Russian-German investment relations in the context of digital transformation of the state and financial sector of the economy

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Abstract. The digitalization of the economy opens up new opportunities for business and the development of interstate investment cooperation, which is caused by the objective strengthening of globalization processes at all levels. The impact of digital technologies on all sectors of the economy is constantly growing. Digital technologies have become the main drivers for financial market transformation, FDI flows development and created new challenges for the next few years. German-Russian investment relations are closely linked to political and digital transformation which requires developing and introducing new solutions that enable interaction among market participants, so the analysis of investment relations between Russia and Germany in the context of digital transformation is relevant for the study. German FDI in Russia and Russian FDI in Germany are presented in the article. Geographical distribution of Russian and German investments are studied. Sustainability of Russian direct investment in Germany is discussed. Industries of investments in the context of digital transformation are defined. Particular attention has been paid to the problems in the field of investment, which have hampered mutually beneficial cooperation between these countries. The prospects for the development of Russian-German relations and the efforts of the Russian side to revive an effective economic policy are considered.

1. Introduction
They still exist – long-term Russian direct investments in Germany, like that of Ilim Timber. Originally, the forest products company wanted to buy only German machines for a new production in Russia and decided instead to take over two complete sawmills in Wismar and Landsberg [1]. Or that of the investor and chairman of the St. Petersburg Kirov works Georgi Semenenko in Rostock [2]. They do not serve – as is the case with many Russian investments in Germany – the system flight but are well planned out of strategic considerations and then prove to be sustainable.

And vice versa, there are also German success stories in Russia, such as Pobeda-Knauf, Interturbo (joint venture of Siemens for the production of electricity generation and distribution equipment), Bosch, Mustang Neva (production of denim clothing) and ERA-Henkel (chemical industry).
But the economic environment is becoming more difficult. In addition to short-term foreign trade figures, one indicator is the long-term investment and reliability of Russian companies in Germany and German companies in Russia. The “RIM Russian Investment Monitor” allows an up-to-date inventory.

German-Russian trade relations have a long history being one of the main axes of European policy. During the period of 2001–2008, these relations demonstrated a steady growth (figure 1). In 2009, at the height of the global economic crisis, a dramatic decline of 36% was recorded. The highest export figures were reached in 2012 and amounted to € 38.1 billion. Since 2012, the indicators have been declining and in 2015-2016 they have almost returned to the indicators of the crisis year of 2009.

Following years of slumping trade activity, the exchange of goods and services between Russia and Germany saw a considerable increase in 2017. Customs officials said trade between the two nations soared by roughly 23 percent in 2017 year on year despite the ongoing negative impact of economic sanctions slapped on Russia. The German-Russian Chamber of Commerce (AHK) said the exchange of goods totaled € 41 billion ($ 50 billion) in 2017. Russia imported German goods worth 19.7 billion € marking a 25-percent increase, while Russian shipments to Germany rose by roughly 21 percent over the same 12-month period [3].

![Figure 1. Value of German exports to Russia (2001-2016).](image)

Russian-German cooperation on the world stage has the greatest weight in the economic context, which can be divided into four important areas: the fuel and energy complex, the automotive industry, the financial sector, and high-tech industries. Germany’s exports to Russia amounted to € 21 billion or 10.7 per cent of its overall imports [4].

At the beginning of 2017 the German-Russian Chamber of Commerce (AHK) and the German Committee on Eastern European Economic Relations (Ost-Ausschuss der Deutschen Wirtschaft) published a survey conducted among German companies operating in Russia [3]. It included 190 enterprises, whose total turnover in Russia amounts to € 29 billion and which employ more than 120 thousand people in that country. These were primarily companies from the machinery, consulting, food and trade industries. Half of the surveyed companies called for the immediate lifting of the sanctions against Russia, and 42 per cent wanted their gradual reduction [5].

