

Foreign direct investment from Finland to Russia

Hydroline case research

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Bachelor's Thesis

Field of Study Social Sciences, Business and Administration			
Degree Programme Degree Programme in International Business			
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Title of Thesis Foreign direct investment from Finland to Russia. Hydroline case research			
Date	09.09.2013	Pages/Appendices	72/1
Supervisor(s) Minna Tarvainen, Anneli Juutilainen			
Client Organisation/Partners Hydroline Oy			
<p>Abstract</p> <p>Russian-Finnish trade relations have long history and are strengthened by the two countries' geographical location and cultural interaction. This thesis observes Russia as a destination for foreign direct investment (FDI) coming from Finland and made in the industrial sector. The work was conducted in cooperation with Hydroline Oy, whose needs and objectives set the frame for the analysis.</p> <p>The main goal of the work was to provide the client company with information about setting up a production facility in Russia to apply this knowledge in the organization's strategic planning. The research flows from a general overview of Russia's economic trends and forecasts to the analysis of the existing Finnish experiences on the market and a specific, company-related investigation of the country's machinery building industry. Although the research method model includes gathering and analysis of facts and figures, the main tool to achieve the objectives is qualitative. The primary information basis consists of interviews conducted with a representative of Hydroline and prominent Finnish investors on the market of Russia. Used as theoretical background as well as material for studying the operational environment, the secondary data contains academic works and publications of the world's major economic and development organizations. Besides, the secondary information applied in the work includes legal documents and on-line materials concerning main FDI costs.</p> <p>All in all, the research describes Russia as an FDI target territory from the point of view of investment suitability for medium-sized organizations similar to Hydroline. The final result is assessed in relation to the strategic value of the study for the client company's market development project.</p>			
<p>Keywords</p> <p>FDI, market entry, business environment, strategic planning, machinery building industry</p>			

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1 INTRODUCTION

Occupying a vast territory and being the storage for a large amount of natural resources, Russia attracts investors from all over the world. At the same time, global media deliver rather contradictory information about the country's economic stability and conditions for doing business. Therefore, the topic connected with the investment process towards this country is considered to be of current importance and of great interest for study and business purposes.

This thesis work is dedicated to foreign direct investment (FDI) from Finland to Russia in the field of industrial goods. The idea about writing a thesis on this particular topic appeared during the author's internship period at Hydroline Oy. Working for this Finnish company from May to August 2012, the author was responsible for conducting machinery-focused market research in Russian industrial sector. Generally, the internship research task at Hydroline was to investigate the two different Russian market entry possibilities: launching cylinder production/assembling in Moscow and Moscow Region and arranging direct export sales to Russia with delivering ready-assembled cylinders from Finland. The current paper concentrates only on production establishment as a market entry option, which allows studying it in more detail.

From the author's point of view, the chosen topic satisfies interests both in Finnish-Russian trade relations and in FDI as a major concept of international strategic management. The choice of the case country is not occasional as well. The author's Russian background allows getting access to Russian language information and makes local business specificities faster and easier to understand.

Client company background information

Hydroline Oy is attracted as a client organization for the thesis case research part. Thus, some company's background information is to be presented before introducing the objectives of the paper.

A medium-sized company, Hydroline is a Finnish leader in hydraulic cylinder production. Since 1962 it designs and manufactures cylinders for heavy machinery applications in the following fields: automotive manufacturing, forest machinery, hoisting/transfer, mining and earthworks (Hydroline 2013a). Currently the company runs a production facility in Vuorela (Siilinjärvi), the approximate capacity of which is 200 000 cylinders.

There are nearly 200 employees working for the company at the moment. (Hydroline 2013b.)

Hydraulic cylinders are the essential elements of mechanisms and might be categorized as input industrial goods - spare parts which constitute the end product (Mukerjee 2009, 34-35). Industrial goods buying and selling transactions form special, business-to-business relations, which are different from those established between organizations and end consumers. In business-to-business relationship both sides are organizations equally active in the process. The purchase decision is taken not by a single person, household or family, but by a number of stakeholders after a demanding and complex decision-making period. The decision time is essentially long, and this is explained by business-to-business purchase large value, volume and high risk in case of failure. Moreover, supplier switching costs are high, and thus, business-to-business relations are usually long and contractual by nature. Unlike emotional and impulsive consumer buying, business purchasing is reasoned by economic benefits and is preceded by scrupulous product information gathering. (Fill & Fill 2005, 5 - 18.)

The key distinguishing feature of Hydroline products is their customized design: each cylinder is manufactured according to the clients' unique specifications and needs. The main raw material for cylinder production is steel. (Laakkonen 2012.) Hydroline promotes high standards of quality and is oriented on innovative technologies together with efficient production solutions. Among the corporate values there are sustainable development, transparency and responsibility in relations with stakeholders, environmental commitment, ethical company policies and employee well-being. (Hydroline 2013c.)

At the moment Hydroline is actively working out its internationalization strategy, and the efforts have already led to certain results. Thus, the company's 4000 m² production facility in Poland, which is now under construction, has become the first major FDI project of Hydroline. Besides that, the company has already established a sales office in Shanghai. Locating nearby, Russia might be the next step for the company in FDI practice and development on the international level. (Laakkonen 2012.)

Thesis main goal and objectives

After interviewing a Hydroline representative about the company's international development plans and the reasons for considering Russia as an investment destination

(Laakkonen 2012), the main research question was formulated as follows: is Russian investment environment suitable enough for a Finnish medium-sized producer of industrial goods? Generally, the prime goal of the research is to get acquainted with Russia as an FDI environment from the specific Hydroline-oriented perspective, with the attention put only to the issues strategically important for the client company. In accordance with this goal, the research objectives are listed as follows:

- describing Russian business environment with the emphasis on its machinery industry, steel industry and labor and real estate trends
- doing the comparison of these trends in different regions of Russia

As Russian market is huge, which promises large investment returns, many foreign companies are ready to view it as the area for international expansion. Foretelling the specific Hydroline case research, the thesis provides broader context of Russian investment environment and presents the area's general characteristics and development prospects. Thus, the paper can also serve as the assisting material for other European industrial organizations wishing to enter the market but lacking basic knowledge about it. According to this, the thesis general objectives are as follows:

- describing the current investment environment in Russia
- summarizing short-term and long-term environment forecasts
- analyzing the existing Finnish FDI experience in Russia and drawing out the environment's main opportunities and threats

Limitations

As far as Russian business environment has been fast-changing during the recent years, the results of the research are recommended for consideration in short term. Chapter 4 ("Russian investment environment general overview") provides the forecasts for the nearest 1 - 2 years, while Chapter 5 ("Hydroline case research") describes only the current situation in machinery building industry observed in year 2013. As it has already been mentioned above, the stress in the research is put onto the industrial sector of trade and business-to-business form of relations: that means the assumptions presented in Chapter 5 can hardly be related to consumer business with its completely different accentuations. Despite that, Chapter 3 ("FDI as a market entry mode") and Chapter 4 are quite general and provide the investment concepts applicable for various types of business.

Thesis contents

To sum everything up, this work consists of introduction, research methods explanation and three main chapters leading from general investment concepts to specific, case-related research. The work's theoretical overview presents the most significant FDI definitions and concepts such as FDI place among the other market entry modes, microeconomic and macroeconomic contexts of FDI, company investment motivations, company internationalization readiness and FDI main types. This information is important for better defining Hydroline motives, narrowing the direction and categorizing the intention of the company as FDI. The next chapter of the thesis opens the research part and presents a general overview of Russian investment environment consisting of economic facts, expert assessments and forecasts. This part also includes a primary data analysis done on the basis of semi-structured interviews with major Finnish companies operating on the market of Russia. The analysis reveals the environment's opportunities and threats drawn out from Finland's actual FDI experiences. Finally, the research comes to the Hydroline case investigation framed with the company's strategic targets, needs and interests.

Besides implementing the research tasks and answering the main question, this thesis attempts estimating the research from the point of view of its business value. The thesis is driven by the desire to provide a usable set of information which will participate in the company's strategic development planning. Thus, the thesis conclusions are partly made about the research meaning and the new perspectives opened by it for Hydroline. The attitude to the work as to a real business project strengthens the author's commitment and creates the sense of the work's urgency and actual importance.

2 RESEARCH METHODS

This work is implemented by means of a qualitative research method because its experience-based approach can better satisfy the comprehensive thesis goal. The essences of the thesis are the two in-depth interviews with Mikko Laakkonen, Hydroline Development Manager responsible for the company's international affairs. Besides that, Laakkonen was a Russian market research supervisor during the author's internship period.

In-depth interviews are usually done in the form of conversation; they are semi-structured meaning that they provide certain freedom of discussion and involve knowledge creation during the interview process (Hennink, Hutter & Bailey 2011). The use of such form in the current work enabled co-operative consideration of the research objectives and results: this allowed matching the interests of Hydroline with the author's own academic targets and tasks.

Attracting Hydroline as a client company partly corresponds with a "case study" type of qualitative data analysis. When conducting a case study, the researcher is focused on a particular company (or companies) and investigates the peculiarities of its (their) strategy, mission and vision, documentation, operations, routines and other company-specific details and situations (Bhattacharyya 2006, 72). In this work the client company's internationalization strategy (as a part of operations) is the research priority and frame. Nevertheless, case studies usually provide the analyses of internal organizational mechanisms (Bhattacharyya 2006, 72), while the current research is conducted as external data gathering for forming the idea about the company's target environment. Thus, the subject of the second interview is a Hydroline's novel/changed/unchanged viewpoint on Russia as an external investment environment appeared after getting familiar with the research results. Distinguished from the case study concept, this thesis is finally defined as "case research" – the work done in co-operation with a client firm with the purpose to implement the firm's tasks concerning certain external issues.

Along with Hydroline information, the research uses primary data of three e-mail interviews arranged with the representatives of three major Finnish companies which are the existing FDI holders in Russia. For the organization not ever running any activities in Russia, such experience might be a reliable source of information about the country's business as it is perceived by Finnish investors. The qualitative tool in this case is chosen to provide competent opinions against general facts, to present the

environment's benefits, constraints and challenges from the point of view of the market's direct actors. Although arranged in a written form for the reason of geographic distance, the interviews are semi-structured, and the questions leave enough space for the representatives to express their opinions on the key topics. The topics are listed as follows:

- form of physical presence on the market
- reasons for coming to Russia
- investments' regional location and the reasons for it
- benefits from the investment
- constraints faced in Russia
- specific assistance obtained from the federal and local authorities
- overall opinion about Russia as a business environment

The three Finnish companies whose responds are referred to in this work are prominent international firms operating in the industrial, retail and service sectors. As the respondents wished to be anonymous, the brand names are substituted for "C1", "C2" and "C3".

The type of analysis occupying a sufficient part of the work is secondary research. Secondary data includes information gathered and achieved by others (Stewart & Kamins 1993, 1). This data type constitutes the theoretical background of the thesis which is formed with the help of academic literature from Savonia university library and international electronic collections. Various secondary sources are also used for the environment's description - the desk study of Russia based on various international publications such as business rankings, editions of a prominent consulting company, Russian official documents, Russian statistics and the data of the world's major economic and development organizations.

The most important part of the work is a Hydroline case research. This analysis uses specific information for formulating trends which describe the four target issues: machinery industry, steel suppliers' market, production real estate costs and labor/personnel expenses in Russia. The data analyzed in this part is accessed in Russian language and found in internet-based catalogues of industrial enterprises and at several on-line estate and job portals. This is archived secondary information previously collected for the purpose other than operational environment analysis, and in the current thesis the author uses it for formulating own assumptions. Additionally,

several aspects are specified with the help of two industry experts in the spheres of HRM and production real estate.

The research method summary is presented in the scheme as shown in FIGURE 1. The scheme demonstrates the gradual flow of the research idea from general FDI concepts and overall market's descriptions to more specific, company-related investigations.

