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## Adaptation of Market Strategies of TNCs in Russia in the Context of Import Substitution Policy

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**Abstract:**

*The policy of import substitution carried out in Russia objectively affected the interests of leading transnational corporations (TNCs) operating in the Russian markets. The restriction of imports of intermediate goods and the fall in the purchasing power of Russian consumers have formed for TNCs both new problems and new opportunities.*

*The analysis of the integration of TNCs in the Russian policy of import substitution is carried out in the article; their role in the development of industries and agriculture is revealed. It is revealed that the strategies of TNCs are characterized by great flexibility, which allowed them to reduce the negative impact of sanctions and geopolitical tensions. TNCs widely use the strategy of acquisition of popular Russian brands.*

*The weakening ruble and the cheapening of labor costs became additional decision-making factors for the localization of production and selection of local suppliers of intermediate goods, investing in modernization of production facilities, the establishment of added value chains with the involvement of national producers that contributed to the successful embedding of TNCs in the policy of import substitution.*

**Keywords:** *Transnational corporations, investment strategies, foreign direct investments, import substitution, localization of production.*

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## **1. Introduction**

Currently in Russia there are many leading TNCs with a share of Russian production of over 30% for certain groups of goods. The sanctions imposed by the EU and US, resulting in the limited access to financial resources and advanced technologies, as well as the response of Russia in the form of a food embargo and a policy of import substitution, could not but influence the conditions of TNCs' activities in the Russian market. A part of TNCs left Russia in connection with the deterioration of the macroeconomic situation and a downgrade of the sovereign and investment rating of the country, unfavorable geopolitical factors, sanctions and Russian retaliatory measures (Idrisov and Ponomaryova, 2015). But a large share of TNCs stayed to work in the Russian market.

The main problems of TNCs in Russia are their limited innovative activities in Russian subsidiaries and inadequate attention to export opportunities of products produced in the Russian divisions of the companies outside the CIS, import restrictions of certain products, which are intermediate goods in the production chain of TNCs, as well as the decline in the purchasing power of the population.

The policy of import substitution combined with a noticeable decline in the purchasing power of the population, starting in 2014, objectively affected the interests of those TNCs that are present in the Russian markets. The deterioration of the macroeconomic situation, the sanctions and counter-embargo forced the Russian subsidiaries of TNCs to elaborate a new paradigm of their development. Occupying a significant market share in food production, TNCs cannot be uninvolved in the policy of import substitution.

Due to this, the need for the analysis of modern trends of functioning of TNCs is very relevant in the Russian market under the conditions of import substitution. The issue of TNCs' integration in policy of import substitution requires a more complete disclosure; TNCs' role in import substitution and the contribution of TNCs to the development of national industry and agriculture need rethinking.

## **2. Problem statement**

Import substitution, which became one of the main directions of Russian industrial policy in 2014-2015, was accepted by the scientific community ambiguously. From the point of view of some scientists, import substitution is an objective reality, and the realization of import-substituting industrialization became inevitable for the country's raw materials export orientation. The overcoming of the technological backwardness of the national economy and the trajectory of its strong growth are impossible without the support of the developing sector by the measures of protectionist policies, restrictions or ban on the imports of products that compete

with local products. The policy of import substitution was seen as the driver of Russia's economic development (Berezinskaya and Vedev, 2015). At the same time, import substitution was entrusted with the task of modernizing the industry and its technological retrofit (Serebryakova *et al.*, 2016).

From the perspective of other authors (Manturov *et al.*, 2016), the hasty intensification of the import substitution policy, influenced by political factors, which replaced the systematic and consistent policy of import substitution carried out in previous years, may lead to its reduced efficiency. The reason for the inefficiency could be the lack of the necessary institutional conditions (Manturov *et al.*, 2016).

A number of researchers have expressed the position against import substitution and protectionism policy (Volchkova and Turdyieva, 2016). Volchkova believes that deep integration into the world economy would help to avoid penalties because the business interests of the private sector are always ahead of politics. From our point of view, this opinion is mistaken: firstly, Russia is very deeply involved in the world economy (Smorodinskaya and Katukov, 2017; Akopova and Przhedetskaya, 2016); however, the nature of this involvement leaves much to be desired in view of its raw material orientation, and secondly, there is no doubt that the "too visible hand of politics" in recent years has begun to have a determining influence on economic policy, ignoring the interests of the business. According to Volchkova, Russia had not and has no reason to pursue a policy of import substitution and the failure of this policy is weal for the country's economy. According to her calculations, in the case of successful implementation of the policy of import substitution, only certain industries would benefit with the slowdown in the economy as a whole (Volchkova and Turdyieva, 2016).

