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“Structural Changes in the Russian  
Outward Banking Foreign Direct Investment”

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# Structural Changes in the Russian Outward Banking Foreign Direct Investment <sup>a</sup>

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**Abstract:** Following recent government initiatives, such as the shift (turn) to the East and the possibility of establishing new economic and investment cooperation with the Asia-Pacific region and other regions, proposed in conditions of financial and economic sanctions imposed towards Russia by the West, the study aims to evaluate whether any significant structural changes in the Russian outward banking foreign direct investment emerged in 2013-17 as the result of the proposed initiatives. By analyzing both the macro-picture of outward banking foreign direct investment and behavioral patterns of Russian banks since 1990s, the study found that only a marginal number of Russian banks, comprising of large state-owned banks, banks closely related to the natural resource-type Russian multinational corporations, and large private banks, have the capacity to expand their operations abroad. While the increasing presence of the natural resource-type Russian multinational corporations in the Asian and African regions is slowly luring Russian banks into these markets, drastic structural changes in the outward banking foreign direct investment are unachievable in the short-term. The geographical distribution of Russian banks remains unchanged with offshore financial centers, Europe, and the Commonwealth of Independent States being the traditional destinations of Russian outward banking foreign direct investment.

**JEL Classification Number:** F23, F30, G20, G21, P29, P33

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## 1. Introduction

According to the Bank of Russia, the amount of accumulated outward foreign direct investment (FDI) calculated by the extended direction principle<sup>1</sup> in 2013-15 was steadily declining. In fact, outward FDI in 2015 constituted only 70% of its level in 2013 and amounted to USD 282.7 billion. This put Russia on the 15<sup>th</sup> place in the global FDI flows ranking (UNCTAD, *World Investment Report 2017*). Despite a slight increase in the amount of investments in 2016, Russia's ranking in global outward FDI has not improved (14<sup>th</sup> place) and the country is still far behind updating its top record of 2012-13 (8<sup>th</sup> place).

A sharp decline in the respected period is explained by both economic (decline of the world economy and Russian GDP, ruble devaluation) and political (deteriorating diplomatic relations with the EU, United States, and Ukraine) factors. In such conditions, the Russian government and the academic society over again started advocating for the possibility of a “shift (turn) to the East.” However, preliminary estimates demonstrate the impossibility of a radical geographical diversification of outward Russian FDI and its re-direction to the East in a short-term; thus, recent intensification of foreign relations with Asian and African countries has experienced a low impact of political factors of 2014-15 (Kuznetsov, 2017). Nevertheless, other studies provide some optimistic scenarios of yet another possible shift – to the African continent. For instance, Russian multinational corporations (MNCs) aim to build their competitive advantages in Angola, Nigeria, and South Africa (Panibratov, 2017).

This study aims to track possible changes in the structure of Russian outward banking FDI by conducting (1) a macro-analysis of its' dynamics and geographical distribution among host economies and (2) a micro-analysis of the behavioral patterns (entry modes and motivations) of Russian banks having foreign affiliates abroad. In particular, we aim to evaluate the perspectives of the shift to the East and other new regions specifically in the Russian banking sector. The rationale for the study is self-explanatory given the rapidly improving positions of the two largest state-owned Russian banks, namely Sberbank and VTB, in the World's Biggest Public Companies Ranking 2017 published by Forbes: Sberbank leaped to the 56<sup>th</sup> place in 2017 (124<sup>th</sup> in 2015) and VTB to the 397<sup>th</sup> (615<sup>th</sup> in 2015).

The structure of the paper is as follows. Section 2 present the macro-picture of outward banking FDI in 1994-2017 and analyzes it geographical distribution by host countries. Section 3 focuses on the micro-picture by investigating entry modes and motivations of foreign expansion of Russian banks. Here we provide selected data on the number of foreign affiliates of Russian banks and summarize the existing theories aiming to explain the motivations of Russian banking FDI. Based on the results obtained in Section 2 and 3, in Section 4 we briefly discuss the possibilities of a geographical shift to the East and other regions for the Russian banking FDI. Section 5 concludes.

