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WORKING PAPER

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INTERNATIONALIZATION OF THE STATE-OWNED ENTERPRISES: EVIDENCE FROM RUSSIA

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Abstract: State-owned enterprises are considered an important phenomenon in the contemporary international business research which has a particular focus on the internationalization of such companies. The most prominent examples of globalizing state companies are the enterprises from emerging markets, whose economies are traditionally shaped a lot by the state influence and where historical legacy still influences the development of economy. This study examines the relationship of the state ownership and internationalization which is still far from being clear, since research on this topic produced controversial results. The controversy may be grounded in the different contexts where state companies operate. We study the Russian state companies, that are the least studied among the emerging market countries, and promise to reveal the insights on the internationalization strategies of SOEs. We examine the association of the state ownership degree and the internationalization level on the sample of state- and private-owned enterprises that are the 250 largest Russian exporters for the 4 years from 2013 to 2016. The results indicate that state ownership degree is negatively associated with the internationalization intensity, but only in case of the indirect state ownership, which we explain with the argumentation of the public agenda that companies pursue indirectly. Russian state companies are considered to have both commercial and strategic goals, and the latter may be connected to the geopolitical aspirations of the government. Firms with indirect state affiliation are used by the government as a leverage to reach non-market goals. Thus, the state pursues strategic (as opposed to commercial) agenda indirectly.

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Content

Background and motivation

State-owned enterprises (SOEs) are considered an important phenomenon in the contemporary international business research with approximately 10% of world GDP that they generate, according to the data of OECD in 2016, and it evokes a rising interest from the scholars worldwide. One of the indicators of such an interest is the special issue of the Journal of International Business Studies (2014), the flagship of international business research. The special issue focused on the phenomenon of the globalization of state-owned multinational companies (SOMNC) and on the diverse approaches of the state towards internationalization (Cuervo-Cazurra et al, 2014).

SOEs are manifested in a state capitalism, a phenomenon that is claimed to contest traditional market economy. This influential market constellation is the type of market economy where state has a dominant role in economy and pursues political goals (Bremmer, 2009). Researchers have largely predicted that SOEs are destined to disappear as a result of pro-market reforms yet in the 1980s but despite these predictions, state capitalism is believed to be reviving (Benito et al., 2016). Moreover, global financial turmoil made governments worldwide obtain ownership of previously private businesses (Shi et al., 2016).

In comparison to private-owned enterprises (POEs), SOEs have other incentives to exist, apart from the maximization of profit as POEs. There is a certain bias against SOEs in the Western research, as SOEs are seen as a basis of communist ideology which results in the debate capitalism vs. communism, and state enterprises seem not to be incorporated in the mainstream theory of a firm (Bruton et al., 2015). Estrin and his colleagues (2012) argue that the state ownership is a rare case in market economy while private ownership is dominating, thus SOEs are seen as somewhat marginal and relict form.

Many SOEs had to dramatically change their face in terms of the degree of state involvement in management and in terms of the scale of its activities, so that they became a mixture of state and private ownership, together with widening the horizons of their operation to overseas (Musacchio and Lazzarini, 2012). These transformations followed after the 1980s wave of pro-market reforms and fall of the communist regimes (Bruton et al., 2015).This was reinforced by globalization processes which resulted in reduced trade and investment barriers together with advanced transportation and progress in communication technologies. All this facilitated transformation of state-owned companies into state-owned MNCs (Cuervo-Cazurra et al., 2014).

Thus, companies with the state ownership go on successfully expanding internationally. Figures from the Investment Report of the UNCTAD (2014) demonstrate that among all MNCs state-owned enterprises constitute a small part but the number of their foreign affiliates and the scale of their foreign assets are significant. UNCTAD estimates that there are at least 550 SOMNCs, with more than $2 trillion of foreign assets and 11% of the FDI flows (UNCTAD, 2014). Globalization of the state companies makes researchers reassess the traditional theories of firm, as they do not equip scholars with the necessary tools to examine SOEs. Some scholars even argue that there is a necessity to develop a distinct theory of state companies, so different they are from private firms, but still play an important role in the global economy (Peng et al., 2016).

