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RESEARCH OF THE POTENTIAL SUBCONTRACTOR  
SUPPLIERS FOR A CASE COMPANY AT THE RUSSIAN  
MARKET

Degree Programme in International Business  
and Marketing Logistics

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The purpose of this thesis was to research the potential subcontractor suppliers for a case company at the Russian market, and to investigate market environment and trade practises in the country. The practical problem of this study was to provide the company with the relevant information, which can be applied in the process of supplier research and further collaboration.

In compliance with the purpose of the study, the framework of the project consists of several parts, and covers such topics as evaluation criteria for supplier, legislations and taxes applied in the specified industry, best transport mode and Incoterms, and trade practises established in the country, including business habits and contract agreement development.

The theoretical part of the thesis contains such topics as sourcing, the process of supplier research, subcontractor relationships establishment, proper supplier criteria and certain aspects of international procurement. The materials used in this section were collected from specialized books and electronic articles.

As the purpose and limitations of research did not imply the contact with potential subcontractor suppliers, among the most suitable methods for information gathering was chosen desk research, which involves the analysis of already available materials, including published and unpublished sources in printed and electronic form.

The study conducted for the empirical part of the thesis was based on the investigation and analysis of electronic sources, including professional magazines, websites of potential suppliers, information portals and news agencies. For the research of the relevant sources of information, the main searching engines in Russia and Europe, Yandex.ru and Google.com correspondingly, were used. In order to verify and supplement the data, such approaches as conversation and the visit to a trade exhibition were applied.

The results of research have indicated, that the potential subcontractors, which could match the requirements of the case company, are widely represented in Russia at the close vicinity to Finland territories. However, the inconsistency of legal and political environment in the country can cause difficulties in the process of effective collaboration. Furthermore, differences in business culture and habits can also lead to miscommunication, and, consequently, require proper study and constant attention.

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## 1 INTRODUCTION

This project is done for the branch of an international company, which is located in Finland and operates in the sphere of marine industry. It designs, manufactures and provides services for propulsion systems for a large variety of vessel types, and has suppliers and customers all over the world. As of now, it purchases specific products (castings, steel constructions and fabrications, which are finished and semi-finished parts used for an assembly of the final product) from suppliers in Finland, Poland, Czech, Bulgaria and China, which is not always suitable for the company in relation to capacity, capability, delivery time and prices.

Consequently, the company is looking for an alternative supply market, and is interested in the investigation of Russian market. The strategic attractiveness of this area lies in geographical location, and, possibly, more favourable prices, than the prices offered by current suppliers. Therefore, as Russia and Finland have common sea and land borders, it creates advantageous conditions for transportation, and presumes regular deliveries with minimum delays. Furthermore, the country has large iron ore reserves and great number of enterprises operating in metallurgical and shipbuilding industry, which supposes the wide variety of potential partners with competitive prices.

However, besides the before mentioned aspects of supplying from Russia, this process can be obstructed by various obstacles concerning legislation and infrastructure, as the trade with Russia is considerably different from Europe, with its own legislations, pitfalls and risks. Furthermore, the case company has negative experience concerning the collaboration with companies from Russia, which is mainly concerned with the trade practises and delivery terms.

Therefore, the company has the intention and purpose to find a supplier in Russia, but does not know how to do it exactly. Moreover, as the company is looking for a subcontractor supplier, it has to be aware of possible pros and cons of long-term

relationships with the Russian partner, and understand how to establish and develop those relationships successfully. It concerns not only legislation, taxes and regulations applicable at the market, but also behavioural aspects and business habits existing in the country.

Russian business environment can be often characterised by hindered access to information provided in English, including both published materials and knowledge of the people. Additionally, as in many other countries, the research of local market can be more efficient if it involves the representative of local culture. Consequently, as I have perfect command of Russian language skills and considerable knowledge about the country, it is easier for me to investigate the market and to find out the issues related to the problem area.

Thus, this project is done in order to research the potentially suitable subcontractor suppliers for the case company, including further analysis of the market trends and trade practices in the country.

## 2 PURPOSE AND CONCEPTUAL FRAMEWORK

### 2.1 Purpose and objectives of the project

From the all described above, the purpose of the thesis is to provide the client company with the list of potentially suitable subcontractor suppliers, including recommendations on further collaboration with Russian counterpart. It assumes that the project will be logically divided into several parts, and will finally provide the information about the potentially suitable subcontractor suppliers for a client, legislation and rules concerning transportation and delivery of the product, and trading habits inherent for Russian society.

On the assumption of that, there are several objectives in this project, which help to achieve the purpose of the thesis:

1. To formulate the main questions and problem areas which have to be covered in the thesis.
2. To find and select relevant materials and data in order to answer the questions set before.
3. To examine and synthesize theoretical data in order to create the basis for the further research.
4. To conclude desk research in order to create the list of potential subcontractors for the client company.
5. To conclude desk research and conversations in order to create recommendations about business relationships with Russian counterpart.
6. To synthesize obtained data and complete the project according to its requirements.
7. To present the project to the SAMK and the company.

## 2.2 Project tasks and problem areas

Even though the theoretical part of the work concerns the sourcing process, the particular focus is made only on the several stages of the sourcing. Thus, such parts of sourcing process as purchase planning, specification development, request for quotation, supplier selection and evaluation, price negotiation, purchasing, inventory control and disposal are left out of the framework. Among the parts covered in this study are general examination of sourcing stages, supplier research process, supplier relationships establishment and legal contract development. Other examined issues are subcontracting, supplier evaluation criteria and legal contract design.

Another key issue covered in this project is supplier-buyer relationships in the frame of international trade: those areas of collaboration, which have to be considered with the particular attention, and the most common problems arising between two parties from different countries. This theoretical background gives guidance for the further empirical research and clarifies which areas of collaboration have to be examined exactly.

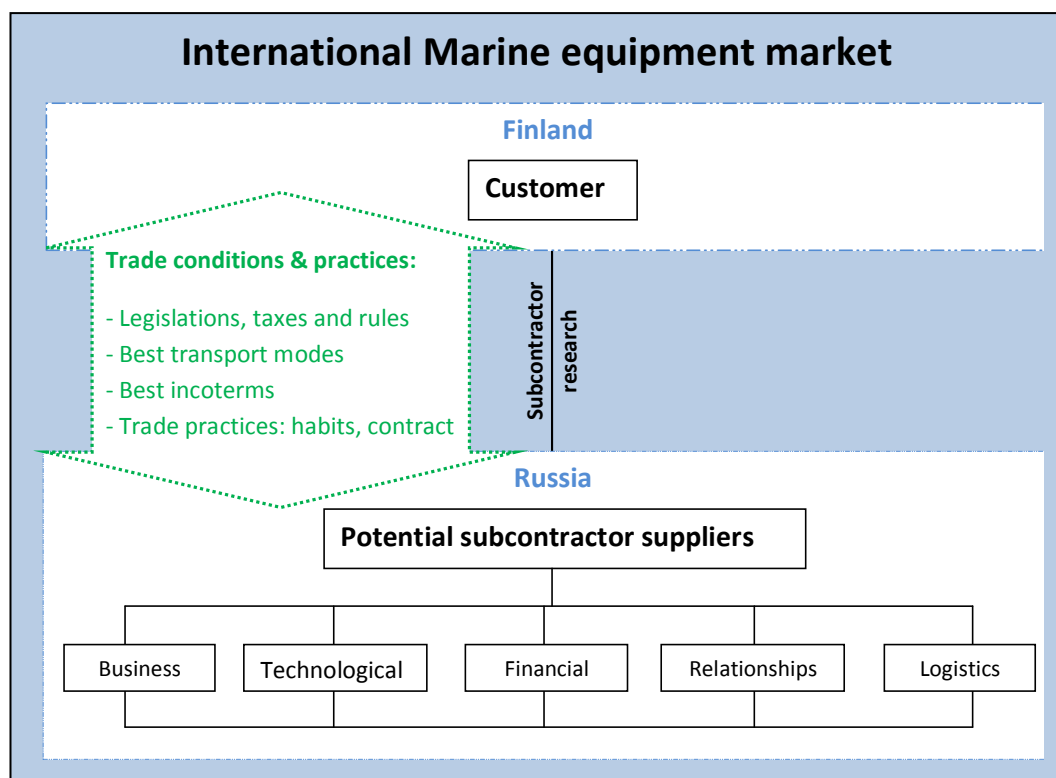
The empirical constituent of the thesis is limited by the requirements to the supplier and the product nature, as well as by the theoretical background and depth of

analysis. The research is also framed by the geographical area and industry type, meaning that my goal is to examine potential subcontractor suppliers of specified product which are located in Russia relatively close to Finland.

Furthermore, the process of evaluation and selection will have quite surface character as well, because the company has its own rules and policy concerning supplier selection. The information about the contract is limited so, that I do not need to develop the contract itself and consider all the articles and clauses included, however I have to explain the importance of having written contract with Russian partner and to underline the most important clauses which have to be considered.

### 2.3 Conceptual framework

Based on the purpose of the project and project problem areas and tasks described above, the framework of the project is presented in a following way:



As it was already mentioned earlier, the research area is limited by the industry type and geographical boundaries set by the case company, which is implied by the

purpose of the project initially. Thus, the customer located in Finland and operating internationally in the sphere of marine equipment industry is looking for a potentially suitable subcontractor supplier in Russia. Supplier research is launched based on several evaluation criteria, which are the most common for almost all the companies and industry types: business, technological, financial, relationships and logistics. Furthermore, the customer is interested in investigation of trade conditions and practices involved in business relationships with Russian counterpart, and namely: legislations, taxes and rules; best transport modes and Incoterms; business habits and behaviours, and contract importance.

### 3 RESEARCH METHODOLOGY

#### 3.1 The concept of desk research

As purpose of this thesis in simpler words sounds as: to create the list of potentially suitable suppliers and the recommendations about doing business in Russia; the research is based on secondary data gathering and analysis.

Consequently, as the research results do not imply any new information and the level of its depth is not profound, the most suitable data collection method in that case is desk research. It generally means the gathering and the analysis of the information, which is already available in the published printed or electronic form (Website of WebFinance Inc 2011).

Of course, in order to obtain such data, as information about the company and the product, potential suppliers and current situation in the industry today, are also used unstructured interviews and conversations, which belong to qualitative methods of data gathering. However, those conversations and interviews are mainly used as introductory and supportive tools for the information gathering, updating and specification.



### 3.2 Advantages and disadvantages of desk research

In order to research and analyse the information relevant for this thesis was chosen such method as secondary research and desk research exactly. As all the methods of data gathering, desk research has its advantages and disadvantages.

