Publishing Information: Article published by Elsevier in the *Journal of World Business* (formerly the *Columbia Journal of World Business*), *Volume 24, Issue 2 (Summer 1989).*

The New US Joint Ventures in the USSR: Assessment and Management of Political Risk

Authors: Douglas Nigh & Karen D. Smith*

***Prof. Dr. Karen Smith Stegen
Jacobs University
Campus Ring 1
28759 Bremen
Germany
Tel. +49-421-200-4873
k.smithstegen@jacobs-university.de

ABSTRACT

This study examines the perception, assessment, and management of political risk by the first American companies entering joint ventures in the USSR. Using information gathered in interviews with executives of these early entrants, the study draws some lessons useful to American companies considering investing in the USSR. The study also compares the political risk management approaches of these pioneering firms with another group of pioneering American firms – those who first established joint ventures in the People's Republic of China (PRC).

INTRODUCTION

In January 1987, the USSR began to put in place the legislation permitting foreign participation in the ownership and operation of joint ventures located in the USSR. By June, the first of these joint ventures with a Western partner (involving the Finnish firm Kati Myynti) was registered with the USSR Ministry of Finance and thus acquired the status and rights of a separate legal entity in the USSR. In November, the first US-USSR joint venture (involving Combustion Engineering, Inc.) was registered. Since that time a number of other American firms have signed joint venture agreements with Soviet partners and joined the relatively small group of American firms pioneering this new form of international business involvement with the USSR.

While some American firms have entered into joint ventures in the USSR, many others have not. Some American firms have considered joint ventures with the USSR but have had second thoughts. A case in point is Ford Motor Company, originally a member of the American Trade Consortium, a group formed by seven leading American companies seeking to work together to expand their business with the

USSR.[1] In March 1989, when the consortium signed an agreement paving the way for major investments in joint ventures in the USSR, Ford was a last-minute dropout. Ford said that, when the environment for doing business in the USSR was better defined, it would reconsider manufacturing motor vehicles there. Ford has a history of having its USSRS business dealings affected by international politics. In the early 1970s, Ford was encouraged by President Nixon to establish a heavy truck plant in the USSR, only to have to abandon the project a few months later when Melvin Laird, then Secretary of Defense, declared he did not want to see Ford trucks coming down the Ho Chi Minh trail in Vietnam.[2] Clearly, politics matter when it comes to the viability of US-USSR joint ventures. Earlier research on the perceptions of American executives as to the desirability of establishing joint ventures in such Eastern European countries as Romania identified the perception of political risk as one of two most important factors preventing the American's participation in such a joint venture.[3]

This study examines the experience of the first American firms to sign joint venture agreements with Soviet partners. Specifically, we investigate the American firm's perception, assessment, and management of the political risk associated with its joint venture in the USSR. We seek to provide a better understanding of these early entrants' political risk perception and management. For these firms, political risk did not deter them from investing in the USSR. We hope that other American companies, for whom joint ventures in the USSR may hold significant potential, may learn some useful lessons from the experience of these pioneering companies.

In addition, we want to compare the political risk management approaches of these pioneering firms with another group of pioneering American firms – those who first established joint ventures in the PRC. A study completed earlier by one of the authors of this study will provide the additional information needed to compare the political risk management approaches of the early US entrants into joint ventures in the USSR and the PRC.[4]

POLITICAL RISK AND US-USSR JOINT VENTURES

What dimensions of the political environment may be of concern to American firms evaluating the desirability of a joint venture in the USSR? In general, they consist of three major areas: (1) the political

---

[1] The six American companies remaining in the consortium are Archer Daniels Midland, Johnson & Johnson, Chevron, Eastman Kodak, RJR Nabisco, and Mercator Corp. Although they have signed a trade accord with the

USSR, no individual company has yet, at the date of our study, signed a joint venture agreement.

[2] Helen Kahn, "Soviets Wooing Ford for Car, Truck Venture" *Automotive News*, December 21, 1987, p. 3.

[3] The other important factor was the belief that more managerial time is required to supervise joint ventures in Eastern Europe. See Ion Amariuta, David Rutenberg, and Richard Staelin, "How American Executives Disagree About the Risks of Investing in Eastern Europe," *Academy of Management Journal,* Vol. 22, No. 1, 1979, pp. 138-151.