According to Idrisov and Ponomaryova (2015) the policy of import substitution is rather a response to the current macroeconomic and geopolitical situation. Its implementation in some import-dependent industries will contribute to the emergence of new products and, possibly, the emergence of new industries, which does not guarantee their achievement of the world level of competitiveness and even the viability.

The main problems of TNCs in Russia are their limited innovative activities in the Russian subsidiaries and inadequate attention to export opportunities of products produced in the Russian divisions of the companies outside the CIS (Gurkov, 2016a; 2016b), import restrictions of certain products, which are intermediate goods in the production chain of TNCs, as well as the decline in the purchasing power of the population and changes in the strategy of Russian consumers' behavior.

The deterioration of the macroeconomic situation, the sanctions, and counter-embargo forced the Russian subsidiaries of TNCs to elaborate a new paradigm of their development, the main directions of which became: the partial balancing of production capacities – the withdrawal of excess inefficient capacities (the sale and/or closure of individual plants) with the aim of bringing long-term demand conditions; the maintenance of the technical efficiency of Russian subsidiaries at the level of average standards of the parent company; increasing the level of localization of production, innovation and technological solutions; increased attention to workforce development; pinpoint investments in certain areas of activity; speeding up of exports.

Since mid-2014, a new type of investment project has appeared in the business models of TNCs in Russia, which obtained the name "projects of fenced field", that is, investments in new production capacities at existing industrial sites of successful Russian companies. It is particularly attractive for TNCs in the field of mechanical engineering and chemical industry. "Fenced field" can either be wholly owned by subsidiaries or be a joint venture. The main feature of such investment projects is the active use of developed infrastructure of the "host" Russian company, which sharply distinguishes them from the previously used practice.

### 3. Review of literature

The wide outspread of TNCs is the factor affecting the economy of both developed and developing countries. The role and impact of TNCs on the economy of countries with transition economies are sufficiently covered in the scientific literature. In particular, the variety of factors has been investigated that attract TNCs to certain markets (in particular, Dunning, 1992; Crittenden and Crittenden, 2010; Hennart, 2012), institutional conditions for attracting foreign direct investments (Puffer and McCarthy, 2011; Kheifetz, 2017), the reasons for the attractiveness of Russia for TNCs (Zvirgzde *et al.*, 2013), as well as the risks of doing business in Russia for foreign companies (Irwin *et al.*, 2015), and the impact of sanctions on Western companies (Johnston, 2015).

The study of Gurkov *et al.* (2016), who conducted a series of interviews with the heads of subsidiaries of Western TNCs in Russia, shows the management practices and experience of doing business. The issues of the companies' activities from the position of economic and food security are considered by such scientists as (Fyodorov and Kuzmin, 2012).

The questions of influence of the import substitution policy on the competitiveness of Russian enterprises and the dynamics of the branch development of the Russian industries in the initial period of import substitution are highlighted in the works (Idrisov *et al.*, 2015; Idrisov and Ponomaryova, 2015; Idrisov, 2015; Idrisov, 2016).

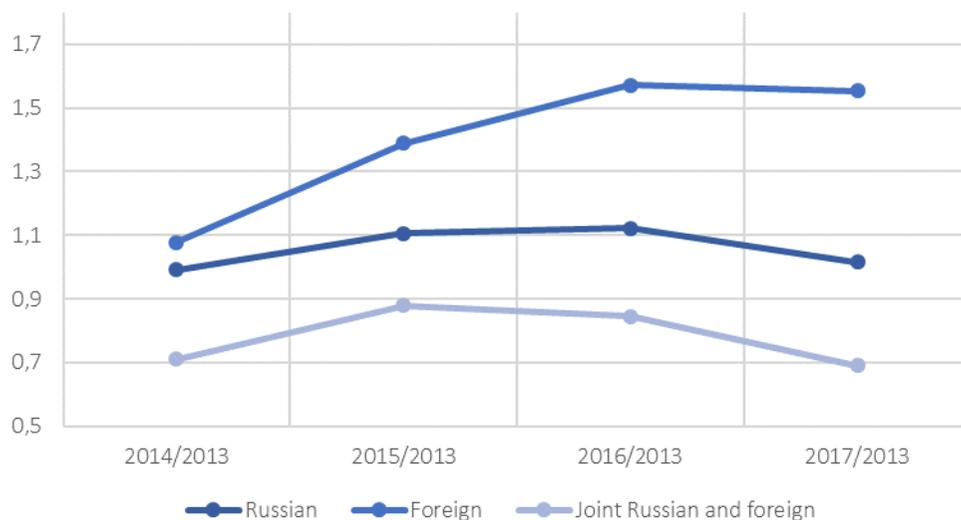
The mechanisms of strategic import substitution are described in the paper by Berezinskaya and Vedev (2015); the policy of import substitution from the perspective of government planning is considered in the paper by Manturov *et al.* (2016). The lessons for Russia based on the experience of foreign countries are analyzed in the article by Zagashvili (2016).

