

SATAKUNNAN AMMATTIKORKEAKOULU
SATAKUNTA UNIVERSITY OF APPLIED SCIENCES

Anna Tulinen

FACING THE CHALLENGES IN EXPORTING TO RUSSIA

SCHOOL OF BUSINESS RAUMA

Degree Programme in International Business and Marketing Logistics

2007

TIIVISTELMÄ

VENÄJÄN VIENNIN HAASTEIDEN KOHTAAMINEN

Tulinen, Anna
Satakunnan ammattikorkeakoulu
International Business and Marketing Logistics
Liiketalouden Rauman yksikkö
Tammikuu 2007
Tanhua, Daniela
Sivumäärä: 85

Avainsanat: kansainvälinen kauppa, vienti, Venäjä

Opinnäytetyön aiheena on Venäjän viennin ongelmien tutkiminen. Työ pitää sisällään teoreettisen osuuden, jonka pohjalta empiirinen tutkimus on tehty. Tarkoituksena oli selvittää minkälaisia ongelmia pienet ja keskisuuret suomalaiset yritykset kohtaavat viedessään tuotteitaan Venäjälle. Venäjän WTO-jäsenyysneuvottelut ovat loppuvaiheessaan ja työn tarkoituksena on myös eritellä niitä etuja, joita tuo jäsenyys saattaa tuoda mukanaan Venäjän kauppaa käyville yrityksille.

Teoreettinen osuus kuvailee kansainvälistä kauppaa ja vientiä. Osassa, joka käsittelee kansainvälistä kauppaa, kuvaillaan lyhyesti kansainvälistä markkinointi ympäristöä sekä luetellaan kansainvälisen kaupan esteet ja ne syyt, joiden mukaan valtiot pyrkivät estämään kansainvälistä kauppaa. Kappaleen loppu keskittyy käsittelemään logistiikan tärkeyttä ja ongelmia kansainvälisessä kaupassa. Viennin osuudessa käsitellään viennin peruskäsitteitä sekä kansainvälisen kaupan dokumentaatiota ja tullin roolia. Viitekehys yhdistää nämä teoreettisen osan elementit.

Opinnäytetyön empiirinen osa on tehty kvalitatiivisena tutkimuksena. Tutkimusta varten haateltiin viittä pientä tai keskisuurta länsisuomalaista yritystä, joilla on kokemusta Venäjän viennistä. Näiden haastattelujen tarkoituksena oli löytää konkreettisia ongelmia, jotka haittaavat tai hidastavat yritysten Venäjän vientiä. Lisäksi haateltiin Suomalais-Venäläisen Kauppakamarin (SVKK), Ulkoasianministeriön, Suomen kuorma-autoliiton (SKAL) sekä tullin edustajia, jotta saataisiin mahdollisimman paljon taustatietoa Venäjän markkinoiden tämän hetkisestä tilanteesta, Venäjän mahdollisesta WTO-jäsenyydestä sekä ongelmista Venäjän tullin ja logistiikan kanssa.

Tutkimustuloksista käy ilmi, että vaikka kauppapoliittinen tilanne ja poliittisten päätösten ennakoitavuus Venäjällä on huomattavasti parantunut, suomalaiset yritykset pitävät Venäjän kauppaa edelleen paljon ongelmallisempuna kuin muiden maiden kauppaa. Tullaus, tullimenettelyt, raskas dokumentaatio ja tullihenkilöiden arvaamaton toiminta ovat suurimpia ongelmia Venäjän viennissä ja haittaavat suomalaisten yritysten Venäjän vientiä päivittäin. Tästä näkyvät seuraukset mm. itärajan pitkissä rekkajonoissa, jotka edelleen aiheuttavat lisäongelmia yrityksille esimerkiksi vapaiden rekkojen saatavuuden heikkenemisenä.

ABSTRACT

FACING THE CHALLENGES IN EXPORTING TO RUSSIA

Tulinen, Anna
Satakunta University of Applied Sciences
Degree programme in International Business and Marketing Logistics
School of Business Rauma
January 2007
Tanhua, Daniela

Keywords: International trade, exporting, Russia

The purpose of this study is to identify the specific and concrete logistical problems that small- and medium sized enterprises face as they export their manufactures to Russia. Another aim is to name some of the benefits achieved from Russia's future membership to WTO that might ease exporting to Russia.

The theoretical part of the thesis discusses the topics of international trade and exporting. The international trade part explains the fundamentals of the international business environment and identifies the trade barriers and the reasons why the governments choose to intervene with international trade. The end of the chapter concentrates on discussing the importance and problems of logistics in international trade. The chapter about exporting clarifies the fundamentals of exporting and discusses the requirements for documentation and the role of the customs in international trade. The conceptual framework combines these approaches.

The empirical part of the thesis has been conducted by using the qualitative research method. The data was gathered by interviewing the representatives of five small- or medium sized enterprises that have some experience in exporting to Russia. Additionally, the representatives of the Finnish Russian Chamber of Commerce, Ministry for Foreign Affairs of Finland (SVKK), Finnish Transport and Logistics (SKAL), and customs were interviewed. The aim of these interviews was to gather as much background information as possible of the Russian current business environment and market situation, as well as the problems with Russian customs and logistics and how Russia's accession to WTO could improve these.

The research results indicate that although the trade policy and market situation has improved in Russia, Finnish exporters still face a lot of problems as they export their products to Russia. They still perceive Russian trade more problematic than trade with others. The greatest problems are perceived to be the high rates of customs duty, the customs procedure, heavy requirements for documentation and the unpredictable actions of the individual customs officers that hinder and delay the deliveries of Finnish exporters daily. The causes of these problems can be seen, for example in the long queues on the frontier that further hamper the exporting, among other things by decreasing the availability of free trucks.

TABLE OF CONTENTS

1 INTRODUCTION.....	6
2 INTERNATIONAL TRADE.....	8
2.1 The International Environment-----	8
2.1.1 Political Environment.....	8
2.1.2 Economic Environment.....	11
2.1.3 Sociocultural Environment.....	13
2.1.4 Technological Environment.....	15
2.1.5 Ecological Environment.....	15
2.1.6 Legal Environment.....	16
2.2 Factors that Encourage International Trade-----	17
2.3 Barriers to International Trade -----	19
2.3.1 Tariffs.....	20
2.3.2 Subsidies.....	20
2.4 Rationales for Trade Intervention-----	21
2.5 International Trade and Logistics -----	22
2.5.1 International Distribution Channels.....	24
2.5.2 International Transportation.....	24
2.5.3 Logistical Problems in International Trade.....	26
4 EXPORTING.....	29
4.1 Fundamentals of Exporting -----	31
4.2 Incoterms -----	34
4.3 International Transport Documentation -----	35
4.3.1 The Key Contracts Related to Export Transactions.....	36
4.3.2 Shipping Documents.....	37
4.4 Export Risk Factors -----	38
4.5 Customs -----	42
4.5.1 Amount of Duty.....	42
4.5.2 Country of Origin.....	43
4.5.3 Bonded Warehouses.....	44
5 PURPOSE OF THE STUDY AND CONCEPTUAL FRAMEWORK.....	45
6 RESEARCH METHOD.....	47
6.1 Basic Paradigm: Quantitative versus Qualitative Research-----	47

6.2 Data Gathering-----	48
6.3 Data Analysis -----	49
6.4 Quality Assessment of the Study-----	51
7 RESEARCH FINDINGS	52
7.1 Interviewed Associations and Companies -----	52
7.2 PESTEL-Analysis of Russia-----	53
7.2.1 Political Environment.....	54
7.2.2 Economic Environment.....	55
7.2.3 Sociocultural Environment.....	56
7.2.4 Technological Environment.....	58
7.2.5 Ecological Environment.....	59
7.2.6 Legal Environment.....	59
7.3 Challenges in Exporting to Russia -----	60
7.3.1 Challenges in the Customs	60
7.3.2 Transportation and Traffic to Russia.....	65
7.3.3 Infrastructure in Russia	67
7.3.4 Distribution Channels in Russia.....	68
7.4 WTO and Russia -----	69
8 CONCLUSION AND RECOMMENDATIONS.....	71
BIBLIOGRAPHY	74

1 INTRODUCTION

This study discusses the specific and concrete challenges small and medium-sized enterprises face as they export their products to Russia. Identifying these challenges may help the companies to be prepared with them. Knowing these problems in advance might also contribute to new methods of circulating the problem areas or to improve them at such. An additional consideration in the study is given to the Russia's future accession to WTO and the benefits Finnish companies could gain from that accession.

The volume of export activity in the world economy is increasing as exporting has become easier. The gradual decline in trade barriers under the umbrella of General Agreement on Tariffs and Taxes (GATT) and World Trade Organisation (WTO) along with regional economic agreements such as the European Union (EU) has significantly increased export opportunities. At the same time, modern communications and transportation technologies have reduced the logistical problems associated with exporting. Consequently, it is no longer unusual to find small companies that are thriving as exporters.

In 2004, the volume of merchandise trade exports rose by 9 per cent, the highest performance since 2000. This acceleration is derived from the dynamic performance of trade in manufactures, which expanded by 10 per cent, or twice as fast as in 2003.

(WTO, 2005)

Russia's gross domestic product is expected to increase 6 percents by the year 2010. This means that the imports in Russia are increasing on an average 10 percent annual rate. The exports, however, are much bigger in Russia, which enables rapid increase of imports for many years. The imports are expected to increase mainly on the field of machinery, devices and transport vehicles. The imports of raw materials and industrial semi finished products are also expected to increase rapidly. (Hernesniemi, Auvinen & Dudarev, 2005, 72)

This forecast is optimistic but it is in accordance with the forecast of the Ministry for Economic Development and Trade of the Russian Federation, as well as with the forecast of International Monetary Fund (IMF). The risks in the forecast are: the collapse in the world prices of oil; tightening of the Russia's internal situation; and the weakening preconditions of the firms' operations if the relations between the politics and the economy tighten. For Finnish exporters the rapid economic growth in Russia is a huge opportunity. They have good possibilities of retaining their share of the growth in Russia's imports, meaning that Finnish exports to Russia could increase on 10% annual rate. (Hernesniemi et al. 2005, 72) Pekka Sutela, the head of the research institute of transition economies in The Bank of Finland states that the indisputable prospects of Russian markets overcome the possible risks. He also says that the proximity of Russia, Finland's good reputation as a reliable supplier and the long history between our countries are great references for Finnish firms operating in Russian markets. (Nousiainen, 2004)

At the moment Russia is the biggest export partner of Finland with the share of 11% of the total exports in 2005. The increase from the year 2004 was enormous 32%. (Tulli, 2006) However, according to the calculations of Sitra at least a quarter of this increase are actually re-exports, meaning that the revenues of these exports go to other countries exporting via Finland. But even excluding re-exports, Russia has been the fastest growing export market for Finland. (Ollus & Simola, 2006) The share of the small and medium size enterprises (SME) of the Russian trade has been increasing in the recent decades. In 2004 82% of the enterprises exporting to Russia were SMEs and their share of the total value of the exports the same year was 29%. (Ollus, 2006)

Despite all of these prospects and improvements in the Russian markets, media is full of news about problems exporters face in Russian markets. The main purpose of this thesis thus is to discover the challenges SMEs are facing as they export their products to Russia. The additional goal is to find out some of the benefits these exporters can achieve by the future accession of Russia to the WTO. I will begin by examining some of the basic fundamentals of international trade in general and then concentrate more closely on exporting in particular.

2 INTERNATIONAL TRADE

International trade is the exchange of goods and services across international boundaries. International trade has been a major driver of global growth and prosperity over the last decades. As trade has expanded, global incomes have grown. Open economies have been able to use the power of trade to increase competitiveness and productivity, helping improve living standards and sustain economic growth.

2.1 The International Environment

As companies move away from their domestic markets the scope of the environment where they operate expands dramatically. It is clear that in this vast environment the number of opportunities and risks, that might influence the company, is multiplied. In order to get a thorough image of the opportunities and risks in the particular market the company is about to enter, careful research and analysis of the new environment must be conducted. One recognised approach to reviewing and evaluating the impact of the external environment is to undertake PEST analysis. PEST analysis is a framework that categorizes environmental influences as political, economic, social and technological forces. Sometimes additional factors, ecological and legal, will be added to make a PESTEL analysis. (Morrison, 2002, 23-24) It is clear that scanning and evaluating the external environment is crucial before entering the foreign market, but the analysis must be continuous in order to be aware of the changes in the market during the operations as well.

2.1.1 Political Environment

Political systems can be assessed according to two related dimensions. The first is the degree to which they emphasise collectivism as opposed to individualism. The second

dimension is the degree to which they are democratic or totalitarian. Finland is considered to be both an individualistic and a democratic country, whereas Russia surely is more collectivistic, and although the way of the country is on democracy, many of its institutions still lack democratic perspective. (Hill, 2004, 46-49)

The type of government in different countries gives significantly different conditions. Practices that are accepted in one country may be unacceptable in a neighbour. (Waters, 2003, 339) This fact leads to political risks that can be classified into two broad categories, macropolitical and micropolitical. Macropolitical risks potentially affect all firms in a country, as in the case of war or sudden changes of government. Such risks may even result in expropriation or confiscation, where governments seize the assets of the company without compensation. Higher general levels of taxation might adversely affect the company, as might security risks related to terrorism, etc. One important factor is the level of corruption in the country: in some countries it is very likely that businesses hoping to operate in the local markets are forced to pay and bribe authorities in order to gain access to the markets. Transparency international (IT) is an international organisation that measures annually approximately 100 countries' level of corruption. In 2005 Russia ranked 126th with a rate of 2,4 out of 10. (IT, 2005) Micro political risks within a country affect only specific companies, industries or types of venture. Such risks may take the form of new regulations or taxes imposed to specific types of businesses in the country. (Wall, 2004, 136)

Some governments positively encourage international trade while others may create a whole web of restrictions and bureaucracy, hindering the international transactions. Typically, customs duty is payable whenever materials enter a country. These are not the only costs of crossing a border, as companies have to pay the cost of compliance with export/import regulations, such as compulsory documentation and information requirements. (Waters, 2003, 341-342, see also Rugman & Hodgetts, 2003, 145-148) Tariffs, quotas and other instruments of trade policy as well as the role of the customs in international trade will be discussed later on in this thesis.

Regional groupings of countries have been emerging and increasing in the past centuries. Finland's political life is largely bound to the EU, and the decisions made in the Finnish political, economic and legal systems must be in line with the rules and

regulations of the EU. Not only is Finland bound to the EU but it is also bound to the agreements signed in the WTO and many other international organisations Finland is a member to.

The WTO today, is the only global international organization dealing with the rules of trade between nations. WTO has 149 members and a long list of countries in accession process, including the Russian Federation. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help exporters and importers conduct their business. WTO is a place where member governments can try to solve the trade problems they face with each other. (WTO, 2005)

WTO agreements provide the legal ground-rules for international commerce. They are contracts binding governments to keep their trade policies within agreed limits. The agreements fall into a simple structure with six main parts: an umbrella agreement that is the Agreement Establishing the WTO; agreements for each of the three broad areas of trade that the WTO covers (goods, services and intellectual property); dispute settlement; and reviews of governments' trade policies.

