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POLITICAL RISK IN FOREIGN DIRECT INVESTMENT IN THE RUSSIAN ELECTRIC POWER SECTOR

Master´s Thesis
in International Business

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8.11.2015
Turku

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1.1 Development of the Russian electricity sector

Russia is the world's fourth largest electricity producer after China, the USA and Japan with the total generating capacity of 223,100 MW and also the fourth largest electricity consumer after China, the USA and the EU with the annual production of 1.055 TWh. Two thirds of the total produced electricity is generated in thermal power plants from the fossil fuels, 17.2% by nuclear power and 15.1% by hydroelectric power (IEA 2011; WFB Russia 2013). This division of energy sources is close to the EU average, although the fuel mix in thermal generation relies on natural gas, 2/3 of the plants, and on coal, 1/3 of the plants. Consequently the availability and the price of natural gas are central to the electricity producers (Erkkilä, Simola & Solanko 2009, 6–7; Solanko 2011, 4). Of final electricity consumption the industrial use covers 46%, the commercial and public services 22%, the residential use 18% and the share of transportation is 12%. The share of agriculture and fishing is minor. Russia is divided into seven regional electricity systems: the Central, Siberia, Volga, Ural, the Northwest, the South and the Far East. The regional electricity systems vary in terms of population, consumption, power structure, role of industries and time zones. Russia is net exporter of the electric power, but the share of export of the total electricity generation is rather modest and the electricity export has not been significant for the Russian economy (Kurronen 2006, 4–5; IEA 2011; WFB Russia 2013).

The Russian electric power sector inherited the problems of the former Soviet Union and the weaknesses of past formed for long the main challenges in the sector and to understand the sector today it is central to mirror the past. In 1992 the ministerial structures of the USSR were replaced by the Unified Energy System of Russia (RAO UES) which took control of all functions in the electric power sector. RAO UES did not have full ownership of all power companies, but there were 72 vertically integrated local electric power companies under its control and these 'AO-energos' produced 70% of all used electricity. Additionally RAO UES was responsible of 96% of high and low voltage grids in Russia. It also owned the central dispatch administration, the Federal Network Company, 36 power plants, 57 R&D institutes and 70 construction, maintenance and service companies. RAO UES was formed as an open joint-stock company with a majority state-ownership (Tompson 2004, 5; RAO UES 2013).

In the nuclear power segment the Soviet Ministry of Atomic Energy was replaced by the Russian Federation's Ministry for Atomic Energy in 1992. The Federal Atomic Energy Agency was established in 2004 and its functions and authorities were acquired in 2008 by the State Atomic Energy Corporation, shortly put RosAtom, which was

established just a year before to consolidate the nuclear assets. Rosatom manages among others the nuclear power plants. In addition to RAO UES and predecessors of Rosatom there were a few small independent power companies with the minor importance operating in the Russian electric power sector in the 1990's (Solanko 2011, 9; Rosatom 2013).

Until the year 1990 the size of the electric power generation capacity in Russia was in line with other European countries, although a decade had passed without any investments in the sector (Kurronen 2006, 6). The electricity consumption first dropped in the post-Soviet depression - especially in industrial and transportation sectors. The household consumption showed signs of gradual grow already during the 1990's, but the prominent increase started rapidly with economic growth in all sectors after the economic and financial crisis in 1998. At first meeting electricity demand was rather easy due to the existing capacity, but soon the economic growth indicated the then generation capacity insufficient and outdated. Moreover the infrastructure of sector was in poor condition. The transmission and distribution losses were 8% of total electricity output in 1990 and already around 12% in 1998–2006 due to the frail condition of the network, neglects or thefts (Chmel 2005, 128–130; Erkkilä et al. 2009, 5–6; Solanko 2011, 5–6; WDB 2013).

Since 1992, the Federal Tariff Commission and its regional offices placed the wholesale electricity prices and transmission fees and controlled the retail trade of electricity and heat (Solanko 2011, 7). The state set consciously the electricity tariffs low in order to control inflation and to boost the domestic competitiveness; the regulated prices were often below the production costs. At the same the government and the regional authorities exercised cross-subsidising by supplying the electricity to people with the lower cost than to industrial consumers – often for populist reasons. As a result, the prices rose slower than inflation, hit the incomes of power companies limiting their investment capability (Ahrend & Tompson 2005, 28; Chmel 2005, 130; Erkkilä et al. 2009, 5).

The electricity sector had the worst productivity figures of all industries in Russia (Tompson 2004, 4). Also by international comparison the Russian electric power sector was highly inefficient. The economy of Russia was one of the most energy-intensive economies due to the country's notable geographic size and cold climate, but also due to its industrial structure and above mentioned tariff policy with the lack of incentives for efficiency (Johnson 2005, 259–260; BW 2007a; Solanko 2011, 6–7). In fact, the inefficient energy consumption made many local products uncompetitive. The regional authorities accuse AO-energos for exaggerating costs in their cost-plus tariffs and not supplying energy to them because they were regarded as slow-paying customers. In general there was a lack of payment discipline; it was very common for consumers not to pay the electricity bills. Consumers, both industrial and households, protest that they pay too high energy prices without guarantees of undisturbed supply. At the end the situation

could not be neglected or otherwise the lack of electricity would have harmed Russia's economic growth, competitiveness and promptly improving living standards. The increased need of electricity itself and efficiency, transparency and openness for the industry raised the discussion of the reform and pushed the idea of privatisation in the sector. The privatisation was seen as a way to attract foreign direct investments since tens of billion Euros investments were needed (Chmel 2005, 128–130; Erkkilä et al. 2009, 5; Solanko 2011, 7; Russian grids 2013). RAO UES started to restructure its operations already in 1999 with the lead of its head Anatoly Chubais. RAO UES was active to develop and open the industry from the very beginning (Kurronen 2006, 7; PMR 2013).

After several political discussions, careful planning and processing of alternative models, Russia approved ambitious electric power reform in July 2001. The reform was huge (Russia regulations 2003; Chmel 2005, 135; Erkkilä et al. 2009, 5–6, 9). The plan was to privatise and to create competitive electricity market by 2006 including a creation of new private owned generation units with sustainable production, to liberalise the electricity prices by 2009 and to create electricity stock market. The main idea of the privatisation was naturally to attract investments for the modernisation and for the creation of new technologies and capacities, but also to create motives to generate the electricity efficiently and with reasonable price in addition to restrict the abuse of market positions (BW 2007c; RAO UESR 2008; Erkkilä et al. 2009, 5, 9–12).

The reform followed the World Bank's standard model of reform in the electric power sector with a creation of legal framework, corporatisation, commercialising the sector's assets, opening the entity and introducing independent regulator to business and creating possibility to privatise power generation and distribution functions (Besant-Jones 2006, 5–6, 11). In March 2003 the Russian government released new Federal laws[1] and revised the existing ones in order to create the legal basis for the improvement. The legislation imposed on a separation of competitive and monopolistic functions of the industry's four main parts generation, transmission, distribution and sales where transmission and distribution are monopolist by the nature, whilst generation and sales represent competitive functions (Tompson 2004, 11; Kurronen 2006, 7; Solanko 2011, 9–10). A month later the government published the Energy Strategy 2003–2020 (ES-2020), a political priority programme focusing on the national energy safety, efficiency, environmental and budget resources, underlining the need for the changes (Solanko 2011, 9).

There was a rough divestment plan for RAO UES. It was clear that the Russian state would maintain its ownership in hydro and nuclear power especially due to the security issues, but also in transmission. As a holder of the transmission grid it can assure equal access for the transmission to all generators. All in all, the division of RAO UES would

[1] Laws no. 35-FZ and no. 36-FZ (Federal laws 2013)

not be easy: the company was so large (Kurronen 2006, 7–9; Erkkilä et al. 2009, 9). After the initial steps the reform focused in the introduction of a system operator to connect demand and supply, and the electricity trading pool, later named for the Administrator of the Trading System (ATS), for the retail sales (Kurronen 2006, 8; RAO UESR 2008). To achieve successful privatisation the electricity prices should fully cover the costs of generation and transmission and enable return for investors (Solanko 2011, 13). As noted the pricing in Russian electric power sector was strongly affected by the politics and the introduction of market-based pricing was seen problematic. In the early stage of reform there was a fear of sky-high electricity prices in the market (Korneev 2004, 93; Johnson 2005, 259–260).

In July 2004 the government published updated reform plan. It reaffirmed that the original timetable for the 29-step reform and the electric power market would be open up at the beginning of 2006, although the process already had been delayed a few times so far. The regulatory work with the wholesale market was in the schedule, but the liberalisation process of RAO UES was stagnated. The Prime Minister Mihail Fradkov indicated that more information about the outcomes of the divestment was still needed. Practically this was a stop for the entire reform and raised public doubts about the political will to proceed (BW 2004; BW 2005b; Kurronen 2006, 9).

There were wide electricity shortages in Moscow region in May 2005 which likely incited the President Putin to criticise the management of RAO UES of focusing in the short-term revenues instead of developing the infrastructure in the national Security Council in the summer 2005. Putin stated that the restructuring of RAO UES is a must, but advantageous only when correctly implemented (BW 2005a). The winter season in 2005–2006 was especially cold and the lack of capacity was obvious. The electric power and heat plants worked in full loads, even though they were suffering from fuel shortages, especially of natural gas, while the grids exceeded their theoretical maximums. There were electric power interruptions and failures together with the lack of operational transparency. Both the president's personal concern and the winter temperatures in -30°C degrees boosted the reform to continue as a necessity, not as a political movement towards liberal markets. Ever since the Russian electric power reform proceeded with notable speed (Kurronen 2006, 11; Erkkilä et al. 2009, 5; Solanko 2011, 9–10).

The President Putin spoke out again in June 2006 stating that inefficiency of the electric power sector slows the economic growth in Russia. Also the head of RAO UES Anatoly Chubais warned that the pace of reform is too slow and more power shortages may occur. The frequent blackouts in St. Petersburg and Moscow had already limited the production growth in the areas while the increase in consumption was notable. The Ministry of Industry and Energy of Russia re-estimated that 70 billion Euros investment is needed for the sector until 2010 referring to private investments especially for the infrastructure. The Finance Minister Aleksei Kudrin confirmed that the state will remain

as a great investor in the sector. The government accepted principles of the division of RAO UES into power generation, transmission and distribution companies and plan to obtain investments by the initial public offerings (BW 2006a; BW 2006b).

In 2006 the vast majority (90%) of the electric power generation capacity was built before 1991 and only 23 GW production capacity was added during 1991–2006 (Erkkilä et al. 2009, 6–7). The government's short-term response for the lack of production capacity was to raise the nuclear power with 10 GW, although the long-term plan focuses to decrease the role of nuclear power in electricity generation. The investment cost about 44 billion Euros and raised the share of nuclear power generation from 16% to 22%. However the benefit was and will be only temporary as the existing capacity is getting older and the capacity utilisation was already relatively low, about 73%. According to estimates in 2006 the electricity consumption would increase 1400–1600 TWh by 2015 which means 20% increase by 2020 compared to level in 1990 and the total need for new production capacity would be about 50 GW in order to replace the aged capacity until 2020 (BW 2006b; BW 2006c; Kurronen 2006, 12; Erkkilä et al. 2009, 7; Solanko 2011, 7).

The investment potential together with growing private consumption, economic growth and populous market has generally increased the interest and value of foreign investments in Russia (Liuhto 2007, 2). New focus for the reform objectives, the gradual liberalisation of the industry and the tariff increase towards world market prices were counted to attract private investors (BW 2006b). Also somewhat surprisingly the electricity sector was not named in the law of strategic industries[2] which was introduced by the Russian government in 2008. The electric power is highly crucial for economic security and the electricity supply to the strategic cities such as Moscow and St. Petersburg is certainly strategically important (Liuhto 2009, 29; Solanko 2011, 11). The Russian electricity sector was regarded very risky for foreign investing due to its uncertain market structures and missing transparency (Chmel 2005, 131). Many challenges were seen on the way; legislative and regulatory policies were possible to delay the reform and the government's commitment for the reform was not obvious, although it was rather unquestionable for foreign operators that Russia needed market conditions for the industry to enhance economic development. Russia also suffered from the lack of electrical engineers, business managers and power equipment manufacturing. The target to increase the competition in the sector was also a question mark (Plakhov 2007, 69).

From the foreign investor's point of view more gas suppliers would have been needed in the upstream energy sector instead of one giant player Gazprom (Plakhov 2007, 69).

[2] The Strategic Investment Law was launched in April 2008. According to the law any foreign investor intending to buy 50% or more of the company in the specified sectors of oil, gas, nuclear power, arms, fisheries, aviation technology, communication or media, requires a governmental approval (Liuhto 2008; Reuters 2008).

Gazprom announced in 2004 that it has already 10% of RAO UES stock and substantial investment plans to expand into a multi-industrial company. However Gazprom's expansion to the electricity market was noted against the reform's objectives. Simultaneously the electric generators were openly encouraged to increase the use of coal. Both Anatoly Chubais and the Minister of Economics and Trade German Gref strongly criticised Gazprom's changed strategy and attempts to negotiate with coal producer Siberian Coal Energy Company SUEK for the coal deliveries as well (IES Holding 2004; BW 2007b). Foreign investors' one concern related to the electric price regulation; as long as the prices are regulated, there cannot be high expectations for the return on capital. Russia had strong fiscal arguments for the price liberalisation, since the state subsidies of electricity prices were 12 billion Euros in 2006. The households use 22% of the produced electricity and the state's part in the end-user electricity prices was already 34% (BW 2007a).

In September 2006, the liberalisation of the sector continued with the establishment of the Russian electric exchange and the government accepted the plan to leave the fully regulated trade. The Federal Tariff Commission was partly replaced by Regional Energy Committees. From the end of 2006 the wholesale was made through bilateral agreements based on estimated consumption; if the usage exceeded the estimate, the spot market prices were used. The price liberalisation was already postponed with 2 years and the updated plan was to increase the share of market-based trade gradually every 6 months so that the end of 2011 all industrial consumers would be using the market based pricing and the residential users a few years later (BW 2006a; BW 2006c; Solanko 2011, 13). At the same the Ministry of Industry and Energy set price hikes so that also the regulated rates would increase 10% in 2007, 9% in 2008 and 8% in 2009 and then reach the actual market prices (BW 2006b). Also the distribution tariffs were to be replaced by market-based pricing in 2011, although the price hikes were reset from 30% increase to maximum 15% increase (BW 2011b). By mid-2008 one fourth of the industrial electricity prices were market-based, in early 2009 the number was 30%, in mid-2009 50% and in mid-2010 the share was already 80%. But there were doubts about the household price liberalisation; the tariffs rose, but they were still far from the actual or industrial prices. The plan was again revised during the process noting that the households face the price increase sooner than promised (BW 2008a; Solanko 2011, 13).

RAO UES approved the updated privatisation plan in early 2007. According to the latest changes the state would not sell the privatised generation companies directly to the investors, but nominates two state-owned intermediate holding companies for the process. The reason was to avoid the legislative disparities and to enhance the much needed investments, but the same time it was accused to be difficult and to delay the privatisation (BW 2007b). The divestment of RAO UES was officially accepted in the company's general meeting of the shareholders in autumn 2007 (BW 2007c). The divestment plan

was carefully considered and the new generation companies were in-line by their generation capacity, value of fixed capital and depreciation ratios of the assets (Solanko 2011, 11).

The generation assets of RAO UES were divided into 22 generation companies: 6 wholesale generation companies (WGC) serving electricity, 14 territorial generation companies (TGC) serving both heat and electricity by their combined heat and power (CHP) plants, while hydro power plants were consolidated to the state-owned hydro power company RusHydro and the rest of the generation capacity of RAO UES was transferred to newly formed InterRAO. The new companies were already listed in Moscow stock exchange by September 2007 and the state and RAO UES had gradually decreased their holdings so that they would leave their ownerships by spring 2008 (BW 2007c; RAO UESR 2008; Erkkilä et al. 2009, 10). The ownership and the management of the high-voltage transmission grid were transferred to the majority state-owned Federal Grid Company. The state-owned holding company, JSC IDGC Holding (JSC Interregional Distribution Grid Companies Holding), remained the control of the interregional and regional distribution grids (BW2007c; Solanko 2011, 10; Russian grids 2013). So the state held the ownership of national power grid and new regional transmission companies, but it also committed to invest in the grid with the incomes received from the privatisation. In addition a fully state-owned System Operator (SO-EES) was established and likewise RAO UES ceased to exist on the first of July in 2008 (BW 2008d; Solanko 2013, 28).

The new generation companies, WGCs and TGCs, were privatised in auctions during 2007 and 2008 and new owners were committed in substantial and legally binding investment plans for the next ten years (Solanko 2013, 28). The Russian gas giant Gazprom acquired strategically important WGC-2, WGC-6, TGC-1 and TCG-3 companies which together cover 16% of the total electricity generation in Russia. Gazprom is currently responsible for the electricity supply to St. Petersburg and Moscow, and the largest owner of the privatised generation capacity with the share of 33% (BW 2007d; Erkkilä et al. 2009, 11; Solanko 2011, 11). The coal producer SUEK bought controlling stakes in Siberian and Far-Eastern TGC-12 and TGC-13 (RM 2010). According to estimate Gazprom and SUEK took control of at least 40% of the electric generation capacity (Liuhto 2008, 24). Russian Norilsk Nickel bought a majority holding of WGC-3 and IES Holding acquired TGC-5, TGC-6 and TGC-9 (BW 2007d; IES Holding 2013).

One of the largest European energy companies Italian Enel entered the Russian electricity sector already in 2004 through the managerial operation of the North West Power plant in St. Petersburg under RAO UES's mandate. The cooperation was successful as the plant capacity was doubled between 2004 and 2007. Enel's involvement in the sector began with a joint venture and in 2006 Enel acquired 49.5% stake of the

electricity supplier RusEnergySbyt (RES) from ESN group. Due to the agreement Enel had an access to the market (Enel SpA Russia; IES Holding 2013). Later in the privatisation process Enel acquired totally 55.43% stake of WGC-5. First Enel acquired one fourth of WGC-5 for 1.2 billion Euros in July 2006 and increased its ownership until 37% and bought finally majority of the shares (Enel Russia; JSC OGK-5; Russia: Electricity reform attracts foreign investors 2007). In 2007 Enel started a project of installing 700,000 electronic reading meters in the province of Belgorod. Moreover Enel has made a contract with RosAtom in order to develop the existing electrical systems and to build new nuclear power plants. Today Enel also participates in the Russian upstream energy sector (Enel SpA – Russia 2013; Enel Russia 2013).

Since 2005 Finnish Fortum looked actively investment opportunities in Russia and took part in the auctions (Rainisto 2008, 10). As Enel, Fortum joined the market through a joint-venture related to the electric generation utilities Lenenergo JSC and Kolenergo JSC which belong to the Northwestern TGC-1. Fortum participated in TGC-1 auction where it managed to maintain its 25% ownership (Lehtinen 2006; BW 2007d). Today Fortum is the second largest owner of TGC-1 with 25.66% share after Gazprom (owning 51.79% stake (TGC-1 2013; Fortum 2013). In early 2008 Fortum agreed to buy 76.49% holding from the Western Siberian TGC-10 with about 2.1 billion Euros. Fortum acquired 93% of the TGC-10 shares during 2008 when the total value of the acquisition raise almost for 3 billion Euros. The acquisition is the largest Finnish made investment by far in Russia in the history (Fortum CIR 2008a, 3; BW 2008b; Liuhto 2008, 13). Fortum is a majority owner of TGC-10 which changed its name for AOA Fortum in 2009 (TGC-1 2013; Fortum 2013).

One of the world's largest privately owned energy company E.ON entered the Russian electricity market in 2007 by acquiring 70% stake of WGC-4 for 4.6 billion Euros in September 2007. The head office and the origins of E.ON Group are in Germany. E.ON operates also in the Russian upstream energy sector and has cooperation with Gazprom (RERAFI 2007; E.ON 2013). E.ON has since actively increased its ownership in the generation companies (BW 2007c; Solanko 2011, 11). German RWE used to operate in the sector through a joint-venture for a while during the reform's early stages. French Électricité de France (EDF) was interested about the electricity assets in Russia, but eventually abstained from investing. The acquisitions were made in trust of the continuation of the Russian energy reform including the wholesale price liberalisation in 2011. In spring 2008 a general plan GenShema-2020 was introduced for the sector. The Energy Strategy through 2030 (ES-2030) was also updated and published in August 2009. It continued the strategy launched in 2003 and confirmed that the electricity reform continues as planned (BW 2009a).

The global financial crisis landed in Russia in late 2008. In a year GDP decreased 8% and the electricity consumption 6% changing the prospects of both GDP and electricity

consumption growth radically. The new investors complained about the magnitude of investments in the changed business environment, but only some of the deadlines in the investment plan were modified on the way. Instead the economic slowdown eased the production targets and the companies did not struggle with the power shortages but faced a difficulty to achieve modern steam-gas and gas turbines for the plants. The generation companies also suffered from the lack of professional employees which hardened the implementation of new capacity (BW 2008d; Liuhto 2009, 30; Solanko 2011, 11). The Russian government kept purposefully the reform running in spite of the financial crisis. The deregulation of the prices was so close to be finalised (BW 2010).

Despite of the public doubt the reform actually happened and succeeded. The wholesale prices for industrial consumers were freed at the beginning of 2011 with a few exceptions. Twelve relatively isolated regions in the Far East, Kaliningrad, the Komi Republic and Arkhangelsk were declared to non-price zones and remained with the regulation. Also sparsely populated North Siberia stayed outside from the wholesale trade. Russia counts on that the healthy competition in the power generation will keep the electricity prices steady (Solanko 2011, 13; Solanko 2013, 28–29).

The current system is dual-functional with two electricity markets: the electric power market and the production capacity market. The idea is to cover both the operational and fixed costs of the generation. The electric power is traded in the pool and bases on a bid auction; the producers give their bids to the market operator ATS a day ahead of the delivery and ATS publishes the daily average prices. Both demand and supply meet in the capacity markets where the focus is in the stable electricity generation capacity. The generators offer their capacity monthly in the auction and the system operator takes the bids from the lowest to the next lowest until the whole amount needed is traded. The sum of these two market prices forms the price of the electricity (Solanko 2011, 14; Solanko 2013, 29). The reform changed the whole structure of the sector. After the privatisation the generation companies are owned by the large Russian and foreign energy companies and so far 10% of the total generation capacity is in the hands of the foreign investors. Russia has put effort on creating true competition in the sector, although the natural monopolies stay independent, but controlled (Erkkilä et al. 2009, 10). Besides the generation assets also the state-controlled 11 regional distribution companies are considered to be partly privatised. The objective to implement massive investments in the generation and distribution capacity is most likely to become true when the owners of the generation companies take care of their investment commitments (BW 2011c).

Although the new electric power market is very liberal, the future challenges relate to the market supervision and regulation. The state has a considerable role and capacity in the sector to rule the regulations. The authority actions must be transparent and effective in order to maintain the trade (Tompson 2004, 22; BW 2011c). Russia has still a huge potential to increase its energy efficiency; it can reduce even one third of the consumption

and its energy usage would be at the same level with OECD-countries (BW 2011a). It is noted that the electricity consumption has remained the same in past few years, although there were estimates of 2% to 4% annual increase (Erkkilä et al. 2009, 8; Solanko 2013, 28).

One concern relates to the competition healthiness; when there are only a few generators the possibility of market manipulation occurs. There lays a risk of 'oligarchic oligopoly' if the market is not fragmented enough and the private owners are allowed to exercise market power or local monopoly power. There are regions where the nuclear or the hydro power dominates the generation. According to the law, the plants are obliged to sell the electricity to the pool. In reality the nuclear and the hydro plants do not have possibilities to be flexible with their production outcomes and the Northeast, Volga and Siberia may suffer from these concentrations (Tompson 2004, 22; Kurronen 2006, 9–10).

Actual failures of the reform – in addition to several postponements during the process – are the troublesome connecting to the power grid and the decision to leave out the heating sector. Heat tariffs remain regulated by the Regional Tariffs Commissions and the Federal Tariff Commission. The municipally lead heating sector with leaking networks guide customers to consume more electricity. The situation does not support the wished energy efficiency and causes problems to the companies producing both heat and electricity. Combined heat and electricity plants are relatively efficient when they produce both heat and electricity, but very inefficient producing only electricity. When the heat price remains regulated, there may be a temptation to subsidise heat production with the expense of electricity (Tompson 2004, 20; Solanko 2011, 13; Solanko 2013, 28–29). As summarised, Russia has today innovative, modern and unique wholesale electricity market and the reform has so far regarded successful. But the final configuration of the Russian electric power sector has not been seen yet.

1.2 Earlier research on investor's risk in Russia and electricity

Risks in foreign direct investing in Russia. There are several academic studies in English about the risks in foreign direct investments in Russia and the Russian investment environment alike. Jones, Fallon and Golov (2000) studied the obstacles of FDI in Russia. The findings show that Russia did not manage to attract FDI in the 1990's as other transition economies. Foreign investors regarded Russia's situation unstable with obscure prospects of long-term returns. The obstacles for FDI were Russia's political and economic culture and its impact on reform policies, taxation and legal infrastructure, the oligarchy, the existence of widespread crime and corruption, limited privatisation processes and the problems to adapt the competitive market conditions. The government

actions were central to change the Russian investment environment from rather hostile to attractive for foreign investing (Jones et al. 2000, 189–196).

Ahrend (2000) studied the Russian investment environment for foreign companies. European companies with production facilities or distribution networks in Russia were surveyed the reasons for investing, the reason for chosen entry mode and what have been the main operational problems in Russia. The findings were relatively stable across the sectors and the company sizes and addressed that large market was by far the reason for investment. The main problem was the inadequate and changing tax law. The companies met problems with property rights, customs, the risk of political change, macroeconomic instability, banking, the Russian accounting system and corruption. Expropriation, payment arrears and poor intellectual property rights were problems with medium-level importance whereas barter, crime and racket were rather minor problems for foreign investors (Ahrend 2000, 11).

