interventions in its firms as politically motivated, and do not show whether there is variation between the oil and gas as well as the electricity industries or firms. For example, Johnson (2004: 461) claimed that for Russia the strategic importance of natural gas plays a much greater role than oil, and Kropatcheva (2011: 556) added that the oil business or market is more flexible than gas, which has more political influence than oil.

Unlike them, other scholars (Adams, 1998: 31-32; Becker, 2000; Guliyev & Akhrarkhodjaeva, 2009: 3180) claimed that despite being private some firms can be pretty much under state control, and that the strategic interests of Russian state and firms can be concurrent. Scholars have argued that a government's relations with firms and its support or intervention in their investment and business activities vary from industry to industry and firm to firm (Blanchard, 2011: 103; Peng & Luo, 2000: 488-489; Ring *et al.*, 1990: 141; Rodrik, 1997: 430; Wang *et al.*, 2012b: 655-658). Abdelal (2015: 559) and Musacchio *et al.* (2015: 122) have underlined that state ownership may not be a good explanation for firms' behaviour. For example, a fully private company may serve home country policies, while a state-owned firm may be busy with profit maximisation. Firms of this type, and their investment activities are classified as 'patriots' (state-owned firms with political objectives which outweigh business rationale), 'conformers' (private firms whose operations frequently conform to the state's official policies) and 'balancers' (firms, usually in metallurgical industry, often balance their business interests with those of the government) (Liuhto & Vahtra, 2007; Vahtra & Liuhto, 2004). One of the purposes of the current study is therefore to explore state-business relations in the business activities of firms from different industries, identifying whether they are politically or commercially driven and finding variations across sectors and firms.

Another angle on this debate suggests that as part of their foreign policy objectives states strive and compete to have more wealth creation instruments within, and power over other, territories, by supporting firms and their foreign business activities. In the geo-economic explanation,[26] there is the possibility of a strong positive interaction "between politically weighty businesses in need of state support on the world economic scene", or the state "seeking to guide large companies for their own geoeconomic purposes, or even selecting them as their chosen instrument" (Bilgin, 2011: 119; Luttwak, 1990: 20). Against the background of corporate strategies this is one of the foreign policy practices adopted by big emerging economies, such as Russia and China (Cooper, 2004; Drezner, 2009; Kennedy, 2010; Kropatcheva, 2011; Shapovalova, 2011), as an international economic strategy to conquer external markets, control sectors of activity considered of strategic value (Gagné, 2007: 15), and achieve broader foreign

[26] Geoeconomics has significant links to geopolitics and by combining economics and geopolitics. It implies a relative decline in military concerns and a growth in economic concerns in interstate relations. Geoeconomics explains how states compete for economic power in the pursuit of national interests through the use of economic rather than military instruments in their foreign policies, to pursue both political and economic objectives by expanding their market share, taking over supply lines, and maintaining their economic security, which would allow them to magnify their power and influence over host countries (Gagné, 2007; Grevi, 2011; Luttwak, 1999; 1990; Wigell, 2016; Youngs, 2011).

policy objectives (Christie, 2009: 10-16; Kefferpütz, 2009: 100-102; Papava & Tokmazishvili, 2010: 103). In this regard, as Susan Strange (2004; 1992) subsequently emphasised, there is an increasing role for firms in today's political and economic system because firms can maximise their home-state's power, help to achieve a broader foreign policy goal in the region (Hsiung, 2009; Papava *et al.*, 2009; Szabo, 2015; Tsygankov, 2005a) and sustain and strengthen the state's economic domination *vis-à-vis* other states (Hurrell, 2013; Luttwak, 1994). A state can therefore pursue regional power to strengthen its geoeconomic and geopolitical position through its firms and their investments (Fredholm, 2005: 7; Kirkham, 2016: 120-124).

After the collapse of the Union of Soviet Socialist Republics (USSR), Russia's influence and power in the post-Soviet region was weakened and in the meantime the European Union (EU) through 'European Neighbourhood Policy (ENP)' (Krickovic, 2014: 513) and the United States (US), through the North Atlantic Treaty Organisation as well as the use of their firms and investments (Rutland, 2009; Spechler & Spechler, 2013), started developing their relations with the former Soviet states and advancing their geopolitical interests in the region, aimed at counterbalancing Russia's power and preventing it from becoming involved in certain projects (Nanay, 2009: 115-116). This was perceived by Russia as an intervention in its traditional sphere of interests where it could lose its geopolitical influence (Newnham, 2013: 118; Svarin, 2016: 132). When Putin[27] came to power, the aim was not only to restore a strong Russian state but also to regain its political and economic power in the CIS (Commonwealth of Independent States). To do this, Russia's broader foreign policy started combining its geopolitical power goals with geoeconomic ones aimed at rebuilding 'Greater Russia', to counter the EU's or the West's influence in the region (Roberts & Moshes, 2016: 544).

Several scholars have argued that Russia's foreign policy has been shaped by geopolitical considerations (Kubicek, 2013; Stulberg, 2015, 2005; Svarin, 2016; Tsygankov, 2003).[28]

[27] Since Putin's arrival, Russia has been in more favour of geoeconomic thinking than geopolitical and its foreign policy is based on more geoeconomic than geopolitical goals. But it does not mean that geoeconomic goals and means cannot be used for more final political goals (Nygren, 2008: 5).

[28] Geopolitics in the classical understanding is a method of studying foreign policy in order to understand and predict a state's international political behaviour, and encompasses the study of the group of relationships between the interests of international political actors, interests focused on a region, geographical factors or methods, and relationships which form a geopolitical order (Agnew, 2003; Devetak *et al.*, 2012).

Business and geopolitical considerations are mixed, especially in the energy business (Heinrich & Pleines, 2015a), and making neighbouring countries dependent on Russian energy resources and companies has been a critical foreign policy objective. By using energy companies and their investments and supplies as "geoeconomic weapons" (Luttwak, 1994) aimed at host countries Russia has wanted to preserve its power and sphere of influence in the region (Adomeit, 2012: 3). Considering the ineffectiveness of the CIS (Atik, 2014) and the former Soviet republics' growing relations with the US, EU and even China, Russia since 2000 has started introducing several integrational projects in the post-Soviet space to reconstruct its economic influence and eventually fulfil its broader political goals (Sergi, 2018: 55). Large-scale investment projects implemented by Russian companies in particular, illustrate corporate integration (Kvashnin, 2016: 222),[29] for example the Eurasian Economic Union (EEU) which aimed to establish a single oil, gas and electricity market as well as a single financial regulator (Nurgaliyeva, 2016; Papava, 2016a; 2016b; Vinokurov, 2017). Consequently, traditional regional integration based on political and military considerations could be replaced by economic integration through investments (Erokhin, 2015; Kheifets & Libman, 2008; Klotsvog, 1998; Libman & Kheifets, 2007; Roberts *et al.*, 2014).

Economic union has not only attracted politicians' attention but also that of corporations (Mostafa & Mahmood, 2018: 163-164), because it can remove regional trade and investment barriers (Gao, 2005: 158; Loewendahl, 2001: 41) and provide companies with a new 'home' market (Buckley *et al.*, 2003d: 196). This could allow firms to exploit perfectly the integration of markets (Buckley *et al.*, 2003b; 2003d) and increase their trade and investments (Buckley *et al.*, 2014: 180-181). As Machado (1996: 61) argued, firms, not ministries and agencies, have been the driving force behind regional integration and investment flows, and governments have attempted to facilitate this trend through several incentives and assistance. All the above-mentioned studies focused predominantly on Russian firms in the oil and gas as well as electricity industries and their roles in Russia's foreign policy objectives, but a few studies (Dadabaev, 2018; Papava, 2010; Papava & Charaia, 2014) have also underlined the roles of other non-resource based firms in the railway and financial industries in Russia's economic and political relations with the post-Soviet states as part of foreign policy goals. Balakishi (2016) and Kuznetsov (2016a) have attempted to study the role of firms from both resource- and non-resource-based industries and their investment activities in the creation of the EEU,

[29] or are seen as a vehicle of 'deep integration' (Blomstrom *et al.*, 2000; Buckley *et al.*, 2003c: 169).

and some policy papers from the Eurasian Development Bank have analysed the mutual investment flows within the union (Kuznetsov *et al.*, 2017, 2016; Kuznetsov & Kvashnin, 2015). Nevertheless, these studies neither used any appropriate existing theory nor provided any novel theoretical contributions. The current study is designed to address this gap in the state-state relations sub-section of each central empirical chapter, to identify the roles of investments in regional integration and to explore whether there is variation across industries and firms.

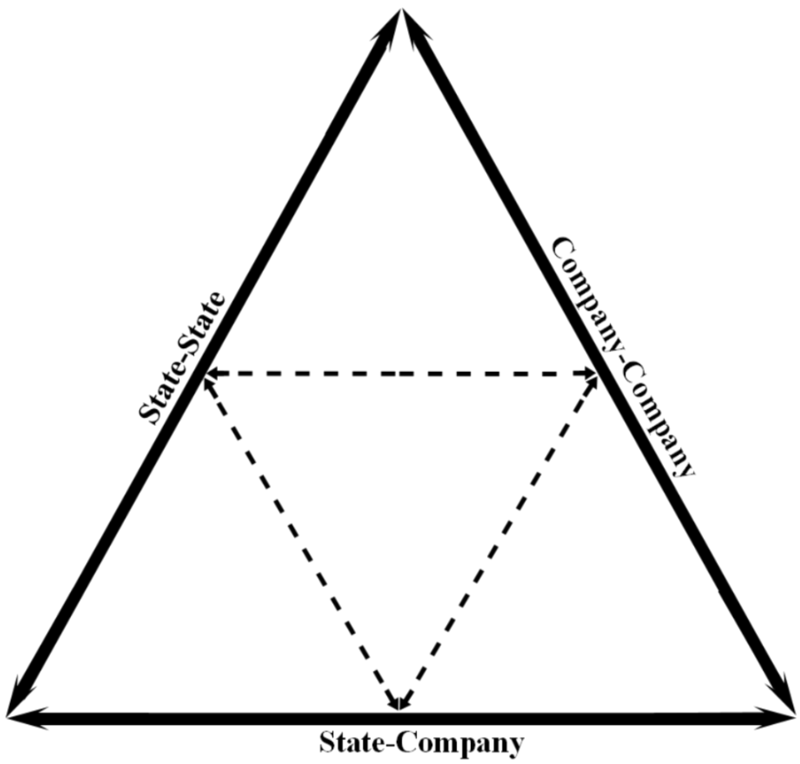

Figure 1: Triangular diplomacy

Considering all the aforementioned studies, state-state, state-company and company-company relations have resulted in the emergence of "triangular diplomacy" or "triads of relationships" as illustrated in Figure 1 (Stopford *et al.*, 1991: 21-22). Dunning started to explore state-business relations in the 1990s by drawing on an IPE approach, and argued that states and firms are seen to cooperate together and accomplish a set of mutual economic goals (Dunning, 1993: 64-74). This interaction was described as a "dynamic and iterative process" (Dunning & Lundan, 2008: 665) and triangular diplomacy was mentioned in one of his later works (*ibid.*: 696). However, home countries' broader foreign policy objectives and other possible political objectives were disregarded. According to several scholars (Cui & Jiang, 2012; Kuznetsov, 2010b; Liuhto, 2002), existing business theories cannot adequately explain firms from large developing economies. Their international expansion and operations in today's international business environment cannot be deemed *just* internationalisation, but political considerations should also be taken into account. Tulder (2010: 72) added that political factors are not only exogenous, but both economic and political factors play an equally crucial role and are also subject to geopolitical and strategic considerations. Accordingly, I argue that all these political factors require to reconfigure the eclectic paradigm. In the state-state relations of sub-sections of chapters 5-8 I therefore study how such political events and politically unstable markets shape Russian firms' entry strategies, influence their business operations and distribution of investments across host countries, and explore whether the state can be a user of, or used for, firms' own goals, whether firms can be instruments or instrumentalisers of the state's own goals, including foreign policy objectives, and whether there are variations across sectors and firms.

2.5 Firms' motivations

In this section I discuss and identify motivations behind firms' internationalisation strategies as part of the interdisciplinary framework. Given O and L advantages, as well as the political economy factors discussed above, I extend Dunning's traditional OLI taxonomy further by including 'system escape' and 'political' motives, in addition to four main motives: resource-, market-, efficiency- and strategic asset-seeking.[30]

Resource-seeking investments are motivated by the need to access physical resources, well-motivated, semi-skilled or unskilled and cheap labour, and to fulfil their needs for organisational skills, management or marketing expertise, experiential knowledge and technological competency by forming collaborative alliances (Clark *et al.*, 1997: 616; Dunning & Lundan, 2008: 68-69). Market-seeking investments are determined by trade flows and customers (Lisitsyn *et al.*, 2005: 4; Liuhto, 2015: 9) and by the adaptation of products to cultural mores, and local needs and tastes (Buckley & Casson, 2010: 96; Dunning & Lundan, 2008: 70). Efficiency-seeking investments are those that aim to benefit from variations in the availability and cost of traditional factor endowments in dissimilar countries with technology-, information- and capital-intensive value-added activities, natural resources and labour-incentive activities, and from economies of scale and scope, differences in consumer tastes, and supply capabilities in broadly similar economic structures or income levels (Dunning, 1998a: 53; Holtbrügge & Kreppel, 2012: 11). Strategic asset-seeking motives aim less to

[30] Dunning (2000: 164-165) borrowed the taxonomy from Behrman (1972) and extended it.

exploit firms' existing ownership advantages, and more to augment a company's global portfolio of physical assets, by acquiring strategic assets and infrastructure, such as oil and gas pipelines and power grids, or establishing strategic alliances with foreign firms (Dunning, 2002b:178;1998a: 54).[31]

Another line of thought on firms' motivation suggests that in addition to Dunning's traditional motives for the internationalisation of firms (2000; 1988), there might be other motives, such as 'system escape' or 'capital flight' (Claessens & Naude, 1993; Loungani & Mauro, 2001; Mulino, 2002; Stoian & Mohr, 2016) and political motives (Orban, 2008; Perović *et al.*, 2009; Wenger *et al.*, 2006) behind home-country firms' internationalisation. Punitive or inconsistent taxation, a bad business environment, restrictions on capital account transactions, lack of appropriate institutional infrastructure, and other home-country macroeconomic factors (Stiglitz, 2003: 81) are the main determinants of the system escape motive (Bulatov, 2001; 1998). Firms might also establish 'spare businesses' in the most stable markets (Kalotay, 2002: 274) to protect their assets in other market economies (*ibid.*: 270). This study explores how often Russian firms intend to establish spare businesses, how they use them, whether they use them in other host countries, and whether this varies from sector to sector or from firm to firm.

Considering the political economy of investments discussed above, firms' investments might not always be motivated by traditional commercial motives, but might be motivated to serve the home-country's foreign policy or to fulfil particular political objectives (Liuhto, 2015: 13; Vahtra, 2009b: 13). In one of his later works with Lundan (2008: 74), Dunning identified 'escape' investments; however, 'political' motives (Fortescue & Hanson, 2015: 284) were rejected and are not part of Dunning's taxonomy. In the light of this, in the political economy of investments sections of chapters 5-8 I examine whether there are political motives behind the internationalisation of Russian firms, and whether there are variations across industries, firms or host countries. All in all, given the facts set out above, the interdisciplinary framework is developed for this study to identify, in chapters 5-8, the commercial and non-commercial motives of Russian firms' and to analyse whether these vary from industry to industry, or from firm to firm or from country to country.

[31] This promotes and advances their long-term strategic objectives (Dunning, 2006: 140), or builds their empire, characterised as 'empire-building' motivation (Penrose, 2009: 163).

2.6 Internalisation strategies and entry modes

Given O and L advantages as well as the political economy factors discussed in the previous sections, this section reconceptualises Dunning's internalisation sub-paradigm (2000: 179-183). The third component of the interdisciplinary framework explains how firms enter a market, whether any prerequisites have to be met, and then what entry modes they choose and the reasons for choosing them. Firms' foreign market entries are influenced by host-country economic, political, industry-related and other institutional factors (Meyer & Nguyen, 2005: 63). In this regard, some preconditions must be fulfilled before entering the markets, including market information, financial and managerial resources (Mitra & Golder, 2002: 350), to allow firms to make the best entry choice.

In order to make a decision, firms gather relevant target market-specific information through government organisations, trade missions, industry associations, and financial and other service providers (Buckley & Casson, 2004: 28; Lundan, 2003: 172). Besides making pre-entry visits and conducting market research (Pedersen & Petersen, 2004: 104), they also employ other firms' former employees who bring their own experiences, contacts and first-hand knowledge of foreign markets and firms (Downes & Thomas, 1999). Firms' initial familiarity with their host-country partners and markets has a positive impact on their post-acquisition activities (Al-Laham *et al.*, 2010: 34). All the fulfilled preconditions and accumulated information provide firms with a range of entry modes to choose from, such as M&As, strategic alliances, joint ventures, subsidiaries, and non-equity arrangements, including keeping or sharing control of their joint ventures and subsidiaries, licensing and contractual joint ventures (Anderson & Gatignon, 1986; Buckley & Casson, 1996; Chi & McGuire, 1996; Görg, 2000; Hennart & Park, 1993; Hitt *et al.*, 2006; Meyer, 2001a; 2001b; Tsang & Yip, 2007). I therefore explore how Russian firms have fulfilled their prerequisites, and the implications of this, during the implementation of investments. I discuss such strategies in the following five sub-sections.

2.6.1 Joint ventures

In this sub-section, I examine the features of joint ventures (JVs)[32] and the possible reasons for firms' decisions to use this entry mode. A strategy of acquiring a controlling stake in JVs, if

[32] JVs are established by the involvement of firms from at least two different countries (Dunning & Lundan, 2008: 269). Each partner has specialised advantages which can benefit both the venture and the other partner (Elenkov, 1995: 73; Glaister *et al.*, 2004: 31-52). One firm holding a majority

not immediately, then in the long term, is one of a range of crucial internationalisation strategies (Geringer & Hebert, 1989: 236; Liuhto & Jumpponen, 2018: 133).[33] Partial acquisition in a JV is also usually both encouraged and financed by the investing firm's home-country banks (Dunning & Lundan, 2008: 271). Firms prefer to establish JVs and use them as a 'Trojan horse' (Nguyen & Larimo, 2014: 29) for the fulfilment of a range of specific objectives. These include: gaining or increasing essential resources and competencies (Meyer *et al.*, 2009: 64); obtaining access to new foreign markets; acquiring host-country market knowledge; minimising host-country uncertainty, risks and costs (Klijn *et al.*, 2014: 205-207; Pfeffer & Nowak, 1996: 385-409); boosting efficient distribution of existing foreign-based assets and connecting them to global network institutions, as they could not achieve all this on their own (Dunning & Lundan, 2008: 270).

Choosing JVs can also be result of firms' limited foreign experience (Hennart, 2009: 1448-1451), regulatory and normative pressures imposed by host-country governments (Minifie & West, 1998: 452-453) and economic and political events (Dunning, 2002a: 829).[34] In line with the U-model's sequential expansion approach, firms gradually improve their 'comfort zone'[35] in regard to host-country markets (Buckley, 1995: 24; Grogaard & Benito, 2007: 75-76) and later enter new markets by using accumulated experience (Johanson & Vahlne, 1977; Nieminen, 2018). I therefore analyse whether this progression is prompted by a firm's experiential knowledge accumulation, and whether the accumulated experience can be used later in a different market. Moreover, taking all the above-mentioned reasons into account, I

(minimum 51%) stake in a joint venture allows it to have *de jure* control in the decision-making in the JV. A firm may not hold *de jure* control (owning less than 50%), but even so, a firm with a minority interest can still influence decision-making in the JV because of its size, experience and degree of contribution to the JV (Dunning & Lundan, 2008: 270).

[33] Moreover, an investing firm with tight control or strong bargaining power over a JV is able to be directly involved in the decision-making processes and business activities of the JV or have more influence over it (van der Meer-Kooistra & Kamminga, 2015: 27-28).

[34] Firms also choose their entry modes by looking at their competitive counterparts in the same host-country market (Yiu & Makino, 2002: 667-668).

[35] According to the firm's internationalising strategy and the JV's performance, a partner in a JV may have both a 'call option' to purchase the other partner's share, and a 'put option' to sell its own share to the other partner (Buckley *et al.*, 2004: 77).

explore in what industries firms usually prefer JVs and why, and whether there is variation across firms' strategic reasons for choosing JVs.

2.6.2 Strategic alliances

Another important cross-border entry mode is a strategic alliance for achieving and advancing a firm's business objectives (Dunning, 2006: 140): to obtain economies of scale by merging commodity supply, production, marketing, networks and distribution activities (Lu & Burton, 1998); to mitigate uncertainties and risks and to avoid making major errors (Buckley *et al.*, 2004: 54); to accommodate the investing companies to host-government policies; to better penetrate new foreign markets (Chetty & Eriksson, 2002: 306-307); to improve their future acquisitions (Buckley & Glaister, 1998: 45-46; Very & Schweiger, 2001: 27); and to obtain access to the host-country firm's distribution channels, know-how and advanced technology and increase its own resources and capabilities (Buckley *et al.*, 1998: 191-192; Inkpen, 2006: 405). For example, western technology and experience are imported through strategic alliances and partnership agreements (Hamel & Prahalad, 1994: 212) rather than by conducting M&As (Collins, 2013: 53). This study explores Russian firms' main reasons for choosing strategic alliance as a bridgehead (Holm & Eriksson, 2000) on which to enter a foreign market, and whether their decisions are dependent on ownership or host-country locational advantages.

2.6.3 Mergers and acquisitions

Another discussion of firms' internalisation advantages suggests that companies might prefer M&As or takeovers to JVs and strategic alliances. Some scholars argued that M&As have been the predominant entry choice for the internationalisation of firms from emerging economies (Aulakh, 2007: 235; Buckley & Casson, 1998: 541-542), especially when investing in a specific host country (Melin, 1992: 111-112). Their international expansion through M&As has also been different in comparison with their western counterparts due to their unique home-country effects and their lack of foreign experience and knowledge (Luo & Wang, 2012: 258-259). This strategic entry option allows firms to enter new markets quickly, to overcome host-country entry barriers, to achieve greater market power, to acquire new resources and knowledge (Vermeulen & Barkema, 2001: 457), to obtain economies of scope from international marketing strategies (Child *et al.*, 2003: 11), and to access an intermediate market share, production facilities, distribution channels, consumers, and experienced management personnel in the host-country market (Buckley & Edwards, 2003: 154-155).[36] The integration process in an acquisition sometimes occurs only gradually, so trust in the acquisition is important to reassure the host-country government (Bijlsma-Frankema, 2004). I explore the main reasons for Russian firms' choice of M&As, whether this has been a predominant entry mode in their internationalisation and whether this varies from sector to sector or from firm to firm or from host-country to host-country.

2.6.4 Subsidiaries

In contrast to the various entry modes discussed above, companies might prefer to set up subsidiaries in their host countries for resource-, market- and efficiency-seeking investment motives (Hood & Young, 1998: 13). This is because foreign subsidiaries are more international (Dunning, 1994; Hadley & Wilson, 2003), provide more advanced management and marketing skills, greater know-how, and better international business contacts, and also allow firms to use their own brand names (Bartlett & Ghoshal, 1998: 117; Vissak & Zhang, 2012: 147).[37] Subsidiaries can also be established as a result of gradual acquisition (Johanson & Vahlne, 1990; 1977). Ownership control of a host-country entity is important (Nguyen & Larimo, 2014: 26-30) and has often provoked disputes between the firms themselves and host-country governments (Dunning & Lundan, 2008: 279).[38] This affects the investing firms' entry strategies (Asiedu & Esfahani, 2001: 647) and accordingly, they demonstrate their political accommodation in various ways, such as employing local people, or providing financial support for local schools and sports. The main underlying logic behind this activity is to safeguard their bargaining position (Henisz, 2000a; 2000b) and business interests in the long term (Luo, 2001: 406). Subsequently, the extent of companies' ownership of their subsidiaries is predicted to increase with the firms' increasing familiarity with host-country business conditions (Eriksson *et al.*, 1997: 352; Erramilli, 1996: 234). Given these facts, I examine Russian firms' relations with a host government or its agencies, the ways they have chosen to

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[36] M&As are a significant index of firms' global competitiveness (Cantwell & Barnard, 2008: 62).

[37] A company's main strategy is to have control over the whole value-chain in order to further strengthen its market position in export activities, to link up with new markets and to internalise their value-chain business activities (Kalotay & Panibratov, 2013: 236).

[38] They may also impose ownership restrictions on investing firms and are interested in equity shares with them.

improve their business positions, and what variations there are in establishing subsidiaries across different host countries.

2.6.5 Other types of entry strategy

Another type of foreign market entry is a licensing agreement, which is the transfer of a right to use a host country-specific entity, such as patent exploitation, pertinent to the production of a physical product. Such an agreement can provide a contractor with some control over the use of rights to maintain its competitive position, although a concessionaire is usually responsible for that production (Dunning & Lundan, 2008: 278). In the case of management contracts, a project owner receives the management 'know-how' of a contractor and then, subject to the terms of the specific contract, obtains the responsibility for undertaking management services. In accordance with a turnkey contract as a one-off agreement, a foreign firm consents to design, construct and prepare a full unit of production (*ibid.*: 279). Considering ongoing political and economic changes, firms' strategies, especially those from Russia, have become more and more multi-faceted and have found more innovative solutions, known as 'transhipping' or 'round-trip' FDI (Kalotay, 2010b: 126; Kuznetsov, 2017b: 80; Kuznetsov & Chetverikova, 2009: 6).[39] The use of 'terminals'[40] (Kuznetsov, 2016b: 82) can help companies save their investments and avoid impediments imposed by the host country. I therefore explore the main determinants in the choice of these types of entry strategy by Russian firms, what variations there are across different host countries, and the extent to which a 'round-trip' strategy has been successful.

2.7 Analytical Framework

In the previous sections, I developed the theoretical framework of this study by considering both economic and political factors, as illustrated in Figure 2 and 3. In this section, I explain the developed analytical framework which I used to explore the internationalisation of Russian firms in the South Caucasus emerging economies. Figure 2 and 3 show that the analytical framework is built on Dunning's eclectic paradigm of international production, incorporating the tenets of the IDP and the U-model, as well as state-business and state-state relation factors and several relevant concepts and classifications of investment motives and entry modes

[39] Also known as 'fake-FDI' (Kuznetsov, 2014: 131-132) and 'indirect FDI' (Kalotay, 2012).

[40] Also described as 'offshore zones' (Kalotay, 2013; Pelto *et al.*, 2003) or 'investing via another country' (Vahtra, 2006: 4-11; Vahtra & Liuhto, 2006: 27).

derived from the extant literature. Given both economic and political factors, Figure 3 shows the relationships between the three levels of investment advantage, known as the Ownership (O), Location (L) and Internalisation (I) advantages, and investment motives.

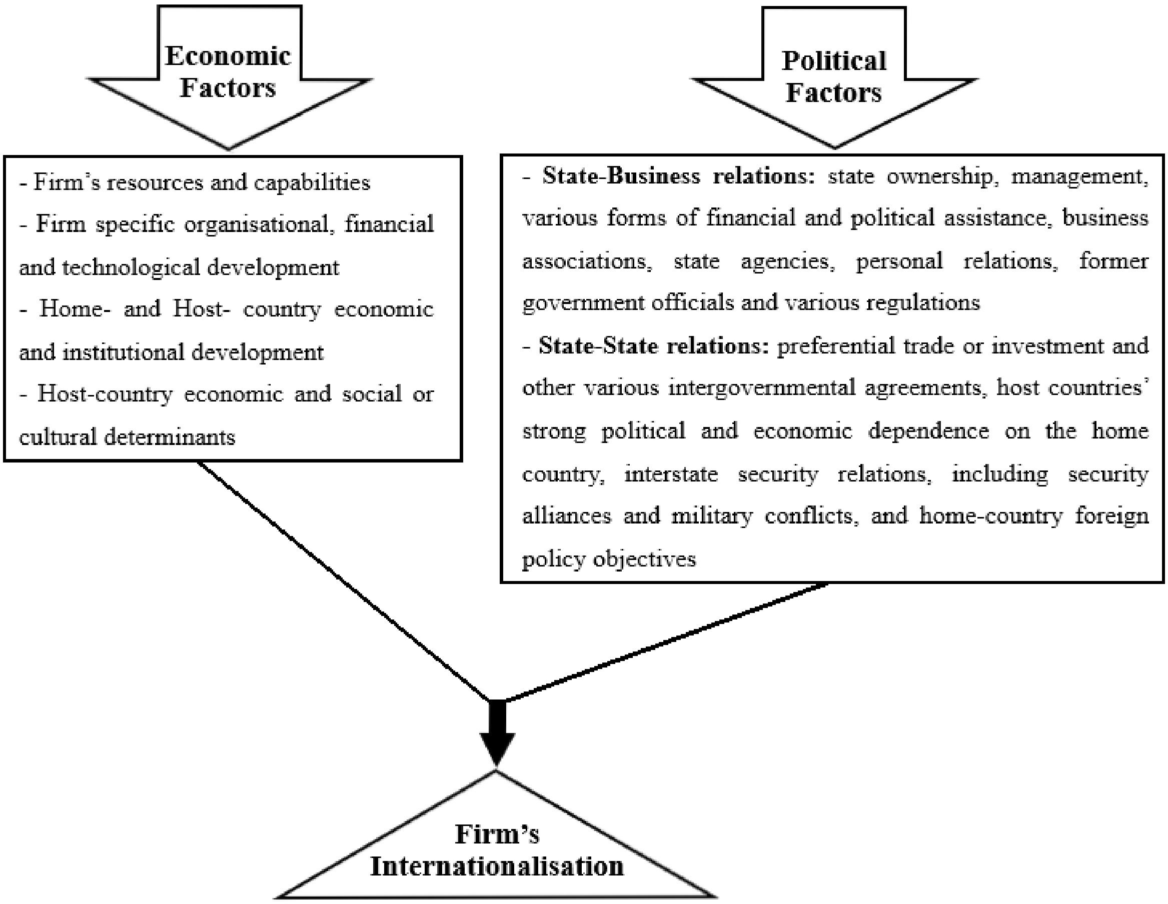

Figure 2: Economic and Political factors influencing firms' internationalisation

The O advantages of this interdisciplinary theory are built on Dunning's ownership sub-paradigm of OLI. This explains why firms want to internationalise and why they should have specific resources and capabilities for their expansion into the South Caucasus markets. In line with the IDP macro-level factors associated with home-country economic and institutional development, and in line with the U-model micro-level factors associated with the development of firms' specific assets and competencies, which affect their ownership advantages and business strategies, these various ownership advantages allow firms to expand their business and to be competitive in the host countries. Therefore, home country determinants, including institutional and economic determinants, and firms' characteristics, resources and capabilities are incorporated into the O sub-paradigm to explain why Russian firms want to internationalise in the South Caucasus countries. This also allows us to determine variations between firms' ownership advantages in the ownership section of each empirical chapter.

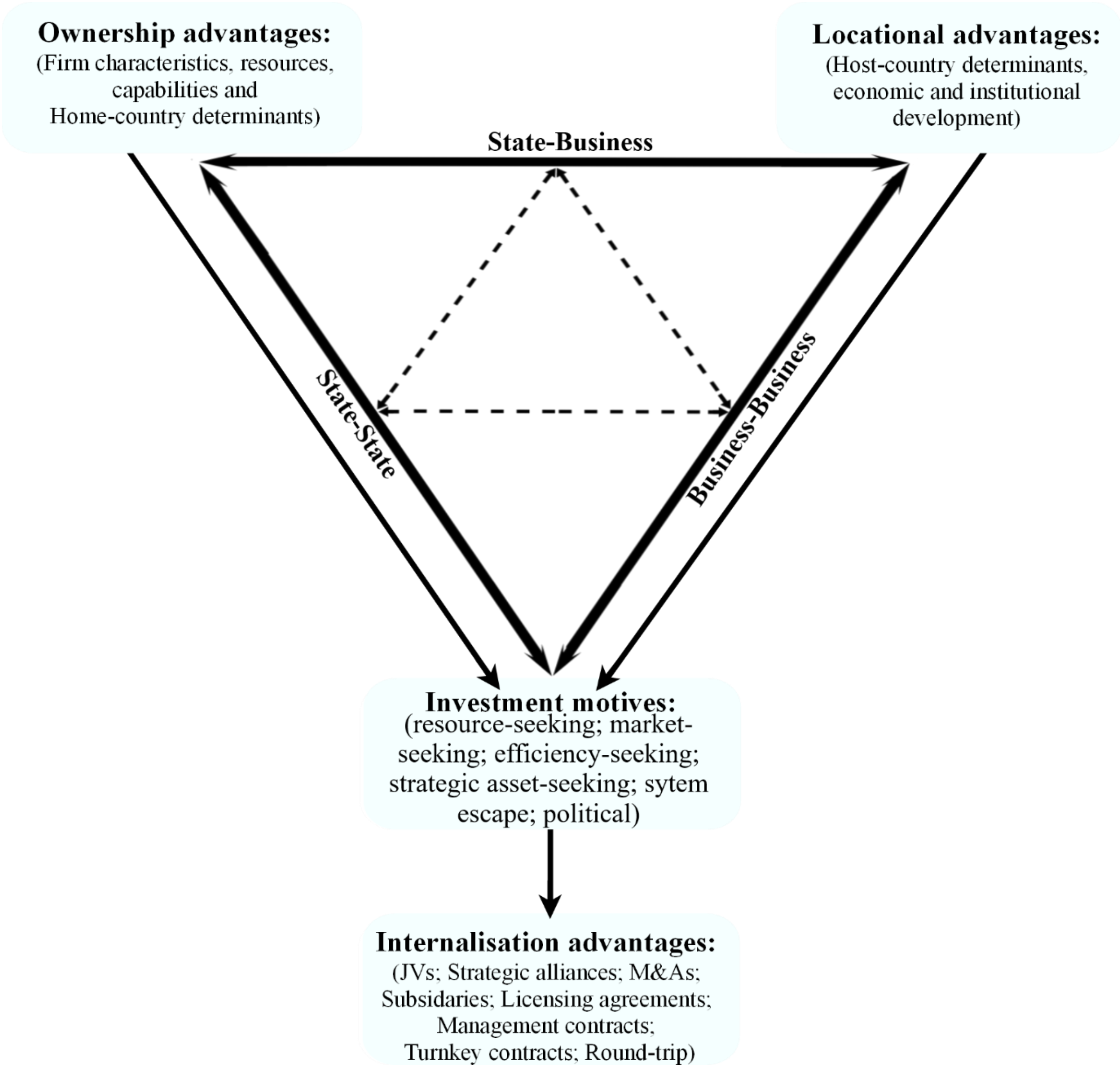

Figure 3: The interdisciplinary framework used for this study

The second leg of the interdisciplinary framework is the L advantage, which draws on Dunning's locational sub-paradigm of the OLI. This sub-paradigm explains where Russian firms are more likely to invest and identifies the locational advantages of the South Caucasus host countries. There are various host-country determinants that influence firms' location choices. These are host-country economic determinants, in line with the IDP's host-country economic development and institutional factors, and other cultural and social factors predicted by the U-model, which have important roles in firms' decision-making about where to invest. The various identified host-country determinants are incorporated into the L sub-paradigm in order to explore Russian firms' decisions in the location sub-section of central empirical chapters about where to enter the South Caucasus markets, and to analyse variations across these host countries.

In studying Russian firms and their investment activities in the South Caucasus, this interdisciplinary framework takes into account the significance of business-business, state-business and state-state relations, namely triangular diplomacy, during the internationalisation process (*see* Figures 2 and 3). This also raises the need to consider home countries' foreign policy objectives because all this has a significant impact on firms' business behaviours, strategies, investment decisions and motives. These factors are explored and analysed in the political economy of investment sections of empirical chapters 5-8.

The O and L advantages, and other political economy factors shape Russian firms' motives for internationalisation. This also identifies their politically and commercially driven investments. In this regard, the interdisciplinary framework sets out four main motives – resource-, market-, efficiency- and strategic asset-seeking – as well as two new 'system escape' and 'political' motives that underlie firms' internationalisation (*see* Figure 3).

The internalisation advantages of the interdisciplinary framework are developed by drawing on the third sub-paradigm of Dunning's OLI. Considering firms' ownership advantages, host-country locational advantages, the political economy of investments and the motives behind their expansion, as examined in the internalisation section of empirical chapters 5-8 Russian firms make strategic decisions about how to enter the South Caucasus markets and what entry strategies to choose, which may include JVs, strategic alliances, M&As, subsidiaries, licensing agreements, management contracts, turnkey contracts and round-trip.

2.8 Conclusion

The purpose of the analytical framework I have developed is to demonstrate how economic and political factors interact and influence firms' internationalisation processes, and to understand whether their investment and business activities are commercially or politically driven, and whether these issues are the same or vary across industries, firms or host-countries. This is usually believed to be true in resource-based industries and has always played an important role in determining contractual conditions and driving deals aimed at obtaining access to natural resources and controlling energy flows (Blanchard, 2011: 100; Milov *et al.*, 2006: 286). It accounts for a significant share of FDI from developing economies (Rosen and Hanemann, 2009: 9). In particular, oil and politics have become intermixed and the home country government has tried to protect its firms' interests, as the US did in the 1910s (Goldstein, 2009: 105). A recent development in the international economy has been the expansion of service- or non-resource-based companies (Filippov, 2013: 217; Gilpin, 2001: 294; Kuznetsov, 2010a: 18-20; Vahtra, 2006: 40) which have not expanded abroad as much as resource- or extractive-based firms. As such, the degree of financial, insurance, telecommunications, railway companies' influence or power is not as great as their resource-based counterparts (Collins, 2013: 53). Most FDI from developing economies has been conducted by resource-based firms, notably those owned by the state, which are primary vehicles of the country's economic growth and national industrial economy, while FDI among service oriented firms from China, India and Russia has been relatively small (Collins, 2013: 73, 80, 106; Filippov, 2008: 9; Pleines, 2009: 71; Vahtra, 2009b: 9).

The internationalisation of Russian firms has been quite different from other developing economy firms and this has attracted the attention of a number of scholars, who have undertaken a range of country- or region-specific, firm- or sector-specific, firm-country-specific and various selected industry studies. The country- or region-specific examples are the Baltic states (Kilvits *et al.*, 2006; Kuznetsov, 2012b), Lithuania (Zashev, 2004), Belarus (Yeremeyeva, 2009), Cyprus (Kalotay, 2013; Pelto *et al.*, 2003), Finland (Vahtra & Lorentz, 2005), Ukraine (Blyakha, 2009) and the CIS (Crane *et al.*, 2005; Kuznetsov, 2012a; Kuznetsov *et al.*, 2017; 2016; Kuznetsov & Anisimov, 2013; Kuznetsov & Kvashnin, 2015; Vahtra, 2005). Firm- or sector-specific examples are oil and gas (Heinrich, 2003; 2001; Liuhto, 2002; McCarthy *et al.*, 2009; Peregudov, 2001), electricity (Trofimenko, 2001), aluminium (Survillo & Sutyrin, 2001), telecommunications (Lisitsyn *et al.*, 2006; 2005) and banking and high technology (Panibratov, 2012; Panibratov & Verbá, 2011; Vinokourov, 2009). Firm-country-specific examples are Lukoil in Bulgaria (Zashev, 2006), Lukoil in Poland (Runiewicz, 2006), the role of Russia in the Lithuanian oil business (Tvaronaviciene & Saee, 2006), and all industry (Liuhto & Jumpponen, 2003; Liuhto & Vahtra, 2007; Panibratov & Latukha, 2014; Vahtra, 2006; Vahtra & Liuhto, 2006; 2004).

The above mentioned scholars have done sectoral analysis based on resource-based firms from the oil and gas, electricity and metal industries, and non-resource-based firms from telecommunications, insurance, financial and railways industries. However, many of these studies still remain descriptive and lack solid theoretical and empirical bases, such as variation across countries, industries and firms, or are mainly focused on the oil and gas sectors. Almost none of this research has provided any specific investment decisions made by the firms or the reasons behind them. Moreover, as discussed above, scholars have attempted to explain the expansion of Russian firms in the post-Soviet states, including the three South Caucasus emerging economies, but only in a very broad sense. They have frequently argued that Russian firms have followed similar internationalisation strategies in the post-Soviet region, but different ones in Europe (Hedenskog & Larsson, 2007; Heinrich, 2003; Vahtra & Liuhto, 2006; 2004). However, the current study argues that there is variation in the internationalisation strategies of Russian firms across the post-Soviet host countries. Furthermore, this is the first study to explore Russian firms' investment activities in the South Caucasus emerging economies, and one of very few studies to study Russian firms and their expansion process in any depth.

Given the factors discussed in the earlier sections and the studies referred to above, some scholars (Culpan & Akcaoglu, 2018; Gorynia *et al.*, 2014; Wilinski, 2012), in seeking to explain international production, especially of firms from Russia, have quite often incorporated the determinants of the IDP and the U-model into Dunning's eclectic paradigm. In the light of these theoretical perspectives, the empirical part of the thesis explores whether economic factors need to be complemented with the other approaches and what the relative importance of these factors is (and perhaps whether they vary across sectors or firms). As discussed earlier in this chapter, the political economy perspective is helpful in understanding firms from developing economies and explain their internationalisation. Thus, economic and business factors seem insufficient to explain the investments of firms from emerging economies, which necessitates the incorporation of political economy factors, including state-business and state-state relations as well as states' foreign policy interests alongside the micro- and macro-economic factors discussed in earlier sections, into Dunning's eclectic paradigm (2000; 1998b). Boddewyn (Boddewyn, 1988; Boddewyn & Brewer, 1994) attempted to extend Dunning's eclectic theory by incorporating several political and economic variables but suggested further theoretical and empirical research on this matter.

Dunning (2001b: 177) emphasised that "the purpose of the eclectic paradigm is not to offer a full explanation of all kinds of international production but rather to point to a methodology and generic set of variables which contain the ingredients necessary for any satisfactory explanation of particular types of foreign value-added activity". He later acknowledged "the need for a broad-based interdisciplinary approach in furthering scholarly research in IB" (2002a: 826) or "an interdisciplinary explanation of international production" (2015: 306-326; 2002b: 259-281). The consequence is that a very robust and appropriate interdisciplinary framework can offer "a degree of intellectual rigour and richness" and provide "well for a fuller understanding of the nature and determinants of international production" (Dunning, 2002b: 268).

As some business scholars have confessed (Kuznetsov, 2010b; Liuhto, 2002; Tulder, 2010), the difficulty in exploring and analysing Russian firms and their investment activities arises primarily from the inadequacy of existing FDI theories. Moreover, given firms' intentions to have close relations with their governments which have minimal interventions in firms' business activities, the political economy perspective is limited to explain this. For the current study, I have therefore developed an 'interdisciplinary framework', as illustrated in Figure 3, to explain firms and their business activities by drawing on the theories of IB, international economics, IPE and IR. This contributes theoretically to both the IB and IPE literatures. A synthesis of various perspectives allows us to assess the relative importance of economic and political factors, which will be explored across various sectors in the chapters to follow, and to examine both whether these factors vary across industries or firms and why. This research not only makes a theoretical but also an empirical contribution to the existing knowledge by examining Russian resource- and non-resource-based firms. The interdisciplinary framework can therefore help us to understand Russian firms and their internationalisation in the South Caucasus emerging economies, to analyse whether there are variations across industries, firms or countries, and to explore the impact of political economy factors on their investment and business operations and their roles in international political economy.

Chapter 3

3 Research Methodology

In the social sciences the case study has been an essential aspect of research methods, used by scholars in the fields of international relations, international political economy and sociology as well as international business and management (Halinen & Törnroos, 2005; Otero-Neira *et al.*, 2009; Rialp *et al.*, 2005; Yan & Gray, 1994). To explain a phenomenon by conducting multiple case studies constitutes a powerful research tool that employs comparative logic which allows researchers both to test theories, and to discover where particular theoretical frameworks are insufficient to build theory (Chetty, 1996: 73; Eisenhardt, 1991: 620; 1989: 535; Glaser & Strauss, 2006: 21). As Eisenhardt (1989: 537, 545) asserted, there is no ideal number of cases, but more than four cases works well in the management and IB studies, and fewer than this makes it hard to build a comprehensive theory. For this research my case studies were twelve Russian firms from oil, gas, electricity, aluminium, telecommunications, insurance, financial and railways industries and their investment and business activities in the South Caucasus emerging economies. In the research design phase, the use comparative multi-case research also helped me to enhance both internal and external validity (Yin, 2014).

3.1 Case selection

There are four main reasons why this study adopted a sectoral approach based on resource- and non-resource-based industries. First, as discussed earlier in the theory chapter, the significance of resource-based firms in large developing economies has been remarkable. Because their FDI has been quite large and they have been the main drivers of the country's economic development in comparison with non-resource-based firms (Collins, 2013: 73, 80, 106; Filippov, 2008: 9; Pleines, 2009: 71; Rosen & Hanemann, 2009: 9; Vahtra, 2009b: 9). The expansion of their service- or non-resource-based firms (Filippov, 2013: 217; Gilpin, 2001: 294; Kuznetsov, 2010a: 18-20; Vahtra, 2006: 40) has been a new phenomenon. For instance, the degree of telecommunications, insurance, financial and railway companies' influence or power are not as much as resource-based-firms and their FDI has been relatively small (Collins, 2013: 53).

Second, according to several scholars (Blanchard, 2011: 103; Peng & Luo, 2000: 488-489; Ring *et al.*, 1990: 141; Rodrik, 1997: 430; Wang *et al.*, 2012b: 655-658), state-business relations and state support or intervention vary from industry to industry and from firm to firm. Both state-owned (Globerman & Shapiro, 2009: 171; Le & O'Brien, 2010: 1302) and private companies (Dinç, 2005: 456; Filippov, 2013: 206; Morck *et al.*, 2008: 348; Rugman, 2009: 58), especially in resource-based industries, benefit from various government financial and other assistance during their internationalisation or when they are in financial trouble. In other words, the government assists them as long as they have strategic significance for the state and successfully implement state goals (García-Canal & Guillén, 2008: 1102; Kuznetsov, 2011b: 7). Abdelal (2015: 559) and Musacchio *et al.* (2015: 122) have also emphasised that state ownership may not explain firms and their behaviour well. Others have added that despite being private firms can be pretty much under government control, and that the strategic interests of Russian state and its companies can be in accord (Adams, 1998: 31-32; Becker, 2000; Guliyev & Akhrarkhodjaeva, 2009: 3180). Firms' operations frequently conform to the state's official policies and the often balance their business interests with those of the government (Liuhto & Vahtra, 2007; Vahtra & Liuhto, 2004). The state-private divide may therefore not be decisive. Taking all this into account, it was therefore more logical to group them by sector, which also allowed me to test Dunning's eclectic framework (2000), identify missing variables, including institutional, cultural and political economy factors, and eventually build the 'interdisciplinary framework'.

Third, considering the facts discussed earlier, other scholars (Liuhto & Jumpponen, 2003; McCarthy *et al.*, 2009; Panibratov & Latukha, 2014) have suggested studying sectoral analysis based on resource-based firms from the oil, gas, electricity and metal industries, and non-resource-based firms from telecommunications, insurance, financial and railway industries. Moreover, the governments of large emerging economies have strategic considerations behind their diplomacies in resource-based industries, especially energy, as these bring great political benefit (Chen, 2008; Kolstad & Wiig, 2012: 29; Lane, 2001; Pleines, 2009). It is often claimed that Russian firms' internationalisation strategies and investments, particularly in the energy industry, can be greatly influenced by its foreign policy (Durnev, 2010: 92; Kalotay, 2010b: 127-128; Tepavcevic, 2015: 33) or used as foreign policy tools (Heinrich, 2003; Liuhto, 2010; Vahtra, 2009a: 160; 2006; 2005; Zhuplev, 2012: 208). Some scholars (Filippov, 2008; Kalotay & Sulstarova, 2010; Kuznetsov, 2010a; 2007; Panibratov & Kalotay, 2009) have also highlighted the important state-business interests of both the Russian state and its energy firms. Besides them, a few others (Dadabaev, 2018; Papava, 2010; Papava & Charaia, 2014) have stressed the roles of other non-resource-based firms, particularly from the financial and railway industries, in Russia's economic and political relations with the post-Soviet states as part of foreign policy and broader foreign policy objectives. All this shows that grouping Russian firms by sector is an appropriate way to analyse and explain their business and investment activities in the South Caucasus countries, and to find out whether there are variations across industries, firms or countries.

Finally, non-resource-based firms have followed their resource-based corporate customers to host countries, where they have growing export flows to serve their international operation (Lisitsyn *et al.*, 2006: 132; Liuhto, 2015: 9; Mihailova & Panibratov, 2012: 176). For instance, telecommunications and insurance firms have entered host countries to serve the interests of the home country's resource-based firms (Collins, 2013: 109-110; Goldstein, 2009: 99). Furthermore, railway and especially financial firms, typically with government support, have invested and established their footprints in host countries where they can both support and streamline the expansion of resource-based firms (Gu *et al.*, 2016: 25; Rui & Yip, 2008: 216-217; Strange, 2004: 79). This was another significant reason to group firms by resource- and non-resource-based type.

Political and economic sensitivity in key sectors emerged from the theory, and based on other studies I selected cases and grouped them into four empirical chapters: two chapters each on resource- and two for non-resource-based industries. I discuss twelve leading Russian firms, in each case exploring and analysing their investment activities in the South Caucasus emerging economies. I discuss oil and gas firms in chapter 5, electricity and aluminium in chapter 6, telecommunications and insurance in chapter 7, and financial and railway industries in chapter 8. These firms are the most prominent and important investors; they hold strong market positions in Russia and play significant roles in its economic growth, as well as in its political and economic relations with other countries. Moreover, these twelve companies have invested in the South Caucasus countries and engage in various business and investment activities. Choosing these case studies also represents a full range of involvement in the South Caucasus emerging economies.

The best reason for using the comparative multiple case studies method is not only to look at cases in depth, but also to uncover patterns, considering the firms' sizes, strategies, behaviours and performances, as well as their relations with the state and roles in state-state relations. This method helped me study the patterns, explain events and discover the reasons for certain decisions, and how they were implemented by the firms. I used cross-sectoral and cross-national comparisons of firms' investment and business activities to compare firms from the same and different industries, to find variations and eventually to explain each company, its internationalisation strategy, its relationship with the state, and role in foreign policy. Comparing these case studies allowed me to go beyond initial impressions and carry out more in-depth research, which, in combination with the other reasons listed above, explains why I chose comparative multiple case studies as the primary method for this research. Given countries' variations in economic and institutional development, firms' variations in development and internationalisation processes, other macroeconomic changes in the region over time, and their relations with the state, as well as various political factors, these case studies provided an opportunity to improve this model and to make the research more dynamic by focusing on what has happened and how. These case studies also helped me explore and understand empirically firms' goals and strategies and the reasons for their decisions, and to show the pattern of state-business relations and analyse variations across industries, firms and countries.

3.2 Interviews

As mentioned earlier, scholars have studied Russian firms and their expansion into the post-Soviet space, including the South Caucasus countries, but only in a very broad sense. They have also claimed that Russian firms followed similar investment strategies in the post-Soviet countries. However, the argument of this research is that there is variation in these strategies. This is the first study to examine Russian firms' investment activities in the South Caucasus and one of very few studies to explore Russian companies and their internationalisation in-depth. Given all this and the lack of data on the South Caucasus, interviews were chosen as a primary source of original and relevant data for the study and to gain a deeper understanding of Russian firms and their various investment activities in the South Caucasus emerging economies. Conducting the interviews helped me to obtain information about variations in the Russian firms' business strategies, decisions, relations with the state and roles in interstate relations, for both past and upcoming events in the South Caucasus.

This research project involved fieldwork between June and September 2017 in Russia and the South Caucasus countries, and was primarily focused on cross-national interviewing which refers to "the collection of interview data across cultural and national borders" (Ryen, 2001: 236). The analysis is based primarily on nineteen interviews with members of the business and political elites of Russia, Armenia, Azerbaijan and Georgia, as Table 1 shows. My respondents were key people with whom to explore and analyse the Russian firms' investment and business activities in the South Caucasus, including senior managers and representatives of firms, senior government officials and experts who are/were involved in the Russian firms' decision-making processes. These people closely follow firms' investment activities and are very knowledgeable about internationalisation processes and the strategies of Russian firms in the South Caucasus emerging markets, as well as the dynamic interaction between the Russian state and its firms, Russia's political and economic relations with the South Caucasus countries, overall economic and institutional development and political changes in the region. Considering all this, therefore, I chose these people as my respondents in the hope of obtaining help in identifying the determinants of the Russian companies' investment decisions, their internationalisation strategies in the South Caucasus emerging markets, and to find out or examine whether there are variations across countries, industries and firms.

The interviews were semi-structured and contained open-ended and discovery-oriented questions in order to explore in depth the respondents' perspectives and feelings on the research topics (Brinkmann, 2014; Daniels & Cannice, 2004). This was crucial when conducting interviews with elite people since the objective was to discover their subjective points of view and the meanings they attributed to events and concepts. In recognition of the variations between the countries and across firms' investment activities, and the sensitivity of issues related to political influence and goals, the interview questions were prepared in accordance with each respondent's field of expertise or occupation and fitted into the general framework of the project from a variety of angles. In order to achieve a higher degree of reliability and validity of interview data, I did a critical analysis in advance by using multiple sources and gathering preliminary information in relation to each firm's investment and business operations, their interactions with the Russian state, Russia's relations with the South Caucasus countries and general political situation in the region. I also gathered some information about my respondents through news media outputs and by reading their research. Interview questions were then formulated accordingly.

Respondent	**Occupation**	**Code**
Senior Manager	• Gazprom	**I-1**
Anonymous	• Anonymous	**I-2**
Senior Manager	• RUSAL	**I-3**
Senior Manager	• MTS	**I-4**
Alexey Kuznetsov	• Member of the Scientific Council of the Federal Agency of Scientific Organizations	**I-5**

	• Member of the Executive Council of the New Economic Association • Member of the Academic Council of the Institute for Energy and Finance	
Stepan Grigoryan	• Since 2002, Chairman of the Board of the Analytical Centre for Globalization and Regional Cooperation • 1998-2000, Advisor to the Minister of Foreign Affairs of Armenia • 1996-1999, Plenipotentiary Representative of the Republic of Armenia in the organization of the CIS Collective Security Treaty • 1995-1998, Ambassador of the Republic of Armenia to the Russian Federation • 1990-1995, Deputy of the Supreme Council of Armenia	**I-6**
Anonymous	• Senior Armenian Official	**I-7**
Vladimer Papava	• 1994-2000, Minister of Economy of Georgia • 2004-2008, Member of Parliament of Georgia (Committee for Finance and Budget)	**I-8**
Irakli Menagarishvili	• 1995-2003, Minister of Foreign Affairs of Georgia • 1993-1995, Deputy Prime Minister of Georgia • 1986-1991, 1992-1993 Minister of Public Health	**I-9**
Zurab Garakanidze	• Head of the Administrative Department of the amalgamated Ministry of Natural Resources and Agriculture of Georgia	**I-10**
Anonymous	• Senior Georgian Official	**I-11**
Giorgi Tarkhan-Mouravi	• Georgian Political Analyst and Co-Director of the Institute for Policy Studies	**I-12**
Kavus Abushov	• Azerbaijani expert in Russian Foreign Policy and Post-Soviet Republics and an academic at ADA University	**I-13**
Gubad Ibadoglu	• Senior Researcher at the Economic Research Centre of Azerbaijan • Board Member of National Budget Group	**I-14**

	• Member of the Euro Integration National Public Committee in Azerbaijan	
Gulmira Rzayeva	• Founder and Managing Director of Eurasia Analytics, UK • Senior research fellow at the Centre for Strategic Studies under the President of the Republic of Azerbaijan, • Research Associate at the Oxford Institute for Energy Studies • Expert/Advisor of the World Energy Council's Global Gas Centre based in Geneva	**I-15**
Ahmad Alili	• Deputy Director, Centre for Economic and Social Development in Baku	**I-16**
Anonymous	• Senior Azerbaijani Expert	**I-17**
Anonymous	• Azerbaijani Economist and Board Member of one of the Leading banks in Baku	**I-18**
Rashad Rasullu	• Vice Chancellor of ATA Holding and Former Member of Supervisory Board of VTB Bank Azerbaijan	**I-19**

Table 1: List of Respondents

3.2.1 Gaining Access

Considering the challenges of choosing suitable respondents who could provide important information, and of access to business and political elites, I used four different methods. First, research involved a few gatekeepers who acted as intermediaries between me and my potential respondents (Cohen *et al.*, 1998; McFadyen & Rankin, 2016; Wanat, 2008). This effective gatekeeping was crucial and allowed me to gain access to respondents, particularly in the case of Azerbaijan. Second, during the four-month research period I was affiliated to the National Research University's Higher School of Economics in Moscow, where I conducted my fieldwork as a visiting researcher. I decided to use the reputation of the institution to gain access to the political and business elites myself. I made telephone calls to the firms, which I then followed up with emails. In attempting to gain access by this method, persistence was really important. I called them and sent them emails again and again. Given the limitations on their time, I tried to be as flexible as I could; my list of interview questions was sent to respondents in advance and some interviews took place by telephone. Finally, I used the snowballing method by identifying an initial number of relevant respondents and then requesting them to recommend other potential respondents who shared similar characteristics or who would be likely to have an affinity with the objectives of my research (Bryman, 2008: 184). As Welch *et al* asserted, this strategy was the most effective way of gaining access to the business and political elites whose views were key to this study (2002: 620).

