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MNC OPERATIONS IN EMERGING MARKETS: POST-CRISIS ADJUSTMENTS OF FDI INFLOWS IN CHINA AND RUSSIA

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OVERVIEW

As the effect of the global financial crisis spreads, foreign direct investment (FDI) worldwide turned sluggish. As the world's two largest emerging economies, both China and Russia, saw a slowdown or even some decline in FDI inflows. The decline of FDI inflow into China can be attributed to three factors. First, tight credit caused by the global crisis has slowed down overall investment activity worldwide. Second, part of the profits or cash reserves generated by MNCs in China has been redirected to support troubled parent companies, instead of being reinvested in the country. Third, the once-guaranteed appreciation of Chinese currency, Yuan, has slowed down since the start of the crisis, which, as a result, has removed one of the key incentives of FDI by MNCs in China. The decline of FDI inflow into Russia can be largely attributed to the sharp decrease of commodity prices and personal wealth.

Although both China and Russia are experiencing a decline in FDI inflows, it does not mean that all MNCs are reducing investment in these two large emerging markets. In contrast, some MNCs are actually increasing investment to capture the opportunities created by the global financial crisis and the responses of Chinese and Russian governments. In this report, we examine the post-crisis adjustments of FDI inflows in China and Russia, particularly regarding the changes in government policies on FDIs, MNCs' reactions and changing investment strategies, and the impact on local Chinese and Russian firms.

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CHINA

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CHANGES IN FDI INFLOW IN CHINA

China has been doing a great job in attracting foreign direct investments (FDIs) over the last two decades. China started to attract foreign investments when the country embraced its reform and opening-up policy in 1978. The pace was slow initially. According to the data from the Ministry of Commerce, China absorbed merely US$1 billion in FDI in the early 1990s. FDI inflow then surged and has since become one of China's leading sources of external financing. China's entry to the WTO around 2004 created another surge in FDI inflow. In 2008, China absorbed a total of $92.4 billion FDI, representing a 23.6 percent year-on-year growth and accounting for about 7.7 percent of the world's total FDI inflow of the year.

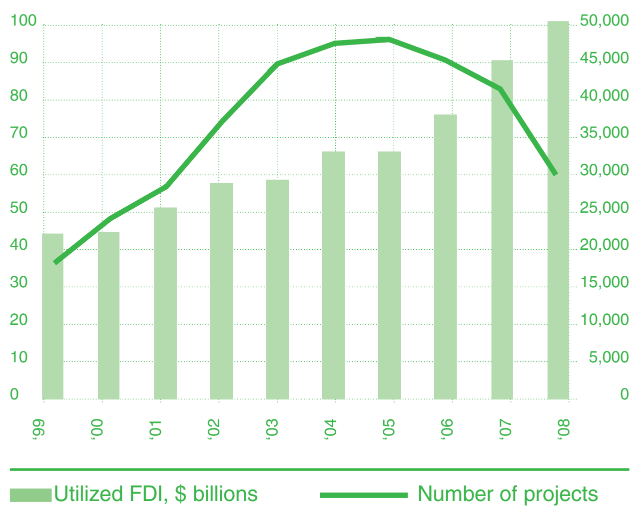
FDI has greatly contributed to China's economic growth, industrial and technological advance, export expansion and the creation of employment. In 2008, foreign-invested enterprises (FIEs) employed about 10 percent of country's workforce, contributed 21 percent of corporate income tax, produced nearly 30 percent of industrial outputs, and contributed about 55 percent of foreign trade, even though this sector accounted for only 3 percent of total enterprises in China.

China has also become increasingly important to many of the world's large multinational corporations (MNC). About 480 of the Fortune 500 corporations have established FDI projects in China, including over 1,000 R&D centers. More than 40 of these MNCs have their regional headquarters in China.

Source Countries and Regions. There has been a shift in the source countries and regions of FDI inflow to China in recent years. Compared to ten years ago, when major developed countries, such as the United States, dominated the list of top investing countries, there has been a significant increase in the amount of FDI inflow from tax haven countries such as British Virgin Islands, Cayman Islands, West Samoa, and Mauritius. In 2008, FDI inflow from these tax haven countries totaled $24.40 billion, accounting for 26.41 percent of the total FDI utilized in China.

In 2008, the top ten source countries and regions of FDI inflow to China were: Hong Kong ($41.04 billion),

FIGURE 1/ China's FDI Inflow (1999 — 2008)



Data source: Ministry of Commerce (2009)

British Virgin Islands ($15.95 billion), Singapore ($4.44 billion), Japan ($3.65 billion), Cayman Islands ($3.15 billion), Korea ($3.14 billion), United States ($2.94 billion), West Samoa ($2.55 billion), Taiwan ($1.90 billion) and Mauritius ($1.49 billion). These countries and regions contributed to 86.85 percent of the total FDI utilized in China[1].

