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The implications of Russia's war against Ukraine for Czech companies operating in the region

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Abstract

The Russian offensive has not only transformed the security arena, but has also been a shock to the economic landscape around the world. Czech companies that used to do business in Russia are working primarily on how they can extricate themselves from Russia, which is now considered highly toxic, and find alternative markets. The state and other business organisations are offering support in this regard.

Recommendations

- Establish a rapid response mechanism for sudden changes that is based on EGAP and CEB structures. The capacity to react quickly to challenges is a critical factor. However, this must not compromise the quality of risk assessment.
- The pursuit of new markets must not result in overexposure to other untrustworthy regimes. The Russian experience also shows that human and political rights issues should not be made light of. A regime that disregards the rights of its own citizens is unlikely to respect the rights of others.
- The state is providing support in the form of advice, entry into new markets, and even guarantees to some degree, but it does not fully assume the risks associated with doing business.

Further casualties of war: the impact on the Russian and Ukrainian economies

One of the by-products of Russia's aggression against Ukraine is the impact that the war has had on Czech companies operating in both countries. This study covers neither the situation faced by firms on the Czech market nor problems with supplies from Russia or Ukraine, but focuses solely on investments and exports to the two countries and how the conflict's adverse consequences on business operations might be mitigated. The paper leaves aside the activities of Czech companies in Belarus, even though the war in Ukraine obviously concerns them as well.

Russia's offensive against Ukraine on 24 February not only transformed the security arena, but also dealt another blow to the economic landscape around the world. The OECD estimates that the war will depress global growth by one percentage point by making certain commodities and foodstuffs less accessible and more expensive.[1] The sanctions enacted by Western countries on an unprecedented scale have severely squeezed trade between Russia and the European Union.[2] Before the war, Russia and Ukraine together accounted for about two per cent of world GDP. The conflict, however, will drastically reduce the GDP of both countries, by an estimated 8.5% or so in the case of Russia and a staggering 35% in Ukraine.[3] The slump in Russia's GDP can be attributed to the effects of the war and sanctions, but also to structural problems such as corruption, state intervention in the economy and the feeble protection of property rights. In Russia, even local economists predict further troubles as Western sanctions disrupt supply chains and foreign firms withdraw. Compounding the situation, Russia's export credit risk rating has sunk from 4 to 7, the highest risk.[4] Although the calls for expropriation that could be heard in certain quarters after the outbreak of the current phase of the conflict have subsided, they could return at any time, typically in response to reports of atrocities perpetrated by Russian soldiers in Ukraine.

While the precise implications of the war for Russia are hard to gauge, the impact on the Ukrainian economy is even more difficult to assess, as the extent to which the fighting will spread remains unclear. The main factors behind the economic collapse are currently the mass destruction of the country's infrastructure during the hostilities and the depletion of the workforce due to emigration and war losses.

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1 https://www.oecd-ilibrary.org/sites/4181d61b-en/index.html?itemId=/content/publication/4181d61b-en

2 https://www.consilium.europa.eu/cs/policies/sanctions/restrictive-measures-against-russia-over-ukraine/sanctions-against-russia-explained/

3 In Russia's case in particular, GDP tells us little because it is a product of higher revenues from oil and gas exports combined with the cessation of imports.

4 https://www.oecd.org/trade/topics/export-credits/documents/cre-crc-current-english.pdf

Czech companies in the Russian and Ukrainian markets: between quitting and sitting tight

The loss of the Russian market is not critical for Czech companies as a whole; rather, the issues relate to just a few selected entities. The exposure of European economies, including the Czech economy, to Russia and Ukraine was not that great even before the Russian invasion began. Prior to the war, Russia accounted for two per cent of Czech exports and imports, while in the case of Ukraine it was 0.7% for exports and 0.9% for imports.[5] Czech companies' investments in these countries are not generally significant either, apart from stand-out cases such as Škoda Auto or PPF, though the latter was already considering whether to exit the Russian market before the current phase of the war. The Russian government's long-established policy of promoting the "localisation of production", favouring local firms over imports even at the prospect of inferior supply, was one of the reasons why the foreign business community had viewed Russia as problematic long before the war.[6]

According to the Confederation of Industry, about 150 Czech companies had a presence in the Russian Federation. Doing business in Russia in particular was hindered by the sanctions imposed since 2014, the notoriously poor business climate in the country and the after-effects of the scandal surrounding the blast at the munitions depot in Vrbětice.[7] Political tensions had effectively blocked Czech companies from gaining more of a foothold on the Russian market. In Ukraine, on the other hand, the situation had been gradually improving as the country's political and economic situation continued to stabilise up until the launch of the Russian aggression. Recent trends thus suggested that the Russian share was stagnating and the Ukrainian share was growing.

