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FINNISH SME'S INTERNATIONALIZATION ANALYSIS. ENTRY MODES TO RUSSIAN MARKET.

– Case study of Tonester Oy Ltd



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The purpose of this thesis was to study internationalization process of Finnish Small and Medium Sized Enterprises' (SMEs), particularly the choice of foreign entry modes and external and internal factors that influence this choice. A case study was conducted on Tonester Ltd, which is the Finnish manufacturer of solid surface material DURAT.

The topic was chosen because of researcher's work placement at Tonester Ltd. The researcher's tasks included expanding international clientele and finding new markets for the company. Russia has been a particularly interesting, but a challenging market for the company for the past several years. Based on the researcher's language and cultural background, the owners of the company consider her the right person to investigate the current market situation and make them aware of its pros and cons.

The empirical part of this thesis is based on the study and analysis of the theory related to the subject, and current information and data related to the target market and the company itself; as well as on the researcher's personal experience from working in the company, structured and non-structured interviews and continuous observations of company's activities.

Tonester Ltd would gain the essential knowledge on the new market they wish to enter; they will also learn about the preferred entry modes and the challenges to be faced. SMEs similar to the case study company can also contribute by using the provided information. The researcher has systemized the knowledge that already exists, but which is not taken seriously by the majority of small and medium enterprises. Many of them do not have a well-prepared marketing plan and enter new markets chaotically, often based on the current demand alone. The information provided in this thesis can help the SMEs to gain the basic knowledge of internationalization process and recommended entry modes.

KEYWORDS: SME, entry modes, company, foreign market selection, strategy, external and internal factors, internationalization

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ASIASANAT:

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LIST OF ABBREVIATIONS (OR) SYMBOLS

SME	Small and Medium Enterprise
IMS	International Market Selection
EU	European Union
ROI	Return on Investment
PMI	Purchasing Managers Index
FDI	Foreign Direct Investment

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1 INTRODUCTION

1.1 Background

SME – Small and Medium Enterprise. The abbreviation "SME" is used in the European Union and by international organizations such as the World Bank, the United Nations and the World Trade Organization (WTO).

The EU adopted this definition on 1 January 2005. There are three broad parameters which define SMEs in Europe:

- Micro-enterprises have up to 10 employees
- Small enterprises have up to 50 employees
- Medium-sized enterprises have up to 250 employees

The European definition of SME follows: "The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro." (European Commission, 1.1.2005)

Manufacturing and service SMEs may enter the foreign markets for several reasons. Some do it because domestic markets are stagnant or foreign markets are growing faster. Some follow the domestic who are going international; this is the common reason among service SMEs – insurance, advertising, engineering, computer and other services. However, the main and most common reason for industrial SME to go international is the search of greater sales volume and strengthening of their competitiveness both at home and in the foreign countries (Söderqvist, Holstius, 2005). For Tonester Ltd this is the fundamental for entering a new market, in this case Russia, as it has already successfully entered a few foreign markets, but is currently experiencing difficulties in maintaining its positions.

"Companies become committed to international markets only when they no longer believe that they can attain their strategic objectives by remaining at home" (Root, 1994).

Today the truth is that all business, small or large, domestic or international, must strive for profit on the world economy scale; economy characterized by massive flow of products, capital, technology and knowledge. In today's business world no business is safe from foreign competition. Among many other SMEs Tonester Ltd has learnt that the best way to protect oneself from the foreign competitors is to attack those competitors on the international level.

Entry strategy for international markets is a complex plan. It sets forth the objectives, goals, resources, and policies that will guide the company's international operations over a future period long enough to achieve sustainable growth in world markets (Root, 1994). For most SMEs entry strategy time horizon is from 2 to 5 years. It normally takes that long to achieve a steady market performance. This time horizon estimation has been realistic for Tonester Ltd in other international markets, e.g. United Kingdom and USA, and the management has no higher expectations for Russian market.

Managers need to plan the entry strategy for each product and each market separately, it is wrong to assume that the same model would work the same way across all international market.

Based on the Observatory of European SMEs report, export sales are mainly based on three factors: demand for a product on the foreign market, capability of serving the foreign market, and capability of adapting to a foreign market. Many SMEs get themselves involved in any project available in order to gain international recognition and extra sales without a carefully thought-through strategy for a specific market (European Commission, 2003).

Deciding on the most appropriate form of market entry involves understanding of each of the various modes available and the market conditions under which one form of entry mode may be more suitable than the other.

A large number of pros and cons face SMEs when becoming international. The influence they have on SMEs' choice of target foreign market and its entry modes will be investigated in this thesis.

1.2 Introducing Tonester Ltd

Tonester Ltd is a Finnish design oriented solid surface manufacturer that has over 20 years of experience in manufacturing its solid surface material DURAT.

Environmental values and design form the basis of DURAT`s company philosophy. DURAT is the solid surface material that contains recycled plastics and is itself 100% recyclable. It is a unique, ecological solid surface material for various kinds of interiors in both private and public sector, such as kitchens, bathrooms and other indoor spaces.

Tonester Ltd was established in 1990 to develop a new sustainable material, which would combine recycling and design. The manufacturing facilities of Tonester Ltd are in South-Western Finland nearby Turku, in Rymättylä. DURAT is one of the oldest solid surface materials in Europe. The company employs 16 people in Finland. Its turnover is 2,002 million EUR.

In November 2007, the official opening of DURAT Joint Venture Company in Ganzhou, China started a new era in the history of the company. The capacity of the factory is primarily targeted to serve the demand in Asian and USA markets. However, plans to feed future warehouses around the world have also been made

1.3 Research questions

The following research questions will be addressed:

1. How does the combination of internal and external factors affect Tonester Ltd`s international market selection?
2. How does the influence of internal and external factors affect on Tonester Ltd`s choice of foreign entry mode?
3. How can Tonester Ltd benefit from gathered data and existing theory when entering the new market, in this case Russia?

1.4 Research Purpose

The purpose of this research is to understand how the Finnish SME makes their international market selection, what set of internal and external factors determines this process, and how to implement this knowledge into reality.

The literature review will address the first two research questions and will serve as a base for analysis required to answer the third question. Tonester Ltd will benefit by learning about the current Russian market situation in general and construction industry in particular. The company will be analyzed against the existing theory on internationalization; the gathered data will help to determine what form of entry mode is acceptable for Tonester Ltd in case of Russia. The case study company will also benefit from the detailed analysis of its international activities.

2 LITERATURE REVIEW

2.1 SMEs' Internationalization

Entry strategy for international markets is a comprehensive plan. It sets forth the objectives, goals, recourses and policies that will guide company's international operations over a future period long enough to achieve sustainable growth in world markets. Entry strategy plan is a combination of several individual product/market plans. Managers need to plan entry strategy for each product in each foreign market. (Root, 1994)

One of the most important decisions regarding the internationalization process of firms is the choice of entry mode. The selection of inappropriate entry mode into a foreign market can have significant and have far-reaching consequences on a firm's performance and survival (Quer, Claver, Rienda, 2007).

One of the basic assumptions in the Uppsala model (the theory that explains how firms gradually intensify their activities in foreign markets) is that a desire to grow motivates a firm to internationalize (Johanson, Vahlne, 1977).

Internationalization process in many cases is a gradual process. Normally, a company starts its operations in the domestic market and then gradually expands further to other markets. Hardly any companies are so called initiate exporters from the very start of their business establishment. However, there are those rare cases when the business is born global and starts the international activities from the first set up of the company. "Born globals" are usually small technology oriented companies and have unique product and process innovation as well as the visionary management (European Commission, 2003).

Based on the studies from the Uppsala school, no matter what specific stimuli triggers the company to internationalize, in general IMS is determined by two major groups of factors:

- External factors: environmental factors.

- Internal factors: company specific factors.

2.2 External factors influencing IMS

The external factors influencing SMEs' IMS can be divided into Economic, Socio-cultural, Political and Legal influences (Hollensen, 2001).

Economic influences

The economic factors on a potential target market include per capita income, infrastructure, stage of economic development, and exchange rate stability. Distribution and marketing system may not be justified to set up in a small market where the potential is low, due to high cost and potential small revenue. The host country's infrastructure is a factor that must be taken into serious consideration. This includes the transportation structures, communication systems, and energy supply. A poor infrastructure may limit the ability to manufacture, distribute and advertise goods. A country that has unstable exchange rate or the one that is difficult to convert to hard currencies such as dollar or euro may be also considered risky to enter.

Socio-cultural influences

Social and cultural factors and their distance between countries are called psychic distance. These barriers are created by cultural differences between the home country and the host country, and the problems of communication resulting from differences in social perspectives, attitudes and language. Markets with low psychic distance are often more attractive for a company when planning a foreign market entry. Less time and effort is required to build a successful business relationship. Because of these factors, companies often make their first foreign entry in a market that is geographically close, e.g. neighbor country, and gain their first international experience in these countries before expanding further.