As this thesis deals with tangible products, I will concentrate on explaining the agreement for the largest area, physical goods, which has a common three-part outline. It starts with broad principle, namely the key treaty of WTO: the General Agreement on Tariffs and Trade (GATT). The two other areas, the General Agreement on Trade in Services (GATS) and the Trade-Related Aspects of Intellectual Property Rights (TRIPS), also fall into this category. Then comes extra agreements and annexes dealing with the special requirements of specific sectors or issues. And finally, there are the detailed and lengthy schedules of commitments made by individual countries allowing specific foreign products providers access to their markets. For GATT, these take the form of binding commitments on tariffs for goods in general, and combinations of tariffs and quotas for some agricultural goods. (WTO, 2005)

Underpinning these agreements is dispute settlement, which is based on the agreements and commitments, and trade policy reviews, an exercise in transparency. Dispute settlement is one of the important parts of WTO's work. Trade relations often involve

conflicting interests. Agreements, including those carefully negotiated in the WTO system, often need interpreting. Appellate Body (AB) makes sure the GATT is understood similarly in every dispute settlement. (Trebilcock & Howse, 2005, 153)

The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. They deal with: agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards and product safety, food sanitation regulations, intellectual property, and much more. But a number of simple, fundamental principles run throughout all of these documents. The following principles are the foundation of the multilateral trading system: securing of fair conditions of trade by the rules on non-discrimination; lowering of trade barriers; improving of predictability, transparency and stability; and contributing to development. (WTO, 2005)

2.1.2 Economic Environment

Most international business takes place within the context of free-market economies in which the market is the key mechanism for resource allocation. It is here that buyers and sellers interact to determine the prices and quantities of the goods and services exchanged. Some most common critics for the system include imperfect information, non-competitive market structure and divergences between private and social costs (externalities), among many other types of market distortion. Occasional periods of economic recession, with declining output and rising unemployment, have helped to temper the more excessive critics. (Wall, 2004, 155, see also Rugman & Hodgetts, 2003, 149)

Although few examples of a command economy remain, this structure was previously used by many of the so-called “transition economies” of Central and Eastern Europe. The command economy dominated every aspect of life, often involving the issue of explicit instructions to factories as to where to buy their inputs, how much to pay their workers, how much to produce and where to sell their output. Individuals were trained in specialist schools and universities and directed to work at specific factories, which

provided their wages, houses, healthcare – and even holidays in enterprise-owned hotels and sanatoria. The national bank was told how much to lend to which factories and how much cash to print to pay wages. However brilliant the plans were in theory, in practice they were often internally inconsistent, leading to massive shortages or surpluses. The direction of movement is towards the market economy, as indeed has largely been the case within the People's Republic of China for more than two decades. Also Russia has been opening its markets towards market economy. This process of transition clearly has implications for companies seeking to invest in, or trade with, these economies. (Wall, 2004, 157-158)

Political systems directly affect the economy, and there are significant differences in prosperity, disposable income and spending habits among countries. (Waters, 2003, 339) It can also be said, that the freer the political and economic system of the country, the better off is the international trade. In WTO, lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties and measures such as import bans or quotas that restrict quantities selectively. From time to time other issues such as red tape and exchange rate policies have also been discussed. Since GATT's creation in 1947–48 there have been eight rounds of trade negotiations. The ninth round, under the Doha Development Agenda, is now underway. As a result, by the mid-1990s industrial countries' tariff rates on industrial goods had fallen steadily to less than 4%. (WTO, 2005)

Inflation and unemployment are linked phenomena which affect all economies, varying in their severity and persistence between countries and regions. They directly affect businesses in terms of costs of raw materials, wages, prices of finished products and availability of labour. (Morrison, 2002, 65) There are many financial factors affecting international trade and logistics as well. For example, some countries do not allow their currency to be taken out of the country, the value of some currencies fluctuates wildly or falls quickly, some banking systems are inefficient, and sometimes exchanging money is difficult. (Waters, 2003, 339-340)

Although Russia's economy has been strengthening during the past few years mainly thanks to the great balance of payment and foreign exchange reserves, the inflation stays on a higher level than that in the most important trading partners of Russia. One of the

main problems in economics in Russia has been to integrate exchange rate politics with the fast economic growth, noticeable oil revenues and control of inflation. (Rautava, 2006)

2.1.3 Sociocultural Environment

Culture is the system of shared beliefs, values, customs, and behaviours that the members of society use to cope with their world and with one another, and that are transmitted from generation to generation through learning. Values relate primarily to notions of good and evil, right and wrong. Values also include notions of the individual in relation to the group. Norms relate to patterns and standards of behaviour. They shape what is considered normal and abnormal behaviour within a society. (Morrison, 2002, 118-119) In general, religion, political philosophy, economic philosophy, education, language and social structure are considered as determinants of culture (Hill, 2004, 101).

Geert Hofstede has identified five main cultural dimensions which distinguish a culture from others: power distance, uncertainty avoidance, individualism versus collectivism, masculinity versus femininity and long-term versus short-term orientation. Power distance is the extent to which members of a society accept a hierarchical or unequal power structure. Based on this Hofstede divided countries to large power distance countries, in which people consider themselves to be inherently unequal, and small power distance countries, in which people tend to see themselves more as equals. Uncertainty avoidance means how members of a society cope with the uncertainties of everyday life. High uncertainty avoidance countries are characterised by high levels of stress and anxiety. These cultures tend to be more expressive and emotional than those of low uncertainty avoidance countries, which have lower anxiety levels.

Individualism, in this context, means the extent to which individuals perceive themselves as independent and autonomous beings. At the opposite pole is collectivism, in which people see themselves as integrated into “ingroups”. Hofstede associates

masculinity with assertiveness, toughness and an emphasis on money and material things. Femininity, at the opposite extreme, demotes sensitivity, caring and an emphasis on quality of life. Long-term versus short-term orientation refers to people's time perspectives in their daily lives. Short-term orientation stresses satisfying needs here-and-now, whereas long-term orientation stresses virtuous living through thrift and persistence. (Morrison, 2002, 139)

In addition to the cultural environment, international businesses must also be aware of the social structure of the country. What is the age distribution of the country, are educated employees available, what is the rate of strikes, crime, etc. are just some of the important factors to consider here. (Morrison, 2002, 154)

Differences in sociocultural settings can critically affect the way international subsidiaries or agents interpret the goals and pronouncements of management. Belief and values, customs, language, and expectations all play a big role in global business and can strongly affect negotiation and communication. (Simchi-Levy et al. 2003, 2004) For example, it is often the practical details that make the movement of materials across international frontiers problematic. Deliveries are often held up in customs for days, simply because the driver cannot speak the same language as the customs people. (Waters, 2003, 340)

Social structure of the country may create problems as technically and managerially competent and trustworthy workers may not be found, or unskilled labour might be relatively expensive. (Simchi-Levi et al. 2003, 205) In some countries, like Finland, trade unions have traditionally had strong position and strikes in, for example, transportation industries are rather common causing problems for businesses. (Morrison, 2002, 171)

It has been stated that the prospects of Russian markets are far greater than is the ability of Finnish firms to benefit from them. The biggest reason for this is surprisingly the lack of Russia- experts, not so much linguistically but more on cultural aspects. The organic growth in Russia in manufacturing industry is about 20%. To be able to gain from the prospects of these markets, Russia has to be known from inside. This is stated

to be the case among the small and medium size enterprises in particular. (Taiviainen, 2005)

2.1.4 Technological Environment

Technology is a key driving force in the world economy today. Technological innovation and the capacity to sustain a technological lead are crucial to success in the competitive environment, for both companies and countries. Acquiring technology from other countries is known as technology transfer and it has been crucial to the process of industrial growth and global integration. (Morrison, 2002, 301)

Technological change can have important effects on the decisions taken by international business. Technological change can involve new processes of production – which raise the productivity of factor inputs – as with the use of robotics in car assembly techniques, which has dramatically raised output per assembly line worker. Around 80% of technological change has been process innovation. However, technological change can also be embodied in new products which were not previously available. (Wall, 2004, 164) Information and communications technology has led to transformational change in all aspects of business life. The growth in business-to-business e-commerce, in particular, is achieving greater efficiencies in design, production and distribution. (Morrison, 2002, 311)

2.1.5 Ecological Environment

Land, water and air are the components of the physical environment which have been affected by industrial processes associated with economic development. It is generally acknowledged that industrial processes cause environmental damage, altering ecosystems. Businesses are becoming more conscious of the need for new, cleaner technologies, mostly because of growing social and ethical considerations among

consumers. Also, international regulations agreed by governments are growing in number. For example the International Organisation for Standardisation (ISO) has developed a certification for standards of environmental management, achievement of which has become a powerful competitive tool for companies.

There are enormous amount of regulations concerning both ecological and ethical issues that companies must be aware of. They must pay attention to looking at all phases of their operations, from production processes to the nature of the products they sell, to assess whether they can be made more environmentally friendly. Consumers have been a source of pressure, creating new demand for example for products which are recyclable. Social responsibility, including human rights, human development and environmental protection, is now seen as a central objective companies because of the growing awareness of not only environmental issues but also ethical issues. (Morrison, 2002, 355-357)

Some governments have imposed heavy taxation on for example fuels, alcohol and tobaccos. There are also national and international limits for certain emissions and wastes produced by the factories. Governments, however, cooperate in this field, and many international agreements, like the Kyoto agreement, enhancing environmental protection have been made that businesses operating anywhere in the world must be aware of. Transportation is said to be one of the biggest polluters and its emissions are tried to be reduced continuously by for example high taxation and regulations on the size and weight of the vehicles. Some governments or cities have even restricted transportation in some parts of their region to reduce the pollution caused by the transportation. (Morrison, 2002, 360)

2.1.6 Legal Environment

There are three main types of legal systems in use around the world: common law, civil law, and theocratic law. Common law system is based on tradition, precedent, and customs. When law courts interpret common law, they do so with regard to these

characteristics. Judgments are based on the individual judge's interpretation of these laws and each new interpretation sets a precedent for future cases. Common law is used in for example the United States. Civil law is based on a very detailed set of written laws and codes. While the judges in a common law system have the power to interpret the law, judges in a civil law system have the power only to apply the law. Both Finland and Russia operate with a civil law system. A theocratic law system is based on religious teachings and is found in most of the Islamic countries. (Hill, 2004, 53-54)

Laws affect international business in variety of ways. There may be legal rules relating to specific aspects of business operations such as off-shore investment, the environment, ways in which financial accounts are prepared and disclosed, corporate taxation, employee rights and pension provisions. There may even be legal rules as to the amount of assets and shares companies may own and the proportion of profits they are allowed to remit back to their home country. Countries vary enormously in the amount of control they impose in these different areas. National laws also affect aspects of the companies' internal organisations such as its human resource management and health and safety policies. The nature of these rules and regulations may, to some extent, reflect the national government's trade and industrial policies. (Wall, 2004, 143-144)

2.2 Factors that Encourage International Trade

The factors that encourage international trade today are numerous. Firstly, as customers travel, watch television and use the Internet or other form of advanced information technology they see products available in different areas. Thus, they demand new products that cannot be supplied by domestic companies. (Waters, 2003, 334) This competition from imports may then stimulate greater research and development and the more rapid adoption of new technology in the home country itself. (Sloman, 2006, 644)

Many regions of the world are becoming more prosperous and are consuming more goods. Foreign companies recognise the opportunities in these growing markets and expand to sell their products in new markets. Additionally, there have been significant changes in manufacturing operations, many which depend on, or work best with, a

stable, large-scale production. The best size for these facilities is often larger than demand from a single market. The result is centralised production, with economies of scale giving lower unit costs that more than cover any increased costs of logistics. However, centralised manufacturing only works if different markets accept the same products, or at least products with minor differences in the finishing. Convergence in tastes allows for example Coca-Cola, McDonald's, Toyota and Sony to sell the same products in virtually any country.

Many organisations are concentrating on their core competencies and are outsourcing other activities. A major industry has grown of specialised support companies that can help with exporting, international transport, trade credit, foreign exchange, customs clearance, and so on. Additionally, integration of the supply chain works towards a smooth movement of goods from initial suppliers through to final customers. This only becomes possible when national frontiers are transparent, and this means that the same organisation has to work on both sides of the border.

As referred to above customers have gained from the development of communication systems such as the Internet. Similarly, developments in information systems – ranging from EDI to on-board systems in vehicles – can fundamentally change the way companies work. They allow more flexible operations, including efficient logistics in even remote areas.

All this has been able because of the developments made in the field of logistics. Containerisation, for example, makes the movement of goods easier, cheaper and more reliable. This encourages many companies to move profitably into new markets. Similarly, postponement allows products to finish manufacture at a later point on the supply chain and be more flexible to customer demands. (Waters, 2003, 334-335)

Kotilainen, Kaitila and Widgrén (2003, 120) list some factors that will most probably influence the economic relations between Finland and Russia in the near future: the continuation of the domestic liberalisation and strengthening of institutions in Russia; Russia's membership to WTO; development of the basis for contractual economic relations between Russia and EU; general globalisation of Russian production; and

favourable economic growth in Russia that is influenced by the above mentioned factors.

Finnish institutions and organisations that encourage Finnish companies to trade with Russia by providing for example help with market research or financing are numerous. Some of the most important ones are the Finnish Russian Chamber of Commerce, Finpro, Finnvera, Ministry of Trade and Industry, Ministry for Foreign Trade, and Sitra. (Hakkarainen, 2006, 12-132)

2.3 Barriers to International Trade

In addition to great advantages, international trade also includes great risks. Trade policy basically means any policy affecting international trade. It uses seven main instruments: tariffs, subsidies, import quotas, voluntary export restraints, local content requirements, antidumping duties, and administrative policies. (Hill, 2007, 203) In addition to these traditional instruments of trade policy there are several different nontariff barriers that aim to hinder the international trade. The most important nontariff barrier in trade to Russia seems to be the requirement of the Russian authorities that foreign goods meet country's product standards or testing standards. (Griffin & Pustay, 2002, 234) In Russia the law of standardisation set in 1993 has occasionally formed an actual barrier to the movement of goods. In addition to the 16 certification systems existing in the country, several different authorities have given their own stipulations. According to the Russian authorities there are more than 500 000 regulations on standardisation of different degrees in Russia. (Pullola, 2004)

I will concentrate more closely on tariffs and subsidies because they are easier to predict than the nontariff barriers. I also believe that these are the instruments I will gain information from the interviewed companies in the empirical part of this thesis.

2.3.1 Tariffs

Tariffs are the oldest and the simplest instrument of trade policy. A tariff is a tax levied on imports or exports, although tariffs on exports are rare. Tariffs fall into two categories. Specific tariffs are levied as a fixed charge for each unit of a good importer. Ad valorem tariffs are levied as a proportion of the value of the imported good. A compound tariff has both an ad valorem component and a specific component. In most cases, tariffs are placed on imports to protect domestic producers from foreign competition by raising the price of imported goods. However, tariffs also produce revenue for the government. Consumers, then again, lose with tariffs imposed on imports because they must pay more for certain imports. Import tariffs also reduce the overall efficiency of the world economy. They reduce efficiency because a protective tariff encourages domestic firms to produce products at home that, in theory, could be produced more efficiently abroad. The consequence is an inefficient utilization of resources. (Hill, 2007, 203-204)

One of the major forces towards global free trade was the General Agreement on Tariffs and Trade (GATT) which stipulated that all its members should be treated equally with similar tariffs. Countries in several regions have taken this idea further to create free trade areas. These have encouraged trade by easing trade restrictions and reducing tariffs, and are one reason why the amounts collected as tariffs on industrial products fell from 40% at end of World War II to 4% in 2005. (OECD, 2003) However, a fall in tariff barriers has raised the other barriers than those caused by the tariffs.

2.3.2 Subsidies

A subsidy is a government payment to a domestic producer. Subsidies take many forms including cash grants, low-interest loans, tax breaks, and government equity participation in domestic firms. By lowering production costs, subsidies help domestic producers in two ways: (1) competing against foreign imports, and (2) gaining export markets. The main gains from subsidies accrue to domestic producers, whose

international competitiveness is increased as a result. However, as subsidies must be paid for, governments typically pay for subsidies by taxing individuals. (Hill, 2007, 204)

2.4 Rationales for Trade Intervention

At this point it is also important to understand why governments choose to intervene with international trade with the above given trade policy instruments. Arguments for government intervention in international trade take two paths – political and economic. Political arguments for intervention are concerned with protecting the interest of certain groups within a nation, normally producer, often at the expense of other groups, normally consumers. Economic arguments for intervention are typically concerned with boosting the overall wealth of a nation to the benefit of all, both producers and consumers.

Perhaps the most common political argument for government intervention is that it is necessary for protecting jobs and industries from unfair foreign competition. Well-established firms and their workers, particularly in high-wage countries, are often threatened by imports from low-wage countries. Countries also argue that it is necessary to protect certain industries because they are important for national security. Defence-related industries often get this kind of attention (e.g. aerospace, advanced electronics, semiconductors, etc.). Although not as common as it used to be, this argument is still made. (Hill, 2007, 207-209; see also Bade & Parkin, 2007, 877)

Some argue that governments should use the threat to intervene in trade policy as a bargaining tool to help open foreign markets and force trading partner to play by the rules of the game. If it works, such a politically motivated rationale for government intervention may liberalize trade and bring with it resulting economic gains. A government may also grant preferential trade terms to a country it wants to build strong relations with. Trade policy has also been used several times to pressure or punish rogue states that do not abide by international law or norms.