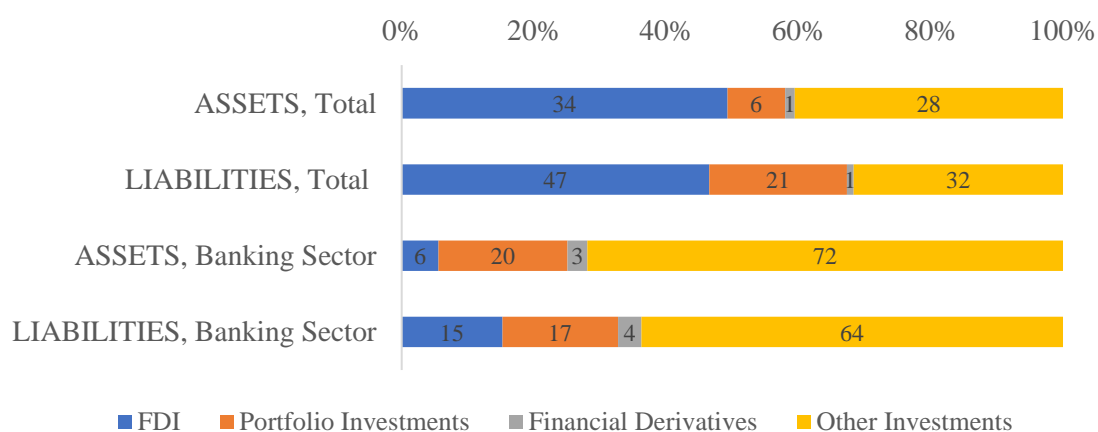
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<sup>1</sup> The extended direction principle partially excludes the round-tripping effect.

## 2. The Macro-Picture

The net investment position of the Russian banking sector in April 2017 was USD 59,024 billion making Russia's banking sector a net debtor. The total assets of the banking sector (stock) amounted to USD 230,505 billion and surpassed the total liabilities of USD 171,481 billion. The assets of the banking sector<sup>2</sup> comprised of other investment (72%), portfolio investment (20%), direct investment (6%), and financial derivatives (3%). The banking sector's liabilities<sup>3</sup> constituted a similar structure: Other investment accounted for 64%, followed by portfolio investment (17%), direct investment (15%), and financial derivatives (4%). In fact, the subordinate role of inward and outward banking FDI in the total assets/liabilities structure of the banking sector is significantly pronounced in 1994-2017. Other investment<sup>4</sup> prevail in the overall structure of outward and inward banking FDI, however, the data on the international investment position of Russia demonstrate a rather divergent picture: the shares of inward and outward FDI in the total structure of assets and liabilities were commensurable with the amount of other investments (Figure 1).

**Figure 1** Structure of the International Investment Position of Russia and Russian Banking Sector by Instruments, April 2017, %



Source: compiled and calculated by the author based on the statistics of Bank of Russia ([www.cbr.ru](http://www.cbr.ru))

The dynamics of banking inward and outward FDI is presented in Figure 2. Inward banking FDI surpasses the amount of outward banking FDI in 1994-2017. In particular, this trend intensified in the 2000s in conditions of financial liberalization when foreign banks progressively expanded their operations in the Russian banking market. As for the dynamics of outward banking FDI, there was a slight growth in its volume until 2013 and after that period its amount stabilized. As of April 1<sup>st</sup>, 2017, the inward banking FDI amounted to USD 26.2 billion while the amount of FDI by Russian banks abroad was USD 12.9 billion. The dynamics of both inward and outward banking FDI was positive even during the global financial crisis

<sup>2</sup> Outward banking investments.

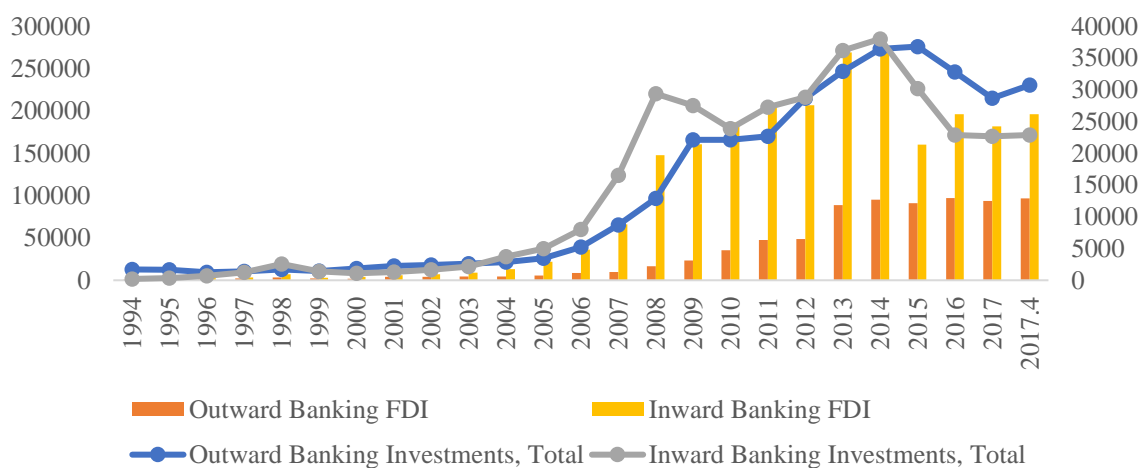
<sup>3</sup> Inward banking investments.