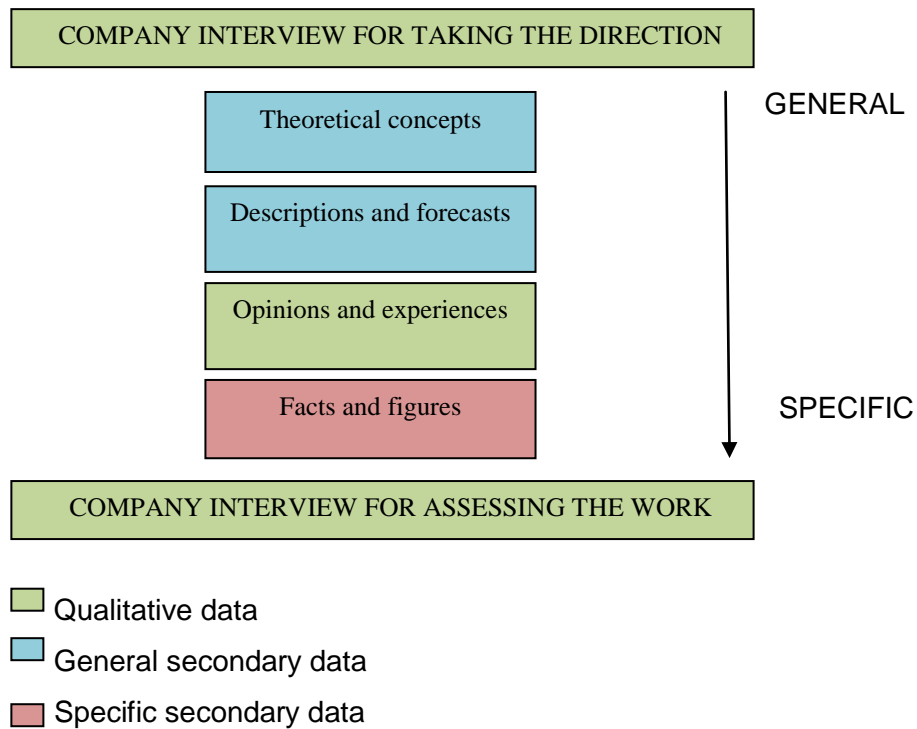


FIGURE 1. Research method model

3 FDI AS A MARKET ENTRY MODE

Nowadays international expansion is a common way for company's development and growth. If firms choose avoiding international markets, they have a risk to face competition both from their local rivals, who use internalization to boost performance, and from foreign newcomers (Bradley 2005, 19). Thus, competition nowadays is global, and whatever strategy a company decides, it should consider this fact.

Firms use wide opportunities of foreign markets for various purposes and by different modes. This chapter has a goal to define FDI as a market entry mode and distinguish it from the other penetration options. FDI is characterized abased on the works of theorists and publications of major global economic organizations. Besides that, the chapter overviews the most prominent FDI motivation concepts explaining the essential reasons for a company to come to a foreign market throughout the challenges. Finally, this chapter classifies FDI types for further defining the one which better suits the investment needs of Hydroline.

3.1 International market entry modes

To begin with, it is necessary to clarify what is understood by "market entry mode" and what types of entry modes are used by companies.

Market entry modes are the arrangements allowing companies to bring their products, technology and human capital to foreign markets (Hollensen 2007, 291). According to Frank Bradley (2005, 282), firms determine the proper entry mode when answering the two strategic questions:

- What is the maximum amount of resources to be put into the venture?
- What is the desirable level of control over the foreign operations to be achieved?

Svend Hollensen's scheme (FIGURE 2) presents three major categories of market entry modes grouped according to the intensity of control, risks associated with the mode and flexibility of the strategy.

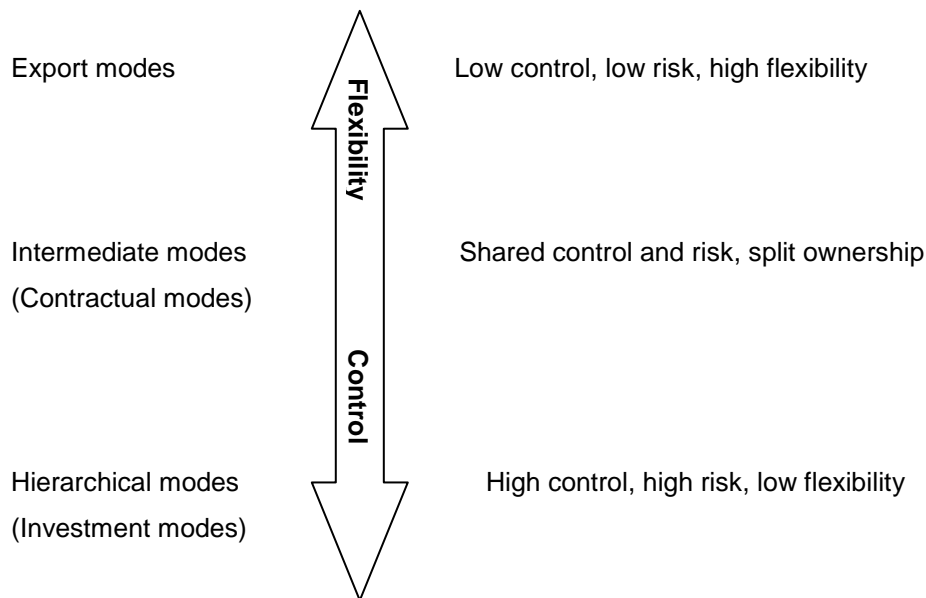


FIGURE 2. Classification of market entry modes. Adapted from Hollensen (2007, 292)

Exporting group includes indirect and direct modes. Indirect exporting means arranging international trade via domestically-based third parties at their administrative, transportation and selling expense. In direct exporting a company sells goods directly to the foreign buyer by hiring a sales agent who acts abroad for commission; another option is transmitting goods via foreign distributors who are entitled to handle goods under the company's brand name and according to the agreed conditions. Direct and indirect exporting modes are flexible, easy to withdraw and are characterized by comparatively low risks and costs. The drawback is that they provide very low degree of control and permit significantly less involvement into international marketing processes than the other modes. (Hollensen 2007, 310 – 329.)

Intermediate entry modes allow a company combining its competitive advantage with the resources of a foreign company via partnership. It makes the foreign market to be achieved at lower costs than in case of establishing physical presence without partner's assistance. This category includes various options such as contract manufacturing (outsourced manufacturing), licensing, franchising, joint ventures and strategic alliances. Along with obtaining shared resources and dividing risks, the investing company has limitations of ownership and control over the operations, as the controlling rights and the ownership partly belong to the partner. (Hollensen 2007, 310 – 329.)

The complete control over foreign operations is possible for a firm only when it implements investment entry modes. Involving physical presence on the investment

territory, these modes provide the highest level of commitment. The residence might be established by extending the existing company abroad under the domestic taxation scheme (branch) or by owning and operating a foreign entity under the foreign taxation scheme (subsidiary). In any case, investment modes are time- and money-demanding, which makes them long-run oriented and risky in terms of withdrawal. On the other hand, investments are done for achieving sufficient increase in production efficiency over the time and enable continuous use of the host country's opportunities. (Hollensen 2007, 356 – 372.) As investments are associated with a number of serious constraints, these modes' strategies should be planned very carefully, and the anticipated benefits should exceed the possible threats.

3.2 FDI definition in microeconomic and macroeconomic contexts

OECD Glossary of Statistical Terms explains "foreign direct investment" as the type of international investment for obtaining a lasting interest by a resident of one country in an enterprise established in another country (OECD 2013a). FDI concept includes the following key elements: direct investment enterprise, direct investor and direct investment relationship. An organization becomes a direct investor when it owns a certain stock of an enterprise residing in a foreign state. This establishment is called a direct investment enterprise (International Monetary Fund 2013). According to IMF definitions, the relations between the investor and the investment enterprise are expressed in the share of ownership, which varies depending on the type of the enterprise. The types include as follows:

- direct investment enterprise as a subsidiary (direct investor owns more than 50 percent of the enterprise's ordinary shares/voting power; the enterprise is incorporated)
- associate (direct investor owns between 10 and 50 percent of the enterprise's ordinary shares/voting power; the enterprise is incorporated)
- branch (direct investor wholly or jointly owns the enterprise which is unincorporated)

If the condition of having the defined percentage in shares is fulfilled, any company (as well as a group of companies, an individual, a group of individuals or a government organization) can become a direct investor. (International Monetary Fund 2013.)

In general, FDI is associated with investing for the purposes of establishing production abroad and gaining control over it (Morrison 2009, 49). FDI fundamentally differs from portfolio investment, another type of overseas investment holding which the investor owns shares in a foreign company without being directly involved in the management (Morrison 2009, 50). Deciding portfolio investment, the investor does not seek for the control over the foreign enterprise and is guided only by financial reasons (Dicken 2011, 20). On the contrary, FDI is a complex strategic step for market obtaining, efficiency increase, optimization of the process and overall business development.

Even though the quoted world economic organizations provide clear FDI explanations, this term might be viewed from different angles. According to Robert E. Lipsey of National Bureau of Economic Research, there are two approaches to FDI used by different branches of economy. The first approach is related to macro context and presents the view on FDI as on capital flow from home to a host country. The size of such flow is measured by Balance of Payments Statistics as one of the indicators of a country's economic development rate. The crucial issue there is the value of a country's investment stock. The second approach belongs to micro context: it examines the investment motivations and its consequences for the investor. (Lipsey, 2001.)

As far as this work is focused on the specific company and its FDI intentions, the case research part of the thesis is done in accordance with micro approach. At the same time, macro approach and global investment statistics are utilized for over viewing the investment environment of Russia.

To sum up, FDI is a way of gaining access to foreign markets, demanding a large amount of resources and a sufficient effort from the investing company's site. FDI as a foreign market entry mode is mainly related to the group of hierarchical (investment) options: it is characterized by high risks, high costs, low withdrawal flexibility, high level of control, long-term orientation and strong commitment. At the same time, FDI does not necessarily occur with the investor's full ownership, and this puts it close to intermediate market entry modes such as joint venture. However, it is often the foreign investor who holds more than 50% of joint venture's total ownership. This percentage provides the investor with high level of control, requires strong commitment and evokes risks and costs typical for hierarchical modes.

3.3 FDI motivation theories

3.3.1 Early FDI concepts

It is crucially important for the current research to reveal the benefit a company might be seeking for when deciding such a high-cost venture as FDI. Company's motivation is seen as the starting point for selecting the priorities to be investigated in the target country. For better understanding the drivers of FDI and its determining factors, this work includes the overview of the most prominent FDI motivation concepts worked out by international theorists.

Historically, theorists expressed their first interest in FDI motivations in 1960-s: at that time more and more companies started planning to move some manufacturing sites from domestic environments to foreign countries (Morrison 2009, 53). Stephen Hymer was one of the first experts to analyze the reasons for establishing enterprises abroad despite various risks and limited empirical knowledge about foreign areas. According to his theory, when establishing production in a foreign country a firm can exploit both "ownership advantage" – the one created by the firm's own specific resources (technology, managing skills and marketing skills) - and "location advantage" – the resources and favorable conditions of the country which is invested in (Morrison 2009, 52). Thus, the investing firm efficiently managing both advantages can successfully survive local competition and increase profits better than the one acting only domestically. Mohammad Yamin has criticized the theory for not providing any specific types of "location advantage" a company can gain abroad and for not taking into consideration the transaction costs eliminating the advantage. (Yamin 1991, 67.)

Another theorist to explain FDI reasons was Raymond Vernon in 1960. According to his Product Life Cycle Theory, domestic production is beneficial only when the product is new for the market and its manufacturing is recently-established. At the "maturing" stage of a product's life the firm needs to meet the growing demand both domestically and on the foreign markets. For these purposes the firm expands its capacity and gets closer to the buyers by establishing production in the countries of export. At the further life cycle stages all the occupied markets become price-sensitive and the competition gets severe; therefore, the new investment is done to those foreign destinations which provide the lowest costs. (Aswathappa 2010, 92.)

Today this theory remains one of the most frequently quoted. However, the nature of products has changed since 1960, and their life cycle stages are much shorter now. As

the result, firms often try to serve different markets simultaneously and at products' early phases; it might be necessary for getting bigger returns and not losing the short-lasting technological advantage. (Morrison 2009, 53.)

3.3.2 Dunning's motivation theory

John H. Dunning has drawn out four major motivations for a company to start FDI: market seeking, resource seeking, efficiency seeking and strategic asset seeking (Dunning and Lundan 2008, 68 - 74).

According to Dunning's descriptions, *resource seeking* motivation appears when a firm cannot get the access to the necessary resources (materials or labor) in the domestic environment. They are unavailable for the reason of high price, lack or absence. *Market seeking* motivation can be related to a firm's need for suppliers and customers operating abroad, for delivery costs optimization, for making a competitive advantage by being physically present on the market or for better matching with the foreign customers' needs and taste. When *seeking for efficiency*, a firm intentionally chooses the economy which is different from the domestic one. Thus, the firm makes the advantage combining both domestic-market and foreign-market beneficial factors; the efficiency can be gained by proper cost management in both of the areas, exploiting differences in supply capabilities or establishing economies of scale. *Strategic asset seeking* means that a firm acquires strategically important assets from a foreign establishment. FDI of such kind provides the access to crucial know-hows of the foreign environment, new technological basis or research and development opportunities. (Dunning and Lundan 2008, 68 – 74.)

In his explanation of FDI drivers, Dunning used "eclectic paradigm" – the combination of diverse factors leading to success. The eclectic paradigm, or OLI, includes three variables, each presenting a set of specific advantages. Assessing them against risks and costs, a company can formulate a proper FDI decision. (Dunning 1988, 18 – 27.)

The first element of the paradigm is the set of ownership-specific advantages presented by the company's own tangible and intangible assets (technology, product or organizational structure) which make it competitive. When a firm has these exclusive assets (so called "O" advantages), it might wish to get better benefit when expanding them to the rest of the world. Thus, being strengthened by "O" advantages, the firm considers "I" advantages, which are the advantages of FDI as an entry mode. For

instance, physical presence at a new market might provide new value chains, the extension of the existing value chains, optimized supply channels or better control over the foreign distribution outlets and intellectual property. The third set of advantages – the “L” group – includes location-specific advantages, which indicate what benefits the new geographic location possesses in comparison to the domestic area. The benefits might include low-cost labor, raw materials, infrastructure and other factors favorable to a specific industry. (Dunning 1988, 18 – 27.) The paradigm is summarized and presented as a scheme in FIGURE 3.

