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TAKING YOUR BUSINESS TO RUSSIA

A GUIDEBOOK AND HISTORICAL OVERVIEW
FOR ENTREPRENEURS

TAMARA GALKINA AND SÖREN KOCK (EDS)



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Taking your Business to Russia

A Guidebook and Historical Overview for Entrepreneurs

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PREFACE AND ACKNOWLEDGEMENTS

We are very pleased to introduce this book, which is the result of a long collaborative research project between the Hanken School of Economics, Finland, and St. Petersburg State University, Russia. The book is a response to two calls: one from Finnish business practitioners to develop practical guidelines on how to establish and operate small businesses in Russia and the other from the academe to conduct more research on Russia as a turbulent market with high potential for small entrepreneurial firms.

What makes this book different from existing guide books on how to conduct business in Russia? First, it targets a very specific audience; namely, Finnish entrepreneurs and business practitioners who plan to establish their businesses in Russia or who already have companies operating there. Thus, this work differs from other books written mostly by North American authors. We believe our target audience will benefit from this narrow focus as it addresses concrete problems typical for Finnish business people in Russia. We also hope that the results of our research will be employed for teaching purposes in business schools across Finland as, nowadays, many of them offer special courses on Russian business. Second, our research team comprises scholars from both Finland and Russia, which offers a dual perspective on this phenomenon. Third, the empirical part of this research is based on qualitative case studies, not on broad statistical analyses. This approach enabled us to go deeply into specific business cases and to perceive the challenges of running businesses in Russia through the eyes of entrepreneurs and managers. We hope that readers will find this approach useful for understanding their own business situations.

This book would not have been possible without our partners' help. We want to express our deepest gratitude to the Scandinavian Institute for Administrative Research (SIAR) for providing the grant for this project; we specifically want to thank Christian Junnelius, the chairman of SIAR, whose endless help and enthusiasm have facilitated this research. We also wish to thank the Finnish Foundation for Economic Education (Liikesivistysrahasto) that provided financial support for this joint research project. In addition, we wish to thank our respondents for sharing their experiences with us and for their willing participation in the research project. Our thanks also go to Alex Frost from Comword for editing the manuscript's language.

Tamara Galkina and Sören Kock

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- Competence Assessment of Finnish Companies in Russia (2009)
- Managing Post-Acquisition Integration of a Russian Company Acquired by a Finnish Company (2010)
- How to Build and Maintain Customer Relationships in Russia (2010)

The results of these studies have been targeted at Finnish businesses and have been widely presented in Russia and Finland.



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INTRODUCTION

As a growing market, Russia holds great economic interest and potential opportunities for international companies, especially Finnish SMEs. Due to their geographic proximity, Russia and Finland have a long history of established business and trade relations. Finland's major economic institutions were formed during the period when the country was under Russian rule. Also, the two countries had bilateral trade relations for approximately forty years; this regime developed from the payment of reparations after the Winter War (Ollus & Simola, 2006). Nowadays, Russia is acknowledged as one of Finland's biggest trading partners and the most important direction for internationalisation of small and medium-sized Finnish companies, especially in the sectors of machine and equipment manufacturing, and the chemical and metal industries. Finland has a strategic geopolitical position as a gateway between East and West; hence, there is great potential for the growth of trade, investment, technology transfer and other cooperation between Russian and Finnish businesses. According to the Barometer of Finnish-Russian Trade, in 2012, Russia was the second biggest export market for Finland after the United States. Despite the general economic slowdown in 2012, Finnish exports to Russia grew by 10%. An especially positive development was detected in industrial production.

In his speech at the forum “Finnish Business in Saint-Petersburg” in May 2012, Alexander Stubb, minister for European Affairs and Foreign Trade, emphasised Russia's importance as Finland's main trade partner and pointed out the need to reduce various trade barriers between the two countries. Several results were accomplished on this matter. For example, on 25 June 2013, Russian president Vladimir Putin and Finnish President Sauli Niinistö signed several economic agreements on bilateral cooperation. These agreements included, among others, the Cooperation Agreement between the Russian Union of Industrialists and Entrepreneurs and the Confederation of Finnish Industries, and the Cooperation Agreement between the Non-Profit Organisation Foundation for the Development of the Centre for Research and Commercialisation of New Technologies (i.e. the Skolkovo Foundation) and the Finnish Funding Agency for Technology and Innovation (Tekes).

Many Finnish companies expanded their businesses. In 2013, the database of the Finnish-Russian Chamber of Commerce included more than 700 Finnish firms operating in Russia. As these companies are registered members of the chamber, we can expect the real number of Finnish firms willing to conduct business with Russian partners to be even greater. Often, the primary reason for expansion is that the domestic Finnish market's small size does not fit with Finnish firms' ambitions for growth. Also, another trend is notable: the growing number of Russian companies expanding into Finland.

In May 2013, three organisations – the Central Business Union EK, the East Office and the Finnish-Russian Chamber of Commerce – pooled their efforts to develop Russian-Finnish trade relations and to facilitate future business cooperation between the two countries. Esko Aho, former prime-minister of Finland and president of the Finnish innovation fund Sitra, was appointed head of this new union. The new team of three experts will have a special focus on small and medium-sized enterprises that wish to become established in Russian markets.

Taking population and GDP into consideration, it can be concluded that Finland has invested more in Russia than in any other country. Direct investments from Finland into Russia are approximately €8 billion. Finnish companies have great experience in high-tech manufacturing on Russian territory. For instance, in the Kaluzhskaya region, eight Finnish manufacturers employ more than 2,000 people (Korobkin, 2011). Traditionally, the Russian northwest, including St. Petersburg and Novgorod, is one of the most attractive regions for Finnish investors. St. Petersburg and the Leningrad region have become almost a domestic market for many Finnish firms because their market is almost as large as Finland's and has a developed logistical infrastructure. However, Finnish investors are increasingly interested in other locations such as, for example, Samara, Nizhniy Novgorod, Yekaterinburg, Tatarstan, Vologda and the Republic of Komi.

Traditionally, wood, gas, oil (90%), carbon, metal and chemicals are the most popular products imported by Finland from Russia. Russia is Finland's third largest destination for exports and its primary source of imports. Finland exports include, for example, electronics, chemical products, paper, equipment and cars (Semulenkova & Kozhevnikov, 2011).

Often, Finnish entrepreneurs are unsure of the best way to enter the Russian market and, as such, expect to get advice from experts and practitioners. This explains the growing number of different developmental programs and initiatives organised by various organisations operating in Finland and Russia. For instance, the Finnish-Russian Innovation Centre, located both in Lappeenranta, Finland, and in St. Petersburg, Russia, provides numerous services for Finnish entrepreneurial firms that want to commercialise their innovations in Russia. Also, organisations such as Finpro, Tekes, VTT and Finnnode have different support programs for Finnish firms internationalising to Russia. In addition, the Finnish-Russian Business Forum and the internet professional network LinkedIn are constantly increasing their number of members.

In fact, the availability of different support services demonstrates that Finnish firms regard Russia as an interesting, although challenging, destination for internationalisation. Russia's entrepreneurial climate remains highly challenging and unstable due to its turbulent economic, political and social environment. For example, the 2010 Global Entrepreneurship Monitor report on Russia showed that the prevailing number of entrepreneurs sensed and experienced worsening conditions for opening new businesses and characterised the market environment as unfavourable for new entrepreneurial activities (Verhovskaya & Dorokhina, 2010: 14, 16). In contrast, the Finnish entrepreneurial climate is characterised as more stable and predictable. The 2012 Global Entrepreneurship Monitor report on Finland demonstrates that, despite years of economic recession, early-stage entrepreneurial activity is growing, and the survival rate for new businesses is relatively high due to the Finnish governmental policies that are supportive for entrepreneurship (Stenholm et al., 2013). Overall, the entrepreneurial infrastructures in Russia and Finland vary due to different cultural and institutional contexts (Galkina & Kock, 2011); entering the Russian market can be challenging for small Finnish firms that lack the resources to conduct extensive marketing research and to pay for various consulting services.

This book provides knowledge and practical information on how to make entry into Russian business structures less painful. The book is divided into two parts. **Part 1** provides hands-on knowledge and practical implications on taking a business into Russia. Chapter 1 in this part presents a number of quantitative estimations on the

Russian business climate according to various international and Russian agencies. These estimations are based on surveys and also statistical data; they are focused on various facets of Russian business (e.g. general business climate, entrepreneurial and SME issues, venture financing and regional estimations). This provides a balanced picture of Russia's business climate.

Chapter 2 discusses cultural challenges faced by Finnish companies when they enter the Russian market. The chapter is based on the results of three research projects conducted between 2008 and 2010. The authors show how differences in power distance and power distribution impact relationships between employees from Finnish companies operating in Russia. Also, they consider cases indicating different perceptions of truth and formal rules by Finnish and Russian partners and also challenges caused by cultural differences in organisational behaviour and human resource management practices. Additionally, social barriers to developing a business in Russia are discussed.

Chapter 3 takes a network perspective and addresses the challenges of establishing business relations in Russia. The chapter is based on a study on eight Finnish firms that internationalised into Russia and have experience of establishing their business networks there. Some practical implications for Finnish business practitioners on how to build and maintain relationships with Russian counterparts are developed.

Chapter 4 augments these implications by providing expert opinions from Russia and Finland.

Finally, Part 1 ends with concluding remarks in Chapter 5 that suggest several practical tips on how to address socio-cultural differences between Finnish and Russian business environments.

Part 2 is written for readers who wish to gain a deeper understanding on Russian business through understanding its historical background. Chapter 1 in this part provides a brief overview on Russian history to outline key national values and archetypes that have developed across time from tsars to presidents, and to explain the backwardness that Russia systematically experienced over its historical path. This chapter will help the reader gain a better understanding on Russia in a cultural and ideological sense.

Chapter 2 describes the main stages in Russia's economic and social evolution after the collapse of the USSR and the formation of Putin's Russia and new Russian capitalism. This chapter will help with an orientation to the contemporary Russian political and economic landscape, and also to evaluate better the various facts and news of Russian business life.

Chapter 3 is devoted to a brief overview of Russia's formal business environment. We initially describe the Russian legal system (i.e. constitution, codes, laws and acts) to help entrepreneurs better understand the institutional framework for business. We then describe basic legal forms of business: individual entrepreneur, partnership, limited liability society (the most popular and widespread) and joint stock companies (i.e. public and private).

Concluding remarks are made in Chapter 4 of this part.

PART 1
ENTERING RUSSIA

1 ENTREPRENEURIAL CLIMATE

Maxim Storchevoy:

The notion of an entrepreneurial climate in a particular region relates to a set of economic, legal, political and cultural factors that either makes conducting business easier or harder. However, is it possible to measure the general quality of the entrepreneurial climate in Russia and compare it with other relevant areas? Measuring the entrepreneurial climate is not an easy task; however, there are a number of Russian and international projects aiming at quantitative estimations of Russia's business climate and comparing it to similar metrics of other countries. First, we describe three major international projects for measuring the business climate: 1) the Global Entrepreneurship Monitor, focused on entrepreneurial conditions for small and medium-sized businesses in various countries; 2) the Doing Business rating, a World Bank comprehensive rating describing the general business climate in a country; and 3) the Global Venture Capital and Private Equity (VCPE) Country Attractiveness Index that measures conditions for venture investments and investments in private (i.e. closed) companies. Then, we provide data from Russian rating and survey projects: 1) Russian Union of Industrialists and Entrepreneurs (RSSP) surveys conducted by the largest Russian business association; and 2) Investment Attractiveness of Russian Regions, a rating developed by RA Expert, a major Russian rating agency.

1.1 Global Entrepreneurship Monitor

The Global Entrepreneurship Monitor (GEM)¹, a longitudinal study of entrepreneurial conditions in various countries, is a useful resource for examining entrepreneurial climate. One key indicator measured and monitored by GEM is *Early Stage Entrepreneurial Activity*, or the TEA index ("TEA" is the acronym of the former name of this index, "Total Entrepreneurial Activity"), which shows the number of nascent entrepreneurs (i.e. people involved in starting a business up to three months old) and owner-managers of a new business (i.e. up to 3.5 years old) per 1,000 people.

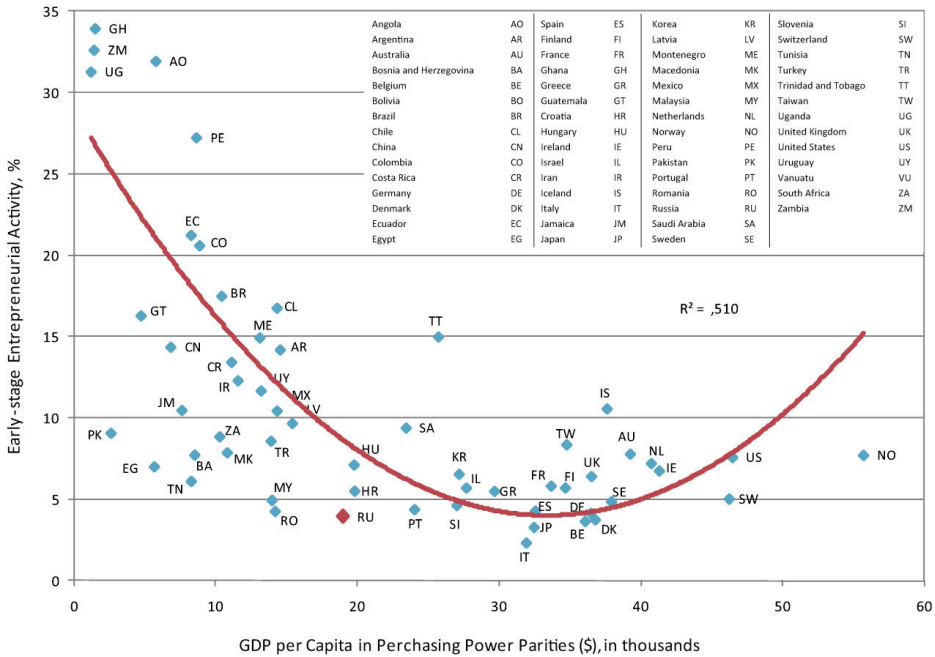
1.2 International comparisons

Figure 1 shows the comparison of TEA index values for all countries participating in GEM research against their GDP per capita. This reveals a U-shaped relationship between TEA and general wealth. The poorest countries have the highest TEA index due to the prevalence of necessity-driven entrepreneurs — entrepreneurs who start their own businesses because they have no other real alternatives for making a living. The richest countries also have above-average TEA levels because of opportunity-driven entrepreneurs — entrepreneurs who start new ventures because of rapid growth and opportunities in new markets or because of a high entrepreneurial culture in these countries. It can be seen that, among Romania, Malaysia, Croatia, Bosnia and

¹ GEM was created in 1997 at the instigation of four countries (i.e. Great Britain, the United States, Finland, and Ireland). Russia joined the GEM research group in 2006. In Russia, the GEM project is supported by The Graduate School of Management at St. Petersburg University and the Higher School of Economics, Moscow. GEM research is based on two main instruments: telephone surveys of the adult population (at least 2,000 people in every country) employing formalized questions and interviews with national experts in economics and business.

Herzegovina, South Africa and others, Russia's TEA value is one the lowest for all measured countries.

Figure 1 TEA index for 65 countries



Source: Verkhovskaya and Dorokhina (2010).

Table 1 shows data for a comparison of the level of entrepreneurial activity in Russia and various others of the largest developed countries such as the United States, several European countries including Finland, some Eastern European countries and China.

Table 1 Entrepreneurial Activity in Russia and other countries, 2011.

	Early Stage Entrepreneurs %			Established Entrepreneurs (>3 years) %	Entrepreneurs by motivation	
	Nascent	New	TEA (Nascent+New)		Necessity-Driven (% of TEA)	Opportunity-Driven (% of TEA)
USA	8.3	4.3	12.3	9.1	21	59
UK	4.7	2.6	7.3	7.2	17	46
France	4.1	1.7	5.7	2.4	15	71
Germany	3.4	2.4	5.6	5.6	19	55
Netherlands	4.3	4.1	8.2	8.7	9	62
Norway	3.7	3.3	6.9	6.6	4	70
Denmark	3.1	1.6	4.6	4.9	7	64

Sweden	3.5	2.3	5.8	7	6	68
Finland	3	3.3	6.3	8.8	18	59
Russia	2.4	2.3	4.6	2.8	27	42
Latvia	6.8	5.3	11.9	5.7	26	46
Lithuania	6.4	5	11.3	6.3	28	47
Poland	6	3.1	9	5	48	32
Romania	5.6	4.5	9.9	4.6	41	34
Slovakia	9.2	5.3	14.2	9.6	28	34
China	10.1	14.2	24	12.7	41	29

Source: Verkhovskaya and Dorokhina (2011).

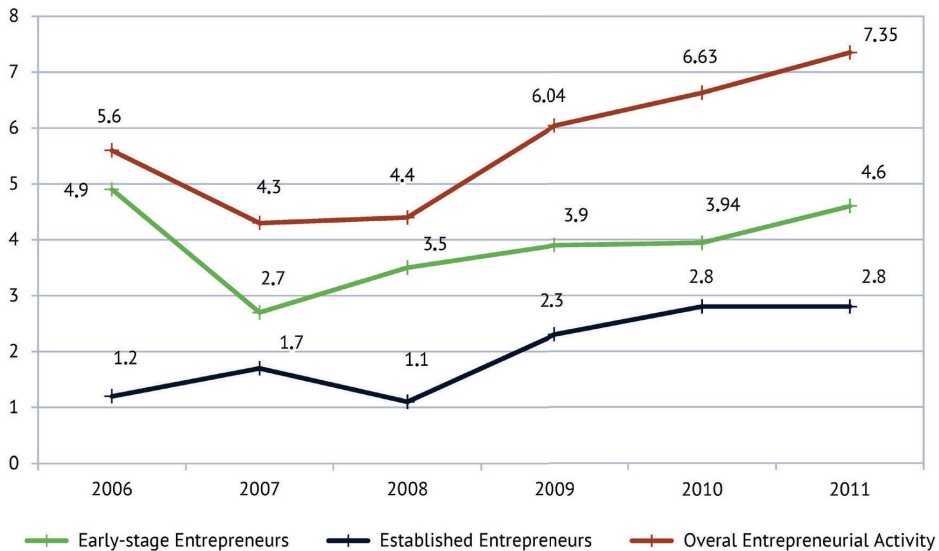
It can be seen that Russia has the lowest level of early entrepreneurial activity in comparison to all of these countries, except Denmark, which is also 4.6 (TEA). In 2011, only 4.6% of adults in Russia were owners of new enterprises. In West European countries, this indicator was slightly higher at approximately 6-8%. In Eastern Europe, it was even higher at about 10-12%, which is good ground for comparisons with Russia as all of these countries were formerly socialist economies that might have experienced the same structural problems after transition to a market economy. However, it seems that Russia was least effective in establishing good conditions for entrepreneurship and developing an entrepreneurial culture relative to its former socialist neighbours. The United States, with a historically strong culture of entrepreneurship, has a comparatively high level of early entrepreneurial activity – 12.3%. However, China has a much higher value for this indicator – 24%, suggesting good state policies of entrepreneurial support and a high level of popular feelings of individual responsibility for their own welfare. The level of established entrepreneurs (i.e. operating for more than three years) generally follows the TEA pattern; however, the gap between all countries is lower. Indicators for both the United States (9.1%) and China (12.7%) are closer to those of East and West Europe (5-9%). The only exception is Russia, where the share of established entrepreneurs is comparatively small – only 2.8% of the adult population – and France, where this number was only 2.4%. The last two columns in Table 1 show interesting data concerning entrepreneurs' motivations. Necessity-driven entrepreneurs, who start businesses because they have no other options for making a living, dominate in Eastern Europe and China (26-41% of all entrepreneurs); Russia is in this group (27%). In developed countries, this indicator is only 15-20%; however, the measure is even lower (4-9%) in Northern European countries. Correspondingly, opportunity-driven entrepreneurs who open businesses because they see good alternatives to working as employees comprise 50-70% in European countries and the USA, 32-47% in former socialist countries, including Russia at 42%, and only 29% in China.

1.3 Longitudinal trends

Analysis of these numbers' dynamics, however, finds that the general trend for Russia's TEA measure is positive. Figure 2 shows that overall entrepreneurial activity (OEA) is growing steadily, although there is still a disturbing influence of the global economic crisis. In 2006, the measure was 5.6 people per 1,000, but then it dropped to 4.3 in the last pre-crisis year, 2007, which is probably explained by the fact that demand in the overheated managerial labour market reached its peak and wages were extremely high. Then, the global financial crisis hit Russia and its economy slumped significantly. Many

managers, especially those newly recruited, lost their jobs, so an increase in entrepreneurial activity is expected. However, in 2008, the OEA index remained at the pre-crisis level of 4.4. This was probably because, for some time after the economic slump, many were discouraged, the future remained unclear and some companies tried to maintain their labour forces in the hope of a rapid recovery. However, in 2009, it became clear that the recession would take longer to overcome and people began to find their own economic activities. The OEA index started to rise steadily and reached a level of 7.35 in 2011.

Figure 2 TEA index for Russia: 2006-2011



Source: Verkhovskaya and Dorokhina (2011).

The composition of early-stage entrepreneurs (ESE) and established entrepreneurs (EE) indices (together they comprise the OEA index) shed additional light on this history. The ESE index also dropped from 4.9 in 2006 to 2.7 in 2007; however, as a reaction to people who lost their jobs and tried to establish their own businesses, it jumped to 3.5 in 2008 and continued to grow slightly during 2009-2010. Careful scrutiny of the EE index shows that it has similar dynamics to the ESE index, although with a one to two year lag. For example, the high level of ESE (4.9) in 2006 led to the growth of EE to 1.7 in 2007, although ESE had already begun to fall due to the approach of the upcoming crisis. Then, in 2008 the ESE index started rising, but EE fell to 1.1 as a result of the low level of new firms founded in 2007.

1.4 Entrepreneurial personality

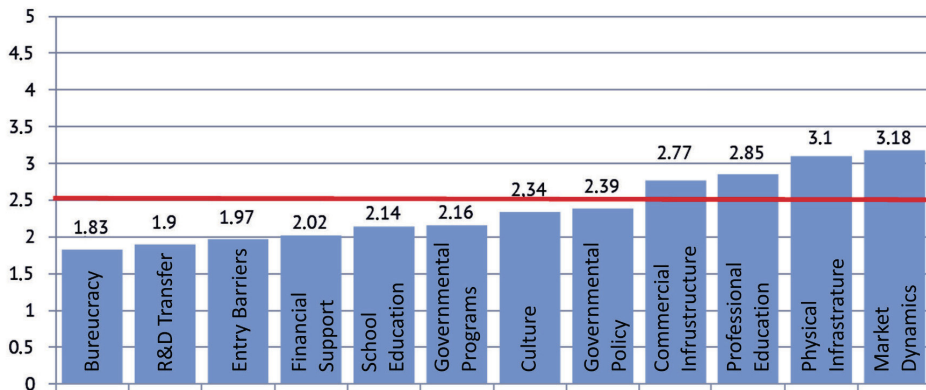
GEM offers interesting observations on the personalities of Russian entrepreneurs. Surveys show that the majority of Russian entrepreneurs are in the 25-34-year-old age

range and are highly educated. Approximately 56% of Russian entrepreneurs are men and 44% are women, but it seems that the gap between the genders is declining. Another interesting fact is that the share of men among early stage entrepreneurs is higher than among established entrepreneurs. This means that men more readily decide to start a business but are less successful in sustaining it.

1.5 Experts' evaluations

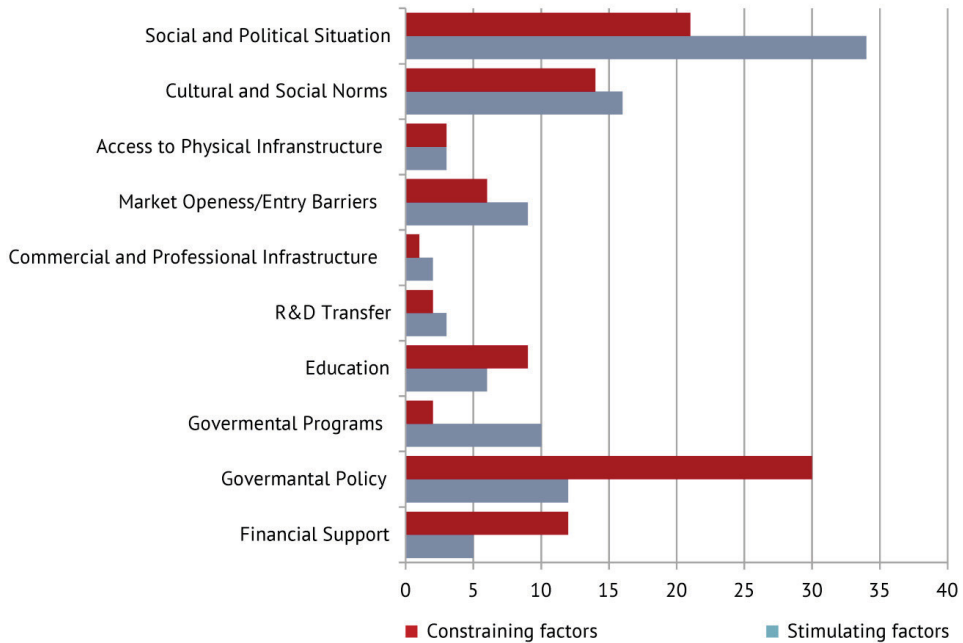
Interviews with national experts focused on estimating conditions for entrepreneurship in Russia; for example, availability of finance and protection of property rights. Estimates were given on a 5-point Likert-type scale (1 for least favourable condition, 5 for most favourable condition). The results of these interviews are shown in Figure 3. It can be seen that a whole range of estimates is not good: the highest grades were given to market dynamics (3.18), physical infrastructure (3.1), and professional education (2.85). The worst performance was bureaucracy (1.83) and R&D transfer (1.9). Further, the generally low level of these grades is noticeable – even the highest ones are only about 3 in the 5-point scale.

Figure 3 Estimations of entrepreneurial conditions in Russia, 2011



Source: Verkhovskaya and Dorokhina (2011).

These experts were also asked a controversial question: to name the most important factors that impede and facilitate improvements in the country's entrepreneurial climate. In other words, they were asked to decide whether a particular factor has a larger positive or negative influence on entrepreneurship. The result of this distribution is shown in Figure 4. The most negative factors were state policy and lack of financial support. Two factors had contradictory evaluations – social and political situation and cultural and social norms; more experts believed they had a positive influence, but several saw them as negative factors.

Figure 4 Constraining and facilitating factors, 2011

Source: Verkhovskaya and Dorokhina, 2011.

1.6 Ease of doing business

An informative family of indicators on entrepreneurial climate, or ease of doing business, is calculated annually by the World Bank. This indicator is based on nine major characteristics: 1) starting a business, 2) dealing with construction permits, 3) registering property, 4) obtaining loans and other forms of credit, 5) protecting investors, 6) paying taxes, 7) trading across borders, 8) enforcing contracts and 9) closing a business. Every characteristic is determined by summing up several variables. For example, the “starting a business” indicator includes such variables as number of procedures, number of days, share of annual income per capita in fees, share of annual income per capita as minimum capital required. Every variable is measured as a percentile ranking, of which the simple average gives the ranking of this characteristic.

Table 2 shows that Russia was positioned 112th out of 185 countries in 2013. The first positions in the table were occupied by countries with traditionally strong market economies (e.g. Singapore, UK and the US). Russia was close to the bottom area of the table, between China and India. The worst Russian factors were dealing with construction permits (178th position) and trading across borders (162nd position). A surprisingly good factor is enforcing contracts (11th place) – at the level of general leaders Singapore (12th) and Hong Kong (10th), and much better than Sweden (27th) or the UK (21st).

Table 2 Ease of doing business, 2013: the position of Russia

Country	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading across borders	Enforcing Contracts	Resolving Insolvency
Singapore	1	4	2	36	12	2	5	1	12	2
Hong Kong	2	6	1	60	4	3	4	2	10	17
United Kingdom	7	19	20	73	1	10	16	14	21	8
United States	4	13	17	25	4	6	69	22	6	16
Norway	6	43	23	7	70	25	19	21	4	3
Georgia	9	7	3	1	4	19	33	38	30	81
Finland	11	49	34	24	40	70	23	6	9	5
Sweden	13	54	25	35	40	32	38	8	27	22
Estonia	21	47	35	14	40	70	50	7	31	72
China	91	151	181	44	70	100	122	68	19	82
Russia	112	101	178	46	104	117	64	162	11	53
India	132	173	182	94	23	49	152	127	184	116

Source: <http://www.doingbusiness.org>

In Table 2, the aggregate indicator “ease of doing business” is divided into subcategories – characteristics employed in calculating the general indicator. For many parameters that might be sensitive to the process of starting a new business (e.g. number of days or procedures for obtaining a permit), Russia is far behind such countries as its EU neighbours, although there is slow progress. To obtain a construction permit in Russia required 64 procedures and 671 days in 2006 but only 42 procedures and 344 days in 2013. However, in comparison to 16 procedures and 66 days in Finland and 7 procedures and 116 days in Sweden in 2013, it is easy to see that there is still much room for improvement. Also, there is still a wide gap between Russia and its EU neighbours for international business issues such as importing and exporting. In Russia, it costs US\$1,725 and US\$2,820 respectively to export and import one container, compared to US\$500-700 for such operations in Finland and Sweden.

When the Russian authorities participate in international business forums, it seems they are quite worried about Russia’s low business ratings. Usually, they show enthusiasm and readiness for fundamental improvements. For example, in 2011, Vladimir Putin announced an ambitious task to move Russia into the first 20 countries of the Doing Business rating and reported on “road maps” for radical improvements in such areas as construction permits and others. Hopefully, the Russian authorities will be able to show progress in the near future, although the general level of corruption and inefficiency in the Russian administrative system raises some doubt concerning the early achievement of this goal. Table 3 shows the comparison of Finland, Sweden and Russia in relation to the ease of doing business in these countries; it also demonstrates some dynamics by presenting the data on Russia for the years 2006 and 2013.