The desk research can be characterised by comparative ease of data gathering and analysis, as it does not imply the development of questioners, the measurement indicators, and the interviews. Thus, it saves the time, energy and makes the work more clear and feasible. Furthermore, it is easier to get the information from the sources, because majority of the data is allocated in books, magazines and in the Internet. Consequently, the availability of the sources is higher than in case with interviews and observations, and other methods where people are involved. (Saunders et al. 2003, 200-213; Morse 1994, 264-267; Website KnowThis.com 2011)

However, the desk research has also the number of downsides. Among those downsides is reliability of the sources, because it is not always possible to check how reliable the information is due to the personal attitudes of the authors, their experience and goals, research bias; commercial goals and security reasons of the firms in the industry and the client company itself. (Website KnowThis.com 2011)

Another disadvantage is that the information can be simply incorrect due to such reasons, as the mistake during the primary research, interpretation and publication. Moreover, taking the data from different sources, it is possible to be stuck trying to compare the different or even contradictory information, while there is no “decisive authority”, which can prove or refute this information. It can be also difficult to decide which information exactly is relevant in the context of the work, especially in case there is many interesting information concerning the topic. The data can be also out of date and it can be difficult to get newer information (e.g. books, magazines, site of the potential suppliers). (Saunders et al. 2003, 200-213; Morse 1994, 267-269)

Even though it is easier to obtain the data on the one hand, the amount of this information can be very limited on another, and acquisition of the more detailed data

can be costly or not available at all. Furthermore, the information can exist in a general shape, however it can be gathered with the different from mine purpose, so, the context can differ and it can make the work messy. In general, the quality of secondary data gathered by desk research can be difficult or even impossible to check and insure, and access to those data might be hindered as well. Those reasons can tie up the process of data gathering and analysis and make it more complicated. (Saunders et al. 2003, 200-213; Morse 1994, 267-269; Website KnowThis.com 2011)

### 3.3 Data collection and analysis

For the development of the theoretical part of the work are used such secondary data, as the electronic and printed books, magazines, articles and blogs available in the Internet. As in majority of the sources the process of supplier research is not defined as a separate term and mainly considered as a part of sourcing process, I decided to concentrate on both terms, trying to describe the process of supplier research in the frame of the sourcing process.

First of all, the theoretical material presented in forth chapter explains the concept of sourcing and supplier research, including the definition, goals, process description, and stages for the process implementation. Even though not all the theoretical background is to be applied in the empirical part of the project, it gives general overview of the concept of sourcing and supplier research, providing an introduction into the project and defining the place of sourcing and supplier research in procurement process.

Another range of issues concerns subcontractor relationships establishment and covers such topics as subcontractor definition, long-term relationships development, ethical behaviour and relationships with the supplier, product specification development and design of legal contract. The choice of these subjects is conditioned by the specific of the case company's activity, meaning that company is looking for a subcontractor supplier, which implies long-term relationships development, where one of the key issues is Ethical code and respect to confidential information.

Furthermore, the required product is tailor-made, which means that its production is based on detailed blue-prints and product specifications. Besides, long-term relationships in their nature require the development of legal contract, especially in case of dealing with Russian counterpart, where heavy contracts are usually among the compulsory terms.

Fifth chapter of this project contains information about the most common criteria for supplier evaluation. As the case company has its own complex system of supplier selection and evaluation, I have chosen those criteria, which are considered as basic in the literature in relation to different companies' types and industries.

The last part of secondary data needed for the theoretical constituent of the thesis concerns issues about special features of doing business internationally, most common problems that can arise between parties from cultural point of view, difference in legislation, currency, language and protocol.

The empirical part of the project is based on the information represented in the theoretical part. First of all, theoretical data help to identify the potential subcontractors based on defined evaluation criteria, and to check validity of theoretical assumptions concerning the role of the contract and other aspect of long-term relationships with subcontractor.

The information relating to the international business relationships is used for the in-depth examination of cultural, legal and business aspect of doing business with Russian counterpart. It helps to find out the most important issues about legislation in the exact industry; taxes and rules applied between Russia and Finland; the most common risks involved in process of customer-supplier relationships in this industry; and specific of doing business with Russian partner from behavioural point of view.

During the research and analysis of the secondary data, some conclusions can appear as a primary data, in case they will help to achieve the purpose of the work. Obviously, majority of the data used in this thesis are secondary documentary data and multiple-source secondary data, however during introductory interviews with the

company representatives and research implementation (e.g. contacting with the potential suppliers), there can be primary data gathered and then used in the work. Thus, the skeleton of the thesis is based on secondary data with some inclusions of primary data.

## 4 THE PROCESS OF SUPPLIER RESEARCH

### 4.1 The concept and the process of sourcing

The definition of sourcing is broadly discussed in the books, articles and core studies and is familiar to audience whether those are supply chain professionals or the average people. Different authors define the process of sourcing differently, however the main concept of sourcing can be simply defined as a set of business processes, which are required to purchase goods or services from suppliers to execute the operations of a company. This process has to be reconsidered and redesigned continuously, and the sourcing decisions have to be implemented in a way that improve the efficiency and responsiveness of supply chain, insure its reliability and increase competitive advantage of the company at the market. (Chopra & Meindl 2007, 58)

Even though the concept of sourcing seems to be easy to understand, it is still to be challenging to find the single clearly determined definition of a term in a literature. Thus, according to Online Business Dictionary, sourcing can be considered as an alternative word for procurement, while in the book “Supply chain management: strategy, planning and operation” written by Chopra and Meindl term of procurement often overlaps with the term of purchasing and finally, procurement can be even considered as a part of sourcing. (Website of WebFinance Inc 2011; Chopra & Meindl 2007, 417-418)

The issue of difference between all the terms is a subject of debates among purchasing professionals and supply chain theorists. While the definition itself is not the core issue in the frame of this project, it would be reasonable to indentify the

difference between those terms briefly in order to designate the set of operations included in the sourcing process and define the place of supplier research in that process.

Thus, I would decide in favour on opinion that the purchasing and sourcing are the parts of the procurement process. Meaning, that procurement is the strategic function of the organization, which covers all the operations concerning supply market research, specification optimization, sourcing, contracting and further collaboration with single or several suppliers, while purchasing is almost the last step of procurement, more operational and transactional function, act of buying. The sourcing in this context is also strategic activity, but related exactly to the process of analysis of the supply market, research, evaluation and selection of potential suppliers, and contract negotiation. (Ylituomi, personal communication on 4 March 2011; Website Purchasing insight 2011; Rae 2011)

Thereby, while the objectives of procurement can be simply defined as: to acquire right quality and quantity of materials at right price, time and from the right source, the objectives of sourcing are concentrated exactly on the research and selection of the right source. Furthermore, as the sourcing is the part of procurement, its goals generally linked to the following:

1. To supply the organization with the flow of services/materials to meet its needs.
2. To monitor supply market trends and select the most suitable suppliers for the company.
3. To negotiate effectively in order to work with suppliers which are willing to generate mutual benefits through coordinated and open collaboration.
4. To maintain effective relationships with existing suppliers and develop alternative sources of supply in order to ensure the continuity and efficiency of supply chain.
5. To buy wisely and effectively so that the ethical means are complied and the cost structure of the company is protected. (Baily et al. 2008, 4)

The process of sourcing generally consists of several steps. First of all the company makes decision about the nature of sourcing: whether the services or products have to be outsourced or produced in-house. In case the company needs to outsource, the

purchasing manager/department considers whether to purchase from a single supplier or several, depending of the firm's strategy and the nature of products. The next step is evaluation criteria establishment and information gathering, which can be implemented through the different kind of sources and databases. Supplier scoring and assessment is the process, which allows to rate suppliers' performance with the help of criteria with assigned weights. (Chopra & Meindl 2007, 58, 418)

After the output from previous steps is received, the company is able to indentify appropriate suppliers which fulfil requirements set and negotiate the contract with chosen supplier. The following action is design collaboration that allows the buyer and supplier to design product components for the final product together. Once the product is designed and all the terms are agreed, the buyer and supplier carry out purchasing transaction and further process of delivery. The final step in this process is further sourcing planning and analysis, which goal is to develop sourcing strategy and identify the opportunities for decreasing the total costs. (Chopra & Meindl 2007, 58, 418)

#### 4.2 The process of supplier research

As it was already mentioned earlier, the process of sourcing involves continuous supply market research, which identifies the range of current and potential suppliers, investigates their capabilities, examines market trends and prospects, and observes the market participants. In order to make right supply decision the company has to know its market thoroughly and dispose reliable information about current and potential suppliers, be aware of production and distribution costs at the market. Generally, the research can be implemented either formally by full-time procurement research staff within the company, or more informally by purchasing managers when they talk to representatives, visit exhibitions, read profile magazines, news and investigate the market trends on continuous basis. (Baily et al. 2008, 199-203)

The supplier research can be considered as a continuation of a supply market research, or as independent part of sourcing process in general. While supply market research is implemented in order to keep the procurement department up-to-dated

and to investigate the whole market, the goal of supplier research is more particular - to find potentially suitable supplier. Supply market research can be a stimulus for supplier research, or, oppositely, if the company has a goal to find new suppliers, the supply market research becomes preparatory stage of supplier research and its part. (Category management toolkit: Supplier research 2006; Category management toolkit: Supply market research 2006)

The process of supplier research can be hardly identified precisely and solely, as both supply chain academics and practitioners have different point of view at that process. Furthermore, this process is a data gathering campaign and naturally cannot follow one general rule and rigid sequence, because all the companies have their own policy and samples regarding supplier research and selection. However, taking into consideration the goal of supplier research, which can be defined as to investigate supplier market in order to find appropriate supplier, the sequence of this process can be generally defined as following:

1. Recognition of the need for supplier selection, which can arise due to new product development, poor internal and external supplier performance, or insufficient capacity of current supplier.
2. Identification of key sourcing requirements, which vary by business and product, however generally include such issues as location, quality, capacity, costs, reputation, delivery and payment terms.
3. Determination of sourcing strategy, such as supply base optimization, long-term supplier relationship or supplier development.
4. Identification of potential supply sources through the wide range of data-bases and different type of published sources, in-house and public events.
5. Limitation of suppliers in selection pool based on the most important criteria set earlier. At this stage the purchaser evaluates potential suppliers preliminary in order to narrow the list before conducting in-depth research and contacting. (Monczka et al. 2005, 207-215)

### 4.3 Sources of information on potential suppliers

Thus, the most common sources of information about potential suppliers available for the purchasers all over the World are:

1. Trade exhibition and shows, which enables the buyer to study and evaluate the range of exhibitors and their products and services, their sizes, level of competition, trends, prices, technologies and performance. It also gives the opportunity to meet the representatives at the stand and make valid comparison of similar products from different sources. Furthermore, the magazines and electronic databases published by exhibitions' administration, provide the list of potential suppliers, including their contacts, and range of the products and services. (Baily et al. 2008, 205; Branch 2002, 29; Monczka et al. 2005, 211)
  
2. The Internet provides the possibility to check the range of the companies operating at the market: online catalogues libraries, online trade directories and lists of manufacturers of required products; the sites of the suppliers; online publications and the latest news, opinions about and comments on potentially suitable sources, and any other articles, blogs or forums. The Internet is a global and almost inexhaustible source of information and depending on the country and exact market, the buyer can find all the required information about current and potential suppliers, including financial reports and sources of their supply. (Branch 2002, 29; Monczka et al. 2005, 212)
  
3. Business clubs, sales conferences and seminars give possibility to obtain the information about market trends and forecasts, participants operating in the field, facilitating expansion of business contacts and network development. The continuous communication with other buyers, partners and competitors can also provide information about new sources and performance of old. (Branch 2002, 29-30)
  
4. Trade directory is an alternative and useful source of information for suppliers' identification. Such directories may be issued by Government, Trade Associations, Country's/National Chamber of Commerce, International Agencies, Importers Associations, Professional Institutes and private companies. Another reliable source



of information is approved lists, which contain the information about the companies, which have been assessed and approved under the quality certification systems, conformity certification applicable in the industry, environmental or professional certification. (Baily et al. 2008, 204; Branch 2002, 29; Monczka et al. 2005, 211)

5. Professional and trade journals, newspapers and magazines contain up-to-dated and useful information about the current trends at the market, and companies involved in exact industry and related fields. (Branch 2002, 29; Monczka et al. 2005, 211)

6. House magazines and sales bulletins of the companies operating in the same field, including competitors, may contain information about suppliers as well. It is also possible to receive or obtain promotional materials on sales conferences or hospitality events, where major suppliers are likely to circulate. (Branch 2002, 29)

