



# **HOW TO ENTER THE RUSSIAN CONSTRUCTION MARKET**

**Business Strategies for OY RVP Niemelä AB**

**Antti Vainio**

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| Tiivistelmä<br><p>Tutkimuksen kohteena oli esitellä ja hahmottaa Venäjän rakennusmarkkinoita ja niiden kokonaisvaltaista nykytilannetta, sekä lähitulevaisuutta keskisuomalaiselle rakennusalan yritykselle, OY RVP Niemelä AB:lle.</p> <p>Yritys on kiinnostunut mahdollisuudesta laajentaa liiketoimintaansa Venäjälle ja näkee sen olevan ajankohtaista lähitulevaisuudessa. Tietoa venäjän rakennusmarkkinoista saatiin olemassa olevista tietolähteistä, markkinoilla toimivilta johtohenkilöiltä sekä muilta asiansiantuntijoilta ja myös osallistumalla koulutustilaisuuteen.</p> <p>Työn tarkoitus on auttaa ymmärtämään venäläisen liiketoimintakulttuurin erityispiirteitä sekä käsitellä keskeisiä asioita, jotka tulee ottaa huomioon jokapäiväisessä yritystoiminnassa Venäjällä. Samalla esitellään toimivia kanavia verkostoitumiseen venäjällä, sekä lähitulevaisuuden rakennusurakoita.</p> <p>Tutkimuksen tuloksista muodostettiin liiketoimintastrategia yritykselle ja suositellaan, millä tapaa se voisi penetroitua venäjän rakennusmarkkinoille.</p> |  |                             |
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| Abstract<br><br>Target of bachelor's thesis was to create an overall picture of the Russian construction market, its current situation and opportunities for Finnish construction company OY RVP Niemelä AB. The company is interested to expand their business to Russia and feels that it will be current in near future.<br><br>Information about the Russian construction market was collected from; existing sources of information, specialists whose have been working on the market and by participating seminar. Purpose of the research was to create a picture what is it to do everyday business in Russia and which issues should be taken into considerations in order to reach and maintain successful business.<br><br>Different ways for networking and opportunities within the near future construction projects are revealed. A strategy plan and recommended penetration way into the market are consisted with the conclusions of the research.<br><br>Before doing decisions or taking any steps for expand business, it is vital for the company to analyze the environment and through this to make an action plan how to proceed and manage business successfully. It is also necessary to understand that Russia is totally different country to do business and some methods which are commonly used around Europe might not work there, e.g. a signature in the contract does not always mean that business deal is sealed, it might mean that now parties can start thinking about doing business together. |  |                     |
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# Introduction

Finnish construction companies have been operating in Russia already decades. They have gained good reputation and their skills are highly valued among Russians. Rapid and smooth economic growth has enriched Russian people and this why they are able to demand higher quality and more luxurious solutions for housing. Currently Russian companies are reforming their machinery and facilities in order to assure their competitiveness internationally in the future. Russian contractors are not always able to answer to these challenges alone and this why external help is needed.

In Russia the infrastructure is old-fashioned and in a bad shape especially in rural areas. In the near future this sector requires huge improvements and investments on the big scale. The Russian government is paying special attention in order to reach these goals. They have made plans and budgetary calculations how to implement and support reforms. A part of the annual budget of the government is reserved for construction and development of the infrastructure.

Many foreign companies are expanding their businesses into Russian market and they usually demand premises which reach the western standards. The government is trying to attract more foreign investments and make it easier for foreign companies to do business in Russia. There have been done many changes and easements along with legislation and taxation for foreign companies. There is no doubt that foreign knowledge and quality in construction would not be welcomed to build "The New Russia".

Purpose of my bachelor's thesis is to create an overall picture of the Russian construction market, its current situation and opportunities for Finnish construction company OY RVP Niemelä AB.

An idea is to create a picture what is it to do business in Russia nowadays by covering the whole construction industry, Russian cultural factors and practical issues. The thesis is meant to help how to survive with everyday business life in Russia. Before doing decisions or taking any steps for expand business, it is very

important for the company to analyze the environment and through this to make a correct action plan how to proceed and manage business successfully.

First part will introduce and overlook a current situation of construction market in Russia. It will go through what has happened so far and how the market has developed. There will be some assumptions about which direction it is moving in the near future. Within the chapter affects of the current financial crisis is considered and evaluated. I will also reveal opinions, experiences and analyses of the Finnish and foreign specialists, who are already working with construction business in Russia. The Russian construction market is approached with help of SWOT-analysis.

Second chapter will cover issues which should be taken into considerations when doing business in Russia. Russian cultural behavior and environment differ considerable from western type. So it is essential to have knowledge and understanding from this field in order to lead business successfully. This chapter will compare Finnish and Russian culture with the help of Hofstede's five dimensions.

Third chapter will concentrate to more practical issues. The chapter covers ways to enter the Russian market and how to proceed successfully. It will also guide how to start business in Russia and reveal which factors should be taking into consideration when setting up new company. There will be also valuable information about channels for networking and forthcoming business opportunities in Russian construction market.

## Choosing the topic

I specialized to Russian business with my studies. I complete my practical training by working in Saint-Petersburg as assistant with the field of consultancy of Russian business. Later on I was studying in Moscow, State University of Management, and I deepen my skills and knowledge about Russian business. Now I have been working for the OY RVP Niemelä AB with construction field. Personally I found construction business interesting and I decided to offer to do my thesis for this company.

OY RVP Niemelä AB is located in central-Finland in Jyväskylä. It's founded at the beginning of year 2008 and at the moment they have approximately 70-80 employees in Finland. Company offers different kind of construction services from various scales, leased manpower services, machinery and tool rental services and HR services for a range of construction projects in Finland. Company has already subsidiary in Estonia and now they're interested if there is potential to expand their business also to booming construction market in Russia.