[4] See John Daniels, Jeffrey Krug, and Douglas Nigh, "US Joint Ventures in China: Motivation and Management of Political Risk," *California Management Review*, Vol. XXVII, No. 4, Summer 1985, pp. 46-58.

relationship between the US and the USSR and its impact of US regulations that affect doing business with the USSR, (2) the political stability of the USSR, particularly the possible replacement of Gorbachev and the reversal of the reforms he has been so instrumental in initiating, and (3) the development of the USSR laws and regulations that may affect the establishment and operation of joint ventures in the USSR.

Political relations between the US and USSR can affect their commercial relations, because the US government has in the past consistently put strategic and foreign policy considerations ahead of economic and commercial ones.[5] American joint ventures in the USSR can get caught in the middle of big-power politics.

Although equity joint ventures are new to the USSR in the post-World War II era, other forms of international business involvement are not. An examination of trade flows between the two countries clearly demonstrates how this form of commerce has been affected by politics. For example, American exports to the USSR in 1980 fell to only 42% of the previous year's level when the US responded to the installation of a Soviet-backed regime in Afghanistan with restrictions on trade with the USSR.

From the point of view of American investors in joint ventures in the USSR, the uncertainty surrounding future US regulations concerning flows of goods, technology, money, and even people between the US and the USSR can be a significant source of political risk.[6] Such home country regulations take on enhanced importance in the US-USSR joint venture context due to the national security concerns of these two superpowers. Working with other Coordinating Committee (COCOM) nations, the US government seeks to keep certain technologies, whether embodied in goods or otherwise, out of the hands of the Soviet bloc.'[7]

The second area of potential political risk for American joint ventures in the USSR has to do with political events within the USSR. Will Mikhail Gorbachev's political and economic reforms succeed? Certainly American investors are given pause for thought when the current US Defense Secretary, Dick Cheney, is quoted as predicting that Gorbachev will ultimately fail to reform the Soviet economy and that his replacement will be somebody far more hostile towards the West.[8] Such an outcome would mean tremendous changes in the USSR's view of the role of foreign-owned joint ventures in the economic development of the USSR.

The third major area of the political environment which may be of concern to American investors is the development of the USSR laws and regulations which affect the establishment and operation of joint

---

[5] Charalambos A. Vlachoutsicos, "Doing Business with the Soviets: What, Who and How?" *Columbia Journal of World Business*, Summer 1988, p. 68.

[6] Tom Laurita and Michael McGloin, "US-Soviet Joint Ventures: Current Status and Prospects," *Columbia Journal of World Business,* Summer 1988, p. 44.

[7] The cost of the US export controls in 1985 has been estimated to exceed $9 billion and involve a $17 billion loss in GNP. See Franklyn Holzman, "Reforms in the USSR: Implications for US Policy," *American Economic Review*, Vol, 79, No. 2, May 1989, pp. 26-30.

[8] "Cheney Remarks on Soviet Future Ruffle the White House's Feathers," *New York Times*, May 2, 1989, p. 1.

ventures, as well as the changes in the Soviet bureaucracy which will implement these regulations. The USSR lacks a commercial code. The Soviet legal establishment seeks to establish “a fair and uniform legal environment that would provide a sound and predictable basis for business.”[9] Exactly what this legal environment will look like is far from clear. Of particular concern are regulations regarding currency conversion, valuation of assets contributed to the joint venture, pricing of production inputs and outputs, and labor relations.

Further, how and when the Soviet bureaucracy will adjust to the economic reforms is uncertain. For example, the foreign trade reforms may take years to become fully implemented. “Because of the foreign trade monopoly, few Soviet officials outside of the Ministry of Foreign Trade are experienced in dealing with foreign companies. It will take time before competent people are shifted and established in their new jobs, responsible to a new bureaucratic chain.”[10]

The above discussion of the political risk that may be associated with a US joint venture in the USSR has been in general terms. We all know, however, that political risk is specific to each individual investment, and capable of being influenced by managerial action. Thus we turn next to examine the individual experience of the American firms which have established joint ventures in the USSR.

METHODOLOGY AND INVESTOR DESCRIPTION

Given that we are dealing with an emerging phenomenon, it is not surprising that an "official" up-to-date list of these US-USSR joint ventures is difficult to come by. To develop a list of American companies that have actually *signed* joint venture agreements with Soviet partners, we contacted the US Department of Commerce and various Soviet agencies and conducted a comprehensive review of business and government publications.[11]

The US Department of Commerce estimated that 12 or 13 American companies had signed joint venture agreements. AMTORG, a Soviet trading agency that often handles joint venture negotiations, provided an estimate of 13 companies. Table 1 shows the 13 American companies we were able to identify as having signed joint venture agreements with the USSR.