3.3 Data Collection

In keeping with the multiple comparative case studies and to accomplish construct validity, for this research I used and analysed a range of primary and secondary sources from interviews, government reports from the Kremlin, corporate publications, mass media outputs, other secondary sources in Russian and English languages, including scholarly articles and books, and quantitative data from the Transparency International, Heritage Foundation and World Bank in relation to the Economic Freedom and Corruption index and GDP annual growth (*see* Table 2). Using both qualitative and quantitative data helped me to identify the key patterns and variations across the countries, industries and firms and to examine the internationalisation of the Russian firms in the South Caucasus. In addition to sources in English, I also used some sources in Russian on Russia and the three South Caucasian states. Looking at so many different sources gave me a well-rounded perspective on this whole subject area, to conduct a more thorough examination of each firm and eventually uncover the variations, as well as avoiding subjective biases. The findings and results are in each case substantiated by evidence from multiple sources and are therefore more convincing and accurate (Chetty, 1996: 77). Moreover, the use of multiple sources of evidence in the data collection enhanced the reliability and validity of data (Riege, 2003: 82).

Source	Availability
Interviews	Business and political elites (Russian, Armenian, Azerbaijani and Georgian)
Government Publications	Policy documents; texts of ministerial and presidential speeches available at en.kremlin.ru
Company/Corporate Publications	Companies' annual and financial reports; company press releases available at www.gazprom.com; www.lukoil.com; www.rosneft.com; www.interrao.ru; www.eng.rushydro.ru; www.rusal.ru; www.rzd.ru; ir.mts.ru; veon.com; corp.megafon.com; 2016.ingos.ru; www.ingoarmenia.am; www.vtb.com; ru.vtb.am; vtb.az and vtb.ge

Mass media outputs	Reports and News items
Secondary Sources in Russian and English	Political analyses and journals; scholarly articles and books on relevant topics
Transparency International	www.transparency.org
The Heritage Foundation	www.heritage.org/index
World Integrated Trade Solution, World Bank	wits.worldbank.org
World Bank	databank.worldbank.org

Table 2: List of Sources

3.3.1 Interviewing

The majority of interviews took place face-to-face, but some were conducted by telephone or Skype depending on my respondents' availability and preferences. Cross-cultural studies require a multilingual approach in order to gain valid and trustworthy data from non-English contexts (Marschan-Piekkari & Reis, 2004: 224). So, using local languages was effective for "opening doors and establishing trust" and to "ensure the interview in the first place" (Welch & Piekkari, 2006: 425). The interviews were held in the English, Russian and Azerbaijani languages, to ensure that respondents felt comfortable and to obtain the clearest data. In fact, most were very comfortable to be interviewed in English and were fluent in that language. Interviewing in English saved time later, as I did not have to translate the data when transcribing and analysing the interviews.

The total number of respondents was nineteen (*see* Table 2) and the length of interviews varied between thirty minutes and two hours; most were between forty-five minutes and an hour. On two occasions, it seemed impossible to carry out full interviews, due to respondents' unexpected phone calls and government-related meetings. I set up these interviews again and completed a full interview with one respondent over three different days, and with the other one over three different appointments on the same day. The interviews were only recorded with the permission of my respondents, most of whom were comfortable with audio-recording. Where they did not give permission, however, I took notes during the interview.

Furthermore, during the interviews, I frequently used the technique of triangulation which allowed me to explore different viewpoints on, and levels of, the same phenomenon, to enhance the reliability of the results and to improve the validity of the data collected (Carter *et al.*, 2014; Fusch & Ness, 2015; Yeung, 1995: 319), which provided a stronger substantiation (Eisenhardt, 1989: 538). Cross-case questions were also asked to find similarities and differences in the investment decisions of firms from the same and different industries and in the locational attractiveness of the South Caucasus countries. Such an examination allowed for the diversion of interviews along new lines which, although not in essence considered part of the interviews, nevertheless assisted towards meeting the research objectives (Gray, 2004: 217). Given the lack of previous research on this topic and in this region, my respondents asked me to share my results with them when the project was completed, and I received positive support and appreciation for carrying out this research and for my contribution to the subject.

3.4 Data Analysis

This research took a thematic analysis model to analyse the data collected from interviews, government and corporate publications, news media outputs and various other primary and secondary sources, as Table 2 shows. Thematic analysis is a widely used and flexible research tool for "identifying, analysing and reporting patterns (themes) within data", describing the "data set in (rich) detail", interpreting "various aspects of the research topic" (Braun & Clarke, 2006: 79) and providing "more a detailed analysis of some aspects of the data" (*ibid.*: 84). There are six stages of thematic analysis in the data analysis process: becoming familiar with the data, generating initial codes, searching for themes, reviewing themes, defining and naming themes and producing the report (Braun & Clarke, 2006: 86-94; Vaismoradi *et al.*, 2013: 400, 402).

In the first stage, I transcribed all the interviews manually into written form in order to conduct a thematic analysis. The transcription process was time-consuming, but was the best way to start becoming familiar with the data, and cultivating a more thorough understanding. I then started reading and rereading the data from various sources, including the transcription, Kremlin reports, corporate publications, news media outputs and secondary sources, to note down my initial ideas regarding each firm's investment activities in the South Caucasus, their relations with the Russian state and various economic, institutional and political economy factors. In order to assess the reliability of the data and obtain the validity of research results, I used 'triangulation' as a way to check opinions and ideas and to verify consistency across different data sources. This helped me to distinguish 'propaganda' from evidence, to make sound judgements about issues and facts and to prevent subjective biases, and most importantly increased the credibility and validity of my research findings.

Next, I worked systematically through the entire data set, highlighted potential themes, namely resource- and non-resource-based industries, into which firms could be grouped for analysis based on my theoretical framework, the interviews, secondary sources, government and corporate publications. These groups are reflected in the organisation of chapters: Chapter 5 discusses oil and gas companies; Chapter 6, electricity and aluminium companies; Chapter 7 telecommunications and insurance; Chapter 8 financial and railway companies. I also identified the structure of the chapters, which would discuss ownership, localisation, political economy of investments, including state-business and state-state relations, and internalisation in that order. In the third stage, at the broader level I started to explore the Russian firms' ownership advantages, the locational advantages of the South Caucasus, their relations with the Russian state and political economy factors in the region, and firms' entry strategies, and then collated all potential information into the relevant chapters under the relevant sub-headings. In the process, I also customised several maps by using SmartDraw diagramming software and created several figures and graphs by using Microsoft Excel. In this data analysis phase, cross-case and cross-nation pattern matching, use of maps, figures and graphs, cross-checking initial results and comparing evidence with the extant literature allowed me to increase the internal and external validity (Riege, 2003: 82).

In the fourth stage, I reviewed and refined each chapter, to check that my thematic map reflected the theoretical and analytical approach of the thesis. It here became evident that some information was not relevant to my argument and research topic, and I consequently removed this and rewrote aspects that were not clear. In the fifth stage, I began writing a detailed analysis by going back to the collated information for each firm. The sixth stage involved producing the final analysis and write-up of my thesis. At this point, the most important went beyond description of the data and related back from the analysis to the main research question and existing literature (Braun & Clarke, 2006: 93; Vaismoradi *et al.*, 2013: 402).

3.5 Ethical Issues

Before undertaking my fieldwork in Russia and the South Caucasus countries, the full research proposal together with supporting documentation was reviewed by the Research Ethics Committee and received their approval. At each stage, I made every effort to ensure the anonymity and confidentiality of my respondents and the data during all interactions with them. I transcribed all the data into written form myself and then stored all written and audio files on my encrypted hard drive, which was saved to the University Remote Desktop to avoid any undesirable incidents. My notes on paper were kept in a locked cabinet in my study room to avoid anyone else gaining access to it. All identifiers were removed from the data and it was coded in such a way that no personal data, including names and other specific information, could be used to identify the respondents.

Given the positions of my informants and the highly important information they provided, keeping their identity anonymous and ensuring confidentially were crucial. Nothing was ascribed to the respondents without first requesting and acquiring their permission. As Table 1 shows, some were happy to be openly identified in the research, whereas others preferred to remain anonymous. Before each interview, respondents were fully informed about the purpose of the project, its main features, potential interview questions, what I planned to do with their information – how I would use it and where I would publish it. During the interviews confidentiality and anonymity of respondents and data were reiterated.

Chapter 4

4 Russia and the South Caucasus: Political and Economic Changes

4.1 Introduction

The purpose of this chapter is to provide a general background on the political economy of Russia and the South Caucasus countries. In the first section I explore and analyse Russia's macroeconomic and industrial development. I start with a brief explanation of the Soviet economy which will make it easier to understand today's Russian firms and their investment activities and whether there is change or continuity. I then explore the initial stages of privatisation and reorganisation in the 1990s and the final stages in the 2000s. I then investigate Russia and its political and economic relations with the South Caucasus countries, including sanctions and conflicts, and their economic and institutional development. In the final section, I examine political and economic integration projects, namely the CIS, CSTO, EEU and GUAM, and the purposes behind the establishment of these unions.

4.2 Macroeconomic Changes and Development in Russia

4.2.1 The Soviet era

An understanding of the Soviet economy, business environment and system is useful for explaining the characteristics of modern Russian firms and their motives for internationalisation in the FSU. FDI provided the Soviet Union with the means to obtain geographical footholds in various international oil and gas markets, and access to the needed services in banking, insurance and transport (McMillan, 1987: 67). Most Soviet firms were engaged in trading and marketing and their subsidiaries serviced their trade activities. In other words, there were several large, home-based trading companies (*ibid.*: 166). Although the majority were predominantly involved in the marketing of oil and gas and raw materials, other firms in the transport, international banking and insurance industries provided them with transportation, financial and insurance services for their foreign trade and investment activities abroad (Hill, 1986). Moreover, political and historical considerations, as well as the size and nature of the investments, defined the Soviet Union's preference for the possession of a majority or full ownership (Liuhto, 2002: 36; McMillan, 1987: 68). The aim of Soviet firms was to acquire majority shares in their investments rather than acting only as profit seekers (Vahtra, 2006: 8). This type of investment strategy also enabled them to have direct control and influence over their businesses (Liuhto, 2002: 36-37). Their business activities were not only driven by commercial motives, but were also perceived as serving the foreign policy or political objectives of the Soviet Union and this eventually undermined the national security of host countries (Liuhto & Vahtra, 2007: 120; McMillan, 1987: 169-185; Vahtra & Liuhto, 2004: 9). These firms were characterised by Hamilton (1986) as "red multinationals".

There was a higher degree of central management during the Soviet era (McMillan, 1987: 64). The headquarters of most state-owned companies were based in Moscow and they had established subsidiaries in various parts of the USSR. These were called 'all-union enterprises'. When the republics were united into a single state there was a common economic space, and firms and their subsidiaries were coordinated and governed by the Soviet Ministry for Central Planning in the same way as a modern headquarters coordinates and governs its subsidiaries and their business activities (Filippov, 2010: 308). Moreover, the suppliers and customers of Soviet state-owned companies were also based in different Soviet republics. After the collapse of the Soviet Union, those assets became located in newly independent states and the links disintegrated. The acquisition of assets located in new sovereign states was a feasible way to re-establish the links and recreate corporate integration (*ibid.*: 309).

In summary, Soviet firms were in general neither very active nor huge abroad because of the difficulty of integrating their activities beyond the planned economy, which was a major economic obstacle (Liuhto, 2002: 35; Liuhto & Vahtra, 2007: 119). During the Soviet period, Russia was the largest oil and gas, electricity and other service provider to the member states of the Soviet Union, supported by the existence of an established interconnected pipeline system, a unified electricity system, a common railway system operating on 1520 gauge, and various other unified systems. This became a windfall opportunity for newly emerging Russian companies to inherit some assets of the FSU. After the fall of the Soviet Union, Russian firms continued to control the corporations or subsidiaries, or the investments of the Soviet companies located in the other post-Soviet states. This change indicated continuity for the new companies, which shows how and why Russian companies inherited Soviet businesses. Similar trends can be found in today's Russian firms' business activities (Vahtra, 2006: 8).

4.2.2 The 1990s: Initial privatisation and reorganisation

After the collapse of the Soviet Union, Russia and other former Soviet republics experienced macroeconomic chaos and enormous political change. Russia's economy was in transition and faced huge budget deficits and severe political and economic problems (*see* Graph 3). During the first decade after the break-up, Russia did not possess a mature market economy, which would have required a well-developed business and regulatory infrastructure for its oil, gas, electricity, aluminium, railways, telecommunications, insurance and financial industries. Consequently there was a need for an institutional infrastructure and economic reforms (Stiglitz, 2003: 80). The Russian government introduced radical market reform through economic reforms (Buck, 2003: 308), in which the privatisation of state-owned enterprises was an important step (Filatotchev *et al.*, 1999: 1013-1014). Considering the legacy of seventy years of Soviet ownership of industry, in the early 1990s the transition to private ownership materialised at a rapid pace (Kalotay, 2008b: 57). Eventually, in November 1992, President Boris Yeltsin signed a Presidential Decree which listed Russia's firms and entities in terms of their specific characteristics of ownership change (privatisation) and transformation into joint-stock companies of state enterprises: industrial, research and production. Through this privatisation and restructuring, there was a massive shift in corporate governance (King *et al.*, 1995).

Resource-based industries: oil, gas, electricity and aluminium

When exploring and analysing the internationalisation speed of Gazprom, Lukoil and Rosneft, it needs to be emphasised that they did not start up from scratch. In 1989, the Ministries of Oil and Gas and the Oil Processing and Petrochemical Industries of the USSR were restructured and amalgamated to form a single Ministry of Oil and Gas Industry of the USSR. Initial plans were developed to establish one state company, Lukoil, for the oil industry, and another, Gazprom, for the gas industry (Heinrich, 2003: 49; Zubkovskaya & Michailova, 2014: 64). Subsequently, plans were changed, however, and Lukoil was established in November 1991, when the Russian government passed a directive on the foundation of Lukoil, and Vagit Alekberov, a former first deputy minister of the oil and gas industry of the Soviet Union, became company president (Lukoil, 2016: 8). Later, under decrees introduced by Yeltsin in February 1993, the Ministry of Gas of the Russian Federation, or the 'Gazprom State Gas Concern', was reconstituted as the Gazprom Russian Joint-Stock Company (RAO Gazprom) (Gazprom, 2017: 16), and the Ministry of Oil of the Russian Federation was converted into Rosneft as a state concern (I-10, 2017). In April 1994, the privatisation of RAO Gazprom was initiated, and later, in June 1998, was reconstituted into today's Public Joint-Stock Company, Gazprom (Gazprom, 2017: 16). Rosneft was incorporated as an Open Joint-Stock Company, the Rosneft Oil Company in December 1995 (Rosneft, 2017: 241). Consequently, this trio received vast oil and gas resources from the Soviet Union.[41] In particular, Gazprom inherited all the gas pipelines and other gas facilities, as well as the foreign customers.

During the Soviet period, and later during the early days of Russia, the Russian electricity industry was under state control and administered by the Ministry of Energy. In August 1992, under a decree established by Yeltsin, the Unified Energy System of Russia (RAO UES) was established as an electricity company. As a result of this reorganisation, RAO UES inherited 70% of the electricity and 30% of heat generation in Russia. Moreover, 72% of the generating capacity and 96% of the total length of trunk transmission lines in Russia, and distribution and supply assets, were transferred to RAO UES's ownership (Ketting, 2008: 95). After the establishment of Inter RAO UES in 1997 as a subsidiary of RAO UES, the electricity trade was carried out through the new subsidiary (Inter RAO UES, 2009: 21). Russia's aluminium industry was also liberalised in the early 1990s. At that time, independent producers still had close ties to the Kremlin, particularly Oleg Deripaska and Victor Vekselberg, and increased their shares through 'voucher actions' (Black *et al.*, 2000: 1733). As a result of this privatisation, in the second half of the 1990s, Deripaska established RUSAL and Vekselberg established SUAL as private aluminium companies (Prokopov, 2005: 32).

Non-Resource-based industries: telecommunications, insurance and finance

As a result of privatisation and reorganisation during the early 1990s, the 'Big Three' were established in the telecommunications industry; namely VEON[42] in 1992; MegaFon[43] in June 1993: and MTS in October 1993 (Lisitsyn *et al.*, 2005: 8-10; MTS, 2018b: 69; VEON, 2018: 5). MTS was founded by the fixed-line operator MGTS in Moscow and several other shareholders as a closed-stock company; 53% was owned by several Russian shareholders and 47% by two German companies, DeTeMobil and Siemens. In 1995, when DeTeMobil obtained Siemens' shares, Sistema, owned by the Russian business oligarch Vladimir Yevtushenkov, consolidated its stakes in the ownership of MTS. In 1997 MTS began expanding its business within the Russian Federation, and in 2000 it started operating as a public company (Lisitsyn *et al.*, 2006: 130; MTS, 2018b: 70). Northwest GSM was rebranded in 2002 as MegaFon, merged with other small Russian telecom companies and expanded its business. MegaFon was

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[41] During this time Yukos was also established as an oil and gas company by Russian oligarch Mikhail Khodorkovsky through 'loans for shares' auctions.

[42] initially known as VimpelCom.

[43] formerly Northwest GSM.

owned by the Russian businessman, Alisher Usmanov. Unlike MTS and MegaFon, VEON was established by a group of researchers in radio electronic technology under the leadership of Dmitri Zimin. It faced difficulties in obtaining GSM licences in time because of a lack of influential lobbyists to establish and develop its network, and its rivals had already started to build their networks (Lisitsyn *et al.*, 2005: 9-10). In the insurance industry, in the early years of post-Soviet Russia, Ingosstrakh remained a state-owned company until its privatisation in 1993. In 1994, it received a licence to carry out insurance and reinsurance activities and began to re-establish its network (Ingosstrakh, 2018). In the financial industry, in October 1990, VTB (Vneshtorgbank) was established as Russia's Foreign Trade Bank by the Russian state bank and the Ministry of Finance to deal with Russia's foreign economic transactions and facilitate its integration into the global economy. In the following year, VTB was authorised to conduct financial transactions. Later, in 1997, VTB was transformed from a closed-stock into an open joint-stock company and the Russian Central Bank became the primary shareholder with 96.8% (VTB, 2017). During this time, non-resource-based industries were relatively new sectors and their significance to the Russian economy was lower than resource-based ones.

The period of the 1990s was the era of oligarchic capitalism and turbulent privatisation. Consequently, Russia's most valuable and strategic sectors and firms, as a result of dubious privatisation[44] (Filippov, 2010: 309) were controlled by oligarchs (McCarthy *et al.*, 2009: 174) who became major owners of the leading Russian enterprises with often close to monopoly control (Guriev & Rachinsky, 2005: 139-143). Moreover, political and economic instability within Russia was exacerbated by the 1998 financial crisis, causing a challenging period for the country and its newly emerged companies, and their business activities were adversely affected (*see* Graph 3). In addition, the August 1998 crisis led to the Russian government's debt default and rouble depreciation. The Russian currency was not freely convertible outside Russia; there were severe currency controls and continuing high rates of inflation. The 1998 financial crisis and political instability exposed Russian companies to financial and operational challenges to add to those caused by their obsolete equipment and outdated technologies, such as an overall fall in production due to severely exhausted resources, poor refinery capacity, declining retail sales in regional markets, inadequate investment in public telecommunications during Soviet times and restrictions on access to advanced western technology. It was very difficult for the firms to operate and develop their business (Kalotay, 2010b: 126).

[44] in other words 'loans-for-shares' actions or voucher deals

This unsettled political and economic environment, macroeconomic instability, punitive taxation, restrictions on capital account transactions and weak protection of property rights led to capital outflow (*see* Graphs 1, 2 and 3) (Loungani & Mauro, 2001; Tikhomirov, 1997). In the 1990s, the outward flow of Russian investments was largely underreported (Kalotay, 2010b: 114). Consequently, firms started to create safety investments abroad in order to protect their assets and themselves from home-country uncertainty and other macroeconomic risks (Bulatov, 2001; 1998). These push factors were escape investments or motives for keeping their assets abroad, as well as their bank accounts (Kalotay, 2010b: 125). For example, Lukoil's international presence and active investments abroad started in the 1990s, and one of my respondents explained that "they had some money cushioned away which they could use to invest somewhere else" (I-2, 2017). In 1999, the Central Bank of Russia began to receive and report increasingly accurate information but was not fully capable of revising its previous investment reports (Kalotay, 2010b: 115). For that reason, the current study does not rely on FDI statistics. This 'system escape' motive also challenges IDP predictions (Collins, 2013: 48; Kalotay, 2002: 270).

In fact, as predicted by the IDP (Dunning & Narula, 1996), the change in the economic system, along with the structural reforms in Russia from central planning to a market economy, had a positive impact on the companies and their investments and became the stimulus for their development and expansion (Liuhto, 2015: 5). At that time, Russia was in the early stages of its IDP and only a few Russian firms from the energy sector, referred to as 'eagle multinationals', managed to establish their international presence at an early stage of restructuring or existence (Collins, 2013: 49). Unlike the energy companies, the Russian electricity, aluminium, telecommunications, insurance and financial companies were not financially or organisationally developed enough to invest outside Russia. During the 1990s, in line with the U-model (Johanson & Vahlne, 1977) these companies began expanding their coverage area within the Russian Federation in order to obtain strong market shares. Moreover, the fact that these Russian firms had emerged in an unstable institutional and unfavourable business environment, triggered by the 1998 financial crisis, political chaos and other various macroeconomic issues, enabled them to be resilient in other markets. Then, after 2000, decisive state intervention was very important (Filippov, 2013: 216). All in all, in the 1990s there was only privatisation, the restructuring of Soviet enterprises or ministries and the consolidation of assets (Panibratov & Verbá, 2011: 64). As a result of restructuring, nearly all ministry staff and administrations were transformed into the management of new companies. This change also meant continuity from the Soviet period, which is a unique and important ownership advantage.

4.2.3 The 2000s: Final restructuring and reorganisation

In the early 2000s, there was a strategic shift in the Russian business environment and economy with the arrival of a new government (Collins, 2013: 48). During Yeltsin’s presidency, Russia was in economic and political chaos. The state primarily contributed to the creation of the large Russian corporations, but did not have investment policies to support its firms and their expansion, and did not have a strategy of using investment as a tool to achieve international strategic goals. When Putin came to power, the state had clear objectives and started to support and promote its firms and their expansion in the service of strategic national goals. The state could now be described as a key ‘institutional entrepreneur’ for investments (Marinova *et al.*, 2012: 233). It provided its firms with political, diplomatic and financial support and other lobbying activities through its embassies, ministries, financial institutions and other state agencies during the implementation of their investment projects.

The development of the Russian economy became one of the primary factors behind firms’ internationalisation (*see* Graph 3). Whereas in the 1990s, system escape had been the primary motive behind the internationalisation of Russian firms due to the harsh regulatory conditions, after the 2000s they began to invest abroad in order to capture new markets thanks to the home-country resource base and economic development (Collins, 2013: 49). For example, given the harsh business environment in Russia and its struggles with the government, the oil company Yukos in 2002 began using Armenia as an escape route to save money (OCCRP, 2014). Russia and the EU concluded their main bilateral negotiations to join the World Trade Organisation (WTO) in May 2004. It was basically perceived that the Russian state’s decisions and activities were aimed at stabilising and effectively improving the economic and political situation in Russia and abroad. Moreover, skyrocketing oil and gas prices generated substantial revenues, boosted corporate growth and accelerated the firms’ expansion (Filippov, 2010: 316).

During the 2000s, the Russian economy and its industries were agglomerated in the hands of several large Russian firms. There was also increasing state ownership or control. Putin listed strategic sectors and firms that constituted Russia’s major exporters, tax revenues and international presence, replacing Yeltsin’s policies and oligarchic capitalism with state-managed or network capitalism (McCarthy *et al.*, 2009: 171-172). This shift had a huge impact on the development of the domestic economy and business environment and led to the creation or final restructuring of key industries (Kalotay, 2010b: 127) either through state finance or more efficient administrative measures instructed by the state. Russian companies started to invest and become global players (Filippov, 2010: 309-311). Putin's policies have influenced internationalisation strategies ever since (Kuznetsov, 2011a: 41). The expansion of Russian companies controlled by powerful oligarchs was a unique Russian way of achieving internationalisation in comparison with other latecomers to the international business environment (Collins, 2013: 49).

Resource-based industries: oil, gas, electricity and aluminium

In accordance with the U-model, as a strategic objective, Gazprom, Lukoil and Rosneft started to strengthen their positions in Russia's oil and gas industry by acquiring assets to diversify their sources of income and reduce their total financial dependency on oil or gas exports and supplies. These three Russian companies were actively involved in several acquisitions. In particular, during 2005 and 2006, two major transactions occurred in the oil and gas industry when the state began to regain strategic control of these industries (Balmaceda, 2008: 7; Vahtra *et al.*, 2007: 282-283). First, in 2005, Gazprom acquired Sibneft[45] and renamed it Gazpromneft. This laid the foundation for the further development of Gazprom's oil business and considerably magnified its refinery segment (Gazprom, 2006a: 4, 16; Kalotay, 2008a: 92). As a result, Gazprom not only diversified its core production activities but also became the third largest oil producer after Lukoil and Rosneft. Second, in 2006, Rosneft made major acquisitions of Yukos' upstream and downstream assets[46] (Rosneft, 2008: 10) and had investments in Armenia (Aghalaryan, 2014a). Although it was a well-governed company, Yukos was exposed to bankruptcy and in 2005 its level of corporate governance deteriorated. In the meantime, however, Gazprom's acquisition of Sibneft had poor transparency and disclosure records but its acquisition improved the company's transparency (Vahtra *et al.*, 2007: 286)[47]. Moreover, although Rosneft was a 100% state-owned company at the time, the state decided to consolidate its ownership in Gazprom by acquiring a 10.74% share which gave

[45] the fifth largest Russian oil company at that time, formerly controlled by the Russian oligarch Roman Abramovich.

[46] which produced 20% of Russia's oil at that time; formerly controlled by the Russian oligarch Mikhail Khodorkovsky.

[47] Sibneft had never officially disclosed the real structure of its ownership and had a poor organisational structure (Vahtra *et al.*, 2007: 286).

it a controlling stake (Gazprom, 2006b: 68). Since then, the state has reduced its shares in Rosneft but still holds the controlling stake (Rosneft, 2016: 204; 2011: 34). Unlike Gazprom, in 2004 Lukoil became a fully private company after ConocoPhillips's purchase of 7.6% of shares in Lukoil from the Russian government (Lukoil, 2005: 7). In 2016, Rosneft was transformed from an open joint- into a public joint-stock company.

In 2004, as part of the state programme for the reform of the energy industry, RusHydro was established as a 100% subsidiary of RAO UES (RusHydro, 2009: 19). As a result of the final structural reforms, the Russian electricity industry underwent reorganisation in 2007. Consequently, RAO UES ceased to be a government monopoly and was converted into several private and state-owned companies (Inter RAO UES, 2009: 12; RusHydro, 2009: 19), and Inter RAO UES and RusHydro became independent companies. The new structure of electric energy generation acquired a new centre of industry administration, the Ministry of Energy of Russia, in May 2008 (RusHydro, 2009: 4). In late March 2007, the merger of RUSAL with its local competitor SUAL, and Glencore, created United Company RUSAL (UC RUSAL) (RUSAL, 2010: 131), which became the world's second largest aluminium company in terms of primary aluminium production output (RUSAL, 2018: 8).

Non-Resource-based industries: telecommunications, insurance, financial and railways industries

In 2001, Alfa group, owned by the Russian businessman Mikhail Fridman, purchased strategic ownership in VimpelCom and became a major shareholder. This change significantly contributed to the company's development (Lisitsyn *et al.*, 2005: 9-10). Later, in 2008, VimpelCom was merged with Golden Telecom, a wireless and telecommunications company also owned by Alfa Group. During the restructuring of VimpelCom in 2009 and 2010, its two major shareholders moved to Bermuda (MTS, 2010: 7). Eventually, in 2017, VimpelCom was renamed VEON and moved its headquarters to Amsterdam. Changes in the ownership structure of MTS took place in late 2004, when Deutsche Telekom sold its 15% shares in MTS and Sistema became the only major shareholder with a controlling stake (Lisitsyn *et al.*, 2006: 130). In 2010, MTS was merged with Comstar, Golden Telecom's rival (MTS, 2011a: 31). After merging with several mobile services providers in 2001, Northwest GSM started to operate under the MegaFon brand. In the 2000s, Alfa Group obtained 25% shares in MegaFon, but in 2012 Fridman sold his entire share-holding after disputes with Usmanov over MegaFon's strategy (Weaver & Thomas, 2012). Eventually, through the USM Group, Usmanov became the largest shareholder with a controlling stake. In the 2000s, Ingosstrakh continued to develop its business and Oleg Deripaska purchased 10% of the company.

In the financial industry, shareholder reorganisation took place in VTB in 2002 when the state took over the shares from the Central Bank of Russia. The final changes in VTB were realised in 2011 and 2012 when the state reduced its shares to 60.93% (VTB, 2017). Whereas all these industries were established during Yeltsin's era as a result of industrial reforms, the Russian railway company was established during Putin's era after his reforms. Russia's Ministry of Railways (MPS), which inherited the Ministry of Railway Transportation of the USSR in January 1992, dealt with massive economic problems and its priority was to ensure the continuous operation of the railways (Murray, 2014: 4). In 2001, the state made a strategic decision to implement a railway restructuring programme (RZD, 2012: 8). In October 2003, under a decree issued by Putin, RZD was established as the successor to MPS, which nevertheless retained regulation of tariffs and other policy-setting functions. These functions were transferred to the Ministry of Transport in July 2004. As a result of the reorganisation of MPS, RZD inherited all the commercial operating assets, infrastructure and employees, and the state became sole owner of the company (RZD, 2005: 8).

The creation and reorganisation of these companies were a result of Russia's institutional and macroeconomic development, which also increased the companies' O advantages. Despite the macroeconomic changes and market reforms, the state maintained its control, had a significant influence over its large firms, and there was a weak institutional infrastructure, as Graphs 1 and 2 show. Although a large proportion of most raw materials industries is still controlled by Kremlin-linked oligarchs (McCarthy *et al.*, 2009: 173) and non-strategic sectors continue to be Kremlin loyalists. Over the years, Russia has developed a unique corporate governance based on the institutional environment and the unique state-firm relations (Connolly, 2015: 35; Guriev *et al.*, 2004; Puffer & McCarthy, 2003). Russia has a history of intensive state intervention in its industries and in companies' activities during the Soviet period (Buck, 2003: 307), but as a latecomer economy, it bypassed this legacy and started investing (Bessonova & Gonchar, 2015: 847). These facts show that the O_t advantages of Russian firms were less technologically-based and more organisational- and management-based. These companies acquired other O_t advantages, such as excess capital and various inherited advantages (Kalotay, 2008b: 59). After Putin's arrival in the Kremlin, the state started to provide support for its companies and their expansion through various ministries, financial and other government institutions (Kheifets, 2008: 74-78).

4.3 Russia and the South Caucasus: Political and Economic Relations

At the beginning of the 1990s, the disintegration of the USSR considerably changed the geo-strategic order in Eurasia. As a result of this dissolution, fifteen independent republics emerged in the region and these new states faced problems such as state-building, economic decline and corruption, as Graphs 1, 2 and 3 show (Donaldson *et al.*, 2014: 158-159). Consequently, within a short period, the post-Soviet area became a focus of global attention in the form of great competition for power. These countries were sometimes referred to as "economies in transition" (Erokhin, 2015: 402). Russia's immense geographical scale, located at the heart of Eurasia and its rich natural resources, especially oil and gas, made the country a major global energy player or power, which also played into Russia's domestic and foreign policies and set big broader political goals (Zhuplev, 2012: 224). In line with Hymers' classical (1960) explanation, these monopolistic and oligopolistic behaviours can be important ownership advantages. Among the post-Soviet states, Russia has been a leading country in terms of its economy and natural resources (Vahtra *et al.*, 2007: 273). The South Caucasus[48] consists of Armenia, Azerbaijan and Georgia and became a geo-strategically important space for global actors because it is located at the crossroads of Europe, the Middle East, Central Asia and Russia (*see* Map 1) (Bishku, 2011: 1; Haas *et al.*, 2006: 11; Ismailov & Papava, 2010: 127; Nichol, 2014: 2). These countries' economic and political security depended on the balance of interrelations with both the major powers and their regional neighbouring states (Kakachia, 2011: 15).

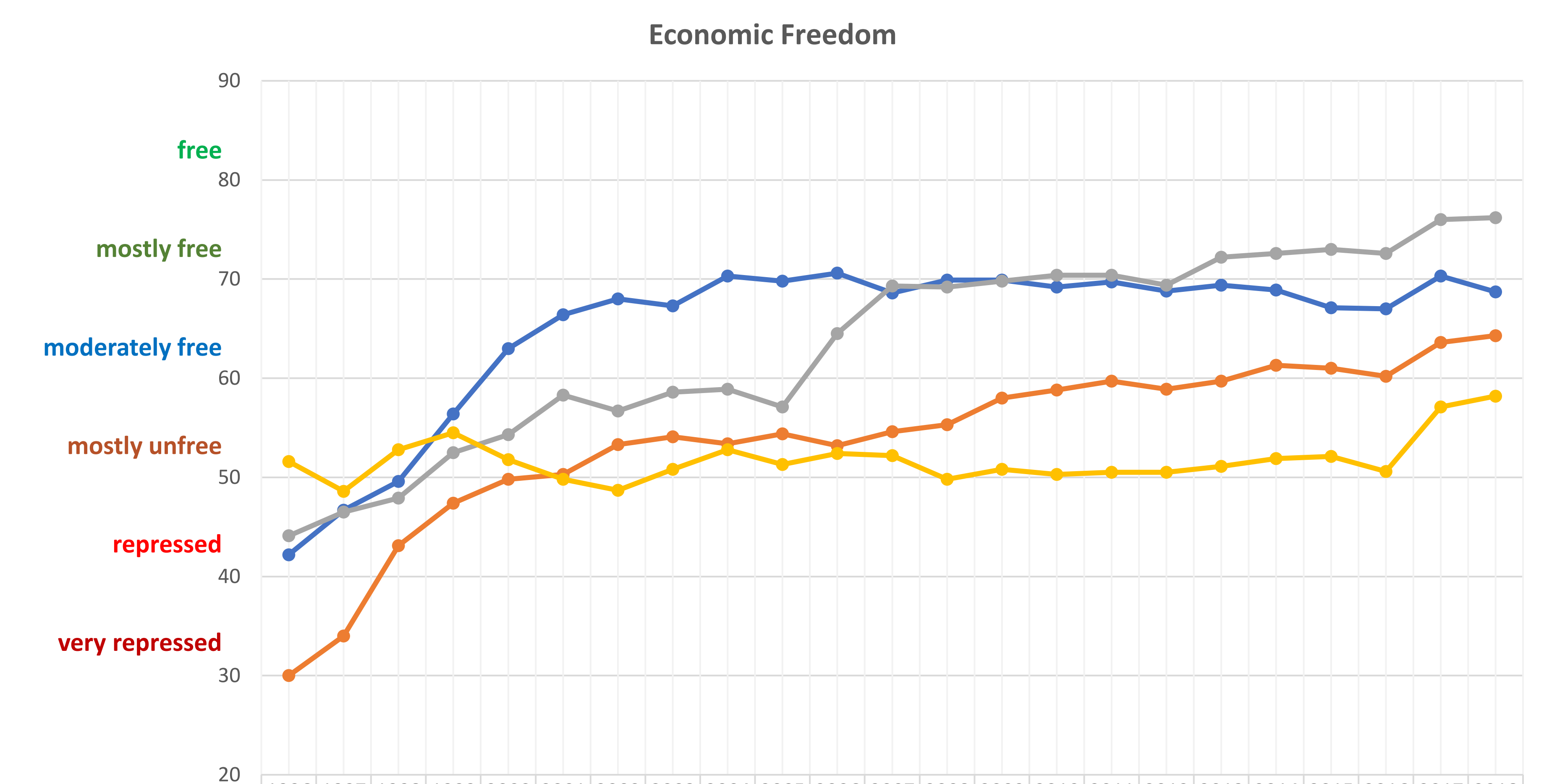
After the 1990s, Russia's foreign policy disregarded its southern border states and rebuilt relations with the South Caucasian republics more as an extension of internal affairs than as external affairs, because the region attracted western attention and Russia was struggling with internal problems (Perovič, 2005: 62). During this period, Russia faced political polarisation and macroeconomic decline amidst a basic lack of consensus over government decisions and an intense weakening of the state in relation to the increasing power of oligarchs, which was conferred on regional governors and administrative elites who diverged from this view. Russia's sovereignty and the state's efficacy were undermined by conflicting sub-national legislative and political loyalties. Within the first decade, the reforms failed to achieve either an enduring and efficient market or democratic institutions. However, with Putin's presidency,

[48] has also been recognised as Transcaucasia or the Transcaucasian geopolitical zone during Tsarist Russia, the Soviet Union up to the present time (Papava, 2013: 46).

policy became linked to macroeconomic stabilisation and the solid development of Russia's economy, the re-centralisation of the power of the presidency, and an increasingly assertive foreign policy. Putin's centralisation efforts effectively marginalised and dominated the regional governors and the powerful oligarchs (Hashim, 2005). In Russian politics, Putin's dominance and consolidation of power has given him an immense amount of authority to shape both foreign and domestic policy.

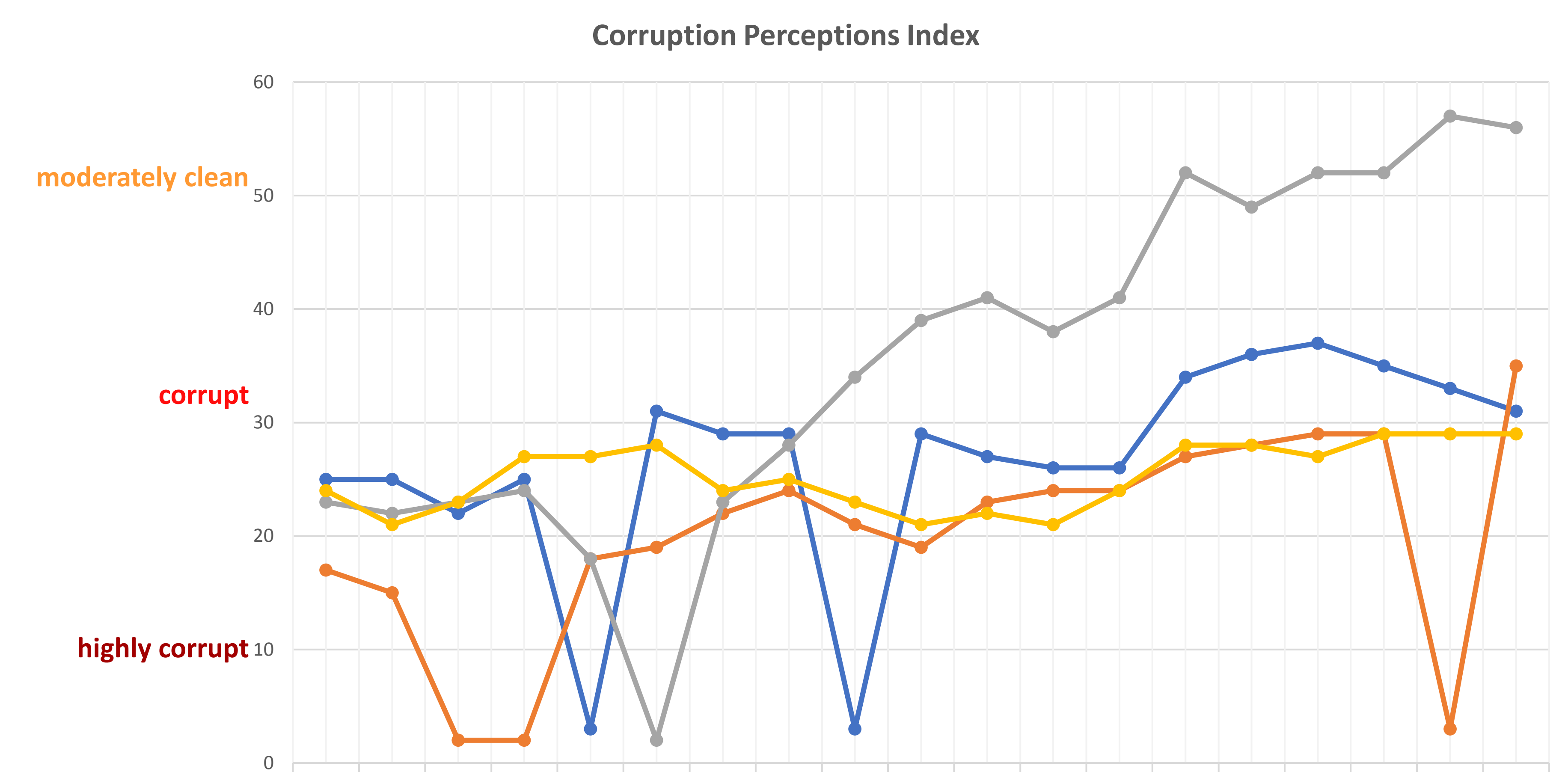
Map 1. Source: The Heritage Foundation, 2013

Another difference between South Caucasus countries is the investment climate in terms of their economic and institutional development, as illustrated in Graphs 1, 2 and 3 (Hübner *et al.*, 2011; Shiells, 2003). Armenia and Georgia are in the WTO but Azerbaijan is not. As Graphs 1 and 2 show, Azerbaijan has been mostly constrained in terms of its level of economic freedom and has been a highly corrupt country. Despite this, it has become economically more developed than Armenia and Georgia (*see* Graph 3). Armenia still has macroeconomic issues, whereas there has been an improvement in the institutional infrastructure of Georgia (*see* Graphs 1 and 2). These variations influence the level of attractiveness of a country for Russian firms.



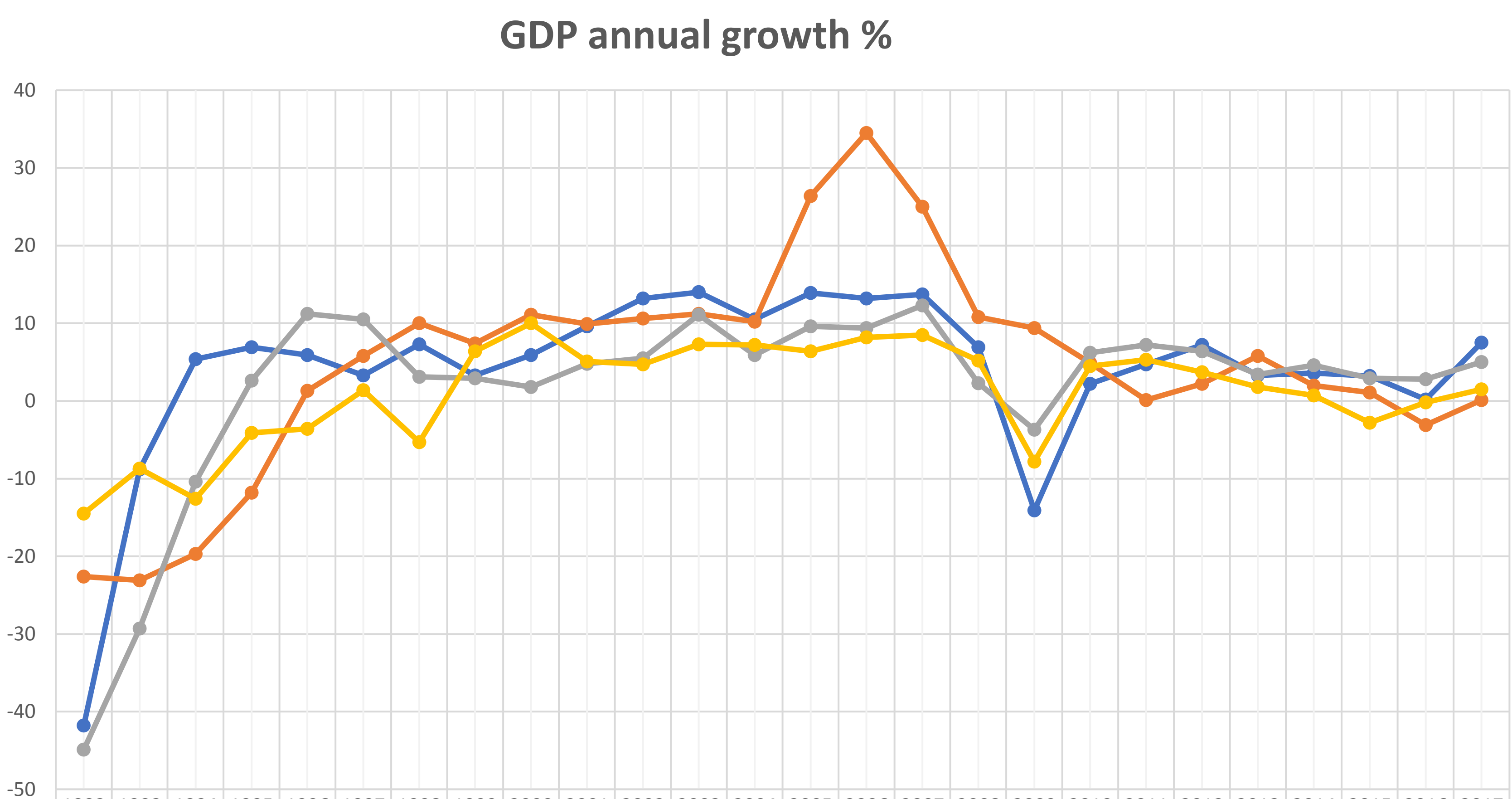
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Armenia	42.2	46.7	49.6	56.4	63	66.4	68	67.3	70.3	69.8	70.6	68.6	69.9	69.9	69.2	69.7	68.8	69.4	68.9	67.1	67	70.3	68.7
Azerbaijan	30	34	43.1	47.4	49.8	50.3	53.3	54.1	53.4	54.4	53.2	54.6	55.3	58	58.8	59.7	58.9	59.7	61.3	61	60.2	63.6	64.3
Georgia	44.1	46.5	47.9	52.5	54.3	58.3	56.7	58.6	58.9	57.1	64.5	69.3	69.2	69.8	70.4	70.4	69.4	72.2	72.6	73	72.6	76	76.2
Russia	51.6	48.6	52.8	54.5	51.8	49.8	48.7	50.8	52.8	51.3	52.4	52.2	49.8	50.8	50.3	50.5	50.5	51.1	51.9	52.1	50.6	57.1	58.2

Graph 1. Source: The Heritage Foundation, 2018



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Armenia	25	25	22	25	3	31	29	29	3	29	27	26	26	34	36	37	35	33	31
Azerbaijan	17	15	2	2	18	19	22	24	21	19	23	24	24	27	28	29	29	3	35
Georgia	23	22	23	24	18	2	23	28	34	39	41	38	41	52	49	52	52	57	56
Russia	24	21	23	27	27	28	24	25	23	21	22	21	24	28	28	27	29	29	29

Graph 2. Source: Transparency International, 2018



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Armenia	-41.8	-8.8	5.4	6.9	5.9	3.3	7.3	3.3	5.9	9.6	13.2	14	10.5	13.9	13.2	13.7	6.9	-14.1	2.2	4.7	7.2	3.3	3.6	3.2	0.2	7.5
Azerbaijan	-22.6	-23.1	-19.7	-11.8	1.3	5.8	10	7.4	11.1	9.9	10.6	11.2	10.2	26.4	34.5	25	10.8	9.4	4.9	0.1	2.2	5.8	2	1.1	-3.1	0.1
Georgia	-44.9	-29.3	-10.4	2.6	11.2	10.5	3.1	2.9	1.8	4.8	5.5	11.1	5.9	9.6	9.4	12.3	2.3	-3.7	6.2	7.2	6.4	3.4	4.6	2.9	2.8	5
Russia	-14.5	-8.7	-12.6	-4.1	-3.6	1.4	-5.3	6.4	10	5.1	4.7	7.3	7.2	6.4	8.2	8.5	5.2	-7.8	4.5	5.3	3.7	1.8	0.7	-2.8	-0.2	1.5

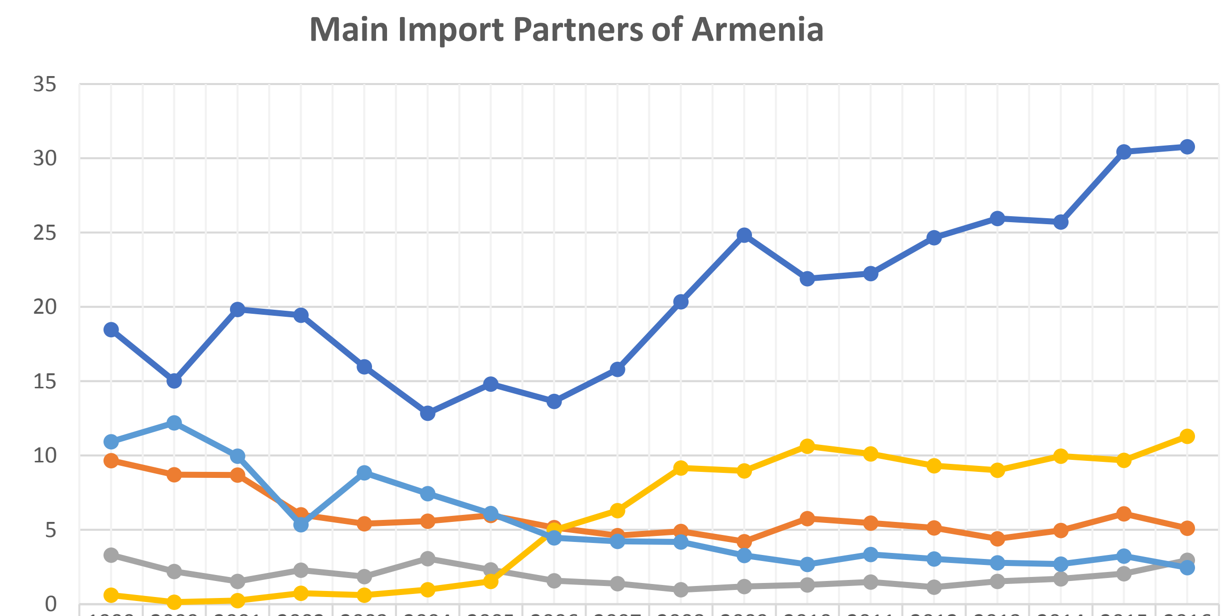
Armenia Azerbaijan Georgia Russia

Graph 3. Source: World Bank, 2018

There are differences between the South Caucasus countries' foreign policies and in their relations with Russia. In the functioning of diplomatic and economic activities, Russia has military, economic or trade and energy levers in the South Caucasus, which reflect the maintenance of its hegemonic position over and influence over the region. While Russia has no military bases in Azerbaijan, it does have a substantial amount of ground forces in Armenia, as well as in Abkhazia and South Ossetia. Russia has closer relations and cooperation with Armenia in this field, and problems with Georgia, which seeks to increase its diplomatic activities with the West. These are also the results of the Nagorno-Karabakh and Russian-Georgian conflicts in the South Caucasus. This provides Russia with military leverage over these countries (Hedenskog & Larsson, 2007: 78-110).

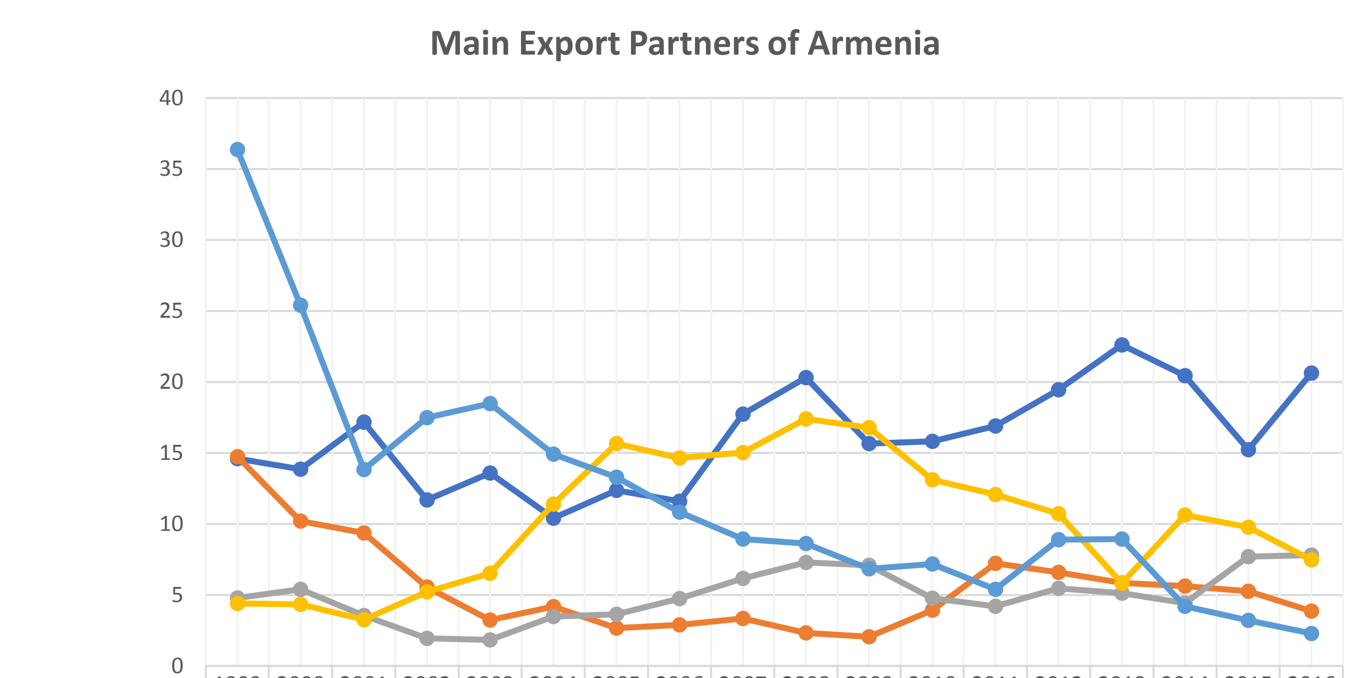
Russia has implemented trade sanctions against Azerbaijan and Georgia to hinder their inclinations towards the west. The situation in Azerbaijan indicates the significance of regional rivalry and informal networks. In 1994, Azerbaijan lost the battle over Nagorno-Karabakh (Lussac, 2010). In the same year, the 'contract of the century' was formed whereby foreign companies gained the right to exploit Azerbaijan's oil and gas fields which served as a foreign policy tool for Azerbaijan's political and economic development which would bring international support against Armenia and Russia (LeVine, 2007: 190). Moreover, in 1994, Russia accused Azerbaijan of supporting Chechen rebels and therefore imposed economic sanctions against Azerbaijan, which refuted the accusation. This forced Azerbaijan to find new partners, and Russia eventually lifted the sanctions in 1996. Azerbaijan remains relatively independent from Moscow because of its energy resources; it has also managed to develop its territorial influence through the integration and consolidation of the west-east transport and energy corridors with Turkey and Georgia. But this does not mean that Moscow has no leverage over Azerbaijan. In spite of western investments and large regional projects, Azerbaijan is careful not to isolate Russia, the influence of which was decisive in the Nagorno-Karabakh conflict, and whose assistance Azerbaijan needs to resolve the issue (Sierra, 2011).

Since the collapse of the USSR, relations between Georgia and Russia have been, in the main, controversial. Initially, the energy elites of Russia and Georgia maintained close interrelationships, which showed the continuing depth of the informal networks from the Soviet period (Jervalidze, 2006). For example, in 2004 Gazprom tried to take over the administration of the Georgian stem of the Russian-Armenian-Iranian pipeline, which was a serious concern for the US. Eventually, the US applied pressure to abandon the plans to move Iranian gas across Georgia to Russia's network (Tsygankov & Tarver-Wahlquist, 2009). Considering these countries' close ties in the 1990s, the 1998 financial crisis in Russia also had a detrimental impact on the Georgian economy and its national currency, as Graph 3 shows (Papava, 2012a: 63). Saakashvili's arrival in office in 2003 led to changes in Georgia's domestic and foreign policies (Spechler & Spechler, 2013: 2), but in 2006, Russia imposed an economic embargo on Georgian products and increased energy prices to punish Saakashvili's government. Since then, Moscow's informal impact on the Georgian economy, particularly the energy sector, has declined (*see* Graphs 8 and 9). It should be noted, however, that when Russia implemented economic sanctions against Georgia, Abkhazia was not subject to them. Following Russia's footsteps, Abkhazia also banned the import of Georgian wine, agricultural products and mineral water products. The tensions between these countries reached their peak during the August 2008 war, which led to diplomatic relations between them being broken off and Moscow's recognition of the independence of Abkhazia and South Ossetia. In response, Georgia withdrew its membership of the CIS, even though it remained in the CIS trading zone (Papava, 2012a: 66). Moreover, although diplomatic relations were terminated over the August 2008 war (Papava, 2010), economic relations continued (Papava, 2012a: 62).