The most prominent examples of state companies that engage in international operations are represented by emerging markets, whose economies are traditionally shaped a lot by the state influence and where historical legacy still influences the development of economy. Overall, a half of the multinational SOEs are headquartered in emerging economies (World Investment Report UNCTAD, 2017). They have common characteristics but also distinct special features in terms of their internationalization strategies and paths (Michailova, Zubkovskaya, 2014).

Relationship of state ownership and internationalization received a lot of scholarly attention in various concerns (Ciu, Jiang, 2012; Estrin et al., 2016; Liang et al., 2015; Bass, Chakrabarty, 2014; Huang et al., 2017 and many others). The way how state ownership is associated with the willingness and ability of SOEs to internationalize and consequently influence performance largely depends on the contexts they are embedded in (Hennart et al., 2017). Research on the internationalizing SOEs has a distinctive bias towards China, and in order to overcome this one-sided perspective we need to examine other big emerging economies and their internationalizing SOEs. Researchers examined the globalizing SOEs from almost all largest emerging markets: China (Cui, Liang, 2012), Brazil (Musacchio, Lazzarini, 2014), India (Choudhury, Khanna, 2014), but Russia remains somewhat in shadow, despite the fact that Russian state companies go overseas actively.

All in all, the research on the internationalizing SOEs produced contradictory results. According to the study of Hennart and his colleagues (2017), who focused on the Brazilian context, the intensity of internationalization is positively influenced by the degree of the state ownership in companies. This positive association contradicts the findings Huang and the co-authors (2017) who studied the case of Chinese companies and found out that the high percentage of state-owned shares exerts negative effects on SOEs' OFDI. In order to clarify the relationship between state ownership and internationalization, we should consider other emerging economies and their internationalizing SOEs where Russia offers a prospective laboratory for the research. Russian state companies promise to reveal the insights on the internationalization strategies of SOEs that experience unique situation: they face the external geopolitical pressures such as sanctions imposed on the state companies, and they therefore have to adjust the strategies of internationalization to them. Examining the internationalization strategies of the Russian SOEs therefore aims to advance knowledge on the influence of state ownership on internationalization which still remains ambiguous (Bruton et al., 2015).

Russian context is very prospective for the purposes of our research, as it offers a good laboratory to study the the state companies that expand internationally. The reason is that SOEs are among the largest enterprises of the country (Expert 400, 2016), while according to Fortune Global 500, 4 of 5 Russian enterprises presented there are state-owned: Gazprom (56), Rosneft (118), Sberbank (199), and VTB Bank (478). Moreover, and among all M&A deals of Russian MNCs in 2014 approximately 50% were deals with state companies (according to the data from Zephyr database of M&A). Therefore, in terms of internationalization SOEs are very present on the Russian and hence on the global market.

State-owned enterprises are defined differently in the scientific literature. Cuervo-Cazurra et al. (2014) describe them as legally independent companies with direct state ownership. This definition may limit them to the firms exclusively to those ones where the government has a direct share. These scholars mention that IB literature tends to represent state and private companies as antagonists who have conflicting agendas, which is in fact the result of such an oppositional definition. There have been then attempts made to dive deeper into this definition to examine the multifaceted nature of state-owned companies. Bruton et al. (2015) suggest to overcome the dichotomy of solely state vs. private enterprises, and extend the understanding of SOEs by defining them as hybrid firms with various levels of ownership and control of the state (as did Diefenbach, Sillince, 2011; Inoue, Lazzarini, Musacchio, 2013). In this study we examine not only firms that are directly owned by the state, but also companies that have indirect ownership by the state via state agencies (Ciu,Jiang, 2012).

State ownership and internationalization

The relationship of the state ownership and internationalization is theoretically elaborated in various theories that examine the way state companies go overseas. Basically, all theories answer the question: how state ownership influences internationalization, encourages or hinders it, in other words, how this specific nature of state companies is reflected in the internationalization path and strategy of enterprises.