<sup>4</sup> For instance, long-term and short-term currency and deposit accounts, loans, and other assets and liabilities)

2008-9, while in 2014-17 foreign investors followed a more prudent policy in Russia and preferred to hedge themselves against business risks in conditions of financial and economic sanctions imposed by the West over the Ukrainian conflict. As for the outward banking investment, its amount increased by almost 60 times in 2000-17 proving the fact that Russian banks have significantly expanded their foreign operations.

According to Abalkina (2014), active foreign expansion of Russian banks in 2000-10 was attributed to the following three factors. First, Russian banks implemented rather successful entry strategies in the CIS region: Sberbank (Russia) acquired Texakabank (Kazakhstan) in 2006 and NRB (Ukraine) in 2007, while VTB expanded its foreign affiliates in Azerbaijan, Armenia, Georgia, Belarus, and Ukraine. The Bank of Moscow also established a subsidiary in Ukraine. Second, VTB received control over some Russian foreign banks controlled by the Russian government established in host countries that were trade partners of the Soviet Union, such as France, United Kingdom, Germany, Switzerland, and Austria. Third, Russian banks became active players on the international M&A market.

**Figure 2** Inward and Outward Banking Foreign Investment in Russia, 1994-2017, USD million, data as of January 1<sup>st</sup>



Source: compiled by the author based on the statistics of Bank of Russia ([www.cbr.ru](http://www.cbr.ru))

As for the geographical distribution of Russian outward banking FDI, majority of it was directed to offshore financial centers (OFC) and countries that serve as transshipment centers for round-tripping FDI<sup>5</sup> (Table 1). These territories amounted for about 60-62% of the Russian outward banking FDI in 2014-17. Major destinations in this group of host countries as of April 2017 included Cyprus (22%), United Kingdom (13%), Luxemburg (8%), Ireland (8%), Netherlands (5%), and Switzerland (3%). According to some research studies (Panibratov, 2017), the switch towards OFC can be explained by the deteriorating economic situation, plummeting petroleum prices, and the related geopolitical uncertainty due to the political tensions in 2013-15 over the Crimea and Ukrainian crises.

<sup>5</sup> In fact, the share of OFC in both total inward and outward FDI in Russia is very high and according to different estimates amounts to 70-80% due to the round-tripping effect (Mizobata, 2015; Gorshkov, 2013, 2015).

The second geographical destination of Russian outward banking FDI was Europe (10%) represented by such host countries as Germany (4%), Austria (3%), Italy (2%), and France (1%). The CIS region, comprised of Kazakhstan, Belarus, and Ukraine, accounted for about 8% of the total banking outward FDI in the respected period. The United States, traditionally constituting a relatively high share, accounted for 8%. Thus, when compared with the previous studies (Gorshkov, 2013; Panibratov, 2012, 2017), the three regions – major destinations of Russian outward banking FDI, namely OFC, Europe, and CIS, remained unchanged. Turkey (2-3%), Singapore (1%), China (1%), and Hong Kong (1%) were the only countries from the Asian region where Russian banks directed their investments in 2014-17.

**Table 1** Outward Banking FDI by Destination 2014-17, % of Total Assets of the Banking Sector, Data as of January 1<sup>st</sup>