	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Russia	18.48	15.04	19.84	19.44	15.98	12.85	14.81	13.66	15.81	20.36	24.83	21.9	22.25	24.66	25.95	25.71	30.43	30.78
Iran	9.67	8.71	8.7	6.03	5.41	5.59	5.97	5.15	4.62	4.9	4.22	5.76	5.45	5.14	4.41	4.96	6.09	5.12
Georgia	3.31	2.2	1.54	2.3	1.86	3.06	2.32	1.58	1.38	0.97	1.19	1.31	1.49	1.14	1.53	1.71	2.05	2.95
China	0.6	0.14	0.25	0.73	0.6	0.98	1.54	4.99	6.3	9.17	8.97	10.63	10.11	9.31	9.01	9.96	9.69	11.29
US	10.93	12.2	9.97	5.36	8.84	7.44	6.1	4.47	4.24	4.19	3.29	2.68	3.34	3.04	2.79	2.71	3.23	2.46

Graph 4. Source: World Bank, WITS, 2018

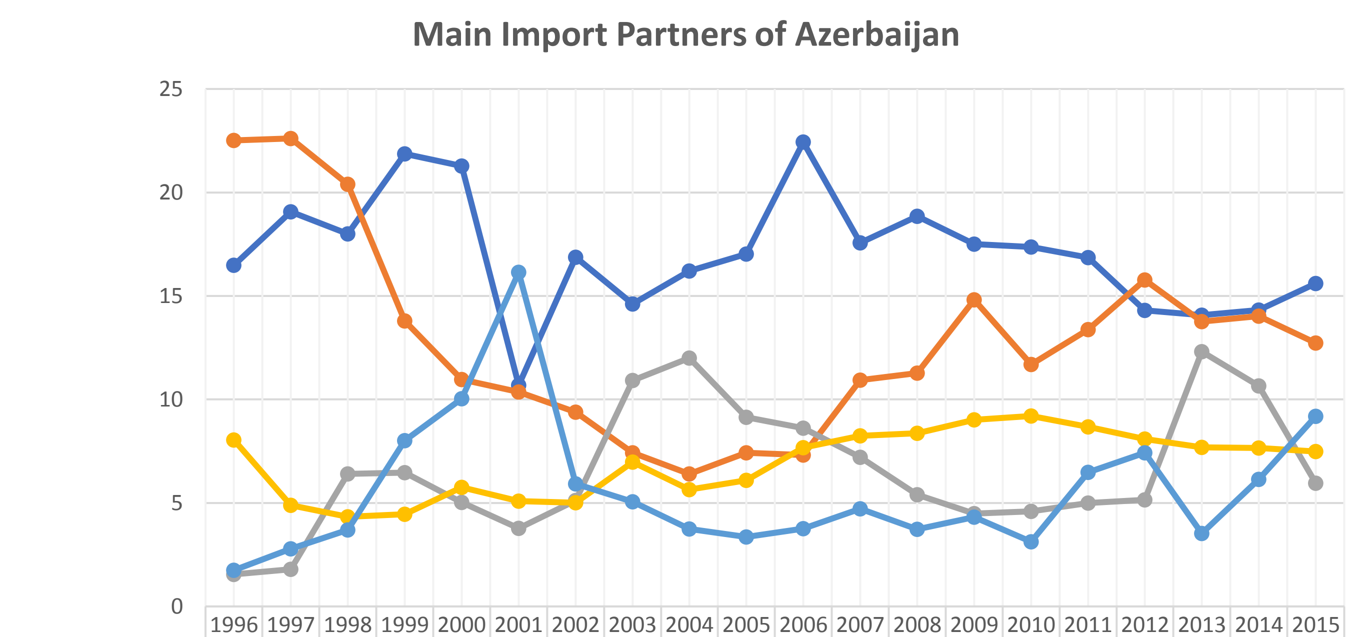


	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Russia	14.6	13.86	17.18	11.68	13.58	10.41	12.36	11.6	17.73	20.31	15.65	15.81	16.91	19.46	22.61	20.44	15.23	20.63
Iran	14.74	10.21	9.37	5.56	3.23	4.18	2.66	2.9	3.34	2.32	2.05	3.92	7.22	6.6	5.85	5.62	5.26	3.85
Georgia	4.79	5.39	3.54	1.95	1.83	3.48	3.63	4.73	6.16	7.3	7.08	4.77	4.21	5.46	5.12	4.42	7.69	7.81
Germany	4.4	4.34	3.26	5.21	6.52	11.4	15.66	14.65	15.03	17.4	16.78	13.11	12.08	10.71	5.82	10.63	9.78	7.47
Belgium	36.36	25.41	13.84	17.48	18.47	14.92	13.29	10.83	8.93	8.63	6.84	7.17	5.4	8.9	8.93	4.19	3.21	2.29

Graph 5. Source: World Bank, WITS, 2018

As Graphs 4 and 5 show, Russia has always been dominant in Armenia's imports and exports, whilst other countries have remained ordinary trade partners. Especially since 2006, Armenia's dependence on Russia has dramatically increased. In 2006, Russia accounted for 13.66% of Armenia's imports and 11.66% of its exports, and in 2016 it accounted for 30.78% of its imports and 20.63% of its exports. There is also a very close Moscow-Yerevan link that preserves important business ties (Halpin & Hughes, 2006). Despite the 2008 financial crisis, in 2009 Russia provided it with a $500 million 'stabilisation loan' (Khachatrian, 2009: 6; Nixey, 2012: 5). In the case of Azerbaijan, during the second half of 1990, Russia took a leading position in its external economic activities (*see* Graphs 6 and 7). Azerbaijan's economy is especially oriented towards the energy industry and its total exports to the West are oil and gas. The windfall from oil and gas resources has enabled Azerbaijan to become an energy exporter. Russia started to be a significant player in Georgia's economy during Sheverdnadze's presidency. Moreover, Graphs 8 and 9 clearly demonstrate that Russia was an important trading partner in Georgia's exports and imports only from 1995 to 2005. After 2006, the economic embargo and the 2008 Russian-Georgian war caused its role in Georgia's external economic activity to decline dramatically (*see* Graphs 8 and 9). The most integrative tendency in the

South Caucasus has been the growing bond between Turkey, Georgia and Azerbaijan, a process launched by the building of the BTC pipeline. Turkey is a growing and significant trade partner of both Azerbaijan and Georgia (*see* Graphs 6, 7, 8 and 9). Within the region, Armenia is dependent on Russia, whereas Azerbaijan, thanks to its natural resources, has reduced its dependence. The 2006 sanctions, price hikes in Gazprom's natural gas supplies and the August 2008 war forced Georgia to search for a development model for its economy (Papava, 2014). Moreover, Georgia and Azerbaijan joined Ukraine and Moldova to establish the GUAM in the early 2000s in order to reduce Russia's influence (*see* Figure 4).

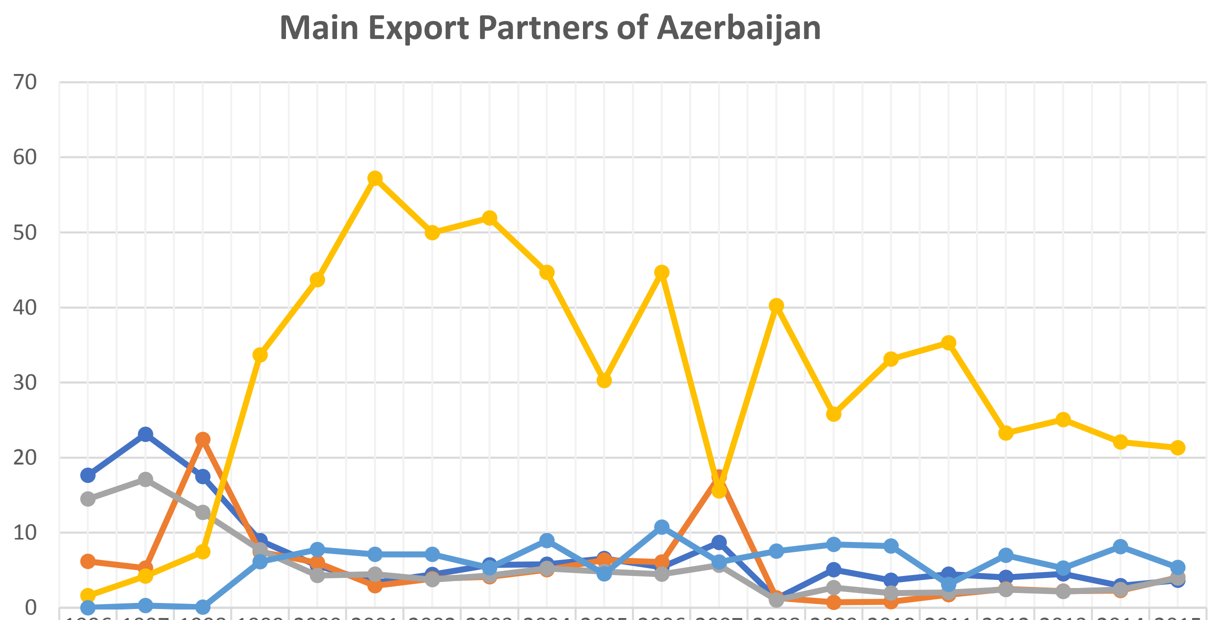


	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Russia	16.49	19.07	18	21.87	21.27	10.69	16.87	14.62	16.2	17.03	22.43	17.57	18.85	17.5	17.36	16.86	14.3	14.07	14.32	15.6
Turkey	22.51	22.61	20.4	13.8	10.96	10.36	9.38	7.43	6.4	7.43	7.31	10.94	11.27	14.81	11.69	13.38	15.77	13.76	14.02	12.73
UK	1.55	1.8	6.4	6.47	5.02	3.77	5.12	10.91	12	9.14	8.62	7.2	5.39	4.49	4.59	4.99	5.15	12.31	10.66	5.95
Germany	8.04	4.88	4.33	4.46	5.76	5.09	5.01	6.97	5.65	6.09	7.67	8.25	8.36	9.01	9.2	8.68	8.09	7.68	7.66	7.48
US	1.75	2.79	3.7	8.01	10.04	16.14	5.93	5.05	3.75	3.35	3.76	4.71	3.72	4.32	3.13	6.48	7.42	3.52	6.14	9.19

Graph 6. Source: World Bank, WITS, 2018

There has been an increasing western presence in the region since 2000 (Nanay, 2009: 115-116), which has obliged Russia's companies to engage in more economic competition (Saivetz, 2003: 595). During this time, Russia began to eagerly support the international expansion of its major energy companies. Putin intended to achieve better coordination of Russia's energy policy, which had suffered from a lack of management under Yeltsin. Balancing the interests of business with the interests of the state led to Putin's attempt to create the Caspian Oil Company. The objective of this consortium, consisting of the three large energy companies Gazprom, Yukos and Lukoil, was mutual development of energy resources on Russia's side of the Caspian sea (Peroviĉ, 2005: 64). The former Georgian Minister of Foreign Affairs, Irakli

Menagarishvili, argued that Russia was against the construction of the BTC pipeline and other projects that bypassed Russia and had tried to block these projects (I-9, 2017). However, the Kremlin later withdrew its objection to western-supported projects and in 2001 Igor Ivanov, Russia's former Minister of Foreign Affairs, declared Russia's readiness to participate, and its energy companies' readiness too, and even contemplated direct participation in this project. Russia softened its opposition to the regional South Caucasus projects and in fact attempted to participate in them, but this came to nothing (Lelyveld, 2001; Peroviĉ, 2005: 64-65).

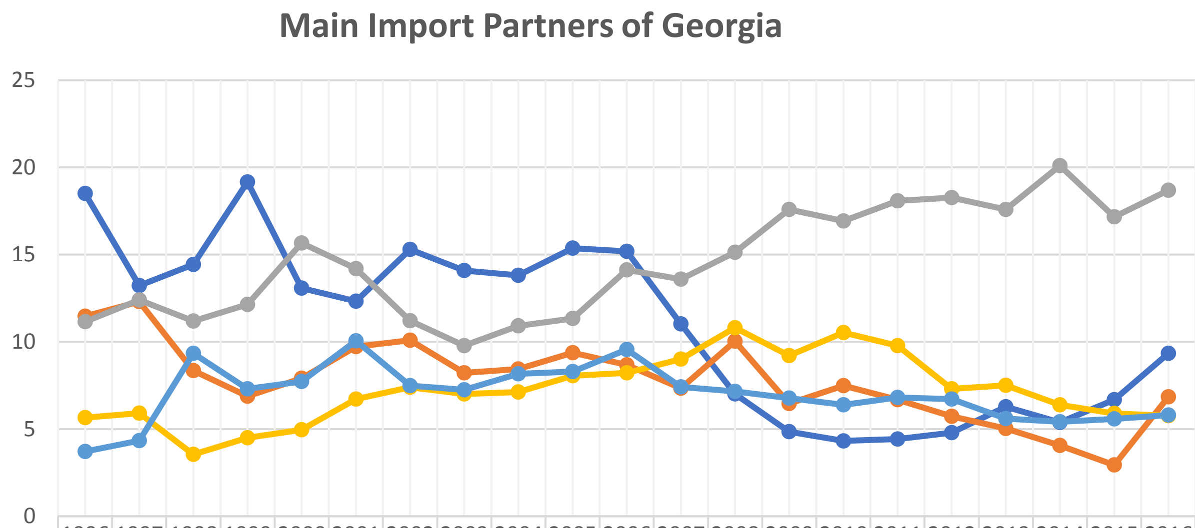


	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Russia	17.64	23.11	17.45	8.94	5.63	3.35	4.41	5.7	5.8	6.57	5.4	8.7	1.22	5.07	3.64	4.48	4.03	4.51	2.94	3.64
Turkey	6.19	5.28	22.41	7.43	6.02	2.91	3.85	4.13	5.05	6.35	6.09	17.44	1.31	0.73	0.8	1.72	2.52	2.2	2.31	4.04
Georgia	14.5	17.08	12.69	7.72	4.28	4.46	3.73	4.3	5.22	4.79	4.48	5.68	1.03	2.69	1.93	2.02	2.4	2.17	2.43	3.97
Italy	1.59	4.21	7.44	33.69	43.69	57.21	49.95	51.93	44.67	30.27	44.65	15.53	40.25	25.79	33.1	35.28	23.28	25.06	22.09	21.31
Israel	0	0.3	0.06	6.13	7.74	7.09	7.11	5.33	8.95	4.49	10.75	6.1	7.55	8.42	8.2	3.09	6.99	5.27	8.12	5.35

Graph 7. Source: World Bank, WITS, 2018

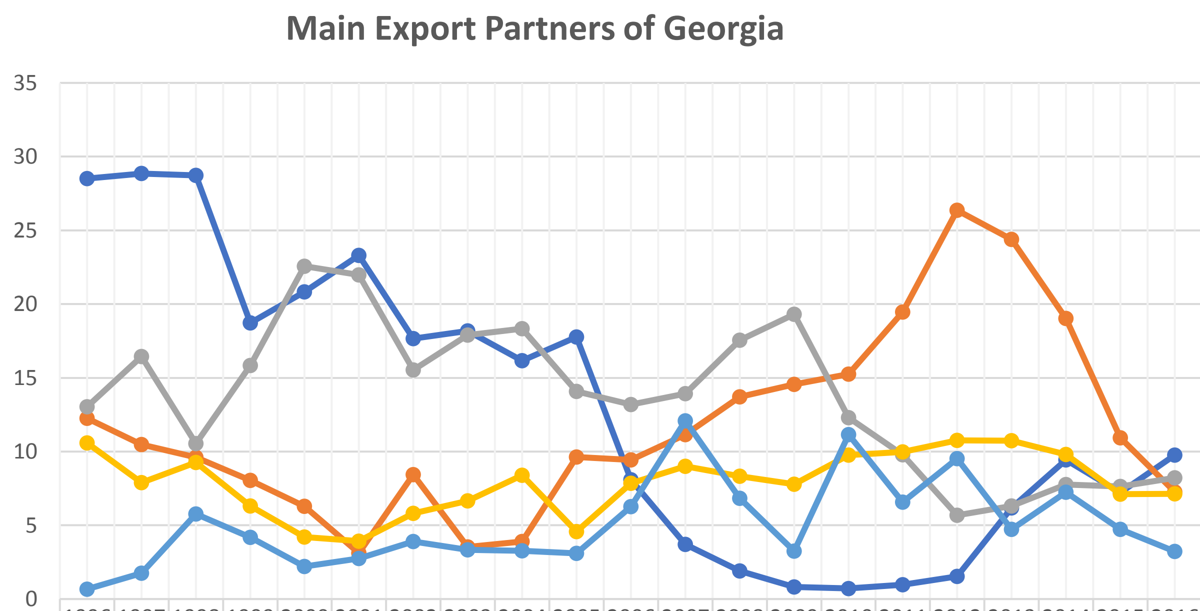
The Putin government's economic policy towards the post-Soviet republics was described as a 'liberal empire' by Anatoly Chubais, head of the former RAO UES state-owned company; it has also pursued a *laissez-faire* policy towards investments (Crane *et al.*, 2005: 406-407; Papava, 2012a: 61; 2010; Sierra, 2011: 237). Russia can only recover its political influence in the post-Soviet region through penetration by Russian companies and the control of strategic sectors in the region. The Russian government has seemed to play an important role in the investments made by state-owned companies in the energy sector, particularly by RAO UES and Gazprom, which made investments in the post-Soviet states as part of their long-standing corporate strategies. These two companies can also be described as having been made in the national rather than in corporate interests. As Chubais argued, "What is good for UES or

Gazprom is good for Russia" (Crane *et al.*, 2005: 433). This implicitly links Russia's national interests to its corporate interests.



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Russia	18.51	13.22	14.44	19.17	13.08	12.32	15.3	14.08	13.81	15.37	15.18	11.03	7.01	4.84	4.32	4.42	4.79	6.28	5.37	6.67	9.33
Azerbaijan	11.46	12.3	8.35	6.88	7.9	9.72	10.09	8.21	8.44	9.37	8.67	7.33	10.03	6.45	7.48	6.68	5.72	5.03	4.06	2.93	6.85
Turkey	11.15	12.39	11.18	12.14	15.66	14.19	11.21	9.78	10.91	11.34	14.13	13.59	15.13	17.58	16.92	18.08	18.26	17.58	20.1	17.17	18.69
Ukraine	5.65	5.91	3.54	4.49	4.96	6.71	7.39	7	7.12	8.05	8.22	9.01	10.81	9.2	10.53	9.78	7.3	7.5	6.38	5.89	5.77
Germany	3.71	4.34	9.33	7.31	7.73	10.06	7.49	7.24	8.17	8.29	9.55	7.41	7.15	6.77	6.39	6.8	6.71	5.6	5.42	5.58	5.8

Graph 8. Source: World Bank, WITS, 2018



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Russia	28.51	28.85	28.72	18.73	20.83	23.3	17.66	18.19	16.16	17.76	8.08	3.7	1.9	0.82	0.72	0.97	1.54	6.17	9.44	7.23	9.76
Azerbaijan	12.25	10.47	9.6	8.05	6.28	3.12	8.44	3.53	3.9	9.62	9.44	11.14	13.7	14.55	15.25	19.47	26.36	24.39	19.02	10.93	7.26
Turkey	13.03	16.44	10.55	15.84	22.57	21.99	15.53	17.89	18.33	14.08	13.19	13.93	17.56	19.31	12.3	9.79	5.68	6.32	7.77	7.64	8.21
Armenia	10.58	7.9	9.27	6.3	4.2	3.93	5.8	6.65	8.4	4.58	7.86	8.99	8.33	7.79	9.76	9.97	10.76	10.74	9.81	7.12	7.13
US	0.67	1.76	5.76	4.19	2.21	2.75	3.89	3.33	3.28	3.09	6.26	12.09	6.82	3.26	11.16	6.56	9.52	4.73	7.25	4.73	3.23

Graph 9. Source: World Bank, WITS, 2018

FDI, imports and exports are helpful proxies to use for analysing the relative size of countries' geographic orientations and economic developments (Linn & Tiomkin, 2007: 219). However, there are statistical deficiencies in the FDI statistics explaining Russia's investments in the South Caucasus (Kuznetsov, 2014: 132). Whereas in the 1990s there were system escape investments to secure some assets, as discussed earlier, in the 2000s many companies established 'overseas' subsidiary companies and started to exercise and implement all their international projects through their registered companies in offshore zones or in other countries, such as the Netherlands, the British Virgin Islands, Bermuda, the UK, Luxembourg, Malta and Cyprus. Their investments might therefore not appear in the FDI statistics. Companies can sometimes use these locations[49] to create 'round trip' investments (Vahtra & Liuhto, 2006: 27) and have invested via these countries in the South Caucasus (I-8, 2017). Because of these statistical deficiencies, I am not using the FDI statistics to explain Russian investment inflows in the South Caucasus countries.

Russia's political and economic ties with the South Caucasus states facilitated the expansion of its home companies and favoured their business operations. The facts discussed above show that there is variation across the South Caucasus countries' economic and institutional development, foreign policies, and relations with the neighbouring countries. Azerbaijan is rich in hydrocarbon resources and has geographic features which enable it to be a transit country. This has been Azerbaijan's clear comparative advantage and strong bargaining power *vis-à-vis* Russian firms (Heinrich & Pleines, 2015b: 108). But it depends on Georgia, and Georgia also depends on Azerbaijan. Both are located on major and primary transportation links, north-south and east-west corridors (Papava, 2012b). Armenia, however, is isolated from regional projects and is a landlocked country because both Azerbaijan and Turkey have closed their borders with it as a consequence of their political disputes. Armenia has closer relations with Russia, whereas Georgia and Azerbaijan look to Turkey and the West as important partners in regional projects (Boonstra, 2015). Taking all this into account, Russia still has substantial economic

[49] For example, Lukoil's subsidiaries are Overseas Shah Deniz Ltd incorporated in Cyprus, Lukoil International GmbH in Austria, and Lukoil International Upstream Holding B.V. in the Netherlands (Lukoil, 2017). RZD has investments in Malta (Kuznetsov, 2014: 131). Inter RAO UES's subsidiary Gardabani Holdings B.V. is registered in the Netherlands and the owner of Khrami HPP-1 and Khrami HPP-2 in Georgia (Inter RAO UES, 2018: 108; 2012: 34). RusHydro International B.V. is also registered in the Netherlands. VEON moved to Bermuda and its headquarters were later registered in the Netherlands.

influence (albeit to varying degrees) and some military power and influence in the South Caucasus.

4.4 Political and Economic Integration

Since the collapse of the Soviet Union, Russia has been in pursuit of control or has been reconstructing its control as a regional power (Zhuplev, 2012: 233). The country's military power, highly centralised governance and historical role in the 'near abroad' inherited from the Soviet Union, together with the role played by energy, have shaped the identity of the Russian state, including its economic and foreign policies (*ibid.*: 225). Russia has also been an initiator of political changes in the region (Erokhin, 2015: 402). The collapse of the Soviet Union undermined Russia's political and economic position. The CIS was established in December 1991 under Russian leadership by the leaders and experts of Russia and other post-Soviet republics. The Collective Security Treaty (CST) was signed between the former Soviet republics in May 1992. Armenia was the first country to join the CIS in February and the CST in May 1992 (*see* Figure 4). Unlike Armenia, Azerbaijan (September 1993) and Georgia (December 1993) signed up to the union and treaty for the purpose of moderating their relations with Russia. The establishment of the CIS and the CST demonstrated political hopefulness about the reintegration of the post-Soviet region. In order to prevent or resolve economic, political and military issues, Russia has primarily used the CIS summits and bilateral talks (Hedenskog & Larsson, 2007: 21). Unlike Armenia, Azerbaijan and Georgia left the CST in 1999. Even before that, in October 1997, as has already been stated, Azerbaijan and Georgia joined with Ukraine and Moldova, both non-CST members, and established the GUAM which has been an official organisation since 2001 (*see* Figure 4), and Turkey has become an observer in this union. In this way, Azerbaijan and Georgia have reduced their potential political, economic and military dependence on Russia.

In the early 2000s, Russia initiated various integrational projects. The CSTO was established in October 2002 as a descendant of the CST and Armenia joined this military alliance (*see* Figure 4). However, the imposed top-down political centralisation could be replaced with historical and cultural experience, and most importantly economic complementarities. In the CIS, there was no progress despite several meetings of representatives of its member states and consequent declarations (Krickovic, 2014: 506). The initial integration attempt through the CIS was a failure because integration could not be achieved just through the political will of its members. Later, Russia's efforts to achieve regional integration within the CIS took a new shape in the form of a more dynamic approach focused on economic pragmatism. Economic integration was attracting more attention in the FSU (Klotsvog, 1998: 83). For example, in October 2000, Russia established the Eurasian Economic Community (EurAsEc) as an initial step towards Eurasian economic integration (*see* Figure 4). This was followed by the establishment of the Eurasian Customs Union (ECU) in January 2010 and Eurasian Economic Space (EAEU) in January 2012 (*see* Figure 4). Accordingly, tariff and customs controls were eliminated (Tarr, 2016).

The ostensible purpose of integration and cooperation in the post-Soviet space was economic, but its primary objectives were political in terms of what could be achieved by economic means, such as trade and investments (Adomeit, 2012: 8). Neither, given the political inclinations of former Soviet republics towards the West, does Russia want to see Western influence in the post-Soviet space (Bahgat, 2010: 173-174). As Gachechiladze (2002: 136) had predicted, growing economic interests might lead to a new political change in the region. Consequently, after several integration projects, in January 2015 the Eurasian Economic Union (EEU) was established (*see* Figure 4) (Roberts & Moshes, 2016: 543) to rebuild Russia's political and economic power and effectively counterbalance the influence of the West (Hashim, 2010: 265). One of the key elements of regional integration within the post-Soviet region has been the development of investment relations. In understanding political or economic changes, it is important to consider the role of investments in the emergence and development of the EEU. Eurasian integration has had a positive impact on firms' business activities and investment decisions, and has eliminated trade, investment and tariff barriers (Kvashnin, 2016: 228). Consequently, the union has boosted investment and trade between Russia and Armenia (*see* Graphs 4 and 5). But the political component of the EEU is a manifestation of Russia's broader foreign policy objectives (also known as geopolitical objectives) (Roberts & Moshes, 2016: 558), which has affected Armenia's integration process (Krickovic, 2014: 501). Unlike in Armenia, however, Russia's attempts to achieve economic integration in Azerbaijan and Georgia have failed. Attempts at persuasion via policies such as economic sanctions and Gazprom price increases in Azerbaijan and Georgia have also failed to enable Moscow to recover its influence in the South Caucasus. Russia's economic embargo and energy price hikes damaged both Georgia's economy and their bilateral relations (*see* Graphs 8 and 9), and in 2009, Georgia withdrew from membership of the CIS (*see* Figure 4).

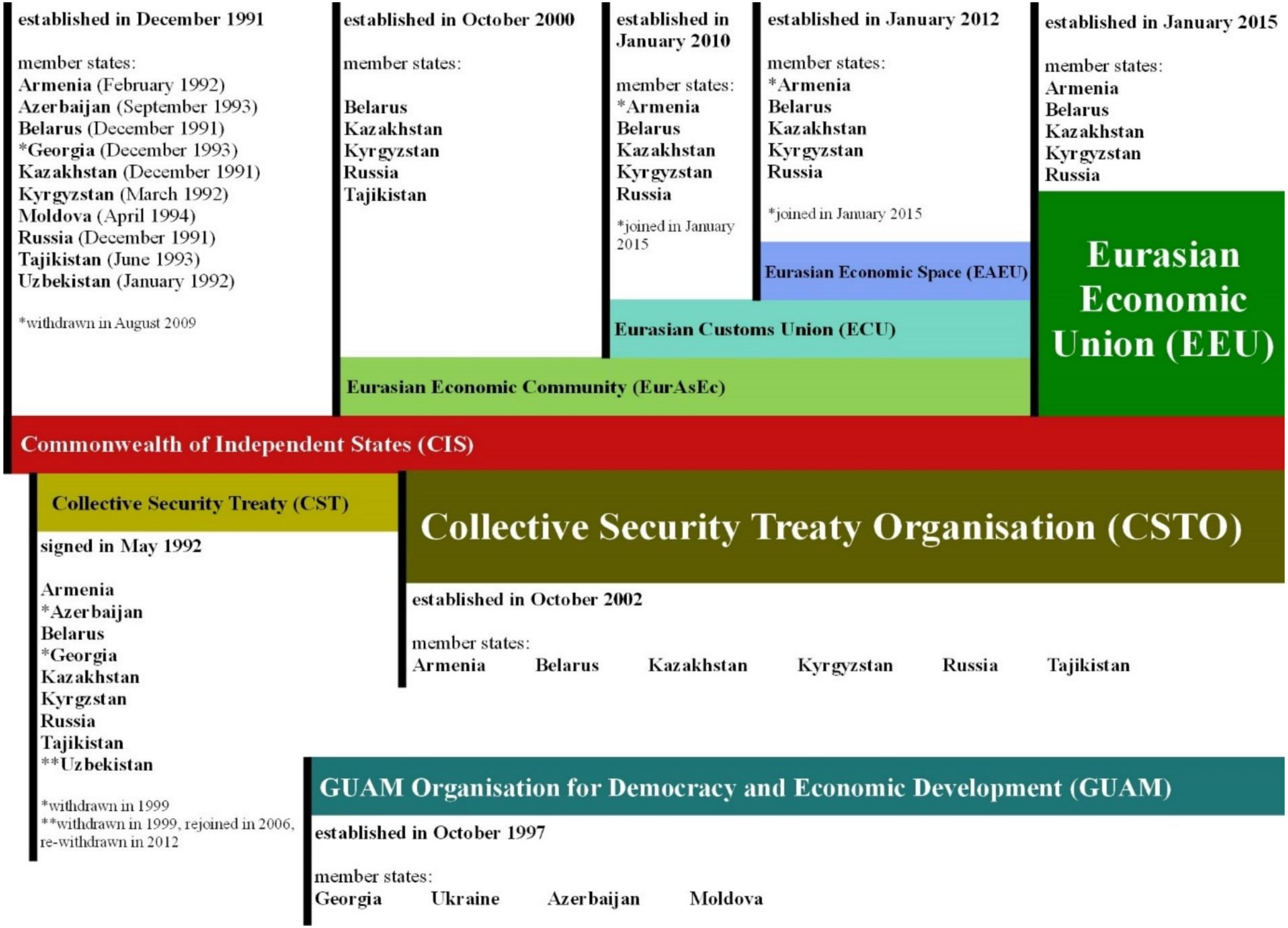


Figure 4: Political and Economic Unions (customised by the author)

Russia's main economic link with the South Caucasus is the CIS trade system, a free trade zone with weak legal and institutional links, and members cannot prosper in new markets with non-traditional exports or maintain their market share of exports, because of the low levels of intra-industry cooperation across the CIS region (Freinkman *et al.*, 2004: 58). Furthermore, the EEU is a Russian-led economic union established by Russia, Belarus, Kazakhstan, Kyrgyzstan and Armenia within the Single Economic Space (*see* Figure 4). The EEU represents the key trends in activities such as the free movement of services, people, capital and goods, and provides for common energy and macroeconomic policies, agricultural and industrial subsidies, as well as a single foreign currency for further integration in the future. The common political, economic and cultural interdependencies, as well as the historical ties inherited from the Soviet Union, have created incentives and facilitated regional integration. These factors have favoured Russia's foreign policy and reinforced its broader foreign policy goals (Krickovic, 2014: 523). Both geographical proximity and psychic proximity, in other words the 'neighbourhood effect', have thus played a significant role in the development of this union (Kvashnin, 2016: 222). However, Russia does not apply economic or conditionality and legislative models in its approach, but relies instead on rebuilding its economic power. It also clearly sees the EEU as an instrument for the reintegration of the post-Soviet region. Russia still has leverage over the region because there are economic, geographical and social links between it and the South Caucasus states. Economic links include trade, credit, investment and bilateral aid flows; geographic links encompass Russian-led alliances such as CIS, CSTO and EEU (*see* Figure 4); and social links involve remittances from South Caucasus workers, linkages between the South Caucasus states and Russia. These linkages all increase Russia's leverage. All in all, these political and economic integrations favour cooperation and facilitate firms' entry into the region.

4.5 Conclusion

During the Soviet period, there was central management: fifteen countries were united into one state and a planned economy. Business enterprises were state-owned and had their headquarters in Moscow, and their subsidiaries operated in other parts of the Soviet Union. Their presence and investment activities abroad (especially those of resource-based firms), were modest, and they were primarily engaged in exporting and trading activities. The financial, insurance and transportation services they needed were provided by other Soviet firms in support of resource-based firms' business activities abroad. Soviet firms' investments were not only driven by commercial logic but also by Soviet foreign policy.

After the collapse of the USSR, mass privatisation and reorganisation took place in Russia as a result of Yeltsin's economic policies and reforms. In the 1990s, Russia was busy with macroeconomic issues. The Yeltsin period of Russian and Caucasian relationships was "full of alliance shifts and other developments out of the control of official state authorities", and was defined by controversy, instability and change. Moscow lost its status as a hegemonic state in the near abroad, particularly in the South Caucasus (Donaldson *et al.*, 2014: 158-164; Nygren, 2008: 101). However, when Putin came to power, there was a significant shift in policy direction, and reorganisation in several Russian industries. Russia also started to return to international affairs by ensuring and improving its relations with western states and international organisations and seeking to recover its status in the region, a process necessary for its economy. Accordingly, Russia started to implement its foreign policies in the South Caucasus republics and cement its position in the region. Nevertheless, it has continued to pursue a variety of bilateral relationships with each of the republics of Armenia, Azerbaijan and Georgia in terms of politics, economics and trade – because they all possess a different economic capacity, and are politically positioned differently not just inside the region, but also in the international arena (*see* Graphs 1, 2 and 3).

All these facts and data show that Russia has played an active role in Armenia's economy and that Armenia has been the country most dependent on Russia (*see* Graphs 4 and 5). Russia and Georgia have had good economic and political relations, but these have deteriorated dramatically since 2006, following Russia's economic embargo and the 2008 Russian-Georgian war (*see* Graphs 8 and 9). For Azerbaijan, Russia has been an ordinary trade and economic partner (*see* Graphs 6 and 7). Another part of Russia's resurgence was focused on strengthening the relations between the CIS countries by creating the EEU and reinstating important political and economic influences in the CIS region. All in all, these countries share a history and cultural traditions, and common infrastructure and business practices which they have inherited from the Soviet Union. Briefly, all this raises important questions about how these variations influence firms' investment and business operations, and whether, once the economic situation stabilises, geographical proximity and historical/social/cultural ties contribute to FDI. So understanding all these political and economic changes, as well as political and economic relations between countries and regional integration projects allows us to interpret Russian resource- and non-resource-based firms’ business activities and to recognise their internationalisation strategies in the chapters that follow.

Chapter 5

5 Oil and Gas Industries: Gazprom, Lukoil and Rosneft

5.1 Introduction

Strategic considerations underly Russian diplomacy in its oil and gas industries and Gazprom, Lukoil and Rosneft are its largest oil and gas companies in terms of assets, revenues, market values and geographical diversification. These companies have footprints with a range of investment projects and trading activities in the South Caucasus emerging economies, as illustrated in Map 2. Gazprom is mostly involved in business with Armenia through its subsidiary ArmRosGazprom (*see* Maps 2, 3 and 4, and Graphs 10 and 12). Gazprom supplies natural gas to Georgia and Armenia, but not to Azerbaijan, although it sells some oil products in all three countries through Gazpromneft (*see* Map 2). It should be noted that until the 2006 price rises in the South Caucasus countries and Russia's sanctioning of Georgia, Gazprom was the sole gas supplier to the South Caucasus markets and ensured 100% gas supplies. Whereas Gazprom became the only natural gas supplier in Armenia, Georgia started to import what it needed from SOCAR and Azerbaijan started to export its own gas because, unlike Armenia and Georgia, it has its own hydrocarbon resources (*see* Map 8). Gazprom used to purchase natural gas from Azerbaijan, which it sold in other foreign markets (*see* Graph 10). Rosneft has a subsidiary company in Armenia and a JV in Georgia, both of which are downstream projects. Lukoil is mostly involved in Azerbaijan in both upstream and downstream projects and has subsidiaries in Azerbaijan and Georgia (*see* Map 2). Unlike Lukoil, Gazprom and Rosneft have investments in South Ossetia and Abkhazia, respectively.

In this chapter, by applying the interdisciplinary framework, I explore these Russian oil and gas companies and analyse the main determinants of their investment decisions in the South Caucasus. In the first section, I examine Gazprom, Lukoil and Rosneft and identify their ownership advantages. I also explore the impact of Russia's economic and institutional development and firm-level development on the internationalisation strategies of Gazprom, Lukoil and Rosneft. In the second section, I investigate the locational advantages of the South Caucasus countries that determined the location choices of Gazprom, Lukoil and Rosneft and explore the level of economic and institutional development and non-economic factors which determined these companies' decisions on where invest. In the next section, I study Gazprom's, Lukoil's and Rosneft's relations with the Russian state in implementing investment programmes, making investment decisions and receiving a variety of state support. I also examine how state-state relations and other political factors have influenced these companies and their investment decisions as well as the distribution of their investments and explore their roles in interstate relations. In the final section, given the various O and L advantages and political economy factors, I explore how Gazprom, Lukoil and Rosneft entered the markets and analyse what internalisation modes they chose and the reasons for their choices.

Map 2: Geographical footprints of Gazprom, Lukoil and Rosneft (customised by the author)

5.2 Ownership

In this section, the first level of the interdisciplinary theory is used to identify Gazprom's, Lukoil's and Rosneft's ownership advantages for international production and analyse the influence of home-country economic and institutional development and the firms' development in terms of their competencies and internationalisation strategies. In line with the IDP (Dunning, 1988), during the first decade after the collapse of the USSR, Russia was in the early stage of IDP and struggling with a lack of economic and institutional development due to its political and economic instability (*see* Graph 3). Moreover, in line with the U-model (Johanson & Wiedersheim-Paul, 1975), these oil and gas companies were in the early stages of development and in the 1990s, they suffered from obsolete equipment and outdated technologies and an overall fall in production.[50]

Gazprom, Lukoil and Rosneft were established as a result of an initial reorganisation and privatisation in the early 1990s. This was one of the prerequisites for their internationalisation. For example, Lukoil implemented its investments in the oil and gas fields of Azerbaijan in 1994 and 1996, respectively. Gazprom entered Armenia by establishing JVs in the gas industry in 1997 and in the banking industry in 1998. However, during the 1990s, due to macroeconomic factors associated with Russia's economic and institutional development (*see* Graph 3) and microeconomic factors associated with their development, the companies were not sufficiently capable of making large and continuous investments and were exposed to financial and operational challenges. When Putin came to power, they underwent shareholder reorganisation, which was accompanied by a favourable economic and institutional environment because of high oil and gas prices and an improved political situation. They then started to strengthen their market positions in Russia. Consequently, in early 2001, Lukoil implemented a JV with the State Oil Company of Azerbaijan Republic (SOCAR) at the Zykh and Govsany fields (Lukoil, 2001: 12), and in 2002 entered Georgia by establishing a subsidiary there. In 2005, Gazprom acquired Sibneft[51] which was later renamed 'Gazpromneft'. This change made Gazprom the third oil producer after Lukoil and Rosneft and enabled it to sell oil products in the South Caucasus states. The internationalisation of Gazprom can also be defined as inherited pipeline internationalisation (Liuhto, 2002: 51) because they inherited the Soviet Ministry of Gas, including foreign customers, the Unified Gas Pipeline System, most of the Russian gas reserves, gas monopoly and other gas facilities. At that time, the former Soviet republics, including the South Caucasus states, were the main customers of Gazprom. All this gave Gazprom oligopolistic and monopolistic advantages, allowing it to be dominant in the South Caucasus countries.

In 2004 and 2005 Gazprom started investing in the electricity industry and acquired a 10.5% share in RAO UES and a 25.01% stake in Mosenergo. In 2007 it consolidated its controlling ownership in Mosenergo (Gazprom, 2008: 6; 2006a: 17).[52] In March 2008, its rival Lukoil also

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[50] Because during the Soviet era they could only operate in support of Russia's energy exports and sales operations to its neighbours (Hamilton, 1986; McMillan, 1987).

[51] Russia's fifth-largest oil company at that time.

[52] Later became a number one in the world in terms of installed thermal energy generation capacity.

began investing in the electricity industry (Lukoil, 2016: 16). This strategic move[53] increased both companies' opportunities to sell natural gas at market prices in foreign markets, such as the South Caucasus, as illustrated in Maps 2, 3 and 4. Moreover, this ensured Gazprom extra pipeline gas and made it a leading Russian company in terms of the number of CNG filling stations it possessed (Gazprom, 2017: 16; 2016: 67). This generation capacity ownership advantage enabled Gazprom to establish its ArmRosGazprom subsidiary in Armenia and build its Abovyanskoye UGSF, the Unit 5 at Hrazdan TPP and CNG filling stations in Armenia (*see* Maps 2, 3 and 4). In 2006, Rosneft acquired both upstream and downstream assets of Yukos.[54] At that time Yukos also had a subsidiary in Armenia, Yukos CIS Investment, which had been operating since 2002 (Aghalaryan, 2014b). Integrating new assets into Rosneft's operating structure made the company "the national petroleum leader" (Rosneft, 2008: 10) and allowed it to seize Yukos assets in Armenia. All these positive macro- and micro-economic changes contributed to these firms' economic development and revenue growth and increased their ownership advantages to exploit in the South Caucasus countries.

Under Dunning's eclectic paradigm (1998a), these three companies' ownership advantages are associated with the possession of vast resource bases[55] that enabled them to pursue active offensive policies in foreign markets. Unlike Lukoil and Rosneft, Gazprom has the unique ownership advantage of the world's largest gas transmission system,[56] and its unique network of underground gas storage facilities (UGSF) in Russia and abroad, including the South Caucasus states, to ensure highly flexible and reliable gas supplies to its Russian and foreign customers (*see* Maps 3 and 4). This advantage provides Gazprom with a centrally operated

[53] including the installation of power generating stations and facilities at the oil and gas fields and oil refineries.

[54] producing 20% of Russia's oil output at that time.

[55] Gazprom holds a 72% share of Russian gas reserves and a 17% share of global gas reserves. Its shares of Russian and global gas outputs are 68% and 12% respectively (Gazprom, 2017: 66). Lukoil is the second-largest oil and gas company after Gazprom and the largest private company in Russia in terms of revenue, accounting for more than 2% of global oil production and refining and holding more than 1% of global proven oil reserves, and in Russia it possesses 15% of oil production and oil refining, and 11% of proven oil reserves (Lukoil, 2018: 41). Rosneft is the third-largest Russian oil and gas company, the second-largest state-owned company after Gazprom in terms of revenue, and a leader in the Russian oil refining industry with over 35% (Rosneft, 2017: 11).

[56] with a total length of 171.4 thousand km.

system of natural gas transaction, transmission and supply, the Unified Gas Supply System (UGSS) (*see* Maps 4 and 7).

Map 3: Gazprom's, Lukoil's and Rosneft's operation facilities in the proximity of the South Caucasus (customised by the author)

All in all, using the ownership sub-paradigm of the interdisciplinary framework has identified Gazprom's, Lukoil's and Rosneft's various ownership advantages and examined the impacts of macro- and micro-economic changes on the patterns of their investments and their internationalisation strategies in the South Caucasus countries. Besides firm-specific tangible and intangible ownership advantages in Russia, the economic and institutional development of Russia and these companies' firm-level development were an initial stepping-stone for them to make investment decisions about where to locate their investments in the South Caucasus countries. They began to consolidate the oligopolistic and monopolistic advantages that they inherited from the Soviet Union in Russia as a result of a high concentration of wealth, which later facilitated the expansion of their investments.

Map 4: Gazprom's UGSS, UGSF and Power Generating Units (customised by the author)

5.3 Localisation

In this section, using the location sub-paradigm of the interdisciplinary theory, I explore the locational determinants of the South Caucasus countries, including institutional, economic and non-economic factors, and analyse their impacts on Gazprom's, Lukoil's and Rosneft's locational choices, business strategies and operations. In accordance with Dunning's OLI (1980), one important factor during their strategic and investment planning is physical proximity (I-1, 2017; I-2, 2017). Their primary business segments are mainly based in Russia, as Maps 3 and 4 show, including refining, petrochemical transportations and power plants, which would enable them to take advantage of growing markets and other investment opportunities, and eventually supply the traditional number of gas and oil products (I-1, 2017; I-2, 2017). For example, the proximity and accessibility of Gazprom's networked UGSFs to its consumer markets provides flexible and stable gas supplies. Gazprom operates 22 UGSFs in Russia, and Kuschevskoye, Severo-Stavropolskoye and Krasnodarskoye are based in strategic locations where Gazprom can transmit natural gas to the South Caucasus markets and build new UGSFs there (*see* Maps 3 and 4).

As Maps 3 and 4 show, Gazprom's Adlesrkaya TPP, Stavropolskaya GRES and Novocherkasskaya GRES and Lukoil's Stavropolenergo, Astrkhanergo, Rostovenergo, and Kubanenergo power plants are situated in geographically strategic regions in close proximity to their operations and the South Caucasus countries. Having these power-generating stations and facilities enables them to sell more gas and oil products without interruption, and gives them potential investment opportunities in the region. For example, Gazprom built Abovyanskoye UGSF and Unit 5 at Hrazdan TPP in Armenia (*see* Maps 3 and 4); in addition, its expansion of the NGV infrastructure was focused on expanding its CNG filling-station network and building filling stations in strategically significant regions, such as the Krasnodar and Stavropol territories, as shown in Maps 3 and 4. The proximity of this infrastructure enabled it to expand into the neighbouring South Caucasus countries (Gazprom, 2017: 66-67; 2016: 86-87), including the eight CNG filling stations installed in Armenia (Gazprom, 2017: 87).

Gazprom continuously monitors the business environment to find investment opportunities in Georgia and Azerbaijan which could enable it to enter these markets and become involved in oil and gas projects there. In this regard, geographical proximity might help Gazprom to enter markets more quickly than its western counterparts (I-1, 2017). Lukoil's and Rosneft's refineries are in geographically strategic and advantageous locations as shown in Maps 3 and 14, and their product is sold in the domestic market and exported to foreign markets by rail and sea. For instance, Rosneft's Tuapse refinery is located on the Black Sea coast, which ensures more efficient and effective export of petroleum products, for example to Abkhazia and the South Caucasus countries. This allows Rosneft to supply the petroleum products by tanker, rail and ferry to Armenia through the Kavkaz-Poti and Batumi routes (*see* Maps 3, 4, 5, 6 and 14). This also increases the volume of trade between Russia and South Caucasus countries (*see* Graphs 4, 5, 8 and 9). This growth in trade prompted Rosneft to enter Armenia in 2012, and Georgia in 2014. This can also be referred to as the 'follow the customer strategy'. Unlike

Georgia and Armenia, as Maps 7 and 8 show, Azerbaijan has a clear comparative advantage in the region due to its energy resources and convenient location, which encourage its use as a transport hub (Kjaernet, 2010: 154). Lukoil benefits from these advantages and supplies its oil and gas products to the Georgian, Turkish and European markets. Thus, geographic proximity or location was one of the key host-country determinants that encouraged these investments in the South Caucasus countries.

Map 5: Transneft's existing trunk oil pipelines in close proximity of the South Caucasus (customised by the author)

Respondents highlighted that the economic performance of their projects was also linked to the development of infrastructure, potential synergies with the regions, advanced technologies, and access to existing pipelines and railways (*see* Maps 5, 6, 7 and 14) to maintain and increase their existing ownership advantages (I-1, 2017; I-2, 2017). For instance, the Gazprom respondent stated that Gazprom considered making upstream investments in Azerbaijan's

Map 6: The existing pipelines in Azerbaijan and Georgia (customised by the author)

natural gas, but this was not attractive for several technical reasons and required significant investments. Moreover, Gazprom has a legacy from the Soviet Union era in the gas transportation system which connects Russia with many other countries and is used to supply gas to those countries (I-1, 2017). Examples of this include Gazprom's efficiency-seeking investments in gas transportation and distribution in Armenia and South Ossetia. Also, Rosneft's investment in the LLC Petrol Market Company in Armenia,[57] and its synergy with

[57] which owns and controls a network of 22 gas stations and three oil storage facilities.

Petrocas Energy International in Georgia,[58] all develop and deepen its commercial activities in the South Caucasus and Central Asia (Rosneft, 2017: 252; 2016: 224). Since the 2014 fall in oil prices, these three companies' investment decisions have not been driven by oil prices, such as Rosneft's entry into the Georgian market in December 2014,[59] but by strategic decisions to have direct access to, or control over, their customers (I-1, 2017). These examples show that strategic decisions[60] and strategic asset- and efficiency-seeking motives were behind the localisation of the Russian oil and gas companies' investments in the South Caucasus.

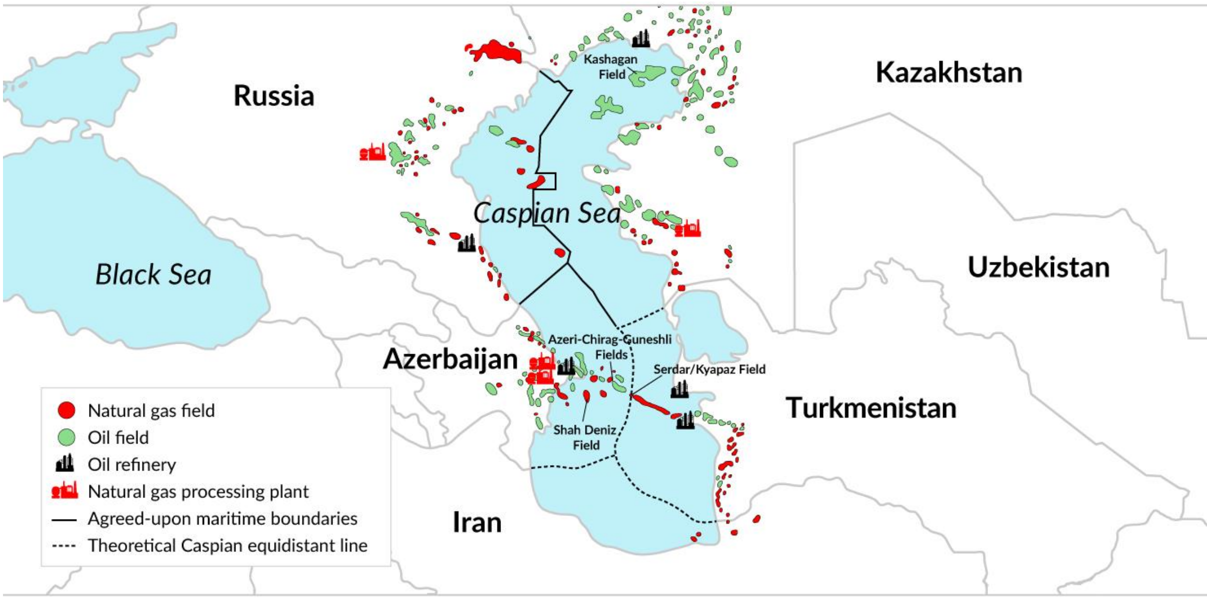
Map 7: The pipelines in the region (customised by the author)

Another strategic consideration in Gazprom's, Lukoil's and Rosneft's investment decisions was not only to earn money, but also to gain experience that they could use elsewhere (I-1, 2017; I-2; 2017). This kind of strategic investment in the South Caucasus can be found in Lukoil's first participation in Azerbaijan's oil and gas fields and Rosneft's acquisitions in Abkhazia, as well as Gazprom's intentions to invest in Azerbaijan, to participate in the privatisation of Georgia's gas pipelines and make its first and only international investment in power generation in Armenia. In regard to the localisation determinants, host-country government incentives such as special tax regimes were significant. Lukoil's gas, produced in

[58] which owns and controls the largest retail network of 140 branded gas stations and high-technology storage assets in the logistics of oil and petroleum products in Georgia, and the oil terminal in Poti port which handles oil and petrochemical products and facilitates its active involvement in trading activities in the Black Sea and Caspian Sea regions.

[59] other examples include Gazprom's strategic projects in European, Nord stream 2 and Turkish stream pipelines.

[60] such as access to high-technology and distribution networks would promote and advance their long-term strategic objectives and eventually build their business empires.



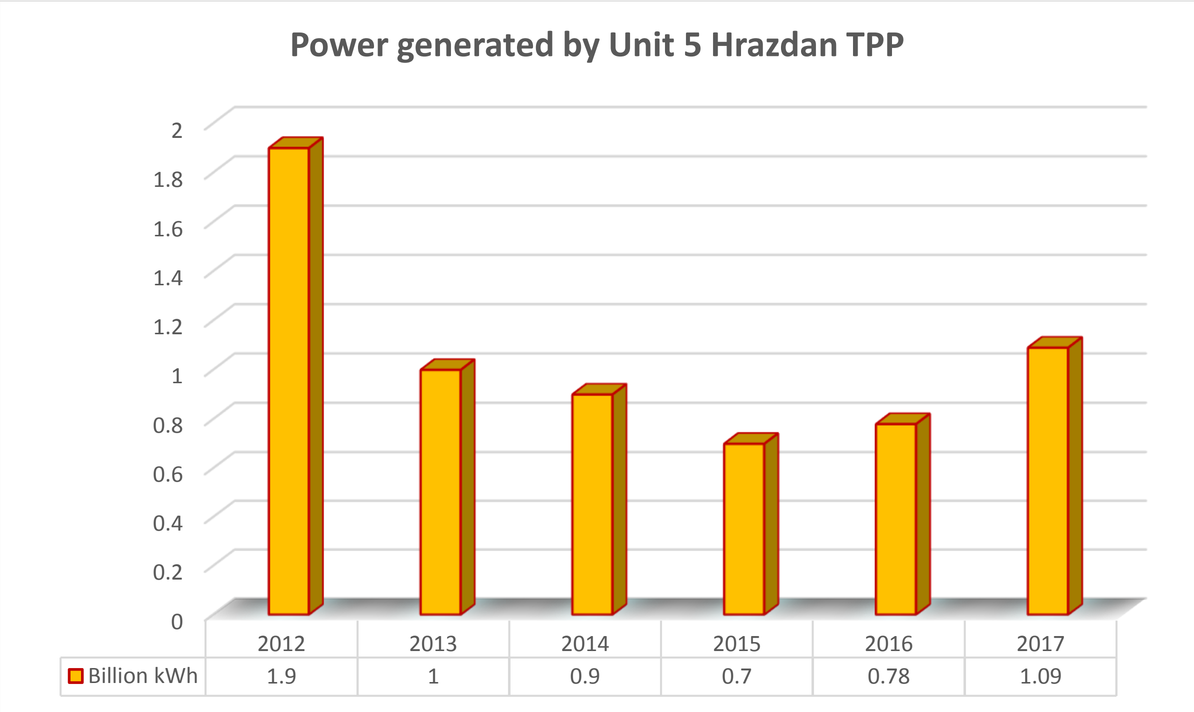
Map 8. Source: US Energy Information Administration, US Geological Survey, 2017

Shah Deniz, is supplied to Azerbaijan's domestic market and transported through the South Caucasus pipeline to Georgia and Turkey, where it is sold at market prices (*see* Map 7). Since the Shah Deniz project was launched in December 2006 (Lukoil, 2010: 39), under the conditions of the Production Sharing Agreement,[61] Lukoil is not subject to taxes in cash on the production and export of gas, except for income tax at a fixed rate (Lukoil, 2012: 19). Moreover, power generated by Gazprom's Unit 5 at the Hrazdan TPP is sold in Armenia and meets the demand for electricity there (*see* Graph 10), which gives Gazprom further opportunities to export to its neighbouring countries. Hence, launching new projects in the South Caucasus along with all the drivers discussed above could lead to investing in adjacent countries and allow the firms to further expand their businesses.

Considering differences in the economic and institutional development of South Caucasus countries, as illustrated in Graphs 1, 2 and 3, Azerbaijan suffered the least damage from the 2008 financial crisis because of its own natural resources, which had a very serious impact on the Armenian and Georgian economies, and even Russia's (I-8, 2017). This is another reason why Russian oil and gas companies have been very dominant in Georgia and Armenia, but not in Azerbaijan (I-14, 2017; I-15, 2017; I-16, 2017). This also shows that Azerbaijan was at a better stage of its IDP than Armenia and Georgia. Moreover, one respondent underlined that the South Caucasus countries and Russia are emerging economies, and that there is not much

[61] This agreement was initially signed in 1994 between SOCAR, BP, Equinor (formerly Statoil), Lukoil and other international companies, and ratified in 1996.

difference between their political systems or authorities (I-2, 2017). In line with the predictions of the U-model (Johanson & Vahlne, 1977), possession of similar political and economic systems[62] reduces their transaction costs between the South Caucasus markets and Gazprom's, Rosneft's and Lukoil's entry sequences. These examples could be real reasons for investing in Armenia and Georgia. However, in Azerbaijan, personal connections[63] played a more significant role, due to the lack of economic freedom and the existence of high-level corruption which could act as a 'grabbing hand', forcing entrants to change their investment and market commitment strategies (*see* Graphs 1 and 2). Unlike Gazprom and Rosneft, Lukoil expanded not through its export activities, but primarily through its personal connections with Azerbaijani leaders (I-5; 2017; I-8, 2017; I-16, 2017). All in all, whereas Gazprom and Rosneft invested in Armenia and Georgia but not in Azerbaijan, Lukoil is the only investor in Azerbaijan and does not have investments in Armenia.



Graph 10. Source: Gazprom, 2018, 2016 & 2014

In summary, using the location sub-paradigm of the interdisciplinary framework, I have explored the various determinants of the South Caucasus countries and analysed their influence on the location choices of Gazprom, Lukoil and Rosneft. Clearly there is not only variation in the location attractiveness of the South Caucasus countries, but also between the firms and in the reasons for their choices of where to locate their investments. These are the results of

62 one of the dimensions of psychic distance.

63 another dimension of psychic distance.

various host country macroeconomic and firm-specific microeconomic factors. Moreover, strategic considerations were predominant in their investment decisions. Economic development, the 'rules of the game', and psychic distance dimensions such as similar political and economic systems and personal connections also determined their locational choices of where invest in the South Caucasus.

5.4 Political Economy of Investments

5.4.1 State-Business Relations

In the 1990s, during Yeltsin's presidency, the Russian state actively contributed to the re-emergence of Gazprom, Lukoil and Rosneft. However, the Russian state had a different agenda to the oil and gas companies, and had no strong policy of supporting and promoting them. But in 2000, when Putin came to power, the state's participation in the ownership of, and its role in the internationalisation of, Gazprom, Lukoil and Rosneft became crucial (Kalotay, 2008b: 58). The most sensitive sector of Russia has long been its oil and gas industry because these companies drive the Russian economy as the principal source of income and as guarantors of energy security. For example, when they were adversely affected by the 2008 financial crisis, the state intervened by reducing their tax burdens (Lukoil, 2009: 15). Furthermore, investing in emerging economies, such as the South Caucasus, required decisive state support and help to overcome various obstacles and speed up the implementation of investment projects. In this section, therefore, by drawing on the interdisciplinary theory developed for this thesis, I explore and analyse this dynamic state-business relationship and its impact on their investment strategies and activities in the South Caucasus.