7. Organizations promoting trade, such as embassies and attaches, are willing to help buyer to find suitable suppliers on the territories they represent. (Baily et al. 2008, 205)

8. Government, Chamber of Commerce or Trade Associations may arrange inward and outward trade missions, where the buyers visit specific country to meet exporters, or, alternatively, exporters visit a country to meet potential buyers or to select import agent. (Branch 2002, 30)

9. Sourcing services and agents can provide the information about potential sources of supply and their products. Even though such services are paid, it can be more convenient and reliable to use them in order to insure the company from possible falls and mistakes, especially when the supplier is located abroad. (Baily et al. 2008, 204-205)

10. Current suppliers can also provide the buyer with the information about already proved potential suppliers, their positive or negative performance and capabilities. (Monczka et al. 2005, 210)

11. Sales representatives usually provide the company with valuable information about their firms through e-mail, direct mail or face-to-face meetings. Even if at the moment of contact the buyer may not have an immediate need for the offered product, the information can be filed for the future reference. (Monczka et al. 2005, 210; Baily et al. 2008, 204)

12. Verbal and recorded knowledge and databases existing within the company are another useful and reliable source of information obtaining. In other words, procurement department may maintain records about performance of suppliers who have been already used earlier, while personnel in other departments are often knowledgeable about the sources and materials acquired. (Monczka et al. 2005, 211; Baily et al. 2008, 204)

#### 4.4 Subcontractor relationship establishment

Effective source decisions are primarily targeted on the development of long-term mutual relationships with supplier, where benefits of doing business together assume the identification of overlapping interests, sharing and exchanging. Consequently, sourcing involves more than simply picking supplier or subcontractor. It deals with development of continuing relationships with both current sources, which already supply goods or services to the company, and potential sources, which have been chosen as an alternative. (Baily et al. 2008, 16, 199)

Furthermore, taking into consideration specific of the industry case company operates in, product nature and requirements, and confidential issues involved in the business, the collaboration between the case company and potential supplier presupposes long-term relationships establishment, which can be also called supplier-buyer partnership. As it was already mentioned in the chapter 3.3 “Data collection and analysis”, the type of supplier the company is looking for is subcontractor supplier, which commonly also imply long-term relationships under the contract.

#### 4.4.1 Subcontractor definition

The case company operates at the market as a general/prime contractor supplier for the owners of the final projects, meaning that it designs, develops, supplies and supports products and systems for the companies operating in naval and commercial marine industry (Website of the case company 2011). As such kind of projects are quite complicated, the company assigns part of its responsibilities to another party, which enables it to concentrate on the main area of expertise. That process of tasks transfer can be called subcontracting. According to Business Dictionary, subcontractor is a secondary contractor who contracts with the prime contractor to perform partly its contractual obligations under prime contract. (Website of WebFinance Inc 2011; Website Investopedia.com 2011)

Thus, the case company hires subcontractors to acquire castings, steel constructions and fabrications, which are finished or semi-finished parts used for assembly of the final product (Mattila, personal communication on 16 March 2011). Therefore, the company creates long-term procurement contract with subcontractor suppliers, which are responsible for production of named tailor-made products for that company only (Ylituomi, personal communication on 1 February 2011).

As the construction projects are very complex in their nature and involve high level of responsibility, it generally requires participation of those suppliers, which are able to meet requirements of the buyer precisely and perform high level of customization. It means that they have to be able to produce tailor-made products, which often implies high level of capacity and capability: adaptation of new production technologies, redesign of operations, new certification obtaining, and acquisition of new facilities and equipment. (Baily et al. 2008, 284)

The subcontracting can be of different levels, which influence the degree of decision freedom of suppliers and degree of risks the customer is exposed to. Thus, for example, in case the subcontractor supplies parts of the product, which is characterized by rigid specification, low technology and minimum quality standards, it has low level of decision freedom and the customer is exposed to low level of risks. As far as the level of technologies increases and the product required becomes

more complicated, the level of subcontracting is growing, bringing higher degree of decision freedom for subcontractor and higher degree of risks for the buyer. (Baily et al. 2008, 285-286)

#### 4.4.2 Building long-term relationships

The basic principle of supply chain relationships is that the buyer and supplier can generate more opportunities for savings working together than independently. Effectively managed relationships increase supply chain coordination and insure the achievements of desired results. In long-term relationships characterized by high degree of trust and cooperation, the supplier is encouraged to make the greater effort on issues that are important to particular buyer; furthermore, it leads to improvement of communication and coordination between parties. (Chopra & Meindl 2007, 454)

In such relationships the partners have to learn about the environment they are operating in, tasks and process of each involved party, their experience, skills and resources available, and the goals of each other. Further performance of each party is evaluated according to improvements in profitability and in fairness. It allows both companies to evaluate the value of such relationships and introduce new ways of improvements. One of the key issues here is the contract design, which has to be characterised by flexibility and transparency. Furthermore, it is crucial to develop the possible tools for the conflicts resolution, which will help to minimize misunderstandings, prevent conflict appearance and manage the situation in case the conflict has arisen. (Chopra & Meindl 2007, 516-517)

Another important consideration about long-term stable relationships is compatibility, which can be examined from different angles. Thereby, there can be an issue of cultural fit, meaning, for instance, values, beliefs and attitudes in relation to working practises, environmental issues and long-term plans. Another example is technical fit that defines the qualification of personnel, comprehensiveness of equipment and willingness to invest in researches, know-how and production facility development. In case the buyer and supplier are at the same level of technical

comprehensiveness, they have more possibilities to develop long-term effective relationships and gain mutual benefit. (Baily et al. 2008, 211-212).

The relationships are exposed to the risk when the perceived benefit of relationships diminishes, meaning that one party is seen to be opportunistic. One of the reasons for that is poor communication, when the mutual benefit of relationships is not revised and redesigned regularly. In order to insure the effectiveness and reliability of relationships the parties have to concentrate on the following issues:

1. The relationships have to be characterised by flexibility, trust and commitment of both parties, and especially top-management involvement.
2. The presence of good organizational arrangements, especially information sharing and exchange, and conflict resolution techniques.
3. Availability of the mechanism that makes the actions of each party and further outcomes visible helps to prevent conflicts, avoid opportunistic behaviour and identify defective processes.
4. The issue of fairness is extremely important as the more fairly the stronger party treats the weaker, the stronger the supply relationships are tend to be. (Chopra & Meindl 2007, 516-516 - 517)

One of the key issues in the context of long-term successful relationships is the transparency of information exchanged between parties and flexibility in cooperation. Besides other requirements, transparent and efficient information exchange implies the design of all-embracing contract with clearly explained rights and liabilities. Another important constitute is detailed product specification developed mutually, which concretize product features and requirements concerning its quality, production and delivery.

#### 4.4.3 Product's specification and blueprints

As the requested product is tailor-made and quite complex, it can require of supplier the adaptation of untested or new production process and obtaining of new certificates. Consequently, the customer has to provide additional information or

attachments to assist the supplier, such as blueprints, products specifications or technical drawings. The buyer can also use request for quotation in order to determine in advance if the potential supplier has possibility to produce new or technically complex item, or if it is able to redesign the operations in order to manufacture this product. (Monczka et al. 2005, 42-44). Product specification can be defined as a statement of product's required characteristics documented in a way that facilitate its procurement, production and acceptance (Website of WebFinance Inc. 2011).

The process of the product specification design requires continuous evaluation and development in accordance with market expectations, changes and needs. It is affected by culture, political and operating environment, technologies, legal environment including national and international quality standards, product life cycle, pricing strategy, value added benefit, competitiveness, patents, design, warranty offered by supplier, availability of spare parts and product access and availability. (Branch 2002, 17)

Getting specification properly is critical in obtaining the quality of the product needed. The quality in that context is not always mean the best quality available, but the right and appropriate quality according to the buyer's needs and operations. In case the specification is not clear from the very beginning, the supplier can be confused and misled which will finally result in inefficient and wrong outcome. Consequently, the buyer has to develop the product specification so, that it is compact, unambiguous, and easy to understand and transmitted. (Branch 2002, 17)

Generally, the product specification covers several elements, such as: (1) technical specification, which has to be developed without any errors and include technical requirements for the product, the supplier competence accreditation (certificates), logistics, product quality and compliance with the national and international standards; (2) commercial aspect concerns value added benefit of the product, its design, packaging, ease of installation and use; (3) legal aspect reflects compliance with safety and quality standards, description of specific materials, clarification of documentation required for customs control, and determination of right custom codes which can decrease import duty tariff; (4) transportation aspect covers transport

mode, delivery terms, routing, transit time, freight, insurance, packaging, stowage areas, and constraints. (Branch 2002, 85-88)

#### 4.4.4 Ethical behaviour and relationships with a supplier

One of the main issues involved in the development of relationships with supplier is clarification and declaration of Code of Conduct or Ethical code of the company, which is especially important in international context as the culture of business relations vary a lot by country. Without a rigid and universally accepted ethical behaviour tradition, the collaboration can stumble on the obstacles and misunderstandings, resulting in inefficient and poor business. Among the basic ethical considerations are following: declaration of interest, confidentiality and accuracy of information, fair competition, business gifts, modest hospitality, prevention of corruption, development of mutual long-term relationships rather than short-term advantage. The main goal of such codes is to consolidate integrated supply chain and to insure effective partnership. (Baily et al. 2008, 78-79).

#### 4.4.5 The development of legal contract

One of the most critical aspects of customer-supplier relationships is an understanding of the legal aspects of business transactions and ability to manage contracts and agreements effectively. The contract defines the content of the further collaboration, helps to improve supply chain performance and minimize information distortion.

Generally, the companies have specific procedures for contracting with their suppliers, however the main topics discussed in legal contracts include: basic features of the standard purchase contract; basic contract principles; execution and administration of agreements; essential elements of the contract; ensuring contract compliance and performance; formal competitive contracting procedures; contract development process; examples of sample agreements; legal definitions; use of formal contract clauses. (Monczka et al. 2005, 90)

Commonly, the contract facilitates parties to achieve as best outcome of the bargain as possible and helps to insure the durability and reliability of future collaboration. Regardless the subject of a contract and its complexity, the terms and conditions should clearly define the rights and obligations of parties, concentrating on the following topics:

- An unequivocal description of the product/service to be supplied;
- Duration of the contract (time set or specific delivery dates);
- Required quality standards and acceptance criteria;
- Defined price or mechanism of price formulation, what the price includes;
- Payment terms and a term of possible recovery of money owing;
- A clause regarding delivery terms, shipping and installation;
- All the terms concerning intellectual property rights, confidentiality, security, publicity and right of audit;
- Insurance and indemnity provisions;
- Terms and conditions concerning legal issues, such as corrupt gifts and commissions' payments, discrimination, health and safety regulations;
- The rights of both parties to terminate the contract in the event of other party default;
- A clause which describes possible risks, emergencies, consequences for late performance and further settlement;
- A terms stipulating under which law the contract is concluded;
- A clause relating to the resolution of disputes.

As a general rule, both parties are trying to develop the terms and conditions so that their positions are protected and risks are minimized. Moreover, both buyer and supplier have to consider the terms of counterpart with caution and make sure that the terms govern the contract from mutual point of view and not bring the advantage to one of the parties solely. Thus, supply chain contract has to concentrate on desired objectives of the buyer and supplier increasing the performance of supply chain. (Baily et al. 2008, 215; Monczka et al.2005, 460; Chopra & Meindl 2007, 455).