However, these studies do not exclude the need for further coverage of contemporary trends in the functioning of TNCs in the Russian market. A more complete disclosure is an issue that requires integration of TNCs in policy of import substitution, in need of rethinking their role in import substitution and the contribution of TNCs to the development of national industry and agriculture.

#### 4. Results

The economic crisis and the sanctions have had an impact on all companies operating in Russia. Deteriorating the business environment and geopolitical risks have slowed the growth rate of newly registered enterprises of Russian and joint forms of ownership to a greater extent than those of foreign ownership (Figure 1). The reason for these disparities lies in the worse conditions of access to financial resources for national entrepreneurs.

**Figure 1.** Growth rate of registered organizations in Russia in the period from 2014 to 2017, % (relative to 2013)

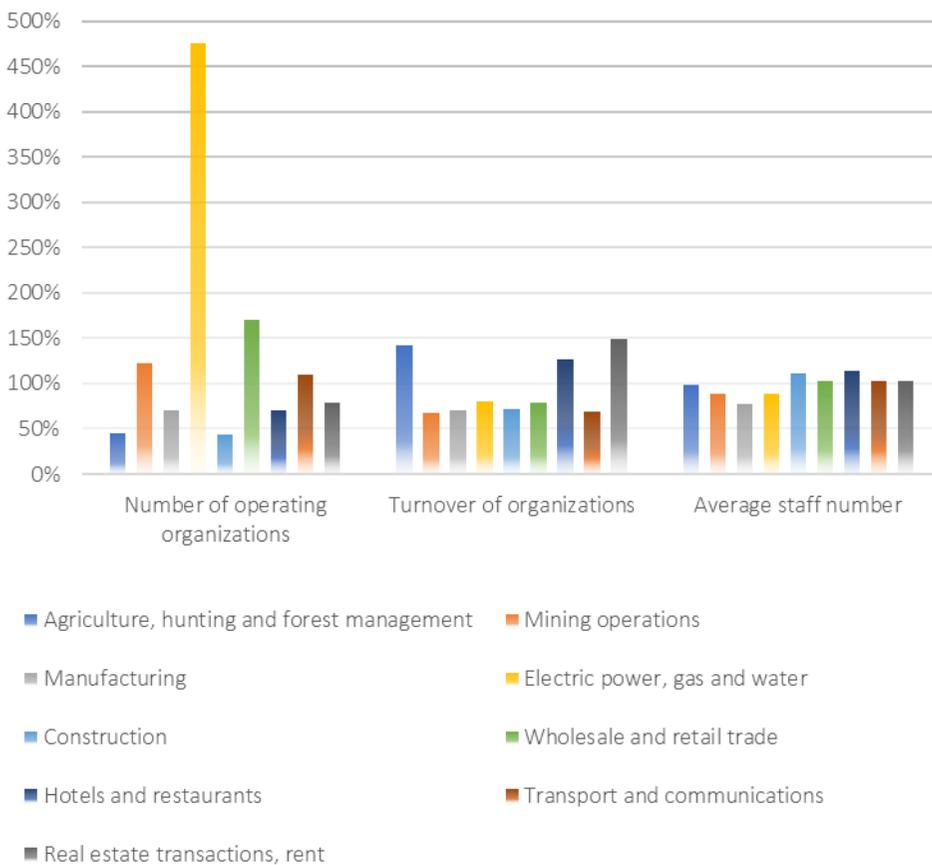


**Source:** (Rosstat, 2017).

And if in 2015-2016 years, a sharp increase in the number of closed enterprises of all forms of ownership was marked, then in 2017 there was also a significant reduction

in the number of liquidated enterprises. At the end of 2014, a lower overall survival rate of companies in Russia was observed (Kuzmin, 2018), which is also seen in the sectoral structure of agriculture, animal production and crop growing, food production, etc. The turnover of organizations, on the contrary, increased in those industries where there was a reduction in the number of organizations (agriculture, hotels and restaurants, real estate transactions); a fall in turnover took place in the sectors in which an influx of new businesses was observed (mining, wholesale and retail trade, transport and communication). The most attractive for foreign capital in 2016 became the energy sector (+375%), wholesale and retail trade (+70%), mining (+23%), and a significant reduction in the number of operating enterprises with foreign capital was observed in agriculture (-55%) and construction (-57%) (Figure 2).