In the era of the reorganisation of the Ministry of the Oil and Gas Industry of the USSR (and later of Russia), in the early 1990s, nearly all the ministry's staff and administration were transferred into the management of new companies. This meant personal continuity[64] with the Soviet period and was an important and unique ownership advantage which allowed Kremlin-friendly private investors to be familiar with government leaders and to overcome market barriers easily in host countries. This is one reason why Lukoil has investments in Azerbaijan.

[64] For example, a former First Deputy Minister of the Oil and Gas industry of the Soviet Union, and since 1991 president of Lukoil, Vagit Alekperov, and the former vice-president Vagit Sharifov were both born in, studied at the same university in, and worked in the oil industry of, Baku in Azerbaijan; they had personal connections with both Russian and Azerbaijani leaders (I-5, 2017).

Having special directors on the boards and management of Gazprom, Lukoil and Rosneft is an extra ownership advantage. These managerial elites[65] have held multiple positions in government agencies and other companies, and are often described as interlocking directorates (Cheng & Kreinin, 1996).[66] These Russian companies, unlike western companies, were described as “less capricious” by a senior Georgian official, as they can move easily into small markets with high political risks (I-11, 2017) because they have unique relations with the state and emerged at a time when the country had high political and economic instability, a weak institutional environment and a weak legal system, which developed their capabilities to compete in the challenging South Caucasus markets. The intangible assets discussed above gave these firms unique management- and organisation-based ownership advantages which increased their familiarity with local business conditions and regulatory environments in these socially and culturally similar countries (I-8, 2017; I-14, 2017) and eventually strengthened their positions in regional and global markets.

The Russian state made its position clear in 2005, when Putin promulgated a decree[67] with the aim of liberalising Gazprom’s share trading,[68] and the state increased its ownership share in Gazprom from 38.37% to over 50%[69] (Kremlin, 2005a). During that time, Yukos was acquired by Rosneft and Sibneft by Gazprom, later renamed ‘Gazpromneft’. When Rosneft was included by the state in the government’s Strategic Enterprises and Organisations List in 2007, Rosneft

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[65] They include Dmitri Medvedev, the former president of Russia and Minister of Energy; Alexei Miller, Deputy Minister of Energy; Viktor Zubkov, former prime minster; Alexander Novak, Minister of Energy; Igor Ivanov, former Minister of Foreign Affairs; Herman Gref, president of Sberbank and former Minister of Economic and Trade; Igor Sechin, deputy prime minister of the Russian Federation and Chairman of Inter RAO UES; Andrey Kostin, president of VTB bank, and others who have occupied and still hold senior positions in large state-owned Russian companies, as RZD and Transneft, and various state agencies. It should be emphasised that the wealthy Russian-Georgian oligarch and a former prime minister of Georgia, Bidzhina Ivanishvili, had some shares in Gazprom (I-8, 2017; I-15, 2017).

[66] Unlike Gazprom, Lukoil and Rosneft have international directors on their boards and management who have international experience.

[67] ‘On Recognizing the Fact that certain Decrees of the Russian Federation have become Invalid’.

[68] However, at least a 50% share still had to be owned by the state.

[69] After approving the sale of Gazprom’s 10.74% to 100% state-owned Rosneftegaz in July 2005, the state obtained the controlling stake in Gazprom (Gazprom, 2006a: 68).

completed its acquisition of Yukos (Rosneft, 2008: 10). By 2010, Rosneft had also taken over Yukos's assets in Armenia (Aghalaryan, 2014b). This increased state ownership in the oil and gas industry and can be perceived as a safeguard against any host-country obstacles or future political interventions in the South Caucasus, as Gazprom and Rosneft were investing in markets associated with relatively high political risks.

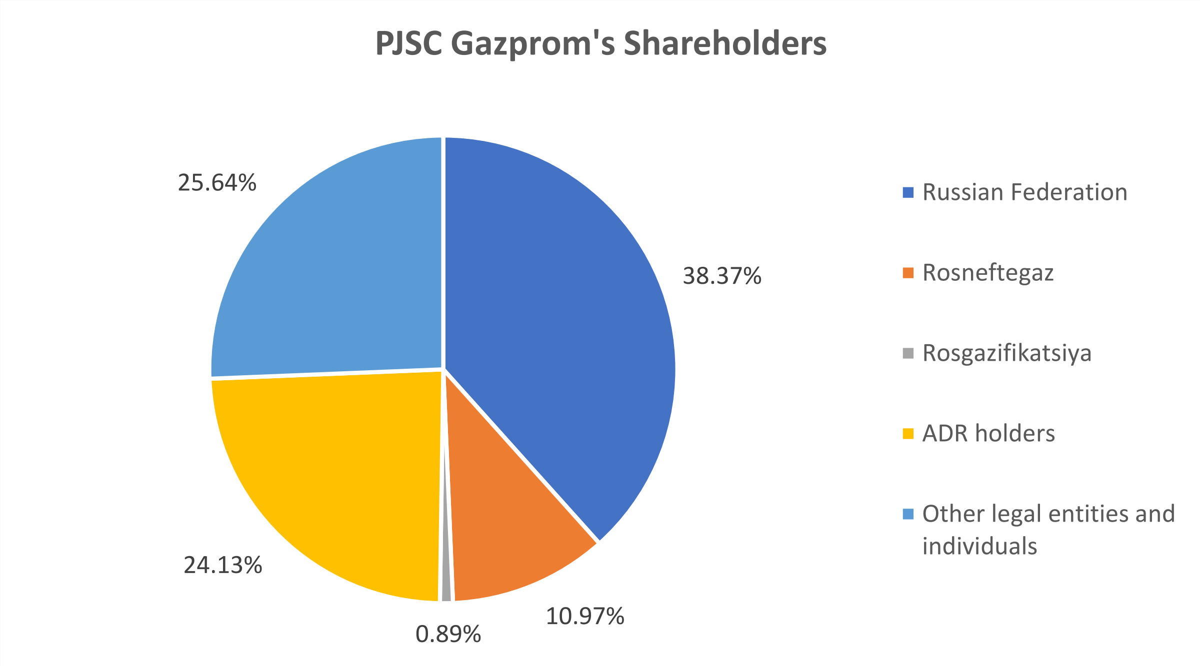


Figure 5. Source: Gazprom, 2019

Unlike Gazprom and Lukoil, Rosneft was fully state-owned until the 2008 financial crisis, when the state decided to increase the number of independent directors on its board of directors and management. Rosneftegaz therefore began to sell Rosneft shares to local and foreign investors.[70] Currently, as Figures 5 and 6 show, the state directly and indirectly owns a controlling stake in Gazprom and Rosneft through Rosneftegaz and Rosgazifikatsiya. Moreover, the top management personnel of Gazprom and Rosneft are often appointed and swapped by the Russian state, allowing it to influence decision-making behaviour through "trusted individuals" (Lioukas *et al.*, 1993: 648-649). On the one hand, the merger of state and private ownership provides Gazprom and Rosneft with strong and unique O advantages to exploit during their internationalisation. On the other hand, this provides Russia with a tool to use for its own political objectives. It is also important to note that the state had residual shares

[70] The state had held a 75.16% ownership of Rosneft in 2010, but by 2015 this had decreased to 69.50% (Rosneft, 2016: 204; 2011: 34).

in Lukoil until September 2004,[71] when ConocoPhillips acquired a 7.6% share from the Russian government and Lukoil became a fully private company (Lukoil, 2005: 7). However, Lukoil's significant business activities remain linked to companies owned or controlled by the state. Lukoil therefore actively maintains its relations with the government, allowing them to grow and to compete with Gazprom and Rosneft.

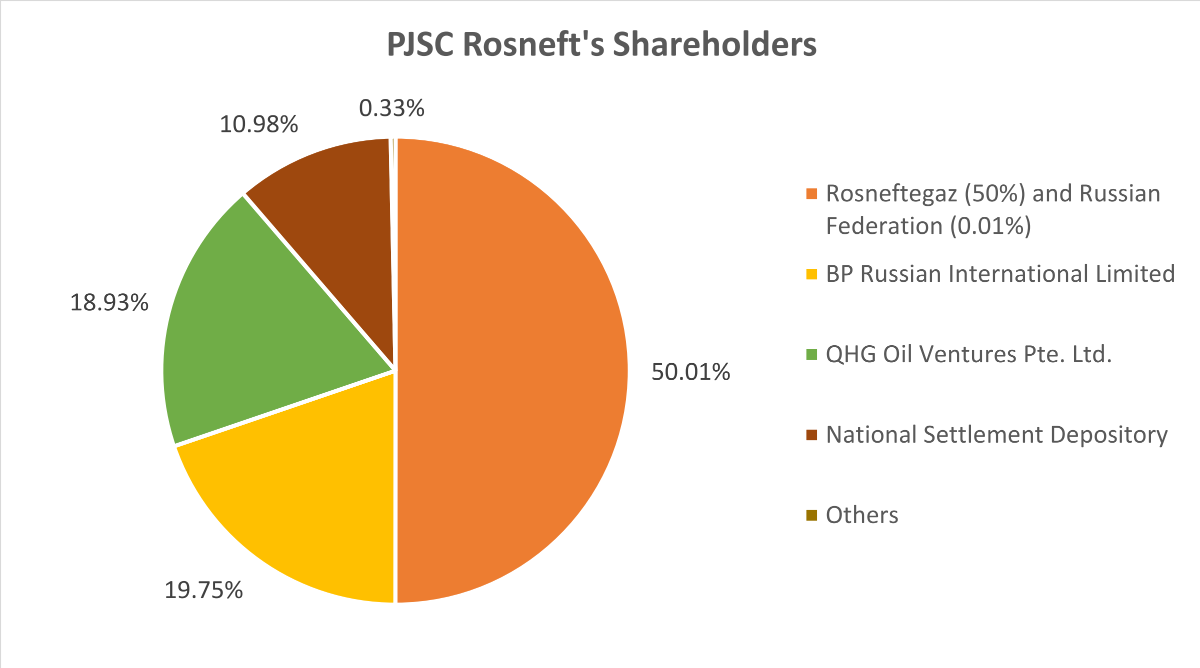


Figure 6. Source: Rosneft, 2019

Infrastructure and financial assistance are particularly important to oil and gas companies because they supply their oil products through railways, pipelines and/or seaports (*see* Maps 3, 4, 5, 6, 7 and 14) and implement major investment projects. Transportation and export of these firms' oil is primarily operated by the state-owned monopolies through the oil pipeline system of Transneft (*see* Map 5) and the railways of RZD (*see* Map 14) (Lukoil, 2017: 247). RZD's investments in the Kavkaz (Russia)-Poti (Georgia) ferry line that stimulates traffic with Armenia and in Armenian railways are very important (Kuznetsov *et al.*, 2017: 36). Transneft owns the Baku-Novorossiysk oil pipeline in the Russian section (*see* Map 5). Furthermore, Lukoil and Rosneft have no opportunity to export their gas output from Russia due to Gazprom's ownership of the UGSS and its monopoly over export routes (I-2, 2017). In Russia, their gas is sold to Gazprom and then transported via Gazprom's UGSS (*see* Maps 4 and 7) (Lukoil, 2012: 19; Rosneft, 2017: 280). An appropriate banking infrastructure is also necessary

[71] In 1999, the state had a 28% share in Lukoil, which fell to 16% in 2000 and then 13.5% in 2001 (Lukoil, 2002: 104).

for large oil and gas companies to fund their projects in the region. The penetration of state-owned Gazprombank and VTB into the financial market of the South Caucasus countries, especially Armenia, was conditioned by the increase in Russian oil and gas companies' investments. Thus, Gazprombank was initially established in Armenia in 1998 to bolster the business and financial flows between Russia and Armenia. In subsequent years, Gazprom consolidated its market position and became the only gas supplier in Armenia. These firms therefore prefer to enter intro transactions with other Russian state-owned monopolies in Russia and the South Caucasus, allowing them to control both transport costs and production and eventually to maximise their gains.

Moreover, the exploitation of natural resources within Russia was limited to private companies. Unlike Gazprom and Rosneft, Lukoil did not have large investment projects in Russia (I-1, 2017; I-2, 2017), and the company therefore maintained its good relations with the Russian state in order to receive its support and started to make resource- and strategic asset-seeking investments abroad. Consequently, a new company emerged which signed its first international cooperation agreement with SOCAR in September 1993 and in the following year joined Azerbaijan's Contract of the Century with the western companies BP, Equinor and others, for the development of Azeri-Chirag-Gunashli's major oil deposits (*see* Map 8). Later, in 1996, Lukoil made its first international gas investment project in Shah Deniz, Azerbaijan (*see* Map 8). Because of these strategic investments in oil and gas projects, Lukoil began to interact with well-developed global energy companies by forming strategic alliances and JVs, eventually aiming to acquire advanced technology and improve its existing knowledge and efficiency. During this time, Gazprom and Rosneft also intended to participate in the upstream project of Azerbaijan, but were never granted permission by the Azerbaijani government (I-1, 2017). One of the reasons for this was that the Azerbaijani government preferred western companies to state-owned Russian companies (I-14, 2017; I-15, 2017). This shows the negative impact of state-ownership on firms.

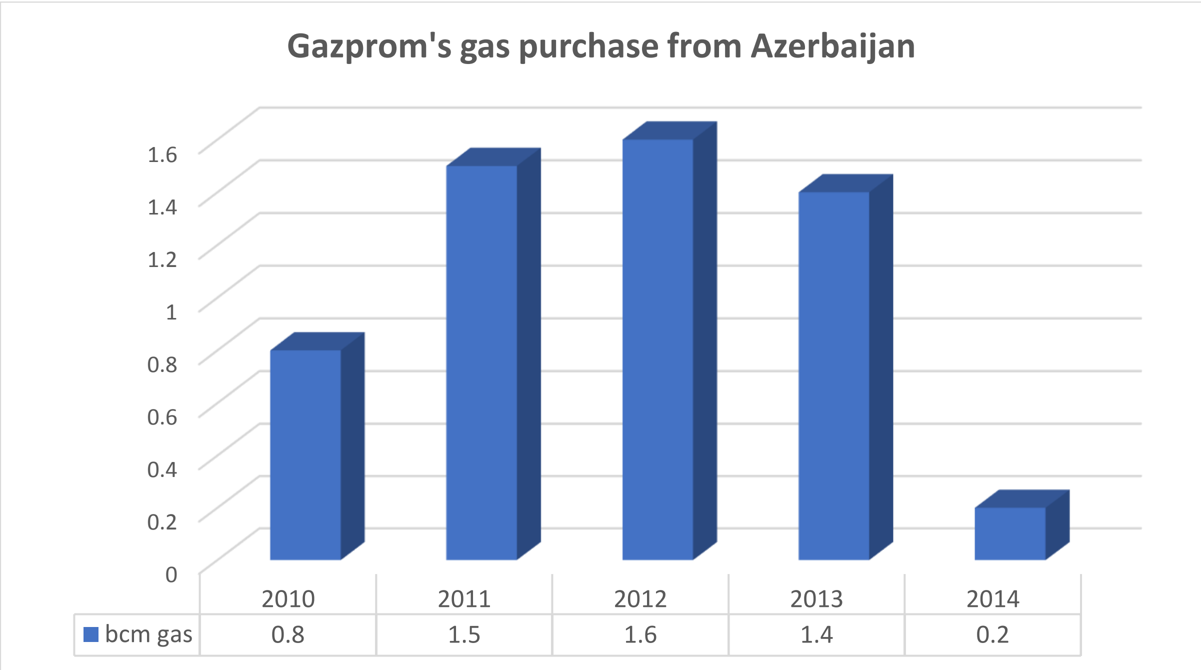
The key motive of the Russian state and its policies is to enhance the country's as well as its oil and gas companies' international competitiveness. The Russian president meets regularly with the presidents of Gazprom, Rosneft and Lukoil, and discusses the companies' past-year performance and future strategically important investment projects, including operational issues. For example, given the economic difficulties of the 1990s and early 2000s, Putin stated at a meeting with the president of Gazprom, Alexei Miller that "Gazprom is without exaggeration the backbone of Russia's economy" and that "Gazprom helped the economy to stay afloat" (Kremlin, 2018a). Moreover, in 2000, as the newly elected president, Putin met the presidents of Gazprom and RAO UES and discussed their interactions and interrelations. They were instructed to set up a joint working group to resolve any potential issues. Putin stated that "their corporate interests might differ" but that the Russian "national interests should unite both companies" (Kremlin, 2000). In January 2003, Putin met with Gazprom and RAO UES again and asked both presidents to study malfunctions in the North Caucasus-South Caucasus and Vladikavkaz-Tbilisi gas pipelines (*see* Map 9) and to solve issues with the fuel and electricity supply to Georgia and Armenia (Kremlin, 2003a). Consequently, Gazprom became the only gas supplier to the South Caucasus countries. This shows that the Russian state provided total administrative support for Gazprom.

Rosneft, Gazprom and Lukoil the largest taxpayers and the Russian state can resolve any potential issues by taking the decisions to regulate the tariffs that directly influence the effectiveness of their investment and business operations (Kremlin, 2013a). Moreover, on Putin's instructions, Long-Term Development Programmes (LTDP) were formed for Gazprom and Rosneft. The primary purposes of those programmes were to determine their status in both domestic and global oil and gas sectors, to make a list of investment programmes for their strategic targets, and to examine and forecast the potential risks and opportunities (Gazprom, 2017: 35; Rosneft, 2015: 22). All this sometimes gives the state political leverage on its oil and gas companies, keeping them more in line with the state's policies rather than following their own economic agendas.

Gazprom, Lukoil, Rosneft and the state have common interests. These are focused on active interaction and cooperation with government authorities and ministries in their investments to resolve complex issues, to ensure their significant contribution to Russia's economy and energy security and to monitor any regulatory changes within the EEU for which they could submit their proposals. Moreover, Gazprom, Lukoil and Rosneft seek to increase their ownership advantages, such as consulting and information support, having easy access to huge financial backing, privileged funding and assets, and other types of assistance. For example, they have signed several cooperation agreements with state agencies, particularly with the Russian Ministries of Economic Development and Foreign Affairs. In January 2003, the former Minister of Foreign Affairs Igor Ivanov, who has been a board member of Lukoil since 2009, met with the presidents of Gazprom, Rosneft and Lukoil and assured them of support and protection through state agencies and diplomats for their foreign businesses and legitimate interests in running foreign businesses abroad (Lukoil, 2010: 13; 2008: 11; 2004: 17). In return, Gazprom, Lukoil and Rosneft provide the Russian state agencies with consultancy and expert advice on the preparation and provision of government proposals, in relation to improving and developing relationships with foreign countries and/or corporations in the oil and gas sector (Lukoil, 2010: 13; 2008: 11). For example, Lukoil is the only Russian oil and gas company investing in Azerbaijan and holds a minor share, 10%, in Shah Deniz, unlike Gazprom and Rosneft. As respondents highlighted, this is highly important for the Russian state, enabling it to monitor the region directly (I-8, 2017; I-14, 2017; I-15, 2017; I-16, 2017). These examples show that the Russian oil and gas companies act as lobbyists and advisers, or 'diplomats', in the word of Susan Strange (1992: 10).

Due to the scale of Gazprom's, Lukoil's and Rosneft's operations in different countries, in which these firms want their businesses to run smoothly without facing any obstacles, and the importance of the security of energy supplies, their business operations are often quite close to political issues (I-1, 2017; I-2, 2017). The Gazprom respondent stated that because of political issues between states, governments try to regulate and control firms or raise artificial restrictions which often negatively affect their business operations. Thus, diplomatic assistance is an instrument of investment protectionism for Gazprom, Lukoil and Rosneft in the South Caucasus (I-1, 2017). One respondent stated that "you try not to put the stick in the wheel but rather help the company" (I-2, 2017); this is the kind of support which they receive from the Russian state. Respondents stressed that Putin's meetings with the presidents of the South Caucasus countries increase the interdependence of two different states. This is very important for them to receive effective support and to resolve issues of political and legal approval together with other governments through intergovernmental meetings (I-1, 2017; I-2, 2017). So they use this mechanism to speed up the internationalisation process and maximise their revenues. For example, during Putin's meeting with the Armenian president, Robert Kocharian, in January 2007, Gazprom's upcoming investments in the Armenian market were discussed (Kremlin, 2007). Consequently, Gazprom continued to complete the construction of the Hrazdan TPP and established a subsidiary bank in Armenia by increasing its shares in Areximbank-Gazprombank in 2007 and achieved full ownership in 2008.

In the case of Gazprom, the intergovernmental agreement is a general description of Gazprom's framework, operations and investments (I-1, 2017). But the details of that project and specific agreements are made between Gazprom and the host-country company or companies. Importantly, the efficiency of energy supplies and natural gas supplies are quite separate issues and they are discussed at governmental level between the governments of different countries separately from other issues. Gazprom has different relationships with each South Caucasus country in terms of natural gas supply. The governments accept the frameworks by signing agreements and by issuing regulatory documents. Gazprom then uses these frameworks as the basis for its investment decisions and agreements (I-1, 2017). For example, in June 2009 during an intergovernmental meeting between Russian president Medvedev and Azerbaijani president Aliyev, Gazprom and SOCAR, witnessed by their presidents, signed an agreement for the purchase and sale of Azerbaijani natural gas (Kremlin, 2009) and this continued until Azerbaijan started exporting its own gas, as illustrated in Graph 11.



Graph 11. Source: Gazprom, 2015, 2014, 2013 & 2012

The transition to market prices for supplying natural gas to the post-Soviet countries was also discussed at state level (Kremlin, 2008a). When countries were unable to afford the new prices (for example Armenia and Georgia), Gazprom imposed 'take or pay' fines on debts for Russian gas supplies. Gazprom pursues these fines in accordance with a contract and conditions dictated by the Russian state. If debts are not paid, then other measures are taken by Gazprom, such as limiting or cutting off gas supplies (Kremlin, 2015a; 2010a). This strategy was also implemented in the South Caucasus, for example, in the acquisition of Unit 5 at Hrazdan TPP and other entities in Armenia. This example shows that the role of the Russian state has shaped Gazprom's business and investment strategies. This is clearly in Gazprom's interests, but it might also serve the interests of the Russian state. These empirical examples show that there is potentially a strong positive interaction between Gazprom's politically weighty businesses in need of support from the Russian state, and the state seeking to instruct Gazprom about its economic and political objectives.

To sum up this section briefly, Gazprom, Lukoil and Rosneft enjoy unique relations with the Russian state through various mechanisms and have exploited them successfully during their internationalisation. These factors seem significant and show the importance of the IPE perspective for examining their internationalisation (Taylor & Nölke, 2010: 163). This type of state support intensifies their investments, eliminates investment barriers in the host countries, accelerates their expansion and ultimately increases their revenues. But it also allows the Russian state to directly and indirectly influence its firms and their business operations, possibly for its own political objectives. Lukoil's case also shows that the political economy perspective is limited for explaining both why the company intends to have close relations with the Russian state, despite being fully private, and the state's lesser intervention in Lukoil than Gazprom and Rosneft. Given the state's dynamic and interactive relations with them, the interdisciplinary framework developed in this thesis is well-suited to explaining their investment and business activities. Moreover, due to state-business relations and relations between the home and host countries, the geographical footprints of Gazprom, Lukoil and Rosneft are very vivid. The Russian state's involvement can give them both advantages and disadvantages because its interests in, or ownership of, oil and gas companies can cause political disputes and increase the unwillingness of the South Caucasus countries to accept their FDI. They fear that Russia can influence them by using these companies. Therefore, the expansion of these firms demands consideration of various political factors to explain their investment activities.

5.4.2 State-State relations

As well as state-business relations, the state-state relations factor has been recognised as a key determinant because, as the Gazprom respondent emphasised, political relations allow them "to be more efficient and to think about more economic issues and operation issues" (I-1, 2017). For example, it was much easier to invest in Armenia where Russia has a good relationship, and good relations with both governments helped Gazprom and did not produce any additional problems (*ibid.*). Georgian and Armenian senior officials also confirmed that the political and economic ties between Russia and the South Caucasus states have been a crucial factor (I-6, 2017; I-8, 2017; I-9, 2017). For instance, when Yukos was bankrupted, the foreign jurisdictions did not recognise this bankruptcy in some of Yukos's foreign assets, except in Armenia given its high degree of political and economic dependence on Russia and its poor institutional and legal systems (Stephan, 2013: 28-29). But any political conflicts or deteriorating relations between these countries might affect these firms' investment decisions and strategies. The Gazprom respondent stated that "sometimes political ties with Russia influence their businesses" (I-1, 2017). Given economic and political changes (*see* Figure 4), as well as conflicts and sanctions in the region, making investments in the oil and gas industry of the South Caucasus carries higher political risks and requires consideration of the importance of political factors. I therefore used an interdisciplinary framework to explore and analyse how political disputes between the states have determined their investment decisions and affected the geographical distribution of their investments across the South Caucasus countries and their roles in interstate relations.

After the fall of the Soviet Union, the South Caucasus countries, especially Azerbaijan, began to attract western investors to their oil and gas sectors and started to develop their relations with the West. Whereas Armenia continued to maintain very close relations with Russia, Azerbaijan's relations with Russia deteriorated, as Azerbaijan's former president Ebulfez Elchibey followed anti-Russian foreign policies and tried instead to develop relations with the West and Turkey. Armenia is also landlocked because of political disputes with Azerbaijan and Turkey (I-1, 2017; I-2, 2017). Moreover, the occupation of Azerbaijan's Nagorno-Karabakh territory by Armenia, with Russia's support, was another major political disruption between Russia and Azerbaijan. However, when Heydar Aliyev, former KGB general and Politburo member, came to power, he followed a different and moderate foreign policy in order to develop the country's political and economic situation (Balakishi, 2016). Foreign investors were invited to make investments in Azerbaijan's Azeri-Chirag Gunashli oil field with the aim of resolving the country's political and economic situation and improve its political status (I-14, 2017).

During this time, the Russian acting prime minister Chernomyrdin urged reconsideration of the status of the Caspian Sea, reserving a twelve-mile, territorial-waters zone for each littoral state and declaring the rest of the Caspian Sea a neutral zone (Becker, 2000: 100). Azerbaijan noticed this growing threat and so, to moderate relations with Russia, Aliyev signed the documents to join the CIS in September 1993. Accordingly, privileges were granted to Russian oil companies to enter Azerbaijan in the context of protecting the country's political interests. However, only Lukoil was granted a 10% share in the oil consortium as the Lukoil president Vagit Alekberov was born in Baku in Azerbaijan and had established personal connections with the Azerbaijani authorities during the Soviet era (I-9, 2017; I-14, 2017). Moreover, in 1994 during the Chechen-Russian conflict, Russia implemented economic sanctions against Azerbaijan, and accused Azerbaijan of helping and sheltering Chechen rebels, although the Azerbaijani government denied this (Balakishi, 2016). In 1996, the sanctions were lifted and Lukoil took up a 5% share of Azerbaijan's gas sector at Shah Deniz (Lukoil, 2003: 22). As a result of these political crises, investment opportunities were created for Lukoil, which entered the market through JVs. During the 1990s, Rosneft and Gazprom also sought to make investments in upstream projects, but the Azerbaijani government was unwilling to allow the Russian state-owned companies to invest there.

Another political crisis took place between Georgia and Russia over Abkhazia and South Ossetia in 2008. In 2006, before the 2008 war, Russia imposed trade sanctions on Georgian mineral water and wine and reintroduced visa requirements. These economic embargos damaged Georgia's economy and their bilateral relations (*see* Graphs 8 and 9). During the conflict, Georgia took counteraction to block oil and gas supplies to both South Ossetia and Abkhazia. Previously, gas supplies to South Ossetia were ensured via the Agara-Tskhinvali leg of the Tbilisi-Kutaisi trunk system in Georgia. When Georgia blocked the energy supply routes to South Ossetia, Gazprom decided to build a new pipeline (Gazprom, 2010: 11). As Map 9 shows, construction of the Dzuarikau-Tskhinvali pipeline started in 2006 from the village of Dzuarikau in North Ossetia and ran to Tskhinvali in South Ossetia. This was to bypass Georgia, avoiding disputes and arguments with this transit country, and ultimately allowing natural gas supplies from Russia to flow directly to the region. In this context and given Gazprom's unique relations with the Russian state discussed above, these political disputes between Russia and Georgia and the very tiny market of South Ossetia show that Gazprom's investments and natural gas supplies overrode its commercial criteria. Consequently, in August 2009, the Dzuarikau-Tskhinvali gas pipeline[72] was commissioned and Gazprom started to supply natural gas under a twenty-year contract (Gazprom, 2017: 16). This was protested by the Georgian government as it violated international law and Georgia's territorial integrity (I-8, 2017; I-9, 2017; I-11, 2017; I-12, 2017).

[72] at 162.3 km, around 69 km of which was in South Ossetian territory, and with an annual capacity of 252.5 mcm.

Map 9: Dzuarikau-Tskhinvali and Georgian Transit gas pipelines (customised by the author)

Despite these prevailing circumstances, Gazprom concluded the acquisition of the Kudar Pass-Tskhinval trunk pipeline in South Ossetia in 2011 (Gazprom, 2012: 53), and continues to supply natural gas to South Ossetia. Moreover, during a working meeting in May 2018 between Alexey Miller, president of Gazprom and Anatoly Bibilov, president of South Ossetia, further expansion of the regional gas infrastructure was discussed (Gazprom, 2018). Gazprom's investments and business activities in South Ossetia are therefore the result of a political event. These political tensions led to the deterioration of Lukoil's share performance in Russia, and Georgia became the worst performers in the emerging economies (Lukoil, 2009: 113). It has thus become impossible for Lukoil and Rosneft to do business in Georgia, until equitable relations are restored between the countries, but there are still no diplomatic relations. Rosneft's business and investment activities in Abkhazia are also the results of politics, but Rosneft has not been involved in political disputes. The commercial motives behind its investments in Abkhazia may outweigh the political motives because, like any other company, Rosneft's aim is to maximise its revenues through downstream projects. From a political perspective, Rosneft's investments in Georgia were made to improve relations between Russia and Georgia after the 2008 war; from a business perspective, they were to improve its company image and gain trust in the country. Unlike Gazprom and Rosneft, Lukoil has no investment or marketing activities in Abkhazia or South Ossetia (*see* Map 2). Moreover, they invested in order both to understand how the technology works and to evaluate the political situations of the host countries (I-1, 2017; I-2, 2017).

Considering these political tensions, the Russian oil and gas companies face potential transit risks on their transportation and export markets in the South Caucasus. Because of this, Gazprom took several significant measures to minimise its dependency and reliance on Georgia, such as diversifying export channels, building new pipelines and improving the accessibility of UGSF abroad in order to supply its natural gas to Armenia and South Ossetia (*see* Maps 3, 4 and 9). In case of emergency needs, Rosneft's ownership of sea terminals, particularly Tuapse port (*see* Maps 3, 4, 5, 6 and 14), ensures the swift reallocation of crude oil and petroleum product supplies from one location to another (Rosneft, 2013a: 191). For example, because of the August 2008 war, Rosneft can still not use Abkhazia as a transit route to supply its petroleum products to Armenia. Lukoil ships 1.2 million barrels of oil a day to the Mediterranean countries through the Baku-Tbilisi-Ceyhan (BTC) pipeline, as illustrated in Map 6 (Lukoil, 2017: 17). During the 2008 War, the BTC, the Baku-Tbilisi-Supsa (BTS) and the Baku-Tbilisi-Erzurum (BTE) pipelines were temporarily shut down, leaving only the Baku-Novorossiysk pipeline running through Russia (*see* Map 6) (I-8, 2017; I-12, 2017; I-15, 2017). So when these firms make investment decisions, they also consider political issues (I-1, 2017; I-2, 2017).

After the disintegration of the USSR, the South Caucasus republics' developing relations with the West and western oil and gas firms and the construction of the pipeline projects[73] supported by the West to supply natural gas from the Shah Deniz field to Turkish and European markets,

[73] including BTC, BTE and BTS pipelines and later TANAP and TAP.

where Gazprom also supplies its gas, were aimed at counterbalancing Russia's power and preventing it from being involved in regional oil and gas projects (Nanay, 2009: 115-116).[74] This also weakened Russia's power and influence in the region.[75] Given these political and economic changes in the region, Russian foreign policy has been shaped by geopolitical considerations (Kubicek, 2013). Its oil and gas firms can maximise its power and help it accomplish a broader foreign policy goal in the South Caucasus region.

After 2004, Russia began using its huge natural gas resources as political leverage to restore its power and influence in the region, which was rooted in the Soviet Union when the countries were knit together and the system was interconnected (Newnham, 2015: 164).[76] Gazprom sought to adjust agreements with these countries (Gazprom, 2008: 63; 2007: 50). In 2006, Gazprom increased its prices in each South Caucasus country. There were both economic and political reasons for this strategy. Armenia handed over its energy assets to Gazprom, which took over full control of Armenia's energy sector and established subsidiaries in its gas and banking sectors. In the case of Georgia, the increase was to punish the Saakashvili government, which was pursuing a western-oriented policy, and to take over the Georgian transit pipelines going to Armenia (*see* Maps 4 and 8) (I-8, 2017; I-9, 2017; I-10, 2017). Like Armenia and Georgia, until it decided to exploit its Shah Deniz gas field in 2006, Azerbaijan was also regularly importing gas from Russia (Balakishi, 2016). These countries initially accepted the increased gas price from \$60 to \$110 tcm in late 2006. However, in 2007 when Gazprom increased the price to \$235 tcm, Georgia and Azerbaijan (but not Armenia) rejected the offer and decided not to ratify the increase (Balakishi, 2016). With the financial support of the US,

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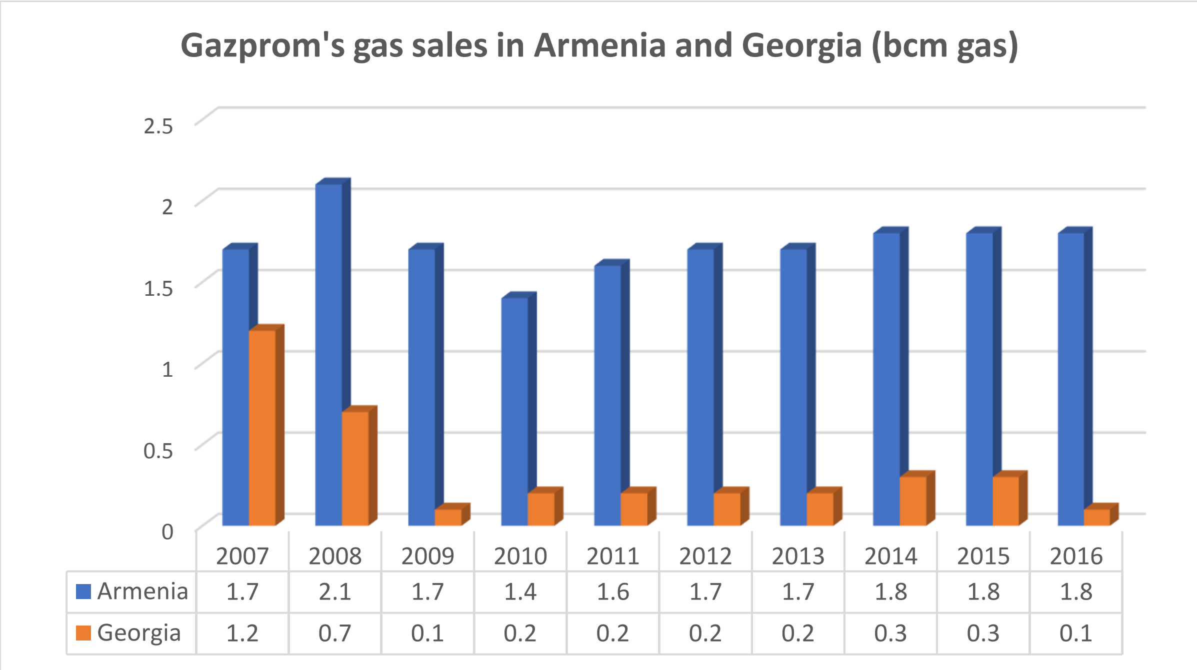
[74] Therefore, Gazprom made a decision to construct two new pipelines: the Turkish Stream as an alternative to the South Stream project (*see* Map 7) and the Nord Stream 2 to enhance the capacity of the existing Nord Stream. These pipelines are developed in response to the TANAP and TAP projects.
[75] Gazprom several times intended to make investments in Georgia and privatise the pipelines, which could have blocked the South Caucasus pipelines. It therefore considered joining the TAP pipeline by booking its capacity. This meant that Azerbaijan could not increase the amount of gas it transported, which may have given Gazprom an opportunity to block this pipeline and strengthen its market position in Europe (I-5, 2017).
[76] During the 1990s, due to the nominal level of payment discipline, relationships between Gazprom and the FSU countries were established through the interconnection between gas supplies and the transit routes through their territories (Gazprom, 2007: 11). This was also because of the relative cheapness of gas produced at facilities which were built during the Soviet era.

Georgia did not sell the pipelines to Russia in settlement of debts (I-11, 2017). Georgia then started to import the gas it needed from SOCAR, which is Gazprom's rival. As Graph 12 shows, Gazprom's natural gas sales fell dramatically in Georgia, but not in Armenia. This policy practice adopted by Russia was to control oil and gas resources and infrastructure through its firms and to achieve broader foreign policy objectives.



Graph 12. Source: Gazprom, 2017, 2016, 2015, 2014, 2013, 2011, 2010 & 2009

Since the disintegration of the USSR, several regional integration projects have been introduced (*see* Figure 4), such as the CIS, CSTO, EurAsEc, ECU and most recently the EEU. Economic union is very important for the efficiency and mechanisms of economic cooperation which help Gazprom, Lukoil and Rosneft to utilise their economic resources in the most efficient way to lower risks, get easy access to the market, and face fewer obstacles in terms of governmental approval (I-1, 2017; I-2, 2017; I-5, 2017). As well as the state authorities, representatives of the Russian oil and gas companies took part in the development of the EEU to improve and develop customs administration procedures and policies (Rosneft, 2018: 307; 2017: 284). For example, Gazprom, Lukoil and Rosneft are not subject to export duties on the oil and gas products exported to EEU members (Lukoil, 2018: 120). During the 1990s and until 2007, in addition to close military cooperation between Russia and Armenia, in terms of real economic cooperation Gazprom was the only company involved through ArmRosGazprom (Kremlin, 2007). In the following years, Gazprom again played an important role in Armenia's joining the EEU. In 2013, a gas discount was granted to Armenia, after which Yerevan made a first step towards agreeing to join the EEU. A further 13% gas discount in April 2015 led to

Armenia being the first and only South Caucasus country to join the EEU (Azatutyun, 2015; Balakishi, 2016; Roberts & Moshes, 2016: 558). Armenia's decision to join the EEU shows that Gazprom had taken its part as a corporate player in a political move that favoured Russia's foreign policy. In other words, traditional regional integration based on politics and the military has been replaced by economic integration, particularly through Gazprom.

Unlike Azerbaijan, Georgia's membership of the EEU would be very beneficial for Gazprom (I-1, 2017) because it is the only transit country to supply its oil and gas products to Armenia. Under its former president, Eduard Shevardnadze (1995-2003), Georgia signed an agreement for Russian gas to go to Armenia through Georgia with a 10% transit fee. In January 2016, Gazprom initiated talks with Georgia's Ministry of Energy to pay cash instead of gas as a transit fee, as the company found payment in gas was not profitable (I-8, 2017; I-10, 2017). Consequently, in 2017, Gazprom managed to reach an agreement with Georgia. Unfortunately, Georgia handed over its energy leverage to Russia (I-8, I-11, 2017; I-15, 2017). The respondents from Georgia and Azerbaijan regarded this decision as a major mistake because – as a result of its location between Armenia and Russia – Georgia could be compelled to join the EEU (I-9, 2017; I-11, 2017; I-15, 2017). Georgia's former Minister of Economy described this move by the Georgian government as "unprofessionalism and the denial of universal knowledge of geopolitics and geoeconomics" (I-8, 2017). The cases of Georgia and Armenia show that political motives were behind Gazprom's long-term investments and strategies to achieve the Russian state's broader foreign policy objectives in the region. But the scenario is different for Azerbaijan, which is Gazprom's rival in the region. Nevertheless, its membership of the EEU can drive them to cooperate more with SOCAR (I-1, 2017), which would be very beneficial for Gazprom.

Any political issues can force the companies to leave the region by selling their shares and facilities as the business becomes economically unviable. For example, under pressure from growing political tensions after the 2014 sanctions, along with economic factors, including plunging oil prices and the depreciation of the rouble, the revenues and financial performance of the Russian oil and gas companies were greatly affected. These issues also led to restricted access to capital, more expensive capital and uncertainty in economic growth (Connolly, 2016). Unlike Rosneft, Lukoil and Gazprom are not on the list of restricted Russian entities. However, Gazpromneft[77] and Gazprombank[78] were subsidiaries also under sanction. Accordingly, Gazprombank sold its subsidiary Areximbank-Gazprombank in Armenia in October 2016 to Ardshinbank, run by Karen Safaryan, a prominent Russian businessman (ArmBanks, 2016). Nevertheless, Ardshinbank along with Gazprombank continues to support the implementation of Russian investments (Arka, 2016). This shows that politics played a decisive role in Gazprombank's decision.

In brief, the factors and events discussed above show that Gazprom, Lukoil and Rosneft play important roles in the diplomatic relations between Russia and the South Caucasus states. Their investments can be perceived as further improving and developing Russia's diplomatic relations with these states. For instance, Lukoil's investment in Shah Deniz with a 10% share in fact went against the company's strategic policy, as it always prefers to hold a major share. Rzayeva insisted that "Lukoil must be in this project" for the political reason that is a 'direct representative' of its home country (Guthrie, 1997: 1291), even if Lukoil may not profit from the investment (I-15, 2017). Rosneft's investments in Georgia after the 2008 war can also be perceived as having improved relations between the countries. Moreover, Gazprom and Rosneft each has investment and business activities in South Ossetia and Abkhazia respectively. These firms can also be seen as 'watchdogs' in the projects to fulfil Russia's tasks (Vahtra, 2006: 20).

Even so, it can be misleading to see political considerations behind all Gazprom's, Lukoil's and Rosneft's investment decisions and activities in the South Caucasus. First, because like all other energy firms they seek to maximise their profits by benefitting from both state-business and state-state relations. Second, because in spite of Russian state-ownership it is not inevitable that Gazprom and Rosneft will always serve Russian foreign policy. Third, the senior Georgian official highlighted that oil cannot be used as a political weapon, unlike gas (I-11, 2017), and it is under Gazprom's monopoly. This shows that the strategic importance of the gas business has been greater (Johnson, 2004: 461) and it has more political influence than the oil business, which is more flexible (Kropatcheva, 2011: 556). Some scholars (Huotari, 2011; Liuhto, 2010; Zhuplev, 2012) put both companies in the same basket without acknowledging the facts, but each should be treated differently. Unlike Lukoil and Rosneft, Gazprom has been an important

[77] the third-largest oil producer in Russia.

[78] the third-largest state-owned bank of Russia, and the financial arm of Gazprom that provides financial services to the Russian companies in Russia and abroad.

player in the development of the EEU and has been involved in disputes between Russia and the South Caucasus countries. Finally, the political situation and the countries' relations with each other in the South Caucasus also play a significant role in the geographical distribution of their investments (*see* Map 2). All in all, both state-state and state-business relations factors are important in explaining Gazprom's, Lukoil's and Rosneft's investments and business activities.

5.5 Internalisation

In this section, given the firms' O advantages, the location advantages of the South Caucasus countries and political economy factors, using the internalisation sub-paradigm of interdisciplinary theory, I investigate how the Russian oil and gas companies entered the markets, what internalisation modes they chose and the importance of choosing those particular modes. When taking investment decisions about joining international projects like the ones in the South Caucasus, firms incur debts from Russian state-owned banks and implement a multilateral risk assessment by gathering market information through their managerial elite,[79] Russian partner[80] and overseas representation[81] to avoid potential risks (I-1, 2017; I-2; 2017). The respondents from Armenia, Azerbaijan and Georgia stressed that the Russian state-owned banks VTB and Gazprombank in the South Caucasus countries were very significant in supporting the investments of Gazprom, Lukoil and Rosneft (I-6, 2017; I-7, 2017; I-8, 2017; I-9, 2017; I-14, 2017; I-16, 2017; I-18, 2017). Once the necessary preconditions were met, internalising the investments and choosing a preferred mode of entry strategy (such as establishing JVs or subsidiaries) was fairly easy.

For the Russian oil and gas firms, JVs were the preferred entry strategy for the South Caucasus markets, although there was variation in their strategic decisions to choose JVs. Unlike

[79] Gazprom and Rosneft have government relations departments and executive members on the company board and management because they are partly owned by the Russian state; Lukoil employed former government officials, so in case of an emergency they could receive information through those channels as well (I-1, 2017; I-2, 2017).

[80] such as Inter RAO UES, RZD, VTB, Gazprombank and others, which had investments in the South Caucasus countries.

[81] The respondents emphasised that the overseas representations of Gazprom, Lukoil and Rosneft helped them gain targeted market information and enabled them to get the information directly from either their employees or their partners (I-1, 2017; I-2, 2017).

Gazprom and Rosneft, Lukoil was the first to enter the region and internalise its investments in Azerbaijan, acquiring a 10% share in the Azeri-Chirag-Gunashli international oil project in 1994 and a 5% share in the Shah Deniz international gas project in 1996 (Lukoil, 2016: 8-11). Lukoil also has a JV with a 10% share in the South Caucasus pipeline company in Azerbaijan (Lukoil, 2016: 179). Forming JVs with local and foreign companies in Azerbaijan and participating actively in regional oil and gas projects provided not only its first international experience but also its first experience with advanced technology, and connected it to global network institutions. None of this could have been achieved by Lukoil on its own. Later, Lukoil established a subsidiary in Azerbaijan and by setting up subsidiaries entered Turkey in 1998 and Georgia in 2002.

During the 1990s, Gazprom attempted to establish its JVs – GruzRosGazprom in Georgia and ArmRosGazprom in Armenia – to distribute its gas in the South Caucasus and to foster cooperation in the transport of gas supplies across Georgia and Armenia (Adams, 1998: 32). ArmRosGazprom JV was established in 1997, and Areximbank-Gazprombank JV bank in 1998, where the latter was intended to support its investments in the South Caucasus (Gazprom, 2014a; PanArmenian, 2014). Gazprom failed to establish a JV in Georgia due to host-country political factors, whereas in Armenia it consolidated its market position and established its ArmRosGazprom and Gazprombank-Armenia subsidiaries in the early 2000s. In Armenia, Rosneft signed a cooperation agreement with Oil Techno company to establish a JV in December 2013,[82] and subsequently, began to explore and analyse the acquisition of potential assets (Rosneft, 2013b).[83] After investing in Armenia, Rosneft successfully entered Georgia in 2014 by setting up a JV with Petrocas Energy International, in which Rosneft has a 49% share (*see* Map 2) (Rosneft, 2017: 126).[84] These examples show that the main reason behind these firms' choice of JVs was to use them as 'Trojan horses' to obtain advanced technology and the

[82] Rosneft started exploring business opportunities for the sale of its petroleum products in the Armenian market in summer 2012. After evaluating the business environment and market demands in Armenia, its forecast was that it could be a main petroleum products supplier.

[83] in the retail and wholesale trade of petroleum products, including an aircraft refuelling business and oil product capacities.

[84] In 2016, Rosneft supplied 62 thousand tons of petroleum products to the Georgian market. This was achieved by unlocking new trading and logistic opportunities by a JV with Petrocas Energy International (Rosneft, 2017: 126).

necessary operating and new business experience from its partners, to accumulate experiential knowledge and eventually to expand into new markets.

Forming a JV was a good strategy for entering new markets where these firms were uncertain about the outcome of their investments. For example, early in 2001, Lukoil took a JV 50% share with SOCAR at the Zykh and Govsany fields (Lukoil, 2001: 12). However, in February 2005, it left the Zykh Govsany project in Azerbaijan because of economic inefficiency associated with a major ecological spend and a high level of reserve exhaustion (Lukoil, 2006: 8). In April 2003, Lukoil sold its 10% share in the Azeri-Chirag-Gunashli project, which it had acquired in 1994, to INPEX South West Caspian. It then signed a new agreement with SOCAR regarding additional conditions for the exploration and development of the D-222 (Yalama) located in the Azerbaijani sector of the Caspian Sea (*see* Map 3). Under this agreement, Lukoil's share increased from 60% to 80% (Lukoil, 2004: 17). At the beginning of 2005, Lukoil completed the drilling of a 4500-metre exploration well as a part of the D-222[85] project jointly with SOCAR, which had a 20% share (Lukoil, 2006: 27). In 2008, Lukoil sold its 15% share in the D-222 project (part of the Yalama-Samur structure) to ENGIE[86] (Lukoil, 2009: 18). This decision could also have been a result of the 2008 financial crisis (I-15, 2017). So Lukoil's strategic decision to JVs with partial ownerships or small shares was about reducing its costs and increasing its core competency.

Establishing JVs was strategically important for Gazprom, Lukoil and Rosneft in reducing cross-border political risks, overcoming host-country-mandated investment barriers, and better securing contracts from the South Caucasus countries. For example, Georgia and Azerbaijan were not always relaxed about Gazprom's and Rosneft's investments there. In 2014, Rosneft considered taking part in the Absheron shelf by entering into a JV with Azerbaijan's state-owned SOCAR. During 2014, a feasibility study development and the task itself were completed by agreeing a fair market value for the asset and establishing a JV (Rosneft, 2015: 74). In 2015, Rosneft participated in a JV with SOCAR in the offshore Absheron field in the Caspian Sea. Rosneft expected that SOCAR might possibly hand over its share (Rosneft, 2016: 81) but this did not materialise, because Azerbaijan is not open to investment by any Russian state-owned oil and gas companies (I-14, 2017; I-15, 2017; I-16, 2017).

[85] the continuation of Yalama Samur.

[86] formerly GDF Suez, a French company.

However, the Georgian government allowed Rosneft's investments with minimum interference (Fortescue & Hanson, 2015: 297). One reason for this was that Georgia's economy is mostly free and moderately transparent, unlike that of Azerbaijan (*see* Graphs 1 and 2). Moreover, Rosneft owns a 49% share in the JV. When a company owns 51% or more of the stake in a JV, it is *de jure* able to control the decision-making in the joint company (Dunning & Lundan, 2008: 270). This is a way of reducing potential political risks (I-11, 2017). In May 2009, Rosneft signed an agreement with Abkhazia's Economic Ministry in Sokhumi on cooperation in a geological study of the Gudautsky region (*see* Map 3), development of oil and natural gas fields, and sales of oil and gas products (Rosneft, 2010: 12). After completion of this geological exploration in the region in 2011, Rosneft entered the Abkhazian market in 2012 (Rosneft, 2013a: 41; 2012: 36). Rosneft currently has business activities in Abkhazia, where it has filling stations and leased stations (*see* Map 2) and operates through LLC RN-Abkhazia (Rosneft, 2018: 11, 187).[87] These factors show that in Georgia Rosneft has tried to monetise synergies, harmonise its operations, improve its relations with the government and develops trust and cooperation.

In some cases, a company's strategy can also be strongly influenced by its ownership structure. For example, in 2006, Gazprom signed an agreement with the Armenian government on the JV ArmRosGazprom. The 2006 price of $110 per 1000 cubic for natural gas in Georgia and Azerbaijan was increased to $235 per 1000 cubic metres in 2007. In Armenia, however, the natural gas price remained at $110 until 2009. Gazprom purchased and completed the construction of generating Unit 5 at Hrazdan TPP (*see* Maps 3 and 4).[88] In exchange, in November 2006 Gazprom's share increased from 45% to 53.4% through the acquisition of the plant (Gazprom, 2007: 50). In order to understand and explain why Gazprom expanded its business in Armenia through takeovers, attention should be paid to Russia's transition from a planned to a market economy as a result of the privatisation and restructuring of Soviet state-owned enterprises in the early 1990s.[89]

[87] This expanded Rosneft's oil product retail networks, and the company now owns key retail networks on three sites in Abkhazia (Rosneft, 2014: 58).

[88] the largest thermal power plant in Armenia.

[89] This also gave Russian oil and gas companies, particularly Gazprom, oligopolistic and monopolistic advantages and the ability to take control of host-country strategic assets and ultimately to evade the coordination problem (I-6, 2017; I-12, 2017).

These firms strove to establish a unified network which would allow the system to work more efficiently and facilitate investments, as the Gazprom respondent stated (I-1, 2017). To have a unified network, they had to have a subsidiary in the locations in which they operated (I-1, 2017; I-2, 2017). Acquiring a controlling stake in JVs, if not at once, then in the long-term, was a crucial internationalisation strategy for all three firms, making it possible to establish subsidiaries. They could also be directly involved in the decision-making process and activities of the JVs and have more influence over them. For example, Gazprom established its subsidiary bank in Armenia in 2007 after increasing its shares in Areximbank-Gazprombank to 80% and in the following year achieved full ownership (ArmBanks, 2012). Furthermore, in 2012, after the 2011 completion of the Hrazdan TPP, Gazprom increased its share in ArmRosGazprom to 80% (Gazprom, 2014b: 59; 2013: 57) and soon after took 100% ownership. After entering Armenia in 2012 with a JV, in August 2015 Rosneft established a subsidiary there, CJSC Rosneft-Armenia, and acquired 100% ownership of the LLC Petrol Market Company (*see* Map 2) (Rosneft, 2017: 252). In line with the predictions of the U-model (Johanson & Vahlne, 1990), Gazprom's and Rosneft's established subsidiaries in Armenia were therefore the result of gradual acquisitions. Lukoil also established subsidiaries in Azerbaijan and later in Georgia, but these were downstream projects because of the Azerbaijani government's ownership restrictions on upstream projects. Rosneft's unsuccessful participation in an upstream project with SOCAR in Azerbaijan is a similar example. Given the facts, these oil and gas companies chose JVs as a first-entry mode by looking at their rivals' strategic entry decisions in the South Caucasus to avoid making similar mistakes. They first established JVs with foreign partners or host governments when entering the South Caucasus and then set up their foreign subsidiaries.

Briefly, both O and L advantages as well as political economy factors determined the Russian oil and gas companies' entry strategies and their business operations in the markets. Establishing JVs was the primary mode of entry and internalisation of their investments, prior to establishing foreign subsidiaries to create a unified network. Moreover, JVs with partial acquisition were also encouraged, and sometimes financed, by the home-country banks of the acquiring company (Dunning & Lundan, 2008: 271). The purpose of establishing strategic JVs in the South Caucasus was to obtain new competences which could give them new opportunities for creating synergies, overcoming country-specific barriers, such as trade or political barriers, achieving quicker access to the markets, developing trust and cooperation with the host-country governments, and eventually expanding their businesses into new markets. In line with the U-model explanation (Johanson & Vahlne, 1977), as a result of their gradual acquisitions of JVs, Gazprom and Rosneft set up their subsidiaries. Unlike them, Lukoil's involvement in JVs was primarily in upstream projects in Azerbaijan, although its subsidiaries in Azerbaijan and those it acquired later in Georgia are downstream projects.

5.6 Conclusion

In this chapter, I have used an interdisciplinary theory to examine Gazprom's, Lukoil's and Rosneft's investment and business activities in the South Caucasus emerging economies. The results have shown that besides possessing firm-specific ownership advantages, macro- and micro-economic factors associated with home-country economic and institutional development and firm-level development have determined the Russian oil and gas companies' internationalisation strategies. The locational advantages of the South Caucasus countries associated with economic, institutional and social or cultural factors have influenced these companies' choice of location (*see* Table 3).

Moreover, the oil and gas companies are both a principal source of income and guarantors of Russian energy security, and Russia therefore considers its oil and gas industries strategically. The empirical findings have shown that through various mechanisms there is an interdependent relationship between the Russian state and the oil and gas companies (*see* Table 3). I have argued that these close state-business relations have increased Gazprom's, Lukoil's and Rosneft's O advantages and played a decisive role during their internationalisation. However, at the same time this can be a disadvantage when there is a dispute between home and host countries, because the state can directly or indirectly influence firms and their business operations possibly for its own political objectives (*see* Table 3). This indicates that the IPE perspective is useful for explaining their internationalisation. However, despite being fully private and the Russian state's minimal intervention in Lukoil, in comparison with Gazprom and Rosneft Lukoil's intention to develop and maintain its close relations with the Russian state, and its state level approach, shows that this cannot be explained by the IPE perspective.

The empirical facts illustrate that interstate relations have also been a key factor in these firms' investment and business activities in the South Caucasus and influenced the distribution of their investments across the region (*see* Table 3). In fact, there is variation across industries and firms, because of firms' individual relations with the Russian state and their various roles and involvement between home-host country relations (*see* Table 3). Because these firms' primary aim is to maximise their profits by taking advantage of state-business and state-state relations. Furthermore, the factors and events discussed in this chapter show that Russia's foreign policy objectives can influence these firms and their investment and business activities (*see* Table 3). They are central to understanding the dynamics of Russian politics and economy and firms can invest and do business even if a particular market does not quite match their business strategies or preferences. However, I also found that the gas business has greater strategic importance for Russia and more political influence than oil, and Gazprom has been a key player among these three companies in the development of the EEU (*see* Table 3). Given the facts, each firm therefore should be treated differently regardless of state-ownership, and the state-private divide cannot help to understand or explain the oil and gas firms' internationalisation. To sum up briefly, this chapter shows that political factors are not exogenous, but are highly influential in oil and gas firms' investment and business activities. These firms have used this in their favour and developed their political behaviour to gain maximum profits. So, the research findings show that the oil and gas business is closely tied to political issues, and that firms in these industries are dealing with political factors alongside economic ones.

Given the various O and L advantages as well as political economy factors, Gazprom, Lukoil and Rosneft entered the South Caucasus markets with JVs as an initial entry strategy and subsequently established subsidiaries as a final stage in the internationalisation process (*see* Table 3). Once they had consolidated their positions in the South Caucasus markets, they began to move to new ones. All this shows that the interdisciplinary theory developed in this thesis is well-suited to explaining the internationalisation of Russian oil and gas companies and their operations. In the following chapter, I take up the points that have been put forward here to explain the determinants behind the investment decisions of the Russian electricity and aluminium companies in the South Caucasus.