Aleshin (2001) identified, classified and assessed the risks related to join venture projects in Russia. The joint ventures shared mutual interest of counterparts; Russians searched for foreign capital, technologies and experience and foreign companies looked for large market with central geographical position and access to resources and production capacity. The study notes that the business environment in transition encompasses uncertainties and risks, although the attention has been on internal risks instead of external risks including political risk. The research identified 2000 risk events and classified them into external and internal risks and by their cause-and-effect connection. In the risk assessment the risks were ranked by their probability, level of loss and the delay duration. The majority of the risks were caused by the organisational and technical reasons which are explained by the fact that the studied joint ventures were the firsts during the transition and there were very little knowledge available. The role of financial reasons was rather irrelevant, but the finance-related risks are likely to increase in the future. The focus on organisational issues would mitigate the risk occurrence (Aleshin 2001, 207–219).

Zabry and Zeghni (2002) examined the Russian business environment's effect on attracting FDI. They reminded that in spite of large market, substantial natural resources and well-educated labour force Russia has not attracted FDI as it ought to. Foreign investments have concentrated on industrial sector and in Russia's central cities. Mainly the risk taking investors and the investors operating in the local government's protected projects have been interested in Russia. Russia's political climate, corruption, lack of property rights and voucher privatisation have created a relatively poor business environment. The research concluded a lack of incentives for broader FDI in terms of both quantity and quality. Russian business climate is perceived too risky and unstable and long-term political, economic and institutional stability is needed to enhance the FDI-led modernisation (Fabry & Zeghni 2002, 291, 300).

Ahrend and Tompson (2005) studied extensively the Russian business environment from the reform and development point of view. They researched both implemented and future economic reforms in Russia making three conclusions: the basic institutions of market economy need to be strengthened, the reforms of state institutions are notable challenge and Russia has great potential to profit from the reforms across the sectors due to the complementarities of the reforms. Reforms alone do not foster economic growth if the Russian state does not improve its role and functionality. The focus should be in the law enforcement, securing property rights, increasing transparency and accountability of governmental institutions together with the anti-corruption work. Russia has already introduced complex and impressive so-called 'second-generation' reforms, such as reform in the electric power sector, but there are still 'first-generation' reforms in process (Ahrend & Tompson 2005, 39, 63).

Liuhto (2007, 2008 and 2009) studied the macro-level political risk of foreign companies operating in Russia before and after the introduction of the law of strategic sectors. He notes the FDI inflows have increased together with political risk in Russia during the 2000's. Centralised political power with stagnated political regime, armed conflicts, postponed WTO accession, corruption and restrictions in foreign ownership in the defined sectors have increased the macro political risk and at the same the country has become more nationalistic and fragmented. The researches indicate that political risk varies between the industries; political risk for foreign investments in Russian telecommunications had significantly increased and made the industry the most risky in 2009. Electricity as a common utility is a strategic asset, although the sector as a whole was not mentioned in the law of strategic sectors. Presumably the foreign ownership in the nuclear power assets was restricted. The studies conclude the situation of electricity sector depends on the future political decisions; Russia will remain unpredictable, but the key to understand and forecast the governmental actions is the national interest (Liuhto 2007, 21–31; Liuhto 2008, 14–36; Liuhto 2009, 9–29).

Laaksonen (2010) studied and identified the sources and effects of political risk for foreign investor investing in the Russian natural gas sector. The study analyses the Shtokman gas field project which is developed by Russian Gazprom together with French Total and Norwegian StatoilHydro. The research findings point out that the main sources of political risk in the sector are the changes in the Russian political leaders, Russia's international relations, the future of global gas market and Russia's position as an energy super power. The bargaining power and the relations of host and home country of the foreign investor are essential political risk factors. The study suggests that the political risk exists in the sector, but nationalisation, forced contract renegotiation, contract revocation and intervention are unlikely risk events. Instead price and export controls and changing legislation are the most probable influences of political risk that foreign investor may face in the Russian natural gas sector (Laaksonen 2010, 91–94).

Hanson (2011) studied has the priority for modernisation in Russian policy improved the business environment for foreign investors. Russia has put emphasis on economic diversification and technological upgrading after the global financial crisis in 2008. The research assessed the latest experiences of FDI and noted that Russia has received a fair amount of FDI inflows lately, although the market has been still hostile for competition and problems occur with the rule of law. The administration has been used to acquire assets from foreign investors. However the research finds that the bureaucratic obstacles have not worsened and the Russian business environment has actually tardily improved. However the study concludes it is not possible to achieve the modernisation without a fundamental political change (Hanson 2011, 2–14).

The investor's risks in electricity sectors. There are also academic studies written in English related to the investor risk in electric power sector both in developed and emerging markets. Buckland and Fraser (2001) studied the political and regulatory risk in the electricity sector exploring the electric power distribution in England and Wales since the vertical unbundling of the sector in 1990 until 1998. The research stresses that business regulator must determine fair return for use of distribution utilities, but regulator's action may lead either to abnormal profits and lower prices for customers or to higher returns and banking gains of distributors and passing the risk to customers. Regulators are influenced by political changes which creates political risk in the segment. The research shows that distributors had returns over and above the normal return. There was a significant hike in utility betas due to the General election in U.K. in 1992 and the market correction took five months to stabilise the situation. The findings suggest that the effects of political risk associated with the regulation have notable impact. In the study the political-regulatory event effected on utility betas; they were not continuous, but tended to cluster in time. The estimates support that cost of invested capital is about to be too generous for the segment and raise the returns in 2000–2005 (Buckland & Fraser 2001, 7–21).

Seethepalli (2005) studied private investors' strategies in the emerging markets in the context of the electric power sector privatisations. The study explores the business environments in terms of macroeconomic, political, institutional and regulatory risks and analyses the risks' impact on private companies investing in electricity sector. The study deals privatisation transaction as a unit meaning the private investment with the level and value of investment, the market entry mode and the ownership structure. The research discusses how the risks affect privatisation transactions, how the private investor's experience and world market share effect on the privatisation transaction and how does the alignment of these influence private investor performance. The empirical analysis was based on the electric power privatisations occurred during 1990–2001 (Seethepalli 2005, 22, 251).

The study concludes that private companies' investment structure is derived from the host country's business environment together with the company's own characteristics. Different risks effect on different aspects of investment. Defining and assessing risks are important for the company management structuring the actions, for the stock market and for overall stability of the investment for next few years. Private investors with past experience cope in the risky environment and have capability to mitigate the risk exposure. Political risk was discussed by the risk of contract repudiation and expropriation. The high level of expropriation risk supports the form of joint-ventures in the sector, whilst high level of contract repudiation risk supports the wholly-owned subsidiaries. However the findings were dispersed and the study suggests further research on political risk and its influence to privatisation process in the sector (Seethepalli 2005, 261–267, 130–131).

Mosquera, Reneses and Sánchez-Úbeda (2008) analysed the medium-term risks of electric power generators in the competitive electric power markets. The premise of the study was that the electric power sector reforms offer new business opportunities, but also risks related to hydro conditions, fuel prices, system demand and carbon dioxide emission price for generation companies. The empirical study was based on Spanish electrical system in 2006. The core finding is the theoretical implication: the research introduces a decision tree approach as a technique for risk analysis and for a source of decision-making and risk management (Mosquera et al. 2008, 319–337).

Jarvis (2010) explored regulatory risk in developing countries in light of the electricity sector in Thailand. Worldwide the state's role as an electricity provider has diminished, but its role as an industry regulator has increased. Institutions are crucial in adapting the risk environment. Despite of several reform efforts, the contemporary electricity market in Thailand is far from competitive and stable, and the introduction of regulatory authority has failed. Turmoil in Thailand's electricity sector was due to lack of institutional mechanisms and eventually the industry became a political arena for debates of political ends. Foreign investors are not interested in the market due to substantial regulatory risk and they ask either for greater rates for return or investment guarantees. The study suggests that the diffusion of regulatory policies in a contested environment hampers the function of regulatory authority, increases instability and enhances regulatory risk in the developing countries. When the institutions are weak and the administrative traditions shifty regulatory risk is not reduced but likely contributed through institutional complexity (Jarvis 2010, 2–23).

Purra (2011) assessed the regulatory uncertainties in a specific governance system analysing the Indonesian electricity sector. The study acknowledges the ruling institutions that shape the risk environment through rules, regulations and policies and thus it stresses the need for understanding and identifying institutions and risk attributes. The institutional problems in policy design, implementation and in the improvement of

institutional resources have been plentiful in the Indonesian electricity sector. The study suggests that problems stem from the incoordination of authorities and policies, the decentralised and dysfunctional political system and the existing protectionism. There is obvious lack of support for foreign investments in the market and the national champions are secured from foreign competition. In addition the role of "judicial mafias" opposing the institutional reforms cannot be ignored (Purra 2011, 4–29).

Gözen (2012) discussed the challenges of regulatory agencies to determine the cost of capital of electric power transmission and distribution utilities in the emerging economies. He states the role of regulatory agencies securing the third party access to electricity network and ensuring fair return for distributors. The study concludes that emerging markets serve business opportunities, but suffer from illiquid capital markets and high level of uncertainties and risks. There is no common understanding among the authorities and researchers to determine the cost of capital in electricity sector and it is suggested to base on estimate with a forward-looking approach and with the calculation of limiting values (Gözen 2012, 150–160).

A summary. Both foreign investments in Russia and the Russian business environment have regularly been studied over last ten years and the research findings support specific role of politics and political risk existence in the Russian business. Political risk identification and assessment are central when investing or considering investment abroad and especially in the country like Russia. Liuhto (2009) stated that the role of political risk has increased in Russia and it varies between the industries. Energy has been the core issue for long in Russia and in its relationship to other countries. However the research focus has customarily been in the upstream energy sector (i.e. Laaksonen 2010), not in the electricity. Due to that in addition to the novelty of the FDI in the Russian electric power sector, there has not been made political risk research on the sector particularly.

The electricity sector serves several perspectives for study. For instance it can be analysed either from the nation's or the operator's perspective. Electricity is a central part of the country's infrastructure, but also many times profitable business as well. The industry itself is rather complex: each segment in the electricity supply has different business model, but the segments are interdependent. The industry is more or less regulated. Buckland and Fraser (2000) and Gözen (2012) focused only on distribution and transmission while Mosquera, Reneses and Sánchez-Úbeda (2008) focused on generation segment.

Risk research suits well in the electric power sector. Investments in infrastructure include additional risks, because the assets cannot be used elsewhere, the infrastructure commodities are socially and economically important and mainly used in the domestic market and often provided by monopolies. Electricity can be regarded too strategic for private ownership instead of government control (Seethepalli 2005). The earlier research

on the electricity sectors both in the developed and emerging economies show that there is not merely political risk analysis of the sector. Regulatory risk (sometimes a pinch of political risk included) has interested the researchers the most. A summary of the earlier research on investor's risk in Russia and electricity sectors is presented in Appendix 2.

1.3 Research objective and structure of the study

Foreign direct investments in the Russian electric power sector are relatively new as the reform in the sector is still partly in process, although largely implemented. It is typical that at the early stage of new investments the political risk is comparatively low for foreign investors, but the situation may change when the capability of national companies to run the business stabilises (Robock 1971, 10). As stated in the previous chapter, the political risk in the electric power sector in Russia has not been studied before and thus serves highly topical and interesting object for the research.

The research objective is to identify and analyse the political risk that foreign investors may face in the Russian electric power sector. The main research question is; **what is the political risk in foreign direct investment in the Russian electric power sector**. The main research question is further divided into two sub-questions:

- What are the macro-level sources of political risk for foreign direct investment in the Russian electric power sector?
- What are the micro-level sources of political risk for foreign direct investment in the Russian electric power sector?

The key concepts of the study are political risk, foreign direct investment and the Russian electric power sector. The theoretical literature of political risk is discussed in the following chapter. The political risk is per se analysed through the political risk sources. The theoretical framework for the research is formed and analysed in light of the existing political risk theories. The research theoretical framework is presented at the end of Chapter 2. Chapter 3 discusses the research design and methodological choices of the study. The research continues with the empirical findings of the study which are presented in Chapter 4. The empirical findings are presented in the order of the research's sub-questions; thus the chapter begins with the empirical findings of the political risk sources at macro-level and ends with the empirical findings of the political risk sources at micro-level for the foreign direct investments in the Russian electricity sector. The research conclusions are discussed through both the theoretical and managerial implications in Chapter 5. Finally the research is briefly evaluated and suggestions for the future research are given.

2 POLITICAL RISK ANALYSIS

2.1 Defining political risk

Political risk became a subject of study in the late 1960's after a climate change in the international business. The changes in the international political environment had had a greater role in many foreign operations and the common assumption that economics and politics are related was made. The phenomenon of political risk was not new, but it had been approached through general obstacles of foreign investment (Kramer, d'Arlin & Root 1959, 348–356; Root 1982, 146; Kobrin 1982, 2, 29).

Pioneering political risk researcher, Root (1982, 146) describes that political risk stems from the uncertainty of changes in political conditions and policies in the host country effecting on the investing company's profitmaking. Root (1982, 146) defines "*political risk is created by a foreign investor's uncertainty about (1) general instability in the host country's political system in the future and/or (2) future acts by the host government that would cause loss to the investor*". According to Robock (1971, 7) "…*political risk in international business exists (1) when discontinuities occur in the business environment, (2) when they are difficult to anticipate and (3) when they result from political change*". As Root, Robock (1971, 7) stresses that to be understood as a risk, there needs to be impact on profit making or other goals of business. The political decisions that do not effect on the business environment are not political risk factors and therefor political instability should be distinguished from political risk (Robock 1971, 7–8).

The concept of risk includes the idea of measurable risk probability. The contemporary environment is not a risk, because a risk refers to changes and future outcomes. The term political, on the contrary, is defined as "*the class of decisions and events that concern the authoritative allocation of values and resources or that otherwise involve issues of legitimacy, authority or use of force*" (Lax 1983, 8). Separation of normal business risk and political risk may be difficult. Governmental decisions are firstly political, but they may effect on business too. However when political action is continuous and political changes are gradual and reflect earlier made policies, the future and the impacts are relatively easy to foresee and thus the changes cannot be considered as political risk (Robock 1971, 8; Robock & Simmonds 1973, 357).

Political risk is often defined either too narrowly, only focusing in the sources of political risk, or too broadly (Fitzpatrick 1983, 249; Lax 1983, 8–9). The correct definition is somewhere in the middle. Greene (1974, for reference see Haendel 1979, 81) sums political risk as "…*that uncertainty stemming from unanticipated and unexpected acts of governments or other organisations which may cause loss to the business firm*", whereas Lax (1983, 9) defines "…*in the generic sense, political risk is the probability that goals*

of a project will be affected by changes in the political environment. It is the likelihood that political changes will prompt a change in the investment climate regulating a project". De la Torre and Neckar (1988, 224) determine political risk as "…*the probability distribution that an actual or opportunity loss will occur due to the exposure of foreign affiliates to a set of contingencies that range from the total seizure of corporate assets without compensation to the unprovoked interference of external agents, with or without governmental sanction, with the normal operations and performance expected from the affiliate*".

Besides the scope in the concept of political risk, Fitzpatrick (1983, 249–250) recognises other tendencies in defining political risk. Political risk is often defined in terms of occurrence of political event. Instead of political events the focus should be in the continuous nature of political environment. Above referred operational definitions of political risk represent deeper consideration of political risk regarding the operational environment (Fitzpatrick 1983, 249–250). Also Kobrin (1982, 40) summarises "…*political risks are contingencies arising from the political environment, not political events and processes per se*". Political risk is not static event, it is dynamic and changing (Robock & Simmonds 1973, 360–361; Haendel 1979, 73).

Kobrin (1982, 38–39) notes that political instability and violence do not directly effect on foreign companies, but they are factors to change political regime and governmental policies which in turn affect foreign companies. Hence political events should be seen as causes of political risk, not as effects. Robock (1971, 7) created a conceptual framework for political risk analysis dividing the sources, the groups and the effects of political risk. The framework is presented in Table 1. The framework is developed for the political risk identification, interpretation and to aid the companies' decision-making. The sources of political risk stand for motives and forces behind the actions, the groups are the parties from whom the risk can be generated and the types of effects are the influences of political risk occurrence. The existence of political forces hostile to foreign companies or participation is a central source of political risk. The political risk effects can roughly be divided into two categories: others change the foreign company operations whilst others end them completely (Robock 1971, 8, 11–13).

De la Torre and Neckar (1988, 223), in turn, approached political risk by comparing the source and the effect of political risk and created four risk type categories. Their model of political risk dimensions is presented in Table 2.

Table 1 A conceptual framework for political risk (Robock 1971, 7)

Sources of political risk	**Groups through which political risk can be generated**	**Effects of political risk on business**
Competing political philosophies (nationalism, socialism, communism) Social unrest & disorder Vested interests of local business groups Recent and impending political independence Armed conflicts and internal rebellions for political power New international alliances	Government in power and its operating agencies Parliamentary opposition groups Non-parliamentary opposition groups (Algerian "FLN", guerrilla movements working form within or outside of country) Non-organised common interest groups: students, workers, peasants, minorities, etc. Foreign governments or intergovernmental agencies such as the EEC Foreign governments willing to enter into armed conflict or to support internal rebellion	Confiscation: loss of assets without compensation Expropriation with compensation: loss of freedom to operate Operational restrictions: market shares, product characteristics, employment policies, locally shared ownership, etc. Loss of transfer freedom: financial (e.g. dividends, interest payments), goods, personnel or ownership rights Breaches or unilateral revisions in contracts and agreements Discrimination such as taxes, compulsory subcontracting Damage to property or personnel from riots, insurrections, revolutions and wars

According to de la Torre and Neckar (1988, 222–224) political risk occurs either from the actions of government authorities or from the actions caused by actors outside the government control. Respectively they divided the exposure of political risk into involuntary loss of control over assets and reduction in the expected value of returns and thus grouped the political risk types to a) massive expropriation, b) selective nationalisations, c) general deterioration of the investment climate and d) restrictions targeted to key sectors (de la Torre & Neckar 1988, 222–223). As Robock's conceptual framework for political risk, the model assists in political risk identification and finding the cause-and-effect connection.

Alon and Herbert (2009, 128) note that originally the idea of political risk was understood as tensions between government and business. The contemporary view underlines political risk's concept where the risk is an outcome of many environmental factors; in other words political risk arises from political processes which are influenced by environmental variables. Political risk means a risk of loss in the international business

due to the instability in host country's government, monetary or fiscal policies, but it is created by diverse political processes influenced by multiple environmental factors and thus it occurs from both governmental policies and social actions (Alon & Herbert 2009, 127–129).

Table 2 Political risk types (de la Torre and Neckar 1988, 223)

Loss may be result of :	**The actions of legitimate government authorities**	**Events caused by actors outside the control of government**
Contingencies may include: **The involuntary loss of control over specific assets without adequate compensation**	*Total or partial expropriation* *Forced divestiture* *Confiscation or unfair calling of performance bonds*	*War* *Revolution* *Terrorism* *Strikes* *Extortion*
A reduction in the value of a stream of benefits expected from the foreign controlled affiliate	*Non applicability of "national treatment"* *Restriction in access to financial, labour or material markets* *Controls on prices, outputs or activities* *Currency & remittance restrictions* *Value-added and export performance requirement*	*Nationalistic buyers or suppliers* *Threats and disruption to operations by hostile groups* *Externally induced financial constraints* *Externally imposed limits on imports or exports*

Several studies refer to the division of positive and negative, internal and external, macro and micro level when discussing of the political risk dimensions (see for reference Simon 1982, 66; Kobrin 1982). Political risk in FDI may mean a substantial opportunity as well as a heightened risk when governments seek their interests (Blank, Basek, Kobrin & La Palombara 1980, 3). Regardless of the negative effects of political risk in the conceptual framework, Robock (1971, 7) well notifies that political risk can cause gains too, although it is mainly understood as a possibility for losses and a threat to the company plans. International experience of multinational companies provides companies' ability to indicate the political risk and even enhance their business opportunities. The assessment of political environment of the host country before and during the investment is central in the risk reduction; it is essential to understand what changes affect the company both in adversely and favourably. Hence political risk can be positive, an opportunity, or negative, a constrain (Robock 1971, 7; Haendel 1979, 81; Blank et al. 1980, 3).

Simon (1982, 66) distinguishes that political risk may be caused by a country's internal and external events, societal and governmental actions and policies and it can effect on all foreign companies or only on particular industry and selective companies. External political risk originates outside of a target country while internal political risk arises inside a country. Thus external political risk can also affect negatively on the domestic companies. Political risk analysis should encompass an evaluation of company's home and host country's political system, because the origins of political risk may arise from the host country, the home country, the international environment or the combination of earlier mentioned (Brink 2004, 21; Alon & Herbert 2009, 130). As Simon (1984, 127) notes a company does not only enter to a given country, but the whole world of that country.

Foreign company may face political risks on macro and micro levels; macro-level political risk affects all foreign companies in the host country while micro-level risk affects only certain industry or selected companies or projects. Political risk for one is not always political risk for another. One can say that macro-level risk influences are dramatic, but micro-level political risk occurs quite often (Robock 1971, 9–10). The international experiences support that certain business projects face greater political risk due to large size of the operations in the host country or due to the dominance in the strategic or otherwise sensitive industry. From all industries the public utilities is the most likely to encounter political risk in addition to industries related to fuels, mining, natural resources, banking and insurance. It would be possible to rank the industries and business activities according to their risk vulnerability, but the list continuously changes (Robock 1971, 9; Alon & Herbert 2009, 129).

Alon and Herbert (2009, 128) picture the macro and micro perspectives of political risk and their overlapping aspects. The model is presented in Figure 1. Both macro and micro level political risks include internal and external and economic, societal and governmental risk factors. Macro and micro types of political risks have common elements, but in micro-level risk analysis the role of the company is emphasised. The central idea is that the company itself can increase or decrease its political risk (Alon & Herbert 2009, 127-129). Consequently the definitions and the dimensions of political risk in addition to the models for political risk analysis of Robock (1971), de la Torre and Neckar (1988) and Alon and Herbert (2009) serve comprehensive and diverse perspective for defining political risk.

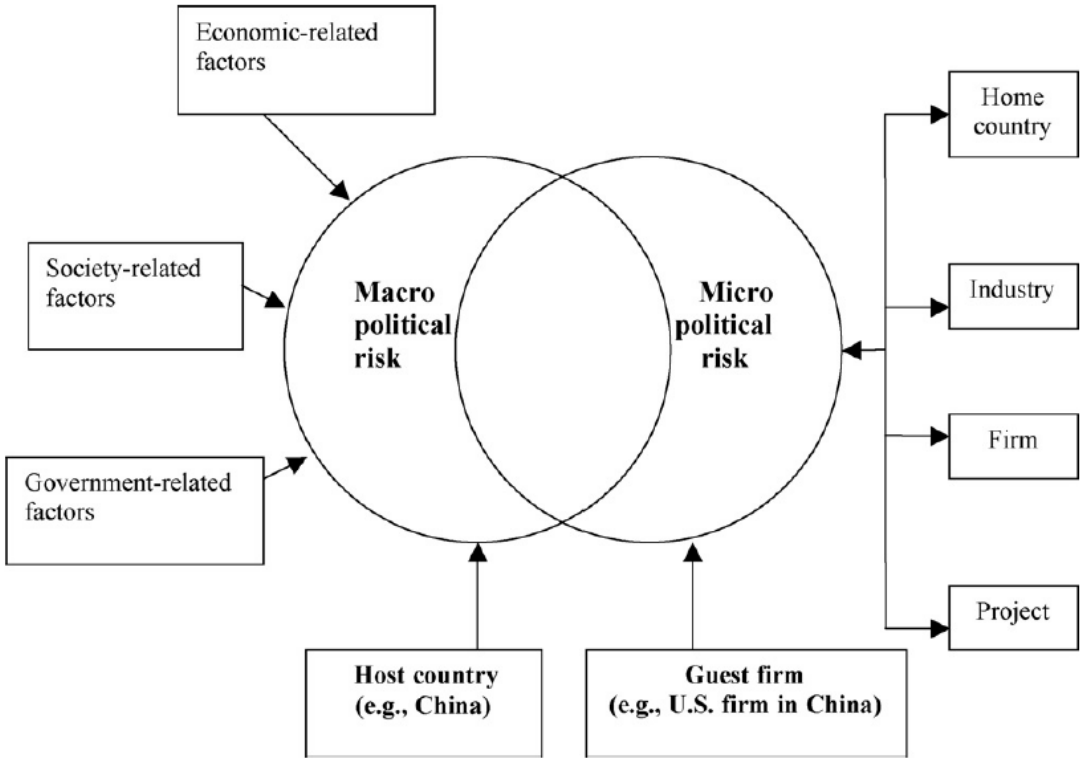

Figure 1 Macro and micro political risks (Alon & Herbert 2009, 128)

As summarised the political risk research points out the sources and the effects – or in other words origins and outcomes, causes and symptoms – as main features of political risk. The research focuses on the political risk sources and hence the study continues with the discussion of macro- and micro-level sources of political risk. The discussion is concluded in the conducting of the political risk analysis for the research. Additionally the earlier presented models are further discussed in the following chapters.

2.2 Macro-level sources of political risk

Root (1982, 144) indicates that the context of political, legal, economic, social and cultural environments forms a country's investment climate which needs to be analysed in a foreign investment project. However, the role of political risk is dominant (Root 1987, 126). Root (1982, 144) states that the analysis of country's future investment climate is, at the same, an evaluation of the investment's political risk. The investment climate and thus political risk can be evaluated through (a) general political stability, (b) government policies toward foreign investments, (c) other government policies and legal factors, (d) macro-economic environment analysis and (e) international payments which are all either directly or indirectly depended of the host country's political actions. The list of factors is suggestive and adaptable for different company needs and aims to identify and evaluate

macro-level political risk sources in a target country (Root 1982, 144–145). A framework for the investment climate evaluation is presented in Table 3.