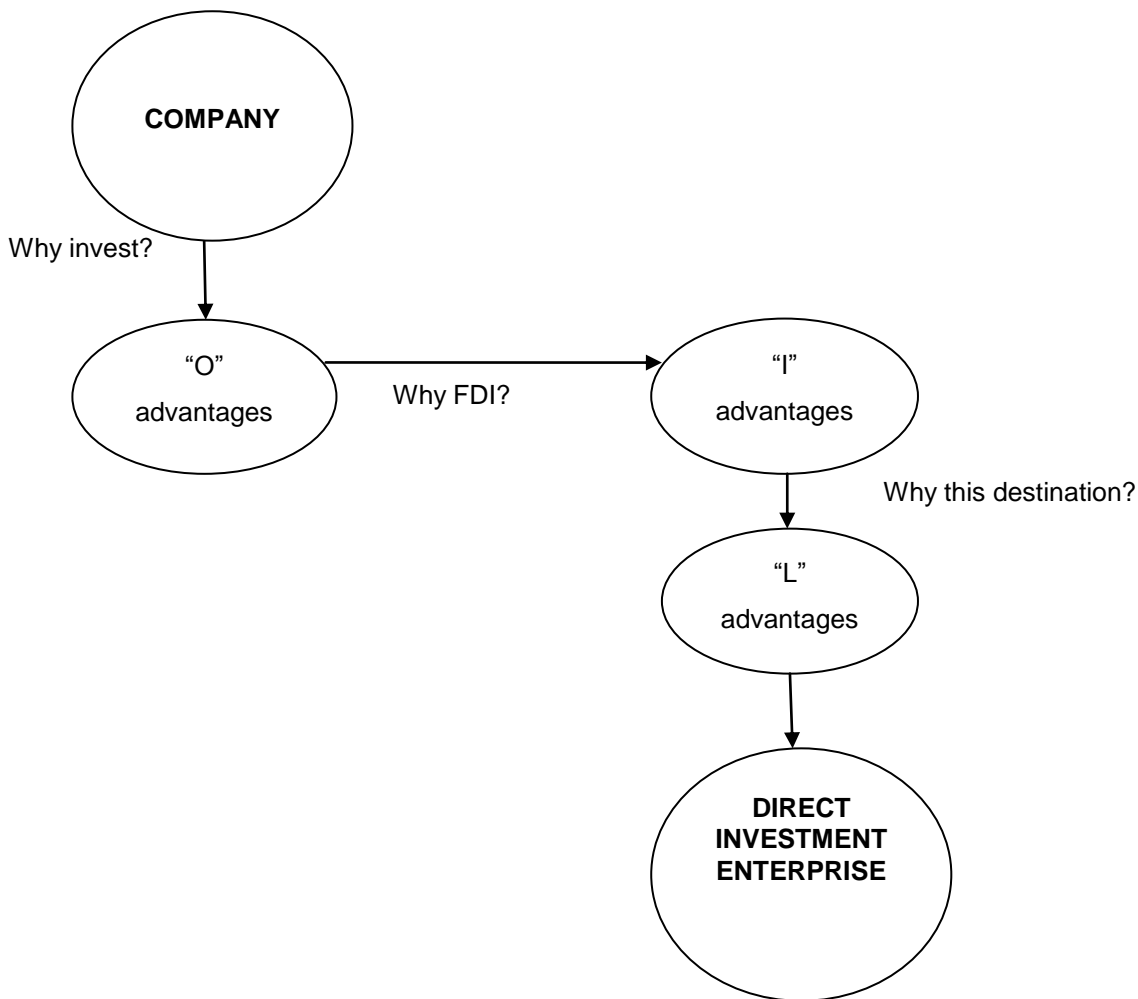


FIGURE 3. Dunning's eclectic paradigm. Adapted from Dunning (1988, 18 - 27)

The eclectic paradigm concept can serve as a framework for company's early strategic planning. Filled with company-related advantages, it can assist weighing them, comparing them with each other, contrasting with the possible costs and risks, and, finally, making conclusions about the investment motivation.

3.4 Uppsala model of FDI readiness

Each company has own approach to the assessment of its readiness for internationalization. Meanwhile, one of the popular theories regarding this issue belongs to Scandinavian experts and is called “Uppsala model”, by the name of the University it was developed in. When investigating the experiences of several Swedish companies in 1970-s, Jan Johanson and Jan-Erik Vahlne drew out a common-spread scheme according to which firms tended to internationalize gradually, from less demanding activities to more demanding ones.

According to the model, firms first distantly collect the knowledge about the target foreign market. If the knowledge is obtained, they more willingly invest into foreign production and express greater commitment in the foreign area. The more successful the foreign activities are, the stronger the commitment becomes, and the more assets are put abroad. Thus, companies usually start with exporting operations arranged by a sales agent; after that they establish a sales subsidiary and, eventually, proceed growing with setting up production facilities in the host country. (Johanson and Vahlne 1977).

The process of internationalization is viewed there as accumulating of knowledge and successive deepening into the foreign market. The knowledge is explained as awareness about the environment’s threats and opportunities, market understanding, performance obtained from local activities, potential demand and supply understanding, competition awareness, distribution channels availability and money transactions experience. (Johanson and Vahlne 1977).

The second observation of the researches concerned gradual approach to the choice of a geographical location. According to Uppsala experts, firms first choose the environments of the least physical distance, and move to farther locations only after receiving enough experience. The distance might be associated with language barriers, education differences, culture, industrial development level and peculiarities of business organization. (Johanson and Vahlne 1977.)

All in all, Uppsala model connects company’s success on the international arena with ‘step-by-step” approach to the process of internationalization. The special stress is put onto the importance of market knowledge and market experience before investing into such demanding activity as production. Nevertheless, contemporary global business

environment might demand quick market development actions and might live no place for a long-term process of obtaining comprehensive knowledge.

3.5 Greenfields, mergers and acquisitions as FDI types

Even narrowed to production establishment, FDI means different degree of effort and control, depending on the project type a company chooses. Foreign production might be set up by a greenfield investment, merger or acquisition.

Merger occurs when a company creates a new entity on the foreign territory by combining its assets and operations with the assets and operations of a company residing locally. Acquisition means that a foreign company acquires the existing foreign assets and operations gaining total control over them. (Calderón, Loayza & Servén 2004, 6.) According to David Ahlstrom and Garry D. Bruton (2010, 177), mergers and acquisitions as FDI types have the following common characteristics:

Disadvantages

- effort to make changes in the existing organizational culture, policies and other aspects of the venue functioning
- probable inflexibility of the existing employees in relations with the new owner
- probable overall organizational inflexibility to changes

Advantages

- fast enter with ready-made assets and operations
- pre-established relations with external stakeholders
- partners' (shareholder's) assistance

Greenfield investment means that a company builds a new venue in the foreign country, wholly owned and controlled by this company's subsidiary (Ahlstrom & Bruton 2010, 178). According to Ahlstrom and Bruton (2010), greenfield investment is mainly associated with the following characteristics:

Disadvantages

- very long construction period
- very high costs
- dealing with unfamiliar environment without partner's assistance

Advantages

- opportunity to use advanced technologies in deteriorating areas
- opportunity to create own corporate culture and organizational structure in inflexible environments
- total control over the operations

Constructed from the ground up, a greenfield project is highly resource-consuming. At the same time the investor structures and develops the venture according to own wishes and without inheriting any existing schemes or routines.

3.6 Theoretical background summary

According to the overviewed theoretical concepts, ideas and assumptions, FDI is a challenging process of establishing physical presence in the foreign area. Such investment is usually done at high cost, and this is the biggest challenge associated with this market entry mode; besides, it demands scrupulous preparation effort and brings return in long term. The other complicating factor is a foreign environment's difference from the domestic business rules, economic trends and other routines. Even having conducted a detailed preliminary research, the investor is exposed to various risks and unpredictable constraints untypical for the domestic market.

Despite all the challenges, FDI is usually driven by strong motivations which consider retaining production in a single location a strategic loss. The reasons for expanding production abroad include unavailability of resources domestically, home market limitations and saturation and various opportunities for efficient costs, resources and assets cross-border management.

As about a company's readiness for FDI, it is traditionally strengthened with gradual internationalization degree increase from exports to physical presence in the foreign location. On the other hand, this approach might be ineffective in the contemporary business world, which demands fast moves especially in the field of technology and innovation. FDI nowadays might be done without preliminary, less demanding market entries: in this case the company's motivations should be strong enough to gain benefit from the environment which is completely unfamiliar.

4 RUSSIAN INVESTMENT ENVIRONMENT GENERAL OVERVIEW

Being a strategic step, FDI demands comprehensive knowledge about the host country as a business environment for turning this knowledge into a benefit. While healthy and strong economic environment eliminates risks, recession trends might leave some space for novel, unconventional decisions; in both cases a company needs to be well-informed about the country's economic, legal, environmental and other peculiarities.

This chapter gives the overview of Russia's economic environment to be applied by Hydroline Oy at the very beginning of their new international strategy planning. The chapter's goal is to give a general idea about the economic state of the country by observing key macroeconomic indicators and elements. Together with this, the overview provides country's development forecasts and observes the main investment opportunities and threats figured out by major global organizations such as Ernst & Young, the Organisation for Economic Co-operation and Development (OECD), the World Bank, the United Nations Organization (UN) and Bloomberg.

Along with the desk investigation of various secondary sources, this chapter observes the experiences of Finnish companies which are presented on the market. The information is obtained by means of interviewing and belongs to the category of primary source data. Essentially, it provides a Finnish view on the environment's investment state, conditions and profitability. The opinions of experienced companies are included to make the research closer to life and support the assumptions collected from the listed secondary materials.

All in all, Russian investment environment general overview has the aim to help the client company deciding whether this location is attractive from their specific perspective, and what of the trends might be viewed as opportunities and threats. The actual conclusions assess the environment's general hostility or favorability by summarizing competent opinions, existing research data and statistics.

4.1 Russia in macroeconomic context

The Russian Federation – as the country is named officially – belongs to the group of upper middle income economies preceding the advanced group of high incomes (The World Bank 2013). The economy is viewed as fast-growing and is associated with so

called “BRICS” countries (Brazil, Russia, India, China and South Africa) characterized by rapid development and world’s biggest markets (Morrison 2011, 8-9; University of Toronto 2012). In UN classifications Russia is also market as “transition” economy separate from “developed” and “developing “groups. Transition block includes the countries which are shifting form planned economic system of former USSR to the principles of free market (Morrison 2011, 46). In 2012 Russia joined World Trade Organization (2012) and is currently handling the application process for becoming a member of OECD (2013b).

In 2008 – 2009 Russia experienced harsh recession, the recovery from which has started since year 2010 and has been marked by positive GDP growth, FDI increase and improvements in labor market (Ernst & Young 2011a, 3). TABLE 1 shows the key Russian macroeconomic indicators with their development trends before and after the crisis.

TABLE 1. Russian macroeconomic indicators (Ernst & Young 2011a)

Indicator	2007	2008	2009	2010	2011
Population, million	142.1	141.8	141.6	141.5	141.3
Nominal GDP, US\$ billion	1287.5	1650.8	1231.6	1483.4	1664.2
Real GDP, change in %	8.3	5.4	-7.9	3.9	4.3
GDP per capita, US\$	9063.2	11638.7	8969.3	10485.0	11781.8
Foreign direct investment, US\$ billion	55.1	73.7	36.2	38.1	40.3
Industrial output, US\$ billion	807.1	994.2	708.5	911.3	999.3
Industrial output, change in %	6.0	2.4	-9.6	6.8	5.0
Unemployment rate, %	6.2	7.1	8.4	7.1	6.7
Average monthly wages, US\$	530.7	695.8	578.5	677.4	750.5
Consumer price index, %	11.9	13.3	8.8	8.7	6.5

Turning to the current situation, experts point both at major strengths and weaknesses of the environment. Russia’s GDP growth in 2012 dropped from 4.3% to 3.4%. In spite of it, OECD predicts this indicator to be continuously increasing with 3.8% in 2013 and 4.1% in 2014 (OECD 2013c). Among Russian economy’s strengths OECD mentions its negative net public debt in the period when most of the developed countries are struggling post-crisis debt problems. The other favorable trend is slow but gradual moving to low-inflation environment with annual inflation rates being declining over the

past 12 years. At the same time, OECD reports that the country is still unable to reach the pre-crisis activity levels, and the economy remains under the recovery process. (OECD 2011, 1.)

The World Bank reports on Russia's further economy growth sound more critical. According to The World Bank (2013) analysis, Russia is currently developing faster than Brazil, South Korea and Turkey. Thus, along the achievements of 2012 there was major surplus in trade balance, small public debt of only 10% from GDP (in comparison to more than 110% in the advanced economies), growth of wages and unemployment decrease. However, the World Bank predicts Russia losing its positions in future because of major weaknesses such as decreasing industrial output and GDP dropping down. The World Bank forecasts further lowering of GDP to 3.3% in 2013 and growing to not more than 3.6% in 2014. Besides, there is an uncertainty concerning the current inflation rate: increased in the second part of 2012, it remained high at the beginning of 2013. (The World Bank 2013.)