Political and legal influences

General attitudes of foreign governments towards imports and foreign direct investment, political stability and trade barriers must be taken into

consideration when a company examines potential target markets for entry. Negative attitudes towards foreign companies by the host country's government may discourage imports and investment because of the threat of protectionism and expropriation of assets. Countries with political instability should be avoided because of uncertainty regarding the future.

Market attractiveness

The importance of market attractiveness for IMS has been lifted by many researches (Jobber, 2008). It consists of several factors: market size and growth rate, competition, costs of serving the market, profit and market potential, and market access.

Market size and growth rate. Large and growing markets can often be seen as highly attractive for export target market selection. It can be stated that market growth is regularly considered as a more important factor influencing the choice of export target market than market size. The expected future demand is seen as more significant than the existing demand (Jobber, 2008).

Competition. Markets where strong and well-established competitors dominate may be less attractive as an export target market. A country where the market concentration is very high is often seen as unattractive (Ibid.).

Costs of serving the market. Distribution and control are two major costs of serving foreign markets. The costs rise when the geographic distance increases between the domestic and export markets. Costs also vary dependent on the choice of entry mode. E.g. foreign direct investment as an entry mode is more expensive than using distributors or agents. The entry can become more risky and less attractive also by the factor that the potential market is not suitable for low-cost entry option (Ibid.).

Profit and market potential. The industry structure can also make some potential markets less attractive, if these markets have a poor profit potential. E.g. if the customers have a high bargaining power, they may be able to push the prices down which will result in the lower potential profit margins on the market (Ibid.).

Market access. There may be existent informal ties between existing suppliers and distributors, which can make it difficult for the new companies to enter the market. It is almost impossible for the new entrants to overcome these barriers if they do not have the resources and competences to build their own new distribution chain within a potential market. It must be also taken in to consideration that in some countries the national suppliers have privileges for example from government's side, and this can give them competitive advantages (Ibid.).

2.3 Internal factors influencing IMS

Company capability profile

Company's capability profile involves factors like skills, resources, product adaptation and competitive advantage (Jobber, 2004)

Skills. Company has to ask themselves whether they have the necessary skills to market abroad. In case these skills are missing from the home organization, the company has to make sure that they can find the needed skills within their sales agents, retailers or distributors abroad. The company also has to ask themselves whether they have the skills needed to understand the requirements of the potential export target market (Ibid.).

Resources. Market servicing cost may vary from country to country. The company has to carefully calculate the potential costs for entering the new foreign market; they have to have the necessary financial resources to compete within the market. It is also important to consider that in the beginning of the establishment human resources might be needed; some foreign markets may require domestic personnel (Ibid.).

Product adaptation. In some markets local preferences and regulations may require product adaptation. The company should analyze whether they have the motivation, resources (both financial and human) and skills to redesign their product in order to fit the foreign market (Ibid.).

Competitive advantage. The main question is: Does the company have possibilities to gain a competitive advantage on the new foreign market? Potential target market has to be studied carefully in order to have realistic

idea whether the company has real possibilities to create and sustain the competitive advantage on the new market (Ibid.).

Company's potential. In order to take advantage of the environmental opportunities and to avoid the potential threats from the environment, the company has to prepare a careful SWOT analysis. The company's skills and resources must be studied and adjusted to the international environment (Dahringer and Mühlbacher, 1991).

Company's management ability, flexibility and commitment. It is highly important that the company's management team is willing and able to go international, as well is to manage the internationalization process further on. Management must be flexible, open-minded in their decision-making, and capable to adapt to the constantly changing conditions of the global international environment (Ibid.).

Planning and control. Companies have to be managed by effective and efficient leader-ship, organization, communication and control, in order to achieve the desired result (Ibid.).

Capacity, cost structure and productivity. There must be a careful analysis made by a company on its cost structure, capacity, flexibility and productivity before going international (Ibid.).

Personnel's motivation and qualifications. These factors are important and need to be measured before going abroad. In order to go international the company has to develop its human resources (Ibid.).

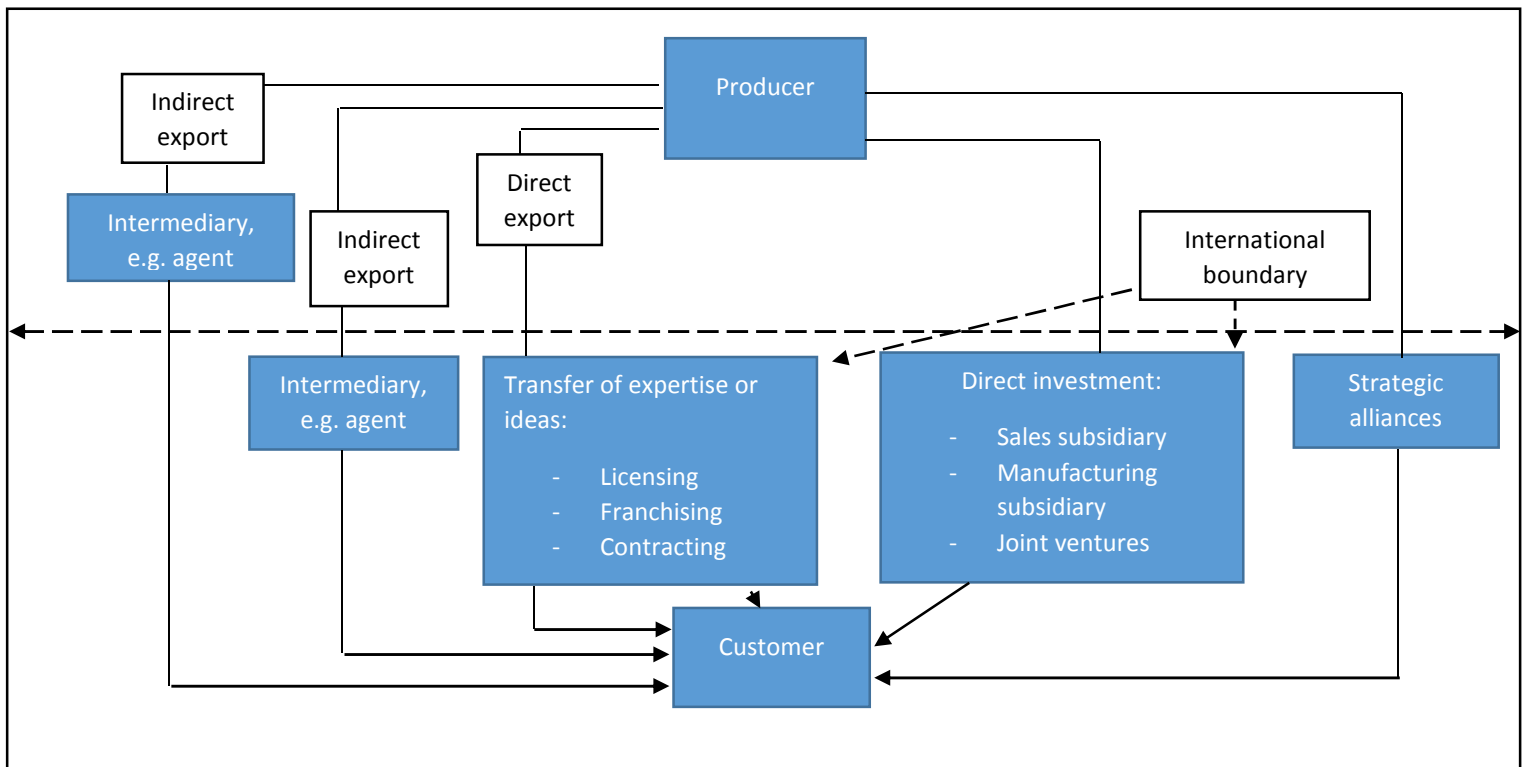
In order to evaluate all of the factors influencing a company's possible success, it has to gather a lot of information, put different factors together, and look at the big picture of its potential before taking any steps towards internationalization.

2.4 Types of Foreign Entry Modes

One of the most important decisions regarding the internationalization process of firms is the choice of entry mode to a new foreign market. The selection of an appropriate entry determines whether the firm firm's . Expansion into foreign markets can be achieved via the following mechanisms (Brassington and Pettitt, 2006):

- Exporting
- Franchising
- Contracting
- Licensing
- Subsidiaries
- Joint Venture
- Strategic alliances
- Direct Investment

Figure 1. Comparison of Foreign Market Entry Modes (Brassington, Pettitt, 2000)



2.2.1 External factors influencing choice of foreign entry modes

Socio-cultural distance. According to Hollensen (2001) countries that have similar business and industry practices, language and cultural characteristics, as well as comparable education levels are socio-culturally close to each other. Great differences within these factors may have a strong influence on the choice of foreign target market and mode of entry. The greater the difference, the more likely it is that the company will stay away from the entry modes as FDI (Foreign Direct Investment) and would prefer joint venture instead. Companies favor low resource commitment and high flexibility when the socio-cultural distance is high.

Country risk and demand uncertainty. Foreign markets are often considered more risky than the domestic ones. Risks concerning investments, inventories, receivables and exchange rates have to be taken into consideration. However, not only economical, but also political risks have to be considered. When the country risk is high, companies favor entry modes, which require low resource commitment (Hollensen, 2001).