Neo-institutional economics studies SOEs in a conjunction with the institutions of both home- and host-countries that are claimed to influence companies in their international expansion. First, institutions of home and host markets are examined in a way that they influence state companies once they internationalize. The impact of institutions demonstrates itself in questions of the very motivation of SOEs to go global (Witt and Lewin, 2007), entry mode choice (Brouthers, 2002; Chan, Makino, 2007; Meyer, Estrin, et al., 2009), choice of destination, organizational form to exist in a host country, and institutional pressures that arise once SOEs decide to expand overseas (Kostova et al., 2008). The question of SOEs' legitimacy is in the centre of neo-institutional theory (Cuervo-Cazurra et al., 2014), which problematizes the possible conflict of the host and home country institutions (Kostova and Zaheer, 1999). To put it simply, neoinstitutional economics posits that companies (should) consider institutions in home and host countries as they shape the strategies of internationalization and affect the way a firm performs at a foreign market.

Meyer and his co-authors (2014) argue that because of the specific status that SOEs have as dual agents of economic and political nature with perceived unfair advantages that state ownership provides and possible political agenda, and because of the historical loading, they face additional institutional pressures abroad. These pressures are particularly strong in the countries where normative control is high and where the market regulates itself with the minimal involvement of the state regulation mechanisms. Thus, institutions represented by various local actors of a host country, illuminate the difference that state companies have as opposed to private ones. The authors claim that institutional constellation of the host economy is a key determinant in terms of the entry mode choice, and in order to soften the institutional pressures, SOEs adapt their strategies to the host markets to enhance their legitimacy. The adaptation is manifested in entry mode they choose and control decisions they execute.

The choice of the entry mode as an legitimacy building instrument often means that SOEs engage in alliances with local firms to exercise isomorphic practices or with both private and state host-country firms. SOEs may also rely intensively on the corporate social responsibility activities in order to enhance legitimacy among the local stakeholders (Cuervo-Cazurra et al., 2014).

Institutional theory examines the phenomenon of SOEs' internationalization, taking into account the political perspective as well, since the influence of institutions is often problematized with respect to politics and "governments as owners" (Cuervo-Cazurra et al., 2014), namely the extent of control the state executes over SOEs and possible political trade-offs. Cui and Jiang (2012) study the effect of state ownership in FDI decisions in the conditions of institutional pressure and found out that state ownership creates political affiliation of state firms with their home-country government. Such affiliation influences the way SOEs take decisions concerning the entry mode in a particular way, namely the higher stake of government in a company positively moderates the effects of home regulatory, host regulatory and host normative pressures on a company to decide in favor of a joint ownership structure (Cui and Jiang, 2012).

Transaction cost theory develops the owner-risk argument, that argues that the state ownership equips companies with different sense of risk-tolerance as opposed to the private companies, because of larger budgets and resources (Kaldor, 1980). As a result, SOEs may be more willing to undertake riskier investments and participate in riskier projects (Cuervo-Cazurra et al., 2014). Because of such an "airbag" SOEs tend to invest into less stable economies that potentially bear risks. Such distinct risk tolerance also results in SOEs more willing and able to choose in favour of more risky entry mode as OFDI through acquisitions and greenfield ventures (Ramasamy et al., 2012; Duanmu, 2014). The owner-risk argument is reflected as well in the SOEs less sensitive to the expropriation risk abroad as the governments in their home countries may use political power to negotiate conditions less favourable in terms of expropriation risk (Cuervo-Cazurra et al., 2014), or neglect the threat of expropriation risk even if it is high, provided that a host country has a positive political relations with a home country (Duanmu, 2014).

All in all, state companies are considered to see the transaction costs differently, and act differently. High levels of government ownership make companies more tolerant to risk and view an investment at a lower transaction cost in comparison to the enterprises that have no or little government ownership. Apart from that, the institutional environments influence subsidiary ownership in a way that it is negatively moderated by the level of government ownership of a firm and its level of legislative connections (Pan et al., 2014).