Naturally, the more complex the contract is and the greater amount of money is involved, the more likely the appearance of disputes between the parties. In the frame



of international trade, the more attention has to be paid to such terms as forum selection (where arbitration forum will take place), choice of law (which law governs the contract), payment (what currency is used to make payments under the contract), language (the official language to be used in the contract) and force majeure. (Monczka et al. 2005, 461)

## 5 PROPER SUPPLIER CRITERIA

As the case company has its own complicated and approved scheme for the supplier selection and evaluation and my goal is limited by the supplier research only, I would define the most common criteria in order to research and make surface selection of potential subcontractors with the help of available electronic and printed sources of information. Thereby, taking as a basis, the integrated model for supplier evaluation proposed by Cebi and Bayraktar, and modifying it with evaluation criteria set by Hokey Min, I would concentrate on such criteria as:

1. Business criteria generally include financial stability of the company, its reputation, size, experience, negotiability and location. Financial stability has to be considered at the first stages of evaluation, as it affects viability of the company, its capacity and technological level. Reputation is another important factor, which is determined by the experience of the company and its past and present performance, it can be considered as approval of company's reliability and compatibility. Location defines and insures the lead time and smoothness of delivery schedule. Negotiability is the flexibility of supplier during negotiation, which determines possibility of long-term relationships. Size of the company and its experience are two other important criteria, which define the level of production capacity and responsiveness. (Monczka et al. 2005, 219; Cebi & Bayraktar 2003, 397; Min 1998, 28)

2. Technological criteria: capacity to meet demand, willingness and ability to contribute in new product development (R&D), quality assurance, availability of required certificates, and willingness and ability to obtain them on request. Quality assurance can be determined by the presence of the relevant quality certificates,

quality system and manual, process and technical capability and quality commitment. Environmental regulation compliance became one of the critical issues, which companies consider looking for the partner to collaborate with. (Monczka et al. 2005, 218; Cebi & Bayraktar 2003, 397; Min 1998, 26)

3. Relationships criteria: communication means, international experience and foreign language skills. Communication means available determine the speed of information exchange, responsiveness and level of possible distortions in information flow. International experience defines the degree of compliance between the companies, minimize the risks involved in new relationships establishment and decrease the level of possible falls. English- or other common language speaking personnel minimise information distortion and improve efficiency of information exchange during negotiation. (Cebi & Bayraktar 2003, 397; Min 1998, 28 )

4. Logistic criteria: lead time, flexibility in changing the order, delivery terms, and transport mode. Logistic criterion is one of the major factors characterizing supplier's value, because reliable delivery, short lead times and favourable delivery terms is a guarantee of efficient business operations. (Cebi & Bayraktar 2003, 397)

5. Financial criteria: cost structure, freight terms and payment terms (Min 1998, 26). The most important question to be answered in that context is the degree of future price fluctuations and supplier's ability to manage currency exchange issues (Monczka et al. 2005, 311).

## 6 INTERNATIONAL PROCUREMENT

International procurement has grown dramatically over the last decades and its scale became larger all over the World. Among advantages of buying abroad can be generally considered following: lower prices, product availability, competitive advantage, wider choice of suppliers, reduced costs and other benefits.

Of course, international procurement has its pros and cons, and apart of benefits mentioned earlier, it has many risks and pitfalls, as trade regulations and nature of businesses vary by country. Moreover, international procurement embraces wide range of other disciplines, such as logistics, negotiations, linguistic and cultural knowledge, terms of trade and Incoterms, import regulations and constraints, international legal environment and related documentation (concerning finance, carriers, insurance and customs). (Branch 2002, 5-7)

Thus, in order to be prepared for the international negotiations and collaborations properly, the purchasing manager, or another person, responsible for the relationship's development, has to examine and be familiar with following issues:

#### 1. Cultural understanding

One of the most considerable barriers in international procurement is the cultural difference, which includes values and habits, affecting the way of thinking and everyday behaviour of people. Knowledge about the common way of behaviour, understanding and acceptance of the differences will facilitate effective collaboration, increasing confidence during negotiations and further cooperation. (Monczka et al. 2005, 311)

Another related term is material culture, which helps to understand the living standards of society and its quality of life. The level of education is the next term, which plays considerable role in cultural understanding. Thus, in countries with high level of education the workforce is trained better and literacy standards are higher, consequently, it is more likely that people there are able to work more effectively, possess foreign language skills and are easier to communicate with. Furthermore, it defines the reliability and extensiveness of market data. (Branch 2002, 34)

Such issue as religion has to be taken into consideration as well, as it affect attitudes and taboos, and often defines the availability and acceptance of the products, gifts, regulate behaviours, working days and hours, dress codes and other norms. Ethic is an important constituent of culture as well and has to be considered with particular accuracy, as its major effect can be observed in different understanding of

information sharing, confidentiality, bribes and other business incentives. (Branch 2002, 35-36)

## 2. Communication problems

The communication problems can arise not only because of language differences, but also due to difference in time between countries, and differences in interpretation of trading and technical terms. Thus, in the frame of valid contract the consensus ad idem (meeting of minds, agreement on the same thing) has to be designed. Even if both parties possess shared language skills, the level of these skills can vary, which can lead to misinterpretation and misunderstandings. (Baily et al. 2008, 315)

## 3. Political and economic system

Political system defines and administrates buying and negotiation processes, and market access. It affects the way the international transactions are executed, level of taxation, rules and regulations, customs and duties. Consequently, the company entering foreign market has to examine political situation and system very carefully in order to be aware of rules, possible privileges and restrictions, and ways to avoid or minimize the risks. Economic system is an outcome of political stances and affects the proceeding of business transactions and operations. (Branch 2002, 36-37)

## 4. Currency difference

Another considerable issue in international procurement is difference in currencies applicable within the countries. The conversation of currencies is implemented easily until those currencies are convertible, however it involves extra funds, and fluctuation of exchange rates cause considerable problems as well. The change in relative value between currencies of importer and exporter is inevitable, because the exchange rates are changing continuously in the same way as price fluctuation. However, in spite of the risks and uncertainty, those issues have to be taken into account and possibly managed. (Baily et al. 2008, 315)

## 5. Payment

The transfer of funds internationally brings its own difficulties and usually needs the involvement of a bank, which service costs extra. Within the EU the most common way of payment is on open account (credit terms), when the customer is allowed to

settle the account within the month from invoice or delivery. The transactions outside the EU are usually settled by a bill of exchange or letter of credit. In that case the most frequent problem is that the seller is not willing to release its' goods to the buyer until the payment has been made. The buyer, in its turn, does not wish to release the funds until the goods are received. On the score of that conflict of interests, the parties usually outsource the bank, which makes funds' transaction only after evidence of performance is produced. (Baily et al. 2008, 316)

#### 6. Different legal systems

The legal system differs from country to country considerably, and reflects the broad political aims of the country, trade barriers, market access, customs, trade blocs and commercial legal environment. It is important for the contractual parties to establish which law is applied for the jurisdiction in case of a dispute. International contracts are often conducted under the authority of international trade organizations, and the parties are obligated to follow certain rules. There can be also a situation where the matters related to the form of the contract fall under the legal system of one country, while the matters concerning performance - under another. (Baily et al. 2008, 318-319; Monczka et al. 2005, 313; Branch 2002, 37)

#### 7. Logistical issues and Incoterms 2010

The infrastructure of different countries varies a lot, and while developed countries have comprehensive transportation system, the transportation system in developing countries causes gaps and delays in delivery. It is connected not only with poor infrastructure, but also with the extent of transportation routes. Thus, fewer paved roads, railroads, airports and shipyards often lead to higher logistics costs and less reliable deliveries. In order to systematize and increase efficiency of shipment transactions, the International Chamber of Commerce (ICC) has developed International Commercial Terms (Incoterms), which last version was published in 2010 year (Appendix 1). (Monczka et al. 2005, 312)

#### 8. Customs

The countries operating within the EU implement their import and export procedures under the simplified rules of a single market. For purchases from the countries outside the EU, there is a need for proper consideration of taxes and customs and

their administration. Each day of delay in delivery can add extra costs to the shipment, thus, it is important to reduce the time the goods are in custom. The delays can be caused by inaccurate, incomplete or incorrect information on such documents as invoices, letters of credit, import licences or waybills, or lack of those documents. (Baily et al. 2008, 325)

#### 9. Organizational issues, management culture and protocol

The effective collaboration between the parties from different countries can be also affected by different organizational and management culture, which influence business objectives and a manner in which the company conducts its business. Protocol concerns the way the companies present themselves, such as dress-code, official language, propriety and discretion, non-verbal messages, decision making, code of behaviour and ethical code, negotiation and decision-making process, bureaucracy, level of hierarchy and subordination. (Monczka et al. 2005, 313-315; Branch 2002, 37)

Consequently, international procurement is quite complex process, where one of the vital issues is to be aware of possible pitfalls involved in collaboration between two countries and to understand the most important aspects of trade habits and processes, current political and economical situation in the country, legal system and cultural habits of the host country (Branch 2002, 5-7).

## 7 RESEARCH FINDINGS

In order to obtain the materials required for the project I have conducted desk research, which has generally taken about two months and was based on the investigation of published materials, including magazines, newspapers, websites, online documents, catalogues and blogs. In the frame of this project, I have also visited specialized exhibition and conducted conversation with the outside specialist.

As it was already mentioned in Chapter 3, the main tool of desk research is the analysis of already available sources, however, in this research the conversation was used as a supportive tool for verification and specification of obtained data. The choice of particular sources of information was conditioned by the specific of the issues have to be investigated, purpose and framework of the project.

Thus, in order to collect the data about the potential subcontractor suppliers I have visited International Maritime Defence Show 2011 (IMDS), that took place in Saint-Petersburg, and conducted conversation with the captain first rank and candidate of engineering sciences Gubkin S.A.

The visit to IMDS allowed me to find out who are the main players at the market today, how they are presented, what the level of international collaboration is, and how much Russian companies are willing to cooperate with the foreign partners. I have also received informational and promotion materials about the participants, trade magazines and newspapers, and the database of the companies presented at the market. Even though IMDS was established for the companies operating in the defence sphere, in many countries and especially in Russia, the main shipyards and shipbuilding companies was initially created with the military purposes, so, the manufacturers in naval and civil shipbuilding are commonly the same.

The conversation with Mr. Gubkin was conducted in order to find out which companies in Saint-Petersburg and Leningrad region have technological possibilities and capacity to implement the order the case company is interested in, their current economic conditions and possible perspectives.

Further detailed research about potential subcontractor suppliers was implemented through the main Russian searching engine Yandex.ru. This research provided me with large number of the Internet resources, including data-bases and specialized information portals.

In that context I would like to notice, that the sources, which can be easily found in published form, are not always profound, complete and up-to-dated. Furthermore, the information is poorly represented in English language, and even in Russian can be

limited. Consequently, it can be challenging to obtain detailed information about potential suppliers: their projects, capabilities, partners and financial situation. There can be different reasons for that, such as certain structural or economical reforms within the companies or sector, weak development and support of the sites and databases, technological problems, and, probably, confidential issues connected with the country's defence sector.

Moreover, in order to be able to collect the valid material or to find out if the manufacturer has technological possibility to create the product, it is important to understand which technological processes are required for the production of the item requested, and to know exact technical terms in Russian language.

Consequently, the research was done in Russian language with the use of Russian-language sources, and the conversation in that context was a tool to sort out and verify the data available, as well as the directive tool for the further research.

In order to find the information about business culture and habits in Russia, I have used international search engine Google.com, and conducted that research in English language. During that study, I was looking for the materials, which contain results of researches, practical suggestions and guidance about doing business in Russia, preferably developed by Finnish authors.

