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## **Entering Russian Markets, Case: CH-Palvelu Oy**

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## **Abstract**

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The main purpose of this study was to find best entry mode for Finnish family-owned SME to enter Russian markets. Russian business environment, potential risk factors and case company's potential to succeed in the new market area were also studied in order to find out what factors need to be considered when entering and operating in Russian business environment that differs from Finnish or Western European. Topic of this study was chosen because case company's plans to expand its physical business to Russia. Empirical part of this study is not public because it contains confidential information from the case company.

This study is conducted by using case study as a Research method and in addition to the information gathered from the case studies this research takes into account empirical knowledge from the international business in Russia that is based on case company's earlier experiences.

The results show that for small family-owned company resources and risk levels of different entry modes have great influence to the selection. Earlier experiences and existing network, or lack of it, also affect which entry mode the company selects. Russian business culture has many characteristics that can cause problems for a foreign company, for example corruption, legislation, actions of state officials and organized crime. If company wishes to succeed in Russian markets and avoid problems it can be done by choosing a right entry mode, right local partners; and have understanding from the environment and product or service that has demand in the new market area.

Keywords: internationalisation, entry modes, Russian markets

## TABLE OF CONTENTS

1 Introduction .....	6
1.1 Background of the Study .....	6
1.2 Objectives and Delimitations .....	7
1.3 Research Questions .....	8
1.4 Theoretical Framework.....	8
1.5 Methodology.....	10
1.6 Structure.....	10
2 Internationalization of SMEs .....	11
2.1 Internationalization in the 21 <sup>st</sup> century and after.....	11
2.2 Internationalization of SMEs and family firms.....	11
2.3 Motives.....	12
2.3.1 Motives for SME to enter international markets .....	13
2.3.2 Motives for Finnish company to start business in Russia.....	15
2.4 Internationalization Theories and Models.....	15
2.4.1 Uppsala model.....	16
2.4.2 The integrative model of small firm internationalization .....	16
2.4.3 Network approach to internationalization .....	18
2.4.4 Limits of internationalization theories and criticism towards traditional theories.....	18
3 Entering new markets .....	19
3.1 Choosing the right entry mode .....	20
3.1.1 Risk exposure.....	20
3.1.2 Control .....	21
3.1.3 Resource Commitment .....	21
3.1.4 Flexibility .....	22
3.2 Combining entry modes.....	22
3.3 Entry modes .....	25
3.3.1 Exporting.....	25
3.3.2 Licensing.....	26
3.3.3 Joint Venture.....	27
3.3.5 New Wholly-Owned Subsidiary/Greenfield investment.....	28

3.4	Conclusion .....	29
4	Russian environment .....	31
4.1	Russian business environment.....	32
4.1.1	Laws/regulations and taxation .....	32
4.1.2	Currency and banking sector .....	34
4.1.3	Business culture .....	36
4.1.4	Easiness of doing business in Russia.....	36
4.1.5	Safety of doing business in Russia .....	39
4.1.6	Corruption .....	42
4.1.7	Ukrainian Crisis and Consequences .....	44
4.2	Finnish SMEs entry to Russian market.....	45
	REFERENCES .....	47

## **List of figures**

Figure 1. Transferability and compatibility of each entry mode	23
Figure 2. Resource commitment and cultural distance	25
Figure 3. Control vs required resources	30
Figure 4. Technology Risk in Entry Modes	31
Figure 5. RUB exchange rate to USD vs. oil	35
Figure 6. Biggest problems in exporting to Russia	40
Figure 7. Russian Competitiveness Index, Security	41
Figure 8. Russian and Finland, corruption rating 2004 – 2014	44

## **List of tables**

Table 1. Motive Theories	13
Table 2. Doing business in Russia	38
Table 3. Doing business in Russia	39
Table 4. Global Competitiveness Index 2014-2015, Security in Russia	41
Table 5. Corruption Perceptions Index 2014	43

# **1 Introduction**

Increases of competition, integration and liberalization in international markets have been responsible for the need for organisations to engage internationalization processes. (Crick & Chaudhry 1997, 156) During past decade companies have been internationalizing in greater numbers and faster than ever before, and the internationalization trend is still continuing. Therefore, internationalization theories that can provide practical information to firms are available in great numbers and are more critical than ever before. However, companies are internationalizing more different ways than before, often using combinations of entry and market strategies. (Axinn & Matthysens 2002, 436)

Russia has a great influence to Finnish economics and business environment. The influence is even larger in Finnish regions that are located geographically next to the Russian border, and that location offers many opportunities for local enterprises, in a form of resources and purchase power that Finnish local markets cannot offer.

In this Master thesis the purpose is to study different internationalization theories in order to find the most economical and low-risk way for a Finnish SME to enter Russian markets. The goal is to find the most recent facts and trends about internationalization models and theories, and apply them to be used in the target company's business environment.

## **1.1 Background of the Study**

This Master's thesis is conducted for a use of company called CH-Palvelu Oy. Company's future strategy is to gain more market share from Russia and this study is for CH-Palvelu Oy to achieve its goals. The development of Finnish Pulp and Paper industry has stagnated, and during last few years, it has started to decline. Whole mills or parts of them have been shut down permanently and at the moment it seems that new mills are not going to be built to Finland ever again, at least under current circumstances. Companies working with that

specific industry have to find their business from international markets for to survive. Russia is the obvious choice for CH-Palvelu Oy to expand its business because of the location, company's earlier experiences from Russian markets and already existing contacts.

## **1.2 Objectives and Delimitations**

The purpose of the study is to research SME's strategies to enter foreign markets in general and more profound study is made how to enter Russian markets. The goals are to find out what benefits company can achieve from international markets, to choose best entry mode for the target company, and analyse the risks that are involved when company decides to go international in general and the specific risks related to Russian market environment. Analysing current international markets and competition, the purpose of developing strategy for CH-Palvelu Oy against other companies with similar products, is also one of study's purposes.

Internationalization as a concept is very large and includes lots of different theories and factors to be considered. This study is limited to serve only purposes of the target company CH-Palvelu Oy. In other words, this study is limited to consider the internationalization process of a Finnish family-owned SME located near Russia and trading tangible goods. Internationalization theories are studied in the general level, those theories that can be applied to all firms despite the company's size or location. Rest of the theories are chosen and researched from the point of view of Finnish SME which international operations concentrate outside the European Union. Russian business environment, its' features and risks that SME expanding to Russia needs to take in to account are also studied in this research.

### **1.3 Research Questions**

***Main Question: What is the best strategy for CH-Palvelu Oy to enter Russian markets?***

The main question analyses different entry modes in general and from the point of view of family owned SME in purpose to find best strategy to start physical operations in Russia. Entry mode selection is limited to exporting, licensing, joint venture and wholly-owned subsidiary that are the most realistic options for SME.

***Sub Questions:***

***SQ1: What are the risks in entering Russian markets and what are the characteristics of Russian business environment?***

This question includes analyses from risks and market environment. Geographically different aspects of internationalization are studied both in general and from the Russian market environment.

***SQ2: What are company's competitive advantages and what benefits it can gain in the new markets?***

In this question target company's services and products are studied and compared to competitors. Question seeks to find out if company has potential to succeed in the new market environment.

### **1.4 Theoretical Framework**

Theoretical research about SME internationalisation process is mainly conducted by using case studies and articles. Theoretical study also includes study of Russian business environment by using databases of different organisations. Case studies and articles as resources have the latest information and they also take account the latest developments and current condition of the markets. Empirical study is made by using the result of the



theoretical research by combining and comparing them with the experiences of the target company. Both the theoretical research and the empirical study are made to serve the needs of the case company, CH-Palvelu Oy, due to that the main focus will be in the internationalization of SMEs and family-owned companies, and Russian market research.

Researchers have studied internationalization from the 1930s and most of the traditional models and theories were developed in the 1970s and 1980s. (Axinn and Matthysens, 2002, 437) These traditional internationalization theories are revised in this paper through more recent studies. This kind of approach is chosen because past two decades have changed the global business environment and markets with faster pace than never before, another reason is that traditional theories are rarely made from the SME point of view, which the target company of this study is. The traditional theories are still part of this study and they can offer valuable information but they are reviewed through the critique that new studies can offer. The recent studies have also combined traditional studies by choosing the most promising aspects of each study and combining them to one new study with the latest results such as the Uppsala model and International Network Model theory to one new theory. (Kontinen & Ojala 2012)

The target company of this study, CH-Palvelu Oy, is a family owned firm. There are only few studies made about internationalization of family owned SMEs that increase the understanding of internationalization, identify the patterns and explain the different options and actions taken by these firms, for example Kontinen & Ojala (2012) in their study from International pathways among family-owned SMEs.

Critical views towards traditional internationalisation theories are also research in this study. There are several newer studies, e.g. Axinn and Matthysens, 2002 and Carneiro et al, 2008, to mention few, that question the traditional internationalisation theories and those should be taken into consideration,

especially when many of the most recent studies even still are based on them and using them as a starting point.