Firms	Investment Destinations	Entry Strategies	Expansion Approaches	State-Business Relations	State-State Relations
Gazprom	Armenia and South Ossetia	JVs, M&As and subsidiaries	Market-, strategic asset- and efficiency-seeking investments: to sell traditional amounts of oil and gas products; to have control over strategic pipelines; to benefit from the interconnected system.	Very high Direct and indirect state-ownership, government appointees, former government officials, personal relations, interlocking directorates, Long-Term Development Programmes, frequent meetings with the president, government support and protectionism through tax reduction, state-owned financial institutions, and intergovernmental meetings, and administrative support, such as 'take or pay' fines: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations, and sanctions, such as trade and energy: determined its investment behaviour and distribution, as well as business activities. Acted as a 'political authority' and involved in disputes. Highly involved in the development of the EEU which eliminated export duties and other various barriers, and attempted to stop west's investments and control energy resources and pipelines supported by the west.
Lukoil	Azerbaijan and Georgia	JVs and subsidiaries	Resource-, market-, strategic asset- and efficiency-seeking investments: to exploit resources; to sell oil and gas products; to gain international experience and acquire advanced	Medium Kremlin-friendly private investor, former government officials, interlocking directorates. dependence on state-owned monopolies, such as RZD, Gazprom and Transneft, and financial institutions, natural resources dependence (limited to private companies), occasional	Political disputes or deteriorating relations, including wars and sanctions: affected its investment and business activities Acted as a 'useful ambassadorial act of peace' in moderating relations and a 'direct representative' of its home country in the projects.

			technology; to benefit from the host-country pipelines.	meetings with the president, interaction and cooperation with government authorities and ministries, and tax reduction and investment protectionism: determined its investment and business activities.	Took part in the development of the EEU to improve and develop customs administration procedures and policies. The EEU facilitates its investment and business activities, such as eliminating export duties and other various barriers.
Rosneft	Armenia, Abkhazia and Georgia	JVs, M&As and subsidiaries	Market-, strategic asset- and efficiency-seeking investments: to sell the oil products; to acquire strategic companies; to benefit from the efficiency of the targeted projects.	Very High Indirect state-ownership, government appointees, former government officials, personal relations, interlocking directorates, Long-Term Development Programmes, frequent meetings with the president, dependence on state-owned monopolies, such as RZD, Gazprom, and Transneft, and financial institutions, government support and protectionism through tax reduction, state-owned financial institutions, and intergovernmental meetings, and administrative support, such as increasing independent directors: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations, and sanctions: determined and affected its investment strategies and distribution, as well as business activities. Acted as a ‘diplomat’ in moderating relations and a ‘watchdog’ in the projects. Took part in the development of the EEU to improve and develop customs administration procedures and policies. The EEU facilitates its investment and business activities, such as eliminating export duties and other various barriers.

Table 3: Russian Oil and Gas Firms in the South Caucasus Emerging Economies

Chapter 6

6 Electricity and Aluminium Industries: Inter RAO UES, RusHydro and RUSAL

6.1 Introduction

Besides oil and gas companies, the electricity companies Inter RAO UES and RusHydro and the aluminium company RUSAL are the largest Russian resource-based firms in terms of assets, revenues, market values and geographical footprints and are strategically important in Russia's economy. They engage in a range of investment and trading activities in the South Caucasus markets as illustrated in Map 10. Inter RAO UES is mostly involved in Armenia and Georgia, investing in hydroelectricity, heat and nuclear energy, including distribution and sales (*see* Maps 10 and 11). Inter RAO UES also supplies electricity to Abkhazia and South Ossetia (*see* Map 10). RusHydro's and RUSAL's investments are based only in Armenia (*see* Maps 10 and 11). In terms of trading, whilst RusHydro is restricted to the Armenian market, RUSAL trades with all of the South Caucasus countries (*see* Map 10). Moreover, Maps 10 and 11 explicitly show that the business activities of the Russian electricity, and aluminium are only involved in Azerbaijan in terms of trading.

Map 10: Geographical footprints of Inter RAO UES, RusHydro and RUSAL (customised by the author)

In this chapter, the interdisciplinary theory is used to study the Russian electricity and aluminium companies and to analyse the main determinants and motives for their investment decisions in the South Caucasus emerging economies. In the first section, I explore the ownership advantages of Inter RAO UES, RusHydro and RUSAL, identify what O advantages they have obtained to exploit in the South Caucasus and analyse the influence of home-country economic and institutional development, and the firms' development in terms of their expansion strategies. In the second section, I examine the L advantages of the South Caucasus countries as well as host-country factors associated with economic development, the 'rules of the game' and non-economic factors, and investigate the companies' decisions about where to invest. In the political economy of investments section, I study the relations between the Russian state and its electricity and aluminium companies, such as the role of state in the companies' O advantages and in the localisation of their investment projects in the South Caucasus. In this section, I also investigate the role of state-state relations and other political factors in the companies' investment decisions and their roles in interstate relations as corporate players. In the final section, in the light of the ownership and location advantages, and political economy determinants, I analyse how the Russian electricity and aluminium companies have entered the markets, what entry modes they chose to internalise and the reasons behind their decisions.

6.2 Ownership

In this section, to explain and understand why the Russian electricity and aluminium companies decided to internationalise, the first phase of the interdisciplinary framework is used to explore the firm-specific advantages of Inter RAO UES, RusHydro, and RUSAL and to analyse the impact of Russia's economic and institutional development and the firms' development on these companies' investment decisions and expansion strategies. In the 1990s Russia was experiencing macroeconomic problems and struggling with a lack of economic and institutional development. During this time the electricity company (RAO UES) and aluminium companies (RUSAL and SUAL) were established as a result of Yeltsin's economic policies and reforms. However, the electricity and aluminium industries suffered from a lack of significant investment and the sectors' plant and equipment were old and outdated. Interpreted in line with the IDP (Dunning, 1986), Russia was in the early stage of its IDP and in line with the U-model (Johanson & Vahlne, 1990), these companies were at a very early stage of development and not capable of conducting investment projects abroad.

In the early 2000s, these industries underwent reorganisation as a result of structural reforms, which creates an argument for applying a theoretical explanation to the analysis of the firms' investment decisions. From 1997-2002, Inter RAO UES was only involved in electricity trading projects in international markets (Inter RAO UES, 2016: 8). After 2003, it began actively to purchase electricity power assets in the neighbouring countries. As illustrated in Map 12, between 2003 and 2005 Inter RAO UES obtained the management rights of Khrami HPP-1 and Khrami HPP-2 in Georgia and the trust management rights of Armenian NPP, as well as purchasing Sevan-Hrazdan Cascade of HPPs in Armenia (Inter RAO UES, 2009: 11). In 2004, Inter RAO UES became a leading Russian electricity company in terms of exports, and in 2005 it strengthened its position, accomplishing substantial breakthroughs in complicated markets, such as the South Caucasus countries (for example by acquiring 100% of the shares of Electric Networks of Armenia) (Inter RAO UES, 2006: 37). This shows that once it became stronger at home, it could then begin first to trade and then to make investments elsewhere.

In 2007, the merger of RUSAL and its local competitor SUAL, as well as Glencore, created the united company RUSAL (RUSAL, 2010: 131). During this time, Inter RAO UES and RusHydro became independent companies whilst RAO UES ceased to be a government monopoly as a result of reorganisation. The liberalisation of the Russian electricity industry provided RusHydro with a unique competitive ownership advantage over its rivals, due to the synergies between generation and retail sales activities. In June 2008, RusHydro joined the Global Sustainable Electricity Partnership,[90] and the company inherited a segment of RAO UES's international representative functions. In the following month, it created its target model for the development of the business (RusHydro, 2009: 7, 9). Consequently, RusHydro made its first international investment in Armenia in 2011 by acquiring a 90% share in the International Power corporation which has seven HPPs of the Sevan-Hrazdan Cascade (*see* Map 11) (RusHydro, 2011: 70). Thus, the creation and reorganisation of these companies was a result of Russia's institutional and macroeconomic development during Putin's presidency, which also increased the companies' O advantages. Moreover, the improved financial status of these firms and accumulated wealth were two other prerequisites for their internationalisation. This was further boosted by skyrocketing oil prices which had a spillover effect on the Russian electricity and aluminium industries (I-3, 2017).

[90] formerly e8 group.

Interpreted in line with Dunning's eclectic paradigm (2003), these companies have one ownership advantage which is associated with the possession of a strong market and resource base in the home market. While RusHydro has a strong installed capacity,[91] Inter RAO UES is the leading Russian company in cross-border electricity import and export operations and the only participant in import and export operations in Russia's wholesale electricity and capacity market (Inter RAO UES, 2018: 29). Before the reorganisation in 2007, RUSAL held 75% and SUAL 25% shares of the domestic market (Panibratov & Latukha, 2014: 136). It is not a monopolistic company but does possess the lion's share.[92] All this creates a robust profit centre from which to develop its expansion activities and compensate for volatile trading and investment results during the implementation of investment projects in the South Caucasus.

According to the eclectic theory (Dunning, 1998a), Inter RAO UES's, RusHydro's and RUSAL's O advantages are divided into tangible (including plants and physical infrastructure) and intangible assets (including organisational capacity, management and knowledge experience). As Map 11 illustrates, several of the electricity generation assets of Inter RAO UES and RusHydro and the facilities of RUSAL[93] are located in geographically strategic regions of Russia. Inter RAO UES and RusHydro operate within the framework of UES of Russia which functions in parallel with the energy systems of the South Caucasus countries (RusHydro, 2018: 13). RusHydro has another advantage in its lack of dependence on gas prices, which is a competitive ownership advantage *vis-à-vis* other electricity companies, particularly thermal generating companies. RUSAL has access to an inexpensive and uninterrupted electricity supply (*see* Map 11), uninterrupted transportation services and access to the infrastructure for the transportation of its aluminium products and materials to the markets (*see* Map 11) (RUSAL, 2018: 88). Aluminium smelters rely on hydro power stations, such as Volzhskaya HPP in Russia and Kanaker HPP in Armenia, and benefit from low-cost and renewable energy. This gives it a competitive ownership advantage in accessing low-cost captive electricity. Moreover, many years of experience in electricity trading inherited from the Soviet era have provided Inter RAO UES with an important ownership advantage allowing it to become a key player in electricity trading in Russia and the CIS countries. This intangible O advantage has also improved the competency of the company's investment activities.

[91] Inter RAO UES holds third place (32.7 gw), Gazprom first (39.2 gw) and RusHydro (39 gw) second in the Russian electricity industry in terms of installed capacity.

[92] RUSAL is number one in the Russian market.

[93] including smelters and refineries.

Map 11: Inter RAO UES's, RusHydro's and RUSAL's operations and facilities (customised by the author)

Furthermore, in 2003 as a consequence of Rosenergoatom's acquisition of 40% of its shares, Inter RAO UES not only became a unified and independent import and export operator in Russia (Inter RAO UES, 2011: 12) but also procured management experience in nuclear energy. Because of this management-based ownership advantage, Inter RAO UES began to seek abroad for new nuclear energy industry assets, for example the Armenian NPP[94] in Armenia (*see* Map 11). RusHydro's accumulated experience in the design, construction and operation of hydro-electric facilities enabled the company to expand its geographical footprints in foreign markets such as Armenia (RusHydro, 2018: 68). These examples show that the

[94] also known as Metsamor NPP.

Russian electricity and aluminium companies possess more management- and organisation-based ownership advantages than technology.

Dunning's eclectic paradigm thus offers a promising mechanism for studying Russia's electricity and aluminium companies and their investment activities; the tangible and intangible ownership advantages discussed here (created in Russia), were stepping-stones to the international expansion of Inter RAO UES, RusHydro and RUSAL in the South Caucasus. However, given the facts discussed above, the economic and institutional development of the Russian state and firms' own development influenced the ownership advantages of Inter RAO UES, RusHydro and RUSAL and their internationalisation strategies in the South Caucasus. Taking all this into account, the ownership sub-paradigm of the interdisciplinary paradigm provides a better explanation and analysis of these firms' various ownership advantages.

6.3 Localisation

In this section, I use the second leg of the interdisciplinary theory developed for this thesis to identify what locational advantages the South Caucasus countries offered and to explore whether institutional and cultural factors, alongside economic determinants, have influenced the localisation of these companies' investments. Once they had acquired and increased their O advantages and consolidated their home-country market positions, as discussed in the earlier section, they started seeking investment opportunities in foreign locations that could provide attractive L advantages for them.

As explained by Dunning's OLI (1998b: 54-60), in relation to the localisation determinant, geographic proximity or location was a critical international business consideration that enabled Inter RAO UES, RusHydro and RUSAL to engage more frequently in international business activities in the South Caucasus than their geographically more distant counterparts (I-3, 2017; I-5, 2017; I-7, 2017; I-8, 2017; I-16, 2017). Their core business segments are primarily located in Russia, as Map 11 shows. The RUSAL respondent added that, as an aluminium company, RUSAL seeks to locate its investments in places where distance-related transaction and/or transportation costs are lower (I-3, 2017). So, as Dunning argued (1988: 2-4), major efforts were made to expand their investments and geographical presence in neighbouring countries located in close proximity to their immobile home-country operation facilities, which would enable them to combine both home- and host-country assets with spatially transferable intermediate products from home to host (*see* Map 11).

Moreover, Inter RAO UES, RusHydro and RUSAL all considered the future advantages which the South Caucasus countries could offer (I-5, 2017). They have sought to exploit foreign markets in the adjacent countries of the South Caucasus where they can supply goods and services. Inter RAO UES invests in a country to occupy a considerable part of the electricity market of that country, to import electricity from that country to Russia, and to use the location of the host-country electricity market to create competitive advantages for itself in neighbouring countries (Inter RAO UES, 2009: 49). For example, after entering the Georgian and Armenian markets and then consolidating its position during 2003-2005, it entered the Turkish market in 2005. Moreover, it also searches for efficient economies of trade; Georgia's geographic location enables Inter RAO UES to supply it with electricity, which it then resells to Turkey or Azerbaijan (Inter RAO UES, 2015: 24). This South Caucasus location advantage also allows RUSAL to sell its aluminium at Armenal in the European market (Arka, 2015). Geographical location advantage therefore plays a significant role and makes it possible to take advantage of facilities in both host and home countries, and to target new markets.

In addition to geographic location, good physical infrastructure has been another key determinant in their investment decision making. These companies choose regions where they can access assets of a similar or equivalent technological level (I-3, 2017), which makes it easier to integrate the new assets into their production processes. They can produce and sell in the South Caucasus domestic markets and trade in the new foreign markets. For example, when making investments and implementing trade activities, parallel and synchronous operations with the UES of Russia and the power systems of contiguous countries constitute an essential technological condition (Inter RAO UES, 2012: 114). The energy systems of Azerbaijan, Georgia, South Ossetia and Abkhazia operate in parallel with Russia's UES (Inter RAO UES, 2018: 40).[95] This is a legacy of the Soviet Union, when there was a unified electricity system. Inter RAO UES made one of its main business development priorities the export of its electricity to contiguous markets, for example, with transmission lines connecting Armenia with Georgia and Iran (Inter RAO UES, 2013: 59). Supplies of electricity to Georgia, and then for resale to Turkey, were realised after cooperation with the Georgian energy infrastructure companies (Inter RAO UES, 2015: 24), and the commissioning of the Akhaltsikhe-Borchkha (400 kV) interstate power line that connects the Georgian and Turkish power systems.

[95] The system operator of UES ensures the reliable management of power systems and oversees the stipulated system parameters.

Moreover, Inter RAO UES seeks to have continuous electricity supplies in Russia's cross-border regions by ensuring a reciprocal reserve with neighbouring energy systems, and *vice-versa*.[96] For example, in 2010 there were issues with power lines being disabled in a section of the Russian-Georgian power lines, which cut off the electricity and negatively affected the company's financial performance (Inter RAO UES, 2011: 99). In this circumstance, Inter RAO UES's ultimate goal, in order to meet consumer demand in Georgia or other markets, was to control cross-border flows of electricity.

The key driver of RUSAL's investments was directly related to the South Caucasus's infrastructure assets. Strong investment in the electricity industry, particularly in green energy, also increased the demand for aluminium (RUSAL, 2018: 51). For example, the targeted aluminium asset, Armenal, in Armenia is located next to the Kanaker HPP, which provides RUSAL with access to uninterrupted and inexpensive electricity. In relation to the available local infrastructure, a reliable transportation system is crucial for getting RUSAL's aluminium products and materials to the Armenian market from Russia and then from the Armenian market to the new markets, including Russia and Europe (*see* Map 14). In accordance with Dunning's explanation (1998a: 54), Inter RAO UES, RusHydro and RUSAL have all sought to sustain and increase their existing O specific advantages when carrying out investment projects in the South Caucasus countries, making similar economies of scale and scope, and investing in companies with similar asset structures to their own, which they find commercially viable and desirable.

Inter RAO UES, RusHydro and RUSAL have all targeted strategically important assets in the South Caucasus. These investments were intended to promote and advance their long-term strategic objectives and to increase their global competitiveness. Inter RAO UES targeted assets such as Telasi,[97] which is the largest power grid and supply company in Tbilisi, and Power Grids of Armenia,[98] which has a monopoly of electricity distribution and supply there (Inter RAO UES, 2016: 68; 2015: 63; 2013: 57). The purpose of its acquisitions in Armenia was also to make good use of the optimisation of cash flows between companies owned or

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[96] The import and export operations of Inter RAO UES are an economic bearer of the reliable functioning of Russia's UES with synchronously operated South Caucasus electricity systems.

[97] owns a 21% share of the whole Georgian electricity market.

[98] selling 100% of the electricity consumed in the Armenian market.

controlled by Inter RAO UES (Inter RAO UES, 2006: 27). Armenal[99] was one of the largest leading plants during the Soviet era, which attracted RUSAL's attention. This shows that resource-seeking alongside strategic asset-seeking investments has been a primary motive behind RUSAL's investment activities in Armenia, aimed at consolidating the company's position among the global aluminium producers (I-3, 2017). Their strategic assets offered possibilities for the Russian electricity and aluminium companies to strengthen their positions in existing markets and to penetrate new markets.

Inter RAO UES, RusHydro and RUSAL seek to locate their investments where they can benefit from market friendly host-country governments. The development of electricity supplies and purchases takes place under commercial contract and as part of parallel operations with foreign energy systems in the neighbouring countries (Inter RAO UES, 2016: 58). The South Caucasus countries possess efficient mechanisms for offering competitive tariffs and their governments[100] regulate the wholesale electricity markets (Inter RAO UES, 2013: 47). Companies operating in these markets must acquire the relevant licences. For example, Inter RAO UES signed tariff agreements with the Georgian government for effective long-term cooperation, including a reduction in tariffs (*ibid.*: 55). This cooperation had a positive impact on the value of its investments in Georgia. These localisation determinants have been primary advantages in preserving the success of all three Russian firms' investments and obtaining synergic effects from the implemented projects.

Growing competition in the South Caucasus region is a locational disadvantage and can force companies to diversify their geographical distribution. The South Caucasus host countries are trying to diversify their energy suppliers and reduce their dependence on Inter RAO UES by building their own electricity generation capacities, particularly HPPs, and increasing competition in their own markets. Unlike Inter RAO UES, the growing demand for electricity, the possibilities of renewable energy sources and the development of hydro-prospects provide RusHydro with favourable conditions and investment opportunities for entering foreign

[99] previously known as the Kanaker aluminium smelter.

[100] The activities of grid companies in Armenia are regulated by the Public Services Regulatory Commission of Armenia. In Georgia they are regulated by the Georgian National Energy and Water Supply Regulatory Commission (Inter RAO UES, 2016: 68). These host-country agencies set the tariffs for the sale and purchase of electricity in the domestic markets as well as for dispatch and transit services.

markets. Inter RAO UES faces competitors in the South Caucasus mainly in Georgia and Azerbaijan, and JSC Azerenerji[101] is one of the key competitors supplying electricity to both markets. In Armenia, RusHydro is one of the Russian competitors, controlling the Sevan-Hrazdan Cascade of seven HPPs, including Kanaker HPP, located in the vicinity of RUSAL's Armenal.

Considering the limited international experience of these companies (especially the electricity companies), some of their investments in the South Caucasus have been made to gain international experience, improve their incremental knowledge and test their already accumulated experience. For example, Inter RAO UES's first and only international investment in the nuclear energy industry was in Armenian NPP in 2003 and was managed until March 2012 (*see* Maps 10 and 11). After obtaining experience in Armenian NPP, Inter RAO UES started to implement nuclear power projects in Turkey in partnership with Rosatom, the Russian state-owned nuclear energy company (Panibratov & Latukha, 2014: 136). RUSAL implemented one of its first and largest international projects in Armenia in 2000, and since then has begun to actively exploit its international investment project. Its main goal was to attract investments and find promising investment projects, to exchange experience in the electricity industries and to establish bilateral cooperation with foreign electricity companies. As predicted by the U-model (Johanson & Vahlne, 2003: 90), these companies have invested in more familiar markets offering the same business environment and regulatory and political systems, before gradually moving to new ones.

Evaluating the macroeconomic conditions of the South Caucasus host countries is crucial when locating investments. In line with the IDP (Dunning, 1998b; 1988), the level of institutional and economic development of the South Caucasus host countries has a significant impact on the inflow of investments (*see* Graphs 1, 2 and 3). For example, Azerbaijan has been perceived as a tough, autocratic and corrupt system and a mature market with high market entry barriers, local monopolies and energy resources (*see* Graphs 1 and 2) (I-14, 2017; I-16, 2017; I-17, 2017). Unlike Armenia and Georgia, it is not a member of the WTO, even though negotiations began in 1997. Moreover, as Graph 2 illustrates, during 2003 and 2004, when corruption was at its highest in Armenia and Georgia, Inter RAO UES was investing in both markets (*see* Graph 2). This variation across the institutional and economic development of the South

[101] Azerenerji is a monopoly in Azerbaijan and controls electricity production and transmission (I-14, 2017; I-16, 2017).

Caucasus countries shows that corruption might have played a ‘grabbing hand’ in Azerbaijan and a ‘helping hand’ in Armenia and Georgia. The respondent from Georgia confirmed the role that corruption had played in speeding up Russian investments in the early 2000s (I-9, 2017).

An unstable national currency, increasing fuel prices and frequent amendments to the statutory regulations applicable to the electricity industry in Georgia affected Inter RAO UES’s prospective investment decisions (Inter RAO UES, 2015: 65). So in 2016 it sold Mtkvari Energy, its generating asset in Georgia (Inter RAO UES, 2018: 110). Moreover, in places where the rules and business conditions have been unpredictable and subject to changes in the markets, Inter RAO UES chose to exit from these markets as their operations became unprofitable. For example, in Armenia, Inter RAO UES’s operating and financial results were highly affected by adverse tariff regulations in the Armenian electricity industry. Increasingly negative macroeconomic risks in Armenia reduced mutual trust in the field of investments and lending. Consequently, Inter RAO UES sold its assets to another Russian company, Tashir Group, and left the market in 2016 (Inter RAO UES, 2017: 48).

To conclude, using the second leg of the interdisciplinary theory I have explored and analysed the various locational advantages of the South Caucasus countries, which have offered Inter RAO UES, RusHydro and RUSAL various opportunities for the development of successful businesses. The South Caucasus emerging economies could also be considered a proxy for these companies’ activities. For example, Inter RAO UES has followed its growing export flows and customers to the South Caucasus markets, which can be described as the ‘follow the customer strategy’. Differences in the level of economic and institutional development of the South Caucasus countries, and these companies’ limited international experience have also determined their choices about where to invest.

6.4 Political Economy of Investments

6.4.1 State-Business Relations

After the collapse of the Soviet Union, Russia experienced political and economic changes which also affected its electricity and aluminium industries. During the Yeltsin era, the electricity and aluminium companies were primarily involved in export activities. When Putin came to power however, the electricity, and aluminium industries underwent reorganisation and the companies became active investors. These resource-based firms make a significant contribution to the Russian economy, and as a result the reorganisation of electricity (though not of aluminium) was driven by state reforms, with the state acting not only as coordinator for the companies at the early stage of their internationalisation, offering tax incentives, and huge financial backing, but also as specialists on targeted economies and other types of support (Kuznetsov, 2017b: 86). For instance, during the 2008 financial crisis, RUSAL ended up in more than $20 billion debt (I-5, 2017) and RusHydro suspended its international investment programmes. In 2010, however, RusHydro decided to make its first international investment in Armenia in 2011 (RusHydro, 2011: 3); and RUSAL started to benefit from the low effective tax rate in the home market. Russia's economic policies have been necessary for these companies' survival, maintaining their O advantages against macroeconomic risks and increasing their competencies for making investments abroad. Considering all this interaction, I use the interdisciplinary paradigm to study and explain the Russian state's relations with its electricity and aluminium companies and its role in their investment activities.

When the Ministry of Energy converted to RAO UES, the new companies were structured by the ministries' staff and administration (Ketting, 2008: 95). This indicates personal continuity with the Soviet Union. During this time Kremlin-friendly investors, Oleg Deripaska and Viktor Vekselberg, took over the Russian aluminium industry through "voucher privatisation". Moreover, the Russian electricity and aluminium companies have had key individuals[102] on their boards and management, providing Inter RAO UES, RusHydro and RUSAL with easy access to exclusive finance and information. Through these managerial elites (Pettigrew, 1992) also known as interlocking directorates (Cheng & Kreinin, 1996), the Russian electricity and aluminium companies have developed the necessary management practices and structural measures to implement and accelerate their investments. For example, in 2016, in order to improve fuel efficiency and optimise fuel expenses, Inter RAO UES entered into a long-term contract with its strategic partner Rosneft (Inter RAO UES, 2017: 8), gaining an opportunity

[102] These individuals were Igor Sechin, president of Rosneft and deputy prime minister of Russia; Anatoly Gavrilenko, Gazprombank board member; Andrey Bugrov, vice president of the RSPP who worked at the Ministry of Foreign Affairs of the Soviet Union; Alexander Nikitin, former senior manager of MTS; Sergei Shmatko, former minister of Energy; Denis Fedorov, head of the administration of Gazprom; Matthias Warnig, supervisory council of VTB Bank and Rosneft; Anatoly Ballo, deputy chairman of Vnesheconombank; Nikolay Podguzov, former supervisory board director of VTB Bank and deputy minister of Economic Development of Russia; Boris Kovalchuk, Nikolay Shulginov and Victor Vekselberg, members of the management board of the RSPP, and others who used to hold or still hold various senior positions in government bodies and large Russian companies.

to implement new projects and carry out existing ones in neighbouring countries. Similarly, in order to take advantage of the logistical proximity of aluminium smelters, as Map 11 shows, RUSAL has sought to establish cooperation and partnership relationships with strategic partners in both upstream and downstream facilities which could provide the company with investment opportunities in the South Caucasus (RUSAL, 2014: 24). For example, the Volgograd aluminium smelter and powder metallurgy facility are located in strategically important locations close to the South Caucasus countries (*see* Map 11). Furthermore, the availability of fuels and reliable fuel suppliers ensures the operation of Inter RAO UES's generating facilities, reduces logistical and price risks, and provides the conditions for making profits in overseas markets (Inter RAO UES, 2016: 26). For instance, the only fuel supplier for electricity generation by Hrazdan TPP in Armenia is ArmRosGazprom, a subsidiary of Gazprom (*ibid.*: 74).

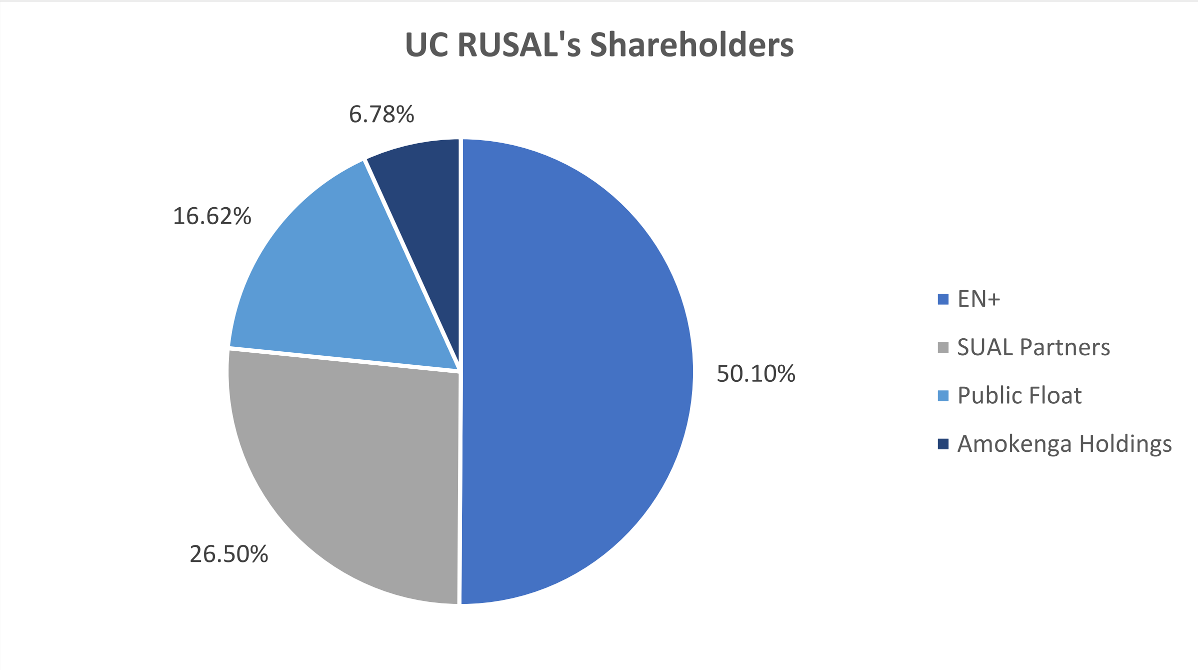

Figure 7. Source: RUSAL, 2019

Unlike Inter RAO UES and RusHydro, RUSAL is a fully private company, as Figure 7 shows. Inter RAO UES and RusHydro are owned by the state either through direct ownership or indirect state-owned entities, such as Rosneftegaz, PJSC FGC UES and the PJSC VTB bank, as Figure 8 and 9 show. The Russian state has a controlling stake in the electricity companies, participating in the management of companies which are in its strategic interests, regulating their activities and determining their production and prices (Inter RAO UES, 2018: 10;

RusHydro, 2018: 13).[103] In accordance with Putin's list of instructions, the Ministries of Energy and Economic Development formulated LTDPs for Inter RAO UES and RusHydro (Inter RAO UES, 2018: 45; RusHydro, 2015: 25) (which did not apply to RUSAL). These programmes for the electricity companies were a first step towards implementing their strategies in accordance with the state's instructions; determining their strategic objectives, target visions, priorities and the implementation of domestic and foreign investment projects aimed at accomplishing strategic goals (Inter RAO UES, 2018: 45; RusHydro, 2018: 30). Furthermore, executive management of Inter RAO UES and RusHydro is often appointed by the government and has political relations with the government or government officials. So, state ownership and appointed managers enable the Russian state to internalise its control over the firms and influence their business operations.

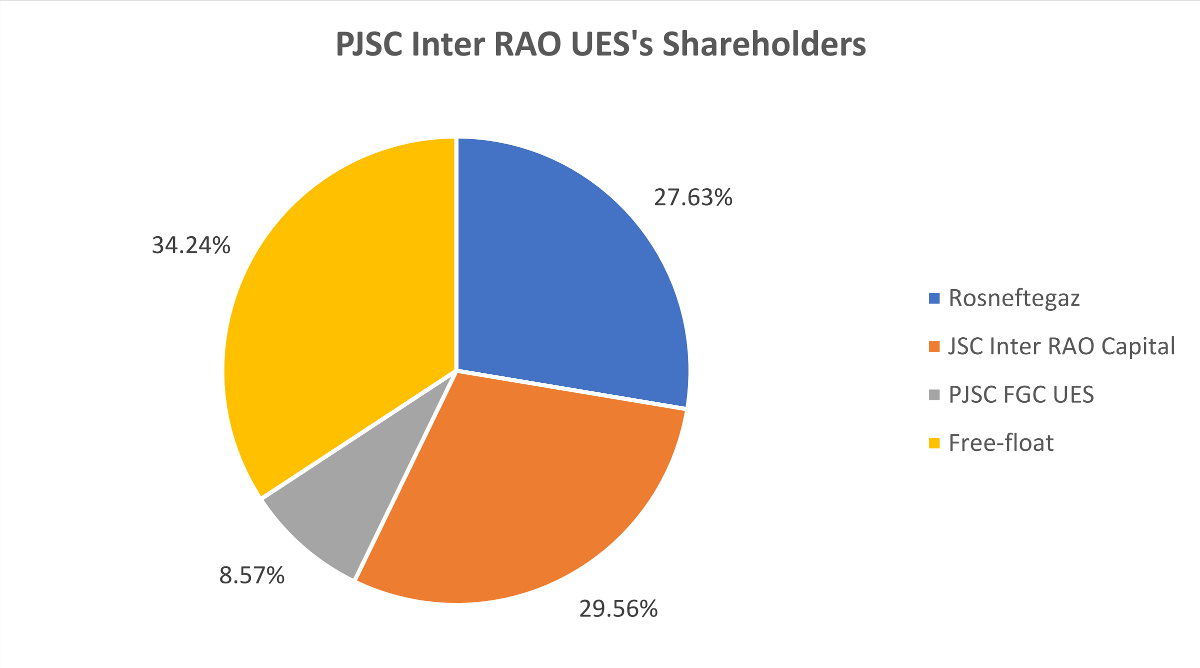

Figure 8. Source: Inter RAO UES, 2019

When investing in a foreign market, cooperation with reliable financial and insurance companies is necessary to avoid economic and political risks in foreign economies. For example, in 2007 Inter RAO UES signed an agreement to cooperate on investment projects with VTB bank (Inter RAO UES, 2009: 112), which has subsidiaries in the South Caucasus countries. The presence of state-owned VTB bank as well as Gazprombank was very important in helping them to make investment decisions and update or reconstruct assets, such as their

[103] Inter RAO UES in 2010 and RusHydro in 2012 were included on the list of open joint-stock companies.

investment in the Electric Network of Armenia (Inter RAO UES, 2010: 66). The owner of RUSAL Deripaska directly and indirectly owned more than 30% of INGO Armenia (RUSAL, 2013: 87). The respondent from RUSAL stated that they generally use Russian and international banks to finance their own subsidiaries (I-3, 2017). These types of formal and informal business ties or loyalty to the government has provided firms with more and greater preferential treatment from the state, and the Russian state with an essential tool to control and influence them.

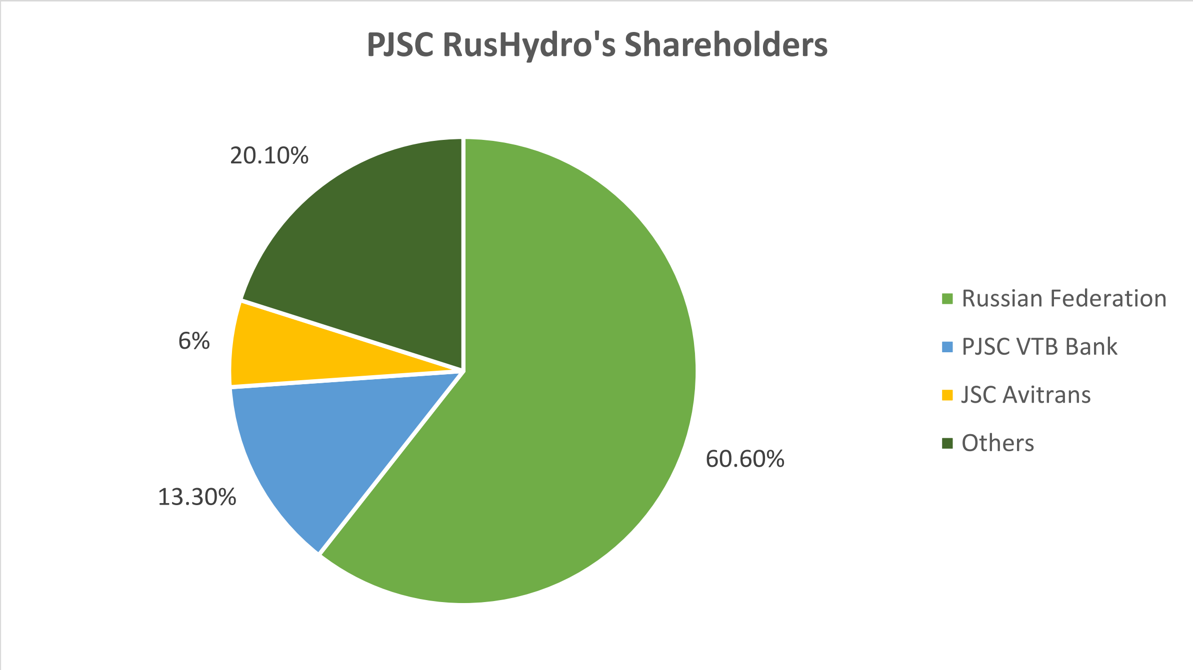

Figure 9. Source: RusHydro, 2019

The electricity and aluminium firms' financial dependence on the Russian state-owned financial companies has also affected their locational choices, investment strategies and acquisition process. Most of Inter RAO UES's and RusHydro's activities are based in Russia and economic conditions outside can make it difficult to enter other markets due to host-country factors such as business regulations, financial crises and inflation. For this reason, state support is needed in the areas of finance and production. In order to refinance RusHydro's debt, in accordance with decrees made by Putin and the Russian government, RusHydro and VTB bank developed a 'debt-for-investments' mechanism. The state supported and guaranteed, at least partially, the debt liabilities of RusHydro and its subsidiaries (Kremlin, 2015b). In March 2017, VTB bank obtained a 13.3% share in the company through a debt-financing mechanism (*see* Figure 9) (RusHydro, 2018: 85). Inter RAO UES and RusHydro identified promising and profitable projects and implemented their investment projects using both state and private financial sources. The allocated investment budget is for implementing investment projects of economic and political importance to Russia in accordance with Putin's instructions. The president of VTB bank meet frequently with Putin and the bank conducts transitions in the Russian and international markets on behalf of RusHydro (Kremlin, 2016). This enables firms to be more competitive, speed up the process and engage more in acquisitions (Blanchard, 2011: 102; Lunding, 2006: 7). But their dependence on crucial state resources may compel them to take part in political strategies and pursue less commercial practices (Goldstein, 2009: 105; Hillman & Wan, 2005: 326).

The presidents of Inter RAO UES and RusHydro meet with the Russian president regularly to discuss the electricity companies' development, including past performance and promising future projects. During the meetings, specific instructions are given on how to discuss and develop mechanisms with Russia's leading business agencies and constitutive entities. For instance, when electricity and fuel supplies to Georgia and Armenia were at issue, in January 2003, Putin met RAO UES and Gazprom and instructed them to investigate malfunctions in the North Caucasus-South Caucasus and Vladikavkaz-Tbilisi gas pipelines (*see* Map 9) (Kremlin, 2003a). This shows that the state has been key in the internationalisation of Russia's electricity companies, providing administrative support.

All three companies frequently cooperate with state agencies and authorities to receive effective support and resolve any host-country operational issues. For example, in 2014 the electricity delivery tariff was increased by 10.1%. The tariff solutions adopted did not help to secure a break-even issue of the Hrazdan Energy Company. This forced Inter RAO UES to purchase electricity at higher tariffs without relevant recompense from consumers. In December 2014, Boris Kovalchuk, a government representative on the management board of Inter RAO UES, met the Armenian president Serzh Sargsyan to discuss and negotiate harmonisation and normalising the operations of Power Grids of Armenia (Inter RAO UES, 2015: 69). The primary purpose of the meeting was to protect Inter RAO UES's investments in Armenia and maintain its market position. However, in 2015 and 2016, Inter RAO UES was again affected by new tariff regulations and consequently left the market. Cooperation with the state and state agencies for the electricity companies is a natural consequence of their state ownership. Unlike them, RUSAL, a fully private company, cooperates with the Russian state through managers who have previously worked in Russian ministries and are responsible for ensuring political support for its international activities, trade policy development, strategic relations with governments and government authorities, and relations with the Russian parliament (RUSAL, 2018: 107, 111-112). The respondent from RUSAL also stressed that "we are operating and working alongside Russian partners, and of course the cooperation with and of the government to develop relations" (I-3, 2017). In the case of RUSAL, it is fair to say that cooperation is therefore more informal.

The policies of Inter RAO UES and RusHydro are a combination of state, company and consumer interests. Under indirect supervision and support from the state, Inter RAO UES has implemented investment projects and expanded its geographical presence in foreign markets in accordance with Russia's interests (Inter RAO UES, 2007: 54). Inter RAO UES and RusHydro endeavour to establish long-term mutually beneficial partnerships and cooperation with foreign partners which also correspond to the geostrategic interests of Russia. Their international activities mainly involve expanding their presence and ensuring Russia's energy interests on the political, industrial and business stages (Inter RAO UES, 2018: 26; RusHydro, 2018: 68). Thus, Inter RAO UES and RusHydro have developed as global companies by relying on Russian state support to implement their investment projects and programmes, which have been consistent with Russia's political and economic interests. RUSAL also enjoys close relations with the Russian state but, as the respondent from RUSAL emphasised, "our decision-making process is based on economic rationale rather than any political reasons" (I-3, 2017). It should be emphasised that political support, especially through intergovernmental meetings, has been necessary for Russia's electricity and aluminium companies when investing in new markets because interacting with the state and improving relations with Russian and foreign partners provides them with opportunities for development. As the respondent from RUSAL stated "we would like to have a fairer and more favourable environment in general for Russian companies" (*ibid.*).

All in all, given the circumstances discussed above, I developed the interdisciplinary theory for this study to explore the Russian state's relations with the electricity and aluminium companies through various forms which have played a major role in the localisation and internalisation of their investments. This could be classified as an O advantage and indicates that the IPE approach is helpful to understand and explain the Russian electricity and aluminium firms' business and investment activities. Considering the limited international experience of these Russian companies, especially the electricity companies, Irakli Menagarishvili, Georgia's former Minister of Foreign Affairs, said that Russian state support would provide direct impetus for their internationalisation and would subdue their competitors in the host countries (I-9, 2017). It should be noted that officially there is no real system of FDI support. The Russian respondent Kuznetsov said that "we have some elements of state support for FDI expansion"

(I-5, 2017) or, in the words of a senior Armenian official, “there is a general policy to support these investments” (I-7, 2017). Moreover, the large companies have agreements with Russia’s Ministry of Foreign Affairs and could take advantage of the RSPP (I-5, 2017). Accordingly, there are indirect relations between the Russian state and the electricity and aluminium companies, and “in practice nobody can assure that they are differently involved in the businesses”, as the senior Armenian official commented (I-7, 2017). Despite being fully private and minimal state intervention in the firm, RUSAL keeps its close relations with the Russian state and government officials in order to benefit several government incentives. So, the IPE approach is limited for explaining RUSAL’s political behaviour. Considering Russia’s political ties with the South Caucasus countries, the Russian state’s interventions and decisions in these companies and their close cooperation, at least with the Russian state and other state agencies, it is necessary to consider the political implications next.

6.4.2 State-State relations

These Russian companies sought internationalisation and developed their foreign expansion based on Russia’s traditional relations. However, doing business in the South Caucasus emerging economies means working directly with home- and host-country governments, and this can also expose the companies to a range of political risks, such as deteriorating bilateral relations and political disputes. Some of these investments could also be made to serve Russia’s foreign policy and political interests rather than just achieve business objectives. The respondents from Armenia, Azerbaijan, Georgia and Russia suggested the need to study the Russian state-business relations behind its firms’ internationalisation motives, and foreign policy, and in this section, I explore whether these companies can, in part, be instruments of foreign policy (I-5, 2017; I-6, 2017; I-8, 2017; I-12, 2017; I-14, 2017; I-16, 2017). The respondent from RUSAL stated that “political and economic ties can easily affect their business decisions” and that “you need to work in the country where you have good relationships with local authorities” (I-3, 2017). For example, RUSAL does not have any issues in Armenia and its investment in ‘Armenal’ runs smoothly because, as the respondent from RUSAL said, Armenia is “friendly to Russia and it is not like investing in any CIS countries, it is like our friend, a friend of Russia” (*ibid.*). This shows that state-state relations are crucial and thus in this section, the interdisciplinary theory is used to explore and analyse how political factors have influenced Inter RAO UES’s, RusHydro’s and RUSAL’s investment and business activities and their political behaviour as well as the role they have played in home and host country relations.

The geographical activity of Inter RAO UES and the primary direction of Russia's foreign economic policy in the electricity industry are the main preconditions that determine the directions of Inter RAO UES's development in international electricity markets (Inter RAO UES, 2009: 48). For example, the management of Enguri HPP is controlled by Inter RAO UES. Enguri HPP produces 40% of Georgia's electricity (Asatryan *et al.*, 2015: 19). As Map 12 shows, the dam is located on the Georgian side, but the generating power plant is located on the Abkhazian side. This caused a dispute between Georgia and Abkhazia in 2003. In order to resolve this, in March 2003 Eduard Shevardnadze, Georgia's president, and Gennadi Gagulia, the prime minister of Abkhazia, met with Putin (Kremlin, 2003b; 2003c; 2003d; 2003e). Subsequently, Putin talked with Anotoly Chubais, a former president of RAO UES, and discussed the energy issues between Georgia and Abkhazia and the possibility of restoring Enguri HPP. The construction of Enguri HPP would provide electricity to Abkhazia, Georgia, and Russia, as had been planned in the Soviet period (Kremlin, 2003b; 2003c). As a result of those tripartite talks, Georgia and Abkhazia agreed to use Enguri HPP together with the help of RAO UES. After the 2008 war, Inter RAO UES took over the management of Enguri HPP, although it remained under Georgian state ownership (Doggart, 2011: 39).

Moreover, Inter RAO UES supplied electricity to Abkhazia and South Ossetia, but because of the conflict in Abkhazia the electricity supply to the rest of Georgia was interrupted. Enguri HPP could be used as a political weapon, and to address this problem Georgia tried to build new HPPs (Asatryan *et al.*, 2015: 19). This example shows that Inter RAO UES has been involved in Russia's foreign policy, and with Abkhazia and Georgia, to harmonise relations and ultimately achieve Russia's strategic goal in the region. Inter RAO UES has therefore had a political role as a diplomatic actor, solving disputes. In the following years further agreements were signed between Russia and Abkhazia to promote further investment activities, trade and economic cooperation (Kremlin, 2018b; 2010b). These examples show that the corporate goals of Inter RAO UES conformed to Russia's political interests and that Inter RAO UES has used political events in its favour.

These resource-based Russian firms contribute to the Russian economy and play a significant role in Russia's foreign economic and political relations. For example, Inter RAO UES's Hrazdan Energy and the Electric Networks of Armenia companies are successful examples of

Russian and Armenian business cooperation whose aim is to be increasing the efficiency of electricity production and distribution. Inter RAO UES's political accommodation and responsiveness is also involved in charitable activities in collaboration with the Armenian Ministries of Education and Culture (Inter RAO UES, 2014: 162). In Georgia, through Telasi, Inter RAO UES has been involved in charitable activities, including providing technical and financial support (Inter RAO UES, 2018: 240). The main reason for Inter RAO UES's strategic involvement was to safeguard its investment activities and to improve its company image in both countries. This is probably one of the reasons why Inter RAO UES still has investments and operations in Georgia, despite the 2006 sanctions and the 2008 war. It also shows that the company has taken into consideration political issues in the region when developing its political behaviour and adjusting its decisions and strategies. However, as Fortescue and Hanson (2015) pointed out, the Russian metal industry is different from energy and political motives do not play a major role in its internationalisation. It should be stressed that the aluminium industry is wholly private. The RUSAL respondent emphasised "we are not like a charity preparing social activities for the sake of the development of the international relations of the Russian Federation" (I-3, 2017). The senior Armenian official also confirmed that RUSAL bought Armenal and invested there because the facilities available for aluminium production are beneficial, and that this investment is commercially driven (I-7, 2017).

In various ways, therefore, political disputes have affected the Russian electricity and aluminium companies and their business decisions. Some of RusHydro's business activities are located near politically unstable regions. For example, the company is concerned about the possible exacerbation of the conflict in South Ossetia which might affect its activities in North Ossetia and Alania (RusHydro, 2018: 52). The 2008 Russian-Georgian war did not affect RUSAL's business decisions because RUSAL did not have investments in Georgia. However, the respondent from RUSAL stated that "local and political tensions only affect our costs", such as transportation (I-3, 2017). For example, as Map 14 shows, the Sochi-Tbilisi via Sokhumi railway line would be the most efficient communication route between Russia and Armenia and would minimise the costs and timing of transportation.

In the case of Inter RAO UES, the 2008 war did not affect its businesses and operations in Georgia. Neither during nor after the war was there any disruption to the electricity supply, which remained constantly available (I-11, 2017). One reason for this was that the company already had a strong foothold in Georgia (I-8, 2017; I-11, 2017; I-13, 2017) and another was that, as Abushov has argued, the Georgian government might have needed Inter RAO UES to stay in order to revive the country's economy after the war (I-13, 2017). As mentioned earlier, Inter RAO UES was also active in charitable projects in Georgia. These factors strengthened Inter RAO UES's bargaining power and its company image. Consequently, in summer 2010, Georgia sold two power stations to Inter RAO UES, and issued three licences for the construction of new hydroelectric stations (I-8, 2017). Therefore, when analysing the Russian companies, the balance between politically and commercially driven investments should be identified. For example, Inter RAO UES and Gazprom are both state-owned companies and according to the senior Georgian official, its investments are commercially driven, outweighing its political interests (I-11, 2017). Russia has not used Inter RAO UES as a political tool against Georgia yet, but may well do so whenever the need arises (*ibid.*). Unlike Gazprom, Inter RAO UES has not been involved in political disputes between Russia and Georgia but has played a diplomatic role in reconciling disputes between Georgia and Abkhazia. The case of Georgia and the implementation of reforms in the electricity industry demonstrates that the electricity industry is part of the Russian economy, which requires "a pragmatic business attitude rather than political considerations" (Panibratov & Latukha, 2014: 136).

After the collapse of the Soviet Union, the South Caucasus countries began to steadily increase their relations with the West, despite their membership of the CIS. Given this growing competition in its traditional sphere of influence and the ineffectiveness of the CIS, Russia initiated several integration projects in the post-Soviet region to restore its power and ultimately to fulfil its broader political goals. The Russian electricity and aluminium companies' expansion strategies were given considerable support as a result of the intergovernmental meetings described above. The expansion of their businesses was also due to their efforts to achieve business reintegration in the CIS area and the economic support of the intergovernmental organisation established in the 1990s (*see* Figure 4). This helped these companies to expand their businesses in the South Caucasus and increased their capital growth.

Since 2003, Inter RAO UES, RusHydro and RUSAL have all recognised that developing international relations and international cooperation has now become important for business development in terms of building and strengthening ties between markets. In particular, the electricity companies have implemented several projects that have been pivotal for Russia from both an economic and a political perspective. Given that Armenia's special political relationship with Russia primarily focused on military and technical cooperation during the 1990s (*see* Figure 4), Putin met with Kocharian in January 2007 and stated that "we will make use of our political relations and the very favourable climate of our relations and transform them into results in the economy" (Kremlin, 2007). As the respondents stated, their regional integration therefore produced a business environment amenable to Russian companies (I-3, 2017; I-5, 2017; I-6, 2017; I-8, 2017; I-9, 2017).

Thorough regional integration at the corporate level turned out to be an engine for evolving economic and political projects of regional integration, namely the EEU (Kheifets & Libman, 2008; Kuznetsov, 2016a; Libman & Kheifets, 2007). In the long term, Inter RAO UES and RusHydro are considering implementing foreign investment projects which could be important for developing the Eurasian power system; they are trying to develop cooperation and partnership relations and to formulate joint proposals on making changes in intergovernmental organisations and integration associations, such as the EEU[104] and the CIS Electric Power Council (CIS EPS) (Inter RAO UES, 2018: 298; RusHydro, 2017: 91). Inter RAO UES participates in the working groups of the EEU to harmonise the rules of the wholesale electric power market and capacity with the rules of foreign countries' electricity markets, and to form unified rules and technical standards to regulate the parallel operation of members' electricity systems (Inter RAO UES, 2016: 207). This close involvement not only maintains Inter RAO UES's market position in the regional union but also consolidates regional integration and ultimately strengthens Russia's political and economic position.

In 2013, Putin and Sargsyan discussed the Russian electricity and other companies' participation in major projects and their increasing regional cooperation at the corporate level. Putin stated that Armenia's joining the Eurasian integration institutions would boost further economic cooperation, remove customs and administrative barriers, increase trade growth and develop business contacts (Kremlin, 2013b; 2013c). For example, the RUSAL respondent stated that Armenia joining the EEU had made life easier and created more favourable conditions, facilitating investment and minimising the tax burden and other additional costs (I-3, 2017). Graphs 4 and 5 show that since Armenia joined the EEU in 2015, its trade has increased further. Consequently, political integration, in the form of the CSTO, was transformed into the EEU and the firms also started to enjoy the new 'home' market. The EEU has provided the Russian electricity and aluminium companies with opportunities to both exploit the market more effectively, and further strengthen their market position.

[104] as a part of their activities with the Eurasian Economic Commission.

In summary, the factors and events discussed above indicate the need to consider state-state relations when exploring and analysing the Russian electricity and aluminium companies and their business and investment operations in the South Caucasus. These firms use this political advantage or political distance, as described by some scholars (Conti *et al.*, 2016: 1983; Liuhto & Vahtra, 2007: 139), in their favour when locating their investments. Moreover, relations between Russia and the South Caucasus countries, as well as various political factors in the region, have affected Inter RAO UES's, RusHydro's and RUSAL's business and investment activities, but in a variety of ways. Considering Inter RAO UES's business involvements in Abkhazia and South Ossetia, politics has been a significant factor in their investment and trading activities. These companies have also played an important role in developing and maintaining economic and political relations between home and host countries. In particular, Inter RAO UES has taken part in diplomatic relations between Russia, Abkhazia and Georgia to solve the disputes. In the words of Dunning and Lundan (2008: 639), Inter RAO UES has performed a "useful ambassadorial act of peace" between these countries.

Moreover, as discussed earlier, not all the investments of Inter RAO UES are politically driven; as the senior Georgian official stated the commercial interests of Inter RAO UES may outweigh its political interests (I-11, 2017). Moreover, the long-term investment motives of the Russian electricity companies are to develop the Eurasian power system. Their investments have been described by Armenian and Georgian officials as economic leverage, forcing the countries to integrate (I-6, 2017; I-8, 2017; I-9, 2017). From the international relations perspective, "the more economic ties you have, the more leverage you have over the countries" (I-12, 2017). Considering all this, besides state-business relations, state-state relations have been another important determinant in these electricity and aluminium firms' business and investment operations and using the interdisciplinary paradigm has helped us to understand the real motives underlying their investment activities in the South Caucasus.

6.5 Internalisation

Given the O and L advantages as well as political economy factors, in this section, I explore by applying the third leg of the interdisciplinary framework how the Russian electricity and aluminium companies entered the South Caucasus markets, what internalisation modes they chose and why. Before they invested in the South Caucasus countries, it was very important to receive the necessary support from the Russian state or state agencies, and to gather information to make investments together with the Russian financial institutions and strategic partners, in order to identify the best entry strategy, accelerate the implementation of their investments and resolve issues. Especially for Inter RAO UES and RusHydro, the CIS EPS served as effective forums for cooperation with its members' electricity companies and agencies. When these necessary preconditions had been met, they then chose various entry modes to invest in the South Caucasus, such as M&As, turnkey projects, management contracts, licensing agreements, representative offices, JVs, cooperation projects or subsidiaries.

M&As have been one of the preferred internalisation modes of the Russian electricity and aluminium companies. Among these companies, RUSAL was the first to enter the South Caucasus markets and to internalise its investments. In 2000, it entered Armenia through the acquisition of a 74% share in Armenal; the remaining 26% share was held by the Armenian government. In 2003, Inter RAO UES began expanding its foreign activities by switching from wholesale electricity sales to supplying electricity directly to consumers and then to reselling to third countries (Liuhto & Vahtra, 2007: 133). Consequently, in 2003, Inter RAO UES implemented investment projects first in Georgia and soon after in Armenia through power supply contracts, and built generating assets (*see* Map 11). Inter RAO UES entered Georgia through the acquisition of a 75.1% share of the Telasi[105] in Georgia; a 24.5% share was owned by the Georgian government (Doggart, 2011: 40). These examples show that both RUSAL and Inter RAO UES followed similar steps. There are several reasons for their entry strategies.

First, entering new markets requires a high concentration of capital and knowhow and the integration process in acquisition sometimes takes place gradually. Because of this, it has been crucial to establish partnership agreements with the host-country government to ensure mutual trust. Other reasons for building cooperation with the host-country governments in Armenia and Georgia include obtaining knowledge directly from their governments, reducing risks, efficient analysis of local businesses and the economy, and the ability to overcome host-country-imposed government trade and investment barriers and eventually to adapt their companies to the environment (I-3, 2017). For instance, in January 2003, RUSAL signed a turnkey contract with the Armenian government to complete the acquisition of the remaining 26% share in Armenal. Subsequently, RUSAL undertook the modernisation of Armenal and completed an extensive retrofit in 2006 (IBP USA, 2013: 124; Meloyan, 2006). Once it had

[105] Telasi is the largest electricity network and supply company located in Tbilisi; it buys and sells electricity and provides network services (*see* Map 12) (Inter RAO UES, 2018: 108).

achieved full ownership of Armenal, RUSAL formed its subsidiary company in Armenia in the final stage of its internationalisation.