To gain the materials about contract issues, transport mode, Incoterms and custom duties applicable in the industry, I have investigated Russian language sources published in electronic form. The documents I have chosen for research findings were developed by professional lawyers which consult the Russian companies operating internationally. These materials include description of the basic practises of contracting, explanation of the main mistakes the companies usually make and recommendations about the most important clauses need to be considered. The materials about a transport mode, Incoterms and custom duties appeared as not profound as I have expected, which partially indicates that these issues do not contain any particular pitfalls and accomplished in a generally accepted way.



According to the purpose of the project and its framework, the empirical part of the thesis is divided into corresponding structure. The first chapter of research findings contain the information about potential subcontractor suppliers and analysis of overall situation at the market they operate. The following section consists of description and explanation of the main clauses of the contract, including brief overview of Incoterms. Transport mode and custom duties represented in the third chapter, and last section contains the analysis of the business habits in Russia, including the most common challenges and cultural differences the foreign companies face doing business with local representatives.

## 7.1 Potential subcontractor suppliers

The potential subcontractor suppliers listed below were chosen in accordance with the main criteria covered in the theoretical part of the project. As it was mentioned earlier, the decision to introduce exactly these companies was made based on investigation of trade magazines, Internet search and conversation with Mr. Gubkin. Evidently, the research of potential subcontractor suppliers implies availability of more profound information, however those companies meet the basic requirements of the case company at the preliminary level in relation to capacity, technological capabilities and location.

1. JSC Baltiysky Zavod was established in 1856, it is located in the western part of Saint-Petersburg and occupies the territory more than six hundred fifty thousand square meters. Its main specialization is construction of icebreakers and ice-classed vessels, naval ships and large commercial vessels for cargo carriage. The shipyard has foundry, steel cutting facilities, hull fabrication and outfitting facilities, slipway with dock, painting and welding facilities, pipe shop, assembly areas and ancillary services. (Website of JSC Baltiysky Zavod 2011)

Production capacity of the shipyard allows it to manufacture wide range of propulsion equipment, machinery for equipping ships, floating nuclear power plants, heat exchanges, steel, cast iron, non-ferrous and core-mould castings, propellers, shafts, bearings, steering gear parts, deck and bilge machinery, valves and pipelines,

steam generators, exhaust and hot-water boilers. In 1990<sup>s</sup> the company has adopted Total Quality Management and Quality Management System and since that time has been granted by the number of Russian and international quality certificates. (Website of JSC Baltiysky Zavod 2011)

The review of the web pages has shown, that even though the company has English version of the website, not all the valuable information is available and up-to-dated in English language. Therefore, production facilities and technological processes, as well as the information about the company and its quality system, history and projects are described in English language comprehensively. However, last news published in English is dated by 2006, while Russian version by 2011 and the last financial data represented in both languages is dated by 2005. (Website of JSC Baltiysky Zavod 2011)

Generally, the shipyard has comprehensive technological capabilities and production capacity, which allow it to implement large and complicated projects. It operates at the market more than one hundred fifty years and has abundant experience working with the foreign customers. Among the Russian shipyards, Baltiysky Zavod is considered as one of the largest and high-powered, however, today, its situation is not stable due to organizational and economical changes within the company and external political factors.

Today, eighty-eight percents of JSC Baltiysky Zavod belongs to JSC United Industrial Corporation (UIC), which owner faced bankruptcy in 2010, and the shares of the shipyard were pawn to the Russia's Central Bank. Moreover, according to the news, the owner of the shipyard was suspected of trying to move out assets and prepare the company to the bankruptcy and liquidation in order to sell the territory for the apartment block's building. At the same time, the general director of the shipyard points out, that such assumptions do not have any grounds, as the shipyard is military object and contains many industrial monuments at the territory, and, consequently, cannot be moved to another location. (FAS allowed to buy "Baltiysky zavod" and "Severnaya Verf" 2011; Website Navaltoday.com 2011; Malysheva & Chernov 2011)

The financial situation at the Baltiysky Zavod is quite challenging though, as it does not have enough orders, and some of the orders it has are going to be transferred to another factories. Some of the shipyard's workers and independent experts consider that situation as a deliberate policy, which can have deplorable results. (St. Petersburg communists deputies protect Baltyisky zavod 2007; Petersburg deputies will inform the government about the problems of Baltiysky Zavod 2011)

2. FSUE Admiralty Shipyards was established in 1704 year, it is located in the western part of Saint-Petersburg and occupies four islands with general area six hundred fifty thousand square meters. It is one of the oldest Russian shipyards and it designs, produces and modernizes large variety of civil and naval vessels, including submarines. Production capacities and technological equipment of the shipyard include steel cutting shop, assembly-welding production, slipway erection workshop, woodshop, outfitting and protective installation workshops, pipe manufacturing and cooper coating workshops, machine-building and electroplating workshops, forging, springs and heat treatment work bays. Besides, it has also transportation and warehousing facilities, tugs and docks. FSUE Admiralty Shipyards has comprehensive Quality management system and wide experience in international projects. (Website of FSUE Admiralty Shipyards 2011)

Speaking about the availability of the information at the web pages of this shipyard, I would point out, that even though the company has English-version website, the information in English is limited and occasionally is not available at all. Hence, services provided by the shipyard, its history, general information, projects and quality system described in English sufficiently, however last news are available in Russian only, and there is no information about financial and economical issues in any language. (Website of FSUE Admiralty Shipyards 2011)

According to the variety of sources, FSUE Admiralty Shipyards has high production capacity, and its professional experience allows the shipyard to implement the orders of any complexity. However, the situation at the company is not so stable as well. The shipyard is a part of governmental holding company "United Shipbuilding Corporation" (USC), which owns eighty % of all shipbuilding projects in Russia. The major part of the largest shipbuilding companies, shipyards, planning

organizations, research institutions and ship repair companies belong to USC (Website of United Shipbuilding Corporation 2011).

In 2008 the corporation has started the development of the project of building modern multifunctional shipyard in Kronstadt, the city which is located in the Gulf of Finland forty eight km west from Saint-Petersburg on Kotlin island.

Nowadays, the USC is going to consolidate on Kotlin such shipyards as Admiralty Shipyards, Baltiysky Zavod and JSC Shipbuilding plant Severnaya verf, however, while the movement of Baltiysky Zavod and Severnaya verf is still to be questionable issue, the Admiralty Shipyards is going to be moved within next ten years, and such decision was already made officially. There are many debates about the topic between community representatives, shipbuilding professionals and authorities, however, according to the President of Economic Development, Industry and Trade Committee, the shipyards will be moved and it is just the matter of time. (Yelin 2011; Obuhova 2010; Myagkova-Romanova 2011; Website of Information agency Rosbalt 2011)

3. JSC Shipbuilding yard «Severnaya verf» was established in 1912, it is located at the southwest of Saint-Petersburg and occupies the territory about nine hundred thousand square meters. The shipyard is one of the leading enterprises in Russian defence shipbuilding industry and specializes in the manufacturing of various types of naval and commercial ships, such as corvettes, destroyers, trawlers, antisubmarine and patrol ships, scientific research vessels and passenger vessels, timber vessels, trawlers, container ships and RO-RO vessels. (Website of JSC Shipbuilding yard «Severnaya verf» 2011)

Its production capabilities include hull plating manufacturing, welding assembly manufacturing, shipbuilding manufacturing, round trip complex and building berth. The shipyard's facilities include laboratory and metrological service; moreover, the company has adopted the number of quality certificates. (Website of JSC Shipbuilding yard «Severnaya verf» 2011)

JSC Severnaya verf has English-based version of the website as well, however, as in two previous cases, the information represented in English language is more limited than in Russian. As a result, such sections as information about the company, its partners, services and products, the history and news are available and up-to-dated in both languages. Nonetheless, the information about financial situation, including annual financial reports, is available in only Russian. (Website of JSC Shipbuilding yard «Severnaya verf» 2011)

JSC Shipbuilding yard “Severnaya verf” belongs to the UIC, which owns seventy-two percents of its shares and, just like in case with JSC Baltiysky Zavod, those shares were pawn to the Russia’s Central Bank. According to the news, both shipyards were on the verge of bankruptcy, however, as opposed to the Baltiysky Zavod, “Severnaya verf” has received many-billion order from the Ministry of Defence for seventeen naval ships. The financial situation at Severnaya verf is quite promising, as the government makes the seventy percents of the orders, and the shipyard has received the large order from Norwegian company. (Chelpanova & Pylaev 2011a; Chelpanova & Pylaev 2011b; Malysheva & Chernov 2011)

Consequently, the situation concerning these three shipyards can be hardly considered as a problem-free and stable. All three companies have reputation of industrial giants of Russian shipbuilding and they strategically important for that sector. However, today, each of these companies is an object of debates because of the different issues. Thus, FSUE Admiralty Shipyards belongs to the USC, while two other shipyards, are still to be owned by UIC. The idea about development of single modern shipbuilding cluster in Kronstadt is discussed already for several years on governmental level and in the media, and all three shipyards were seen as the links of one production chain.

Nonetheless, while the decision about the movement of Admiralty Shipyards was made, the decision about two rest shipyards is arguable. USC has an interest in taking up shares of Baltiysky Zavod and Severnaya verf, however the parties (USC and UIC) cannot negotiate the price. Moreover, Baltiysky Zavod and Severnaya verf were recently inspected by Public prosecutor’s office, Tax Administration and Accounts Chamber for several times already, however, there were not found any law

violations. There are many different opinions about the situation: some considers it as an effort to free attractive territory in the central part of the city, others as a method to speed up the takeover of the shipyards by USC, which strives to integrate the major shipbuilding enterprises of Russia in order to create monopoly. (Malysheva & Chernov 2011; Chelpanova & Pylaev 2011b; Mozgovoy & Makarov 2011, 12)

4. JSC Almaz Shipbuilding Company was based in 1931 year, it is located in the central part of Saint-Petersburg and occupies the territory about one hundred sixty five thousand square meters. The company specializes in the manufacturing of air-cushion amphibian ships and its technological capability allow it to accomplish such machine-building orders as components for nuclear electric power stations, drill rig blocks, propeller shafts, high-precision metal structures and other mechanical articles from steel, aluminum and other construction materials. (Website of JSC Almaz Shipbuilding company 2011)

Production facilities of the company include shipbuilding ways, hull-construction workshop, mounting and assembly-welding workshops. JSC Almaz also possess comprehensive Quality Management System and continuously develops its quality policy and strategy. (Website of JSC Almaz Shipbuilding company 2011)

The website of the company is translated in English language and covers such topics as general information about the company, its products, services and projects and quality system. The latest news in English are dated by 2008, while the Russian version - by 2011. Financial reports are represented in Russian language and are not available in English. (Website of JSC Almaz Shipbuilding company 2011)

JSC Almaz can be also considered as the company with high level of professionalism and abundant experience, however, the company deals with less complex vessels and projects, and differ from previously described shipyards in relation to capacity and technological capabilities.