Entry Mode. In the 1980s, most FDI in China (about 80 percent) took the form of joint ventures with local firms. In the 1990s, most (about 60 percent) took the form of wholly-owned foreign enterprises (WOFEs). In 2008, WOFE was still the primary mode of FDI in China. There were 22,396 new WOFEs absorbing foreign investment of $72.3 billion, which accounts for 78.3% of total FDI utilized in China. There were 847 M&As by foreign companies for $2.1 billion, which accounts for only 2.25% of total FDI utilized in China. The scales of the M&As are usually small. Over 80% of the M&As were below $10 million, and less than 1% of the M&As were above $100 million[2].

Industry Sector. There has also been a change in the distribution of FDI among industry sectors. In the manufacturing sector, the majority of FDI went into labor-intensive industries such as textile in the 1980s, and went into mechanical and electronic product industries in the 1990s, catering to export-oriented investment strategies. Since 2000, more and more FDI went into high-tech industries. In 2008, the manufacturing sector received foreign investment of $49.9 billion, representing a 22.1% increase from 2007 and accounting for 54% of utilized FDI during the year. The high-tech industries, led by electronics and communication equipment, received $11.2 billion, representing a 16.2% increase from 2007[3].

The services sector has seen a significant increase in FDI inflow. The Chinese government has been actively promoting foreign investors to enter the services sector because it can help absorb the country's redundant labor force. In 2008, the services sector, excluding financial services, received foreign investment of $38.1 billion, representing a 24.2% increase from 2007 and accounting for 41.3% of utilized FDI during the year. The financial services sector absorbed FDI of $15.9 billion, representing an 81.9% increase from 2007.

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Agriculture and related industries have also seen a surge in FDI inflow recently. This sector received foreign investment of $1.2 billion in 2008, representing a 28.9% increase from 2007.

IMPACT OF THE GLOBAL FINANCIAL CRISIS ON FDI IN CHINA

Although China absorbed a record of $92.4 billion in FDI inflow in 2008, the growth rate of monthly FDI inflow (on a year-to-year basis) actually turned into negative in the fourth quarter of the year. This trend continues in 2009. Up to June 2009, FDI inflow to China has experienced negative growth for nine consecutive months. China absorbed only $43 billion in FDI during the first half of 2009, representing a 17% decrease from the first half of 2008.

CHANGES IN GOVERNMENT POLICIES

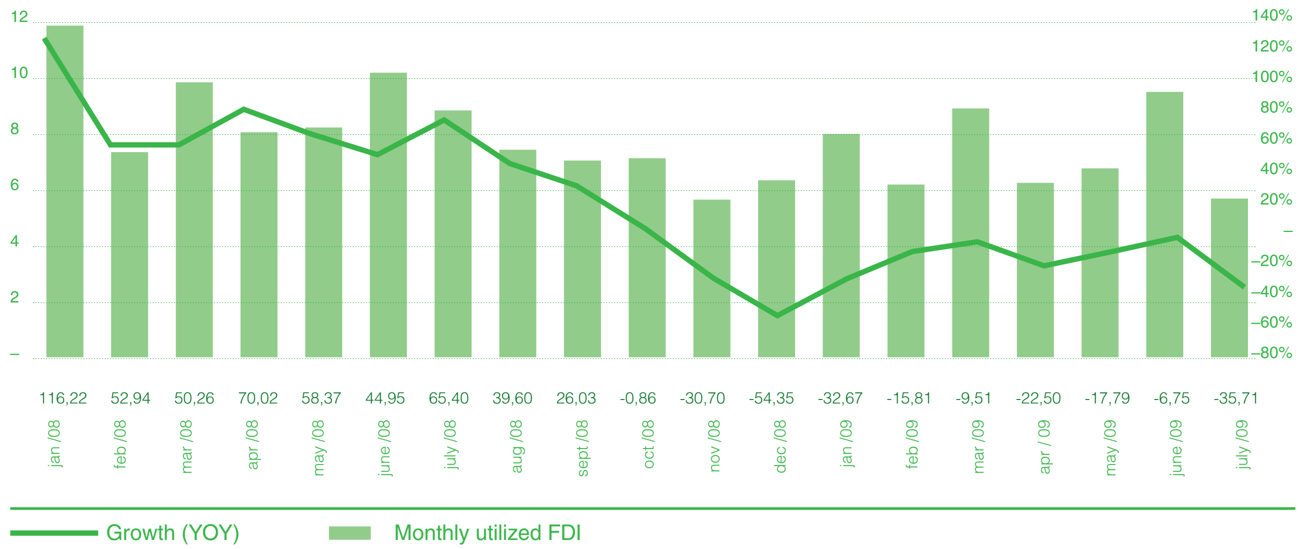
In response to the global financial crisis, the Chinese government quickly unveiled a $586 billion stimulus package on November 9, 2008 to revitalize the country's slowing economy. The money will be spent over the next two years to finance programs in 10 major areas, such as low-income housing, rural infrastructure, water, electricity, transportation, environment protection, technological innovation and rebuilding from several disasters[4].