Whilst Root (1982, 144–145) approaches the general political stability including the evaluation of ruling and opposing political powers as a possible source of political risk, Robock (1971, 11–12) points out the different political ideologies, philosophies and agendas as a main source of political risk (see Table 1). According to Robock (1971, 8) a country's hostility to foreign operations is crucial and determines the degree of political risk in the country. Alike the evaluation of government policies toward foreign investments in Root's framework rates the level of either attractiveness or hostility. The hostility for foreign investments, in turn, can stem from the concepts of national security, national welfare and economic aims. If the country does not want to increase its dependency of other and enforces the self-generation, this economic philosophy increases the political risk (Robock & Simmonds 1973, 362–363; Root 1982, 145).

Root's model for evaluation encompasses also a detailed assessment of other government policies and legal factors as well as macro-economic environment analysis (Root 1982, 145). Robock (1971, 12) refers to economic environment mentioning different interests of local business groups and groups' ways to influence the political power, but he disregards the legitimacy and on the contrary emphasises the social risk factors. In addition Robock (1971, 12) states the possible sources of political risk are social unrest including internal rebellion, for instance racial or religious disorder, lack of political cohesion and ineffective law enforcement due to general turmoil they affect.

Final assessment relates to a country's international payments through balance of payments and foreign exchange (Root 1982, 145). Robock (1971, 12) deals the relationship of countries with somewhat broader approach. He reminds that the countries lately became independent have a substantial political risk since the roles and attitudes towards foreign companies still look their places. Also the changes in the international alliances and cooperation might destabilise the country and further political risk for those that operate in the nation. Similarly armed conflicts between nations and new intergovernmental agreements cause political risk. Both Root and Robock note the corruption or scandals relation to political risk as they are often tools of driving political interest and to harm the foreign operations in the industry (Robock 1971, 12; Robock & Simmonds 1973, 362–364; Root 1982, 145).

Table 3 A framework for the investment climate analysis (Root 1982, 144–145)

Checklist for evaluating the investment climate of a foreign target country

A. General political stability
   1. Past political behaviour
   2. Form of government
   3. Strength / ideology of government
   4. Strengths / ideologies of rival political groups
   5. Political, social, ethnic and other conflicts

B. Government policies toward foreign investment
   1. Past experience of foreign investors
   2. Attitude toward foreign investment
   3. Foreign investment treaties and agreements
   4. Restrictions on foreign ownership
   5. Local content requirements
   6. Restrictions on foreign staff
   7. Other restrictions on foreign investment
   8. Incentives for foreign investment
   9. Investment entry regulations

C. Other government policies and legal factors
   1. Enforceability of contracts
   2. Fairness of courts
   3. Corporate / business law
   4. Labour laws
   5. Taxation
   6. Import duties and restrictions
   7. Patent / trademark protection
   8. Antitrust / restrictive practices laws
   9. Honesty / efficiency of public officials

D. Macroeconomic environment
   1. Role of government in the economy
   2. Government development plans / programs
   3. Size / growth rate of gross national product
   4. Size / growth rate of population
   5. Size / growth rate of per-capita income
   6. Distribution of personal income
   7. Sectorial distribution of industry, agriculture and services
   8. Transportation / communications system
   9. Rate of inflation
   10. Government fiscal / monetary policies
   11. Price controls
   12. Availability / cost of local capital
   13. Management-labour relations
   14. Membership in custom unions or free trade areas

E. International payments
   1. Balance of payments
   2. Foreign exchange position / external indebtedness
   3. Repatriation restrictions
   4. Exchange rate behaviour

Simon (1984), in turn, notes that different political risks are dependent on a host country's key actors and their interactions affecting risk events as well as there are specific country characteristics influencing the political risk context. Political risk exists both in industrialised and developing countries, since the level of country's development does not correlate with the level of political risk or political instability (Robock 1971, 6; Green 1974, 29). On the contrary political risk occurs in the developed countries too, but the government orientation towards foreign investments differs in industrialised and developing countries. In addition to general suspicion towards foreign investors, the level of protectionism is relatively high in developing countries and internal and external conflicts, as regrettable, but usual part of the developing process, are more probable in developing than developed societies. On the contrary in industrialised economies moderate political risks, for instance risks related to environmental standards, price controls and taxation, are likely to occur (Simon 1984, 127–130).

Simon (1984, 127–128) argues that in addition to the level of economic development, the degree of openness of socio-political culture varies between the countries and thus creates different macro-level political risks. Causes stemming from the country's open or closed political system are notable political risk sources. In politically closed economies, where dissatisfaction and frustration cannot be openly expressed, foreign companies are more likely to face violent conflicts, whereas the forms of nonviolent activity are probable in politically open countries. Also the level of public pressure for disinvestment increases when invested to politically closed economy (Simon 1982, 128).

Therefor Simon (1984, 128–129) determines political risk by the degree of economic development and by the level of openness of a country's political system and further groups the political risk sources based on the direct/indirect and internal/external nature of the risk. The macro-level political risk matrix is presented in Table 4. Both advanced levels of the economic development and the openness of socio-political system decrease political risks due to increased general stability, but even an open-industrialised economy encompasses political risks mainly stemming from the societal factors, boycotts, strikes and protests. Still these other forms of political risks are also relatively moderate and nonviolent by the nature; there can be bureaucratic delays, public pressure for environmental controls, pressure of local interest groups and international trade disputes (Simon 1982, 130).

Table 4 A framework for macro-level political risk (Simon 1984, 132–133).

		INDUSTRIALISED		**DEVELOPING**	
		INTERNAL	EXTERNAL	INTERNAL	EXTERNAL
OPEN	DIRECT	Host government licensing, price controls, taxation Adverse legal rulings Negative media reports	Home government licensing, taxation policies Regional and global organisations' monitoring of MNE operation	Local content rules, joint venture pressure, technology transfer and import / export regulations Strikes, protests, boycotts, negative public opinion Adverse legal rulings Negative media reports	Home government licensing, taxation policies Regional and global organisation's code of conduct for MNE
	INDIRECT	Bureaucratic delays and procedures Elections, public pressure for environmental controls Local business pressure for subsidies, favourable treatment	Host-home country trade disputes Bilateral / multilateral trade agreements detrimental to MNE Global economic developments	Intra-governmental friction General strikes, elections Local business pressure for subsidies, favourable tax rates	North-South issue disputes Anti-MNE public sentiment due to home country's foreign / military policy Regional / borders wars High external debt, default Commodity price fluctuations
CLOSED	DIRECT	Restrictions on remittances Strikes, terrorism, violent demonstrations / protests	Home government restrictions on operations Negative home and international public opinion, disinvestment pressure	Nationalisation, expropriation Terrorism, riots, strikes	Home government restrictions on operations Negative home and international public opinion, disinvestment pressure
	INDIRECT	Coups, radical regime change, leadership struggles Revolution, guerrilla war, riots	Deteriorating host-home relations International economic sanctions / boycott International protests Global economic developments	Coups, radical regime changes, leadership struggles Revolution, guerrilla war, riots	North-South issue disputes Anti-MNE public sentiment die to home country's foreign / military policy Regional / border wars High external debt Commodity price fluctuations

Closed political system forms rather controversial investment environment. When free expression of opinions is limited, violent bursts are probable in closed-industrialised host country. In a closed-industrialised country, political risks may occur through several internal or external restrictions and protests, and violent forms of risk events such as coups, regime and leadership changes are possible indirect internal political risks. Simultaneously externally stemmed risks including international protests and disinvestment pressures are increased (Simon 1984, 130–131). Foreign investor's home country's foreign affairs impact likely on developing countries' orientation towards foreign investments. An open-developing host country runs to increase its self-sufficiency which enhances the likelihood for internally risen political risks. However as noted the openness of the society lessens the violent outcomes and external public pressure and possible risks are related to strikes, protests, intra-governmental friction, media and business pressures. A serious indirect external political risk in developing countries is the mounting external debt (Simon 1984, 131).

Host government actions directed to foreign companies are the most likely in closed-developing countries. The country's vulnerability to undergo a radical political change increases the serious political risk effects such as nationalisation and expropriation. Also direct internal risks are societal turmoil, terrorism and riots while externally possible risks are negative public opinion with disinvestment pressures. Indirect internal risks are similar with the closed-industrialised economies and indirect external risks similar with the open-developing countries (Simon 1984, 131).

Alon and Martin (1998) created a quantitative model for macro-level political risk assessment of host country for foreign direct investing. The multidimensional model with six categories encompasses external and internal risk sources together with governmental, societal and economic factors. As noted, internal sources of political risk are domestically accomplished when external sources are generated by the investor's home country, third country or the international environment (Alon & Martin 1998, 10, 12).

The model of Alon and Martin is presented in Table 5. There internally stemmed governmental risk factors are evaluated through the degree of elite repression referring the government's attitude towards its citizens, the degree of elite illegitimacy measuring the amount of opposing population and the likelihood of regime change. The first two factors examine political instability in a target country and the latter adverse effects of policy in a case of political change (Alon & Martin 1998, 13). The society-related variables are the degree of fragmentation meaning the social diversity of ethnicities, languages, tribes and religions; the extent of congruent cleavages referring to possibility of social conflict and the sense of alienation including the sense of nationalism, xenophobia or fundamentalism. Internally risen economy-related risk factors are GDP growth per capita giving the relation of economic growth to population growth and living standard, the income distribution accounting for development and size of middle-class

and the likelihood that economic goals are to be met measuring the institutional structures of host country (Alon & Martin 1998, 14).

Table 5 Macro-level political risk assessment (Alon & Martin 1998, 15)

	Internal	**External**
Government	• Degree of elite repression • Degree of elite illegitimacy • Likelihood that regime change will affect policy	• Likelihood of political violence • Degree of involvement in international organisations • Possibility of restrictions on investment, capital or trade
Society	• Degree of fragmentation • Potential for social conflict • Sense of nationalism, xenophobia, alienation or fundamentalism	• World public opinion • Disinvestment pressure • Regional diversity and incongruent interests
Economy	• GDP per capita growth • Income distribution • Likelihood that economic goals will be met	• Future economic policies regarding foreign direct investment • Likelihood of balance of payments problems • Likelihood of currency inconvertibility / instability

Governmental factors of external dimension of political risk are the likelihood of political violence including wars, border disputes, terrorism and regional conflicts; the degree of the country's involvement in the international organisations indicating the chance to receive aid when needed and the possibility of regulatory restrictions on investment, capital or trade flows. Externally originated societal risk sources are the world public opinion, disinvestment pressures and regional diversity with incongruent interests. Especially the first variables are often related. Economic risk variables are the future economic policies regarding FDI, the likelihood of balance of payments problems and the likelihood of currency inconvertibility or instability. Nonetheless the last two aspects are usually linked and may further policy changes in the country (Alon & Martin 1998, 14–16).

The researchers have managed to include a future oriented, forward-looking approach in the assessment model. In the model a country is evaluated through these 18 variables in six main categories and each variable is scored between -2 to +2 regarding the relevance of the risk factor in the context of evaluated country. A -2 refers to high probability of the risk cause and a +2 to positive value of the risk cause. Zero is neutral and indicates that there is no problem with the variable. The variables can also be

weighted according to company's concerns. The assessment results a cumulative score for political risk which can be used in the planning stage of investment, in indicating the possible change in the investment environment or when comparing the investment climates of several countries (Alon & Martin 1998, 17–18).

Macro-level political risk is more researched topic than micro-level political risk partly due to its better generalisation; typically there are more data available for macro political risk analysis than for micro-level analysis (Simon 1982, 69; Alon & Herbert 2009, 128). Micro-level political risk sources are discussed in the following chapter.

2.3 Micro-level sources of political risk

Micro political risk is the uncertainty originating from political processes or events which effects on specific industry, project, company or companies either operating or considering to entry the country (Kobrin 1982, 39; Alon & Herbert 2009, 130). Micro political risk exposure for the foreign company varies in terms of industry, level of technology and ownership structure. Strategically important industries such as insurance, banking, transportation, finance, natural resources and utilities include more extensive political risks than other industries and the foreign companies operating in those fields should be more aware of the underlying risks (Kobrin 1982, 39).

Since political risk in certain industry varies due to the dominance of foreign companies in it and due to the capacity of national companies to run the business successfully. Foreign companies' investments, their management and technical skills, are welcomed at the early stage of the industry's development, but when the skills and knowledge are adapted by the national counterparts there may lay a risk of market limitations (Robock 1971, 10). For foreign companies it is crucial to identify political risk sources at micro-level as they may increase or decrease political risk of the investment. This means that foreign company needs to analyse the impact of its own background, nationality, industry, situation in the market, the country relations and the project characteristics in the assessment of micro-level political risk (Alon & Herbert 2009, 127–128).

Robock (1971, 9–10) was a path-breaker to distinguish the macro- and micro-levels of political risk. For political risk analysis he suggests that one should 1) understand host country's government in power, its patterns and behaviour and its norms for stability, 2) know foreign company's products and operations in a target country, 3) identify sources and effects of political risk in the business and 4) plan foreign operation in terms of political risk probability and time (Robock (1971, 16). Consequently Robock (1971, 16) notifies the role of foreign investor and the industry it operates in political risk scenario and represents the following questions for company-level analysis:

1. Are periodic external inputs of new technology required?
2. Will the project be competing strongly with the local nationals who are in or trying to enter the same field?
3. Is the operation dependent on natural resources?
4. Does the investment put pressure on balance of payments?
5. Does the enterprise have strong monopoly position in the local market?
6. Is the product socially essential and acceptable?

Although not a framework, Robock (1971, 16) serves a comprehensive list of firm-related questions in order to assess the political risk exposure at micro level. Simon (1982, 66–67) classifies micro-level political risk by host country's internal and external origins and with the relation to societal and governmental actions and policies. The micro political risk assessment framework is presented in Table 6.

Table 6 Political risk at micro level (adapted from Simon 1982, 67)

	Societal-related micro political risk	**Governmental-related micro political risk**
INTERNAL	• Selective terrorism • Selective strikes • Selective protests • National boycotts of firm	• Selective nationalisation/expropriation • Selective indigenisation • Joint venture pressure • Discriminatory taxes • Local content/hiring laws • Industry-specific regulations • Breach of contract • Subsidisation of local competition • Price controls
EXTERNAL	• International activist groups • Foreign MNE competition • Selective international terrorism • International boycott of firm	• Diplomatic stress between host and home country • Bilateral trade agreements • Multilateral trade agreements • Import/export restrictions • Foreign government interference

Simon (1982, 66–68) states the wide scope of political risk sources, but also notes the challenge to define micro political risks as they vary by the type of investment. He lists that industry or project related terrorism, kidnapping, striking, protesting and boycotting are micro-level sources of political risk originating from the host country's society. In turn international activism and terrorism are also risk factors stemming from outside of

the country (Simon 1982, 68). Several examples point out that selective expropriation and selective nationalisation are actually more likely political risks than expropriation and nationalisation at macro level. Additionally on governmental level forced joint ventures with indigenous partners, discriminatory laws and regulations, subsidisation and price controls are possible sources of political risk at micro level. Externally loss of business opportunities may due from country diplomacy, bilateral and multilateral trade agreements, business restrictions and foreign government interference. The model's classification and distinguished risk sources can be implemented as preliminary analysis of political risk at micro level (Simon 1982, 68).

Alon and Herbert (2009, 130–131) also created a framework for the micro-level political risk assessment. Political risk in the framework is divided into internal and external dimensions, further into economic, social and governmental environments, and into firm-specific aspects. The model for micro political risk analysis is presented in Table 7. According to Alon and Herbert (2009, 130–133) domestically developed economic-related political risk sources are labour conditions, foreign company's congruence with host country's economic interests and goals, and availability of alternative suppliers; and societal political risk sources are host country's characteristics in internal power distance, uncertainty avoidance and collectivism. The micro political risk sources stemming outside of the country in terms of economy are degree of host country's economic dependence, especially on foreign company's home country; foreign company's home country economic policies and international balance of payments. In terms of society, external political risk sources at micro level are foreign company's home country or other party public opinion, international activism and degree of cultural distance between foreign company home and host countries (Alon & Herbert 2009, 133–134).

Table 7 Model for micro political risk analysis (adapted from Alon & Herbert 2009, 131)

INTERNAL ANTECEDENTS	**Economic-related factors**	**Society-related factors**	**Government-related factors**
	1. Labour conditions 2. Congruence with national economic interests and goals 3. Availability of alternative suppliers	1. Degree of power distance 2. Degree of uncertainty avoidance 3. Degree of collectivism	1. Level of governmental control 2. Degree of nationalism 3. Congruence with governmental goals 4. Transparency and corruption
EXTERNAL ANTECEDENTS	**Economic-related factors**	**Society-related factors**	**Government-related factors**
	1. Degree of economic dependence 2. Home country economic policies 3. Balance of payments	1. Home country or third party public opinion 2. International activists 3. Degree of cultural distance	1. Diplomatic or economic relations 2. Membership in bilateral and multilateral agreements 3. Currency (in)stability
FIRM-RELATED FACTORS	**Contribution of the firm/project to the local economy**	**Bargaining power of the firm relative to the government**	**Governance structure**
	1. Level of technology 2. Size of operations 3. Level of exports	1. Dependence on the local market 2. Extent of natural resource seeking 3. Level of firm diversification	1. Level of local ownership 2. Financial policies adverse to BOP 3. Intra-corporate transfers

Internally and externally arisen governmental political risk sources and firm-related political risk sources are discussed more extensively. The first internally rose government-related political risk source is the level of governmental control. When a host country government holds a substantial power on the economy, the political risk is increased for foreign companies operating in the country. In extreme situation government decisions impacting on economy are made on political reasons and regulatory actions may lead to foreign company discrimination. The degree of nationalism is a significant factor. In several cases, the growing degree of nationalism has led to nationalisation or expropriation. Foreign company's congruence with host government goals is important, since the company acting against the national interests may find itself in trouble. However, for instance the state subsidisation can share opinions of foreign investor and host government. Lastly lack of transparency and existence of

wide spread corruption are crucial challenges for foreign companies and can evolve into entry barriers (Alon & Herbert 2009, 132–133).

Externally originated political risk sources in terms of government power are host country's diplomatic or economic relations, memberships in bilateral or multilateral agreements and currency stability or instability. Companies stand for their home countries, even though not on purpose, and their foreign operations are thus dependent the diplomatic relations of the countries. Bilateral or multilateral agreements usually favour foreign expansion and decrease the political risk exposure. Correspondingly the lack of memberships in multinational organisations can have adverse impact on foreign companies. The stability of local currency effects on balance of payments, local inflation, trade deficits, foreign company imports, cost of living and therefor to local consuming and markets. Hence currency stability, or instability, correlates with political risk exposure (Alon & Herbert 2009, 133–134).

A company related political risk factors are examined through the company's contribution to the local economy, bargaining power of the company relative to the government and governance structure. When foreign company's contribution to the local economy is notable, threat of serious political risk occurrence is relatively low. But the future development with the project or the industry may increase political risk exposure. Alon and Herbert (2009, 134) suggest to measure the company's contribution by level of technology, size of operations and level of exports. If foreign company holds unique and scarce technology, its operations are relatively safe; technology transfer in general decreases political risk. Also the great size of investment operations, especially in terms of job creation in the host country, and the extent of exports lessen political risk. Foreign company exports from host country assist the country's balance of payments and reduce foreign company's dependence on the country mitigating the micro political risk (Alon & Herbert 2009, 134).

Foreign company's dominance in the market is essential what comes to political risk occurrence at micro level. Bargaining power of the company to the local government is divided into dependence on the local market, extent of natural resource seeking and level of firm diversification. Political risk is increased along with the foreign company's dependence on the host country. On the contrary, when the host country is dependent on foreign investor, the political risk lowers. Earlier experience supports that companies operating in natural resources are the most likely to face the effects of political risk. Thus the extent of natural seeking is essential variable in micro-level political risk analysis. Diversification is an asset to political risk, because multinational that has diversified its products and markets protects itself from the regulation and is less vulnerable for political risk events (Alon & Herbert 2009, 134–135).

The first variable of the investing company's governance structure is the extent of local ownership. Foreign company must consider the model of ownership at the stage of market

entry. Local ownership and use of revenues for local benefit naturally lessen micro political risk. Foreign company supporting the host country's goals in balance of payments faces lower political risk while company's adverse financial policies towards host country's balance of payments increase the likelihood of political intervention. Last variable under the governance structure is the intra-corporate transfers meaning the relations between parent company and subsidiary. The greater independence of subsidiary and use of local management together with local personnel creates trust between the investor and the host country. However, the intra-corporate transfer is considerable source of micro political risk (Alon & Herbert 2009, 135).

The framework can be utilised as a qualitative model where each variable is ranked by their importance, impact and likelihood for the foreign operation and finally summed an overall result. The framework is analogical with Alon and Martin's (1998) macro-level political risk assessment and could be used together. Company may carry out micro political risk analysis with the macro political risk assessment, but the division do not replace each other. Micro political risk analysis together with macro political risk evaluation helps foreign company to receive relatively good understanding of its political risk exposure and probability (Alon & Herbert 2009, 128, 135–136). Political risk analysis for this research is discussed in the following chapter.

2.4 Synthesis and framework of this research

Understanding sources of political risk is one, but the risk assessment and compliance is another (Simon 1982, 68). Political risk analysis implies the means to predict the kinds of risk foreign investor may face in a target country. There are signs and clues indicating the possible political risk sources (Brink 2004, 78). The identification and evaluation process can change the obvious decision to another and help the company to copy with the changing political environment (Robock & Simmonds 1973, 374).

The paper has so far presented various frameworks for macro and micro political risk assessment, but the frameworks as such are not sufficient enough for this particular study. Root (1982, 144–145) places the analysis of a host country's investment environment equal to the assessment of macro-level political risk sources. The approach is pragmatic, but too broad for political risk assessment. The analysis of investment environment of a country measures present and past conditions, but lacks in future orientation. Still the suggested themes and factors are possible political risk sources at macro-level and they support the findings of other researchers too.

Robock's (1971, 7) conceptual framework serves general understanding of political risk. Its identification of political risk sources, groups and effects is pivotal. The distinction of sources and effects of political risk is regarded and the study will focus only

on political risk sources. However more dimensions are needed for conducting analysis of political risk sources. Simon (1984, 132–133) offers rather complex model typing and assessing a country's macro-level political risk situation. The combination of the economic development and openness of the society creates proper insight into macro-level political risk sources, but with the dimensions of direct and indirect, internal and external the framework is difficult to implement. The model also stumbles upon defining; especially the separation of open and closed socio-political culture is challenging in the contemporary world. Consequently the framework in this study classifies political risk sources according to their internal and external origin.

The multidimensional model of Alon and Martin (1998, 15) gives, in turn, an operational approach for identifying political risk sources at macro-level. Another dimension in addition to internal and external origins of political risk source is risk source's relation to host country's economy, society and government. This study focuses on government-related factors of political risk and thus only internal and external governmental variables were adapted from the model. The assessment of Alon and Martin (1998, 15) results a numeric value and thus requires a comparative analysis for evaluation. This study is conducted as a qualitative case study and therefor it differs from the original idea of Alon and Martin.

Robock's (1971, 16) concept of political risk analysis and firm-related enquiry, Simon's (1982, 67) and Alon and Herbert's (2009) models for micro political risk analysis are adapted in the research's framework. Firstly the core value of Robock's (1971) research is above all in conceptualisation of political risk, but the firm-related questions in micro-level risk assessment are regarded utilitarian in the study. Simon (1982, 66–67) classifies micro-level political risk sources by internal and external origins and with their relation to societal and governmental actions and policies. The recognition of society and government relations is excellent, although the framework lacks economic factors and company-specific sources. Alon and Herbert (2009, 130–135) present a model for micro-level political risk assessment. Internal and external antecedents of political risk are further divided into economic, social and governmental environments, and into firm-specific aspects. The firm-related dimension consists of factors related to company's contribution to local economy, its bargaining power with local government and governance structure. The model is comprehensive, but falls in redundant complexity. There are some overlaps between the variables and some of the political risk sources for instance transparency, corruption and currency instability can be regarded as macro-level political risks as well.

A special model for the analysis of the political risk sources of foreign direct investments targeted to Russian electric power sector is based on the earlier mentioned researches; additionally the sector-specific political risk models of Lax (1983) and Laaksonen (2010) were considered in the research synthesis. The framework is presented

in Table 9. Following the structure presentec by Laaksonen (2010) for analysing the political risk in natural gas industry, the framework focuses on 1) the macro-level and 2) the micro-level government-related sources of political risk for foreign direct investments in the Russian electric power sector. The general targets of the analysis are to understand the present government and its way to operate in the host country, analyse the foreign companies' product and operations with respect to possible political risk and define the political risk sources on business (see Robock 1971, 16). The framework begins with the definition of internally and externally arisen government-related political risk sources at macro-level and continues with the definition of also internally and externally arisen government-related political risk sources at micro-level. The micro-level analysis is divided into industry and company level sources.

Table 8 The framework for political risk analysis for this study

SOURCES OF POLITICAL RISK			
		INTERNAL	EXTERNAL
AT MACRO LEVEL		Degree of political stability The continuity of current political power and policies Probability of regulatory restrictions on investment, capital and/or trade Level of transparency and corruption	Host government's involvement in international organisations Likelihood of violence due to political conflicts, terrorism, wars and border disputes Currency (in)stability
AT MICRO LEVEL	INDUSTRY	Government control over industry Degree of selective nationalisation/expropriation Discriminatory industry-specific taxes and regulations Breach of contracts and agreements Price controls and subsidisation	Foreign government interference
	COMPANY	Contribution to the economy Congruence with the host government goals Bargaining power relative to the host government	Diplomatic stress between host and home country

The macro-level analysis of political risk sources consist of factors that indicate the country's both present and future general political stability and the host government behaviour in its international context. The current general political stability in the country is firstly studied quite straight-forwardly by a concept of the degree of political stability which consists of the analysis of power holding government and opposing groups. Therefore the concept includes the factor of competing political philosophies and the intra-governmental friction presented in the earlier studies. The following concept the continuity of current political power and policies brings future approach to the study and describes both the host country's political stability and the nature of the government power. This factor was also discussed before with regime and leadership changes. To be noted that the chosen concept comprises in some extent the ideas of elite repression and illegitimacy and the effects of regime change to policies.