2014	2015	2016	2017	April 2017
<i>Non-CIS</i>				
United Kingdom (19%)	Cyprus (23%)	Cyprus (23%)	Cyprus (24%)	Cyprus (22%)
Cyprus (18%)	United Kingdom (13%)	United Kingdom (11%)	United Kingdom (11%)	United Kingdom (13%)
United States (11%)	United States (10%)	Luxemburg (10%)	Luxemburg (9%)	Luxemburg (8%)
Austria (6%)	Luxemburg (6%)	United States (9%)	Ireland (9%)	Ireland (8%)
Ireland (6%)	Austria (5%)	Ireland (7%)	United States (8%)	United States (8%)
Luxemburg (5%)	Ireland (5%)	Netherlands (5%)	Netherlands (5%)	Netherlands (5%)
Germany (4%)	Netherlands (5%)	Austria (4%)	Jersey (4%)	Germany (4%)
Jersey (4%)	Germany (5%)	Switzerland (2%)	Switzerland (4%)	Switzerland (3%)
Netherlands (4%)	Jersey (3%)	Germany (3%)	Germany (3%)	Austria (3%)
Turkey (2%)	Switzerland (3%)	Jersey (3%)	Austria (3%)	Jersey (3%)
France (2%)	France (2%)	Turkey (2%)	Turkey (3%)	Turkey (3%)
Switzerland (2%)	Turkey (2%)	France (1%)	France (1%)	Italy (2%)
Finland (1%)	China (1%)	Hong Kong (1%)	Italy (1%)	Singapore (1%)
Belgium (1%)		Singapore (1%)		France (1%)
<i>CIS</i>				
Belarus (3%)	Ukraine (3%)	Belarus (2%)	Kazakhstan (3%)	Kazakhstan (2%)
Ukraine (3%)	Belarus (2%)	Ukraine (2%)	Belarus (2%)	Belarus (2%)
Kazakhstan (1%)	Kazakhstan (1%)	Kazakhstan (1%)	Ukraine (2%)	Ukraine (2%)

Note: The data for host countries with the share of less than 1% is omitted. The grey color indicates the countries that are OFCs.

Source: compiled by the author based on the statistics of Bank of Russia ([www.cbr.ru](http://www.cbr.ru))

### 3. The Micro-Picture

In this section, we focus on the behavioral patterns of Russian banks expanding their businesses abroad by investigating their entry modes and motivations for foreign expansion.

Foreign market entry modes of Russian banks include the following basic methods: representative offices, subsidiaries, and branches. The selected statistics on representative offices and foreign branches is presented in Figure 3. In 2017, there were 22 representative offices of Russian banks registered in non-CIS countries, nine representative offices in CIS region, and six foreign branches.

Historically, representative offices were the most common entry mode of Russian banks due to the simplicity of their establishment and relatively low foreign market entry costs. In addition, their establishment could be implemented in a “notifying” rather than a “permissive” manner: Russian banks had to only notify the Bank of Russia of their intention to establish a foreign representative office (Abalkina, 2014). Newly established banks in the process of financial liberalization in Russia preferred this entry mode as it allowed them to establish good connections with the business partners in host countries.

The number of foreign representative offices of Russian banks has been steadily declining: In 1997, there were 147 representative offices registered abroad (including 112 in non-CIS countries), while in 2017 Russian banks had only 31 representative office abroad. This is presumably due to the increased bankruptcy cases of parent banks (especially in crisis conditions of 1997-98), while in 2000s this trend may simply reflect the generally declining trend in the number of Russian banks registered on the domestic market due to the increased number of domestic M&A as the result of stricter capitalization requirements. Also, this might be explained by the growing presence of Russian multinational corporations (MNCs) in host countries and their increasing demand for the services provided by Russian banks abroad in the form of subsidiaries or branches.

**Figure 3** Representative Offices and Foreign Branches of Russian Credit Organizations, 1997-2017



Source: compiled by the author with references to <https://fedstat.ru>

The official statistics on the number of foreign subsidiaries is not available, but according to the estimations (Abalkina, 2015), there were about 55 foreign subsidiaries with Russian participation of more than 50%, with the majority of them being registered in CIS (33.8%) and Eastern Europe (28.2%). Historically, first subsidiaries of Russian banks were established by the government during the Soviet Union and were supervised by the Central Bank and Vneshekonombank of the USSR. They were called *sovzagranbanks* and were mainly established for the purpose of servicing foreign trade transactions and handling the accounts of the embassies of the Soviet Union in Austria (Donau-Bank AC), Switzerland (Russische Kommerzbank), Luxemburg (East-West United Bank), Germany (Ost-West Handelsbank), France (BCEN-EUROBANK), United Kingdom (Moscow Narodny Bank), and Cyprus (Russian Commercial Bank). With the collapse of the Soviet Union in 1991, Russia has inherited these foreign subsidiaries (Bazhanov, 2005) and gradually transferred their supervision to the state-owned VTB, thus considerably expanding its foreign network.