Russian business environment is studied and evaluated through case studies but the main sources of information are publications made by private organisations, for example international audit company KPMG, and governmental or public organisations; Ministry of Foreign Affairs of Finland or Bank of Finland, and Universities research centres such as Nordic Dimension Research Centre (Nordi) and Center for Markets in Transition (Cemat). These sources offer latest and true information from different market areas.

### **1.5 Methodology**

This study is conducted by using case study as a Research method. Method was chosen because it offers understanding from a real-life phenomenon in depth (Yin 2009, 18) and offers most recent information when used right. The research questions cannot be answered directly through any kind of research and there is more than one right answer. All these factors support the use of case studies as a research method. Because more that my questions seek to explain some present circumstances, the more case study method will be relevant. (Yin 2009, 4) In addition to the information gathered from the case studies this research takes in to account empirical knowledge from the international business in Russian that is based on the case company's experiences.

### **1.6 Structure**

Structure of the thesis consists three main parts. First part is literature review that focuses on the internationalization process in general and states the already existing theories, models and major studies conducted earlier. Second part is the theoretical research where the latest trends and study results are examined through articles, journals and case studies. This part should provide the most resent information to be used in the third part. Third part is the empirical research that utilizes the observations made in two previous parts. At first the case company CH-Palvelu Oy is introduced and then its potential and

resources are evaluated from the international point of view. The final result and purpose of the third part is to develop best strategy for CH-Palvelu Oy to enter Russian markets.

## **2 Internationalization of SMEs**

Because CH-Palvelu Oy is a small family-owned company, internationalization process of an organization is studied from the point of view of SMEs in general level by concentrating to the family ownership aspects also. Large MNCs and their process of entering new market areas are not considered in this paper.

### **2.1 Internationalization in the 21<sup>st</sup> century and after**

The mature multinational corporations used to play the dominant role in the internationalisation but in the 21<sup>st</sup> century also the SMEs have started to move towards international markets in increasing numbers. The reasons why also smaller companies are internationalizing their operations can be found from the fast developing information technology that has brought countries closer to each other, several countries have encouraged their SMEs to increase their international activities to boost economic growth and reduce unemployment. Traditional exports are coming under pressure because the marketing and production conditions are changing fast; when company operates physically in the market it sells its goods to it can respond to change more rapidly and one important factor supporting SMEs to enter foreign markets are the trade unions and free trade agreements. (Ruzzier et al. 2006)

### **2.2 Internationalization of SMEs and family firms**

The involvement of the management and owners is the feature that makes the family business different from the non-family business. The family business is in many cases built up by different generations and it is critical for the family in economical and emotional level. The importance of the business might cause managers to avoid risk taking and implementing new innovations.

Internationalization of family firms is usually considered to be slow and risk avoiding process. The reason for the slow pace may be caused their limited financial capabilities, insufficient managerial skills or knowledge, restricted growth objectives, and unwillingness to accept outside expertise. The factors that enhance internationalisation of family owned companies are their long-term orientation, and simplicity and speed of decision making process. It has also been found that those family firms are more likely to be successful in their foreign expansion that are willing to use information technology, are innovative and committed to internationalisation, and can distribute power and resources that are available. Often, a new generation taking part to the business has also been seen as a positive factor to internationalisation. (Kontinen & Ojala, 2012)

### **2.3 Motives**

There are many theories and studies from the motives for expanding across countries for example Cuervo-Cazurra, (2012) and Dunning, (1993). Most studies tend to assume that companies expand to abroad in the search of new markets (Cuervo-Cuzurra, 2012) and ignore other motivating factors such as search for assets, resources and efficiency. Dunning's main motives changed over time and offered a different number of motives before the last study; Dunning and Lundan, (2008) that decided to emphasize four motives. These four "seeking" motives were; market-, resource, - factor, and strategic asset-seeking. (Cuervo-Cazurra & Narula, 2015) In 2015 Cuervo-Cazurra, Narula & Un, 2015, made a study that reviewed the motives of internationalisation an clarified them, at the same time providing a modified classification that integrates and refines previous ideas. It had four motives, such as Dunning Lundan, (2008) also the arguments were similar to Dunning, (1993). These four motives were (1) *sell more*, (2) *buy better*, (3) *upgrade* and (4) *escape*. (Cuervo-Cazurra, Narula & Un, 2015). In table 1 motive theories are compared and explained.

<b>Dunning</b>	<b>Cuervo-Caruzza et al</b>	<b>Objectives/motives</b>
Natural Resource-seeking	“Buy better”	To obtain certain resources of a higher quality with lower cost that could be purchased in the home market.
Market-seeking	“Sell more”	To export goods or services to another country; from the existing domestic markets to new markets.
Efficiency-seeking	“Buy better” and “Sell more”	To rationalize the structure of established investment that investing firm can gain from the governance of geographically dispersed activities.
Strategic asset-seeking	“Upgrade”	Promotion of long-term strategic objectives that are sustaining or advancing global competitiveness
Escape investment	“Escape”	To escape or avoid restrictive legislation, regulations and organisational policies by home government.

*Table 1 Motive Theories (Cuervo-Cazurra, Narula & Un, 2015)*

### **2.3.1 Motives for SME to enter international markets**

When it comes to motives for SMEs to enter international markets can be external or internal, and often combination of both. The integration and liberalization in international markets speeded up rapidly after the mid-90s causing increased competition in local markets and easier access to foreign markets. During the 21<sup>st</sup> century globalisation, e-commerce, and trade unions and agreements have brought different markets even more close to each other.

External factors are often results from the environmental factors such as economic climate and trading conditions in the domestic market, domestic market size and location or proximity of the potential export markets. These

factors can be foreign country regulations, the availability of information from the foreign market, state or organisation sponsored export promotion programs and unsolicited orders or inquiries from abroad. (Crick & Chaudhry, 1997, 160) When e-commerce and webpages became general for almost every company the change of receiving unsolicited inquiries from abroad increased significantly, especially if company is producing or selling special products. These changes in markets have made it possible for even a one man firm that has a niche product to start exporting goods successfully to more broad market area without the effort it used to take. (Rundh, 2007)

Internal factors are e.g. firm size, export experience and management's or decision-makers' attitudes and skill sets. When it comes to SMEs and especially family owned firms the internal motives are in the key role when company considers starting international operations. Economic factors, like lack of finances, can prevent small or mid-sized company from entering new markets, if company has a limited financial resources risks are often avoided but there are many supporting non-profit organisations to consult with export related issues and e-commerce can be started with relatively small risk and investment. External contacts of the decision makers seem to have an important influence also, for example frequent travelling to the export markets influence positively to the successful exporting. (Rundh, 2007)

The main goal to every company is making profit and ensuring the continuity of the business operations. Crick & Chaudhry (1997) found out that making a quick profit was not a management's motive for exporting. Instead firms were motivated by long-term profitability secured by market diversification and long term growth. (Crick & Chaudhry, 1997) Companies that operate in more than just one market area are not so vulnerable from changes in economic or political environment of the domestic markets.

From the internal motives the key factor is the top management's involvement and influence to initiate export activities. In family firms the owner is the decision-maker that determines company's commitment to exporting. Small

firms often have limited resources in personnel which can prevent international business activities. Personnel might not have earlier experience, general skills or commitment for entering international markets. When company is small and has also limited economic resources hiring skilled and experienced managers is a challenge. Another personnel problem in family firms can occur when company is passed to the next generation. Even if the previous owner had the necessary skills to operate in international market, the next generation of owners might not and the existing export activities stop or eventually dry out when new ownership starts. (Crick & Chaudhry, 1997)

### **2.3.2 Motives for Finnish company to start business in Russia**

In her research Tolvanen (2009) mentioned that largest number of companies that took part in the study decided enter Russian market because of the growth potential it offered. They saw Russian markets to be dynamic and growing and in specific areas there was only little or none competition. Study's respondents also stated that Finnish domestic markets were small and the full market potential, or share from, it was already reached. (Tolvanen, 2009, 12)

Another important motive, according the study, was the proximity of Russian market. Short distance to Russia was considered as benefit in logistics and enables companies to be strategically "present" in new international market. (Tolvanen, 2009, 13) Russia offers, in addition to Moscow and St. Petersburg, other towns with population of 300 000 – 900 000 inhabitants in Finnish nearby areas that have increased purchasing power; both consumers and companies.

### **2.4 Internationalization Theories and Models**

In this paper theories and models were chosen from the SME's point of view. The models and theories that were chosen to this study are the "Uppsala model", "the integrative model of small firm internationalization" and "International network model".

Even though "the Uppsala model" can be considered as expired information it is one of the most know internationalisation models and still used in many

internationalization studies as starting point. It has also been updated after it was introduced in the 1970s. “The integrative model of small firm internationalisation” is a one example of those studies that have used Uppsala model by revising the results and combining its principles with another theory.