Other variables with the domestic origin are the probability of regulatory restrictions on investment, capital or trade and the level of transparency and corruption. The concepts were selected to explain the host government's behaviour and patterns. The probability of restrictions on foreign operations represents the potential risk sources in the host country. The same factor may be examined as an external risk source (see Alon & Martin 1998), but in the study's framework it is emphasised the host government's decisions to restrict the foreign investing. The level of transparency and corruption refers to the transparency in policy making and the country's legal system, the degree of bureaucracy and the distribution of corruption. These issues link to the potential political risk sources.

The international context is considered in the external variables of macro-level political risk sources. The first variable is the host government's involvement in international organisations which refers the country's international relations and the international agreements obligating the host government. The concept covers international alliances as a possible risk factor. Currency instability is potential macro-level risk source which is strongly affected by the host government decisions in relation to other countries, but is regarded to originate outside of the country. Currency instability refers to the general political stability. The likelihood of external and government-related violent bursts is linked to the country's foreign policy and memberships in international organisations, but was chosen to the framework due to its crucial effect on political risk situation in the country. The issue was described as the likelihood of political violence in the earlier study.

As noted the micro-level analysis is divided into industry-specific and company-specific variables of political risk sources. The host government control over the industry is the first internal industry-level factor. Considering the electricity as public utility and the role of government as the regulative authority and the majority holder of many companies in the electric power sector, the issue is analysed at micro-level instead of macro-level. Secondly the degree of serious political risk effects such as nationalisation

or expropriation is regarded a potential factor for political risk in this politically and socially sensitive sector. At industry-level analysis the next concept is the discriminatory industry-specific taxes and regulations. The variable is also related to the breach of contracts and agreements in the industry. These concepts describe the micro-level governmental restrictions and prompt to define the risk sources and effects. Price controls and subsidisation are regarded a potential risk sources considering the nature of the product and the sector; the past price regulation of electricity in industrial use and the existing regulation in the household tariffs and in the electricity distribution are considered in the analysis. The industry-specific and externally stemming micro political risk sources are limited to the foreign government interference on the industry.

The company-level political risk sources arisen internally are grouped into the firm's contribution to the economy, the congruence with governmental goals, and the bargaining power in the host country. The company's contribution to the local economy is counted in the company's input of technology and capital and the general size of the operations. These issues form possible political risk sources. The congruence with the host government's goals is essential with the socially sensitive product such as electricity. However the variable is also linked to the macro-level transparency of policies and the governmental goals in the industry. The bargaining advantages towards host government are gained with the superior technology, capacities, management and capital which all decrease the political risk exposure. But the concept also includes dimensions of the competition with the state-owned nationals, the existence of real competition in the sector, dependency on natural gas and coal supplies and the company's level of diversification. The issue of joint venture pressure was ignored due to the majority ownerships of foreign companies operating in the Russian electricity sector.

The external company-specific sources are limited to the diplomatic relations of host and home country. The company represents its home country and the change in the country relations may have positive or negative effect on company's operations. The bilateral and multilateral trade agreements are discussed at macro-level and thus left out from the company analysis. The import and export restrictions are not relevant, because the core nature of electricity and therefor it is ignored in the framework.

Quite often the companies understand that they need political risk analysis, but they rarely have means to do it (Simon 1982, 62; Fitzpatrick 1983, 251). Many methods concentrate on political instability instead of political risk and its impacts (Fitzpatrick 1983, 252). Additionally these challenges are carefully considered in the creation of the research's theoretical framework.

3 CONDUCTING RESEARCH

3.1 Research methodology

The research method is chosen with respect to the research objective, and a qualitative approach is regarded the most suitable method for political risk study. The content of qualitative research has rather varied in its history and today we can say the qualitative research method is more an approach than a technique; it draws distinctions within a sample, produces in-depth information and aims to create further understanding of the phenomenon in hand (Eskola & Suoranta 1998, 16). In other words the qualitative study concludes the set of practises and tries to make the surrounding world visible. It attempts to make sense to research objective (Denzin & Lincoln 2008, 4–5). One can continue that the mission of qualitative research is a conceptual understanding of the world, and qualitative methods in general aim in theory formation instead of verifying the hypothesis (Grönfors 1982, 11–14; Eskola & Suoranta 1998, 74). The political risk researches in electricity sectors are not common and thus no hypotheses were set for the study. The study is merely exploratory and explanatory, but also an academic study seeking for continuation for contemporary political risk theories.

The qualitative and the quantitative research methodologies are often seen competing, but they are rather complementary. The confrontation of qualitative and quantitative research methodology is not sensible, but qualitative research can be defined in the comparison to quantitative research. Roughly put qualitative research consists of words, whilst quantitative research is a collection of numeric and statistical data. Quantitative research is usually seen stemmed on positivistic or post positivistic science, while qualitative research is based on existential phenomenological philosophy. The qualitative research offers tools to examine empirical phenomenon and gives possibility to conceptual consideration of the matter (Grönfors 1982, 13–14; Miles & Huberman 1984, 21). The qualitative research with respect to its conceptual latitude is regarded beneficial for this study. The qualitative methods also enable description and adaptation of the process, the chain of events or the changing nature of the study objective; such as political risk scenario is (Grönfors 1982, 11–12; Eskola & Suoranta 1998, 25; Koskinen, Alasuutari & Peltonen 2005, 24).

The basic elements of qualitative research are qualitative data collection and qualitative study analysis; it also includes certain subjectivity, inductiveness, committed observing, naturalism, hermeneutics, Aristotelianism, teleology, phenomenology and narration (Eskola & Suoranta 1998, 14–16). The researcher's subjectivity in the study process is both empowering its explanatory power and influencing the study objectivity. This two-fold nature of subjectivity is considered during the process and the researcher's

impact on the study findings is to be minimised. The aim after all is to make sense to the study objective, to find the truth. The subjectivity is further discussed in Chapter 3.4 Trustworthiness of the research. The naturalistic, hermeneutic and phenomenological features are reasonable for the study, which strives for both profound understanding and theory formation in field of micro-level political risk. The purpose is to gather as much as possible information of the Russian electric power sector and its political risk scenario for the foreign investors; the interest is in the detailed structure and meanings of the studied phenomenon.

Still the study is primarily deductive than inductive. In inductive study the theory is based on empirical findings and the reasoning proceeds from details to general. But this research uses a theoretical framework which guides the data collection, and the study findings are analysed by means of this theoretical framework. The theoretical context leads empirical research and reasoning proceeds in deductive manner from facts and generalisations to details. The causality in the research is discussed through the deductive analysis when the study includes a priori theoretic level and an empirical level (Grönfors 1982, 27, 29–31). In addition to the study structure, the political risk phenomenon itself includes some causal connections. Above mentioned arguments and the multidimensional nature of political risk support the choice of qualitative method for the study.

The researcher considered for long the case study model for the research, but eventually rejected the idea. Abruptly the study object is the foreign companies in the Russian electric power sector and the data is collected from the object by interviewing which is especially appropriate when the researcher wants to deepen the understanding of decision-making in different cultures (Ghauri 2004, 111; Eriksson & Kovalainen 2008, 117–124). Qualitative research is regarded to be quite challenging as it requires explicit research questions, thorough literature review, well-thought research design and good language skills. Also the access and practicability of the qualitative data gathering and analysis must be pre-considered, because the success of qualitative research is often dependent on external influences (Grönfors 1982, 40; Scapens 2004, 107).). As in every research, but especially in qualitative research, one of the main focus areas of the study is the data collection and its problematic nature (Grönfors 1982, 11–12). More information about the data collection for the research is followed in the next chapter.

3.2 Collecting the research data

As noted the current foreign companies', E.ON, Enel and Fortum, operations in the Russian electric power industry are chosen for the research object. The object is regarded to serve the needed information as the investigation of these companies' operations in the

Russian electric power sector will offer information of the micro-level political risk scenario. The research focuses on the impact of their country of origin, their actions and operations in the Russian electricity and their role in relation to the Russian government. The investments of E.ON, Enel and Fortum in the Russian electricity sector are described more detailed in Chapter 1.1.

The empirical data in general may be collected from many sources – from documents, articles, brochures, letters, agendas, annual reports, statistics, interviews to observations – and it is possible to combine both qualitative and quantitative materials. The complementary use of qualitative and quantitative data or the use of various sources has usually a positive effect on research validity. The data of this study is collected by interviewing – which is at the same the most used method for data gathering in business research (Miles & Huberman 1984, 21; Eriksson & Kovalainen 2008, 125–127). However, several data sources have been used in order to achieve background information for the research and there is a level of observation included in the interviewing (Silverman 1993, 9). Still interviewing is chosen for primary way to collect research data. The interviewing is seen advantageous due to its convenience, but also its systematic way to collect data that would be challenging to collect otherwise. Interviews serve possibility for wider observation, observation beyond the words, when the interviewer monitors both interview environment and existing non-verbal communication (Jyrinki 1974, 8–12). The interviewing as a method to collect study data is in line with the study purposes understanding and exploring the phenomenon of political risk in the Russian electric power sector and finding examples of political risk sources.

Interview in general is organised talk where interviewer asks questions and interviewee answers them, although interview sometimes reminds an everyday conversation; the interview includes interaction between the participants involved, all influencing each other. The interview can naturally take place face to face, over telephone or computer and so on (Eskola & Suoranta 1998, 85; Eriksson & Kovalainen 2008, 78–79). Interviews are distinguished into structured interview, semi-structured interview and unstructured interview. A structured or in other words standardised interview has a little flexibility as the interviewer asks the same questions for every interviewee with given alternatives for answers. The structured interview may be conducted as a survey (Jyrinki 1974, 8, 11–13; Koskinen et al. 2005, 104).

An unstructured interview is sometimes called open interview, focused interview, non-directive interview or even ethnographic interview. The interviewee may talk freely because the unstructured interview lessens the researcher's impact and takes an advantage of the lack of standardisation in the conversation (Grönfors 1982, 105–106; Koskinen et al. 2005, 104–105). A theme interview is sometimes used as a synonym for a semi-structured interview, and the theme and the semi-structured interviews present the half way of two earlier mentioned extremes. The semi-structured interview is recommended

for sensitive subjects and especially when the researcher has chosen themes and questions to follow in the interview. Usually the interview questions are either open or suggestive, the number of interviewees is limited or even small, and the aim is for both profound and informative data. In the semi-structured interview the interviewer asks everyone the same questions, when in the theme interview there is only the chosen themes to lead the conversation (Eskola & Suoranta 1998, 86; Metsämuuronen 2001, 43; Koskinen et al. 2005; 104–105).

This interview design was carefully considered in the study construction. It was noted that the interview design should fit with the somewhat sensitive nature of the study. The semi-structured interview was seen the most advantageous with giving boundaries for the data collection but without limiting the research itself too much (Eskola & Suoranta 1998, 88, 139). The certain flexibility in the research design was also appreciated because new questions may arise during the interviews (Eriksson & Kovalainen 2008, 127). Thus the research interviews are conducted unstructured or semi-structured without a selection for answers. The theoretic framework of the research is operationalised to interview questions in order to get the empirically measured counterparts for the theoretical concepts (Miles & Huberman 1984, 34; Eskola & Suoranta 1998, 75–77). The number and the quality of the questions were analysed many times. It is pointed that the correct questions are more important than the amount of questions. The questions were evaluated in terms of their informative value and importance, their clearance for the answerer or the chance for misinterpretation (Jyrinki 1974, 41-43). The interview questions are listed in Appendix 3.

The coverage is challenging to estimate and it is often discussed in the new studies (Eskola & Suoranta 1998, 215). The researcher targeted at least five interviews, but the number of interviews could be extended if necessary; the data limiting is after all based on the theoretic coverage. Still the more important thing than the amount of interviews is the depth and the validity of the interpretations (Eskola & Suoranta 1998, 66–67). The interviews represent the researcher's discretionary sampling. The researcher's preliminary will was to interview experts who are researchers, economists and electricity company representatives with various backgrounds, but having substantial knowledge about the Russian electricity sector. The chosen interviewees have indisputably good experience or knowledge about the political risk factors in Russia. Additionally the international perspective would have been beneficial for the study, but the researcher did not reach representatives from E.ON and Enel and thus decided to hold to Finnish experts and company representative. The interviews were eventually planned to take place face to face, although phone interviewing was a considered possibility. The data collection is led by the study's theoretical framework. Naturally the core is not the interviews themselves, but the discussion and the issues within the conversation and responding. The

study bases on carefully chosen samples without certain prejudice or expectation in order to find results (Eskola & Suoranta 1998, 18–19, 65; Peräkylä 2008, 351).

The first expert interviewed was economist Laura Solanko from the Bank of Finland Institute for Economies in Transition (BOFIT). Laura Solanko works as a Senior Advisor and has specialised in Russian economic developments, Russian energy sector, Russia-EU energy relations and Russia's financial markets. In 2006–2013 Solanko followed closely the Russian electricity reform and wrote several papers of the reform. Consequently the researcher was keen to meet Solanko due to her expertise on the Russian business environment and the Russian electricity sector. The interview was held in April 2015 at the premises of the Bank of Finland in Helsinki. Solanko's background in research was seen in the interview and the researcher got valuable feedback from Solanko to define the research questions more specifically.

The second expert interviewed was professor Veli-Pekka Tynkkynen from University of Helsinki Aleksanteri Institute. In addition to the Russian energy policy, his areas of expertise are in the Russian environmental policy, power and democracy, regional and environmental planning and the geography of Russia. The interview took place in Tampere in April 2015 at Stockmann department store's restaurant along with the lunch. The interview and additional conversation was both very informative and lively, and took almost two hours.

The third expert interviewed was economist and CEO Pekka Sulamaa from Sulamaa Consulting Ltd. Sulamaa's fields of expertise are especially in electricity and Russia; Sulamaa conducted his doctoral thesis about the competitive tendering in electricity market. Sulamaa also worked as an economist in the Finnish high-voltage grid transmission company Fingrid until in 2011 when he established his own consulting company. As a consultant Sulamaa focuses on Russia and the Russian electricity market and produces a Newsletter about the development of electricity sector in the North-West Russia. Sulamaa has closely followed the electricity reform in Russia and possess quite actual information about the Russian electric power sector today. The interview of Sulamaa took place in April 2015 at the cafeteria in Hyvinkää center.

The fourth expert interviewed was Fortum's chief economist and vice president Simon-Erik Ollus. Today Ollus has worked in Fortum over five years and leads the company's Industrial Intelligence unit. Previously Ollus has been economist in the Bank of Finland and has specialised both in Russia and electricity sectors for years. Ollus represents Fortum quite often and he gives both public statements and interviews to media. Also the earlier interviewed experts suggested the researcher to contact Ollus. The interview of Ollus was a great opportunity to receive the opinion of the investor company for the study. The interview took place in April 2015 at Fortum's head office in Espoo.

The fifth interviewed was CEO Raimo Valo from the East Office of Finnish Industries. Valo works to enhance the business opportunities of the East Office's member companies

in Russia; the East Office gathers and analyses data especially concerning the political and economic development in Russia, maintains the business networks, promotes the Finnish businesses in Russia and shares widely information. Besides his contemporary position in the East Office, Valo is a member of several company boards and operates closely with the Ministry for Foreign Affairs of Finland and the Confederation of Finnish Industries. He has gained substantial experience of Russian business by working and living in the country for seven years; Valo used to work in Russia in the financing and banking sector. The lively and cheerful interview was held in June 2015 at the meeting premises of the East Office in Helsinki. The interview took about an hour and some questions were not questioned in the time frame. However the researcher started with the crucial questions and sees the interview went very well.

The sixth expert interviewed was investor and a company board professional Seppo Remes. Remes has exceptional substantial experience of the Russian electricity and he has lived and worked in Russia for decades. Remes has been a member of AOA Rosseti's board of directors since 2008 and he was already a board member in RAO UES in 2003–2004. Contemporary AOA Rosseti is the Russian power company of the interregional and regional distribution grid companies (IDGSs / RDGCs). Remes has not just followed closely the Russian electricity reform he has also been making the reform. Remes can be regarded as a genuine insider of the Russian electric power sector. Remes is also a member of several company boards; i.e. the Russian companies Sollers, OAO Sibur, the nanoindustrial company Rosnano, the Investor Professional Association and the Russian Institute of Directors. He is a co-founder and the chairman of the board of EOS Russia AB – a company investing in the Russian electricity assets – and CEO of Kiuru Partners LCC. The researcher met Remes in June 2015 at the cafeteria of hotel Kämppi in Helsinki.

The seventh and last interview was with Under-secretary of state Matti Anttonen. Alike Matti Anttonen is Director General of the department for external economic relations in the Ministry for Foreign Affairs of Finland. Anttonen has worked for the Ministry for Foreign Affairs since 1986 and has comprehensive and profound knowledge of foreign operations and politics in Russia. Before his contemporary position, Anttonen served years 2008–2012 as the Finnish Ambassor in Russia and years 2002–2006 as the Deputy Chief of Mission at the Finnish Embassy in the United States. He has also worked as the Director for Russia and as the Deputy Director General of the Eastern Affairs operating with Russia and other CIS countries in the 1990's and until 2002. Anttonen has lived several years in Moscow. The researcher visited Anttonen in August 2015 at the premises of the Ministry for Foreign Affairs of Finland in Katajanokka, Helsinki. The interview was very pleasant and lively; the conversation continued a while after the interview.

One way to prove the sufficiency and extent of data is to find the saturation. When the findings repeat each other, the data is enough for the study (Eskola & Suoranta 1998,

215). The researcher is very satisfied with the number and quality of the interviews. The data saturation was clearly to be seen soon after the fourth and fifth interview which confirmed the amount of interviews required for data collection. Also the choice to have semi-structured interview was seen beneficial; the researcher was able to change the order of the questions and to ask also additional questions. In every interview additional questions were asked depending on the conversation or the interviewee's expertise. All the interviews were recorded with the approval of the interviewees and after the interview the conversations were transcript for analysis. The interviews took place in Finnish as intended and because both the interviewer and the interviewees were native Finnish speakers. The quotations presented later in Chapter 4 have been translated by word to word into English by the researcher herself. All in all the interviewees are extremely experienced in the research topic and were able to provide their own perspectives about the study subject. A few interview requests were politely refused as the contacted experts thought they do not have information about the sector itself that much.

It is often presented the data collection and analysis as separate processes, but they rarely are so (see i.e. Eriksson & Kovalainen 2008, 127). The amount of interviews does not replace the careful analysing of the data and also small data may be sufficient when it is well analysed. The purpose of the data is also to verify the sufficiency of the theoretic framework for further studies so it operates as a study motivator too (Eskola & Suoranta 1998, 215). Chapter 3.3 continues with the research's data analysis.

3.3 Analysing the research data

The analysing research data is often the most challenging part of the research and tends to fall to be mainly descriptive. The qualitative data in case studies in general is trustworthy, but may be troubled to organise. There are various demands for the analysis; the case study aims to find the complex truth, the study is both descriptive and operational and in addition the results are often needed for practical use. Still the aim is to analyse the data without prejudices, to retain the data information, to take the interviewees' opinions as examples of general and to search both similarities and differences in the research data (Eskola & Suoranta 1998, 137–139, 146; Metsämuuronen 2000, 17–18).

Miles and Huberman (1984, 21) simplify the qualitative analysis into the data reduction, the data display and the conclusion drawing and verification. Grönfors (1982, 146) takes epistemological point of view where the research analysis can also be distinguished into three; first the researcher has an abstract view of the subject, next the empirical data is organised and examined in detail, and finally the case is analysed by combining both abstract concepts and experiences. In qualitative research it may ease the analysis when the analysing is divided into passive quantifying and active qualifying. The

passive quantifying focuses on quantities and tries to find the strongest correlations and causal connections, while the active qualifying aims to consider the human actions, the data versatility and the phenomenon with broad perspective without highlighting the number or frequency. When both perspectives are used the research also benefits from surprising and unusual (Grönfors 1982, 147).

The qualitative research analysis is criticised that the part of potential in data is often left out. The data reduction does not refer for losing it; conversely it means the process of focusing, simplifying, selecting and abstracting the data without misplacing its valuable information. It is understood that the analysis also happens together with the data collection. The data is chipped to conceptual pieces and accumulated to conclusions in synthesis. In other words the data is abstracted; it is organised so that the conclusions are severed from the interviews and taken to theoretical level. The theoretical concepts must be linked to the experiences, and thus the study concepts, data and conclusions form a logical entity (Grönfors 1982, 144–146; Miles & Huberman 1984, 21).

There are several techniques for analysis. The qualitative data is usually analysed through narratives, coding core concepts and themes, clustering or categorising the data characteristics, matrices, decision tree model or comparing the predicted and found. Also the mix of methods is recommended (Ghauri 2004, 117–121). The research objective is to identify and analyse what kind of political risk sources foreign investors may face in the Russian electric power sector. The theoretical framework of the research, its symbolic construction intending to explain, is based on selected categories (or themes) from macro-level political risk sources to micro-level sources. The theoretical framework is operationalised into interview questions that produce empirically measured answers. Hence the data is processed in categories and the categorising as a technique was favoured as a systematic way to analyse the research data. The similarities of the interview responses are naturally searched, however the researcher has a strong focus to find both commonalities and differences and point them out clearly (Eskola & Suoranta 1998, 22–23, 77–83, 150; Koskinen et al. 2005, 163). The operationalisation table of the theoretical framework including the categories is presented in Table 10.

Table 9 The operationalisation table for identifying the political risk in the Russian electric power sector

Study objective	Categories	Questions
Political risk in FDI in the Russian electric power sector	Internal macro-level sources of political risk	1, 2, 3, 4, 5, 6, 7
	External macro-level sources of political risk	8, 9, 10
	Internal industry-level sources of political risk	11, 12, 13, 14, 15, 16, 17, 18
	External industry-level sources of political risk	19
	Internal company-level sources of political risk	20, 21, 22, 23, 24, 25
	External company-level sources of political risk	26, 27, 28

Initially the sorting phase of the analysis divides the data, when the used categories help to find the main concepts and interpret it in order to finally draw research conclusions. The theory operationalisation and the used categories were crucial to join the research theory and empirical findings. Then the research proposition can be accepted. From practical point of view the pre-analysis right after the interview was seen advantageous as the theory grows along with the data. Also the research problem evolves in the process (Ghauri 2004, 117–121). Special focus was put on analysing not to lose information and the interviews were examined as any other qualitative source of information (Peräkylä 2008, 359).

3.4 Trustworthiness of the research

The trustworthiness of qualitative research can be evaluated through concepts reliability, validity and generalisability (Eriksson & Kovalainen 2008, 290–291). Reliability refers to established consistence of the research; how another researcher would be able to repeat the research and gain the same results. Additionally it means that the research data is systematically collected and the data itself is trustworthy. The reliability can be tested with various indicators (factors that prove the conformity in phenomenon), several observations (different questions asking the same) and use of many observers (Eskola & Suoranta 1998, 213–214). It is suggested that the reliability is analysed through congruence, the accuracy of study instrument, the objectivity of the instrument and the continuity of the phenomenon (Grönfors 1982, 175). The research data is seen reliable when it does not include inconsistencies. Thus together with the research design, the

interview questions play a significant role in the research reliability (Eskola & Suoranta 1998, 213–214).

In the study the research methodology, the selection of the cases, the collecting and the analysing of research data are explained in detail in the previous chapters and the careful description pursues for improved research reliability. The external observer, such as a reader, is able to follow the research process (Eskola & Suoranta 1998, 214–216; Koskinen et al. 2005, 159). The congruence was searched through the interview questions. Moreover, seven interviews were conducted which later enabled the data comparison. Advantages and disadvantages of chosen data collection instrument, interviewing, were carefully weighted during the research process, and the interviewing was seen beneficial to gather data from the sensitive subject. The researcher's presence and observations during the interviews were also valued in data collection and improves the instrumental accuracy of the study. In addition to reasoning behind the chosen methodology and methods, also other design decisions made by the researcher are described in the study which enables the objectivity and the repeatability of the research (Grönfors 1982, 175).

The researcher chose the research object and the interviewees while some other researcher could have chosen differently. However the study object is arguable representative and simple. The data is both collected and analysed by the research herself and no other researchers were used to verify the answers and the findings, which obviously weakens the research objectivity. The study is a thesis work for the writer and therefore no help for empirical process was asked. On one hand the continuity of the phenomenon in the study is rather strong; the central part of the phenomenon, the Russian electric power sector, was monitored from the Soviet times to the industry reform. Also past experiences of FDI in the electricity sectors were examined in order to create proper background information for the research. When the empirical part of the study focuses on the contemporary and future prospects of Russian electricity sector, it is noted that the continuity of the phenomenon, how the phenomenon is understood in different times, is well considered and verified in the research (Grönfors 1982, 175).

In the research reliability evaluation, the researcher's role in the process and the analogy between the research results and conclusions could be more stressed (Miles & Huberman 1994, 278). In other words the objectivity of the study is formed with the recognition of the certain subjectivities in it. The interviewing is not fairly a neutral tool for collecting data. It is recognised that the interviews are also conversations influenced by the interviewer; in other words they are interactions between the interview and the interviewer (Eskola & Suoranta 1998, 18, 85; Fontana & Frey 2008, 116, 118–119). It is noted that the interviews were many times lively and cheerful conversations and completed with additional questions. The interpretation that the complete neutrality is not achieved by interviewing is accepted. Actually a specific involvement of the research may

even sometimes light up the whole case and serve more information than would have been found with straight recorded responses (Scalpens 2004, 108). Still the interviewer's role and influence is minimised in this research. The unstructured interviewing was chosen to decrease the influence of researcher's underlying motives and beliefs and the chosen research method was trusted to give better depth for the study.