Chinese government has also adjusted policies to attract foreign investment. For example, the central government relaxed and decentralized the regulations on foreign investment in recent months. Local governments are now authorized to approve foreign investment projects worth up to $100 million without seeking ministry-level approval. This relaxation and decentralization in authority applies to business start-ups, acquisitions of domestic firms and expansion of existing operations of foreign-owned companies. In addition, the government has lowered the export quota for FIEs so that FIEs can supply the domestic markets rather than meet the export quota of their outputs.

Another change in government policies is to make the central and western regions more attractive to foreign investors. To attract foreign investment, local governments in the central and western areas have come up with various preferential measures such as tax breaks, low-interest loans and cheap rent on industrial-purpose land. Foreign investors are encouraged to invest in agriculture, environmental protection, infrastructure and industrial upgrades. With tax breaks, they can also invest in occupational training, operation of holiday destinations and even passenger transportation by bus or train. Foreign investors can start businesses either on their own or via joint ventures with Chinese partners[5].

Relaxation and decentralization in authority applies to business start-ups, acquisitions of domestic firms and expansion of existing operations of foreign-owned companies.

FIGURE 2/ The movement of FDI Inflow in the past year



Data source: Ministry of Commerce (2009)

[1] Ministry of Commerce.
[2] China Investment Guide, June 2, 2009.
[3] China Investment Guide, June 2, 2009.
[4] China Daily, November 9, 2008.
[5] China Daily, December 26, 2008.

MNC REACTIONS AND ADAPTATIONS

Due to the global financial crisis, many MNCs are suffering from sharp contractions in demand, causing serious challenges for them. However, China's relatively fast economic growth (China's GDP still grew by 6.1 percent in the first quarter of 2009, though this was the lowest in ten years), increasing per capita income and domestic consumption, massive government stimulus package, and well-controlled inflation still make the country attractive to many MNCs. According to a survey by the US-China Business Council, 88 percent of foreign businesses in China are profitable and 81 percent have a higher profit margin than elsewhere. In a symposium for foreign funded enterprises held by the State Council in Shenzhen on February 21, 2009, high-level executives from 14 enterprises, including the ABB group, Best Buy, the A. P. Moller-Maersk Group, Accenture, and the Kerry Group, expressed their confidence in investing in China[6].

Many MNCs see new opportunities amid the global financial crisis to invest in China. They take advantage of the recent changes in government policies to adjust their strategies and to strengthen their positions in the country.

One of MNCs' reactions and adjustments is to accelerate localization in response to the lowered export quota for foreign-owned companies. For example, Cisco announced a $16 billion investment plan in China amid the crisis, emphasizing its strategy to be more localized in China, shifting from "Cisco in China" to "China's Cisco". Bosch Group also announced that it plans to invest another €850 million ($1.18 billion) between 2008 and 2010, in addition to the €1 billion ($1.4 billion) the company already invested in China in the years up to 2007. "We see ourselves as a true partner for China's dynamic economic development. More than ever before, Bosch is also a Chinese company," said Franz Fehrenbach, chairman of the board of management of Bosch Group[7]. Bosch has established a solid basis to further increase its presence in China. By the beginning of 2009, the number of Bosch associates in the country is about 23,000, greater than in any other countryoutside its home country, Germany. Its research and development (R&D) activities in China embrace all its business sectors. Thanks to the ongoing investment by MNCs and the increasing need to be closer to local customers, there are now approximately 1,000 R&D centers in China with most of them in the technology sector[8].

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Another reaction is to take advantage of the stimulus package to increase investment in energy and environment protection, especially regarding clean and renewable energies. Several large MNCs, including Siemens, ABB Ltd., Bosch Group, and Alstom, have decided to increase their investment in this area. For example, Siemens plans to invest RMB 5 billion (about $735 million) in China to develop technologies to improve energy efficiency and environment protection[9]. ABB Ltd. is investing $150 million this year to expand and develop its facilities in China[10]. Alstom has decided to expand its investments and plans to set up new factories in China in 2009,said Patrick Kron, the company's Chairman and CEO. Kron noted that the $586 billion stimuluspackage launched by China's central government includes investments in environment-friendly infrastructure, which means a favorable investing environment and enormous business opportunities for Alstom[11].

These MNCs react to not only the immediate impact of the stimulus package, but also strong business growth in the past and the long-term potential of the Chinese market in the future. For example, Joe Hogan, chief executive officer of ABB Ltd, believed that demand for ABB's technologies to improve industrial productivity, energy efficiency, and grid reliability will continue to grow despite the current global financial crisis. According to Brice Koch, president of ABB North Asia and chairman of ABB China, global energy demand is set to jump more than 50 percent by 2030, and 30 percent of the world increase in power demand will come from China.