According to the World Bank analysts, the main problem of the economy is that it grows based on consumption instead of investment which is comparatively small. Among the advice given in the analysis conclusions is improving the investment climate in the country, and this leaves a chance for some favorable investment reforms in future. (The World Bank 2013.)

As about inward investment situation, Russia was a host area for a sufficient amount of investment in year 2012. Despite this fact, the country's FDI inflow growth rate was negative and equaled -16.6% (United Nations Conference on Trade and Development 2013). The comparison to the other BRICS countries presented in TABLE 2 shows that Russian FDI inflows occupy the middle position letting forward China and Brazil. The position is unstable due to Russia's overall very low growth rate indicator.

TABLE 2. FDI Inflows in BRICS countries in 2012. Adapted from Global Investment Trend Monitor (United Nations Conference on Trade and Development 2013)

Country	FDI inflows, billions of US\$	Growth rate, %
China	119.7	-3.4
Brazil	65.3	-2.0
Russia	44.1	-16.6
India	27.3	-13.5
South Africa	6.4	10.3

According to the European Commission data, European Union accounts for 75% of the Russian investment stocks, which makes it Russia's biggest investor in the world (European Commission 2012). In 2011 European investments constituted approximately 78% of the world's FDI to Russia. The largest European investors were Cyprus, Netherlands, Luxembourg and Ireland; FDI from Finland accounted for 0.4% of all the European investments (The Central Bank of the Russian Federation 2013).

4.2 Russia as investment environment

4.2.1 OECD and Ernst & Young analyses

On the international arena Russia's capabilities as FDI environment are estimated ambiguously. OECD views Russian business environment mainly as problematic and names poor investment climate as the main reason for which Russia remains unable to reach the standards of OECD advanced economies (OECD 2011, 1-5). Corruption, government's strong influence on the economy, weak law and restrictive foreign trade regime determine such negative implications as low competition, slow innovation development, dependence on natural resources, low investment and slow movement to advanced living standards. (OECD 2011, 1-5.)

Corruption is viewed as probably the heaviest risk for investors to face in the area. As it follows from Corruption Perceptions Index of 2012, Russia scores only 28 of 100 points in the chart and skips forward all the other OECD countries, BRIC countries and the majority of developing states (Transparency International 2012).

The key strength and asset of Russia as business environment is well-educated workforce. Despite of a very low state's expenditure on education - less than OECD average - the number of people with higher education continues to increase. The population with at least upper secondary education constitutes 88% of the country, and 54% of the people have tertiary qualifications. (OECD Country Note 2012.)

Ernst & Young present quite optimistic view on Russia as an investment destination. Their attractiveness survey of 2012 showed that 19% of international investors named Russia among the most desirable regions to go (Ernst & Young 2012, 4-5). The most attractive field for FDI in 2012 was manufacturing, which received 400 projects and brought Russia to the fourth place in Europe in this sector. Approximately 80% of the foreign investors already running business in the country have plans for expanding or maintaining the operations in 2013. (Ernst & Young 2012, 4-5.)

Investors come to Russia for various reasons and are attracted by different factors. FIGURE 4 presents the summary of foreign investors' opinions on the key features of Russia as an investment environment. As it follows from the diagram, the main features making the country beneficial from FDI point of view are natural resources, market potential and skilled low-cost labor force.

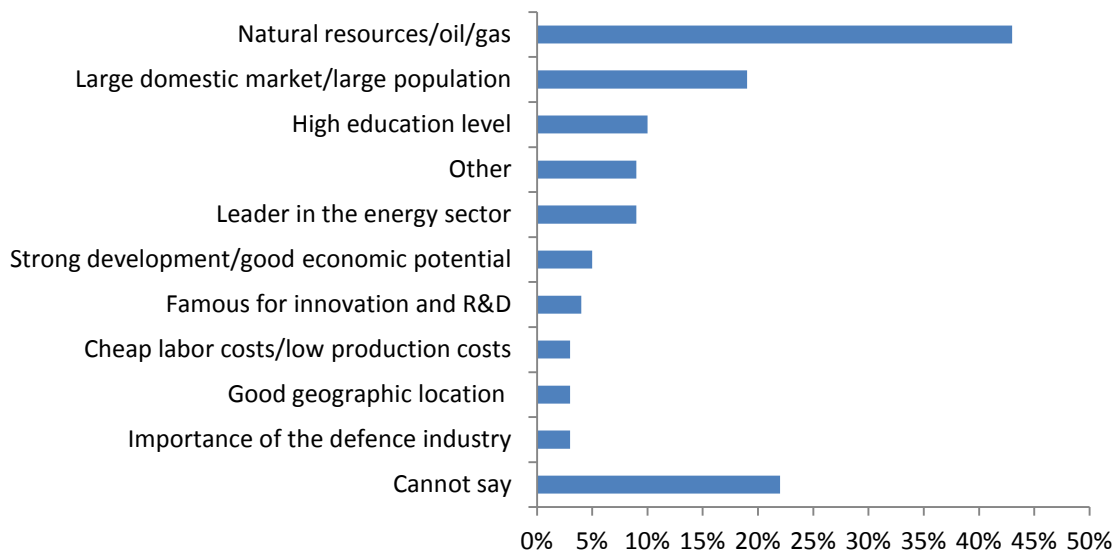


FIGURE 4. Russia's world-class features. Adapted from Russia Attractiveness Survey (Ernst & Young 2012)

Among the biggest concerns expressed by the responding investors regarding Russian investment climate are risky political, legislative and administrative environments, poor

infrastructure and low support of sustainable development. The biggest strengths include the size of the market, telecommunications accessibility/quality and labor education, costs and skills (FIGURE 5).

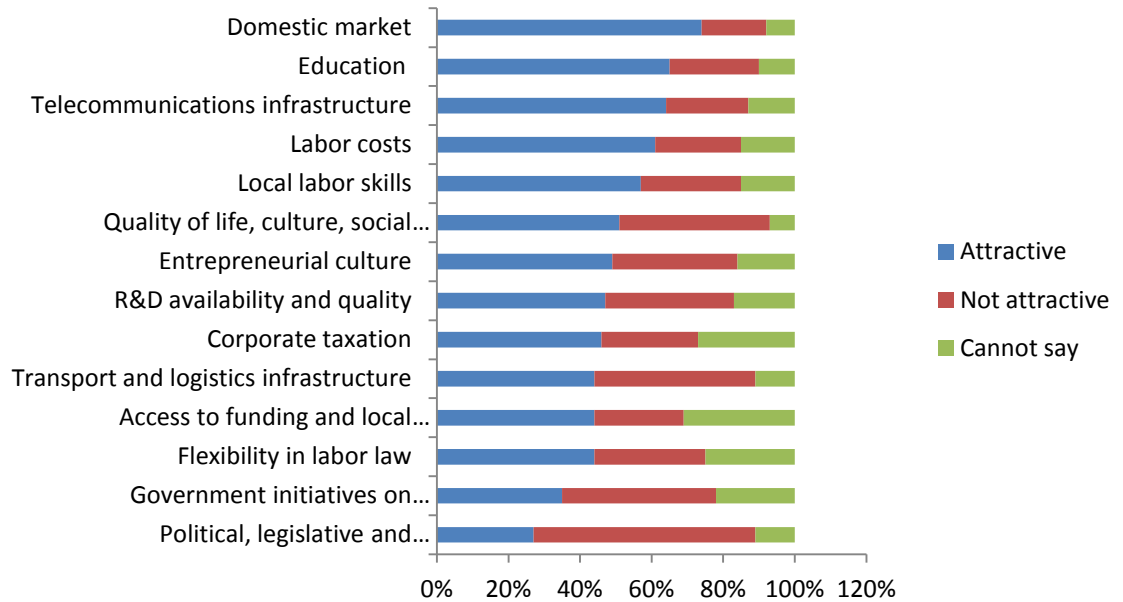


FIGURE 5. The most and the least attractive features of Russian economy. Adapted from Russia Attractiveness Survey (Ernst & Young 2012)

To sum up the analysis of Ernst & Young, the country's major strengths and weaknesses are collected in TABLE 3. As it can be seen from the table, Russian huge population contributes its endless market potential. The country's labor force is positively characterized both by size and competence, at the same time being relatively cheap. Along with this, the country is well-developed in the field of internet and telephone communications. On the other hand, Russia is not safe in terms of legal risks, and its administrative procedures are complicated and vague. Additionally, the country's infrastructure does not meet international standards especially in rural areas. The other problem is poor innovation support and, as a result, low R&D activity on the corporate level.

TABLE 3. Russia's investment environment characteristics. Based on Russia Attractiveness Survey (Ernst & Young 2012)

	Market opportunities	Education	Labor costs/skills	Telecommunications
Strengths	<ul style="list-style-type: none"> - 9th biggest population in the world - biggest population in Europe 	<ul style="list-style-type: none"> - approximately 100% of literacy rate - one of the world's highest proportion of science and engineering graduates 	<ul style="list-style-type: none"> - world's 8th largest labor force - average monthly wage of US\$ 806.40 (2011) 	<ul style="list-style-type: none"> - world's 4th largest number of land operational lines and mobile phones - largest internet user in Europe (2011)
	Political, legislative and administrative environment	Infrastructure	Innovation and culture of entrepreneurship	
Weaknesses	<ul style="list-style-type: none"> - costly and complicated processes of getting electricity, getting construction permits and cross-border trading - vague property rights - corruption 	<ul style="list-style-type: none"> - more than 60% of highways do not meet international standards - generally poor quality of roads - appropriate transportation only in urban areas - low ranking in Logistics Performance Index 	<ul style="list-style-type: none"> - low R&D activities in corporations - weak conditions for innovations - lack of tax incentives for business set up - lack of access to funding 	

4.2.2 Russia's place in business environment rankings

In Bloomberg's ranking of Best Countries for Business (Bloomberg Television 2012) Russia occupies the 48th position among 160 states being ahead of India and Brazil. The ranking takes into account the following indicators:

- degree of economic integration (WTO membership, state tariffs, global market correlation, market concentration, global market research access and environment's risk)
- cost of setting up a business
- labor and materials cost
- cost of moving goods (logistics, transportation and infrastructure)
- "less tangible costs" (corruption, property rights, inflation, taxes and accounting adaptability)
- consumer readiness (middle class, consumption, import tariffs and GDP per capita)

All the indicators are transferred into percentage rates from 0 to 100 (from less favorable to more favorable). TABLE 4 demonstrates the listed indicators' rates for Russia, other BRICS countries and Poland (*included into the comparison list as the host area for Hydroline's existing investment).

TABLE 4. BRICS and Poland at Best Counties for Business ranking. Adapted from Bloomberg Rankings (Bloomberg Television 2012)

Country	Ranking place	Economic integration	Cost of business setting up	Labor and materials cost	Cost of moving goods	Less tangible costs	Consumer readiness
China	19	71.0%	22.9%	44.3%	48.7%	34.7%	33.8%
*Poland	22	77.5%	20.7%	45.9%	36.3%	37.0%	38.8%
South Africa	25	73.2%	28.7%	50.6%	31.4%	36.7%	23.4%
Russia	48	66.6%	22.8%	55.9%	30.5%	21.6%	33.1%
India	49	78.9%	20.6%	49.8%	37.5%	16.4%	31.3%
Brazil	50	81.2%	17.4%	41.4%	34.5%	31.4%	24.6%

As it can be seen from the table, Russia enjoys its best scores for "labor and material costs" indicator, meaning the environment is the efficient area from production costs

perspective. The country shows weakness in logistics and infrastructure organization together with “less tangible costs” (corruption, property rights, etc).

World Bank Doing Business ranking of the International Finance Corporation puts Russia to the 112th position out of 185. This index measures the conduciveness of a country’s regulatory environment to business setting up and operating (Doing Business 2012). TABLE 5 demonstrates Russia’s positions for various indicators in comparison to the other BRICS countries and Poland. The higher the position is, the better assessment the indicator has gained.

The table shows Russia occupying upper middle position in the world’s business. The country is ahead of the two of the BRICS states - India and Brazil. Russia has obtained high results for “registering property” indicator, meaning that the procedures associated with property are easier in Russia than in many other countries of the world. High scores are gained for taxpaying, enforcing contracts and resolving insolvency.

According to the ranking, Russia’s weaknesses are seen in the complicated process of obtaining construction permits, problems with getting electricity (poor infrastructure) and trading across borders (unfavorable regulations and tariffs). It is necessary to mention that Russia occupies only 117th place regarding the “protecting investors” parameter: it is lower than for all the other observed countries.