The research's validity refers how valid, true, the research findings are and the validity in the research is divided into internal and external validity. The internal validity points the logic in theoretic and conceptual attributes, meaning the congruence of theoretical and conceptual definitions. It can be monitored by looking research's theoretical conclusions, concepts or consistence of hypothesis. The external validity describes the logic between theory, conclusions and experiences; it refers to the validity in interpretations, conclusions and data. The finding is valid when it is described as it is and it is uphold by evidence (Grönfors 1982, 173–175, 178; Eskola & Suoranta 1998, 213).

The internal validity in the study is presented in the theory creation, the research design and in the operationalisation of the theoretic findings into interview questions in order to measure the study matter. The external validity refers to the research's generalisability to other cases (Koskinen et al. 2005, 167). In this study the basis for the external validity is reliable information. Concerning the expertise and the seniority of the interviewees, their responses are regarded very trustful. The study target is to take the findings from the object to the general and evolve the contemporary political risk theory.

The validity in qualitative research may be established by analytic induction, triangulation or member check where the analytic induction is often linked to the grounded theory and coding data. But there are various triangulations to use; triangulation of methodologies (combination of qualitative and quantitative), triangulation of methods (various techniques), triangulation of data (cross-checking the evidence from multiple sources), triangulation of theories (many theories used in explaining, understanding and interpreting) and triangulation of researchers (several researchers used in the study). In member check the participants of the study go through the researcher's interpretations (Eriksson & Kovalainen 2008, 292–294). This research is completely qualitative research conducted by one researcher, so validity cannot be argued by the triangulation of methodology or researchers. However there were various theories searched and examined in the research's theory creation and the theoretic framework combines many of the known political risk theories.

The interviews were the main source of the study, but the study combines observing technique with interviewing to increase the data validity. The verbal data is always challenging in terms of validity; has the interviewer really understood the answer or is there a difference between sayings and thoughts of the interviewee. The researcher observed how the interviewees' expressions are in line with their behaviour. The acts were observed through what the person did or should have done and were the behaviour

general or specific. Also the conversation time frames were counted (Jyrinki 1974, 129–131). The data saturation was achieved already after the fifth interview. When the chosen sources and methods create the same results, there will be positive triangulation improving the constructional validity of the research (Ghauri 2004, 115; Koskinen et al. 2005, 158). The research generalisability was considered through external validity as the generalisability is about whether the research findings and the results can be extended from the used cases to other context. Generalisability may also be divided into statistical and analytical. Analytical generalisation is conducted with the study, when the findings are compared to existing theories. If the findings support the theoretical framework, there is some replication (Eriksson & Kovalainen 2008, 292–294).

The challenges of the qualitative research are rather superficial analysis than insufficient use of qualitative methods (Eskola & Suoranta 1998, 33). To conclude the researcher is in the central role in the data collection in this study, but it is still faulty to say that the study is not objective. To some extent the perfect objectiveness is not even achievable (Grönfors 1982, 21). Wilkinson and Young (2004, 222) point out that the obvious and unfortunate fact is that the process of exploring information is quite often imperfect and restricted by its reliability and validity. The reliability, validity and generalisability serve a traditional framework for research evaluation, but the use of these concepts is also questioned. Ghauri (2004, 117) admits to value authenticity over reliability in the qualitative research. As noted the validity is defined as an establishment of correct operational measures for the concepts being studied. All openness in the research increases the validity of the study, everything is told. The study aims to be systematic, explicit, comprehensive and reproducible. As is with the reliability, also validity of the qualitative research is essentially based on the detailed description of the study process; the study report includes how the study is conducted, how the data is surveyed and how the different influences are analysed (Grönfors 1982, 178–179; Flink 2005, 17).

4 POLITICAL RISK IN FDI IN THE RUSSIAN ELECTRICITY

4.1 Macro-level sources of political risk

To begin with the contemporary politics in Russian, all interviewees describe the current Russian political system highly centralised where the political decisions are made at the top level of the political hierarchy. The top political decision-maker is the President Putin together with his closest staff. The interviewees used also words such as regime and cabinet when describing the Russian political elite. Anttonen notes there are not genuinely several parties participating in the political decision-making. The political system is basically distinguished into regions and thus into the regional administrations. At the same the Parliament and its various levels have only a little significance. Sulamaa tells three separate political opposition groups just joined together, but the opposition is still spread and there are no strong challengers for the contemporary political power.

Tynkkynen sums the decision-making personalises very much for Putin and his closest, but Russia is not entirely an autocracy. He adds the ministries are actually more experienced and professional than ten years ago. The political decision-making is more based on consideration than before and the political work is more professional within the sectors, although many ministers are originally from the security sector. Remes shares slightly another opinion and mentions how the centralised power enables ad hoc – decisions; often the political decision-making is prolonged and inefficient, until the decision is made too prompt and is not thought through-out. The centralised political power was raised in the discussions for several times.

Whether the political decision-making in Russia is predictable or unpredictable two-fold responses are given. Solanko notes the political decisions in Russia may seem unpredictable, but most often they have logical direction and both the motivations and goals behind the decisions can be evaluated. Still the lack of general transparency in the political decision-making makes the Russian politics unpredictable. Tynkkynen says the unpredictable features of the political decisions and actions relates to the political leaders' fear of losing power. Valo agrees with him and states the Russian politics is not surprising, although the current international situation has changed the political decision-making and thus causes surprising policies sometimes. They note the main driver for political decision-making has not been the economic welfare anymore, but also the superpower politics. However the contemporary political power is quite popular in Russia.

Sulamaa refers that due to the highly centralised political power, the political decisions are often made by one man, the President Putin, and in order to receive predictableness we should get into Putin's head. He continues there is naturally some predictableness in the political decisions and says:

> *"Some issues can be evaluated through what for instance the reform means for the regular consumer. If the prices tend to increase, one can think it is politically difficult decision. In the contemporary political situation, [the Russian leaders] do not want to cause any harm for regular consumers."* Pekka Sulamaa 27.4.2015

Sulamaa compounds Russia is conservative decision-maker in the energy issues. Ollus somewhat agrees with Sulamaa when he determines the Russian political decision-making in comparison to the most of the European countries. Ollus notes the Russian politics and energy policies have been relatively stable both during the electricity reform and after the implementation. Russia conducted the electricity reform as it was originally planned by Chubais and additionally Russia has also followed GenSchema and production plans. This can be compared to the situation in many European countries where political decisions related to emission trading, subsidisation policies to renewables and energy tax policies have fluctuated energy companies' stock rates; any changes in the energy politics cause a great risk for the investors in very capital intensive electricity sectors. The contemporary politics have increased the amount of tariffs and subsidies in the electricity sector in Europe and thus increased the political risk in the sector. Several energy companies have lost even 60% of their stock value in last six or seven years, but Fortum has managed to keep their stock price in 2008 level. There has not been anything similar like this with Russia reminds Ollus. He compounds that the European Commission established energy related institution jointly with European countries, Russia and CIS-countries called Energy Charter. Under the Energy Charter the energy companies are able to petition to court and get arbitrage if they are unfairly treated. In practise all the cases so far have been between the European companies and the European states. Ollus describes the situation following:

> *"But if we look the Russian investment atmosphere over time, it has been relatively stable after the decision of energy reform was made. […] Of course there is some unpredictability in Russia, but so there is unpredictability everywhere else too. […] In the end of the day, the contemporary policies related to the Russian energy are pretty much what they have been in the strategies. The only thing that has been disappointment is that the macroeconomics has not developed according to expectations, in that way what in the mid-2000's was expected from Russia."* Simon-Erik Ollus 30.4.2015

The interviewees sum unanimously the greatest problems in contemporary Russia political and the political decisions affecting the economy. The most common view is that the political lead focuses on creating superpower status for Russia in order to keep and strengthen its power, and simultaneously neglects the long-term economic development of the country. Tynkkynen points out the Putin's regime has emphasised the nation's economic modernisation and diversification and has focused on maintaining the power where the economic growth people give support for the leaders. Hence there is an interrelation between leaders wanting to stay in power and the nation's wealth behind the political decisions. But the politics has recently changed he says. During the last two years there have been compromises in the economic issues. For the made decisions the lead has searched support by promoting the idea of external threat coming from other countries. The primary reason for this is the fear of losing power and the secondary reason is the superpower politics and pretension. Anttonen shares this perspective and compounds:

> *"Everybody knows the contemporary political system cannot renew itself. This political system is able to continue its existence, but it cannot change, because everything is based on one person. And when this one person doesn't change, the system doesn't change either."*
> Matti Anttonen 19.8.2015

Anttonen sums the countries like Russia are very stable until they become very unstable. The political leaders like in Russia are often very populistic and unable to make necessary economic renovations, since there is always a fear that the people get upset and thus economic reforms are not favoured by the people in power. Not a single political leader has lost its power in the elections in Russia. The leaders have been died, killed or dismissed, but they have not been changed in the elections. Moreover Russia lacks the normal channels for people's frustration.

Remes considers that nowadays everything is related; he mentions how people have not possibilities to municipally influence and they do not trust the political leaders. The state in turn should invest in economic reforms and renovations instead of bulging and blustering. Sulamaa compounds Russia does not have large middle-class which would create political system based on voting and elections. The centralised political decision-making reflects in every attempt to develop the society. Sulamaa concludes:

> *"So the economic problems are huge, but the greatest problem is political."* Pekka Sulamaa 27.4.2015

Solanko says the Russian economic policy is too controlled and lacks open dialogue which makes the internal politics the greatest problem in Russia. It has not been tolerated

to criticise the political leaders for years anymore, but it used to be tolerated to criticise and discuss the economic decisions. Currently you cannot do that either. Until a year and half ago it was clear the political decisions concentrated on economic growth for Russia and its inhabitants, but not anymore. Before the political decisions were based on keeping the power and strengthen it of course, but also to provide better living standard for Russians.

Tynkkynen indicates the political and economic problems are linked due to Russian economic dependency on natural resources. Both Tynkkynen and Valo mention along with the political will to increase the people's prosperity, there is a creation of oil culture or a superpower culture in the energy sector. The central leaders in the Russian federation try to create Russia as an energy superpower and the media strengthens the message. The energy resources are somewhat part of the Russian identity; the energy is an instrument for the foreign affairs and emphasises nation's honour as a superpower. There has been a cultural need to determinate the country through superpower concept and with something that resonates in the West since 1990's. This is the ideological frame the Putin's regime strongly builds and the power in energy supports the power in military forces.

Valo sees the current geopolitical situation alienates the political decision-making from the economy to other issues and bases on returning the superpower status for Russia. In addition the theme increases the popularity of the contemporary political leaders. In the context Russia is unfortunately not able to implement needed reforms in the economy. In 2000's the Russian economy grew strongly and the state had afford to restructure industries and consuming sector, for instance in banking. Today there is a lack of capital because the capital is needed to secure rouble, and the urgently needed reforms in construction, logistics and basic infrastructure cannot be implemented. This trend started already from the Georgian war and the aggression in politics bases on external threat and threat from Nato. Valo reminds that the capital is not really escaped from Russia, but Russia has been forced to pay off its loans due to the geopolitical situation. Ordinary Russians have undone their deposits in some extent, but this has had minor impact in capital. At the same the share of black market in Russia is still high, about 25 to 30%.

Sulamaa and Ollus bring forth the decline of Russian economy due to the low oil price and economic sanctions set by other countries. Ollus continues that the only disappointment from the investing company's point of view is the Russian macroeconomics which has not been developed and met the expectations many had ten years ago. Russian economy is still largely dependent on natural resources; the country has not attempted enough to modernise the society and has not managed to diversify its economy. Personally he thinks the economic reforms implemented in the 2000's would have produced wider economic ground for businesses, but the curse in the natural resources is so strong. In addition the productiveness of work has decreased all the time. Considering these issues Russia is very vulnerable for global trends, currently for low oil

price and geopolitical situation in Ukraine. Global sanctions do affect Russia. Russia loses capital which can be seen with the rouble's currency rate.

All interviewees agree that the state's role in the Russian economy is big, too big. Valo sums the state's role is completely dominating and even strengthening. Solanko says:

> *"The state both owns and controls too much when it suffocates the competition and stops the economic development by its own mechanisms."*
> Laura Solanko 15.4.2015

Remes agrees and says that oversized role of state in the Russian economy causes inefficiency and especially prevents the business opportunities of small and medium-size companies. Even though the localness is both promoted and favoured in Russia. Sulamaa mentions that the state's role in the Russian economy is notable and it is actually greater than usually thought. Russia had planned economy during the Soviet era and the tradition for regulation still exists. The level of bureaucracy is high. Ollus says the state's significant role in business can be seen in for instance in holdings and corporate structures; both liberalisation and privatisation are in progress in Russia. Russia is relatively corporatist; there are not small companies like large companies which should have the central position in national economy and employment. The Russian economy is more rigid than dynamic.

Tynkkynen continues the state has not succeeded in the economic modernisation; the only achievement is in the energy efficiency. The energy sector is so highlighted in Russia, especially gas and oil which dominate the economy, and affects the whole political field. Narrow-minded focusing on the energy has prevented the diversification of economy. Naturally the world market price of oil has affected and has guaranteed economic growth when the oil price has increased. But no big changes have needed to implement. Still the business leaders in Russia are interested in where the money grows and the capital has somewhat escaped from Russia after the violent outbursts in Ukraine when the Russian oligarchs move their money to other sources. Anttonen adds that Russia lacks the property rights; the state has not tried or even wanted to implement decent property rights to Russia. There are huge state-owned companies in the business, but at the same when the state is the owner, no one owns the company. The companies are somewhat 'masterless', because they are often ran by the operational management so the state's role is used several individuals who may look for their own good. Similarly the managers are the supporters of the current political system so they cannot be punished from the malpractices.

When asked how the interviewee thinks the Russian politics and its political leaders will change in the next five or ten years, Remes politely passes the question. Other interviewees think it is hard to tell, but generally regarding dramatic changes are unlikely.

Solanko says it seems that there are no challengers for contemporary political leaders and Anttonen notes the political opposition is too weak and incoherent to challenge the leading party. People can be unsatisfied, but there are not ways or channels to constructively express the discontentment, reminds Anttonen.

Tynkkynen notes the whole situation changed when the crisis in Ukraine started. Europe has imagined that Russia is in energy related interdependence with Europe, but actually Russia is a lot more dependent on the European energy market than Europe is on the Russian energy supplies. So far this interdependence has limited some actions of Russian political leaders, although not entirely. As noted the power of current political leaders is strongly based on energy and sometimes it is not possible to back up. It is unlikely that Russia increases violence in Ukraine, but it has now achieved geopolitical victory by occupying Crimea. It has been able to show for the world. If the Russian economy slows down more for long, the Russians do not believe there is a conspiracy from the West and will question the contemporary centralised political power. But if the economy grows, this may not happen, he regards. Then the core question is the world market price for oil. The Russian political lead will for sure slacken and uses soft ways to run the political goals. The less educated people give their support to Putin, but the classic middle-class, which has got enriched during Putin has been in power, criticises.

Sulamaa estimates the tightened economic situation forces Russia to renew and diversify its economic structures in one way or another. The crucial question is does Putin continue in power or does he dare to share the power down in the political organisation which is quite unlikely. Although the force from the economy is hard, the Russian politics probably will not change as long there are same leader in power. The greatest opposition is the regular people who get dissatisfied if the economy slows down. Ollus regards usually all political leaders want to increase the national prosperity and people's well-being; Russia has to gradually liberalise its economy and move to market-oriented economy, although it takes time. Russia is a pretty bizarre nation for Finnish, but is it really bizarre for Indians or Brazilians. There are plenty of more regulated and more protectionist developing nation than Russia in the world.

Valo is certain that Putin wins the presidential election on 2018 and maintains his power. At the matter of fact Valo supports the elections to be held in advance, because then the current political lead would have courage to begin and implement the economic reforms, even the reforms that would complicate peoples' lives in the short term. One of the greatest problems is the nation's inefficiency which is common for other oil economies as well. The change in the political lead would take Russia only to worse direction; who would take the leadership if people began to protest against the ruling political leaders, would it be siloviks or the army? He sums that these options are must worse than Putin. Valo agrees with Tynkkynen that the situation in Ukraine plays a crucial

role in the future of Russian politics and reminds the Russian economy would not take the change in Ukraine, but there is not much to lose either.

A majority of the interviewees see the general situation for foreign companies reasonable good and the companies are doing business as usually in Russia; after all the business situation can actually be even better than publicly regarded. Although excluding the strategic sectors, reminds Solanko. In general Russia is profitable country for business and Finnish companies operating in Russia are there to stay. For instance Remes and Tynkkynen consider the contemporary challenges for foreign companies are the decreasing demand and tightening competition, but the situation is still mainly positive. Tynkkynen concludes the operations in the Russian market are shadowed by the demand risk due to the people's wealth and the nation's bureaucracy. However the operational risks are decreased compared to the situation in ten years ago. Remes also notes the foreign companies usually have competitive edge over the domestic companies. Alike Anttonen draws all companies, both domestic and foreign, suffer from the decreasing economy, but the foreign companies probably have better chances to cope in the difficult situation than locals.

Correspondingly Ollus sees there are both pros and cons of being foreigner in Russia. Overall Russia has for instance own custom regulations and own characteristics, but there are also countries with much tighter regulations. Russia has some restrictions in business and currently set sanctions from other countries have impact on business. Sulamaa notes it is difficult to estimate whether there will be more restrictions in the Russian business; anyway every country has some kind of restrictions. In Russia a lot is linked to the political scenery, the politicians in power and do the Russian politics liberalise. The consumers have a lot of power with these questions. However, the new general business restrictions for foreign investors are likely and Sulamaa notes that the restrictions are often quite hidden in the Russian bureaucracy; after all the state has means to harden the foreign companies' operations. Simultaneously the mercantilist view, where the imports would threat the country, has increased its popularity in Russia. The perspective varies depending is an actor or a bureaucrat supporter of old Russia or a modern thinker.

Anttonen points out that Russia has traditionally had various restrictions in food industry and in the strategic sectors, but the country has now set import sanctions for several foreign products due to the geopolitical situations. At times Russia tried to implement the European directives and customs in the business, but it has not succeeded. Solanko, in turn, regards new regulatory restrictions are unlikely. Tynkkynen sums the political decisions are made in sense of security, which may not be according to the foreign company's best. He sees there might not be new business restrictions, but the idea of other countries as enemies is probably increased in the politics and the media and may affect several businesses. Despite of varying responses, there are several regulatory restrictions in business in Russia.

Little two-fold answers are given when discussed about the level of corruption in Russia. Ollus refers Fortum has regarded it as ‘business as usual’ in the last five years. Together with Solanko they note the corruption in Russia is as it is measured and pointed by the international transparency agencies and in international corruption ratings. Respectively Tynkkynen and Remes think the corruption in Russia has increased. The role of energy is so stressed that the corruption has become a way to collect funds for authorities and this negative dimension of the social development are still taboo subject in Russia. Anttonen sees the level of corruption in Russia follows the economic trends; for instance what comes to stealing or bribing in the economic upturn there are obviously more money to betray, in downturn the amounts are smaller. Remes sums:

> *“There is too much bureaucracy [in Russia]. The problem in corruption is that one needs to pay so that the rules are followed. […] The direction has been to worse. The large companies thou see this differently.”*
> Seppo Remes 24.6.2015

What comes to transparency, according to the interviewees Russia has in general gone worse and the transparency in Russia has even weakened during the past years. Solanko states there used to be discords and critics for political decisions related to economy, but not anymore. Sulamaa, in turn, mentions rather odd trials where persons have been convicted on at least weird grounds. The state’s control over media decreases open discussion and transparency. Actually the state’s control on media has tightened so in the last few years than independent media cannot operate. Putin talks about fighting corruption, but there has not been any change for better, says Sulamaa.

The interviewees conclude the possibility for new violent conflicts where Russia is involved cannot be excluded. Solanko sees there is no direct or immediate threat for new violent outbursts, but the situation in Ukraine smoulders and may be spread. Sulamaa sums that in addition to the conflict in Ukraine, the border disputes are possible as the borders of Russia are large. Solanko considers the situation is difficult to estimate, for instance a year ago not many foresaw the war in Ukraine. Remes regards there will not be major changes in Ukraine, but the enlargement of Nato could cause violent confrontation, whereas Valo for his part sees the open armed wars and battles unlikely as well as the confrontation between Nato and Russia. Anttonen reminds the entire question is not a matter of faith; there have been violent outbursts in the South border of Russia since 1994 and over 10 000 humans have died in the conflicts. He regards violent conflicts are likely, because the situation in Ukraine is unsolved and due the problems in the Islamist world.

Tynkkynen determinates the risk of new violent conflicts depends on several factors. If the Putin’s regime stays in power, the new conflicts are likely. The Russian political

lead's ostentation and pompousness prove the risk exists. Russia may try to destabilise the contemporary power in the Baltic countries for instance. He considers there is actually chance for not to face violent conflicts, but the political operations are more indirect and politics will interfere in business. Russia already uses carrot and stick diplomacy in its foreign affairs. The occupation of Crimea was a surprise for some, but not for everyone as the Russian foreign affairs and national defence has followed certain logic since the Georgian war. Russia may not even plan to occupy Crimea, it is possible it just had a plan to follow, if the orange revolution exceeds from certain point.

Respectively Valo notes the world misinterpreted the consequences of Maidan, Ukraine. Putin told already in 2008 to George W. Bush that Ukraine is not a country or nation and must mean Ukraine has not sovereignty, it is not a country and it has not ever been a country. Additionally Putin has openly supported a federative system for Ukraine. Valo adds Russia would then have an opportunity to peacefully seize Kiev through its federative parts. From the Russian perspective Ukraine is dispersed with regional centres and its Eastern part could be autonomic part of Russia. Economically the Eastern Ukraine is from 75 to 80% of Russia with open border line without any customs formalities. However, from the European perspective Ukraine is a sovereign country and Russia has no right to interfere it. But the EU has taken a bit arrogant attitude towards Russia. A mistake was made after the aggression in Georgia; the Russian troops both entered and left Georgia without any global sanctions. He states the Russian actions in Ukraine are totally wrong and reprehensible, but it is good to understand the background as the question is not only about Ukraine. The Russian foreign affairs have followed certain strategy for years and therefor the violent outbursts are not necessarily planned, but they are possible. Valo calls it more like feeling than a strategy. Russia uses propaganda in media and creates nationalism and patriotism which also focuses keeping the current leaders in power. Still a war is not very likely; the Russian people simply do not want to fight. Therefor the political leaders want to avoid visible confrontations and thus keep the people happy. After all, it has always been people who have changed the political power in Russia, although not in elections, but by protesting.

Rather surprisingly the interviewees have various opinions about the role of Russia in the international organisations. Solanko mentions the role of Russia in general in international organisations has not been very co-operative, but neither prohibitive. The role depends on the organisation. Both Tynkkynen and Sulamaa refer the Russia's role and participation quite stagnated; the participation is passive or stalled, and very much just being a part. Remes shares another perspective and describes the Russia's role in the international organisations active whenever it is possible. Anttonen sees Russia may mentally differ from other European countries, but in the international organisations Russia is just a European country driving its own goals; it acts as any other country and there is not anything problematic in the participation.

The interviewees unanimously see rather great currency rate risk in Russia; the currency rate risk in Russia has inevitably realised lately and generally there is a greater risk for currency rate fluctuation than in many other countries due to rouble's tight link to the cost of energy, especially to the world market price of oil. The currency rate risk is smaller for foreign company when the company's operations focus in Russia. The companies who produce and export from Russia may benefit from the rouble's low value, but the fluctuation is harsh for all and complicates normal business actions such as cost accounting and pricing. The currency's vulnerability for fluctuation has always impact on companies and effects when realising the profits. Still the rouble is the world's strongest basket currency tied to both euro and dollar; the rouble is strongly linked to oil incomes because 75% of export incomes come from oil sales and the rate depends how the oil barrel is valuated. The interviewees present it is quite difficult for foreign companies to protect against the currency rate fluctuation. Ollus clarifies the practical implications related to the currency rate fluctuation in Russia following:

> *"The Russian currency market is not the world's most liquid and the currency protection costs quite a lot. Euro-dollar rate is very easy to protect with small premium for ten years, but it you want to protect rouble rate in one way or another, you need to pay quite high risk premium. In practice you can make currency trade and you can pay for 15% to 20% premium for year or two. […] Someone who invests in with small amount, it does not need to protect [the investment] than for a year. We need to protect five or ten years' needs. Several tools are thou considered how to protect the currency rate. And you cannot completely protect all the time."*
> Simon-Erik Ollus 30.4.2015

Moreover Anttonen notices Russia may return export restrictions for currency as it had in 2006. Nevertheless at the same it would be a public notice of nation's bankruptcy, which of course is not the Russian lead's wish. Remes compounds it is possible to evaluate the rouble's fluctuation based on when Russia pays debts to the West; the rouble's value tends to lower at the time. There is so much volatility with rouble that the real rate is not clear. By 2016–2017 Russia has used its safe money and it can be seen whether there is economic growth or not. If the economy continues to decrease, the market may overreact and the currency rate will weaken even more.

4.2 Micro-level sources of political risk

4.2.1 Industry-level sources of political risk

The interviewees consider the Russian electric power sector reform was both successful and advantageous for the state and the industry. The reform was regarded successful especially in terms of structure and timing. For instance Solanko notes the reform was carefully and thoroughly planned and especially its active implementation worked well, but unfortunately after the implementation the development in the industry has stopped and the state's role has again emphasised in the open industry-specific questions. The state's holding has grown in the electricity, the distribution sector is still incomplete and in addition the reform in the heating sector is to be implemented. Valo, in turn, concludes the reform succeeded, because industry was renewed, prices were liberalised, the sector achieved foreign direct investments and there are both local and international actors in the field. The privatisation including the auctions was normally and honestly handled and the reform was topical and implemented as planned. The difference between reformed electricity sector and regulated heating sector is notable. Anttonen reminds the privatisation of the electric production assets and letting foreign companies to interfere in country's core infrastructure was a forward decision from the society that has traditionally been suspicious towards foreigners. He sees the timing for the reform was just a perfect; it is likely that a year later none of three European companies would have invested in the sector. The global downturn hit Europe in the late 2008 and both rouble and the nations' gross national profit decreased 10%.