Many governments have long had regulations to protect consumers from unsafe products. The indirect effect of such regulations often limits or bans the importation of such products. Also, protecting and promoting human rights in other countries is an important element of foreign policy in many democracies. (Hill, 2007, 209-210) According to public choice analysis the special interest will often dominate the general interest on any given issue for a simple reason: special-interest groups are willing to work harder for the passage of laws favourable to their interests than the general public is willing to work for the defeat of laws unfavourable to its interests. (Griffin & Pustay, 2002, 225-226)

To allow new manufacturing to get a toehold, the argument is that governments should temporarily support new industries (with tariffs, import quotas, and subsidies) until they have grown strong enough to meet international competition. These kinds of policies are particularly common in developing countries and, mainly to promote their economic development, GATT has recognised the infant industry argument as a legitimate reason for protectionism. (Hill, 2007, 214; see also Bade & Parkin, 2007, 877)

The new trade theory, on its behalf, argues that in industries where the existence of substantial scale economies implies that the world market will profitably support only a few firms, countries may predominate in the export of certain products simply because they had firms that were able to capture first-mover advantages. To be able to capture the first-mover advantage, businesses are looking for aid from governments who then, as the argument goes, could benefit the situation by increasing national income. (Hill, 2007, 214)

2.5 International Trade and Logistics

The Council of Logistics Management gives a precise definition for business logistics: “Logistics is the process of planning, implementing, and controlling the efficient, cost-effective flow and storage of raw materials, in-process inventory, finished goods and related information from point of origin to point of consumption for the purpose of

conforming to customer requirements.” (Waters, 2003, 9) In this sense international logistics then basically means logistics operations in an international setting.

Waters (2003, 19) compresses the importance of logistics in the following sentence: “Without logistics, no materials move, no operations can be done, no products are delivered, and so, no customers are served. “ In international context, logistics is the provider of fluent movement of exports and imports. Waters (2003, 333) also states that trade increases prosperity, and trade depends on logistics. This is because stronger economies can move more materials, as they can afford to consume more products, and they have more efficient logistics, due to better infrastructure, systems and support. Greater prosperity thus allows efficient logistics, but there is a cycle and efficient logistics can actively contribute to prosperity. In general, it can be seen that the poorer the country the poorer the logistics in that country.

A product is of little value if it is not available to customers at the time and place that they wish to consume it. However, not only is the right place and time enough in today’s customer service expectations, the product also needs to be delivered with the right quality, in the right quantity, with the right price and to the right customer. (Ballou, 1999, 11) Logistics is not just vital for international trade; it is also expensive, with costs often forming a surprisingly high proportion of turnover, which means that it directly affects profits and other measures of organisational performance. Logistics has strategic importance with decisions affecting performance over long term; it forms links with suppliers, developing mutually beneficial, long-term trading relationships; it forms links with customers, contributing to customer satisfaction and added value. Logistics also has a major affect on lead time, reliability and other measures of customer service; it is the most important provider of availability. It determines the best size and location of facilities and it also gives public exposure with visible locations, advertising on trucks, corporate citizenship and so on. (Waters, 2003, 22-23) I will next define the activities of logistics that are essential to this thesis and then discuss the specific problems logistics faces in international context.

2.5.1 International Distribution Channels

Physical distribution channel is the term used to describe the method and means by which a product or a group of products are physically transferred, or distributed, from their point of production to the point at which they are made available to the final customer. In general, this end point is a retail outlet, shop or factory, but it may also be the customer's house, because some channels bypass the shop and go direct to the customer. (Rushton, Oxley & Croucher, 2000, 49)

In addition to the physical distribution channel, another type of channel exists. This is known as the trading or transaction channel. The trading channel is concerned with the non-physical aspects of the transfer of the product. These aspects concern the sequence of negotiation, the buying and selling of the product and the ownership of the goods as they are transferred through the various distribution systems.

Channel structures can differ very markedly from one company to another. The main differences are the types of intermediaries, the number of levels of intermediaries, and the intensity of distribution at each level meaning whether all or just selective intermediaries used at the different levels. (Rushton et al. 2000, 49-53) The international distribution channels are often more complex and lengthy than in traditional domestic distribution.

2.5.2 International Transportation

The success of the transportation industry in developing a fast, reliable, and efficient transportation system has considerably contributed to the dramatically expanding level of international trade. Inexpensive transportation has allowed domestic companies to take advantage of the differences in labour rates worldwide, to secure raw materials that are geographically dispersed and to place goods competitively in markets far from their domestic borders. Thus, the logistician must be aware of the special requirements for moving goods internationally. (Ballou, 1999, 150)

Exporters are always being confronted with making transportation decisions for which the choice between the different transport modes is a critical factor. The many factors affecting decision-process are cost, time sensitivity or delivery requirements, nature of product to be transported and size of orders, and customer needs, origin and destination locations. (Cook, 2004, 36) There are traditionally four different modes of transportation: rail, road, air and sea. Because most of the exporting to Russia is carried out on wheels or by rail inside the country's boundaries, I will concentrate more closely on explaining them.

Rail

Rail freight systems have the major benefit of being a relatively cheap form of transport. This is particularly true for bulky and heavy consignments that require movement over medium to long distances and where speed is not vital. (Rushton et al. 2000, 339-340) According to the Finnish Customs the amount of goods exported via railroad in 2005 was 994 000 tonnes, of which 372 000 tonnes were exported to Russia.

Road

Road freight is the most important transportation mode within Europe. Trucking moves freight with smaller average shipment sizes than rail. The inherent advantages of trucking are its door-to-door service such that no loading or unloading is required between origin and destination; its frequency and availability of services; and its door-to-door speed and convenience. (Ballou, 1999, 142-143) Finnish exports transported via road amounted to about 3,5 million tonnes in 2005. The share of Russian exports was a little over 1,5 million tonnes making the road freight predominantly the most used transport mode on Finnish exports to Russia. (Tulli, 2006)

Container systems can be viewed as specialized mode of freight transport, although the container is now a fundamental feature of all the major national and international transport modes – road, rail, sea and air. Containerisation makes possible the development of what is known as the intermodal system of freight transport, enabling the uncomplicated movement of goods in bulk from one transport mode to another. The

most important attributes of containers and container systems are that they enable a number of small packages to be consolidated into large single unit loads. Also, there is a reduction in the handling of goods, as they are distributed from their point of origin to point of destination. (Rushton et al. 2000, 342-343)

In international context, more products are moved far greater distances than ever before because companies have developed the concepts of focus factories, with a single global manufacturing point for certain products, and the concentration of production facilities in low-cost manufacturing locations. Long-distance modes of transport have thus become much more important to the development of efficient logistics operations that have a global perspective. All of these changes serve to emphasize the need to understand the particular advantages and disadvantages of the different freight transport modes. (Waters, 2003, 335)

2.5.3 Logistical Problems in International Trade

The world is not a single homogenous area. There are differences in geography, physical features, climate, infrastructure, population density, economic strength, political systems, cultures, and just about everything else. As from logistics point of view any of these factors can give problems. (Waters, 2003, 333)

International logistics are different from national logistics, and it is not just a case of moving the same activities to another location. For example, international trade usually has much bigger order sizes to compensate for the cost and difficulties of transport. International markets are more unpredictable, with large variations in the demand and importance of any market. Most organisations have less experience with international logistics, thus they are working in areas where they have less expertise. Additionally, there are more intermediaries involved in international logistics, such as freight forwarders and customs agents, and these intermediaries and distances involved make relations with customers more difficult and remote. Also, communications become more difficult at a distance and across cultures. Not only this, but financial

arrangements can be less certain too, and documentation is certainly more complicated. (Waters, 2003, 338)

Many logistics companies use sophisticated technologies for e-commerce, efficient customer response, satellite location, in-cab navigation, real-time routing, total communications, and a whole range of other developments. Most of the world, however, does not have access to, does not need, or cannot afford the latest technological development. In many areas the movement of loads depends on manual effort and bullock carts, and a lorry is the most advanced technology available.

As with all logistics, a vital concern is the flow of information. This is obviously more difficult at a distance, and across borders. Unfortunately, it is also more important to have efficient information systems for long international supply chains, where there are more opportunities for things to go wrong. If a delivery is delayed at a border, both the supplier and customer want to know exactly what is happening, and how to solve any problems. But if the border is in a remote area, it can be difficult to get any information, let alone an accurate account of the situation. Intermediaries who help the flow of materials can actually cause problems with information flows. If several people are working on different aspects of movement, it may be difficult to co-ordinate their activities or assign responsibilities. Development in mobile communications and EDI are improving information flows, and some organisations are using this to get an advantage over their competitors. Other improvements come with the removal of trade barriers and harmonisation of business practices. (Waters, 2003, 338-339)

In international context route choices become much more restricted than in domestic movement because goods must move through a limited number of ports and customs points in order to leave or enter a country. Thus, international shipments must move under more documents than domestic shipments, are subject to delays brought about the legal requirements for entering and exiting a country, and are subject to the routing restrictions of two or more countries. In addition, limited carrier liability results in increased protective packaging, and increased insurance and documentation costs as a hedge against potential loss. This helps to explain some of the popularity of containerisation for moving high-values goods in international markets. (Ballou, 1999, 150-151)

In developed countries, the manufacturing and logistics infrastructure is highly developed and highway systems, communication and information systems, and advanced manufacturing techniques allow the development of advanced supply chains. However, this is not the case in all parts of the world. In many developing countries the infrastructure is generally insufficient to support advanced logistics operations. Roads are often in poor shape. Warehousing facilities are frequently unavailable. Distribution systems may be nonexistent. It might even be that not all transport modes are available. In general, specific supply chain decisions have to be considered carefully, because many of the things taken for granted in the developed countries may not exist here. (Simchi-Levi et al. 2003, 204)

Russia's current logistics infrastructure has been inherited from the Soviet Union, where infrastructure and logistics sector were oriented to serve the needs of national economic life and not international trade or transit. The most important elements of Russia's current infrastructure are comprehensive railroad network, relatively extensive network of inland waterways, airway network that at least in principle covers even the remote areas, and the road network that compared with the western countries is relatively coarse and in poor condition. Telecommunications networks follow along the railroads. The influence of state in the logistics issues remains strong in Russia. (Hernesniemi et al. 2005, 36) According to the article "Kilpailu Venäjän kuljetuksista kiristyy" by Juha Europaenus, the value of logistics in Russian economy is about 15-20 percent of the gross domestic product. Almost half of the logistics is concentrated on railroads, which functions relatively well despite of the high tariffs imposed by the monopolistic markets.

A firm – particularly a smaller business or one just beginning to export – often lacks the expertise to market its products abroad, so it will seek a local distributor to handle its products in the target market. Problems may arise if the business judgments of the local distributor and the exporter differ. The exporter and the importer may disagree on pricing strategies, with the exporter preferring lower retail prices to stimulate sales and the distributor favouring higher prices to fatten its profit margins. The exporter may want its distributor to market its products more aggressively in hopes of building sales volume; the distributor may believe that the additional sales generated by this strategy

will not cover the increased expenses incurred. Thus the importance of selecting a distributor whose goals and business philosophy are compatible with those of the exporter cannot be overstressed. (Griffin & Pustay, 2002, 323)

Branch (2000, 459) have listed some problems that might occur along the chosen distribution channel. He mentions that the industrial disputes or build-up of traffics at the so called bottlenecks of the channel can seriously disrupt a service and result in the goods arriving late. This is exactly the case with the long truck queues on the Russian border.

The Minister for Foreign Trade and Development, Paula Lehtomäki states in her article of “Venäjän kaupan haaste ja mahdollisuus” published in *Kaupapolitiikka* at the end of year 2004 that among the small and medium sized enterprises, the difficulties of finding suitable and reliable partners and the creation of functioning distribution network in Russia are raising the threshold of entering Russian markets.

4 EXPORTING

There are six basic entry mode alternatives, of which a company wanting to sell its products internationally must choose of: licensing or franchising, exporting, setting up a local distribution network, using local assemble and finishing, full local production, joint venture. (Waters, 2003, 342-343) This thesis concentrates on exporting, which is the oldest and the most common way in which a company begins to go international. Exporting is also considered less risky than other methods of internationalisation and can be a way to get a foothold on markets before making the more resource-intensive foreign direct investment (FDI) decisions. (Wall, 2004, 35-37)

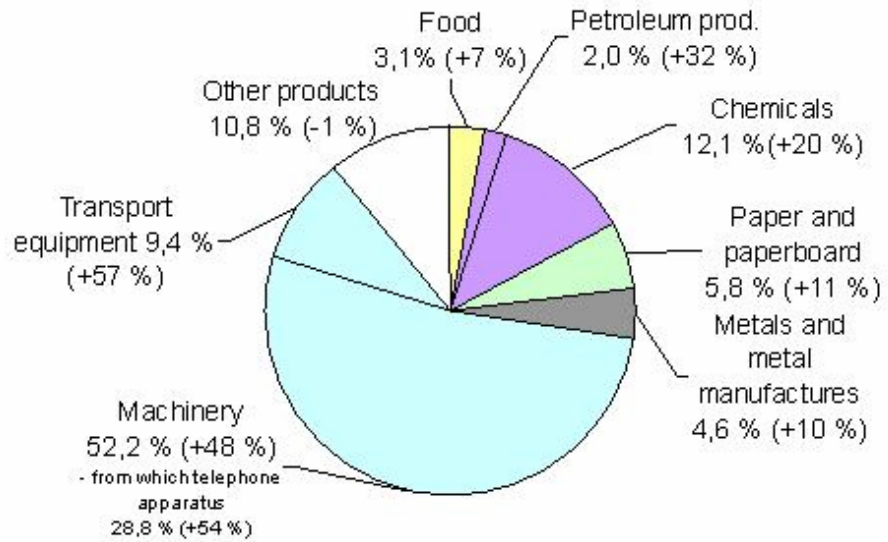
Exports are the industrial cross-border supply of goods, service and intellectual property rights (patent rights, utility models, designs, trademarks, copyrights) to foreign customer. They are referred to as visible exports, if they can be physically presented to

the foreign trade authorities before passing the national border. Since this applies to goods only the export of services and intellectual property remain invisible. (Grafers & Schlich, 2005, 15-16) The purpose of this thesis is to examine some logistical problems in exporting manufactures to Russia, thus services and intellectual property are not given consideration here.

Exports, imports and transit trade jointly constitute foreign trade. The combination of an export and an import contract in one transaction between three partners from three different countries is known as transit trade. Transit traders reside neither in the exporting nor in the importing country but operate from a third country. (Grafers & Schlich, 2005, 17-19)

The growth of exporting can be put down to the liberalisation of trade that has taken place globally and within regional trading blocks over recent decades, with the World Trade Organisation (WTO) significantly reducing tariff rates and quotas imposed on most imports. At the same time, international transportation costs are still falling and cultural barriers to trade are now more readily recognised and overcome than has previously been the case. Governments may further stimulate trade by providing export-promoting initiatives in order to improve the country's balance of payment, meaning the balance between the exports and imports. These export-based methods of internationalisation are sometimes broken down into indirect exporting and direct exporting. (Wall, 2004, 35)

According to Finnish Customs, in 2005 Finland exported goods worth of 52,4 billion euros. Russia became the biggest trading partner on exports. The share of Russia of the total exports was 11%, Sweden rated 10,8% and Germany 10,6%. The year before the share of Russia was 8,9%, Sweden was the biggest country of export destination with 11% and Germany second with the share of 10,7%. During the first half of the year 2006 exports to Russia have increased by 13%. The following graph illustrates the division of the exports to Russia in 2005 by product group.



Total value of exports to Russia in 2005 was 5,7 bn euro (+ 32 %)

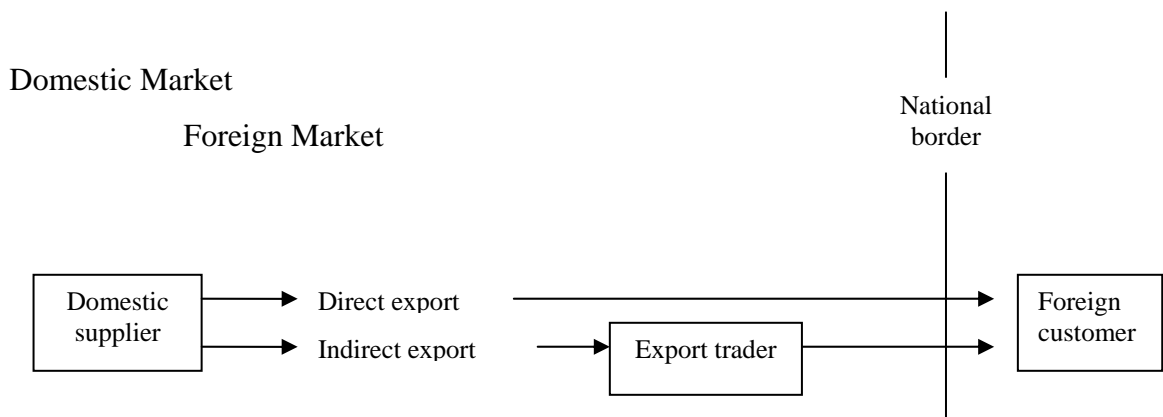
Graph 1: Exports to Russia by products 2005

Exports to Russia have more than doubled during the last decade. The change from the year 2004 to year 2005 was enormous 32%. However, the country specific statistics of Customs revealed that the balance of payment between Finland and Russia in 2005 was on deficit. This means that Finland imports more from Russia than it exports to Russia. (Tulli, 2005)

4.1 Fundamentals of Exporting

Exporting can be divided into two different forms: direct exporting and indirect exporting. Direct exporting means that the exporter has to organise the cross-border marketing process on his or her own – from market research and marketing planning to physical distribution and communication. However, if the company's own resources are not sufficient to manage all these tasks, specialised marketing service suppliers in the target market may be employed. In any case, direct exporting requires a significant commitment of time and attention to achieve acceptable results. (Grafers & Schlich, 2005, 23)

Indirect exporting then again happens when a company does not itself undertake any special international activity but rather operates through intermediaries. Under this approach the exporting function is outsourced to other parties, which may prepare the export documentation, take responsibility for the physical distribution of the goods and even set up the sales and distribution channels in the foreign market. The following graph illustrates the two different schemes of exports.