Table 1: Identifiable American Companies with Joint Ventures in the USSR (as of March 1989)

Combustion Engineering
Delphi International
Dresser Industries

[9] "Foreign Investment in the USSR: New Avenues," *Business Eastern Europe*, September 26, 1988, p. 305.

[10] Val Zabijaka, "Soviet Trade Reforms Offer New Challenges for US Business," *Business America*, August 17, 1987, p. 9. See also H, Stephen Gardner, "Restructuring the Soviet Foreign Trade System," *Columbia Journal of World Business*, Summer 1988, pp. 7-12.

[11] Some of the more useful publications included International Chamber of Commerce, *Guide to Joint Ventures in the USSR*, 1988; Business International*, Business Eastern Europe*; and *Columbia Journal of World Business*, Summer 1988.

Elan International
Honeywell
IDG Communications
Innovation International
Management Partnerships International
Occidental Petroleum
Pan American World Airways
Radey International
Roma Food Enterprises
Tambrands

Note: Nine of these participated in the study; however, the names are not separated from non-participants in order to maintain the anonymity of respondents.

Of these 13 companies, nine participated in the study. Of the remaining four, two could not be located and two were not able to participate because the relevant executive was in the USSR at the time of the study. Those companies not participating tended to be the smaller service companies with less international experience.

For each company in the study, we interviewed, by telephone, one or more executives knowledgeable about the company's joint venture in the USSR. Information concerning the company in general, the company's joint venture in the USSR, and its political risk management practices was gathered through the telephone interviews with these executives.

Most, but not all, of the participants in this study were large companies. Indeed, one firm was quite small. Three others had 1988 sales ranging from $0.3 to $0.6 billion, while the remaining group of five firms ranged from $3.5 to $19.4 billion.

With the exception of the smallest firm, the participants had extensive overseas experience prior to establishing the USSR joint venture. On average, these firms had affiliated operations in approximately 25 countries.

In addition, five of the firms had extensive experience doing business with the USSR, in some cases going back 50 years or more. These five firms were the five larger ones.

The activity of the joint ventures established by participating firms tended to include an advanced technology component, such as computers, instrumentation, or process control systems. Most involved the provision of both business goods and services, which promised to increase the productivity of many sectors of Soviet industry. The two ventures which do not quite fit this pattern involved the manufacture of a consumer product and the provision of a consumer and business service.

FINDINGS

Risk Perception

All of the American firms perceived that their joint venture in the USSR involved some political risk. As to the nature of this risk, six of the nine firms cited the uncertainty surrounding future US-USSR relations and potential changes in US trade policy. Some executives frankly admitted that they saw the political risk coming more from “the American side.” The firms that saw this aspect of the political environment as significant tended to be those whose business has a high technology component.

The political stability of the USSR and the uncertainty concerning the success of Gorbachev's political and economic reforms were mentioned by six firms as potentially having a significant impact on their joint venture in the USSR. Of course, with a change in government comes the possibility of a number of changes in regulations affecting joint ventures and even expropriation (mentioned by one firm as its biggest fear). Yet a couple of firms expressed the belief that even if Gorbachev were removed from the scene for some reason, reform in the USSR would continue and foreign-owned joint ventures would still have a role to play in the economic development of the USSR. It should be noted that these two firms are among those with no experience with the USSR prior to entering into the joint venture.

Surprisingly, few firms expressed concern about any uncertainty surrounding the future development of specific Soviet rules and regulations. A couple of firms expressed concern about ruble convertibility and any slowdown in the movement to make it more convertible, but all firms had structured their joint venture agreements so as to be able to secure hard currency by various means for their participation in the joint venture. These firms had their signed agreements and a high degree of confidence that the provisions of their contracts with the Soviets would be fulfilled. One firm did express concern about the uncertainty of who, in the Soviet bureaucracy, has the power to make decisions. This firm speculated that contacts made in the Soviet bureaucracy might have to be abandoned as political changes occur.

How does the perceived level of political risk associated with a joint venture in the USSR compare to that of similar direct investments made by these firms in other foreign countries? Although three firms felt that a joint venture in the USSR did involve some increased risk, especially compared to ventures in developed countries, an equal number expressed the sentiment that the political risk associated with a joint venture in the USSR was lower than that in many developing countries. This latter view of the relative political risk is a reflection of the extensive international business experience of these three firms.