#### **2.4.1 Uppsala model**

The Uppsala model is probably one of the most cited traditional theories in the literature of international business. (Kontinen & Ojala 2012, 497) Johansson and Vahlne (1977, 1990) developed the Uppsala Internationalization Model that was influenced by the earlier studies made around sixties, Cyert and March (1963) study about behavioural theory of the firm and Penrose’s (1959) theory of knowledge and change in organisations (Ruzzier et al., 2006)

The Uppsala model was developed to explain the incremental, (step by step occurring), internationalization process of multinational companies. According the model when companies are selecting their markets, they are expected to enter first into nearby markets which have similar language, culture, political system, level of education, level of industrial development, etc. After firm’s knowledge of international operations increases, it starts to develop operations in countries that are physically more distant. The model assumes that that the business environments in countries that are psychically close are easier to understand and for that reason business operations are easier to implement. (Kontinen & Ojala, 2012) Uppsala model has received also lots of critique and there are many exceptions to this theory; for example, some business environments share just geographical locations but have only little psychical similarities, e.g. Central-America and USA or EU area and Russia, and entering those geographically closest markets is often the first area where companies start their international operations, despite the fact how different they are, for example in culture, politics or technical development.

#### **2.4.2 The integrative model of small firm internationalization**

The integrative model, Bell et al. (2003) present three different internationalization pathways of SMEs by combining ideas from Uppsala



models and INV theory. The three pathways that model includes are; traditional SME, born-again global and born global. Pathways referred in the model are a variety of strategic used in the firms' internationalisation processes. (Axinn & Matthyssens, 2002)

The first pathway describes the traditional SMEs that internationalize their operations by entering, slowly and incrementally to psychically and geographically, closest market. The internationalization of traditional firms comes through single incidence based on unplanned orders and enquiries from overseas. The motives of the internationalization are survival and growth, because the product development focuses first on the domestic market and only after that to foreign markets. (Kontinen & Ojala, 2012, 499) Integrative model's first pathway follows same theoretical findings, or at least has many similarities, with the Uppsala model.

Models second pathway are the born global –firms. These firms internationalization happens fast and simultaneously to several foreign markets and are not influenced the psychical distance. They internationalize to niche markets that their products sell well and are driven by first-mover advantage. They do not develop their products primarily for domestic markets but instead for international business environment. Definition of born global company is that they achieve foreign sales in two to five years, at least 25% of their income is coming from foreign sources and they operate at least in five countries. (Kontinen & Ojala, 2012, 499)

The third internationalization pathway that represented Bell at al. (2003) is the born-again global pathway. Born-again companies have previously operated in domestic markets but entered the international markets suddenly due an event such as clients internationalizing their operation, change in management or ownership, or a takeover by another company. Changes in management and in ownership offers company more, knowledge, financial and other resources that they can access to foreign markets. (Kontinen & Ojala, 2012, 499)

### **2.4.3 Network approach to internationalization**

When company is internationalizing it forms strategic alliances with partners, clients and other actors. These alliances help the company to overcome obstacles that new market area might bring and they also can offer information from the new markets that might help to avoid before they appear. Networks offer Network approach. Uppsala model suggest that knowledge is acquired only through company's own experiences but network model emphasizes that gaining knowledge and market expertise can be done also through networks. (Laacks, 2010)

When it comes to smaller firms forming networks is usually the only option because of their limited resources. By outsourcing the supporting functions of their business to third parties a company can gain information from the clients and markets, it gets required expert knowledge and specialized business services, and through these they can strengthen company's competitiveness. (O'Farrel et al., 1999) To make a networks successful is depending on the co-operation of all the parties involved in the network and their common goal is to gain competitive advantage when relational international theories suggest that companies join networks just to get access to resources that they cannot obtain by themselves from their local markets. (Laacks, 2010)

### **2.4.4 Limits of internationalization theories and criticism towards traditional theories**

The traditional theories have developed over time; but not enough. Most theories have their roots in industrial organisation and have developed in the 1970s and 1980s when large North American companies started to invest to Europe and smaller European organisations started to export to their neighbour countries. (Axinn & Matthyssens 2002)

Since late 1900s lots many changes have happened in the global international markets and it is not just the MNEs that are internationalising their operation but also small and medium sized companies, and not just tangible goods but more and more services. The limitations of traditional theories have always been that

they do not state directly whose behaviour they are planned to explain, MNCs, manufacturing firms, western companies or all of them? (Axinn & Matthyssens 2002)

There are two options how internationalization theories could be update to match the modern market environment: adaptation or innovation. The researcher could try to “upgraded” to most promising traditional theories and modify them to be more topical. The other option is to be innovative but it requires holistic and longitudinal qualitative research from renewed period of time. (Axinn & Matthyssens 2002, 445, 446) Even though, being innovative rather than acquiring background information from earlier theories, requires lots of effort and resources it might be the best option. When “table is cleaned” and study is made by using just latest information and facts it gives the actual description of current situation and the result are not distorted through the theories that were used to think as the ultimate truth but might not be anymore.

As a conclusion can be said that at this moment traditional theories combined with recent studies, provide an valuable information about internationalisation but when traditional internationalization theories are used as a resource, their limits should be acknowledged, critical thinking should be involved and the different facts, that have changed or ceased to exist as the time has passed, should be considered. Also, As in the study Axinn & Matthyssens (2002) stated, most of the traditional theories are made for MNEs point of view and cannot be applied directly for SMEs, and that fact should be kept in mind especially when internationalization of small companies that provide services are studied.

### **3 Entering new markets**

After company has made its decision to start international operations next and very critical and important step is to find right strategy for entering the new market. The investments based on that decision have a long term influence on company.

There's several ways for a company to enter a new international market. The most common entry modes are exporting (not always considered as an entry mode), licensing, joint venture, acquisition or starting a new wholly-owned subsidiary. All these entry modes have their own pros and cons and there are many external and internal factors that influence to the entry mode, for example, company size and resources, their own involvement in future, level of risk company is willing to take, political climate in the home country and the new country, cultural differences between the countries, and existing or potential partners for the new venture.

### **3.1 Choosing the right entry mode**

When different entry mode options have been revised in the company that is planning to enter new markets a firm needs to choose an option that suits best its own purposes and available resources. Like said before there are many factors affecting to that choice and it needs to be done carefully because entry and money when it is not conducted successfully; entry mode is very important strategic decision. When company is choosing its entry mode it should, at first, consider four strategic effects which are risk exposure, control, resource commitment and flexibility. (Chen & Messner, 2011)

#### **3.1.1 Risk exposure**

Risk management is of the most important factors that company needs to consider when starting international operations. Entry mode that firm chooses determines the exposure for environmental and organisational uncertainties that impact to its performance in the new market area. Evaluations of risks need to be made carefully. In the entry mode selection two king of risks need to considered; investment risk and contractual risk are both relevant to the entry mode selection. Investment risk in the host country contains the stability of present political and economic conditions and governmental policies that can have critical effect on company's profitability and survival in that country. Risks can be, for example, state's obstruction of restoring profits from the host country and controlling the foreign assets, or host country's government not following

international trade agreements. Contractual risk is the cost and uncertainty of making contracts in the host country and the difficulty of enforcing them if needed. (Chen & Messner, 2011) In entry mode selection a typical risk can be, for example, how a licensing or a joint venture partner can be held responsible if they break their contracts.

### **3.1.2 Control**

Company's need to influence its operations and decision making in a foreign market need has great effect on which entry mode it should select. The level of control has an important role in company's ability to achieve goals and following the desired concepts in order to achieve competitive advantage and maximize profits. In foreign country operations highest level of control can be achieved by choosing a wholly-owned subsidiary as entry mode and lowest in licensing. Having control over company can carry out strategies, resolve disputes fast when they arise and solve problems rapidly before they cause damages. In the other hand having too much control in the foreign market environment can cause problems if the environment is not familiar and there is lack in knowledge how to operate in the foreign market. High level of control also usually equals high resource commitment; high equity and high overheads. (Chen & Messner, 2011)

### **3.1.3 Resource Commitment**

There are differences how much resources different entry modes require. The amount of resources that needs to be invested varies from almost none with exporting, to small training costs in licensing, to large investments in facilities and employees in wholly-owned subsidiary. (Osland, Taylor, Zou. 2001) Resource commitment is the assets invested to the venture and those assets cannot be reinvested to other uses without loss of value, the resources can be tangible or intangible. Intangible assets are, for example, managerial skills or patents; and tangible resources money or machinery. Resource commitments also set an exit barrier from the venture for example exiting foreign market usually causes costs for example due currency changes or impairment of facilities. (Chen & Messner, 2011)