Market size and growth. These factors are extremely important when choosing entry mode. The larger the market and the higher the market growth is, the more likely companies are to commit to high resource demanding modes: wholly owned sales subsidiaries or majority owned joint ventures. Small markets can be served by exporting or licensing, if the market is geographically isolated and cannot be served directly from the home country (Ibid.).

Direct and indirect trade barriers. Tariffs and quotas on import products favors the establishment of local manufacturing subsidiaries. Product and trade regulations and host country's product standards also influence the choice of entry mode. For example, preference for "national" products in the host country favors the creation of joint ventures and other contractual arrangements with local companies. When regulations and standards demand significant product adaptations, companies often establish local production, assembly or finishing facilities (Ibid.).

Laws and regulations. The form of entry mode might be regulated or prescribed by the government in the target market country (De Burca, Brown and Fletcher, 2004).

Geographical distance. When the geographical distance between the countries is great, then the shipping costs for products become too high and therefore direct and indirect marketing become ineffective; forms of entry modes like manufacturing subsidiaries or contracting are more appropriate (Root, 1994).

2.2.2 Internal factors influencing choice of foreign entry modes

Speed. Depending on the choice of foreign entry mode, the time of reaching the target market may vary. Some entry modes might take years to implement, while others take a lot less time (Brassington and Pettitt, 2000).

Costs. Different types of entry modes require different investments. It might be that the usage of certain entry mode can justify high costs due to high benefits in the long run (Ibid.).

Payback. Payback time for the company's investment can be crucial when an organization enters a foreign market. In order to receive the profit in shorter period of time it is wiser e.g. to acquire a local established manufacturer, rather than building a new factory (Ibid.).

Long-term profit objectives. The organization must know in advance, what it wants to achieve in the foreign market and how to exploit the opportunities the market has to offer. The choice of foreign entry mode is a first step in a long-term strategic plan (Ibid.).

Company size. Size of the company indicates its resource availability. The larger the company, the better resources it has for the foreign involvement (Hollensen, 2001). However, SMEs have less bureaucracy, hierarchical thinking and expensive information systems. They are more innovative and customer-oriented and have shorter response times in implementing new technologies and meeting specialized needs. Developing and managing business and social network relationships can increase the smaller firm's rate of international development. Smaller companies can also benefit from working with larger companies already gone international (Ibid.).

International experience. Previous international experience reduces the costs and un-certainty to serve a new foreign market (Ibid.).

Product complexity and differentiation. When deciding where the production should be located physical characteristics of the product play a very important role. Characteristics, use and selling of the product may vary extensively from one product to another, which greatly influences the choice of foreign entry

mode. For example, complex technical products require before and after sales, which may be a problem when the company is using intermediaries. This may encourage a company to use their own production, assembly or finishing facility in the host country. These forms of entry modes require high financial and human resources. It is easier to sell less complex products, which do not require differentiation by using direct or indirect export mode, especially if these products have a high value or weight (Hollensen, 2001).

Risks. If the company is not willing to take many risks when entering a new market, it will most likely use direct or indirect export more or some form of intermediary; these entry modes require less financial, human, and managerial resources. These modes also provide low control, low risks and high flexibility for the company. Joint ventures and other forms of contractual agreements provide a way of sharing risks, financial exposure, and costs for establishment, local distribution channels and local personnel. These forms of entry require considerable amount of time and effort. The most expensive modes of entry are local production, assembly or finishing facilities. These modes provide high risk, high control and low flexibility for the company, however in the long run they may benefit the company the most (Ibid.).

Control. The degree of control the company requires over international operations has to be taken into consideration. The level of control is linked to the resource commitment abroad. When using indirect export, a company has little or no control, at the same time it has to provide minimum resources. Contractual manufacturing or licensing provides more control. Joint venture gives even more control, though control issues may create a major conflict between the partners. Wholly owned subsidiaries provide the most control, but they also demand high managerial and financial resource commitment (Ibid.)

Flexibility. Export mode is the most flexible one; companies using this mode may quickly adapt to the changing environment and make a withdrawal from the foreign market. Intermediate or contractual modes may limit the company's ability to adapt to the changes. The least flexible modes are the ones with high resource commitment, like wholly owned subsidiaries (Ibid.).

Relationships. The relationships the company has with its suppliers and customers can highly affect the choice of foreign entry mode. The more complex the entry mode is, the deeper and closer the relationships, commitment and trust will be. Better and deeper relationships with suppliers and customers create strong networks between companies (Fredrick & Webster, 1992).

Managerial reasons. Previous experiences of company's management affect the choice of foreign entry mode. Country of birth, age, education, years spent abroad, frequency of business trips, knowledge of the foreign markets may affect positively or negatively on manager's willingness to go international and the further commitment to the new market (De Burca, Brown and Fletcher, 2004).

3 RUSSIA AS A TARGET MARKET FOR FINNISH COMPANIES

3.1 Economic environment. General overview.

Russia was the EU's third trading partner, after the USA and China. The EU is by far Russia's main trading partner, accounting for more than 54% of its overall trade. Trade between the two economies showed steep growth rates until mid-2008 when the trend was interrupted by the economic crisis and unilateral measures adopted by Russia, which had a negative impact on EU-Russia trade. Since 2010 mutual trade has resumed its growth and reached its record levels in 2012 (European Commission. Countries and regions. Russia)

However, the Russian economy is currently struggling again. The combination of low oil prices, international sanctions and geopolitical risks have a great effect on the economy, which is expected to enter into a deep recession this year. Although the manufacturing and services PMIs (Purchasing Managers Index) improved this April, especially in services, the results continue to show challenging business conditions in both sectors. On the positive side, the ruble has made a comeback in recent weeks, which was caused by the rebound in oil prices, the ongoing deleveraging of Russia's corporate sector and easing tensions with neighboring Ukraine.

Panelists (The Focus Economics Panel) expect the economy to contract 4.2% this year, which is up 0.1 percentage points from last month's (April) forecast. In 2016, the panel expects the economy to recover somewhat and grow a tepid 0.4%. (Focus Economics, Russia Economic Outlook, May 2015)

3.2 Finland-Russia economic relationship

Trade between Finland and Russia had flourished throughout the present decade and Russia had reemerged as being among the most important trading partners for Finland. In 2005, Russia's share of Finland's total foreign trade

was 12%, and in terms of trade turnover, Russia was Finland's second biggest trading partner, second only to Germany (Russia in the Finnish economy, Simon-Erik Ollus and Heli Simola, Sitra Reports).

The investments of Finnish firms in Russia have also contributed to the competitive advantage of Finnish companies and have clearly been profitable: they have gained returns on most of their investments made in the 2000s. (Ibid.)

Unfortunately, the picture has changed since year 2014, and nowadays Finland's economic recovery depends on Russia normalizing trade relations with Europe. Finland is more exposed than any other euro member to the economic sanctions taken against Russia.

According to the Prime Minister Alexander Stubb: "Finland's economy is in the middle of a "lost decade" as the EU's deteriorating ties with Russia collide with a decline in Finnish industry". The biggest risk is the uncertainty over how long this crisis will last. Open economies like Finland benefit greatly from global trade, but also take the biggest hits in difficult times like the ones we are currently facing. (Finland's Economic Fate Hinges on Russia as Relations Worsen, Kati Pohjanpalo, 2014)

According to the head of the political party of Finland "Centre" ("Keskusta"), Juha Sipilä, Finland needs to maintain good neighborly relationship with Russia and that the European Union is obliged to pay the damages Finnish producers have suffered because of trade restrictions with Russia due to the economic sanctions.

"Center" party supports the EU's anti-Russia sanctions; however, Sipilä notes that European Commission should support the victims of the sanctions, i.e. Finnish producers.

An opinion poll (according to a national survey conducted by the Finnish chambers of commerce) has revealed that most businesses in south-eastern Finland are already facing repercussions from the recession in Russia, more than half of all companies in the south-eastern region of Kymenlaakso have already been damaged by the West's sanctions against Russia. About 1,700

companies from the region took part in the poll. (Finland's Border Areas Hit Hard by Anti-Russian Sanctions, Sputnik News, 2015)

3.3 Conclusion

Russia is one of Finland's most important business partners and Finnish companies take Russia's economic crises in their stride. In the 2000s, foreign trade between Finland and Russia grew by around 25 per cent a year prior to the economic crisis in 2009. The consequences of the current crisis have already started to show at a rapid pace. For many SMEs, especially in eastern Finland, Russia is the first and only country in which to establish international operations Russia in the Finnish economy (Kosonen, 2010). Finland also has a strong position in total Russian imports because nearly 30 per cent of Russia's total imports transit through Finland. In relation to the population, Finnish direct investment in Russia is among the highest in Europe. The presence of the Finns can also be felt in Russia: in St Petersburg and its surroundings, Finns account for around one-fifth of the foreign-owned companies in the area. (Russia in the Finnish economy, Simon-Erik Ollus and Heli Simola, Sitra Reports)

Although the Russian economy declined dramatically in 2009, the upturn has also been rapid. The current crisis has a far more strong effect on both Russian and Finnish economic situations, as it has the political nature and involves the whole EU. There is no expectancy that Russia will achieve the speed of growth prior to the crisis in the near future. It is already clear that sanctions hit Finland disproportionately, and the aid from the EU partners may become necessary in the nearest future.