Tynkkynen reminds it was a must to renew the electricity sector and in turn Russians are quite satisfied with the reform process and outcome. The foreign companies' investments also support the reform's success. The best structure for the industry would have been the Nordic model, but Russia's characteristics including some unstableness support the implemented structure; the capacity market was separated from the wholesale market which improves stability and security for the investments. It is important the electricity can be sold there where it is reasonable paid. He sees possible problem with the state-owned system operator who determinates where the electricity is supplied and has thus chance to control the areas; simultaneously it is able to favour some actors over others. If the market is actual liberal, there would not be restricting factors or market manipulation at all, the industry structure now enables 'gambling'.

Sulamaa is somewhat careful with his statement considering how well Russia succeeded in the electricity sector reform. He points out the huge extent of country and reform in hand and therefor one cannot say the reform was not succeeded. Russia differs territorially a lot; especially the European side and Siberia are quite different and thus

divided into several price zones. The Russian electricity industry is based on so-called nodule-model which is rather complex from the cost accounting point of view. However, all the functions were separated from the integrated electricity system and electricity production and sales are basically competitive sectors, whereas transmission, distribution and the system operator are monopolies. Additionally capacity and wholesale markets are distinguished. But the industry still has problems; the capacity situation is changing; today there is an over capacity in the production and no new investments are made, but the existing capacity is aging fast. The electricity price is quite stable and the companies take their profits from the capacity markets. There are administrative problems how to join the heating sector to the current system. The distribution network is rather weak and does not enable large price areas. The distribution costs are regularly counted, but the system is rigid and based on regulation. Sulamaa reminds that in general the regulation in the electricity sector is adverse:

> *"[…] The idea of liberal electricity market is to have sometimes very high prices. That creates then the investment potential. If they [electricity markets] are regulated, the market disappears."*
> Pekka Sulamaa 27.4.2015

Ollus notes that electricity reforms are still rare and the sectors are regulated in many parts of the world; a great deal of the world's electricity production investments are made with feed-in tariffs or with other state-regulated tariffs which make the investment a project-like and the agreed tariffs guarantee the return on investment. In this context the Russian electric power reform was very ambitious; the electricity infrastructure has not been invested in since the collapse of the Soviet Union. In the late 1990's it was quite obvious that economic growth in Russia required substantial investments in electricity infrastructure. Hence Anthony Chubais got RAO UES under his management and a mandate to renew the sector. The reform was both planned and implemented in 1998–2013 which is a very short period of time considering the size of the energy system in hand, and this is incredible, notes Ollus. There is no other electricity sector which has been as much liberalised in the short time frame and according to the original reform plan. There are still some details related to energy tariffs, a lack of competition in some segments and the missing reform for heating which could be improved.

According to Remes 70 to 75% of the electricity reform is now implemented and the central changes have been done. The industry structure and the electricity production segment are pretty much in order. The structure of distribution network is quite all right, it is good to have a system operator and in a whole the big picture is good. The electricity prices and wholesale prices are liberalised. The creation of separate capacity market was significant, although in production the markets should be convergent. It is a good question

is the separate capacity market still needed in five or ten years. The regulation is both advantage and disadvantage in the capacity market. There is not lack of electricity and the reserves are reasonable. Likewise the transmission and distribution networks operate independently and are coordinated by the holding companies and additionally the regional operation works well. Considering these Remes agrees the electricity reform has succeeded well. The problem is that the state owns entirely the distribution segment and there is far too much corruption involved that it should rather be called 'stealing'. Remes favours privatisation for the distribution segment, but estimates the market following:

> *"In the distribution the only sensible way is to privatise at least part of them, to get reasonable benchmark [in the segment] so the companies and the state can control its kinds better. Now it is such arguing between them. It is such ironic social competition. […] So therefor there will be great problems in the distribution, because it is inefficient. And there are also problems with the regulation. […] The greatest problem is however, objectively seen, the heating sector. It is still unsolved."*
> Seppo Remes 24.6.2015

The Russian state's control over the electricity sector was described regulatory or general. To be concluded the state controls the electric power sector through the regulations. Valo laughs the Russian state controls everything in Russia so why not the electricity as well. Russia's control over the industry was also described as any other state's control over the country's electricity sector. Albeit the state's control over the electricity sector in Russia was also described more intensive and problematic than in many European countries. Tynkkynen notes the state owns entirely the system operator and transmission grid and thus is able to choose which companies sell and distribute the electricity; thus the state increases grey area in the sector. According to Remes the state's interference in the sector in Russia is quite straightforward; the government annually controls and regulates the sector through the energy ministry and it for instance approves the investment budgets for transmission and distribution grids and factual sets the prices in the capacity market. The Russian state has changed the regulative rules in the distribution several times, although there supposed to have long-term regulative base for business. Overall there is a lot of manual guidance in the industry.

Consequently Sulamaa sees Russian state participates and controls the electric power sector more than the European countries, because the Russian system is centralised and the European model bases on dispersion. In the European model, the companies and purchasers make their offers in electricity exchange and the exchange calculates the prices. In Russia there is a system operator which in practise is the Russian state itself. The system operator calculates the prices and sets regulation for offerings. There are

several types of agreements for production capacity in the capacity market. In some agreements the profit for capacity related production is guaranteed for five or ten years. There are also annual capacity auctions where mainly the old heat sector offers its production for sale. And there are also bilateral agreements. So the current capacity market is very fragmentary and there is a general wish to simplifier it. It is likely that the agreements in capacity will be unified and simplifier. There also discussion about the nodule model. The question is strongly linked to the distribution capacity and may it be changed in ten years. For Finland there could be a possibility for wider electricity exports to Russia; the old capacity in Russia may cause temporary production problems and in Finland the electricity prices can go very low with the increase of wind and nuclear power. So then it is possible that Finland could occasionally export inexpensive electricity to the North-western Russia.

Ollus, in turn, tells the Russian market system in electricity is also used in Spain, Italy, Portugal and the UK. He refers the electricity markets in Russia and the UK are actually quite similar where the state-owned companies both operate and regulate the sector. But from the Nordic point of view Russia differs from the Nordic energy market. The Nordic model is a perfect market, a utopia; the electricity market is both naïve and highly efficient and so competitive that the competition is made several times before the electricity supply. The market structure is quite different from many electricity markets and it is therefore an end example. The Nordic electricity market is a forward market and thus quite illiquid. The repayment time for plant investment is possible to calculate and often the market changes so that the investments can be very profitable. In Russia the capacity supplier agreements guarantee certain tariff for the produced electricity what repays the investment and the company is able make reasonable profit. The logic is pretty much the same in the Finnish wind power investments. The most interesting change in the electric capacity market relates how the old capacity is shut down and what kind of capacity is left; one question is that will there still be two different capacity markets after five years. The companies of old production capacity compete in the capacity auctions and if the company fails twice in the auction, the production capacity should be shut. Fortum has the contemporary capacity supplier agreements, but there will be time when the electricity is priced by the market. Then it is very important that the market is healthy and the prices are determined by demand and supply. The right level of electricity supply is always a bit sensitive topic everywhere; the sector regulator wants to maintain good security and delivery reliability, but it also requires over capacity. However there is notable over capacity in the Russian electric production and a lot of old capacity from the 1930's and 1940's should be closed. Currently there is 80% more capacity than the theoretical maximum demand is in the cold winter day in Russia. This is due to the new investments and the economic growth has been more moderate than expected. The planned over capacity for security and delivery reliability is normally 10% to 20%.

The interviewees seemed to wish for the industry development in the next five and ten years, but are quite composed with their hopes. The general opinion was that fundamental changes are rather unlikely. The new investments in production or distribution are unlikely as the economy decreases and the cost of capital is high. However, the distribution segment would require investments. Solanko, in turn, estimates the electric power sector can be changed to strategic sector defined by the law of strategic sectors. Although will it be publicly appointed or not, really does not make a difference. She regards the state's ownership in the distribution sector remains significant. Valo thinks there will not be big changes in the electricity as the industry has been through massive renovation and structural changes; the infrastructural change needs to be done in the heating sector which would certainly affect the companies holding combined heat and electricity plants. He points the heating reform would be crucial, but it unfortunately is much likely postponed, because the political leaders do not want to increase households' heating costs. He describes the situation:

> *"Yes, when there are -30°C degrees out, you still need to open all windows to get normal heat as it is so damn hot. And it hasn't any significance, because it [heating] is half-free. And the heating doesn't really cost anything, it is very bad business. […] it is the sector that needs reforming."*
> Raimo Valo 24.6.2015

Remes notes the industry participants are very careful to make any adjustments. It is likely that there will not be new contracts for agreed profits for electricity produced by new capacity. But the partial privatisation in the distribution segment is possible in the next five years. He estimates three or four regional distribution companies out of eleven and 30 to 40% of the coverage to be privatised. But there are several scenarios for heating. The best solution for heating would be new regulation including alternative boilers with top price pricing logic. The system is possible to implement even for the big areas. The logic may be a bit harsh for the regulator because each area needs own tariffs, but the calculation itself is not a hard thing to do. Regular people are able to do it if they are decently paid and they do not become corrupted. Otherwise they can count whatever they want to warns Remes. There is a decision in principle the whole country would be gradually reformed and no pilot projects would be used. It is possible the reform will be implemented after the presidential election in 2018. That would be the best scenario; relatively efficient system with lesser concerns related to regulation. But there is a risk related to current political and economic situation that the reform will be further postponed which blocks the investments in the sector. The electricity reform was promptly implemented with respect to the European countries, although there were some two or three years delay. Remes concludes:

"The delays just belong to the process, I have lived it once."
Seppo Remes 24.6.2015

Both opportunities and threats for the foreign companies were seen in the Russian electricity sector. The interviewees note that Russia is a huge market and growth in electricity demand especially among the households is a possibility for the foreign investors. The need for electricity remains in Russia regardless how much and how fast the Russian economy develops. The foreign companies also have advantage in efficiency in relation to the Russian counterparts; the company achieves significant competitive edge by improving the electricity production. However the threats for foreign direct investors are the political decisions that increase the regulation in the sector.

Tynkkynen points out there are substantial additional gas reserves in Russia which may affect the electricity production too; one opportunity relates to additional gas which is freed in the oil pumping. But the sector has threats as well. Tynkkynen agrees the foreign companies' operations can be harmed by the increased regulation and the Russian state as a system operator and a responsible of the transmission and distribution is able to favour certain companies more than others. Then the company's home country operations can either strengthen or weaken the company's status in Russia; quite often the companies also deal with Russian energy companies at their home countries. If the cooperation works well, the company benefits in Russia. He notes one of the greatest threats in the sector is the unreformed heating sector; the heat is currently sold at very low price and this harms the companies' profitability. There is also a social risk involved. The most of the Russian expect to get low cost heating since they are citizens of the energy superpower. There are long roots in the history for the ideology. The political risk is that if the heating costs increase, the state cannot provide heat for the households and the ruling persons are criticised. Therefor the political support for the heating reform is not strong.

Sulamaa presents a market niche for local electricity systems in Russia. The contemporary political lead is very conservative and may not be interested in the renewables, although there are wind, solar and wood power available in Russia. The local electricity systems require special equipment for electric production and distribution that especially Finnish companies have. Sulamaa sees the biggest threats in the industry relate to the worsen economic and political situation in Russia. Tightened political situation together with global trade sanctions can cause confiscation of foreign assets in the industry. The confiscation in Russia would probably be handled indirect and by using bureaucracy so that foreign company cannot operate in Russia anymore. He emphasises this would require a very bad situation. In general the threats in the industry are seen bigger than the opportunities what reduces the further investing.

Ollus regards the opportunities and threats of foreign direct investor are the same in Russia than in any other electricity sector; the business opportunity is a question of the company's comparative advantage, good technology for instance. The market risk is in all electricity production. Simultaneously the market risk is the country's macroeconomics. The company's success is related to the demand development, fuel development, technologies and other external factors, but there is also a political risk involved; the energy markets are somewhat regulated and politically sensitive in all countries. Thus both market and political risks needs to be considered in the electric power industry.

Valo, in turn, sees there are threats all the way to confiscation in the Russian electric power sector. The greatest risk is in 'responds in kind', some kind of payback or revenge. Russian government can level restricting actions to the foreign investors in the sector if it regards the Russian companies are discriminated in Europe. For instance the shareholders of Yukos won a trial in Belgium and France and the arbitration court made a decision to confiscate 44 billion dollars of Rosneft's assets in order to follow the court's order. The decision was certainly not favoured by the Russian government and the responding actions in kind could be expected in Russia. He notes the arbitration court's decision caused diplomatic stress between the countries, although it is not the court's concern to consider what will now happen to for instance Total's assets in Russia. The problem is that when something like this happens, it is typical that Russia chooses one sector and can confiscate all the foreign assets regardless of the foreign companies' home countries. The same happened when Russia introduced new customs for wood; the root cause for new legislation lied in Russia's relation to China, but the biggest payer for the customs was after all Finland. One central question related to threats in the electricity sector in Russia is to what extent Russia continues to isolate.

There are huge possibilities in the distribution segment says Remes. He sees there are a few foreign companies who could own distribution networks in Russia; the companies could enhance the production and still make substantial profit with the contemporary tariffs. The current distribution companies are huge; one company is usually responsible for the electricity distribution for the area size of Austria or Czech Republic. At the same the companies are extremely cheap laughs Remes; value of one company is about 150 million dollars, but it should be close to 40 billion. The foreign companies could significantly make the distribution more efficient. The government, the ministry of economy and majority of the energy ministry were willing to privatise some of the distribution assets with control of 50%, or 25%. But today the Russians do not want to lose the control. Another opportunity is with small, independent electricity production solutions when the distribution network gets worse; there are many electricity consumers looking for secure electricity supplies.

Remes sees the industry threats are mainly the same for domestic and foreign companies. One threat in the electricity business is electricity demand which can refract. The companies obviously have normal business risks in relation to their effectiveness and competitive edges. In principle it is possible that the state would begin to favour its own electricity production, nuclear and hydropower, in the production market structure. The risk is rather unlike, but exists in the business; the nuclear power and hydropower could be favoured based on the ecological issues. There could be more regulation limiting the possibilities of the foreign companies, however Remes regards this very unlikely. The greatest threat lies in heating and affects the companies who have invested in plants producing both electricity and heat. The threat concerns simply when and how the reform is done. It is obvious that the price of heat will increase; otherwise no one invests in the sector and the efficiency can only be improved by decreasing the loss. The state controls the price increase that the prices do not rise over the consumers' ability to pay. The better option for waiting would be direct subventions from the state to consumers. Besides Remes thinks the heat prices will not rise in 30 to 40% of the cases, but can even decrease. The heat production is not totally profitable or unprofitable; the companies do not invest at all in heating and they get a few percent margins on top of the production costs. Consequently the companies take everything from the electricity price. The challenge is that the companies must run the production because of the heat production and the regulator cannot do anything for the electricity prices.

Anttonen mentions there is an export opportunity to China for the electricity produced in Russia. The scenario is currently unlikely, but after a few years it may happen. He sees the greatest challenges the foreign companies have in the Russian electric power sector are the same than in other sectors in Russia; they are not making profit enough. The investments were expensive and made with the expensive financing and now the production incomes come in weak roubles. Therefor the threats are related to the business, not to the regulation. A realistic threat is with the unreformed heating sector. Russia has the world's leading combined electricity and heat producers and specialists, but it will not make the industry profitable. The amount of loss is so substantial.

The interviewees communicate that any kind of success in Russia requires good personal relationships including the relationships to Moscow and to the top leaders. The personal relations in Russia are extremely important; they have always opened doors and reduced the bureaucracy. Also Solanko argues that the success of the foreign company in the Russian electricity sector is heavily depended on the political power and the persons leading the country. However, it often depends on the size of the business if the personal relationships include the top leaders as well. Valo says the political risk is always the most important risk in Russia, but it does not mean this risk is about who is the current president or the prime minister. The local decisions affect the most on the company's operations and therefor the relationship to local and regional decision-makers, especially

to governor, needs to be good. It was generally agreed the regional authorities are especially interested in the investments, inexpensive heat and electricity.

Ollus states the political will can have an impact on the companies' success, but the foreign companies have succeeded in the Russian electric power sector in terms of their efficiency; the European energy companies operate more effectively with their modern practises and processes, efficient organisations and latest technologies than their Russian counterparts. Tynkkynen thinks it is possible the foreign companies' success is linked to the persons leading the country, because sovereign country has right to rule in the sector. Still he considers the success is more linked to the reform structure and operations under the capacity agreements.

Remes says the good relations to the persons leading the country both effects and not effect on the foreign companies' success in the sector; he cannot see political lead that would nationalise or evict the foreign companies. The foreign companies have advantage in efficiency and they work by the rules. The reform had Putin's support, it would have not implemented otherwise. The President Putin hesitated during the process which caused the delays, but the greatest decisions were made in informal discussions between Putin and Chubais. Kremlin also pointed Alexander Volochin as a chairman of board in RAO UES in order to look after the reform. These kind of decisions are never unpolitical Remes reminds. Electricity is always strategic for the country. Putin has personally stated the FDI in the electricity sector have been the best foreign investments in Russia. In other words the good relationships and support are required in Russia; it also limits the level of corruption.

The interviewees in general do not entirely exclude the possibility of selective nationalism in the electricity sector, but see it unlike. From the company perspective Fortum is not afraid of the selective nationalism in the sector. Almost all interviewees reminded Russia is however quite nationalist where local production is favoured. Many interviewees consider all forms of industry-specific nationalisation are possible, but the nationalisation and expropriation of foreign assets are not likely options. Expropriation in general is after all a very extreme effect of political risk. Solanko says it is much likely that the domestic companies are favoured in the sector, and this has actually already happened. Sulamaa notes that Russians in general are quite nationalists. However he regards that extreme nationalism in business would only happen in very bad national and global situation; the Russians after all appreciate foreign know-how. Remes does not believe in expropriation at all, it would need a third world war or alike and then the whole sector would not matter anymore. It is possible that the domestic companies are favoured in the small scale, for instance in capacity pricing. It has already happened systematically in the electricity equipment purchases, because there is general obligation to buy equipment produced in Russia.

Ollus does not think the selective nationalism would occur in the sector. He argues the electricity production is not oil, gas or diamond production where national resources are exploited. Fortum is much appreciated and one of the strategic companies in Russia; the company works to improve the Russian living standard. Electricity and heat production are is part of the nation's infrastructure; both products are locally used commodities that are central to the society. He notes efficient and socially responsible energy company is valued by the society and its local inhabitants and says:

> *"As long as we do it with responsible and efficient manner, we have nothing to fear."* Simon-Erik Ollus 30.4.2015

Valo finds the atmosphere in Russia is more anti-American and anti-European than it has been which enables favouring the domestic companies in the industry. However there have not been clear signs from it; actually the Eastern Office only has a few cases to settle in Russia right now. Conversely Valo has personally noted Russians have been very friendly to foreigners and also frauds are decreased lately. It is possible that Russians do not want to cause unnecessary disputes at the moment. It is quite normal that Finnish companies have some problems in the Russian market, but now the companies have not really had adversities. Anttonen regards the possibility of nationalism so far unlikely, although Fortum's positioning in the heating sector makes the company rather unique with the unique problems. He does not speculate with the nationalistic actions, but notes the heating in much more visible for the consumers and thus nationally more important.

Moreover Solanko and Tynkkynen see new taxes, price controls and other economic restrictions are probable in the electricity sector; especially if profits rise too high, there can be political decisions restricting the profit making. The political pressure to increase the taxing may also come from the weakening economy. Anttonen and Valo, in turn, do not believe in new regulations or taxes; the market operates as it is planned, there is plenty of capacity so there is so need for increased control. Sulamaa also regards for his behalf there are already so many regulations in the industry via tariffs and price limits that new taxes, regulations or price controls are very unlike. For politicians it is important that the consumer prices will not rise too much and make the people unsatisfied. Ollus says there is always a risk that new taxes, tariffs or economic restrictions would set. Remes, in turn, does not believe in new regulation, although there is some kind of uncertainty in the sector. There can be discussions to longer the repayment times for the capacity agreements, DPMs. Also some new rules for capacity market could be introduced. The distribution tariffs were just frozen, because the prices cannot rise over the inflation. The introduction of ecological tax is also one option Remes concludes.

The interviewees quite unanimously regard the contracts and agreements in the sector are as form and binding as they generally are in Russia as there has been strong interest

to secure the electricity production in Russia. Ollus confirms Fortum has experienced the contracts binding in the Russian electricity sector. Sulamaa and Remes point out the made capacity agreements which define the return for investment have worked and been binding. Sulamaa's experience is that the contracts and agreements in the Russian electric power sector have worked well, but he laughs that in general a contract is a contract in Russia and it can be unilaterally dissolved. Remes compounds the investments in general have not worked well in Russia, but he continues that the Market Council in the sector works extremely well and no breach of contract has revealed. Valo adds the agreement process differs but the contracts are mainly binding in the sector.

The interviewees regard some other country's government can interfere in the Russian electricity sector, but think the scenario is unlikely since the interference would hardly affect anything. The interviewees asks why any other country's government would want to interfere in the Russian electricity sector and take a head-ache from some other country's energy maintenance or is there even a country that has such big interests in the sector. According to the general view not even Finland, Germany or Italy would interfere the industry. Valo states Russia will not let any other country's government to interfere the electricity sector; the foreign governments and companies crossed the line in the oil and gas sectors and the companies' assets were bought out. However, the electricity sector is different as there is not dominance in the sector and the industry is better balanced. Tynkkynen says it is more likely to be other way around; Russia as electricity exporter could make changes in international electricity trade, but Russia has not interdependency in electricity with any country. Consequently Sulamaa reminds that foreign governments have indirectly interfered in the Russian electric power sector since the investor companies are majorly state-owned, but the companies know what they are doing and the home government's involvement is not required. He adds that it is possible that home governments interfere in the sector in case of the companies are harassed or there is a risk of hidden expropriation in quite difficult political situation.

4.2.2 Company-level sources of political risk

The interviewees quite unanimously see that besides investments the foreign companies brought dynamics, competition and efficiency to the sector; their role was and still is important. In fact Valo and Remes regard the foreign companies' significance has increased and today the companies have notable role in the Russian economy. Remes notes the companies, E.ON, Enel and Fortum, did not have a specific role in the reform. Nevertheless there was a big change with the investment decisions when E.ON and Fortum got their representatives in RAO UES. Nowadays the role of these foreign

investor companies is crucial; they are more or less regarded as Russian companies, they make the industry better and thus work irrevocably as sprinters in the field.

Solanko and Anttonen remind that the foreign companies' direct investments were extremely wanted for the sector; it was also clear that precisely the European investments were required. Solanko believes the company's position and significance vary by the size of the company actions and positioning in the segments certainly has some kind of impact on the company's status. Anttonen for his part notes the foreign companies' role was significant factor for the reform success and showed the industry is not just a playground for Russian oligarchs. Consequently the companies needed to pay for the assets and the foreign investors likely boosted the price level too, which was extremely beneficial for the Russian state. He states E.ON, Enel and Fortum have an operational excellence and the companies are the industry benchmarks in a way. So their role was and still is to enhance the sector. There were also Russian counterparts with a little experience waiting opportunistically huge incomes. They must have noted they need to work in order to make business in the sector.

The interviewees point out that the investments of E.ON, Enel and Fortum gave a positive signal for the industry. The number and magnitude of foreign direct investments was a certain test how the reform succeeded. Tynkkynen considers the role of all three foreign companies is significant and especially Fortum's role is central in the area where it operates; from the local perspective Fortum is rather Russian company. Sulamaa notes all three foreign investor companies operate in the Market Council where they genuinely have a say especially what comes to industry development. Both Ollus and Sulamaa think E.ON's, Enel's and Fortum's role is to encourage the business, show the direction for Russian electricity companies and thus boost the positive development in the industry.

Sulamaa agrees with Solanko that the companies' position varies based on the electric segment; in the regulated distribution segment the foreign companies have a supplier or an advisor role than the in the production where the companies have own business vision and assets. Ollus confirms Fortum's responsibility of cities heating in the Tyumen area makes the company a much more local than others. The heat tariffs are locally defined and Fortum works with the local politicians and is at the same much closer to its customers than E.ON and Enel. Moreover Anttonen emphasises the local role of Fortum. E.ON and Enel as only electricity producers have the possibilities only in the electricity and the risk management is thus rather easy. The regional authorities or end-consumers do not have direct relationships to E.ON or Enel. Fortum is responsible for heating in Tjymen and Cheljabinsk and its role is crucial for the inhabitants. Heating is not profitable, but it is a must from the social point of view.

Two-fold responses were given when discussed about the foreign companies' goals' congruence with the goals the Russian government has for the electricity sector. A

majority of the interviewees see the goals of Russian operations of E.ON, Enel and Fortum are in line with the Russian government's targets. Tynkkynen sums:

> *"Well, [the congruent goals between the government and the foreign companies are] not really one in one, in this situation unfortunately. The ultimate goal is common; to provide the functionality of the Russian electric power sector and hence create business opportunities to companies and investments."* Veli-Pekka Tynkkynen 17.4.2015

Valo, Remes and Anttonen, in turn, define that the social goals are congruent between the investor companies and the Russian government, but the operation needs to be commercially profitable. The Russian state is not interested in the profitability of the foreign investments, all the required capacity investments are done and it is after all the companies' job to do. On the other hand Solanko sums the companies seek for profit and it is in line with the government targets. Remes sees there is always a conflict between the cheap electricity and maximal profit. However he compounds the security and system targets are congruent with the Russian government and the foreign companies in the sector.