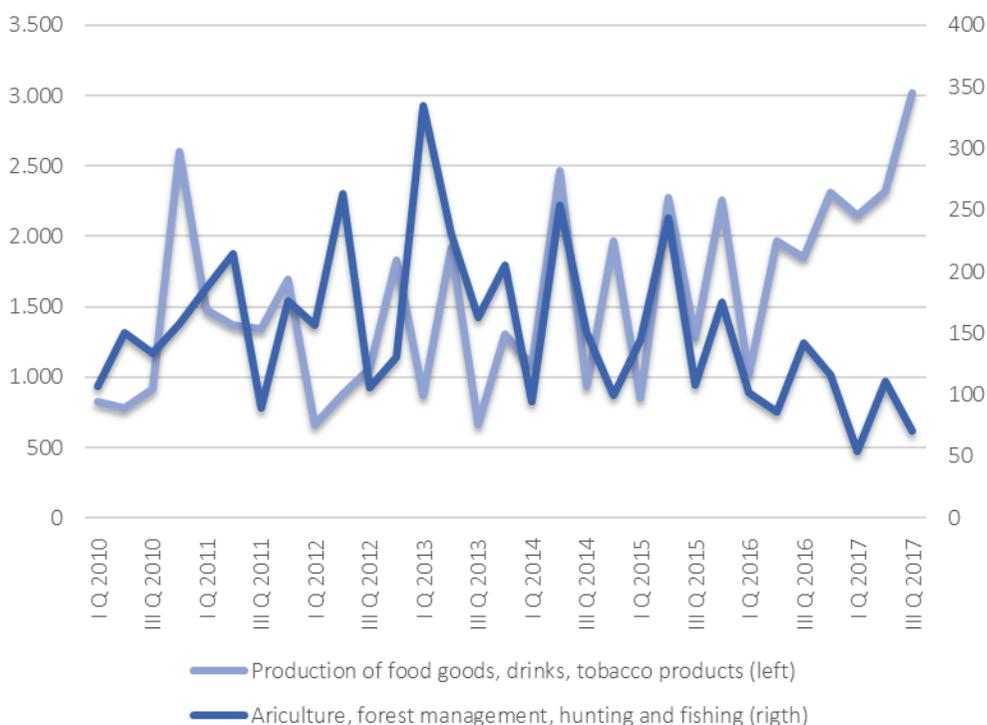
**Figure 2.** The number of organizations with foreign capital and their performance in 2016 in % to the level of 2013



Source: (Rosstat, 2017).

Overall, during the period of intensification of the policy of import substitution in the context of sanctions, the Russian economy has experienced a positive trend in foreign direct investment, with a noticeable increasing trend in the industry of the real sector of economy (mining and manufacturing) with the reduction of FDI inflows into the financial sector. At the same time, FDI in the food industry grew throughout the entire period and in the third quarter of 2017 reached its record high, surpassing the pre-sanctions high rates in 2010 (Figure 3).

**Figure 3.** FDI inflow in the food industry and agribusiness



**Source:** The Central Bank of the Russian Federation, 2017.

In 2016, among Forbes 50 largest TNCs in the Russian market (Forbes, 2017), ten companies operated in the automotive industry, nine companies – in the food industry, eight – in manufacturing, five companies produced mass consumption goods, three – home appliances and electronics, four tobacco companies and three companies worked in the energy sector (Table 1).

**Table 1:** Revenues of the largest TNCs in Russia in 2016 in percent to 2015

Industry	TNC, country	Revenue of 2016 as % to 2015
Mechanical engineering	Toyota Motor, Japan	121
	Volkswagen Group, Germany	112