The number of foreign branches is rather low. There were only six branches of Russian banks registered abroad as of January 2017: Sberbank (India, 2010), VTB (India, 2008; China, 2008), Promsvyazbank (Cyprus, 2002), Avtovazbank (Cyprus, 1993), and Bingbank (Greece, 2016 (2007)<sup>6</sup> (Table 2).

Geographical presence of foreign branches and domestic affiliates is presented in Table 3. In 2001-13, Russian banks expanded their operations to CIS (34%), Eastern Europe (28%), Western Europe (21%), Asia (14%), Africa and Latin America (1.4% each).

In 2013-17, the foreign activity of Russian banks was gradually contracting. The number of their foreign affiliates remained stable and in some cases, it actually diminished. Economic and financial sanctions imposed by the United States, European Union, and Japan had a negative impact on Russian banks as they were deprived of the long-term financing over 30 days and investors in these countries were prohibited to purchase new shares or Eurobonds issued by Russian banks (Gorshkov, 2017, *forthcoming*). Thus, foreign expansion in 2014-17 was not the business priority for Russian banks. In fact, according to the mass media reports, some banks have announced foreign market exits. In particular, VTB has decided to close its foreign affiliates in France, Serbia, and India due to the optimization strategy of the VTB Group. In 2015, another Russian bank Alfa-Bank sold its Alfaforma Capital Markets (United States) due to the unprofitability of its business. Presumably, the impact of the sanctions had some far more significant repercussions than officially announced by the Russian government.

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<sup>6</sup> The year in brackets shows the year of initial establishment of the Greek branch by another Russian bank that was acquired by Binbank in 2016.



**Table 2** Geographical Distribution of Foreign Branches of Russian Banks as of August, 2017

Bank	FDI destination
Sberbank (50%+1 voting share)*	<u>Representative Offices:</u> Germany (2009); China (2011) <u>Subsidiaries:</u> SB of Sberbank JSC (Kazakhstan, 2006, M&A); JSC BPS-Sberbank (Belarus, 2009, M&A); Sberbank Europe Group (Austria, 2012, M&A of Volksbank International AG); Subsidiaries of Sberbank Europe Group are present in 11 European countries, namely Austria, Bosnia and Herzegovina, Croatia, Czech Republic, Hungary, Slovakia, Slovenia, Serbia, Ukraine, Germany (282 branches); Sberbank (Switzerland) AG (Switzerland, 2011, M&A); Denizbank (Turkey, 2012, M&A); “SBERBANK” PJSC (Ukraine, 2007, M&A) <u>Branches:</u> India (2010)
VTB (60.9%)	<u>Subsidiaries:</u> CJSC “VTB Bank (Armenia)” (Armenia, 2004, M&A); JSC “VTB Bank (Georgia)” (Georgia, 2005, M&A); Banco VTB Africa, S.A. (Angola, 2006, M&A); VTB Bank (Austria) AG (Austria, former <i>sovzagrانبank</i> ) with subsidiaries VTB Bank (Deutschland) AG (Germany) and VTB Bank (France) SA; CJSC VTB Bank (Belarus, 2009, M&A); JSC VTB Bank (Kazakhstan, 2009, greenfield); OJSC VTB Bank (Azerbaijan, 2009, greenfield); VTB Bank JSC Belgrade (Serbia, 2016, M&A of a Russian bank that had a subsidiary in Serbia); Subsidiaries in the United Kingdom, Cyprus; JSC VTB Capital Holding has branches in Singapore (via VTB Capital plc. UK) and Dubai (2009), and offices in Hong Kong (2012), Bulgaria (2012), London (2012), and Singapore (UK subsidiary); Russian Commercial Bank (Cyprus) Ltd. (Cyprus, 1995, Luxemburg, former <i>sovzagrانبank</i> ) <u>Branches:</u> JSC VTB Bank Branch (India, 2008), China (2008)
Promsvyazbank	<u>Representative Offices:</u> China (2004); India (2006) <u>Branches:</u> Promsvyazbank-Cyprus (Cyprus, 2002)
Avtovazbank (Promsvyazbank Group)	<u>Branches:</u> Avtovazbank (Cyprus, 1993)
Gazprombank (Gazprom)	<u>Representative Offices:</u> Eurofinance Mosnarbank Beijing Representative Office (China, Venezuela) <u>Subsidiaries:</u> Belgazprombank (Belarus, 1997); Gazprombank (Switzerland, 2009, M&A of Russische Kommerzial Bank AG (1992)); Bank GPB International S.A. (Luxemburg, 2013)
Alfa-Bank	<u>Subsidiaries:</u> Kazakhstan (1994); Belarus (2008 via ABHH in Luxemburg); Amsterdam Trade Bank N.V. (Netherlands, 2001); Alfa Capital Markets (United Kingdom, 2000, via Alforma Capital Markets, Inc.); Ukraine (2001, 2014); ABHH (Luxemburg); Alfa Capital Holdings (Cyprus); Zumo (Austria, 2015)
Binbank (dispersed ownership with Russian citizens as ultimate shareholders)	<u>Branches:</u> B&N Bank Greek Branch (Greece, (2016), M&A of a former Russian bank “KEDR” that had a Greek Branch established in 2007)
Vneshekonombank (non-commercial state-owned bank)	<u>Representative Offices:</u> United Kingdom, Germany, Italy, France, United States, China, India <u>Subsidiaries:</u> Belvneshekonombank (Belarus), Prominvestbank (Ukraine)