### **3.1.4 Flexibility**

Flexibility is a factor that needs to be considered when deciding an entry mode. It means company's ability to react to the changing markets and revise their own strategies. Flexibility is important because companies cannot predict what happens in the future, or at least cannot predict all possibilities. With highly flexible entry strategy companies can withdraw from the risky or stagnant markets more easily or penetrate a market further by changing the original strategy faster than it could be done with entry modes that have low flexibility and save considerable amounts of money and time. Due to this high flexibility can reduce loss and improve firm's readiness to avoid risks. Therefore, the variation of flexibility between entry modes should be revised carefully to optimise the selection. (Chen & Messner, 2011)

### **3.2 Combining entry modes**

Selection of certain entry mode can be challenging and many times companies need to combine and/or sequence different entry modes to enter and grow in the new market, in addition of choosing just one. Combining different entry modes can avoid deficiency of an individual entry mode and optimise the entry performance by using best characteristics of multiple modes. Sequencing multiple entry modes can help company to adapt to changing internal and external environments and to achieve better results than a single entry mode. Studies, Chen & Messner (2011), show that when modes are sequenced the transfer usually goes from less risky and resource committed mode to more risk and resource committed, which can be considered to be the most natural and reasonable way. (Chen & Messner, 2011)

Entry modes \ Entry modes	Strategic alliance	Joint venture project	BOT/Equity project	Licensing	Local agent	Representative office	Joint venture company	Branch office	Sole venture company
Strategic alliance									
Joint venture project	←								
BOT/Equity project	←	•							
Licensing	←								
Local agent									
Representative office		↑							
Joint venture company	•	•	•		←				
Branch company	←		•	•		←			
Sole venture subsidiary		•		•		←	↑	•	

Notes: ← Can be changed to • Can coexist with

Figure 1. Transferability and compatibility of each entry mode (Chen & Messner, 2011)

When figure 1 is reviewed it can be noted that strategic alliance is the most compatible entry mode. Entry modes that involve a contract with a partner (e.g. licensing and joint venture) can usually go exist with other entry modes but cannot be changed to other entry modes because of the existing contracts. Representative office has high transferability and compatibility when other entry modes that require investment are not that flexible but can co-exist with other modes. (Chen & Messner, 2011)

In many cases when company is a SME their process of choosing an entry mode is a passive process. It means that the entry mode is not actively chosen by these companies but instead is a result from agreements with their foreign customers and partners such as importers and distributors or the companies are just fulfilment of an individual order. In these cases is no actual choice of an entry mode but instead the entry mode adoption is a passive response to an external stimulus. (Musso & Francioni, 2014)

The impact of cultural distance to the entry mode was researched recently in study made by Gollnhofer and Turkina, (2015). According to the earlier studies high cultural distance cause low resource commitment strategies, such as exporting, licensing and joint-venture because high cultural difference is considered to lead higher perceived risk and that's why companies prefer more flexible entry mode strategies. However, some scholars claim that high cultural distance equals higher risks and companies will choose high risk resource commitment (acquisition and Greenfield investment) to gain control of their investment. (Gollnhofer & Turkina, 2015)

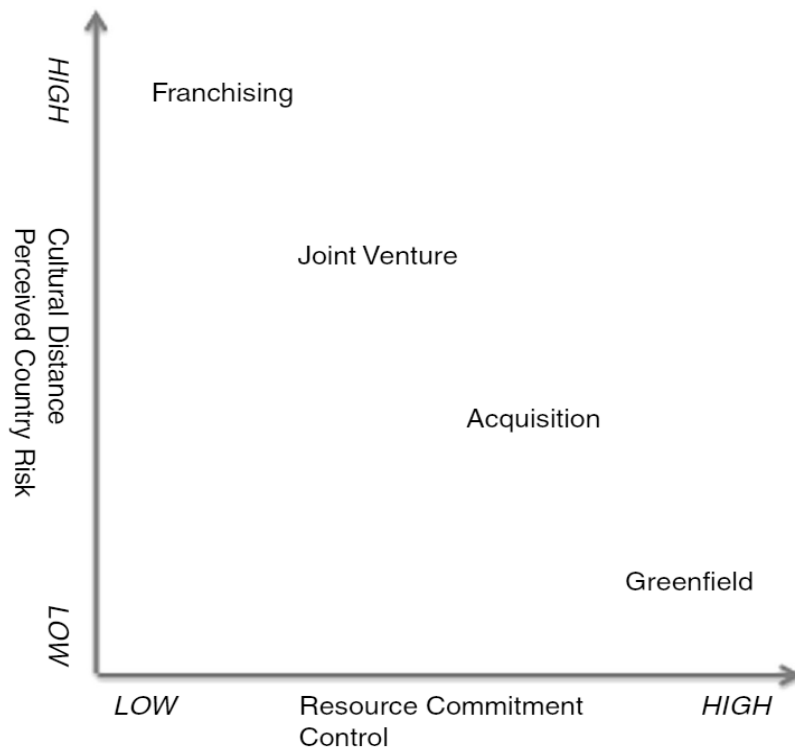


Figure 2. Resource commitment and cultural distance (Gollnhofer & Turkina, 2015)

When figure 2, resource commitment and cultural distance is revised an assumption can be made that high cultural difference makes more difficult to for a company to cope with foreign market and it is expected to choose a lower commitment entry strategy with less capital at stake but the accessibility to local



resources are maximised through local franchise or joint venture company. (Gollnhofer & Turkina, 2015)

### **3.3 Entry modes**

There are various entry modes that a company can use when entering a new market. The traditional entry modes are exporting, licensing, joint venture, acquisition and new wholly-owned subsidiary. These five entry modes mentioned are the traditional ones but more specific classification can be also made. For example, Chen and Messner (2011) identified and defined ten basic entry modes: ,strategic alliance, local agent, licensing, joint venture company, sole venture company, branch office, representative office, joint venture project, sole venture project and BOT/equity project. This study is made from the point of view of a family owned SME so researching the traditional entry modes suits its purpose best in this case excluding acquisition that is fast and efficient way enter new markets but for a Finnish family company buying a Russian company is going to be too expensive, risky and difficult to implement.

#### **3.3.1 Exporting**

Exporting is the most common way to enter a new international market but it is not always considered as an actual entry mode because company does not physically operate in a foreign land. It is also the easiest and cheapest way because there is no need to establish operations in other countries. Only thing that is needed is a good distribution channel. (Hitt, et al., 2005) When target market is very competitive and there are many similar products that can be substituted companies usually favor exporting. Companies feel that using a high control entry mode that would involve more resources is unnecessary because products can be replaced with similar products end users are sensitive to price. Cost and prices are lowest usually in exporting because production and operations are done in fewer locations and that keeps the fixed costs low. (Osland, Taylor, Zou. 2001) Exporting is also a good option when the target market has strong governmental restriction, has different business culture or is otherwise unstable. With just exporting goods a company can avoid

investments risks and contractual risks when it has no investment in the target country.

As a negative side; exporting goods to another country can cause high transportation and custom tariffs. It also effects to the possibility to control the marketing, distribution and customization of the products. The level of customer service is very low when company is just exporting goods to another country. There is not local representative present and face to face communication is not possible most of the time. Delivery times can be also long because of the customs and distance that goods need to travel before they are available for the end user and that can lower customer satisfaction. . (Hitt, et al., 2005)

### **3.3.2 Licensing**

In licensing a company authorizes another firm to manufacture and sell its products, or in distribution network just sell the goods. The company that is licensed will pay royalties from units that are produced and sold. The risk of investments is taken by the licensee so it reduces the risk from the company that is entering a new market. So the risk in using licensing as an entry mode is very small. (Hitt, et al., 2005) Licensing is a good option when the host government does not treat foreign companies equally compared to national organizations. Licensing offers little bit more control in the new market than exporting and local service is also present. Another factor that favors licensing is that investment risk is minimal. (Osland, Charles, Zou. 2001) If company lacks capital but wants to expand to new markets licensing is decent alternative and the lack of capital that can be invested to a new venture is often the main problem in family owned SMEs. In licensing arrangements it is the licensee that contributes the capital to start the business and usually buys the “opening” stock and consulting from the host company that causes money flow in and not the opposite.

Negative attribute of licensing is that the company loses the control over product quality and distribution. Licensing also gives quite low profits and there is always possibility that after the license agreement has expired the licensee

has learned the licensor's technology and competences. (Hitt, et al., 2005) It means that in licensing the technology risk is high because another company is using the name and products or solutions of the host company basically without any supervision. (Osland, Charles, Zou. 2001) If there is similar products in the markets licensee could also try to replace the original product to another one when it has founded its customer base.