Like RUSAL, in order to expand its international activities further, in March 2013 Inter RAO UES signed a Memorandum with the Georgian government on the development of cooperation in the electricity industry until 2025 (Inter RAO UES, 2014: 21). However, Inter RAO UES was not allowed to acquire full ownership of Telasi of Georgia because of the Georgian government's concerns and the strategic importance of Telasi. As the respondent from Georgia stated, electricity is a strategic industry in Georgia and allowing a foreign country, particularly Russia, to acquire a 100% share in Telasi would be to put the country at risk (I-8, 2017). Then, having acquired a 75.1% share of Telasi in Georgia in January 2003, in September 2003 Inter RAO UES entered the Armenian market and participated in the acquisition of the Sevan-Hrazdan Cascade of HPPs, including Hrazdan TPP (*see* Map 11). In order to operate, Inter RAO UES established the International Energy Corporation, and a licence was granted by the Armenian Anti-Trust Committee to produce electricity in Armenia for the next fifteen years (Inter RAO UES, 2006: 37). Subsequently, Inter RAO UES began to consolidate its position in both the Armenian and the Georgian markets. In 2004, for instance, it obtained a 100% share in Mtkvari Energy in Georgia, followed in 2005 by a 100% stake in Electric Networks of Armenia (*see* Map 11) (Inter RAO UES, 2006: 37; Vahtra, 2006: 22). This internalisation approach was essential to ensure the system reliability of Russia's electricity supply through the preservation of the synchronous electricity operation systems of contiguous countries, the creation of electricity backup at the border, and to participate actively in the inauguration of privatisation processes in the electricity industry in geographically strategic locations for import and export operations. In 2005, Inter RAO UES started implementing investment projects and electricity supplies in Turkey. Another Russian electricity company, RusHydro, followed in its footsteps, entering the Armenian market in 2011 through the acquisition of 90% shares in the International Power corporation, which has seven HPPs of the Sevan-Razdan Cascade (*see* Map 11) (RusHydro, 2011: 70).

Unlike RUSAL and RusHydro, Inter RAO UES has used other entry strategies, such as licensing agreements and management contracts through intergovernmental agreements. For instance, in 2003, Inter RAO UES and the Armenian government signed a five-year trust management agreement for Armenian NPP. In 2004, Inter RAO UES received the management rights for 100% shares to exploit Khrami HPP-1 and Khrami HPP-2 in Georgia (*see* Map 11) (Inter RAO UES, 2018: 108; Vahtra, 2006: 22). In December 2008, in accordance with the decision of the intergovernmental commission for economic cooperation between Russia and Armenia, Inter RAO UES was granted a new five-year trust management for Armenian NPP (Inter RAO UES, 2011: 78). During this time, Inter RAO UES also obtained joint management of Enguri HPP, the largest HPP in Georgia, to undertake management services, although the shares remained under Georgian state ownership (*see* Map 11) (Doggart, 2011: 39; Dzvelishvili & Kupreishvili, 2015: 11). Inter RAO UES's investment activities show that they simply took over the management and the use of the rights of local operating companies. In Azerbaijan, unlike in Armenia and Georgia, in order to implement their investment projects and to use it as a hub which would give access to new markets, Inter RAO UES in 2009 signed several agreements to develop its international projects through trilateral meetings between Russia, Azerbaijan and Iran on issues of cooperation in the electricity industry (Inter RAO UES, 2010: 12).

To sum up briefly, given the O and L advantages, as well as the political economy factors, Inter RAO UES, RusHydro and RUSAL entered the South Caucasus economies either directly through M&As, licensing agreements or management contracts, or gradually by signing several cooperation agreements or memorandums, followed by opening a JV or a representative office. They also established subsidiaries, such as RUSAL's subsidiary in Armenia. After consolidating their positions and gaining enough international experience, they moved on to new markets. Moreover, Russian companies, such as RusHydro, Rosatom and the Tashir Group, entered the Armenian electricity market by taking over assets from Inter RAO UES. This happened first in 2011 when RusHydro purchased the Sevan-Hrazdan Cascade of seven HPPs from Inter RAO UES. Armenian NPP was managed by Inter RAO UES until March 2012 when it was transferred to the Russian state-owned nuclear energy company, Rosatom (Inter RAO UES, 2012: 33). In 2015 and 2016, Inter RAO UES's operating and financial results were affected by adverse tariff regulations in the Armenian electricity industry. Inter RAO UES then exited the Armenian market by selling and transferring Electric Networks of Armenia and Hrazdan TPP to the Tashir Group (Inter RAO UES, 2018: 19, 48). These examples show that Inter RAO UES was replaced by RusHydro, Rosatom and the Tashir Group through direct takeover.

6.6 Conclusion

The interdisciplinary theory developed for this thesis has been used to analyse and discuss the Russian electricity and aluminium companies' investment and business operations across the

South Caucasus countries. This analysis of Russian electricity and aluminium firms shows that besides firm-specific ownership advantages, the economic and institutional development of Russia and the firms' own development have significantly affected Inter RAO UES, RusHydro and RUSAL and their expansion strategies. The various host-country factors associated with economic development, formal and informal institutional constraints and non-economic factors have also determined the firms' location choices and influenced their operations in the South Caucasus (*see* Table 4).

Like oil and gas companies, Inter RAO UES, RusHydro and RUSAL are of strategic importance to the Russian economy, and both electricity firms are guarantors of the energy security of Russia. I have therefore explored various forms of the Russian state's relations with these firms, and its various means of support for their efforts to improve their global competitiveness, through financial institutions, ministries and intergovernmental meetings (*see* Table 4). The findings show that the state has played a decisive role in the localisation and internalisation of the investments of Inter RAO UES and RusHydro, and to a lesser extent RUSAL, in the South Caucasus markets. On the one hand, this shows that the political economy approach is helpful to explain the Russian electricity and aluminium companies and their business and investment activities. On the other hand, as a fully private firm, RUSAL's unique relations with the Russian state through its managers and personal connections to benefit from various government incentives and also in which the Russian state has minimal intervention indicate that the political economy perspective is limited to explain and understand why the firm has this type of behaviour (*see* Table 4).

The empirical results show that state-state relations have also influenced investment decisions and business activities, in particular those of the Russian electricity companies, in various ways. Unlike the oil and gas companies, the electricity companies have more pragmatic business attitudes than political considerations. However, these firms have played a role in interstate relations, as for instance with Inter RAO UES's investment and business operations in Abkhazia and Georgia and started benefitting from the Russian-led economic integration (*see* Table 4). Unlike the aluminium company, I also identified electricity companies' long-term objectives and their roles in the Eurasian integration projects which conform Russia's broader foreign policy objectives to restore its power and control former post-Soviet South Caucasus region (*see* Table 4). This shows that political factors, which are underestimated by Dunning, have been significant in firms' investment and business activities and that they have learnt how to benefit from state-business and state-state relations. Because firms not only deal

Firms	Investment Destinations	Entry Strategies	Expansion Approaches	State-Business Relations	State-State Relations
Inter RAO UES	Armenia, Georgia, Abkhazia and South Ossetia	M&As, management contracts, licensing agreements, and cooperative projects	Resource-, market-, strategic asset- and efficiency-seeking investments: to exploit resources; to get involved in electricity trading and use a 'follow the customer strategy' or export activities; to acquire strategic assets, to have control over distribution channels and to gain experience in different electricity producing segments; to benefit from similarly unified electricity systems.	Very high Indirect state-ownership, government appointees, former government officials, personal relations, interlocking directorates, Long-Term Development Programmes, public-private partnerships or business associations, frequent meetings with the president, interaction and cooperation with government authorities and ministries, government support and protectionism through tax reduction, state-owned financial institutions and intergovernmental meetings, and administrative support, such as solving malfunction in electricity supplies to Georgia and Armenia: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment behaviour and distribution, as well as business activities. Acted as a 'useful ambassadorial act of peace player' in moderating relations and involved in social activities. Involved in the development of the EEU, for instance the Eurasian power system. The EEU facilitates its investment and business operations, such as eliminating export duties and other various barriers.
RusHydro	Armenia	M&As	Resource-, market- and strategic asset-seeking: to exploit resources; to sell electricity in domestic	Very High Direct and indirect state-ownership, government appointees, former government officials, personal relations, interlocking directorates, Long-Term	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment and business activities.

			markets; to gain international experience.	Development Programmes, public-private partnerships or business associations, frequent meetings with the president, interaction and cooperation with government authorities and ministries, government support and protectionism through tax reduction, state-owned financial institutions and intergovernmental meetings, and administrative support, such as 'a 'debt-for-investments' mechanism: determined its investment distribution and business activities.	Involved in the development of the EEU, for instance the Eurasian power system. The EEU facilitates its investment and business operations, such as eliminating export duties and other various barriers.
RUSAL	Armenia	M&As and turnkey contracts	Resource-, market-, strategic asset- and efficiency-seeking investments; to exploit resources; to sell produced products in domestic and foreign markets; to acquire strategic facilities; to benefit from the efficiency of the targeted facilities and employees.	Low: depending on political and economic situations. Kremlin-friendly private investors, former government officials, dependence on state-owned companies, such as RZD, Gazprom and RusHydro, and financial institutions, public-private partnerships or business associations, interaction and cooperation with government authorities and ministries through its managers, and government support and protectionism through tax reduction, state-owned financial institutions and intergovernmental meetings: determined its investment and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: affected its investment and business activities. The EEU facilitates its investment and business operations, such as eliminating export duties and other various barriers.

Table 4: Russian Electricity and Aluminium Firms in the South Caucasus Emerging Economies

with economic problems, but also political problems which are results of various forms of government interventions and government-government interactions. The research results also show that all this has also varied from firm to firm, from industry to industry and from country to country.

Their O and host-country L advantages, as well as political economy factors, have determined Inter RAO UES's, RusHydro's and RUSAL's entry modes, such as M&As, turnkey projects, management contracts, licensing agreements, representative offices, JVs, cooperation projects and subsidiaries (*see* Table 4). Considering all this, the interdisciplinary theory developed for this thesis constitutes a strong analytical framework for explaining this kind of Russian investment and the determinants of the various characteristics of the Russian electricity and aluminium companies. Moreover, the results enable a better understanding of the development of the companies' internationalisation processes, are important for understanding Inter RAO UES's, RusHydro's and RUSAL's investment decisions in the South Caucasus, and can serve as a reference and guide for researchers and policymakers. In the next chapter, I take up the points which have been put forward here to explore the non-resource based Russian firms, telecommunications and insurance companies' investment activities in the South Caucasus.

Chapter 7

7 Telecommunications and Insurance Industries: MTS, VEON, MegaFon and Ingosstrakh

7.1 Introduction

Internationalisation of non-resource-based firms were a new trend in early 2000s and they started to pursue aggressive investment activities. This type of group includes the telecommunications companies MTS, VEON and MegaFon and the insurance company Ingosstrakh, which are the most prominent and largest non-resource-based companies in Russia in terms of brand reputation, assets, market share and international business geography. As Map 12 shows, these companies have substantial investments in the South Caucasus emerging markets. Armenia is the only country hosting subsidiary companies of MTS, VEON and Ingosstrakh. Unlike Armenia, Ingosstrakh has only opened a representative office in Azerbaijan. MegaFon is the only one of these companies to have subsidiaries in Abkhazia and South Ossetia (*see* Map 12).

Map 12: Geographical footprints of MTS, VEON, MegaFon and Ingosstrakh (customised by the author)

By applying the interdisciplinary framework developed for this thesis in this chapter I consider these Russian telecommunications and insurance companies and investigate the main determinants behind their investment decisions and business activities in the South Caucasus.

In the first section, I examine what ownership advantages MTS, VEON, MegaFon and Ingosstrakh possess and how they have used them in the South Caucasus. I also explore how home-country economic and institutional development and firm development shaped these firms' ownership advantages and internationalisation strategies. In the second section, I investigate and identify the locational attractiveness of the South Caucasus for MTS, VEON, MegaFon and Ingosstrakh and analyse a set of host-country factors in terms of economic and institutional development and non-economic factors that have influenced the locational choices of these companies. In the subsequent section, I examine the Russian state's relations with its telecommunications and insurance companies and its role in their investment activities. I unearth the various types and different levels of state support for these companies. Then, I also consider state-state relations and several political factors which affected the companies' investment decisions and business operations, and examine how they have used political factors in their favour. In the final section, based on the ownership and location advantages, as well as political economy factors, I explore and analyse how these companies internalised their investments in the South Caucasus, what decisions they made when choosing entry modes and the reasons behind them.

7.2 Ownership

The first leg of the interdisciplinary theory developed for this research is used to explain in this section the investment decisions behind the internationalisation of the Russian telecommunications and insurance companies and to examine and identify their ownership advantages. In the 1990s, Russia was in the early stages of its IDP and was suffering from economic and political issues and inadequate institutional infrastructure (*see* Graph 3). The telecommunications and insurance companies were also almost new sectors in some respects, given that such services operated in a very different way in the USSR and therefore were not organisationally and financially developed enough. In line with the IDP and the U-model (Johanson & Vahlne, 2009; Narula & Guimón, 2010), these macro- and micro-economic factors had negative impacts on MTS, VEON, MegaFon and Ingosstrakh, which were suffering from a lack of competencies to make investments abroad, because their economic prospects should have been strong enough to compensate their investments abroad.

After Putin came to power in the early 2000s, the Russian government implemented a number of significant reform programmes, including a new land code, restructured natural monopolies, and introduced pension, legal and tax reforms. The new government offered a more favourable investment and a promising economic development environment specifically in these sectors, including greater protection of minority shareholder rights and making corporate governance a higher priority than previously (VimpelCom, 2002: 24). Also, robust economic development due to rising oil prices stimulated further spectacular growth in the telecommunications and insurance industries (I-4, 2017; I-5, 2017; I-7, 2017; I-17, 2017). In line with the IDP (Stoian, 2013), this improved home-country economic (*see* Graph 3) and institutional development and market growth motivated MTS, VEON, MegaFon and Ingosstrakh to seek new markets in developing neighbouring countries (Panibratov & Latukha, 2014: 154; Vahtra & Liuhto, 2004: 75).

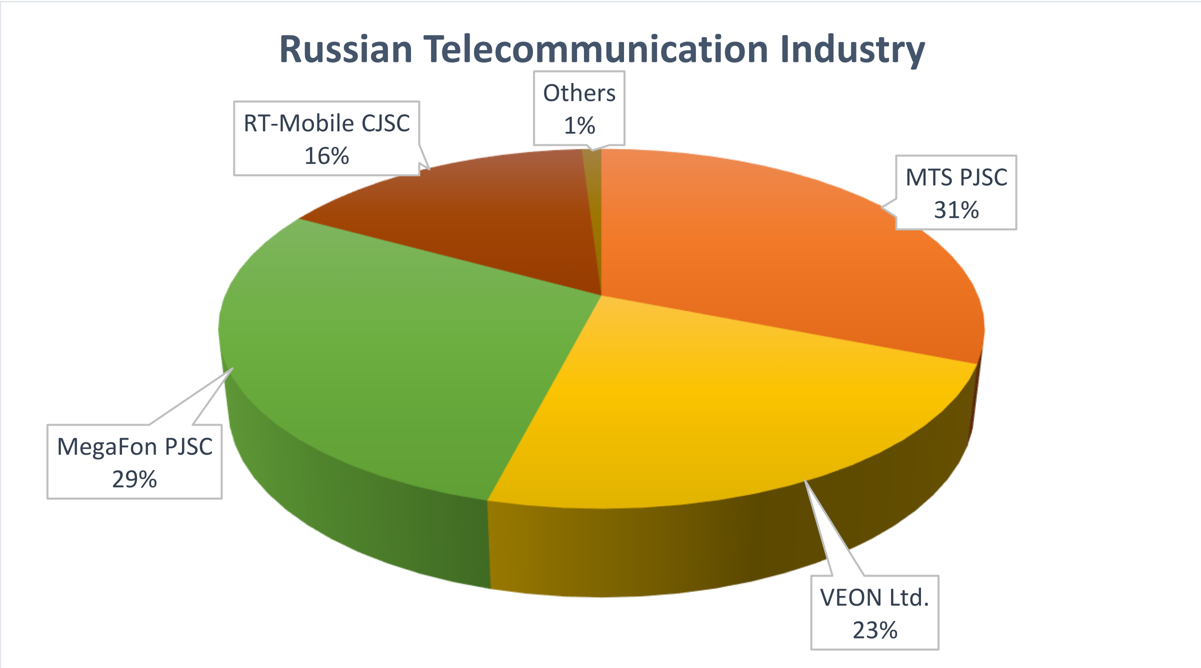

Figure 10. Source: MTS and MegaFon, 2018

Under Dunning's eclectic paradigm (2003: 4), the Russian telecommunications and insurance companies had O advantages relating to the possession of technologies, market share, managerial expertise, trademarks, brand reputation and finance. MTS, VEON and MegaFon were created from scratch as they did not inherit any research institutes, and the existing institutes did not possess developed telecommunications technologies (Filippov, 2008: 21). So in the Russian telecommunications industry, cooperation with foreign investors as part of an initial corporate strategy, particularly German and Scandinavian ones, contributed both technologically and financially to the emergence of MTS, VEON and MegaFon and increased their managerial experience (Lisitsyn *et al.*, 2006: 131; 2005: 5). In line with the U-model predictions (Johanson & Wiedersheim-Paul, 1975), these companies began expanding their coverage within the Russian Federation in order to obtain a strong market share. The core businesses of the Russian telecommunications and insurance companies are located in Russia. As Figure 10 shows, the three dominant telecommunications companies in Russia account for 83% of the Russian telecommunications market (MegaFon, 2018: 12; MTS, 2018a: 26). These Russian companies' dominant market positions in Russia gave them greater capacity to expand through M&As in the South Caucasus.

Moreover, VEON's unified national business model,[106] developed and implemented in the home market, allowed it to expand its commercial operations in the South Caucasus. MTS adopted corporate strategies[107] which resulted in the company's organisational development and later enabled it to enter Armenia through the acquisition of K-Telecom.[108] In addition to its significantly growing size and expanding geographical footprint, VEON initially registered in Bermuda during its reorganisation in 2009-2010, and its headquarters was later moved to Amsterdam (VEON, 2018: 5). The restructuring of VEON in these offshore locations has given it potential to access equity capital markets without any significant restrictions (MTS, 2010: 8) and to eliminate the Russian origin of investments. Considering the relationship between Russia and Georgia at the time, this event enabled VEON to increase its share in Mobitel-Georgia from 51% to 80% in 2012 (VimpelCom, 2013: 31). MTS, VEON[109] and MegaFon are the most prominent telecommunications brand names in Russia; the name Ingosstrakh[110] dominates in the insurance industry, and these companies operate in the South Caucasus under their brand names. Ingosstrakh has unique competence to serve major Russian corporate

[106] Implementing this business model in the region enabled VEON to more quickly establish a sophisticated network infrastructure, enhance network standardisation and accomplish greater economies of scale in the fields of sales and marketing and information technology (VimpelCom, 2008: 22).

[107] Its 3+1 corporate strategy, adopted in June 2006, was to reinforce its leadership in Russia, to use synergies and growing opportunities for further growth in the CIS, and to create additional value in emerging markets through an M&A approach (MTS, 2008: 18-19). In 2007, MTS adopted a 3+2 corporate strategy to expand its geographical presence and develop its networks in the markets, which contributed to its most effective growth (MTS, 2008: 8).

[108] the leading operator there.

[109] under the 'Beeline' trademark.

[110] Ingosstrakh is the fourth-largest Russian insurance company (Ingosstrakh, 2017: 5).

clients[111] in Russia and in the South Caucasus. All this has enabled these firms to take advantage of emerging opportunities in the South Caucasus markets.

Fast developing technology and competition in the Russian and South Caucasus markets has driven the telecommunications companies to improve their technology-based ownership advantages, which has allowed them to compete and operate successfully. In February 2008, VEON completed a merger with Golden Telecom[112] (MTS, 2011b: 9). In response to VEON's move, MTS made a strategic decision to merge with Comstar.[113] The completion of MTS's integration with Comstar in 2010 increased its growth rate and shares (MTS, 2011a: 23), and enabled it to become a dominant telecommunications company in Armenia. Consequently, in December 2010, MTS commenced a commercial test of the first 4G/LTE network in Armenia, aimed at expanding the company's presence there (MTS, 2011b: 72). These strategic decisions in the home market transformed VEON and MTS into integrated telecommunications providers in Russia and the CIS. In the case of MegaFon, the company started to invest in that segment to develop and acquire assets in neighbouring countries, such as Abkhazia and South Ossetia. Having the technology, the organisational capacity and the ability to organise these ownership advantages enabled MTS, VEON and MegaFon to sustain and improve the quality of their mobile and broadband services, and to find and form effective connections with host-country customers.

Briefly, in accordance with Dunning's eclectic theory (2001b), the internationalisation of the selected Russian telecommunications and insurance companies was dependent on their possession of sets of firm-specific ownership advantages. However, in line with the predictions of the IDP (Dunning, 1988), Russia's economic development (associated with Putin's presidency), high energy prices, and the government's economic policies and reforms influenced their outward investment flows (I-5, 2017; I-7, 2017; I-14, 2017). In line with the

[111] including RZD, Gazprom, Gazprombank, MegaFon, VEON and RUSAL. More specifically, Oleg Deripaska, the owner of RUSAL, owns a 10% stake in Ingosstrakh (*see* Figure 15).

[112] a principal rival of Comstar and a leading provider of fixed-line integrated telecommunication and internet services in Russia and the CIS.

[113] Golden Telecom's rival. Furthermore, since October 2006, Comstar has had investment projects in Armenia, owning the leading CallNet and CorNet companies that provide data transmission and internet services (Balakishi, 2016; Socor, 2006). In particular, CorNet was the only WiMax service provider in Armenia, which allowed Comstar to use this synergic effect and eventually develop the WiMax service in Russia (Business Wire, 2006; Rustocks, 2010).

U-model (Johanson & Vahlne, 1977), the Russian telecommunications and insurance companies started the internationalisation of their businesses through various stages, considering their limited experience and the uncertainty of foreign markets. They first started to occupy a strong position in the home market and began to seek markets in close physical and psychic proximity in order to take advantage of the most promising investment opportunities and to expand their network and business coverage in the South Caucasus markets. Given all these facts, I developed the interdisciplinary theory for this study to investigate and identify these companies' various competitive advantages.

7.3 Localisation

In this section by using the location level of the interdisciplinary theory I explore the market-specific attractiveness of the South Caucasus countries associated with their level of economic and institutional development and other non-economic factors, and identify the main factors that have determined MTS's, VEON's, MegaFon's and Ingosstrakh's locational choices in these markets. Under Dunning's OLI (2003: 17), one of the key determinants of investment decision-making is geographic proximity or location, which favoured the international expansion of Russian telecommunications and insurance companies into the South Caucasus. For example, outside Russia, Azerbaijan is one of the most strategically important regions for Ingosstrakh in terms of geography (Ingosstrakh, 2010: 34) because it is located at the cross-roads of Russia, Iran, the Caspian Sea and Turkey, and the North-South and West-East international railway corridors and other pipelines pass through the territory of Azerbaijan. Moreover, the South Caucasus markets are located in close proximity to Russia and the headquarters of MTS, VEON, MegaFon and Ingosstrakh. This allowed them to benefit from the region's economic development and to seek further investment opportunities in the South Caucasus for their expansion. They could use this close physical proximity to leverage their home market by accumulating experience in emerging and similarly low-penetrated markets, such as the South Caucasus, in order to benefit from the growth potential of these markets.

In accordance with Dunning's eclectic paradigm (2000), in addition to market-seeking, strategic asset-seeking motives also played a significant role in the investment decisions of the Russian telecommunications and insurance companies in South Caucasus markets that offered good networks and physical infrastructures. This determinant greatly encouraged the acquisition of host-country companies operating in local telecommunications markets with the existing infrastructure (Filippov, 2014: 220; Lisitsyn *et al.*, 2006: 131; 2005: 12). There were strategic considerations behind the localisation of Russian telecommunications and insurance companies' that would promote their long-term strategic objectives, particularly to maintain and develop their competitiveness (Panibratov, 2012: 175; Panibratov & Latukha, 2014: 144). For example, ArmenTel was a mobile operator and monopolist in the provision of fixed lines in Armenia, and Mobitel covered the entire territory of Georgia and had significant numbering capacity. Furthermore, Mobitel had interconnection agreements with ArmenTel, and VEON in Russia, and 22 agreements with local operators to offer voice-call termination to its own network (VimpelCom, 2014: 77). Their strategic and leading positions in local markets and their interconnection agreements with each other as well as with Russian and other operations were the main reasons for VEON's entry into Armenian and Georgian markets to acquire mobile and fixed-line operators and to build a network empire.

Moreover, due to developing technologies and growing competition in Russia and the South Caucasus host countries, telecommunications companies forecast the potential demand in wireless network and internet services. Thus, in September 2007, MTS entered the Armenian market by acquiring 80% of International Cell Holding[114] (MTS, 2018b: 70). Once the Russian telecommunications companies entered the region, they started expanding into broadband markets, offering high-speed internet. Since then, MTS's subsidiary in Armenia has started to expand aggressively in Armenia, launching and expanding 3G/LTE networks to sustain its leadership (*ibid.*: 80). This shows that the location of the Russian telecommunications companies' investments was also determined by technological considerations.

The 'Big Three' targeted leaders in the South Caucasus markets because the acquisition of major national subscriber bases and the possibility of implementing new technologies enabled them to expand their networks. The same strategy was followed by Ingosstrakh, targeting the major Armenian insurance company EFES, which held a considerable market share and served many corporate customers in Armenia (Panibratov, 2012: 178). A series of acquisitions outside Russia not only provided high growth potential, but also consolidated their home-market positions. Before 2008, for example, as shown in Figure 11, MegaFon was losing its Russian market position and its competitive struggle with MTS and VEON. Then, as Kuznetsov explained, MegaFon entered Abkhazia and South Ossetia (I-5, 2017) and as Figure 10 shows, MegaFon then consolidated its home-market position and became the second-largest Russian telecommunications company with a 29% market share, whilst MTS and VEON dropped to

[114] a 100% indirect owner of K-Telecom, a leading wireless operator in Armenia.

31% and 23% respectively. This shows that the internationalisation strategy has been the best option for their business development.

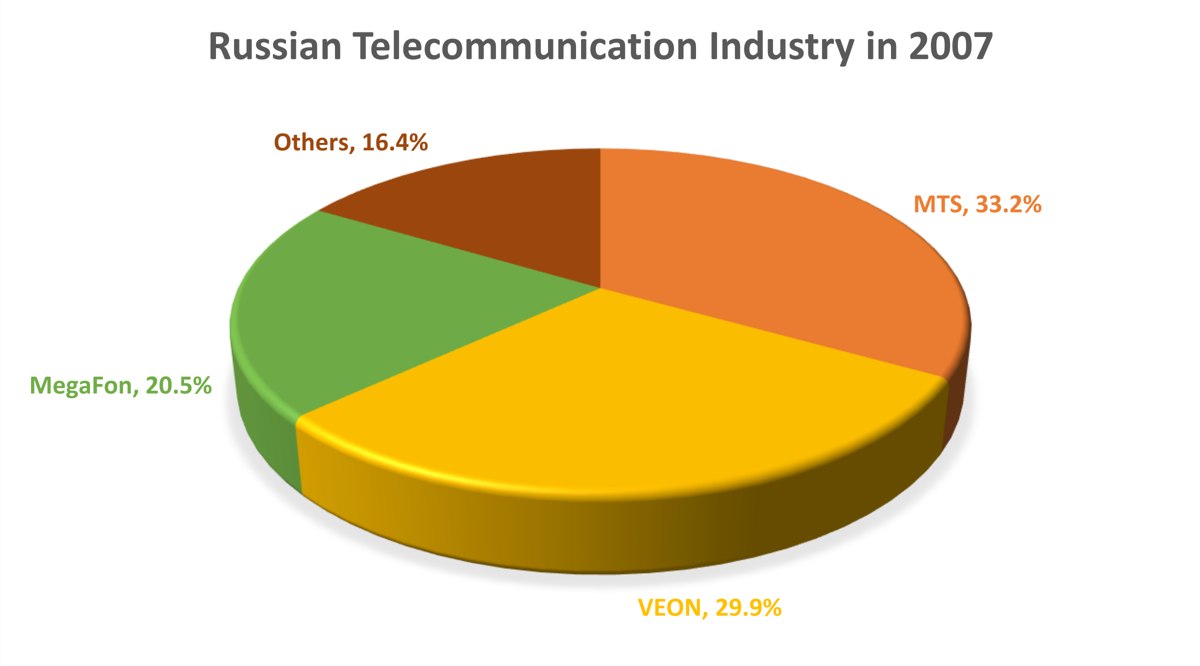

Figure 11. Source: MTS, VimpelCom and MegaFon, 2008

Besides aforementioned determinants, tax and exchange rates were also important in the companies' investment activities (Blonigen, 2005: 383). The South Caucasus countries offered different levels of tax and exchange rates to MTS, VEON, MegaFon and Ingosstrakh. For example, the official income tax rate in Armenia and Georgia is 20%, but it is 24% in Russia (VimpelCom, 2008: 147). The functional currency[115] of MegaFon's subsidiaries, domiciled in Abkhazia and South Ossetia, is the Russian rouble (MegaFon, 2011: 77). Moreover, the determined official Value Added Tax rate is 10% in Abkhazia and South Ossetia, but 18% in Russia (MegaFon, 2011: 78). So corporate tax competitiveness and different tax rates across the South Caucasus markets potentially influenced these companies' decisions about where to invest.

Moreover, a necessary institutional infrastructure in the host country, including a degree of economic freedom and corruption, played a crucial role in determining the locational choices of the Russian telecommunications and insurance companies. The MTS respondent emphasised that regulatory risk is very important in MTS's decision-making as host-country governments often try to protect this sector for security reasons (I-4, 2017). In Azerbaijan,

[115] Revenues, costs, equipment and property purchases, trade and debt liabilities are priced, incurred and measured in Russian roubles.

property rights and local companies are to a great extent controlled by the politically dominant ruling elite (I-14, 2017; I-17, 2017). As Graph 1 shows, economic freedom in Azerbaijan has been repressed, whereas Georgia and Armenia have been mostly moderately free. As the MTS respondent stated, MTS's business transactions and operations are doing well in Armenia because of low regulatory risks (I-4, 2017). In Georgia, after the Rose revolution, Saakashvili opened the doors to Russian investors such as VEON (I-8, 2017). The business environment and market in Georgia began to be more liberal under the Saakashvili administration (I-16, 2017; I-14, 2017; I-11, 2017). For instance, in early 2005 the Georgian government organised tenders in its telecommunications industry which attracted the 'Big Three' to bid (Lisitsyn *et al.*, 2006: 144; 2005: 32). So regulatory considerations and political changes in the host country determined the locational choices of the selected Russian telecommunications and insurance companies.

Given the different levels of economic freedom across the South Caucasus countries, as Graph 2 shows, corruption may have played a 'grabbing hand' in Azerbaijan where it created significant costs for these companies and consequently influenced their investment inflow, but a 'helping hand' in Armenia and Georgia, where facilitated transactions sped up investment procedures and ultimately increased investment inflows. The respondents from Armenia and Georgia stressed that both countries have corruption problems (I-6, 2017; I-9, 2017). In line with the predictions of the U-model (Hallen & Wiedersheim-Paul, 1979), the international business activities of the Russian telecommunications and insurance companies in the South Caucasus have been directly related to the fact that it has a similar level of institutional development to Russia (*see* Graphs 1 and 2) as well as similar economic and political systems, and a common culture. They therefore faced less resistance in the South Caucasus (I-4, 2017).

Another key factor in determining the investment locations of these Russian companies in Armenia was the 'Armenian diaspora': the respondents from MTS and Armenia stated that the Armenian diaspora had played a decisive role and facilitated MTS investment (I-4, 2017; I-7, 2017). All of the factors discussed above contributed to the dramatic increase in the number of cross-border M&As and strategic alliances in the South Caucasus. Furthermore, these companies' had limited international experience outside Russia, and, in line with the predictions of the U-model, Kuznetsov stressed that, it is better to start to implement investments in a country where markets are located in close proximity to firms' core businesses in Russia, where they feel more comfortable and have detailed knowledge of the economic, political and cultural landscape (I-5, 2017). Investing in these markets can also be to obtain international experience or to consolidate their strong position in all CIS countries, in order to build their network empire before moving outside the CIS (I-4, 2017). For example, in 2003 Ingosstrakh opened its first representative office in Azerbaijan and entered Armenia through the acquisition of a 75% share in EFES (INGO Armenia, 2017: 19; Ingosstrakh, 2009: 100), and after consolidating their market positions in the South Caucasus, MTS, VEON and Ingosstrakh, markets, also started investing in Europe, Asia and Africa.[116]

Despite some cultural and historical similarities, each South Caucasus country is unique in the size of its population and territory, possession of natural resources and level of economic development (*see* Graph 3) (I-4, 2017; I-16, 2017). A country's macroeconomic development or issues greatly influences the companies' financial positions, business activities and revenues. For example, after the 2008 financial crisis, Ingosstrakh's affiliate in Azerbaijan displayed the highest growth rate with 37% across its all affiliated companies (Ingosstrakh, 2012: 43). The growth in the Armenian market was largely driven by INGO Armenia's leading position in the health and accident insurance segments (Ingosstrakh, 2009: 48). In line with the IDP (Dunning, 1986), improved economic development and economic reforms implemented in the South Caucasus were also key factors in the internationalisation of the Russian telecommunications and insurance companies in that region (Lisitsyn *et al.*, 2006: 132; 2005: 14; Panibratov & Latukha, 2014: 154).

The variation across the South Caucasus economies influenced their decisions about which countries to enter, and the level of their investment inflows. As Graph 3 shows, Azerbaijan's economic development measured by GDP annual growth was higher than Armenia and Georgia, even Russia, whereas Armenia and Georgia were at similar stages of their IDP to Russia. According to the MTS respondent, Azerbaijan has therefore been perceived as a mature market, in other words it was at a more developed stage of IDP because it is relatively rich due to the possession of oil and gas resources (I-4, 2017). Moreover, Azercell, Bakcell and Nar Mobile already had strong market shares in the Azerbaijani telecommunications market (I-15, 2017; I-17, 2017). The Georgian market had demonstrated relatively higher levels of competition and openness with local and foreign telecommunications companies than the

[116] For example, MTS opened representative offices or became involved in strategic alliances in far distant regions, such as in India and Africa, whereas they established subsidiaries in nearby markets, such as the South Caucasus countries.

Armenian market (I-8, 2017) because Geocell, MagtiCom and MTS's competitor VEON operated successfully in the Georgian telecommunications market (I-5, 2017; I-12, 2017). The MTS respondent stated that despite the mass economic issues of Armenia, MTS in Armenia is "self-sufficient" and "makes enough money to be able to afford its own capital investments" (I-4, 2017).

Some scholars have argued that the chronological sequence of the market entries suggests that this order is dictated by markets with higher incomes and GDP growth, larger national subscriber bases and better telecommunications infrastructures (Lisitsyn *et al.*, 2005: 16). However, this is not true in the case of the South Caucasus; Azerbaijan might have been considered the most promising target, but its market was tightly closed and highly monopolised by the local operators,[117] directly or indirectly under control of the government (I-14, 2017; I-15; I-17, 2017). Azerbaijan did not need and did not want to see another operator, especially a Russian operator. As Rzayeva (I-15, 2017) argued, "any telecommunications company cannot come and invest in Azerbaijan". Armenia showed a 4.5% penetration rate in terms of subscriber base and penetration level, whilst Georgia and Azerbaijan had over 18% (Lisitsyn *et al.*, 2006:143; 2005: 30). But this was only followed up by MTS, which invested in Armenia in September 2007 by obtaining an 80% share of K-Telecom (MTS, 2018b: 70) because VEON had entered Georgia first in July 2006 through the acquisition of a 51% share in Mobitel, and later entered Armenia in November 2006 by acquiring a 90% share of ArmenTel (VimpelCom, 2008: 59; 2007: 68).[118] Similar scenarios were seen in the localisation of Ingosstrakh's investments in the South Caucasus. In 2003, Ingosstrakh established a subsidiary in Armenia through the acquisition of the EFES insurance company but only managed to open a representative office in Azerbaijan because the development of local insurance companies and reinsurance capacities restrained them from using external insurance companies in Azerbaijan, where local insurance companies operate (Ingosstrakh, 2015: 26). This shows that high income or GDP growth, a large population and good telecommunications infrastructures are not the

[117] Azercell, Bakcell and Nar Mobile.

[118] Armenia and Georgia also showed different development strategies for VEON. For instance, in Georgia, VEON's investment in Mobitel and its initial operations in 2007 were at an early stage, and the company's network and subscriber build-out were primary objectives. In Armenia, VEON's investment in ArmenTel and its operations had a good financial position, even though they required modernisation upgrading (VimpelCom, 2008: 14).

only factors to consider in choosing where to invest and could not have driven the chronological sequence of these companies' market entries.

The internationalisation of the Russian telecommunications and insurance companies into the South Caucasus countries in fact fits the 'follow the customer strategy' to where the firms had growing export flows and customer bases. It should be noted that, as discussed in Chapters 5 and 6, the corporate subscribers of the Russian telecommunications companies had already entered the South Caucasus markets, and they were actively developing economic cooperation. The migration flows within the CIS and later the EEU were also significant in fostering the expansion of the Russian telecommunications companies and presented an initial prerequisite and motive to locate their investments by improving collaboration with the host-country telecommunications operators. For example, an Armenian high-ranking official stated that approximately 75-80% of Armenians work in Russia and that 20% of Armenia's GDP is "built on private transfers and remittances from Armenians who work in Russia", which provided "good traffic for the Russian telecommunication companies" (I-7, 2017). Therefore, MTS's main priority in Armenia was the development of the Viva Tariff line, providing customers with an opportunity to call Russia on similar terms to calls made inside the VivaCell-MTS network (MTS, 2018a: 49). Ingosstrakh is focused on developing its relations with Russian companies in the South Caucasus. For example, as Figure 15 shows, Deripaska owns a 10% share in Ingosstrakh and is directly and indirectly beneficially interested in more than 30% of INGO Armenia (RUSAL, 2013: 87). Moreover, its major corporate customers operate in the South Caucasus and need a reliable insurance company to support their operations in the markets there. As a result, the cooperation in providing roaming and insurance services to these companies' corporate customers abroad encouraged the Russian telecommunications and insurance companies to enter the South Caucasus markets.

To sum up, the second leg of the interdisciplinary theory has identified and explained various locational advantages of the South Caucasus and their potential impacts on the investment decisions of the Russian telecommunications and insurance companies in locating their investment projects. Clearly, profit maximisation in their investment decisions was the main motive for their internationalisation into the South Caucasus markets. The different levels of economic and institutional development, including the degree of economic freedom and corruption, and various non-economic factors, including the diaspora, the common culture and similar business practices across the South Caucasus, directly influenced the Russian telecommunications and insurance companies' decisions on where to invest. However, their decisions were affected in different ways by variations across the South Caucasus markets which determined their strategic decisions on how to enter those markets.

7.4 Political Economy of Investments

7.4.1 State-Business Relations

Over the past three decades, political and economic events have affected the Russian telecommunications and insurance firms and eventually shaped the behaviour and strategies of the Russian state towards its firms. For example, in the first decade after the collapse of the Soviet Union, Russian telecommunications and insurance companies were at a stage of reorganisation or privatisation as a result of the market reforms and economic policies implemented by Yeltsin. During this time, appropriate Russian state support was not provided, especially in the telecommunications industry. However, the scenario changed positively when Putin came to power. The investments of the Russian telecommunications and insurance companies increased rapidly in the period 2000-2010 and the companies pursued aggressive expansionist strategies in the neighbouring countries (I-5, 2017; I-17, 2017). Given their limited international business experience, being at an early stage of internationalisation, and the L advantages of the South Caucasus countries, the role of the Russian state in supporting these companies' investments played a decisive role and increased the companies' ability to use their ownership advantages to exploit the targeted markets. By applying the interdisciplinary theory developed for this research, I therefore now explore and analyse the interaction of the Russian state with MTS, VEON, MegaFon and Ingosstrakh through intervention in their investment activities, which was able to determine the geographical spread of the firms' investments and their success in the South Caucasus host countries.

Among the telecommunications companies, MegaFon is the only company controlled by large shareholders, the USM Group[119] directly owns 56.32%; LLC MegaFon Finance has 22.52%; Gazprombank,[120] holds 18.96% (*see* Figure 12). The majority of shares in MTS, VEON, MegaFon and Ingosstrakh, despite their status as fully private companies, are controlled by prominent Russian business-people who have close relations with the Kremlin and sometimes

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[119] owned by Alisher Usmanov, a Kremlin-friendly business magnate, and has also investments in technology, media, such as Mail.Ru, a Russian internet company, as well as metals and mining industries.

[120] Russia's third largest state-owned bank.

have working meetings together (*see* Figures 12, 13, 14 and 15). They are described as "Kremlin-friendly private investors" (Milov *et al.*, 2006: 301). Given its company structure and location, VEON is not a typical Russian company but should nevertheless be classified as a Russian company because its LetterOne Russian shareholder[121] holds 47.9% of the common and voting shares (*see* Figure 14) (Kuznetsov *et al.*, 2017: 21). Unlike the 'Big Three', Ingosstrakh inherited ownership advantages from the Soviet Union when it was a fully state-owned enterprise,[122] including established foreign relations and networks, as well as key contacts (Kuznetsov, 2010a: 18). These inherited and strong management and organisation-based ownership advantages allowed Ingosstrakh to obtain and accumulate market knowledge and later paved the way for them to gradually increase their presence in the foreign markets. So, considering the state's direct and indirect relations with the firms through state-owned companies and businesspeople, the Russian state has had different relationships with each company and has provided various types of support.

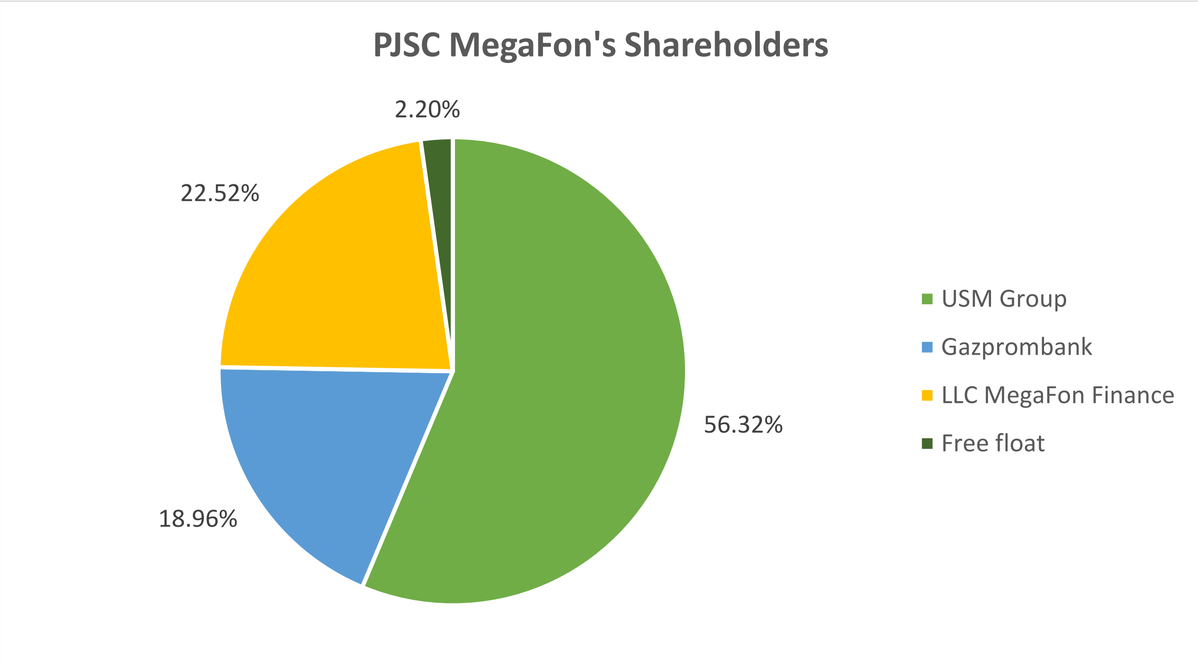

Figure 12. Source: MegaFon, 2019

When Putin came to power, the Russian telecommunications industry lacked advanced technology and the companies were far behind their western counterparts. For them to expand

[121] owned by Mikhail Fridman, owner of the Alfa Group, a Kremlin-friendly oligarch.

[122] For example, the Chief Agency of Foreign Insurance of the USSR, established in 1947, was a predecessor of Ingosstrakh. Later, in 1972, Ingosstrakh became a 100% state-owned company able to operate abroad (Ingosstrakh, 2018).

outside Russia, they needed to have the advanced technology which would enable them to defeat competitors in the targeted South Caucasus markets, which would have required direct or indirect government support (Kim *et al.*, 2004: 32). Accordingly, in early 2000, Putin met western leaders and, during meetings regarding the development of Russia's telecommunications companies, he also met foreign telecommunications companies and witnessed their partnership agreements with the Russian telecommunications companies. For example, in 2002 Putin witnessed VEON's and its shareholder Alfa Group's partnership agreement with Norwegian Telenor for the development of Russia's mobile telecommunications industry (Kremlin, 2002). Putin met the German leader Gerhard Schroeder in 2004, when MTS's shareholders Sistema and Siemens signed an agreement on strategic cooperation (Kremlin, 2004). With the strong support of the Russian state for the development of these companies, after 2005 the Russian telecommunications companies started to benefit from the EU and US high-tech markets (Kremlin, 2005b). This support increased their O advantages and improved their technological competencies to catch up with the advanced western telecommunications companies. As a result, in the operations of the two Russian telecommunications companies, the decisive role of the Russian state underpinned their international business expansion and eventually they both entered Armenia and Georgia, VEON in 2006 through the acquisition of ArmenTel in Armenia and Mobitel in Georgia, and MTS in 2007 through the acquisition of K-Telecom. This shows that managers recognise the importance of political connections with their home government when investing.

Given the L advantages of the South Caucasus and the firms' limited international experience, Russian state support helped them to internalise their investments and to speed up the integration process. Therefore, the presidents of Sistema,[123] which held a 44.36% share in MTS[124] (*see* Figure 13), and of Alfa Group, with a 47.90% share in VEON through LetterOne (*see* Figure 14), met with Putin to access policymaking (Markus, 2007: 285), especially at the early stage of their international expansion (Hoskisson *et al.*, 2013: 1306). Moreover, Alfa Group had links with MegaFon through its ownership of a 25.1% stake in the company until April 2012 (Belton, 2007; Kremlin, 2008b; Weaver & Thomas, 2012). They discussed the companies' present situation and possible future steps, particularly their aggressive policies for

[123] majority share controlled by Vladimir Evtushenkov, a Kremlin-friendly business oligarch, who is also a chairman of Sistema PJSFC.

[124] MTS is also controlled indirectly through MTS's PJSC's subsidiaries, including MGTS PJSC, Stream Digital LLC and Bastion LLC (*see* Figure 13).

international expansion into new markets in the emerging economies, and they asked for state support during the implementation of their investment projects. In return, Putin assured them that the support they needed to help them enter new markets and protect their investments in existing markets would be provided through Russian authorities or agencies, including intergovernmental meetings, embassies, financial institutions and ministries (Kremlin, 2008b). As a result of this type of state-business interaction, the Russian telecommunications companies entered the South Caucasus markets, including Abkhazia and South Ossetia, and consolidated their positions in these markets.

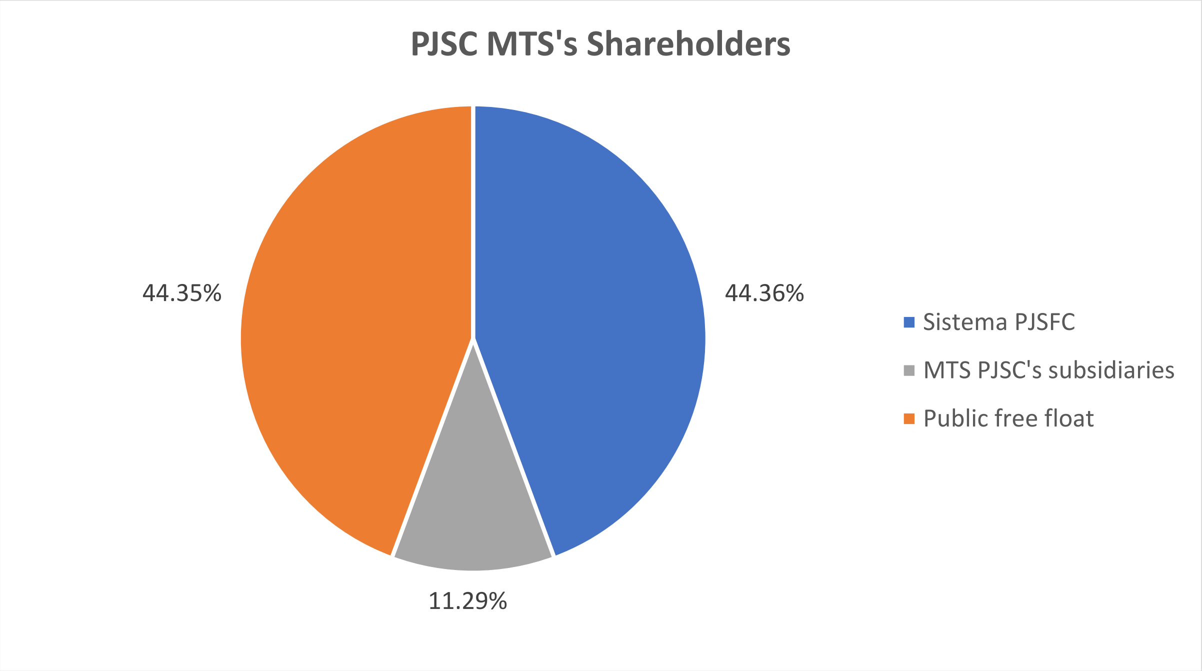

Figure 13. Source: MTS, 2019

During Putin's intergovernmental meeting with the Armenian president Kocharian in 2007, the efforts and interests of the Russian telecommunications companies in developing their business activities and making considerable investments in Armenia were emphasised and discussed. Kocharian stated that VEON's strong market position would enable it to become a leader in the Armenian telecommunications market (Kremlin, 2007). Moreover, the Russian state's relationships with these companies has varied over time. When these telecommunications firms had become very successful in the international markets and were well-managed, in 2008 MTS and VEON stopped having working meetings with the Russian President. However, if the company's international presence was more limited, as is the case with MegaFon, it would need more state support, and company leaders would meet with Putin more frequently. For example, working meetings took place in June 2015 between Putin and Alisher Usmanov of the USM Group, a MegaFon shareholder (*see* Figure 12), and MegaFon's results and business activities in the existing markets were discussed (Kremlin, 2015c). These examples show that the state-state and state-business relations factors have been the significant drivers of these firms' investment strategies and success.

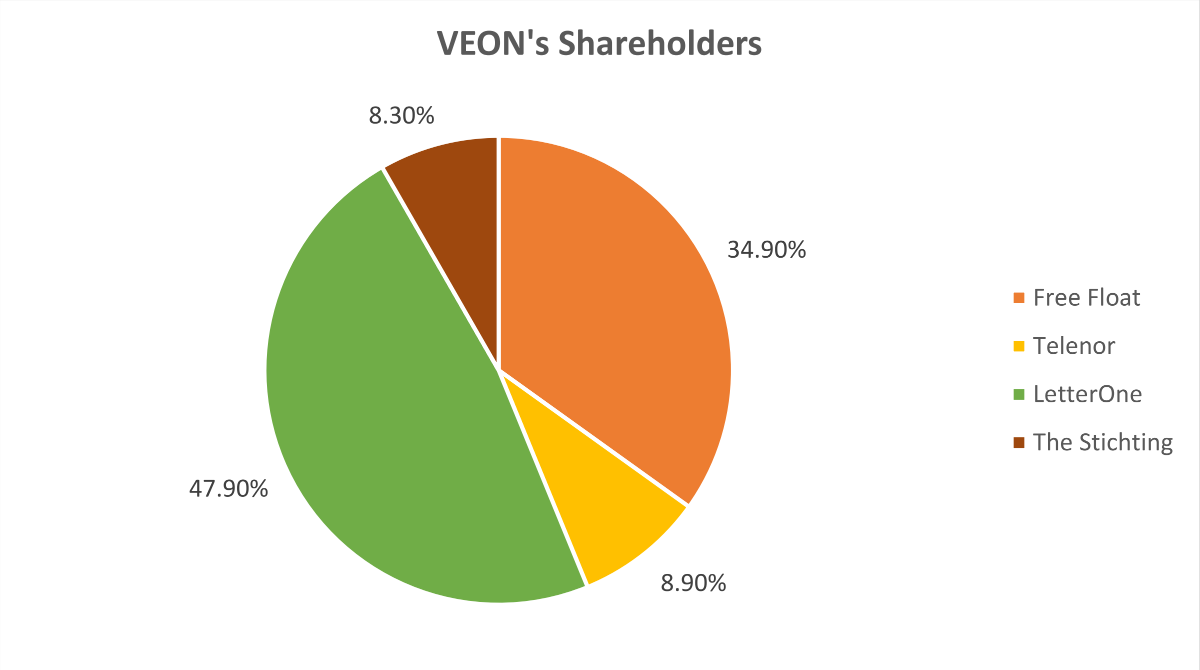

Figure 14. Source: VEON, 2019

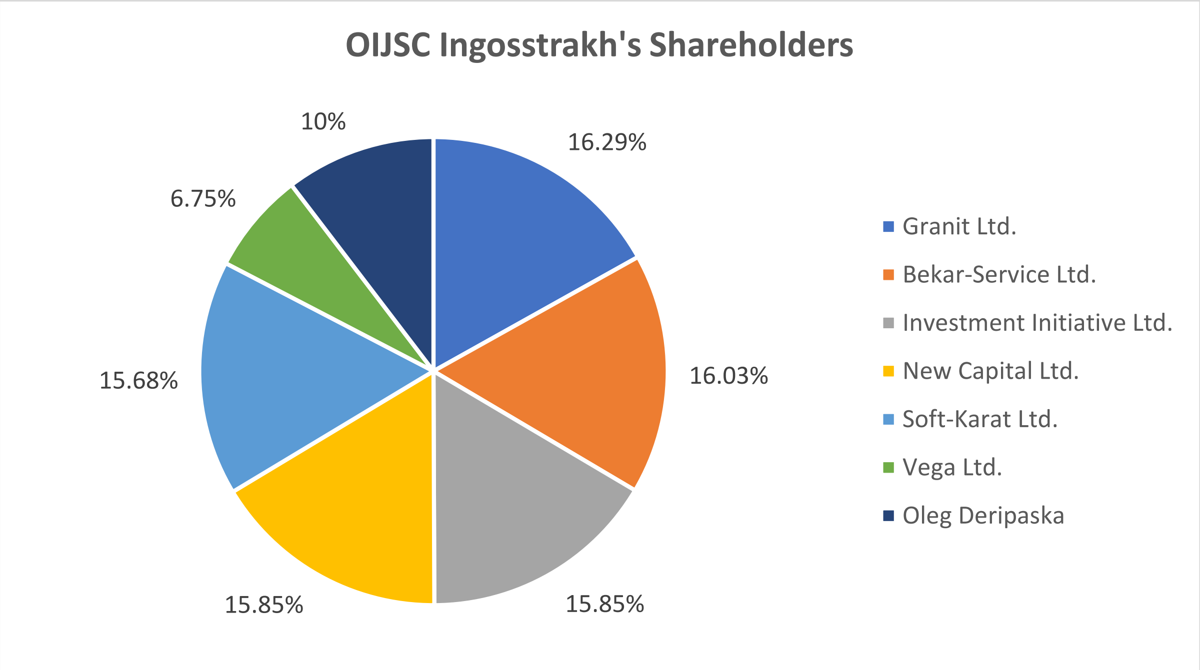

Figure 15. Source: Ingosstrakh, 2018

In brief, the Russian state has provided decisive and timely support to these private companies, MTS, VEON and MegaFon, but to a lesser extent in comparison with the resource-based companies discussed in Chapters 5 and 6. There is no real intention to control them, as they are well-organised and managed. They also receive limited financial support, although the industry is still under the close control of the Russian state because of their fast-growing economic output (Panibratov, 2012: 175; Panibratov & Latukha, 2014: 153). For instance, in April 2011, the Russian government reorganised the state-owned telecommunications companies under Rostelecom (RT-Telecom), which, with a 16% market share, as shown in Figure 10, is the fourth-largest mobile operator and the largest fixed-line operator in Russia (MTS, 2011b: 9). As a state-owned company, Rostelcom controls 69% of all fixed-line telecommunications services in Russia and can influence telecommunications policy and regulation in Russia (MTS, 2017: 7). The current study found no specific examples of Russian state support for Ingosstrakh.

All this shows that the level of direct or indirect state support and involvement through various mechanisms in these firms' internationalisation and their investment activities varies greatly according to the significance of the company to the Russian economy and its interests, as well as firms' international experience, such as MegaFon. This requires consideration of the political economy approach when exploring emerging market firms and analysing their business and investment activities. However, as mentioned earlier these politically linked firms are still dependent on the home government possessing telecommunications policy and regulations and Russia is their primary market, both of which can influence these firms. The Russian state's involvement in these firms' success in host markets through intergovernmental meetings, and the Russian president's working meetings with their CEOs has also been crucial and effective in their business and investment operations. Taking all this into account, managers recognise the importance of the state's role and therefore aim to maintain and develop close relations with both the Russian state and government officials, although the former has minimal intervention in these firms compared to its involvement in the resource-based firms explored earlier in Chapters 5 and 6. These firms would also not flourish if they were not loyal to their home country government. The political economy perspective cannot provide a good explanation of this political behaviour and these firms' intentions. So the interdisciplinary theory developed in the thesis is a comprehensive analytical framework for exploring the Russian state's relations with these firms and involvement in their investment activities and to analyse the variation in this state-business interaction.