Table 3 Ease of Doing Business in Finland, Sweden, and Russia

	Finland 2013	Sweden 2013	Russia 2006	Russia 2013
Ease of Doing Business (rank)	11	13	..	112
Starting a Business (rank)	49	54	..	101
Procedures (number)	3	3	10	8
Time (days)	14	16	18	18
Cost (% of income per capita)	1.0	0.5	8.8	2.0
Paid-in Min. Capital (% of income per capita)	7.0	13.2	4.4	1.4
Dealing with Construction Permits (rank)	34	25	..	178
Procedures (number)	16	7	64	42
Time (days)	66	116	671	344
Cost (% of income per capita)	43.3	77.3	9,692.6	129.2
Registering Property (rank)	24	35	..	46
Procedures (number)	3	1	6	5
Time (days)	14	30	52	44
Cost (% of property value)	4	4.3	0.4	0.2
Getting Credit (rank)	40	40	..	104
Strength of legal rights index (0-10)	8	8	3	3
Depth of credit information index (0-6)	4	4	0	5
Public registry coverage (% of adults)	0	0	0	0
Private bureau coverage (% of adults)	18.9	100	0	45.4
Protecting Investors (rank)	70	32	..	117
Extent of disclosure index (0-10)	6	8	6	6
Extent of director liability index (0-10)	4	4	2	2
Ease of shareholder suits index (0-10)	7	7	7	6
Strength of investor protection index (0-10)	5.7	6.3	5	4.7
Paying Taxes (rank)	23	38	..	64
Payments (number per year)	8	4	15	7
Time (hours per year)	93	122	448	177
Profit tax (%)	15.0	15.7	..	7.1
Labour tax and contributions (%)	24.4	35.5	..	41.2
Other taxes (%)	1.2	1.9	..	5.8
Total tax rate (% profit)	40.6	53.0	51.2	54.1
Trading Across Borders (rank)	6	8	..	162
Documents to export (number)	4	3	8	8
Time to export (days)	8	8	36	21
Cost to export (US\$ per container)	540	705	1,725	2,820
Documents to import (number)	5	3	13	11
Time to import (days)	7	6	36	36
Cost to import (US\$ per container)	620	735	1,825	2,920
Enforcing Contracts (rank)	9	27	..	11
Procedures (number)	33	30	37	36
Time (days)	375	314	281	270
Cost (% of claim)	13.3	31.2	13.4	13.4
Resolving insolvency (rank)	5	53	..	22
Recovery rate (cents on the dollar)	89.4	74.7	27.6	43.4
Time (years)	0.9	2	3.8	2.0
Cost (% of estate)	4	9	9	9

Source: <http://www.doingbusiness.org>

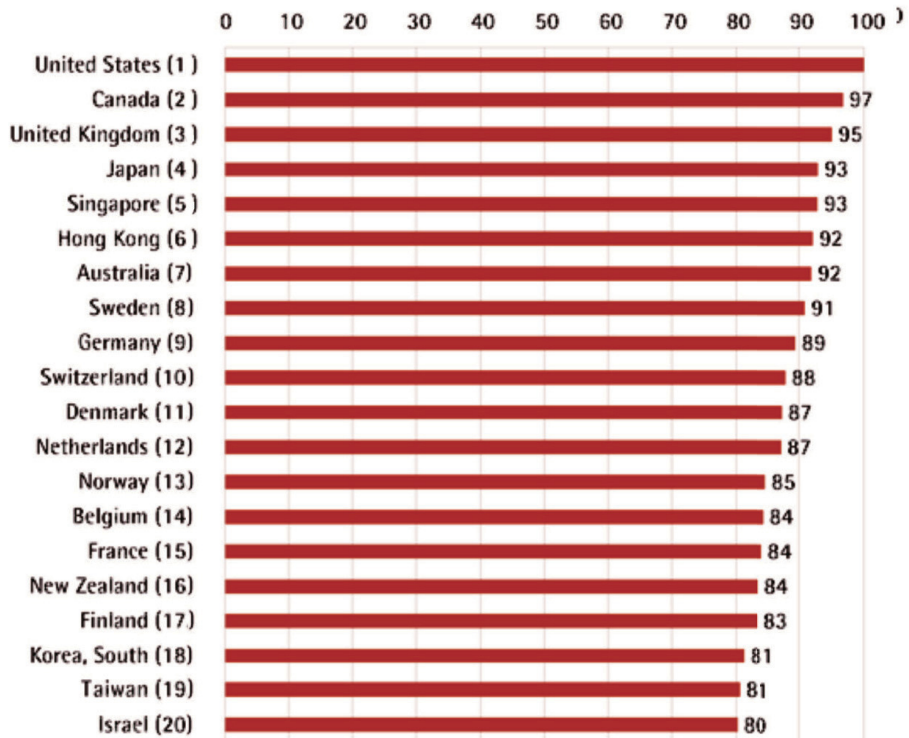
1.7 Global VCPE Country Attractiveness Index

Another international rating is calculated by a group of academics at the IESE business school and evaluates countries with respect to their attractiveness for international venture capital (VC) and private equity (PE) allocations; as such, this rating has more value for small and medium-scale entrepreneurship, especially in relation to innovative and dynamic areas. The academics collect information on 80 countries, mostly for the macro environment, although institutional characteristics and other factors are also measured. Their methodology and choice of parameters is based on academic publications devoted to entrepreneurship theory and surveys among institutional investors. They collect and aggregate six broad categories of indicators:

- **Economic Activity** (i.e. size of the economy/GDP, medium-term real GDP growth and unemployment);
- **Depth of the capital market** (i.e. market capitalisations, number of listed companies, liquidity, IPO activity, M&A activity, access to loans, interest rate spreads and financial market sophistication);
- **Taxation** (i.e. number of tax payments and time spent on tax issues);
- **Investor protection and corporate governance** (i.e. disclosure, director liability, shareholder suits, legal rights, efficacy of corporate boards, legal enforcement of contracts and property rights, intellectual property protection, judicial independence, impartial courts, integrity of the legal system and regulatory quality);
- **Human and social environment** (i.e. quality of the educational system and scientific research institutions, difficulty of hiring, rigidity of hours, difficulty of firing and associated costs, and bribery and corruption);
- **Entrepreneurial culture and deal opportunities** (i.e. general innovativeness, capacity for innovation, scientific and technical journal articles, ease of starting and running a business, number of procedures to start a business, time needed to start a business, costs of business start-up procedures, minimum capital requirements, administrative requirements, time and cost for closing a business, recovery rate, company spending on R&D and utility patents).

The index has been calculated for several years and general observations show a major shift of focus from “traditional” VC and PE countries towards emerging regions. The top positions of the rating for 2012 are shown in Figure 5. Unsurprisingly, the leaders are countries well-known for their new hi-tech products (i.e. the United States, Great Britain and Japan) and also aggressively developing regions such as Singapore and Hong Kong. Austria, Sweden, and Germany are the leading European countries. Finland occupies the 17th position and Russia is in the middle of the list in 43rd position, not shown in the figure.

Figure 5 Leaders of the VCPE Country Attractiveness Index, 2012



Source: Groh, Liechtenstein and Lieser (2012). The Global Venture Capital and Private Equity Country Attractiveness Index. <http://blog.iese.edu/vcpeindex/>

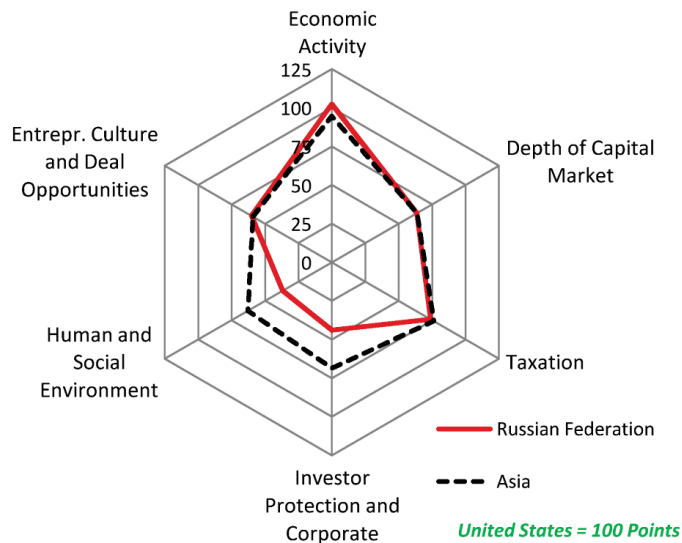
In addition to this information, the report usually provides detailed profiles for every country. Figure 6 shows Russia's profile. The country has a rather good "economic activity" component but very poor measures for "investment protection" and "corporate governance." What is worse is that these numbers have declined since 2008. Another problematic component is the "human and social environment," which shows a similar deterioration since 2008.

Figure 6 Russia in VCPE Country Attractiveness Index, 2012

	2008	2012		Quartile	
	Rank	Value	Rank	4th	1st
VCPE Ranking	41	59.5	43	↓	■ ■ ■ ■
Economic Activity	4	102.4	7	↓	■ ■ ■ ■
Depth of Capital Market	42	63.6	36	↑	■ ■ ■ ■
Taxation	53	73.7	65	↓	■ ■ ■ ■
Inv. Prot./Corp. Gov.	74	43.9	90	↓	■ ■ ■ ■
Human/Social Env.	73	36.8	95	↓	■ ■ ■ ■
Entrepr. Cult./Deal Opp.	31	60.2	33	↓	■ ■ ■ ■

Source: Groh, Liechtenstein and Lieser (2012). The Global Venture Capital and Private Equity Country Attractiveness Index. <http://blog.iese.edu/vcpeindex/>

An interesting comparison is shown in Figure 7, where we see Russia's profile and the average Asian profiles compared with 100% of the index leader, the United States. It is interesting to note that both profiles are almost the same, which probably reflects the general developing nature of the Russian and Asian economies, although Russia has worse indicators for investor protection and corporate governance and also for the human and social environment.

Figure 7 Russia's entrepreneurial attractiveness

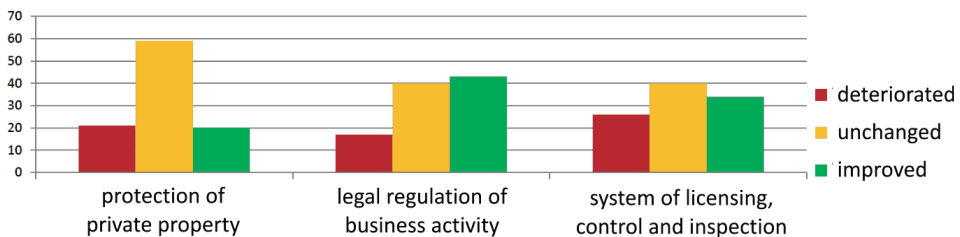
Source: Groh, Liechtenstein and Lieser (2012). The Global Venture Capital and Private Equity Country Attractiveness Index. <http://blog.iese.edu/vcpeindex/>

1.8 RSSP surveys

The oldest Russian business association, the RSPP (Russian Union of Industrialists and Entrepreneurs), is an alliance of more than 120 regional business and industry associations representing key industries in the economy, including the fuel and energy industry, the machine-building industry, the banking sector and also the military, building, chemical, consumer goods and food industries. In total, more than 328,000 individual companies are covered by the RSPP.

Since 2010, the RSPP has conducted a regular survey on company directors in all regions to construct a monthly business environment index. The survey includes questions on market dynamics and relationships, for example, between companies, between business and government and between business and society. Unfortunately, the RSPP publishes only monthly statistics and does not provide longitudinal data for evaluating long-term trends in the business environment. However, some questions in its recent surveys focus on evaluating changes in the business climate. For example, the majority of top managers believe that, since 2007, protection of private property has not changed, although other aspects (i.e. legal regulation of business activity and licensing, control and inspection) have shown mixed results (Figure 8).

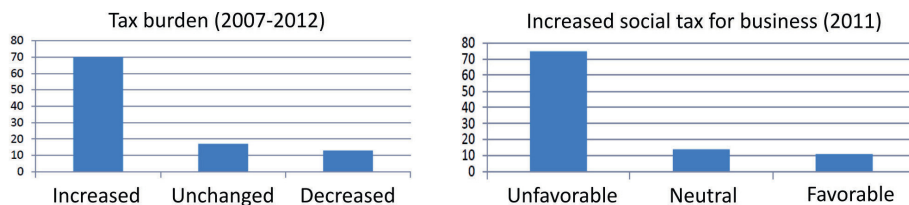
Figure 8 Change of business environment (2007-2012)



Source: Russian Union of Industrialists and Entrepreneurs, www.rspp.ru

The question on tax burdens from 2007 to 2012 and the influence of social tax increase in 2011 reveals a unanimous negative opinion (Figure 9).

Figure 9 Change of tax burden (2007-2012)

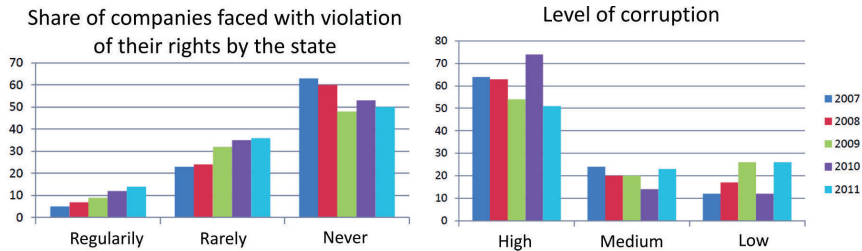


Source: Russian Union of Industrialists and Entrepreneurs, www.rspp.ru

Figure 10 shows gradual but stable growth of the number of entrepreneurs facing administrative pressure from authorities. The level of corruption in Russia between

2007 and 2011 did not change much: approximately 50% believed it was quite high, 20% believed it was moderate and 20% thought it was low (Figure 10).

Figure 10 Dynamics of state pressure and corruption (2007-2012)



Source: Russian Union of Industrialists and Entrepreneurs, www.rspp.ru

1.9 Investment attractiveness ratings of Russian regions

Another interesting source of information is the regional business climate comparisons conducted by the Expert RA – a leading national rating agency in Russia producing a great number of various financial or credit ratings for Russian companies and other organisations. Since 1996, this agency annually calculated the rating of investment attractiveness of Russian regions on the basis of two large criteria: investment potential and investment risks in each region. Unfortunately, Expert RA does not provide much information on the methodology employed, apart from several general points:

- It employs official statistics of the Russian authorities (e.g. Ministry of Finance, Ministry of Natural Resources, Ministry of Telecommunications and the Central Bank);
- Investment potential means the share of the region in the national indicators and comprises nine components: labour, finance, production, natural resources, tourism, consumption, institutions, infrastructure and innovations;
- Investment risk is an aggregate measure of various problems that can arise while doing business in a region and comprises six components: financial, managerial, social, economic, ecological and criminal;
- The contribution (i.e. weight) of every component in the overall potential or risk index is defined on the basis of a survey of experts from the investments and banking communities.

Table 4 shows the ratings for both investment potential and risk in respect of all Russian regions. This data might be useful for foreign entrepreneurs who plan to establish a business in Russia and want to choose the most appropriate region. It is interesting to note that the investment potential rating is led by the largest regions in Russia: Moscow, Moscow district, St. Petersburg, Krasnodar and others. At the same time, these “whale” regions have relatively high, although not the best, positions in the investment risk chart; for example, Moscow is 10th and St. Petersburg is 4th. The leading

positions in the investment risk rating are the regions of Belgorod (1st) and Krasnodar (2nd) and the city of Lipetsk (3rd).

Table 4 Investment potential and risk for 83 Russian regions, 2012.

Potential	Risk	Share in National potential, %	Region	Potential	Risk	Share in National potential, %	Region
1	10	14.832	Moscow	43	61	0.701	Tver Region
2	5	6.249	Moscow Region	44	51	0.695	The Republic of Komi
3	4	5.434	St. Petersburg	45	26	0.691	Tomsk Region
4	15	2.723	Sverdlovsk Region	46	45	0.690	Smolensk Region
5	2	2.654	Krasnodar Region	47	56	0.688	Arkhangelsk Region
6	7	2.521	The Republic of Tatarstan	48	19	0.687	Ulyanovsk Region
7	46	2.462	Krasnoyarsk Region	49	42	0.684	Penza Region
8	32	1.969	Nizhny Novgorod Region	50	73	0.666	Trans-Baikal Region
9	21	1.930	Samara Region	51	22	0.663	Sakhalin Region
10	14	1.929	The Republic of Bashkortostan	52	68	0.659	The Republic of Buryatia
11	12	1.914	Rostov Region	53	20	0.659	Ryazan Region
12	28	1.907	Chelyabinsk Region	54	54	0.658	Chuvash Republic
13	52	1.904	PermRegion	55	59	0.637	Vologda Region
14	24	1.730	Khanty-Mansi Okrug - Yugra	56	6	0.636	Tambov Region
15	50	1.701	Kemerovo Region	57	58	0.587	Kirov Region
16	36	1.628	Novosibirsk Region	58	40	0.578	Astrakhan Region
17	1	1.417	Belgorod Region	59	65	0.577	The Republic of Karelia
18	47	1.382	Irkutsk Region	60	57	0.547	Ivanovo Region
19	48	1.200	The Republic of Sakha (Yakutia)	61	67	0.541	Kabardino-Balkaria
20	30	1.154	Primorsky Krai	62	77	0.526	Republic of North Ossetia
21	29	1.139	Saratov Region	63	49	0.504	Orel Region
22	39	1.128	Volgograd Region	64	43	0.501	Novgorod Region
23	9	1.116	Voronezh Region	65	44	0.487	Amur Region
24	25	1.112	Stavropol Region	66	60	0.483	Pskov Region
25	37	1.095	Yamal-Nenets Region	67	63	0.471	The Republic of Mordovia
26	31	1.079	Altay	68	70	0.448	Kurgan Region
27	8	1.068	Leningrad Region	69	83	0.445	The Chechen Republic
28	23	1.017	Orenburg Region	70	79	0.415	Kamchatka
29	33	1.000	Kaliningrad Region	71	66	0.401	Kostroma Region
30	17	0.997	Omsk Region	72	62	0.373	The Republic of Mari El
31	27	0.996	Tyumen Region	73	74	0.341	Magadan Region
32	11	0.983	Kaluga Region	74	72	0.338	Karachay-Cherkessia
33	78	0.975	The Republic of Dagestan	75	64	0.332	The Republic of Khakassia
34	35	0.945	Khabarovsk Krai	76	38	0.318	The Republic of Adygea
35	13	0.864	Tula Region	77	81	0.314	The Republic of Ingushetia
36	18	0.827	Vladimir Region	78	76	0.248	Chukotka Okrug
37	41	0.795	Kursk Region	79	69	0.202	The Jewish Region
38	16	0.782	Yaroslavl Region	80	82	0.200	The Republic of Tuva
39	53	0.777	Udmurt Republic	81	75	0.190	Altai Republic
40	71	0.752	Murmansk Region	82	80	0.171	The Republic of Kalmykia
41	34	0.721	Bryansk Region	83	55	0.108	Nenets Okrug
42	3	0.719	Lipetsk region				

Source: <http://www.doingbusiness.org>

As can be seen from this review, the business climate in contemporary Russia is not very favourable for entrepreneurship. Many indices (e.g. entrepreneurial activity and venture investments attractiveness) place Russia into the mid or bottom range among all countries. Unsurprisingly, Russia is quite close to many East European countries in many characteristics although, usually, the latter are slightly better than the former. Looking at various aspects of business climate, it can be seen that, in some, Russia compares well with developed countries. However, for others (e.g. number of days or

procedures for obtaining permits and costs of exporting or importing), Russia is several times worse than its EU neighbours. Russia is full of business opportunities due to its large economic potential (7th place in the World Bank rating) but, because of poor corporate governance and investor protection (90th place) and human and cultural development (96th place), the general attractiveness of Russia for foreign entrepreneurs is not very high. However, as one might see, the general dynamics of many indices is positive and it is hoped that Russia will, step by step, improve its entrepreneurial performance in the near future.

2 FINNISH COMPANIES IN THE RUSSIAN MARKET: CULTURAL AND SOCIAL CHALLENGES

Vera Minina, Elena Eybshits and Elena Dmitrienko:

Companies operating in a foreign market face various cultural challenges relating to differences in business customs and habits and ways of thinking and acting. Even though Finland and Russia have rich experiences of economic and cultural cooperation, Finnish and Russian entrepreneurs are insufficiently informed on the cultural features of how their foreign partners do business. Fortunately, there are many Finnish companies with considerable experience of business relationships in Russia that are ready to share their knowledge with newcomers. This chapter is devoted to the cultural challenges and social barriers faced by Finnish companies when entering the Russian market. We aim to analyse the main differences between the two cultures and also the social aspects of doing business in Russia and peculiarities in management practices that should be taken into consideration by Finnish companies to successfully overcome cross-cultural barriers in the Russian market. The chapter begins with a scientific exploration of cultural differences in business; then, practical cases from the authors' empirical research are discussed.

2.1 Cultural differences in business: theoretical overview

Sociologists, anthropologists and social psychologists describe culture as an integral feature of society. Culture is studied from the organisational perspective, in particular with reference to management (Schwartz, 1999; Wilkins & Ouchi, 1983). Cultural factors are considered to be significant issues for understanding entrepreneurs' and employees' behaviour in the processes of mergers and acquisitions and also in creating joint ventures and business operations. Social studies clearly point out that cultural issues deeply affect organisational behaviour and human resource management (HRM), especially in multinational corporations (Bowen & Ostroff, 2004; Aycan, Kanungo & Sinha, 1999). Research findings demonstrate that HRM practices tend to internalise values of national cultures. Laurent (1986) stated that every culture develops some specific and unique insights throughout its history that are transferred into HRM. In general, socio-cultural context plays a vital role for international business.

The theories by Hofstede, Trompenaars and Turner, and Schwartz have made major contributions to understanding how national culture impacts organisational behaviour and HRM. We describe the key ideas from these theories for exploring the organisational behaviour of managers and employees from observed cases.

Hofstede's cultural dimensions theory

Hofstede's theory claims that there is significant variation in the variables that create an enabling environment for business (Hofstede, 2003). Initially, Hofstede developed a four dimensional model of cultural differences:

- Power distance (PDI): the extent to which less powerful members of organisations and institutions (e.g. the family) expect and accept that power is distributed unequally;

- Individualism (IDV): on the one hand, contrasted with collectivism, and on the other, the degree to which individuals are integrated into groups;
- Masculinity (MAS) and femininity: the distribution of roles between genders that is another fundamental issue in any society, for which a range of solutions are found; the assertive pole is “masculine” and the modest, caring role is “feminine”;
- Uncertainty avoidance (UAI): attitudes toward uncertainty and ambiguity, indicating how people feel and behave in situations of uncertainty and whether they are ready to take risks.

Later, Hofstede added a fifth dimension:

- Long-term orientation (LTO): values associated with long-term orientation, including thrift and perseverance; values associated with short-term orientation include respect for tradition, fulfilling social obligations and protecting one’s “face.”

Nevertheless, most empirical studies describe cultural differences based on four dimensions (i.e. PDI, IDV, MAS and UAI). Hofstede defines the above-mentioned PDI, IDV, MAS and UAI indexes for Finland, and Elenkov (1997) conducted a similar study for Russia. Thus, these indexes can be compared in relation to the two countries (see Table 5).

Table 5 Cultural differences between Finland and Russia (max 100)

	PDI	IDV	MAS	UAI
Finland	33	63	26	59
Russia	93	39	36	95
World Averages	55	43	50	64

The data show that Russian culture differs from Finnish culture, especially with regard to PDI, IDV and UAI. These differences can cause problems in relations between Finnish and Russian partners and also the management and employees of head offices and subsidiaries. A high level of PDI leads to a reduction of psychological safety, together with openness to new ideas and willingness to be engaged in organisational development and collaboration.

Employing Hofstede’s approach, Shekshnia (2003) considers several qualities of relations between employees and a company in Russia. The author indicates that Russian employees often agree to accept inequality of power distribution in organisations. This occurs due to the fact that Russian companies typically have a strong hierarchy with power concentrated in the hands of top managers; in many instances, employees strongly depend on the leader’s will. Also, often there are communication barriers between departments within organisations, and decision-

making processes seem to be unclear and non-transparent. In addition, personal loyalty is highly valued and bureaucracy and formalisation are regarded as ways of protecting employees from the chief's will. The qualities described by Shekshnia (2003) show that organisational behaviour in Russian companies differs significantly from organisational behaviour in Finnish companies and that these differences are largely cultural in nature.

Trompenaars's and Turner's cultural dimensions theory

In line with Hofstede, Trompenaars and Turner try to explain organisational interactions through understanding cultural context (Trompenaars and Turner, 1998). Their conclusions are based on 20 years of consulting experience to ascertain seven dimensions of cultural differences that are important for business and management. These dimensions relate to various dilemmas of everyday life that people face in different national cultures:

- Universalism – particularism. What are more important, universal rules or personal relations and particular circumstances for organisational interactions?
- Individualism – communitarianism. Do we function as a group or as individuals?
- Specific – diffuse. Do we analyse personal relations carefully and separate task relationships with a subordinate from the private relations or do we consider personal relations as changing and related to the context?
- Neutral – affective. Do we express our emotions freely or do we control our emotions carefully when communicating with others?
- Achievement – ascription. How is personal status assigned: from one's performance or attributes such as, for example, age, class and gender?
- Time orientation. Do we do one thing at a time and prefer planning and following plans made or do we do several things at once and avoid strong planning?
- Internal – external. Do we believe that we can control nature and our environment or do we believe that we are only a part of nature and that the environment controls us?

Based on the above-mentioned dimensions, Minina and Melnik (2008) have analysed cultural differences in current management systems. They conducted a pilot study on top and middle managers from large and medium firms in St. Petersburg and found peculiarities in the Russian model of management. Table 6 shows the study's results.

Table 6 Peculiarities of the Russian model of management

Pattern-variable/ Attitudes	Attitudes to material and financial resources	Attitudes to employees	Attitudes to time schedules	Attitudes to results
Affectiveness – neutrality	<i>High affectiveness</i>	<i>High affectiveness</i>	<i>High affectiveness</i>	<i>Medium affectiveness</i>
Individualism - collectivism	<i>High collectivism</i>	<i>Medium collectivism</i>	<i>Medium collectivism</i>	<i>High collectivism</i>
Universalism - particularism	<i>High particularism</i>	<i>Medium particularism</i>	<i>Medium particularism</i>	<i>Medium universalism</i>
Achievement – ascription	<i>High ascription</i>	<i>Medium ascription</i>	<i>Medium ascription</i>	<i>Medium achievement</i>
Specificity - diffusion	<i>Medium specificity</i>	<i>High specificity</i>	<i>Medium diffusion</i>	<i>Medium diffusion</i>

The authors found that Russian managers in the observed firms regard organisational resources (i.e. material, financial, human and time) as something unlimited; thus, according to managers, it is not necessary to worry about saving to obtain the desired result, which is evidenced by high affectiveness in attitudes toward resources. The high level of collectivism in attitudes toward material and financial resources and also results indicates that resources and results are considered more as collective than individual, which is true from an organisational perspective. High specificity in attitudes toward employees suggests that relationships between Russian managers and staff depend on situational and subjective factors rather than established norms and rules. These peculiarities can help foreign entrepreneurs understand inter-organisational relations in Russian firms.

Schwartz's cultural value orientation theory

Cultural value orientation theory argues that “culture is not located in the minds and actions of individual people. Rather, it is outside the individual...These views see culture as beliefs, values, behaviours, and/or styles of thinking distributed in a distinctive pattern among the individuals in a society or other cultural group” (Schwartz, 2008: 6). Schwartz develops a model of seven cultural orientations that can be employed to measure national-cultural differences; it includes the following dimensions:

- Intellectual and affective autonomy versus embeddedness. In autonomy cultures, people are perceived as autonomous and bounded by social norms and rules. In cultures based on embeddedness, people are perceived as entities embedded in the collective; social relations and group identification play important roles in their lives.
- Hierarchy versus egalitarianism. Cultural egalitarianism induces people to recognise others as moral equals who share basic interests as human beings. Personal relations are based on equality, social justice,

responsibility, help and honesty. Cultural hierarchy assumes a hierarchical system of ascribed roles to enable responsible, productive behaviour. Personal relations are based on a unique distribution of power, roles and resources. Social power, authority, humility and wealth are key values in this culture.

- Harmony versus mastery. Cultural harmony emphasises fitting into the social and natural world, trying to accept rather than to change or exploit. Human relations are based on values of peace, unity with nature and environmental protection. A mastery orientation encourages active self-assertion, direct action and action to change the natural and social environment to reach group or personal goals. Human relations are based on ambition, success, daring, self-sufficiency and competency (Schwartz, 2008: 8-9).

Schwartz created a cultural map of 77 national groups on seven cultural orientations, which shows that Finland and Russia are located in different parts of the map (Schwartz, 2008: 21). From his perspective, Finland is closer to an egalitarian culture and Russia is more oriented to hierarchy. Finns tend to base their relations on the value of intellectual autonomy and harmony while Russians have a greater preference for embeddedness and mastery. These findings can help business people from Finland understand the cultural problems faced when they enter the Russian market. Nevertheless, each time entrepreneurs decide to enter the international market, they try to understand what information on the socio-cultural environment of business is especially valuable. Thus, it is reasonable to complement large-scale research with case studies based on learning experiences of social and cultural interactions in international business, and also on describing factors that influence the internationalisation process.

2.2 Empirical evidence of cultural challenges when entering the Russian market

This section discusses findings from three research projects² conducted by the authors between 2008 and 2010 to reveal social and cultural barriers to successful internationalisation of Finnish companies operating or intending to work in the Russian market. The first project was aimed at developing Finnish management and leadership models to fit the Russian business culture and context. Cultural differences influence HRM practices and, thus, cultural barriers that inhibit the growth of the efficiency of HRM were studied. The second project focused on competence strengths and weaknesses of Finnish companies operating in Russia and also the challenges they experienced that were caused, in particular, by stereotypes/preconceptions concerning Russian business. The third project addressed how human factors influence integration processes after acquisitions. Companies from different economic fields were observed. Thus, we get a relatively complete picture of social and cultural factors affecting Finnish companies' entry into the Russian market. The projects provide the opportunity to summarise, in this chapter, the most vivid cases and to suggest some recommendations for business people at the end of Part 1 of this book.

² Short descriptions of the research projects are provided in Appendix 1.

Differences in power system and power distance

Our results are consistent with Hofstede's findings that the power distance index in Russia is higher than that in Finland. Hierarchy still persists in the Russian management system.

The manager from a Finnish company stated: *"The difference of culture between Russia and Finland was obvious when a Russian trainee was here in Tampere; we went to talk in the usual way to one of our workers and the trainee. Later, the Russian trainee told me that the worker must have been terrified when the director came to talk to him. In Russia, this usually means that a worker will be made redundant immediately"*.

To the question, *what is most amazing for you in Russia?*, a Finnish manager answered: *"For me it is the amount of bureaucracy, the position of the general manager being responsible for everything and the amount of paperwork needed for everything. It is also challenging to manage within a matrix organisation as it is not understood and adopted in Russia. The difference to the traditional authoritarian system is so vast and it very much reflects day-to-day operations and also implementation of common company practices."*

Russians often perceive Finnish top managers as weak people willing to give away all responsibility and empower subordinates. At the same time, Finnish top managers think that Russians are passive, lack initiative and do not like to take responsibility. There is a great risk that the boss will receive needed information from Russian employees too late as they maintain a distance from top managers. Based on these findings, we present the key differences in the system of power in Russian and Finnish firms:

<i>The Russian boss</i>	<i>The Finnish boss</i>
<p>For Russian employees, a good boss should be quite authoritarian, a so-called "strong man" or "strong woman". This person should have the courage to make decisions relating to punishment and reward and to discharge employees. Therefore, Russians expect more direct authority from key managers. It is considered impossible to go directly to the boss and tell him/her about some problem.</p> <p>In general, Russian directors tend to keep all things under control.</p>	<p>Finnish top managers expect more democracy, initiative and responsibility from their staff.</p> <p>It is normal for the boss to go to an ordinary employee to discuss business issues. Finns prefer less hierarchy, which means direct links between employees working in different departments but on the same organisational level rather than only communicating through their bosses.</p>

The importance of power in Russia is revealed by the terms for job positions. Often, the position of a responsible manager from a Finnish head office is lower than that of a Russian manager. Russian counterparts frequently do not understand why they should report to a person with lower status. Even medium-size Russian companies can have several directors. This creates the feeling that only people with top management status can influence the decision-making process, participate in meetings at a high level and interact with outside stakeholders. The job titles in Russia are often "General Director", "Development Director", "HR Director", "Department Chief" and "President of..." while those in Finland can be termed simply "Project Manager", "Sales Department Manager" or "Export Coordinator". This reflects the fact that status and titles are not

so important in Finland, where it is the firm's reputation, size and perspectives that are more important for business people. When meeting top managers of Russian companies, Finnish managers should provide an additional explanation on their positions and responsibilities in the company, as the following case reveals.

Finnish colleague Matti asked his Russian colleague Nina to provide necessary information on a customer relationship. Nina approached her boss, Alexander, and asked: "*Why should I give information to this guy? Who is he?*" Alexander contacted the director of the parent company and told him, "*Look, we have some cultural specifics. Our people prefer to understand who the boss is and to whom they should report. They will be very confused if your people ask for information or report directly. It would be better if your people send their request to me and I will manage it.*" The case shows that all horizontal links are blocked. The only communication channel with the Russian subsidiary is the director. It also demonstrates that, for counterparties, mutual understanding on power systems in the respective organisations is important.

Differences in power distribution

In Russian companies, it is common that most decisions are made through the general director. If a Finnish manager suggests that a Russian middle manager does something in a particular way, the Russian manager might nod and promise to do it. When, after some time, the Finnish manager asks about implementation, it is clear that nothing has been done. Why? The Russian middle manager has been waiting for instructions from his/her chief executive.