Note: \* figures in ( ) show the share of the government participation.

Source: web-sites of banks, periodicals; Sokolov (2013); information about Alfa-Bank is compiled with references to Panibratov (2017, pp. 306-314).

The determinates of Russian outward banking FDI were discussed in Gorshkov (2013). Based on this study and other literature sources it is possible to depict the following peculiarities in the behavioral patterns of Russian banks.

**Table 3** Hosting Regions of Russian Outward Banking FDI in 2000-13 (Number of Foreign Branches and Subsidiaries with the Dominant Russian participation)

Hosting Region	Newly established subsidiaries and branches by 2000	New foreign entries			Total number of foreign subsidiaries and branches, 2001-2013
		2001-05	2006-10	2011-13	
CIS	8	6	16	2	24
Asia	2	3	6	1	10
Eastern Europe	2	4	3	13	20
Western Europe	2	8	4	3	15
Africa	0	0	1	0	1
Latin America	0	0	1	0	1
Total	14	21	31	19	71

Note: The grey color indicates the hosting regions that may be regarded as relatively new destinations as the result of a shift to the East.

Source: Abalkina, 2014, p. 24.

First, expansion of Russian banks was implemented by several stages. In the 1990s banks were primarily established in Western Europe with branches as the main form of entry, while in 2000-13 foreign affiliates of Russian banks were mostly concentrated in CIS and were established by M&A as a common entry mode (Abalkina, 2014). In 2013-17, the foreign expansion strategy of Russian banks was contracting.

Second, Russian outward banking FDI are implemented primarily by large state-owned banks (Sberbank, VTB) and banks strongly linked to the natural resource-type Russian MNCs (Gazprombank). This due to the historical reasons such as the legacy of the *sovzagranbanks* (Bazhanov, 2005; Abalkina, 2014) established for serving the interests of the Soviet government that were later inherited by Russia in the form of *roszagranbanks*. At present, however, motivations of foreign expansion by state-owned Russian banks is mostly guided by economic rather than political motives (Panibratov& Verba, 2011; Panibratov, 2012) and these banks are being active members on the international M&A market (Abalkina, 2014). Nevertheless, the government influence on foreign expansion of Russian banks remains high as the politicians make the key decisions regarding foreign operations of many Russian MNCs. In fact, the Russian government shapes the geographical distribution of outward FDI due to the licensing requirements and supervision functions of the Bank of Russia. In a sense, being a state-owned brings both advantages and disadvantages.

Third, foreign expansion of private Russian banks is rather limited. At present, there are only a few banks having international presence in other countries, such as Promsvyazbank, Binbank, and Alfa-bank, with the latter being the most active in establishing international

networks. Promsvyazbank and Binbank both received access to foreign markets as a by-product of a domestic M&A and their future policy regarding foreign affiliates remains unclear.

Fourth, popular destinations for Russian outward banking FDI are CIS and Eastern Europe. This fact is explained by geographical, cultural proximity of the regions (Gorshkov, 2013; Panibratov, 2017) and by large trade flows and common history existing among them (Panibratov, 2012, 2017; Panibratov and Verba, 2012) as well as by the similarities in the economic development (Abalkina, 2014) and institutional environments<sup>7</sup> between home and host countries. To some extent, expansion in the CIS region is driven by the “follow the customer approach” where there is cultural and historical proximity and where they are relatively competitive (Gorshkov, 2013).