Similarly, Bosch Group believes that its resource-saving and energy-efficient innovations are in strong

[6] People's Daily, February 24, 2009.
[7] China Daily, December 31, 2008.
[8] China Daily, December 26, 2008.
[9] http://info.china.alibaba.com/news/detail/v4-d1006149385.html
[10] China Daily, May 13, 2009.
[11] People's Daily Online, February 10, 2009.

demand in China as the country targets sustainable growth. In the company's new investment in China, the focus is on developing and manufacturing clean, safe, and energy-saving automotive products and solutions. Bosch's 2008 sales in China are about €2.3 billion ($3.2 billion), a sharp 30 percent increase from 2007. It is the fourth consecutive year of high growth.

The global financial crisis makes the importance of the Chinese market even more prominent in some industries. One of them is the automobile industry. In contrast to the significant drop in the United States, Europe, and Japan, car sales in China remained strong. China sold 4.5 million passenger cars in the first six months of 2009, representing a 25.6% increase from a year ago, as the government's tax reduction and incentive subsidy for rural residents spurred small car sales. In fact, China is now the world's biggest auto market in terms of the units of vehicles sold. Foreign carmakers are rushing to either raise vehicle output or open new plants in China as a stronger-than-expected economic recovery in the first half of 2009 have raised expectations about the world's biggest auto market. For example, GM plans to double its output in China to 2 million units annually over five years. Nissan will lift production at its joint venture Dongfeng Motor Co by 20 percent from this October, and its Guangzhou plant will be able to roll out 460,000 units a year, up from 360,000. Honda will enlarge the annual production capacity at its Dongfeng Honda plant in Hubei province to 200,000 units by the end of July, which will help boost its total output in China to 610,000 units.

Another area is the broad financial services sector. In 2008 China approved foreign investment in 23 financial services companies, including banks, non-banking financial service institutes, security companies, and insurance companies. The financial services sector absorbed foreign investment of $15.92 billion, representing an increase of 81.85%. Foreign financial companies continue to show great interest in

Some MNCs even plan to use investments in China as a way to overtake their rivals as industry leader.

investing in China. For example, on April 17, 2009 the Commerce International Merchant Bankers (CIMB) of Malaysia bought 19.99% ownership of Yingkou Bank in Liaoning Province for $51 million[12]. Assicurazioni Generali S.p.A., the largest insurance company in Italy, decided to acquire 30% of the shares of Guotai Asset Management Company for €100 million[13]. Michael Smith, CEO of the Australia and New Zealand Group Ltd., said that it is now the best time to invest in China and that his company plans to significantly increase the banking business in China[14].

Foreign financial service companies do not only increase investment in the financial services sector, but also increase investment in local non-financial companies with strong market conditions or potential. For example, Goldman Sachs acquired 25% ownership of Kouzijiu, a Chinese liquor producer in Anhui Province, for $52 million in July 2008[15], and 25% ownership of Red Lion Cement, a major large cement producer in China, for $120 million in December 2008[16]. Bain Capital LLC agreed to buy about 16 percent of Gome Electrical Appliances Holdings Ltd., China's second-largest electronics retailer, for about $300 million in June 2009[17]. The deal marks Bain Capital's biggest acquisition in China. Beijing-based Gome has more than 800 stores in at least 160 Chinese cities.

Given that China is the world's fastest-growing major economy, some MNCs even plan to use investments in China as a major step to overtake their rivals as industry leader. For example, Germany's Metro AG, the world's fourth-largest retailer in sales, believes that with an aggressive plan to expand in China, it can overtake

[12] 21st Century Business Herald, April 28, 2009.
[13] No.1 Caijing Daily, July 10, 2009.
[14] http://bank.hexun.com/2009-07-20/119747008.html

[15] No. 1 Caijing Daily, November 13, 2008.
[16] EZCapital, December 1, 2008.
[17] Bloomberg.com, June 8, 2009

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U.S. giant Best Buy Co. as the world's biggest consumer-electronics retailer. With a local joint-venture partner, the German retailer plans to open a Media Market store in Shanghai next year, rapidly followed by at least another 12 and, in the medium-term future, about 300 more in large metropolitan areas. Metro's attack shows how fiercely global retailers are competing in lucrative international markets, as growth in their already mature home countries slows with the downturn.

IMPACT ON LOCAL FIRMS FROM MNCS' CHANGING STRATEGIES/ADJUSTMENTS

MNCs' adjustments in China have important implications for local firms. First, the acceleration of localization and increasing focus on the Chinese market will surely increase the level of competition faced by local firms. The competition does not only come directly from MNCs that are in the process of localization such as Cisco and Bosch, but also local Chinese firms that receive foreign investment for expansion such as Red Lion Cement and Gome. Moreover, the competition is not limited to the product market, but the input market as well, particularly regarding local talents. For example, as more and more MNCs establish R&D centers in China, local Chinese firms have to compete with MNCs for top researchers.