### **3.3.3 Joint Venture**

In joint venture two companies start their international operations together and share their resources and risks at the same time. Usually this kind of joint venture involves a foreign company that has the knowledge of local customs, norms and policies. (Hitt, et al., 2005) Joint ventures are often encouraged by the governments in means to local enterprises to acquire technologies and knowledge from the foreign company and some countries even pressure high-tech companies that wish to enter their markets to do so. The local company is not the only one that benefits from the joint venture, company that enters the new markets gets international strategies and experiences. When experience level is increasing firms can invest more capital to the venture with better confidence. (Osland, Charles, Zou. 2001)

Problems may occur when JV partners' ways of doing business or understanding the desired goals differ. (Hitt, et al., 2005) Usually control of the JV is shared according the ownership. When equity ownership is over 50 percent it gives that partner largest number of control. In JV technology risk is also present despite the fact it offers more control over operations that licensing. The partner selection should be done so that both parties of the venture have something to offer. For example, technology and knowledge that another company shares is a good motivation for a developing nation company to establish a JV with develop nation firm, and a good reason for high-tech or experienced company no to choose JV as an entry mode. (Osland, Charles, Zou. 2001) Companies are more willing to set up joint ventures when technology shared is not the type that should be protected. The technology risk

and possibility of losses are lower when core technologies that are critical to a business are not shared.

### **3.3.5 New Wholly-Owned Subsidiary/Greenfield investment**

Founding a new subsidiary is the most costly and complex entry strategy but in other hand it gives to greatest degree of control. Another major factor is that own subsidiary gives the best profits if it is successful. The company also maintains the control over technology, marketing and distribution. Because company is new and probably lacks knowledge from the new markets it has to invest to work force and hiring local experts and consults requires lots of capital investments. (Hitt, et al., 2005) Companies choose WOS when investment risk in the foreign market is low and/or there are not qualified partners available. (Osland, Charles, Zou. 2001) Finding a potential partner is harder if cultural differences between the countries are high because managers of the two countries might have totally different views business etiquettes and ways of doing sustainable business.

One important strategic factor for companies choosing wholly-owned subsidiary (WOS) as entry mode is the change of reacting fast to changing markets and respond quickly to competitors' actions because it has the highest control of the entry modes. Decision can be made fast because there is no need to negotiate with the local JV partner. Starting business operations is also faster with wholly-owned subsidiary than establishing a joint venture where the initial negotiations can take years until agreement satisfies both parties.

Some companies still fear expropriation of assets especially in countries that have unstable political situation. Another fear that organisations have with WOS which requires high resource commitment is hyperinflation and economic crises that can increase investment risks. WOS is a good entry mode when entering stable economies e.g. European Union countries, or at least Norther European countries, and the United States but risks increase when the country or economy is not integrated to the rest of the world.

### 3.4 Conclusion

When company's management has decided to enter new market area, they need to understand the importance of the selection of the entry mode and the different natures of their modal choices. Entry modes differ in terms of the quantity of required resources/investments, flexibility, level of control, and the amount of risks; investment risk or technology risk. These different features of entry modes are related to each other, for example increased control leads to lower technology risk but at the same time requires higher resource commitment. Company that is going international should be able to find the best balance from these features and then decide what entry mode serves them best.

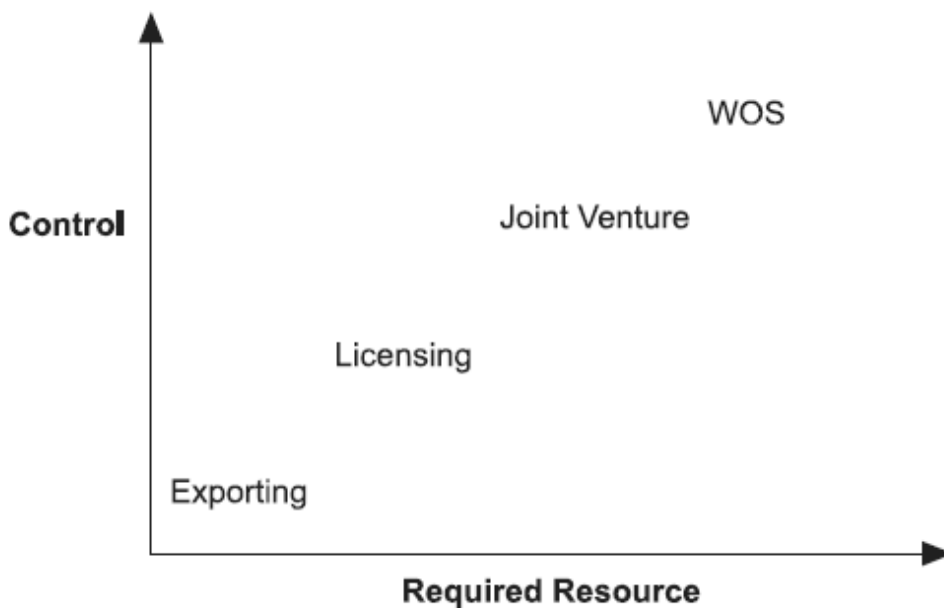


Figure 3. Control vs required resources (Osland, Taylor, Zao, 2011)

In figure 3, Control vs required resources, (Osland, Taylor, Zao, 2001) can be seen how the level of control increases the amount of required resources. The more company is willing to invest to the new venture the more control it gets. Problem with SMEs is that resources are usually the factor that the company is missing and for that reason is force to choose exporting or licensing as an entry mode. Flexibility is also related to the amount of control. Highest flexibility to

react changing markets is in wholly-owned subsidiary because in that entry mode there is not another party to negotiate with but instead the decision can be made inside the company. In exporting and licensing the flexibility is low because the company does not have physical operations and own staff in the local market.

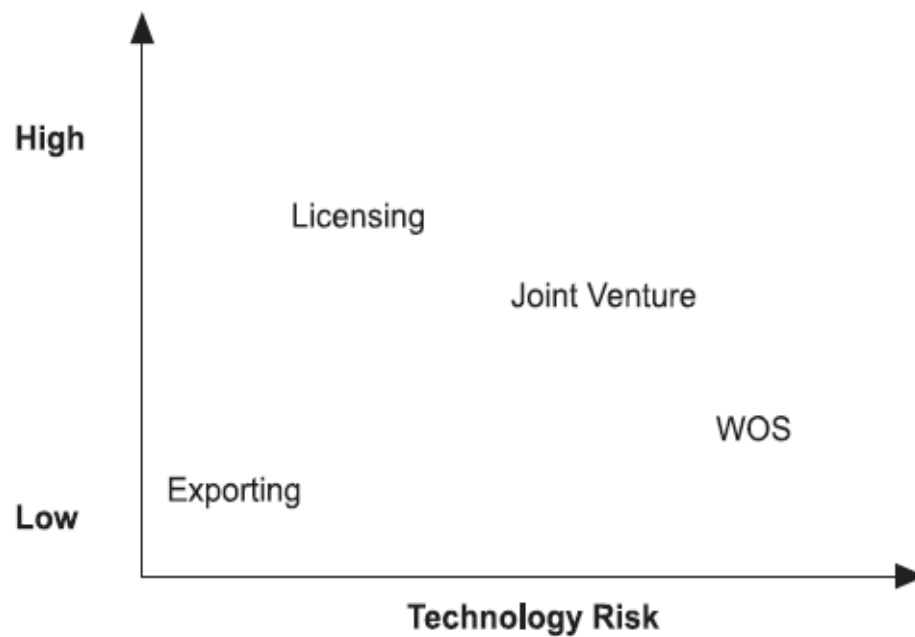


Figure 4. Technology Risk in Entry Modes (Osland, Taylor, Zao, 2011)

Figure 4 Technology Risk in Entry Modes (Osland, Taylor, Zao, 2001) shows that licensing has the highest technology risk because it has very low level of control but still the technologies are given out to the licensee to be used without supervision. Technology risk gets smaller when company's own equity is increasing in the venture. Exporting has the lowest technology risk but in exporting physical operations do not happen in the foreign market. Investment risk does not follow the same pattern as technology risk exposure in the figure 4. Investment risk is highest in the WOS and joint venture because they need the most investments and tangible resources in the new market area.

Even if company has done its research on entry modes and their features, they might not be able to find one right entry mode or company's manager could make a bad decision and choose wrong entry mode from the beginning, or situation in the new market has changed and the original entry mode is not optimum anymore. In these cases entry modes can be changed or combined. All entry modes are not compatible with each other in changing or combining. Entry modes with contract with another party can usually exist with other entry modes but are hard to change because of the agreements. When choosing the entry mode companies should also pay attention to the entry modes compatibility because they might end up to a situation where entry mode needs to be revised or combined. *(Osland, Taylor, Zao, 2011)*

#### **4 Russian environment**

In this part of this paper Russia is studied as an environment in general level and more throughout as a business environment for foreign company. Study's objective is to find out the best way for Finnish SME to enter Russian market so the Finnish perspective is the most important when the foreign business environment is researched.

Recent years, from the 2012 to present, have been politically difficult to the relations between Russia and western world. In the beginning of 21st century Russian seemed willing to get more integrated to Europe both politically and economically, Russia joined WTO and made it easier for other countries to operate in their country. 2013 Russian foreign policy changed and that escalated to Ukrainian crisis that led to sanction and political crisis between Russia and Western countries. Russian domestic policy also took quite many steps back and became very restricted for those who do not fit perfectly to the society and do not agree with the present government. The recent events (Ukrainian Crisis and sanctions) between Russia and western countries have impact on doing business in Russia also for a private company that is exporting

goods from EU to Russia, so they need to be taken in to consideration in this study.