TABLE 5. Doing business ranking of Russia, BRICS countries and Poland. Adapted from Economy Rankings (Doing Business 2012)

Country	Ease of doing business	Starting business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing Contracts	Dealing insolvency
South Africa	39	53	39	150	79	1	10	32	115	82	84
Poland	55	124	161	137	62	4	49	114	50	56	37
China	91	151	181	114	44	70	100	122	68	19	82
Russia	112	101	178	184	46	104	117	64	162	11	53
Brazil	130	121	131	60	109	104	82	156	123	116	143
India	132	173	182	105	94	23	49	152	127	184	116

In spite of several problematic parameters, Russia experiences growth in comparison to the year 2011 and has improved its ranking place by 8 positions. According to A.R. Belousov the Minister of Economic Development, Russia's goal for 2013 is obtaining the place among the world's top 100 states in the rating. (Ministry of Economic Development of the Russian Federation 2012.)

4.2.3 Russian business environment regional differences

Currently Russia is divided into 83 administrative regions which present rather heterogeneous business environment. Ernst & Young's Measuring of Business Environment in Russian Regions (Ernst & Young 2011b) analyzes the variety of conditions for doing business in 10 regions with high business activity. These regions and areas are Voronezh Region, Irkutsk Region, Kaluga Region, the City of Moscow, Perm Region, Rostov Region, the City of Saint Petersburg, Tomsk Region, Tver Region and the Republic of Tatarstan. FIGURE 6 demonstrates geographical location of the mentioned regions.



FIGURE 6. The map of Russian regions covered by Ernst & Young research

Ernst&Young analysis is based on interviewing companies' representatives about several obstacles for doing business in each region. The factors likely to impose obstacles include: infrastructure (electricity supply), trade (customs rules and import/export regulations), business inspections, compulsory certification procedures, licensing and permits, tax rates, work of tax services, crime and theft, unfair competition from the shadow economy, court system, access to finance, labor regulations and workforce education. (Ernst & Young 2011b.) The companies' average opinion on the severity of the factors in each region is presented in TABLE 6.

To sum the analysis up, Tver Region and the Republic of Tatarstan (highlighted in the table) are the areas with the least severe obstacles for doing business in comparison to the other locations. The City of Moscow and Rostov Region (highlighted in the table) are the environments with a big number of severe obstacles and constrains. All in all, high level of tax rates is considered to be the major problem for all the regions, while favorability of labor regulations is their common strength.

TABLE 6. Average obstacle assessment for 10 Russian Regions . Adapted from Ernst & Young (2011 b)

	Infras tructu re	Trade	Inspe ctions	Certific ation	Licen sing	Tax rates	Tax services	Corrupt ion	Crime	Shadow economy	Courts	Finance	Labor regula tions	Work force educa tion
Voronezh	-/+	-/+	-/+	-/+	-/+	-/+	-/+	+	-/+	-/+	-/+	-/+	-	+
Irkutsk	+	-	-/+	-/+	-/+	+	-/+	-/+	-/+	-/+	-/+	-/+	-	-/+
Kaluga	+	-	-/+	-	-/+	+	-/+	-/+	-/+	-/+	-/+	-/+	-	-/+
Moscow	+	-/+	+	-/+	-/+	+	+	+	+	+	-/+	+	-	+
Perm	-/+	-	-/+	-/+	+	+	-/+	+	+	-/+	-/+	+	-	-/+
Rostov	+	+	+	-/+	+	+	+	+	+	+	-/+	+	-/+	+
St. Petersburg	-/+	-/+	-/+	+	-/+	+	-/+	+	-/+	+	-/+	+	-/+	-/+
Tomsk	-/+	-/+	-/+	-/+	-/+	+	-/+	+	-/+	-/+	-/+	+	-/+	-/+
Tver	+	-	-/+	-	-	-/+	-/+	-/+	-/+	-	-	-/+	-	+
Tatarstan	-	-	-	-	-	-/+	-	-	-	-/+	-	-	-	-

34

- No obstacle or minor obstacle
- /+ Moderate obstacle
- +

4.3 Finnish investment experiences in Russia

Close neighborhood of Russia and Finland naturally stimulates the two countries' investment relations. According to Finnish-Russian Chamber of Commerce, the biggest Finnish investors on the market of Russia represent the fields of energy, engines manufacturing, logistics, chain stores, building, construction solutions and materials, woodworking, gas stations, tires manufacturing, banking, pharmacy, coffee production, package production, paper production and food products (Suomalais-Venäläinen Kauppakamari 2013).

Currently many of the investors continue enhancing their Russian enterprises by developing projects in various Russian regions. Thus, Paroc Group, which is the producer of efficient construction materials and solutions, is launching production in Tver Region in autumn 2013 after purchasing and reorganizing an old plant in the location. The investment is worth 180 000 000 EUR. Another company, Wärtsilä, is building a diesel engines production enterprise in Penza, the central city of Penza Region. This is a partnership enterprise organized together with Russian Transmashholding giant specializing in transport machinery. The investment is worth 54 000 000 EUR. YIT has also started a new development project on the recently bought 3 hectare land plot consigned for the building of 18 apartment houses. All in all, Chamber of Commerce announces 8 major projects of Finnish companies in Russia for the coming years, which shows that Finnish-Russian investment relations are evolving. (Suomalais-Venäläinen Kauppakamari 2013.)

To understand what makes Finnish companies come to Russia, what might disturb their operations here and what finally retains them in the location, this thesis observes the actual experience of Finnish investors on the market. The current chapter analyzes the results of interviewing the representatives of three major companies: C1, C2 and C3. Being originally from Finland, these establishments have expanded to the Russian market, and now they are truly experienced in long-term investment relations with this country.

The first company to be observed (C1) runs several plants in Leningrad Region, where industrial products are manufactured for further delivering within the chosen area. The prime reason for the company to come to the territory of Russia is market-seeking: the market of Leningrad Region exceeds the whole domestic market with its rather limited possibilities for expansion. Besides that, Leningrad Region lies close to Finland, which is the company's evident convenience. As about the competitive edge to be brought to the

new territory, C1 has put the stress on Finnish quality: this is the strong association with Finnish companies easily distinguished by a local buyer.

Currently the demand for C1's kind of products in Leningrad Region remains high, and the market potential is assessed as large even in longer term perspective. Establishing production in Russia has brought sufficient increase in sales and allowed negotiating higher annual volumes of the product's supplies. Among the constraints faced in Russia, the representative of C1 names construction permit obtaining, permanent electricity supply receiving and fragile legal environment including the collection of receivables and land ownership issues.

In the opinion of C1 representative, an investor considering Russia as an FDI location should be prepared to face problems, meet specific local market's requirements, struggle tough competition and carry costs. According to the company, Russia suits the investors wishing to increase turnovers, while profit margins are likely to be low because of the competitiveness.

C2, an establishment running sales outlets, operates in Leningrad Region as well. Among the reasons for coming to Russia the company representative names more purchase volumes at better conditions because of the increased quantity. As C1, C2 mentions limited possibilities for growth in Finland – the factor that makes stretching to Russia a logical step of further development. Besides that, international activities are viewed by C2 as the possibility for testing marketing models in different environments – the experience which finally provides the necessary knowledge to implement domestically.

The company representative explains the choice of St. Petersburg by proper logistics, which is a crucial factor for retail business. The strong image of Finnish companies in the area is also mentioned as the competitive advantage. The main constraint is the difficulty of finding and retaining suitable personnel for the key positions. In general, C2 representative speaks about lack of employees in the city that has very low unemployment rate.

According to C2, Russia might be a place for FDI if the investor has carefully done the preliminary research: Russia demands adapting the strategy to its local needs and requires knowledge of its specific rules of doing business.

C3 operates in Russia in the field of marketing, sales, services and engineering solutions. Russian market is considered by the company as big and potential even in the

long term, and this has determined the investment decision. Among the various locations of the company's presence there are St. Petersburg, Murmansk and Sakhalin Island.

The representative of C3 recommended Russia as FDI destination, though figured out several problems an investor might be exposed to. Firstly, it is not easy to find managers and specialists with fluent English skills. Nevertheless, this situation is currently improving. Secondly, a recently coming investor might struggle difficulties with legislation and customs practices, as C3 did when starting the activity in Russia.

4.4 Russian investment environment summary

The assessments of Russian capabilities as the investment environment vary in the analyses of different economic and development organizations. At the same time, it can be noticed that the economic situation in the country is considerably stable, with gradual economic growth and no major crisis predicted for the nearest few years.

Corruption is seen as one of the biggest constrains for doing business in the country, and it spreads to all the regions. The other problems include government's strong influence on business, infrastructure poor quality and accessibility, complicated administrative permits and inspections and restrictive customs regulations (the last issue will be hopefully solved with Russia's joining WTO in 2012). Besides all mentioned, Russia provides low levels of investors' protection and financial support, which is a negative sign in the context of FDI planning.

However, Russia annually attracts a sufficient amount of FDI are coming due to several strong investment capabilities of the country. The prime Russian strengths are huge market size, continuing economic development, low material costs, major amount of educated workforce, favorable labor regulations and good balance of labor costs and skills. The areas of Russia with the most favorable investment conditions are Tver Region and the Republic of Tatarstan, while Moscow and Rostov Region are considered to be severe environments with a big number of constrains for doing business.

Generally speaking, the responds of the three interviewed Finnish investors do not contradict the findings of the secondary research. Russia is valued by the investors for the size and long-term potential of its huge market promising turnover increase. St. Petersburg is named as a target FDI destination by all the three companies, and this choice is explained by the proximity to Finland, proper logistics and strong local image of

Finnish companies and goods. Among the environment's threats all the companies name legislation risks. The other mentioned constraints include recruiting difficulties and severe competition. Competition of such degree might threaten profit margins even if the turnovers are several times higher than domestically.

It is indicative that none of the companies have obtained any special assistance or funding from the local authorities – this might correspond with OECD and Ernst & Young research results showing weak governmental funding and support of innovation and investment in the country. Nevertheless, it might also be explained by the fact that the respondent companies are of big size, and they might have no need in this support.

In spite of a number of risks, Russia is advised as the investment host country by all the three respondents. FDI to Russia is viewed as the opportunity for a Finnish company to grow and develop further when the Finnish market becomes saturated. It is recommended, though, to conduct careful preliminary work including a detailed market research and environment analysis because the Russian market demands localization of goods and adaptation to the specific conditions.

5 HYDROLINE CASE RESEARCH

This chapter presents the results of the case research done for Hydroline Oy in order to assist company's decision about entering the market of Russia. The considered entry mode is FDI with setting up a production subsidiary on the target territory. As it has been mentioned above, this mode is the most demanding one because it involves high risks and excessive costs. To cover the risks and costs, such venture should bring a sufficient return on investment. As it follows from the interview with the client company representative, Hydroline sees the long-term investment advantage in the optimization of labor and raw material costs together with the increased number of major potential customers (Laakkonen 2012).

Being the most demanding and the least safe of all the internationalization project types, FDI might turn a strategically worse choice than exporting or intermediate market entry modes. Nevertheless, this work does not have the aim to compare market entry opportunities and threats of different types of modes. It only concentrates on the issues of FDI to provide Hydroline with the information which will help figuring out whether this particular mode is affordable and beneficial for the company or not.

If extrapolated to Dunning's eclectic paradigm of FDI motivations, Hydroline reasons for spreading to Russia might be summed up as shown in FIGURE 7.

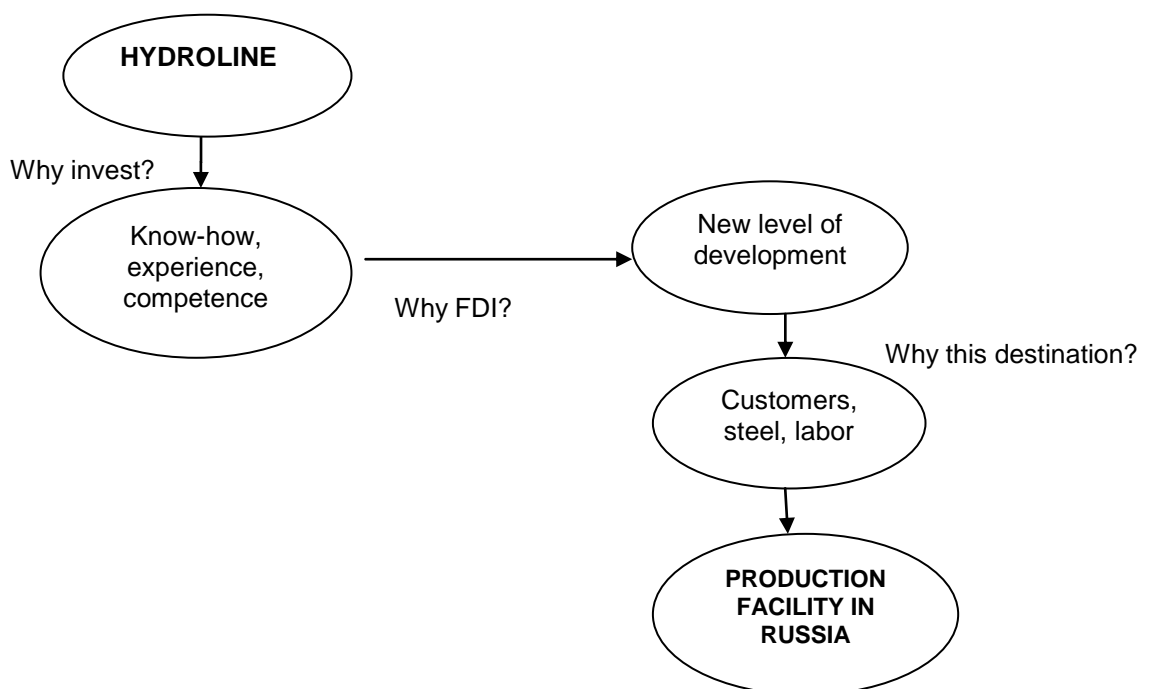


FIGURE 7. Hydroline FDI motivations

Hydroline has know-how, competence and organizational experience to bring to the new environment: internationalization in this case is viewed as the opportunity for the company's further growth. Generally, Hydroline FDI intentions are based on market-seeking and efficiency-seeking reasons - the traditional reasons for investing into BRICS economies. Russia might possess significant steel and labor resources which constitute Hydroline's production costs. Therefore, producing goods in Russia might allow efficient managing of the resources for the sake of the whole organization in general. As for the market-seeking motivation, Russia has major domestic potential because of its size. Additionally, this factor might also attract to the market some of the international companies considered as Hydroline's potential customers.