In 2016, German companies invested up to € 1.95 billion in Russia, which is about € 170 million more than in 2015. This means the end of the investment collapse that occurred in 2014, when German entrepreneurs began to implement only 11 new projects in Russia worth about € 400 million. According to experts from AHK, the upward trends will also continue this year [3].
Germany is one of the most active investors in Russia. According to the E&Y report presented at 2016 investment forum in Moscow, 106 projects were implemented in Russia by investors from Western Europe in 2015, which is the highest figure in a decade. German companies participated in 36 projects (mainly in industrial production), which gave them a leading position among all foreign investors in this regard.

The methodological basis of the research contains works of leading foreign and national specialists in the field of business investments, as well as content analysis and its application to the Russian Investment monitoring and German Investment Monitoring. The following materials were used in the research: abstracts from scientific publications, methodological materials, analytical overviews, materials from forums and scientific and practical conferences and other.

The research methods consist of general scientific methods which include empiric (observation, comparison, description, prognosis, modeling, systematic analysis), theoretical (formalization, hypothesis and deduction, moving from the abstract to the concrete) and general logical methods (analysis, generalization, analogy).

2. Russian FDI in Germany in the context of digital transformation of the state and financial sector of the economy

The development of Russian foreign direct investment is closely linked to political transformation. With the collapse of the USSR, the so-called “red multinationals” [6–8], i.e. state-owned companies with foreign subsidiaries, virtually disappeared overnight. The stock of Russian direct investment fell from $699 million in 1992 and 1993 to almost zero.

Since the mid-nineties, the number of foreign subsidiaries of Russian companies, and thus Russian direct investment, began to rise again slowly [9]. Only with the end of the first Russian financial crisis at the end of 1998 does the number of foreign investments by Russian companies skyrocket. Most of the 100 largest Russian companies have been multinational since 1999. Since the beginning of the millennium, they have benefited from the accelerated internationalization of the global economy, coupled with the catch-up effect of a later market entry compared with investors from other BRIC countries (Brazil, Russia, India, China) [10, 11].

At this time, in addition to investments from Brazil, India and China, significant Russian investments in Germany are also noticeable for the first time. The economic strengthening of the BRIC states also involves a corresponding economic policy claim that is evident in international activities. Consequently, these countries are increasingly emerging as investors, as evidenced by direct investment activity since the beginning of the millennium. Thus, the direct investment stocks from the BRIC states in Germany since 2001 increased from €968 million to the current €6.8 billion, or more than 700 percent. Russia’s previous outstanding role is clear: the country dominates the direct investment portfolio of the BRIC countries with (dwindling) distance ahead of China (€3 billion), India (€425 million) and Brazil (€38 million). It is therefore justified to speak of Russia – still – as an important investment partner of Germany.
Figure 2. Development of the direct investment stocks of the BRIC states in Germany.

However, Russia's role is changing: at the beginning of the millennium, Russian investments accounted for almost 70 percent of BRIC investment, and in 2016 this value dropped below the 50 percent mark for the first time. A development that began in 2011. At the same time, China's share of direct investment in BRIC countries in Germany has grown from 18 percent in 2001 to 44 percent in 2016. If things continue in the same direction, China will soon replace Russia as the leading investor in the BRIC group.

3. German FDI in Russia in the context of digital transformation of the state and financial sector of the economy

According to the German companies represented on the Russian market, agriculture and food industry are the most attractive sectors for investors in Russia. They were indicated by two thirds of the respondents interviewed by the AHK chamber and the German Committee on Eastern European economic relations. Production of machinery and equipment, as well as energy and chemical industry received half the readings. It is not surprising that the manufacturer of agricultural machinery Claas decided to invest in Russia. The company allocated € 120 million for the construction of a new plant in Krasnodar.