Graph 2: Scheme of exports

Exporting has two distinct advantages. First, it avoids the costs of establishing manufacturing operations in the host country, and second, exporting may help a firm achieve experience curve and location economies. By manufacturing the product in a centralized location and exporting it to other markets, the firm may realize substantial economies of scale from its global sales volume. (Hill, 2005, 487) The advantages of indirect exporting in particular, clearly involve the fact that no additional costs need to be incurred or expertise acquired in order to access the overseas market (Wall, 2004, 36).

However, exporting also has a number of drawbacks. The most obvious drawback to exporting is that high transport costs can make exporting uneconomical, particularly for bulk products. Also tariff barriers can make exporting uneconomical. Similarly, the threat of tariff barriers by the host-country government can make it very risky. A

common disadvantage of exporting arises as the local agent employed by the company often carries the products of competitors as well, and thus has divided loyalties. (Hill, 2005, 487-488) The company may also end up with having little or no control over local marketing issues and little contact with the end-user, so that there is no feedback for marketing. (Wall, 2004, 36)

Exporters often face voluminous paperwork (also referred to as red tape), complex formalities, and many potential delays and errors. According to a UN report on trade and development, a typical international trade transaction may involve 30 parties, 60 original documents, and 360 document copies, all of which have to be checked, transmitted, re-entered into various information systems, processed, and filed. The United Nations has calculated that the time involved in preparing documentation, along with the costs of common error in paperwork, often amounts to 10 percent of the final value of goods exported. (Hill, 2007, 534-535)

Exporters have many options to ease the burden of, for example, documentation, marketing, transportation, etc. They may use one or more intermediaries – third parties that specialize in facilitating imports and exports. Export management companies, freight forwarders, manufacturers' agents, manufacturers' export agents, and international trading companies are just some of the intermediaries available for exporters looking for help. (Griffin & Pustay, 2002, 324-326)

An export management company (EMC) is a firm that acts as its client's export department. An EMC typically is knowledgeable about the legal, financial, and logistical details of exporting and so frees the exporter from having to develop this expertise in-house. The EMC may also provide advice about consumer needs and available distribution channels in the foreign markets the exporter wants to operate in. EMCs usually operate in one of two ways: on a commission base or by taking title to the goods. (Griffin & Pustay, 2002, 325)

Freight forwarder, on the other hand, generally acts as an agent for the exporter in physically shipping cargo internationally. Among the many additional services offered by freight forwarders are the handling of export and customs documentation, insurance and port and terminal charges. Small exporters will therefore often consult with their

freight forwarder before quoting a price for a particular international transaction. There are several different functions and types of forwarders: consolidators, customs brokers, port agent, air freight agent, road haulage brokers, and loading brokers. (Astrup, 2003, 244-246 & 270)

4.2 Incoterms

International carriage of exports frequently involves problems of cost burden, risk transfer and the obligation to procure further services like loading, harbour services, customs formalities, insurances, etc. Problems occur as a consequence of geographical diversification of practices concerning these items, and changes in individual interpretation of usage in different places. (Grafers & Schlich, 2005, 181-182)

“Incoterms 2000 are internationally standardised “trade terms”, which enable exporters to quote prices that clearly allocate the costs and risks of international transport between seller and buyer. Insurance responsibilities and customs formalities are also covered by Incoterms” (Astrup, 2003, 94).

Incoterms are classified into four main categories which stipulate the risk transfer and whether or not the exporter is required to clear goods for export, to carry out customs formalities and to pay duties, taxes or other charges:

E-terms: Exporter delivers when goods are placed at the foreign customer's disposal on the exporter's premises or another named place (e.g. a warehouse or factory), not cleared for export, not loaded on a vehicle (EXW: ex works).

F-terms: Exporter delivers when goods pass the ship's rail in the port of shipment or when they are placed at the disposal of a carrier nominated by him: free carrier (FCA); free alongside ship (FAS); free on board (FOB).

- C-terms Exporter delivers when goods pass the ship's rail in the port of shipment or when they are placed at the disposal of a carrier nominated by him. Additionally he pays cost and freight necessary to bring the goods to a named place of destination: carriage (CPT); carriage + insurance: cost + freight (CFR); cost, insurance, freight (CIF).
- D-terms: Exporter delivers when goods are placed at the foreign customer's disposal at a denoted place: delivered at frontier (DAF); delivered ex ship on board of a vessel at a named port of destination (DES); delivered ex quay at a named port of destination (DEQ); delivered duty unpaid (DDU) or delivered duty paid (DDP) at the foreign customer's premises or another named place in the country of destination.

While the EXW term represents the minimum obligation of the exporter, DDP represents his maximum obligation and it should not be used if the exporter is unable directly or indirectly to obtain the import licence. (Grafers & Schlich, 2005, 181-182)

4.3 International Transport Documentation

International trade is flourishing today because traders have learned to manage and overcome the various risks involved in international business. Export risk management is based on documentary systems and customs which translate the rights, costs, and responsibilities of the export process into documentary equivalent. Thus, the export process is actually twofold, involving the real shipment of physical goods, and the complimentary documentary exchanges. It is just as important for the exporter to provide the correct documents as it is for him to provide the correct goods.

On the exporter's side, the documentary system has a drawback in that the fulfilment of physical delivery does not excuse documentary failures. This is particularly a problem for small exporters who have requested payment by documentary credit, but then find that their own faulty record-keeping makes it impossible for them to present conforming

documents in time. The all-too-common result is delayed payment or other payment difficulties.

The only solution for exporter is to make sure before entering into an international contract of sale that he thoroughly understands the documentary obligations that will be required of him. There are service providers who provide help in these problems but they can only do part of the job. (Hill, 2007, 16-18)

4.3.1 The Key Contracts Related to Export Transactions

The central export contract is the contract of sale: the parties to this contract are the seller and the buyer. A broker or agent may act for seller or buyer in this basic framework. In a contract of sale, the parties generally specify at least the price, quantity, products, delivery and payment terms. The surest way to put the transaction on solid footing is to negotiate a precise contract of sale which deals clearly with all these key elements.

Another basic contract is the contract of carriage, which is formed between the shipper and the carrier. The carrier may act through an agent or broker. The contractual terms and conditions of transport contracts are generally found in a transport document known as a bill of lading (or a similar but non-negotiable transport document, such as a sea waybill, air waybill, data freight receipt, cargo quay receipt, etc.).

International payment mechanisms generate another series of contractual agreements. A letter of credit, for example, is based on an underlying contract of sale, which requires that the buyer forms a contractual agreement with its bank, and in the case of a confirmed credit, requires that the confirming bank irrevocably undertake to pay the beneficiary under the credit and that a further contract be formed between the issuing bank and confirming bank.

International shipments of goods are usually insured through an insurance contract between the insurer and the seller or buyer. When the seller is obliged under the sales

contract to procure insurance, it is important that the conditions and insured amount under the policy be in accord with the conditions of the contract of sale. In particular, sellers under CIF or CIP Incoterms 2000 need to be aware of requirements imposed by Incoterms 2000 as regards the minimum insurance coverage which they must procure for the buyer. (Astrup, 2003, 43-45)

4.3.2 Shipping Documents

The documents associated with international transport frequently play a key role in the payment mechanism and the underlying sales contract. Bill of lading (B/L) is a central document in the traditional export transaction, linking the contract of sale, the documentary payment contracts, and the contract of carriage. The bill of lading plays a triple role in the international sales transaction, acting as 1) transport contract, 2) evidence of receipt of goods, and 3) document conferring the right to control delivery of the goods. (Astrup, 2005, 248) Bill of lading is issued by the carrier as evidence that they acknowledge receipt of your goods and that they agree to transport it to the destination that is indicated and becomes the contract and agreement of carriage between the exporter and the carrier (Cook, 204, 208).

A commercial invoice is essentially a bill for the goods sold. It should comprise all essential information concerning the sale, including a precise description of the goods, address and identity of exporter and importer, and delivery and payment details. In many countries, customs authorities use the commercial invoice as the basis for calculating import duties. Dishonest traders have been known to prepare a separate, deliberately understated invoice for submission to customs authorities so as to reduce the amount of duty paid; this fraudulent practice is known as double-invoicing and when detected can result in substantial penalties. (Astrup, 2005, 246-247) Double-invoicing is rather common in Russian trade, in fact, it can be said that it has been increasing in during the past few years. In 2004 exported products lost approximately 60% of their value as they were transferred from Finland to Russia, the same figure was 50% in year 2000. (Ollus, 2006)

An inspection certificate is generally issued by a respected independent agency who verifies that the quality, quantity or specifications of the goods shipped are in accordance with the sales contract. Certificate of origin, then again is a certificate, usually issued by a local chamber of commerce, establishing the country where the merchandise was produced or manufactured. Insurance certificate is a proof of type and amount of insurance coverage, generally required for payment by letter of credit. A packing list is a highly detailed list describing the weight, volume, content and packaging for each separate export package.

An export license is an official permit issued by an agency of the exporter's governments, without which the goods cannot be exported. Hazardous items, such as toxic chemicals, or politically sensitive goods like weapons often require special export licences and may in addition be subject to quotas or ceilings. Some countries also require an invoice on an official form for all imported goods. These consular invoices are generally purchased from that country's local consulate in the exporter's country. (Astrup, 2003, 247)

4.4 Export Risk Factors

The problems of international logistics and the trade barriers examined above are valid in exporting as well. The following risk factors are specifically characterising the problems in exporting in particular.

Country Risk

Country risks refer to the environment of the foreign market where the exporter is operating. They can best be scanned by a thorough PESTEL-analysis explained in the earlier parts of this thesis.

The normal risks involved in selling any product become magnified in the export context because of the additional investments required by an export programme. For example, a market which has been steadily growing for several years may suddenly

decline for example due to exchange rate instability, before an exporter can amortize investments in local distribution. There are companies that have gone bankrupt after investing heavily and overoptimistically in export operations which suddenly failed due above mentioned factors. (Astrup, 2003, 16)

In order to assess the country risk, the OECD has launched a system to classify buyer countries into seven risk categories (1=low, 7=unacceptable). OECD country risk classification is based on quantitative indicators concerning the financial and economic situation of the countries as well as the payment experience of them. It also takes account of qualitative factors such as political, economic, and financial factors of the countries. The country credit risk is described as the likelihood that a country will service its external debts. (Grafers & Schlich, 2005, 159) The OECD country risk rate of Russia is 4, whereas it for Finland is 0. (OECD, 2006)

These country statistics and other form of country risk experts are a good way of finding out whether export credit guarantees – guarantees that the country is able to pay – are available to the particular country. If these guarantees are not given, then companies are recommended to sell on a money first –principle. (Lipasti, 2006, 32-35)

Foreign Customer Risk

Firms engaged in international trade have to trust someone they may have never seen, who lives in a different country, who speaks a different language, who abides by a different legal system, and who could be very difficult to track down if he or she defaults on an obligation. Thus, there is an increased risk of non-payments, late payment, or outright fraud. Consider a Finnish firm exporting to a distributor in Russia. The Finnish exporter might be concerned that if he/she ships the products to Russia before receiving payment from the Russian importer, the Russian importer might take delivery of the products and not pay the Finnish exporter. Conversely, the Russian importer might be worry that if he/she pays for the products before they are shipped, the Finnish firm might keep the money and never ship the products or might ship defective products. Thus neither party to the exchange completely trusts the other. This lack of trust is exacerbated by the distance between the two parties – in space, language, and

culture – and by the problems of using an underdeveloped international legal system to enforce contractual obligations.

Due to the lack of trust between the two parties, each has his or her preferences as to how they would like the transaction to be configured. To make sure he/she is paid, the manager of the Finnish firm would prefer the Russian importer to pay for the products before shipping them. Alternatively, to ensure he/she receives the products, the Russian importer would prefer not to pay for them until they arrive. Thus, each party has a different set of preferences. Unless there is some way of establishing trust between the parties, the transactions might never occur. A letter of credit or similar international payment mechanisms have been introduced to overcome this problem of lack of trust between international traders. (Hill, 2007, 543)

Contract Risk

The type of contract involves different economic risks when the exporter is engaged as a single contractor or as partner with other suppliers. Either alternative may turn out as strength or weakness. There is obligation for each party to take over if the other one fails to perform, for whatever reason. So the exporter may be faced with jobs and responsibilities he just did not intend to bear.

Of course, risks vary with the contract volume. Pure suppliers of goods, services or intellectual property rights often turn out to be less complicated and consequently less risky than other contracts for work, which contain additional performance risks and liabilities derived from the combination of deliveries and services (general contracting).

Furthermore, special risks are involved by the contract period. The contract value and the volume of possible penalties, if contract period is unusually long, are extraordinarily high in relation to the parties' financial outfit (equity, turnover, cash-flow, profit). (Grafers & Schlich, 2005, 163)

Risks Involved by the Object of Trade

The subject matter of the export contract involves technical risks concerning the operative functionality of the goods supplied and their adequacy for everyday use. These risks increase dramatically if there is a considerable difference between foreign and domestic users and consumer habits. Apart from repairs and maintenance additionally required, the goods' useful economic life may be concerned and product liability may adopt proportions unknown at home.

The quality of natural products (plants, animals, minerals) varies in the course of time and from source to source. Perishable goods involve specific risk in this context. Also, the quality of the goods may have been damaged during the carriage. International usage defined brackets with more or less fuzzy delimitations and introduced the term "tel quell", according to which a quality within given limits of tolerance has to be accepted without complaints.

The risk of quantity is characteristic for products made-to-order in customer tailored batches where the production technology does not allow planning output quantities exactly in advance (e.g. steel production). In order to solve the problem, the parties agree that the quantity actually supplied will be paid, irrespective of the contract value but within a well defined margin. (Grafers & Schlich, 2005, 164)

Carriage Risk

As explained earlier, international transportation tends to involve greater distances, with cargo often changing hands or undergoing prolonged storage, so that there is a greater risk of damage, loss or theft, than in domestic trade. Consequently, exporters and importers must understand their legal rights against carriers. If the goods have been damaged through the carrier's fault or negligence, the carrier's liability may depend on the contractual provisions and shipping information contained in the bill of lading. (Astrup, 2003, 14)

In most cases the exporter does not have to bear any of these risks and consequently does not need a corresponding insurance because according to INCOTERMS the

majority of these risks are transferred to the foreign customer as soon as the goods are dispatched for delivery or are handled over to a carrier or a forwarding agent. Exceptions are delivered according to D-terms. Particular risks may occur with DDU and DDP, if consignments are held up by non-tariff barriers. There is no insurance cover for this risk and there is hardly any other realistic solution. (Grafers & Schlich, 2005, 166)

4.5 Customs

International trade transactions always involve at least two customs clearances, one upon export and one upon import. Upon export, an export licence may or may not be required. Export licenses are most commonly required in the case of sales of politically or strategically sensitive goods, such as exports of arms or weaponry, chemicals or high-technology goods. (Astrup, 2003, 269)

Upon import, duties and taxes will be payable. The choice of Incoterm will determine who, as between exporter and importer, has the responsibility of export or import clearance. The clearance responsibility has three components: (1) the responsibility to obtain necessary licenses and fill out forms and declarations; (2) the responsibility to pay official duties and taxes; and (3) the assumption of the risk that customs clearance may be physically or legally impossible. (Astrup, 2003, 269) As referred to above in the chapter of freight forwarders, traders generally rely on customs brokers /also known as customs house brokers (CHB's) to clear goods through customs.