> *"Every electricity producer has the same targets than government has. There needs to be enough energy and electricity in the system and adequately investments that the energy supply works. We and the Russians companies have congruent goals. When you have planned the electricity marker efficiently, then all participants see the same targets."* Simon-Erik Ollus 30.4.2015

says Ollus and stresses that common goals and shared targets of the companies in the industry measure how well the industry is planned to operate. Sulamaa says E.ON, Enel and Fortum have common goal with the Russian government to develop the electricity market and create successful market mechanism to the industry, but the difference in the targets is that the foreign companies know prices rise occasionally in the competed markets and sometimes the prices are really high. The end-consumer should have the prices in-line with the wholesale electricity prices. The dilemma is that the political decision-maker does not want to let high electricity prices to people which would further decrease the working capital of the households and make people unsatisfied.

As economist of the national institute Solanko cannot answer for the question related to the companies' ability to reach the expectations for return on investments. Similarly Tynkkynen laughs he is not an economist, but sums that for instance Fortum took a great risk with the expectation of great incomes as well. So far the revenues have not been that

good, but there are several factors from economic slowdown to delay of heating reform affecting the situation. Valo and Anttonen argue it will take time for Fortum to receive the return on investment, because of the unreformed heating sector. They estimate that considering the electricity production only, the estimated revenues can be reached in five to ten years. Sulamaa compounds the capacity agreements ensure certain profit for produced electricity and as long as the agreements are valid the investor companies can make profit from the sector. At the same the electricity price has been stable. Furthermore the foreign companies have normal business risks involved, for instance currency rate risk and risk of weakened general economic situation in the country. The Russian economy weakens and simultaneously the electricity demand has decreased. The foreign companies businesses have come down and it is possible that expectations for the return on investment need to be reconsidered.

Ollus recalls Fortum has had several projects from dams to nuclear reactors in Russia since the 1950's. Fortum has also been a minor shareholder in Lenenergo since the 1990's, so the Russian electric power market was both near and familiar to Fortum. The investing and growing in the Russian electricity sector has been a long-term strategy for the company and the reform was actually a golden opportunity to be bigger than never before. Fortum has followed its planned strategy and the only disappointment has been the development of Russian economy and currency rate. Fortum targeted 18.2 billion roubles revenues from the investments in Russia until 2015. Unfortunately the rouble's rate to euro has halved from 2008 so the sum is naturally different in euros than estimated. Still Ollus counts Fortum makes rather well profit in Russia and states the return on investment in Russia is not yet on the targeted level, but he sees the level is possible to reach by working hard. The annual profit in Russia has been over 200 million euros. In other words Fortum has made satisfactory profit and sees the investments in Russia are the best it has made. A lot has happened since 2008; not many could estimate the global economic downfall in 2008 or emissions trade is not working as effectively as planned. Due to these factors there are many energy companies who have invested in gas turbines in the Central Europe and are now forced to make write-offs and loss. In this context he is quite satisfied with the company's situation in Russia.

Remes for his part sees the foreign companies will meet their financial expectations in the industry. E.ON has made more money they never expected; it has had millions euros operating profit annually and Remes is certain E.ON has never made financial that well anywhere in the world before in five years. E.ON has also realised all the profits from Russia to Germany. Enel complaints, but it is making decent profit. Fortum is also been rather profitable, but the heating business is problematic, he concludes.

The interviewees were asked about E.ON's, Enel' and Fortum's bargaining power in relation to the Russian government and upstream fuel suppliers. Overall the interviewees hesitate with the responses, especially with the question related to the bargaining power

with the Russian government. The interviewees raise a need for the foreign companies to act together with the common targets in the industry. The interviewees talk about the negotiations and the changes with the fuel supplies proving the bargaining power with the suppliers. All three foreign companies in the electric power generation are great customers of the huge upstream fuel suppliers such as Gazprom and SUEK.

Tynkkynen regards E.ON, Enel and Fortum have some bargaining power against the Russian government according to common principles, but they do not have so-called 'one European voice'. All companies promote the privatisation and deregulation as a guarantee of private income maker which is in conflict with the government's policy. Solanko judges the question related to the foreign companies bargaining power difficult to answer; it would better to ask in relation to some other counterparts or about certain topic. Valo and Remes, in turn, state E.ON, Enel and Fortum have bargaining power with the Russian government with the issues related the companies' operations. The companies have both central statuses in the sector and local boards who actively promote the companies' best in Russia. Consequently they see it important that the companies have dialogue with the Russians together, not as a single company. Anttonen also reminds the foreign companies are not acting as a one in Russia. The foreign companies in the sector are quite different based on the segments they operate in which makes their need for bargaining power different too.

Ollus and Sulamaa consider E.ON, Enel and Fortum have bargaining power in relation to the Russian government through the Market Council, a council who operates under energy ministry and pursues for industry improvement. Energy market organisations and producers have continuous dialogue and hence the companies participate and are heard before the reforms and legislative changes. Ollus notes that as in all lobbying the company's creditability and track record are involved in Russia; Fortum operates both nation-wide and locally. Fortum's Russian head office located firstly in Chelyabinsk, but the company soon had to move it to Moscow where the company could better promote its interests and handle the electricity production optimisation with the national regulator. Fortum has still office in Chelyabinsk and operates actively in the Tyumen area too.

Sulamaa considers the companies might have more freedom for bargaining with the coal suppliers than gas suppliers as there are bilateral agreements used in the coal supplies and gas market for gas supplies. Ollus would not use word bargaining when discussed the companies' relation to fuel suppliers. He refers the electricity companies always tender different supply chains and look for the best supplier contracts and costs. In Russia the gas market and price are still regulated, although there are plans for gradual price liberalisation. Gazprom has the greatest volume and tries to increase the gas price, but smaller suppliers such as Novatek compete with the lower price and hence challenge Gazprom and simultaneously make market a bit healthier. Fortum has several fuel suppliers in Russia; its plants in Russia are both sizeable and tailor-made the fuel mix and

suppliers is quite decentralised. Uniform plants with a few fuel suppliers would be beneficial, but require more investment.

The interviewees agree Russia has decent political level relations to Finland, Italy and Germany; especially Italy has been active to maintain the relation and since the relations to Italy have always been excellent. Tynkkynen values Italy is culturally more close to Russian than other two countries, the second best relation is to Finland and then to Germany. The Russians have positive image of Finnish and they appreciate the size of Germany, but historical reasons still affect the country relation. Germany is regarded more engineering and colder than other countries. As a whole the attitude to the European Union is quite critical and the confrontation has increased. Valo describes the country relations also quite straightforward. Chancellor of Germany Merkel and President of Finland Niinistö mostly take care of the country relations to Russia, but also the public officer level relations are alright.

Tynkkynen sees the country relations certainly impacted the investments. The background is in the history; both Germany and Finland have cooperated with Russia in energy issues since the 1960's. These countries have the understanding of the Russian context, although the interest for investing came from the companies. E.ON, Enel and Fortum have been able to weight both risks and opportunities before entering the market. He thinks the companies' success in Russia is somewhat related to their acquiescence towards Russia. The relationship to Germany has certainly hardened. Finland is regarded as a good-doer especially when Fortum supports Rosatom's nuclear power investment in Finland. Valo sees E.ON, Enel and Fortum would not have invested in the sector if there would have been diplomatic stress between the countries. As mentioned Germany, Finland and Italy have traditionally had good relations to Russia and especially Finland and Germany are regarded as easygoing business partners which are highly appreciated in Russia. He regards the country relations certainly can affect the companies' success, especially if there is dialogue between the nations. The trade is currently even easier than two years ago, since Americans stopped the trade with Russians and boycott the market.

Sulamaa describes the country relations satisfactory; the relations could be better too. Both Sulamaa and Remes note Russia's relationship to Finland is relatively good compared to relation to Germany. Solanko told that during the reform in particular European energy investors were wished to be interested in the sector. Russia's relations to China do not support the idea of Chinese energy companies to invest in Russian electricity. Simultaneously the capability of Chinese companies to enhance and develop the industry was not trusted in Russia. On one hand it would have been quite strange if American company would have invested in Russian electric power sector. Therefor the country relations were not significant factor for investing, but had some significance. Being European was emphasised and the companies' own eagerness and strategy to invest in Russia. The auctions are regarded to be transparent and successful thus that the best

bidder got the plant. It is not known that some company could have been left out or that bidders would have been unfairly treated. The country relations have remained the same last five years and have not affected on the companies' operations. She notes that the impact of the country relations for investor companies' success in Russia in the next five will be indirect and likely minor. If the country relations worsen, the first impact will not be on electricity sector.

Sulamaa responses that the relations of Russia and investor companies' home countries had absolutely impact decisions to invest in the sector, although the Russian market was already familiar to all three investor companies. He sees that currently the country relation between Russia and Finland is not that good and this atmosphere bars investing. Especially small or medium size companies do not invest or even search for investment opportunities in Russia, although there could be a lot of business potential. Russians usually respect companies that invest even in the bad times. He notes that E.ON, Enel and Fortum have made huge investments and tend to remain in the Russian electricity sector in next five and ten years. It is quite obvious that everyone hopes that diplomatic relations would get normal; some sort of diplomatic crisis between Russia and the home country would be a catastrophe for the company due to its great investment. He sums that country relations effect on the business success.

Ollus notes the bilateral trade relations are significant what comes to direct investing. Regarding Fortum's order of magnitude the company has basically taken the responsibility and created the business relations itself without the state's or export promotion organisations' help. Therefore the country relation is not that important for the company having Fortum's size and creditability than for smaller companies. However the Finnish political leaders rarely participate in exports, but the culture is totally different in Italy and Germany. Ollus says:

> *"Generally speaking in the country like Russia, if the politician is involved in the business, it often adds positive value for the business."* Simon-Erik Ollus 30.4.2015

He sees that Finland has always had good relations to Russia. Fortum has been interested in Russian market for long and it has sold for instance engineering services to Russia. Russia is Finland's neighbouring country so it is close with notable demand and thus strategically interesting. Regarding Fortum as a company and especially the industry it operates in, the geographical dispersion is not recommended and strategically important markets are nearby. The diplomatic relations between the countries have impact on all international business, although country relation is not the only meaningful factor affecting the trade. Finland has good reputation in Russia and the Russians know Fortum

is a Finnish company. Ollus reminds that Fortum does not have direct commercial advantage from its nationality, but sums:

> *"Fortum is a Finnish company in Russia, although we have Russian operations there. Some kind of organisation is a guarantee for quality."*
> Simon-Erik Ollus 30.4.2015

Anttonen, in turn, concludes Finland, Germany and Italy have all positive perspective towards Russia and it is not a surprise these companies saw business opportunity in Russia. The political culture in Finland is rather different compared to other countries and it is not a mission for Finnish state to promote Finnish companies direct investments abroad. Still weak or bad country relations could ruin the foreign companies' businesses in Russia. Europe is regarded much more negatively lately in Russia than two years ago, but Finland, Germany and Italy are more seen as friends than enemies.

4.3 Summary of main empirical findings

The interviewees had somewhat differing opinions about the foreign investors' political risk in the Russian electricity sector, although there were no fundamental divergences. The interviewees had also unanimous vies for certain questions. Overall several conclusions were drawn from the empirical data and the research's main empirical findings are summarised in Table 10.

The interviewees regard Russia has centralised political system where the decisions are made at the top level in Moscow. Likewise the political system is distinguished to regional authorities who report to Kremlin. Russia suffers from high degree of corruption and bureaucracy, and simultaneously the level of transparency has decreased. The political decisions have aimed at the nation's prosperity and economic development, but are currently shadowed by the political lead's fear of losing power. This feature makes the political decisions rather populistic, unpredictable and in ambivalence with the economy's best. Nevertheless in energy issues the government was regarded to continue conservative.

Table 10 A summary of the research's main empirical findings

1. The political decision-making in Russia is centralised and lacks transparency increasing the uncertainty of political actions. People's support for the contemporary political lead is searched from the international confrontation and superpower setting. The sudden changes within the political lead are unlikely.

2. The greatest problem in Russia is its politics reflecting the country's macroeconomics; the economy is rather unilateral and dependent on natural resources.

3. Russia has traditionally had restrictions on foreign trade in the strategic sectors. Due to the conflict between Russia and the EU about Ukraine, Russia has set sanctions to the European imports.

4. The government controls the Russian electricity sector through the regulations and the state holdings. The government and the foreign companies have somewhat congruent goals in the sector, although there is always dissonance between inexpensive electricity and maximal profit.

5. E.ON, Enel and Fortum have positively contributed the Russian electricity sector with investments, efficiency, dynamics and competition. Generally Russia lacks decent property rights, but the contracts in the electricity sector have been mutually respected.

6. The bilateral relations between Russia and Germany, Italy and Finland have been good. The size and creditability of E.ON, Enel and Fortum gives security for investments, but the diplomatic stress could also harm the operations.

7. E.ON, Enel and Fortum have a say for the decisions affecting their operations in the Market Council. Fortum is only foreign company operating in the heating and requires good regional relations. The unreformed heating sector is seen problematic for Fortum.

8. The risk of new violent confrontations cannot be entirely excluded; Russia is militarily involved in Ukraine, Syria and its Southern border. It is very improbable, but in a case of war nationalisation or expropriation of foreign assets in the electricity sector may happen.

9. The level of transparency, corruption and bureaucracy is high in Russia. The currency rate fluctuation is a great risk for FDI. Rouble's low rate and economic downturn may cause problems in profit transfers and capital exports.

10. The political risk in the electricity sector is likely to occur in small scale favouring of domestic production, harassment of foreign operations, increased industry regulation or taxation, market manipulation, subsidisation, extortion or retribution based on the company's home country policy.

In the upcoming years major changes in the Russian political system and within its political leaders were seen unlikely, or even unwanted. The political opposition is not strong enough to challenge the current political lead and a coup by certain parties could only take the country to worse. It was noted that Russia lacks the democratic channels to express discontentment in the country, when the people's dissatisfaction may outburst uncontrollably. Hence Russia is regarded politically stable, until it comes very unstable. Regarding the foreign companies' relationship to the Russian political authorities, also the country relations play a role.

Russia's both past and current foreign relations to Germany, ly and Finland were described either good or satisfactory. In general the bilateral trade relations have significant impact on direct investing and E.ON, Enel and Fortum were able to weight both risks and opportunities before entering the market. Still the interviewees had somewhat differing views concerning the impact of diplomatic stress between Russia and the companies' home countries. Sulamaa and Anttonen stated diplomatic crisis between Russia and the home country would be a catastrophe for the company. Additionally Tynkkynen and Sulamaa noted Russia can indirectly extort the companies in order to advocate the issue the state regards important. Valo regarded that good dialogue between the countries may even enhance the company's success in the sector, although at the same there is a risk of retribution if the Russian companies' operations are limited in the company's home country. Conversely Solanko and Ollus saw the impact of the country relations is minor due the investor companies' notable size and creditability.

The government's control in economy is huge and the country is regarded quite corporatist. Russia has not succeeded in the economic diversification and is still economically dependent on natural resources, especially oil and gas, making it vulnerable for the global trends such as low world market price of oil. Similarly nationalist and mercantilist views have increased popularity in Russia. Adversely Ollus presented the electricity as a product is locally used commodity securing itself the business, whereas some experts emphasised the Russians' perspective to electricity as government's service to people. Russia has traditionally had restrictions on foreign investment and trade in the strategic sectors and currently there are sanctions for the European imports due to the contemporary geopolitical situation. The Russian economy is in downturn and both domestic and foreign companies suffer from the decreasing demand. The interviewees estimated the foreign companies actually cope with the challenging situation better than Russian firms due to the foreign companies' edge in efficiency and technologies and access for inexpensive financing.

The empirical findings supported that E.ON's, Enel's and Fortum's positive contribution to the Russian electricity sector is evident; the companies have brought the sector investments, dynamics, competition and efficiency. The interviewees noted the

foreign companies in the electricity sector have congruent targets with the Russian government related to the industry functionality and development. However Anttonen, Remes and Sulamaa saw conflict with the correct level of profitability. Sulamaa stated the idea of regulation in the sector is rather ambivalent; the government does not want to raise the households' electricity bills, but the liberal market should sometimes have high price peaks which enable further investments.

The interviewees could not exclude the likelihood for new violent conflicts where Russia is involved, although there is not really direct threat for violent confrontation. The enlargement of Nato may or may not cause violent conflict, the interviewees have adverse opinions. The likely violent confrontations were seen to relate to Ukraine, the Islamist world and the Southern border of Russia. The interviewees linked the extreme effects of political risk, such as nationalisation, confiscation and expropriation of foreign assets, possible in war between Russia and the EU. It was concluded that the foreign companies should not be highly concerned about them.

The interviewees unanimously regarded rather great currency rate risk in Russia due to rouble's rate fluctuation. Among others the low world market price for oil and Russia's geopolitical contention has reduced the Russian economy and the currency rate risk has lately realised. Remes estimated the country has used its monetary reserves until 2017, and if the economy is not recovering, the foreign companies' profit transfers to home countries can be limited. Additionally Anttonen noted the general restriction for capital exports as an option in poor economic situation. The interviewees weighted the possibility for new regulation in the electricity production segment. Solanko and Tynkkynen saw the foreign companies profit making can be restricted, especially if the profits are high. The government may want to set taxes or other restrictions in order to keep the consumer prices relatively low. Naturally the pressure for increased taxation may come from the weakening economy. Also the degree of subsidisation in the sector is issue to follow by the foreign investors.

Surprisingly the interviewees had differing views about the governmental control over the electricity sector. Ollus pointed the company perspective where the Russian state controls its electricity sector as any other European state. The experts, in turn, partly thought the governmental control in the Russian electric power sector is stronger; the state has substantial holdings and it both regulates and controls the sector through the system operator and the energy ministry. Additionally the state-owned companies operate both in the sector in hand and the upstream energy sectors. The reform is now 70% implemented and the state's role has been emphasised in the open topics causing potential political risk source for the foreign investments. Tynkkynen estimated the sector structure enables market manipulation including favouring of domestic companies and restriction and harassment of foreign companies. At the matter of fact the interviewees confirmed the domestic companies have already been favoured in the small scale, for instance in

capacity pricing. Additionally the state can increase the state-owned nuclear or hydropower production by the regulation. Yet the interviewees regarded the foreign companies have a say for issues affecting their operations. E.ON, Enel and Fortum operate actively in the Market Council and they commonly promote privatisation and liberalisation in the sector.

In general Russia has insufficient property rights in addition to existing breach of contracts. However the empirical findings proved that the contracts and agreements have been mutually respected in the electricity sector. The interviewees appreciated Russia's ambition to follow both the reform plan and GenSchema, and in addition the electricity reform was mostly regarded successful. The foreign companies' contemporary capacity agreements ensure certain margin for produced electricity and the investor companies have been able to make profit in the sector. Remes presented E.ON has in fact made more money in the Russian electricity sector it never expected. E.ON has had annually millions euros operating profit and respectively has realised all 100% to Germany. Both Enel and Fortum have also made decent profit in the capacity market, although the unreformed heating sector delays Fortum to meet the initial financial target. Ollus confirmed the company's return on investment in Russia is not yet on targeted level, but is regarded good. Moreover he stated the investments in Russia are the best Fortum has ever made. The electricity price has been relatively stable, and in comparison to Europe, the market risk has actually been positive in Russia. Overall the interviewees trusted the companies will both make even and make profit in the sector within ten years. The best financial outcomes would be achieved with healthy electricity market and prosperous economy.

5 CONCLUSIONS

The chapter concludes the research's main empirical findings with the earlier reviewed literature and theoretical framework. Firstly the theoretical implications of the political risk in foreign direct investments in the Russian electric power sector are presented and secondly the research's main empirical findings are concluded for the managerial use for the companies operating in Russia. At the end the suggestions for further studies are assessed.

5.1 Theoretical implications

The research's framework for political risk analysis, which was discussed in detail in Chapter 2, focused to picture the present government and its way to operate in the host country, analyse the foreign companies' product and operations with respect to possible political risk and define sources and effects on business. The framework was limited to government-related sources of political risk in foreign direct investment in the Russian electric power sector. Here the theoretical framework of the study is discussed in relation to the empirical findings and finally the framework for the political risk in the Russian electric power sector is presented.

Simon (1984, 128–133) presented the political risk as a combination of the degree of country's economic development and the level of openness in the country's political system, and emphasised the intra-governmental friction as a potential political risk source. Root (1982, 114) also discussed the political instability and noted how the country's investment climate is in relation to the country's political risk assessment and therefor the country's degree of political stability needs to be evaluated. Robock (1971, 7) conceptualised sources, groups and effects of political risk and pointed out the competing political philosophies as a risk source whereas the government in power and its opposing parties are the groups from whom the risk may be generated. Likewise Alon and Herbert (2009, 128) stated the political risk arising from the host country's government's instability. Alon and Martin (1998, 13–15), in turn, discussed the degree of elite illegitimacy meaning the level of opposing population and the likelihood of regime change as sources of political risks. Therefor the research theoretical framework began with the concept of the degree of political stability and the continuity of current political power and policies in Russia.

The empirical findings concluded that the contemporary political system in Russia is much centralised and the political decisions are made at the top level of the political hierarchy. The Parliament has only a little significance and the political system is more distinguished into the regional administrations; moreover the political opposition is weak

and incoherent, and there are no strong challengers for the leading party. The interviewees saw dramatic changes in the Russian politics and among the political leaders are improbable in the next five years. The regime change conducted by the army or siloviks could take Russia only to worse direction. However the interviewees reminded that not a single Russian leader has lost its power in the elections. The greatest opposition lies in the regular Russians, although there are not ways to constructively express the discontentment. It was well summed that the countries like Russia are very stable until they become very unstable. Regarding the Russian electric power sector, the state was presented conservative decision-maker in the energy issues and in the electricity sector the government has followed both GenSchema and the reform plan. Still it can be concluded the degree of political stability is a macro-level political risk source for the foreign investors in the Russian electricity sector. Considering the consequences, the possibility of political regime change is also a significant political risk in Russia. Therefore the continuity of current political power and policies is related to the macro-level political risk in Russia.

Although Simon (1984, 132–133) and Alon and Martin (1998, 14–15) discussed the restrictions on investment, capital or trade as the investor's home country oriented source of risk, the study's initial framework emphasised the concept as an internal risk where the host government's decisions restrict the foreign operations. Additionally Root (1982, 144–145) discussed both incentives and restrictions on foreign holding, investment and staff under the concept of government policies towards foreign investment. The empirical findings showed there are regulatory restrictions in foreign investing and business in Russia. Russia has own business characteristics, custom regulations and it has traditionally had specific restrictions on industries; currently the country has set import sanctions for several foreign products and both nationalist and mercantilist views have increased popularity in Russia. The level of business restrictions was linked to the political scenery and the politicians in power and apparently the probability of regulatory restrictions on investment, capital and trade forms a political risk source at macro-level. Valo noted a possibility for retribution in business if the Russian companies are misused in Europe from the Russian perspective. This was regarded pivotal perspective and consequently the probability for new restrictions on investment, trade and capital was seen externally oriented source of political risk.

The empirical findings addressed the politics for the Russia's greatest problem which reflects in the country's macroeconomics. The Russian economy is quite unilateral and highly dependent on natural resources. This economic constriction was emphasised as governmentally related political risk source at the macro-level. Additionally the state has substantial role in the Russian economy and it has not succeeded to implement decent property rights to the country. These features harm the competition and economic

development in Russia. Hence the empirical analysis emphasised the state's control over the economy as internally originating macro-level political risk source.

Both Robock (1971, 12) and Root (1982, 145) saw corruption and scandals as drivers for enhancing the political risk to foreign operations. Alon and Herbert (2009, 131–133) noted how the corruption and the lack of transparency are central challenges for foreign investing and simultaneously they refer to the country's legal system and bureaucracy. The interviewees unanimously regarded the transparency in Russia has weakened during the past years; for instance it is not tolerated to criticise the economic politics and the state controls rather strongly the media. Two interviewees thought also the corruption has increased in the last five years in Russia; the central contemporary problem in corruption is that there needs to pay that authorities follow the rules. Additionally the level of bureaucracy is very high. Evidently the lack of transparency and the level of corruption form macro-level political risk source for the foreign direct investment in the Russian electricity sector.

Alon and Martin (1998, 14–16) discussed the degree of involvement in international organisations as both governmental and external political risk factor and stated the aspect indicates the country's international relations and the international agreements obligating the host government. The Russia's role in the international organisations was rather variedly described normal, uncooperative, stagnated, passive and active when possible. The responses picture Russia's international relations, but the issue was not regarded as significant political risk source for the research object. Russia's involvement in the international organisations and treaties has not confluence with the Russian electric power sector.

Robock (1971, 7) linked the armed conflicts and internal rebellion to political risk sources. Consequently Simon (1984, 128–133) noted regional and border wars as an external political risk of which especially developing countries suffer. Also in the politically closed economies, where the dissatisfaction cannot be openly expressed, occurs more violence. Alon and Martin (1998, 15) joined the likelihood of political violence including wars, border disputes, terrorism and regional conflicts for political risk dimensions. The empirical findings stated the likelihood for violent conflicts in Russia and political violence from Russia is involved and cannot be excluded. The issue is a possible external political risk source at the macro-level. The interviewees considered there might not be direct or immediate threat of new violent outbursts, but the situation for instance in Ukraine, with the Islamist world and the Southern border of Russia continuously smoulder. For instance Tynkkynen compounded the new conflicts are likely with the current political regime and the Russian political lead's ostentation and pompousness prove the risk.

Currency rate is affected by the host government decisions in relation to other countries and the currency stability refers to the general political stability of the country.

Although Alon and Martin (1998, 14–16) included the likelihood of currency inconvertibility in the economic political risk sources, in the research's initial framework the concept was seen also governmental risk source. The interviewees unanimously regarded rather great currency rate risk in Russia. The rouble is the world's strongest basket currency, but the degree of currency rate fluctuation is high due to its tight link to the world market price of oil. The fluctuation complicates normal business actions and has always impact on realising profits.