Fifth, the analysis of entry modes and strategies of Russian banks shows that representative offices and subsidiaries are the most common entry modes. In 1990s, Russian banks preferred greenfield investment and in 2000s it was gradually replaced by M&A. Russian banks generally prefer M&A when they enter foreign markets that share institutional affinity with Russia (CIS) provided the fact there are banks that can be potential M&A targets. On the opposite, in countries that significantly differ from the Russian banking market and where they lack expertise, greenfield investment is commonly selected (Sberbank, VTB branches in India).

And lastly, the majority of outward banking FDI is directed to OFCs and transshipment centers which is also typical for Russian MNCs utilizing these territories for both licit (tax optimization) and illicit (tax evasion, money laundering) purposes. OFCs are deployed to camouflage the origin of investments and to enjoy institutional arbitrage<sup>8</sup>. Round-tripping of Russian banking FDI results in an establishment of the so-called pseudo-foreign and quasi-foreign banks in Russia (Gorshkov, 2015). In addition, Russian outward banking FDI might be explained by the “system-escape motives” typical for Russian outward FDI to the West. (Panibratov, 2017).

Many Russian banks are utilizing OFCs to overcome institutional and legal barriers to establish foreign affiliates such as permissive procedures from the Bank of Russia on establishing foreign affiliates. For example, Alfa-Bank acquired banks in Ukraine and Belarus via its Cyprus holding company ABH Holding S.A. (ABHH). In April 2014, Alfa-Bank Ukraine acquired the Ukrainian subsidiary of the Bank of Cyprus Group, and in August 2015 it planned M&A of other Ukrainian banks such as Ukrsoobank (UniCredit Group) following Ukrainian market exits by European banks (Panibratov, 2017). Utilizing OFCs and transshipment territories as platforms to camouflage the identity of the ultimate beneficiaries of Russian banks allows companies to enjoy institutional arbitrage in their foreign expansion strategies. In fact, the expansion of outward banking investments to the offshore territories in recent years may be regarded as their attempts to find new ways of capital procurement in conditions of economic and financial sanctions.

Moreover, Russian banks expand to foreign markets via third countries that are not necessary OFCs. For instance, Sberbank expanded to Austria and Bahrein by acquiring a bank in Turkey.

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<sup>7</sup> Such as legal systems, financial freedom, and regulations (Abalkina&Ryabova, 2014).

<sup>8</sup> Institutional arbitrage is a situation when a firm is able to exploit differences between the two institutional environments (Ledyaeva et al., 2015).

#### **4. A Shift to the East: How Far Can Russian Banks Go?**

In 2016, Russian outward banking investment was directed to Vietnam, Hong Kong, India, China, Republic of Korea, Singapore, Thailand, Turkey, the Philippines, and Japan. According to our estimate, the share of Asian countries in the Russian outward banking FDI was about 4%.

When compared with other geographical destinations of outward banking FDI, the share is rather low even though there is a positive growth dynamics. A growing interest towards Asian and African banking markets by Russian banks is highlighted in Abalkina&Ryabova (2014) and Kuznetsov (2017). The share of the Asian region in the world economy is steadily growing and it has a large growth prospects and can provide enormous investment opportunities. Russia's investment cooperation with the Asia-Pacific region stated in 2012 when political ties with the region intensified. However, recently the cooperation is being decelerated due to the Ukrainian conflict (Makarov & Morozkina, 2015). In case of the African countries, the expansion of Russian banks to these regions is also attracted by investment projects of Russian MNCs in the region.

According to Table 2, the banks having presence in Asian and African markets include the following:

- (1) Sberbank (a representative office in China (2011), a subsidiary in Turkey (DenizBank, 2012), and a foreign branch in India (2010));
- (2) VTB (a subsidiary in Angola - Banco VTB Africa, S.A., (2006, M&A), two foreign branches in China (2008) and India (2008), and offices and branches of VTB Capital Holding in Hong Kong and Singapore;
- (3) Promzvyazbank (representative offices in China (2004) and India (2006));
- (4) Gazprombank via Eurofinance Mosnarbank (representative offices in China and Venezuela); and, though not being a commercial bank,
- (5) Vneshekonombank<sup>9</sup> (representative offices in China and India).