5. Sredne-Nevisky Shipyard JSC was established in 1912, it is located in the Leningrad region and occupies the territory of three hundred thirty four thousand

square meters. It specializes in manufacturing of low-tonnage civil and naval ships, including corvettes, anti-torpedo ships, patrol and passenger vessels. The company offers complete construction cycle for ships and vessels with low-magnetic steel, fiber-reinforced plastic and aluminum. Sredne-Nevsky Shipyard provides the customers with the wide range of technological services, including machining, demagnetizing, metal plating, manufacturing and welding of metal construction of any complexity, cutting and bending of metal plates, turning and milling. It has metal-working and metal-plating workshop, assembly and delivery workshops. (Website of SNCZ Sredne Nevsky Shipyard 2011)

The website of the company proposes the availability of English-based version, however, almost all the pages which open from the English-based menu do not contain any information. At the same time the information about the company and its production capabilities is up-to-dated, the quality system and last news are represented in Russian language, while financial reports are not available at all. (Website of SNCZ Sredne Nevsky Shipyard 2011)

In general, Sredne-Nevsky Shipyard, steadily develops Total Management System and introduces innovative technologies. It has reputation of reliable partner and constantly expand its businesses in local market and abroad. (Seredenko 2011, 46)

6. Vyborg Shipyard JSC was established in 1948 year in Vyborg, which is located in fifty km from the Finnish border and one hundred thirty km from Saint-Petersburg. It is one of the largest shipbuilding companies of the North-West region and its closeness to the number of Finnish and Russian harbours makes the shipyard strategically attractive and favourable for the shipbuilding and ship repair. Among the activities of the shipyard are construction of offshore drilling platforms, shipbuilding, steel production, ship repair and modernization and steel production. (Website of Vyborg Shipyard JSC 2011)

The shipyard has hull assembly workshop, steel preparation and unit assembly, painting chambers, pipe and mechanical workshops, equipment installation and commissioning workshops, outfitting and block assembly workshops. Production facilities of Vyborg Shipyard enable it to manufacture big-size structures of steel,

stainless steel and aluminum. The shipyard's production technologies and quality system have been certified by the number of Russian and International organizations. (Website of Vyborg Shipyard JSC 2011)

The website of the company has English-based version and almost all significant information is represented exhaustively in both languages, with the exception of financial reports, which provided in Russian only. (Website of Vyborg Shipyard JSC 2011)

7. JSC "Kanonersky Shiprepairing Yard" was established in 1883 year and located at the northwest of Saint-Petersburg on Kanonarsky island. The shipyard provide wide range of ship repair services, including hull blasting and painting, repair of hull structures (replacement, restore, modernization), repair of propellers, engines, ship's gears, boilers and pressure vessels, vessel modernization, repair and replacement of pipeline system and fittings, electric motors, generators, electric and navigation equipment, as well as certification of welders and testing of welded materials. The shipyard has foundry, forge, mechanical and electrical workshops. The quality system of the Kanonersky Shiprepairing Yard is supported by Russian and international quality certificates. (Website of JSC "Kanonersky Shiprepairing Yard" 2011)

The information at the website of the company is equally presented in both languages, Russian and English, however, English-based version is more limited, which concerns news and financial reports. As opposed to the listed above companies, the site of Kanonersky Shiprepairing Yard contains less information in general and covers only the most important issues. (Website of JSC "Kanonersky Shiprepairing Yard" 2011) For the better use, the contact information of all the enterprises listed above is provided in a table in Appendix 2.

Among other alternative potential subcontractor suppliers, which have different location, however can be more attractive in relation to other characteristics, are JSC "PO "Sevmash", OJS "Ship repairing center "Zvezdochka" and Yantar Baltick Shipbuilding Plant.



Sevmash and Zvezdochka are located in Severodvinsk town (Arkhangelsk region), and both are one of the largest industrial interposes in Russia and well-known in the naval and civil shipbuilding sector in Russia and abroad. Technological capacity and production facilities of the enterprises enable them to cope with the contract of any complexity. Yantar Shipyard is located in Kaliningrad and belongs to the industrial shipbuilding giants, however one of the main advantageous is its location in a special economic zone, which has preferable tax and customs policy. (Gubkin, personal communication on 7 July 2011; Propellers of “Zvezdochka” are for a whole world” 2011, 4). The maps, represented in Appendix 3 shows the allocation of shipyards in Saint-Petersburg and other cities.

The shipyards and shipbuilding companies listed above vary by sizes, production capacity, technological capabilities, professional experience and experience of collaboration with foreign customers, however all of these enterprises potentially meet requirements of the case company. There is no doubt, that the choice of exact company requires more detailed and comprehensive examination, which also involves contacting and negotiations.

Therefore, not all the shipyards are able to produce the casting of large tonnage and sizes, whatever the technological process is involved. Additionally, almost all the companies have quality system, however the availability of particular certificates is different. In any case, at the web pages of the companies provide the information about the dimensions and tonnage of the casting they are capable to produce, including materials used and technological processes involved.

Even though Environmental legislation in the country has different scale and effectiveness as in Europe, in 2002 the government has approved the Russian Federation’s environmental doctrine. The companies, operating in the industrial sector, have to follow local environmental legislation. The standards specified in environmental law are normally concern emission formation, quantities and limits, and may include transport and the ecological impact of fuel. Among the quality standards, which are currently in force in the country, are GOST R ISO 14001-98 and ISO 14001-96 (environmental management), GOST R 12.0.006-2002

(occupational safety) and OHSAS 18000 series (occupational safety and health). (Iivari 2008, 154-155)

## 7.2 The most important clauses of the contract agreement

The contracting in Russia differs from many other countries by its complexity, extensionality and, sometimes, necessity to have many other approved documents which support and supplement the contract. In order to define the most important clauses of the contract I have investigated the materials published by Russian lawyers specialized in export and import legislations. These publications generally consist of practical recommendations and basic principles of export contract's development, which imply, that the potential subcontractor supplier may follow those principles, and the contract will probably contain the clauses explained below.

The general order for foreign-trade contracting in Russia is conditioned by the United Nations Convention on Contracts for the International Sale of Goods (CISG) (Titova 2011).

Commonly, Russian enterprises operating in foreign-trade environment use two approaches to agreement's development: brief or very detailed text. The practice shows, that both methods contain many pitfalls. In case of disputes, short contracts do not provide enough information necessary for problem resolution, which involve extra time and resources. However, attempts to cover all the conditions and possible consequences in details, complicate the process of negotiations and make the document difficult to understand. (Selivanovsky 2005)

According to the Russian Civil Code, in case one of the parties of foreign-trade bargain has Russian residence, the contract has to be made in written form only, otherwise it can be declared invalid (Smolina 2002; Simina 2001; Titova 2011). It can be single signed document, or the collection of documents the parties has exchanged via post or electronic means (Simina 2001). However, in practice, it is not suggested to use fax or e-mail for the document's exchange and agreement, as well

as for delivery of attachment and appendices of the contract, because then there is a risk of discrepancy between copies (Smolina 2002).

The contract is considered valid when the parties have achieved agreement about conditions and put the contract in understandable and clear form. According to the lawyers suggestions, it is better to define, when the contract is put in effect – at the moment the parties achieved agreement and signed the contract, or when the agreed action was implemented (for instance, shipment). Another recommendation is avoid to avoid the use of existing patterns, as they may not reflect the specific, concrete terms and conditions of present contract. The text of the contract has to be considered with particular attention and concretized in each detail, so that the terms and definitions are interpreted unambiguously and understood similarly. (Frolov 2002)

In the same way, the parties have to decide upon official language of the contract, and language used for correspondence and further collaboration. Commonly, the contract is developed in languages of both parties and both versions have equal legal force (which has to be set in the text of the contract). The contract can also be made in one language, or the language of a third country, which is known by both parties. However, for the Russian party it is favorable to have Russian-based contract as then the process of VAT compensation proceeds faster. (Frolov 2002) Furthermore, in compliance with the Instruction of Russia's Bank and Governmental Customs Committee of Russia, the exporter is obliged to provide the bank with the Russian-based copy of the contract (Simina 2001).

In order to avoid falsifications it is proposed to put the signature and stamp at each page of the contract, furthermore, the quantity and validity of signed and stamped pages can be indicated in text of the contract. In case the contract has reference to other documents or appendixes, their headings have to be precisely identical. On the contrary, in case the contract has other documents and appendices attached, it has to be mentioned in the text. (Frolov 2002)

#### 1. Introductory clause:

This clause contains the name, place and date of contract's conclusion, its number, and full name of the parties. It is advisable to make sure, that the person, signing the

contract is the same one who is named in this clause and he/she is authorized to sign the document (which can be proved by charter, warrant, or certificate). (Frolov 2002; Smolina 2002)

## 2. Subject of a contract:

The subject of a contract describes concrete product, which is exported and has custom value. The name of the product and its nature have to be concretized (in case of need in both languages), including type, class, quality, material, technological characteristics and dimensions. As the applied measures vary by country and industry, the terms used in the product description has to be equally understood and applied by both parties. (Frolov 2002; Simina 2001) In case the product is complicated and its description can be challenging, the link can be made to the graphics and drawings (Titova 2011).

## 3. The order of the product acceptance in relation to the quality and quantity:

As the heading indicate, this clause covers information about quality and quantity of the products delivered, and include description of the order the product accepted, period of acceptance, the term of claim for replacement and the term of independent expert judgment. The parties have clearly define and agree what is the quality requirements and which documents and certificates prove it. (Smolina 2002; Frolov 2002)

## 4. Delivery terms

Another question to be covered is delivery terms, which refers to the insurance, transportation, custom duties, date or schedule of delivery. These matters can be agreed in accordance with Incoterms, or formulated by the parties as distinct from Incoterms conditions. (Simina 2001) In case the parties use exact Incoterms it has to be clearly set in the contract, as in Russia Incoterms have only recommendation character (do not have legal force) and will not be applied by default (Smolina 2002). Thus, if the terms of delivery described in the contract do not coincide with conditions of Incoterms chosen, the preference will be given to the former (Titova 2011).

The terms of delivery can be based on the concrete date or fixed time period; another choice is the application of special terms (such as “Just-In-Time”). Special attention has to be paid to the early delivery stipulation: in case the early delivery is unacceptable or allowable it has to be concretized in the contract. (Titova 2011; Smolina 2002)

Two thirds of the disputes resolving in foreign-trade arbitration concern the terms and dates of delivery. Apart from other significant conditions the term of delivery determines the beginning of warranty for industrial goods. The period for complaints about the quality and quantity of the goods starts from the date the product has been delivered. (Titova 2011) In that context, the period for complaints has to be clearly determined in the text. If this condition was not clarified in the contract, it falls under the limitation of action applied in the country of supplier (which is three years in Russia). (Smolina 2002)

##### 5. Currency clause, price and order of payment:

In this clause the parties have to define the currency of price and the currency of payment, (as they can be different), conversion course, exchange clause, payment terms and the terms of purchase in installments (if it is granted). The price might be set for the single unit or for the total sum of the contract, it can be fixed or floating (Frolov 2002; Simina 2001). In practice, the Russian enterprises prefer to use fixed price, however the lawyers propose to use such prices only in short-term contracts, while the most recommended method is the sliding-scale prices (Titova 2011). It is also suggested to fix the cases, when the price can increase or go down (Frolov 2002).

The most common method of payment used by Russian exporters is payment by bank account transfer (Frolov 2002; Simina 2001). The letters of credit applicable in export operations in Russia can require the availability of the documents, which can be difficult of access for the seller (such as certificates about product acceptance issued and signed by the buyer), consequently, this payment method can be challenging (Titova 2011). The information required for the payment transaction, including full names and addresses of banks assigned, accounts numbers, and

payment details of the company, is frequently set in that clause or separately in the end of the contract before the signatures (Simina 2001).

#### 6. Arbitration agreement:

Arbitration agreement is one of significant clauses of the contract as it defines under which law and legal body the disputes are to be resolved. In case it was not concretized, the dispute falls under the law of the country the contract was signed (Frolov 2002; Smolina 2002; Simina 2001). The clause can be included in the contract or attached to it as a separate document, and have to contain which disputes can arise exactly. It is quite common, that the parties are not willing to apply the law of another country, and especially it concerns Russian legal system, because foreigners have doubts about professionalism and impartiality of judges. In practice, Russian enterprises prefer the arbitration of Chamber of Commerce and Industry in Stockholm, Sweden. (Frolov 2002)

#### 7. Packaging and Labelling:

This clause covers such subjects as type of a packaging, its material, size, technological characteristics necessary for the safe transportation, as well as information provided at the label and places for labelling (Frolov 2002). If the packaging is not required, it has to be mentioned in the text of the contract (Titova 2011).

