Saul Estrin Klaus E Meyer March 28th, 2023

Why it’s so difficult for companies to leave Russia

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After the start of Russia’s war on Ukraine, many multinational companies announced their intention to leave Russia. But despite the pressure from numerous stakeholders, including Western governments, few companies have managed to get out of the country. ***Saul Estrin*** *and* ***Klaus E Meyer*** *have studied multinationals’ exit strategies and write that four sets of challenges may explain their sluggishness in leaving Russia.*

Since the start of the Russia military invasion of Ukraine in 2022, numerous stakeholders have been lobbying multinational enterprises (MNEs) to disengage from Russia. Western governments have imposed sanctions that restrict many (but not all) business activities in Russia and many companies have announced an intention to exit from the country.

Yet, only relatively few companies so far have actually fully divested their Russia operations, though more than a thousand have announced their intention to curtail their activities. The Yale CELI List of Companies that have curtailed operations in Russia still features several hundred companies rated “F” – meaning they are essentially maintaining business as usual in Russia. Evenett and Pisani find that only 9% of foreign firms operating in Russia have closed down at least one of their subsidiaries.

We explore this question of multinational exit strategies, with a focus on Russia. In previous work, we have reviewed the evidence on the consequences of sanctions, and developed a framework for corporate decision-making when faced with political adversity. Even with the best of intentions, managing an exit is actually very difficult. This leads us to suggest the sluggishness that MNEs display in leaving Russia is due to four sets of challenges.

1. Interdependence of global operations

MNEs tend to function on the basis of internationally dispersed operations which are integrated globally and connected by intensive flows of products, technology and people. This organisational architecture implies that the decision to close a subsidiary in one country will necessarily impact global operations, not always in straightforward ways.

This interdependence may be small when the subsidiary solely has a sales and service role, as for example in restaurant franchises such as Starbucks or McDonalds, or specialist retailers such as Decathlon and OBI. However, the interdependence is high, and disruptive for the parent organisation, when the subsidiary is procuring critical raw materials or intermediate products for the parent that cannot easily be obtained elsewhere as does for example Danish building materials producer Rockwool.

The interdependence is complex in many manufacturing value chains where products and knowledge flow in multiple directions between units in different countries. This would be common, for example, in the automotive and machine tool industries. Thus, companies have to change and extend their supply chains if they close one operation, which can be slow if they seek to avoid disruptions or supply quality problems.

2. Ethical challenges

Many activists argue that continued presence in Russia equates to supporting Russia's military activities in Ukraine and/or human rights abuses in the country, and therefore companies ought to withdraw. However, ethical considerations can also arise when leaving a country.

First, what are the moral obligations to the people in the country? First and foremost, these are the employees. Moreover, food producers or retailers such as Bonduelle or AUCHAN serve vulnerable populations such a low income groups. Even more worrying, pharmaceuticals and healthcare companies, such as GSK, Astra Zeneca or Siemens Healthineers, provide essential medicines. Withdrawing medical treatments creates more human rights challenges than it resolves.

Second, what happens to the assets of the company after the exit? Will these assets end up in the hand of local oligarchs or a hostile government? For example, Unilever argues that "were we to abandon our business and brands in the country, they would be appropriated – and then operated – by the Russian state. In addition, we do not think it is right to abandon our people in Russia". This is a particular concern for companies with distinct technologies, intellectual property, or customer data (think telecom or internet service providers) that may be abused if falling under direct or indirect state control.

Third, will the exit create opportunities for third parties (from 'neutral' countries) to bypass the sanction regime, thus nullifying any potential negative effect of the exit on the host economy? Russian entrepreneurs certainly are eager to exploit business opportunities that fill voids left by departing Western brands.

3. Operational challenges to selling a business

Liquidating a fully operational company completely is rarely the best course for an MNE not only because of the financial loss, but also because of likely host government responses. It may for example pre-empt a departure of the business by expropriation. However, selling a business unit is a complex transaction that requires extensive negotiations with various partners.

First, potential buyers are few and far between, not least as a result of sanctions which affect new foreign direct investment and transfers of capital in and out of the country. Hence, the value of the business unit is much reduced – and the market for corporate control is very thin. McDonalds in Russia were able to sell to their local management team, and the business continues almost unaffected by the ownership arrangements and a new brand name. Also Goldman Sachs sold some operations to its own employees. Yet not every management team has the competences and financial means to make a management buy-out work.

Other than managers, potential investors may originate from third countries that did not introduce sanctions, though these too may be concerned about the impact of sanctions by the EU or US on their other markets. These buyers likely have lower valuations of the assets to that of the exiting company.

Second, if the MNE is withdrawing for ethical reasons, it would probably want to make sure the buyer lives up to comparable ethics standards, e.g., with respect to supplying the military and or ensuring the maintenance of employment standards. However, finding local buyers willing to commit to that and enforcing such contracts may be very difficult.

Third, the Russian subsidiary may not be a viable separate business unit with all the supporting structures an ongoing business needs, such as accounting, information technology and leadership team. Moreover, many companies operate in regional structures where Russia operations are just part of a regional organisation that also includes, for example, Ukraine. For example, Carlsberg's Russia operations were an integral part of its operations across several states of the former Soviet Union, and creating a separate entity that could be sold to a new investor was a complex process. Taking international premium brands out of the operation is the most visible aspect of that, but practically more challenging is disentangling back office functions and IT systems.

4. Russian policies

In practice, the Russian authorities may have considerable bargaining power via-á-vis subsidiaries of MNEs operating within its boundaries. These may be inherent in the legal structure, or deliberately created as response to foreign companies' non-cooperation with the local authorities.

First, any foreign subsidiary operates under the laws of the host country. In consequence, the subsidiary would typically have many contractual and legal obligations from which it cannot simply walk away. A sudden withdrawal is likely to result in legal action by business partners, or by the authorities. Moreover, any sale of a business unit would be subject to the usual regulatory approvals for M&A, especially in highly regulated industries such as finance, telecommunication and mining. Philip Morris' CEO Jacek Olzak thus argued the Russia authorities made it impossible for them to leave "the talks have stalled because nobody knows how I can make it work".

Second, some companies allege that the Russian authorities deliberately create obstacles to their withdrawal strategies by expropriating their assets. For example, German energy group Wintershall reported that €2bn worth of assets had been expropriated in Russia, and it was exploring how to sue to Russia state to recover the assets. These legal cases are insufficiently transparent to assess, but the incentives for the Russian authorities to act in this manner are strong.

Conclusion

The case for exiting Russia is strong for many companies for both economic and ethical reasons. Companies which have left have often found their standing, and their market valuation, benefitting from such a move. Yet, finding the exit door is not easy.

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