Second, with the increasing importance of the Chinese market, the relaxed government regulations about M&As by foreign firms, and the intention of MNCs to increase their market share and become industry leaders, local Chinese firms, particularly those with high potentials, may increasingly become MNCs' targets of acquisition. However, the Chinese government has concerns about potential market monopolies as more and more M&As have consolidated industrial structures in recent years. The implementation of a new antimonopoly law has, therefore, posed constraints on aggressive M&A activity. The failed proposal of Coco-Cola to acquire China's largest juice maker, Huiyuan Juice Group, for

Local Chinese firms, particularly those with high potential, may increasingly become MNCs' acquisition targets.

$2.3 billion perhaps indicates the government's concerns about monopolies in a single industry. Therefore, we predict that it is the secondary local Chinese firms, not industry leaders that are more likely to become acquisition targets of foreign firms.

Third, the acceleration of localization by MNCs can also create many opportunities for local Chinese firms, particularly those in the supporting industries. For example, to bolster its ambitious expansion plans in China, KFC recently placed an order worth $732 million with three Chinese chicken suppliers. The expansion plans of foreign auto makers surely will bring many opportunities to local suppliers as well as sales and service providers. Even for those local firms that directly compete with MNCs, there are increasing opportunities for them to cooperate and/or to learn from their foreign competitors.

[18] Xinhua News Agency, March 19, 2009.
[19] China Daily, July 16, 2009.

RUSSIA

CHANGES IN FDI INFLOWS IN RUSSIA

Until recently, Russia attracted virtually no foreign investment, first due to the closed economic system, then due to the political and economic uncertainty of the 1990s. Since the mid-2000s, however, as Russia's GDP and personal income showed fast growth, FDI inflows have increased sharply, from less than $10 billion in 2003 to over $70 billion in 2008. According to a survey by SKOLKOVO, by the beginning of 2008, there were over 50 MNCs each employing over two thousand people in Russia.

Source Countries and Regions. According to Rosstat, the source countries of FDI inflows into Russia remain largely the same as before the financial crisis. European Union (EU) countries are the major sources, with low-tax jurisdictions such as Luxembourg (10.5% of total FDI inflows) and Cyprus (9.4%) featuring prominently. The most significant change is that FDI inflows from the Netherlands (15.2%) and Germany (10.2%) have surpassed Britain (now just 6.6%), which used to be the leading investor into Russia before the global financial crisis. In the first Quarter of 2009, the major source countries of FDI in Russia are the following: Netherlands, Luxembourg, Germany, Cyprus, United Kingdom (Great Britain), United States, and France. These countries contributed 76.2% of all the FDI Russia received[20].

Entry Mode. Cross-border M&As play a major role in FDI in Russia. During 2005-2008, Russia witnessed 330 M&As by foreign companies for approximately $70 billion, representing about 40% of the total FDI inflows and 30% of all the M&As in Russia during that period in terms of both the volume and the value of transactions[21]. This pattern is very different from that in China, where M&As account for less than 5% of FDI inflows. Apparently, in Russia's rapidly growing market, MNCs prefer M&As in order to obtain market share fast. However, according to the Central Bank of Russia, only 12% of FDI inflows in 2008[22] were in M&As, indicating a sharp drop. The number of M&As by foreign

[20] http://www.gks.ru/bgd/free/b04_03/IssWWW.exe/Stg/d02/91inv21.htm
[21] http://www.mergermarket.com/pdf/Deal-Drivers-Russia-March-09.pdf
[22] http://crisiscrunch.pbndc.com/?p=306
[23] Rosstat, www.gks.ru
[24] http://www.cbr.ru/eng/statistics/print.aspx?file=credit_statistics/class_sector_e.htm

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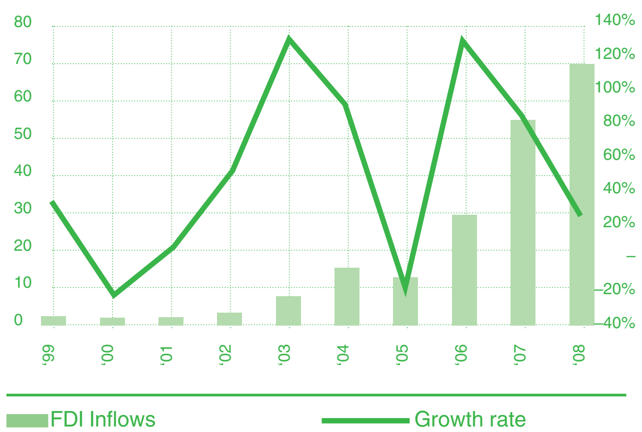
FIGURE 1/ Russia FDI Inflows (1999 — 2008)



Data source: SKOLKOVO based on Central Bank data companies also dropped from 128 in 2007 to 98 in 2008.

Industry Sector. In the early years the very limited FDI in Russia was mainly concentrated in the oil industry. During the mid-2000s, foreign investors increasingly targeted Russia's growing internal market rather than export-oriented industries, particularly in retail, wholesale, and real estate. Moreover, Moscow claimed a large share of foreign investment. In the height of the real estate boom and wage inflation in 2007, Moscow claimed over 56% of all FDI inflows in Russia, of which 52% was in the retail and wholesale sector and 27% in real estate[23].

