Return to bandit country – where next for Russian business

Earlier this year I sat down over coffee in London with a tech client who had lost his business in Russia. Like many others, he was forced to sell at an eye watering discount of 50%. He was unceremoniously pushed into selling to a previously unknown businessman. What did we know about this individual? A murky career under the radar, a smattering of dubious pipeline deals, almost certainly a proxy for a state-connected energy company. As we mulled over the events that had led to such a sudden change in fortunes, I began to think about what lies ahead for Russia as an investment destination.

Western businessmen like him have no practical choice – both morally and commercially – but to leave Russia The country is now uninvestable. But the level of rapaciousness displayed in the dismantling of decades of foreign investment is startling. Renault, IKEA, McDonalds, Shell have all sold to local companies. Earlier this year, other firms – such as Finland's Fortum and Germany Uniper – were put under 'temporary management' by the Kremlin. Russia has effectively created the conditions for unilateral state confiscation of foreign assets. Exiting firms are now required to contribute a mandatory 10% of sale proceeds to the Russian government. Others – banks such as Unicredit and Citi – are now stranded and unable to exit without state permission. That said, it is worth noting that some companies (and one or two banks) are still risk reputational censure by continuing to operate in Russia – perhaps hoping to keep their heads down until the tide turns.

I have worked in Russia and advised companies on the region for the past 25 years. In the 1990s – the era of 'loans for shares' – connected tycoons could, literally, erase their competitors' names on shareholder registers. Business disputes were often settled by private militia. Street level assassinations were common. In later years the overt violence subsided, but never really went away.

In the years after the shock of the 1998 sovereign default, Vladimir Putin constructed a finely balanced system of enforced (albeit kleptocratic) state-arbitrated governance with himself at the apex. Business sectors were carved out and handed to the most favoured businessmen. The regime wasn't equitable, nor was it by any stretch of the imagination run with 'good governance'. But there was an uneasy stability that allowed foreign investment in Russia to flourish, alongside increasing oil revenues and a milder period of geopolitics, then punctured by the poisoning of Alexander Litvinenko in 2006 and Russia's invasion of Georgia in 2008. Then came 2014 which marked the true beginning of the Russia-Ukraine war. (Ukrainians often correct people who assume that the war began in 2022.)

After the calamity of the full-scale invasion of Ukraine last February, the nature of doing business in Russia – for foreign and domestic companies – has gone through another seismic inflection point. The increasing scope of sanctions has for all intents and purposes made direct investment in Russia impossible – at least for most US and European companies. What comes next?

A huge tide of contentious work against the Russian Federation and Russian entities will keep the litigation and arbitration teams of the world's law firms busy for a decade. Much of the focus will be the timeline and Russia's rhetoric around nationalisation. Other cases will focus on the hasty sales of tainted assets to proxies and middlemen. The awards will be large, but the complexity will lie in the ability to locate and enforce judgements against Russian assets abroad.

Assets in Russia and abroad have been transferred into new ownership and into 'clean' structures to avoid overt associations with sanctioned or otherwise tainted owners. New networks of enablers outside Russia are emerging. Previously popular lawyers and fiduciaries are being discarded and, in some instances, they are even being sanctioned themselves. Two Cypriots - Demetris Ioannides and Christodoulos Vassiliades – were recently sanctioned by the UK government as 'enablers' for structuring sanctioned Russians' assets.

Third countries such as India, China, and the UAE are coming under increasing scrutiny over the trading of Russian commodities. India and China are now taking the bulk of Russian oil at steep discounts, but we are also seeing the creation of elaborate trading networks (oil to India, Russian insured, paid for in Dirhams, shipped via the UAE).

Finally, for those left inside Russia, the corporate landscape will start to self-cannibalise. Putin, distracted by the war, will be unable to expend much time or political capital acting as an arbiter in commercial disputes. Fiefdoms and dissent will emerge in sharper relief – captured so dramatically in the attempted mutiny against key government officials by the militia leader Evgeny Prigozhin, a consummate feuder with both government officials and rival businessmen.

I expect a return to the turf wars of the mid-late 1990s, accompanied by much the same economic pressures – a devalued rouble and potential falls in oil revenue, but with much smaller foreign direct investment, technology imports and financial services. The fight for dwindling resources will be more vicious, and the circle of successful players that emerge will be smaller.

After the years of arbitration and litigation have passed – and certainly after some kind of regime change or a significant halt or ceasefire in the Russia/Ukraine war – investors will return. What will they return to? The operating environment will have changed so radically that they will have to learn to deal with a new set of syndicate-like organisations. Russia's regions will have more clout, with governors and local industrial groups becoming more independent and detached from Moscow. Perhaps any 'power vertical' will function even less efficiently – with a patchwork of idiosyncratic regional rules of the road.

Of course, the trajectory is one of many possible outcomes. And for the moment Russia's economy is stable but ossified, locked into state control, with the benefits of successful inward investment evaporating. While Putin remains, there's no hope of a turnaround. As I finished my coffee in London with the exiting investor, I asked him how he viewed the longevity of the Russian president. He muttered darkly – "*It really is time for the devil to come get this guy".*