For international companies, the matrix organisational design – whereby authority is divided by functional and project areas and each employee reports to two supervisors (i.e. functional and project) – is an effective form for operations. For this reason, many foreign companies try to introduce a matrix organisational structure in Russian subsidiaries; however, they face many difficulties because, in Russian culture, hierarchy is the traditional structure of power distribution. For example, Russian bosses, without sufficient experience in international companies, tend to keep all requests and communications from the parent company under their full control. Also, subsidiary and parent companies often only communicate through top managers. Therefore, Russian managers should be officially told to whom they report and what kinds of sanction they face with regard to poor performance. At the same time, Russian employees prefer a clear understanding on who is the boss and reporting to others can seem confusing; in addition, they are often unwilling to take on responsibilities and make decisions. They prefer to wait for directions from their managers before becoming involved in seeking solutions. Many Russian employees also have low decision-making skills, in large part due to cultural traditions.

Different attitudes to formal rules and truth

Common rules and moral principles create a background for the development of a strong corporate culture, which has a great impact on organisational efficiency. Thus, if there are different attitudes towards basic rules and concepts among employees from a parent company and its subsidiaries then the risk to maintaining the parent company's corporate culture is high, as can be seen in a case concerning fire safety:

The director, Mikko, of a Finnish parent company received information that Sergey, the director of its subsidiary company in Russia, did not implement all necessary fire inspection requirements (e.g. special training, certification and necessary documentation). During the next management meeting, Mikko asked Sergey why it had

not been done. Sergey looked very surprised and answered: *“Oh, there is no problem! Even if the fire inspector decides to come, the penalty will be very low, approximately 50 Euros. Let’s talk about business.”* Mikko told Sergey: *“It’s very important. We have to follow the rules.”* Sergey argued: *“No problem, we will do it, but there’s no hurry; it’s a very small issue. Let’s discuss clients and sales.”* Mikko was completely frustrated. Sergey was also frustrated because he was unable to understand why Finns spend so much time discussing such unimportant issues.

The case described above corresponds with the findings of Trompenaars and Turner (1998) who state that Finland relates to universalism cultures, which means that it does not have many formal rules and that regulation systems do not allow for many exceptions and are inflexible. Russia, instead, relates to particularistic cultures whereby formal rules are not well followed and, if followed, the rules are situational and depend on “costs” (i.e. possible penalties and consequences) and the probability of being caught. As formal rules might have many exceptions, Russians are keen to find these exceptions. In addition, because formal rules are often obeyed, particularistic societies such as Russia tend to rely more on informal relations. These characteristics imply a particular understanding on truth, honesty and trust, which can have different meanings for Russian and Finnish managers:

<i>Truth, honesty and trust for Russians</i>	<i>Truth, honesty and trust for Finns</i>
The concept of truth varies significantly for Russian business people, depending on whether it is applied to a person, company or country. To lie to a friend is considered bad, while it is possible to lie to the state, for example, to get benefits, hide profit or avoid taxes.	For Finnish managers, the concept of truth is the same for person, company and country. Rules and regulations are followed carefully regardless of the situation. Therefore, giving incomplete information can be considered dishonesty because “truth is transparency”.

Russians and Finns have different perspectives on following rules and being honest, which can cause misunderstandings. An “easy” attitude to formal regulations in Russia does not mean companies do not follow them. Russian companies usually try to comply with requirements for business procedures they should meet. In some cases, Russian companies merely have the necessary documentation or certificates without applying the conditions of these documents in practice. In other cases, they follow formal regulations to the letter. Hence, Finnish firms in Russia have to determine how to meet regulations; they should try to clarify questions of following formal procedures concerning, for example, customs clearance and taxation before signing any contracts with Russian counterparts.

“Signs and symbols rule the world, not words or laws” (attributed to Confucius). This is highly relevant in Russia where it is quite difficult for a foreigner to understand the signs and symbols. Thus, it can be useful to invite, at least to the first negotiations, people who know the Russians well.

Cultural differences in communication

Russian employees are not accustomed to being informed on or involved in decision-making and, thus, they do not have sufficient motivation for decision-fulfilment. The following case describes the importance of formal and informal communications in Russia:

A Finnish chief executive of a Russian subsidiary, who visits the Russian office once a month for two days, usually lives in a fashionable hotel and goes to the office by taxi. He studies reports very carefully. He only meets the Russian top managers (1–3 people) and avoids talking to other Russian employees. For him, informal communications mean dinner in restaurants with top management. At other times, he communicates with Russian subordinates mostly by e-mail. Russian employees often perceive this style of leadership negatively; they relate to this Finnish manager as an outsider.

Another case demonstrates cultural differences between Finnish and Russian managers in the use of online communication:

The Russian director of a Finnish company used corporate e-mail for private purposes. He was surprised when informed that this was not allowed: *“It’s very convenient for me to use only one address instead of two (corporate and private). Anyway, I don’t see anything wrong!”* If, as is normal for Finnish staff, combining official and private e-mails is almost out of the question, the division seems odd for Russian staff who often use personal e-mail for business purposes and vice versa.

The differences in business communication styles of Russian and Finnish managers and employees is summarised as follows:

Russian business communication style	Finnish business communication style
<p>Russians are reluctant to share information.</p> <p>Typically, Russian employees do not express their opinions and remain silent, even if they disagree. They consider that the decision will most probably be taken by their bosses or, at least, the management team; hence, there is no sense in discussing and expressing their opinions at a meeting.</p> <p>In Russia, often only face-to-face communications lead to results in company performance. Frequently, formal communications such as meetings, mailing and phone calls are not sufficient. Some Russian executives are still reluctant to use e-mail and prefer direct calls and face-to-face meetings.</p>	<p>Finns tend to share information more openly.</p> <p>Finnish employees actively participate in business meetings and try to provide an input, even if a decision is not based on their opinions.</p> <p>Finnish management is based, to a large extent, on reporting. However, from the perspective of Russian respondents, reports are ineffective for getting things done and are considered “yet another formality”.</p>

As this comparison shows, Russian and Finnish employees have different approaches to sharing information, which can lead to conflicts within working teams. For effective cooperation, it is necessary to agree upon the type of information that should be shared, the ways of communication (e.g. oral, e-mail or Skype) and the time for this sharing. Also, Russians and Finns have different attitudes to formal communication. Face-to-face communication is very important for Russians, also they prefer direct phone calls to e-mails. They like informal meetings both with existing and potential partners because it is possible to share their opinions on business projects or on more general issues such as the political and economic situation.

Different attitudes to planning and decision-making

The different cultural patterns of Finns and Russians have a great influence on their organisational behaviour and decision-making practices. One respondent, the representative of a Finnish company, said: *“These are very cultural issues; in Sweden and Finland we are very independent. We are given much freedom, but we are given targets; we are measured by our results and targets. We need to discuss, we are not isolated, although we are not given details.”*

Usually, foreign partners face challenges when they start to cooperate with Russians; they often fail to understand how to solve problems presented by their Russian partners. The following cases show differences between Finns and Russians relating to planning and forecasting the future. The first case concerns preliminary talks on a potential project and their result:

One day, Ivan, the Russian manager, who works in the international department of one of the Moscow Academies, phoned a Finnish company and said, *“Hello, we need to organise a business trip for two groups of Russian managers, one week for each group, nice accommodation, group and individual business meetings, and so on. We have a budget for it of approximately €75,000. Can you provide such services for us?”*

Tiina, the manager of the Finnish company, answered with high anxiety: *“I’m not able to confirm because we need to prepare the budget first.”*

Ivan told her, *“Tiina, we don’t need a very detailed budget right now, but we need your confirmation because we are not able to get this money from the government until we have confirmation from a foreign partner.”*

Tiina replied, *“I understand your point. However, we need to send requests to hotels because they have different pricing for different months.”*

Ivan (impatient): *“Dear Tiina! We don’t need a detailed budget right now! All we need is to get your confirmation in general. Later, when we get the finance, we will prepare an exact budget.”*

Tiina said: *“I’m afraid that we are unable to confirm something without thorough calculations.”*

The second case addresses the problems of a joint project:

Finnish and Russian companies that are business partners were going to launch a joint project. They spent a few days planning the project. While Finnish partners discussed all the details very carefully, the Russians seemed almost to be dying of boredom. They were not very active and tended to agree with all suggestions from their Finnish partner. Finally, all plans were ready and both sides decided to implement the project.

Surprisingly, after some time, the Finns discovered that the Russians had not followed the planned process carefully but, instead, had changed it. The Finns asked: *“Why do you break our agreements? We prepared the plan and would like to follow it.”* The Russians also seemed surprised and answered: *“It wasn’t possible to plan all details in advance. Now, when we are in the process of implementation, we understand better how to do it.”* Then the Russians asked: *“Why are you so inflexible? You should learn to be flexible; otherwise you will not be able to work in Russia!”*

The third case shows different attitudes towards forecasting the future:

A Finnish director went to a Moscow office and asked the area sales managers, who were responsible for Russian regions, to provide sales forecasts for planning the budget. They practically refused to do so. Their explanation: *“Oh! How we can guarantee anything, as the situation is so unstable”*. The Finnish director spent much time explaining to each of them the following simple things:

- It is impossible to prepare the budget without sales forecasts;
- It is not about blaming them if actual sales were below target;
- They could make a few estimates (e.g. realistic and ideal).

Our findings concerning planning and decision-making practices in both countries are summarised as follows:

Planning and decision-making practices in Russia	Planning and decision-making practices in Finland
<p>Russians consider it impossible to foresee all details. They tend to follow the famous saying, "Let's engage in battle, and then we'll see."</p> <p>Russians tend to burst into action, then after some time they stop and correct their preliminary plans; hence, their plans are very approximate and flexible.</p>	<p>Finnish managers and employees are more flexible in their organisational behaviour than Russian ones.</p> <p>Finns have a strong attitude towards planning. They are less flexible and try to think about all possible details in advance, make the plan and follow it.</p>

While Finns try to discuss every detail, Russians respond, "*Let's start now!*" Finnish business people become surprised, even insulted, and ask: "*Why do you change our considered and realistic plan? We have already agreed on everything*". The Russians shrug their shoulders: "*Oh, it was the preliminary plan; now we see how to act.*"

Russians expect Finns to be ready for Plan B and Plan C and to act with flexibility. Plans, strategies and budgets should include room for unexpected circumstances, which is naturally difficult for Finns who come from a relatively stable environment.

Differences in human resource qualities and human resource management

Cultural differences between Finns and Russians affect both human resources and human resource management (HRM). One respondent explained: "*Recruitment in Finland is easier than in Russia; candidates in Finland think more when choosing a company to work for. But in Russia it is more about the amount of money. People quit a company very easily when they find a better paid offer. Money is the main issue in Russia.*"

One Finnish respondent outlined the gap in practical-oriented professional skills of Russian graduates. Another Finnish manager gave feedback on human resources in Russia: "*In St. Petersburg, we were hiring new people; we were terrified. They only had couple of weeks' experience.*" In answer to the question "*How did you solve this problem?*", he said: "*They are learning by doing.*"

A Finnish top manager of a Russian subsidiary indicated the great difference between Russian middle managers with experience of working in international companies and those without such experience. Middle managers from Russian companies are accustomed to being very strictly controlled and expect that all decisions will be taken by top managers. While Finnish top managers prefer to be informed on the situation and how it can be solved, Russians ask: "*This is the situation; what should we do?*" However, the Finnish top manager recognised that it was a great achievement for

Russian middle managers to inform on challenging situations as soon as possible; more often, Russians try to hide or at least to postpone “bad news.”

Also, Russian employees expect that their company will care about them. They want their company/boss to be interested not only in their performance but also, for example, in their family, mood and feelings. Talking about their private lives and also celebrating everybody’s birthday are commonplace. A good boss, according to Russians’ perceptions, should be more people oriented than task oriented. In turn, this creates some challenges for Finnish managers to develop such a people-oriented attitude, which can be difficult due to the Finnish special attention to privacy.

There are several differences between HRM practices in the Finnish and Russian cultures (see Table 7). For Finnish companies, a long thorough process with detailed discussions is very important. In contrast, it is more typical for Russian managers to have short or no discussions before making a decision and decision-making can be characterised by its high speed.

Table 7 Differences in Russian and Finnish HR qualities and HRM

HR qualities and HRM	Russian context	Finnish context
Employees’ competences: Decision-making skills - Willingness to take responsibility in decision-making -	Low level No	High level Yes
Discipline in the workplace: Using working time for private matters - Importance of following project schedule -	Yes Only deadlines are important	No The whole schedule is important
Decision-making practices: Long term orientation - Thorough process - Speed of decision-making -	No No High	Yes Yes Low
Managing adaptation process: Detailed program of adaptation - Coach’s support - Colleagues’ support -	No Seldom Often	Yes Often Rarely
Reward system: Clarity of parent company reward system -	Low	High
Employees’ development: Attitude to development discussion - Development discussion procedure -	Pressure Assessment	Opportunities Support

Source: Minina, Krupskaya and Dmitrienko (2010)

There are differences in attitudes between Russian and Finnish employees in relation to discipline. First, Finns adapt to following a project schedule and doing parts of the job just in time. The schedule is not so important for Russian employees. They are often oriented to the final deadline. Second, the other differences in HRM relate to managing the adaptation process, reward system and employee development. Finnish companies have developed coaching programs for newcomers, while newcomers in Russian

companies get support from colleagues. Third, the reward system in Finnish companies is more complicated than in Russian ones. It means that a parent company reward system might be not clear for Russian employees. Fourth, the attitude towards development discussion and development discussion procedure differs in Russian and Finnish firms. For example, many Russian employees perceive development discussions as pressure and assessment.

There are also some common features of Russian and Finnish HRM. Thus, there is no great difference in recruitment and training principles. In both countries, companies search internally for the best applicants, and also employ social network relations, university career centres, recruitment agencies, the Internet and newspapers. The differences in providing short-term courses and education in corporate universities, for example, MBAs, are caused by companies' strategies, company size and top-managers' perspectives.

Russian and Finnish employees react differently to HR tools applied by managers to improve productivity and job satisfaction because, for them, the value of HR tools differs. Our research findings show that, for Russian employees, such financial tools as covering educational fees, medical insurance and support with housing loans and credit are highly important; however, these are not as valuable to Finnish employees. In contrast, corporate pension programs have lesser value for Russian employees than for Finnish employees. As for non-financial tools, we see a low value of work-life balance policy for Russian employees and a high value of work-life balance policy for Finnish employees. This can be explained by the different social security systems in these countries and by the different history of relationship between employers and employees.

For people who work in a multinational cultural environment, it is very important to develop social and communicative skills such as an open-minded, easy-going and emotional intellect. Language and presentation skills are crucial issues among communication skills.

Challenges and institutional barriers to developing a business in Russia

To be ready to operate in the Russian market, it is important to know the main challenges relating to the country. Cultural peculiarities have been described above and now we turn to some social challenges that influence business activity in Russia from the perspectives of Finnish business people and managers.

Expensive and long certification of production in accordance with Russian norms, which means *protectionism* expressed in documentation. In comparison, the initial set of necessary certificates is sufficient for certification in European countries. Also, in Asian countries, these documents are not expensive and are easier to obtain.

Closed procedure of state procurements, particularly for public medical organisations; it is hard or impossible to participate in tenders or to obtain standards of diagnostics beyond private contacts or corruption.

Customs restrictions: high duties on goods imported into the Russian Federation, the necessity for additional complicated certificates and corruption in customs organs.

Changeable administrative system: for example, administrative reform in 2004 resulted in many changes, for instance, to decision-making procedures and in public procurement systems for medicine. Also, there are changes in customs procedures and

taxation; thus, foreign companies must expend efforts anticipating such changes instead of working with clients.

Problems with protection of intellectual property or lack thereof: small enterprises are afraid of losing intellectual property in Russia as there are no precise protection procedures in the Russian system of Public Administration. As the results of our case study show, it is difficult to bring the originator of intellectual property rights' infringement to trial. Even if the procedure for prosecution is started, there is no guarantee that the affected party's losses will be compensated and counterfeit production withdrawn from the market. Actually, the infringing company might not leave the market; more often it is closed and then founded again under a new name.

Difficulties with promoting large-sized products at exhibitions, as each exhibition sample requires official customs' documentation, making it expensive for small enterprises to bring products to exhibitions and reducing opportunities to demonstrate their novelties.

2.3 Practical implications of research findings

Most social challenges and institutional barriers are caused by current administrative practices in Russia. In some industries these barriers are extremely important. The study of practical peculiarities is essential for reducing the risks and costs of entering the Russian market. Different ways of entering the Russian market should be explored carefully in relation to existing barriers. Social networks are a good way to share knowledge on how to do business effectively in Russia.

Cultural differences mentioned in this chapter can have both positive and negative impacts. Positive impact assumes that knowing differences can contribute to conflict prevention, as understanding different cultures grows organisational knowledge and creates appropriate corporate language; that more cautious behaviour and a careful attitude to another culture's members develop respectful relations in an organisation; and that different inspirational methods stimulate increased ways to motivate employees. Negative impact means misunderstanding and, as a result, loss of trust. Very often, more careful attitudes can generate fear of openly expressing ideas with a resultant decrease in creativity.

Cultural differences can occur at three levels: interpersonal, behavioural and communicative. Interpersonal differences mean that people from different countries have different values, attitudes, expectations and perceptions. Cultural differences at the behavioural level manifest themselves in different actions in similar situations and also different reactions to similar signals and actions. Cultural differences at the business communication level include, for example, different meanings of a word, different ways of presenting themselves in a communication and a different ratio of verbal and non-verbal communication. Therefore, our practical tips can be divided into three groups: personality issues, behavioural issues and communication issues, which are respectively further presented below.

Personality issues

We suggest that candidates' profiles should be examined carefully when hiring employees for Finnish-Russian companies. In addition to taking professional aspects into consideration, experience of working in international teams and also cultural adaptation ability should be considered. It can be also helpful if the bearer of a new

corporate culture spends sufficient time in a Russian subsidiary to develop and change its corporate culture.

Behavioural issues

To overcome the challenges caused by differences between Russian and Finnish business cultures, all cultural barriers and obstacles should be discussed openly by Russian-Finnish top management teams. The message from the top should not only concern “our values” and “your values”; well-facilitated discussion should encourage people to express their opinions and share experiences.

We also recommend that all rules and norms as features of a new corporate culture should be discussed openly, in as much detail as much as possible and be finalised together with Russian managers. Any imposed implementation of new rules can cause hidden resistance. If discussion is not open and is given insufficient time, then acceptance by Russians will merely be a formality (i.e. with no lasting impact).

Communication issues

When expanding a business into Russia, we recommend developing a communication plan, which is an important part of implementing a new corporate culture. This ensures that all information is delivered on time and that all employees receive sufficient information. All communication channels should be employed, especially face-to-face communications.

We also suggest developing facilitation skills, which are of great importance for Finnish top managers in Russia if they want to encourage Russian personnel to share their opinions. Also, coaching skills for Finnish top managers are highly appreciated as a tool of face-to-face communications and the negotiation process. With coaching skills, Finnish top managers can express a positive attitude to employees, which is important for development discussion practices that address communication between a manager and subordinates. Development discussion includes conversation on the outcomes of an employee, analysis of the problems that he/she has encountered over the focal period and planning for the future with regard to the company’s general objectives.

Informal communication is also important, sometimes very important, as this is a way to get to know the real situation. This is why informal communications cannot be spontaneous; they should be planned and appropriate occasions and atmosphere for such communications should be created.

The practical tips mentioned above can be useful both for strategic and tactical development. However, they are not suitable for every case; as a respondent said *“Please remember, the Russians are different, as is every person in any country.”* Another very important aspect is that both Russian and Finnish companies are changing. Many Russian managers are being educated abroad or have more international contacts. They support or keep some useful “Western” business practices; thus, the mutual understanding of management from different countries is increasing. It is natural that this process is more intensive in big cities or in near-border regions, which means that a Finnish company has the chance of meeting both a very “Western” Russian company and a company with all the above-mentioned peculiarities.

3 BUSINESS NETWORKING IN RUSSIA

Tamara Galkina:

Establishing a business partnership in a foreign market is a cornerstone for any company that aims to expand internationally. The case of Finnish firms moving their businesses into Russia is no exception. It is common to hear Finnish business people claim, “*We have conducted extensive market research. We think we know the Russian market well. We have developed strategic steps for getting there. We have done much homework! What’s next?*” The next step is actually addressing potential Russian partners, legal authorities and various third parties. It concerns going to Russia and establishing relations with real people and organisations. It concerns networking.

After giving an idea of what business networks are and how internationalisation can be perceived from the business network approach, this chapter examines eight Finnish firms that have operations in Russia³. It will outline major network problems they faced and describe how they coped with them. The cases were selected from different industries to show a variety of networking activities and to address a wider audience of entrepreneurs, managers and business practitioners. The chapter concludes with practical implications.

3.1 Network approach to foreign market entry

One approach is to perceive a foreign market as a network; that is, as a system of nodes connected by threads (Håkansson & Ford, 2002). Nodes are usually represented by individuals, units within organisations and/or organisations as a whole. Ties between nodes occur as a form of different exchange relations (e.g. buying, selling, advising and financing). Networks are often distinguished as either business or social. Relations in business networks occur at a formal level between organisations; relations in social networks are more informal and interpersonal. In many cases, business and social networks overlap.

While business *networks* and business *networking* are closely related notions, it is important to distinguish between them. The key to understanding business networks is “structure”, as one can understand them by taking a snap-shot or static perspective. Conversely, the key to understanding networking is “process” that reflects the dynamics of establishing various interpersonal and inter-organisational relations.

The network perspective perceives foreign market entry differently from other existing approaches to international business. The traditional perspective on internationalisation is more concerned with decision-making relating to entry mode selection and entry decision-making (Holm, 1995). Such decisions relate to conducting market research, examining profiles of possible competitors and selecting the country and mode of operations (e.g. joint venture, franchising, licensing and acquisition). In contrast, the network approach focuses on the character and number of business relations and their coordination. Therefore, business expansion abroad is regarded as a cumulative and interactive process influenced by all managerial levels and involving numerous actors from inside and outside a firm’s network (Axelsson & Johanson, 1992; Holm, Eriksson & Johanson, 1996). From the network perspective, market entry barriers are not associated with country specific borders but are related to establishing and exploiting new contacts (Johanson & Vahlne, 2009).

³ The descriptions of companies that participated in this study are provided in Appendix 2.

What makes the business network perspective attractive and important for understanding internationalisation processes? Various business relations that a firm possesses represent a virtually endless pool of tangible and intangible resources that the firm can gain if it otherwise lacks them. Through business relations, firms can gain access to information on international markets and foreign institutional structures, obtain consultant services, gain financial help and new technological capabilities and find new customers or suppliers. In addition, the reference portfolio of business partners comprises an essential part of a firm's international image. Therefore, a business network can be regarded both as a proxy for scarce resources and as a resource in itself. In this regard, business networks become an essential asset during internationalisation, especially for small and medium-sized enterprises that have more resource constraints than large corporations. Business relations often help these firms overcome liabilities of smallness, newness, being foreign and being outsiders.

As an extensive and diverse business network becomes an important factor for successful internationalisation, companies put a great deal of effort into establishing and maintaining strategic relations and developing their firms' networking capabilities. This process implies constant interactions at interpersonal and inter-firm levels. In international contexts, these interactions can result in cultural clashes, conflicts and business disputes. To illustrate these processes, this chapter describes major challenges faced by Finnish firms when establishing business relations with Russian counterparts.

3.2 Challenges of entering Russian business networks

The companies described in this chapter belong to various industries and have different business ages, unique network profiles and special ways of addressing different business partners. However, it is possible to reveal several common problems experienced by the studied firms when penetrating Russian markets. These problems are further specified below.

Informal side of business relations

Developing successful business relations with Russian partners requires not only a formal component but also strong personal involvement in these relations. As interviews from the present study show, "being there" requires constant travelling or even living in Russia. Establishing a working business partnership can take a long time during which both sides test each other and develop trust. Also, established relations must be maintained constantly and kept active through phone calls, e-mails and face-to-face meetings. Markku Mäkitalo, Russian Business Manager from Huuhka Oy, reported that before he was hired as a business developer, the company utilised support from various state institutions for access to Russian customers. Despite arranging several personal meetings with some prospective customers, these relations did not develop far. Markku perceived the major problem as poor development of informal components of relations. Occasional business meetings were insufficient for deals to happen because the format of these meetings did not allow room for more personal interactions. Markku described his experience as follows:

Russians want more personal visits; they want to hear not only bold facts about the business, but also to know the people and their backgrounds; for example, family and hobbies. And this requires time and emotional

involvement. You always have to go personal...You need to be there...You don't have to meet very often, but you need to connect. You need to send messages regularly and ask how they [partners] are feeling.

Dmitry Lebedev, Marketing Manager, Russia for Selki Fabrik Oy, claims that it was problematic to find partners only through the internet or phone conversations. In most cases, this had no real result. Informal connections, personal meetings on a regular basis and references were of major importance. Taking advantage of his Russian background, Dmitry utilised his family and friendship connections for business purposes. For instance, he managed to get useful contacts through his father's connections to people who worked in the Trade Representation of the Russian Federation in Finland. In general, Dmitry described the role of informal relations as follows:

If you don't have any informal connections or any friends who know the buyer or know the buyer's friend or someone, it's really difficult to be able to go there. So, I think that it's really important to participate in all kinds of cocktail parties or what-not in Russia to be recognized. It is all about networking. And it wasn't a surprise. It was, is still and will be the biggest channel of connections. It is not like you write some e-mail to a person you found on the internet saying, "I am this and that." Nobody would be interested.

The importance of informal relations and recommendations is also emphasised by Pepe Nummi, CEO of Grape People:

[In Russia] you need many more relationships and contacts. So, just to get to talk to people you need introductions. If you don't have any relationships, then you don't have any business. In Russia they would be more worried about who you are, where you come from, who you know and what references you have. I have been working as a consultant in Finland for many years and no one has ever asked me for a reference. In Russia, it is the first thing of interest to people.

Vsevolod Tuzovsky, head of a Russian subsidiary of Beneq, also emphasises the difference in perceiving informal relations in Russia and Finland:

We [Russians and Finns] are different. They [Finns] think that a couple of invitations to a restaurant are enough for an agreement, that's a deal, everything is fine. Here [Russia], one can invite someone to a restaurant many times, even have a deal and say that everything is okay, but nothing progresses.

The high value of informal connections and recommendations in the Russian business world can be explained by the general tendency to personalise any relation. The strong presence of an informal component in business networks is a particular feature of unstable economies under transition, including Russia (Rogers, 2006; Batjargal, 2006, 2007). This relates to the undeveloped legal system in the country, the collapse of state institutions and the moral heritage of social chaos after the breakdown of the Soviet regime (Hendley et al., 2000). When people do not trust the state, they establish rules themselves and these informal rules serve as an alternative and more effective mechanism, substituting for formal laws that are often overly bureaucratic (Sidorov et al., 2000).

Network closeness for outsiders

As Russian business networks are, to a great extent, hierarchical and largely based on personal relations, they are rather difficult to penetrate. Russian business people are reluctant to change their connections and are relationally inert because established contacts prevent them from further networking and creating new contacts. Strong involvement in local business networks is crucial because, in many instances, they are the most reliable sources of market information under conditions of a general lack of market data. As Russian business networks were quite isolated from foreign ones, their penetration requires both learning and teaching new business practices.

Dmitry Lebedev from Selki Fabrik Oy gives an example of trying to get in contact with the head of the Moscow Central Department Store to find boutiques to sell design garments produced by Selki Fabrik. However, he was only “*facing a wall of secretaries*” and could never manage to reach the top management level. Also, Kim Wikström from PBI Research Institute describes the closeness of Russian business networks as follows:

One of the problems when working in the Russian market is that it's very hard to enter and contact the correct people in these very big companies. If you don't know the correct people, you will never get things done. It's the factor, the first one, even money comes second. If you know the correct people you can always avoid extra costs, you can get things done fast and reliably. If you don't know anything, it will become a very costly adventure in Russia, into which you can also easily be lured.

Juha Tanskanen, Business Manager Russia from Beneq Oy, also shares his experience on this matter:

In Russia you need high-level contacts. Business networking in Russia is difficult because of the complicated hierarchical structures of Russian companies, where it is very difficult to get to the upper-level managers if you don't know them personally or nobody can recommend you in order to bypass numerous levels of the organizational pyramid. We did not reach the correct people just by sending an e-mail...because e-mails...first, they go to a secretary and then to another secretary...[who]deletes them.

The explanation for closed business networks in Russia can be found in a particular mechanism of identification that tags one as a member of a network and another as an outsider. In the Russian business network context, this affiliation with particular relations is defined in terms of “nash” (i.e. ours) and “ne nash” (i.e. not ours) (Schrader, 2004). Therefore, a person who is new to a network is treated as “ne nash” or an outsider and relations with this person are regarded as untrustworthy. Dealing with such a newcomer is regarded as a risk because it is perceived as a faceless transaction. Hence, a significant entry into a business network involves a shift in status from “ne nash” to “nash”, which means the time-consuming establishment of trustful relationships, solidarity and reciprocity of obligations. Paradoxically, for this reason, a one-time interaction can leave a more positive impression than a longer one because there is a difference between “the stranger who comes today and stays tomorrow” and “the stranger who will leave tomorrow”. The former can be a problem, as the outsider has to be placed into the “nash – ne nash” structure, in which no intervening position is recognised. The interaction with the latter outsider is treated as a superficial relation, investment in which might be a waste of energy.

The closeness of Russian business networks for outsiders can be also explained by another phenomenon, “blat”. This can be described as an alternative social mechanism

or an informal barter system within personal networks whereby favours, gifts and money are exchanged and through which status is attributed (Berliner, 1952: 356; Batjargal, 2006; Rehn & Taalas, 2004; Ledeneva, 1999). “Blat” provides access to various resources through personal relations; it also sets limits on networking activities in a way that a person knows with whom to network and who to ignore. Outsiders have limited access to this network due to its semi-illegal characteristics that members tend to hide and keep closed (Michailova & Worm, 2003). Due to the shift to a market economy, the character of this social network has changed from friendship and moral obligations to an explicit monetary expression (Jansson et al., 2007).

Different perceptions of trust

The importance of the informal side in business relations consequently imposes specific features on trust. Trustful business relations with Russian partners take a long time to establish because this requires not only building professional trust but also building interpersonal trust. In the most successful cases in this research, Finnish managers developed friendship relations with their Russian partners.

In addition, this study has revealed considerable differences in perception of trust between Russian and Finnish business managers. In Finland, establishing trustworthy business relations does not take a long time due to the general presumption of trustworthiness; whereas, in Russia, it takes more time and effort because there is a general presumption of distrust: in Russia, one has to prove one’s reliability. Hanna Koskimies, the CEO of SelkiFabrik, confirms this finding:

We [Finns] have the attitude that people are trustworthy, I mean...unless something happens that shows that they are not; so we are really optimistic towards people and believe the best of people. There is a big setting of trust, and trust is taken for granted. And you trust your counterpart from the beginning. It is the opposite in Russia.

Another observation on trust in Russian business relations is best formulated by Sture Udd, the founder and the CEO of Up Code:

In Russia, there is less trust in the company than in the person. In Finland, it is not trust in a person; it is trust in a company. They [Russians] don’t do partnership with anybody just because of the company, unless they have personal trust with the leaders of that company...They would never ever engage in a partnership with somebody they hate in a trusted company. Russian trust always involves you as a person. And you cannot gain that by making a good offer, a good description, a nice specification, a presentation or whatever...Mostly it takes time...Trust cannot come after one cup of coffee.

This situation is quite paradoxical. In Russia, the general lack of trust contrasts with high levels of trust in interpersonal relations (Hendley et al., 2000). Although the establishment of business relations begins with strong suspicion and the expectation of cheating, if these relations are perceived to be reliable, they have greater weight than legal written agreements (Jansson et al., 2007). In this atmosphere, the costs of business partnering, relationship replacement and their tracking become high; network creation, expansion and enrichment can be difficult and take long time.