There are versatile factors explaining a growing interest of Russian banks in the new Asian and African markets. For instance, the turn to the East might be explained by their intention to acquire access to cheap financing in conditions of inaccessibility to the traditional European capital and banking markets as the result of sanctions imposed by the West. Thus, other banking investments and financial derivatives are growing faster, however, this will not necessary result in the consequent foreign market entry by Russian banks.

In case of the Asian region, Russia is establishing banking relations here with Sberbank, Vneshekonombank, Gazprombank, VTB, and Promsvyazbank taking the initiative. Particularly, this is true for India, where Russian banks aim to provide financial and banking services for the joint Russian-Indian large-scale investment projects (Panibratov, 2017).

Another Asian direction in the foreign expansion of the Russian banks is Turkey. In September 2012, Sberbank acquired a 99.85% stake in DenizBank that is in the top 10 private banks in Turkey with an extensive domestic (599 branches) and international branch networks

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<sup>9</sup> Vneshekonombank is a state corporation "Bank for Development and Foreign Economic Affairs" that operates to enhance competitiveness of the Russian economy, diversify it and stimulate investment activity. Vneshekonombank is not a commercial bank and its activity is regulated by a Special Law No. 82-FZ which came into force on June, 4, 2007 (Information retrieved from <http://www.veb.ru/en/about/today/index.php>).

(15 affiliates). Overall, DenizBank provides services to 5.4 million customers focusing on consumer lending, lending to small and medium-size enterprises and agricultural companies. By acquiring DenizBank, Sberbank acquired access to foreign markets in Austria and Bahrein.

Nevertheless, there are significant obstacles associated with language barriers, differences in institutional environments, and different business practices existing in Asian countries. The Asian market is different from the European and post-Soviet one, thus even Russian MNCs, lack necessary skills and experience (Makarov & Morozkina, 2015). Nevertheless, despite significant barriers, a turn to the East for Russian business is important and should be further promoted at the government level, however, there are significant barriers (Kuznetsov, 2017).

The expansions of the VTB Group now operating in Angola, Namibia, and Côte d'Ivoire and Russian Renaissance Capital that acquired 25% of Ecobank, a Togo-based bank with a large network on the African continent, are driven by Russian MNCs aiming to establish global control over value chains of their own businesses, secure natural resources, and to build competitive advantages in new regions (Panibratov, 2017). Entry modes chosen for entering these markets mostly include M&A of the local subsidiaries as these markets are institutionally imperfect and there are significant difficulties in starting business from scratch due to the institutional idiosyncrasies of these markets.

Overall, the shift to the Asian or African regions for Russian banks is unlikely to be implemented in the near future. The scope of their activities remains rather low and their interest in the region is to a great extent guided by Russian MNCs participating in investment projects in these regions. Russian banks lack enough expertise and know-how in providing services to the local banking market participants and existing operations are mostly to serve resource-related projects of Russian MNCs. Nevertheless, it is possible to assume that even without direct presence in host countries, Russian banks participate in the capital procurement methods of financing, such as issuing Eurobonds or participating in the global debt markets, in some more financially developed markets of Singapore and Hong Kong. In fact, some studies (Sokolov, 2013) demonstrate that investment business such as syndicated loans and financial derivatives of Russian banks is expanding.

## **5. Conclusion**

To sum up, only a marginal number of Russian banks expand their operations abroad. These include large state-owned banks, banks closely related to natural resource-type Russian MNCs, and large private Russian banks. The amount of Russian foreign affiliates in 2013-17 has not significantly increased and at present Russian banks do not demonstrate active expansion of their foreign networks due to the sanctions imposed by the West. Their direct and indirect<sup>10</sup> impacts are decreasing Russian MNCs' capability to invest abroad (Liuhto, 2015). Provided the fact that expansion of Russian banks is state-driven and closely related to investment projects of natural resource-type Russian MNCs, it is possible to conclude that under financial and economic sanctions, Russian banks will be discouraged to implement new foreign market

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<sup>10</sup> Indirect impact includes, for instance, tumbling ruble exchange rate, increasing interest rates of Russian banks (Liuhto, 2015).

entries in the near future. In fact, since the imposition of sanctions, the number of foreign affiliates of Russian banks has been declining.

Thus, despite Russia's government proclaimed policy of a shift (turn) to the East, at least in case of the banking sector, such drastic structural changes are unachievable in the short-term. Asia and Africa have the potential as future destinations for Russian outward banking FDI but the development of these markets by Russian banks at present is predetermined by the activities of Russian MNCs.

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