In the food industry a particularly large deficit is observed in the dairy market, where Russian producers are able to meet only less than 80% of domestic demand. The largest dairy company in Germany DMK GROUP wants to profit from this opportunity. In 2016, it acquired a controlling stake in a Russian cheese producer located outside Voronezh and announced that production will double. The new facility will not be limited to the production of previously available cheap types of cheese, in which palm oil is used due to the shortage of milk in Russia. DMK announced that it will also produce “European” cheeses such as mozzarella, Maasdam, mascarpone and blue cheese at the Russian plant [12, 13]. Currently they are not in Russian stores because of the Russian Federation government embargo on European food. In General, experts are optimistic about the decision of the management of the DMK group to expand its activities in Russia. However, there are also skeptics who argue that Russians would be willing to pay higher prices for “made in Germany” cheeses, but they would not necessarily be willing to do so for “Made in Russia” products. Recently, the image of Russian food producers has been badly damaged by serious scandals. Therefore, DMK group will have to convince Russian consumers that its products manufactured in Russia are “German”, i.e. of the highest quality [14–16].
The list of German investors in Russia is much longer and includes Henkel, which opened in 2016 a plant for the production of washing powder and cleaning products in Perm, and the pharmaceutical company Bionorica, which this year begins construction of a production plant in Voronezh.

According to statistics compiled by the German-Russian Chamber of Foreign Trade (AHK) the number of Russian-based companies with German equity participation decreased by 5.2 percent in 2017. [3]

Almost two-thirds of the companies surveyed by the AHK want to further expand their activities in the Russian market. None of the companies’ reps said they wanted to reduce their business in Russia. Also, since 2015, the accreditation procedure for representative offices and branches of foreign legal entities changed. Thus, accreditation competences, which previously lay with the State Registration Chamber, were completely transferred to the tax authorities. Representatives and branches of foreign companies in Russia had to face numerous procedural difficulties and unsubstantiated cancellations during the re-registration.

Figure 3. Total German FDI in Russia vs total Russian FDI in Germany [4].

In 2017, foreign investors invested in 238 projects — this is a record number for Russia for the entire period of the study since 2010. Asian countries showed great interest in the Russian economy: for the first time China became the leader in the number of projects involving FDI, top ten investors also included Japan and South Korea. By the end of 2017, Western European countries showed variety of trends. In 2015 and 2016, the first place in terms of new projects was occupied by Germany. However, in 2017 the number of German projects in Russia decreased to 28 (compared to 43 in 2016).

The region-leader of number of FDI projects is Moscow and Moscow Region. Unfortunately, in 2016 there was a reverse trend in St. Petersburg and the Leningrad Region, where the number of new FDI projects dropped from 22 to 15 in 2016. The US accounted for a third of FDI projects in the region, Germany’s FDI projects are present too, but its number is less. Leningrad Region ranked the second place in the investment attractiveness of Russian Regions in 2017, and St. Petersburg took the 7th place.

The biggest incentives for entrepreneurs from Germany are the prospects of rapid growth and the sheer size of the market. It turns out, however, that they are not as strong as they seem. German investors are complaining about the conditions of running business activity in Russia. Inflation reaching several percent annually, volatile ruble exchange rates, bureaucracy and corruption are the key factors that undermine Russia’s investment attractiveness. In the World Bank’s Doing Business report for 2017, Russia was ranked 40th out of 190 countries. This is certainly better than at the beginning of this decade, when its position hovered around the 120th spot, but still worse than in 2016, when it was ranked four places higher than now.