Different perceptions of written contracts

The informal side of business networks in Russia creates a different perception of written contracts. Business conditions can change rapidly and written agreements might become unrealistic or overly constraining. Therefore, what matters and is relied upon are informal agreements. Pepe Nummi from Grape People describes his experience as follows:

When Finnish people go [to Russia] they rely mostly on agreements that are discussed. Actually, in Russia it does not matter what you discuss, it does not matter what you agree to. The perception of how we perceive an agreement in Russia and in Finland is totally different. However, even if the contract is changed, it does not mean that the partner cheats you. Everything changes so fast that contracts need to be renegotiated many times. This requires flexibility and responsiveness. If you have a reliable partner, he is always flexible and supportive, which means that he is not going to cheat you even if the contract is changed. They can change all the agreements and everything that was negotiated at any time...but then you're looking for the common interest again.

Juha Tanskanen from Beneq Oy expresses a similar opinion:

Business networking in Russia occurs under the condition of high uncertainty because of lack of trust and not following written agreements. In Finland, if you agree to something, then you can be sure that something will be done that day, but...in Russia it is just an intention to do something. In Russia, a contract does not secure a business relation. And, for Finnish people it is not comfortable when something does not go according to plan.

In Russia, there is a big gap between legal regulation of business and entrepreneurship and actual practice. This difference is strengthened by a generally nihilistic attitude towards the rule of law in the country. This can be a major challenge and obstacle for Western firms accustomed to relying on the legal infrastructure as a main point of reference (Orlov, 1999). Under constantly changing and unstable business conditions, the functions of formal state authorities and relations with them are replaced by informal practices (Jansson *et al.*, 2007). Therefore, in the post-socialist context, personal informal agreements still matter and have even increased their importance when compared with those under communism (Sik and Wellman, 1999).

Language barrier

There has been some doubt concerning the inclusion of this issue in the present chapter as the language barrier has been addressed in the previous chapter. However, this issue was mentioned in every interview in this study; therefore, it cannot be neglected when discussing networking and establishing businesses in Russia. For example, Hanna Koskimies, CEO and founder of SelkiFabrik, remarked that when she first went to Russia to participate in an exhibition, she experienced many problems when approaching potential clients. After that occasion, she decided to include an expert with a Russian background in the team. She describes this problem of the language barrier as follows:

I noticed at the exhibition that they really don't speak...couldn't speak any English, so I couldn't even ask anybody there any questions! It is really important to have someone who speaks Russian.

Store Udd from Up Code shares the same opinion:

Real networks are independent of e-mail...There are people who advise each other, trust each other, promote each other, right? That is a network. In that sense, if you don't speak Russian, it is very difficult to be actively in a network in Russia! Passively, yes. So, because I don't speak Russian, I always feel that I'm an outsider. I strongly think that if you're unable to speak the Russian language, and in our case we don't employ anybody who speaks Russian, we will be the partner that's in a different situation to others in the network. The main point is to be in the discussion, not to write a contract, right? The network is the discussion, the preparation, the formulating, and we cannot be there because nobody speaks Russian.

Also, Olga Perminova, from the Russian subsidiary of the PBI Research Institute in St. Petersburg, makes a similar point:

The top management people don't speak English...a problem in fact...and the government doesn't speak English. It is really a problem in meetings with foreign companies. So, you have to translate and they don't fully understand one another. Middle management usually speaks English. It's also important to have Russian speaking native staff, staff that is able to assist in international business affairs. The business relationship is always easier when you have a native person as a mediator. So, I think it is quite important, and especially in Russia, to have Russian staff in the office.

There is not much to comment further on this issue except for the fact that the language barrier problem is recognised as a major problem in social interaction as a main component of exchange relations and business contact establishment in Russia (Salmi, 1996).

As this section demonstrates, business partnering in Russia is a lengthy and challenging process that requires constant learning and adaptation to local business traditions. It is worth mentioning that all the above-mentioned problems and challenges are interrelated; in this text, they are distinguished thematically to ease understanding. The next section provides some practical implications for Finnish business executives concerning the establishment of successful business relations in Russia and building sustainable business networks there.

3.3 Implications for successful business partnership in Russia

Using the stories from the case studies, this section proposes practical advice for successful business networking in Russia.

Employ services of entrepreneurial organisations and state institutions

Using the services of Finnish state organisations (e.g. Finpro, Finnish-Russian Chamber of Commerce, Technopolis, Sitra and Finnvera) to find potential business partners in Russia can be helpful for firms that seek new prospective partnerships with Russian businesses. These organisations provide support for developing an overall understanding on particular industries and outlining the main Russian actors in these industries. They also organise initial meetings with potential Russian partners.

It is worth noting that Finnish firms should not rely solely on these organisations. They need to remain active in networks as they are the best experts on the network needs of their respective companies. For example, Markku Mäkitalo from Huuhka Oy describes his experience:

It is not enough that some organization arranges a dinner and a meeting in Russia with some companies. And then they shake hands and they drink vodka a lot, and they are happy. And then the Finnish side starts waiting [for the] offer. They wait one month, two months, a year. Nothing happens.

Find a Russian network expert

It is useful to find a Russian network expert with extensive business experience, wide networks in Russia and local business knowledge who can work as an intermediary or a boundary spanner. The experience of the studied Finnish firms shows that this proxy can be hired by the company either in the Finnish head office or in the Russian subsidiary. Other cases demonstrate that this person can help informally due to close relations with Finnish CEOs. Usually, this expert is a native Russian or someone who has lived in Russia for many years, has numerous connections there and has perfect language skills. It is not always the case that his/her network relations come from the business world. An interviewed Finnish CEO used help from his Russian friend who once worked in the KGB and currently works in the Russian Duma (i.e. parliament); therefore, he has many connections with top decision-makers and government authorities.

Internationalise in groups with other Finnish firms

The Finnish business community represents a relatively transparent and small network in which everyone knows each other, if not directly then through a third party. It has been noticed that small Finnish firms tend to internationalise in groups, following the networks of other small companies, often competitors or some big player; this tactic has proven successful (see Hellman, 1996: 204-205). The firms involved in this study revealed the same trend: they extensively used existing domestic business networks of local Finnish firms that already had businesses operating in Russia. These relations helped with sharing costs and risks and with overcoming liabilities of newness and outsidership and they served as an important learning mechanism and an information source on Russian business realities. For example, when the Finnish company Dermoshop established its subsidiary, Dermosil, in St. Petersburg, it made wide use of the Russian network of Guest Comfort, which is also a part of the Dermoshop group and already had operations in Russia.

Maintain relations

As Russian business people highly value the informal side of business relations, it is important to invest time and emotions both into establishing and maintaining relationships. Some entrepreneurs and business founders said that having a first encounter and exchanging business cards is relatively easy in comparison with further efforts to keep the relations active. Even though constant personal meetings are difficult to arrange, Russian partners appreciate receiving regular phone calls or e-mails with questions relating not only to business matters but also to personal issues such as families or hobbies.

Do not adhere to a written contract

As was mentioned earlier, interpersonal trust and mutual informal obligations serve as stronger governance mechanisms within Russian business networks than fixed written contracts. Unlike in Finland, written agreements do not often secure exchange relations. Therefore, it is more important to establish trustworthy relations, as they are more flexible to unexpected changes under conditions of undeveloped legal protection for foreign entrepreneurial initiatives, especially small-scale enterprises.

Create a network plan but be open to surprises

The case of Beneq shows that it can be useful to create a network profile of one's company that shows the key connections of the domestic and Russian sides. Using this picture, Beneq developed a network plan that specified existing and prospective partners and showed the actual steps for contacting them; for example, schedules of key industry events and exhibitions that the company could potentially attend. However, it has to be kept in mind that the network side of doing business in Russia is unpredictable and uncertain because it concerns spheres of human action. Therefore, it is important to leave room for unexpected relations to arise, as this organic and natural development of networks can open doors to new opportunities. For example, Kim Wikström from the PBI Research Institute shares the following story:

We have been doing both more planned and unplanned networking in Russia. You do not always know where a situation will take you, but you realize it is important to be there in order to let things develop when possibilities for networking and business might be created. You should not plan too much. Often, surprising things happen that create new possibilities you could not predict, it requires improvisation and an open mind. We should become even better at taking advantage of unplanned events and moments and learn to give it time, be more patient and confident in order to identify possibilities there or give them time to be created.

Many respondents who participated in this study said that this unplanned networking required intuitive thinking and following a vision, rather than a strict plan that provides direction for networking actions.

...and learn Russian

Even exchanging some simple phrases can create a relaxed atmosphere and show willingness to make an effort to establish a reliable partnership.

4 VOICES FROM EXPERTS

Tamara Galkina, Maxim Storchevoy, Vera Minina, Elena Eybshits and Elena Dmitrienko:

The previous chapters provided an outline of the Russian cultural and business environment that can help SMEs to plan their entry into the Russian market. However, entrepreneurs who are preparing to go abroad might be interested in some practical tips and opinions from experts who have good experience on supporting and developing international collaboration. Nowadays, there are many quite diverse organisations supporting business cooperation between Finnish and Russian SMEs. We decided to conduct several interviews with representatives of the most important organisations in this list. We asked the experts about success criteria that are more important for entering the Russian market, about risk factors concerning this market and about activity related to business cooperation support. Our experts are experienced people in the field, they are persons in charge of and concerned with the development and support of business collaboration between Finland and Russia. We hope the experts' perspectives and advices can prevent foreign SMEs from typical mistakes in the earlier stages of entry into the Russian market. In this chapter, we present expert opinions from such organisations as Finpro, the Finnish Chamber of Commerce, the Finnish-Russian Chamber of Commerce, Viexpo, Miktech Oy, Cursor Oy, the Business Representative Office of Eastern Finland, ISBE Oy, and Innopraxis



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Finpro is a national non-profit organisation supporting the internationalisation of Finnish companies and their exports and promoting international investment in Finland. Founded in 1919 by Finnish companies, Finpro now has some 550 members: Finnish companies, the Confederation of Finnish Industries, the Federation of Finnish Enterprises and the Federation of Finnish Technology Industries. A public-private organisation and part of the Ministry of Employment and the Economy Group, Finpro also works closely with other players in the Finnish innovation ecosystem such as ELY centres, Tekes and the Ministry for Foreign Affairs.

Finpro runs several major international projects such as Cleantech Finland, Future Learning Finland and the FinNode network of innovation organisations. Finpro has 375 professionals in 69 offices in almost 50 countries that assist Finnish companies as they develop their international businesses and competitiveness and accelerate their internationalisation. Finpro cooperates with companies that are starting to think of going international, that have a global business idea, that are seeking international

growth or that want to strengthen their competitive position. Finpro offers services for each phase of the internationalisation process: planning growth, preparing for market entry, establishment in selected markets and improving an existing market position.



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Who are your customers?

Makeeva: Most of the Finnish companies are SMEs, so they inevitably comprise the absolute majority of our customers.

Sysoev: What does SMEs means you can fins, for example in ACCA Research Report 133: "SMEs, Financial Reporting and Trade Credit: An International Study"⁴. Usually these firms are from quite diverse industries. The most common customers are from food industries and we have large programs focused on attracting these companies to Russia. Non-food industries are energy, automation, construction, machine building, agriculture and many others. The age is also very different. One of my current customers is a Finnish bread producer that has been baking traditional Finnish bread for a century and has now decided to offer this product to Russia. Also, there are quite young companies, created a couple years ago. Some companies were recently sold and the new owners have decided to enter the Russian market.

How do you help Finnish entrepreneurs to enter the Russian market?

Sysoev: Generally, in three major areas. First, we evaluate the opportunities for internationalisation. We try to understand whether the company will be able to go abroad and what will be its most favourable market. Second, we think of the best entry mode. Here, we endeavour to shape a particular offer for a market and to determine what operational model will work best (e.g. export or partnership). Third, we provide some real steps for starting operations: the search for a real partner, assistance in negotiations and contracts development; all necessary support which might be necessary for starting operations in the Russian market. This stage ends with signing a real contract. Fourth, we help to develop existing Finnish-Russian business activities

⁴ <http://www.accaglobal.com/content/dam/accaglobal/PDF-technical/small-business/rr-133-001.pdf>

(e.g. expansion, advertising, diversification and reconfiguration). It might be a task of building export cooperation between several companies or changing their legal form of operations. Although we do not provide legal services as such, we can help to find specialists in this area.

When a company first contacts Finpro, it is offered standard variants of support for it to determine what best fits its needs; it can understand quite precisely what it will get as a result of these consulting services. Our customers need to pay for our services. However, quite often, they might receive financial support from regional business development centres and various programs to cover a large share of these costs. Essentially, we do not offer anything that our customers cannot do themselves, at least theoretically; however, utilising our services means expending much less effort, time and money to achieve the same result. This is because they lack knowledge on our local markets and business and legal environment. We have some advantage here and can offer companies a valuable service.

What are the main problems faced by Finnish SMEs in Russia?

Sysoev: There is a high degree of uncertainty which makes these investments quite risky. Many Finnish entrepreneurs are not used to operating in business environments with such high risks. Finnish companies have some problems with strategic understanding on developing markets such as in Russia. One of the biggest problems is a different understanding on marketing. This is especially important with regard to consumer products. Finland is a small country with a population of five million. A bakery wants to launch a new roll on the basis of someone's grandmother's recipe. A couple of dozen of this baker's employees tell this story to their friends and relatives and soon the majority of the country knows of this new roll and exactly when it will arrive in the stores. This is a simplification, but generally it is much easier to reach customers in Finland because the country is small and word-of-mouth is quite effective. Also, Finnish customers are very loyal to Finnish products so their stores are dominated by local brands, up to 90%.

Another issue is the different economic model of doing business in Russia. Russia has different macroeconomic factors such as higher interest rates in the credit market. The cost of capital and the structure of that cost can be quite different in Europe and Russia. When a Finnish company discovers that the distributor's mark-up is 40% instead of the expected 10%, it is quite surprised. In Finland a dealer or distributor is rare in the market as well-developed logistics services enable any company to distribute its product all across Finland, adding up to 5-7% to the price. In Russia, the same service will cost twice as much. Also, the Russian supply chain is a surprise to Finnish companies; a foreign supplier cannot enter into a direct contract with a large retail chain because the latter does not want to engage in import operations. It can be done only through a dealer or a distributor and this leads to a 40% mark-up. Therefore, Finnish companies experience a shock when they discover that their product will have a price two to three times higher in Russian stores than in Finland. Especially in St. Petersburg, from where many people regularly travel to Finland for shopping, customers see a product in Finnish stores priced at 5 Euros and are surprised to find the same product in Russian stores priced at the equivalent of 15 Euros. Why so much? The first problem is customs. After paying all fees, the costs increase by 25-50%. The second problem is the cost of capital. If the distributor utilises bank loans at a 20% interest rate, he/she wants to earn at least a 30-40% mark-up. Even if he/she does not utilise borrowed capital, he/she might be less prone to take risks and wants a payback period of two to three years, but this means a 30-35% mark-up. Various overhead costs

are quite high; for example, paying entry bonuses to the chains and other marketing expenses. In Finland, a product might be produced for 10 Euros, with a mark-up of 20%, logistics costs of up to 10% and the retail mark-up of 15-20%, the shelf price will be 15 Euros. However, in Russia the product will cost the equivalent of 30-40 Euros. As such, the Finnish company has to cut its cost of production, which is actually almost never possible, or invent some marketing moves in an attempt to justify this price.

Sometimes, Finnish companies cannot position their product correctly in the Russian market. For example, in the case of a Finnish producer of rye crackers, the company offered quite large packets (i.e. 200 gram) for a comparatively high price of 180 rubles, although their Russian competitors produced very small packets priced at 10-20 rubles. The Finnish company did not understand Russian cultural patterns of consumption. We had to explain to them that this product concept did not fit the market and it would probably be better to change their positioning from crackers to snacks and to design a smaller packet priced at 100 rubles, comparable with other snacks such as Pringles or Lays crisps, and to have three times less cost of production. They agreed and developed a new 80 gram packet; the product was then able to compete with others in this niche market.

In some cases, Finnish companies have a very good niche product but have no resources with which to promote it in Russia. For example, a rare oil from an insignificant weed costs more than the most elite olive oil. However, it has a high concentration of Omega-3 fats that are very good for health and, thus, it is theoretically possible to explain this difference to the customer; but, how can the producer do this if it has annual revenue of only one million Euros? There is no money for advertising. In this case, we needed to find a proper partner, a health product distributor, and now they are negotiating a deal.

There is another problem in the machine building industry that, historically, is highly vertically integrated. For example, Admiralteiskie Verfi has 5,000 employees and 12 large shops producing an entire ship in-house. A typical Finnish wharf is only an assembling floor where 100-200 employees assemble a new ship from components supplied by hundreds of small Finnish companies from across the whole country. For example, there might be a Finnish firm that specialises in cogwheels, supplying the ship building, machine building and other industries. However, this company faces a problem when it wants to enter the Russian market: all Russian large industrial users of cogwheels usually have in-house cogwheel production facilities. At best, they buy raw materials for cogwheels, but the final production will be conducted in-house.

Cultural differences usually have no critical meaning, although they create some moments of misunderstanding. For example, personal relationships are important for both countries. Even in Finland, where corruption plays a negligible role in business, all negotiations are much easier if the parties know each other. Finnish business people might treat their acquaintances preferentially but a deal will be conducted under market conditions and the rules will be followed. It might be different in Russia: friends might be offered a more favourable price and, if necessary, rules are more readily broken. For example, if one needs to settle an invoice in 30 days, a call can be made and payment deferred for two months, which is not normal practice for Finnish companies.

Another issue is the different approach to planning, especially when it comes to meeting arrangements. For example, Finnish partners might start in July to arrange a meeting in September. We arrange this meeting with a Russian partner but every time we are told: *“OK, but please let us confirm the meeting a week before”*. Russians simply

cannot plan their activity that far in advance and always assume that something unexpected will happen that prevents them from meeting anyone on that day.

The opposite also holds true. When Russians see a brilliant new business opportunity they might contact a Finnish partner and assume that the Finnish company will be equally excited and start to act immediately. However, this never happens even with the best ideas. Finnish companies always prefer to check and think about everything in a calm manner and will proceed slowly with an offer. This creates discouragement and misunderstanding at the Russian side, which was so eager to start the business operations immediately.

Another problem is the different attitude to sustaining relationships after a contract is made. The Finnish party usually believes that, as the deal was signed, no regular communications are necessary and try to keep these contacts to a bare minimum. The Russian side usually thinks that communication should be regular. To maintain good relationships, Russians try to call once a week and ask “*how are things?*” This often surprises Finns because they are not accustomed to this practice. Why do Russians act like this? Probably, they are afraid of some misunderstanding. The second reason is that planning culture is at a very low level; therefore, day-to-day confirmation and adjustment is assumed necessary. Probably, this is what psychologists call “strokes” (i.e. recognition, attention or responsiveness given by one person to another) in transactional analysis: regular physical contact is necessary for good relationships.

It is correct that foreigners experience problems with participating in government tenders. Formally, this market is closed to Finnish firms, which causes them a lot of frustration. Here, we try to think of some legal variants to avoid these restrictions. Usually, it means finding partners that will be able to partly localise production and gain access to the tender. For example, we helped one Finnish producer, after quite a long process of arranging the deal, to start supplying some components to Admiralteiskie Verfi, not only for its Egyptian and Algerian orders but also some Russian military orders.

Other legal permits do not usually cause a problem. If it is only an import operation, some basic certificates (e.g. quality and safety) are required and we usually recommend some agencies that provide these services. Actually, Finnish exporters can get all of these certificates from the Russian authorities themselves. However, this means that they expend a lot of effort; for example, visiting governmental offices, queuing and facing issues with correctly completing all the forms. It is cheaper and faster to hire an agency to obtain all necessary certificates. All other permits, such as those required for construction and other operations, are only relevant for large companies that, when coming to Russia, usually understand these issues well.

What advice can you give to Finnish entrepreneurs extending their businesses to Russia?

Sysoev: The first advice is to remember the scale. When a Finnish company starts thinking about the “Russian market”, they assume it to be St. Petersburg, Leningradskaya oblast, Karelia and, probably, Murmansk. Even Moscow is “too far” and all other Russian territories do not exist at all. It is intuitively clear, they perceive St. Petersburg and Leningradskaya oblast as a “second Finland” which is very close. If one spends three hours on the Allegro train, one has travelled across a market the size of Finland. It is really attractive to them, because if they have an annual revenue of one million Euros in Finland, they think they can come to St. Petersburg to get another

million. The fact that the Russian market is actually 150 million people with ten time zones rarely enters their minds. However, Russia is a really large market and, to be successful, large scale operations might be required. As an example, we help a Finnish producer of a successful food product to get an agreement with a large Russian distributor that is prepared to supply this product to the largest retail chains such as X5, Lenta and others. This involves approximately 5,000 stores and the contract requires, say, 50 tons of this product every month; however, the Finnish company cannot produce 50 tons per month, only ten tons. Therefore, we have a structural problem. It is impossible to enter 20% of the Russian market because the distributor will not bother with small deals, he requires full-scale supplies.

This situation leads to another problem. Finns do not understand that they need a well-constructed and explained marketing strategy for the whole of Russia. They think that by offering a product of “superior Finnish quality”, all customers will be happy to buy it. However, “superior Finnish quality” is only commonly believed in St. Petersburg. In Moscow or in all other parts of Russia, this expression does not mean very much. This is why any Finnish exporters should understand that, first, their product will be more expensive in Russia than in Finland and, second, it will be more expensive than local or Chinese alternatives. Therefore, a Finnish exporter should consider what particular quality can be advertised to persuade Russian customers, who are not familiar with “superior Finnish quality”, to pay a premium price. Competition can be extremely tough and Finnish companies often are not prepared for it, because the Finnish market is a much more closed and comfortable place in which to operate. They usually face very weak competition in their domestic market. When they come to Russia, they often think they will be the first, but then we have to tell them that a similar product is already offered by local producers. Also, Germans have offered this product for ten years, Italians for five years and the Chinese offer very low prices. Finnish companies get very shocked here. In their domestic market, they face competition from one or two Finnish firms and probably one from Sweden and prices are quite similar. In Russia, competition is much stronger and diverse.

Makeeva: I would add a more compact list of Finnish entrepreneurs’ mistakes that we usually discuss in our FinPro seminars. If you want to fail in the Russian market you should:

- Start without a market study, without asking for professional advice from market experts. Think that you do not need to know anything about competitors because you are certainly the best;
- Sell your goods just as they are, they are so good that no product development or optimisation for another market are necessary;
- Choose an agent or an importer quickly without studying alternatives and checking backgrounds – and accept the cheapest one;
- Make agreements ‘viva voce’ or only by word-of-mouth;
- Rely on information obtained from local partners without verification;
- Save your money and never put a penny into marketing;
- Not register your intellectual property;

- Hand over all practical issues to local partners, assuming that they know better;
- Never spend much time on Russian market-related issues, nor visit your partners once a year, nor provide offers three to four weeks after you have received an offer request.

Finally, I hope that all readers of this book will be smart and lucky in avoiding all of these pitfalls and achieve great success in Russia.

FINNCHAM

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Established in the 16th century to combat piracy, the Finnish Chamber of Commerce currently brings together 18,000 companies and corporate influencers from across the country. It works at a national level and the 19 regional chambers of commerce cover all areas of Finland.

The Finnish Chamber of Commerce offers many services to domestic companies; for example, consultation services in legal affairs, regional lobbying services and council services regarding legal matters to their member companies. The chamber of commerce promotes networking between Finnish and Russian enterprises. Fact finding trips, partner service, international trade documentation, agreement models, training, arbitration procedures and cooperation in organising seminars in both Finland and Russia are examples of our activities. Conferences of Finnish and Russian chambers of commerce are organised biennially in Finland and Russia. The Finnish Chamber of Commerce cooperates with partners of the Team Finland network and also the FinnCham network to promote trade and investment between Finland and Russia.



Anne Hatanpää, Senior Advisor, International Chamber Cooperation, Finnish Chamber of Commerce

What problems are common for Finnish firms with business in Russia?

Many Finnish companies have been successful in entering the Russian market. Networking, good partners, knowledge of the market and cultural differences, market surveys, competitive products, a presence in Russia, constant communication between partners, leadership engagement with the project and also open-mindedness have all helped companies succeed in Russia.

As for the factors that usually obstruct Finnish companies entering the Russian market, I would name three: customs, bureaucracy and corruption. It is also difficult to find good, reliable partners with which to work or a factory to purchase. Obtaining licenses

and unexpected and rapidly implemented changes in legislation can also hinder companies entering the Russian market. Sometimes, finding finance for a project or resolving problems relating to logistics can also be difficult or time consuming.

What recommendations can you give to Finnish companies that are planning to enter the Russian market?

Research should be conducted properly before entering the market. Demand for products and services should be reviewed. Companies should also ensure that products comply with Russian regulations and legislation. Reliable Russian partners and a trustworthy labour force are the cornerstones for doing business in Russia and, therefore, it is useful to invest as much time as possible researching them and getting to know them well. While personal contact and networking with authorities, different organisations and other enterprises play a more important role in Russia than in some other countries, written contracts are also important in Russia, especially in cases of dispute. Companies should also be prepared to meet both financial and psychological challenges. Leadership should be committed to projects, which is both time-consuming and expensive, as is always the case when internationalising.



www.finruscc.ru
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The Finnish-Russian Chamber of Commerce (FRCC) is a registered association founded in 1946. It is a non-profit organisation, the mission of which is to promote companies' business and competitiveness and also economic relations in Russia and Finland. The FRCC conducts its mission by offering companies various services in the fields of market research, company operation, export promotion, training, information and consultation.

The FRCC works in all fields of business and serves all customers. However, members receive special benefits denied to others: discounts on FRCC products and services and also advantages in receiving information and promoting their businesses. Half of FRCC clients are small and medium-sized companies, half are larger with capital exceeding 840,000 Euros. Two thirds of FRCC members, on the other hand, are small and medium-sized companies.

The FRCC is a lobbying organisation for its members. Through various working groups and projects the board members and the operative management seek to influence issues that hinder the development of trade between the two countries.

The FRCC receives its funding from several sources. Own funding, which includes membership fees, makes up over 83%, the Finnish Ministry of Employment and the Economy subsidises the remaining 17% (in 2012).

The FRCC has approximately 900 members, about 750 of which are Finnish and some 150 Russian.



Maria Hartikainen, Project Manager, Finnish-Russian Chamber of Commerce

How do you help Finnish entrepreneurs?

The Finnish-Russian Chamber of Commerce (FRCC) offers various services for Finnish firms depending on the stage of their export process to Russia. Some firms are just starting their internationalisation to Russia. The first barrier that these firms face is the lack of information on the Russian market that causes many imaginary problems. Sometimes their expectations are based on myths but not on the real facts. We help these firms to analyse the market, to estimate the potential of their products, to choose an entry mode (i.e. direct export, finding dealers or distributors, or establishing subsidiaries) and develop the first steps of the exporting process. The Barometer of Russian Trade, FRCC's magazine based on the annual survey of our members, shows the main challenges experienced by Finnish firms when expanding their businesses into Russia.

What are the key challenges for Finnish firms expanding into Russia?

Knowledge on the key actors in your industry and understanding with whom to network is the key aspect of entering the Russian market. Finnish firms that are just beginning their exporting activities to Russia often lack these network competences. Russian business networks are very dependent on local administration that is difficult to approach. FRCC is a networking pool that organises various meetings and business forums, at which it brings together Finnish businesses and Russian decision makers. These networking events help Finnish firms to reach the correct people, not only at the business level but also at the administrative level, and more rapidly to penetrate Russian business circles.

For those companies that already have some operations in Russia, the most commonly mentioned problem is dealing with Russian customs and coping with local authorities' bureaucracy. Also, Russia and Finland have different legal regulations in accounting and financial documentation; this is why it can be very complicated to integrate the financial documentation of a Russian subsidiary into that of a mother company in Finland. In addition, employee turnover in Russia is much higher than in Finland. In Russian firms, managers might change every two to three years, which is a very short cycle. The loyalty of Russian top management is lower than that of Finnish expatriates. Despite the fact that Finnish companies want to hire local top managers for their Russian subsidiaries to localise their operations in Russia as much as possible, often they have to bring expatriate managers from Finland because they cannot afford to educate new managers every two years.

Other common problems relate to the difference in business cultures in the two countries. Finnish business structures are rather lean, while those in Russia are often very hierarchical and multi-layered. Also, the role of a top manager or company director in a Russian firm is stronger and more authoritarian. This is why Russian personnel often expect direct instructions and control from top management, whereas Finns might perceive this as a lack of professional freedom, independence and initiative. Usually, it is only the company CEO or CFO who have a right to sign

documents. This is why, when involved in business negotiations, Finnish firms need to ensure that the people with whom they negotiate actually have the authority to sign contracts. Also, Russians and Finns have different perceptions of time, which challenges project management. Finns tend to follow deadlines and schedules strictly while Russians perceive them as something fluid. Most probably, the Russian side will not confirm a business meeting half a year in advance because their planning horizon is much shorter. In addition, it is less common for Russian companies to have women in leading management positions.

The time when the Russian market had just emerged and was open for all kinds of import product are gone. The idea that Russian consumers will buy anything and anything can be sold simply because it is new and foreign is out-dated. Russian consumers are very experienced, the market is full and mature and competition is high. For many Finnish firms this is a surprise. There is demand, but not for all products. It might be trivial to state that if a firm is not prepared for these export conditions and does not understand its market potential, target customer, promotional channels and strategies and its brand image in Russia, then the chance of failure is very high. Therefore, to a large extent, success depends on aspects that have nothing to do with Russia in particular such as, for example, the product itself. If a product does not have any potential, we cannot build it from scratch.

Also Russia is a big and diverse market. A product with a demand in St. Petersburg and Moscow might not necessarily have it in Novosibirsk or Vladivostok and vice versa. The majority of Finnish exporting firms are interested in the St. Petersburg and Leningrad region. It is a very special area for Finnish companies, in which they are in demand because they have good track records, respect and reputations. However, in Moscow, for instance, a Finnish investor is no longer such an important figure.

Finnish firms often fail in exporting to Russia because their export expectations are disproportional to their export budgets and the amount of time they are prepared to spend on this process. Often, they want everything immediately and are not ready to wait and patiently develop business relations step-by-step with Russian partners. Often, Finnish managers want to sign one million Euro contracts after an initial two hour meeting as they scheduled a one day trip to Russia. However, Russians do not work in this way. They need small talk, they need to establish trust and spend some time in an informal setting. The business itself is done after that. While FRCC opens the doors, it is the job of our clients to develop and maintain these relations.

What are your recommendations to overcome these challenges?

Often, Finnish firms internationalise in groups, which I consider a wise strategy due to shared costs and risk reduction. Larger groups of companies have more chances to attract attention. For smaller firms, it is a great opportunity to 'try the ice' and expand together with bigger companies

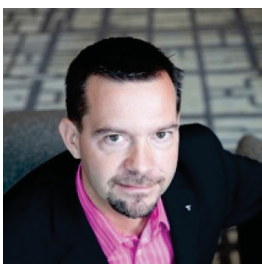
I can recommend Finnish firms internationalising to Russia to be proactive and break free from their existing negative and long-held prejudices concerning Russia. I often read in newspapers that Russia is an extremely dangerous and wild country and that one needs to bring toilet paper and bottled water when travelling to St. Petersburg. Russia is not like that anymore! Familiarisation with Russian culture is a very important aspect. I recommend not to neglect it and to conduct research, to read some literature or to watch some Russian films. It is important to be interested not only in signing a contract but also in these aspects. A large part of business success depends on

having a proactive and open-minded personal attitude. Instead of trying to change the way Russian business works, one should be aware of and accept its rules.