During 2005 - 2008, Russia witnessed 330 M&As by foreign companies for approximately $70 billion

IMPACT OF THE GLOBAL FINANCIAL CRISIS ON FDI IN RUSSIA

The global financial crisis has pushed FDI in Russia downward significantly. According to the Central Bank, FDI inflows dropped by more than half in the first Quarter of 2009 compared to the same period a year ago, from $21 billion to barely $10 billion overall and from $14 billion to just $5.5 billion in the non-financial sector[24]. To some extent, this drop can be explained by the fact that new construction comes significantly cheaper this year than in the first half of 2008. However, the most important factor is the much lower attractiveness of investment projects in Russia due to a much bleaker economic forecast.

CHANGE IN GOVERNMENT POLICIES

Russian government's behavior towards FDI inflows has always been an ambivalent mix of protectionist mistrust and a willingness to attract more investment. In the recent years, some consistent policies have started to emerge regarding certain industries. For example, in the oil and gas industry, there has been a gradual shift from arrangements dominated by foreign companies to those dominated by Russian state-controlled companies. Widely publicized cases include the purchase of a controlling stake in Sakhalin Energy by Gazprom and the minority role of Total and Statoil Hydro in Shtokman Development.

In May 2008[25], the Russian government created a list of industries that are restricted to foreign investors.

[25] Federal Law #57 «On the procedure for foreign investment in companies of strategic importance for national defense and security».

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In addition to defense, energy, aircraft and aerospace industries, television, and critical infrastructure that have long been deemed strategic, the list includes natural resource deposits, radio, publishing, printing, and telecommunications. The goal is to clarify the rules for foreign investors interested in acquiring control over strategic entities or gaining access to strategic natural resource deposits. Under the new regulations, foreign investors must report to the government each time they acquire a 5% or greater stake in a Russian strategic company. Any deal transferring control over a strategic company to a foreign entity must now be approved by a special government commission.

In other industries, however, the government has purposefully created conditions for foreign investors to enter en masse. One such industry is energy generation, considerable chunks of which were sold by the former state monopoly to European giants such as E.On, Enel and Fortum. Another is automotive manufacturing. Thanks to an incentive package, seven out of the top 10 world vehicle manufacturers have built or are building factories in Russia, and parts suppliers are following. New rules have also been introduced to the banking industry, prompting a series of takeovers by MNCs in financial services.

The government, both federal and regional, will continue to be a major factor in the dynamics of FDI in Russia. Officially, President Medvedev and Prime Minister Putin, as well as several key governors and mayors, have recently restated that they would continue to implement policies to attract foreign investment. In practice, however, issues of unpredictable regulation changes and unsatisfactory property rights enforcement can deter potential investors. A recent case in point is the court decision to effectively expropriate from the Scandinavian group Telenor 30% of voting shares of VympelCom, a major telecommunications company, supposedly to cover damages to other share holders resulting from Telenor's blocking of VympelCom's entry to the Ukrainian market several years ago[26].

The government, both federal and regional, will continue to be a major factor in the dynamics of FDI in Russia.

[26] The Financial Times, June 9, 2009.

MNC REACTIONS AND ADAPTATIONS

According to this year's World Investment Prospects Survey of 240 company executives from the largest non-financial MNCs by the United Nations Conference on Trade and Development (UNCTAD), Russia is still one of the five most attractive markets for FDI during 2009 to 2011, following China, United States, India, and Brazil. However, because of the global financial crisis, many MNCs have adjusted their investment strategies in Russia. FDI inflows to Russia in 1Q2009 largely went to projects already underway. Few major new projects were started.

The biggest change was in the retail and wholesale sector. Overall, FDI in the Russian retail and wholesale sector dropped to 22% of the total in 1Q2009, while in 2007 it accounted for as much as 39%[27]. This drop is probably due to falling consumer income and increasing competition, both of which have a negative impact on profit margins. Increased pressure on retailers from governments at all levels does not help, either. For instance, the furniture retailer IKEA declared in June that it was freezing consideration of any new investment projects in Russia due to "unpredictability of administrative procedures"[28]. On the other hand, hypermarkets, which are better positioned to face increasingly price-conscious shoppers, seem to be an exception. Carrefour, one of the world's top retailers, opened its first hypermarket in Russia in June and plans two more openings before the end of the year[29].

The share of mining and fuel extraction operations in overall inward FDI is also down to an unusually low 8%, which is a direct consequence of lower commodity prices[30]. A notable exception is the purchase of Imperial Energy, a midsized oil producer based in London but operating in Russia, in March for over $2 billion by an Indian company, ONGC. Realizing the need for foreign investment to help with large new oil and gas projects, the government has sent clear signals to majors like Total, BP and Shell that their participation is welcome – as long as they do not try to gain control. In response, on April 22 TNK-BP offered £4.30 per share for a minority stake in Sibir Energy, 2 1/2 times more than the previous day closing price[31]. In the middle of June 2009 Total reached an agreement with NOVATEK to develop the thermokarstic deposit in the Yamal region[32].