**Sustainability of Russian direct investment in Germany**

Getting a detailed overview of the investment activities of Russian companies in Germany is not easy. This is due both to the different definition of “investment activities” and “Russian companies” in existing studies as well as to the fragmented structure of Russian investments in Germany, which are
therefore often not covered by statistics. This was the reason for establishing the “RIM Russian Investment Monitor” at the University of Stralsund in 2016. In addition to the geographical location of Russian investments in Germany, the range of activities, operating indicators and type of investment are recorded at the level of individual companies. The data come from a variety of German and Russian sources and are combined in the “RIM Russian Investment Monitor”. Experts estimate that between 800 and 3,000 Russian companies are based in Germany [17]. Other sources [18] assume that “Russian companies are involved in over 5,000 companies in Germany”. On the basis of a comprehensive data analysis, the “RIM Russian Investment Monitor” currently contains information on more than 1,700 active German companies with Russian participation. Due to the high number of key figures recorded for each company, there are several analysis possibilities, which should deal here with the geographical distribution, the main activities and the temporal development of Russian investments. “Berlin, car dealers, stagnation” – this formula cannot reduce the Russian investment activities in Germany, but these three terms well reflect the current situation.

First of all, there is the geographical distribution of Russian investments, which has not shifted in recent years. Berlin is the undisputed leader in Russia with 342 (19.8 percent of companies, 2016: 18.8 percent). Berlin has been able to further strengthen its position vis-à-vis its southern counterpart in terms of its share of Russian investments: Bavaria currently has 323 companies with Russian investors (18.7 percent of companies, 2016: 20.1 percent). North Rhine-Westphalia is in third place with 278 companies (16.1 percent of the companies, 2016: 16.9 percent), which have a participation of Russian companies or private investors. In addition to Berlin, Hamburg and Frankfurt, German cities are the three preferred locations for Russian investors.

While the total number of more than 1,700 companies with Russian participation is quite impressive, an analysis of the concrete activities of these companies in Germany allows a more differentiated picture. For the majority of investments, the motivation does not seem to be a classic direct investment, as described for example by Jacobsen [19], but is more in the personal motivation of the private investor.

Alone 312 companies are concerned with the management of real estate. As a reason for investing, it is more likely to assume a system flight, which is revealed, for example, in the analysis of investment behavior at the popular Baden-Baden location. Baden-Baden has more companies with Russian participation than, for example, Leipzig. Experts assume that “... soon half of all Baden-Baden real estate will belong to Russians” [20]. But also, at other German locations “wealthy Russians invest more and more in German real estate, which cost more than one million euros” [21]. The (real estate) investors “use [...] German management companies that represent their interests towards the users of office buildings and retail parks as well as the tenants of multi-family houses” [22], which is also explains the high number of companies with this main focus.

In addition to these real estate investors, the analysis primarily reveals a comprehensive activity in the areas of vehicle trade (525 companies) and provision of unspecified services (247 companies). Taken together, these three areas of activity account for 63 percent of all German companies with Russian investments. Classic businesses, such as manufacturing, account for 125 companies. Thus, the Russian direct investment activity in Germany – at least according to the main focus of activity – cannot be regarded as consistently strategic and company-driven.

Another criterion that allows a classification of Russian investment behavior in Germany is the sustainability of the commitment. For this purpose, the “RM Russian Investment Monitor” allows an analysis of the currently economically active companies by date of incorporation. Here are two aspects conspicuous. On the one hand, there are comparatively few – still active – German companies in which Russian investors participated before the year 2007. This suggests that the sustainability of Russian companies' involvement in Germany is low in numbers. On the other hand, Russia's commitment to a “start-up boom” in 2013 appears to be gradually declining. Of the companies founded or acquired in 2013, 254 are still active, compared to only 124 of the companies founded in 2016 are still active.

In summary, it can be stated that Russian investments in Germany are in the majority not based on traditional investment motives – safeguarding of production factors and natural resources, development of foreign markets, increase of efficiency or securing of technologies – but more to secure of assets.
4. German FDI in Russia in the context of digital transformation of the state and financial sector of the economy

According to the experts’ estimation, which was presented at the St. Petersburg International Economic Forum (SPIEF) 2018, German firms continue investing in the Russian economy despite facing barriers from economic sanctions. In 2017 German private investment in the Russian economy gained €1.6 billion [23].

These are not only car manufacturers, which invest heavily in Russia, but also family and medium-sized businesses.