As about FDI readiness according to Uppsala model, Hydroline has not previously done any smaller investments into the Russian market. Nevertheless, the location choice is, to some extent, driven by the market's proximity and traditional Russian-Finnish trade relations: this makes FDI to Russia safer than major investment to any of the world's more distant locations. Moreover, the company is not a novice at foreign production; its newly-established facility in Poland is a significant experience of FDI in Slavic countries, which Russia belongs to.

All in all, the subject of the current research is a hypothetical FDI project of Hydroline Oy in Russia. It includes establishing a greenfield production facility of small or medium size in one of the Russian regions providing the optimum proximity to machinery building centers, potential customers and raw material suppliers. The key project costs defined by the company as the ones of particular interest are labor costs, administrative expenses, raw material costs (steel) and land purchase costs. The legal form of business taken into consideration is subsidiary. Based on these issues and Hydroline's main FDI motivations explained above, the chapter objectives are formulated as follows:

- observing raw material costs in various regions of Russia
- defining Russian steel production and machinery building centers
- observing labor costs and administrative expenses in various regions of Russia
- observing production land prices in various regions of Russia
- describing Russia from the point of view of its machinery industry, steel industry, labor and real estate opportunities and trends with the focus on the needs of Hydroline

Additionally, the chapter contains essential information about the main articles of Russian FDI Law and Tax Code concerning the rights, restrictions and obligations a foreign investor similar to Hydroline is exposed to.

The research material basis includes official documents, catalogues of industrial portals, corporate webpages, price lists obtained from steel-producing companies and on-line job and real estate advertisements.

5.1 Russian foreign investment law and tax obligations

When planning the investment to Russia, a foreign company should know that it enjoys the same rights and is exposed to the same restrictions as local Russian companies. The rights of foreign investors are protected by federal laws, and in case of unlawful actions from the side of Russian federal authorities the losses of the investors are to be compensated. (Federal Law № 60-ФЗ 1999, article 4 – 5.)

Generally, the property of foreign investors cannot be seized under nationalization or requisition. In rare cases when nationalization or requisition might take place (according to the international agreements and federal decisions) the property is to be reimbursed. (Federal Law № 60-ФЗ 1999, article 8.)

Foreign investors in Russia are protected from unfavorable changes in legislation happening after the investment process started. The protection spreads to the companies owing more than 25% in a Russian business venture. The unfavorable changes include as follows:

- inward customs rates (excluding those understood as measures of country's economic safety protection)
- federal taxes (excluding excise-duties and VAT for goods produced in Russia)
- off-budget funds' fees such as social, health and insurance payments (excluding Pension Fund fees)
- total tax burden
- new limitations and prohibitions for business activity

The protection is valid within 7 years right after the investment project has been launched and its budgeting has begun. (Federal Law № 60-ФЗ 1999, article 9.)

Along with protective conditions, there are several limitations for foreign investors keeping them distant from the country's strategic assets. These assets are the following: suboil and mineral areas of federal importance, natural monopoly services and market dominant companies, live aquatic resources, hydro-meteorological and geothermal activities, nuclear and radiation-emitting activities, encrypting and bugging equipment and military technologies. The transactions arranged with the Russian companies belonging to these fields need special approvals and permits from local authorities. (Federal Law № 57-ФЗ 2008, article 6.)

As the legal form of business chosen for Hydroline is subsidiary, the taxation of the establishment is to be done by the rules of Russian legislation. According to the Tax Code of the Russian Federation, Russian business entities are exposed to three types of taxes – federal, regional and local (Federal Law № 146-ФЗ 1998, article 12 – 5). Hydroline will be the subject of the following taxes:

Federal (general for all locations)

- value-added tax 18%
- profit tax 20%

Regional (specific for each particular region)

- property tax (up to 2.2%)
- transport tax (2.5 - 15 RUR per horsepower for automobile; 5 - 10 RUR per horsepower for bus; 2.5 – 8.5 RUR per horsepower for truck)

Local (specific for each particular location)

- land tax (up to 1,5% of land's cadastral value)

Income tax extracted from employees' salaries is usually counted and transferred to the budget by the employer. The income tax rate is currently 13 % (Federal Law № 117-ФЗ 2000, article 224).

5.2 Steel industry centers and material costs

As it has already been mentioned, the main production material of Hydroline is steel. Russia is known as one of the biggest producers of steel in the world. According to the report of World Steel Association (2013), Russia occupies the 5th position in the top 10 list of steel producing countries. The four of Russian major metal corporations are

included into WSA 25 top world's largest steel producers. These industry giants are Severstal, Evraz Group (its production assets in Russia), Novolipetsk Steel (NLMK) and Magnitogorsk Iron and Steel Works (MMK). (World Steel Association 2013.)

The current research is based on the Metaprom Industrial Portal catalogue of Russian biggest steel producing enterprises (Metaprom 2013). The enterprises are selected according to the contents of their product assortment with the focus on the material used by Hydroline - steel for production needs in round-bar shapes. As the result, 21 relevant enterprises are sorted by region and mapped as it is shown in FIGURE 8.



FIGURE 8. Regional distribution of Russia's major steel producers

As seen from the map, the majority of steel enterprises are situated in the eastern part of the country with the highest concentration in Chelyabinsk, Sverdlovsk and Kemerovo regions. In the central and western areas the steel production leaders are Moscow Region and Vologda Region.

With such intensity of steel production, Russia might be expected to have comparatively low steel prices if compared to the countries of Europe. TABLE 7 presents the results of the price list research done according to the corporate information of 6 Russian steel trading companies: Severstal (2013) works, Novosibirsk Metal Works of Kuzmin (NMZ-K 2013), Metal Servis (2013) trade company, Sklad Metalla (2013) trade company, StaleProkat-NN (2013) trade company and Industrial Metal Complex (2013) trade company.

To compare with, MEPS EU Carbon Steel Prices table indicates the average merchant bar price in Europe as 538 EUR for April 2013; the average price for January – April period was 551 EUR (MEPS 2013). The prices obtained from VAT-referencing companies for the most common merchant steel sort (analogue of FORM 300 H, RACOLD 03 F) are below the European average. It is necessary to mention that the reviewed prices more probably include the commission of the trading firms which arrange the sales. Besides, such price lists mainly consider one-time orders. In case of a direct long-term contract with a producing enterprise the prices are expected to be lower.

TABLE 7. Russian merchant (construction) steel prices (round bar 16/25 mm diameter, EUR¹ per ton)

Trading company	Sort (approximate European analogues of GOST)	Price per ton	Region	District
VAT excluded				
Severstal (price list for August 2013)	FORM 300 H RACOLD 03 F	435	Vologda	North Western
	RAEX 355 N RAEX 384 P	468		
VAT included				
Novosibirsk Metal Works of Kuzmin: (price list for 08.08.2013)	FORM 300 H RACOLD 03 F	570	Novosibirsk	Siberian
	EN 10083-1 En 10263-4 En 10250-3	690		
	RAEX 355 N RAEX 384 P	747		
Metal Servis (price list from 08.08.2013)	FORM 300 H RACOLD 03 F	556	Moscow	Central
	RAEX 355 N RAEX 384 P	608		
No VAT reference (more probably included)				
Stale-Prokat-NN (on-line prices)	FORM 300 H RACOLD 03 F	599	Nizhniy Novgorod	Volga
Industrial Metal Complex (on-line prices)	S355J0	718	Leningrad Region	North Western
	E355+SR	524		
Sklad Metalla (on-line prices)	RAEX 355 N RAEX 384 P	611	Moscow Krasnodar Nizhniy Novgorod	Central Southern Volga
	37 Cr4 37 Cr4KD 41 Cr4 41 Cr4KD 41 CrS4	617/624	Sverdlovsk	Ural
	15 Cr 15 CrA 20 Cr 20 CrH 20 CrMn	631		

¹ Converted from RUR according to Central Bank of the Russian Federation from 08.08.2013. Rounded to integers

5.3 Russian machinery building industry

One of the prime reasons for Hydroline to consider coming to Russia is bringing the product closer to new customers - Russian machinery building companies as well as foreign machinery giants producing in Russia. There are 10 target fields of machinery building figured out together with Hydroline as the ones of the company's particular interest. These fields are listed as follows:

- cars and components
- buses and trolleybuses
- hoisting, loading and transportation machinery and equipment (including cranes, elevators, trucks and caravans)
- forestry/agriculture equipment and machinery
- boring equipment and machinery
- oil/gas industrial equipment
- food industry machinery and equipment
- pulp and paper industry machinery and equipment
- metal industry machinery and equipment
- excavators

Based on the I-Mash (2013) resource catalogue of Russia's machinery companies, 273 enterprises are sorted by specialization and geographical location as shown in FIGURE 9. The distribution is done by districts². Additionally, the map is supplemented with district geography of major steel producers to create the full picture of the country's material supply and machinery components demand potential. The global machinery giants with own brand-name production facilities on the Russian territory are marked separately.

² Major administrative divisions of the territory. The information about Russian federal districts is provided in Appendix 1

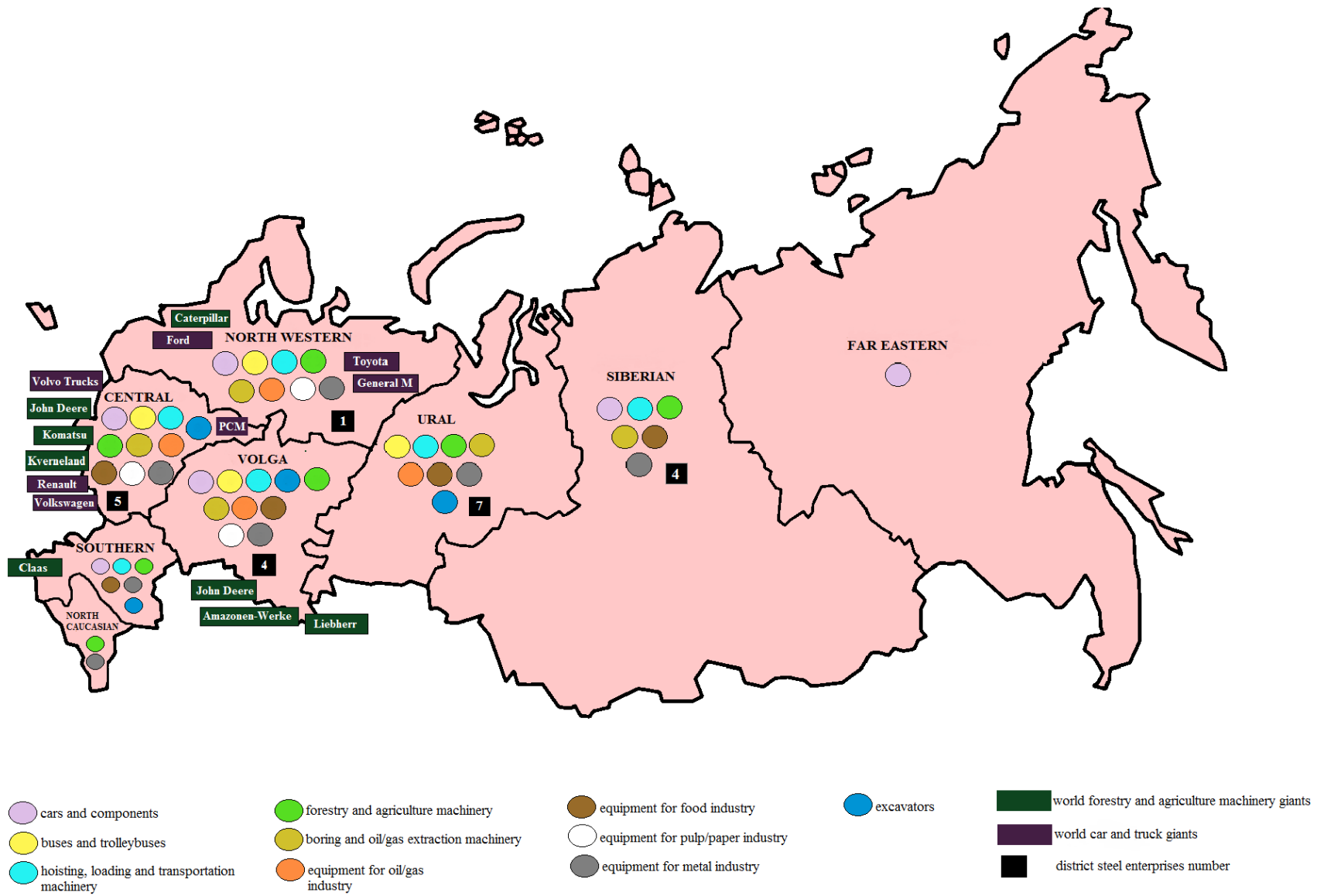


FIGURE 9. Russian machinery building centers, steel industry centers and major international machinery investors

As it follows from the machinery enterprise overview, Central Federal District and Volga Federal District are the areas where machinery is presented in all of the target fields. Moreover, all the regions in these districts have machinery building enterprises on their territories. In Central Federal District the biggest concentration of machinery enterprises is observed in Moscow Region (29 enterprises of district's 80 as total), where machinery is produced within all of the 10 target fields. Tver Region also has intensive machinery production (9 enterprises) in the following fields:

- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery
- oil/gas industrial equipment
- excavators

The other machinery building centers of the district are Tula Region (7 enterprises), Tambov Region (5 enterprises) and Voronezh Region (5 enterprises).