Czech companies' strategies for leaving the Russian market vary greatly depending on how much their management believes that a return might be possible. Dalibor Dědek's Jablotron, for example, declared that it was pulling out of the country immediately after the invasion and shut down all of its systems for Russian customers. Elekon had a similar response. Exporters such as Plzeňský Prazdroj and Staropramen stopped accepting orders from Russia.[8] In other cases, companies redeployed their workers to various training courses or switched them to part-time jobs. Then there are companies that sold their business to Russian partners with the understanding that they were not ruling out a possible return to Russia. As for companies operating in

[5] "Situace pro český export na Ukrajinu v lednu 2022", 24 January 2022, Businessinfo https://www.businessinfo.cz/clanky/aktualni-situace-pro-cesky-export-na-ukrajinu/
[6] Tomáš Hart, "Investovat v Rusku? Něco za něco", 15 April 2022, https://www.kurzy.cz/zpravy/588488-investovat-v-rusku-neco-za-neco/
[7] "Evropa se bojí odvety za případné sankce. České firmy mají v Rusku potíže už delší dobu", 1 February 2022, https://www.businessinfo.cz/clanky/evropa-se-boji-odvety-za-pripadne-sankce-ceske-firmy-maji-v-rusku-potize-uz-delsi-dobu /
[8] https://www.e15.cz/byznys/prumysl-a-energetika/ceske-firmy-zarazily-obchod-s-ruskem-nejvice-utrpi-strojari-a-vyrobci-vozidel-1388244

Ukraine, after the Russian attack, efforts centred on helping Ukrainian staff to get out of the country. The motives behind the responses include principled stands by the owners of businesses, efforts to take care of Ukrainian employees, concerns that Russian partners would take legal action, and, in the case of exporters, attempts to mothball the business while waiting to see how the Russian war against Ukraine played out.
In the near future, companies operating on the Russian market – even if they deal in commodities and products that have avoided Western economic sanctions – can expect to face problems now that many Russian banks have been excluded from the SWIFT system and shipping options have been compromised. However, the war has also altered the principles guiding Czech business people's approach to exports and investments in Russia. Having previously viewed Russia as an authoritarian but otherwise stable country, businesses and state institutions such as EGAP (an export insurer) have now turned away from Russia.[9] In the immediate aftermath of the Russian invasion, EGAP stopped guaranteeing loans headed for Russia, and CzechTrade closed its offices in Moscow and Yekaterinburg. Currently, then, there is an appetite to find ways of leaving Russia that do as little damage as possible. In the case of Ukraine, companies are keeping an eye on how combat operations are unfolding – they often talk about returning to the country if Ukraine is able to defend itself and the warfare stops.

What now? The search for adaptation strategies

In the foreseeable future, a return to the situation before 24 February 2022 or even February 2014 is not on the cards. In all likelihood, the war will grind on as neither side has enough forces to defeat its adversary any time soon. Sanctions could be lifted only if Vladimir Putin were to leave and be replaced by a much more liberal regime, reparations were to be paid to Ukraine, etc. The prospect of that happening, however, is far-fetched and borderline impossible. Consequently, the present situation will become the "new normal" for the near future, with the lifting of sanctions against Russia out of the question.

Czech companies that were doing business in Russia are now focusing their efforts on how to extricate themselves from Russia, which is now considered highly toxic, and find alternative markets. The Ministry of Industry and Trade has organised several seminars on matters related to the war's economic impact in Russia and Ukraine, as well as on the options available to companies to respond to the situation.[10] Parallel to this, CzechTrade has initiated crisis guidance for companies exporting to both

[9] "Ruská federace – Stručný politický a ekonomický přehled", 25 March 2022, https://www.egap.cz/cs/zeme/ru
[10] "Exportní semináře MPO k ruské agresi proti Ukrajině", 17 May 2022, https://www.mpo.cz/cz/zahranicni-obchod/mezinarodni-obchod-dle-teritorii/vychodni-evropa-a-stredni-asie/_ve-ctvrtek-od-dvou-do-ctyr_-mpo-porada-seminare-k-ruske-agresi-proti-ukrajine--266375/

countries.[11] Opportunities to provide support to Czech entities operating in Russia are currently limited by constrained diplomatic relations. In practice, this guidance may involve legal advice, in particular on how to close a business in Russia while countering the threat of lawsuits from Russian entities. In this respect, firms have often sought various forms of confirmation that their departure or non-delivery of goods is the result of sanctions. Such confirmation, if warranted, can and should be provided. On the other hand, the Czech government has argued against the provision of any financial compensation to businesses for losses incurred as a result of forced withdrawal from Russia.

The logical strategy in the new climate will be to seek out other markets. EGAP is one entity pursuing this course of action and has reduced its premiums in relation to OECD countries by 30% to 50%.[12] Central Asia is the closest region geographically, but other, more distant destinations also beckon. Here, too, it is necessary to be alert to various risks, such as the nature of local regimes. Nor should the prevailing market conditions affecting the world economy – the COVID-19 pandemic and the spike in inflation – be overlooked. Even so, from the government's point of view, such support is worthwhile, though companies must understand that any final decision, and hence responsibility, lies with them alone.

There is no way of telling how and when the post-war reconstruction of Ukraine will be undertaken. The Czech Republic's response to Russian aggression has earned it a relatively good reputation that can be leveraged by Czech companies. The gradual roll-out of European standards across Ukraine could be another positive factor that will further boost competitiveness and stability here. In both cases, however, this will hinge most heavily on how the war pans out. Should Russia triumph and install an occupying administration, any chance of European countries financing reconstruction would obviously vanish, along with all opportunities for Czech companies.

[11] "Krizové poradenství pro firmy exportující na Ukrajinu a do Ruska" https://www.czechtrade.cz/sluzby/ukrajina-2022/krizove-poradenstvi

[12] "Pojištění vývozu do zemí OECD zlevňuje až o polovinu, ukazuje nový ceník EGAP", 24 May 2022, https://www.egap.cz/cs/pojisteni-vyvozu-do-zemi-oecd-zlevnuje-az-o-polovinu-ukazuje-novy-cenik-egap