# Construction Industry in Russia

## Background

Thinking about market of Russian construction business as structure of companies, approximately 113 thousand construction companies were operating in Russia in year 2005. 95 % of these companies were SMEs with staff less than 100 employees. Companies from private sector took care of 87.5 % of the contractor work, state owned 9.3 % and foreign companies 3.2 %. (Boltramovich etc.2006)

Construction in Russia has been increasing annually approximately 30% in area (square meters) within last years, but instead prices have went up explosively, 2-2.5 times annually (ETLA 2007). There are many factors, which support the fact that there is huge demand for foreign construction skills. At the moment construction market in Russia is starting to open and stepping away from highly monopolized situation by local construction giants.

Construction volume in Russia has been increasing steadily with 12.3% average annual growth after year 2002. Within last two years whole construction sector has been expanding twice as much. Construction industry has share of 5.6 % of the total Russian GDP according statistic from year 2007 and it is growing smoothly.

The mainstream of construction is concentrated to near of big city areas. Geographical areas like the city of Moscow, Moscow Region and Saint Petersburg covered 30 % of the total construction output only by themselves in year 2007. The construction and overhaul of residential building is booming, mostly because of economic growth and emergence of middle class. Affiliate closely with this area, building of detached houses and wooden construction have been issues of newness which are also interesting foreign construction companies. Especially

Finnish companies have been very active on this field because they have good knowledge and skills from these areas.

Construction of non-residential buildings is another interesting sector for foreign contractors. Construction of huge mega shopping malls, office centers and logistics complexes usually require the help of foreign knowledge of construction. Moscow and its surrounding areas cover 50-60% share of the commercial property market in Russia and approximately 20-25% share lies in Saint Petersburg according the statistics from 2007. (Obetkon 2007)

Residential house construction has the greatest weight among all the other segments in construction industry. Approximately 45 million square meters of residential space for housing were build in Russia in 2007, which has had 80-90 % of share of the entire construction market within last years. However commercial and industrial construction has been developing rabidly as well due economic growth and spreading of welfare. People are able to consume more so the retail trade is booming and many new mega-malls are build on the outskirts of the big cities by the foreign contractors. Government is investing to the infrastructure and aims to develop it to meet with current standards.

The Moscow city is the top of iceberg thinking about price level. Real estate prices in other big cities are two to four times lower than in Moscow but they are also going up fast.

## Types of Construction

### Residential house building

As mentioned before, construction of residential housing has become one of the most important sectors within Russian construction industry. According to the survey of ETLA (Ministry of Trade and Industry of Finland), which was conducted among 140 households that bought new apartment between 2004 and 2005, most of new apartments which are sold to the end customers are 90 % finished. The customers will either do the finishing work by themselves or hire private professional or contractor to do this work. Usually the quality of work is not good, so this is why there is demand for qualified construction companies. The reason for this problem is lack of training and share of grey economy. Very often finishing works are delaying and this is why customers are ready and willing to pay for quality and effectiveness.

Approximately 515 thousand new dwellings were constructed during the year 2005. The average size of the apartment was 84.7 square meters. Share of 25 % of the apartments were built in the Moscow City and surrounding region. Based on the survey the Moscow Region is more popular place to build than the City of Moscow because of lack of free land area and high price level. Saint Petersburg is the third popular and largest construction area thinking about building of residential housing.

In Saint Petersburg the choice of the apartment is determined by price and location. Instead people from Moscow were pointed out reasons like cleanliness of the neighborhood and the condition of the building and apartment. Well functioning design solutions were also regarded in both cities. People of Saint Petersburg are more ready to take a risk and buy an apartment in the early stage of construction than in Moscow. In general people from Moscow have greater buying power and more environmental issues to cover e.g. pollution.

Russian people want to finish their apartment by themselves because they want to assure pleasing results and another hand totally finished apartments are not available on the market with the big scale. The survey revealed that if there would be finished apartment on offer, many Russians would consider them as potential option. Within this segment there would be demand for foreign construction companies, who has knowledge and skills. There are already some foreign companies operating in Russian construction market, which are selling fully finished apartments e.g. YIT. (Boltramovich ym.2006)

## Commercial and Industrial construction

Industrial construction is the sector which is mainly dominated by local companies. Huge government owned companies in oil-, gas- and other raw materials industries usually own their construction companies or somehow are tightly connected with them. Construction of pipelines and other facilities for the development of these industries are usually financed by state investments. So this why for the foreign construction company's point of view it is not easy to go between their businesses.

The more potential and attractive construction projects for foreign construction companies are found from western companies which are operation on different industry sectors in Russia. These kinds of companies understand meaning of quality and do appreciate western standards with construction. Good examples are car manufacturing companies, western retail chains and other companies from various industries. Usually these companies have already established good position in the Russian market and are interested to expand their facilities aiming to generate more market share and profit.

## Infrastructure building

Many times infrastructure in Russia is not updated and it requires immediate improvement in order to meet modern standards. The mainstream of infrastructure construction is tightly attached e.g. with the development of transportation systems and public engineering. These projects are usually implemented with help of public- and private investments.

The government is investing money in order to develop rail- and motorways. Construction and modernization of harbors, airports and railway stations are also current issues. In the near future government will concentrate to develop of transportation infrastructure in Siberia and Far-East, close to border with China, where there are many natural resources. (M&A International INC.2007)

The Russian government is planning to invest 160 billion Euros for road construction between 2010 and 2015. Specialists have estimated that during this period there should be constructed 8000 kilometers of new roads and expand 6300 kilometers of existing roadways. This evaluation consist construction of highway between Moscow and Saint Petersburg and also highway from Moscow to Novorossisk. (German Office for Foreign Trade, 2008)

## Production of Construction material and machinery

There is no point to cover this segment of construction industry well because RVP Niemälä is not involved with production of construction materials. 92 % of the used construction materials are Russian-made. Foreign companies which are operating with this field prefer to acquire existing factories and building new ones inside Russia, because of trade barriers and high transportation costs. These kinds of companies are big global players who want to expand their business and have the share of potential of the Russian construction business. For them it is easy to compete against local players because of unique quality of their products. (Boltramovich,S. 2006)