Among the international companies producing on the territory of Central Federal District there are agriculture and forestry machinery giants such as John Deere (2013), Komatsu (2013) and Kverneland Group (2013). Car and truck fields of international machinery are represented here by Renault (2013), Volkswagen (Volkswagen Group Rus 2013) and Volvo Trucks (Volvo Trucks Россия 2013). TABLE 8 shows the location, type and specialization of the facilities run by these international machinery companies on the territory of Central Federal District.

TABLE 8. International machinery companies in Central Federal District

Brand name	Country of origin	Russian name	Facility location	Region	Type of production	Specialization
John Deere (Deere & Company)	USA	Джон Дир Русь	Domodedovo	Moscow	Semi knocked down assembly	Loaders, dump trucks, agriculture machines
Renault S.A.	France	Renault Россия	Moscow	Moscow	Full-cycle production	Cars
Volkswagen Group	Germany	Фольксваген груп Рус	Kaluga	Kaluga	Full-cycle production	Cars
Volvo Trucks Corporation	Sweden	Вольво Восток	Kaluga	Kaluga	Full-cycle production	Trucks
Kverneland Group	Norway	Квернел анд Груп	Lipetsk	Lipetsk	Welding, coloring and assembling	Agriculture machines
Komatsu Ltd	Japan	Комацу СНГ	Yaroslavl	Yaroslavl	Full-cycle production	Excavators, dump trucks

Volga Federal District is another Russia's large center of machinery building. Of 75 enterprises observed in the district, 11 are situated in Bashkortostan, 11 in Perm Kray and 11 in Tatarstan. These regions produce machinery in the following fields:

- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery
- oil/gas industrial equipment

Additionally, there are bus production enterprises in Bashkortostan and Tatarstan and an excavator enterprise in Tatarstan. Besides that, three major international companies operate their machinery building facilities in Orenburg, Samara and Nizhniy Novgorod regions. These companies are John Deere (2013), Amazonen-Werke (Amazone 2013) and Liebherr (Liebherr 2013). The information about their facilities can be found in TABLE 9.

TABLE 9. International machinery companies in Volga Federal District

Brand name	Country of origin	Russian name	Facility location	Region	Type of production	Specialization
John Deere (Deere & Company)	USA	Джон Дир Русь	Orenburg	Orenburg	Semi knocked down assembly	Agriculture machines
Amazonen-Werke H. Dreyer GmbH&Co. KG	Germany	Амазоне-Евротехника (partnership)	Samara	Samara	Semi knocked down assembly, full-cycle production	Agriculture machines
Liebherr-International AG	Switzerland	Либхерр-Нижний Новгород	Dzerzhinsk	Nizhniy Novgorod	Full-cycle production	Tower cranes, diggers

Ural Federal District is also the area of developed machinery-building industry (48 enterprises) where the enterprises of the following fields can be found:

- buses and trolleybuses
- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery
- oil/gas industrial equipment
- food industry machinery and equipment
- metal industry machinery and equipment
- excavators

Along with this, the district leads in the steel casting industry being the destination for 7 large steel enterprises. The leading machinery building areas on the territory are Sverdlovsk Region (17 enterprises) and Chelyabinsk Region (16 enterprises). Chelyabinsk enterprises produce mainly in the following fields:

- buses and trolleybuses
- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery
- food industry machinery and equipment
- excavators

Sverdlovsk enterprises produce machines as follows:

- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery
- oil/gas industrial equipment
- food industry machinery and equipment
- metal industry machinery and equipment

Within the district, machinery industry is also widely developed in Tyumen Region (8 enterprises) and Kurgan Region (6 enterprises).

In North Western Federal District machinery enterprises are concentrated mainly in Leningrad Region (11 of 24), the center of which is St. Petersburg. There are the following machinery fields to be found in the area:

- cars and components
- buses and trolleybuses
- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery
- oil/gas industrial equipment
- metal industry machinery and equipment

Besides that, 4 of the world's machinery giants have established their brand-name works in the region. These companies are: Caterpillar (2013), Ford (2013), Toyota (2013) and General Motors (GM Media 2013a, GM Media 2013b). The information about these companies' activity in Leningrad Region is presented in TABLE 10.

TABLE 10. International machinery companies in North Western District

Brand name	Country of origin	Russian name	Facility location	Region	Type of product ion	Specialization
Caterpillar Inc	USA	Катерпиллар Тосно	Tosno (St. Petersburg)	Leningrad	Full-cycle	Hydraulic excavators, dump trucks
Toyota Motor Corporation	Japan	Тойота Мотор Корпорэйшн	St. Petersburg	Leningrad	Full-cycle	Cars
General Motors	USA	Джи Эм Авто	Shushary (St. Petersburg)	Leningrad	Full-cycle	Cars
Ford Motor Company	Switzerland	Форд Мотор Компани	Vsevolozhsk	Leningrad	Full-cycle	Cars

In Southern District (24 enterprises) the machinery centers are Krasnodar Kray (10 enterprises) and Rostov Region (8 enterprises). The following fields can be found in both regions:

- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- food industry equipment

Additionally, there are enterprises producing in the field of boring and oil/gas industry machinery in Krasnodar Kray, and car and excavator producers in Rostov Region. Claas (Claas Group 2013), a world giant in the field of agriculture machinery, runs a facility in the regional center of Krasnodar Kray (see TABLE 11).

TABLE 11. International machinery companies in Southern District

Brand name	Country of origin	Russian name	Facility location	Region	Type of production	Specialization
Claas KGaA mbH	Germany	КЛААС	Krasnodar	Krasnodar Kray	Semi knocked down assembly	Loaders, agriculture machines

Volgograd Region can also be marked as a machinery area in Southern District, as there are nearly 5 enterprises on the territory.

The machinery building center of another major steel producer, Siberian Federal District, is situated in Altay Kray (7 enterprises of district's 19 as total). The fields found in the region are the following:

- cars and components
- hoisting, loading and transportation machinery
- forestry and agriculture machinery
- boring equipment and machinery

North Caucasian and Far Eastern districts cannot be marked as the areas of machinery building industry development.

5.4 Labor and personnel expenses

Russia does not have any federal specialization-related or education-related norms for wages and salaries: the issues of this kind are decided regionally and differ in each particular case. The law defines the minimal monthly salary as 118³ EUR in year 2013 (Federal Law № 232-Ф3 2012, article 1), but it might be applied to various job positions.

Meanwhile, it is possible to observe some general tendencies of payments in the industrial sector by examining job advertisements recently published in different parts of the country. The current research is based on the information provided by the following job portals and internet-based publications of job advertisements: Rabota.ru (2013), Head Hunter (2013), Job.ru (2013) and Yandex job search (Yandex Работы 2013).

The observed positions are chosen in accordance with Hydroline's specific interest and listed as follows:

- welder
- production worker
- foreman (highly qualified worker, senior worker)
- CNC machine operator
- production engineer
- CNC programmer
- purchase manager

³ Converted from RUR according to Central Bank of the Russian Federation from 18.08.2013. Rounded to integers

- business-to-business sales manager
- internal logistics manager

Among the selected positions there are those belonging to production costs and to administrative expenses. As the purpose of this research does not include FDI budgeting and is limited only with observing general trends in labor market, the presented overview covers only monthly salaries.

The locations for comparative analysis include the City of Moscow and the City of St. Petersburg, which are metropolitan areas and the centers of the country's administrative, industrial, social and cultural life. Of all the other locations, Tver Region and Tatarstan Republic are selected as the areas of the most favorable investment climate according to Ernst & Young. Besides, these are the regions with well-developed machinery sector. Kaluga Region is additionally included into the research as it is the host area for the two major foreign investors in the automobile construction field.

The results of the salary research are presented in TABLE 12. On average, the highest salaries are offered for the positions of business-to-business sales managers, CNC programmers, foremen and welders. Moscow enterprises offer the highest salaries for all the positions. In St. Petersburg the salaries are higher than in non-metropolitan locations for 6 of the 9 positions (welder, production engineer, CNC operator, purchase manager, business-to-business sales manager and internal logistics manager). It was noticed that the advertisements in Moscow and St. Petersburg offer specific salary values more often than in Tatarstan Republic, Tver Region and Kaluga Region, where the salaries are frequently marked as contractual.

TABLE 12. Average monthly salaries in Russian regions/cities in EUR⁴ (n=number of offers)

Region/city Position	Moscow City	St. Petersburg City	Tatarstan Republic	Tver Region	Kaluga Region	Average for all regions
Production						
Production worker (n=47)	670 (n=10)	520 (n=11)	540 (n=9)	510 (n=9)	540 (n=8)	560
Foreman (n=56)	970 (n=12)	780 (n=15)	740 (n=12)	810 (n=8)	830 (n=9)	820
Welder (n=159)	940 (n=60)	850 (n=50)	840 (n=25)	650 (n=11)	760 (n=13)	810
CNC operator (n=110)	890 (n=30)	820 (n=52)	780 (n=13)	630 (n=6)	550 (n=9)	740
Engineering						
Production engineer (n=149)	810 (n=31)	750 (n=76)	570 (n=21)	690 (n=12)	540 (n=9)	670
CNC programmer (n=16)	1250 (n=3)	840 (n=4)	490 (n=3)	880 (n=4)	630 (n=2)	820
Management						
Purchase manager (n=282)	890 (n=110)	800 (n=113)	530 (n=36)	410 (n=10)	490 (n=13)	630
Business-to-business sales manager (n=68)	1140 (n=15)	980 (n=23)	660 (n=17)	770 (n=4)	800 (n=9)	870
Internal logistics manager (n=120)	870 (n=39)	750 (n=54)	610 (n=16)	700 (n=6)	690 (n=5)	720

According to Ivan Sorval, the former Deputy Director of Development at Pitkyaranta Cellulose Works, salaries are usually supplemented with monthly bonuses equal 38 – 41% of the salary (Sorval 2013). Thus, the numbers presented in Table 12 should not be viewed as final payment values, and the bonus amounts should be taken into consideration. As about salary growth, the indexation of salaries takes place annually

⁴ Converted from RUR according to Central Bank of the Russian Federation from 18.08.2013. Rounded to integers, to tens

and is done according to the official inflation data. Sorval also mentions that the highest salaries are paid to highly qualified production workers operating specific machinery and directly participating in the cellulose production process. (Sorval 2013.) That corresponds with the results of the salary research showing welders and foremen among the best-paid positions.

5.5 Land and production estate costs

Involving a facility construction on the host territory, greenfield investment demands establishing land ownership in the country of investment destination. The current research investigates land purchasing opportunities in Russia and examines possible purchase costs associated Hydroline's needs.

As it follows from Russian legislation, the land to be purchased in Russia must be included into the country's cadastral register (Federal Law № 136-ФЗ 2001, article 37). Before concluding the deal, the seller is obliged to provide all the information about the land's limitations and constraints. The purchase contract is invalid if the seller leaves the right to redeem the land plot on the wish or limits the new owner's usage of the plot including rent or resell. (Federal Law № 136-ФЗ 2001, article 37.) According to the Cadastral Code (Federal Law № 136-ФЗ 2001, article 37), the purchase contract might be lowered in value or annulled in case the seller does not provide any of the following information:

- building permits
- neighboring land plots which might affect the usage of the plot
- land qualities which might affect the land value or the planned building
- any other land factors which might affect the usage of the plot

The plots observed in the current research belong to the category of industrial lands. The law defines this category as the land used or assigned for organizations' activity or manufacturing facility exploitation. Manufacturing facilities include production, administrative and maintenance buildings. (Federal Law № 136-ФЗ 2001, article 88.)