However, during the past decades, the Finns learned how to make business with Russia and they still take the economic potential of the neighboring country very seriously. During any economic crisis one man's loss, has always been another man's gain; and any complicated situation has a potential of giving birth to new unexpected opportunities.

4 MARKET ANALYSIS

4.1 Construction industry in Russia

According to PMR (PMR Publications), in 2013 the construction industry was impeded only by civil engineering construction. This trend continued in 2014, but a fall in non-residential construction activity was also recorded last year. Many new developments have been postponed, and this has ultimately delayed the expansion of Russia's still struggling construction industry.

The key factors contributing to the decline in construction activity in the last few years are:

Weak economic growth, with the GDP growth rate falling to 0.6 percent in 2014 from 1.3 percent a year earlier and expected to contract more than 3 percent in 2015. Lack of growth in fixed capital investments, which underwent a 2.7 percent year-on-year decline in 2014, following a weak 0.8 percent growth recorded a year before. This indicator expanded by 10.8 percent and 6.8 percent in 2011 and 2012, respectively. Among the key factors that contributed to the decline in fixed capital investments in 2014 were the ruble's double-figure devaluation (50 rubles for 1 EUR in spring 2014, 90 rubles for 1 EUR in December 2014), which has made imports significantly more expensive, the sharply deteriorating macroeconomic performances in Russia and negative revisions for economic development in the near future (PMR Publications, Europa Property, Construction industry in Russia to resume growth in 2016, April 2015).

In 2014 oil and gas companies started to cut previously planned investment programs, mostly because of the deteriorating fund-raising environment for Russian energy companies in the wake of industry-specific sanctions imposed by the developed countries, along with the substantial devaluation of the ruble, which eventually made the import of technologies more expensive. (PMR Publications, Europa Property, Construction industry in Russia to resume growth in 2016, April 2015)

Nevertheless, the construction industry in Russia is projected to resume growth in 2016, mostly thanks to the following factors (Timetric Construction Reports, Construction in Russia – Key Trends and Opportunities to 2018, 2015):

- Low base effect created after a notable contraction in 2015 preparation for the 2018 FIFA World Cup will start to go through the active stages of many of its large-scale infrastructure projects. There are 11 host cities for the World Cup, indicating a broad demand for stadia, transport infrastructure and accommodation. The hotel market is highly developed in major cities such as Moscow, Saint Petersburg and the Black Sea, and resort towns such as Sochi. Small cities with a population of around 1 million such as Pereslavl-Zalessky, Ryazan, Irkutsk and Lipetsk are registering a rise in the construction of hotel projects. Host cities submitted projects to be developed with a total value of about \$43 billion. At least \$21 billion will be spent in the next five years from government and private investors (Ibid.)
- Retail construction market - ranks №1 in Europe (building retail space). Reason: still has a lower ratio of shopping malls to people. Moscow is the most popular European city that attracts international retail chains. 41 new international brands entered the Moscow market in 2014 (PMR Publications, Europa Property, Construction industry in Russia to resume growth in 2016, April 2015)
- Continuous active residential and commercial construction in the Moscow area. Many projects in both the middle and luxury segments - opportunity for manufacturers of windows, doors and other finishing materials (Ibid.)
- Green building materials and energy saving technologies. Increasing demand due to increasing utility tariffs (Timetric Construction Reports, Construction in Russia – Key Trends and Opportunities to 2018, 2015).
- The inflation in Russia will start to ease gradually, thus creating background to the Central Bank for further rate cuts, which ultimately will encourage banks to offer less expensive loans (PMR Publications, Europa Property, Construction industry in Russia to resume growth in 2016, April 2015).

From the personal experience, the researcher can add that nowadays the citizens of Russia with “free” money tend to invest in real estate property in times of crisis, as this is the only “hard currency” they trust.

Furthermore, political tensions between Russia and the EU countries are expected to ease gradually from 2016 onwards, with Russia being more interested in improving deteriorating relationships, as oil prices will not rebound to triple-figure values in the near future (PMR Publications, Europa Property, Construction industry in Russia to resume growth in 2016, April 2015).

4.2 Solid surface market in Russia

Cast polymer products or solid surfaces are relatively new in the Russian market. Local entrepreneurs are very interested in establishing an engineered stone factory in one or more territories of the country. Interest in cast polymer production equipment and technology is primarily registering from the construction sector.

In Russia, solid surface was first created in 1975 at the Moscow Institute of Chemical Technology and in the Yerevan (Armenia) Institute of Stone and Silicates. In the former USSR, a plant in Estonia produced cultured marble bathroom equipment for Sweden. Today, several polymer cast manufacturers in Russia are located in geographical proximity to Moscow or in Western Russia. The Tver-based Polymer Concrete Company manufactures equipment for bathrooms utilizing local ingredients, such as limestone for filler. Novoteks Company has ten years of experience in the Russian market and produces a broad assortment of cast polymers, including equipment for bathrooms, finishing materials for construction (floor/wall tiles), windowsills, etc. A Moscow-based company KAMROCK® manufactures engineered stone imitating rock, limestone, dolomite, pebbles, and brick for interior and exterior finishing. The company has a well-developed distributors' network throughout Russia. Synthetic unsaturated resins are manufactured at two plants in Western Russia.

The current leading suppliers of solid surface materials to Russia include DuPont, Wilsonart, Formica, Avonite, LG Chem (Korea), NESTE Chemicals (Finland), and Cheil Industries (Korea). However, Russian market for engineered stone finishing materials is insufficient to meet the demand.

The demand for engineered stone and solid surface materials in Russian construction market is expected to increase. Growth is fuelled by consumer interest in the high-end surfacing materials, which are durable, ecologically clean, and aesthetic. (International Surface Fabricators Association, Solid Surface in Russia, by Chuck Sawyer)

The construction industry is the primary consumer of finishing materials.

A local company may enjoy the following benefits from starting a cast polymer production in Russia:

- High profitability/short payback period
- Low autoimmunization -- inexpensive manual labor could be applicable
- Low energy consumption
- A small production facility allows manufacturing a broad assortment
- Local fillers are in abundance

A local manufacturer can expect to supply cast polymer products to the following end-users in Russia:

- Construction companies
- Building products wholesalers
- Firms/Individuals finishing their facilities
- Municipal construction committees
- Food processing/chemical/medical facilities refurbishing their facilities.

4.3 Conclusion

Firms entering Russia face several barriers. These barriers include a lack of information, unclear regulations and corruption. According to traditional research on internationalization processes, market entries either take place through intermediaries such as agents or distributors or through a firm's own representative in the country, mainly a subsidiary. The choice of entry mode is affected by firm resources; as compared to small firms, large firms tend to have greater levels of economic and managerial resources for investments in the host market of entry.

Research shows that most of the exports either take place directly through dyads or indirectly through intermediaries such as agents and distributors. Russia stands out by having most indirect export relationships, with agents being of equal importance to distributors (Söderqvist, Holstius, 2005).

A major issue in third-party relationships is to allocate marketing resources between relationships to the intermediary and to the customers. The relationship with the agent provides the seller with a linkage to the market: to obtain information on the market and to manage the communication with customers in the foreign language, and with parties belonging to another business culture. The indirect relationship could, however, cut off the seller from its customers, in particular since it is in the interest of the agent to keep the seller in darkness about market developments. Large social and cultural distances tend to prevent sellers from being involved in the market and build up network experiential knowledge and institutional knowledge. The learning by the seller is especially low when the relationship with the agent is weak.

The agent works more as a support organization in the local market, assisting the seller with sales and service, and working as a language and cultural interpreter. However, communication problems of the type discussed above can also be found for this type of agency relationship. These problems are hard to solve in any major way as long as the representative in the market is an independent firm, which cannot be fully controlled by the seller (Söderqvist, Holstius, 2005).

Network relationships are a critical part of the entry process in the East Baltic countries and Russia. To create relationships, it is a question of finding contacts, maintaining, and developing them. To reach the final stage, striving for long-term relationships is critical. It is an advantage to be present in a market through a local representative or a firm's own subsidiary. In terms of future plans, some firms want to stay with their present agents, since they benefit from these contacts, as well as enjoying a reduction in risks. Other companies plan to replace the agent with a subsidiary of their own. To have many good relationships, having their own representative in the market, and direct contacts through own customer visits are important strengths. Some companies saw the lack of good relationships as a major weakness, as it is challenging to find influential and profitable contacts. A poorly developed contact network often accompanies inexperience in a market.

Compared to the past, when one had to know people, who know people, bidding process and the process of locating potential customers in Russia has become significantly easier. Nowadays, bidding process is highly influenced by rapidly developing e-commerce. E-platforms are used to announce new tenders, and therefore the information has become available to a much wider group of bidders. These platforms are used by both, private companies and developers.