Currently the amount of Russian construction machinery companies has been increased. Nevertheless, foreign companies have huge advantage against them because only few Russian companies are able to compete with the quality of western manufactures. Despite the current financial crisis demand for modernization is expected to remain at the high level in Russia. Many Finnish players, such as Pekkaniska, are expanding now their business because of growing demand. (Pekkaniska.2009)

## SWOT Analysis

### Strengths

- Total growth of construction industry affected by national economic growth
- Size of the Russian construction market
- Development is still in the early stage, so there is still huge potential for "outsiders"
- Demand is partly higher than supply e.g. residential building
- Taxation benefits for foreign companies
- Economic growth and expansion of the middle class
- Growth of foreign investments
- Geographical location
- Government is supporting the development of the construction industry

### Weaknesses

- Entry barriers
- Bureaucracy and corruption
- Undeveloped infrastructure
- High prices of land and rent of premises
- Construction industry is still partly dominated by local construction giants
- Lack of open competition
- Low transparency and rather high degree of monopolization

## Opportunities and Trends

- Wooden construction and building of detached houses will be future trends
- Enormous need for reconstruction and repair of old facilities and dwellings
- Construction in the other part of Russia, despite big cities
- Finnish quality and knowledge is highly appreciated
- Cooperation with other Finnish construction companies, forming alliances
- Reconstruction and repairing old facilities and residential buildings
- Developing market area, huge potential and growing demand for western construction knowledge
- People require more innovative housing solutions
- Turnkey-solutions and finishing work of the new apartments
- Growth in construction of elite housing and commercial estate

## Threats and risks

- Bureaucracy
- Time is running out
- Price level is going up fast as well
- Finding qualified workforce and keep them with the company
- Share of grey economy in the construction industry
- Illegal immigrants from new CIS countries, especially central Asia and Moldova, fulfill most heavy and low-paid work



- High risks with long-term construction projects affected by unstable macroeconomic situation

# Analyzing the Russian construction market based on specialist working on that field

## Current situation

Many specialists are forecasting that current financial crisis will not last long in Russia if the prices of oil and other raw-materials will not decrease anymore radically. Policies of the government has also big role in survival from the crisis. Current crisis has decreased the value of stock market already by 40% and inflation has been in high level. Most of the Russian people have not invested money in the stock market because lack of trust so the wealthiest people have been those who suffered most.

Latest BOFIT analysis of the current situation of Russian economy forecasts that growth of GDP will be around 1-3 % on following year 2009. This forecast is based on assumption that oil price per barrel will stay around 40-50 USD, which naturally will fluctuated and might not even be so low. Following decrease is certainly temporary, and already forecast of year 2010 growth of GDP is around 3-4 %. The high level of inflation and decrease of the growth is so tightly dependent about current low price level of raw-materials because these bring the most income to the government. Russian economy is quite closed economy compared to e.g. European countries so this will also help Russia to recover from the crisis faster. Previous years have been beneficial for economic growth and also budget of government. The government has had surplus with budget many years, so now they are covering effects of financial crisis with these funds. They have supported e.g. official banks with billions in order to guarantee their reliability in global investment environment. Many other industries are being supported as well; residential building is one example of these kinds of industries.

On December 2008 the growth of construction business has decreased temporarily close to zero, but the overall growth on year 2008 was around 11.3 %. Finnish volume of construction in Russia has been annually around 1.3-1.5

billion according to Russian construction strategic research by SITRA and Rakennusteollisuus ry. The research forecasts that value will rise to 4.5 billion within next five years. It says that Finnish construction companies which operate within Russian market have all the conditions to increase their existence and authority. The research also encourages Finnish SMEs to take a risk, try their wings and enter to Russian construction market without hesitations. Ilpo Jalasjoki, president of board of RT, emphasizes that especially area of St.Petersburg is very attractive for Finnish construction companies but also point out the value of Moscow Region and other developing areas. (SITRA and Rakennusteollisuus ry, 2006)

## Forecast

Currently Finnish companies, which are operating in Russia, are preparing to the time after crisis. Russia is attracting Finnish companies despite the current weak situation of the economy. Some of these companies are using the crisis as an asset for future business positioning by expanding their businesses. Other ones are developing their business strategies to respond the demand after the crisis. Jouni Paasirova, regional manager of Kesko Group, says that time of the crisis is good time for expanding business; prices of land and costs of construction have decreased significantly. He lines; "Winners of the crisis are those who are able to buy cheap land, build premises while prices are at the cheapest level and this how they can gain the best advantage after economy is starting recover."

Vesa Vertanen, Head of Itella NLC, believes that current recession in Russia is temporary and will not last long. He points out that when the crisis is over, expectations of the growth will be very potential for the Finnish companies. Now it is the time to concentrate into development of business strategies and strengthening market positions. When considering making investments it is wise to do them while prices are at the low-level. He says that Finnish companies should realize that Russian market potential has not disappeared anywhere due the crisis. (Niinivaara, S.2009)

# How to do business in Russia

## Business Culture

### Background

Finland and Russia have been neighboring countries for several years. These countries have long mutual history. There have been always many transactions between each others for example in business area. Russia has gone through many changes in recent years, as The Soviet Union collapsed in 1991. This has had very liberating affect into Russian culture and their habits. Nowadays Russian people are and can be much more open for foreign countries ideologies.

Russia is the biggest country in the world, thinking about land area. Russia's population is over 150 million. On the other hand thinking about Finland; population is little bit over 5 million and even though society is well-organized. Compared to others countries Finland is in top class when evaluating equality between genders. In Finland there aren't huge differences between social classes. Instead in Russia it is easy to recognize which people are poor or rich; there is a huge gap between social classes. According Rosstatt over 25 percent of Russian population is living under the poverty line. It is very difficult to obtain correct evaluation because lack of statistical information from the rural areas and this why the realistic estimated value is even higher. This is one reason why Russian people differ from Finnish people; In Russia you have to create networks to be able to survive. People stick together trying to struggle against society's bureaucracy. This behavior is caused partly by colorful history of Russian people; In Russia or in Soviet Union there has been always only strong leaders in head of the country (weak leaders has been able to maintain the power in their hands for only short time periods) and people have been under tight and powerful control.