The way state ownership influences internationalization is often examined by means of the agency theory and its variations. Agency theory states that because of agency conflict SOEs are typically less efficient, and thus less able to develop resources that will help them to compete abroad. Consequently, SOEs are considered to be less likely to internationalize. Estrin et al. (2012) find empirical support to this supposition but as well state that broader perspective is needed to grasp the diverse environment in which SOEs operate. And here a contradiction to other theories can be illuminated. According to the political economy and state capitalism paradigm, the degree of state ownership is positively associated with the internationalization level of SOEs. The evidence was found on the Brazilian context (Hennart, 2017). Scholars that use resource-based view argue that the state shares have a negative effect on the OFDI of SOEs (Huang, 2017). This contradiction illustrates the ambiguity over the relationship of state ownership and internationalization that we seek to resolve by examining the internationalization of SOEs in Russia.

SOEs in Russia

Russian economy is characterized a lot by state influence and intervention: according to the 2016 Report of the Federal Antimonopoly Service, 70% of the economy of the country is controlled by the government via state companies, and this share has increased from 35% in 2005 (Vedomosti, 2016).There is a current trend of further increase in state control over economy in the recent years. The government has played an active role in the emergence of the Russian multinational enterprises, and in outbound FDI from the country. Though the Russian economy is substantially shaped by the state, it does not automatically mean that international activities are dominated by SOEs. For example, the role of SOEs in the OFDI is quite large comparing with the economies of the developed countries, but still rather low in comparison with economies of other emerging markets, especially their flagship - China (Kuznetsov, 2011).

Researchers examined Russian SOEs with regards to their role in the economy (Radygin, 2015), their ownership structure (Abramov et al., 2017; Vernikov, 2010) but internationalization in particular, to the best of our knowledge, was not addressed by the scientific community, although the Russian state-owned companies are globally among the leading investors (Kuznetsov, 2013; Dikova et al., 2016). In top 20 largest Russian enterprises by the amount of foreign assets there are 6 companies that have various share of the state. Resource firms dominate the list, not only gas&oil and metals, traditionally leading export industries, but also chemical, electricity and service companies (Kuznetsov, 2013).

Russian SOEs' international activities received scant attention from scholars. The scarcity of research on the Russian SOEs' internationalization may be explained by the lack of transparency that they demonstrate, which results in the missing data (Kuznetsov, 2011). Some state enterprises, such as state corporations, are legally in fact non-commercial organizations that were created to serve the public interest, they are hence free from the obligatory reports that commercial companies have to present.

Russian SOEs enjoy administrative support, access to loans and resources (Panibratov, 2013) which give them additional advantages in internationalization. In media in and outside Russia its state-owned companies are often seen as a vehicle to realize political goals of the government and secure national interests of the country. Researchers also argue that the state companies in Russia are widely considered to have both commercial and strategic reasoning while expanding overseas, and the extent of each remains unclear (Jirusek, Vicek, 2015). As a result, internationalization strategies are expected to be tightly interconnected with the foreign policy of the state (Vaahtra, Liuhto, 2004).

These contextual specificities suggest considering the public agenda reasoning which argues that the Russian SOEs will pursue strategic, rather than commercial goals in their internationalization process. Taking into account the expected political agenda in the internationalization strategies of the Russian state companies, we assume that the state ownership degree is negatively associated with the internationalization level, since the political reasoning leads companies to the overseas expanding that pursues strategic goals that are not necessarily correlated with the high internationalization intensity. Apart from that, because of the specific status that SOEs have as dual agents of economic and political nature with perceived unfair advantages that state ownership provides and possible political agenda, and because of the historical loading, they lack legitimacy (Meyer et al., 2014). As a result, they might face additional difficulties as they internationalize and end up less internationalized than private-owned companies. Thus the hypothesis: the degree of the state ownership of the Russian SOEs is negatively associated with the internationalization level.

Hypothesis: state ownership of the Russian SOEs is negatively associated with the internationalization level.

Method

In order to examine the influence of state ownership on the internationalization degree of SOEs companies we ran Tobit regression analysis on the sample of 438 observations of the export activities of Russian companies. Tobit regression is used because the dependent variable - the degree of internationalization - is bound to 100 (Tobin, 1958). We used the list of the 250 largest Russian exporters for the years 2013-2016, published by the Expert Rating Agency. The list consists of the two parts: the major list of 200 largest Russian exporters on a federal level, and the second part, 50 companies, are taken from the list of the largest exporters of the Siberian region. The 200 of the companies constitute 80% of the overall volume of export in Russia. The choice of the sample is grounded in the lack of data on the internationalization activities of the Russian SOEs, and therefore, most firms in the list do not have a degree of state ownership. The final sample is the result of exclusion of the companies with missing data.