For investigating the average prices for industrial lands, the following internet-based real estate portals and webpages are used: Invest-Nedvizhimost (2013) real estate company, Portal Nedvizhimosti (2013) real estate portal, Akrus real estate company (Nedvizhimost Akrus 2013), Move.su (2013) real estate portal, Doski.ru (2013)

advertising portal, Zemelny Vopros (2013) real estate portal, Afy (2013) real estate portal, Peterburg Nedvizhimost (2013) real estate portal, Realty.dmir.ru (2013) real estate portal and Kalugahouse.ru (2013a, 2013b) real estate portal. The observed regions remain the same, though Moscow and Leningrad regions are taken entirely; Tatarstan Republic, Tver Region and Kaluga Region are overviewed together for the reason of limited number of advertisements related to these areas. The considered land plots have the size of 0.5 – 3.5 hectares as agreed with Hydroline. According to all these specificities, the average production land prices are presented as shown in TABLE 13.

TABLE 13. The average production land prices in Russian regions in EUR⁵ (n=number of offers)

Region	Moscow (n=17)	Leningrad (n=16)	Tatrstan Republic, Tver and Kaluga regions (n=19)	Average for all regions
Average price per 100 m ²	4810	3450	2726	3662
Minimum price per 100 m ²	570	740	280	
Maximum price per 100 m ²	12910	7800	9880	

Along with lands, the observed real estate sources offer the plots with ready-built production facilities of different quality. TABLE 14 illustrates the assortment and possible variations in prices depending on the plot's size and the buildings' condition by the example of Moscow Region.

⁵ Converted from RUR according to Central Bank of the Russian Federation from 20.08.2013. Rounded to integers, to tens

TABLE 14. The prices for plots with industrial buildings in Moscow Region in descending order, EUR⁶

Plot's size, hectares	Buildings on the plot	Utilities	Distance from the Moscow Automobile Ring Road, kilometers	Price per plot
1.2	- 2 production halls of 3070 m ² - unfinished production hall of 700 m ² - building of 174 m ² - fully repaired office building - garage - automatic gates	All (gas, water, heating, electricity, sewerage) including internet	80	1408200
0.35	- 1 production and administrative building of 9219 m ² ; 2 floors	Gas, water, electricity, sewerage	14	794900
0.48	- hanger of 570,4 m ² - warehouse of 1062.7 m ² - office of 207.5 m ²	All including internet and telephone	55	726800
0.5	- 1 production building of 1070 m ² ; 1 floor	Electricity, water, gas connection possibilities	45	386100
0.27	- 1 semi-finished building of 1218.2 m ² ; 2 floors	No	170	67000

To sum up the investigation, Moscow and Leningrad regions provide more offers at significantly higher prices than non-metropolitan regions. The prices strongly depend on the utilities available on the territory: the most expensive plots are supplied with all the necessary utilities including water, gas, electricity, heat and sewerage. The less expensive lands have electricity, gas (or both of these utilities) on border of the plot or do not have any. In Moscow and Leningrad regions the price also depends on the plot's proximity to the ring roads of Moscow and St. Petersburg. As Tver and Kaluga regions are situated in Moscow neighborhood, the proximity to Moscow also affects the prices for the production lands of these areas. Additionally, the prices are often marked as contractual in Tatarstan Republic, Tver and Kaluga regions, where the advertisements

⁶ Converted from RUR according to Central Bank of the Russian Federation from 21.08.2013. Rounded to integers, to hundreds

leave the space for bargaining; in Moscow and Leningrad Regions the prices are mostly specific.

It is important to mention that the observed lands are not located in industrial parks and belong to private owners; this makes the buyer exposed to certain legal risks, which are of great severity in Russia. Unlike private, small-scale sellers, industrial parks offer much bigger degree of safety and legal clearance. An industrial park is a specially created area managed by a developer and offering land plots with utilities and infrastructure under proper administrative and legal conditions (Industrial Parks in Russia 2011). On the other hand, the lands of the parks are significantly more expensive. Thus, the prices for land (without buildings) in Greenstate industrial park (Leningrad Region) varied in year 2012 from 6500 to 11000 EUR per 100 m² (Krasova 2012). As it can be seen from TABLE 13, this offer sufficiently exceeds the average non-park prices even in Moscow. Anyhow, a company choosing more economical option outside industrial parks should consider hiring a local layer for careful examining the documentation, permits and peculiarities of the chosen plot.

5.6 Case research summary

Generally speaking, Russia has major potential in those fields of machinery building which are defined as Hydroline's areas of interest. The machinery producing enterprises are located in all of the districts, but concentrated in Central, Volga, North Western and Ural parts of the country. Moreover, these are the areas of intense steel production with several steel suppliers being among the world's industry leaders.

Russia as an FDI destination hosts several major international companies running their plants of semi knocked down assembly or even full-cycle production. The leading FDI host regions are Moscow, Leningrad and Kaluga. There are two advantages supported by this fact. Firstly, these international corporations might be considered as Hydroline's potential buyers of global meaning. Secondly, the presence of foreign machinery firms on the territory signals that FDI made in the machinery industry of Russia might be successful.

As about land purchasing, there are various opportunities for greenfield investment in the country. Local sellers provide quite a wide range of production lands at the prices increasing with the proximity to Moscow and St. Petersburg. The plots of small and medium size can be easily found in Moscow and Leningrad regions, while in the other

observed regions the offer is smaller. Along with lands, it is possible to purchase plots with ready-made production buildings, the prices for which vary harshly depending on the buildings' size, construction state and readiness for usage.

Turning to labor and personnel expenses, Moscow salaries tend to be several times bigger than the ones in non-metropolitan areas. The most valued professionals in the Russian industrial sector are qualified workers, CNC engineers and industrial sales managers. When doing salary planning, a company should consider monthly bonuses and annual salary changes in accordance with federal inflation data.

6 THESIS CONCLUSIONS

The current research provides a description of Russian investment environment for the purposes of industrial business. Russia is overviewed reflecting the needs and objectives of Hydroline Oy as a client organization. Thus, the research covers such issues as the country's general economic situation, the reasons driving Finnish companies to come to Russia, the constraints to be faced in the environment, the level of local machinery industry development, raw material potential and possible labor and real estate costs associated with a greenfield project.

All in all, the research showed that Russia has a well-developed, scaled metal and machinery building complex with significant representatives on the international level. Its major centers are located in Central, North-Western and East-European parts of the country. Market, labor and material resources form the environment's biggest investment advantages. Meanwhile, infrastructure problems, administrative constraints, legal risks and severe competition might be the problems affecting FDI process and return on investment.

Client company's feedback

The main question of the thesis was asked about Russia's suitability as an investment environment for the organization similar to Hydroline. After the work had been completed, the company representative was acquainted with the research results and interviewed about the work's strategic value. According to Hydroline (Laakonen 2013), the following issues provided by the current research are of the company's greatest importance:

- general knowledge on all BRICS countries and Poland; the view on Russia via comparison to these economies
- labor and raw material costs, availability and regional distribution
- potential customers' location

Russia as an investment environment is now seen by the company from several new viewpoints. Thus, the scale of the country's metal extraction industry indicates the need for mining machinery which is among Hydroline's core target industries for attracting potential clients. Another strategic point is infrastructure weakness: the country might need bigger volumes of construction machinery, which might result in the increased

demand for machinery components. Finally, Russia is the place where Hydroline might already find its target potential customers of international importance. All these factors make Hydroline's presence on the Russian market an urgent opportunity for development and growth.

As about the anticipated environment's benefits, the company pays special attention to the workforce quantitative and qualitative positive sides. Comparatively low labor cost is viewed as the additional advantage. Among the most concerning issues for Hydroline are the problems in the country's political, legislative and administrative environments: the constraints of such kind might be escaped by a big corporation, but for a medium-sized company they might be disastrous. For instance, difficulties with getting electricity might damage the company's operations significantly.

To sum the work up, Russia is generally viewed as a suitable environment for Hydroline to accomplish the strategic objectives and development plans. The research has contributed to the company's understanding of Russia's main FDI capabilities. Hydroline sees its further Russian market familiarization in gradual and systematic moving from less demanding activities to FDI - the approach standing close to Uppsala model principles. Currently the company is interested in starting Russian market operations with exporting from Finland.

Discussion

The objectives of the current thesis work are viewed as achieved. The research has served as background material for the client company's strategic planning and enhanced the knowledge about Russia as an FDI destination in the specific machinery segment. Dealing with machinery building industry was a challenging task: along with the knowledge of business processes, the work requested technical environment awareness and understanding of industrial product as a concept. The previous internship experience and frequent consulting with Hydroline via e-mail were of great assistance when attempting to learn the particulars of this demanding business segment. All in all, the author evaluates the work as successful and considers that she was able to deliver a quality and urgent outcome. She tried to provide the necessary degree of industry understanding and could accentuate the most important aspects of the target environment.

In spite of the positive company feedback and self-evaluation, there is still some space for improvement. The work would undoubtedly benefit if the author additionally included

several detailed interviews with industrial experts of both Finnish and Russian sides: machinery-building factory managers, lawyers, real estate agents and government representatives. Unfortunately, finding of an interviewee is the biggest difficulty of the whole process, and it was great luck to obtain information from such prominent Finnish enterprises which are referred to in the current thesis.

The attention might also be paid to the fact that in the case research part the target trends are compared within only five regions. The scope of the work would be excessively large if the author included all the 83 areas of the country into this comparison. The author's idea was to do the general comparison of non-metropolitan districts against Moscow and St. Petersburg which are the countries' business and administrative centers. Meanwhile, the work could be further developed in the direction of more precise regional comparison – that might be the next step in the Russian market planning.

Personal growth

The current work has enriched author's own experience with understanding the nature of FDI together with knowledge about Russia as an investment area and a machinery industry destination. Moreover, cooperation with an actually existing company has served as the training platform for such activities as market research, operational environment analysis, business planning and internationalization process.

The work of this type gives a major benefit for a future professional in the sphere strategic marketing. As a strategic step, FDI is the concept which is likely to be dealt with when working at a multinational organization; thus, knowing the essentials of FDI is of great value for a business student. Another important factor boosting author's personal growth is the orientation of the thesis on the industrial sector. Russian background would probably determine author's career to be connected with Russian-European trade. As Russia is a world's major exporter of commodities and industrial goods, this particular field of business seems to be the most promising in terms of professional development.

According to all said, the current research has provided the unique opportunity to implement the author's existing experience to the client company's needs and at the same time sufficiently multiplied the knowledge of Russia for further using it when growing as a professional. In addition, the author felt strong commitment to the work because of her previous participation in the company's operations during the internship

period. It was true satisfaction that the final outcome has contributed to the Hydroline's development planning, and it will even increase if the work finally brings benefit to the company's overall performance.

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APPENDIX ONE. FEDERAL DISTRICTS OF THE RUSSIAN FEDERATION

Central Federal District:

- Belgorod Region
- Bryansk Region
- Ivanovo Region
- Kaluga Region
- Kostroma Region
- Kursk Region
- Lipetsk Region
- Moscow City
- Moscow Region
- Orel Region
- Ryazan Region
- Smolensk Region
- Tambov Region
- Tula Region
- Tver Region
- Vladimir Region
- Voronezh Region
- Yaroslavl Region

North-West Federal District:

- Arkhangelsk Region
- Kaliningrad Region
- Karelia, Republic
- Komi, Republic
- Leningrad Region
- Murmansk Region
- Nenets Autonomous District
- Novgorod Region
- Pskov Region
- St. Petersburg City
- Vologda Region

South Federal District:

- Adygeya, Republic
- Astrakhan Region
- Kalmykia, Republic
- Krasnodar Krai
- Rostov Region
- Volgograd Region

North Caucasus Federal District:

- Chechnya, Republic
- Dagestan, Republic
- Ingushetia, Republic
- Kabardino-Balkaria, Republic
- Karachayevo-Cherkessia, Republic
- North Ossetia-Alania, Republic
- Stavropol Krai

Volga Federal District:

- Bashkortostan, Republic
- Chuvashia, Republic
- Kirov Region
- Mariy El, Republic
- Mordovia, Republic
- Nizhny Novgorod Region
- Orenburg Region
- Penza Region
- Perm Territory
- Samara Region
- Saratov Region
- Tatarstan, Republic
- Udmurtia, Republic
- Ulyanovsk Region

Ural Federal District:

- Chelyabinsk Region
- Khanty-Mansiysky Autonomous District
- Kurgan Region
- Sverdlovsk Region
- Tyumen Region
- Yamalo-Nenetsky Autonomous District

Siberian Federal District:

- Altai Territory
- Altai, Republic
- Buryatia, Republic
- Irkutsk Region
- Kemerovo Region
- Khakassia, Republic
- Krasnoyarsk Krai
- Novosibirsk Region
- Omsk Region
- Tomsk Region
- Trans-Baikal Territory
- Tuva, Republic

Fareast Federal District:

- Amur Region
- Chukotka Autonomous District
- Jewish Autonomous Region
- Kamchatka Territory
- Khabarovsk Territory
- Magadan Region
- Primorsky Territory
- Sakha, Republic of (Yakutia)