4.5.1 Amount of Duty

The amount of duty varies widely, depending on the value of the goods, tariff schedules of the importing country, customs classification of the goods and in some cases, the origin of the goods. Customs officers will strictly verify the declared value of the goods, since duty is often calculated as an ad valorem percentage.

Customs valuation is covered by an international treaty, the GATT Customs Valuation Code, which sets forth the basic rule that the customs value of the goods is the value agreed between exporter and importer in the invoice. Clearly, the invoice value will in turn depend on the amount of transport services included in the price under the chosen Incoterm; for the same goods, a CIF value will always be higher than an FOB value. In some countries duties are calculated on an FOB basis, in other countries on a CIF basis. This may generate confusion when customs officers refuse to accept values base on invoice process calculated under other Incoterms. The easiest solution is to convert the invoice value to a customs value for the purposes of the customs declaration.

In some cases customs officers will consider that the invoice value is suspect. This may be because the transaction contains some element of fraud or because the exporter is dumping goods into the import market at prices below the production cost in order to capture market share. In these cases, the invoice value may have to be adjusted upward to arrive at a value acceptable to the customs officials. If traders have any reason to anticipate problems in this area, they should consult with customs in advance.

In most countries, goods are classified into various categories under the Harmonized Commodity Description and Coding System promulgated by the WTO. Under the harmonised system, goods are classified into more than 5000 separate categories, each of which is identified by a specific good code. It is not unusual for a particular piece of merchandise to fall between two official customs designations. Understandably, the traders will wish to have applied whichever designation is assigned the lower duty. In the event of disputes, the trader will commonly have the right to appeal the customs ruling to a specialised legal tribunal. (Astrup, 2003, 270-271)

4.5.2 Country of Origin

The amount of the duty assessed will often depend on the country of origin. Thus, certain European countries have customs agreements with the European Union such that imports and exports are imposed duty at preferential rates. More importantly, under the

United Nation's Generalised System of Preferences (GSP), many developed countries have granted preferential or free entry to imports from developing countries.

This leads to the important question of the origin of export goods. Generally, this origin is determined and documented by a certificate of origin which is procured from, and stamped by, a chamber of commerce or other official export agency. Origin is a simple matter in the case of agricultural products and raw commodities, or even in the case of manufactured products when their components come from the same country.

The question becomes more complex in the case of manufactured products, the components of which may not come from countries accorded preferential status. The two criteria for deciding whether a particular product meets the origin requirement for preferential status are a process criterion and a percentage criterion. Under the process criterion, the finished product will generally be accepted for preferential rates if it falls into a different product category than the components. Under the percentage criterion, a minimum of from 35% to 50% (depending on the importing country) of the content of the final product must come from the country accorded preferential status. (Astrup, 2003, 271-272)

4.5.3 Bonded Warehouses

A bonded warehouse is authorised to store imported goods without payment of duties for a given period of time. The utility of these warehouses is that the importer can inspect the goods, or have her customers inspect them, before paying the duty. In the event that the goods are unsatisfactory, the importer can either reject them, or if she has already purchased them, seek to have them sold or re-exported to a third party. Another advantage is that for goods assessed as having high duties (e.g. tobacco and alcohol products), payment of the duty can be delayed, thereby enabling the importer to save the interest value on the amount of the duty throughout the period of storage. (Astrup, 2003, 272)

5 PURPOSE OF THE STUDY AND CONCEPTUAL FRAMEWORK

The purpose of this study is to identify some specific and concrete challenges SME's face as in exporting to Russia. Additionally, this thesis attempts to name some of the benefits achieved from Russia's future membership to WTO that might ease exporting to Russia.

Research problems

Although exports to Russia have increased at a remarkable level and Russia became the biggest export partner of Finland in 2005, especially small companies are still struggling with the problems with Russian trade. The main research problem thus is:

What are the specific challenges that small and medium sized enterprises face in exporting manufactures to Russia and why do these problems occur?

Russia's accession to WTO is speculated to take place as the biggest problems hindering the accession are won. Russia's accession in WTO must have some positive (as well as negative) effects on trade with Russia. The other research problem of this thesis is to find out:

How Russia's future membership to WTO could benefit the Finnish exporters?

Research Objectives

The following research objectives should be in accordance with the above mentioned research problems:

To understand the gains and restrictions of international trade

To develop a comprehensive picture of the current situation in Russian markets

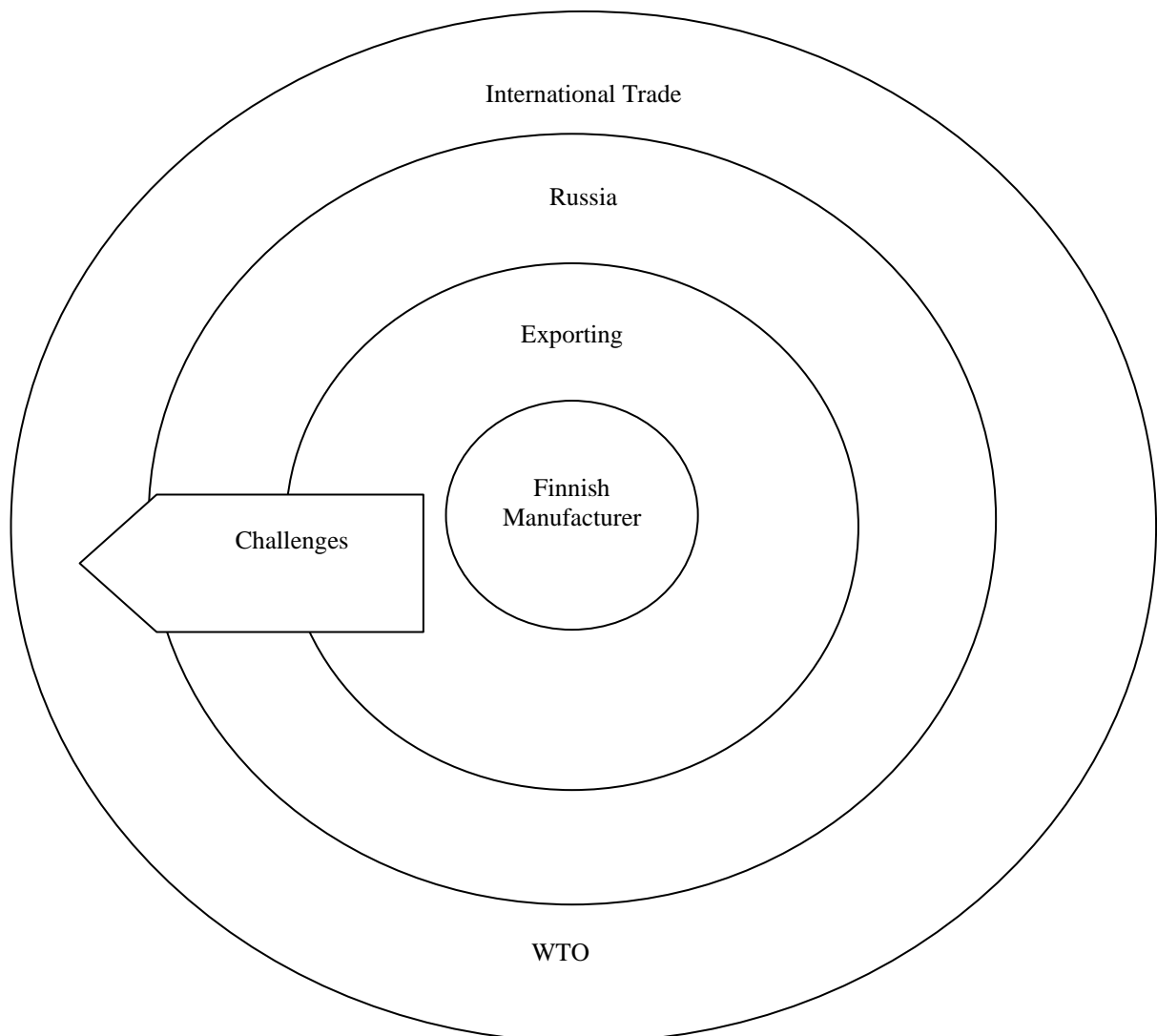
To develop understanding of exporting and its special features

To understand the importance of logistics and the problems it may generate in exporting to Russia

To understand what are the rationales behind these problems and to estimate whether some of these reasons are more influential than other reasons

To predict how Finnish exporters could benefit from Russia's future membership to WTO

CONCEPTUAL FRAMEWORK



Graph 3: Conceptual Framework: Logistical Problems in Exporting to Russia (own picture)

The idea of the conceptual framework is to present all the ideas of the theory as a process and thus work as a guideline to the empirical research. The starting point of the graph is a Finnish manufacturer exporting to Russian customer. Exporting and international trade include challenges that hinder the exportation. World Trade Organisation (WTO), agreements of which the member countries are bound to, attempts to solve these and other problems among the member countries in international context.

6 RESEARCH METHOD

6.1 Basic Paradigm: Quantitative versus Qualitative Research

As the purpose of this study was to identify the specific and distinctive challenges small and medium sized enterprises have in exporting to Russia, I chose to conduct qualitative research method over quantitative method. Creswell (1994, 57) explains the fundamental characteristic of a good qualitative purpose statement to be that it implies or expresses the assumptions of the qualitative paradigm based on experiences of individuals (in this case individual companies) in a natural setting. If, however, I had chosen to identify the problems from already existing literature and studied, in what proportions those “variables” then existed among the case companies, I would have chosen the quantitative method, which would have begun with identifying the proposed variables for a study. (Creswell, 1994, 57-63)

Vilkka and Airaksinen (2003, 63), on their behalf, state that the qualitative research method is functional when the aim of the study is to find a comprehensive understanding of the phenomena. The starting point would still be that the researcher is looking for unwritten facts.

6.2 Data Gathering

The data was gathered through semi-structured interviews. The interviewees were selected by keeping in mind the purpose of the study. Finnish-Russian Chamber of Commerce (SVKK) was selected because of the powerful position it has over trade with Russia. As majority of the exports to Russia is carried out on wheels, Finnish Transport and Logistics Association (SKAL) was selected to be the source of data for the logistical problems in exporting process. The representative of Finnish Customs was interviewed as a source for gathering data about the problems in Russian Customs in particular. Ministry for Foreign Affairs in Finland, then again, acted as the source for data about the current situation of Russia's accession process to WTO. The example companies were selected with the following criteria: they were small and medium size manufacturers operating in the near by region of Rauma and they had at least some experience with exporting to Russia.

The semi-structured interview was used to examine today's rationales in Russian market and the prospects of Russia's future WTO membership with a representative of Finnish-Russian Chamber of Commerce. The distinctive problems within international logistics in trucking industry and Russia were discovered with the same type of interview with a representative from Finnish Transport and Logistics. Individual semi-structured interview was also used in gathering data from a representative of Ministry for Foreign Affairs in Finland about the possible benefits gained from Russia's WTO membership and general problems with Russian trade. Similarly, individual semi-structured interviews were held with the representatives of the five example companies. These companies were selected among small and medium sized enterprises that had experience in exporting their industrial products to Russia. The interviewed persons in these companies were the persons responsible of trade with Russia. The aim of these interviews was to gather data about the specific challenges companies face in exporting to Russia.

Hirsjärvi and Hurme (2001, 34-35) say that because interviewing is a flexible method of gathering primary data it is suitable to many different situations. Interviewing is the most suitable method in cases where the research problem is a relatively unknown area

and where it is difficult for the researcher to know what is the direction of the answers. Interviews also apply in situations where the answers of the interviewee are desired to put into a larger context. In cases where the researcher knows in advance that the topic of the research will produce many-faceted answers that indicate many directions, it is interviewing that is the most suitable method of research. Interviewing is by far the most effective way of gathering data if answers need to be clarified or deepened.

In semi-structured interviews the researcher will have a list of themes and questions to be covered. In comparison to the structured interview with predetermined and standardised, always identical questions, semi-structured interviews leaves room for free flow of conversation and questions, outside the predetermined ones, can be made if the conversation that allows. Semi-structures interviews are used in qualitative research in order to conduct discussions not only to reveal and understand the “what” and the “how” but also to place more emphasis on exploring the “why”. (Saunders et al. 2003, 246-248)

As there five different areas of data I wished to explore by these interviews, I designed five different interview guides, which were list of questions and probing follow-ups that guided me through the interviews. The questions derived from the topics covered in the theory part of this thesis. All of the interview guides can be seen in the Appendixes. The interviews with SVKK, SKAL, customs and the Ministry for Foreign Trade in Finland were conducted through telephone, which recorded by note-taking, and e-mail, which did not need any recording as the data was received in text form. The company interviews were held in face-to-face situations, which were recorded by tape-recording.

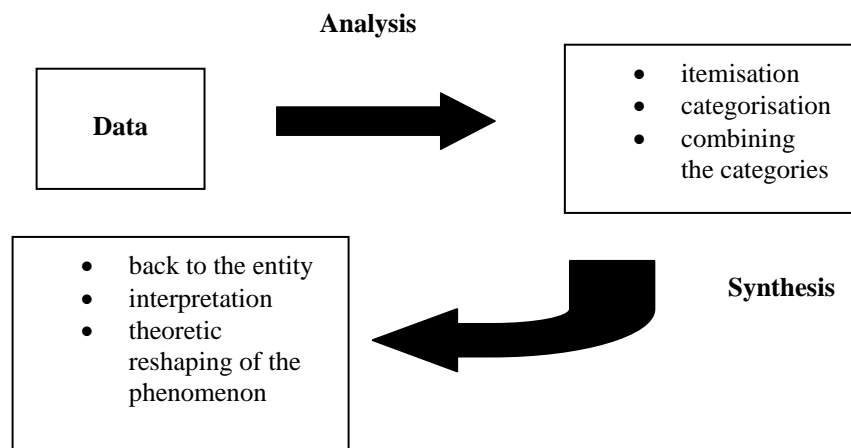
6.3 Data Analysis

Qualitative data are based on meanings expressed through words. They result in the collection of non-standardised data that require classification into categories and are analysed through the use of conceptualisation. The process of qualitative analysis generally involves the development of data categories, allocating units of the original data to appropriate categories, recognising relationships within and between categories

of data, and developing and testing hypotheses to produce well-grounded conclusions. (Saunders et al. 2003, 406)

The many different strategies to deal with the data collected are often grouped into four main categories: understanding the characteristics of language, discovering regularities, comprehending the meaning of text or action, and reflection. The first two categories in the list above are associated with some analytic strategies that commence deductively, where data categories and codes to analyse data are derived from theory and predetermined analytical framework. (Saunders et al. 2003, 406) I used the deductive approach by discovering regularities in the field of challenges in exporting to Russia.

Hirsjärvi and Hurme (2001, 143-144) explain the process of data analysis to be both analysis and synthesis. In analysis the data is itemised and categorised, and in synthesis the researcher tries to create a comprehensive picture of the findings and represent the examined phenomenon in a new perspective. A simple graph illustrates this process as follows:



Graph 4. The Data Processing from Analysis to Synthesis

6.4 Quality Assessment of the Study

A number of data quality issues can be identified in relation to the use of semi-structured interviews. They are related to reliability, validity and generalisability. (Saunders et al. 2003, 252) Hirsjärvi and Hurme (2001, 186) state that the research findings are reliable if two different researchers get the same results or if the results after two different interviews with the same person are the same. The reliability of interviews depends on whether for example all the respondents understand the questions in the same way. Reliability of face-to-face interviews can be addressed by using tape-recorders and then preparing transcripts. The reliability can be further improved by comparing the analysis of the same data by several researchers. (Silverman, 2001, 229-230)

Validity refers to the extent to which the researcher gains access to the knowledge and experience of the interviewees, and is able to infer a meaning that the interviewee intended from the language that was used by this person. (Saunders et al. 2003, 253) Two forms of validation that are suggested to be particularly suitable to the qualitative research are to triangulate – to compare different kinds of data and different methods to see whether they support one another – and respondent validation – taking findings back to the subjects being studied. (Silverman, 2001, 233)

Generalisability is a standard aim in quantitative research where often the number of respondents is far greater than in qualitative research and thus generalisation is easier. However, in this thesis qualitative research is used. Having several example companies in addition to other respondents is an advantage, but still, generalisability is a problem. Saunders et al. (2003, 261) argue that where researcher is able to relate the research project to existing theory, he or she will be able to demonstrate that the findings will have a broader significance than the case or cases that form the basis of the work. This is clearly what I needed to do in order to, and was also the reason why so much secondary data about Russia was conducted already in the theory part of this thesis.