#### 8. Liabilities of the parties:

At this section of the contract the parties define the responsibilities of each party in relation to the contract accomplishment. It is recommended to consider concrete conditions, which will cause the party broken the liability the tangible material damage (penalty), because, then the attitude of the counterparts will be more reliable and conscientious. (Frolov 2002)

The size of penalty is commonly equal to the damage cost, including the value of profit lost. Among the reasons for penalty charge could be delay or default in delivery, groundless cancellation of the product by the customer, delay in payment for delivered product, late opening of credit or its opening based on conditions, which were not stipulated by the contract. (Simina 2001; Titova 2011).

#### 9. Amendments and additions to the contract:

The order of the changes and additions, which can be included in the contract later, has to be explained and agreed. Thus, there are two methods available: first allows to include the changes and additions in the text of the contract each time it is necessary, and only after that those amendments and additions come into force; second assumes that the changes and additions to the contract can be developed as a separate documents and appendices. (Simina 2001)

#### 10. Exemption of liability (Force-majeure):

This clause contain the description of circumstances which exempt the parties from liabilities and cannot be caused artificially, such as earthquakes, floods and epidemics (Simina 2001).

The legal terms in different languages usually have distinct shade of meaning, consequently, the question of foreign-trade contracting requires involvement of professional lawyers with large experience in this sphere. The clauses for the export contract proposed by Russian lawyers can be definitely combined in different order, reduced or developed further, however the enumeration of the issues covered in this clauses indicate which conditions are considered as the most significant, and where the number of mistakes is higher.

Furthermore, the trading relationships are regulating by number of International agreements. Even though Russia does not belong to some of these agreements, local enterprises follow the general contracting rules established by United Nations Convention on Contracts for the International Sale of Goods and widely use Incoterms.

### 7.3 Transport mode

The transportation routes between Finland in Russia are quite diverse, and the delivery of goods from one country to another can be implemented with any transport mode, as the territories border upon the sea and land. Thus, the choice of

exact transport mode depends on the requirements of the parties of the contract and characteristics of the goods to be delivered. Of course, the air delivery in that case is seen as less rational due to its groundless expenses, while the road, sea and rail transportation modes are more common. The most common transportation method used in the trade between Russia and Finland is the road delivery by trucks or articulated lorries.

However, increased trade between countries causes the growth of the traffic, leading to long lines, which sometimes can reach Hamina harbour and in general take thirty two hours of waiting (Website Cargo.ru 2010). Another challenge in the process of delivery relates to the transparency of Customs office operations at the Russian-Finnish border, and exactly, bribes. Thus, in 2009, the Finnish transport companies have paid an annual average of more than fifty thousand euro in bribes. Besides, corruption causes such indirect costs as delays, obstacles to competition, extra-processing and court fees. (Staalesen 2009)

According to Kauko Aromaa, such situations happen because Russian operational authorities at the border do not follow many rules determined by international and bilateral agreements which Russia has ratified, or comply them selectively. Moreover, some of the rules established by EU and Russia differ fundamentally (such as for inconsistency between axle weight standards). (Aromaa 2009, 42)

Furthermore, the condition of the road infrastructure in Russia was admitted as a worst in Europe by World Bank (Website Cargo.ru 2011). At the same time, the development of logistic network in Russia, and in Saint-Petersburg and Leningrad region in particular, possess positive tendency which is proved by the fact that in 2008-2009 in Saint-Petersburg and region were constructed seven warehouses of A class (Yelin 2010).

Consequently, the transportation of the product from Russia to Finland has wide range of choices in transport modes, however can face obstacles in processing the load through the border. In relation to the nature of the product the case company is interested in, the choice of particular transport mode depends on the measures and weight of this product. In any case, majority of the potential subcontractor suppliers



listed above are allocated in one territorial area, while the delivery from rest (located in Kaliningrad and Severodvinsk) can be accomplished by sea or land as well.

#### 7.4 Custom duties

The question about custom duties and custom clearance of the products related to the shipbuilding or metallurgy, is not covered in the sources enough to make conclusion about the ease of the process. The information about the export operations covers such general topics, as order of a clearance and payments involved. Thus, when the load is moved through the Russian border there are following customs duties to be paid:

- Custom duties are established as a percentage of a customs value of a good, in Euro per unit (according to the measurements applied), or as a combination of two previous rates. The number of the products, which are exposed to export customs duties, is significantly fewer than the range of a goods incurred import duties. These products usually concerns raw materials strategically important for the country, such as oil, gas, non-ferrous metals and products made from them. According to the last news, Russian government decided not to expose the export custom duties to the steel and iron-ore materials (Website Tamogniya.ru 2011).
- Value Added Tax (VAT).
- Excises are applied to such products as alcohol, spirits, beer, tobacco goods, jewellery, oil, gas condensate, natural gas, petrol, vehicles with an operating engine capacity of 2500 cubic cm.
- Customs duties for customs clearance are equal to 0,1% of cost of goods in roubles, or 0,5% in foreign currency in concordance with the exchange rate established by Russia's Central bank.
- Other payments depend on the terms of bargain and can include custom duties for storing goods, for custom's convoy, and for information and consulting services. (Website of St. Petersburg External economic relations 2011)

## 7.5 Business culture and habits

The difference in business behaviour turned out a challenging topic to investigate. On the one hand, the fact, that business habits in one country differ from an etiquette adopted in another, is obvious. On the other hand, even though the evidence of such differences can be easily indicated in the process of collaboration, these characteristics might be difficult to identify concretely, especially when they have to be formulated and described in the frame of academic work.

The materials available in the Internet provide exhaustive information about doing business in Russia, however they mainly concern geography, political and legal systems, economical situation, taxation, accounting, banking and labour law. The explanation of social characteristics covers such aspects as population, religion, education and living standards.

Such information is valuable for understanding of the basic characteristics of the Russian society, and can be useful for the companies investing in Russia. Nonetheless, the concretization of particular business habits can be found in the Internet more rarely, or seems to be too simplified to be perceived as guidance. Consequently, in order to narrow the information, that required for this topic I have used such quires as “challenges of doing business in Russia”, “business behaviour in Russia” or “Russian business habits”.

As it was already mentioned earlier, the materials used for this section include the research projects developed by Finnish authors in English language. Interestingly enough, that the topics of these works sound as: “Corruption on the Finnish-Russian border” and “Business security and Russia”. Besides that, overwhelming majority of resources about doing business in Russia support the opinion, that Russian business environment is challenging, risky and unpredictable. Therefore, Pekka Iivari assumes, that the Russian market require from the company large capacity to take risk, well-established relationships (on both business and personal level) and persistence to stay at the market even in difficult conditions and changes (Iivari 2008, 9).

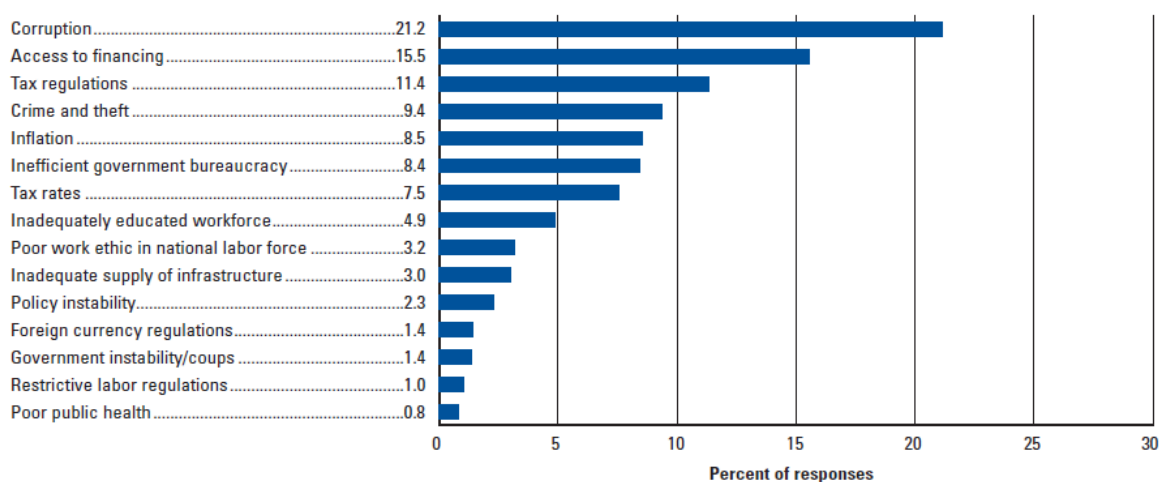
At the same time almost all the authors conclude, that Russian market is very promising and professional level of people have improved considerably over last decades. Moreover, in case Russia will join WTO, the legislations and business procedures will approach the European standards, and trade practices will be regulated by agreements and rules established by this international organization (Iivari 2008, 10).

In general, many data, used in this research, is taken from blogs and sites where people exchange their knowledge and experience. Such data have less value in the frame of academic work, however they can provide valuable and concretize information about particular habits and standards of behaviour in Russian business world.

#### 7.5.1 The most problematic factors for doing business in Russia

The Global Competitiveness Report 2010-2011 published by World Economic Forum provides data about the level of economic competitiveness of the countries. It contains following index rates: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, good market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication and innovation. The most problematic areas for doing business in Russia are represented in a chart below.

**The most problematic factors for doing business**



Note: From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between one (most problematic) and five. The bars in the figure show the responses weighted according to their rankings. (Schwab 2010, 286)

Thus, the corruption remains the main obstacle for doing business in Russia for both, Russian and foreign enterprises. As it was already mentioned in one of the previous chapters “Transport mode”, the Finnish transportation companies quite often face corruption at the border with Russia. The research, implemented by Kauko Aromaa and his project team, proves this fact based on the results of the interviews with civil servants and businesspersons.

Results of the research admitted, that Finnish respondents are aware of corruption at the border, and many of them distinguish large-scale and small-scale corruption (where the former involve large sums of money, while the latter is limited to chocolate box, pack of cigarettes or small number of cash in exchange to flexibility of authorities). At the same time, the borderline between gift and bribe is still to be indistinct. Therefore, the respondents suppose that this difference is defined by the context of a situation: the formal position of recipient, the stage the gift was given (before or after the deal), and motive of giving. For some respondents, gift giving was a sign of politeness and friendship, and in that context such gift does not have to be of a high value. (Aromaa 2009, 15-16)

According to the research, Finnish enterprises and authorities, assume that such situation is a consequence of the Russian complicated governmental structure, confusing jurisdictional relationships, authority culture and bureaucracy. However, the businesspersons concluded that the difference between gifts and bribes is clear for all the parties involved. At the same time, Finnish businesspersons, which have broad international experience perceive corruption as a method to solve problems and as a need to “play by the local rules”. (Aromaa 2009, 15-16, 19)

Based on another report, developed by consulting agency specializing in Russian market, among the general challenges the foreign companies usually face are

bureaucracy, language skills and cultural differences, the “risk” factor, finding the right partner and poor infrastructure (VM consult 2011, 15).

Bureaucracy in Russia exists in many spheres of social and business life of people; however it has an effect of different scale. While in one case, the need to obtain and approve the documents can cause only confusion and extra time, in another case it leads to corruption, extra costs and business fails. In office environment it can express in such formalities as signing and stamping of documents for internal and external use (because an unsigned document is not valid, and it has to be verified with a round stamp), and multi-level administrative culture with long decision-making process (Iivari 2008, 158,161).