Approaches to Risk Assessment

In developing their assessments of political risk, the American firms consulted a variety of sources. Internal sources of information were heavily relied upon, especially by those five firms that had extensive previous business experience with the USSR. In some cases, these firms already had offices in the USSR and relied on their people in place as well as their accumulated knowledge and established contacts within the USSR. These five firms also relied to some extent on external sources, which included Soviet and American government officials, banks, consultants, and publications on country analysis and political risk.

For the four firms without extensive business experience with the USSR, internal sources were important in two particular cases. The two firms had affiliates in Eastern Europe and relied on their managers there for information. These firms with no USSR experience sought information from a wide variety of external sources including the Commerce Department, the State Department, the Department of Defense, Soviet ministries, AMTORG, the USUSSR Trade and Economic Council, and consultants.[12]

A number of firms found trips to the USSR for firsthand information gathering by top executives to be especially useful. The executives talked with Soviet officials and American embassy personnel and secured useful USSR publications. These firms felt their top executives could best develop a judgment of the future of perestroika by firsthand observation. One firm said it simply felt that sources in the US were not accurate.

It is fair to characterize the approach to political risk analysis used by these pioneering American firms as informal and unstructured, with heavy involvement by the highest level executives. In no case concerning the assessment of the political risk associated with a joint venture in the USSR, do we find evidence of the application of an institutionalized assessment function utilizing structured, systematic analytical methods. Rather the approach used in most companies involves intuitive judgments of the political risk, made by the CEO or another executive with country responsibility or, less frequently, by headquarters staff.

In general, the firms did not report employing individuals whose primary responsibility was to analyze political conditions in foreign countries. One firm did have a strategic analyst for whom political risk assessment was a part-time responsibility. In another firm, government affairs personnel were responsible for political risk assessment.

Finally, the political risk assessments concerning the USSR joint venture were seldom integrated in any formal way with economic and other considerations involved in the establishment of the joint venture. In general, they were integrated implicitly by an individual or considered as one factor in discussions among executives concerning the establishment of the USSR joint venture. One firm did report that it used the assessment to shorten the payback period and increase the return on investment criterion.

These findings concerning the political risk assessment approaches of these pioneering American firms are quite consistent with what we know about the practices of American-based multinational enterprises.[13] In general, a formal political risk function utilizing explicit, systematic methods is still very much in the early stages of development for most American multinationals. We found nothing in this study to contradict this earlier, more general finding.

Political Risk Management

In setting up their joint ventures, all firms used some method to reduce their vulnerability to political risk. The most common approach was to limit the value of the assets contributed to the joint venture. No firm really had what it considered a large amount of capital at risk. Two firms which did have larger investments structured their financing packages to shift the risk to the lenders. Another firm's risk was

---

[12] The US-USSR Trade and Economic Council is a nonprofit organization with offices in New York City and Moscow, It operates as a consulting firm providing members only with information on such topics as joint ventures, economic cooperation, trade agreements, and government regulations.

[13] See Stephen Kobrin, *Managing Political Risk Assessment*, Berkeley: University of California Press, 1982.

lessened by the mobility of its assets. In general, the companies contributed information, technology, and managerial expertise, rather than money and goods which could become trapped within the USSR.

A technique of risk management used by one firm was to give its joint venture a very high public profile. The support of top governmental officials of both the US and the USSR was sought, and the officials were involved in the signing of the joint venture agreement. This firm believes that such extensive publicity surrounding its joint venture puts pressure on the partners to perform as agreed upon.

Partner selection played a role in the political risk management of one firm. A Western-style local partner less susceptible to governmental influence was purposely sought out for the joint venture. For another firm, its lobbyists in Washington, D.C. played an important role in its overall risk management activities.

Even though political risk insurance is available, no company used this tool in its management of political risk. It is true that political risk is not available through Overseas Private Investment Corporation (OPIC), whose charter does not permit it to operate in Warsaw Pact countries.[14] Although such insurance is not available from OPIC, American investors in Soviet joint ventures can purchase insurance against expropriation and contract repudiation from such private insurance companies as American International Group (AIG).[15] It is clear that not all firms were aware of this option. Two of the larger firms commented that they do not use political risk insurance as a matter of policy.

What steps have the American firms taken with regard to the ongoing management of political risk? As the joint ventures have become operational, most of the companies reported they are not monitoring political risk. The two companies with a department or individual who handles political risk are monitoring the situation in the USSR. Of the other companies in the study, two have continued monitoring the political risk on an informal basis. One company reported that the individuals involved in the joint venture are "staying in tune with what's going on," and the other company has continued assessing the political risk due to unanticipated political events which affect its joint venture. These events involved American government restrictions and Soviet government concerns regarding the emigration of Soviet citizens. One firm noted that there is an ongoing substantial exchange of information among those firms doing business in the USSR.