Investment in the manufacturing sector, particularly the manufacturing of consumer goods, is less affected by the global financial crisis. Several large MNCs, including Coca-Cola, PepsiCo, Unilever, and Nestle, continue to invest or expand their businesses in Russia. For instance, in April Unilever purchased the sauce business of Baltimor, a Russian food company[33]. Another example is the automobile industry. Despite a catastrophic plunge in car sales, major car makers such as Nissan, Toyota, GM, Volkswagen, and Daimler all showed their commitment to the Russian automobile market. Meanwhile, two Japanese companies, Isuzu and Suzuki, decide to postpone the building of new factories in Russia[34].

Foreign investors continue to show interest in the financial service sector. For example, in September 2008, Deutsche Bank purchased 40% of the asset management business of UFG, a Russian investment banking group[35]. In November 2008, the French banking group Societe Generale confirmed that it would continue to invest and develop subsidiaries in Russia[36]. Also in November 2008, KMB Bank (now Intesa), owned by the Italian group Intesa Sanpaolo since 2005, stated that it would increase the number of offices in Russia from 63 to 90 by January 2009[37]. The British insurance company Aviva has now become the largest foreign pension fund company in Russia after acquiring ING's business in April 2009[38].

With respect to entry mode, MNCs continue to show a strong preference for M&As over greenfield projects. According to ReDeal, MNCs spent nearly $3 billion on about 15 M&As during 1Q2009. This view is reinforced by a survey of 72 private equity houses by KPMG and Mergermarket in December 2008 to February 2009[40]. According to three quarters of respondents to the survey, low valuations and distressed situations will be the most significant drivers of M&A activity in the short term. Indeed, the sharp drop in prices goes a long way towards explaining the continuing interest in acquisitions in Russia.

[27] http://www.gks.ru/bgd/free/b04_03/IssWWW.exe/Stg/d02/91inv21.htm
[28] The New York Times, June 23, 2009.
[29] Carrefour press release, June 18, 2009.
[30] Rosstat, www.gks.ru.
[31] http://www.moscowtimes.ru/article/600/42/376505.htm
[32] http://www.investinrussia.info/en/press/news/00306/
[33] Unilever press release, April 29, 2009.
[34] http://www.russia-ic.com/news/show/7590/
[35] Deutsche Bank press release, September 11, 2008.
[36] Kommersant, November 13, 2008.
[37] http://www.expert.ru/articles/2008/11/13/intesa_sanpaolo/
[38] http://www.globalpensions.com/global-pensions/news/1446993/aviva-gains-ing-pension-business-russia
[39] http://www.mergers.ru/
[40] http://www.kpmg.ru/index.thtml/ru/press/news/index.html

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PROSPECTS, CHALLENGES & CONCLUSIONS

FDI in China and Russia showed different patterns in the past. FDI in China was largely in the manufacturing sector and export-oriented. In contrast, FDI in Russia was largely market-seeking in which MNCs were attracted to the market demand in Russia. Therefore, the impact of the global financial crisis on FDI was different in China and Russia. Because of the decrease in global demand, the relaxation of government regulations on export quota, and the increased income level in China, MNCs are now more focused on the domestic demand and are, thus, accelerating localization in China. To most MNCs, China will become increasingly important. A primary challenge for these MNCs is to effectively manage the localization process, especially with respect to localizing their products and managing their growing business in China.

Such a shift in FDI orientation is not apparent in Russia. Except for the energy sector, MNCs are still focused on the domestic demand in Russia. Because of the impact of the global financial crisis on their personal wealth, Russian consumers are becoming more price conscious. This change presents a great opportunity for MNCs using a low-cost strategy to expand and grow market share. For MNCs that target the high-end and mid-tier markets, the challenge is to decide whether they need to modify product and service offerings to accommodate this change in consumer spending. To make the decision, the critical questions are (1) how long it will take for Russian consumers to reach their previous wealth level, and (2) whether this global financial crisis will have some permanent impact on their spending behavior.

Although post-crisis FDI in both China and Russia is now market-driven, the industries that attract most FDI are different. In China the manufacturing sector still receives the largest amount of FDI, with a significant portion of it going to high-tech industries such as electronics and communication equipment. Apparently MNCs are still attracted to China's low-cost and skilled labor. Meanwhile, they realize that there is an increasing demand in high-tech products in China. With the increasing competitiveness of local Chinese firms, MNCs must move fast to enter these industries. Otherwise, they may face the risk of falling behind in the competition with local firms.

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In Russia, the retail and wholesale sectors still receive the largest amount of FDI. Several factors may contribute to this pattern. First, there is still high demand for consumer products. Second, local Russian firms cannot meet this demand. Third, the policies of Russia do not provide strong incentives for MNCs to invest heavily in other industries. There are two implications. First, there are great opportunities for MNCs that manufacture consumer products and serve the retailers and wholesalers. These MNCs should consider following their customers to make more investment in Russia. Second, the Russian government should make it more attractive for foreign manufacturers of consumer products to invest in Russia.