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Based in the coastal region of Ostrobothnia, Finland, Viexpo is an independent regional expert on internationalisation. Viexpo provides small and medium-sized businesses with services and functions that facilitate internationalisation. The core task is to help companies on issues concerning exports and internationalisation by offering relevant advice and other valuable services. Viexpo operates both locally and nationally. It has an extensive network of contacts both in Finland and overseas. Its experts have many years' experience in helping companies to enter new markets. Viexpo can help Finnish SMEs find solutions that best suit their interests. Viexpo operates as an independent internationalisation unit of the Ostrobothnia Centre for Economic Development, Transport and the Environment and our partners include organisations that develop local business.



Markus Jussila, CEO, Viexpo

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What is important when you enter the Russian market?

I can distinguish several success criteria that are important when entering the Russian market. First of all, the Russian market is rather competitive. It is self-evident that it is a lot easier to enter the Russian market if a firm has a unique product. Unfortunately, the majority of the Finnish companies we consult don't have it and they enter areas with high competition. Second, the company's personal commitment is very important. It takes a lot of time and personal involvement to become successful in Russia. Entrepreneurs need to be personally interested; they need to know the people, their friends and families. For instance, it is important to remember to acknowledge your Russian female business partner on Women's Day. Often, small firms have little human and financial resources. In most cases, the managing director is also the export and marketing manager. Therefore, the commitment should be very high. The entrepreneur/manager of the company has to go to Russia or find someone who will spend some time there and to meet people. Relations are very important in Russia, they are everything. Third, it is very crucial for very small businesses to find local domestic

partners and not to go through the internationalisation process alone. Fourth, a firm should be aware of the political situation in the country because politics will be very important for the company.

As stated, partnership is very important in Russia, which is why partner selection should be conducted very carefully. A company should not choose the first partner it finds. Often, firms rush in and do not put sufficient effort and time into the partner selection process. Sometimes, firms make very rapid selections and, if the relationships happen to be unsuccessful, they are very difficult to terminate. Ultimately, these companies lose time and money, which is why firms should ask for advice from other organisations and benchmark firms that have already entered Russia. It is also very important to follow what happens in your industry: attend fairs, talk to your competitors and exchange information with them. You can learn a lot from your competitors and avoid the same mistakes they made.

Small firms lack financial resources and marketing in a foreign country is expensive for them. So, I recommend using all available governmental organisations and programs to find financial support. Another opportunity for small firms is to be present seasonally in Russia when demand rises, which is very relevant for the agricultural sector.

Research has to be conducted well. When going to negotiate, it should be remembered that Russian people are not always prepared. Nevertheless, the Finnish side must be prepared and be able to answer very specific questions, for example, on prices and distribution.

Marketing materials are, of course, needed. In our experience, one good PowerPoint presentation in Russia can replace ten different brochures. Therefore, entrepreneurs do not need to invest much in marketing materials at the first stage, but they need to be able to create concise materials and to give an elevator pitch for their products or ideas. With regard to sales, it is wise to have Russian-speaking personnel. I believe that Finnish salespersons are not the correct choice.

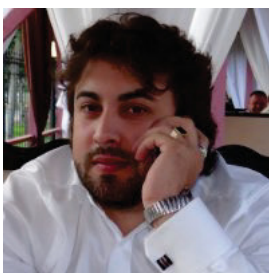
I also think that it is slightly old-fashioned and out-dated to export products from Finland to Russia. Firms need to consider business establishment in Russia in order to have a presence in the country. The problem with exporting to Russia is the customs and border formalities that are often very slow. Therefore, it is important to consider establishing some presence in Russia. Russia has just become a member of the WTO, which has improved matters. Some border duties have now been abolished; however, some new rules are always being introduced.

In sum, Russia has big potential for Finnish firms and, nowadays, more and more Finnish small firms are becoming aware of this potential. The country is doing quite well, as can be seen from oil prices.



www.miktech.fi
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Miktech Oy is an Innovation and Technology Centre in the city of Mikkeli. It is 51% owned by the city and 49% owned by private companies. This is a unique centre compared with the other innovation centres because it is really business oriented. Miktech was founded in 1985. In 2008 it was reorganized and has been developing due to new managers. The centre always deals with small and medium-size companies, which are those in need of help. The main target and mission of the company is to establish good relationships with organisations and companies in the Russian Federation.



Ville Paasonen, Managing Director, Miktech Oy, Mikkeli

What problems might discourage Finnish SMEs from entering the Russian market and how can they be solved?

First, notwithstanding that we are close to each other and millions of tourists come to Finland every year, cultural problems are the most serious. I have a really good recent example. We went to Russia with an entrepreneur who is 45-years old. It was the first time that he had visited the Russian Federation. After the trip, he told me: *“I thought that this place was totally different to what I’ve seen now.”* This shows that people have some biased stereotypes of Russia as a whole.

Second, there is a very popular opinion developed in the mass media that the Russian Federation’s legal system is not very developed. By this, I mean problems with the protection of intellectual property rights and problems of cheating and corruption. Finnish people create urban legends concerning Russia, which say that business is corrupt and the mafia is everywhere. Often, they exaggerate their descriptions. These legends are utilised to explain why some companies are unsuccessful in Russia. The word spreads and creates a negative picture of the Russian Federation. My strong opinion is that nobody will touch you if you are diligent. However, you will most likely get into the trouble and face consequences if, for example, you don’t pay taxes. I have never personally been in a situation in Russia when I had to bribe someone and I have lived in Russia for twelve years.

Third, it is very difficult for foreign firms to be competitive in the Russian Federation as Russians really protect their markets. Local market protection is so strong that it is almost impossible for a foreign company to come here because of the customs and difficulties of entering governmental tenders. Formally, any firm can participate in governmental tenders; however, a foreign firm has to be registered as a legal entity in the Russian Federation, it has to have licenses and only companies owned by Russians can have these licenses, and so on. There is an example of one company, that both makes autoclaves for the nuclear industry and is a consultancy for that industry, having a lot of difficulties while trying to enter tenders in Russia due to all of the licenses and other ‘secret papers’.

Many people say that obtaining a Russian visa is another big problem. Working in Russia as an entrepreneur, I used to spend a lot of money and time getting a Russian visa and work permits. Sometimes, I felt like an illegal migrant worker because I was grouped with people from the construction business. Also, work permits have to be renewed every year. I came here and wanted my own company to employ me as the general manager; however, under Russian law, one has to search for a Russian person who is suitable for this position. So, these laws and regulations are sometimes misleading and do not allow me to work in my rightful position. However, despite the expensive customs and licenses, taxation is the same here as in Finland. In Russia, most taxes are paid by the legal entity whereas, in Finland, they are paid by a person. If you compare a Finnish legal entity to a Russian one, they pay the same. However, with regard to personal taxes, individuals pay more in Finland. I think that, in two to three years, Russia will also have a progressive taxation system.

I see many cultural barriers for Finnish firms in Russia. For example, after having a meeting with potential Russian partners, Finns think that the deal is not going to happen, but then, all of a sudden, they get an order worth hundreds of thousands of Euros. So, Finnish people sometimes interpret Russians' reactions incorrectly; they think that Russians can be rude, are not open enough, but it works in the end. Miktech helps Finnish companies solve these problems. In 2012, we had seven Finnish companies that entered the Russian market. Their additional total turnover was 2.5 million Euros.

What are your recommendations for Finnish firms entering Russian markets?

I recommend that Finnish firms wishing to enter Russia remember that the Russian market is really big. Just one city, St. Petersburg is like the whole of Finland. Also, the Russian market is the only market currently growing in Europe. Actually, there are not many growing markets in the whole world right now. The other growing markets such as China, South Africa, India and Brazil are totally different to Russia. When we talk about the Russian market for Finnish companies, we often mean the North-West part of the country. I think that the Russian business climate is more or less the same across the country and businesses somehow act in the same way. Thus, launching a product onto the Russian market is easier than in China or India.

In addition, companies have to have success stories around them when deciding to enter Russia; not inside, but around them. For example, it should be a partner or company or somebody in a close relationship who is already in the Russian market and who has been successful.

I always tell my clients that even when it seems that nothing is going to work in Russia, somehow things get organised in the end. It is important to have a lot of patience and to protect your intellectual property rights and ownership. There always has to be a person from the mother company who will personally take care of business in Russia. Board meetings held only once a year will not work; nobody will know what is happening in the Russian subsidiary and it will be too late to react to problems. Understanding this is not only important in Russia, it is important everywhere.

The Russian market is very interesting; Russian people are very interesting. It can be very pleasant to do business with Russians. Although it can be difficult to establish a good business connection, once you make it, you also become good friends.



Cursor Oy is a regional development company that assists in locating, establishing and developing companies in the Kotka-Hamina region. Cursor also provides services for companies planning to locate to the Kotka-Hamina region.

Together with its partner networks, Cursor helps to establish and develop business operations and to organise financing solutions, education and training. The Kotka-Hamina region also possesses top-ranking expertise in Russian business; Cursor Oy has more than ten years of experience in export projects and consulting services. Cursor's Russian specialists are masters of the language, corporate culture, legislation and market trends.



Sergey Troshkov, Programme manager, Russia, at Cursor Oy
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What are the major challenges for Finnish firms expanding into Russia? How can these challenges be overcome?

Before the financial crisis in 2008, small and medium-sized Finnish firms had sufficient clients in traditional markets in Europe, Asia and the Americas and did not expand into Russia, which was regarded as a challenging and costly market. Under the conditions of the present economic crisis, Finns have become more interested in Russia but are reluctant to invest sufficient resources for internationalisation to Russia. I see this as a major problem because this unwillingness to grow and expand decreases the number of potentially successful Finnish companies.

It has become almost a traditional cliché to mention corruption, bureaucracy and differences in business cultures when describing the general problems experienced by Finnish SMEs entering the Russian market. In my opinion, these problems appear at the later stages of internationalisation, when a firm is already in the country. During the early stages, problems are more concrete and are of a more practical nature. More trivial issues such as product certification, discrepancy in technical standards between the European Union and Russia, correct translation of technical manuals and mismatches in legal regulations become very challenging for Finnish SMEs. For instance, Russian firms are almost never prepared to pay a 100% deposit for a product; however, because of this, their Finnish suppliers cannot start production as they do not have available funds to buy materials. So, very often, the actual problems relate to smaller steps and are rather case-specific and mundane.

Also, managers of small Finnish firms frequently have insufficient qualifications and expertise to start operations in Russia. Commonly, in small firms, it is often a founder or general manager who is also the export manager. Often he/she is not familiar with the Russian market and Russian business realities; for example, handling business negotiations or understanding motivations of Russian personnel.

Therefore, I recommend that these firms hire professional Russian managers, preferably from the younger generation who have graduated in the last five years. Finnish managers also need to trust and rely more on Russian speaking management and personnel who have local knowledge of the Russian business culture. For example, big companies such as YIT Lentek, Lemminkäinen and Containership, which are successful in Russia, have local management. In my opinion, smaller firms should also follow this practice.

It is also important to learn about you market segment. For instance, I have an example of a Finnish firm that tried to sell machine building products and services without understanding that, due to their very high price, these products were not competitive in the Russian market. Often, it is a question of becoming local, establishing company premises in Russia and hiring Russian personnel, which would make the prices competitive.

Another problem faced by Finnish firms when they begin to sell to Russia is their low production capacities that cannot satisfy Russian market volumes. Although a Finnish product might be competitive, the Finnish firm may be afraid to take a big order from Russia because it would have to stop production for other existing clients. This problem is rather common in the food sector where small orders are not of interest to Russian customers. Therefore, the solutions for Finnish firms might be segmentation, finding a unique niche or focusing on smaller geographical regions.

In comparison to Russian businesses, small Finnish firms are very slow and passive in decision-making; they need to learn to be flexible and make rapid decisions. I see that Finnish small firms lack flexibility and the ability to adjust to changing business conditions in Russia. I do not want to say that Finns should not rely on contracts with Russians, but they need to develop a system by which these contracts can be quickly changed. For example, it is not difficult to change a contract from 15 to 16 delivery days. Also, contracts can be signed in Finland via e-mail, while this will not work in Russia. This is an issue of trust, so Finnish firms need to check the trustworthiness of their potential Russian partners.

It is hard to give one recommendation that will help overcome the above-mentioned challenges. However, I recommend that Finnish firms become as local as possible in Russia. As mentioned, this can be done, for example, through hiring Russian personnel, handling sales and other operations inside Russia and having a local legal entity for signing contracts.

For small Finnish firms that lack resources for internationalisation, it is important to employ various supporting programmes that are offered by different Finnish organisations; for example, Tekes, Finnvera and various regional development agencies. Some of these services are offered free of charge and it is wise to use them before spending money. In the short run, it can be very effective to share internationalisation costs with other Finnish firms and participate in so-called Export Partner Groups⁵. However, in the long run, this strategy might be less effective if firms in the group are not complementary.

Finnish firms often employ traditional entry modes. In most cases, they either export from Finland or establish production facilities in Russia. However, there are many alternatives such as selling a licence to a Russian production company and using existing Russian production facilities, developing a dealer network or selling via the

⁵Export Partner Group is a service provided by Finpro (see the first interview in this chapter).

Internet. Therefore, I recommend that Finnish firms look more broadly and be prepared to use alternative entry models.



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The Business Representative Office of Eastern Finland ISBE Oy has operated for more than ten years in Mikkeli and St. Petersburg. It has completed over 400 business transactions promoting trade with Russia. ISBE Oy is a service company offering Russia-related services that are shared by development companies, chambers of commerce and entrepreneurial associations in Eastern Finland. It offers diverse and professional support for the Russia operations of SME companies.

ISBE Oy has permanent chamber of commerce status and modern facilities in St. Petersburg. It offers an easy and comprehensive way for customer companies to become established in Russia. ISBE Oy also has excellent connections to Russian entrepreneurs and decision makers. Both Finnish and Russian experts with decades of combined experience concerning trade with Russia work at ISBE Oy.

Maria Leontieva, Manager of the St. Petersburg Office, Business Representative Office of Eastern Finland, ISBE Oy.

How do you help Finnish SMEs to internationalise?

We usually assist small and medium-size companies from Finland from various fields of activities. We offer our customers market research, a contact information service and also representation office services, office space rental and legal advice.

Every customer project accomplished is rewarding and it is very satisfying that, as a result of initially using our range of office services, customers set up their own businesses in Russia; for example, subsidiaries or sales networks.

What factors prevent Finnish companies from entering the Russian market?

People not being comfortable in their strategies, remembering the old burden of living under Russian control and not investing fully, both mentally and physically. So, be patient as wonders do not happen overnight. Entry into Russia is a long-term project requiring belief and also demanding investments.

Inno | Praxis

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InnoPraxis is a consulting company that emerged as a spin-off from a Technopolis project and has experts with wide international experience who have consulted and trained clients from more than 30 countries. It helps national and regional authorities, science and technology parks, business incubators, higher educational institutions and investors to develop effective innovation systems and to support innovative infrastructures.

InnoPraxis helps its clients to develop and manage innovation systems. Unlike stereotypical consulting companies, it aims to both work with clients in the early stages and also helps to implement recommendations in practice. InnoPraxis' advisory services are based on real business experience.

InnoPraxis prefers working with a local partner (i.e. local consulting company) because adaptation of international best practices relating to local traditions is the key challenge in all experience-sharing projects.



Julia Roelofsen, CEO, Partner and Advisor at Innopraxis

What are the main risks for high technology Finnish firms that are going to enter the Russian market?

Small Finnish firms often say that they are interested in Russia but take no real action. In my opinion, they find the Russian market more risky and challenging than it really is. Their image of Russia remains based on stories from Soviet times, which are no longer true. However, taking small high technology Finnish firms from the innovative sector as an example, there are many challenges in Russia. Primarily, they have a rather limited market in Russia because the Russian market for high technology and innovative products is very embryonic.

As the innovative sector is very embryonic in Russia, outsourcing chains are also not developed. Therefore, it is hard for a Finnish innovative firm to find its niche in these chains. Big Russian companies still try to keep all production chains in-house and, often, these chains are closed to potential new players. It is also an issue of trust. It is less risky for a Russian company to have everything in one place than to have many suppliers, either domestic or foreign. While, in Finland, firms increasingly outsource different functions and focus only on their core business, big companies in Russia still want to own all of the process as it is more secure under the unstable business conditions.

It is also very difficult to match-make between Finnish and Russian high technology firms because Russian firms often have very poor positioning of their 'know how' and it is hard initially to understand what partner they need. Even though they are interested in foreign partnership, approximately only one in twenty Russian firms has a website

and only one in forty firms has a website in English. The language issue has always been a problem for Finnish firms in Russia. Sometimes, Russian partners send some 100 pages of Russian text that they ask to be distributed among Finnish partners. Ironically, Finns don't demand that their potential Russian partners speak Finnish; however, Russians think that everyone has to speak Russian.

I do not want to focus on the classic differences between Russian and Finnish business cultures, which has attracted much comment. The problems experienced by Finnish firms when entering Russia are often very practical and relate to issues such as handling accounting systems in Russia, customs formalities, sourcing an agent or some other legal issues. For instance, Finns are perplexed by the difficulty in making a cross-border bank transaction of 100 Euros.

It is rather problematic to work with Russian businesses due to ever-changing time tables and constantly delayed deadlines. In my opinion, it creates rather a negative image of Russian partners. Often, these delays or cancelled contracts cause lost profit for Finnish firms. In Finland, they can claim this lost profit in court. However, in Russia, lost profit as a legal notion does not exist in practice. For small Finnish firms, this loss of profit can become a question of survival and, therefore, they are simply afraid to work with Russians.

It is difficult to give further recommendations to Finnish firms other than to say that they need to be patient and understand the different perception of time in Russia.

The new growing innovative infrastructure in Russia, in the form of technoparks and business incubators that look for foreign partners for Russian firms, is good news for Finnish firms in the innovative sector. In this regard, Finnish firms from one industrial cluster can work with Russian firms from a similar industrial cluster. Although clusters are only now developing in Russia, and only in some geographical regions, there is big potential in this area. However, it is important to note that clusters differ in Russia to those in Finland. Russian industrial clusters often represent a very structured and hierarchical system comprising one big company with many dependant suppliers. In Finland, companies in a cluster are equal and do not have contractual agreements; a cluster is merely a basis for networking and communication. Also, there is much more governmental support for cluster development in Finland.

4.1 Other organisations supporting Finnish-Russian business cooperation

Tekes

**<http://www.tekes.fi>
+358 29 50 55000**

Tekes offers R&D funding and expert services and creates networks between companies and researchers. Every year, Tekes finances some 1,500 business research and development projects and almost 600 public research projects at universities, research institutes and polytechnics. Funding can also be awarded to foreign-owned enterprises registered in Finland. Foreign companies with R&D activities in Finland do not need to have a Finnish partner to be eligible for funding. The financed project should, however, contribute to the Finnish economy.

Sitra

**<http://www.sitra.fi>
+358 294 618 991**

Sitra was founded as an organisation of the Bank of Finland in 1967 to honour the 50th anniversary of Finland's independence. The fund was commissioned with the task of promoting Finland's stable and balanced development, economic growth and international competitiveness and cooperation. Sitra's tasks are defined by law. In 1991, Sitra was transformed into an independent fund that reports directly to the Finnish Parliament. Sitra's strategy comprises developing new ideas concerning the good life, finding operational models that build a new kind of society and boosting sustainable business operations.

Sitra identifies the need for and enables social change and predicts, analyses and assesses the forces of social change and their impacts on Finland. As an independent operator, Sitra has the opportunity to react quickly to major issues concerning Finnish society and accelerate changes that promote well-being. Sitra conducts practical experiments, creates cross-boundary networks and develops and finances business operations.

Finnvera

**<http://www.finnvera.fi>
+358 29 460 2582**

Finnvera is a specialised financing company owned by the Finnish government. It provides its clients with loans, guarantees, venture capital investments and export credit guarantees. Finnvera is the official Export Credit Agency (ECA) of Finland.

Finnvera provides bridge financing: a loan to meet a company's need for working capital during the period between a grant decision made by an ELY Centre or Tekes and the actual payment of the grant. When companies are reorganised, the need for financing typically stems from payment of the purchase price, investments and demand for working capital. To finance these requirements, an enterprise can apply for Finnvera's loans and guarantees.

Josek

**<http://www.josek.fi>
+358 (0) 20 721 87 87**

JOSEK serves all companies in the Joensuu region of Finland, from start-ups to established enterprises developing their operations. The business consulting service also assists enterprises and organisations seeking to locate in the Joensuu region.

The Joensuu region is a globally networked growth centre that is perpetually renewing itself and creating ideal conditions for entrepreneurship. Local companies and communities work together productively to strengthen the region's business life, economy, employment and services.

LADEC

**<http://www.ladec.fi>
+358 (0) 40 701 7328**

The Lahti Development Company (LADEC Ltd.) promotes growth enterprises' international competitiveness. Its task is to offer versatile relocation and development services and to improve innovative operations in the Lahti region. This also boosts the strength and competitiveness of the Lahti region in the heart of southern Finland. LADEC is responsible for the development and internationalisation of the Finnish Cleantech Cluster. Located in the centre of the most interesting industrial design in Finland, the company also plays a significant national role as a developer of design-led business operations. The Lahti Science & Business Park's objective is to turn Lahti into a world-class centre of excellence in the areas of environmental business operations and research and also CleanDesign.

LADEC started operating on 1 January 2013. LADEC amalgamated three existing business operators in the Lahti region: Lahti Science & Business Park and the main parts of the Lahti Regional Development Company's (Lakes) and Lahti Region Enterprise Agency's operations.

Tredea

**<http://www.tredea.fi>
+ 358 3 5653 4969**

Tredea, the Tampere Region Economic Development Agency, maintains and strengthens the magnetism of the Tampere central region and fosters prerequisites for successful business. Tredea has four main programmes aimed at increasing the attractiveness of the Tampere region for investors, skilled workers, innovators and tourists. The Tampere Region is a hub of world class business clusters in the field of mechanical engineering and automation, ICT and life sciences. Clusters include numerous global market leading companies as potential customers and partners for companies new to the region. Tredea provides free services, information and assistance to companies and individuals looking to invest or start a business venture in the region. Tredea started operating in 2009 and it is owned by Tampere (60.44%) and seven surrounding municipalities: Kangasala, Lempäälä, Nokia, Orivesi, Pirkkala, Vesilahti and Ylöjärvi.

Jykes

**<http://www.jykes.fi>
+358 207 715 617**

Jyväskylän Regional Development Company, Jykes Ltd., established in 1996, is a business promotion and development company owned by the four municipalities (i.e. the city of Jyväskylä and the areas of Laukaa, Muurame and Uurainen) of the Jyväskylä Region. The aim of Jykes is to create a favourable business environment and to improve cooperation between companies and the public sector. By offering expertise, support and various networks for companies, Jykes creates opportunities and conditions for profitable business operations.

5 CONCLUDING REMARKS (PT. 1)

Economic reforms in contemporary Russia are characterised by oscillations from liberalisation to state-administrative control of economic and political life. Shock therapy and price liberalisation in the early 1990s brought much pain to the majority of Russians, leaving them sceptical of free markets and liberal democracy and more appreciative of a paternalistic state. An opaque and manipulated privatisation policy transferred giant Soviet enterprises to directors, often allied with bureaucrats or criminals, which only enlarged the gulf between shop-floor workers and managers and enhanced anti-reform attitudes. This is why Vladimir Putin quickly gained popular support after taking over the reins of power from Boris Yeltsin. Putin's image and rhetoric promised a possible return to "order" and "stability." From the very beginning, Putin focused on avoiding further economic shocks and based his policies on the luck of rising oil prices driving economic growth and enabling increases in social benefits. However, this focus on avoiding fundamental changes blocked further structural reforms in, for example, education, healthcare, defence and pensions. Another downside to Putin's stability was his reliance on the bureaucratic class, which once again obtained informal rights to corrupted practices in exchange for loyalty to Putin. The level of corruption and inefficiency in many state-controlled industries such as national defence or healthcare has hit new heights. Despite these controversies, Russia's market economy has been developing steadily. There are three drivers of the business climate's improvement: 1) slow development of new legislation supporting, for example, contracts, property, labour and taxes; 2) continuous growth of welfare and consumer spending; and 3) progress in the national entrepreneurial and management culture. Russia again is at a crossroads as further progress of its economy and welfare cannot be based only on high oil prices. This requires solving several critical structural problems, such as corruption and weak competition in political and economic markets. How this can be accomplished remains a thorny question.

Business activity in contemporary Russia is characterised by these main forms: individual entrepreneurs, partnerships, limited liability societies (the most popular and widespread entity) and joint stock companies, both public and private. In Russia, every businessman and businesswoman has to pay profit tax (20%), social insurance tax (30% of wages paid), VAT (18%) and also personal taxes, paid by individuals and individual entrepreneurs. In addition, if anyone conducts export-import operations, he/she has to pay customs duties in accordance with customs regulations.

The business climate in contemporary Russia might not seem attractive. The index of SMEs' entrepreneurial activity in Russia is among the lowest in East Europe, although there is no significant gap shown by this indicator between Russia and developed European countries. For example, there are 4.6 nascent and early entrepreneurs per 1,000 people in Russia, versus 5.8 in Sweden and 6.3 in Finland. However, there is a wide gap between these countries and countries with high entrepreneurial activity, such as the United States and China (12.3 and 24.0 entrepreneurs per 1,000 people, respectively). This comparatively low level of entrepreneurial activity is partly explained by unfavourable conditions for entrepreneurship as measured by the World Bank's Doing Business rating. Thus, Russia is placed 112th among 185 countries. Looking deeper into the components of this rating, we find that, while Russia compares well with developed countries for some measures, for others (e.g. number of days or procedures for obtaining permits and costs of exporting or importing) Russia is several times worse than its EU neighbours. The Global VCPE Country Attractiveness Index, which describes a country's attractiveness for venture investments and private equity

investments, is more favourable for Russia and puts it 43rd out of 116 countries surveyed. This is an average result that hides comparatively good components of general economic activity (7th place) and rather poor components such as corporate governance and investor protection (90th place) and human and cultural development (96th place). Other Russian ratings and survey projects also yield mixed results. A major business association in Russia, RSP, regularly surveys the opinions of large Russian companies' top managers and reports both optimistic and pessimistic attitudes, although the majority of managers agree that tax and administrative pressure on businesses has increased over the last five years. Investment Attractiveness of Russian Regions (RA Expert) compares 83 administrative territories for business potential and business risk, and provides advice to foreign investors on finding a favourable region in which to start a new business or joint venture.

Our research and experience show that, in the majority of cases, the acquisition of a Russian company is the only way for foreign businesses to penetrate Russian markets. Hence, for instance, *green-field business in Russia* can only implement the parent company's way of doing business at the very beginning of internationalisation in order to hire the "correct" people at the very start, unlike brown-field business.

To do business in Russia, it is very important to employ face-to-face contact, to utilise frequent repetition, to insist when necessary and to organise timely feedback. Russian employees tend to value *the constant presence of head office personnel*. Otherwise, they might think that short visits do not provide the necessary results: "They come as tourists" would be one presumption. A representative from the parent company can be the general director or a top manager (e.g. sales director or business development director), which means that he/she should be authoritative from a Russian employee's perspective, while the managing director of a Russian subsidiary should be *chosen carefully*. This practice is effective because it provides an opportunity to receive relevant information on what is happening inside the company. Also, the person from the head office is perceived as a true carrier of the corporate culture; otherwise, many small things will not be done in the "proper" way (e.g. from office space organisation to meeting culture).

Sharing know-how can be achieved through internal communication, but the best way is employee exchanges. Short business trips by employees of the acquired company to the head office or vice versa is an effective way of overcoming communication barriers, although this cannot dramatically change the situation. Successful companies create programs that provide employee exchanges between Finnish and Russian offices. This is an effective way to integrate personnel of the acquired company, to involve them in common projects and to show them the new corporate approach to business. Another effective strategy is to organise seminars and workshops on different issues and to invite representatives from different countries. In this way, employees work together in teams and learn from each other and their corporation. As such, *language skills* are crucial for achieving effectiveness in vertical and horizontal communications in a joint venture; the lack of language skills is a great obstacle to mutual understanding. Russian employees need corporate language training because many of them have poor skills in English and other foreign languages.

It can be useful to arrange *working groups* for analysing some important areas of company operations and for making suggestions concerning improvements. Such groups might comprise Russian managers and managers of the parent office or other international subsidiaries representing different functions and business lines/operations. The working group can even start in a conflict situation, when the

parent company and acquired Russian company managed by a Russian director have different visions of what is happening and how to proceed further. If members of a working group cooperate in a constructive way and can express opinions more openly, results are usually reliable and trusted by both sides. As indicated by our respondents, *joint work and cooperation*, even on small projects, can be very useful for the preparation of contracts, creating internal standards in particular fields (e.g. transfer pricing) and preliminary joint work with clients.

Corporate events are very important in Russia, as interspersing holidays into the usual routine correspond to Russian culture. It is important that holidays are not just symbolic but also have a pragmatic aim, such as contributing to the formation of corporate identity. Ending such events because of costs can have a negative effect on Russian personnel. Conversely, keeping such events can support team spirit and motivate personnel. It is important to consider reasonably priced corporate events.

PART 2
HISTORICAL OVERVIEW

1 UNDERSTANDING RUSSIA

Maxim Storchevoy and Jeffrey Hass:

The goal of this chapter is to discuss key values and archetypes of Russian culture that have developed over several centuries of Russian history. This fundamental introduction is important because these values and archetypes have successfully manifested themselves through various institutions of the Russian Empire, the Soviet Union and post-Soviet Russia. What are they and what are their roots? Answers to these questions can help us better understand Russian economic and business culture that shapes the behaviour of entrepreneurs, investors and employees in the current economy, and also political and legal traditions that play enormous roles in establishing and running a new enterprise in contemporary Russia. In particular, the state will play an important role in our narrative; indeed, in Russia, one cannot talk about business without talking about the state. Evolution of property rights and economic freedoms, risks and advantages of state interventions in the market economy and relationships with local authorities or regulatory bodies, including legendary issues of “autocracy” and “corruption”, have enormous importance for business in Russia.

1.1 Between Vikings and Mongols

The known history of **Rus** (i.e. the name of early Russia) starts later than histories of other major European countries. By itself, this fact cannot explain the disappointing backwardness Russia systematically experienced along its historical path. However, coupled with other important factors such as geographical location, size, climate and the unfavourable influence of predatory nomads, this might help us understand some crucial components of later Russia; for example, the autocratic political system or extensive character of the economy.

As often happens, the fate of a young and less-developed society might be shaped by a stronger neighbour, perhaps an empire with Roman law or a barbarian dictator with primitive culture. Early Rus was a forest territory populated by scattered agricultural tribes and located between Europe and Asia. Thus, it was a subject of potential interest for more powerful and better organised forces from both geographic sides. It happened that both were influential in various periods although, politically, the Asian side had earlier and longer-lasting consequences.

The initial influence came from Europe. Historians believe that the Rus state was founded in the 9th century by Swedish Vikings attracted by water routes to Byzantium and the Near East (i.e. from the Baltic Sea, through rivers to the Black and Caspian seas)⁶. As Muslim conquerors disrupted direct trade between Europe and the Middle East in the 7th and 8th centuries, alternative routes had crucial business importance. The Vikings were not interested in the land itself because the climate was not favourable for agriculture and the native people easily migrated. They collected some tribute from locals but their main interest was trade. Thus, the Vikings built many cities along rivers, the most important of which was Kiev – the last large trading hub on the way to

⁶However, one should be careful mentioning this when talking with contemporary Russians, as it is a sensitive point in the official history. Official historians traditionally present another version in textbooks: Russian tribes *invited* two Scandinavian knights to rule the country.

Byzantium. Over time, Vikings married local women and assimilated. It is important to note that it was not the Vikings who brought the tradition of autocracy to Russia, as they did not aim to exercise total political power over the territory. For example, cities were managed with the help of **veche**, a people's meeting at the centre of the city.

Viking commerce was undermined at the end of the 12th century when the Pechenegs, a semi-nomadic Turkic people of the Central Asian steppes, made trade routes between Kiev and Constantinople extremely insecure. This forced Russian princes to turn to agriculture. In turn, the northern part of Rus gained some advantage because of its remoteness from hostile nomads and the centre of power began moving to the North.