This is my personal opinion based on my knowledge and experiences from both countries. When you do major favor or help someone who is "normal" person in

Russia, it is almost sure that if you meet this person again after ten years that person still remembers you and feels like owe you something. Instead in Finland doing a favor to some random person might often mean or is interpret that you are either stupid or you trying to be something that you aren't; and it's almost sure that person you have tripped to help forgets your act or does not feel like owe you something.

It is also necessary to understand that Russia is totally different country to do business and some methods which are commonly used around Europe might not work there, e.g. signature in the contract does not always mean that business deal is sealed, it might mean that now parties can start thinking about doing business together.

## Russian culture

Hospitality and maintaining family's honor are issues which have still main role in Russian culture. An invitation to a Russian home is a real educational experience about the true meaning of hospitality. Visit a small city or village will reveal "the real heart of Russia". Russia is still a little bit isolated and powerfully controlled country, but still many improvements has happened and usually all the changes require long period of time. Russia has gone through several changes in the last few years. People who have visited Moscow last time ten years ago would be very surprised about how "Western" downtown has become. Couple of years ago international businessmen rated Moscow as the most expensive city to conduct business, more costly than even Tokyo or New York.

## Power distance

In Russia power means that you can do almost anything; buy someone out from head of the company or arrange for your cousin a job placement. Too much power in hands of single person will be eventually threat to society in Russia. Sometimes the Power prevails over rights; the person who has the power says always eventually the last words. The main goal in Russian business career development is everlasting attempt to reach top lever; be above of other people. Basic family structure is much closer than in Finland; children respect older people, their parents, and take care of e.g. Grandparents when they are too old to survive by themselves. Initiative and obedience are basic norms which every youngster should learn from studies and parenting. Teachers share their wisdom and have all the right answers in Russian educational hierarchy.

The highest political power is hands of few people. When society is requiring radical political changes the only way is the revolution. Good examples of these facts are collapse of the Soviet Union and nowadays political situation. When Russian person is rich, it is very easy to notice that – fancy clothes and 500 - series Mercedes Benz. In Finland this thing is another way around. People tend to be easily jealous, so being a rich is not always demonstrated in a same way. Appearance is very important in Russian culture, Russian rather buy new car than new furniture for his apartment. When Finnish person is walking on the street and wearing jogging clothes which feels comfortable to wear, Russian rather emphasizes the style of his or her outfit.

Many status symbols are generally used in Russia and person with plenty of power has many privileges. Good examples for these facts are again 500-series MB or privilege to cross the border first with help of money. Hierarchical differences between employees within the organization are very huge and this factor promotes many ways inequalities between people.

## Individualism/collectivism

Russia has gone through big ideological changes and the transformation process is not over yet. Communism as an ideology was absolutely collectivism in almost every area. Because of these roots it is kind of difficult to classify Russian individual or organizational values into one certain class.

Usually in Russian culture individual's private life is shared with friends and there is also right to privacy up to certain point. Social networks are very important in every area. Without contacts it is very hard to survive on your own. Identity is based on individual but environment has a huge affect on that. Things are kind of other way around in Finland.

Russian people are very patriotic and usually they think in terms "we" if there is situation where there are foreign people involved as well; " In our country there is everything: the most skilful artists, the best ice- hockey team and the greatest gun in the world- Kalašnikov". Differences in way of thinking between huge metropolis like Moscow and small town like Murmansk are very discriminating. Relationships between management and employees are perceived in moral terms, like a family link more that mutual advantages. The easiest way to get a job is to have some relationships or contacts to company, but of course personal skills are important too.

## Masculinity/ femininity

Russia is still kind of masculine society compared to Finland. In Finland dominant values of society are caring for others at the same time when driving person's own benefits. In Russia the family's or group's benefit is essential and of course also individual's benefit at the same time. Woman's main job is to be tender and take care of home and children. This is not straight model that everyone follows and there are always exceptions depending e.g. about social class which people are belonged. Usually the best solution for conflicts is to fight them out;

compromises are not done very often. In politics there is not many women in parties compared the amount of men. Things are changing slowly in this area and when welfare in Russia starts to divide more equal it is going to accelerate this process.

Only the strongest survive is the motto for example in study life. If you fail in school it is disaster, only the best grades are accepted. Russian universities are well known around the world because their high- quality research and high level of tutoring. The meaning of life is taking care of family and to do work. Nowadays many Russian have more than one work at the same time e.g. person might work during the daytime as a teacher of primary school and working night shift as a cashier.

### Uncertainty avoidance

Russian people generally want to be aware of everything and in many cases like to lean on traditions that have been predominated before in the past. What is different is often considered dangerous. Russian society is in this way kind of conservative to changes. Sometimes when there is some kind of protesting against leading political ideology it will be eliminated by government's censorship. Way of thinking: "There is only one truth and we have it" describes very well nowadays ideological situation in Russia. The main reasons for this are origin from history and high patriotic ideology. This is shown well for example the amount of black raze people in Russia or the amount of other religion member in Russia. There are not so many people whose origin is Africa in Russia, because of strong uncertainty avoidance and of course violence that has been concentrated to them. (Vainio, A.2006 & Kniazev, K.2008 & Rosstatt 2008 & Hofstede, G.2004)



## Legislation

The new law was recently reformed in Russia. Nowadays the private ownership and free trade of urban and commercial areas are allowed. Still foreigners cannot own the land in Russia but they can rent it for 49 years. Foreign enterprises have to take this into consideration especially in property developing contracts. (Rinne.2007, 7.)