Government tenders are published at <http://www.zakupki.gov.ru>, the state-owned tender e-platform. Russian government is applying efforts to eliminate corruption during the bids.

Despite of the positives the obstacles remain:

- Corrupt self-regulation organizations and the industry in general
- State-subsidized contractors are reluctant to try new technologies and working with new partners
- More than 75% of construction materials are sold through distributors or by representative office in the country with a rather high markup (average 50%).
- Country's own certification system, not applicable in any EU country

- Extreme importance of Russian language knowledge. E.g., all tenders are published only in Russian language in accordance with Russian legislation (Russia's Construction Sector/What is the Russian Market Demanding? Timur Uddin, Commercial Specialist, Pavel Smolenkin, 2014)

It is clear, that the relationships are a critical part of entering the Russian market. A surprisingly large share of the international trade is direct between customers and suppliers via subsidiary. There is a low degree of FDI by the SMEs in Russia; that is caused by the SMEs' lack of resources. This observation demonstrates the importance of building strong business networks to be successful in a host country market. SMEs in Finland lack resources to obtain knowledge on complex markets like Russia, which results in trade complications.

5 RESEARCH METHODOLOGY

The purpose of this research is to study and analyze Finnish small and medium sized enterprises' internationalization, SMEs' choice of foreign entry modes, external and internal factors that influence this choice and what is the most important – how to implement this knowledge in case of a particular company, Tonester Ltd, and the new potential target market – Russia.

Qualitative research method was chosen in order to accomplish this thesis. It is important to keep in mind that the empirical data used in this thesis is highly based on the company's, the respondent's and the researcher's perceptions and attitudes.

Structured and non-structured in-depth interviews, continuous observation of company's activities and management's behavior, as well as the researcher's personal experience as a case study company's employee were used as data gathering procedures.

Deep knowledge of the industry and company's daily routine played an important role in this study, and gave the researcher an opportunity to explore the research subject in its natural settings. The researcher was involved in all the case study company's export activities, starting from accepting orders and ending with distribution establishment, e.g. she was in charge of the North American distributors marketing needs, providing them necessary information, marketing material, taking part in trade fairs etc. The researcher has also taken part in numerous trade fairs in the UK and Finland as a company representative.

Interview questions (Appendix 1) were created based on the theoretical part of this work; the data was collected from books, articles and Internet sources. Both types of interviews, structured and non-structured, were chosen because the researcher has a good knowledge of the industry and was able to go deeper into the subject during the non-structured interviews; though, the structured interview was also necessary in order to get the precise information

and avoid unnecessary side tracking. Structured interview was conducted face-to-face in order to be able to explain possible misunderstandings in the questions asked. The researcher has chosen to interview the founder and the co-owner of the company for obvious reasons. Miss Tuominen, who also carries a title of the company's Design Manager, possesses the knowledge of company's history, its development and has been actively participating in all of the activities related to both, domestic and international sales. Mister Kari Karppinen, the Managing Director of Tonester Ltd, has also taken part in the interview. The former colleagues of the researcher were interviewed in the non-structured manner. The researcher has also gathered the information on company's internal and external activities by participating in weekly and monthly meetings, trade fairs and business events.

Besides interviewing and observing the case study company, Tonester Ltd, the researcher has also conducted the non-structured interviews with construction and design industry SMEs during Habitare event 2013 - 2014, Filnand's largest and most reputable design, furniture and interior decoration fair. The style of the interview was informal; the researcher engaged in conversations with SMEs presenting at the fair and asked them basic questions on their internationalization plans. Such as: Have you already been involved in international activities? If so, what are the countries you trade with and through what entry mode? If not, then do you have any plans of going international? etc. The majority of representatives have responded positively to the first question. Most of the Finnish SMEs in design or interior decoration industry have at least one foreign trading partner. The researcher has also made the conclusion that the statement from chapter 2 of this thesis: "many SMEs get themselves involved in any project available in order to gain international recognition and extra sales without a carefully thought-through strategy for a specific market (European Commission, 2003)". is correct.

6 INTERNATIONALIZATION OF TONESTER LTD

The detailed analysis presented in this chapter is based on the results gathered through the structured interview (Appendix I), non-structured interviews and observations of the case study company's activities. The existing theory is taken as a base for this analysis.

6.1 International market selection by Tonester Ltd

The main factors influencing Tonester Ltd's market selection are:

- *Geographical closeness of the foreign market.* Tonester Ltd is highly transport dependent. In the present moment, it is not profitable for the company to concentrate on the distant markets, due to the high transport costs and damage risks. The company is not able to conduct direct exports without the geographical closeness.
- *Market size and potential.* Russia is one of the biggest and most important trading partners for Finland. The demand for engineered stone and solid surface materials in Russian construction market is expected to increase. Construction industry in Russia is projected to resume its growth in 2016; the current weakened state of the national currency (ruble), general uncertainty and saving policy accepted by many companies, are the major obstacles for companies considering the Russian market entry at the moment. However, the weakened economic state of the country creates new opportunities for foreign SMEs willing to invest in the local labor force. Potential employees are willing to work for less and are in need of new job opportunities.

6.1.1 External factors influencing international market selection

The analysis of each factor is based on the interview responses by Ms. Tuominen, Mr. Karppinen and the researcher's personal experience. The researcher's opinion can be considered valuable, because during her work-

placement at Tonester Ltd she was involved in all the export activities carried on by the company.

Economic influences

Per capita income is very significant when Tonester Ltd selects their international markets. The company's main customers are the upper middle to higher income class. This statement mainly concerns the orders in Finland and other European countries. Tonester Ltd manufactures a high quality product and offers its clients flexible delivery times. The factory in China can serve other markets at a lower price; however, the delivery times are much less flexible because of complicated logistics.

Infrastructure is an important factor when Tonester Ltd selects their international markets due to the fact that the company highly depends on transports. In order for the product to be successfully delivered to the destination, the company needs a safe and well-managed logistics network. One of the researcher's tasks was to arrange deliveries to the company's international clients. Due to the product's nature only certain types of logistics services could be used, which often resulted in complications and additional financial expenses.

Exchange rates have a significant importance for the international market selection for Tonester Ltd. Finland belongs to the Euro zone and with a weakened value of Euro at the present moment; it is a lot easier to have a successful trade with markets like USA. However, high dollar value and weakened ruble in Russia has become an obstacle. Both countries are very important target markets for Tonester Ltd and both of them have dollar as their main trade currency; USA officially and Russia unofficially.

Socio-cultural influences

Psychic distance has only average importance in international market selection for Tonester Ltd. Similarities in culture and language have helped the company's success in the Nordic countries, but being a small company it has received a lot of attention from the overseas markets such as USA, Japan and Australia. Tonester Ltd's main trading partners after Finland and Sweden are

Holland and Great Britain, and the last but definitely not least – Tonester Ltd has a joint venture with the company in China.

Political and legal influences

Political stability is not a key factor when Tonester Ltd selects their international markets. However, laws and regulations have a higher importance. Due to the specific nature of the product produced by the company, laws and regulations of the construction industry in different countries may either significantly benefit the trade or really slow it down. Mr. Karppinen has taken part in the events arranged by Finpro (www.finpro.fi) and has been approached by companies interested in setting up a foreign subsidiary in e.g. African countries or Syria. Due to the unstable and unpredictable political situation in those countries, the offers were declined.

Trade barriers had no importance in Tonester Ltd's previous market selections, as it was mostly trading within the European Union, which has no restraining trade barriers. However, when choosing Russia as its new target market the company has a set of challenges and a lot to learn about different regulations and barriers when building its entry strategy (please refer to chapter 4 of this thesis). Neither Ms. Tuominen, nor Mr. Karppinen have any knowledge on this matter. The researcher would suggest contacting the above-mentioned Finpro, as they possess the necessary information and offer free of charge service in internationalization for Finnish SMEs.

Market attractiveness

Market size and growth rate are very important factors in the international market selection by Tonester Ltd. As previously mentioned, the company's product Durat belongs to the high-end

Russian market growth has slowed down significantly due to the current crisis, however the prognosis is optimistic and the economy is due to resume its growth in 2016 (Chapters 3 and 4).

Competition has become significant during the past decade. There are very strong players producing similar products. The company still maintains its positions on the domestic market, but the completion in e.g. Northern America

is fierce. According to Ms. Tuominen the main reason why the company started to export during its very early years, was because they had no competition. The clients approached the company, and not the other way around. Tonester Ltd and its product DURAT still occupy a specific niche and have clientele, which remained loyal to the company not only in Finland, but also in the international markets. Unbeatable environmental value of the product was the reason for its popularity in the past and it is only becoming a stronger advantage because of the global environmental awareness and new positive laws and regulations. However, the ever-growing competition and the high cost of the product have caused in the loss of turnover during the past three years.

Profit and market potential are very important factors when Tonester Ltd selects their international markets because the company has high fixed costs. Both Ms. Tuominen and Mr. Karppinen have agreed that because of the company's current weakened state, the quick profit is now more important than a long-term goal. However, they have recently made significant financial investments in the US market, which has a tremendous potential for Durat.