#### **4.1 Russian business environment**

When company makes the decision to enter Russian markets it needs information about the new markets. Problems that Russian environment can cause should be studied before the entry but often all the possible difficulties and regulations cannot be predicted, especially from Russia where regulations and laws can change very fast. These features are learned through experience after operating while in Russian environment.

There are many differences in Russian business and state levels compared to the Western European countries, e.g. Russian laws and regulations, taxation and currency, business culture, corruption, safety of doing business. These different factors should be studied and considered and acknowledged before entering the Russian market.

##### **4.1.1 Laws/regulations and taxation**

Majority of participants in research conducted by Tolvanen (2009) highlighted the importance of having access to the information from recent regulations, taxation and laws. The large amount of business related paper work and slow processing time were also considered to be one of the major difficulties when operating in Russia. (Tolvanen, 2009)

The turning point of Russian business environment from the legal point of view was the law on enterprises and entrepreneurship passed on the 25<sup>th</sup> December 1990 that allowed a freedom of occupation and profit-seeking as the target for businesses. (Dickinson, 2004) Law passed on the 1990 was a step forward and it made it possible for people to start their own businesses and seek profit in Russia, and it made Russia a potential and possible country for a foreign investors.



Even after the law on enterprises and entrepreneurship was passed 1990 and abolished in 1995 it seemed that Russia had set the key pieces of legislation affecting to the freedom of businesses right. In reality citizens and entrepreneurs have no real protection and rights before the law and they are not treated equally. Operations of companies that act legally in the eyes of the law can still be restricted by individual governmental or municipal agencies that are legally authorized to inspect and regulate small businesses. These agencies can be, for example licensing office, police, fire department, building inspectorate, health inspectorate, tax inspector, tax police, consumer rights office and the environmental protection committee. (Dickinson, 2004, 23) With the large number of different agencies company's operation can be put to a halt without any legal justifications by overburdening it with inspections and false results. Even if in 2001 president Putin pushed through legislation which restricted each agency to inspect business ones in two years at the most but when inspections can last up to 2 months and there are multiple agencies the burden for businesses is still immense. (Dickinson, 2004, 23)

Property rights in Russia were set in Civil Code of 1995. It stated that owner of the property may do anything in relation to the property that is legal in the law-wise. The right to own, use, dispose and inherit property is protected by the law and it also applies to foreigners. When law is interpreted it can be said that purchasing land for commercial purposes should be safe in Russia. (Dickinson, 2004, 25) Limitations for foreigners' ownership of land is set in 2001 Land Code which gives the right to purchase land only in urban environment that is only 2% from Russian territory. Civil Code of 1995 limits and sets the rules for a termination of the ownership, for example in situations where state has interests in the property or land it stands. State interests can be related to military issues, security of the country, energy, transport, space, cultural, telecommunications and historical heritage. (Dickinson, 2004, 25) When considering Russian state's passed and resent actions or practices of interfering to the private business sector, and the various reasons mentioned above that allows them to seize property, it can be said that foreign ownership is not as safe that the written laws may imply. For example, a scenario where state officials are finding

something historically and culturally significant from the ground that an unwanted foreign business has its commercial building on is not hard to imagine.

As a conclusion from the laws considering entrepreneurship and property rights in Russian can be said that the Russian state has still the power to monitor and regulate all the businesses inside their region. State has left various loop holes to the laws and regulations that allows it to seize or prohibit ownership and prevent companies from doing business if they see it necessary. These uncertainties make it risky to invest Russia and forces at least smaller companies to seek other options than owning its own facilities in Russia.

#### **4.1.2 Currency and banking sector**

In the first years after Soviet Union collapsed in 1990 the RUB exchange rate appreciated strongly against Western currencies and it caused increase in import. In 1998 the currency exchange rate of RUB depreciated strongly and it increased the exports of Russian goods. It also made Russia more interesting market for foreign investments. (Tiusanen, 2007) When a country's currency rate is deprecating it makes that country's goods more competitive abroad (Riad, Cool, Goddard, Khambata, 2006) but importing goods from abroad from country that uses different currency is more expensive; and when country's currency is appreciated the competitiveness in imports and exports are opposite.

After the 1998 the price of oil has increased until the year 2014 when it started to decrease. Increasing prices in oil between 1998 and 2014 brought profits to Russian export sector; it also stabilized the currency rate of Ruble. (Tiusanen, 2007, 21) Russia is relatively small economy in world scale and it is the only country that uses Ruble as currency. Russian exports are depending on oil and it makes their economy quite vulnerable to the changes in oil prices. In year 2013 71, 4% from Russian exports were from fuels and mining products. (World Trade organization)

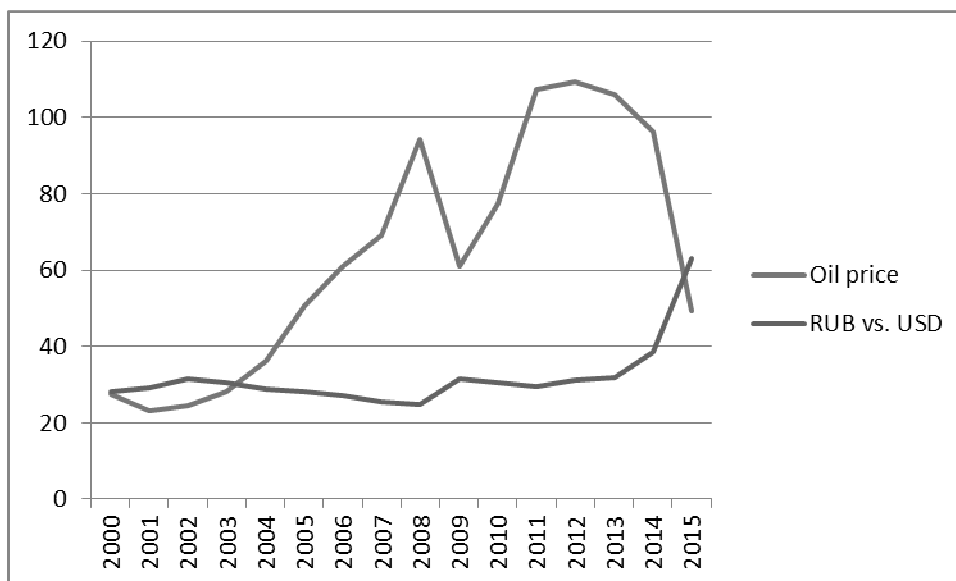


Figure 5: RUB exchange rate to USD vs. oil price (Statista, 2015) RUB in USD (Usforex, 2015)

When RUB exchange rate and oil prices are compared together a clear pattern can be seen how the oil price affects the value of Ruble. When oil and gas export prices increase it affects Russian currency and causes Ruble to appreciate and it makes other products from different industry sectors to compete worldwide. Other reason for Ruble crisis of 2015 was due the Ukrainian crisis and the sanctions set by western countries. (Usforex, 2015)

Commercial banks have been permitted since 1988 in Russia and 5 years after 2000 private banks had started operating in Russia market, but in the 90s only minority of them met the Western banking standards. The credit market was in the hands of state banks so monetary policy was heavily politicized. It was hard to find background information about enterprises which made assessing credit risk problematic. (Dent, 1994, 19) Studies show that Russian banking sector has improved significantly when Russia became more integrated to the world's economy. (Tolvanen, 2009, 15) Earlier studies from the improved Russian banking sector do not take in to consideration the 2014 crisis.

### **4.1.3 Business culture**

Most western people recognize Russian business culture as corrupt, bureaucratic and non-transparent. When in Western Europe the key is to create a sustainable business in Russia the goal is to make fast profits. (Tolvanen, 2009) In Russian business environment paper work is in important role but the contracts are not always honored.

Business culture in Russia is hierarchal than in Western Europe. Managers are not usually questioned and employees own ideas are not brought up as often. Even if in Russia team thinking and working is common and encouraged the teams do not work without a person in charge. (Tolvanen, 2009)

Russian business is focused on networks, finding reliable and right partners are the key issues. The partner network works as an information hub that enables sharing information in the market and it minimizes the risks when company is operating with partners that are honest and their actions transparent which is even more important with government officials. Personal relationships are also very important in Russia. (Tolvanen, 2009)

Finding qualified and loyal personnel is a challenge in Russia and long term employees are rare and mostly driven by money. In Finland employees motivation to work is affected other factors than just salary, in Russia the motivation and loyalty is driven by money. The salary levels are increasing rapidly in the major cities and skillful persons are not interested working in smaller towns. (Tolvanen, 2009)

### **4.1.4 Easiness of doing business in Russia**

World Bank Group measures the easiness of doing business and gives a country a ranking according the results from different areas. In 2014 Russia was place in place 62. (World Bank, 2014) When Russia became part of the WTO in 2012 the ranking was 120. (Kosonen, 2011) Joining the WTO improved the easiness of doing business in Russia significantly.