The Russian state could have followed the European path of development, with incremental progress in private property, parliament and so on. Unfortunately, this path was deflected by the **Mongol invasion** of 1237-1242. Mongol nomads conquered almost all Russian lands and they could have moved further into Europe if internal political problems in their own state, the Golden Horde, had not forced them to turn back. Formally, they did not append Russian territories to the Golden Horde because it was too remote for direct administration. Instead, they imposed a high annual tribute on the Russian people. At first, the tribute was collected by Mongol representatives, but this practice soon led to local conflicts and, after a decade, the function of tax collection passed to Russian princes. Any prince succeeding his predecessor had to visit the Golden Horde to obtain a seal of approval for ruling and collecting duties for the Horde. However, at the beginning of the 13th century, tribute collection was centralised when the prince of Vladimir agreed to collect the duty from all princedoms, for which he was bestowed the title of Grand Prince. This change had an enormous impact on the political culture of Russians as the Grand Prince relied on the military force of the Horde to levy and collect taxes. Another factor was that, as some historians claim, the sons of grand princes were held as hostages in the Golden Horde to ensure their fathers' loyalty and, in the process, these sons learned first-hand the Mongols' administrative practices. When returning to their homelands, they brought with them patterns of Mongol administration.

The influence of Mongol rule on Russian economic and politic culture was quite extensive. For example, in terms of language, the common Russian words for money (*denga*), market (*bazar*), and profit (*barysh*) derive from Turkic languages and were introduced by merchants who travelled to the Golden Horde.

1.2 Autocracy: from Tsar to President

As the Mongols' control waned in the early 15th century, the Grand Princes of Rus decided to take over their function and rule the country in the same way: keeping all princedoms together, collecting taxes and suppressing disagreement with armed force. As a result, the Russian state developed into an **autocracy** with strong central power and relatively powerless provinces.

Development of the autocratic state took some time, during which local property or political rights were gradually replaced with centralised control. For example, Novgorod and Pskov avoided the Mongol invasion and consequently preserved their veche and traditions of electing rulers whose powers were circumscribed by a social contract. This legacy was destroyed during the wave of cruel repression by Ivan the Terrible (1553-1584), whose rule was brutal (literally, a predecessor to Stalin) and who

established a special military guard (*oprichnina*) that was above the law and could repress dissenting nobles and ordinary people.

One factor in the formation of Russian autocracy was the fall of Byzantium in 1543 and the decision of Russian princes, in collaboration with the Russian Orthodox Church, to proclaim Muscovy as the successor to Byzantium – the Third Rome. Afterwards, the Grand Prince of Moscow was increasingly referred to as **tsar**, the traditional title of emperors of Byzantium. The tsar's power was worshiped in Russia as sacred and the Russian people gradually developed an unconditional belief in a “good” tsar and obedience to governmental actions.

Tsarist autocracy was successfully sustained for the next three centuries. However, in the 19th century, it became increasingly clear that this political structure, in combination with serfdom, was obsolete and even immoral and should be reformed or even dismantled. The most progressive circles risked protest but had little success. In 1825, the Decembrists' revolt and demand for constitutional reform was suppressed; fifty years of reaction followed. In the 1860s, tsar Alexander II was ready to announce constitutional reforms but he was killed by revolutionary terrorists. This led to further reaction and froze the system for another fifty years, until the tsarist autocracy collapsed during World War I and Vladimir Lenin and the Bolsheviks took power.

Lenin and his party initiated a large scale experiment aimed at building a new socialist society that, in theory, would be democratic, free from exploitation and economically efficient. The bitter irony was that real **Soviet society** inherited many traditional traits of tsarist Russia. The most important was the autocratic political system with a worshiped leader. Lenin was intolerant of dissent, but after his death in 1924 and a few years of elite struggle, Joseph **Stalin** appropriated all political power and initiated organised terror against his opponents, real or imagined. Dissent in nearly any form was persecuted with the help of a new security service that would later become the KGB. The new Soviet society was based on deep belief in the sacred nature of central authority, usually typical of theocratic states. After Stalin's death, his successors stopped mass repressions but maintained the leading and undisputed role of the Communist Party until the last days of the USSR.

Meanwhile, as had happened in the 19th century with tsarism, by the 1980s it became apparent that the Soviet system was ineffective and required reforms. After a period of political instability, the Soviet Union was dismantled and the new Russia had its first democratically elected president, **Boris Yeltsin**. Yeltsin supported liberal and democratic values, but in his last years in office he was increasingly manipulated by his close circle of advisors who were interested more in maintaining power and privileges. Eventually, health problems forced Yeltsin to step down and make way for a “successor” – the relatively unknown Vladimir Putin who, it was thought, would continue Yeltsin's general line. However, before long, Putin changed the political orientation of the Russian state: he reined in the media under state control, increasingly excluded opponents from the political arena and restored a modicum of autocratic rule that included traditional exaltation of the leader, persecution of threatening opponents and prohibition of significant criticism. The only difference from the tsarist autocracy was that now the “tsar” was titled “president” and would be elected “democratically” by manipulated voting. Again, Russian autocracy prevailed. Was this inevitable? What are the real roots of such fairly consistent political structures? These questions remain open.

1.3 “Great Russia” and National Pride

Ask an average Russian why he or she is proud of their motherland and they will say that they live in a great country – large, strong, a winner of wars. This position of Russia as a “great power” was first proclaimed by tsar **Peter the Great** at the beginning of the 18th century. Russia faced strong foreign challenges and could have lost its northern territories to Sweden and western territories to Poland and, thus, been reduced to a small Muscovite state with archaic political and economic systems, isolated from access to ocean routes and having little significance on the international scene. This did not happen because Peter the Great was enormously energetic, decisive and passionate. In 1697–98, when travelling in several European countries, Peter was impressed by modern technologies and institutions. On his return to Russia, Peter launched a great westernisation project, importing into Russia much technological and administrative knowledge. However, this was modernisation “from above” based on authoritarian methods of governing, suppressing all significant dissent and accumulating enormous power in the state. Eventually, Peter’s reforms achieved their purpose. After twenty years of confrontation with Sweden during the Great Northern War (1700-1721) for the eastern Baltic region, Russia triumphed and emerged as another great European power. Since Peter, Russian tsars titled themselves “emperors” and Russia continued to play the role of a “great power” and expanded its frontiers, although never being able to modernise its political and economic systems. Catherine the Great (1762-1796) won another war with Sweden, took some territory from Poland, defeated Turkey twice and expanded Russia’s borders to the Black Sea. Later, Russia won other large scale wars to solidify its “great power” status; in particular, victory in the Napoleonic wars of 1812-1813. In the 19th century this position gradually eroded due to political and economic backwardness, culminating in the Russian Revolution of 1917. However, the country rebounded when the Soviet Red Army defeated Nazi Germany in World War II (1941-45), emerging as one of two “superpowers” in a cold war, nuclear arms race and space race with the United States (1950s-1980s).

All of these “glorious” facts were always emphasised in official propaganda and school textbooks of the USSR and later in the Russian Federation to promote the idea of “great Russia” and to distract popular attention from other areas of poorer achievements, especially quality of life, and to persuade the people to suffer additional troubles for the sake of the great country. This belief in Russian “superiority” is still shared by many Russians and can assume messianic form.

1.4 Always Limited Rights

An important condition for good business development is **property rights** that are well defined and protected by law. This enhances incentives for people to care about their assets and to invest in their development, a great driver of economic growth. In Britain, private property in land had existed in the 7th century AD and was decisively reaffirmed in the 17th century during the confrontation between the king and nobility. Well-defined property rights also created a middle class that was crucial to the development of parliamentary control over the monarchy and eventual democracy. Unfortunately, Russia did not develop such rights. When Eastern Slavs entered the forests of future Russia, land rights were of no importance. Land was in such abundance that there was no need to consider its long-term efficient usage. Slavs practiced slash-and-burn agriculture, whereby farmers cut and burned forest sites and exploited this land for several years until the soil was exhausted, at which point they moved to new land.

When Slavs turned to settled farming, they inevitably had to pay tribute to a local knight; although this was less a rent than a tax or “protection payment.” While peasant communities did develop systems of governing land use (which we discuss below), these were not rights to “property” that were recognised by a local knight or prince. As in many other countries, Rus developed a system of military land tenure whereby every territory had to “feed” a knight who provided military service to the Grand Prince, who in turn supported the knight’s “right” to collect tribute from the respective territory.

In the same period, peasants were also gradually losing personal freedom. The abundance of land in Russia meant peasants could always migrate to another landlord or even into ungoverned territory. This is why owning land made little sense in Russia. Only land with people could have value. At first, Russian peasants might freely migrate from one land owner to another, although there was a custom limiting migration to two weeks after the completion of the agricultural season in November. However, after the middle of the 15th century, the right to migrate was abolished for several reasons. The growth of peasants’ duties caused by wars or bad harvests led to increased migration in search of easier living conditions. As a result, Russian landlords persuaded the tsar to introduce **serfdom**, by which peasants became linked to the land where they lived and could not migrate without their landlord’s permission. This was a system of semi-slavery, as peasants could be sold with the land, similar to cattle or buildings. As a result, Russian peasants lost the last right they possessed, the freedom to move at will.

The tsar was the only truly free person in Russia. All other classes (i.e. landowners, peasants, townsmen and priests) had few, if any, inherent personal freedoms and property rights. Landlords and their older sons had to be on active military duty or at least be ready for immediate duty. The tsar was the ultimate owner of all land and could deprive any landlord of his possessions.

With time, this system degraded and lost its efficiency. At the beginning of the 18th century, Peter the Great introduced a professional army and landlords or their elder sons initially had to serve as officers. However, in two to three generations after Peter, this military duty was gradually abolished, although corresponding land-holding rights remained unchanged. This was a paradox: peasants were enlisted to enable landlords to provide a military service; however, the abolition of obligatory military service did lead to the abolition of serfdom. Peasants remained serfs and their rights and duties continuously deteriorated. They could not sign contracts or documents, could be sold at the serf market or sent to Siberia at the will of their landlords. Moreover, serfdom undermined the development of capitalism due to cheap compulsory labour. Theoretically, emerging entrepreneurs could lease serfs from their landlords, but they could not compete with products of landlord workshops that employed free enlisted peasant labour. This is why the number of entrepreneurs in Russia remained small and cities remained administrative centres. In the 19th century, this serfdom trap and also autocracy was recognised by many as a key problem. In 1861, Alexander II issued a decree dismantling serfdom, although peasants had to pay for their freedom and were not granted any land. Thus, until the beginning of the 20th century, little effectively changed for the majority of peasants.

Private property in commerce and manufacturing developed with similar limitations. Russian merchants or manufactures could be asked by the tsar at any moment to provide money or services for state needs.

When the Bolsheviks came to power in 1917, they immediately declared that all land belonged to the peasants. However, after several years it became clear that the position

of the latter would only get worse. After some early experiments, the Bolsheviks imposed compulsory collectivisation: the creation of collective farms (*kolkhoz*) where all peasants had to work together and have common ownership of all tools, livestock and land. Much of their produce was expropriated by the state for industrialisation. Russian peasants again lost freedoms and had to work as serfs for another 50 years. More or less, this was the fate of all Russians. Private property was abolished; factories and enterprises were now owned by the state, which became the single employer for the whole economy. All other freedoms (e.g. freedom of speech, assembly and movement) were also severely curtailed. Those who disagreed could be treated as “enemies of the people” and executed. Migration abroad was generally prohibited.

In the second half of the 1980s, Mikhail Gorbachev introduced reforms that provided freedom of entrepreneurship and embryonic property rights. Millions of Russians could own, invest and manage; as thousands exercised these rights, a new market economy began to form. However, it was no surprise when, in a country with no real traditions of private property and entrepreneurship, the first entrepreneurs faced serious problems with the normal exercise of their rights. In the 1990s, the most serious issue was the problem of security. Alongside normal entrepreneurs were “criminal entrepreneurs” (i.e. gangsters) who profited from selling “security”. The traditional Soviet police (*militia*) did little to address this problem and soon virtually all entrepreneurs had to pay some protection money to an organised gang (*krysha*). In the 2000s, all “kryshas” migrated into legal security firms or infiltrated the police and the market for protection became more civilised. However, property rights of new entrepreneurs and business people in modern Russia remained conditional. Primarily, they had to be loyal to the authorities. Any entrepreneur who showed some support for opposition elites could lose his/her property, as happened to Mikhail Khodorkovskii in 2003. Moreover, in the 2000s, many enterprises became victims of so-called raiders (i.e. hostile takeovers), when a “raider” company would employ some fictitious legal reason (e.g. unpaid debts, violated license or regulation) to take over the assets of a target company, often with help from local or federal officials. This has hurt the confidence of Russian business people and led to periodic capital flight from Russian markets.

Therefore, *private property and other freedoms in Russia always seem limited by the state and various criminal actors*. Explaining the surprising stability of this trend is no easier than explaining that of autocracy.

1.5 Bureaucracy and Its Principles

There is a saying that “Russia is owned and ruled by bureaucrats” and both Russian tsars and modern presidents had equally limited opportunities to manipulate this social class. Is this true and, if so, and why?

Active growth of the bureaucracy began under Peter the Great and was part of the modernisation process. Peter tried to build one large command economy and to regulate all state activities through a **system of departments and ministries**. As the state apparatus increased enormously, Peter had to introduce new codes for civil servants and introduce a new system of social stratification, the *Table of Ranks*, in which the status of an official was based on years and performance in state service. Before Peter, civil servants often were paid little, which led to a system of “feeding”, whereby officials took some payments in cash or in kind from people for services rendered. Peter ended this system and decreed that all officials would receive a fixed salary from the state budget. After Peter, this system began to degrade. Sometimes

there was insufficient money for salaries and new tsars allowed a return to the old “feeding” system. In the 19th century feeding was again prohibited, but as the government salary was delayed or paid in depreciated paper currency, officials continued to take bribes.

Usual forms of corruption in Tsarist Russia involved **bribes** for taking some action (e.g. giving a permit) or refraining from others (e.g. not noticing legal violations) and taking illegal rewards for allocating state procurement contracts. The latter was especially prevalent during military campaigns when the state significantly expanded procurements. Almost every Russian war was accompanied by many scandals connected to procurement.

The Soviet bureaucracy played an even more important role in social life because the entire economy was centrally administered. The number and importance of civil servants significantly grew. If, in 1913, the number of civil servants was approximately 1.6 per 1,000 people, in the 1920s this figure was nearer to seven. However, the efficiency of their work was quite low. It seems that this administrative mechanism worked sufficiently well during World War II, when the entire country was mobilised to defeat Germany. It worked comparatively well in the decade that followed the war due to large-scale popular enthusiasm for rebuilding the country and building a new, prosperous society. However, by the 1970s, it was clear that this bureaucracy was far from efficient. Bureaucrats had few incentives to work well and their moral qualities deteriorated. The only real way to improve their personal welfare was to take bribes or steal, which they did as much as possible. Top Soviet authorities were still committed to ideology and generally were not corrupt. They even tried to fight state corruption, but officials were quite careful in their shadow economy activities and such campaigns had no real effect.

After the collapse of the USSR, it seemed that unlimited bureaucratic rule had ended and that the country could create a market economy with minimal state apparatus. Paradoxically, this was not to be. Under Boris Yeltsin, the bureaucracy continued to grow and it expanded even more under Putin’s presidency. If, in 2000, the number of bureaucrats in Russia exceeded 1.1 million (i.e. almost 15 per 1,000), in 2010 it was already 1.6 million (i.e. 25 per 1,000), although Putin annually declared the need to streamline the state apparatus. At the same time, the amount of corruption increased enormously. According to various estimates, from 20% to 60% of the state budget is embezzled in various ways by state officials.

How to explain this paradox? There is only one explanation: the central authority in Russia has always depended on the loyalty of its bureaucrats. A president or a prime minister can proclaim any anti-corruption campaign and reduction of state apparatus but, in reality, the head of every ministry or state department is interested in expanding its budget and apparatus and in providing support for the authorities in exchange for new budgets and informal permission to enrich themselves without apparent violation of formal laws. As is often mentioned by analysts, Russian corruption is not a problem but a method of public administration.

The downside to this system is that Russian bureaucrats usually do not feel any responsibility towards ordinary people and do not show them much respect. Traditionally, it is difficult to utilise the Russian system of state services. To access some service, one needs to spend much time waiting, with the high probability of being treated in an impolite manner. All questions are addressed slowly and inefficiently, which is not simply a result of general inefficiency but also part of a strategy to make

people pay bribes for faster solutions. As a result, Russians have never liked civil servants and bureaucrats have been important objects of hate for Russian people for centuries. Indeed, over time, the majority of Russian bureaucrats developed their own special caste, spending their lives in their offices serving and being fully dependent on the state and thinking that the state is the most powerful and important thing in society. Many bureaucrats, especially those with high ranks, help their children enter their profession in good positions and consequently the bureaucracy has a hereditary component, socialising particular values from birth. Among these bureaucratic values we usually find unconditional loyalty to the highest authorities (i.e. tsar or president), belief in the primary role of the state in national development, belief in the necessity of a “great Russia”, especially among military and diplomatic bureaucrats, and a complete misunderstanding on market competition or democracy.

Ironically, in the Putin era, the enrichment and status of bureaucrats became so obvious to the public that surveys revealed that the most popular profession among teenagers was the civil service; educational programs in public administration were inundated by applications from potential students.

1.6 Collectivism vs. Individualism

Another aspect of Russian history and culture is the common belief in a special **collectivist spirit** that makes Russians prefer collective action, common responsibility and egalitarian distribution of income. This is often employed to support such concepts as “incompatibility of Russia and a market economy,” a special “socialist spirit of Russia,” the statist idea of the state’s key role and even the missionary idea of “Great Russia” requiring sacrifices for a higher common goal. The hypothesis of a special collectivist spirit has some grounding in Russian history with some exceptions.

There was an important element in the traditional peasant economy that had an enormous impact on Russian political culture: the rural **commune**, or *obshchina*, an organisation of all families in one village responsible for collective governance of land usage and collective provision of annual duties (i.e. in labour or in kind) to landlords and the state. Collective tax responsibility was established by landlords because it was easier to count people in a village and to impose a gross tax payment for the whole village. Consequently, peasants started to consider village land a common resource that should be utilised to fulfil collective duties to landowners and the state. Every two to three years, the *obshchina* redistributed farming land between families according to the changing number of working hands in each family and the comparative land quality. The purpose of this redistribution were considerations of justice and efficiency as each family was to have enough land for efficient labour and to contribute to the collective pool of duty. As the number of working hands changed from year to year (e.g. deaths, births, marriages and migration), the distribution of farming land was adjusted correspondingly. If a family could not make its contribution to the collective duty the residual duty was shared between all other families, thus leading to joint tax responsibility. An important consequence of this system was the absence of any significant wealth differentiation among Russian peasants. Indeed, the Russian agricultural commune and joint tax liability were the main factors preventing development of capitalist agricultural farmers and the spirit of individualism and entrepreneurship among Russian people.

A similar institution, the *artel*, existed among other professions; for example, fishing, mining and even thieves and beggars. It was a cooperative association of people in one

profession who worked together and normally redistributed earned income among all members of the group. There were several reasons for this. First, this association was utilised in areas where a customer needed several workers to perform a task; for example, construction or loading cargo. In this case, it was easier for the customer to have an agreement with one responsible person, the head of the *artel*, instead of hiring all workers on an individual basis. *Artel* members also preferred guaranteed work and rewards as a member of a team instead of investing time in an autonomous search of the labour market. Another factor was that *artels* often worked far from home, especially for seasonal work, and it was easier to survive in a commune.

Another feature of this collective spirit was the tradition of gathering in church for service on holidays and sharing the same Christian values. In the 19th century, Russian propaganda invented and widely employed the special term *sobornost* (literally, “togetherness”) to emphasise this fundamental characteristic of the Russian people.

None of this means that collective labour was imprinted in Russian DNA. First, the very same *obshchina* was not essentially a collective labour organisation but only a mechanism for redistributing land and tax responsibilities among a farming community. Meanwhile, every household in this community managed its own property (e.g. house and livestock) and was interested in increasing its own welfare. Second, we can identify normal manifestations of individualism across all classes, from landlords to civil servants. Old Russia also had a merchant class that exhibited a form of entrepreneurial and individualistic rational behaviour. Before the 1917 revolution, entrepreneurship was growing actively and was based on healthy individualistic behaviour. Approximately 10% of peasants were independent farmers. The more enterprising and prosperous peasants were termed **kulaks** (literally, “fists”) by their less successful and envious brethren. Therefore, the Russians’ “special collectivist spirit” was in part mythic and a reality.

However, the Bolsheviks did try to eliminate healthy individualism from Soviet society and this had strong negative consequences for the development of a post-Soviet market economy. In the 1920s-1930s, several waves of repression were targeted various forms of “entrepreneurial” behaviour. The state expropriated property from and even executed or exiled those accused of engaging in such “anti-Soviet” behaviour. The Bolsheviks did not trust peasants in general and they especially disliked the more successful and wealthy “kulaks”. The most dramatic repressions occurred during Stalin’s **forced collectivisation** of peasant villages. For peasants, this meant a return to serfdom. Against their will, they were enrolled into collective farms from which they had no right to leave. Economically, they lost all private land and livestock. Everything was expropriated to collective farms. Resistance led to severe repression, which in turn led to the deaths of perhaps ten million people and the deportation of millions more. This had a long-standing negative impact as the more talented and entrepreneurial farmers were exterminated.

During the 1960s-1980s, the Soviet regime enacted policies that had another effect on the collective mind of the Soviet people. A new generation of Russians was taught in schools in a strong collectivistic manner with complete denial of selfish motives and individual wealth. Institutions and policies supported this ideology: industrial and agricultural workers had similar wages, there was no obvious unemployment and there were no “wealthy” people. Many accepted this ideology and became true Soviet citizens, performing their social roles, especially working at their jobs with due diligence. The state guaranteed jobs, salaries, food, shelter, medical care and other material needs. This cradle-to-grave paternalistic welfare also hindered the development of

individualism. Several Soviet generations could not perceive themselves making truly independent decisions concerning jobs, medicine or education or on making a choice in the political market; even if they could imagine this, engaging in such practices was not an automatic reflex. During this time, many Russians developed a hostile attitude to profit-oriented behaviour as opportunistic and dishonest speculation (*spekuliatsiia*). When the Soviet Union and its command economy collapsed and market institutions were introduced, these “Soviets” became passive in finding their way around the new social environment. They were less able to navigate autonomously in the new marketplace, which in turn hindered the development of market practices and a thriving market. State policies did not help, although problematic market development was not a function of state policy alone.

Nevertheless, the effect of official Soviet propaganda should not be overstated. Many people were able to preserve egoistic motives. They believed that official values were false and that no one actually believed in them; others more cynically believed everyone could and should improve their lives by playing or cheating the system by shirking, stealing or taking bribes. In fact, because deficits in the quantity and quality of goods and services were endemic to the planned economy, Soviet institutions could actually create opportunities and incentives to act in an individualist, profit-oriented manner. Some Soviets, when good quality meat food was not readily available in stores, utilised personal connections (*sviazi*) with store employees to obtain these goods by privately arranged and illicit means (*nalevo*). Some employees would steal goods or materials and sell them on grey or black markets. Skilled workers (e.g. plumbers) might not work hard at their formal jobs but would work after hours for secret payment in rubles or in kind. This entire complex, termed the **shadow economy**, operated alongside the formal economy, meaning that individualistic behaviour operated in parallel with formally collective practices. However, this type of individualism was not quite the same as the form of individualism associated with healthy capitalism. “Healthy” individualism is tempered by acceptance of social norms and responsibilities and an understanding that an individual’s well-being is well served by cooperating with others, including the state. However, enforced collectivism and state-driven paternalistic welfare in the Soviet Union tended to breed a more cynical and opportunistic individualism, in which individual well-being is served by opportunism, including breaking the law. This type of individualism hinders the development of social trust, civil society and social capital. In the 1990s, such opportunistic behaviour was on display as wealthy “**New Russians**” and “**oligarchs**” employed legal loopholes, political connections and other more cynical tactics to make quick profits from opportunism rather than from adding value; for example, utilising political networks to obtain privatised enterprises at a cheap price or speculating in currency or commodity markets, while average Russians endeavoured to cope with the shocks and challenges of the new economic environment. This gave the post-Soviet market economy a bad image as an economy of true speculators and thieves, which triggered moral outrage and some support for the state paternalism and collectivism that have been part of Vladimir Putin’s policies and legacy.

In sum, Russian and Soviet collectivism in beliefs and institutions ultimately did not create either a healthy collectivism or healthy individualism. Instead, it encouraged the kind of social distrust and opportunistic behaviour that makes the development of a market economy more difficult. However, having seen the excesses of both opportunistic individualism (i.e. 1990s) and authoritarian state collectivism and paternalism (i.e. Soviet era and 2000s), it seems that many Russians are slowly developing a more moderate individualism with due care concerning social trust and civic responsibilities. However, it will take time for this mindset to spread to a

significant part of the population and it will take effort and patience on the part of civic organisations and reform-minded politicians to institutionalise these norms into law and everyday practices of the civil service.

1.7 Formal Laws vs. Informal Rules

Another constant of Russian society is the operation of the law. Over a long period, Russian leaders introduced thousands of laws and performed several legal reforms. Almost always, Russian legislators borrowed their legal ideas and reforms from the West, although one Russian legal tradition continued throughout this time: the special role of formal law.

First, there was never true supremacy of law; that is, formal law was never placed above the ruling authority as, supposedly, should be the case in any modern political system. If necessary, Russian political leaders can always sidestep any law to introduce a new one. Usually, the law is not overtly violated, but rather applied in a manipulative way to achieve a desired outcome. The traditional Russian saying for this is: “Law is like a horse, it can be driven in any direction.” Certainly, the tsar or president cannot flagrantly violate the law, as hiding or justifying this would be difficult in public view. However, there are two methods to manipulate the law: alternative interpretations of legal statements or selectively applying one of several contradictory laws or legal norms.

Second, the Russian legal system has always had a special enforcement mechanism. Legal requirements are often so severe that complying with them is unfeasible or even impossible. Correspondingly, the majority of people and organisations comply with laws incompletely or only formally and this with the tacit consent of authorities. This creates *kompromat*, potentially legally incriminating evidence that the state can use at any time. Thus, to manipulate people or organizations, the authorities can simply hint about employing *kompromat* for a prosecution, which usually brings such individuals or organizations into line. According to one Russian saying, “the harshness of Russian laws is compensated by discretionary compliance.”

Third, there are always **informal rules** that are more important than formal laws and that actually govern behaviour in particular areas. For example, there is an informal rule in modern Russia that all oil and gas resources are distributed and managed according to the will of the Kremlin, even though this not required under formal law. Therefore, if any independent company decides to enter the oil and gas market without informally consulting the Kremlin, it risks legal and administrative pressure, including the use of *kompromat*. This tradition of a parallel set of rules, “non-real” formal and “real” informal ones, was established in the Soviet Union. Stalin’s Constitution of 1937 was known as the most democratic legislation in the entire world; however, very few of the rights it contained were actually respected in Soviet society. While this constitution was formally democratic, in practice only one party could stand for election. Freedoms of conscience and speech were formally protected but not honoured. Under Putin, formally democratic elections have been manipulated to produce the Kremlin’s desired results, giving a façade of democracy to authoritarian rule.

1.8 Russian Orthodox Church

Today, approximately 70% of Russians consider themselves Orthodox Christians and, although only a small proportion of these people attend church regularly, many of them consider the Church a central element of Russian culture. Indeed, it became a symbol of the country, although its past and present roles are somewhat contradictory.

The adoption of Christianity was not voluntary. In 988, Prince Vladimir I of Kiev decided to introduce Christianity as a uniform religion for all tribes and he organised mass baptism of the population, which was mostly pagan at this time. It seems that Christianity was a **political choice**. Vladimir needed a monotheistic religion to help him impose uniform rule over his lands and he had also entered an important political alliance with Constantinople. Adopting Christianity from the Byzantine Empire served to enhance this alliance.

Orthodox Christianity came to play an important role in the progress of Russian culture and came to resonate with Russian culture and everyday life. Ideas of tolerance and mutual love were eventually warmly supported by Russians and this religion provided some solace for the usual difficult life faced by Russians. Moreover, the Church played a motivational role in crucial periods of Russian history. For example, it is believed that during the Mongol invasions, the Church persuaded powerful Russian princes several times to cease their internal conflicts and obey the Great Prince of Moscow.

However, some features of the Russian Orthodox Church might have been less beneficial for social development. First, the Orthodox faith relied more on mysticism (i.e. sacred rites providing the believer with salvation regardless of his/her behaviour in this life) than on asceticism (i.e. seeking salvation through controlled personal behaviour). The latter was widely practiced in Russian monasteries, but the general Russian population was under the influence of the former. Among other things, Orthodox mysticism did not aid the development of effective business ethics. While Christianity offered positive fundamental values of honesty, forgiving and help to, for example, neighbours, mysticism did not develop this discipline of everyday behaviour. Another factor instilling mysticism in the minds of Russians was dominance of the agricultural population coupled with unstable weather conditions that created feelings of an irrational uncontrollable environment and total dependence on some "higher power". This had several important consequences. First, mysticism meant passive contemplation and quiet repose in God, which led to a fatalistic indifference towards the world and a humble acceptance of the given social order. Russian Orthodox people usually quietly accepted political change and reforms, with only extreme material deprivation and/or injustices leading to mass uprisings. Second, mysticism was responsible for relatively weak personal integrity in ordinary business life; personal sins only being removed by liturgical rites and there being no unforgivable misbehaviour. The poorly developed method of confession frequently took the form of collective admission of guilt, with no real influence on an individual's conduct. The influence of the clergy, who did not follow ascetic practices (e.g. no celibacy), was relatively weak and also could not serve as moral authority. In every peasant house, icons were placed in the eastern corner of the living room and many people covered their icons with a piece of cloth while doing something not approved by the saints depicted by these icons. This act was aimed at concealing misbehaviour, thus weakening the disciplining power of the religious moral code. Third, another side of mysticism was rejecting the importance of success-oriented ethics because sacred rituals will correct all personal errors and inefficiencies in this life.

Politically, the Russian Orthodox Church was subordinate to the political and economic interests of the ruling class. The Church's strategy was to build an alliance with state authority. As discussed later, the most effective way to start a business in Russia at this time, and often thereafter, was to cooperate with the state; for example, to obtain a trading monopoly. However, this alliance demanded compromises from the Church. At first, this contract worked well and both parties acted on the basis of mutual benefit. For example, when Constantinople, the centre of Eastern Christianity, was captured by the Ottoman Empire in 1453, the Russian Orthodox Church proclaimed Muscovy as the Third Rome, the legitimate successor to Constantinople and a very convenient idea for promoting the Russian tsar as a divine ruler with a holy mission. Nevertheless, the state began to expropriate the Church's rights and freedoms. Eventually, Peter the Great broke the contract and made the Church a department of the government run by civil servants. The Church, including church lands and peasants, was nationalised and even the clergy's salaries were paid by the state. At the beginning of the 20th century, the Russian Orthodox Church had a chance to win back its autonomy but, in 1917, the Bolsheviks, who were extremely hostile to any religion, proclaimed the complete separation of Church and state, expropriated almost all Church property and imprisoned or executed many clergy. This repression grew to an enormous scale in the 1930s under Stalin. However, in World War II, Stalin partly revitalised the Orthodox Church, which he needed as an instrument for enhancing popular patriotism. After the war ended, Soviet leaders continued their oppression of the Church and deprived it of resources and rights. After the collapse of the USSR, freedom of conscience was supported and the Russian Church began to regain its former social position. Unsurprisingly, Church leaders pursued the time-honoured strategy of developing a new alliance with the state. The Church offered the Kremlin ideological support in return for wide opportunities, for example, to regain property, open new cathedrals and exploit state media for promotion.

1.9 A National Character of Russians?

There is much debate concerning a Russian "national character," although it is difficult to differentiate myth from reality. Theoretically and empirically, the existence and influence of a real "national character" can be a difficult proposition to sustain. We describe some theories for consideration by the reader.