7 RESEARCH FINDINGS

7.1 Interviewed Associations and Companies

The interview with the business adviser Anne Pajalin in the Finnish Russian Chamber of Commerce was held through e-mail. The final answers to the questions posted at the end of November were received in 14th of December. The aim of this interview was to define the current business environment in Russia. Additionally, the trade barriers were discussed in this interview, as were some of the problems with Russian customers and the distribution network there. The interview guide used in this interview can be seen in Appendix 1.

In the interview with a Finnish customs attaché Pasi Toivanen, the aim was to examine the Finnish customs' viewpoint of the problems in the Russian customs. Mr. Toivanen operates in St.Petersburg and the interview was held through e-mail in 18th of December. The interview guide to Finnish Customs is given in Appendix 2.

Mr. Antti Seppälä was interviewed as a representative of the Finnish Transport and Logistics (SKAL). This interview was also held by e-mail at the beginning of the year 2007. The aim was to discuss the logistical problems in exporting to Russia. The interview guide can be seen in Appendix 3.

Mrs. Johanna Ala-Nikkola from the Ministry for Foreign Affairs of Finland was introduced from the topic of the possible effects to Finnish exporters of the Russia's future membership to WTO. This interview was held by telephone in 7th of December. The questions asked from Mrs. Ala-Nikkola can be found in Appendix 4.

All of the five company interviews were held before Christmas, they were conducted in face-to-face situations in the premises of the companies through a semi-structured interview. All of the companies were naturally asked the same questions that can be found in Appendix 5. The companies were small- and medium sized enterprises with

some exporting experience from Russia. The share of exports to Russia varied from 5% to well over 50% of the total sales of the company. In compliance with the wishes of the interviewed companies, the thesis was conducted anonymously in what comes to the companies.

In addition to these sources, I also used secondary data in the forms of latest articles on the topic to support the findings.

7.2 PESTEL-Analysis of Russia

Both the Finnish Russian Chamber of Commerce (SVKK) and the Ministry for Foreign Affairs of Finland agreed with that there is an enormous potential in the Russian markets that still has not been fully exploited. The markets and demand there are huge, and at the moment there is also money there to improve the networks and buy quality products from abroad. The business environment in Russia is still difficult but continuously stabilizing and increasing the attractiveness of the Russian markets. According to the latest barometers of SVKK the expectations of the Finnish enterprises are high and investments to these markets are given. 76 % of the Finnish enterprises operating in Russia are expecting growth. The same barometers revealed that the bigger the company, the better the results from the Russian markets. The Russian bureaucracy still seems to be a high threshold for the smaller companies. Furthermore, 89% of the Finnish firms operating in Russia expect the Russian economy to grow, every fifth even strongly. (Nykänen, 2006) These facts were supported by the findings of this research. The Finns have a good reputation of reliable supplier of quality products in Russia, which all of the interviewed companies had benefited from. Additionally, the geographic proximity of Russian markets further improves the competitiveness of the Finnish exporters. The following PESTEL-analysis of Russia is based on the data gathered from all of the respondents.

7.2.1 Political Environment

According to Mrs. Anne Pajalin from SVKK, the governmental political environment in Russia affects the business environment mainly through the legislation and different regulations. The local politics in different cities and administrative districts affects the every day business life more. In local level the businesses get involved with the political decisions while bargaining ground and estate, and while agreeing on capital investments. However, Mr. Pajalin admitted that the business can be made more complicated through the bureaucracy that is influenced by the political decisions. This verification was strongly proved by the findings from the interviews with example companies: all of them perceived Russian bureaucracy as a heavy burden to carry. The corruption in the customs and other governmental institutions further worsens the business environment in Russia. I will come back to corruption as I come to explain the findings about Russian customs.

In trading sense, the political environment in Russia has changed remarkably during the past few years. The situation has stabilised and become more predictable. However, the interviewed companies mentioned the words nationalism and protectionism several times. According to them, there seemed to be a lot of talk in Russia about wanting to protect the domestic markets from foreign competition and reducing the imports of foreign goods for the benefit of the domestic producers. However, as long as there are only a few competitive firms operating in the same field as the Finnish exporters, and as long as the demand stays as high, this trend is not expected to grow. Still, the Russian political environment has recently tightened: the control of the government seems to intensify. They have started to work on the grey economy and, for example control over the exchange of foreign currency from country to another has increased. The Russian importers have to obtain a special trading passport to be able to buy products abroad. The primary reason for this is to have control over exporting and importing, but the exporters often considered this as protectionism.

7.2.2 Economic Environment

The economic growth in Russia creates a good basis for the enterprises to begin and develop operations in Russia. The economic growth is strong in all districts of Russia, not just Moscow and St.Petersburg. This economic growth is influenced by the tax revenues and raw material exports and it enables the budget investments to other fields. According to SVKK, this generates further opportunities for Finnish firms in the means of increased amount of projects by the Russian government. It is predicted that as long as the energy prices increase and as long as Russia has oil, there will be money in Russia. With this money the economic growth is expected to continue positive. The changes in political environment may, however, change the economic situation. The inflation in Russia is rather high – 9% in the year 2006, according to the Bank of Finland – but it has been stable during the past few years, thus the interviewed companies do not expect quick changes in inflation to create problems for them.

The problems in customs procedures, the high duties and taxation in general, and the long history of command economy have led the companies in Russia to seek ways to overcome these problems through informal, grey economy. The companies have been forced to hide their profits thus avoiding taxes by paying under the table. Double- even triple bookkeeping exists, of which all of the respondents were aware of and agreed upon. The same goes with double-invoicing. Even salaries are often paid black in Russia to avoid the taxes. This is something the Finns often find hard to understand, because in here it is easy to see where the tax money is going to, and people commonly agree on paying taxes for common good. In Russia, however, it is not this simple. All of the interviewed companies were amazed by the exceptional ability of the Russians to find solutions to their problems caused by the difficult business environment. As mentioned above, the companies operating in Russia have been forced to this flexibility and although the situation is getting better, the companies are still working on the edge and forced to seek even illegal ways to cope in the harsh environment: they would simply not survive without.

7.2.3 Sociocultural Environment

According to Pajalin, the sociocultural environment causes problems especially for the firms that are just beginning their operations in Russia. The operations modes and management culture, in particular, differ greatly from that of the Finnish ones, and if the firm is not aware of these differences and does not manage them, problems occur. Every interviewed company had most of their contacts in either Moscow or St. Petersburg, and they all spoke positively about the business style in these big cities: the behaviour is constantly changing towards the western style, further easing the business operations there. At the same time, they predicted, however, that Russia will hardly ever be entirely a western country.

The experiences of all of the interviewed companies told that the language skills of the Russians have improved, especially among the young companies that hire younger generation. Three out of five interviewed companies had employees who talked Russian, the others used interpreters. According to them, the company could cope with English as long as the company was doing business on an every day level. The experience of the interviewed companies was that most of the assistants and managers in Russia speak English but as a step or two is taken higher, Russian is a must. The general rule thus is that the business is done in Russian. One of the interviewees, who actually come from Russia, said that the above mentioned hiding of the profits and avoiding of taxes all go together with the fact that Russians often say what the listener wants to hear but act entirely different. This had caused problems among two of the interviewed companies.

Russians are generally clever negotiators, which often surprised the Finns. The know-how is also generally on a good level. The culture brings along the differences in behavior and ways of negotiating: Russians often present their ideas with polite words avoiding frankness. The sellers are then supposed to be able to get the message from these nicely put sentences. This is then where the language barrier comes up: the negotiation language is Russian, which naturally leads to the Russians having better initial position in the meetings.

All of the interviewed companies admitted that there is a lot of know-how in Russia. The people are commonly well educated, especially in the biggest cities. The engineering education, especially, is well appreciated in Russia, at least on theoretical level. The problem seems to lie in practical level; the processes of producing high quality products are not managed. Thus although there is know-how in Russia, they still seem to lack skills in practical production and in technology, which is partly explained by the lack of money in the organisations. According to Mrs. Pajalin the obsolete technology in many branches in Russia demands a lot of investments and renovation in the near future, creating further opportunities for the Finnish exporters. The working moral, especially among the young people has increased in Russia: they are working harder and longer days. This was agreed by all of the interviewed companies. Thus the old opinion of the Russians and especially the Soviet Union citizens being lazy people is beginning to be but a vague memory.

According to Mrs. Pajalin, the solvency and reluctance to pay among the Russians is beginning to be better than the reputation. Every now and then Finnish firms come into contact with dishonest, non-paying buyers. The Finnish Russian Chamber of Commerce always recommends that before moving to crediting the Russian customers, the firm should check the background of the customer and ascertain the solvency of that customer.

Every interviewee was familiar with late payments from the Russian customers. They considered that the late payments have mainly been due to the Russian enterprises keeping the money circulating. Russians seem to lack methods of planning the cash flow and finance in general. The late payment from their customer causes them to retard their payment to the exporter and vice versa, when their customer pays on time, they are able to pay on time. Every interviewee had credited the most liable Russian customers but used advance payments or letter of credit with the new customers and customers whose creditability and background they had not been able to acquire or that information had not assured the company. The competition in the Russian markets has, however, lead to competition in terms of payment as well. The exporters found it difficult to offer advance payments, especially when competing of a bigger customer. They were thus forced to give longer terms of payment and as all of the payments never came in time, the occurred problems were obvious.

In today's business life the flow of information no longer plays an important role. The most common channels of communication in business with Russians are Internet and telephone, also fax was still often used. The Russians also value and expect face-to-face meetings, thus they were considered necessary in the trade with Russians. Russians were perceived anxious in all of the interviewed companies. A common answer in Russia when asked about the desired time of delivery was told to be: "yesterday". This means that a quick delivery time is one of the biggest competitive edges there. This was where all of the respondents agreed on.

The problem with information flow at the moment seemed to lie in the complexity of the supply chains: the many intermediaries between the end customer and the exporter that may delay, change or even hide the original message. Three out of five interviewees had faced difficulties in getting reports and other numbers such as the forecasts from the partner. They had often had to force the partner to deliver this sort of information. The problem with forecasts in Russia is that although some figures are available, no one seems to be able to predict the development of the Russian markets. There are too much of variables, which from the Western point of view seem incomprehensible. The situation has, however, improved from what it was still three to four years ago when any numbers for forecasting were impossible to get.

7.2.4 Technological Environment

In information technology, the respondents agreed, the Russians are partly ahead of the Finns. The young, self-educated people have pushed the IT development on its feet in Russia. At the moment most of the hackers and viruses come from there. However, outside the biggest cities, for example the Internet connections are not so fast and it is rather expensive as well. It could be said that there are a lot of highly skilled people in Russia but that there is also a lot of non-skilled people there as well. Similarly, there are enterprises with the newest technology and enterprises with machines from the period of the Soviet Union. These differences are mainly found between the cities and the vast rural area. The gap between for example the Moscow and the Siberia is enormous. This

applies to all of the different business environments, not only the technological one, and was strongly agreed by all of the respondents.

According to Mr. Seppälä, the differences in information systems between Finland and Russia delay and hamper the daily deliveries between the countries. Although the harmonisation of the information systems is proceeding in the so called Finruslogict-project, there is still a need for double work load with the documents: the information from, for example, EU- form cannot be electronically transferred to the Russian system.

7.2.5 Ecological Environment

As Russia inherited the land and the society from the Soviet Union, and ecological or ethical issues were simply not considered in the past era of the Soviet Union, the condition of the nature and the lack of respect to ecological matters is understandable. As the money has been tight, ecological and ethical issues have been forgotten, and the companies and the people have been forced to concentrate on satisfying the basic needs of staying alive. According to Mrs. Pajalin, the ecological awareness is just now beginning to develop in Russia. As ecological thinking and the legislation in this field are generalising, the ecological regulations drive the companies to certain solutions that Finnish firms could then offer and sell for them. Thus business opportunities can be seen in the ecological awakening of Russia as well.

7.2.6 Legal Environment

The legislation in Russia is continuously reformed and monitoring of these changes is perceived difficult among the companies. Russian legislation is beginning to be at the same level with the West but problems still occur in local level interpretations that are not in accordance with the actual law. Another problem is the slowness of the implementation: in Russia these sorts of issues tend to take time before they are fully placed. Thus, the legal environment is still considered as a risk in operations in Russia.

The big investments, in particular, may fail to be made in the lack of predictability in legislation. The unpredictability of the customs, meaning the sudden decisions of the individual customs officers that do not correspond with the actual legislation, is hindering the exporting process to Russia daily. The trucks are continuously being put on queues on the border by putting in new claims that the companies then have to follow, thus causing delays in deliveries and increasing overall costs. These issues will be discussed more closely in the following chapter.

7.3 Challenges in Exporting to Russia

Following the table of content of the theory part, the next chapters concentrate to explain the findings of the interviews of the example companies, customs, and the SKAL. The intention was to support the responses of the two latter experts with the experiences of the example companies.

7.3.1 Challenges in the Customs

According to the customs attaché Pasi Toivanen, the greatest problems concerning the Russian customs are found in customs procedures, rate of customs duty, customs' officers, technical regulations and the inadequacy of the basic infrastructure in Russia. The Ministry for Foreign Affairs agreed with these and raised the unpredictability of customs procedures, the high rates of customs duty and the technical regulations to be the predominantly greatest problems in the customs and simultaneously the greatest trade barriers to Russia. The findings from the interviewed companies supported these statements.

At the beginning of the year 2004 Russia introduced the new customs legislation that as legislation is modern and corresponds to the standards of WTO. However, Mr. Toivanen pointed out the great deficiency of this legislation: there are no real

application decrees for it. Primarily the application should be based on international agreements that pass the national legislation, the decrees made by the Russian Federal Government, and the regulations of the customs of the Russian Federation. However, the application of these neither is always consistent, which allows the individual customs officers to make own interpretations, which then vary depending on the customs and the frontier crossing point.

Customs duties are part of the trade policy. Russia has implemented both import- and export duties whereas EU only has import duties. The current customs duties in Russia are higher than in many other countries. In practice, the rates of customs duties are divided into four main groups: 5%, 10%, 15%, and 20% customs duties. With some products the duty may even be higher. Among the interviewed companies the rate of duty varied from 10% up to 20% of the product's value presented in the sales invoice. They were commonly perceived as high. If the accession to the WTO succeeds, the rate of duties is estimated to decrease to 6-7%, meaning considerable savings for Finnish exporters. With decreased customs duties, the firms would then be able to decrease the price of the exported product and thus, better compete in the markets. As the customs procedures are also expected to become more predictable and transparent after the accession, the deliveries to Russia would become more fluent and quicker, thus providing further chances for further savings in the overall costs. The principal rule amongst the exporters had been that the customer pays the customs duties and takes care of the customs clearance, which meant that the exporter hardly knew about the problems their products had faced in the customs. However, three out of the five respondents had a few Russian customers for whom they delivered all the way there to the customer's premises or to the agreed terminal by using the services of a freight forwarder. The others only carried the goods to the Finnish side of the border from where on the customer were responsible of the goods and their customs clearance.

The certification system in Russia was perceived to be the biggest technical barrier in the trade with Russia – many products require compulsory certification without which the trade and customs clearance in Russia is not possible. The enterprises exporting to Russia have to deal with many kinds of documentation requirements including the certification. This heavy documentation and the meticulous correspondence of them with the other material are perceived as trade barriers that have delayed and/or

hampered the deliveries of all of the interviewed companies. Every interviewed company admitted having had problems with mistakes in documentation. For example, if the papers said there were 13 pallets in the delivery but there only were 12, problems arose. The right quantity of the pallets will have to be indicated by unpacking all of the pallets, thus retarding the process and causing risks for damaged goods.