Federal Law on Government Regulation of Gambling will come into effect 1.7.2009. According to the law gambling- and casino business is only allowed inside four regions in Russia. These Regions are Krasnodar, Rostov, Primorje and Kalingrad. This will consider construction business as well because new law will create major construction projects inside these regions. In the near future four gambling cities are supposed to build, which estimated investment value will be approximately 31.2 billion USD. (Finpro, 2009) This huge construction project will be covered more later on with the thesis.

## Marketing

When new construction company is starting to operate in Russian market marketing is not playing so big role at the beginning. Instead networking has more importance at this stage. In order to gain long-term success in business it is crucial to create wide and effective cooperation network. Participation to exhibitions is very efficient way to create connections and spread the awareness of the new company. Good service and quality are also essential, because in many cases by word of mouth is irreplaceable; people tend to recommend functional solution to their fellowships. Connections play big role in Russian business life; sometimes decision-maker of the company might accept the most expensive business offer only because offer-maker is his friend.

Russian tends to search information about companies from internet so it is necessary to have website also in Russian language. Advertising in industry's publications and magazines is also good way to reach potential customers.

Creating and developing brand image plays bigger role with big and global companies. This is prevailing later on, when company has stabilized its market share and positioning on the market.

## How to enter the Russian market

There are many issues to cover by management of the company when entering into new market; which foreign market to enter, when to enter them and on what scale and of course the choice of the entry model. General market attractiveness consists from many factors such as situation on the political and economical stages. (Hill, C.2004, 393-398)

Thinking about Russian construction market as a targeted expansion of business we can say that there is possibility for long-run growth and profit potential. The demand in the market has increased and smooth growth will continue also in the future. The political situation will remain at the same stage because the most important political leaders still have the same way of thinking. Russia is enormous country and all radical changes require long period of time. (Pan, P.2008 and Kynnäräinen, P.2008)

## Entry Modes

There are several ways to enter to Russian market. In this case the most potential and possible ones will be covered. Management of the company should think carefully how to penetrate the market, either start totally new company or buy existing one. Possibilities are to go through whole penetration process alone or share the risk by joint venture.

## Wholly owned subsidiary

The best way to avoid all the trade barriers and to ensure comprehensive control over business operations in Russia is set up subsidiary into to country. This alternative is also potential if the company is planning long-term or permanent business operations in Russia and wants to generate profit through business operations. On another hand it is always remarkable investment to set up subsidiary into Russia, and eventually company itself carries all the risks alone. There are many forms of companies in Russia and the most potential ones are covered with a next part.

### Forms of companies in Russia

#### ZAO (CJSC)

Closed joint-stock company, ZAO, is legal entity whose shares are distributed among limited amount of shareholders. The maximum amount of shareholders is 50, and the minimum value of stock capital should be at least 10 000 rubles (224 Euros). Sole ownership is not allowed; company cannot be established or owned by a single shareholder. Shares of the company are bonded stocks and they are traded between limited amounts of persons. To set up company in Russia allows doing business transactions inside the country. All the taxes are paid in Russia, and the subsidiary is primary accountable of all the business actions. In case of bankruptcy or insolvency at the end parent company will be secondarily responsible if subsidiary cannot solve inconveniencies by itself. The limited amount of shareholders and owners' preemption ensure tight control over the structure of ownership for the parent company. This is one remarkable reason why ZAO is very popular among foreign investors.

## OAO (OJSC)

Open joint-stock company, OAO, is legal entity, whose share can be traded publicly without permission of other shareholders. The amount of shareholders is unlimited, and shares can be sold without limitations. OAO is common company form with those companies which were before state owned and are now privatized. The minimum value of stock capital should be at least 100 000 rubles (2240 Euros). Sole ownership is not allowed; company cannot be established or owned by a single shareholder. OAO is basically structured with the same way than ZAO and the biggest difference is that it is public. OAO is not usually used by SMEs.

## OOO (LLC)

Limited liability Company, OOO, is legal entity with capital stock. There is not similar company type than OOO in Finland. Shares of stocks are not bonds, and company is rather divided into "parts". The owner of OOO is not called as shareholder, but rather participant and amount of these cannot exceed 50. Every participant has vote and also right to participate in decision making. At the beginning, when company is founded, it is divided into different sized parts usually among founders of company. Minimum value of stock capital should be at least 10 000 rubles (224 Euros). All the taxes are paid in Russia, and the subsidiary is primary accountable of all the business actions. In case of bankruptcy or insolvency at the end parent company will be secondarily responsible if subsidiary cannot solve inconveniences by itself. OOO can be compared GmbH which is one of the company type used in Germany. OOO is commonly used among small businesses because foundation and maintenance of the company is much cheaper and simpler compared to joint-stock companies.

## Branch and representative office

Setting up branch or representative office in Russia is well-functioning option if company is planning short-term operations or just observing potential of the market. In these cases it is not required to go through whole corporation formation process and company does not have to take care of so much paperwork. Branch or representative office is not considered independent legal entities but has the right to pursue commercial activities.

Time to maintain operations through branches or representative offices are limited. Branch can be authorized up to five years and representative office one to three years and after this it is possible to apply extension. With representative office it is easier to issue invitations for foreign staff or partners and there are less frequent reporting requirements. The amount of employees is limited; up to five foreign employees can work in representative office. The registration process is needed to complete before company can start operations. These two types are most suitable for marketing and business preparation operations.

## Administration of the company

Basically all the business operations are governed by CEO. This person does not have to live permanently in Russia and can have any nationality. Authorization is also possible to delegate to person who is registered as an entrepreneur or it can be divided between CEO and executive group. Government of the company is not obligatory with structure of Russian company, but there has to be always sole executive body that has control over business operations.

Every foreign employee working in Russian company has to obtain a working permit and visa. In all the cases Russian labor contract has to be signed and taxes paid. Employer has to make notification to the migration service if employee moves to another country or to another city inside Russia. The migration service might conduct outer inspections to companies which employ foreign citizens in order to verify the validity of work permits and visas.