Factors that have effect on the easiness of doing business are, for example, the number of permits and the procedures obtaining them, government legislation and involvement, and access to credit. (Kosonen 2011, 2)

TOPICS	DB 2015 Rank	DB 2014 Rank	Change in Rank
Starting a Business ✓	34	58	↑ 24
Dealing with Construction Permits	156	172	↑ 16
Getting Electricity	143	141	↓ -2
Registering Property ✓	12	17	↑ 5
Getting Credit	61	55	↓ -6
Protecting Minority Investors	100	97	↓ -3
Paying Taxes	49	48	↓ -1
Trading Across Borders	155	154	↓ -1
Enforcing Contracts	14	14	No change
Resolving Insolvency	65	62	↓ -3

*Table 2: Doing business in Russia (World Bank Group)*

TOPICS	DB 2015 Rank	DB 2014 Rank	Change in Rank
Starting a Business	27	22	↑ -5
Dealing with Construction Permits	33	33	No change
Getting Electricity	33	33	No change
Registering Property	38	27	↓ -11
Getting Credit	36	30	↓ -6
Protecting Minority Investors	76	75	↓ -1
Paying Taxes	21	20	↓ -1
Trading Across Borders	14	14	No change
Enforcing Contracts	17	16	↓ -1
Resolving Insolvency	1	1	No change

*Table 3. Doing Business in Finland (World Bank Group)*

In addition to the bureaucratic regulations the fluency of business in Russia is affected by other factors such as availability of resources and the regulations in practice. According the study (Global Federation of Competitiveness Councils, 2011) most problems of SMEs operating in Russia were related to market situation, human resources and difficulties in receiving credit. Smaller problems were dishonest competition, corruption and regulatory requirements. These smaller problems were not considered as significant individually but those were often related to each other and so causing difficulties. The results can be interpreted so that for example corruption was not considered as a problem because it is that deep in the society that it is taken as normal way of doing business. (Kosonen, 2011, 10)

Majority from all the problems that Finnish export companies face in international markets are related to Russian exports (42% in 2010). It can partly be explained with the fact that Russia is the most significant trade partner to Finland but Russia has also more trade barriers than most of the other export countries. Experiences of Finnish companies are similar than general studies made from Russian market environment. According the barometer by Registered Association Finnish-Russian Chamber of Commerce (2014), the difficulties are found in custom procedures, which include inconsistency, unpredictability, slowness and changes in practices. Technical problems mentioned in the barometer study high custom tariffs, and various document and certificates required.

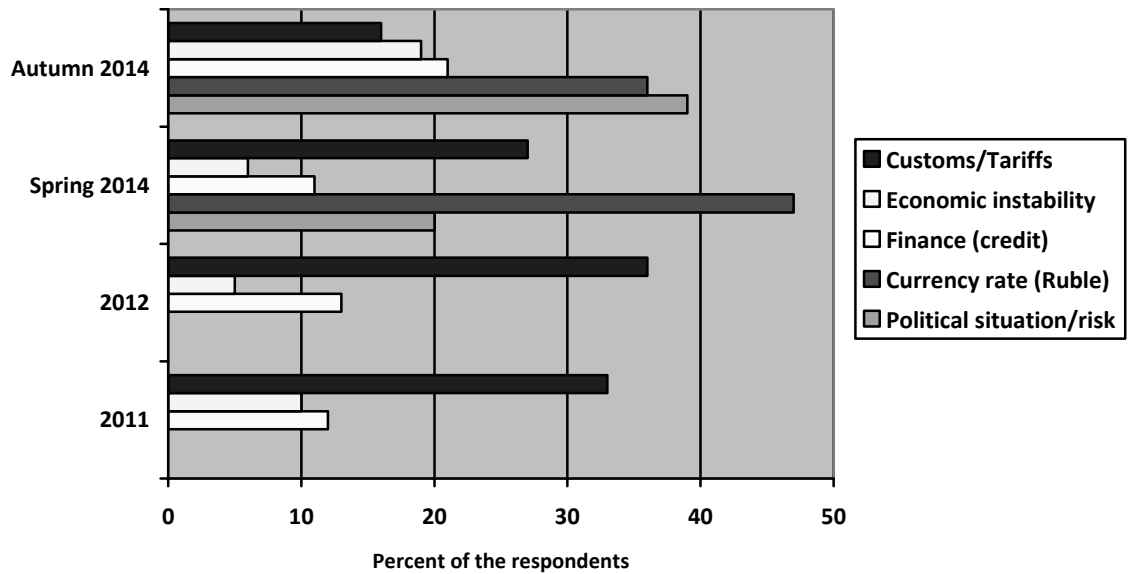


Figure 6. Biggest problems in exporting to Russia (Association Finnish-Russian Chamber of Commerce, 2014)

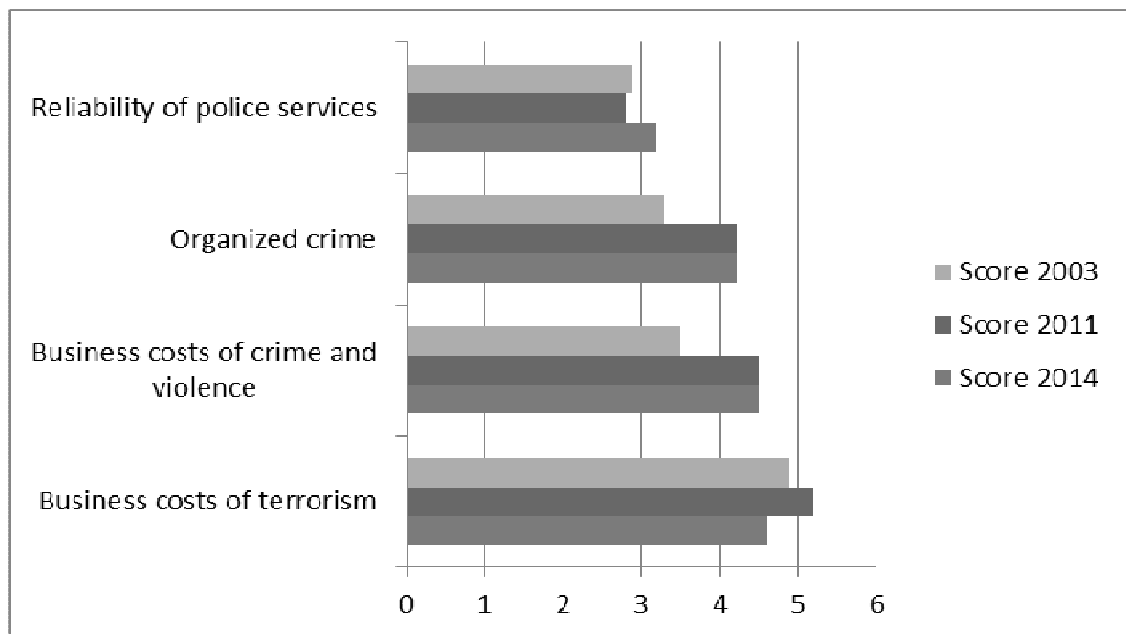
“Problems in exporting to Russia” -chart clearly shows that the targets of concern have changed during the year 2014 from bureaucracy related issues to political and monetary factors. This can be explained with the current events in Ukraine, political assassinations and threatening political environment in Russia, economic sanctions set by western countries and the weak ruble. Bureaucracy and resource related problems have been decreasing since 2012 and the focus has been changed towards political and economic problems. This can be explained with the Russia’s WTO membership or the other option is that nothing has changed but bigger and more serious concerns have come up and replace the old ones.