At micro-level, the industry-specific political risk sources were noted by Kobrin (1982), Robock (1971) and Alon and Herbert (2009). Also in the research's initial and final political risk construct distinguish the micro-level political risk sources to industry-level and the company-level sources. The concepts of governmental control over the industry and degree of nationalism were discussed by Alon and Herbert (2009, 130–133). Simon (1982, 67–68) brought out selective expropriation and selective nationalism as potential micro-level political risk sources.

The governmental control over electricity sectors, in general, is usually strong and Russia was described to control the sector as other countries do or even more intensively. After all the Russian state holds the system operator, the transmission and distribution grids, sets the tariffs in the distribution and controls the sector through the energy ministry. The Russian government controls the production through the regulations, although the idea of regulation in the segment is rather adverse, because the free electricity market should have price peaks too. The industry reform is partly in progress and the state's role has emphasised in unsolved questions. The contemporary structure enables favouring, restricting and other types of market manipulation. As a conclusion the Russian government holds substantial control on the sector and thus increases the political risk for the foreign companies. The interviewees did not exclude the possibility of selective nationalism in the electricity sector, but regarded its extreme effects, such as expropriation, very unlikely. The extreme effects could mainly happen in war. The research result did not support the degree of selective nationalisation or expropriation as industry-level political risk source. However, it is possible that the domestic companies are favoured in the small scale, for instance in the capacity pricing.

Simon (1982, 66–68) discussed both the discriminatory industry-specific taxes and regulations and the breach of contracts at the industry-level political risk sources. The research's empirical findings noted the new taxes and increased subsidisation are somewhat probable in the electric power sector, but above all the industry already has multiple regulations. The new taxes are possible if profits rise too high and thus the political lead may want to restrict the profit making in order to keep the consumer prices relatively low. The political pressure for increased taxing may also come from the macro-level, from the weakening economy. Although there were two-fold insights of new taxes, subsidisation and regulatory restrictions in the electricity, there was a clear evidence of

contemporary regulation in the sector being a political risk for the foreign direct investments. Whether the business restrictions would be discriminatory for the foreign companies, there was not unanimous or clear perspective for the issue. Furthermore the empirical findings stated the foreign companies have experienced the contracts binding in the Russian electricity sector which was also general perspective of the contracts and agreements in the sector. The contracts have been respected in Russia as there has been strong interest to secure the electricity production and therefore the breach of contracts was not seen as a political risk source.

In addition to the industry-specific political risk scenario, Simon (1982, 67) noted the foreign government interference may form a micro-level externally originating source of political risk. The research's empirical findings concluded that some other country's government can interfere in the Russian electricity sector, but the interference would not affect anything. Consequently the foreign government interference was not regarded as a potential micro-level source of political risk.

When moving towards to the company-level political risk sources, the concepts of firm's contribution to the economy, congruence with governmental goals, bargaining power in the host country and diplomatic stress between home and host country were discussed when conducting the initial framework for the research. Robock (1971, 16) emphasised the foreign company's economic, technological and social contribution to host economy. Both Simon (1982, 67) and Alon and Herbert (2009, 130–135) discussed diplomatic and economic relations and stress between host and home country and congruence with the governmental goals. The congruence with the host government's goals was regarded essential with the socially sensitive product such as electricity. Alon and Herbert (2009, 131) also stated the bargaining power of the company in relation to the government.

The interviewees quite unanimously stated the foreign companies brought the sector investments, efficiency, competition and dynamics; their role was and still is notable in the Russian economy. It was noted that the foreign investments showed the industry is not just a playground for oligarchs; the companies paid current price for the production assets what was very beneficial for the industry and the state. E.ON's, Enel's and Fortum's positive contribution to the Russian economy was rather evident and indisputable and thus the concept of contribution to the economy was not seen as potential source for political risk in the Russian electric power sector.

There were two different opinions about the foreign companies' goals' congruence with the goals of the Russian government. The majority of interviewees regarded the ultimate goal to provide functionality to the sector and create business opportunities is common. However, it was added the social goals are congruent, but commercial profitableness is only in the companies' interest; there is always a conflict between the cheap electricity for the end-consumers and maximal profit of the electric generators. It

can be concluded that the foreign companies' profit-making may be incongruent with the host government goals and forms a possible risk source. Additionally the empirical findings strongly pointed out that the unreformed heating sector is very problematic for Fortum who has assets in heating. The heating sector would require reform, but the political will for the reform is not unambiguous. Hence the issue cannot be ignored and the unreformed heating sector was noted for a company-level source of political risk for the foreign companies in the Russian electric power sector.

The bargaining power of E.ON, Enel and Fortum was looked in relation to the Russian government and the upstream resource suppliers of which many are state-owned. The companies have some bargaining power against the Russian government according to common principles and about the issues related the companies' operations. The companies promote privatisation and deregulation in the sector which can be in conflict with the government's policies. The companies had tendered the suppliers what proves there are bargaining power with the fuel suppliers. Overall it was noted the companies have different needs for bargaining and the changes with the bargaining power in the host country was seen a political risk source for the companies in the sector.

The interviewees agreed Russia has decent political level relations to Finland, Italy and Germany. The countries have traditionally had good relations to Russia and E.ON, Enel and Fortum were able to weight risks and opportunities before entering the market. The bilateral trade relations are significant what comes to direct investing and E.ON, Enel and Fortum would not have invested in the sector if there had been diplomatic stress between the countries. It was seen that diplomatic crisis between Russia and the company's home country would be a catastrophe for the company due the investment's extent. Conversely a few interviewees saw the impact of the country relations somewhat minor, because of the companies' notable size and creditability. Despite of divergent perspectives, the diplomatic stress between Russia and E.ON's, Enel's and Fortum's home country was regarded company-level political risk source with external origin in the sector.

To be concluded the empirical findings did not fundamentally change the research's initial theoretical framework, but they specified and detailed the political risk construct for foreign direct investments in the Russian electric power sector. Three new concepts were included in the political risk sources in the framework, whereas five concepts based on theoretical discussion were excluded as they were not regarded significant for the electricity sector in Russia. The included concepts were the host country's dependency on natural resources, the host government's control over economy and the unreformed heating sector. Consequently the concepts of host government's involvement in international organisations, contribution to the host economy, degree of selective nationalism, breach of contract and foreign government interference were excluded. The

framework for the political risk for foreign investors in the Russian electricity sector is presented in Table 11.

Table 11 The political risk construct for the foreign direct investment in the Russian electric power sector

SOURCES OF POLITICAL RISK			
		INTERNAL	EXTERNAL
AT MACRO LEVEL		Degree of general political stability Continuity of current political power Dependency on natural resources / economic constriction Governmental control over economy Transparency and corruption	Restrictions on investment, trade or capital due to home government actions Likelihood of violent political conflicts, wars and border disputes Currency instability
AT MICRO LEVEL	INDUSTRY	Governmental control over industry Taxes, regulations, subsidisation and price controls	
	COMPANY	Congruence with governmental goals in relation to profit making Unreformed heating sector Bargaining in host country	Diplomatic stress between host and home country

The theoretical implications presented in Chapter 2 did not individually serve disposable construct for analysing the political risk in foreign direct investments in the Russian electricity sector. The new political risk framework integrates the earlier theories and models, and additionally manages to create practical construct for the Russian electricity industry. Countries, industries and foreign direct investments in general have various features, but the political risk framework for the electricity sector in Russia could be used in other energy sectors in Russia, for instance in analysis of heating sector or the upstream energy sectors. Similarly the construct serves a pervasive model for further theoretical development. In addition to the theoretical discussion, the research findings are also concluded for managerial implications. The managerial recommendations are presented in the following chapter.

5.2 Managerial recommendations

The chapter combines the research's empirical findings and researcher's own contribution for managerial recommendations for the companies that currently operate in the Russian electricity sector, but also for the companies that have invested or consider investing in Russia. The empirical findings are analysed in light of what kind of recommendations for the foreign companies in Russia can be concluded.

The interviewees stressed the foreign electricity companies' abilities to cope with the characteristics of Russia's political environment. Simultaneously the same conclusion can be made for all foreign companies operating in Russia. A frequent macro-level political risk analysis is highly recommended for the foreign companies operating in Russia. Although the research presented political risk construct for the foreign direct investments in the Russian electric power sector, the framework's macro-level risk assessment is sufficient tool to be implemented in any industry in Russia. The foreign investment's macro-level political risk can be analysed by evaluating the investment through the framework's internal and external macro-level sources of political risk. Consequently the research suggests the foreign companies in Russia to conduct regularly a market risk analysis next to their macro-level political risk source assessment.

The empirical findings supported that the foreign companies in the electricity sector need to invest and maintain good relations to Moscow and in addition Fortum, who operates also in the heating, requires functional relationship to the regional authorities. At the same the potential changes in the Russian regional economies may affect Fortum more than other foreign companies in the industry. Referring to Fortum's positioning in the heat sector, a few interviewees even regarded the primary investments will determinate the foreign companies' success in the sector, since they cannot change the assets they bought. The common view among the interviewees was that the unreformed heating sector is problematic for Fortum. The heating sector in Russia comprises political, economic and social risks for foreign direct investment and the research strongly supports the Russian heating sector for a subject for own political risk analysis. Moreover one can conclude all foreign companies in Russia are required to invest in the relations to Moscow and to the regional authorities. It depends on the company's product and the magnitude of business on what level the relationship is maintained.

The Russian politics were summarised to lack both transparency and open dialogue. The political lead is rather populistic and the decisions are weighted how the regular Russian consumer is affected. Simultaneously the political actions are shadowed by the fear of losing power and the superpower politics are presented in order to support the contemporary lead. As a result the government has neglected the long-term economic development in Russia. These special features of the Russian political lead are crucial to understand in order to analyse the politics and the future policies in the country.

At the industry-level, the empirical findings suggested that the governmental regulation in the Russian electricity sector is a serious challenge for the foreign companies in the sector. In addition to the macro-level political risk assessment and the market risk assessment, the companies in the electricity sector and in other industries as well, should include the industry-specific analysis for instance into its market risk assessment. The research concludes the central industry-level political risk sources are the increasing governmental control over the industry and the host government's set taxes, rules, subsidisation and other price controls in the industry. The companies need to analyse especially well the product they are producing and selling in Russia and note the product's sensitiveness in relation to the regular Russians' living standard.

At the industry-level, the crucial contemporary questions for the foreign companies in the electricity production are how the old capacity is shut down and what kind of market remains; it is possible that capacity markets are unified in five years. E.ON, Enel and Fortum have the capacity supplier agreements, but the electricity will be later priced by the market. Then it is very important that the market is healthy and the prices are determined in relation to demand and supply. It is not guaranteed that the old production capacity will be closed according to the set rules in the industry. The closure of old capacity and the market improvement would benefit the foreign companies. Furthermore it is important that the companies continuously work and analyse the degree of existing capacity, the market structure and transparency and the quality of contracts in the Russian electricity sector.

When discussing the diplomatic stress between the home countries and Russia, the companies rarely can affect the country relations. The research's empirical findings noted E.ON, Enel and Fortum cannot significantly affect diplomatic relations between the countries, but they can actively build good company-citizenship in Russia. Hence the research stressed the foreign companies in the electricity sector should jointly have dialogue with the Russians, not individually. They could have so-called 'one European voice'. Additionally Russians appreciate foreign companies' technological competence and their commitment to the Russian business even in the economically weak times. The construction of good company-citizenship, including maintaining the supplier and employee relations, sponsoring and local charity, is evidently important for all foreign companies in Russia. In this very corporatist country, the cooperation with both other foreign companies and Russians in the sector is valuable conclusion.

The profit levels naturally have the companies close attention, but the political risk related to the profit-making should be continuously estimated in the Russia. Moreover the currency rate fluctuation is an issue to be worried about. What comes to the currency protection, it was pointed out that the risk premium for rouble is very high; if company wants to protect rouble's rate fluctuation, it needs to make currency trade and additionally pay 15% or 20% premium for the next two years. E.ON, Enel and Fortum, who have

made long-term investment in Russia, need to consider the currency rate protection with other tools and they need to accept that the currency protection for several years is not possible. All companies need to have implemented strategy for the currency protection in Russia; the companies with investments of relatively short break-even time can protect their investments in traditional ways, other companies could evaluate their international operations and what kind of currency rate risk the other market areas have. The currency rate fluctuation requires continuous following and the companies need to estimate the direction of rouble's rate in relation to future oil price estimates and the repayment schedule of Russia's loans abroad.

The interviewees presented several business opportunities in the Russian electricity sector. Firstly considering the already made investments in the capacity market, Russia is a huge electricity market where the need for electricity remains regardless the direction of economy. Also China is potential market for the electricity producers operating in Russia. Although the scenario is currently unlikely, it may be probable in a few years. These aspects lessen the market risk in the sector. However, the Russian macroeconomics follows closely the Russian political decision-making. The empirical findings stated the open and economically liberal Russia would enjoy economic growth, but if the country isolates it certainly effects on the business and decreases the Russian economy.

Moreover the country and electricity has potential for new foreign direct investments. The distribution network's poor condition drives the demand for secure electricity supplies and there are several locally operating companies looking for local electricity production systems. The establishment of small and independent electricity production units could be profitable business for a foreign equipment producer or a small or medium-size energy company. Additionally there are opportunities within the resource and fuel fleet; Russia has fine wind, solar, pellet and wood resources and substantial additional gas reserves freed in the oil production. If the contemporary macro-level political risk scenario in Russia is favourable, the research encourages companies to seek for these business opportunities in Russia. SME's in the sector needs to ponder the various models for holding; sometimes a joint-venture with the Russian counterpart lessens investment's micro-level political risk dramatically.

Additionally there are excellent possibilities in the electric distribution segment where a few foreign companies could own distribution networks in Russia. The companies could enhance the production and still make substantial profit with the contemporary tariffs. The distribution companies in Russia are simply huge and simultaneously extremely inexpensive; the value of one company is about 150 million dollars, although it could be close to 40 billion dollars. Considering the companies' competence and background, E.ON, Enel and Fortum could be interested to widen their investing to the distribution segment in the Russian electricity. Naturally the further investing in the sector requires tolerable macro-level and micro-level political risk in Russia.

5.3 Suggestions for further research

The research's empirical data was mainly collected from the economists and experts in energy and Russia, although Simon-Erik Ollus was able to give the investor company perspective. The researcher was eager to interview also representatives from E.ON and Enel, but unfortunately she was not able to contact suitable persons from the other investor companies. The empirical findings pointed out differences between the investor companies, E.ON, Enel and Fortum, in the Russian electric power sector and therefor the views of the company representatives would have been beneficial. Unfortunately the research also lacks the international perspective; during the process the researcher made practical decision to interview only Finnish experts in the field. The decision was pragmatic; the researcher lives in Finland and it was natural for her to contact Finnish experts and company representative. At the same the researcher was positively pleased to interview experts from different fields and with various backgrounds. Still it would have been interesting to have Russian, German and Italian perspectives for the study.

Ollus and Solanko also presented that several interview questions should be answered in the comparison of some other country. This was noted as a challenge for any political risk study; how to examine objectively the political risk of certain country and industry without involving the other countries in the study. The political risk is somewhat comparable risk.

The research was conducted during the several years which in one hand increased the value and context of the study, but also created inefficiency in the process. The researcher was able to go through substantial amount of material written in various phases of the electricity sector reform. As noted, there have not been political risk studies about the foreign direct investments in the Russian electric power sector before due to the novelty of foreign direct investments in the sector. Hence the research had a forerunner's role to provide information. However, the Russian politics tend to change and it is crucial to note that the interviewees took place mainly during the spring and the summer 2015. The political risk in Russia is continuously evolving and the interviewees may answer differently now or later for the interview questions. In October 2015 several newspapers reported Russia to launch a law to seizure foreign owned assets in Russia. On October 28th the Russia's upper chamber of parliament approved legislative proposal for Russian state to be able to confiscate foreign assets in the Russian territory in response to the similar actions with the Russia assets in some other country. The bill now waits for the presidential signature. The decision relates to the arbitration court of Haag's decision to freeze the former Yukos' assets in Belgium and France (MT 2015). Needless to say, this Russian governmental decision changes as well the political risk in foreign direct investments in the electricity sector.

The research topic was quite broad and could have been more limited, although the broad perspective made the research at the same extremely interesting. The research was limited to the electricity, but the empirical findings showed its tight link to the heating sector. The electricity consists of several segments and the research of whole sector increased the study's extent. After all, the research could have been limited only in one particular segment or a company in the industry; the segments evidently have divergent political risks involved. The study also pointed Fortum as rather unique company in Russia and thus the research could have only focused on Fortum's operations in the sector. Furthermore the future studies could concentrate on other perspectives, societal and economic, than the governmental political risk sources. The researcher warmly recommends that different electricity segments, companies and other categories of political risk for subjects of future studies.

Overall the political risk assessment of the electricity sector in Russia is possible to conduct through the risk factors given in the research. The research concluded that the political risk framework for the electricity sector in Russia could be used in analysis of other energy sectors in Russia, for instance in analysis of heating sector or the upstream energy sectors. Especially the research's macro-level political risk assessment is adaptable for other foreign direct investments in Russia too. Additionally more detailed research perspective would certainly serve a comprehensive insight of the foreign investments' political risk in the Russian electricity. New research on the foreign direct investments in the Russian electricity sector would be very interesting to conduct after five and ten years in order to see the development of the industry and the companies and estimate how the political risk has changed in the sector.

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APPENDICES

Appendix 1 A list of companies in the sector

COMPANY	MAJORITY OWNERSHIP
WGC-1	Federal Grid Company, RusHydro
WGC-2	Gazprom
WGC-3	Norilsk Nickel
WGC-4	E.ON
WGC-5	Enel
WGC-6	Gazprom
TGC-1	Gazprom, Fortum
TGC-2	Sintez Group
TGC-3	Gazprom
TGC-4	Various Russian shareholders
TGC-5	IES Holding
TGC-6	Federal Grid Company, IES Holding
TGC-7	Various Russian shareholders
TGC-8	Lukoil
TGC-9	IES Holding
TGC-10	Fortum
TGC-11	InterRAO
TGC-12	Siberian Energy Investment Ltd
TGC-13	Siberian Energy Investment Ltd
TGC-14	Eneropromsbyt

The list is compiled by the researcher in May 2014

Appendix 2 A summary of earlier research

The earlier research on the risk assessments of FDI in Russia and in the electricity sectors are summarised in the following table.

Researcher	Published	Title	Research method	Summary of the study
Jones, Fallon & Golov	2000	Obstacles to foreign direct investment in Russia	Desk research	The purpose of the study was to identify the obstacles of FDI in Russia. They were Russia's political and economic culture and its impact on reform policies, taxation and legal infrastructure, the existence of oligarchy, crime and corruption, limited privatisation and the problems in competitive market adaptation.
Aleshin	2001	Risk management of international projects in Russia	Quantitative document analysis	The study aimed to identify, classify and assess the risks of joint venture projects in Russia. The classification criteria were external and internal risks and cause-and-effect connection, and the assessment criteria were risk probability, level of loss and delay duration in the project. The most of the risks were organisational and technical due to the lack of knowledge. The focus on these would mitigate the risk.
Ahrend	2000	Foreign direct investment into Russia – pain without gain? A survey from foreign direct investors.	Quantitative analysis based on questionnaire data	The research investigated how foreign investors operating in Russia see Russian investment climate. The main problem was a lack of legal framework. The problems occur especially in tax law and property rights.
Zabry & Zeghni	2002	Foreign direct investment in Russia: how the investment climate matters	Desk research, quantitative analysis	The purpose of the study was how the Russian investment environment matters to in attracting FDI. The research finds there is a lack of incentives for FDI inflows and Russia is regarded risky and unstable. Long-term political economic and institutional stability is needed to boost FDI.
Ahrend & Tompson	2005	Fifteen years of economic reform in Russia: What has been achieved? What remains to be done?	Desk research	The research evaluated the reforms in past and future. It suggested proceeding with strengthening the basic institutions of market economy, the state institutions' reforms and the reforms across the sectors in a broad front. The study criticised planned 'second-generation' reforms (i.e. reform in electricity sector) when there still were several 'first-generation' reforms implemented.

Liuhto	2007	A future role of foreign firms in Russia's strategic industries	Desk research	The paper discussed the strategic policies in Russia as the country has invisibly implemented regulatory policies for certain sectors. The research introduces a matrix to evaluate the sectors by their sensitiveness, military connection and economic importance for Russia. The electricity sector was regarded strategic, but open for future changes.
Liuhto	2008	Genesis of economic nationalism in Russia	Desk research	The paper studied thoroughly the Russian law of strategic sectors and analysed the law's effects for foreign operations in the named sectors. The study concluded the state ownership will be increased in the sectors and evidently the law will affect the FDI flows too.
Liuhto	2009	Who doesn't risk, never gets to drink champagne… but how much one has to risk just to have a relaxed drink in Russia	Desk research	The research studied the macro-level political risk in Russia. Both FDIs and political risk have increased in last ten years and Russia has become more nationalistic and fragmented. Political risk varies between the industries. Electricity is also a strategic asset.
Laaksonen	2010	Political risks of foreign direct investment in the Russian gas industry – the Shtokman gas field project in the Arctic Ocean	Qualitative research	The study purpose was to identify the sources and the effects of political risk in the Russian natural gas sector. The main risk factors are the changes in the Russia's political power, its international relations, the future of global gas market and Russia's role in the global energy sector. The political risk exists in the sector, but its effects related to ownership risk were seen unlikely. Price and export controls and changes in legislation are the most probable effects of political risk.
Hanson	2011	Risks in Russia – is the environment changing?	Desk research	The purpose of the study is to assess has the priority of modernisation in Russian policy improved the business environment for FDI. The findings suggest that bureaucratic obstacles have not worsened and the Russian business climate has tardily improved, but the modernisation is not achieved without fundamental political change.

Buckland & Fraser	2001	Political and regulatory risk: Beta sensitivity in U.K. electricity distribution	Desk research quantitative analysis	The research studies the political and regulatory risk in the electricity distribution. The findings suggest the significant influence of political-regulatory event in the segment and may lead to too generous returns.
Seethepalli	2005	Risk, structure and performance: an analysis of private investor strategies in emerging economy electricity markets	Doctoral thesis Quantitative and qualitative analysis	The purpose of the study is to analyse the business environment in terms of macroeconomic, political, institutional and regulatory risks and how the risks effect on private companies investing in electricity sector. The study finds that business environment and company characteristics influence in investment structure. Risks effect on different aspects of investment and the past experience helps companies to cope in risky environment.
Mosquera, Reneses and Sánchez-Úbeda	2008	Medium-term risk analysis in electricity markets: a decision-tree approach	Case study	The research analyses the medium-term risk of electric power generators in competitive electricity markets. The study demonstrates a theoretical implication, a decision tree approach – a technique for risk analysis and for use of risk management.
Jarvis	2010	Risk, regulation & governance: institutional processes and political risk in the Thai energy sector	Desk research, qualitative data	The study explores the regulatory risk in developing countries in light of Thai electricity sector and suggests that the diffusion of regulatory policies in contested environment hampers the regulatory authority function, increases instability and enhance regulatory risk through institutional complexity in developing countries.
Purra	2011	Institutional and regulatory reform in the Indonesian electricity sector: opportunity or risk to FDI?	Desk research	The study analyses the regulatory uncertainties in the Indonesian electricity market and suggests that the reasons for the substantial institutional problems in the market are in the incoordination of authorities and policies, the decentralised and dysfunctional system and the protectionism.

Gözen	2012	Key issues and challenges in estimating the cost of capital for energy network utilities in emerging markets	Desk research	The study discusses the challenges in determining the cost of capital of electric power transmission and distribution in emerging economies. It concludes there is no common way to determine the cost of capital and suggests the estimation based on forward-looking approach with calculation of limiting values.

Appendix 3 The interview questions

Topics	Questions
Internal political risk sources at macro level	1. How would you describe the contemporary political power in Russia as a decision-maker? 2. What are the most significant political problems in Russia at the moment? Are the problems economic, political or social? 3. What is the state's role in the Russian economy? 4. How do you think the Russian political power and politics will change in the next 5 and 10 years? 5. What is in general the situation of foreign companies in Russia? 6. Are there exceptional regulatory restrictions in investing or trading in Russia? 7. Have the level of transparency and corruption changed during the last five years in Russia?
External political risk sources at macro level	8. What is the likelihood for violent confrontations at the Russian borders in the next few years? 9. How would you describe the Russia's current role and involvement in the international organisations? 10. What is the currency rate risk in Russia?
Internal political risk sources at industry level	11. How Russia succeeded in its electric power sector reform? 12. Does the Russian state involve or control the electric power sector differently than for instance the majority of the European countries? 13. What is the Russian electricity sector like after five years? 14. What kind of opportunities and threats foreign investors have in the Russian electricity sector? 15. How strongly the success of foreign companies in the Russian electricity sector is related to the Russian political power and the persons leading the country? 16. Could there appear selective nationalism in the sector? 17. Could there be new industry-specific taxes, price controls or other economic restrictions in the sector in the next five years? 18. Are the contracts binding in the sector?
External political risk sources at industry level	19. Could some other government interfere the Russian electric power sector?
Internal political risk sources at company level	20. What was the role and significance of Enel, Fortum and E.ON in the Russian electricity sector during the reform? What kind of role they have now? 21. Does the role and position differ based on their diversification on different electricity segments? 22. Are E.ON's, Enel's and Fortum's targets and expectations for their Russian operations convergent with the goals of the Russian government? 23. Do you think that foreign companies' expectations in return of investment will be met? What would be the timeframe for that? 24. Do E.ON, Enel and Fortum have bargaining power with the Russian government? 25. What is the companies' bargaining power with the fuel suppliers?
External political risk sources at company level	26. What are the relations between Russia and the home countries of investor companies Italy, Finland and Germany like? 27. Do you think the country relations impacted on the investments and do they affect now in the operations? 28. Do you think the country relations have impact on the companies' success in the future?