It is necessary to have personal head-accountant in all Russian company forms. There are many bookkeeping companies to hire for this job, if company does not have accountant within its own staff.

## Registration

When setting up business there are many issues to cover before company can start its business operations in Russia. Registration of the company is one of the most important and complicated process before anything. At first of all it is time consuming process and plenty of paper work is needed to do. Tax department is currently trade register authority in Russia who processes and is responsible about registration of new companies. All the basic points about the new company has to been considered and decided before the registration process can be started.

It is wise to consider carefully which company form to choose. This depends what is the purpose to start operations in Russia. All the commercial activities

and purposes to generate profit require setting up subsidiary in Russia. In marketing or research purposes representative office or branch might be sufficient. In these kinds of cases the parent company is fully responsible for all the business activities of the branch.

The name of the company can contain full name of the parent company or can be abbreviated. The formal name always consist the company type as well (e.g. ZAO, OOO or OAO). Name can contain foreign borrowed words but must be always transcript in Russian. It cannot be; official name of any country, name of the state department of Russian federation, name of international organization or public association or against common moral principles.

There are many documents which are required for registration of the company: extract from the trade register, articles of association, copy of passport of CEO, document which confirms the address. All the documents should be certified with apostil and should also translate in Russian by official translator.

### Location of the office

Registered company or representative office should always have juridical address in Russia. Possibilities to acquire office are to buy or rent one. Currently there is shortage of smaller offices (100 square meters) in big cities. Location of the office must planned carefully keep in mind availability for the customers and others services for managing everyday business.

### Banking

Every company which is operating in Russia needs to have Russian bank account. There are many banks which might not be reliable or are unstable to take care of their responsibilities. It is reasonable to use help of professionals when concerning about which bank to choose. It is possible to open T-type bank account for the subsidiary in Russia. With this kind of bank account it is possible



to handle transaction in internet. Paper versions of the all the receipts with signature of CEO and head-accountant are still needed later on for the bookkeeping. When choosing the bank, it wise to choose branch of the bank located near the office because often account opened in one branch cannot operated from different branch of the bank.

As mentioned before it necessary to have head accountant in the staff or at least hire accounting company to take care of these issues.

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## Ownership

Sometimes it recommended having Russian co-owner with the subsidiary. It makes easier to manage customer-and local government relations. It is important to think carefully division of shares and how to discharge profits in situation where Russian co-owner is taken to share ownership of the company. Specialists are recommending keeping at least 51 % of the ownerships for the parent company, more preferred is 75% in order to assure strategically own position. It is good to write separate contract between shareholders about organization of the governmental issues and other responsibilities. Russian co-owner might try to gain more personal benefits with help of personal relationships e.g. rent premises from friends and put expenses too high. There have been situations where Russian co-owners have tried to capture whole business. Very commonly VAT is considered as direct expense instead of part of the billing. Many SMEs are drawing up bookkeeping only for the fiscal declaration. Company should make sure to check background and reliability of the Russian partner. (Kekki, P.2009)

## Recruiting Workforce

Business is done between people and in many cases human resources of the company is the most important asset. When planning business operations in Russia, it is reasonable to hire Russian workforce. The final decision power is recommended to keep in Finnish hands in order to assure control over the business and guard benefits of the parent company. Russian workforce is the most productive under strong control and managerial skills.

Russian working mentality is kind of ignorant towards the success of employer, this why use of "stimulant" within wages works in Russia. Part of the salary can be paid based on the results or sales of the employee. Competent, educated and language skilled workforce is highly appreciated in Russia. There is tough competition among companies about skilled and talented persons.

Demand and supply of qualified workforce is in imbalance, this why finding suitable workforce is very challenging and time-consuming process for the companies. In many cases there are lots of applicants for the open occupations, but only minority of them are eventually suitable and qualified. Qualified applicants are aware of the situation in the market and often price themselves too expensive for the companies. Generally wage level within educated workforce in big cities of Russia can be compared to Finland, but currently it is even higher. It is common that people are not used to be committed with employers for years. They tend to leave company very easily if better paid job will appeal. Fake degree certificates are also remarkable problem in Russia. This will put "honest" student under speculations and suspicions.

In the future there should be more co-operations with education institutions and companies in order to assure supply of qualified and suitable workforce. Use of head hunting agencies is common in Russia among foreign companies. In the company's point of view it is essential to create attractive and employee-friendly image in order to keep and attract workforce. (Kivelä, H.2006, p.57-62)

## Channels for networking

In Russia money means power and it works another way around as well. There might be a situation where the most expensive deal is approved and reason behind this was that representative of the company is friend of decision maker. Without connections you are nothing in Russia. Whole society is based on favors and friendship. It is crucial fact, this why we cannot change it and try to do business, "our", western way.

### Exhibitions

Participation as a visitor or an exhibitor to construction exhibitions and events is good way to obtain current information about the construction industry and its trends. Exhibitions create best foundation to get familiar about the "players" on the market and to create valuable connections. Again, networking is the key word for successful and long-term business in Russia. There are many Russian and foreign organizations that offer turn-key participation packages into these events. This chapter will introduce and list the most popular construction events in Russia among foreign companies.

### Moscow

#### MosBuild

Mosbuild is the biggest and well-known exhibition event in Moscow among construction industry. It is divided into six main categories which cover entirely the whole building industry. Annually number of visitors is around 80000-90000 and amount of exhibitor varies 2600-2700 from 40 different countries. Finnish companies have participated very eagerly to the exhibition within recent years. The exhibition is usually held on spring between March and April. There is good information package about the exhibition and its feature on the official website of the event ([www.mosbuild-expo.com](http://www.mosbuild-expo.com)). Finnish exhibitions organizers, such Arvelin International and Entre marketing, organize participation for Finnish

companies at the event. It is also possible contact straight to Russian main organizer, the Mosbuild team.