The documents that the customs always requires varied from company to company and product to product, but the most common were the stamped sales invoices from which the value that determines the amount of duty and the quantity of the delivered products can be seen, and some kind of a certificate that the product is accepted in the Russian markets. Customer's requirements varied even more widely, some of them were: detailed packing list, sales contract, product specification, licence, and technical passport. Other documents such as the important bill of lading were often handled and carried out by the freight forwarder. Furthermore, the documents under company's responsibility varied among the interviewed companies based on the sales contract and used Incoterm: the exporter who did not use a freight forwarder had to prepare 16 different documents of which many had to have several copies raising the final number of papers of one single delivery up to 50. For the exporters who used freight forwarders the amount of required documents varied between three and five. Generally copies were required from the sales invoice (up to nine pieces) and packing list (up to three pieces), further growing the thickness of the document pile that travelled along side the physical products. Interestingly, all of the invoices and other documents needed to be stamped before delivery. Russians usually demanded these stamps to be circular, which takes back to the period of the Soviet Union where only the directors had circular stamps that were only received with a special permission. Similarly, one of the interviewed companies had run into a following problem: their customs code had six numbers (same to every country) but in Russia two zeros had to be added at the end of the code to make it valid there. If these zeros were missed from any of the export documents, customs was authorised not to let the delivery pass the customs. Furthermore, an individual customs officer might suddenly stop the truck and spend hours in calculating the sums in the invoices by hand. 0,1€ difference in the documents and in the sum calculated by the officer might then lead to the sending of new invoices and other documents. It is crucial that the same, correct sum is found in all of the documents, not just in the invoices. At the moment, it takes up to six weeks for the Finnish carrier to acquire a

visa from Russia, whereas it only takes approximately a week for the Russian carrier to acquire the common, unrestricted Schengen- visa from Finland. At the same time, the cost of the Russian visa with the expenses reaches 140€ and the Schengen-visa only 35€ Further inequalities between the Finnish and the Russian carrier are discussed in the next chapter.

The unpredictability of the Russian customs officers was perceived as the second biggest problem in the customs. The practice with which the previous delivery had passed the customs clearance fluently, did not apply the following time or the meticulous reading of the papers and careful inspection of the goods were all common problems. All of the example companies had faced or at least heard of the problems with the Russian customs officers. According to the respondents corruption is a huge problem in the Russian customs. However, they themselves did not have to deal with these issues, as the carrier was often the one having to deal with these sorts of issues. Common opinion among the exporters also seemed to be that these individual customs officers cause problems and delays for the exporters just because they can and because they want the carrier to pay them “under the table” – a phenomena, which is very common in Russia. Mr. Toivanen said that the quantity and extension of corruption in Russia is hard to put into concrete numbers. The corruption as a concept can be differently understood in Russia than in the West. However, he admitted that the corruption can be said to be even the greatest problem hindering Russia’s way to a developed society. He added that corruption in Russia is not only the problem of the customs but of all the Russian institutions that handle money. The activity of the Russian customs, like mentioned above, is retarding and hampering the trade so that the delivery of especially perishables may be problematic.

According to Mr. Toivanen, there are seven inspection authorities operating in the Russian crossing points at the moment, each of which alternately does his or her inspection. This has led to the fact that there are up to 52 inspections made per the customs clearance of a loaded truck in Russia, whereas the same number in Finland is on average five per loaded truck (Huovinen, 2006). Thus, even if the total time put on these inspections would be less than a half an hour, the effects of it in queues would still cause a certain compound impact. To overcome these inspections and possible unpacking of the pallets in the customs, the companies were commonly using a special

inspection certificate, which was supposed to guarantee that the goods were in accordance with the sales invoice. However, some of the interviewed companies had run into occasion where the pallets were unpacked even if the inspection certificate would have been valid. The causes of these actions can be seen in the even 50 kilometre's queues to the crossing points of South-East Finland. The increased traffic towards East also affects these queues. According to Mr. Toivanen, the numbers of the so called transit transport through Finland to Russia has quickly multiplied during the last 10 years.

Three out of the five interviewees agreed with that there are differences between the frontier crossing points, the customs points of Nuijamaa and Vaalimaa in the South-East Finland being the worst places. All of the interviewees agreed with that it is up to pure chance how the customs clearance would pass: firstly, it all depends on the crossing point and then, on the individual officer that reads the documents.

Russia's Minister for Transportation, Igor Levitin admitted in the meeting of Permanent Partnership Council (PPC) of EU and Russia that the truck queues delaying at the frontier between Finland and Russia are partly caused by the infrastructure of Russia, which is not on the same level with the Finnish one. I will discuss the Russian infrastructure more closely in the next chapter. Mr. Levitin also admitted that one big factor hindering the traffic on border is the different legislation on different sides of the border. Furthermore, he said that there are improvement points in the Russia's internal flow of information as the decisions of customs authorities and transportation authorities do not always correspond with each others. (Ylönen, 2006)

The effects of these problems with the Russian customs for the operations of the Finnish exporters interviewed here were numerous. The planning and controlling of both production and carriage became more difficult and the on-time deliveries were at continuous risk. The unpredictability of the customs procedures caused extra expenses on deliveries because every extra day spent on the frontier or customs terminal cost something for the exporters. According to Mrs. Pajalin these problems in the customs clearance have also led to misuses, by which she meant the way of the Russian firms to handle the customs clearance through informal channels leaving the duties and taxes unpaid. This affects the pricing in the markets so that the price of formally imported

products no longer is competitive with these informally cleared products. The long queues at the frontier caused also other problems than those of slowness and extra costs. Some of the companies had faced problems booking the car: as a huge number of trucks are standing in the queue at the frontier, the availability of free cars decreases. As the companies had the goods ready and packed but the truck to carry them to Russia was missing, the goods did not move. Two of the interviewees had even faced situations where two of their deliveries to Russia were standing on the frontier and other two were standing in the warehouse waiting for a delivery. Companies would naturally want the flow of the goods where money is tight to be fluent since extra costs can be calculated to arise as the goods stay put.

Apart from these “trade barriers” caused by the customs, the interviewed companies had little examples to give about the trade barriers in Russia. One of the interviewees had come across to a project in Russia where domestic producers were favoured. This kind of government intervention is common all around the world as an attempt to keep the money in the country and protecting jobs and industries. They are also hard to control and WTO has little capabilities in interfering in them.

7.3.2 Transportation and Traffic to Russia

The above mentioned problems with customs clearly cause challenges in transportation as well. Three out of five interviewees used freight forwarders to ease the document burden of exporting to Russia, the others had found them too expensive and handled the process on their own. As the results of this research indicated, the Finnish exporters are using more and more Incoterms, which transfer the responsibility of freight and costs before the Russian customs to the Russian customer. All of the exporters interviewed agreed in that it was important to build strong relationships with the third parties, meaning the freight forwarders, carriers, distributors and others. Reliability is crucial in any foreign trade, especially in the markets like Russia, where corruption and crime is part of every day business life. All of the interviewees had heard of thefts or disappearances of products and documents in Russia, but only one had actual

experience with it. One of their export documents – a certificate of the goods being accepted in the Russian markets – had disappeared during more than one carriage. These certificates were probably used elsewhere when some other products were imported to Russia. Human mistakes also take place, but in most of the cases there is some distance that is trying to benefit from the certificate by stealing it from some one and then selling it forward. This comes back to the commonness of the grey economy in Russia: the difficulty and expensiveness of customs clearance has led some companies to illegal ways of overcoming the barriers in the customs. It is clear that every stolen or missed document slows up the operations.

According to Mr. Seppälä from Finnish Transport and Logistics (SKAL), the amount of the Finnish carriers in traffic to East has decreased from 700 to less than a hundred active entrepreneurs. In the quantity of the cars this has meant the decrease from 1500 to 500. The share of the Russian carriers of the total exports to East has increased from 51% in 1996, to the current 87% at the same time as the share of the Finnish carriers has decreased from 38% to 6%. Mr. Seppälä listed few main reasons that have led to the decrease of Finnish entrepreneurs in the road traffic to Russia: the above mentioned visa question, the practices with the licences to oversized and –weight transport, the inspections on the dimensions and mass of the trucks, fines, extracts from register, and the insurances needed on the road. The practices in these aspects cause inequality between the trucks registered in Finland and Russia. These aspects were selected for the purposes of this thesis: they all have influence on exporting to Russia.

If the carrier needs to acquire a permit for oversized or – weight transport, this may take up to six months in Russia and cost several ten thousands, whereas the same permit is received in two days from Finland with about 100€ Furthermore, in Finland the customs and other authorities inspect the cars in what comes to their dimensions, mass and the technical condition; however the inspection is directed to less than 2% of the carriages when calculated from the border crossings. The same amount in Russia is full 100%. Another problem caused by the customs to the carrier is that there is a difference between the axle weight of a European truck and a Russian truck. In Russian the amount is 10 tonnes, whereas it in EU is 11,5 tonnes. The Russian customs has recently been tightening the inspections of axle weights, and the crossing of the standard by 100-

300 kilos costs 50€ for a Finnish car but only 10€ for the Russian car of the very same company.

Even more, the Finnish carrier faces occasional and arbitrary collection of money and fines in Russia. The situation is worst in the area of Svetogorsk. The Russian carriers do not face similar problems in Finland. Furthermore, the Russians absolutely demand an extract from register that meets the standards from the Finnish trucks; the local police may even demand it in Russian as well. Additionally, the insurances needed in transportation are in imbalance between these countries: the Finnish carrier pays up to 5000€ more for inspections than the Russian colleague. Finland and other Scandinavian countries demand special border insurance from the trucks from the countries that do not belong to the Green Card system. Many Russian carriers currently present a motor insurance certificate (the Green Card) in the countries other than Russia. However, according to Mr. Seppälä, the authenticity of these cards has been doubted.

The interviewed exporters perceived Russian carriers commonly as cheaper than the Finnish ones, which partly explain the popularity of their use in carriages to East. However, the differences in prices cannot be amazed after the above given list of inequalities between the two carriers. The respondents found little or no difference in the reliability between the two. Nevertheless, the increased number of Russian carriers in the traffic to East, further complicates the exporting process. Exporters need to take into consideration not only the above mentioned factors in international transportation but also the language barriers and cultural differences that may hamper the deliveries already inside the Finnish boundaries.

7.3.3 Infrastructure in Russia

Mr. Toivanen pointed out one great problem that may hinder the trade now and in the near future: the inadequate infrastructure of Russia. The distinctive problems related to the Russian current infrastructure are the extreme imbalance of the density of the logistics networks; huge distances; the relative remoteness and isolation of the logistics

networks from the world's main routes; the inadequate number and capacity of the frontier crossing points, and the bad condition of most of these networks. Although the government has begun to put more emphasis on improving the infrastructure of the country, quick changes are not possible because of the huge distances and harsh climate conditions. (Hernesniemi et al. 2005, 130-131) As the road network is disconnected and the rail network does not reach the most remote areas or is too slow, there might be several different modes of transport used in one single delivery inside Russia. All of the interviewees were familiar with these kinds of problems. One of the respondents had even heard of that their products had been delivered via helicopter to the end customer at the time of a year when road damages were common. Two out of five respondents told that as Moscow has been growing so rapidly, the infrastructure has not been able to follow, thus leading to massive traffics outside the city and in the customs terminal there. These traffics further delay the deliveries and cause similar problems as the delays in the customs. One of the interviewees explained the approximate delivery time to Moscow to be about a week for their product if everything goes well at the border. However, before the products are cleared in Moscow and placed in the end stock of the customer, it may well take another week, depending on the traffics in Moscow.

7.3.4 Distribution Channels in Russia

The distribution in Russia is challenging, said Mrs. Pajalin. According to her, the beginning of the distribution channel is the most problematic area. The above mentioned commonness of grey economy and misuses in the customs clearance are obvious causes of risk. Mrs. Pajalin also said that no actual established wholesale system exists in Russia. This is why Finnish exporters had found it difficult to find reliable partners that would have operated according to the wishes of the importer. According to the SVKK, Russian distributors often operate on their own, how they themselves desire, thus the Finnish seller may not be able to control the distribution operations nor dictate the modes of action that would be in accordance with the image of their own product. The end customer information may also be hard to receive from the distributors, which leads to uncontrolled selling of the products and problems in the

portfolio decisions. Every interviewed company had had some problems with the distributors in Russia at some point of the operations, mostly at the beginning of the export process there. A very common difficulty had been the finding of a partner whose thinking pattern and set of values would have been close to those of the exporter's. Whereas many of the Finnish exporters valued development and consistency in strategy, many of the Russian distributors seemed to make daily decision in what is good business today and what will be good business tomorrow and then lived accordingly. Thus at the beginning of the operations in Russia, all of the interviewees had had many negotiations with several instances before having finding the suitable partners.

Good way to start operations in Russia was to ask for help from domestic professionals in the field: for example SVKK or Finpro were good alternatives and three out of five interviewees had experience with cooperating with these instances. SVKK, for example offers counselling, consulting, market research, customer or partner search, negotiation arrangements, practical arrangements of business trips, trade fair trips, seminars etc. One of the interviewees also spoke about the importance of contacts: it was important for them to know someone there in order to get somewhere. However, this was not often enough; they also needed to be very careful with the received information especially when doing business through telephone: the name and position of the person at the other end of the line should always be asked; otherwise they might end up stating they never said that. Thus caution is needed while doing business with Russians. With the words of a Russian interviewee: "They can do tricks". Russians as customers is discussed more in the next chapter.

7.4 WTO and Russia

Finland has been the member of GATT since the May 1950 and the member of WTO since the birth of the organisation. Russia, however, is not yet a member of WTO. The accession process of Russia began soon after the collapse of the Soviet Union in 1993. (WTO, 2005) According to Johanna Ala-Nikkola from the Ministry for Foreign Affairs of Finland Russia has chosen to first negotiate the bilateral agreements with all of the current members of WTO and then move on to the multilateral agreements that would

eventually complete the accession process by combining all the bilateral agreements and integrating the decisions made in those agreements into final conditions and regulations. The bilateral negotiations between USA and Russia were completed in the mid November 2006 in Hanoi. These negotiations were the most remarkable bilateral agreements that had remained open. At the moment Russia lacks the bilateral agreements with Georgia, Moldova and Costa-Rica, of which the two latter ones are progressing, according to the informal sources of the Ministry for Foreign Affairs of Finland. Georgia, however, has informed that the previous bilateral agreement between them and Russia is no longer valid, and if new negotiations cannot be achieved, they will take a stand of opposing the beginning of the formal multilateral negotiations. On an informal level these multilateral negotiations have already been kept but without formal multilateral negotiations the accession of Russia will never become valid. These multilateral negotiations were supposed to begin at the beginning of the year 2007, but the reluctance of Georgia may well delay them.

In his article of "Osaamisella ja integraatiolla kumppanuuteen" published in *Kaupapolitiikka* in 2005, Mikko Taiviainen states that Russia's accession to WTO and integration to global economic system is a must for Russia because it already is economically dependent on other countries. The biggest problems in the negotiations at the moment have to do with tariff rates, technical trade barriers and other customs procedures, as well as with some aspects of pricing energy and protection of intellectual property. (Tapio, 2005)

Mrs. Ala-Nikkola agreed with Mr. Taiviainen and Mr. Tapio in that problems still exist with the technical regulations and the double tariffs of the railroad in particular. She added that these are the aspects that are most important for the EU: it demands balancing of these regulations and double tariffs. At the moment the commercial legislation of Russia is more or less in accordance with the foundations of WTO. The problem remains to be the slowness of implementation. It has to be remembered, however, that none of the current members of WTO has accessed the organisation with fully satisfying the conditions. The conditions have to be satisfied by the agreed deadline. Usually the transition time is 0-4 years depending on the country in question. Anne Pajalin predicted that the transition time in the case of Russia will be many years, thus quick changes should not be expected.

Mrs. Ala-Nikkola was determined with the greatest advantage of Russia's accession to WTO: it is the decrease in the rate of import (and export) duties. According to the bilateral negotiations with EU and Russia, these rates would fall to 6-7% from the current maximum of more than 20%. The final rate will be determined in the multilateral negotiations. However, Russia's membership to WTO would not necessarily decrease the duty of all of the products because the member countries are allowed to maintain high duties by appealing to certain reasons such as the danger of the products for the society. Also, the predictability and transparency should be increasing as Russia no longer would be able to suddenly raise the customs duties above a certain limit. Especially on the level of trade policy it is important that Russia becomes involved in the international commercial legislation. The effects of this would then move on to the practical level of trade. Mrs. Ala-Nikkola stated that a lot has already improved. The accession process has brought along the fact that Russia has been forced to modernize and revise its legislation –the legislation concerning the customs and the technical regulations in particular – even before the actual membership. Part of these effects will, however, become visible afterwards because the implementation in Russia takes time.

8 CONCLUSION AND RECOMMENDATIONS

This research proved that although improvements and development have been achieved in the Russian markets, especially in the economical and legal environment, they still cause challenges for Finnish exporters. The greatest challenges occurred in the technical regulations and bureaucracy, unpredictability of the actions of the individual customs officers, the high rates of customs duties, and the continuously changing legislation. Further problems could be found from the inadequate infrastructure and distribution in Russia as well as from the increased traffic to East.