Dependent variable: degree of internationalization

To test the hypothesis we use the dependent variable of FSTS reflecting on the internationalization degree of companies. The degree of internationalization is measured as the ratio of the foreign sales to total sales (FSTS), the conventional indicator of the internationalization degree (Sullivan, 1994). We admit that there are limitations in such a method of measuring the internationalization degree, as it is reflected solely in the export activities of a firm but have to decide in favor of this measure because of the availability of data.

Independent variables: direct and indirect state ownership degree

The independent variables we use present the stake of the state in the ownership structure of firms. To measure it we use the the percentage of direct and indirect state equity in the company (Abramov et al., 2017). The information is obtained from the databases, if not the case, we addressed the annual reports of companies. We divided the percentage of direct and indirect state ownership (the latter means the company is wholly or partially owned by the other company that is in turn owned by the state).

Control variables

To control for firm size we used company's financial data, namely gross profit lag, to control for the experience of companies we used variable age (number of years since the foundation), to control for the location near the seaport we used a dummy variable (as a variable that may reflect the opportunities for a company to intervene in export activities), to control for industry we used dummy variables of industries (particularly OilGas industry). We also used political connections as a dummy variable to control for the political affiliations of the companies. The criterion to attribute a company political connection was the fact that its executive board included politicians of any level: national, federal or municipal. This data was gathered manually from companies' webpages, their annual reports and other documents.

Descriptive statistics of the sample

The most companies in the sample belong to traditional leading exporters - resource industries such as oil and gas, iron industry, chemicals and petrochem, precious gems, their overall share in the sample is 70,5%. They are followed by the machinery (12,5 %) - the major non-resource export industry (Expert 200, 2016), food industry (10,5%), construction materials firms (2,5%), tobacco companies (2%), printing industry (0,5%), multi-industry companies (1,5%). There are slight differences across the years in terms of the list of companies and the percentage of industries, and there is a trend observed of increase in the percentage of the non-resource export among the leading exporters (Expert 200, 2016).

The list is dominated by the private companies (82%), and the share of the firms that have direct or indirect state ownership amounts to 18%. Nevertheless, taking into account that we have panel data, we believe the number of observations enables us to test the first hypothesis concerning the percentage of the state ownership and its influence on the internationalization intensity of companies. Following Hennart, we consider both companies with and without state equity relevant for the examination of the internationalization of the SOEs (Hennart et al., 2017).

The half of the companies in the list are large (with on average 1000 - 5000 or more than 5000 employees), the other half consists of medium companies with 23% (250 - 1000 employees), small companies with 27 % (up to 250 employees). The most companies were established more than 10 years ago: 39% of firms are 10-20 years old, 34,5% - more than 21 years old, the relatively new companies amount to 18,5% (6-10 years) and 8% - less than 5 years. It is then obvious that a substantial part of the companies were established in the 1990s at the time when the Russian companies started opening up for the international markets.

Preliminary results

The table 1 demonstrates the results of the tobit panel regression run with STATA

The random-effects tobit regression demonstrates that the model is significant, since the p-value is less than 0.05. State ownership direct is found insignificant, whereas indirect state ownership is significant (coefficient is 0.02) but negatively associated with the internationalization degree operationalized as FSTS. Political connections and age do not show significance as a control variable. Among the industry controls OilGas turned to be significant which is not surprising, taking into account the resource specifics of many countries in the sample. Thus, belonging to the oil and gas industry is proved to be positively associated with the internationalization degree of companies.