### CTT Moscow

CTT Moscow is another leading construction exhibition held in Moscow. It is also international event and there are annually many foreign participants. The main purpose of the CTT is to develop and internationalize Russian construction industry. It is very efficient channel for foreign companies for networking and entering Russian construction business. Whole scale of construction industry is covered. The event is usually held on summer during the June. 818 exhibitors from 25 different countries participated to CTT on 2008. Share of foreign companies was quite remarkable, over 34 percent. More information about the exhibition and participation is available on the official website ([www.ctt-moscow.com](http://www.ctt-moscow.com)). Arvelin International is one Finnish company which organizes stands for the event.

### Holzhaus

Holzhaus is important exhibition about wooden construction in Moscow region. Construction of the houses from the wood is becoming more and more popular in Russia. Finnish companies have hundreds of years experience from this field and their superior quality is highly appreciated around the world. Whole scale of wooden construction is introduced within this event; building, turn-key solutions and design. This exhibition has been very popular among Scandinavian and German companies. More information about the exhibition and participation is available on the official website ([www.holzhaus.ru](http://www.holzhaus.ru)). Arvelin International is one Finnish company which organizes stands for the event.

## Saint-Petersburg

### Baltic build

BalticBuild is the biggest and well-known construction exhibition in Saint-Petersburg. The event is very popular among Finnish companies and generally have very international atmosphere. 706 exhibitors from 19 different countries participated to this event on last year. Almost 50 percent of the all participants aimed to establish new business contacts and especially foreign companies have reported the event very efficient for this purpose. BalticBuild in Saint-Petersburg is similar than Mosbuild in Moscow. Construction industry is covered broadly and sections are divided separately. The exhibition is held annually in Lenexpo exhibition center during autumn. Comprehensive information about the event and participation is available on the official website ([www.balticbuild.ru](http://www.balticbuild.ru)). Finnish exhibition organizers, such Arvelin International and Entre marketing, organize participation for Finnish companies at the event. It is also possible contact straight to Russian main organizer, Primexpo.

### Interstroy Expo

This exhibition is consisted from forum and exhibitions from different fields of construction industry. The content of the forum deal with current topics of Russian construction industry; development, trends, investments and internationalization. Whole scale of construction industry is covered within the exhibition. Exhibition is held annually in Lenexpo usually during the spring. According the latest statistics 927 companies were represented and over 13 percent of them were foreign exhibitors. More than 27 percent of the all participants aimed to establish new business contacts and most of them reported achieved potential clients. Amount of visitors varies around 40000 annually. Comprehensive information about the event and participation is available on the official website ([www.interstroyexpo.ru](http://www.interstroyexpo.ru)). Finnish exhibition organizers, such Arvelin International and Entre marketing, organize participation for Finnish

companies at the event. It is also possible contact straight to Russian main organizer, Primexpo North-West.

### Wooden construction

Wooden construction is important exhibition about wooden construction in Northwest Russia. Companies from all the fields of construction industry are welcomed to join this event. Construction of the houses from the wood is becoming more and more popular in Russia. Finnish companies have hundreds of years experience from this field and their superior quality is highly appreciated around the world. Whole scale of wooden construction is introduced within this event; building, turn-key solutions and design. This exhibition has been very popular among Scandinavian and German companies. More information about the exhibition and participation is available on the main organizer's website ([www.restec.ru](http://www.restec.ru)).

## Supporting organizations

### Consultancy

There are many domestic and foreign consultancy companies operation in Russia. Some potential companies which have many years of experience from Russian market and might be interesting for RVP Niemelä are e.g. Jykes ZAO, Finnish-Russian Chamber of commerce and Fintra. These kinds of companies offer various services and training for development of new business, internationalizing and penetration into new market. It is possible for the company which is interested to expand its business to Russia to order extensive, all-inclusive and current market researches, contact finding packages and profitability researches from these kinds of consultancy companies. In order to save time and avoid exploitation of resources, it is very essential to have full and current picture from the reachable market. Small investment to qualified market research might save wasted investment of million Euros.

### Financial issues

Usually, especially for SMEs, penetration into new market is huge investment which might require some external financial help. There are many supporting organizations besides banks which might be very useful to fulfill gap between budget and planned investment for internationalization. Finnvera is one of the most remarkable organizations, which support internationalization of Finnish companies by offering finance. It supports companies by offering finance to e.g. R&D, establish of the subsidiary abroad, working capital, investments or exports. It is also possible to apply subsidies for internationalization from the EU and regional or national governance.

## Bookkeeping and legislative issues

Legislation and accounting issues are usually ambiguous for many companies which are planning to start business operation in Russian market. Every company which is operating inside Russia needs to have head-accountant, who will take care of bookkeeping of the company. Besides hiring some person for this job it is possible to buy all the accounting and legislation services from the qualified foreign or Russian company. Companies such as ZAO Konsu or Avenir Group are operating on this field and they have many years of expertise of conducting successfully accounting and legislation operations in Russia. Konsu offers full range of services in Russia: business start-up-, Financial management-, legal- , auditing- and tax planning services. It has many Finnish and foreign satisfied customers e.g. Kone, Finnair, UPM and Kemira. (Pätilä, A.2009 & Pitkänen, M.2009)



## Opportunities within the near future construction projects in Russia

### Sochi

Winter Olympic Games will be held in Russia in the city of Sochi in year 2014. Naturally this will be a remarkable construction project for local and foreign construction companies. Total cost of building the Olympic city and facilities are estimated to be 13-15 billion USD. Russian government is trying to attract foreign investors and contractors to help with this huge project. At the moment 11 Finnish construction companies are negotiating about forthcoming contracts with Russian parties. Finnish association, Finpro, is leading the negotiations. Russians have offered to Finnish contractors two building grounds in Sochi. Another building ground which is located at the centre of the city is interesting for Finns. They are planning to build a hotel complex on it to serve Olympic visitors and participants. The planned hotel would be built from wood, because of the possibility of earthquakes in the area. The hotel is planned to consist of 1450 rooms. Estimated value of this hotel complex project is approximately 100 million USD.