Market access has had no major significance for Tonester Ltd in the past, but trading with more geographically and culturally distant European countries such as Spain or France, or overseas markets like USA, has proven that the market access is actually an important factor. Ms. Tuominen and Mr. Karppinen have both struggled with the fact that they could not manage those markets with their own resources and are forced to create the distribution channels, which is always a costly process. Market access factor would have a vital importance in Russia because of the cultural distance, gray trade and trade barriers (Chapter 4). Besides, there are existent informal ties between the local suppliers and distributors, which can make it difficult for the new companies to enter the market.

6.1.2 Internal factors influencing international market selection

Company's capability profile involves factors like skills, resources, product adaptation and competitive advantage (Jobber, 2004)

A company has to ask themselves whether they have the necessary skills and resources to market abroad. The company also has to ask themselves whether they are willing to adapt the product to meet the needs and wants of local clientele, and whether it has the competitive advantage to survive on the potential export target market.

Company capability profile

Skills within the company are of high importance when Tonester Ltd selects their international markets. Higher management and sales department are actively involved in the development of both domestic and international markets. It is essential for the company to have qualified and dedicated personnel, as it is small in size.

Resources are highly important for the international market selection by Tonester Ltd. Products like DURAT need rather heavy marketing, therefore positive turnover is essential in order to be able to enter the new international markets and to compete within the markets. It is also important to remember that the resources are needed not only at the beginning of the establishment. The competition is ever growing and the company constantly needs to remind of itself through participating in foreign fairs, establishing new retailers and agents, advertising in magazines, arranging "lunch and learns" etc. Based on the researcher's own observations, this is where the company tends to fail. Even though, both Ms. Tuominen and Mr. Karppinen seem to understand the concept, they have not been successful in planning for long-term objectives.

Product adaptation so far has had an average level of importance in international market selection by Tonester Ltd. Scandinavian style and design have gained high popularity all over Europe and overseas countries during the past decade, therefore Tonester Ltd had no need to adapt the product to any

of the countries it has been trading within the past. However, in case of Russia, there would be a need for adaptation to the market. Ms. Tuominen and Mr. Karppinen have attended Mosbuild trade fair in Moscow and have seen that the clientele preferences differ from the ones in Scandinavia and Western Europe.

Competitive advantage is of high significance to Tonester Ltd. The company provides high quality sustainable product, which gives it a competitive advantage, as there is no other material on the market that has the same qualities and possesses the same environmental value. The opening of the factory in China gave Tonester Ltd an opportunity to take over larger projects for e.g. hotels and restaurants, as it can now offer larger quantities at a lower price, which was not possible to achieve by only having a factory in Finland. However, as already mentioned in section 6.1.1 the situation is rather challenging because of the ever-growing competition and low purchasing power.

Company's potential

According to Dahringer and Mühlbacher, the company has to prepare a careful SWOT analysis in order to take advantage of the environmental opportunities and to avoid the potential threats from the environment. The company's skills and resources must be studied and adjusted to the international environment. This part has proven to be the most challenging for Tonester Ltd. Strong ambitions of the management team do not match the company's current potential. The analysis of this chapter is mostly based on the researcher's own observations and non-structured interviews of the company's two former employees, who wish to remain anonymous.

Management ability, flexibility and commitment are the key factors for the international market selection. The employees of the company are not eager or willing to fulfil the new goals without a total management support, commitment and motivation. The management has proven to be flexible with the existing foreign markets, but has a hard time adapting to the new ones. The current lack of financial resources prevents them from being more adaptable to the constantly changing global business environment.

Planning and control are highly important for Tonester Ltd. Company's daily operations require strict control, precise organization and an efficient follow-up. Current management seems to be lacking the effective leadership and communication skills, which results in less than desired results.

Excess capacity is of high importance to Tonester Ltd. Possibilities gained with the opening of the factory in China gave Tonester Ltd a chance to enter new international markets. The capacity is currently not being used at its fullest, which results in the loss of turnover.

Personnel's motivations and qualifications are of high importance to Tonester Ltd when selecting new international markets. Due to the company's small size, it is vital that each employee is dedicated to the new task and has qualifications to perform it well. Because of the recent downsizing, the remaining employees met the challenge of multitasking. They also have to perform the tasks they were not originally qualified for. The employees are reluctant to set the new objectives and goals, and undertake new projects.

6.2 Tonester Ltd's choice of foreign entry modes

Tonester Ltd has previously chosen direct and indirect exports as their main foreign entry modes, due a relatively low country risk and minimal investment. They have established a joint venture company in Ganzhou, China in 2007. This company was found at the pick of Tonester Ltd's international activities. The economic conditions were favorable on both, domestic and foreign markets, but the capacity at the Finnish factory was very limited. Expanding in Finland would have been expensive because of high labor costs. The company used the in-house relations to complete this project. Mr. Yu, who used to work for Tonester Ltd in Finland had the necessary cultural background and the language skills to assist the management. Mr. Yu, Mr. Karppinen and the former employer of Tonester Ltd Mr. Rantanen, who had the technical background and has previously worked in Asia, have paid several visits to business events and trade fairs in China in order to find the right partner. The process took 2 years. The above information was gathers through

interviews and researcher's own experience, as she became the employer of Tonester Ltd right before the contract between the 2 parties was signed. Mr. Yu currently works in China, but is employed by Tonester Ltd Finland. His position is humorously described by Mr. Karppinen as "Finnish eyes and ears".

6.2.1 External factors influencing choice of foreign entry modes

Socio-cultural distance is moderately significant for Tonester Ltd's choice of foreign entry mode. Socio-cultural closeness of Nordic countries has eased the market entry when the company made its first steps in the international markets. The communication with local sales representatives is also easier when the cultures are similar. However, working with the Chinese partners has proven to be very challenging. The psychic distance between the two countries is enormous. Despite of the presence of Mr. Yu and his efforts to make the communication more effective, there have been multiple conflicts with the Chinese management. This information is based on the researcher's personal experience in the company, as she had to function as an intermediary between the factory in China and Tonester Ltd's clientele in Europe and Northern America.

Country risk and demand uncertainty are important factors to take into consideration when choosing foreign entry modes for Tonester Ltd. The company acted on several foreign markets before making a decision to create a joint venture company. Good knowledge and information about the market are crucial in determining which entry mode to use, the level of involvement, investments and risks. Based on the interview results, both Ms. Tuominen and Mr. Karppinen, though being extremely tempted by the Russian market size and potential, are equally concerned about the current political situation and economic instability in the country.

Market size and growth are of high importance for Tonester Ltd's choice of foreign entry mode. These factors have affected the potential customer search, and further on the search of sales representatives. The bigger was the market potential, the more investments were made. Joint venture in China is a perfect

example. It was necessary to establish in order to create excess capacity and serve such large markets as the North America and Canada. Small markets can be served by exporting (preferred entry mode) or licensing, if the market is geographically isolated and cannot be served directly from the home country (Hollensen, 2001).

Direct and indirect trade barriers have had no significant effect on the choice of foreign entry modes by Tonester Ltd until recently. The new markets, such as USA, Canada, Australia and potentially Russia in the future, have different direct and indirect trade barriers, which need to be studied carefully before making a final decision on the choice of foreign entry mode. As previously mentioned in the section 6.1.1 of this chapter, neither Ms. Tuominen, nor Mr. Karppinen possess the necessary knowledge on the subject and need to consult a professional organization such as Finpro.

Laws and regulations have had low importance when choosing foreign entry mode for Tonester Ltd. However legal restrictions and demands in the new potential markets may affect the company and force them to make certain product adaptations. This knowledge can be obtained from the professional organizations as well as the knowledge on direct and indirect trade barriers.

Geographical distance is of high significances for Tonester Ltd when choosing a foreign entry mode since the product is transport dependent. Having warehouses in the most active markets and strong relations with local sales representatives is essential. Independent deliveries of products outside Europe are cost and time consuming, they also has a great risk of potential damages with no local support to resolve the problem. The above conclusion is based on the researcher's personal experience, as she was in charge of weekly deliveries all around Europe.

6.2.2 Internal factors influencing choice of foreign entry modes

Speed is a key factor for Tonester Ltd's choice of foreign entry mode. It is important for the company to gain revenues and profits relatively fast when entering a new market, in order to compensate foreign investment costs.

Therefore, they have chosen direct and indirect exports as the main forms of

entry modes. Establishing a joint venture company in China took 2 years, and a lot longer to make the operations work. The impression the researcher gained from Ms. Tuominen's and Mr. Karppinen's answers to this question was that they do not put the emphasis on the long-term goals, but want the profit immediately and therefore are willing to engage in any kind of project which will offer them a quick result.