7.4.2 State-State Relations

Building on Russian state-business relations, Russian-South Caucasus specific political and economic linkages have become an important factor in decisions about where and how to invest. The ‘Big Three’, along with Ingosstrakh seek to internationalise and expand into foreign markets through the use of Russian traditional relations, including political and economic relations (Kuznetsov, 2016b: 81; Lisitsyn *et al.*, 2006: 132) because despite being private these companies' business activities and financial positions depend on the interstate relations between Russia and the South Caucasus countries. Moreover, the core assets of the Russian telecommunications and insurance companies are primarily located in Russia. Deteriorating interstate relations between Russian and the South Caucasus countries, including political disputes between them, will affect the companies' investments, financial conditions and operations in both the host and home markets, as well as the distribution of their investments across countries. For example, Russia implemented economic sanctions against Georgian products in 2006, and had gas price disputes with Gazprom during 2004 and 2006. Moreover, the 2008 August war between Russia and Georgia over South Ossetia and Abkhazia culminated in Russia's recognition of their independence from Georgia. Taking these political events into account carefully, the interdisciplinary paradigm is applied to examine what strategies these firms followed to enter the South Caucasus markets and whether there is variation across industries, firms or host countries.

Among the Russian telecommunication companies, VEON was the first to enter the South Caucasus markets of Georgia and Armenia in July and November 2006 respectively, but using different entry strategies; it acquired a 51% share in Mobitel in Georgia, but a 90% share in ArmenTel in Armenia (VimpelCom, 2008: 59; 2007: 14). These strategic decisions about entry modes were the result of the political crisis of 2004 and 2006 between Georgia and Russia, which eventually influenced VEON's expansion strategy in Georgia. Furthermore, VEON only managed to begin its commercial operations in Georgia in March 2007 (VimpelCom, 2008: 84) because apart from the level of development between Armenian and Georgian assets, Russia had implemented several sanctions against Georgia. In June 2006, energy and trade sanctions were imposed and in the following month VEON entered Georgia (Newnham, 2015: 167). In October 2006, a dramatic raid was staged by the Russian authorities against Georgians in Russia. During this time, the 2006 crisis reached its peak with the severing of transportation and postal links by Russia to Georgia for several weeks (Myers, 2006; Newnham, 2015: 167). In the light of these political events, VEON's entry with a 51% share in Mobitel and the start of its commercial operations in March 2007 were appropriate decisions in terms of minimising the political risks and eventually consolidating its position in the market. Unlike Georgia, VEON's entry into Armenia occurred through the acquisition of a 90% share in ArmenTel. The high political crisis in Georgia might have affected MTS's decision not to enter that market; it preferred to enter Armenia in September 2007 by acquiring an 80% share of K-Telecom. Moreover, considering another political crisis between Azerbaijan and Armenia over Nagorno-Karabakh, the respondent from MTS added that MTS's "business in Armenia [was] considered being competitive or maybe something not desirable by Azerbaijani government" (I-4, 2017). All this shows that the variations between VEON's and MTS's entry strategies and location choices in the South Caucasus were the result of interstate political factors.

The August 2008 war had different impacts on MTS, VEON and MegaFon and their investment decisions. MTS had no business in Georgia, but as the respondent from MTS stated, "there was a potential repercussion from that engagement that might impact Russia", MTS's primary market, and so MTS had to "acknowledge that risk" (I-4, 2017). After this political event, Georgia became more sensitive to Russian companies and their investments. Taking this into account, VEON made a strategic decision to move its headquarters to Amsterdam in 2009 (VimpelCom, 2010: 2). This decision was made to protect its investments in Georgia and eliminate "Russian traces" (I-5, 2017; I-8; 2017). In the meantime, VEON learnt the Georgian government's policies and market conditions and predicted that Georgia's government would feel more comfortable with European companies and their investment inflows because of its western-oriented foreign policy. Papava, a former Georgian Minister of Economy, argued that "if the investments come under the Russian label, it would be politically controversial" (I-8, 2017). Consequently, this strategic decision produced positive results in Georgia as VEON increased its stake in Mobitel-Georgia from 51% to 80% (VimpelCom, 2013: 31).

In March 2017, VimpelCom was rebranded to VEON to remove the remaining 'Russian labels' (Kuznetsov *et al.*, 2017: 21; VEON, 2018: 5). This could also lead experts not to consider VEON a Russian company (Kuznetsov, 2017b: 83). Kuznetsov added that "they try to say that they are not a Russian company" (I-5, 2017), but the respondents from Georgia considered VEON to be a Russian company (I-8, 2017; I-9, 2017; I-12, 2017). The former ministers of Georgia's Foreign Affairs and Economy asserted that in today's international business, "it does not matter where the company is registered, even a totally state-owned Russian company", "it is an instrument to operate in the country without any label that these are the Russian companies" (I-8, 2017; I-9, 2017). In Kuznetsov's words "it is a type of migrant transnational corporation" (I-5, 2017). This example shows that Russia's deteriorated relations with Georgia affected direct investment inflows from Russia and later changed VEON's investment and business strategies in Georgia. Thus, VEON's headquarters was moved to Amsterdam, and it was then rebranded to hide the origin of the investment.

MTS in Armenia, and VEON in Armenia and Georgia, established successful businesses and started to expand into new markets. Unlike them, MegaFon's business geography was restricted to Russia and Tajikistan. Moreover, MegaFon's market share in Russia, measured against MTS and VEON, was decreasing, as Figure 11 shows. Moreover, before the August 2008 war, people in Abkhazia and South Ossetia were using MegaFon's services and the Georgian government accused and fined MegaFon for illegally expanding its network without having licences in Abkhazia and South Ossetia, which it regarded as a criminal activity (Mchedlishvili & Kiselyova, 2008a; 2008b). MegaFon had taken advantage of this political crisis as "an opportunity to make investments in South Ossetia and Abkhazia" and to gain licences to conduct its mobile services there (I-5, 2017). Kuznetsov argued that "you can track some connections between politicians" and "MegaFon" (*ibid.*). For example, the Alfa Group was a former shareholder of MegaFon and had a 25.1% stake in MegaFon until April 2012 (Weaver & Thomas, 2012). In October 2008, the Alfa Group's president, Mikhail Fridman, met with Putin to discuss VEON's and MegaFon's expansion policies into the new markets and to obtain Russian state political support during the implementation of their investments and the further consolidation of their market positions (Kremlin, 2008b). Consequently, in the same year, MegaFon entered Abkhazia and South Ossetia through the acquisition of a 51% share in Debton, owning 51% shares in AquaFon in Abkhazia and in Ostelecom in South Ossetia, despite all the efforts of the Georgian government to thwart it (MegaFon, 2010: 25, 82).

In 2009 and 2010, MegaFon completed the acquisition of the remaining 49% of Debton, continued to restore the network infrastructure in South Ossetia that was destroyed during the 2008 war, started commercial operations under the MegaFon brand and opened offices there (MegaFon, 2011: 35; 2010: 25, 82). As a result, MegaFon consolidated its position not only in Abkhazia and South Ossetia, but also in Russia and became the second-largest telecommunications company, as Figure 10 shows. This outcome shows that MegaFon's investment decisions in Abkhazia and South Ossetia, which look like political moves, were actually for economic objectives, to expand its geographical footprint abroad, and to strengthen its market position in Russia (I-5, 2017). MegaFon's case also proves that politics not only brings risks but also investment opportunities and therefore matters in firms' investment decision-making. This also shows that MegaFon has used this political advantage in its favour when locating its investments in Abkhazia and South Ossetia and developed its political behaviour.

Since the dissolution of the Soviet Union, in order to restore its position Russia has been trying to create economic and eventually political power in the South Caucasus by supporting its firms there. This policy practice was adopted by the Russian state when Putin came to power. The political and economic relations between Russia and the South Caucasus countries as well as Russian broader foreign policy objectives, including integrational projects, have affected Russian companies' investment and business activities. In these circumstances, timely and appropriate state support has allowed them to improve their competencies, speed up their internationalisation processes and protect their existing investment projects in the South Caucasus. This eventually promoted an increase of investment inflows in the host countries, which illustrates corporate integration, and can also be seen as a vehicle of 'deep integration' (Blomstrom *et al.*, 2000; Buckley *et al.*, 2003b).

Integration within the framework of the CIS, CSTO and later the EEU is perceived to be a primary goal of the Russian state (*see* Figure 4) (Kvashnin, 2016: 222). For example, in Armenia, Russian resource-based firms in the oil, gas, electricity and aluminium industries, were the driving force behind the cooperation. The efforts of the telecommunications and insurance companies were prominent in this cooperation and increased overall investment inflows in Armenia (Kremlin, 2007). For instance, Ingosstrakh maintains its robust relations with leading Russian companies in key sectors of the economy and fortifies their market positions not only in Russia, but also in the South Caucasus. All this transformed political and military cooperation into economic cooperation, as Figure 4 shows. Unlike all the Russian companies, especially the resource-based ones discussed in this study, the EEU was not relevant to the investment decisions of either the Russian telecommunications (I-4, 2017) or the insurance firms, but created a new 'home' market (Buckley *et al.*, 2003b: 196), allowed them to exploit perfectly the integration of markets, and reduced investment barriers and transaction costs (Gao, 2005: 158; Loewendahl, 2001: 41). Nevertheless, they carefully follow "[geo]political development within the region" which is considered to be the second-biggest issue after regulation (I-4, 2017).

Given the facts and examples explored above, political events have shaped the business environment in the South Caucasus, and the investment decisions of the Russian telecommunications and insurance companies and their methods of operation. Observing and forecasting the conflicts and changing power relations happening in the region between the various actors, and understanding the behaviour of competitors were part of investment decisions. By doing this, MTS hesitated to enter Georgia and Azerbaijan, VEON moved its headquarters to Amsterdam in 2009 before rebranding in March 2017 to eliminate its 'Russian traces', and MegaFon entered Abkhazia and South Ossetia in 2008 after the August war. Ingosstrakh has a subsidiary in Armenia and a representative office in Azerbaijan, but no business in Georgia. Moreover, the respondents from MTS Armenia, Georgia and Azerbaijan emphasised that Armenia's economic dependence on Russia, and other factors, such as political and military dependence (*see* Figure 4), made it easier for the companies to invest (I-4, 2017; I-6, 2017; I-7, 2017; I-8, 2017; I-12, 2017; I-14, 2017, I-15, 2017; I-17, 2017). From a political economy perspective, interstate security relations have affected firms and their investment decisions (Pandya, 2016: 464-466; Stopford *et al.*, 1991: 50-51), and also promoted investment flows. My findings also show that political instability or military conflict may bring both issues and opportunities. Firms therefore consider political factors in their investment decision-making process and accordingly adjust their decision and strategies. So, I have shown that as a result of various political determinants there were significant variations between firms' entry strategies and timings, location choices and business operations. In summary, the interdisciplinary theory developed in this research provides a good basis for understanding the Russian companies' behaviour during their investment decision-making, their political behaviour and their strategies to politics.

7.5 Internalisation

Given the O advantages of MTS, VEON, MegaFon and Ingosstrakh, the L advantages of the South Caucasus and political economy determinants identified above, in this section, I use the third leg of the interdisciplinary framework to explain how the Russian telecommunications and insurance companies internalised their investments in the South Caucasus markets, what entry modes they chose and their reasons for choosing them. After Russia, the CIS is the companies' second home market (MTS, 2018b: 9), but acquiring information from the most reliable sources, such as Russian government agencies and public-private partnerships, and securing financial partners in relation to financing their investments, are both identified as prerequisites for entering the markets (Wilinski, 2012: 50). Once all the necessary prerequisites have been met, the Russian telecommunications[125] and insurance companies made clear entry mode choices, such as opening representative offices and establishing subsidiaries, JVs or M&As and partnerships with the leading host-country companies or governments.

Considering the L advantages and political distance of Armenia discussed earlier, the most preferred internalisation strategy of MTS, VEON and Ingosstrakh in Armenia was the acquisition of major shares, in other words taking over local companies (I-6, 2017; I-8, 2017; I-13, 2017; I-16, 2017). For instance, VEON acquired a 90% share in ArmenTel in Armenia in November 2006 (VimpelCom, 2008: 59) and MTS entered the Armenian market through the acquisition of an 80% share in K-Telecom in September 2007 (MTS, 2018b: 70). The same strategy was initially implemented by Ingosstrakh in 2003 by obtaining a 75% share of the Armenian insurance company EFES (INGO Armenia, 2017: 19; Ingosstrakh, 2009: 100). However, the entry behaviours of the Russian telecommunications and insurance companies in Georgia and Azerbaijan, as well as in Abkhazia and South Ossetia, were different in comparison to their behaviour in Armenia. For example, VEON entered Georgia by acquiring 51% shares in Mobitel. MegaFon exhibited similar entry behaviour in Abkhazia and South Ossetia. Although no telecommunications companies managed to enter Azerbaijan, Ingosstrakh opened a representative office. All this shows that the variation in the firms' entry modes and the percentages of ownership shares also depended on their degree of ownership advantages, the host-country conditions and political economy factors. Moreover, their ultimate goal was to acquire a *de jure* controlling stake in the targeted South Caucasus companies.

Increased rivalry in the Armenian telecommunications market resulting from the potential entry of new telecommunications companies offering highly competitive prices, state-backed operators and the strengthening of existing operators, might have negatively influenced MTS's and VEON's ability to increase their subscribers. This could cause a reduction in their operating margins and different pricing, service and marketing policies (MTS, 2011a: 11). As a strategic

[125] Regarding the internalisation determinant, the Russian telecommunication companies first established cooperative ties in the 1990s with neighbouring countries' operators to provide roaming services to their Russian customers travelling abroad (Lisitsyn *et al.*, 2005: 5). This step preceded full-scale foreign market entries by MTS, VEON and MegaFon and was a prerequisite for internalisation in the South Caucasus, which enabled the Russian telecommunications companies to build successful performance and business operations there.

decision, VEON was involved in M&As with the Armenian government by acquiring 90% of ArmenTel's shares and owning the remaining 10% with the Armenian government. MTS was similarly involved with a leading local operator, K-Telecom, by acquiring 80% of its shares and also sharing the remaining 20% with the Armenian government (MTS, 2018b: 70; VimpelCom, 2007: 90). This strategic involvement with the Armenian government allowed these firms to reduce their market risks and develop their businesses further.

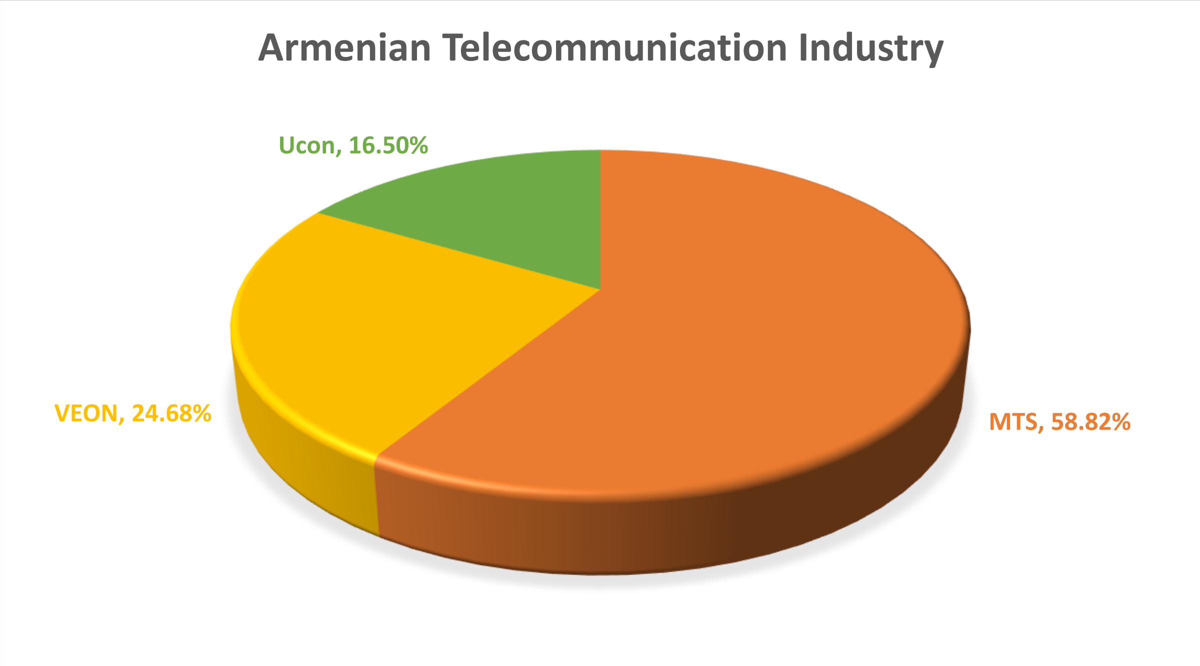

Figure 16. Source: MTS, 2018

MTS's and VEON's operations in Armenia can be referred to as monopolist or occupying dominant positions in the Armenian market. For example, as Figure 16 shows, MTS's and VEON's Armenian market shares are 58.82% and 24.68% respectively, and together account for 83.5% of the total. So the Armenian state authorities might have influenced their positions and performances by issuing regulations and laws (MTS, 2012: 105). For example, in Armenia, VEON's fixed-line business was subject to government regulation of tariffs. Therefore, the Russian telecommunications companies established good relations with the local state agencies and companies in order to be successful in their operations (Lisitsyn *et al.*, 2006: 145; 2005: 41). VEON's strategic partnership with the Armenian government was aimed to better secure contracts and to quickly achieve full ownership of ArmenTel. As a result, VEON reached 100% ownership of ArmenTel in April 2007 by acquiring the remaining 10% from the Armenian Government and at the same time received the right to seek tariff adjustments at the wholesale and retail levels based on the costs incurred (VimpelCom, 2007: 91-92). MTS entered a call and put forward an option agreement for the acquisition of the remaining 20% in K-Telecom.

Moreover, local mobile services were rebranded as ‘VivaCell-MTS’ and ‘Beeline-Armenia’ (MTS, 2018b: 70). Consequently, MTS and VEON developed their infrastructure networks in Armenia by expanding their coverage and increasing the existing network capacity in the licensed territories and expanded into the neighbouring countries through M&As or new licences in the countries in which they operated.

Considering the potential technological and development differences between the Russian and Georgian, the Abkhazian and South Ossetian telecommunications markets, as well as political relations between them, when implementing investment projects, it was appropriate to establish and later develop partnerships with local partners to reach similar levels of development (Panibratov, 2012: 178). For example, VEON entered Georgia in July 2006 through the acquisition of a 51% share in Mobitel, but only started its commercial operations there in March 2007 (VimpelCom, 2008: 84; 2007: 14). In 2008, MegaFon acquired a 51% share in Debton, owning Ostelecom in South Ossetia and AquaFon in Abkhazia, starting to restore the telecommunications infrastructures in 2009, with Ostelecom engaging in commercial operations from March 2010 (MegaFon, 2010: 25, 82). The use of existing technology to develop the telecommunications infrastructures of Georgia, Abkhazia and South Ossetia, where VEON and MegaFon had invested, played a highly important and positive role in establishing and improving their relationships with the Georgian, Abkhazian and South Ossetian governments.

VEON’s acquisition of Mobitel in Georgia allowed it to overcome its rivals by securing agreements with the host-country company to develop its Beeline network for roaming. VEON also put a call option for the remaining 49% share in Mobitel, and started operating under the Beeline brand (VimpelCom, 2008: 84). The main reasons MegaFon acquired Debton were to facilitate its own entry into the Abkhazian and South Ossetian markets, and to acquire licences to conduct mobile services (MegaFon, 2010: 82). Therefore, the establishment of relationships with the host-country governments was a matter of importance in internalising their investments and later developing their business operations further and consolidating their market positions. For example, penetration in Georgia and Armenia led to about 90% significant business opportunities for further development in VEON’s core business (VimpelCom, 2010: 16).

Both establishing partnerships with a host-country company or government to acquire technological know-how and oligopolistic behaviour played a significant role in gaining market knowledge, management skills, sharing decision-making and contributions, and understanding local politics and customs (Dunning, 1998b: 50; Mihailova & Panibratov, 2012: 177). The oligopolistic advantages resulted in a high concentration of wealth, which facilitated the growth of VEON's business in Georgia, and of MegaFon's in Abkhazia and South Ossetia. As a result of these strategic decisions, in March 2009 MegaFon increased its stake to 75%. Soon after, MegaFon completed the full acquisition of Debton and consolidated its 51% shares in AguaFon in Abkhazia and Ostelecom in South Ossetia. In 2010 MegaFon increased its stake in Ostelecom to 75% and opened its first office in Tskhinvali (MegaFon, 2011: 35; 2010: 82). In both markets, MegaFon operates under the MegaFon brand (MegaFon, 2010: 25). In subsequent years, MegaFon increased its market shares in Abkhazia and South Ossetia to 58.8% and 100% respectively (MegaFon, 2018: 12). The same successful market expansion was carried out by VEON in 2012 through the consolidation of its share in Mobitel from 51% to 80% (VimpelCom, 2013: 31).

Ingosstrakh developed its business in the South Caucasus through M&As or strategic partnerships. In 2003, it entered both Armenia's and Azerbaijan's insurance markets, but with two different internalisation modes. In Armenia Ingosstrakh established a subsidiary by acquiring 75% of EFES, later renamed 'INGO Armenia', which in 2004 became a full member of Ingosstrakh's INGO group, but in Azerbaijan it opened a representative office (INGO Armenia, 2017: 19; Ingosstrakh, 2009: 100). Establishing a subsidiary in Armenia was a result of the vast Russian investment inflows into Armenia and Oleg Deripaska's ownership share in Ingosstrakh (*see* Figure 15), and its insurance services were provided not only to local customers but also to the large Russian corporations. In the inward treaty business, its largest partner in Azerbaijan is the A Group Insurance Company, allowing Ingosstrakh to maintain reasonable relations with the host-country's top insurance companies[126] in the reinsurance of property and cargo, civil liabilities, and construction and erection risks (Ingosstrakh, 2017: 42, 55; 2016: 45, 48-49; 2014: 39).

The representative office in Azerbaijan enabled Ingosstrakh to strengthen its position, retain specific insurance niches, ensure the direct insurance and inflow of inward re-insurance, and to widely integrate Ingosstrakh into the global insurance market as the only Russian insurance company (Ingosstrakh, 2010: 49). Ingosstrakh opened and maintains its representative office in a place where stable growth has been observed in the host-country insurance markets. For

[126] such as AXAMBASK, Xalq Sigorta, Azergarant IC and Baku Sigorta.

example, Azerbaijan showed a 60.8% growth rate in 2012 in comparison with 2011, which came primarily from mandatory types of insurance (Ingosstrakh, 2013: 52). The insured parties are leading resource-based companies in Azerbaijan (Ingosstrakh, 2014: 39) and Ingosstrakh's representative[127] office there ensures a flexible reaction to ongoing changes and adaptation, the development of its relations with host-country partners, and the conservation of an admissible degree of interaction with the neighbouring insurance markets, such as Georgia (Ingosstrakh, 2017: 33; 2016: 63).

Given the O and L advantages, as well as various political issues, the third leg of the interdisciplinary framework has shown that these companies followed both similar and different strategies to implement and develop their businesses. In Armenia, MTS, VEON and Ingosstrakh established their subsidiaries very quickly through the acquisition of local companies and consolidated their market positions. The same occurred in Abkhazia and South Ossetia through the acquisition of AquaFon and Ostelecom by MegaFon which later became subsidiaries of MegaFon. In Georgia, VEON also managed to establish a subsidiary after acquiring Mobitel, but the whole process of the initial acquisition and later consolidation of its position in the local company took longer than it did in Armenia. This was a result of Georgia's locational advantages, its liberalised market and its institutional development (*see* Graphs 1 and 2). Unlike Armenia and Georgia, Azerbaijan is a highly closed and monopolised market (*see* Graphs 1 and 2), and economically the strongest country in the South Caucasus due to its vast natural resources. Taking into consideration the variations across the South Caucasus host-country determinants and firms' competencies discussed in the previous section, Ingosstrakh accomplished the opening of a representative office. In the final stage of these companies' internationalisation, their main strategy was to establish subsidiaries because subsidiaries are more international (Dunning, 1994; Hadley & Wilson, 2003), provide better business contracts, and most importantly allow them to use their own brand names (Vissak & Zhang, 2012: 147). Moreover, in line with the predictions of the U-model (Johanson & Vahlne, 1990), they established their subsidiaries as a result of gradual acquisition.

[127] The representative offices and their activities are synchronised with Ingosstrakh's operating sub-divisions aimed at creating a well-balanced and lucrative new reinsurance portfolio (Ingosstrakh, 2013: 52).

7.6 Conclusion

By applying the interdisciplinary theory developed for this thesis, this chapter has identified various determinants behind the investment decisions of the Russian telecommunications and insurance companies and studied their investment and business activities in the South Caucasus. Based on this analysis and its results, alongside firm-specific resources and capabilities, home-country economic and institutional development, and firm development significantly affected their ownership advantages and eventually their internationalisation strategies in the South Caucasus. The various location advantages of the South Caucasus countries associated with host country-specific determinants, countries' economic and institutional development and non-economic factors determined the location choices of the 'Big Three' and Ingosstrakh (*see* Table 5).

I have also explored the Russian state's direct and indirect relations with its telecommunications and insurance companies and discussed the various state supports for these companies and the extent of its role during the internationalisation of these companies (*see* Table 5). Unlike resource-based firms, the internationalisation of these non-resource or service-based firms were a new trend for Russia. These companies received timely and effective support through meetings with the President, private-public partnerships, financial institutions, intergovernmental meetings, and personal ties, especially in the early stages of their internationalisation, but to a lesser extent in comparison with resource-based companies discussed in the earlier chapters (*see* Table 5). Firms' individual relations with the government have varied according to their significance to the Russian economy and its interests, and their overseas experience. Ingosstrakh and MegaFon are the best examples for these variations (*see* Table 5). This suggests the importance of the political economy perspective for exploring firms' internationalisation and business activities. However, the CEOs of telecommunications and insurance firms are Kremlin-friendly private investors and recognise the importance of maintaining close political relations with the government and government officials who can exert influence through regulations and policies and provide effective and timely support in home and host countries through various forms (*see* Table 5). However, unlike its relations with their resource-based counterparts, the Russian state has very minimal intervention in these firms (*see* Table 5). Firms this type of political behaviour challenges the political economy approach which is not able to explain it well.

Firms	Investment Destinations	Entry Strategies	Expansion Approaches	State-Business Relations	State-State Relations
MTS	Armenia	M&As and subsidiaries	Market-, strategic asset- and efficiency-seeking investments: 'follow the customer strategy'; to find unsaturated markets and increase the coverage area; to acquire leading companies; to benefit from the efficiency of the targeted companies.	Low: depending on political and economic situations. Kremlin-friendly private investor, personal relations, public-private partnerships, meetings with the president, especially at early stages of its internationalisation, and government support and protectionism through embassies, ministries, state-owned financial institutions and intergovernmental meetings: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment behaviour and distribution, as well as business activities. The EEU facilitates its investment and business operations, such as eliminating regulatory and other various business and investment barriers.
VEON	Armenia and Georgia	M&As and subsidiaries	Market-, strategic asset- and efficiency-seeking investments: 'follow the customer strategy'; to find unsaturated markets and to increase the coverage area; to acquire leading companies; to benefit from the efficiency of the targeted companies.	Low: depending on political and economic situations. Kremlin-friendly private investor, personal relations, public-private partnerships, meetings with the president, especially at early stages of its internationalisation, and government support and protectionism through embassies, ministries, state-owned financial institutions and intergovernmental meetings: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment and business activities, as well as method of operation. The EEU facilitates its investment and business operations, such as eliminating regulatory and other various business and investment barriers.

MegaFon	Abkhazia and South Ossetia	M&As and subsidiaries	Market-, strategic asset- and efficiency-seeking investments: 'follow the customer strategy'; to find unsaturated markets and to increase the coverage area; to acquire leading companies and to increase the international experience; to benefit from the efficiency of the targeted companies.	Low: depending on political and economic situations. Kremlin-friendly private investors, personal relations, indirect state-ownership through Gazprombank, public-private partnerships, meetings with the president, especially at early stages of its internationalisation and because its limited international experience, and government support and protectionism through embassies, ministries and state-owned financial institutions: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: affected and determined its investment and business activities, but in a positive way. The EEU facilitates its investment and business operations, such as eliminating regulatory and other various business and investment barriers.
Ingosstrakh	Armenia and Azerbaijan	M&As and a representative office	Market-, strategic asset- and efficiency-seeking: 'follow the customer strategy'; to acquire the leading company and to establish a strategic partnership; to improve the efficiency of the company.	Very Low Kremlin-friendly private investors and personal relations: determined its investment distribution and business activities	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment and business activities. The EEU facilitates its investment and business operations, such as eliminating regulatory and other various business and investment barriers.

Table 5: Russian Telecommunications and Insurance Firms in the South Caucasus Emerging Economies

Besides various types of state-business relations, interstate relations have also been influential and decisive in the investment decisions of the Russian telecommunications and insurance firms, the methods of their business operation and the distribution of their investments (*see* Table 5). Firms have used the political distance in their maximum favour which has promoted investment flows. The results also show that political instability or military conflicts not only cause risks, but also bring opportunities (*see* Table 5). Companies therefore take political factors into account when investing and accordingly adjust their decision and strategies. Moreover, given Russia's broader foreign policy objectives to restore its power in the region, the empirical results show that these companies have positively benefitted from these events, such as Russian-led integrational projects (*see* Table 5). All this tells us that political factors are not exogenous, have affected firms' investment and business activities, and accordingly they have learnt how to use state-business and state-state relations in their favour. The empirical findings also show that these non-resource-based firms acknowledge the implications of political issues, along with economic ones. They have therefore developed their political behaviours with the aim of understanding, avoiding and diversifying political risks.

O and L advantages, as well as political economy factors, have determined the Russian telecommunications and insurance companies' entry strategies, including representative offices, subsidiaries, JVs or M&As (*see* Table 5). All in all, the proposed interdisciplinary theory can provide a better analytical framework for understanding and identifying the main and various determinants in the Russian telecommunications and insurance companies' investment and business operations, and their corporate strategies than Dunning's OLI theory alone. In the next chapter, I take up the points which have been put forward in this chapter to investigate another group of non-resource based Russian firms, financial and railways companies' investment and business activities in the South Caucasus.

Chapter 8

8 Financial and Railways Industries: VTB and RZD

8.1 Introduction

Alongside telecommunications and insurance firms, the internationalisation of other types of non-resource-based company were also part of new trend in the early 2000s. Firms of these types include the financial company VTB and the railway company RZD, which are the largest Russian service-based firms in terms of assets and market share. These corporations engage in a range of investments and trading in the South Caucasus markets. VTB has established subsidiaries in Armenia, Azerbaijan and Georgia (*see* Map 13), whereas RZD has investments in the railway networks and container transportation of Armenia and Abkhazia, and in ferry transportation in Georgia (*see* Map 13). In terms of expanding the company's presence in other countries, Azerbaijan has been perceived as a regional partner of RZD. Moreover, the business activities of the railway companies are only involved in Azerbaijan in terms of trading.

Map 13: Geographical footprints of VTB and RZD (customised by the author)

In this chapter, I use the interdisciplinary paradigm to study these two non-resource-based firms and to analyse the key factors and reasons in their investment decisions and business activities in the South Caucasus emerging markets. In the first section, I identify VTB's and RZD's O advantages and analyse how home-country economic and institutional development and these firms' development influenced their O advantages and expansion strategies. In the second section, I identify various L advantages of the South Caucasus developing economies, including country-specific and other host-country factors associated with countries' economic and institutional development and cultural or social distance. Here I investigate VTB's and RZDs decisions about where to invest. In the next section, I explore the relations between the Russian government and its financial and railways firms through various mechanisms, and study its role in their internationalisation process. I also examine in that section interstate political and economic relations, as well as various political determinants, analyse how they have shaped the Russian financial and railways companies' investment and business operations in the South Caucasus, and explain their roles in state-state relations as corporate players. In the final section, considering O and L advantages, as well as political economy determinants, I study how VTB and RZD entered the South Caucasus markets, what entry strategies they pursued, and why, during their internationalisation process.

8.2 Ownership

In this section, I use the first phase of the interdisciplinary paradigm developed for this study to explain and understand why the Russian financial and railway firms decided to internationalise, to investigate their firm-specific advantages and to examine the impact of macro- and micro-economic factors on their overseas expansion. In the interpretation of the IDP (Dunning, 1986), Russia was in the early stages of its IDP in the 1990s, politically and economically unstable and suffering from a lack of economic and institutional development (*see* Graph 3). In line with the U-model predictions (Johanson & Vahlne, 1990), they were in a very early stage of development, inexperienced and not financially or organisationally strong enough to expand overseas. Unlike VTB, however, RZD was established in the 2000s because the MPS was dealing with massive economic problems and its primary priority was to ensure the continuous operation of the railways (Murray, 2014: 4).

In the early 2000s, Putin's arrival at the head of the Russian government and his structural reform programmes led to the reorganisation of the entire railway industry, whereas during this time VTB experienced only management reorganisation. Moreover, given their limited international experience, in line with the predictions of the U-model (Johanson & Vahlne, 1977), these Russian companies internationalised in several stages. For example, RZD passed through four stages of reform. The first stage (2001-2002) was the preparation of necessary regulatory documents and the resolution of financial issues for the separation of the state regulator's functions of the MPS from its business functions. The second stage (2003-2005) was the completion of the reorganisation of the railway industry (RZD, 2006: 26). The third stage (2006-2010) involved a transition to a phase of implementing investment projects (*ibid.*: 27), as a result of which RZD entered the Armenian and Georgian markets in 2008. The fourth stage (2012-2015) was ensuring RZD's competitiveness, its integration with other national transport systems, a unified tariff as part of the north-south and west-east international corridors and the unified transport system of the CIS and EEU (RZD, 2013: 123). Furthermore, as a result of Putin's reforms, Russia's institutional and macroeconomic development accelerated as oil prices rose (I-5, 2017; I-7, 2017) (*see* Graph 3). All these home-country economic and institutional developments, as well as firm-specific microeconomic developments increased VTB's and RZD's O advantages and motivated them to look for new markets in neighbouring countries.

In line with Dunning's OLI (2003; 1998a), the Russian financial and railways firms' internationalisation is dependent on their possession of various ownership advantages, such as a strong market position, a resource base, managerial expertise, trademarks and brand reputation in the home market. For instance, VTB is Russia's second-largest and second most important bank (VTB, 2018a: 11), and possesses funding capabilities and customer service skills – particularly with corporate customers. RZD is a natural monopoly, with a peculiar monopolistic position in relation to several destinations, distances and freight, as illustrated in Map 14. Moreover, its rail lines are located in geographically strategic regions of Russia. RZD inherited the '1520-gauge space' from the Soviet Union, which provides it with several important ownership advantages when it comes to implementing its investment activities within the 1520-gauge zone (RZD, 2010: 120). For example, the railway systems of the post-Soviet South Caucasus countries also operate on 1520 gauge. All this provides them with a strong balance sheet, financial performance and a robust profit centre to pursue their expansion activities and to take advantage of various emerging opportunities in the South Caucasus by establishing subsidiaries.

The possession of transaction-based ownership advantages such as detailed knowledge of the cultural, political and economic landscape of each South Caucasus country has enabled the Russian financial and railways companies to establish and consolidate their customer ties. Moreover, the economies of Russia and the South Caucasus countries have experienced periods of broadly similar instability since the dissolution of the USSR. This is another type of ownership advantage which has allowed the firms to take full advantage of local know-how and limitless opportunities, as well as personal connections in the South Caucasus emerging economies. For instance, VTB's investment in Azerbaijan and shared ownership with ATA Holding of VTB Azerbaijan stemmed from the establishment of strong personal connections with the ruling elite in Azerbaijan, because ATA Holding is perceived to be a 'family business', linked to Aliyev's family (I-14, 2017; I-17, 2017). This ownership advantage not only helped VTB to enter the market but also to improve its market position and later to consolidate its ownership of VTB Azerbaijan.

Dunning's OLI theory (2001a) offers a promising mechanism for exploring and analysing VTB and RZD and the firm-specific tangible and intangible ownership advantages they accumulated in Russia, which encouraged them internationalise in the South Caucasus. However, in line with the predictions of the IDP (Dunning, 1988), Russia's economic and institutional development as a result of Putin's reforms and the rise of oil prices influenced VTB's and RZD's investment flows and their internationalisation strategies in the South Caucasus. According to the U-model predictions (Johanson & Vahlne, 1977), these firms' internationalisation took place in several stages. They expanded within the Russian Federation first, and later strengthened their market position. When they became financially and organisationally strong enough, they started seeking international expansion in the South Caucasus emerging economies. Considering all this, the first sub-paradigm of interdisciplinary theory is therefore used to study and examine these firms' various O advantages.

8.3 Localisation

After improving their O advantages and consolidating their market positions in the home market, VTB and RZD began searching for investment opportunities in the South Caucasus countries. In this section, I use the second phase of the interdisciplinary paradigm to identify various locational advantages of the South Caucasus markets, including economic, institutional and non-economic determinants, and to analyse their roles in determining these firms' location choices.

Given VTB's and RZD's primary business segments located in Russia as Maps 13 and 14 show, as predicted by Dunning's OLI (2000), geographic proximity or location was one key factor in their investment decision-making and favoured their geographical expansion. For example, railways systems in the South Caucasus countries operate on 1520 gauge, which provides RZD with great transit potential due to their geographical locations (*see* Map 14) (RZD, 2010: 120). It should be noted that the role and impact of geographic proximity on the investment decisions of the non-resource and resource-based companies, as discussed in Chapters 5, 6 and 7, have similarities and differences. Acquisitions in these countries offer new operating environments. A degree of geographical proximity to the targeted market is regarded as a crucial determinant, as firms' transportation costs can be higher or lower (Dunning, 1998b: 48; Eckert & Rossmeissl, 2011: 15). Both core businesses are located in Russia, allowing them to transfer their O advantages across the Russian border through their own companies, but non-resource-based companies are free from distance-related transactions or transportation costs as they do not have large physical plants and facilities, and do not need to transport their assets or products. However, when markets are located a great distance from non-resource-based companies' headquarters, they might encounter uncertainties in relation to the financial and operational needs of remote businesses. Furthermore, the firms' headquarters should be directly involved in effectively monitoring, gathering market research and strategic planning in order to be able to follow through their investment projects and carry out their business operations (Keegan, 1971: 87). Thus, the inability to control the subsidiaries in those markets might adversely affect the companies' businesses and financial bottom lines.

Moreover, given firms limited international experience, in line with the tenets of the U-model (Johanson &Vahlne, 2003: 90), VTB and RZD invested in more familiar South Caucasus markets that offered a similar business environment, and similar regulatory and political systems. These host-country markets are located in close proximity to these companies' core businesses in Russia, allowing them to establish their subsidiaries in adjacent markets,[128] such as the South Caucasus countries. The financial and railway companies chose the South Caucasus because the markets there were well-known to their managements (Kuznetsov, 2017b: 84). Considering the limited international experience of the railway company in particular, some of its investments in the South Caucasus have been made for the purpose of obtaining foreign experience, enhancing its incremental knowledge and testing its already accumulated experience. For example, as a newly emergent firm, RZD made its first international forays into Armenia in 2008 (Kuznetsov, 2016a: 354), later investing in Georgia and soon afterwards Abkhazia.

[128] VTB opened representative offices and became involved in strategic alliances in far distant regions, such as in Europe, Asia and Africa.

Map 14: Russian, Armenian, Azerbaijani and Georgian Railway networks (customised by the author)

The South Caucasus is part of the north-south international transit corridor and the Eurasian transportation system (RZD, 2009: 45). The development of international cooperation with these neighbouring countries, therefore, not only solidifies RZD's position, but also enables RZD to use the South Caucasus as a hub to target new markets in the adjacent countries. All this shows that proximity or location has played a significant role in their investment decisions, allowing them to benefit from it. As well as geographic proximity or location, good physical infrastructure has been another important factor in firms' locational choices (Dunning, 1998a). For example, the railway systems of the South Caucasus countries share a common information environment and technological standards, as they operate on 1520 gauge, which they inherited from the Soviet Union (RZD, 2010: 120), and this is an important location advantage for RZD. Economic efficiencies from the implementation of projects mean that RZD is capable of including the railway systems in its logistical chains; for example Armenia's railway system, which operates using RZD's infrastructure on the north-south and west-east routes (RZD, 2016: 102).

VTB and RZD also targeted strategically important assets with strong business records and control of crucial export and import routes. These strategic investments aimed to promote and cultivate their long-term strategic goals and improve their international competitiveness. For instance, VTB's investments in the South Caucasus – Armsberbank,[129] the United Georgian Bank,[130] and AF-Bank in Azerbaijan – all had strong business records and played important roles in commercial banking, which allowed VTB to develop its long-term competitive position in the region (Papava, 2012a: 65; VTB Armenia, 2015; VTB Azerbaijan, 2018: 5; VTB Georgia, 2018: 9). In order to secure its logistical chains, RZD invested in and acquired various assets in the South Caucasus to ensure the export of Russian commodities from domestic production sites to the South Caucasus and other foreign markets. The Armenian and Abkhazian railway networks gave it control over the operation of import and export traffic flows in these economies, and the Caucasus-Poti (Georgia) ferry line ensures railway links with Armenia (RZD, 2012: 183). RZD's presence outside Russia is a rail concession in Armenia accounting for less than 4% of the CIS and 2% of the Russian markets in terms of carriage volumes, but this has created the chance to obtain a foothold in other markets, such as in the Iran-Azerbaijan corridors (*see* Map 14) (RZD, 2012: 80). Under Dunning's eclectic paradigm (2000), both market-seeking and strategic asset-seeking motives played important roles in VTB's investment decisions in the South Caucasus, whereas strategic asset-seeking was the critical internationalisation motive underlying the Russian railway's investment.

It has been important to evaluate the South Caucasus emerging economies' economic and institutional development, including their degrees of economic freedom and corruption, when choosing where to invest. As predicted by the IDP (Dunning, 1998b; 1988), these macroeconomic factors have had a significant influence on the inflow of investments (*see* Graphs 1, 2 and 3). For instance, unlike Armenia and Georgia, Azerbaijan has been perceived as a mature market with high market entry barriers and natural resources, and a tough and corrupt system in which economic freedom is repressed, and in which property rights and local

[129] the first savings bank in Soviet Armenia (founded in 1923, and with more than 90 years of business traditions).

[130] the third-largest bank.

firms are to a great extent controlled by the ruling elite (*see* Graphs 1 and 2) (I-14, 2017; I-16, 2017). Georgia became more liberal after the Rose revolution, under the Saakashvili administration, and as the Georgian respondent confirmed, this provided VTB with an opportunity to invest (I-8, 2017).

Given the different levels of economic freedom across the South Caucasus emerging economies, as shown in Graph 2, corruption may have been a 'helping hand' in Armenia and Georgia, speeding up investment procedures and ultimately accelerating investment inflows, whereas in Azerbaijan it may have been a 'grabbing hand' that created significant costs for these firms and consequently affected their investment inflow. For instance, as Graph 2 shows, during 2003 and 2004, VTB invested in Armenia and Georgia, when corruption was at its highest in both countries. This was confirmed by the Armenia and Georgian respondents who emphasised that both countries had struggled with corruption (I-6, 2017; I-9, 2017). A similar event happened when RZD won a tender for the acquisition of Armenian railways in 2007 (*see* Graph 2). Moreover, as Graph 3 shows, the South Caucasus countries have exhibited varied levels of economic development, as measured by their annual GDP growth. Azerbaijan's economic development has been higher than that of either Armenia or Georgia, or even Russia (*see* Graph 3). Taking the localisation of VTB's investments in the South Caucasus as an example, VTB entered Armenia through the acquisition of a 71% share in Armsberbank in March 2004, and 51% shares in the United Georgian Bank in January 2005 and in the AF-Bank in Azerbaijan in December 2008. VTB increased its shares in its Georgian subsidiary in the following years but only managed to achieve full acquisition of the remaining shares in Azerbaijan in October 2017 (VTB, 2018b: 83). In line with the IDP (Dunning, 1998b), all this variation across the South Caucasus countries determined VTB's and RZD's decisions on where to enter, and the level of their investment inflows.

Like the telecommunications and insurance companies discussed in Chapter 7, the Russian financial and railways companies' internationalisation in the South Caucasus markets complies with the 'follow the customer strategy', moving where they had growing export flows and customer bases. For instance, the corporate customers of VTB and RZD, discussed in Chapter 5 and 6, had already established their businesses in the South Caucasus markets and they have both focused on developing their relations with Russian companies there. For example, VTB's business development in the CIS is a key priority of its international strategy. VTB has been actively engaging with large Russian corporate clients in the South Caucasus and frequently initiates investment projects there through its subsidiaries. VTB's subsidiaries act as Russia's ‘economic ambassadors’ in the South Caucasus, where they operate and support the international business activities of Russian companies (VTB, 2012b: 58). For example, VTB Armenia finances key sectors of the Armenian economy, including RZD’s investments in the railway network and its modernisation, the power grids and pipeline projects implemented by Gazprom and RusHydro, and various projects implemented by other large Russian companies (VTB, 2012a: 46). VTB’s active presence in the financial markets of the South Caucasus countries allows it to provide a wide range of financial services to its corporate clients (VTB, 2013: 50). All in all, the existence of corporate customers in these markets has encouraged the Russian companies to enter.

In brief, the second phase of the interdisciplinary framework identified and analysed the locational attractiveness of the South Caucasus emerging economies for the Russian financial and railways companies. The South Caucasus has provided VTB and RZD with various L advantages when choosing where to invest. Moreover, the levels of both economic and institutional development in these emerging economies, as well as of various non-economic factors have varied over time and influenced the companies’ location choices. This, and their limited international experience, offered VTB and RZD various opportunities for the successful development of their businesses.

8.4 Political Economy of Investments

8.4.1 State-Business Relations

In the early 1990s when the USSR collapsed, Russia began to experience various political and economic changes and challenges. All this influenced not only the Russian state, but also this latecomer economy’s strategies and behaviours towards VTB and RZD. In the financial industry, VTB was at an early stage of privatisation or reorganisation during the Yeltsin era, as a result of his economic policies and market reforms, whereas the railway industry was reorganised under Putin and RZD was consequently established as a railway company. In the 1990s there was neither decisive nor appropriate state support for these industries. However, after Putin’s arrival in the Russian government, the scenario was positively changed. For instance, under Putin, the Russian state has taken the role of coordinator in the initial stages of VTB’s and RZD’s internationalisation, or when they have been in financial trouble by means of financial assistance, tax reduction and various other support (Kuznetsov, 2017b: 86). In this way, considering VTB’s and RZD’s limited international experience, the early stage they were at in their internationalisation and the locational attractiveness of the South Caucasus markets, the role of the Russian state has been decisive in these firms' expansion and offset their ownership disadvantages. Taking all this into account, in this section I use the interdisciplinary framework developed for this study to explore and analyse the Russian state and its relations with these firms through state-ownership, financial dependence, intergovernmental meetings, management, government regulations and policies that could affect VTB's and RZD's investment strategies and their success in the South Caucasus emerging economies.

Both VTB and RZD inherited intangible assets from the Soviet Union, including great industry knowledge, accumulated experience and established foreign relations and networks, as well as key contacts (Kuznetsov, 2010a: 18). For example, VTB has key management and board members who used to hold, and still do hold, various positions in the executive office of the USSR, the Russian state committee for Economic Cooperation with the CIS, the Russian Ministries of Finance and Economic Development, and other state agencies, as well as leading Russian companies (VTB, 2018a: 112-116). RZD was created as a new railway company out of the MPS, by the ministries' own staff and administration (Murray, 2014: 4). This represents personal continuity with the USSR. Both companies possess a unique form of managerial elite[131] who used to occupy, or who still occupy, various senior positions in government agencies and large Russian corporations. These strong, inherited management and organisation-based ownership advantages provided VTB and RZD with easy access to information, finance, consultation and various forms of support, which encouraged their rapid expansion and facilitated the acquisition process in the South Caucasus host markets.

In 2002, when the Russian state took over shares in VTB from the Central Bank of Russia (VTB, 2017) giving it direct majority ownership of VTB with 60.93% (*see* Figure 17), a new team of managers was appointed. This significant change developed VTB, transforming it into a universal financial and banking institution with a leading position in Russia, able to expand swiftly into the adjacent countries through a series of strategic acquisitions in the South Caucasus. The Russian state's stake in VTB ensures financial strength and is a guarantor of the

[131] This managerial elite includes Vladimir Yakunin, former president of Russian Railways; Andrey Kostin, president of VTB bank; Alexander Shokhin, former President of the executive board of the RSPP; Yevgeny Ditrikh, Russia's Minister of Transport; Sergey Stepashin, former Minister of Russia's Justice and Internal Affairs; Igor Shuvalov, assistant to the Russian president; Alexander Ryazanov, a former member of management board of Gazprom; Arkady Dvorkovich, Russia's deputy Minister for Economic Development and Trade, and other individuals.

bank's stability. As a fully state-owned company, RZD, unlike VTB, was provided with the LTDP by the Ministry of Economic Development in accordance with Putin's list of instructions. This was an initial step towards implementing its investment and business strategies in accordance with the Russian state's instructions. Thanks to this programme, RZD determined its target visions, strategic goals, and domestic and foreign investment projects aimed at accomplishing strategic objectives (RZD, 2017: 26). Its investments in Armenia and Georgia and its intention to use Azerbaijan as a hub, for example, were made with strategic goals in mind.

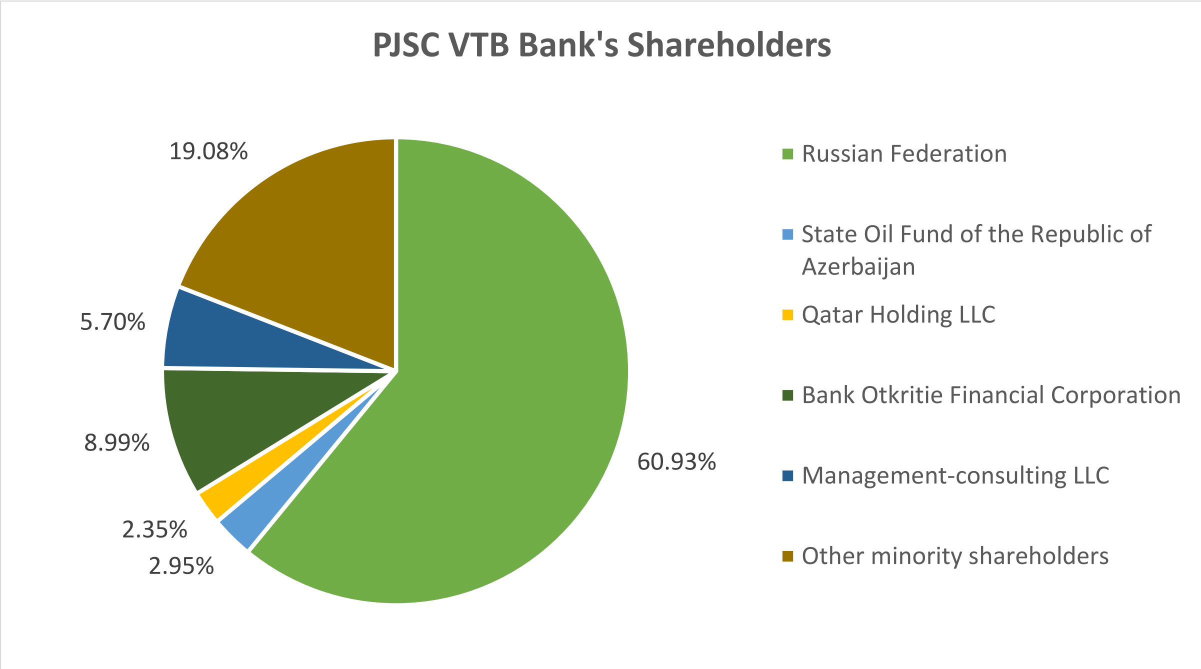

Figure 17. Source: VTB, 2019

The Russian state also provided timely and appropriate financial support both for the development of VTB and RZD, and to maintain their financial capabilities and resources before and after the 2008 financial crisis, and economic and political crises from 2014 on (RZD, 2007: 177; VTB, 2015: 6). For example, the Russian President and government set the key performance targets and tasks for 2004-2006, and RZD was allocated substantial finance for their achievement (RZD, 2007: 34). In 2004, the Russian state also listed RZD among its strategic companies (RZD, 2009: 10). Moreover, during the 2008 financial crisis, the state introduced anti-crisis measures aimed at supporting the banking industry, including liquidity, the loans system and operating capacity. Financial stability was a key focus of these anti-crisis policies (VTB, 2009: 2). This state intervention maintained VTB's and RZD's ownership advantages and later paved the way for them to enter the South Caucasus markets. Consequently, VTB invested in Azerbaijan by acquiring a 51% share in AF-Bank in December

2008, which was renamed ‘VTB Azerbaijan’, and started operations in March 2009 (I-14, 2017). Azerbaijan was also negatively affected by the 2008 financial crisis, as Graph 3 shows. The fact that both crucial state support and the emergence of opportunity in Azerbaijan were a result of the 2008 financial crisis shows that timing was a key factor.

In Georgia, VTB continued to consolidate its ownership of VTB Georgia by purchasing the remaining shares from the EBRD; in December 2008 its shares increased to 77.57%, in November 2009 to 87.07%, and in August 2010 it consolidated its position with a 97.38% share in VTB Georgia (VTB, 2018b: 83; VTB Georgia, 2010; 2009; 2008). During this time RZD also invested in Armenia, Georgia and Abkhazia. However, political support was needed for VTB to enter the South Caucasus markets, and especially, given the L advantages there, in Azerbaijan, where the market was highly monopolised (*see* Graph 1). Ibadoglu explained that “there is no fair competition” (I-14, 2017). Moreover, the respondents from Azerbaijan stressed that Russian state support alone was not enough to succeed in Azerbaijan; companies must also receive support from the Azerbaijani government (I-14, 2017; I-17, 2017). So, sharing the ownership of VTB Azerbaijan with ATA Holding, which was linked to the ruling elite, and the presence of the State Oil Fund of Azerbaijan (SOFAZ), which was linked to the Azerbaijani government, with a 2.95% share (*see* Figure 17), were significant determinants of VTB’s achievement of full ownership in late 2017.

It should be emphasised that VTB plays a key role as a state agent in providing funds and financing vital sectors of the Russian economy and companies’ investment projects, not only in Russia, but also in the South Caucasus (I-17, 2017; I-18, 2017). Its key role in public-private partnerships is strongly encouraged by the Russian state (Kremlin, 2016). As a leading Russian financial institution with a strong international presence, VTB is aware of the importance of its role as a representative of Russia and Russian business in the international business world. VTB’s subsidiaries act as Russia’s “economic ambassadors” (VTB, 2012b: 58) in the South Caucasus, where they serve major Russian corporations and support their international business activities (I-6, 2017; I-8, 2017; I-9, 2017; I-12, 2017; I-14, 2017). The Russian state sometimes provides additional funds for VTB to significantly increase the size of the loans it makes to strategically important Russian companies (VTB, 2009: 8). VTB enters into transactions with all the leading Russian companies. Its executive members are also management and board members of RusHydro, RUSAL, Gazprom and Rosneft operating in the South Caucasus markets (VTB, 2018a: 112-116). This not only augments its O advantages against its counterparts in the targeted South Caucasus, but also accelerates its internationalisation processes, as well as those of other large Russian firms in the South Caucasus. This can also be classified as a unique ownership advantage.

VTB acts as project initiator, prepares agreements and reviews proposed projects that could be conducted in the South Caucasus, particularly in Armenia. It develops close relations with leading Russian firms and helps them strengthen their market positions in both Russia and the South Caucasus emerging economies. For example, VTB is seen as a reliable financial partner of Russian companies, helping them enter foreign markets and playing a significant role in supporting and facilitating both their access to suppliers, and their efforts to become suppliers themselves in foreign markets (VTB, 2012b: 58). Moreover, the state's role in VTB's and RZD's success and their interrelations are quite evident. The presidents of VTB and RZD meet with the Russian president frequently and discuss both companies' past and present situations as well as their future plans and participation in large projects. Key instructions are given to these firms on how to develop mechanisms and solve issues together with Russian leading corporations and state entities.

For instance, in accordance with the state's instructions, some VTB shares were issued in 2011 and 2013 to sell to international investors, particularly international investment funds (VTB, 2014: 4; 2013: 9). This enabled the SOFAZ to become one of VTB's shareholders with 2.95% of the shares (VTB, 2014: 4) (*see* Figure 17). This later facilitated VTB's acquisition of the remaining 49% share in VTB Azerbaijan in the second half of 2017. VTB sometimes instructs certain Russian government agencies and the Central Bank to review its proposals and any other issues in accordance with Putin's instructions (Kremlin, 2018c). Furthermore, VTB bought RusHydro shares in exchange for debts under Putin's instructions (Kremlin, 2015b). These examples illustrate that there is complete state support for VTB. Moreover, VTB's president meets regularly with Putin and the bank conducts transactions in the Russian and international markets on behalf of RZD (Kremlin, 2016). There are several proposed and completed projects in Abkhazia and Armenia, particularly RZD's investments in restoring the Abkhazia and Armenian railway infrastructures.[132] All this shows that the Russian state's direct

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[132] For example, in 2010, RZD started to reconstruct the railway traffic between Vesyoloye and Sokhumi (RZD, 2011: 161). In June 2011, it inaugurated a railway service between Russia and Abkhazia, and in 2013 the reconstruction of Abkhazia's railway infrastructure was completed (RZD, 2014: 13; 2012: 30). In 2012, RZD constructed the Zamanlinsky bridge in Armenia, and in 2016

and indirect support or intervention has been crucial to the internationalisation of these financial and railway companies.