Seija Spiridovits, project manager of the Finnish Sochi-program, puts stress on the importance of finance from the Finnish government. Building of this kind of hotel complex would bring welfare and boost Finnish economic life. Jukka Kettunen, representative of Pöyry Group, estimates that the duration of the project is 2 to 3 years. This means that construction of the hotel complex has to be started at the latest by year 2010.

Russians are suggesting that Finnish companies would set up a factory in Russia which would produce wooden elements for the construction of the Olympic village. This factory would produce also elements for Russian residential building after the Olympic Games. (Niinivaara, S.2009)

This hotel complex project and possible other contracts within the Sochi-program are good opportunities for Finnish construction companies. There are no obstacles why Oy RVP Niemelä AB should not try to participate by sub-

contracting to construction of Sochi Olympic city and its facilities. The first step would be to ask more information from e.g. Finpro and then contact to involved construction companies.

Spiridovitsh thinks that Finnish companies can accomplish best results from construction of Sochi by cooperation together and with Russians. She reveals that there are also opportunities with construction of hockey arenas and community halls because Finns have good knowledge and experience from these fields. (Pakkanen, S.2008)

### Azov City

Gambling-and casino business in Russia will be allowed only inside four regions because changed legislation. New law was approved on year 2006 and it came in valid on January 2007. Gambling- and casino business is allowed only inside four regions after 1<sup>st</sup> of July 2009. Government decided to locate these gambling regions as following: on the Shore of Azov Sea (Krasnodar-Rostov district), Novosibirsk region (Altayskiy district) and Vladivostok (Primorje district) and Kalingrad region.

So another promising construction project, even more expensive than constructing Sochi Olympic city, will be building of these gambling cities. Very attractive target is especially Azov City, which is the most expensive and the biggest project among other gambling cities. The estimated costs of building Azov City are 17.9 billion USD. Area of the city will be approximately 2000 hectares and it offers for investors to build e.g. hotels, gaming halls, casinos, movie theaters, water parks, housing solution for service staff and many other construction projects.

Foreign investors have been very interested to buy land areas and build facilities on the Shore of Azov Sea. American consulting company, Innovation Group Plc, has designed and zoned Azov City. At the moment the biggest foreign investor is Austrian, Asati Worldwide, which is planning to invest approximate 100 million Euros to Krasnodar region. The company announced to construct 100 000 square

meters of facilities. With this major project, constructing "Russian Las Vegas", there are defiantly possibilities also for Finnish contractors. (Spiridovitch, S.2008)

## Conclusions and recommendations

### Time is running out

The biggest Finnish construction companies are already operation in Russia, such as YIT, NCC, SRV and Skanska. Also Turkish and German construction companies have realized the potential of Russian construction market and nowadays they are considerable competitors for Finnish companies. Thinking about Finnish SMEs, most of them have not dare to take a risk and even try to enter to Russian construction market, nevertheless there would be a lot of potential and demand for them. It is crucial fact that business in Russia, within every industry, is all about networking. Company has to create wide network with important and skillful Russian people in order to succeed with its business in the long run. This takes long time; it does not happen within one night. Past years have been very favorable for the economic growth of Russia and this has directly affected also to construction industry. Real estate- and land prices have went up explosively, especially in the urban areas. There is also another side with this; prices of workforce and construction materials are increasing at least as fast as well. Competition is increasing all the time, with local- and foreign players in the construction markets. Customers are able to demand more, better quality and more exact timeframes. It would be reasonable and wise to enter to Russian construction market now, right after the bottom of the financial crisis, because later it might be too late or at least much more difficult.

## Economic crisis affecting Russian construction market

Despite the current economical crisis construction industry in Russia has to be developed and there will be many projects available. Russian construction market is still in a very early stage; many improvements for infrastructure has to be made, gap between building of residential housing and demand for new housing solutions has to be filled. These requirements will not be completed without help from foreign construction companies. There are many opportunities based on the fact that Finnish superior quality with outcome and construction skills are kept highly valued in Russia.

Current pattern of RVP Niemelä, which is used on the whole in Finnish market, is new in Russia. Rental of workforce in Russian construction market is not as developed as e.g. in Europe. One remarkable reason behind this is use of cheap and illegal immigrants for low-paid work from new CIS countries. Another reason is that pattern of rental services for equipment and especially workforce is not known or well-developed yet on the market. (Golovko, M.2009) Third reason which is affecting the development of the situation is that rights of employees are not at the same level than e.g. Finland. Employer might not gain remarkable economical advantage or savings when using rental workforce. Nevertheless it is also important to remember that sometimes resources of the companies are limited and often subcontracting is needed in order to implement construction project successfully.

Market penetration with the same pattern which RVP Niemelä is using in Finland would currently require insuperable amount of investments and know-how, taking into consideration all the available and possible resources of the company.

Recommended ways to penetrate to Russian market for RVP Niemelä would be; either subcontracting or cooperate with another foreign construction company which is already operating on the market or has some experiences and/or connections from Russia. RVP Niemelä could gain some valuable information, connections and know-how from the Russian construction market by stick at first with international construction contracts. These kind of construction projects are

easier and safer for RVP Niemelä to enter, because usually foreign customers can respect quality and western standard more than Russian fellows.

Now it is not time to hustle to Russia as an inexperienced player, taking into consideration of current situation of the Russian construction market which was evaluated and revealed within the research and internal assets of the RVP Niemelä. It is rather wise still put some effort and proceed smoothly in order to reach and assure success on the Russian construction market in the future.

Good way to RVP Niemälä to penetrate Russian construction market would be subcontracting with big Finnish companies with their construction projects. These kinds of companies are e.g. YIT and SRV, who have many remarkable construction projects going on in Russian construction market. This how they could get started easier and gain experience from Russian construction. Later on if and when business is starting to develop they can consider going further by taking bigger risks and expanding their business smoothly. There will be many attractive construction projects, such as building of Sochi Olympic City, Russian casino regions and many others.

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