Costs are important in Tonester Ltd's choice of entry modes. Costs usually have a stronger importance at the beginning of company's internationalization, however due to the small size of Tonester Ltd and expensive fixed costs, costs are still of high importance when choosing an entry mode. In case of Russia costs will be higher than in the previous international markets due to the socio-cultural difference and complexity of market. Significant investments would have to be made in order to have a proper market study and finding a new local representative. Marketing costs will also be high as DURAT is unknown in the Russian market and will require significant publicity. It might be that the usage of certain entry mode can justify high costs due to high benefits in the long run (Brassington and Pettit, 2000). Which would be applicable in this case, if it was not for the company's weakened financial state and the challenging country conditions in Russia.

Flexibility is important for Tonester Ltd's choice of foreign entry mode. "Export mode is the most flexible one; companies using this mode may quickly adapt to the changing environment and make a withdrawal from the foreign market. Intermediate or contractual modes may limit the company's ability to adapt to the changes. The least flexible modes are the ones with high resource commitment, like wholly owned subsidiaries" (Hollensen, 2001). The researcher cited the above to Ms. Tuominen and Mr. Karppinen, and they both agreed that the company has been acting according to this theory during all the years of its international activities.

Risks "If the company is not willing to take many risks when entering a new market, it will most likely use direct or indirect export more or some form of intermediary; these entry modes require less financial, human, and managerial resources. These modes also provide low control, low risks and high flexibility for the company. Joint ventures and other forms of contractual agreements

provide a way of sharing risks, financial exposure, and costs for establishment, local distribution channels and local personnel. These forms of entry require considerable amount of time and effort. The most expensive modes of entry are local production, assembly or finishing facilities. These modes provide high risk, high control and low flexibility for the company, however in the long run they may benefit the company the most” (Hollensen, 2001). The description of *risks* factor cannot be described in a better way, than it was done by Hollensen. The theory can be implemented to a case study company by 100%. According to Mr. Karppinen his dream is to have at least three fully owned foreign subsidiaries in different parts of the World, but unfortunately it is just a dream at the moment.

Payback does play an important role for Tonester Ltd’s choice of entry modes. According to Mr. Karppinen the company’s size and present economic situation require a rapid win back. The company is no position of making large foreign investments. Yet again, his answer proved that the company is willing to get involved in any foreign project without a clear thought-through plan, but to gain the immediate profit.

Long-term objectives should be and are of high importance for Tonester Ltd, but unfortunately currently only in theory. Entering foreign markets with small demand because of the short-term goal makes no sense for the company in a long run and they are striving to establish the long-lasting and fruitful relationships, but in order to improve the financial situation, they are willing to settle for random projects with quick payback time. The above analysis was made based on the interview and researcher’s personal observations through participating in weekly and monthly company meetings.

Company size highly affects Tonester Ltd’s choice of foreign entry modes. The present size and market share of the company do not allow large foreign investments and prevent it from future development.

“However, SMEs have less bureaucracy, hierarchical thinking and expensive information systems. They are more innovative and customer-oriented and have shorter response times in implementing new technologies and meeting specialized needs. Developing and managing business and social network

relationships can increase the smaller firm's rate of international development. Smaller companies can also benefit from working with larger companies already gone international" (Hollensen, 2001). Yet again, the theory fits perfectly into the case study. However, in researcher's opinion the company needs to show more flexibility on the management level, implement less hierarchical style of leading the company (which is unfortunately practiced by both Ms. Tuominen and Mr. Karppinen), and establish and maintain strong relationships with large construction industry players on the domestic market.

International experience is very important when choosing a foreign entry mode. Based on the interview results, the experience gained by the company in Scandinavia, Holland and the UK makes the entry of other European markets easier due to their similarities. Previous international experience has proven that it is virtually impossible for such a small company to practice direct exports with such distant countries as USA, Australia or India. Tonester Ltd was lucky to find a great distributor in the United States, and now relies on their expertise and determination.

Type of product factor plays an important role in Tonester Ltd's choice of foreign entry mode. Due to complexity of some products produced by the company and logistics problems, it has become a matter of vital importance to create a strong network of local fabricators of similar material in the foreign markets, as well as manufacturing subsidiaries, when the financial capital allows it. The company already has a network of local fabricators in the UK, who can manufacture the final product (vanity units, tabletops etc.) from the sheet material supplied from Finland. The practice has proven to be very successful. According to Ms. Tuominen, there is no future for Tonester Ltd without such networks, however establishing the relationships with such companies may take years, as it did happen in the UK case.

Planning and control "When using indirect export, a company has little or no control, at the same time it has to provide minimum resources. Contractual manufacturing or licensing provides more control. Joint venture gives even more control, though control issues may create a major conflict between the partners. Wholly owned subsidiaries provide the most control, but they also demand high managerial and financial resource commitment" (Hollensen,

2001). Ms. Tuominen and Mr. Karppinen have agreed with the above theory 100%. It is very important for Tonester Ltd to be able to control the whole value chain and have reliable manufacturing subsidiaries producing the high quality product. The company has already experienced difficulties with its Chinese partners because of the poor quality control provided by the local production manager. There is also a rather high risk of knowledge spilling when choosing a joint venture mode. Durat is a very unique product with a unique manufacturing recipe; being a founder of the company and one of the creators of the product, Ms. Tuominen is highly concerned with this problem.

Relationships are of high importance for Tonester Ltd's choice of foreign entry mode. Because of the company's small size, limited financial and human resources, good contacts and strong relationships with both local sales representatives and manufacturing subsidiaries are of vital importance. Good personal contacts are also important in finding new clientele, suitable sales representatives, advertising agencies etc. in the foreign markets.

6.2.3 Conclusion

The company has utilized both direct export and direct investments. During the first years of its internationalization, the company used only direct export. Due to low geographical distance, low or non-existing trade barriers and low cultural distance this type of entry mode suited Tonester. The company took the initiative to start exporting in 1993 when the Finnish market was saturated. Tonester saw a growing demand for its product Durat in Sweden and other European countries due to its unique nature and qualities. In 1996, the company expanded its exports to Norway and the United Kingdom. In 2006, the company made a direct investment when the joint venture was created in China. The growing demand for the product not only in Europe, but also in North America, made this step natural and logical in order to create new capacity and satisfy ever-growing markets. The company's investment in China did affect the company's finances and unfortunately, because of the current economic situation, the investment has not been fully paid back.

Tonester Ltd has been primarily influenced by the following external factors in its decision on foreign entry mode:

- Socio-cultural distance, country risk and demand uncertainty, market size and growth, legal restrictions and geographical distance.

Tonester Ltd has been primarily influenced by the following internal factors in its decision on foreign entry mode.

- Speed, costs, flexibility, risks, company size, international experience, type of product, planning and control and managerial reasons.

Company's current potential appears to be a significant obstacle on the way to achieving new goals and maintaining the present positions.

Table 1. Entry modes to Russia. (Researcher's own construction based on the theory by Hollensen, 2001, Brassington and Pettitt, 2000)

Mode	Conditions favoring the mode on the Russia market	Advantages	Disadvantages
Exporting	High political risk, socio-cultural distance, country risk (particularly political risk and current unstable exchange rate)	Low risk and investment, short payback time, speedy entry	Low level of control, tariffs and trade barriers add to total product cost, transport costs, limited access to local information
Licensing	Socio-cultural distance, investment barriers, legal protection possible in target environment	Low risk and investment, speedy entry, ability to avoid trade barriers, high ROI	Low level of control, knowledge spillovers, potential threat of a licensee becoming a competitor, limited license period
Joint Ventures	Socio-cultural distance, high sales potential, country risk,	Overcomes ownership restrictions and cultural distance,	Difficult to manage, decrease of control, knowledge spillovers,

	government restrictions on foreign ownership	establishes long-term goals, combines international experiences of two companies, requires less investment, more flexible than FDI	partner may become a competitor, greater risks than exporting and licensing
Direct Investment	High sales potential	Greater knowledge of a local market, minimum knowledge spillover, can be viewed as a local player	Requires significant resources and commitment, may be difficult to manage local resources, high risks
Sub Supplying	Socio-cultural distance, country risk (particularly political risk and current unstable exchange rate), trade barriers, high marketing and investment costs	Minimum risk and investment, speedy entry, international experience of the main supplier, tariff and trade barriers do not add to total product cost, long-term profit objectives	Very low level of control, potentially long payback time

7 CONCLUSIONS

7.1 Research purpose

The purpose of this research was to understand how the Finnish SME makes their international market selection, what set of internal and external factors determines this process, and how to implement this knowledge into reality.

The following research questions were addressed:

1. How does the combination of internal and external factors affect Tonester Ltd's international market selection?
2. How does the influence of internal and external factors affect on Tonester Ltd's choice of foreign entry mode?
3. How can Tonester Ltd benefit from gathered data and existing theory when entering the new market, in this case Russia?

The first two questions were answered by using secondary data, the existing theory of internationalization process and previous research made on Finnish SMEs, and primary data, gathered through the interviews and observations.

The third question was answered by using secondary data, reports and articles on the Russian economy as a whole and construction industry in particular, and the primary data gathered through observations and personal experience within the case study company.

