Santamarina + Steta

Ukraine-Rusia Conflict:
Implications for Companies in Mexico

February 24th, 2022, went down in history as the turning point for dozens of multinational brands who, two weeks into the Ukraine-Rusia war, are still looking for a solution that will sketch their position and leadership between morality and financial impact. A demand compelled by consumers around the world.

More than 300 companies have decided to halt operations in Russia and join the social unrest over Vladimir Putin's decision to initiate an armed conflict against Ukraine. However, many continue to supply goods and food supplies, while others keep their payroll active to avoid impacting their employees. Two actions that represent an elevated expense in a market with an uncertain future.

"We no longer have isolated markets. All markets are linked to each other and what happens in a country necessarily affects or benefits other regions of the world", explains Vicente Grau, Santamarina + Steta's expert on antitrust matters and economic competition.

Russia only represents 3 percent of consumer goods sales, limiting the impact on production and sales for brands such as Danone, Henkel, PepsiCo, L'Oréal, Nestlé, Kimberly Clark, Colgate-Palmolive, Coca-Cola, Unilever, and Clorox. This situation has led them to contemplate actions based on their human values. For example, PepsiCo, which employs 20,000 people in Rusia, has declared that, for the time being and to not generate more victims, it will maintain food products and local brands sales.

"From a legal standpoint, when a client asks if they can leave a country overnight, the first thing that needs to be reviewed are the contracts and legal commitments they currently have, whether they are distribution contracts, production obligations, or concessions."

"Before making that decision, a legal analysis is necessary. Another issue worth considering is the supply of necessities, which if taken away from the population can represent a reputational damage", says Grau.

And although investors and analysts have stated that there is no legal pressure from NATO, the United States, or Ukraine to stop supplying basic needs, companies are facing criticism for continuing operations in Russia, which has quickly led to an unprecedented business exodus.

Despite social demands, for Vicente Grau, the consumer goods producers bear the greatest responsibility in leaving Russia, as they have a social obligation to provide consumers without their basic human needs.

Economic Uncertainty

The recent Ukraine invasion made Russia the most sanctioned country in history, with 5,581 economic penalties in less than 15 days, according to Statista. These penalties seek to put pressure on Moscow to change the course of the conflict.

"Many countries will reconsider before supporting Russia, especially if there are sanctions imposed by other powers, such as NATO and the United States. That's why many companies are reconsidering doing business with Russia," the expert believes.

Among the most severe sanctions are the airspace closure for Russian airlines, the expulsion of the international payment platform SWIFT, and the United States and United Kingdom's ban on importing Russian oil and gas.

However, all the closures, the plummeting value of the ruble, and the suspension of financial transactions by Visa, Mastercard, PayPal, and American Express are having the opposite effect: the most affected being investors, brands, and the average Russians.

Although Putin's government claimed to have a war chest of more than 4.5 trillion rubles ($53 billion dollars) aimed at limiting economic instability, the sanctions have already raised the Russian central bank's key interest rate to a record high of 20 percent, leaving losses of up to 40 percent of its value against the U.S. dollar.

What counter action is Russia taking? To impact the West, Putin's government responded by banning the exportation of more than 200 products and raw materials, affecting an estimate of 48 countries that "have committed hostile actions" against Russia. And although no company has yet made an official statement, it is known that most of them are related to telecommunications, agricultural, electrical, and technological equipment.

Historic Exodus

The number of companies leaving the country, updated daily by Yale University, reveals the financial impact in the European country. Practically all sectors have been hit by the war, from textiles and energy to technology, finance, automotive, food, and entertainment. A trend expected to continue throughout March.

The financial institutions that withdrew from Russia include the World Bank, HSBC, and ING Group. In the technology sector, the following stand out Meta Platforms (Facebook's parent company), Instagram, WhatsApp, Twitter, YouTube, TikTok, Apple, Intel, Microsoft, Google, Samsung, Sony, and Ericsson. Amazon is the only tech company that has not taken action against the country.

Other multinationals that have joined the boycott are Nike, Adidas, Puma, H&M, Levi's, Channel, Airbnb, Ford, Toyota, Mitsubishi, Honda, Volkswagen, BMW, Mercedes-Benz, Daimler Truck, Mazda, General Motors, Jaguar Land Rover, Aston Martin, Renault, Harley-Davidson, Shell, Disney, Netflix, McDonald's, and Starbucks.

For the most part, companies are assessing how temporary their exit will be and how can they expand their market in other countries if Russia does not give in to the ceasefire. Most have decided —without much detail on logistics and administration— to keep stores closed, salaries paid, and retail sales until inventory is exhausted through eCommerce.

Simulations from the Kiel Institute for the World Economy (IfW Kiel) offer an overview of what these actions could mean for all sectors in Russia.

"We are seeing how the world gives much more importance to economic and market issues, and how they can influence whether a country benefits or harms. It is curious how countries reacted and instead of attacking or militarily defending Ukraine, they started a trade war", says Vicente Grau.

For example, the energy embargo would have the most serious consequences. If all gas imports and exports are halted, the Gross Domestic Product (GDP) would fall by almost 3 percent. The oil embargo, on the other hand, would cause a 1.2 percent drop in GDP.

"Our calculations are just models, but they clearly show that the economic consequences of trade embargoes would affect Russia much more than its Western allies," explains Hendrik Mahlkow, a researcher at IfW Kiel.

Santamarina + Steta's expert believes that three sectors will continue to impact the Russia-Ukraine war: trade, technology, and media.

“The consequences of the war are seen from three areas: technology, media, and economy. Their response to military attacks has been to start an economic war”, he exposes.

How Does It Directly Impact Mexico?

The repercussions of the armed conflict between Russia and Ukraine on Mexico's economy will depend on how much the war escalates and the actions taken by European countries and the United States.

Given that sanctions have been imposed on the production of raw materials, international prices have risen. Also, oil and gas prices have increased worldwide. According to the Federal Government, the impact has mainly affected metals such as nickel, aluminum, and gold, as well as some grains like wheat and corn.

Likewise, according to the Agricultural Markets Consulting Group (GMCA), of the 23.3 million tons of fertilizers exported by Russia, Mexico receives one million, meaning the country could be affected by a short-term shortage.

However, the economic repercussions that companies may have will also be rewarded by the consumers since, according to a Reuters/Ipsos survey, 77 percent of Americans support the sanctions imposed on Russia. In contrast, a Morning Consult survey states that three-quarters of the population is willing to support and consume more brands that stop selling goods and services in the country that started the armed conflict.

"From an economic competition perspective, many of the multinational companies leaving Russia for reputational reasons will look for opportunities elsewhere. Russian market investments will need to go to other markets where they can recoup their losses. They will readjust their production in other parts of the world," says Vicente Grau.

The Santamarina + Steta expert ends with a favorable prediction, as he assumes that one of the implications of companies leaving Russia is that investments will move to other exploitable regions of the world, that is, with opportunities for expansion, such as Latin America and the USMCA area (Canada, the

United States, and Mexico), where the market could expand rapidly, and multinationals can find a lifeline for recovery.

Vicente Grau A.
Partner
Mexico City
+52 55 5279 5466
vgrau@s-s.mx

Más de 30 años asesorando a clientes mexicanos y extranjeros en proyectos inmobiliarios, competencia económica, planeación patrimonial y Family Office.