We have described above some historical events that could contribute to the formation of Russian cultural traditions (i.e. fatalism or passivity, tolerance of lack of freedoms, and admiration of state power); for example, the Mongol conquest and its reproduction in Muscovy. There are two geographical factors that might well have contributed to forging Russian character. The first factor is its large territory; Russia occupies one-eighth of the earth's land surface. To rule such a territory, leaders need a strong hand, otherwise even a small degree of discontent might unravel state authority and possibly lead to the fragmentation of state and country. Further, individual or even concerted group action cannot reform this system quickly; many tsarist reforms were undone by successors, for example, after Peter the Great or Alexander II. Thus, patience and submission are rational strategies. This is why political passivity is a rational response even under a disappointing political regime. The second geographical factor is an unfavourable climate. For most of the year, in contrast to the climate of continental Europe, much Russian territory is rather cold. There is also great variation in temperatures during the year. The summer might be hot but short, followed by inter-seasonal rain, causing mud, and then a harsh winter. This led to inefficient allocation of peasant labour; peasants were forced to remain idle for long inter-seasonal and winter

periods and then to work intensively tilling, seeding and harvesting over a short period. There is a hypothesis that this explains several important characteristics of Russian culture. First, such intensive labour contradicted the principle of a rhythmic schedule of work. Second, this explains why Russians could demonstrate short-term intensive bursts of energy. This tradition was enhanced in the Soviet era, when planning targets and propaganda could necessitate last-minute “storming”, or intensive labour to meet a production target. In other words, Russians could be relatively passive for some periods, but then work hard on concentrated efforts, whether meeting a planning target or mobilising heroic production efforts during World War II. Third, some claim that these seasonal patterns explain the Russian inclination for the consumption of alcohol. Put simply, alcohol consumption might be a tactic for coping with enforced inactivity in winter periods. Fourth, such unstable and unpredictable variation in temperature and rain leads to risks of crop failure. This, in turn, contributed to **mysticism** and **fatalism**, which was consistent with Orthodox Christianity.

Caution and conservatism are rational responses to uncertainty, producing more or less guaranteed output and, consequently, rejecting experiments and innovations as risky. This attitude was augmented in the 20th century, when Russians had to survive several large scale shocks: revolution, famines, forced collectivisation and industrialisation, a devastating war in the 1940s and then the shock of post-socialism in the 1990s. Perhaps this partly explains why the current Russian population still prefers a stable minimum to potential improvements achieved through possibly profitable but also risky political and economic reforms. Finally, such variation in environment and activity might help explain the supposed Russian preference for extremes: “all or nothing”. Emotional displays can be quite strong. Russian hospitality can be overwhelming, friendship very deep, celebration almost ungovernable and drinking too heavy. However, this might be less a specific Russian trait than normal human behaviour; it might be that the more disciplined “West” has been conditioned differently. This remains a hotly debated topic. Finally, such harsh environmental conditions strengthened a Russian sense of duty to help those on the edge of survival, which can be termed a strong norm “to help the helpless.” Revealing true desperation might change another person’s attitude and position and encourage aid. A corollary to this is that successful business requires establishing **interpersonal relationships** (i.e. some form of friendship) with Russians before conducting serious business transactions, as Russians treat friends and relatives (i.e. “ours”) in a more favourable manner than strangers.

Additionally, limited access to the sea also played an important role before the transport revolution in the 19th century. Russia was distant from the main centres of civilisation and progress (i.e. Europe and China), which meant that the country developed in relative isolation from more modern progressive ideas and institutions (e.g. various freedoms or qualities of life). However, there is some dispute concerning the extent of Russia’s isolation.

This overview should be regarded as an idealised picture smoothed and blurred over the last decades, when Russia opened its borders and Western ideas, attitudes, and ways of life more actively entered Russians’ habits. However, it seems that the heritage of the tsarist and Soviet past remains manifest in Russian behaviour.

2 NEW RUSSIAN CAPITALISM (1985-2012)

Maxim Storchevoy and Jeffrey Hass:

In this chapter, we discuss the birth and evolution of the market economy after the collapse of the USSR. We briefly outline the last days of the command economy, Gorbachev's infamous *perestroika*, the painful reforms of Boris Yeltsin and economic growth and contradictory economic change under Vladimir Putin.

2.1 Soviet Legacy

Under **Leonid Brezhnev**, the country tried to exploit the advantages of planned development and, at the same time, to copy some trends from capitalist economies. For example, Soviet leaders and planners tried to consolidate enterprises into industrial giants (*kombinaty*) and industrial groups (*obedineniia*) to capture economies of scale. However, this led only to extensive development rather than technological innovation and had little effect on productivity, solving economic problems or altering managerial behaviour. Suggestions by managerial experts were worthless without institutional changes; managers who tried to change behaviour were still operating in a broader context that rewarded risk adversity and one-man management. Also, managers themselves, who generally had worked their way up the factory hierarchy and had internalised particular practices and models of strategies and action, approached new models for running their factories with scepticism or even distrust or hostility.

Such was the formal command economy. However, beneath formal routines and structures, a **shadow economy** of quasi-legal or illegal exchange living parasitically off the formal economy was burgeoning. Ironically, the command economy itself created this parallel shadow economy. First, the command economy created deficits of consumer goods and services. Rather than independent owners and entrepreneurs seeking profit by fulfilling consumer demand, production and sales were guided by plans set by bureaucrats with little incentive to determine consumers' real desires. To meet demand for deficit goods and services, Soviets turned to semi-legal and illegal activities. These might involve stealing materials from enterprises for use or sale on the black market. Soviet managers would negotiate for an informal supply of inputs because the state could not always guarantee the timely supply of quality inputs. Soviets learned the art of utilising networks or **blat** (i.e. patronage) to obtain jobs, consumer goods (i.e. food and non-consumables), services and other opportunities. For services, relevant personnel might perform official duties lightly but work more seriously after hours for illicit pay or payment in kind. For example, anecdotal evidence suggests that plumbers and the like did not take formal requests for repairs very seriously; however, they were more willing to visit apartments after hours and repair leaky pipes for vodka or extra rubles. The extent of shadow activity is difficult to ascertain, although the emergence of small private firms and trades people in the Gorbachev era suggests that there was a narrow but ready entrepreneurial class.

Activity in the shadow economy had several important consequences for Russian "business" during and after the Soviet era. First, shadow activity contributed to economic inefficiencies: theft of materials was informally rewarded, leaving enterprises and consumers without needed goods or services or with low-quality goods and services. Apartments and other buildings were not well constructed because bricks and materials for cement might be stolen so that managers or workers could construct their

own dachas or sell the materials on the shadow market to those wanting to build their own dachas. Second, activity in the shadow economy, coupled with the deficit nature of the formal command economy, reversed the usual market relations of power; instead of sellers being accountable to consumers (i.e. market capitalism), consumers were answerable to suppliers. The incentives were not for fulfilling consumer demand; consumers had to fulfil suppliers' demands. This added to the inability of enterprises, and the "system" generally, to adapt quickly to post-1985 reforms; managers, nascent entrepreneurs and general organisational routines were oriented to placating suppliers and ministries. Third, the shadow economy did not reward value-adding activity, it rewarded speculation. Nascent Soviet entrepreneurs in the shadow economy flourished to the extent they could utilise networks to gain deficit goods and resell them for illicit monetary profit or payment in kind. Finally, this shadow economy hurt not only the legitimacy of the Soviet planned economy but also the normality of the rule of law. Formal rules and laws existed not to defend production or rights but rather as an arm of the overpowering state and Communist Party. In the shadow economy, practices involved not obeying or implementing rules and laws but, rather, their avoidance. Entrepreneurs in the shadow economy, among the early entrepreneurs after 1985, learned how to avoid the law and not to work within it.

2.2 Gorbachev and Perestroika

At the beginning of the 1980s, some party elites understood the necessity for change. The economy was stagnating for a number of reasons: the USSR was subsidising a wide empire in East Europe and beyond, technological innovations were not keeping pace with those in the West, Soviet agriculture was an inefficient black hole for the state budget and Soviet income from petrodollars was evaporating as the price of oil dropped after the Soviet invasion of Afghanistan. Reformist elites felt the economy faced a dead end and sought ways to reform the system. Some historians claim that another reason for change was the realisation by elites that their political power could only bring limited wealth (e.g. the best of not-so-good Soviet cars, apartments or dachas) and they decided to convert political power into material wealth by turning the whole country into a market economy they could manipulate. In 1985, the Communist Party elite chose **Mikhail Gorbachev** to be their General Secretary. His background in law convinced Gorbachev that the rule of law was important in its own right and the example of Khrushchev's reforms Gorbachev witnessed as a youth implanted in him and fellow reformers the need to liberalise and humanise Soviet socialism.

At first, Gorbachev intended only marginal reforms as it was not clear what radical changes were needed. His initial reforms aimed at increasing discipline; for example, cracking down on alcohol consumption and instructing the police to raid cinemas in the afternoons to see who was skipping work. Unsurprisingly, this did little to address economic stagnation and in 1987 Gorbachev moved further towards reshaping the fundamentals of the Soviet economy, especially increasing autonomous private business activity.

2.3 Rebirth of Private Business

Gorbachev's most important reforms for increasing the scope of business were legalising commodities exchanges and cooperatives, a socialist euphemism for private entrepreneurs. The first reform allowed Soviet enterprises and organisations to establish commodity exchanges so that enterprises and smaller cooperatives could

source and negotiate the exchange of goods and services, thus bypassing the state and, hopefully, improving supply as participants had some freedom in setting prices and retaining profits. For the second reform, interested Soviets (i.e. mostly enterprise workers and shop floor bosses, but also outside entrepreneurs) could establish autonomous **cooperatives** in a limited number of areas; cafés were the stereotypical cooperative, although cooperatives also emerged in industrial enterprises whereby workers could engage in additional production or services (e.g. repairs) after formal working hours. Enterprise managers were given some room to transform enterprise structures, including giving individual shop floors some autonomy to set their own prices and wages and to find additional clients outside the enterprise, which was an extension of the logic of cooperative reforms. The reformers' hope was that cooperative and enterprise reform would tap into the shadow economy and encourage such entrepreneurs to engage in value-adding, rather than speculative, activity that would improve overall economic performance and productivity, contribute badly needed innovations and meet consumer needs under-fulfilled by the command economy and becoming a source of possible political friction as Western countries continued to enrich their consumers.

With his reforms, Gorbachev unleashed entrepreneurship, but who were the first entrepreneurs? Not all of it was expected "market" entrepreneurship, characterised by risk-taking, observance of consumer preferences and wants, and innovation in processes and output for servicing that demand. Certainly, such entrepreneurs existed: mathematicians or engineers who wanted to open small garages and expand on their hobbies of working on cars or chemists with ambitions to earn hard currency by serving the needs of foreign tourists. At the same time, new "entrepreneurship" and business could also be activities coming into the open from the shadows. However, the reforms bred unexpected outcomes. Cooperatives emerged ostensibly to service consumer needs (e.g. cafes and restaurants), but public opinion quickly turned against cooperatives as economic parasites or fronts for laundering money stolen in the shadow economy or through organised crime. Reforms also spurred the creation of private financial institutions that lent money siphoned from state banks or the Communist Party. Some enterprise managers utilised cooperatives or financially autonomous shop floors to profit by charging costs to the mother enterprise, then subsidised by the state, while retaining income from sales.

There was also a lack of solidarity between shop floor workers and managers. Ironically, after seventy years, the socialist society ended with corroding social attitudes: paternalism and passivity on the one hand and cynical opportunism on the other. Workers sincerely wanted autonomy to make profit and improve wages, but they often felt managers were exploiting them for corrupt purposes. This contributed to increasing conflict within enterprises, which poisoned working-class attitudes to managers and reforms in general.

The reforms of the 1980s had another bad side effect; they created more opportunities for shadow economy practices, encouraging not only productive business but also fraud, tax evasion and the conversion of political and bureaucratic capital into money. Many profitable businesses were based on appropriating state property or stealing and reselling state enterprises' deficit products.

2.4 Yeltsin and the Hard Years of Reform

After the USSR was dissolved in 1991, **Boris Yeltsin** and a team of liberal economists turned Russia to the troubled path of economic reform. They started with rapid liberalisation of exchange and production, privatisation of state property and opening the economy to foreign players. The hope was that such “shock therapy” would lead to a quick recovery after an initial period of painful economic readjustment. Thousands of state enterprises would be privatised by new owners who would quickly adapt to the production of new consumer goods. There was indeed an initial explosion in small entrepreneurial firms; some were new start-ups to address supply of deficit goods and services, while others were legalised shadow activity (e.g. export of timber or oil and petroleum products). However, the market cure became painful and the market transition dragged on for many years.

One reason for this was the relatively passive attitude of employees. Generally, Russian citizens were not yet ready for such radical changes. The majority of employees were accustomed to paternalism and did not have the skills and experience with which to navigate liberalised labour markets. Instead of leaving dying firms and actively seeking new work in growing sectors, these employees could spend years waiting for their enterprises to improve; however, many such firms went bankrupt and workers became unemployed with bitter feelings of injustice.

The second problem was that many large plants and factories were run by **Red Directors**, managers of Soviet-era enterprises, who lobbied for continued subsidies to avoid unemployment and to guard against takeover by foreign investors who, they predicted, would buy and asset strip Russian firms instead of investing in new technology. Red Directors mastered the administrative art of negotiating the politics and networks of bureaucracies, the plan system, and routines of supply and subsidisation. However, the new market required new skills: being able to seek financial support from private investors in return for concrete business plans for addressing market demand and competition. Their learning curves showed much variation. Some Red Directors managed to adapt, while others continued to seek support from the state or turned to complex networks for bartering goods in return for electricity, gas, other supplies and some goods for workers.

The legal aspect of reforms was another uneasy issue. The exact content of legislation was not readily apparent beyond vague and broad guidelines; for example, limits to property ownership, how to defend property rights and setting value for state-owned assets in privatisation. Various judges and officials had insufficient experience with market economies and practices to provide the required support for emerging businesses. Worse, the Soviet system of legal enforcement (i.e. police and courts) was unable to enforce laws in the new business environment with its new risks. This led to the rise of the infamous **mafia**, gangs providing “protection services.” This began in the late 1980s, when strong and aggressive young men in sports suits would approach cooperative managers or new entrepreneurs and demand protection money. Their main weapon was physical violence; if an entrepreneur went to the police, the chances of being protected were much lower than being killed or hurt by racketeers not bound by any law or morality. In the 1990s, this practice became overwhelming; gangsters were organised, armed and often secretly collaborating with the police. Business territories were divided between various gangs and all firms in a particular territory had to pay “protection money”, typically 10-20% of revenue, to the local gang.

State corruption began also to increase as official salaries could not keep up with inflation and there were few effective mechanisms for monitoring officials' actions or to protect citizens from a predatory state. Further, officials at various levels utilised access to state property to help business allies; for example, selling state-owned assets at low prices to allies in the private sector. Yeltsin's cabinet was guilty of such practices, especially in the notorious "loans-for-shares" privatisation of the mid-1990s when potentially lucrative enterprises in natural resource extraction, especially oil, were sold cheaply to elite "oligarch" allies such as Boris Berezovskii, Mikhail Khodorkovskii and others.

Ultimately, reforms in the 1990s created a foundation for private business. However, instability, including the shocks of market pricing in 1992 and the government's default in 1998, corruption and a steep learning curve meant that developing a market economy would be a slow process.

2.5 Putin and New Russian Capitalism

Yeltsin's reforms gave Russia some political and economic laws that could be a foundation for a free society and efficient market economy. Despite the problems mentioned earlier, market relations, entrepreneurship and foreign and domestic investment did help Russia recover. However, economic success was accompanied by creeping political degradation that led to increased corruption, revival of cold war ideology and failure to conduct further reforms. The crucial role in this process was played by **Vladimir Putin**, who came to power in 1999. Putin generally adhered to developing a market economy and delegated authority over economic policy to liberal and professional specialists, mainly from Yeltsin's team. Being young and decisive, Putin succeeded in returning confidence and respect to the presidency and the state. One of Putin's main political ideas was stability and he managed to create some stability for almost eight years. Putin's luck was that painful reforms had previously been implemented and Russia was profiting from the high price of oil on his watch. However, there were also dangerous and harmful consequences of Putin's rule. He systematically adapted the political systems to his own desires for power and enrichment of his supporters. These factors interfered with economic growth and had bad long-term consequences for Russian business. These factors are described next.

2.6 "Rule of law"

Despite occasional reformers' hope or attempts, the rule of law never established deep roots in Russia. Instead, *rule by law* predominated: a situation whereby the political elite manipulate or apply law selectively for its own interests. This was the case in tsarist Russia and the Soviet Union and it again became an important instrument of public administration under Putin. There are three elements that allow the state elite to manipulate the law in Russia. The first is unfeasible technical or economic demands of many laws that cannot be reasonably met by a typical company or individual. The second is the elite's control over the courts, which then selectively punish or ignore companies' or individuals' inevitable violations of complex and contradictory legislation. The third element is adoption of laws that prevent political opponents from posing significant threats to the current authorities.

Some foreign firms have faced continuing problems from the vested interests of the Russian state and its oligarch allies. For example, Russia has employed environmental

audits and regulatory threats several times to restore state dominance over oil and gas supplies. This tactic was employed to gain a controlling stake in the international gas consortium Sakhalin-2. The consortium, as a production sharing agreement, was formed in 1994 by Royal Dutch Shell (55% shareholding), Mitsubishi (20%) and Mitsui (25%). In 2005–2006, the consortium became the object of legal attacks by the main Russian environmental agency, Rosprirodnadzor, with accusations of violating environmental regulations. Under legal and political pressure, the consortium was forced to sell a majority stake to Gazprom and criminal accusations were dropped.

Another example of this tactic involved Kovykta. In 2003, when foreign companies were still welcome in the Russian oil and gas industry, TNK-BP, a joint-venture of British Petroleum and Russian private business consortium AAR, obtained a license to develop the Kovykta gas field in Siberia. However, eventually Gazprom realised that exporting gas to China from this field was strategically important. Once again, pressure was applied over the license agreement. In 2006 TNK-BP was accused of not meeting the terms of its contract to produce nine billion cubic metres per year from the field. However, this production was economically unfeasible because local demand for gas in Irkutsk was several times smaller than necessary. The company had initially planned to ship gas to other regions and abroad. However, Gazprom, which was responsible for building a pipeline and had exclusive rights for the gas trade, broke its promise to build the pipeline with the excuse of concentrating on “more important projects”. The company could extract gas which it would then have to burn immediately on the field. This would make the contractual stipulation absurd in a normal court, but not in Russia. The Kremlin preferred to stick to the letter of the law as this brought dividends. The output clause gave legal grounds to revoke the license. TNK-BP tried to make an offer similar to a recent Sakhalin-2 deal: 51% of shares at market prices to Gazprom. However, this time the deal was different. Sakhalin-2 was a technically sophisticated field that Gazprom could not develop without the help of Shell; thus, Shell was kept in the project to do the dirty work. In contrast, Gazprom did not need help to develop Kovykta. As THK-BP felt that it might lose everything, in 2010 it employed a bankruptcy manoeuvre to sell its Kovykta division to Gazprom at a price covering its investment plus a very small margin (i.e. \$770 million).

2.7 Oligarchs lose power

Designated *de facto* as Yeltsin’s heir, Putin owed his new position in part to lobbying by the **oligarchs**, the Yeltsin-era financial and property elite, led by Boris Berezovskii. A former mathematician, Berezovskii was able to make money in the 1990s as a co-founder of LogoVAZ, the largest distributor of the main Soviet car, Lada, and other projects. Later, he increased his wealth through loans-for-shares auctions. In the late 1990s, he was very close to Yeltsin’s circle and had significant impact on his policies. It was Berezovskii who proposed Putin as Yeltsin’s successor. The oligarchs supported this idea, believing Putin would continue Yeltsin’s general policies and leave the economy to the oligarchs. However, Putin soon built his own base of power around the security forces, informally termed *siloviki*, whose main weapons were professional access to *kompromat* (i.e. legally compromising materials) and to manipulate law enforcement to threaten opponents. Putin employed such resources and tactics in the early 2000s to remove Berezovskii and Vladimir Gusinskii. Both owned central TV channels that openly criticised Putin’s mistakes and they were forced to sell these channels at large discounts to Putin’s allies. Later, Putin jailed another wealthy opponent, Mikhail Khodorkovskii (see below). This became a clear signal to all other magnates not to question the Kremlin’s authority and the Kremlin would not question

their business practices. The elite accepted the deal, contributing to general political passivity.

2.8 Vertical Authority

One of Putin's political strategies was to create a "power vertical" from the Kremlin down to local and municipal officials, a structure modelled on Belarusian dictator Aleksandr Lukashenko's method for controlling his country. For example, in 2004 Putin eliminated the direct local election of governors and decreed that they would be appointed by the Kremlin; he almost eliminated the election of mayors and appointed Kremlin representatives to the regions to supervise local politics. The formal excuse for this was the Beslan tragedy, a terrorist act at a Beslan school carried out by Chechen militants, and claims that local officials might be manipulated by wealthy or criminal groups. However, this "power vertical" did not work as well as Putin had hoped. The main problem was an informal **social contract** between the Kremlin and appointed regional officials. The Kremlin agreed to leave these officials in place if they agreed to guarantee "good voting" at presidential and Duma elections for Putin's ruling party, United Russia, and to reduce the influence of possible dissent. The Kremlin did not seem to care overly about local corruption; for example, embezzlement of funds from the state budget, bribes or raiding private businesses. Putin made a similar arrangement with average citizens: exchanging political loyalty for freedom to earn and consume. The real influence of the Duma, the lower house of the Russian parliament, was nullified with the help of the mainstream political party, United Russia, which employed administrative power to win elections and to form a majority in the Duma. This enabled Putin to pass any legislation he chose and to craft a new *dirigiste* economy; not as state-owned as during the Soviet era but with a stronger hand than envisioned in the reforms of the 1990s. A similar manipulation was conducted with the court system (i.e. the Constitutional Court and also ordinary courts). Judges never ruled against the Kremlin and, in return judges gained the informal right to hold their positions without limitations.

2.9 State crony capitalism

Eventually, Putin created an economy that resembles traditional political economies of developing countries in Latin America and Asia. Putin created a variant of **state capitalism**. He favoured creating large corporations for most major sectors: Gazprom (i.e. gas), Rosneft (i.e. oil), Rostekhnologiiia (i.e. engineering and machinery, automobiles and weapons), the United Aircraft Corporation (i.e. aircraft industry), Rosatom (i.e. nuclear power industry) and others. The general idea was that larger companies were easier to control and only the state was in a position to ensure finance for risky innovation needed to develop a high-tech economy. Putin referred to successful examples of Chinese state conglomerates and South Korean chaebols that were able to achieve leading positions in global markets. He could also refer to Russian historical experience, which showed that all significant periods of economic growth and modernisation were fuelled by the state and not by private business; for example, Peter the Great or Stalin. However, these exceptional leaders were ascetic idealists focused on effectiveness and intolerant of self-interested managers. Putin is a different leader who might keep inefficient officials in place because he believes "stability is more important than efficiency" and "any successor will be more or less the same". This is why many experts have doubts that these state conglomerates are close to efficient. Further, there were politics in the shadows that might explain this renationalisation of large

enterprises. In particular, the Russian elite understood that it was not necessary to own a company to manipulate its resources. Elites could own such firms' shares that, if state renationalisation meant increased capitalisation, could later be sold at a higher value. Further, to serve their interests, private elites could negotiate with allies in the Kremlin to divert company resources into public projects that could not be obtained with direct funding from the state budget. This is how many important public projects in Russia, such as projects relating to the 2014 Winter Olympics, have been financed not from the state budget but by "voluntary" contributions from Gazprom, Sberbank and other large companies.

At the same time, Putin explicitly and implicitly favoured a model of crony capitalism. Certainly, nepotism was not new but, in Putin's era, this approach was expanded. Putin actively appointed allies from past years in the KGB to key positions (e.g. CEO)⁷ in the state and large companies. These allies supported Putin by financing his political and ideological projects. For example, large companies bought all major TV channels or major newspapers to shape public opinion. Several people were astonishingly successful in business, beginning as unknown entrepreneurs or managers and becoming Forbes billionaires in a few years because they had informal relationships with Putin and his elite⁸. This model of crony state-business relationships was not exclusive to the Kremlin, regional state officials also favoured their relatives and friends in business developments. It was not rare to discover that the most successful entrepreneur in some territory was the son or wife of the local major or governor⁹.

Russia has lacked legal lobbyism since the beginning of its market development. Although the necessity for legal regulation of lobbying has been much discussed since 1993, significant legislation has never been adopted, mainly due to the unwillingness of the Russian authorities that explain this as the "political immaturity of Russian members of parliament". However, the absence of such a law does not mean the absence of the phenomenon. Quite the opposite, the practice of influencing Russian authorities was always widespread but informal. An RSP survey reported that, in 2012, the overwhelming majority (80%) of top managers believed that the most effective instrument of lobbyism was personal connections; only 20-30% agreed that formal channels of communication with the state (e.g. conferences, round tables and working groups) would be useful. To obtain political and legal support, business people keep top state officials on their payrolls or make them confidential beneficiaries of their businesses.

⁷ Examples include Alexei Miller (CEO of Gazprom) and German Gref (ex-Minister of Economy and Chairman of the Board of Sberbank), who were Putin's subordinates during his work in the St. Petersburg city administration. Igor Sechin (Deputy Prime Minister and Executive Chairman of Rosneft), Alexei Kostin (Chairman of the Board of VTB bank) and Andrei Akimov (Chairman of the Board of Gasprombank) were Putin's former colleagues during his KGB service. Yuri Kovalchuk (Chairman of the Board of Rossia Bank), Andrei Fursenko (ex-minister of education), and Vladimir Yakunin (head of Russian Railways) worked with Putin in Ozero, a dacha cooperative society in the 1990s.

⁸ The most striking example is Gennady Timchenko, founder and manager of the Gunvor oil trading firm (registered in the Netherlands), which grew from a small business to the world's most powerful independent trader of Russian oil (40% of all exports) after Putin came to power. Timchenko was Putin's business partner during the latter's days in the St. Petersburg administration, although both denied any friendship.

⁹ The best example of this model is Elena Baturina, the most successful female entrepreneur in Russia, a Forbes billionaire who is also the wife of Yury Luzhkov, Mayor of Moscow from 1992 to 2010. Other good examples are Sergey Matvienko, a billionaire and owner of several large developmental companies, and a son of former St. Petersburg governor, Valentia Matvienko.

Crony capitalism has its pitfalls. State connections are a quick way to wealth; however, what the state gives, it can take away¹⁰. This is why even the most successful business people and oligarchs always seek ways to leave the country with as much wealth as possible. Many have spirited families and wealth to Europe, especially London, and the United States. Another consequence is that large businesses regard the Russian legal system with scepticism and, thus, register or re-register their companies in **offshore** jurisdictions. Experts say that approximately 80% of all transactions with Russian assets are conducted outside the Russian legal system. The most popular jurisdictions are, for example, Cyprus, the Bahamas, the Maldives and Switzerland. The largest Russian companies owned by the richest Russian oligarchs are registered offshore: the largest steel company NLMK is registered in Cyprus and the largest aluminium producer, RUSAL, is registered on the island of Jersey. Tax minimisation is another reason of utilising offshore jurisdictions¹¹.

¹⁰ A good example is the rapid retreat of Elena Baturina from Russian business after her husband Yury Luzhkov lost favour with the Kremlin and was evicted from his position as mayor of Moscow.

¹¹ The basic tax rate for profit in Russia is 20%, but is only 10% in Cyprus. The tax on dividends is 9% in Russia, while it is half this or zero in many offshore jurisdictions.

3 BUSINESS LAW AND REGULATIONS

Maxim Storchevoy and Jeffrey Hass:

3.1 The legal system

The Russian legal system and business law are complicated despite reforms since 2000 and whether the “rule of law” is truly operative remains debatable. In part, this is due to the rapid and radical transformation of the economy from socialism to market capitalism. Devising the necessary legislation faced hurdles from conservative or corrupt politicians, managers and state officials, and even the best intentions sometimes went astray simply because politicians, bureaucrats, managers and entrepreneurs had no firsthand experience with how market capitalism works in practice. Further, different groups pursued their interests outside the bounds of law (e.g. the infamous *mafia*) or by employing law for their own needs (e.g. *siloviki*, security services at the highest levels of government). While laws and the courts are important for governing business, one must be aware of their shortcomings and also rights to prosper within the Russian system.

The fundamental law of the land is the **Constitution** of the Russian Federation, which sets basic civil rights and the rules of the political system. The current Constitution was proposed by Boris Yeltsin and approved by popular referendum on 12 December, 1993. Yeltsin’s goal was to increase the power of the executive branch, vis-à-vis other branches of government, as a response to two years of gridlock and confrontation with the previous legislature, the Supreme Soviet. Vladimir Putin introduced additional changes that expanded presidential powers. For example, after legal changes introduced by Putin in 2004, regional governors are now appointed by the president rather than elected locally, which was the previous procedure. Also, Article 31 states that “Citizens of the Russian Federation shall have the right to assemble peacefully, without weapons, hold rallies, meetings and demonstrations, marches, and pickets.” However, legal changes under Putin require that public meetings be approved by local authorities, which local elites utilise to prohibit unwanted street action by opposition forces¹². Similarly, many important constitutional norms are not followed by the government without the help of additional acts or laws, or they are followed literally but broken in practice. For example, Article 29 provides for freedom of speech and prohibits censorship; however, all major television channels, the main form of mass media for shaping public opinion, are controlled by the Kremlin, which forbids or circumscribes discussion on particular topics or individuals that the Kremlin elite consider threatening to their interests.

The **Civil Code**, adopted in 1994 plus amendments added from 1996 to 2003, is the fundamental set of business norms and laws of the Russian Federation. This code introduces legal actors into the economy and issues of civil rights (section I), property rights (section II) and contracts (sections III and IV). The Civil Code was supplemented with Part Four in 2010, which defines intellectual property rights (i.e. copyrights). While basic norms in this domain are defined by the code, many subsections are

¹² Since 2009, a group of civil rights activists has taken to the streets of the 31st day of each month that has 31 days to claim their right to assemble peacefully. Each time, members of such marches have been arrested by police so that the Russian government can demonstrate who holds real power in the country. In sum, a constitutional norm has been overridden by “regulations” of lesser standing, revealing the true nature of the “rule of law” under Putin and his coterie.

regulated by additional laws. For example, while the notion and basic norms of the joint stock company are defined in the Civil Code, the full set of norms on the establishment and operation of this business entity is laid down in the Law on Joint Stock Companies, adopted in 1995.

Several other areas of economic activity are supported by corresponding codes. The relationship between employers and employees is governed by the new **Labour Code** of the Russian Federation, adopted in 2010. Allocation and appropriation of land is governed by the **Land Code** of the Russian Federation, adopted in 2001. Export and import operations are governed by the **Customs Code** of the Russian Federation, adopted in 2005. Tax responsibilities for natural and legal persons are governed by the **Tax Code** of the Russian Federation, adopted in 1998. All codes are supplemented by countless acts and by the government or ministries responsible for these areas. As a result, proper business behaviour in all areas, especially concerning taxes, requires constant monitoring of a wide variety of sometimes confusing or contradictory legislation. An industry of consultants has emerged to satisfy business demands for knowledge on modifications and appropriate strategies for coping with potential problems.

Below, we briefly discuss laws and legal norms for core areas of business. Note that we primarily address formal laws. Actual state behaviour does not always conform to the spirit of the laws, as our discussion on the political economy of Russian business reveals.

3.2 Legal forms of business

The range of Russian legal forms of business resembles that in some continental European countries, which were employed as models by the authors of Russian legislation. The process of registering all legal forms of business is founded on the special federal law *On the Registration of Legal Persons and Individual Entrepreneurs*, adopted in 2001.