Political support through government officials and intergovernmental meetings has been both necessary and effective for VTB and RZD when entering new markets because cooperating with the government and developing relations with both Russian and foreign partners provides them with opportunities for business development. Zurab Garakhanidze, head of the Administrative Department of the amalgamated Ministry of Natural Resources and Agriculture of Georgia, explained that some economic investment decisions made without political support could face barriers in the host county (I-10, 2017). In 2006, for example, RZD met with Georgian and Armenian railway companies to discuss its proposal to open a railway line through Abkhazia, and later to inform Abkhazia about the project (Kremlin, 2006a; 2006b). However, the proposal came to nothing because of the 2008 political crisis between Russia and Georgia. RZD actively engaged with the Russian state authorities to take advantage of all the political opportunities to remove the gaps in the Armenian railway transportation network which were an impediment to trade relations between Russia and Armenia, and the economic development of Armenia (RZD, 2009: 47). So RZD made a strategic entry into Poti, Georgia, via Malta, by investing in the Caucasus-Poti ferry line to stimulate traffic with Armenia (*see* Map 14) (I-5, 2017).

In May 2006, before they entered Armenia, RZD's president had a working meeting with Putin to discuss the company's local and international activities, as well as those within intergovernmental organisations (Kremlin, 2006c). In January 2007, in talks with the Armenian president Robert Kocharyan during his visit to Armenia, Putin indicated that RZD could also launch new projects in Armenia and had shown interest in the Armenian railways (Kremlin, 2007). In September 2007, the Armenian government invited tenders for its railway network, and in November 2007, RZD opened a representative office there (RZD, 2009: 47; 2008: 29). Soon after, in 2008, RZD established its wholly owned South Caucasus Railways subsidiary in Armenia. Like RZD, VTB's active role in broadening economic cooperation has also been discussed at intergovernmental meetings, such as the 2010 and 2013 Armenia-Russia intergovernmental meetings (Kremlin, 2013b; 2010c). The Armenian respondent commented that "the government of Russia is pushing the Russian companies to cooperate with Armenia"

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implemented new improvement and modernisation projects on the Armenian railway infrastructure (RZD, 2017: 99; 2013: 119).

(I-7, 2017). Given the former Georgian Minister of Economy, Vladimer Papava's, comment that "the Russian companies feel that they are in a safe area" (I-8, 2017), it is clear that Russia's total administrative support and its instructions have increased VTB's and RZD's O advantages and played a decisive role in their decisions about where and how to invest.

In summary, foreign expansion of VTB and RZD is strongly supported by the Russian state. The circumstances and facts discussed above show that both companies have been closely involved with the Russian state, and that the Russian state has been closely involved with both in various ways, such as state-ownership, financial dependence, management, meetings with the president, interstate relations, government regulations and policies. VTB and RZD also take advantage of the RSPP (I-5, 2017). This close interaction between the Russian state and both firms can be classified as an O advantage. Consequently, timely and decisive state support has helped VTB and RZD to improve their resources and capabilities, to accelerate their internationalisation and acquisition processes, and to protect their existing investment and business operations in the South Caucasus emerging economies. Given all these facts, the political economy approach has been useful and helpful in analysing and understanding the internationalisation of the Russian financial and railways companies. Therefore, I developed and used the interdisciplinary framework to investigate the Russian state-business relations and analysed VTB's and RZD's investment and business activities.

8.4.2 State-State Relations

Alongside Russian state-business relations, political and economic relations between Russia and the South Caucasus countries have also been a significant determinant in the internationalisation and foreign expansion of VTB and RZD. These firms use Russia's traditional relations in their favour to enter new markets (Kuznetsov, 2016b: 81) and their investment and business operations rely greatly on intergovernmental relations. However, political conflicts and deteriorating relations between states, including sanctions and military conflicts, can influence VTB's and RZD's investment behaviours and strategies in the South Caucasus. Given these firms' close interactions with the Russian state, as explored earlier, these firms' investments could also be perceived as an instrument that serves Russia's foreign policy and political objectives rather than pursuing commercial interests, something that was confirmed by the Armenian, Azerbaijani and Georgian respondents (I-6, 2017; I-8, 2017; I-12, 2017; I-14, 2017; I-16, 2017). Considering all this, in this section, by applying this framework

I explore whether VTB and RZD can be tools of Russian foreign policy and analyse the impact of political events on their businesses in the South Caucasus host countries.

These non-resource-based Russian firms play an important role in the political and economic relations of Russia with the South Caucasus countries. For example, in Russia and abroad, VTB and its subsidiaries are perceived as "economic ambassadors" that finance projects of strategic importance to benefit Russia, cement economic relations between Russia and the South Caucasus republics (VTB, 2013: 50), and support the development and growth of trade between the countries (VTB, 2012b: 58). For instance, since its entry into Armenia in 2004, trade between Russia and Armenia has significantly increased, as illustrated in Graphs 4 and 5. Over the past years, as Graphs 4, 5, 6, 7, 8 and 9 show, the expansion of trading and investment activities in the Armenian market has led to that country becoming Russia's largest trade partner. This is one of the factors that also encouraged RZD to invest in Armenia in 2008. Since RZD's 2008 entry, Armenia's imports to and exports from Russia have significantly increased, making Russia a major trade partner (*see* Graphs 4 and 5). Moreover, as respondents from Armenia, Azerbaijan and Georgia argued, there were political reasons for VTB's investments, such as supporting politically influential businesses and developing political economic relations (I-6, 2017; I-8, 2017; I-9, 2017; I-12, 2017; I-14, 2017; I-18, 2017). Unlike VTB, the investments of the Russian telecommunications and insurance companies were commercially rather than politically driven (I-11, 2017). According to the former Georgian Minister of Foreign Affairs, "VTB is not a free market player in the financial sphere" but is an "instrument for controlling and keeping eyes on many issues of the state interest" (I-9, 2017) because "the idea is to take control of the main aspect of the economy" (I-12, 2017).

RZD has also been perceived as a Russian state structure which supports the state's missions; its target projects are linked to Russian state instructions (RZD, 2008: 66). A core link in the international transportation system is the expansion of Russia's foreign economic relations and consolidation of its position. For example, in September 2008, after the August conflict in Abkhazia and South Ossetia, the Russian president Medvedev had a working meeting with the president of RZD to discuss state railway issues and the possibility of rebuilding the railway infrastructure "in the two new entities under international law", Abkhazia and South Ossetia (Kremlin, 2008c; 2008d). Medvedev stated that "we have to help them" and "we are close now to signing a treaty on friendship and mutual assistance" (Kremlin, 2008c). After the war, RZD started to implement the construction work on a *de facto* railway link with Abkhazia with the help of the military railway workers. However, there was no direct rail link between Russia and South Ossetia. RZD explored a potential rail link from Russia to South Ossetia, but this project could be only carried out with state support and approval (*ibid.*). Later, in 2009, RZD obtained management rights to the Abkhazian railways and started to construct a railway line between Vesyoloye and Sokhumi, as Map 14 shows (Cooley & Mitchell, 2010: 65; Lavrov, 2010; RZD, 2014: 13). In the following years further agreements were signed between Russia and Abkhazia to promote further investment activities, trade and economic cooperation (Kremlin, 2018b; 2010b). These examples show that the corporate goals of RZD conformed to Russia's political interests.

The diplomatic crisis between Georgia and Russia, therefore, has affected the financial and Russian railway companies and their business decisions in various ways. For example, VTB has a significant role in improving diplomatic relations between them and tries to acquire a better company image through its "economic ambassadors". Its political accommodation and responsiveness is demonstrated by its roles as general sponsor of the Georgian Olympic Games school, the Federation of Horse Racing, the National Gymnastics Federation and Georgia's national football team, through its subsidiary VTB Georgia (VTB, 2018a: 111; 2018b: 63). The primary logic underlying VTB's timely strategy is to safeguard its bargaining power and business operations in Georgia. As Map 14 shows, the Sochi-Tbilisi via Sokhumi railway line would be the most efficient communication route between Russia and Armenia and would minimise both costs and journey times. The reopening of this railway line was initially discussed in 2003, during Putin's meeting with Shevardnadze and the Abkhazian prime minister Gennadi Gaguli (Kremlin, 2003d), but the 2008 conflict brought the project to a halt. In 2008, RZD took over the Armenian Railway network and established its South Caucasus railway subsidiary. There was a hidden agenda behind RZD's investment in Armenia (I-16, 2017), which was not just an economic consideration, but also, according to Kuznetsov, "a politically based decision to develop Armenian railways" (I-5, 2017). After the 2008 war, Georgia became aggressive towards Russian state-owned companies, so it was out of political considerations that RZD established its subsidiary, Black Sea Ferries, in Malta, in order to operate a line to Poti (Georgia), which would enable the company to supply Russian goods, including aluminium and petrochemical products, to Armenia. Consequently, RZD entered Poti in Georgia via Malta by acquiring a 51% share and *de jure* control of decision-making in the Caucasus-Poti ferry line to stimulate traffic with Armenia (*ibid.*) (*see* Map 14).

Another angle on this debate suggests that after the disintegration of the USSR, Russia started to restore its political and economic power and prevent western influence in its traditional sphere of interests. Russia's aim took on a new shape with the arrival of Putin and his support for firms through various mechanisms. This strategy became a tool for the achievement of a broader foreign policy for Russia. For example, VTB's and RZD's corporate goals are to advocate Russia's long-term interests (RZD, 2010: 39). These corporate goals involve establishing a rouble settlement zone across the entire post-Soviet space, controlling the railway networks, integrating the Russian railways into the Eurasian transportation system and eventually controlling the north-south and west-east international transport corridors. In the words of Susan Strange (2004; 1992), the role of these firms in today's political and economic system can maximise Russia's power and help to accomplish its broader foreign policy objectives in the region. Given growing competition in the region, several scholars (Kubicek, 2013; Stulberg, 2005; Svarin, 2016; Tsygankov, 2005b) have highlighted the geopolitical considerations in Russia's broader foreign policy. For instance, in the railway industry, the major infrastructure project in the South Caucasus is the Baku-Tbilisi-Kars (BTK) railway, which forms the shortest route to China from Europe via the ports of Baku and Aktau (*see* Map 14). The South Caucasus can be a gateway and link in both the west-east and north-south directions. In the growing trade between China and Europe, Kazakhstan is also interested in this project (I-8, 2017). This developing alternative international corridor that bypasses Russia is the result of growing competition in the region (RZD, 2017: 44). Thus, RZD's strategic priority is to establish a corridor between Russia and Iran in the Caspian region as part of an international north-south transportation corridor, as illustrated in Map 14.

There was still a plan to rebuild the railway line from Russia to Armenia via Abkhazia and Georgia when Bidzina Ivanishvili, a Russian-Georgian businessman, became prime minister of Georgia in October 2012. Ivanishvili repeatedly made statements about restoring this railway line and, especially to appease Armenia, connecting to Russia via the line. However, "the resistance was too strong", according to Tarkhan-Moravi (I-12, 2017). The project was not supported by Georgian politicians and was perceived as a betrayal of Georgia's national interests. Tarkhan-Moravi underlined that the proposed project was economically useless and was "purely a political project" (*ibid.*). The project was also criticised by Azerbaijan. During the Nagorno-Karabakh conflict, with the Russian 102nd military base in Gyumri, Armenia (*see* Map 14), Armenia's numerous military agreements and active cooperation with Russia within the CSTO (*see* Figure 4), Azerbaijan feared that Russia would supply its military bases in Armenia via Georgia (Platonova, 2013; Zhidkov, 2012). RZD's subsidiary, South Caucasus Railways, provided special transportation services alongside its goods and passenger trade for state, military and other special-purpose transport requirements (RZD, 2009: 193). The project was intended to strengthen Russia's strategic presence in the South Caucasus and to connect it directly to Armenia (I-12, 2017). Georgia became dependent on Azerbaijan's oil and gas in return for reducing its dependence on Gazprom and was an active player in the regional energy and railway projects. As Figure 4 shows, neither country is a member of the Russian-lead CSTO and EEU and both cooperate within the GUAM to counter Russia's influence. Georgia therefore did not wish to make worse either its relations with Azerbaijan or its position in regional projects.

As corporate players, VTB and RZD have different roles in Russia's broader foreign policy objectives. VTB's corporate strategy and strategic goal in the South Caucasus markets is to bolster mutual penetration of the national economies, ultimately leading to the creation of a common economic space or economic integration (VTB, 2012b: 58). VTB strives to establish a rouble settlement zone, which makes a financial infrastructure necessary so that the rouble can be used as a means of payment across the entire post-Soviet region. As a first step, VTB has tried to turn the rouble into a regional currency (Kremlin, 2008e). Furthermore, effective cooperation with the CIS countries allows RZD to maximise its use of the competitive advantages of the 1520-gauge domain. In 2013, the Council of the CIS held sessions that were attended by Georgia as well as the member countries. Tangible results were accomplished with the development of a unified system of transport (RZD, 2014: 61). During the establishment of the EAEU in 2012, RZD was an active player and was directly involved in the work of the EEC. The purpose was to ensure the integration of transport processes within the union (RZD, 2013: 131). Firms engaged in these types of activities at the corporate level became crucial drivers of regional integration, namely the EEU. This shows that the financial and railways companies' efforts had special roles in regional integration. Military and political cooperation in the 1990s within the framework of the CIS and CSTO was replaced with economic cooperation in the EEU, which is a primary goal of the Russian state and its broader foreign policy objectives (*see* Figure 4) (Kvashnin, 2016: 222). For instance, given Armenia's close political and military cooperation with Russia in the 1990s was later in the 2000s transformed into economic cooperation as Figure 4 shows.

Like other resource based companies, especially electricity ones, RZD effectively cultivates its international transportation activities as part of the EEU and these have been carried out using the platform of the Council of Rail Transport of the CIS members (RZD, 2016: 3). One of the most important events for tariff regulation in 2014 was preparation for the signing of the EEU

Treaty which took effect in 2015 (RZD, 2015: 27). RZD has used the opportunities offered by the EEU and the Railway Transport Council of the CIS to expand its presence in the international transportation markets, geographically speaking. The establishment of the United Transportation and Logistics Company by the railway companies of the EAEU led to the implementation of the biggest project and development within the EEU. RZD also acquired the right to modify tariffs for railway freight transportation services within specific price limits as part of the intergovernmental treaties which form the contractual foundation of the EAEU and then the EEU (RZD, 2017: 23). As a result, Armenia joined the Russian-led EEU and as also shown in Graphs 4 and 5, the trade between Armenia and Russia increased further.

Briefly, all the issues discussed above show that state-state relations and Russia's broader foreign policy objectives are significant for explaining VTB's and RZD's investment and business activities in the South Caucasus host countries. During their internationalisation into these markets, the Russian financial and railways companies took advantage of the 'political distance' (Conti *et al.*, 2016: 1983), and VTB as an "economic ambassador" and RZD as a "political authority" (Strange, 1996: 45) have played significant roles in Russia's political and economic relations with the South Caucasus republics. Their long-term corporate goals, such as the establishment of a single financial currency across the post-Soviet region and the control of the north-south and west-east international transport corridors, conform with Russia's broader political interests. All in all, state-state relations along with state-business relations have been a crucial determinant of the activities of VTB and RZD in the South Caucasus markets, and using the interdisciplinary paradigm is helped to identify the real motivations behind their expansion in these countries.

8.5 Internalisation

Having discussed VTB's and RZD's O advantages, the South Caucasus markets' L advantages, and political economy factors, in this section, the third phase of the interdisciplinary paradigm is used to investigate how the Russian financial and railways companies invested in the South Caucasus countries, what entry strategy they chose, and why. Macroeconomic conditions and political factors in the South Caucasus markets require the fulfilment of some preconditions to investment, such as market information and financial resources, to hedge against any potential risks. Both companies consulted the Russian government and its agencies and took advantage of public-private partnerships in both home and host countries. Providing support by bringing together the state and financial service providers has facilitated their foreign expansion (Vahtra, 2006: 41). RZD also used the CIS Railway Transport Council as a way of gathering information and cooperating with the members', railway administration companies and agencies. After all the necessary preconditions had been met, VTB and RZD entered the South Caucasus markets through M&As, representative offices, management contracts, JVs, cooperation projects or subsidiaries.

VTB made various strategic decisions to internalise its investments in the South Caucasus. Given the L advantages of Armenia and various political factors discussed earlier, VTB entered Armenia in March 2004 through its acquisition of a 71% share in Armsberbank, which was later, when it joined VTB's banking subsidiaries in June 2006, renamed 'VTB Armenia'. Considering the increasingly vast Russian investment inflows from its large corporate customers, in July 2007 VTB decided to acquire the remaining 29% of shares (VTB Armenia, 2015). However, its entry strategy in Georgia and Azerbaijan was different from that used in Armenia. Host-country governments are inclined to protect their local companies in the financial industry against the Russian state-owned bank and might not have allowed VTB to complete its ownership of local companies, causing VTB to encounter an unfavourable regulatory environment. VTB therefore entered Georgia and Azerbaijan by acquiring 51% shares in local banks and establishing strategic partnerships with host-country governments and companies. In January 2005, VTB entered into a strategic partnership with EBRD by acquiring a 51% share in the United Georgian Bank (Papava, 2012a: 65; VTB Georgia, 2005). This was intended to mitigate cross-border political risks, while gaining experience, adapting the company to the new environment and eventually increasing VTB's shares in the bank. In December 2006, the United Georgian Bank was renamed 'VTB Georgia' and VTB's shares increased to 53.17%, with 18.37% of the remaining shares belonging to EBRD (VTB Georgia, 2006). In line with the 2006 agreement between VTB and EBRD, VTB gradually started purchasing further shares in EBRD and in August 2010 consolidated its 97.38% in VTB Georgia (VTB, 2018b: 83; VTB Georgia, 2010).[133]

After considerably strengthening its position in Armenia and Georgia, VTB entered Azerbaijan in December 2008 by acquiring a 51% stake in the AF-Bank and sharing ownership with ATA

[133] For instance, in December 2008, VTB's shares in VTB Georgia increased to 77.57% and in November 2009 to 87.07% (VTB Georgia, 2009; 2008). In August 2010, VTB purchased the remaining 7.57% of shares in EBRD and consequently consolidated its 97.38% share in VTB Georgia (VTB, 2018b: 83; VTB Georgia, 2010).

Holding, which had links with the ruling elite and held the remaining 49% (I-14, 2017; I-17, 2017). A banking operating licence was issued in March 2009 and operations started in late 2009 (VTB, 2010: 18; VTB Azerbaijan, 2009). The strategic partnership with ATA Holding made it easier for VTB to secure contacts from the Azerbaijani government, to achieve easier access to the Azerbaijani market, and to analyse the local business and economy. Rasullu, a former member of the Supervisory Board of VTB Azerbaijan and a representative from ATA Holding, in September 2017 stated that VTB was planning to complete its acquisition of the remaining shares in VTB Azerbaijan (I-19, 2017). Given the L advantages of Azerbaijan, entering into a strategic partnership with ATA Holding eventually enabled VTB to purchase the remaining shares only in late 2017, nine years after its first entry (VTB, 2018b: 83). All in all, variations in the economic and institutional development of the South Caucasus countries (*see* Graphs 1, 2 and 3) and different levels of investment and trade flowing between Russia and these countries (*see* Graphs 5, 6, 7, 8 and 9) determined VTB's entry and influenced the speed at which it was able to consolidate its ownership of its subsidiaries.

RZD implements strategically important infrastructure projects abroad. In order to gain access to foreign railway infrastructure markets effectively and quickly, it first signs memorandums and cooperation agreements with neighbouring countries and companies and participates in the meetings of intergovernmental organisations.[134] This strategy was chosen to overcome high entry barriers and obtain new knowledge and experience. After September 2007, the Armenian government announced a tender for its railways, to select a concessionaire; in November 2007, RZD opened its representative office in Armenia (RZD, 2009: 47; 2008: 29); and in December, it approved a set of documents to establish a 'South Caucasus railways subsidiary' in Armenia (RZD, 2008: 29). In this way RZD started actively cooperating with the Armenian government and regulatory agencies to better secure contracts and contacts in Armenia. Consequently, the concession agreement was signed in February 2008 between RZD, South Caucasus Railways

[134] One of the first agreements on coordinating the preparation for the project to build the Astara (Azerbaijan)-Astara (Iran)-Rasht (Iran) railway line (*see* Map 14) was signed by the heads of the Russian, Iranian and Azerbaijani railways in 2005 (RZD, 2006: 58). In May 2006 another important agreement was signed between RZD, Georgian Railways and Anship LLC on the shipping of goods, using freight containers and cars, and mutual resolutions for their use in direct international rail ferry transport via Kavkaz (port) in Russia and Poti (port) in Georgia (*see* Map 14) (RZD, 2009: 44). Furthermore, one of the momentous intergovernmental meetings, the 44th session of the CIS Railway Transportation, was held in Yerevan in October 2006 (RZD, 2007: 16).

and the Armenian Ministry of Transport and Communication (RZD, 2013: 119), and later RZD won the concession for the management of Armenian railways (RZD, 2009: 6) for a thirty-year term with an option to extend for another twenty years (*ibid.*: 47). In June 2008, in the final phase of the internalisation of its investment, RZD established its wholly owned South Caucasus railway subsidiary in Armenia. After setting up this subsidiary, in December 2008 RZD decided to close its representative office in Armenia and managed to establish a joint venture with a 51% share in the Kavkaz (Russia) and Poti (Georgia) ferry lines for the purpose of ensuring communication with Armenia (*ibid.*: 11, 187). Given the political crisis between Russia and Georgia, this was achieved via Malta to avert political risks. RZD also received full management rights of Abkhazian railways in 2009 through the acquisition of assets management rights (I-8, 2017). These development activities of RZD were intended to provide logistical and transport services in contiguous states.

Unlike in Armenia and Georgia, RZD signed several agreements to carry out its investment projects, and to use Azerbaijan as a hub which would give access to new markets. To implement the intended railway project for the construction of the Astara (Azerbaijan)-Astara (Iran)-Rasht railway line as part of the north-south international railway corridor, three trilateral meetings were held between Russian, Azerbaijani and Iranian railways: in March 2008 in Tehran; in August in Moscow; and then in October in Baku (RZD, 2009: 82). After two international cooperation forums in 2010,[135] the directors of the railways of Russia, Azerbaijan and Iran, and the government authorities of Iran signed a trilateral memorandum in February 2011 (RZD, 2012: 187; 2011: 57). Consequently, tripartite agreement was reached to establish a JV in Russia, with representative offices in Azerbaijan and Iran. The main strategic decision, to enable the establishment of a JV, was the preparation of future business plans and the further implementation of the project to build a new railway line from Rasht (Iran) to Astara (Iran) to Astara (Azerbaijan) as part of the north-south international transport corridor (*see* Map 14). In 2015 and 2016, RZD and Azerbaijani railways signed new memorandums on cooperation aimed at expanding the transit potential of Russia and Azerbaijan, and developing the transportation route between Europe, Russia, Azerbaijan and Iran as part of the north-south

[135] the ‘1st International Geopolitical Symposium 1520: Strategic Dialogue’ in Moscow; and the ‘International Regional Railway Business Forum Strategic partnership 1520: The Caucasus Region’ in Baku.

international transport corridor (RZD, 2017: 98; 2016: 102). This provided promising international potential and a solid base for RZD's further development.

To sum up briefly, after obtaining O advantages in Russia, identifying the L advantages of the host countries and recognising political economy factors, the interdisciplinary paradigm has explained that VTB and RZD entered the South Caucasus markets either through M&As or management contracts, or more gradually by signing several cooperation agreements or memorandums, followed by establishing a JV or opening a representative office. As a final stage of the internationalisation process both companies also established subsidiaries, such as those of VTB in Armenia, Azerbaijan and Georgia, and of RZD in Armenia. The way they internationalised and the speed at which they did so, also varied from market to market due to various political and macroeconomic factors. For instance, as predicted by the U-model (Johanson & Vahlne, 1990), VTB established its subsidiaries in Azerbaijan and Georgia through gradual acquisitions.

8.6 Conclusion

In this chapter, I have used the interdisciplinary paradigm developed for this research to study and understand the Russian financial and railway companies' business and investment activities in the South Caucasus emerging economies. The results have shown that besides having firm-specific competitive advantages, Russia's economic and institutional development and the firms' own development have substantially influenced both companies during their internationalisation process. The level of economic and institutional development of the South Caucasus countries, as well as non-economic factors, have also affected VTB's and RZD's location choices and their operations in these economies (*see* Table 6).

Furthermore, I have investigated the Russian state's relations with the financial and railway companies through various mechanisms (*see* Table 6). These types of mechanisms have played a significant role in both firms' internationalisation. Like the telecommunications and insurance companies discussed in an earlier chapter, this type of non-resource-based firm has also been a new phenomenon in Russia's foreign FDI since early 2000s. However, both these service-based firms have received significant state support at different levels due to their importance in the Russian economy and its international relations (*see* Table 6). The findings have shown that a political economy approach has been useful for understanding these firms' investment behaviour.

Besides Russian state-business relations, state-state political and economic relations have also influenced both VTB's and RZD's investment decisions and determined their entry strategies, particularly of the Russian railway company (*see* Table 6). Additionally, military conflicts have not only brought problems, but also offered investment opportunities, such as those of RZD in Abkhazia. The political influences documented in this chapter also indicate that the state can use its financial institution and railway company for its political objectives. VTB, as an 'economic ambassador', and RZD as a 'political authority' took part in Russia's foreign relations in the South Caucasus (*see* Table 6). Moreover, I found that their long-term corporate goals, such as VTB's attempt to establish a single currency across the post-Soviet space and RZD's aim to control the north-south and east-west international transportation routes, coincide with Russia's broader foreign policy objectives (*see* Table 6). In this way the empirical results illustrate that political factors are not exogenous, and that firms consider these to be as necessary as economic factors when making investment decisions. All in all, the research findings reported in this chapter demonstrate that these emerging economy firms from the financial and railway industries, and their investment and business activities in the host countries, cannot be fully understood without due regard to the forms of state-business and state-state interactions.

Given O and L advantages, and political economy determinants, VTB and RZD entered markets through M&As, representative office, JVs, round-trip, management contracts, cooperative projects and subsidiaries (*see* Table 6). All this shows that the interdisciplinary paradigm developed for this study is a strong analytical framework with which to explain this kind of Russian investments and understand the various characteristics of the Russian financial and railway companies. In the following chapter, I conclude the thesis by identifying the contribution of my research at a number of levels and outline a future research agenda.

Firms	Investment Destinations	Entry Strategies	Expansion Approaches	State-Business Relations	State-State Relations
VTB	Armenia, Azerbaijan and Georgia	M&As and subsidiaries	Market- and strategic asset-seeking: 'follow the customers strategy', mainly corporate; to finance the Russian companies.	Very High Direct state-ownership, government appointees, former government officials, personal relations, managerial elite, frequent meetings with the president, government support and protectionism through tax reduction, finance, and intergovernmental meetings, and administrative support: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment behaviour and business activities. Acted as an "economic ambassador" to support the large Russian companies' expansion and to improve Russia's economic and trade relations with the South Caucasus countries; and involved in social activities. Involved in the development of a rouble settlement zone and economic integration.
RZD	Armenia, Abkhazia and Georgia	Representative office, JVs, round-trip, management contracts, cooperative projects and subsidiaries	Strategic asset- and efficiency-seeking investments: to control the railways network system and to benefit from the efficiency of the 1520-gauge domain.	Very High Direct state-ownership, government appointees, former government officials, personal relations, managerial elite, Long-Term Development Programmes, frequent meetings with the president, government support and protectionism through ministries, tax reduction, state-owned banks, and intergovernmental meetings: determined its investment distribution and business activities.	Military, political and economic dependence, conflicts or deteriorating relations: determined its investment behaviour, entry strategies and distribution, and business activities. Acted as a 'political authority' to support trade relations between Russia and Armenia and involved in disputes. Involved in geopolitical projects and in the development of the Eurasian transportation system.

Table 6: Russian Financial and Railway Firms in the South Caucasus Emerging Economies

Chapter 9

9 Conclusion

To address the question 'what are the main drivers of Russian investment?' and to find out 'whether there is variation across industries, firms or countries?' this research has explored resource- and non-resource-based Russian firms and their investment activities in the South Caucasus emerging economies. It contributes to existing knowledge and the IB and IPE literatures in the following empirical and theoretical ways:

First, the existing literature has claimed that Russian firms have followed similar investment strategies in the FSU but different ones in Europe, and the Russian companies and their investment operations in the post-Soviet region, including the South Caucasus, have been studied only in a very broad sense. However, exploring several Russian firms from the same and different industries and analysing their investment and business activities in the South Caucasus emerging economies has shown that the Russian firms have followed not only similar, but also different investment strategies, because of the variations in their ownership advantages and the locational advantages of the South Caucasus countries. This shows that firms' investment strategies have varied from industry to industry and from firm to firm, regardless of whether they are state-owned or private. To analyse 'why' Russian firms have decided to internationalise I used the first leg, the O element, of the interdisciplinary theory. The results show that these resource- and non-resource-based companies possess various tangible and intangible assets. They have vast and strong resource and financial bases which have enabled them to exploit the South Caucasus markets. The companies from resource-based industries have monopolistic and oligopolistic advantages. Specifically, Gazprom has a monopoly on gas exportation and transportation, Inter RAO UES is the only company dealing in electricity import and export, and RUSAL holds almost a 100% market share of the aluminium industry. In non-resource-based industries, firms have strong market positions, and among them RZD is a natural monopoly in the railway industry and controls all important rail and ferry lines.

To understand developing economy firms, especially from Russia, this research has found that since the 1990s macro- and micro-level factors have affected Russian firms and influenced their choice of internationalisation strategies. This is because, as discussed in detail in Chapter 4, these external (macro-level) factors, associated with Russia's economic and institutional development, and internal (micro-level) factors, associated with Russian firms' organisational, financial and technological development. Dunning's original eclectic paradigm (1980; 1977) therefore remained static. Given structural changes and transformations of the economy influencing firms from developing economies, the OLI was later reconfigured with the IDP (Dunning, 1988; 1986; 1981) and then extended with the incorporation of institutional factors (Dunning & Narula, 1996; McMillan, 1996; Stoian, 2013). For example, after the collapse of the USSR, Russia was in the early stages of the IDP and experienced serious political, economic and institutional problems. However, because of the huge macro-economic issues in Russia, a 'system escape' type of investment was used by businesspeople to insure their businesses and assets and to establish spare business capacity abroad. In the 1990s, under Yeltsin's reforms and polices, the oil, gas, electricity, aluminium, telecommunications, insurance and financial industries were reorganised and privatised. As a result, the following resource-based companies were established: Gazprom, Lukoil, Rosneft in oil and gas, RAO UES in electricity, and RUSAL and SUAL in aluminium (through 'voucher auctions'). Non-resource-based companies MTS, VEON and MegaFon in telecommunications, Ingosstrakh in insurance and VTB in finance were also reorganised and privatised. This was an initial stepping-stone for their internationalisation. Unlike the non-resource-based companies, Lukoil was the first company to invest outside Russia, in Azerbaijan, in the oil (1994) and gas (1996) industries; this was followed by Gazprom's investments in Armenia's gas (1997) and financial (1998) industries.

At that time, from a microeconomic perspective, non-resource-based Russian companies in particular were not organisationally or financially developed enough to invest outside Russia. In line with U-model predictions (Johanson & Vahlne, 1977), these firms were at very early stages of development. After Putin came to office in the early 2000s, the Russian government implemented several significant reform programmes. The country started to experience macroeconomic development and the restructuring and reorganisation of its resource- and non-resource-based-industries were complete.[136] Positive macroeconomic changes were

[136] In the oil and gas industries, Gazprom acquired Sibneft and renamed it Gazpromneft, Rosneft acquired Yukos, and in the telecommunications industry Northwest GSM acquired several mobile companies and started operating as MegaFon. In the electricity industry, RAO UES ceased to be a monopoly and Inter RAO UES and RusHydro became independent companies. In the aluminium industry, RUSAL merged with SUAL, and in the telecommunications industry VEON merged with Golden Telecom and MTS with Comstar. Unlike these companies, RZD was established in the 2000s after the reorganisation of Russia's railway industry. In addition to these developments, various ownership reorganisations took place in Lukoil, Ingosstrakh and VTB.

accompanied by skyrocketing oil prices, and these changes had a positive impact on the Russian companies and their investment activities. In line with Johanson and Vahlne's (1990) U-model predictions, the companies first consolidated their home-market positions and then began to follow aggressive expansion policies in the South Caucasus.

Using the second leg of the interdisciplinary theory, the L element, I identified the locational advantages of the South Caucasus countries and analysed resource- and non-resource-based firms' locational choices about 'where' to invest. Physical proximity, geographic location, physical infrastructure, host-country government incentives, the optimisation of tariff policy, tax levels and exchange rates were significant determinants in the South Caucasus. But there were similarities and differences in the role and impact of geographical proximity in the investment decisions of the resource- and non-resource-based firms. The South Caucasus markets are located close to Russia where the companies' core business segments are primarily located. This enabled them to transfer their O advantages across the Russian borders through their own firms. But non-resource-based firms were free from distance-related transaction or transportation costs because they owned no physical plant or facilities and did not need to transport their assets or products. Nevertheless, when non-resource-based firms' headquarters are located a great distance from their markets, they might encounter uncertainties in relation to their financial and operational needs because the headquarters should be directly involved in the firms' foreign operations and business activities. The inability to control and run foreign business operations in those markets might have adversely affected their businesses and financial bottom lines. Besides this variation across both types of firms, the South Caucasus countries differed in terms of their geographical locations and possession of natural resources. Unlike Georgia and Armenia, Azerbaijan has a clear comparative advantage in the region as a consequence of its energy resources and convenient geographic location which promote its use as a transport hub. Georgia is also important, because the only way of supplying resources and products to Armenia, a landlocked country, is through Georgia. This variation in the South Caucasus markets potentially determined the Russian firms' decisions about where to invest.

Besides all the factors discussed earlier, this study has shown that there is also a range of significantly important macroeconomic factors related to the economic and institutional development of the South Caucasus countries, and non-economic factors related to 'cultural and social factors' that determine both resource- and non-resource-based firms' decisions about where to invest. From the macroeconomic perspective, there is variation in the economic and institutional development of the South Caucasus countries. Azerbaijan is the strongest economy and a mature market in the South Caucasus. Because Azerbaijan is rich in natural resources (and is even perceived as a rival to Russia in that respect) [137] it was least damaged by the 2008 financial crisis, whereas Armenia, Georgia, and even Russia were seriously affected. In terms of institutional infrastructure, which received limited attention from Dunning and which he later referred to as a “neglected factor” (Dunning, 1998b), Azerbaijan has been perceived as a tough and autocratic system with high market-entry barriers and local monopolies. Moreover, Azerbaijan has a more corrupt system than Armenia and Georgia, and whereas Armenia, Georgia and Russia are members of the WTO, Azerbaijan is not. All these variations across the South Caucasus countries influenced the Russian firms’ locational choices and business activities.

In line with the U-model predictions (Hallen & Wiedersheim-Paul, 1979), the international business activities of the Russian firms in the South Caucasus have always been directly related to common cultural, social and colonial links. Another key factor in determining the investment locations of the Russian firms in Armenia was the role of the ‘Armenian diaspora’, especially in the telecommunications industry. These examples could be the real reasons for investing in Armenia and Georgia. In the case of Azerbaijan, however, strong personal connections have been very important. For example, Lukoil is the only Russian oil and gas company to have invested in Azerbaijan, but its expansion there took place not through its export activities, but primarily through its personal connections with the Azerbaijani leaders. Another example is VTB’s share ownership in ATA Holding in VTB Azerbaijan. In line with the IDP (Dunning, 1997a: 236-242) and U-model predictions (Johanson & Vahlne, 2003: 90), the empirical results of this research show that these companies invested in neighbouring countries to gain international experience, to increase their incremental knowledge and to test their accumulated experience, and then gradually moved on to new ones. The Russian firms also pursued the ‘follow the customer strategy’ in the South Caucasus. While resource-based companies followed their export and trade destinations in the South Caucasus countries, non-resource-based companies followed their corporate customers. Host-country location factors thus offered different opportunities and key interests for the Russian companies in the localisation of their investments.

[137] Azerbaijani firms in the oil and gas, electricity, railway, insurance and financial industries invest in, and supply their products and services to, the same markets as Russian firms.

Second, as an 'institutional entrepreneur', the role of a state is crucial for both developed and developing economy firms and plays a necessary role in the macroeconomic development of a country, the transformation of markets, and the establishment of industries and firms. The empirical findings documented in this study show that the Russian state has established a specific form of state capitalism which has shaped and affected both state-owned and private companies - when, where and how they internationalise. Its role and its various forms of intervention went far beyond encouraging industrial development and firms' expansion, particularly in certain industries that have strategic importance for the Russian economy and its relations with other countries. This makes the firms fulfil their government's political objectives, which are also part of a national economic policy to achieve political affirmation for the home country at a regional or global level. The research results indicate that among resource-based industries this has been very evident in oil, gas and electricity sectors, but only to lesser extent evident in aluminium. Among non-resource-based industries, state intervention has been more intense in the financial and railway sectors, whereas in telecommunications and insurance sectors it has been lower. Therefore, given these variations and the locational advantages of the South Caucasus emerging economies, the role of the Russian state has been important in exploring and analysing Russian companies' business activities.

As a large developing economy, Russia has created various mechanisms to bring its government and firms together. The Russian state has intervened in firms either directly or indirectly through ownership structure, management, networks/personal connections, financial dependence, government regulations and policies, ministries and business associations. Through these mechanisms, the state has provided the companies with a variety of support such as tax incentives, massive financial backing, diplomatic assistance, total administrative support, protection for their investments in host countries, and specialists in the targeted economies, and has acted as a coordinator during the early stage of the firms' internationalisation, which has increased their ownership advantages to exploit the targeted markets. The state's relations with companies from the same or different industries has varied, however. The results also show that the Russian state, through direct and indirect involvement in firms' investment and business activities has affected their expansion strategies, timing, location choices and behaviours. These interactive relationships between the Russian state and its companies have shaped its political and economic objectives and its firms' strategies and aims.

State-ownership is a unique form of interdependence between Russian firms and their government, and variation in firms' ownership structures, including majority or fully controlling stakes and a golden or minority shares, has influenced firms' behaviour and performance. Gazprom, Rosneft, Inter RAO UES, RusHydro and VTB are state-owned companies with majority stakes, whereas RZD is a wholly state-owned company. These companies are controlled directly and indirectly through various fully or partially state-owned entities. It needs to be highlighted that the Russian state was a minority shareholder in Lukoil until September 2004 when ConocoPhillips obtained the Russian state's residual stake. This has been a key factor in the state's interaction with them. In Russian state-owned firms, the Russian government often appoints top management and can even swap appointed managers. These 'trusted individuals' have political relations with the government and allow the state to influence firms' decision-making behaviour. This study has shown that the presidents of the state-owned firms meet frequently with the Russian president to discuss their business performance and future investment projects. This type of behaviour and the importance of meeting with government officials on a regular basis have also been evident in other large developing economies (Rodrik, 2011: 144-148; Rutland, 2001: 25; Schneider, 2015: 4). The study's findings show that state-ownership mattered for FDI, or accelerated the firms' acquisition processes in host countries. But besides this, where there are close home-host country relations, in other words where the host country economically and politically is dependent on the home country, have been significantly important during firms' internationalisation processes.

Given state-ownership and state-appointed managers, it is believed that state-owned companies are more influenced by state intervention than private ones, and that they often fulfil state interests and lobby for assistance. However, as discussed in chapters 5-8, both type of firms and their presidents recognise the high importance of state intervention and state policies. The Russian state can influence its MNCs through various other mechanisms, regardless of their affiliation. Alongside the state-owned companies, the private ones have also developed close relations with the Russian state and have mainly benefitted from its support in the early stages of internationalisation. These politically connected firms have taken advantage of their political networks to access key resources for their internationalisation and development. So in this research the comparison of firms' investment and business operations from the same and different industries suggest that the state-private divide is not decisive.

The presidents of these firms are described as Kremlin-friendly private investors and their managers still hold multiple positions at government agencies and other companies. These managerial elites meet with the Russian president when they need special help and support, and appoint other politically connected people. These companies have also received huge support via intergovernmental meetings between Russia and the South Caucasus countries. This type of support has been very important, especially for firms in the energy sector, and has sped up internationalisation processes for both state-owned and private companies, consolidating their market positions and maximising their revenues. Empirical examples include Lukoil's participation in, and Gazprom's trade deals with, Azerbaijan; Rosneft's and RusHydro's involvement in Armenia; Gazprom's investment and business operations in Armenia and South Ossetia; and Inter RAO UES's management of Enguri HPP which is located between Georgia and Abkhazia. Both meetings with the president and intergovernmental meetings were also very decisive in the initial stages of firms' internationalisation where firms had limited international experience, particularly the telecommunications and railway companies in Armenia and Abkhazia. This shows that the role of the state has been key to both types of Russian firms' internationalisation. Through their owners, the private companies were and still are either directly or indirectly linked to the Kremlin. Moreover, these companies inherited unique accumulated experience, contacts, foreign customers, excessive capital and facilities from the Soviet era. Their inherited and strong management- and organisation-based ownership advantages enabled them to gain and accumulate market knowledge in terms of business, the market and the culture of the targeted markets and later paved the way for them to gradually increase their presence in the South Caucasus markets. These types of informal ties between the state and its firms are viewed as a feature of large developing economies, such as Chinese network capitalism (Lin & Milhaupt, 2013: 701; Xing & Shaw, 2013: 95).

All Russian firms have resource dependence on their state and state agencies and can be influenced by the state directly or indirectly. For instance, main markets, vast resource bases and the financial power of Russian firms are accumulated in the Russian state. VTB is a key financial tool and receives administrative support from the Russian state to finance Russian companies and investments abroad. In other large developing economies, such as China and Brazil (Chen *et al.*, 2010: 1508-1509; Conti *et al.*, 2016: 1983; Dinç, 2005: 453), the state is also viewed as a crucial player in the financial industry, and resources are commonly controlled by the state. Moreover, the Russian state possesses several regulatory and macro-level policies, including income taxation, tax rebates, and investment guidelines. Major transactions and investment projects, particularly those in resource-based industries, have required the approval of the Russian state, regardless of firm type. Besides this, the Russian state has formed a set of firm or industry specific investment programmes. All this controls firms and influences their internationalisation strategies, to both serve the country's economic development and advance firms' global competitiveness. Unlike VTB, the Russian state has formed LTDPs for Gazprom, Rosneft, Inter RAO UES, RusHydro and RZD to target and implement investment projects and to achieve their strategic goals. Furthermore, the Russian state has formulated an 'investments-for-debts' scheme with Gazprom in some countries, and with VTB and RusHydro aimed at solving RusHydro's financial debts. This type of policy can also be found in China, for example in its 'go global' polices (Hoskisson *et al.*, 2013: 1306; Wang *et al.*, 2012a: 429).

This thesis has demonstrated that both state-owned and private companies have a different sense of loyalty and range of interests to the Russian government. If they had violated the Russian government's political objectives or acted against its strategies or policies, they would have been subject to a lot of government pressure, and could hardly have resisted implemented or altered government regulations, and eventually lost their assets, like Yukos for example. Even in today's developed economies, such as South Korea, private firms would not have developed if they were not loyal to their government, and the development of the private sector has almost entirely relied on direct government support and regulations (Buğra, 1994: 7-8). Both types of firms also frequently cooperate with the Russian state agencies and authorities as well as business associations, to receive effective support and to resolve any host-country operational issues.

The research findings indicate that there is a mixture of political and economic motives behind all these state interventions through various mechanisms. This, in fact, has helped Russian firms during their expansion, but in return obliged them to conform to government objectives and to improve and develop relationships with the host countries. These examples illustrate that these companies act as lobbyists and advisers, or, as Susan Strange (1992: 10) might put it, 'diplomats', and the level of state support and involvement varies greatly according to a company's significance to the Russian economy and its interests. The exchange relationship between Russian MNCs and their home government sometimes makes it hard to separate their business interests from Russian government interests. Taking all this into account, by considering state-business relations I therefore developed the interdisciplinary theory to explore the Russian state's role in firms' investment activities in the South Caucasus.

Third, this research has found that Russian firms' business and investment decisions about where and how to invest are also determined by interstate political and economic relations. Some investment and business projects are realised and discussed at the intergovernmental level with the participation of home and host country leaders and their firms. Given state-state, state-business and business-business relations, known as 'triangular diplomacy', in an increasingly integrated international political economy, countries and firms have encountered different opportunities for, and restrictions on, using investments to further their foreign leverage or for development. There are strategic considerations behind Russia's diplomacies in resource-based industries. A mixture of political and economic motives is therefore often interlinked in these industries, because non-resource-based firms' investments account for most of the country's FDI, are the main bearers of the country's economic development and can produce political benefits. The impact of resource-based firms on the South Caucasus host countries is also significantly high. This was also confirmed by my respondents from the South Caucasus countries. Unlike Russian resource-based firms, the expansion of non-resource-based ones started in the early 2000s, although their FDI and impact on the South Caucasus host countries has been relatively low. This has also been the case for other large developing economies (Chen, 2008; Filippov, 2008; Lane, 2001; Pleines, 2009; Rosen & Hanemann, 2009).

The research has found that both firm and industry types of companies have relied on interstate political and economic relations. First, this dimension has been an important determinant of firms' decisions to enter markets. Second, Russian firms have used the political advantage or process in their favour when locating their investments in the South Caucasus countries. Third, considering the political and economic relations between Russia and the South Caucasus countries, discussed in detail in Chapter 3, the state's intervention in these firms, their decisions, and firms' close cooperation, at least with the Russian state and its state bodies, it is necessary to consider how political factors affected their investment activities in the South Caucasus emerging economies.

Since the collapse of the Soviet Union, Russia has established the closest relations with Armenia. Moreover, Armenia has also been politically, economically and militarily dependent on Russia. Armenia is landlocked because of political disputes with Azerbaijan and Turkey. However, unlike Azerbaijan and Georgia, Armenia's largest trade partner has always been Russia. This made it easier for Russian companies to invest in Armenia. The investments of Gazprom, Rosneft, RZD and MegaFon in Abkhazia and South Ossetia, and Lukoil's first international investment in Azerbaijan, were also the result of political factors. However, these investment opportunities were not all the same. Although political motives were significant in driving Gazprom's and RZD's investments, it was commercial interests that influenced those of Rosneft, MegaFon and Lukoil. RZD's investment in Armenia was also politically driven, as it was linked to its goods and passenger trade for state, military and other special-purpose transport requirements.

Political events in the South Caucasus have determined the distribution of Russian firms' investments and trade activities, and their locational choices, as well as their entry and business strategies. Therefore, firms include these political issues in their investment scenarios either to reduce risk or to profit from it. In other words, political instability not only brings restrictions, but also creates investment trends and profit opportunities. Inter RAO UES and VTB in Georgia have both been involved in social activities to demonstrate their political responsiveness and improve their firms' images. Because of the political disputes between Russia and Georgia, RZD entered Poti in Georgia via Malta to stimulate traffic with Armenia, and VimpelCom moved its headquarters to Amsterdam in 2009 before being rebranded as VEON in March 2017 to remove the remaining 'Russian labels'. Rosneft entered Georgia by using a JV to reduce the political risks, as it already had investments in Abkhazia. By contrast, this political crisis affected RUSAL's transportation costs, as Georgia is a transit country. Lukoil has good business in Georgia and therefore has no investment or marketing activities in Abkhazia or South Ossetia. Moreover, whilst there are Russian investments in Abkhazia and South Ossetia, no Russian companies have been involved in the Nagorno-Karabakh region. These variations exist because Russia has different relationships with all the South Caucasus countries, and because of differences between the Nagorno-Karabakh and Russo-Georgian conflicts. Given the political risks in the region, MTS did not enter Georgia and Azerbaijan.

Fourth, the study has shown that in today's international business an understanding of politics is vital for Russia in particular, as well as more generally. Since firms have become political actors in building, maintaining and moderating political and economic relations between home and host countries, their investment and business activities have also been considered as major supplements or corporate tools of the home country's foreign policy. They also play a role in the development of economic integration in the region. As such, it should be considered a significant factor in firms' investment decision-making, and business scholars need a deeper grounding in this topic. As corporate players, the Russian firms have all played their roles in intergovernmental relations. Gazprom, Rosneft, Lukoil, Inter RAO UES, RusHydro, RZD and

VTB have each had a different role. Gazprom is the only company which has been involved in political disputes in the South Caucasus; Lukoil invested in Azerbaijan to moderate the relations between Russia and Azerbaijan in the 1990s and since then has been the only Russian oil and gas company to operate there. A similar example was Inter RAO UES's involvement as a diplomatic actor in placating relations between Georgia and Abkhazia. Moreover, RZD's objective is to intensify trade relations between Russia and Armenia. VTB has followed a similar policy to RZD, but another role is to support all Russian investments through its economic ambassadors.

FDI is therefore more influential than trade and is used by the Russian state as a strategic instrument for a variety of motives or reasons: to gain access to the South Caucasus markets, take over or control strategic assets, and to isolate host countries from others and make them dependent on the Russian state. For instance, after the collapse of the USSR, Russia's power in the FSU was weakened and the West's broader political objectives in this region started growing and its relations with the former Soviet republics became very intense. The West began supporting its firms and their investments in certain regional projects in the South Caucasus that aimed to prevent Russia from becoming involved in these projects and counterbalancing its political and economic power in the region. This western intervention in Russia's traditional sphere of interests could weaken its power in the region. Given this, the Russian state as part of its broader foreign policy has therefore started supporting both its resource- and its non-resource-based companies and using them as 'geoeconomic weapons' to restore and fortify its economic and political position. This type of policy practice is often adopted by large developing economies, such as China, as an international economic strategy(Cooper, 2004; Drezner, 2009; Kennedy, 2010).

Meanwhile, Russia introduced several integrational projects to restore its power in the FSU and eventually achieve its broader political goals. Since the early 2000s, large-scale investment projects implemented by Russian firms have started illustrating corporate integration. In other words, their investments have become a vehicle of 'deep integration'. In the development of Eurasian integration, known as the EEU, the Russian oil, gas, electricity, railway and financial companies have each played their part in improving and developing customs administration procedures and policies. In the long term, Inter RAO UES's and RusHydro's aims are to develop the Eurasian power system, RZD's to develop the Eurasian transportation system by controlling north-south and west-east international railway routes and VTB's to establish a rouble settlement zone. Among these companies, Gazprom has played a decisive and effective role in Armenia's decision to join the EEU. All these results imply that these MNCs' long-term corporate goals conform to Russia's broader foreign policy objectives in the region.

All the empirical examples documented in this thesis show that as a result of the various political events in the South Caucasus, the differences between the South Caucasus countries and in their relations with Russia and each other, there are variations in the Russian firms' investment and business strategies, timings and political roles as corporate players. The factors and examples discussed above demonstrate that politics and economics are strongly intertwined with these Russian firms' investments and business operations. In another example, amidst growing political tensions after the 2014 sanctions, Gazprombank sold its subsidiary in Armenia. Considering political events and changes, the South Caucasus countries represented different interests and abilities to the Russian firms. They therefore added political factors to their investment and business scenarios to profit from it. Furthermore, these companies not only contribute to the Russian economy but also play a significant role in Russia's foreign economic relations. In other words, the corporate goals of these Russian firms sometimes serve Russia's political interests. These examples also show that there is continuity with the Soviet Union in today's Russian firms' business activities. The research findings show that state-state relations have been an important determinant and influenced Russian firms' business and investment operations, and I therefore developed the interdisciplinary theory to examine this.

Given all the economic and political determinants, using the third leg – the internalisation sub-paradigm – of the interdisciplinary theory, I examined how the Russian companies entered the South Caucasus markets. JVs were the most preferred entry strategy in the expansion of the Russian oil and gas companies, but not for companies from the other industries. Among the other companies discussed in this study, RZD also established JVs in Georgia via Malta, and in Azerbaijan with the Azerbaijani and Iranian railways administrations for the preparation of future business plans and the further implementation of the project to build a new railway line. This JV is located in Russia but has representative offices in Azerbaijan and Iran. Unlike the oil and gas companies, the electricity, aluminium, telecommunications, insurance and financial companies mainly entered the South Caucasus markets through M&As in local companies with a clear path to controlling and expanding geographic clusters in the South Caucasus. Moreover, Inter RAO UES, RUSAL, RZD and Ingosstrakh used strategies such as licensing agreements, management contracts, turnkey contracts, opening representative offices and cooperative projects through intergovernmental agreements. Among them, only RZD and Ingosstrakh entered the market by opening representative offices; RZD's in Armenia and Ingosstrakh's in

Azerbaijan. RZD and Inter RAO UES also established strategic partnerships and cooperative projects with host-country companies and with the government in Azerbaijan to gain fast and effective access to markets, and to develop their international projects by using Azerbaijan as a hub. Moreover, Inter RAO UES's and RZD's investment activities in Armenia and Georgia show that they simply took over the management and use of the rights of local operating companies through management contracts and licensing agreements. RUSAL signed a turnkey contract with the Armenian government and became the sole owner of the asset.

All in all, considering various political and economic issues between South Caucasus countries, and variation across their relations with Russia and the West, as well as their economic, industrial and institutional development, Armenia has been unsuccessful in resisting Russia's companies and its powerful influence. The results show that Gazprom, Rosneft, RUSAL, RZD, MTS, VEON, Ingosstrakh and VTB have established subsidiaries in Armenia. Other examples show that other Russian companies, RusHydro, Rosatom and the Tashir Group entered the Armenian electricity market by taking over assets from Inter RAO UES. Unlike Armenia, Georgia has been relatively successful in resisting Russia, whereas Azerbaijan has been described as a competitor in some respects. Lukoil, VTB and VEON operate in Georgia through their subsidiaries. RZD and MegaFon are the only companies that have formed subsidiaries in Abkhazia and South Ossetia. Lukoil and VTB are the only Russian companies to have subsidiaries in Azerbaijan.

The evidence presented in this thesis has shown that given state-business and state-state relations, as well as other political factors, each firm should be treated differently. This is because the interdisciplinary framework developed for this study has explained well the role of the state and its interventions in state- or privately-owned firms from the same or a different industry, and also allowed both a comparison of these firms' internationalisation processes and business activities, and, importantly a separation of political considerations from economic ones, rather than generalising and counting all state interventions as political considerations. In general, first, firms want to expand their businesses with minimum loss and run them smoothly. Second, as part of their national economic or foreign policies, states have their own interests in firms' business and investment activities. Third, given the first and second reasons, firms and states may collaborate on achieving common objectives, work together whenever one party needs help, and support each other, and of course this may vary from industry to industry, from firm to firm and from country to country.

Therefore, the Russian state's relations with or interventions in its firms have varied from industry to industry and from firm to firm. So, this research has clearly distinguished political and economic motives underlying the Russian firms' investments and identified state interests as well as the interests of firms. I have also shown here that today's international business politics is not just associated with IR, it is also highly important in IB. The results show that politics is considered to be one of many drivers of investment strategy which has brought both opportunities and risks for the Russian firms. In summary, the interdisciplinary theory developed by incorporating political economy determinants, including state-business and state-state relations, alongside macro- and micro-economic factors, has provided a good basis for understanding Russian firms' investment activities and identifying the real motivations behind their expansion, their impacts on the countries in which they have invested and their roles in interstate relations as corporate players.

Finally, to explain international production, especially of firms from Russia, in some existing studies the IDP and U-model variables have quite often been incorporated into Dunning's eclectic paradigm. In light of these theoretical perspectives, the empirical part of this thesis has discovered that economic factors need to be complemented by the other approaches, and the relative importance of these factors varies across industries and firms. The political economy approach has been helpful in understanding Russian firms and useful in explaining their internationalisation. Thus, economic and business factors have been inadequate to explain Russian resource- and non-resource-based firms and their investment and business activities, which have necessitated the incorporation of state-business and state-state relations factors as well as other political considerations into Dunning's eclectic paradigm. Moreover, the results of this thesis show that political factors are not exogenous, and that they have been as crucial as economic factors in influencing firms' strategies and behaviours. Furthermore, the political economy approach remains inadequate to explain firms' efforts to maintain close relations with a government which has minimal interventions in their investment and business operations. So, the thesis has shown that firms have increasingly become influential actors in today's international political economy and international relations. All in all, the research highlighted the practicality and flexibility of Dunning's framework, which (in line with the facts, Dunning's acknowledgement of the need for further development of his framework, and his development of the theory over time) has allowed me to build a more comprehensive theory. Taking all this into account and considering the inadequacy of existing FDI theories, this research has resulted in the development of an 'interdisciplinary theory'. The study provides a better understanding of Russian firms and their investment and business activities, and of today's international business and firms' investment strategies, offering empirical examples and theoretical justifications.

This study has shown that the interdisciplinary theory that I have developed here is an analytical framework well-suited for exploring and analysing the various determinants of Russian firms' business and investment activities. However, the study does have some limitations. First, the use of the research materials from government and company reports and interviews could have been maximised by conducting a more detailed quantitative analysis or an econometric analysis of FDI. But, unfortunately, there were statistical deficiencies in the FDI statistics, as explained earlier. Using quantitative analysis in IB studies is of uppermost importance to discover and analyse new phenomena in comparing or contrasting analysis with research findings discovered through other study methods. Time and money were the second and third limitations; the budget was small as this study was self-funded, and limited time was available. Without these limitations, the study could have incorporated more interviews, especially with representatives from the Russian corporations and their subsidiary companies as well as home and host country partners.

Taking these limitations into account, this research could be further developed by using econometric analysis and more interviews to explore Russian firms' investment activities in the South Caucasus yet more deeply. In the future, researchers could also extend the findings reported here by using the interdisciplinary theory developed for this study to explore and analyse the similarities and differences between the investment activities of Russian and foreign companies in the South Caucasus. The interdisciplinary theory could also be used to investigate other big emerging economy firms, including Chinese firms, to explore whether other countries also engage in this process. If so, this could allow us to understand why and how, and to analyse whether this is something new or specific to certain sorts of developing or authoritarian countries, or a reassertion of an old pattern that was used by today's developed economies. In spite of these weaknesses however, the study has been both worthwhile and timely in allowing me to extend Dunning's theory and providing rich information about Russian firms' expansion into the emerging economies of the South Caucasus and contributes to the theoretical IB and IPE literatures. Moreover, the results enable a better understanding of the development of firms' internationalisation processes and can serve as a reference and guideline for researchers and policymakers.

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