Russian bureaucracy was perceived difficult and is a great trade barrier especially among the smaller enterprises. Meticulous reading and zero tolerance for errors in the

required documents are hampering and delaying the exporting operations of SME's daily. Furthermore, corruption is still common both in the Russian customs and the other institutions there that handle money. The exporters raised the unpredictability of the actions of the Russian customs officers to the second biggest challenge in exporting to Russia. The lack of proper application decree of legislation in Russia causes differences in interpretation of the laws, especially among the customs officers. These individual officers are perceived to cause problems for the deliveries even deliberately. All of the exporters interviewed here had heard of the cases where the carrier had been forced to pay under the table to enable fluent clearance of the delivery.

The rates of customs duty in Russia are higher than in many other countries. This research revealed that the rate of customs duty is commonly above 10%, and sometimes even higher 20%. The exporters interviewed here, had overcome the high duties and other problems in customs by negotiating an Incoterm favorable for them: transferring the responsibility of the freight and costs to the customer before they pass Russian customs. Many Russian importers have, however, used informal and illegal ways of clearing the goods. The grey economy is common in Russia.

Overall the problems in the customs clearance caused by the above mentioned factors and the uncontrolled work of too many Russian customs inspectors have formed a trade barrier greater than no other in Russia. Nationalism and protectionism have been claimed to raise their heads but the trend is not expected grow in the near future because of the huge demand which the domestic suppliers cannot satisfy by themselves.

The slowness of the customs and the inadequate infrastructure in Russia have led to the growing queues at the frontier. This has caused further challenges in the means of increasing delivery time and overall costs, as well as decreasing availability of free cars as most of them are standing at the frontier.

Examples of logistical challenges in exporting to Russia were inconsistency of the Finnish and Russian information systems, technological differences in equipment of logistics between these countries, the inequality between the Finnish and Russian carriers in what comes to the insurances, length and cost of application periods for visas and special permits, and the fining and other special demands of the Russians for the

Finnish carriers. The creation of a reliable distribution network and selection of the right partners in Russia were also perceived difficult.

Altogether the challenges in exporting to Russia make it very complex, time consuming, and costly. If Russia's accession to the World Trade Organisation (WTO) succeeds, the expected benefits will mainly apply to the decrease in the rate of customs duties and increase in predictability and transparency at the customs.

I recommend the companies that are considering exporting to Russia to first study and analyse the effects of the challenges explained in this thesis. Identifying the challenges may help the companies to be prepared with them and, ideally develop useful and legal ideas to overcome the challenges.

BIBLIOGRAPHY

Books :

Astrup J. etc. 2003. Guide to Export-Import Basics: Second Edition. Paris: International Chamber of Commerce

Bade, R; Parkin M. 2007. Foundation of Economics. Third Edition. Boston: Pearson Education, Inc.

Ballou, Ronald H. 1999. Business Logistics Management. Fourth Edition. New Jersey: Prentice-Hall Inc.

Branch Alan. 2000. Export Practice and Management, Fourth Edition. London: Thomson Learning

Creswell John W. 1994. Research Design: Qualitative & Quantitative Approaches. Thousand Oaks: SAGE Publications, Inc.

Cook Thomas A. 2004. Mastering Import & Export Management. New York: AMACOM

Grafers H.W; Schlich A.W. 2005. Strategic Export Management. Helsinki: WSOY

Griffin R.W; Pustay M.W. 2002. International Business, A Managerial Perspective. Third Edition. New Jersey: Pearson Education Inc

Hernesniemi H; Auvinen S; and Dudarev G. 2005. Suomen ja Venäjän Logistinen Kumppanuus. Helsinki: Taloustieto Oy

Hill, Charles W.L. 2004. Global Business Today. International Edition. New York: McGraw-Hill Companies

Hill, Charles W.L. 2005. International Business: Competing in the Global marketplace. New York: McGraw-Hill Companies

Hill Charles W.L. 2007. International Business: Competing in the Global Marketplace. New York: The McGraw-Hill Companies

Hirsjärvi Sirkka; Hurme Helena. 2001. Tutkimushaastattelu: Teemahaastattelun teoria ja käytäntö. Helsinki: Yliopistopaino

Kotilainen M; Kaitila V; Widgrén M; and Alho K. 2003. Suomen ja Venäjän Taloussuhteiden Kehitysnäkymät. Helsinki: Taloustieto Oy

Morrison Janet, 2002, The International Business Environment: Diversity and the Global Economy. New York: Palgrave

Rugman A. M; Hodgetts R. M. 2003. International Business. Third edition. Essex: Pearson Education Limited

Rushton, A; Oxley, J; Croucher, P. 2000. The Handbook of Logistics and Distribution Management. Second Edition. London: Kogan Page Limited

Saunders M; Lewis P; Thornhill A. 2003. Research Methods for Business Students. Third edition. Essex: Pearson Education Limited

Silverman David. 2001. Interpreting Qualitative Data: Methods for Analysing Talk, Text and Interaction. Second Edition. London: SAGE Publications Ltd

Simchi-Levi, D. Kaminsky, P. Simchi-Levi, E. 2003. Designing and Managing the Supply Chain: Concepts, strategies and case studies. International Edition. Second Edition. New York: McGraw-Hill Companies Inc. Distribution strategies

Sloman John. 2006. Economics. Sixth Edition. Essex: Pearson Education Limited

Trebilcock M.J; Howse R. 2005. The regulation of International Trade. Third Edition. London: Routledge.

Wall S; Rees B. 2004. International Trade. Second Edition. Essex: Reason Education Limited

Waters D. 2003. Logistics; An Introduction to Supply Chain Management. Hampshire: Palgrave Macmillan.

Vilkka Hanna; Airaksinen Tiina. 2003. Toiminnallinen opinnäytetyö. Helsinki: Kustannusyhtiö Tammi

Articles:

Europaenus, J. Kilpailu Venäjän kuljetuksista kiristyy. Finpro: kansainvälistymisen aikakauslehti, 2006. Lokakuu, pp.14-15

Lehtomäki, P. Venäjän kaupan haaste ja mahdollisuus. Kauppapolitiikka, 2004, Vol. 5, pp. 34

Lipasti, R. Vaaran maantiede. Finpro: kansainvälistymisen aikakauslehti, 2006. Lokakuu, pp.32-35

Nousiainen, I. Suomen Pankin Pekka Sutela: Venäjän kiistattomat mahdollisuudet ylittävät riskit. Kauppapolitiikka, 2004. Vol. 5, pp. 6-7

Nykänen, P. Yritysten Venäjä-odotukset laantuivat. Kauppalehti, 2006, joulukuu, N:o 234, pp. 13

Ollus, S-E. Jälleenvienti kasvattaa Suomen Venäjän-kauppaa. Tieto&Trendit. 2006, Helmikuu, pp. 36-40

Rautava, J. Venäjän talous vahvassa vedossa. Tieto&Trendit. 2006, Helmikuu, pp. 30-34

Taiviainen, M. Osaamisella ja integraatiolla kumppanuuteen. Kauppapolitiikka, 2005, Vol. 4, pp. 10-11

Taiviainen, M. Pökyä pesään pk-sektori. Kauppapolitiikka, 2005, Vol. 4, pp. 12-13

Tapio, T. Venäjä ja WTO: Mikä muuttuu ja milloin? Kauppapolitiikka, 2005, Vol. 4, pp. 11

Ylönen, U. Logistiikkatyöryhmä ratkomaan tavaraliikenteen ongelmia. Logistiikka, 2006, Vol. 7, pp. 10

Online articles and web-pages:

Hakkarainen, M. 2006. Verkot Venäjän vesille – Venäjän kaupan tietolähteitä. [online] Helsinki: KTM. [referred to 29.11.2006]. Available at: [http://ktm.elinar.fi/ktm_jur/ktmjur.nsf/0/13EF3722319DDA21C22571000041481B/\\$file/ratu13mos_2005_netti.pdf](http://ktm.elinar.fi/ktm_jur/ktmjur.nsf/0/13EF3722319DDA21C22571000041481B/$file/ratu13mos_2005_netti.pdf)

Huovinen, S. 2006. Liikenne- ja viestintäministerin vastaukset eduskunnan kirjallisiin kysymyksiin. [online]. Helsinki: Liikenne- ja Viestintäministeriö. [referred to 07.01.2007]. Available at: <http://www.mintc.fi/scripts/cgiip.exe/WService=lvcm/cm/pub/showdoc.p?docid=2014&menuid=96&channelitemid=15207>

International Transparency. 2005. Transparency Perception Index 2005. [online] [referred to 5.11.2006]. Available at: http://www.transparency.org/policy_research/surveys_indices/cpi/2005

OECD. 2003. Policy Brief: The Doha Development Agenda: Tariffs and Trade. [online]. [referred to 26.10.2006]. Available at: <http://www.oecd.org/dataoecd/35/49/8920463.pdf>

OECD. 2006. Country Risk Classifications of the Participants to the Arrangement on Officially Supported Export Credits. [online]. [referred to 4.11.2006]. Available at: <http://www.oecd.org/dataoecd/47/29/3782900.pdf>

Ollus, S-E; Simola H. 2006. Russia in the Finnish Economy. [online] Helsinki: Sitra. [referred to 5.11.2006]. Available at: <http://www.sitra.fi/julkaisut/Raportti66.pdf?download=Lataa+pdf>

Pullola, L. 2004. Tekniset kaupan esteet ja Venäjä. [online]. Ulkoasiainministeriö. Helsinki: Kauppapolitiikka. [referred to 27.10.2006]. Available at: <http://www.kauppapolitiikka.fi/netcomm/news/showarticle.asp?intNWSAID=21107>

Suomen Pankki. 2007. BOFIT viikkokatsaus 2007. [online]. [referred to 07.01.2007]. Available at: <http://www.bof.fi/bofit/fin/3viikko/intro.stm>

Tulli. 2005. Foreign Transports 2005 Total. [online] [referred to 27.10.2006]. Available at:
http://www.tulli.fi/fi/05_Ulkomaankauppatilastot/06_Tilastoja/taulut/Kuljetus2005.xls

Tulli. 2005. Foreign Transports by Country 2005. [online] [referred to 27.10.2006]. Available at:
http://www.tulli.fi/fi/05_Ulkomaankauppatilastot/06_Tilastoja/taulut/KuljetusMaat2005.xls

Tulli. 2006. Foreign Trade 2005: Finnish Trade Figures. [online] Helsinki: National Board of Customs. [referred to 26.10.2006]. Available at:
http://www.tulli.fi/fi/05_Ulkomaankauppatilastot/05_Tilastokatsaukset/pdf/2006/pocket2005.pdf

WTO. 2005. International Trade Statistics 2005. [online]. Geneva: WTO Publications. [referred to 26.10.2006]. Available at:
http://www.wto.org/english/res_e/statis_e/its2005_e/its2005_e.pdf

WTO. 2005. Understanding the WTO. [online]. Geneva: WTO Publications. [referred to 26.10.2006]. Available at:
http://www.wto.org/english/res_e/statis_e/its2005_e/its2005_e.pdf

Graphs:

Graph 1: Tulli

http://www.tulli.fi/en/03_Foreign_trade_statistics/07_figures/figures/figure22-06.jpg

Graph 2: Grafers H.W; Schlich A.W. 2005. Strategic Export Management. Helsinki: WSOY

Graph 3: own picture

Graph 4: Hirsjärvi Sirkka; Hurme Helena. 2001. Tutkimushaastattelu: Teemahaastattelun teoria ja käytäntö. Helsinki: Yliopistopaino

APPENDIX 1:

INTERVIEW GUIDE TO FINNISH RUSSIAN CHAMBER OF COMMERCE

PESTEL- Analysis

- Describe the current
 - political
 - economic
 - sociocultural
 - technological
 - ecological
 - and legal environment

Trade barriers to trade with Russia

- What kind of barriers have Finnish enterprises faced as they have been exporting their products to Russia?
- How and why have these barriers occurred?
- How have they affected the trade in Russia?
- Other problems concerning the trade barriers?
- What kind of benefits do you think Finnish exporters are going to achieve as Russia access the WTO?

Problems with distribution channels and other intermediaries in Russia

- Is it easy to find reliable partner in Russia? Why/why not?
- What kind of problems have the Finnish enterprises faced as they have created, developed and maintained their distribution channels in Russia?
- Other problems concerning the distribution channels?

Problems with Russian customers

- How much do Finnish enterprises face late payments or non-payments with Russian customers?
- Are there problems with the flow of information? What, how, why?

- Other problems concerning the business behaviour, know-how etc. of the Russian customer?
- What kind of aid can Finnish enterprises get concerning the Russian trade?
- What kind of aid do you give?

APPENDIX 2:

INTERVIEW GUIDE TO FINNISH TRANSPORT AND LOGISTICS (SKAL)

- What kind of problems does truck cargo include in road carriage to Russia?
- How do you think these problems affect the exporting operations of Finnish enterprises?
- What are the problems in Russian infrastructure?
- How do you think these affect the exporting operations of Finnish enterprises?
- Do technological differences exist between Finland and Russia concerning logistics (availability and usage of the newest haulage, IT- and other equipment)? What, how, why?
- What are the most common documentation requirements in Russian carriage?
- Do these requirements cause problems? What, how, why?
- What kind of barriers to trade have you heard of in carriage to Russia?
- What kinds of problems occur in customs? How, why?
- How do these problems affect the operations of the Finnish exporters?
- What other logistical problems does exporting to Russia cause? How, why?

APPENDIX 3:

INTERVIEW GUIDE TO FINNISH CUSTOMS

- What are the biggest problems at the moment concerning
 - customs procedure
 - rate of customs duty
 - technical barriers
 - customs officers of the Russian customs?

- Other problems in the Russian customs?

- How do you think, these problems affect the operations of the Finnish enterprises?

APPENDIX 4:

INTERVIEW GUIDE TO THE MINISTRY FOR FOREIGN AFFAIRS OF FINLAND

Russian Markets

- What are the future prospects of Russian markets?
- What are the current risks and problems in Russian markets?
- What are the biggest and most influential trade barriers in Russia at the moment?

Russia and WTO

- What is the current situation of the accession process?
- What are the greatest risks and problems in the realization of the accession?
- How might the exporting of the Finnish firms be improved by the accession of Russia to WTO?
- In what time line could these benefits be achieved?

APPENDIX 5:

INTERVIEW GUIDE TO EXAMPLE COMPANIES

General information

- Company information (year of foundation, field of industry, number of employees etc.)

The history of trade with Russia

- When has the trade with Russia began and how?
- Has the company acquired help from some Finnish organisation or institutions? Which?

The present trade with Russia

- What is the current state of the Russian trade within the company? (how many Russian customers and where are they located, how big proportion of the products sold to Russia, how is the current exportation organised, what transportation mode mainly used? etc)
- Is the company satisfied with the current Russian trade?
- What are the future prospects and plans for the trade with Russia?

Russian markets

- How does the current
 - political
 - economic
 - sociocultural
 - technological
 - ecological
 - legal environment of the Russian market affect the operations of the company?
- The opportunities and threats in these environments?
- Has the company attempted to overcome these problems? How?

Logistics

- What kind of problems has the company faced in organising the transportation to Russia?
- What other problems related to the transportation and how have they affected the trade with Russia?
- Is the company using third parties to take over transportation and other logistical activities? Which company and what are they responsible of?
- Has the company had any problems with these third parties?
- What kind of problems has the company faced in creating and maintaining the distribution channels? (representatives in Russia etc.)
- How have these problems affected the trade with Russia?
- Has the company had problems with the distributors in Russia?
- How have they affected the trade process?
- What kind of problems has the company faced with the flow of information with the Russian customers or other Russian partners?
- How have these problems affected the trade process?
- Other logistical problems?
- What is your way of competing in Russia?

Customs

- What kind of problems has the company faced with the customs duties?
- How have they affected the trade process?
- What kind of problems has the company faced with customs authorities?
- How have they affected the trade process?
- Does the company use bonded warehouses? What and how have they affected the process?
- Other problems with the customs?

Export documentation

- What are the documentation requirements for the company concerning the Russian exports?
- What kind of problems has the company faced concerning the documents?
- How have these problems affected the exportation process?

- Has the company faced problems with the contract negotiations?
- How have these problems affected the exportation process?

Russian customer

- Has the company faced customers who are reluctant or incapable of paying the bills in time?
- Has the company faced problems with the requirements of the Russian customer/Does the Russian customers require more than the others)
- Has the company had problems with the flow of information with the Russian customer?
- How have these problems affected the exportation process?
- Other problems with the customer?

Other

- In addition to the above mentioned problems, has the company faced any other problems with the Russian trade?