FDI flows into Russia have been on the decline after 2013, due to geopolitical tensions between Russia, Ukraine and the Western countries. While inflows rose to $37.1 billion in 2016, they fell once again in 2017 to $25.3 billion, the second lowest level since 2006 (UNCTAD World Investment Report 2018).

Table 1. Countries of origin and number of investment projects in Russia [24].

| Country of origin | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|-------------------|------|------|------|------|------|------|------|------|
| China             | 3    | 3    | 0    | 4    | 7    | 12   | 9    | 32   |
| Germany           | 26   | 13   | 28   | 12   | 11   | 36   | 43   | 28   |
| USA               | 24   | 24   | 29   | 24   | 14   | 29   | 38   | 19   |
| Italy             | 6    | 6    | 5    | 2    | 4    | 12   | 7    | 17   |
| Japan             | 11   | 6    | 9    | 14   | 8    | 10   | 12   | 17   |
| South Korea       | 4    | 0    | 1    | 1    | 3    | 3    | 2    | 12   |
| France            | 10   | 9    | 14   | 7    | 14   | 20   | 20   | 11   |
| Switzerland       | 11   | 4    | 4    | 3    | 8    | 8    | 7    | 11   |
| UK                | 14   | 4    | 2    | 3    | 6    | 5    | 2    | 8    |
| Finland           | 8    | 6    | 5    | 5    | 6    | 9    | 7    | 7    |

The share of FDI in the GDP remains relatively low in view of the country’s growth and economic potential and working capital investments represent a large share of overall FDI. There was a significant decline in number since 2015 because of the sanctions and geopolitical issues. In recent years, Russia has undertaken economic reforms, but administrative problems, corruption and uncertainties about regional stability have remained major challenges. Russia has adopted a law allowing it to seize the assets of foreign states on its own territory, in response to the confiscation of Russian property by the European countries in the Yukos affair. FDI is not expected to recover due to the absence of real improvement in Ukraine and the enduring issues of governance. Nonetheless, capital outflows should slow down. Russia is ranked 35th (out of 190 countries) of the 2018 Doing Business ranking established by the World Bank, a 5-point increase compared to the previous year.

Geography of investments

There are currently about 500 representative offices, companies with German capital and joint ventures in the northwest region. Investments cover a wide range of economic sectors. The German economy is represented here by medium-sized as well as large companies.

Companies with German participation include Pobeda-Knauf, Interturbo (joint venture of Siemens for the production of electricity generation and distribution equipment), Bosch, Mustang Neva (production of denim clothing) and ERA-Henkel (chemical industry).

The majority of the FDI projects exist in Central region of Russia, mostly in Moscow and the Moscow region. St. Petersburg and the Leningrad region take the second place. One of the most striking examples is the recent investing activity of Knauf Company in Russia. Knauf, a German-based international construction company, is going to invest over €6 million in the production facilities in Krasnogorsk, Moscow Region, which manufactures modules for the individual and multi-story housing construction. It is planned to supply the first modules for housing construction in Krasnogorsk in 2018.
As for St. Petersburg and the Leningrad region at the St. Petersburg International Economic Forum in 2017 Knauf and Leningrad region sign $62 million investment agreement. Under the agreement, the Company shall invest at least RUB 3.5 billion in the reconstruction of a finishing cardboard production facility in the Leningrad Region.

The German Lorenz Snack-World, specializing in the manufacture of snack products, will open a new production shop in the town of Kirishi in the Leningrad Region. The new production facilities will enable the company to increase its own capacity by almost three times – from 2 to 5.5 thousand tons of pretzels and straws per year. According to Dmitry Yalov, Chairman of the Committee for Economic Development for the Leningrad Region, the investor considered different regions of our country for the development of its production, but after analyzing the conditions offered in the Leningrad region chose Kirishi. The total investment in the project will be 1.7 billion rubles.

