



## Investment climate in Russia and challenges for foreign business: The case of Japanese companies



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### ABSTRACT

The improvement of the investment climate in Russia and its positive effect on the inflow of foreign direct investment into the country's economy is being declared at the highest levels of the Russian government as an important objective for the further economic development of the country. One of the most important instruments for that improvement should be the consideration of foreign investor's opinions and ideas and reaction to the most urgent and critical issues which serve as obstacles to their investment activities in Russia.

This paper considers the case of Japanese investors in Russia. It is based on the results of a survey of Japanese companies doing business in Russia (members of the Japanese Business Club Moscow) and content analysis of a set of interviews with the representatives of the Japanese business and academic community and also of non-governmental organizations.

We identify which factors attract Japanese capital to Russia and which hinder investment activities. Studying Japanese investment in Russia reveals the particular challenges and obstacles that make Japanese companies reluctant to engage in business activities in Russia. The research reveals and systemizes the factors restricting the development of investment cooperation and their roots, and identifies possible ways of overcoming these challenges.

The analysis shows that the constraining factors can be divided into 3 groups by the origin: external – associated with the problems of the investment climate in Russia, internal – associated with specific features of the Japanese production and management system, and other factors – non-economic factors which mainly concern business culture and informational issues.

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### 1. Introduction

Investment climate analysis, especially in the context of institutional framework building in developing and transition economies, arouses great interest among

researchers. A number of large international projects, such as EBRD Business Environment and Enterprise Performance Survey (BEEPS)<sup>2</sup> and Doing Business by the World

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<sup>2</sup> Business Environment and Enterprise Performance Survey (BEEPS) – a project conducted under the auspices of EBRD (European Bank of Reconstruction and Development) and examining the quality of a set of aspects of the business environment. Five rounds of survey have been already conducted (1999, 2002, 2005, 2009 and 2012–14).

Bank Group,<sup>3</sup> are focused on investment climate research and provide scholars with an extensive database of characteristics and indicators for different aspects of the issue which allow comparative studies to be conducted. Thus, in the paper of Hellman, Jones, Kaufmann, and Schankerman (2000), the authors summarize the results of a subset of questions from the BEEPS relating to governance and corruption in transition economies and its influence on the environment faced by businesses in different countries. The issue of entry regulation for start-up firms in 85 countries including developed, developing and transition economies was investigated in Djankov, Porta, Lopez-De-Silanes, and Shleifer (2002) and regulation of labour markets through employment, collective relations, and social security laws in Botero, Djankov, Porta, Lopez-De-Silanes, and Shleifer (2004).

Moreover, since 2004 the World Bank has extended its methodology to regional studies. As far as Russia is concerned, regional reports on business climate have been issued twice: in 2008 when they covered 10 cities and towns (primarily regional capitals) (*Doing Business in Russia, 2009*) and in 2011 when the focus was extended to 30 towns (*Doing Business in Russia, 2012*). Later in 2013–2014 the Agency for Strategic Initiatives<sup>4</sup> in cooperation with business associations conducted a research project aimed at measuring the investment climate related indices in Russian regions and rated them by different criteria (regulative environment, business-related institutions, resources and infrastructure, small enterprise support) (*National Rating of Business Climate in the Regions of Russian Federation, 2015*). Moreover, the investigations of the investment climate in Russia are carried out under the auspices of an official specialized advisory body – the Foreign Investment Advisory Council (FIAC) (*Doing Business in the Russian Federation, 2014; Investment Climate in Russia – Foreign Investor Perception, 2015; Russia's Investment Climate, 2012*).

As far as the Japanese research of business climate in Russia is concerned, the leading agencies are Japan External Trade Organization (JETRO) and ROTOBO (Japan Association for Trade with Russian and NIS). The JETRO Survey reports 2014 and 2015 on the activities of Japanese-Affiliated companies in Russia provide a comprehensive view of Japanese companies on the business conditions in Russia (Japan External Trade Organization (JETRO), Europe, Russia and CIS Division, Overseas Research Department, 2014; 2015; ROTOBO Report Industrial Investment in Eurasia, 2011).

In recent years investment relations between Russia and Japan have experienced significant development.

According to the Japan External Trade Organization (JETRO)<sup>5</sup> data during 2005–2014 Japan's FDI stock in Russia increased 29 times (JETRO Reports and Statistics, 2015).<sup>6</sup> Despite volume growth, Japanese FDI in Russia also experienced major shifts in terms of structure and technology. The share of FDI inflow into manufacturing industries of higher technological complexity and capital intensity increased significantly. Regional distribution of Japanese FDI is becoming more diversified; apart from regions which have been traditionally attractive for Japanese capital (Moscow, St. Petersburg and the Far East), investment cooperation with regions of the Central, Volga and Ural Federal districts is developing intensively.

However, despite recent progress in investment relations and complementary economic interests of the two countries the level of cooperation is far below its potential. The share of the two countries in the structure of mutual trade and investment relations is rather modest: Russia accounts for 2,26% of Japan's foreign trade turnover and 0,24% of Japanese FDI outflow (in 2014 according to JETRO), while the Japanese share in Russian foreign trade turnover is almost 4% (in 2014 according to the Russian Federation Federal Customs Service, Foreign Trade Statistics, 2015<sup>7</sup>), 1,54% in the inflow of all types of foreign investment, 3,93% in the FDI inflow (in 2013 according to the United Interagency Information and Statistics System, 2013<sup>8</sup>). Japan is ranked 10th in the list of top investors in the Russian economy in terms of investment stock of all types and 16th in terms of FDI stock in 2013.<sup>9</sup>

Therefore using the case of Japanese investment in Russia we can observe that there might exist particular challenges and obstacles that make Japanese companies reluctant to engage in business activities in Russia. Revealing those obstacles and finding ways to neutralize them may give additional impetus to the development of investment cooperation between Japan and Russia.

This paper analyzes the factors attracting Japanese capital to the Russian economy and challenges that Japanese business faces during the process of adaptation to the Russian business environment. The purpose of the research is to reveal and systemize factors restricting investment cooperation development and their roots and to find out possible ways of overcoming these challenges using the strengths of investment ties between the two countries.

<sup>3</sup> Doing Business is a yearly report of business regulation elements assessment implemented yearly since 2003 in 189 economies by the World Bank Group.

<sup>4</sup> Agency for Strategic Initiatives – a non-government organization established by the Russian Government in 2011 to promote new priority economic and social projects. Website: <https://asi.ru/eng/> Accessed on 27 June 2016.

<sup>5</sup> JETRO Reports and Statistics, Japan's Outward and Inward Foreign Direct Investment, FDI stock (Based on International Investment Position, net), Outward <http://www.jetro.go.jp/en/reports/statistics/> Accessed on 16 October 2015.

<sup>6</sup> From 87 million USD in the beginning of 2005 up to 2,5 billion USD in the beginning of 2014 (JETRO).

<sup>7</sup> Russian Federation Federal Customs Service, Foreign Trade Statistics <http://stat.customs.ru/apex/f?p=201:7:34916493764136::NO> Accessed on 16 October 2015.

<sup>8</sup> United Interagency Information and Statistics System, Foreign Investment Inflow <https://www.fedstat.ru/indicator/31335.do> Accessed on 16 October 2015.

<sup>9</sup> Ibid.

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