Industry	TNC, country	Revenue of 2016 as % to 2015
	Daimler, Germany	106
	Kia Motors, Korea	119
	Hyundai Motor, Korea	110
	Nissan, Japan	100
	Renault, France	112
	BMW Group, Germany	117
	Ford Motor, USA	129
	Jaguar Land Rover	100
Food industry	PepsiCo, USA	103
	Nestle, Switzerland	118
	Mars, USA	110
	Danone, France	107
	Carlsberg Group, Denmark	105
	Coca-Cola Hellenic Bottling, Switzerland	119
	McDonald's, USA	108
	Mondelez International, USA	97
Trade	Anheuser-Busch InBev, Belgium	108
	Sanofi, Germany	108
	ReWe Group, Germany	93
	Cargill, USA	109
	Globus Group, Germany	116
	Leroy Merlin, France	124
	IKEA, Sweden	99
	Groupe Auchan, France	98
Mass consumption products	Metro Group, Germany	102
	Procter & Gamble, USA	102
	Unilever, The Netherlands – United Kingdom	108
	Henkel Group, Germany	112
	Johnson & Johnson, USA	109
Manufacture and sale of tobacco products	Schneider Electric, France	100
	Japan Tobacco International, Japan	113
	LG Electronics, Korea	101
	ISMT, United Kingdom	131
Household appliances and electronics	Anheuser-Busch InBev, Belgium	112
	Apple, USA	165
	LG Electronics, Korea	101
Electricity	Samsung Electronics, Korea	104
	Uniper, Germany	101
	Fotrum, Finland	106
	Enel, Italy	101

The decline in real disposable incomes of the population began in 2014 – 99% from the level of 2013 and continued in 2015 (97%) and 2016 (94%). The number of population with money incomes below minimum subsistence income has grown in

2015 by 3.4 million, in 2016 – by another 0.3 million people and made in 2016 13.5% of the total population, which is by 2.8% more than in 2012 (Rosstat, 2017). All this contributed to the change in the strategy of behavior of the Russian consumer. Among the most popular strategies, there was the choice of a store with low prices, finding promotions and purchasing only the most necessary products, as well as purchasing products in large packages to reduce overall costs. According to (The Nielsen Company, 2016, 2017), the popularity of low-price stores at Russian consumers in March 2016 has reached 63%, and the interest to "big" purchases as a means of cost reduction in 2016 was shown by 15% of the respondents. The transition of Russians to the saving mode when buying food products has been also reported in other studies (Kisin, 2016). The first signs of recovery in retail trade with food appeared in the spring of 2017 and in June the growth was 1.2% compared to the same period in 2016, due to the reduction of inflation and, as a consequence, a certain stabilization of the demand, which demonstrates the growth of consumer confidence.

In 2016, the decline in revenue among the TOP 50 TNCs in the Russian market was marked just in three trading companies: REWE Group (Germany), IKEA (Sweden), Groupe Auchan (France) and one food company – Mondelez International (USA). At the same time, within each industry, some companies managed to increase revenue, other companies reported a decline in revenue, which is likely due to external market conditions, increased competition among TNCs and factors of internal character. In the food industry, large TNCs have achieved moderate revenue growth after a decline in the sales volume in 2014-2015. This is partly due to a recovery in the purchasing power of the population, partly due to the flexibility of the strategies of TNCs.

In the current difficult economic situation, TNCs decided to stay in the Russian market, having overcome a certain decline in the sales volumes; in 2014 and 2015 they achieved strong growth and continue to implement major investment projects. The trend of localization of production is not new to TNCs in the Russian market. For example, Table 2 shows the production sites of TNCs in the food industry (Table 2).

Danone invested in a partner farm Damate, acted as a co-investor for the construction of a commercial dairy complex in Tyumen. The total investment of the group of companies Damate, JSC Rosselkhozbank (Russian Agricultural Bank) and Danone amounted to RUB 5.6 billion (Ishchenko, 2016). According to the agreement signed by Damate and Danone all the milk produced in the complex is sent to the Danone enterprise (Danone, 2018).

The McDonald's company from the first years of its presence in Russia considered the establishment and development of local network suppliers of food, agricultural,

and other products as one of its priorities. Currently, the company commenced the next stage of import substitution – the vertical integration of suppliers, from growing the raw materials to the processing, packaging, storage, and transportation of finished products, expands its strategic partners among the local producers of meat industry (manufacturer of bacon Marr Russiya) and the Russian fishing companies (OOO A. Espersen, Peter Boss).