7.2. Practical implications

Tonester Ltd, initiated their first export activities on their own. There were no unsolicited orders from abroad involved in the beginning, and Tonester Ltd has not been following the gradual stage process in their internationalization. It can be stated that the decision to go international for Tonester Ltd was natural due to the economic recession in the Finnish market at the time and the positive prospects for a future demand in the Swedish market that was similar to the Finnish one. The more experienced Tonester Ltd has become internationally,

the less risky their business abroad has turned out to be. It has been natural for Tonester Ltd to go international and export within the Nordic countries due to the geographical proximity of the markets and the similarities in traditions of interior design, culture and politics. The company had shown stable growth in late 90s and during the first decade of 2000 and had changed the scale of their operations due to the merge with a Chinese company. The situation has changed during the past 3 years because of the economic recession in Finland and the World in general. The company is in desperate need of new prospective markets, as it has the capacity, but no volume in orders.

The recommendation for Tonester Ltd and the companies that find themselves in the similar situation is to look beyond the traditional values and their traditional strategies. Tonester has the capacity and product potential to become a strong player on several international markets, but the lack of human resources, old habits and unstructured approach towards new markets restrain them. Top management involvement and dedication is highly important for SMEs at all the stages of internationalization. Their vision, support and careful follow-up are vital to the employees of a company, as times of internationalization are new and confusing to many, they also often require new knowledge, technology etc., therefore top management guidance and support is needed throughout the process. The researcher has personally come to face the problem while working in Tonester Ltd, when top management had a vision, but was not effectively sharing it with the rest of the personnel or giving the necessary support. The problem still exists at a certain level, but has been partly eliminated by arranging weekly, monthly and annual internal meetings during which the essential problems are discussed, old tasks are assigned and the old are reviewed.

Technology and internet have had a very significant impact on the company's development. Implementing such programs as ERP and CRM has brought the company to a new level by helping it systematically control its internal processes and clientele. International market is filled with products competitive with Tonester's product Durat. Foreign direct investment, such as establishing additional manufacturing subsidiaries, may be risky for a company at its present stage, but by being proactive, highly flexible and innovative the

company can make much needed contact and establish agencies, distributions channels and other forms of similar entry modes.

This will require high concentration and longer term goals. One of the biggest problems for Tonester Ltd seems to be a chaotic approach towards its targets. Many SMEs, including the case study company, get themselves involved in any project available in order to gain international recognition and extra sales without a carefully thought-through strategy for a specific market. Many foreign projects require extra resources, additional certification, certain investment (such a foreign travel), technical support, and efficient follow-up. Without the good strategy, SME might not only loose the potential sales, but also gain a reputation of an incompetent and unreliable company.

More proactive and risk-taking approach could secure the company additional profitable opportunities and open new windows to new global market.

However, considering the present economic situation and the weakened state of the company itself, another solution may be less risky and potentially very profitable in the future. Tonester Ltd can take an indirect approach and start building strong relationships with Finnish large construction companies, which already have a very strong presence on the Russian market (such as Skanska and YIT), and eventually become a sub supplier. Large companies can pull them out in international market by using their customers and international network, and present the product, Durat, as a part of the package offered to the final consumer.

Despite the slowdown in the economic growth of Russia, the demand for e.g. small apartments is still in constant growth. YIT alone has an estimate of 900 ongoing construction projects in Russia (Finnish Construction Companies Looking for Market Potential Abroad, 2014)

This approach could save Tonester Ltd a substantial amount of finances, which they would have to invest if they choose any other form of foreign entry because of the challenges presented by the Russian market.

Based on the recent observations of company's activities, its financial state, management's reluctance to invest in foreign agents/distributors and limited marketing budget, the option mentioned above may be the only logical

approach at the moment. Yet again, this proves that the SMEs approach towards the international market selection and entry does not have to fall into any certain known pattern. An inventive approach and out of the box thinking while the resources are limited may bring very fruitful results.

7.3. Implications for theory

The aim of this research was to explore and describe a phenomenon in a specific area of research. Previous research on the subject has provided the researcher with theory, from which the research problem and research questions were formed.

The conclusion for the theoretical part would be that each company's specific prerequisites must be examined separately in order to gain understanding why the company does or does not follow the most common theoretical patterns concerning a company's internationalization, international market selection and choice of foreign entry mode. A greater influence of some particular factors, both external and internal, may vary depending on the situation of the company studied. Company's profile, economic situation and export target market situation are the factors that must be taken into consideration, particularly during the unstable times.

The level of expected competition, the size of the foreign market, the market growth rate, trade policy relations between Finland and the potential target country are one of the most important IMS criteria not only for the case study company, but for the majority of Finnish SMEs. A relative ease in obtaining the quantitative criteria on the foreign market (market size, potential growth) makes it the primary information sought for by SMEs. However, the qualitative criteria (political situation, laws and regulations, competitive situation) must not be neglected, especially when targeting the potentially profitable, but very challenging markets like Russia.

The traditional theory, describing internationalization as a gradual process, beginning with random exporting and ending with foreign subsidiaries is being challenged by the concept of "born globals" and the fact that

internationalization combines multiple activities, mutually supporting each other, rather than being only stages in a process.

The contribution of this thesis to existing theory is based on the empirical study. This contribution can serve as a base for further research and be added to what has been examined and described in previous research, e.g.

- To investigate how companies come up with unconventional methods of internationalization under the complicating conditions, such as economic recession or political instability
- How companies can benefit from entering challenging markets under inconvenient circumstances by taking risks and gaining, where the others loose

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Other references:

- Personal experience and continuous non-structured interviews with Tonester Ltd management

- Structured interview with Tonester Ltd management (Appendix I)

APPENDIX I

Interview guide

I. Company's background

1. Name and title of the respondent? – **Tuominen Ulla, Design Manager, co-finder and co-owner**
2. Who established the company and when? – **Tuominen Ulla and partners, who wish to remain unknown. Established in 1990. Original name: Stonester Ltd**
3. How many people does the company employ? – **16 people**
4. The company's total turnover? – **€ 2,02 m (year 2014)**
5. What products does the company manufacture? – **Solid surface material – Durat**
6. What products are being exported? – **Sheets, sinks, bathtubs, vanity units, table tops etc.**
7. What is the total share of the products exported? – **Around 30%**

II. History of internationalization

1. Why did the company start up the export activities? – **Because of the unstable economic situation in Finland and a growing demand for sustainable, yet design oriented products in Scandinavia**
2. How did the company start up the export activities? – **By direct exporting to the neighboring Scandinavian countries.**
3. For how many years has the company been exporting? – **More than 20 years**
4. To which countries did the company begin to export? – **Sweden. Later on the United Kingdom, Norway, Germany**

5. To which countries does the company exports nowadays? – **There are steady exports to USA, Sweden, Norway, The Netherlands, The United Kingdom and Germany; the rest of Europe is served on demand by direct exporting.**

6. Does the company aim to export in the near future? - **Yes**

7. How have the motives for export changed since the beginning of export activities? – **At the beginning of export sales, the main motive of export activities was not the quantity, but quality. Tonester Ltd did not have the capacity to sell the product in large volumes, but aimed at the costumers who were able to give a product a free continuous promotion, e.g. hotel chains, restaurants, cruise ships etc. Nowadays, because of the gained capacity, the company is aiming at high volumes in sales, which are much needed to improve the current weakened state.**

8. Which motives were the most important at the beginning of the internationalization? How has the situation changed? – **The most important motive at the beginning of the internationalization was to gain a reputation of the company manufacturing the first sustainable solid surface material on the market and establish Durat as a design oriented material suitable for high-end projects. The prospective has changed because many more companies entered the international market, offering quality and variety at a lower price. Nowadays, the goal is to create a strong distribution network, in both Europe and overseas, and lower the costs in order to be able to serve more markets and consumer segments.**

Answers to the next two sections of the interview are provided in Chapter 6 of this thesis.

III. Company's foreign market selection. Please state the level of importance for each of the factors below.

- Geographical distance
- Infrastructure
- Exchange rate stability

- Physic distance
- Political stability
- Trade barriers
- Market size and growth
- Competition
- Cost of serving the market
- Future potential

IV. Internal factors that influenced the company's target market selection. Please state the level of importance for each of the factors below.

- Skills
- Resources
- Competitive advantage
- Management ability
- Unique products
- Planning and control
- Personnel's qualification and motivation

V. Company's choice of entry mode. Which entry modes have already been used by the company, and which entry mode would it consider to enter the new market?

- Direct export - **used**
- Indirect export - **used**
- Licensing

- Franchising
- Contracting
- Sales subsidiaries – **strongly considered**
- Manufacturing subsidiaries – **strongly considered**
- Joint ventures - used
- Alliances

VI. How have the following external factors influenced the company's entry mode?

The answers to the following two sections are also provided in Chapter 6 of this thesis.

- Socio-cultural difference
- Country risk and demand uncertainty
- Market size and growth
- Direct and indirect trade barriers
- Competitive environment
- Trade regulations
- Geographical distance

VII. How have following internal factors influences the company's choice of foreign entry mode?

- Speed
- Costs
- Flexibility
- Risks

- Long-term objectives
- Company's size
- International experience
- Type of product
- Planning and control
- Management expertise
- Relationships