Moreover, although in both countries the energy sector becomes increasingly important, the focus is different. In China, the focus is more on clean and renewable energies. In Russia the focus is more on traditional energies. Although this difference in focus reflects the difference in the resourcefulness between China and Russia in terms of traditional energy reserves, it has important long-term implications for FDI inflows. In China MNCs have increased investment in clean and renewable energies to take advantage of both government incentives and market demand. In Russia MNCs are still focused on traditional energies. It is very likely that, with the help of MNCs, China will become a leader in the generation of clean and renewable energies. While it is unlikely for renewable energies to replace traditional ones, the Russian government should make sure the required investment stays in the race for the benefit of clean and renewable energies development.

Lastly, there is a difference in post-crisis FDI in China and Russia in terms of the entry mode. In China, MNCs are increasingly interested in acquiring local Chinese firms with high market potential or taking an equity position in these firms. In contrast, Russia has seen a sharp drop of FDI inflows in the form of M&As although M&A is still MNCs' preferred entry mode in Russia. This difference partially reflects the differences in government policies. The Chinese government appears to be increasingly more open to foreign companies' acquisition of local firms. In contrast, the Russian government seems to be putting more restrictions, which may require reconsideration, especially as Russia tries to recover from the global financial crisis.

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Despite the differences in government policies, resource endowments, culture, and economic development stage, China and Russia are becoming increasingly important to the world economy. No matter how MNCs adjust their global strategies in response to the financial crisis, they should not ignore or withdraw investment in either country. In the long-run, their performance in these two markets will significantly affect their competitiveness and performance in the global market.

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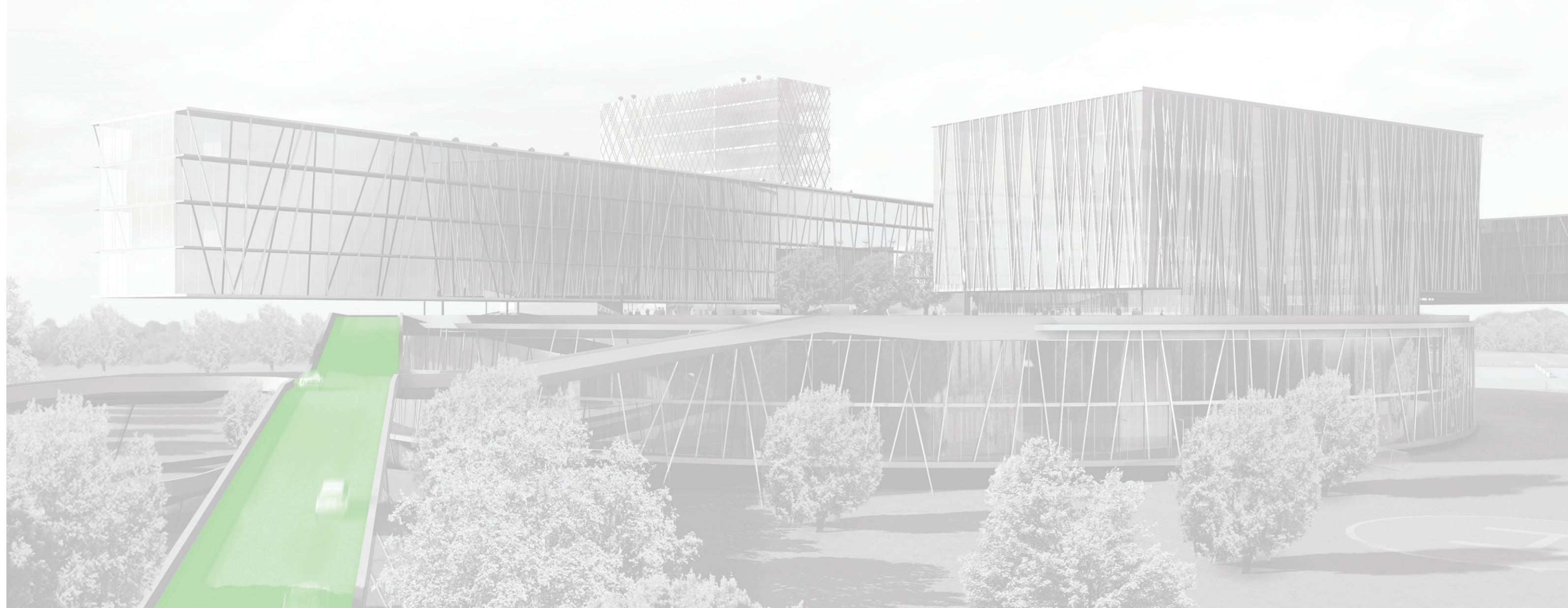

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