Table 1.

```
Random-effects tobit regression                 Number of obs      =       438
Group variable: Firm                            Number of groups   =       113

Random effects u_i ~ Gaussian                   Obs per group: min =         1
                                                               avg =       3.9
                                                               max =         4

Integration method: mvaghermite                 Integration points =        12

                                                Wald chi2(7)       =     26.52
Log likelihood  = -1911.5899                    Prob > chi2        =    0.0004
```

FSTS	Coef.	Std. Err.	z	P>|z|	[95% Conf.	Interval]
SODIRECT	-.0543465	.0786727	-0.69	0.490	-.2085421	.0998491
SOINDIRECT	-1.071899	.4665415	-2.30	0.022	-1.986304	-.1574948
Politicalconnections	-.9743111	5.460578	-0.18	0.858	-11.67685	9.728225
age	.3720906	.3206745	1.16	0.246	-.2564197	1.000601
OilGas	21.31422	6.913969	3.08	0.002	7.763087	34.86535
others	8.784851	5.407173	1.62	0.104	-1.813014	19.38272
lgross	-3.328658	.9232709	-3.61	0.000	-5.138235	-1.51908
_cons	105.2959	18.34024	5.74	0.000	69.34974	141.2421
/sigma_u	23.46079	1.711147	13.71	0.000	20.10701	26.81458
/sigma_e	13.78475	.5413041	25.47	0.000	12.72381	14.84568
rho	.7433657	.0322979			.6762636	.8024036

Discussion and contribution

Preliminary results show that the hypothesis is confirmed just for companies with indirect state ownership, so the state ownership degree is indeed negatively associated with internationalization level of state companies, but solely for those where state has indirect stake. It may mean that firms with indirect state affiliation are used by the government as a leverage to reach non-market goals. Thus, the state pursues strategic (as opposed to commercial) agenda indirectly. Apart from that the negative effect of state ownership on internationalization intensity may be explained by the following reasons: first, state ownership is often associated with insufficient level of competitiveness of its products, services or corporate management for competing on the internationals market; second, benefits that a company gets from the state participation in its ownership structure don't create incentives for going and expanding abroad; third, state ownership makes companies vulnerable to international political crisis and sensitive to the foreign policy of a state.

The results demonstrate positive association of the internationalization level to the oil and gas industry which is in line with the market-seeking motives of resource companies that are in pursuit of markets to sell their production. Company size is found to be negatively associated with the internationalization level, and this result may fit to the reasoning of the public (domestic) agenda of the state. It means that large companies are guided in their internationalization aspirations by the public agenda of the government.

The limitation that we acknowledge with regards to the present study is that the dependent variable we use, the ratio of foreign sales to total sales, fails to grasp the internationalization activities of state companies that happen outside the export entry mode. Thus, the activities of foreign subsidiaries of companies are not taken into account. One more limitation is the small percentage of the state companies in the sample which is grounded in the lack of data on the internationalization of the Russian SOEs. Despite this limitations, potential theoretical contribution of this study lies in advancing knowledge on the interplay of the political and economic reasoning behind the internationalization strategies of SOEs which is far from being clear-cut. Further investigation should focus on finding out, how country context influences the relationship between state ownership and internationalization and why state companies in various contexts internationalize differently. Another prospective path for future research is to investigate other factors that influence internationalization strategies of the Russian SOEs.

Conclusion

This study aims to examine the way how state ownership influences internationalization of companies, using the evidence from the Russian context. State companies worldwide expand over their national borders and thus get over the traditional domestic focus. How exactly the state ownership is associated with the state ownership remains a question, for the prior research produced contradictory results in this concern. The ambiguity might well be grounded in the various country-contexts where state-owned enterprises are firmly embedded. Contextual differences are taken into account by scholars but there is still a lack of knowledge on how particularly the country context impacts the relationship of the state ownership and internationalization.

The results of this study show that the state ownership, in line with our hypothesis, is negatively associated with the internationalization degree, but solely in case of the companies with the indirect ownership. It suggest using the argumentation of the public goals of SOEs that influence the agenda of the state companies and result in lesser degree of internationalization. The direct state ownership turns out to be negatively associated with the internationalization level

The focus of this study is on the question how state ownership influences the internationalization of the Russian SOEs. It may seem yet another replication study in a different context, but our goal is broader, namely to contribute to the understanding of the internationalization of the state companies theoretically. Therefore, we strive to know not just how state ownership influences companies’ ability to internationalize, but why it happens the way it does. Further investigation will advance knowledge in this concern.

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