#### 4.1.5 Safety of doing business in Russia

Security and safety risks have been changed a lot from the Soviet times to current Russian Federation. Risk factors have moved from the organized crime and extortion to organizations’ internal security risks such as misuse of funds or treachery. Despite the improvements in safety hostile or aggressive takeovers are still a threat for the SMEs. (Kosonen, 2011, 13)

	Rank 2014
Business costs of terrorism	104
Business costs of crime and violence	70
Organized crime	101
Reliability of police services	114

*Table 4. Global Competitiveness Index 2014-2015, Security in Russian Federation from the 144 countries studied (World Economic Forum)*



*Figure 7. Russian Competitiveness Index, Security (World Economic Forum) Competitiveness Index, Security, scale 1-7 (7=best)*

When safety and the costs of safety in Russia are compared to other countries in the world, and especially to those that are interesting for foreign investors, Russia is lacking in competitiveness when it comes to security. Russia is ranked from 144 countries scored in 2014 - 2015 by the World Economic Forum to place 70 – 114 depending on the area. When current results are compared to the results from the early 2000 there are major improvements in most of the areas but recent development has been stagnating or even negative; increase



in the threat of terrorism can be explained with the current events in Ukraine. One area that has not improved much and is still in the worst 25% in the world is the reliability of the police. (*World Economic Forum*)

Security risk caused by organized has decreased a lot during last 10 years and even more from the 1990s, when it was part of companies everyday actions. The most common form of crime at first was demands of protection money from security services and, after that, when organized crime organization came part of the everyday business they started also to offer services in collecting debts and as contract enforcers. When 1992 Russia legalized private security providers many criminal organizations went legit and started offering security services as registered companies. In the beginning of 21<sup>st</sup> century 75-80% from the security companies was estimated to have connections to organized crime. In the recent years the situation has changed and only 3-5% of the companies have criminal background and most of them operate under FSP or police, and the managers have background from these state organizations. (Kosonen, 2011)

Takeovers are a risk in Russia and they are usually conducted by company's Russian employee or some other person that is working closely with the company. Takeovers can happen because company's owners are usually located in their original home country and they have Russian manager that has right to write company's name and has the responsibility from the Russian businesses. This trusted manager can move the company from its real owners to himself or to a third party. The crime is very hard to prove because the person had the right to write company's name. Another and more common way to takeover business in Russia is to start another similar firm and move the clients and operations to it from the foreign owned company. Because of these risks companies should stay in control in their foreign business and not give one local person too much power over the business. (Kosonen, 2011)

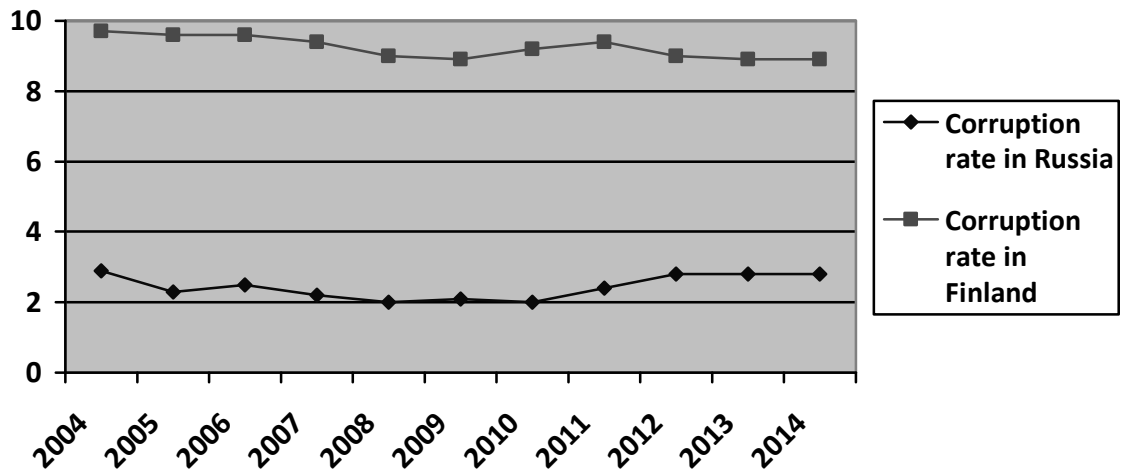
#### 4.1.6 Corruption

Discussion about corruption has been increasing in governments and organizations. Clear bribery is considered to be wrong in most countries but it still exists even in low corruption states in the form of misuse of power to gain benefits. Russia is a country where corruption is recognized to exist and play major role in business environment. (Karhunen & Ledyeva, 2011, 1)

In 2014 Russia was ranked in Transparency International's world's corruption chart in place 136. Russia was in same level as countries such as Iran, Nigeria and Lebanon.

RANK	COUNTRY	2014 SCORE	2013 SCORE
136	Iran	27	25
136	Kyrgyzstan	27	24
136	Lebanon	27	28
136	Nigeria	27	25
136	Russia	27	28
142	Comoros	26	28
142	Uganda	26	26
142	Ukraine	26	25
145	Bangladesh	25	27
145	Guinea	25	24

*Tabel 5. Corruption Perceptions Index 2014 (Transparency International, 2014)*



In the chart values 0 (0 = highly corrupted) – 10 (very little corrupted)

*Figure 8. Russian and Finland, corruption rating 2004 – 2014 (Transparency International, Corruption Perception Index)*

When easiness of doing business in Russia improved when it became a member country of the WTO, the amount of corruption did not. It has stayed in the same level past 10 years. When charts above are revised it can be said that corruption has played a major role in Russia and it is deep in the society. It also seems that corruption is not decreasing or disappearing from Russian business culture any time soon.

In Russia corruption takes also many forms but for a foreign company operating in Russia the most common form is the public sector corruption. Russia is an example of a country where corruption is present everywhere but is disorganized. Bribes are collected by different officials from different governmental levels from individual police officers to high ranking state officials. (Karhunen & Ledyeva, 2011) The most typical forms of corruption that Finnish company encounters in Russia are the official authorities bribes related to speeding up processes with unofficial payments, inspection fees or questionable fines or other monetary sanctions. (Kosonen, 2011) The complexity of bureaucracy is one of the main reasons for business related corruption. Giving the officials bribes will speed up the processing time and rules or regulations can be bent with monetary compensation to a right person.

In Russia business to business kickback money is common and often needed to close deals. (Kosonen, 2011)

According studies made by Transparency International Russians images from the corruption in Russia improved. It seemed that during Vladimir Putin's first presidency corruption decreased and Russian people were optimistic that the trend will continue but from the 2004 the optimism started to decline. In 2010 the situation was even worse than in 1996 when the Transparency International made their first poll. Vladimir Putin stated in the first years of 21<sup>st</sup> century that corruption will be attacked in Russia but after 10 years companies have experienced the corruption to return to "normal" or worse than during president Boris Jeltsin's time. (Kosonen, 2011)

#### **4.1.7 Ukrainian Crisis and Consequences**

The crises started when European Union and Russia both tried to achieve the economic influence in Ukraine 2013 and when the current president that favored Russia rejected EU agreement. The rejection of the agreement led to an internal political crisis and violence because Ukrainian people wanted get more integrated to the Europe and the Russian citizens living in Ukraine or Ukrainian people with Russian background wanted Ukrainian state to move closer to Russia. The conflict and violence eventually forced president Janukovyč to resign in February 2014. Russia reacted by occupying Crimea using military force and that expanded the crisis from internal to international. Conquering of the Crimea was bloodless but crises escalate to war in East Ukraine where Russian separatists that were supported and instigated by Russian state. (Yle, 2015) Russia's actions in Ukraine during the crisis made Western countries to set economic sanctions against Russia on and more sanctions are considered because there is no solution in sight after one year from the first sanctions set in March 2014, and Russia seems to get even more involved to the war. (European Council, 2015)

Sanctions that were set by EU and other Western countries since March 2014 were diplomatic and economic. Diplomatic actions led to the cancellation of the

EU – Russia summit, EU countries did not take part G8 meeting in Soči but instead held their own G7 without Russia. EU countries suggested that negotiation from Russia's change to join the OECD and to the International Energy Agency will be suspended; also the negotiations concerning visa and any other agreements between Russia and EU will be put to hold. Economic sanctions were focused against Russian state and individual citizens. 150 persons' and 37 organizations' funds outside Russia were frozen and travel bans enforced. Economic sanctions set to Russian state or industry sectors were prohibition for certain Russian financial institutions, energy and military sector to operate in EU market. Export and import of weapon grade material was banned and limitation of Russia industry to use certain technology related to oil industry. European Investment Bank was also asked to suspend new finances to Russia. (European Council, 2015)

#### **4.2 Finnish SMEs entry to Russian market**

After the decision to enter new markets one of the first steps is to decide the entry mode and for that decision information about the possibilities is needed. Tolvanen, 2009, in her study targeted mainly large organizations that operated in Finland, and most of them started their business in Russia by buying an already existing Russian company. Using agents at first and then starting own company was another popular way to entering Russia. The difference between large organizations and SMEs entering Russian markets was that when larger companies started their own subsidiaries in the new market smaller companies operated from Finland. The similarity was that both MNEs and SMEs favored using agents at first. (Tolvanen, 2009, 14) Using agents is the easiest way to start exports because they are already familiar with the new market, they often export the goods and when they purchase goods to themselves before hand and after that intermediate those to the end user it involves little or none credit risks.

Corruption and corruption distance (how corrupt the investor's home country is compared to the host country) also affect to the entry mode decision. (Karhunen & Ledyeva, 2011, 3) In this case corruption distance between countries is very

high, Finland ranked in place 3 and Russia in place 136. (Transparency International 2014) When the corruption distance is high companies usually choose to enter new markets with joint venture over a wholly-owned subsidiary. There is a benefit of having a local partner that has knowledge from the new market area including corruption practices. (Karhunen & Ledyeva, 2011, 4) The corruption laws of the home country also have affect to the entry mode strategy. Anti-corruption laws usually prohibit local businesses from taking apart in any corrupt activities. (Karhunen & Ledyeva, 2011, 6) These laws also encourage to finding a partner in the new host country that these laws do not apply or in most cases they are not enforced.

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