**Table 2:** *Production sites of TNCs operating in the Russian food market (compiled by the author based on public sources)*

TNCs, country, year of foundation	Market segments	The beginning of work in Russia	The number of manufacturing facilities in Russia
Danone, France, 1919	dairy products, baby food, bottled water, medical nutrition	1992	20
PepsiCo, USA, 1890	food and drinks	1974	20
The Coca-Cola Company, USA, 1892	concentrates, syrups, soft drinks	1980	12
Unilever, United Kingdom, 1929	food and beverages; personal care products, household chemicals	1991	8
Nestle, Switzerland, 1866 (2015 merger of Kraft Foods and Heinz KraftHeinz)	food, drinks	1871	11
Heinz, USA, 1844 (2015 merger of Kraft Foods and Heinz KraftHeinz)	drinks and food	1995	2
Fazer, Finland, 1891	food, bakery and confectionery products	1997	4
Bonduelle, France, 1853	canned and frozen vegetables	1995	2
Bunge, USA, 1818	vegetable oil, margarine, mayonnaise, flour, mixes	2004	5
Mars, USA, 1911	food, food for pets, chocolate, chewing gum	1991	10

The sanctions and weakening ruble have led to the reduction in the cost of labour in Russia below the level of China, which could not be taken into account by foreign investors. In 2016, the solutions on the localization are implemented by TNCs in many industries.

TNCs that came to the Russian market in the early 1990s with the intent to remain forever, from the first years of their presence developed the strategy of localization of procurement. So, the Coca-Cola company during the last 18 years has increased the share of local procurement of raw materials and packaging from 10% to 95%, Mars buys 85% of the ingredients from the local suppliers that are located either in the vicinity of factories or from the large suppliers, such as Cherkizovo and Miratorg) (RNS, 2017); Danone plans within five years to purchase the products of new plant of shock freezing of berries and fruits Fragariya for its production facilities in Russia. The PepsiCo plant in Omsk buys 10% of the total produced milk in the region (PepsiCo, 2018).

Coca-Cola carries out more than 90% of all procurement from the local suppliers, whose share in 1998 increased by 9 times, buys 3% of sugar produced in the country for its world production and about 12% of the raw materials for juice production (which is grown in Russia, according to natural and climatic conditions), 100% of wrapping materials (Coca-Cola HBC Russia, 2018).

## **5. Discussion**

The main strategies of TNCs in order to reduce the negative impact of macroeconomic factors became:

- (1) the expansion of product line and efficient assortment management;
- (2) the production of goods in different price categories. For example, Danone has improved the quality and enriched the product lines of acquired by it Unimilk (Ishchenko, 2016); Bunge company, one of global agricultural holdings, a manufacturer of sunflower oil under the brand name Ideal, purchased from the Argentine company Molinos, since 2015 in the low-price segment has begun to produce sunflower oils;
- (3) the reduction in production, on which Russian consumers economize, and the production of goods, on which the Russians continue to spend their reduced budget. In the conditions of Russian consumers' economizing on products that are not related to the goods of prime necessity, for example confectionery, Mars company has focused on the production of food for animals that are experiencing growth in terms of both value and volumes, and the segment of sauces for cooking (Russians started visited less restaurants and cafes and more cook at home) (RNS, 2017);
- (4) the output of products in accordance with the norms of consumption and nutritional value. Danone concern introduces new standards based on the official recommended norms of consumption of nutrients (WHO, the European Agency for, Food Safety etc.), modern scientific recommendations for healthy eating habits aimed at improving the nutritional value of foods for daily consumption;

- (5) the improvement of the efficiency of suppliers, technologies and best practices, and protection of the entire supply chain. Danone organized the project of "The Dairy Academy", which is forecasted to increase the efficiency of Russian farms on average by 6%, milk yield – 8%, and the cost of production will decrease by 6-7%) (Ishchenko, 2016);
- (6) the optimization of logistics organization. Coca-Cola has transferred the functions of delivery in remote branch offices of the outsourcing company.

## **6. Conclusion**

The analysis of the integration of TNCs in the Russian import substitution leads to the following conclusions. The embargo imposed by Russia on many food products and agricultural raw materials contributed to a further localization of TNCs' plants and the transformation of procurement policy in the direction of maintenance and development of local industries. In the food industry, large TNCs have achieved moderate revenue growth after a decline in the sales volume in 2014-2015. This is partly related to a recovery in the purchasing power of the population, partly – to the flexibility of the assortment management strategies of TNCs.

The intentions of the TNCs that have been present in the Russian market for a long time to stay there forever are expressed in the continuing implementation of investment projects in modernization and construction of their production sites. The behavior of TNCs in the market is characterized by great flexibility that allowed them to reduce the negative impact of sanctions and geopolitical tension. The strategy of the acquisition of popular local brands, in terms of the patriotic mood of Russian consumers of "buying Russian", has allowed TNCs in the food industry to hold a significant share of the Russian market for selected product groups.

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