A COMPARISON OF US-USSR AND US-CHINA JOINT VENTURES

An earlier study by Daniels, Krug and Nigh investigated the political risk management approaches of the American firms who were the early entrants into joint ventures in the PRC.[16] The 11 firms in the China

---

[14] It would take congressional legislation to permit OPIC to include the USSR in its insurance activities. When the issue of Hungary came to the House floor recently, it was voted down. Interview with Ben Erulkar, OPIC officer for Yugoslavia.

[15] American International Group charges $0.50-$0.75 per $100.00 for expropriation insurance and $1.00-$3.00 per $100.00 for contract repudiation insurance. Interview with Danial Wagner, AIG.

[16] Daniels, Krug, and Nigh, *op. cit*. This study identified 15 American companies with joint ventures in the PRC as of September 1983.

study were all large firms with significant international experience. This earlier study and the study at hand provide an unusual opportunity to examine the first firms making an investment in a locale. How do the political risk management approaches of these two groups of pioneering American firms compare? Below address some significant differences.

While both groups perceived that their joint ventures involved some political risk, the firms with USSR joint ventures were more concerned with the political risk emanating from the US political environment, particularly with regard to export controls. The uncertainty surrounding the direction and timing of the US government's response to Gorbachev's political and economic reform initiatives loomed large for those firms whose joint ventures depend heavily on the transfer of certain technologies from the US to the USSR.

The two groups differed in the sources of information relied upon to develop their political risk assessments. In the case of the China ventures, no American firm had anywhere near the experience doing business with China that many of the firms establishing USSR ventures had. Consequently, the firms could not rely on their usual internal sources and had to seek out new sources and, in the end, rely on fewer sources than usual. In contrast, many firms with USSR joint ventures were able to rely on their usual internal sources of information, built up over the years in doing various forms of business with the USSR. For these firms, entering a joint venture was simply an extension of the USSR-related business activities into another form of involvement.

In managing political risk, both groups reduced their vulnerability by keeping their initial investments in the joint ventures relatively low, although this was more common in the case of the USSR. More significant differences, however, existed in the use of political risk insurance as a tool of risk management. Whereas *no* firm with a Soviet joint venture used it, 70% of the firms with Chinese joint venture had purchased political risk insurance. These latter firms used insurance, largely from OPIC, to reduce the risk from expropriation, war, insurrection, and civil strife. The lower usage of political risk insurance in USSR joint ventures by the American firms can probably be attributed to the unavailability of OPIC coverage, having less capital at risk, and their greater business experience in the host country.

CONCLUSION

This study has examined the perception, assessment, and management of political risk by the first American companies entering joint ventures in the USSR. Although these firms perceived that there was political risk associated with their joint ventures in the USSR, they considered it to be at a manageable level. They designed their participation in the joint ventures so as to reduce their vulnerability to political risk, usually by putting little capital at risk or by shifting the risk to lenders or the Soviet partner. These multinational firms also structured their joint venture agreements so that they were assured of receiving hard currency for their participation in the joint venture, in most cases by selling their products to the US-USSR joint venture or by generating joint venture exports that were readily exchanged for hard currency.

What about the future? To what extent will political risk considerations deter other American firms from joining this relatively small group of early entrants into joint ventures in the USSR? We would argue that more and more American firms will find the political risk associated with potential USSR joint ventures to be at a manageable level.

Although there are indeed many uncertainties concerning future political events in the USSR and between the US and the USSR, the later American entrants can draw on the experience of the pioneering firms in the design and operation of their joint ventures so as to reduce their vulnerability to political risks.

Another factor which bodes well for reducing the influence of political risk factors is the fact that it is the uncertainty surrounding future US government policy that forms such a large component of the political risk. American companies certainly have more legitimacy and capability to influence American laws and regulations than they do foreign ones. The rationalization of export control regulations and their application, as well as the extension of OPIC coverage to include the USSR, are two areas in which concerned American companies can be expected to be active.

To conclude, the increased use of methods to manage political risk vulnerability rather than simply avoiding it, the increasing experience of the American business community in doing business with the USSR, the more widespread availability of such information to potential investors, and the possibility of concerned American companies influencing American government policy, all point to a lessening of the role of political risk in deterring the formation of future US-USSR joint ventures.