The strongest trading partner in European container traffic and second strongest worldwide in Hamburg remains Russia. In 2017, 405,000 TEU went to Kaikanten with this trading partner in Hamburg. However, volumes remained 10.7 percent below the previous year. That the volumes are weakening, indicated from April 2017 and must be booked under competition in transshipment traffic. This is also confirmed by the opposite trend in Russian Baltic Sea ports, whose container throughput increased by an average of +10.2 percent in 2017. At present, over 100 Hamburg and St. Petersburg companies have mutual contacts. They are mainly active in the sectors of trade, transport and logistics, services, gastronomy, environmental protection. In the ranking of the most important partner countries of the Port of Hamburg, Russia ranks second behind China.

Table 2. German Foreign Direct Investment in the Russian Federation: positions by industry, millions of USD [4].

| German Foreign Direct Investment in the Russian Federation: positions by Industry | millions of USD |
|---|---|
| Manufacturing | 6571 |
| Wholesale and retail trade; repair of motor vehicles and motorcycles | 5102 |
| Financial and insurance activities | 1871 |
| Mining and quarrying | 1052 |
| Real estate activities | 687 |
| Public administration and defense; compulsory social security | 364 |
| Transportation and storage | 235 |
| Information and communication | 146 |
| Professional, scientific and technical activities | 101 |
| Agriculture, forestry and Fishing | 12 |
| Water supply; sewerage, waste management and remediation activities | 3 |
| Human health and social work activities | -23 |
| Unallocated | 21 |
| **TOTAL DIRECT INVESTMENT IN RUSSIA** | **18778** |

The most attractive industries for German Direct investments according to Central Bank of Russia estimation are: manufacturing, wholesale and retail trade; repair of motor vehicles and motorcycles; financial and insurance activities; mining and quarrying. [4].
5. Conclusion

Russian investments in Germany are strikingly different from those of other countries and are therefore characterized to a great extent by the economic policy and digital environment. First, it should be noted that Russian foreign investment – not only in Germany – does not have a long tradition. Due to their systemic nature, they only appear significantly since the beginning of the millennium. The role of Russia within the BRIC countries has been leading so far, but this leadership position has been under pressure since 2011, not least because of massive Chinese investment.

The overall picture and thus the reaction of Russian investment behavior in Germany to the tense economic policy relationship, which has now been tense for several years, is difficult to assess due to insufficient data. The “RIM Russian Investment Monitor” allows first conclusions, which underline the leading role of Berlin as an investment location. At the same time, it should be noted that the majority of Russian investments in Germany are not based on a classic investment motive but serve to secure assets. Successful long-term investments can be found mainly in the manufacturing sector. Digitalization of the finance sector opens new opportunities for investment activities development introducing new solutions that enable interaction among market participants.

As for the “GIM German Investment Monitor” it should be noted that the investments still exist. Despite all the political and economic threats and barriers, German business continue investing in the Russian economy. The leading industries are manufacturing; wholesale and retail trade; financial and insurance activities. The major investment flows exist in Moscow and the Moscow Region and St. Petersburg and the Leningrad Region. Totally, Russia still is rather attractive for German investors because of some points: the country is close enough to Europe, which greatly simplifies the logistics of cooperation; the mentality of Russians and Germans is also quite close, especially when compared, for example, with the countries of the Asia-Pacific region and, finally, the current economic situation in Russia allows the regions to offer German companies very favorable investment conditions. The federal and regional governments should put great efforts to minimize the barriers in order to improve the conditions of doing business, especially in the part that affects the situation with a fairly rapid and sometimes unpredictable change in legislation. Investors are busy with digital transformation of their internal processes and business models, which brings them to developing and introducing new technologies on their own, as well as to partnering with IT companies. The asymmetry of German-Russian investment activity in the context of digital transformation of the state and financial sector of the economy needs to be overcome. A digital transformation of the investment market makes it possible to attract significant and long-term investment, which is vital for Russian companies.

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