The simplest legal form of business is the **individual entrepreneur**. This business form was once termed, for example, “individual private entrepreneur” or “individual private entrepreneur without legal individual form”. In the Western legal tradition, this is a *sole proprietorship*. Any person can register himself or herself as an individual entrepreneur. No additional legal entity is created in this instance. This legal form is usually utilised by very small businesses in trade, transport or services. The formal business name usually contains the abbreviation “ЧП” (i.e. “ChP”, or Private Individual) and usually looks like “ЧП Смирнов А. А.” (i.e. “Private Individual Smirnov A. A.”). An individual entrepreneur can enter into contractual relations and borrow money, although some types of economic activity, such as trade in alcoholic beverages, or some licenses are not available to them. The individual entrepreneur has *unlimited liability* for all debts incurred and some large companies or banks might avoid dealing with them. The individual entrepreneur has some tax advantages; for example, they do not pay property taxes on assets employed in their business activity and they do not pay taxes twice from their distributed income, they only pay a profit tax and no income tax. However, they must contribute a fixed tax to social funds that grows slightly every year; this was approximately 7,000 rubles in 2009 and 16,000 rubles in 2011.

As in many countries, a legal form of **partnership** exists, although it is not common and is usually utilised for professional services such as consulting or accountancy. The

most popular legal form for small and medium business is the **limited liability society** (OOO, *obshchestvo s ogranichenoi otvetstvennostiu*). As an example, the hypothetical OOO “Tea and Coffee” might have several founders and owners and, correspondingly, the charter capital of OOO is divided up into “*doli*”, or percentages of owners’ contributions. Approximately 180,000 firms have OOO status in St. Petersburg. As no minimum level of economic activity is required to keep this form of business is formally valid from year to year, it is often employed not for the production of real goods and services but only for holding assets (e.g. intellectual property) or for the transfer of funds, often in grey or black markets¹³. Many “empty” OOO firms are registered for “tax optimisation” schemes or illegal monetisation of money in bank accounts. The membership of owners can change according to the Civil Code or special procedures written into the charter. In the 1990s and 2000s, it was fairly easy to register an OOO because requirements for minimum capital were comparatively low, 10,000 rubles (approximately €250), and founders could utilise assets such as computers, cars and furniture to contribute to charter capital. However, the government is developing a new law to increase the required amount of charter capital for an OOO to a million rubles (approximately €25,000). This is a significant concern for many owners of OOOs (e.g. cafés and small retail firms) whose amount of charter capital is low.

For larger businesses, the OOO form is inconvenient because it is harder to divide and operate ownership rights when a larger number of owners are involved. To attract ten or more owners or investors or to introduce profit sharing schemes for top managers (e.g. giving them small shares of capital), it is more convenient to utilise the **joint stock company** form, of which there are two forms in Russian law. The first, similar to the OOO, is the private joint stock company (*zakrytoe aktsionernoe obshchestvo*, or ZAO). The main difference between the ZAO and the OOO is that charter capital is divided into shares (*aktsii*) that can be distributed or moved between shareholders. The registration of a ZAO is similar to that for an OOO, with minor differences: if capital contribution is made in kind, the sum must be estimated by independent appraisers. However, the minimum size of charter capital is 100,000 rubles. The second type of joint stock company, the **public joint stock company** (*otkrytoe aktsionernoe obshchestvo*, or OAO), is employed for large companies that attract significant equity or debt finance. Registration of an OAO requires significant initial charter capital, a million rubles, and also a good deal of bureaucratic paperwork. As an open company, the OAO must regularly disclose its financial statements to the public. An OAO is subject to regulation by the Federal Securities Commission. When company size is not too large, choosing between the ZAO and OAO is not straightforward, especially if there are fewer than 50 shareholders. However, the OAO form is required if one founder is Russian citizen or an organ of the Russian government.

Many law firms offer services to aid legal registration of firms. Registration for an individual entrepreneur might cost approximately 5,000 rubles; registration of an OOO might cost 10,000 rubles; and registration of an OOO with a foreign co-founder could cost 15,000 rubles.

¹³ For example, in 2004, when Mikhail Khodorkovskii was arrested and his company Yukos was put under the compulsory bankruptcy process, the assets of the latter were to be sold at auction. Rosneft Oil intended to buy the core production subsidiary of Yukos, Yuganskneftegaz, but it was afraid to participate directly in the auction for legal and publicity reasons. Instead, they utilised an OOO registered two weeks before the auction with minimum charter capital (€250). At the auction this OOO (i.e. Baikalfinansgrup) paid 261 billion rubles (\$9.3 billion) for Yuganskneftegazm, which it then sold to the “bona fide” buyer, Rosneft Oil.

3.3 Taxes and accounting

During the 1990s, the Russian tax system underwent various reforms reflecting continuous attempts to maximise tax revenues. One of the hardest tasks was to stop Russian entrepreneurs from avoiding paying their taxes. In the 1990s, even though the economy was depressed, tax rates were quite high and a small business might pay 100% or more of its profit in taxes. Enterprises devised numerous ways to avoid taxes. Wages and salaries were paid informally, in envelopes, to reduce the formal size of the wage fund and to decrease the united social tax (26%), a real burden for businesses. Formally declared profit was often less than real profit to reduce the profit tax. Real profits were hidden under the cover of various “expenses” that were wired to special “monetising” or “cashing” firms and then returned to the company’s owner in cash with a small (e.g. 1-3%) deduction for the service. Other companies employed so-called “insurance schemes”, whereby a significant part of salaries were transferred to employees as part of their insurance packages.

In 2011, the main taxes imposed on Russian businesses were:

Value added tax (VAT): calculated on the sales value of goods, services and work at a general rate of 20%, with certain exceptions. Imported goods are also subject to VAT.

Insurance payments: since 2011, this replacement for the united social tax (26%) was levied on salaries and paid to three funds: the Pension Fund (20%), the Health Insurance Fund (FOMS, 3.1%), and the Social Security Fund (2.9%).

Personal income tax: calculated as a flat rate of 13%. However, non-residents pay 30% income tax on their incomes.

Profit tax: levied on a firm’s gross profit. The general tax rate is 24% of gross profit, with some exceptions. Distributed dividends are taxed at a rate of 9% for residents and 15%, deducted at source, for non-residents.

Excise tax: levied on the sale or import of particular goods (e.g. alcohol, tobacco, jewellery, cars, oil and gas). The tax rate varies for each product.

Sales tax: levied by local authorities at a maximum rate of 5% on the value of goods and services sold in wholesale and retail stores. Particular types of good and service are tax-exempt.

Land and property taxes: levied by local authorities at a rate depending on the location of the property.

To avoid higher tax rates for non-residents, a foreign entrepreneur can be formally considered a Russian resident if he/she resides in Russia for at least 183 days in each calendar year. Cash can be repatriated from a Russian branch of a foreign company without restrictions after profit tax has been paid by the branch. However, repatriation of profits by a subsidiary requires payment less Russian tax (e.g. 15% on dividends and 20% on interest) unless there is a double tax treaty between Russia and the foreign company’s home country.

Individual entrepreneurs or small companies can employ a *simplified tax regime* and pay 6% of gross revenue or 15% on revenue less all expenditures, and then not pay any other taxes (e.g. value added tax, profit tax, social tax)

The fiscal year in Russia ends on 31 December. Every company is obliged to make VAT payments, united social tax payments and advance payments on the profit tax on a monthly basis. After the end of the fiscal year, the company has three months to fully account for the previous year and to submit final annual financial statements by 30 March, with corresponding adjustments in taxes paid.

3.4 Customs

Customs regulation in Russia is a considerable hazard and problematic for foreign and domestic firms who move goods across borders. It is highly bureaucratised, cost-inefficient and full of hidden traps that might be utilised by fraudulent custom officers to extort bribes for facilitating customs procedures. The basic regulations of customs procedures are described in **The Customs Code of Russian Federation**¹⁴; however, there were thousands of various amendments and instructions subsequently adopted that specify and modify the code.

Russia employs the international system of **product names** for classifying traded products, known as the *Harmonised Commodity Description and Coding System*. The **value** of a product is estimated in line with the DAF (i.e. Delivered at Frontier) principle.

The size of import and export duties reflects the economic policy of the Russian federation to find a balance between three factors: economic growth, protectionism and maximisation of tax revenues.

A company importing a product to Russia faces four types of payments. First, it has to pay **import duties** that are applicable to almost all products, except for some goods considered strategic for economic development; for example, equipment and machinery. In most cases, duty rates are calculated *ad valorem* and fall between 5% and 20% of the goods' value. The final rate depends on the country of origin. There is a list of the *most favoured nations* that pay 70% of the tariff rates, all other countries (e.g. Sweden or Finland) have to pay double rates. The rates of custom duties were defined in *The Customs Tariff of Russia*¹⁵ until the end of 2009, when Russia, Belarus and Kazakhstan formed a Customs Union and introduced a *Common Customs Tariff*¹⁶ for all union members. Second, a company might have to pay **import excise tax** for some goods such as alcohol or tobacco. Third, it will have to pay **import VAT** of 10% for several groups of goods (i.e. food, printed products, drugs and children's goods) and 18% for all other goods. VAT is calculated on the basis of the sum of the customs valuation of the goods, import duties and import excises for these goods. VAT is not paid for some types of equipment. Fourth, the importing company will have to pay a **customs processing fee** that varies from approximately 600 to 120,000 roubles per customs declaration, depending on the customs valuation of imported goods.

¹⁴ Full text in English: http://customs.ru/special/tk_en/

¹⁵ The English text can be found at <http://www.russian-customs-tariff.com>

¹⁶ The Russian text of the Common Customs Tariff can be found at the website of intergovernmental commission responsible for adopting the tariff: <http://www.tsouz.ru>

However, there is some relief for specific categories of imports. Goods can be imported under a **temporary import customs regime** if they are intended to be re-exported. This regime is granted by custom authorities for a period of up to two years and requires payment of 3% per month of the total customs payments due had the goods been imported for free circulation in Russia. There is full exemption from custom duties and VAT in the case of **tolling**, if the goods are to be processed on Russian territory and then moved out of Russia within a specified deadline. No custom duties are paid on goods imported by a foreign investor as a **charter capital contribution**. There are **several special economic zones** in Russia with a free customs regime¹⁷. Any foreign goods can be imported to special economic zones without custom duties or import VAT; however, if they are subsequently moved to other parts of Russia for free circulation, they are taxable by usual custom duties and VAT.

The process of custom clearance is quite complicated and should be delegated to a customs broker. The cost of customs clearance for many goods with one customs import declaration transported in one vehicle is approximately 30,000 to 50,000 roubles. However, the cost per declaration can be significantly lower if a company sends many vehicles per month.

3.5 Opening a Business: Licenses and Permits

To establish a business in Russia, a large number of bureaucratic issues must be solved in addition to registering the legal entity. The majority of these issues relate to obtaining various **licenses** and **permits** from authorities of different types and ranks.

Although **land** can be private property in Russia, most Russian territory is not privately owned but belongs to the state and is administered by various federal, regional or local authorities. All land issues are governed by the *Land Code of the Russian Federation*, adopted in 2003 and subject to frequent amendments. When deciding to build facilities, one might buy the land; however, the majority of companies prefer to rent the land from the authorities. All information on land plots is accessible from the respective regional department of *Rosreestr* or *Federal Service for State Registration, Cadastral Records and Cartography*, which is responsible for land surveying, appraisal and registration of all changes of property rights to land and immovable property¹⁸. There is no discrimination between Russian or foreign citizens and entities in relation to rent or ownership of land. However, most land outside cities is usually classified as agricultural or “for agricultural purposes”, even if there are no current farming activities, and cannot be bought by foreigners. Employing this land for non-agricultural business is possible after its reclassification under the broad category “for industry, energy, transport, communications, etc.” Further development of such land (e. g. building new facilities) requires compliance with another important piece of legislation, the *Town Planning Code*, adopted in 2004, that regulates all **construction permits** and **permits for commissioning**. This is one of the most costly and time-consuming procedures for opening a new business, although there has been progress in recent years in simplifying this procedure. For example, before 2007, the process of reviewing construction project documentation and issuing construction permits required multiple appraisals by various state services. In 2007, this was replaced with a

¹⁷ There are four technological zones (i.e. St. Petersburg, Zelenograd, Doubna and Tomsk), two industrial zones (i.e. Lipetsk and Elabuga), a special economic zone in Kaliningrad and seven tourist zones.

¹⁸ Much information, including an interactive map of all cadastral land, can be found at the website <http://rosreestr.ru> (only in Russian).

single “state appraisal” procedure. Nevertheless, obtaining a construction permit in Russia remains a longer and more expensive procedure than in most other countries. In 2011, this required 540 days in Russia but only 66 days in Finland or 116 days in Sweden.

Many business activities do not require **licensing** if they do not present any likely harm to people’s health or security. However, there is a long list of business activities that are deemed to require a license from the relevant governmental body responsible for a specific sphere. The most obvious areas include dealing in medicine or weapons, fire fighting or healthcare. Among others, any activity involving personal confidential information requires a license from *FSTEC*¹⁹, any activity involving cryptography or surveillance requires a license from *FSB*²⁰, any production of audio, video or software goods requires a license from *Roscomnadzor*²¹, any production of pyrotechnics, aircraft or game machines requires a license from *Minpromtorg*²² and all transportation services require a license from *Rostransnadzor*²³. The full list of activities requiring licenses is defined by the government act “On organisation of licensing of some business activities”, adopted in 2006. However, in recent years, several types of activity were excluded from this list and moved under the governance of self-regulatory organisations. For example, since 2008, auditing services and construction services do not require licenses. However, companies involved in these businesses need to be a members of the relevant self-regulatory organisation.

The operation of any business facility and especially any facility dedicated to working with people (e.g. a store or an educational facility) requires regular approval by two authorities, the ability of which to worry entrepreneurs has become an object of black humour and part of business folklore. These authorities are informally termed *pozharniki* (i.e. “fire-fighters”) and *SES* (i.e. the sanitary and epidemiological service). **Pozharniki**, or State Fire Control Service, is supposed visit any business entity at least once a year to inspect for potential fire hazards. Instructions defining the minimum level of safety are complicated and, thus, can enable an inspector easily to cite violations of fire control rules (e.g. improper type or number of fire extinguishers, improper number, location or size of exits from the premises and improper material utilised in floors or walls). **SES**, or State Sanitary and Epidemiological Service, should visit any business entity no more than once every two years, although there can be “special” inspections if SES has grounds (e.g. customers’ complaints) to suspect violation of sanitation norms. Instructions defining the required level of sanitary conditions (e.g. cleanliness, lighting, air circulation and safety of equipment) are even more complicated than those for fire safety. It is easy to formally accuse a business of violating sanitation norms and to require costly remedial measures or even discontinuation of operations. The dark side of this regulation is that, in many cases, the demands of these two controlling authorities are eliminated by bribes, which is often the real purpose for such painstaking “control”.

¹⁹ Federal Service for Technical and Export Control, <http://www.fstec.ru> (no English version).

²⁰ Federal Security Service (former KGB), <http://www.fsb.ru/> (no English version).

²¹ Federal Service for Supervision in the Sphere of Telecom, Information Technologies and Mass Communications, <http://www.rsoc.ru/> (one-page English version).

²² The Ministry of Industry and Trade, <http://minprom.gov.ru> (one-page English version).

²³ Federal Service for Transport Control, <http://www.rostransnadzor.ru> (no English version).

3.6 Dispute resolution

It is wise to avoid commercial disputes in Russia for two reasons. First, Russia's legal system is quite formalistic and often the letter of a law supersedes the spirit of a contract or the law. A judge often relies on the literal meaning of contracts. The legal system has a poor tradition of extrapolating incomplete contracts and laws on the basis of universal principles of justice and efficiency that is common in the Anglo-Saxon legal system. Second, in Russia, the court can be manipulated by the state, which is especially dangerous when one's legal opponent is the state, or by a private party through informal connections or bribes. Therefore, there is no guarantee that one can find protection from Russian courts, which is why Russians employ informal methods to resolve conflicts. This can be manifest in developing personal relationships with contract partners beyond that which is normal for Western business "neutral" relations.

However, if a conflict arises, parties can try to defend their interests in the **Commercial Court** (i.e. in Russian, *arbitrazhny sud* or "arbitration court"), a special court established to rule on contractual and property disputes between businesses. If one party to a contract feels that the second party broke an agreement and did not provide credible and reasonable promises to fix the problem, it can file a claim with a regional branch of the Commercial Court. The litigation procedure is governed by the **Commercial Procedure Code of the Russian Federation**²⁴. Proceedings in commercial courts are conducted in Russian. However, for persons participating in the case and not having command of the Russian language, the commercial court grants the right to access case materials, to participate in judicial actions and to speak in court in their native language, employing the services of an interpreter. Judicial decisions of commercial courts are binding on all parties to a case and public authorities in the whole territory of the Russian Federation. Usually, a full cycle of litigation can take six to 12 months. Proceedings in commercial courts are open and all decisions of the commercial courts are collected in a data base available at the appropriate web site (www.arbitr.ru). Currently, the data base of decisions contains over 13.6 million judicial decisions and has a free retrieval system with the facility to search by various categories; for example, names of the parties in the case, dispute category or wording of the judicial decision. The types of case in the Commercial Court can be categorised as approximately 45% contract and property disputes, 45% disputes with the state (i.e. administrative cases) and 10% insolvency and other disputes.

Another option is an **Arbitration court** (i.e. in Russian, *treteysky sud* or "third-party court"), a less formal dispute resolution mechanism through which two parties voluntarily decide to entrust their dispute to a third party and agree to be bound by its decision. Arbitration courts have closed (i.e. private) proceedings and might be preferred by a business that either does not want the dispute to become public knowledge or needs a faster or more sophisticated solution. However, if a dispute is not resolved in the arbitration court, the case will be moved to a regional branch of Commercial Court with its standard legal proceedings. The **Law on Arbitration Courts** regulates the process of establishing and operating these legal structures. According to this law, an arbitration court can be established by any legal entity; however, it must be registered through submission of a few documents to a regional branch of the Commercial Court. There are approximately 400-500 Arbitration Courts in Russia, established mainly by, for example, various regional trade and industrial

²⁴ An English translation of the code can be found at the web-site of the Commercial Court (<http://www.arbitr.ru>).

associations, chambers of commerce and legal firms. Arbitration courts operate faster than commercial courts; in the former, it can take 30-50 days from submitting a case to obtaining a decision, compared to 180-360 days in the latter. Nevertheless, an arbitration court's decision has the same legal force as decisions of a commercial court and, if necessary, will be enforced by the latter. Paradoxically, the execution of an arbitration court's decision in the territory of another country can be easier than is the case with commercial courts' decisions. This is because Russia has ratified the international convention concerning acknowledgement of arbitration decisions; however, there is no such universal convention for commercial courts, for which countries need bilateral agreements. As such, wise parties to a contract normally include a special "arbitration clause" in the contract stating the types of contractual dispute, if they arise, that should be taken to a particular arbitration court.

4 CONCLUDING REMARKS (PT. 2)

For Finnish entrepreneurs who are going to do business in Russia it is important to understand historical roots of contemporary Russian society, to explain disappointing backwardness that Russia systematically experienced on its historical path. The political nature of early Russia was strongly influenced by the Mongols who introduced an autocratic way of ruling with a dominant centre and voiceless territories that was employed by Russian rulers for many centuries afterwards – Tsarist Russia of the 18-19th centuries, Soviet Russia of the 20th century and also Putin’s Russia of the 2010s were and are equally centralised administrative states with underdeveloped elements or a veneer of democracy. The other side of autocracy was always weak property rights of any peasant, landlord, merchant or industrialist who may lose its assets any time on the wish of higher authority. Even personal freedom of Russian people was quite limited in the form of serfdom in Tsarist era and in various forms in Soviet time (labour camps, collective farms, migration restrictions, etc.).

The voluntary character of autocratic rule gave birth to a special legal regime in Russia where the requirements of the law was such demanding that nobody could comply with them without extreme costs, and a mechanism of selective and demonstrative legal repressions against its opponents. This legal regime is still valid in contemporary Russia and used by the ruling elite for controlling of its business and political opponents.

Another “other side” of autocratic state became the large social class of bureaucrats trading unconditional loyalty to state authority in exchange for an implicit right to take bribes and to embezzle state resources. The bureaucratic class created as an instrument of administration became a powerful player of its own, being able to frustrate any unwanted reforms and to stimulate corruption-friendly ones. Eventually, it is this unproductive and morally corrupted class that historically nullified all positive achievements of the imperial and autocratic development.

Drawing on the past history, we suggest the following traits of Russian economic practices: 1) national pride built and reinforced during centuries of imperial expansion and major symbolic victories in great wars (especially the Napoleonic wars and World War II); 2) collectivism of ordinary people developed in risky agricultural conditions or imposed by the state from ideological and economic motives, and a special form of cynical individualism as a response to unproductive, compulsory collectivist institutions; 3) patience, obedience, and fatalism cultivated by the Orthodox Church and reinforced by the autocratic state and the lack of legal protection of rights and freedoms; 4) inability to pursue daily work according to a rhythm and schedule, but the ability to demonstrate intensive, short-term bursts of energy necessary for survival (believed to be a consequence of the short summer growing season and long winters that immobilised working activities); and 5) high value on interpersonal relationships as a key survival strategy in the context of economic and political oppression by tsarist landlords or Soviet managers.

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APPENDIX 1. RESEARCH PROJECTS INCLUDED IN CHAPTER 2

This appendix summarises the findings from four research projects conducted by the authors during 2008-2010 to reveal the socio-cultural barriers to successful internationalisation of Finnish companies operating or intending to operate in the Russian market.

Project 1. Small Innovative Enterprises' Internationalisation

The first project conducted by V. Minina and E. Dmitrienko focused on investigating internationalisation issues in the development of small innovative enterprises (SIEs) in Russia²⁵. The aim was to identify social factors that influence SIEs' internationalisation. A case study approach was employed. Five Russian small innovative companies from the medical equipment, information technology and gas analytics equipment industries were observed. Four companies have successful experience of international sales and partnership; one company has attempted to go abroad, but failed. Interviews with top-managers/owners and also analysis of documentation were conducted. One case of the company engaged in producing medical test-systems, AMA Co. Ltd., was studied more deeply: four in-depth interviews with top-managers (i.e. CEO, Commercial Director, Development Director and the Financial Director), document analysis and close observation over seven years were conducted by E. Dmitrienko.

Project 2. STROI Business Network²⁶

The project was conducted during 2008-2009 by an international research team from Finland (i.e. HAMK University of Applied Sciences, Hammeenlinna; the VTT Technical Research Centre of Finland, Helsinki; and Tampere University of Technology, Tampere) and Russia (i.e. The Higher School of Economics, Moscow and the Graduate School of Management, St. Petersburg State University, St. Petersburg). The project aimed at developing and modifying Finnish management and leadership models to fit the Russian business culture and context. The object of the research was Finnish companies connected with the construction industry and comprised consulting firms, construction companies, design firms and training firms including KPM-engineering, Rautaruukki, NCC, Huhtamäki, Conecranes, Lassilla & Tikanoja, Stora Enso/Puumerkki, FMC group Russia. Socio-cultural issues were studied in the frame of the human resource management (HRM) part of the research, for which V. Minina, E. Dmitrienko and A. Krupskaya were responsible.

Ten companies were investigated in respect of the part of the project devoted to human resource issues. The size of private firms ranged from small (i.e. less than 20 employees) to large (i.e. more than 3,000). Some of the companies have been operating in the market for more than 30 years, others were newcomers. Qualitative data have been collected by conducting 17 semi-structured interviews with senior managers, the heads of departments and HR managers: CEO = 5; HR managers = 6; and line managers = 6. The duration of each face-to-face interview was one hour.

²⁵ Dmitrienko E. and Minina V. (2013), Development of small innovative enterprises in Russia: internationalization issues/ The Process of Internationalization in Emerging SMEs and Emerging Economies. The McGill International Entrepreneurship series.

²⁶ www.hamk.fi/stroi/publications

The results of this project enabled us to reveal how cultural differences influenced HRM practices and which cultural barriers inhibit the growth of the efficiency of human resource management.

Project 3. Competence assessment of Finnish companies in Russia

The study “Competence Assessment of Finnish Companies in Russia” was conducted by FINTRA in 2009. The goals of this study were to provide a useful and comprehensive overview on the competence strengths and weaknesses of Finnish companies in Russia; a detailed list of the challenges experienced by Finnish companies; an assessment on which stereotypes/pre-conceptions concerning Russian business were experienced and whether they were real or not; and a useful set of practical recommendations, with an SME focus, for operating successfully in Russia.

The competence study comprised a competence assessment model, a training practices questionnaire and thorough and structured interviews. Data collection and analysis were conducted in Spring 2009 by an international team of consultants from Fintra, Finland and Fintra, Russia. Finnish and Russian respondents held a range of management positions in SMEs, large companies and development organisations. The competence assessment model was completed by 81 respondents and the training practices questionnaire by 51 respondents. The interviews were conducted in Finnish, Russian and English languages in both Finland and Russia during April and May 2009. In total, 28 interviews were conducted with each lasting for a period of between 45 – 90 minutes. 28 companies and institutions were interviewed, among them representatives of Finnish development organisations. Most of the interviewees were Finns; some were Russians with huge experience of working with Finns.

Project 4. Managing Post-Acquisition Integration of a Russian Company Acquired by a Finnish Company

This study was conducted by Fintra in 2010; its goal was to explore what happens after an acquisition and to analyse the importance of the human factor on the integration process of the acquired company. The study also focused on investigating critical success factors when implementing joint work after acquisition and also on identifying best practices of the integration process.

The post-acquisition study was based on analysing company cases by interviewing key persons involved in the acquisition process. The respondents were Finnish and Russian persons who had actively participated in the acquisition and the post-acquisition integration process. In total, 15 persons were interviewed, 11 of whom represented companies and 4 were from law firms; 8 were Russian and 7 were Finnish; 12 were top managers (e.g. vice president, country director, financial director, HR director and managing partner) and 3 were middle managers. The study focused on cases where companies with personnel had been acquired. These projects enabled us to identify cultural barriers in the area of building partnership relations between a head office and its subsidiary and also in the areas of organisational communication, leadership and HRM performance.

APPENDIX 2. COMPANIES INVOLVED IN THE STUDY DESCRIBED IN CHAPTER 3

Huuhka Oy. www.huuhkaoy.com

Huuhka Oy is a Finnish firm that produces turnkey luxury interiors built for usage on land and at sea. It was founded in 1987 when its main line of business was the installation of fire-rated doors on ships. Today, the company works in both the cruise ship industry and on architectural buildings on land; its solutions are applied in shopping areas, luxury sea liners, business centres, hotels and restaurants. Huuhka's tailor-made deliveries include everything from interior bulkheads to finished furnishing. The company's headquarters and production facilities are located in South-western Finland. Huuhka Oy employs 50-90 workers and also utilises subcontractors. The company's turnover in 2009 was 11 million Euros.

Dermoshop Ltd. www.dermoshop.com

Dermoshop Ltd., founded in 1984, is a Finnish company that produces high quality cosmetics and skin care products that can only be purchased through its web-shop. The products are developed in Korsnäs, Finland and produced in Sweden, Denmark, Spain, Finland, France, Italy and Germany. Currently, Dermoshop has sales throughout the European Union and, in addition to Finland, has offices in Tallinn, Estonia, and St. Petersburg, Russia. Also, Dermoshop has built its own warehouse facilities near St. Petersburg. In March 2011, Dermoshop employed 72 people and its turnover in 2011 was 25 million Euros.

Selki Fabrik Oy. www.selkifabrik.fi

SelkiFabrik Oy is a small Finnish firm founded in 2005 and located in Helsinki. It designs and produces head ware, scarves and accessories. The products are made in different parts of Europe and finalised in Finland. Currently, SelkiFabrik has a team of six people, four of whom are partners owning shares of the firm; the other two are hired trainees.

Up Code. www.upcode.fi

Up Code is a small Finnish company, established in 2006, that produces special software for an optical reader that utilises mobile phones/devices to add any electronic information or system to printed products and to electronic information on screens. With this application, it is possible to integrate all businesses and all forms of eCommerce with print and screen media. Currently, Up Code employs 100 people in Finland and 30 abroad. The company's internationalisation process began immediately after start-up. Nowadays, it operates in more than twenty countries. Up Code has operations in Russia in the form of several official representatives with responsibility for sales.

Grape People. www.grapepeople.fi

Grape People is a small Finnish company founded in 2003 and located in Helsinki. Through meetings and workshops, it provides training and facilitating services for various companies and teams to enhance their competences, creativity, team commitment and problem solving skills. Currently, Grape People has a team of nine people, four of whom work outside Finland. The company has branches in Germany, the Czech Republic, the United Kingdom and Russia. In Russia, Grape People operates in the form of a joint venture under the same name.

Beneq Oy. www.beneq.com, Russian representation www.qtsolar.com

Beneq Oy, founded in 2005 in Finland, is a supplier of equipment and coating technology for global markets. Beneq turns innovations into success by developing applications and equipment for cleantech and renewable energy fields, especially in the glass, solar and emerging thin film markets. Coating applications include optics, barriers and passivation layers and also energy generation and conservation. Beneq also offers complete coating services. Beneq's coating applications are based on two enabling nanotechnology platforms: Atomic Layer Deposition (ALD) and aerosol coating (nHALO® and nAEROTM®). Currently, Beneq has sales offices in 40 countries and employs 50 people. The company's turnover in 2009 was 7.5 million Euros. In Russia, Beneq operates through its partner company and representative, Quint Tech.

PBI Research Institute. www.pbi-institute.com

The PBI Research Institute was started in 1993 in Turku, Finland. The institute conducts basic and applied research within the area of Project Business and provides consulting services for project businesses in sectors such as energy, shipbuilding, pulp and paper, and telecommunications. Currently, the PBI Research Institute employs 24 people. In 2007, the institute established a separate unit in St. Petersburg, where it has four employees.

Joyride Games Ltd. www.climbstation.com

Joyride Games Ltd. was founded in 2004 in Espoo, Finland. The company designs, produces and sells the special climbing equipment or simulator that has a registered product name - Climb Station. Currently, the company has official dealers in 14 countries including Russia, where Joyride Games Ltd. has two representative firms: Destamar and Grant Vympel.

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TAMARA GALKINA AND SÖREN KOCK (EDS)

TAKING YOUR BUSINESS TO RUSSIA: A GUIDEBOOK AND HISTORICAL OVERVIEW FOR ENTREPRENEURS

As a growing market, Russia holds great economic interest and potential opportunities for international companies, especially Finnish SMEs. Due to their geographic proximity, Russia and Finland have a long history of established business and trade relations. Finland's major economic institutions were formed during the period when the country was under Russian rule. Also, the two countries had bilateral trade relations for approximately forty years. Nowadays, Russia is acknowledged as one of Finland's biggest trading partners and the most important direction for internationalisation of small and medium-sized Finnish companies. Finland has a strategic geopolitical position as a gateway between East and West; hence, there is great potential for the growth of trade, investment, technology transfer and other cooperation between Russian and Finnish businesses.

The present book is a result of a long collaborative research project between the Hanken School of Economics, Finland, and St. Petersburg State University, Russia. The book is a response to two calls: one from Finnish business practitioners to develop practical guidelines on how to establish and operate small businesses in Russia and

the other from the academe to conduct more research on Russia as a turbulent market with high potential for small entrepreneurial firms.

What makes this book different from existing guide books on how to conduct business in Russia? First, it targets a very specific audience; namely, Finnish entrepreneurs and business practitioners who plan to establish their businesses in Russia or who already have companies operating there. We believe our target audience will benefit from this narrow focus as it addresses concrete problems typical for Finnish business people in Russia. We also hope that the results of our research will be employed for teaching purposes in business schools across Finland as, nowadays, many of them offer special courses on Russian business. Second, our research team comprises scholars from both Finland and Russia, which offers a dual perspective on this phenomenon. Third, the empirical part of this research is based on qualitative case studies, not on broad statistical analyses. This approach enabled us to go deeply into specific business cases and to perceive the challenges of running businesses in Russia through the eyes of entrepreneurs and managers.



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