The risk factor imply, that political stability in the country has been achieved, however the policy is often characterized by inconsistency and u-turns (VM consult 2011, 15). Moreover, the fact that the authorities have an effect on the policy and activity of private companies is incontestable. Compared with Finland, the dependency of enterprises from governmental decisions in Russia is more significant (Iivari 2008, 17).

The authors of “Doing business in Russia - Industry overview” conclude that difficulty of finding the right partner is considered as one of a key concerns for foreign companies. The road condition is another problematic area, which affect business efficiency: the quality of roads is poor, and the average speed remains low as a result, which all together leads to the high percentage of car accidents. Finally, the authors summarize, that roads, rail, sea ports and airports are not efficient enough and there is a lack of modern facilities and practices. (VM consult 2011, 16-17)

The level of foreign language skills Russian entrepreneurs possess remains lower than in Europe, and even though the English language skills was improved, majority of Russian entrepreneurs are not able to communicate in English effectively (VM consult 2011, 15). Another challenge mentioned in that context is cultural differences, which are covered in the following chapter.

### 7.5.2 Business behaviour and etiquette

As a general rule, business etiquette in Russia is tend to be formal, and is implemented in the same way as in many other European countries. The delegation for the negotiations has to be selected thoroughly, because an age, status and gender of participants can influence the attitude of Russian counterpart, and define how seriously they will perceive negotiations. The reason is that Russians prefer to deal with those, who have important positions within a company, and women or young managers can undermine the confidence of Russian managers, and such negotiations might be considered as temporary and impersonal. Consequently, the meeting has to be held by the same level of the people: vice president VS vice president, deputy director VS deputy director. (Website Askarussian.com 2010; PricewaterhouseCoopers Russia 2010, 14)

The punctuality is one of the most ambiguous characteristics of Russian business behaviour, because the delay from a partners is perceived differently: while own delay from a Russian partner is seen as of little consequence, the counterpart is expected to be punctual. Such kind of behaviour can be interpreted as a test for the partner's patience, and, in general, the patience is one of the basic rules in collaborations in Russia. Thus, foreign entrepreneur can expect quick decisions, while Russians are tend to be more flexible in time spending, and accustomed to wait for the results they aimed at. (Website Askarussian.com 2010; Priest 2011; Website of BCI Marketing Partners Inc. 2007)

Furthermore, while majority of Europeans, including Finns, have item-oriented approach, Russians are person-oriented and tend to emphasize the opinion of the person responsible for decision-making. The agenda for a meeting is distributed in advance, and the best modes of contact for that fax or e-mail, as a mail is often unreliable. In general, the agenda prepared by Russian partner may be overloaded and poorly planned, which reflects the state of affairs concerning the time management, moreover the meeting is often lasts longer than it was agreed. (PricewaterhouseCoopers Russia 2010, 14; Iivari 2008, 158)

Another amusing characteristic is, so called, dual ethic, which concerns the attitude Russians can demonstrate to the foreigner, meaning, that local people are tend to make difference between “ours” and “strangers”. In practice, Russian managers can possess high ethical attitude toward those, who belongs to their personal connections, and, at the same time can violate ethical standards in respect to people from outside (violate obligations or break agreements). (Website Askarussian.com 2010)

In that context, it is important to mention such essential component of Russian life, as a “connections” or “relationships”. Many studies confirm, that Russian business people entrust personal relationships rather than contracts. (Priest 2011) Such survival networks of unofficial contacts help to obtain reliable information, ensure that the matter proceeds in required direction and increase the possibility to achieve required results. In general, the foreigners perceive this feature as a fundamental cultural characteristic, which differs Russian culture from the major part of Europe, including Finland (Iivari 2008, 158; Aromaa 2009, 18).

Russians emphasize respect as an important component of any collaboration, and prefer personal and informal communication. Therefore, it is recommended to avoid impersonal messages in both face-to-face and writing communication, as it can be considered as a lack of respect. Besides organizational gains, Russian entrepreneurs can expect from collaborations personal advantages. (Website Askarussian.com 2010; Website of BCI Marketing Partners Inc. 2007)

Another characteristic of Russian business culture is an uncompromising behaviour, because the compromise can be seen as a sign of weakness. The “final offer” does not always mean the actual end of negotiations, and detailed contract can follow verbal agreement in the end of negotiation. Furthermore, Russian entrepreneur can overestimate the interest of customer or investor: while the foreigner can monitor the local company in order to find out potential possibilities for collaboration, local entrepreneur may perceive it as a promise for the forthcoming bargain. (Website Askarussian.com 2010; Priest 2011)

One of the most discussed topics in the materials collected for this study is “Accepting and giving the gifts”, because this issue is often compared with bribes

and, consequently, corruption. Many authors conclude, that “the gifts” is inevitable part of doing business in Russia, and in the frame of business relationships they typically mean “building the relationships”. Such symbolic gifts may contain the logo of the company, and, commonly, receiving a gift is followed by giving a reciprocal gift. (Website Askarussian.com 2010; Iivari 2008, 161)

The business environment in Russia is changing rapidly, consequently, for doing business there, it is suggested to use local consultants or well-established connections, because knowledge of Russian culture and experience in local environment play significant role. Nonetheless, local entrepreneurs is not always versed in the legislations and trading rules applied in the country, and even those of businesspersons, who have international experience can underestimate cultural differences between the countries. (Website Askarussian.com 2010; Iivari 2008, 159)

Other difficulties Finnish entrepreneurs face in Russia concerns differences in ethic, lack of international work experience of local people, lack of professional qualification, initiative and teamwork skills (Iivari 2008, 161).

The last topic to be covered in that section is public holidays. The period of the time those Holidays take can turn into several days and cause the decreased responsiveness and work stoppage. There are following public holidays in Russia:

- New Year holidays (1, 2, 3, 4 and 5 January);
- Russian Orthodox Christmas (7 January);
- Defenders of the Fatherland Day (23 February);
- International Women’s Day (8 March);
- Spring and Labour Day (1 May);
- Victory Day (9 May);
- Russia Day (12 June);
- Unity Day (4 November).

The holidays can take several days, because if it falls on a Tuesday or Thursday the days are joint in order to make three days off consecutively. In that case, the nearest Saturday or Sunday is declared as official work day. If the holidays follow one after another, like New Year and Orthodox Christmas, there can be more than one week



off. Commonly, the government publishes such schedules two or three months before the year begins, so such shortages can be considered and agreed with the partner in advance. (Website of PricewaterhouseCoopers Russia 2010, 14)

## 7.6 Sources of information

Among alternative sources of information, which can be used for supplier research and news investigation, are several data-bases, catalogues, magazines and events. Regrettably, not all these sources provide the information in English language, however they still possess profound data about industry and the companies operating at the market.

### Exhibitions:

1. The NEVA International Exhibition, which takes place in Saint-Petersburg, specializes in commercial maritime industries (Shipping, Shipbuilding and Offshore Energy) and represents large number of the Russian and International companies. The English version of the site: <http://neva.transtec-neva.com/about.html>
2. The International Maritime Defence Show is one of the leading international exhibitions in the naval shipbuilding and maritime equipment. It takes place in Saint-Petersburg and represents the main shipbuilding and ship repairing companies, design bureaus and research institutes. The English version of the site: <http://www.navalshow.ru/eng/>

### Catalogues and data-bases:

1. The trade catalogue published by Infomir, “Shipbuilding/Navigation” provides information on potential suppliers with detailed description of the products and services they offer. The data included in the catalogue is represented in English and Russian languages, and can be easily used by foreign company. Thus, the section “Propulsive systems and components” consist of 29 sub-sections, and include the list of companies, which services are divided into: producer, installation, service, distribution, designing and development. The printed version of the catalogue is

distributing at the exhibitions, specialized forums, seminars, conferences, and other events; is sending to the subscribers and companies operating in the field; and is selling through the main book-stores or Internet shops. The Internet version of the catalogue is available at: <http://infomirspb.ru/?cg=search>, however the research can be conducted in Russian language only.

2. The Internet catalogue provided by Yandex.ru is divided into sections of business activities, and contains the links to the websites of the companies, informational portals, magazines and websites of the exhibitions. The address in the Internet: <http://yaca.yandex.ru/yca/cat/Business/Production/Engineering/Shipbuilding/>

3. Shipbuilding portals, which provide the information about the industry, its main participants, current news and forthcoming events:

- Information portal Korabel.ru (<http://www.korabel.ru/>) in addition to other information includes the catalogue of the companies (<http://www.korabel.ru/catalogue.html>) and catalogue of the sites (<http://www.seasearch.ru/>). The information is presented in Russian language only.
- Information agency Portnews.ru has English version of the website <http://en.portnews.ru/>
- Russian Shipbuilding portal Shipbuilding.ru ([www.shipbuilding.ru/rus/](http://www.shipbuilding.ru/rus/)) provides information about shipbuilding sector, including list of the companies and technologies. The English version of the site is <http://shipbuilding.ru/eng/>, nonetheless, it contains less profound and updated information than Russian-based version.

#### Magazines:

1. Information and analytical magazine “Maritime market” contains information about shipbuilding, shipping, port activity, ocean and shelf exploration. The English version of the site: <http://www.maritimemarket.ru/?lang=en>

2. The magazine “Maritime business of North-West region (Morskoy Biznes Severo-Zapada)” provide current news in the industry and do not have English-based version: <http://www.mbsz.ru/>

3. The magazine “National defence: arms & military technologies” contains the information about national defence of Russia, however often covers the news about naval sector. The electronic version of the magazine is provided in Russian language only (<http://www.nationaldefense.ru/>), while printed issue can be published in English in the frame of such event, as international exhibition or forum.

For the verification of information about suppliers’ reliability Pekka Iivari suggests to use following sources:

- 1.Registrations authorities provide information about basic capital payments, juristic and establishing persons, their shares and basic capital.
2. At the disposal of Tax inspection agency and pension fund the information about payments to these instances and unpaid taxes. The tax authorities’ registers provide information about registration of the company, its governmental register number, changes in company over the time or its termination. The principle of publicity applied by Tax authorities in Russia is comparable with Finnish system and provides the list of a companies which have not paid taxes or which operations have been nullified. However as the share of underground economy in Russia is larger, the information that can be useful for the company evaluation is not always at Tax authorities’ disposal. Another source is the Federation’s Tax Inspection Services register, which is available in the internet, however provide the information only in Russian language.
3. License chamber provides the information about operating permits.
4. Statistics committee is the source of chargeable statistical and accounting information.
5. Law enforcement authorities, such as the Ministry of internal affairs, can inform about the subjects of background check, if they occurred.
6. The Russian Central Chamber of Commerce disposes the Register of reliable business partners, and this service is chargeable as two previous. (Iivari 2008, 58-61).

The institutions established for the development of collaboration between of Russian and Finnish businesses, can be useful in the search as well, because they provide

information in Finnish language. Among such organizations are “The Trade representation of the Russian federation in Finland” (<http://www.rusfintrade.ru/?lang=fin>) and “Registered Association Finnish-Russian Chamber of Commerce” (FRCC) (<http://www.sykk.fi/>).

In general, I would conclude, that almost all the resources, including the websites of potential suppliers, are poorly represented in English language, while foreign resources are not as extensive as local, because the information is changing fast and, probably, the access to the local sources (entrepreneurs, authorities, media) for foreigners is more complicated. Consequently, the resources I have presented in this section are more profound in point of the scope and newness, however some of them can be useless for the person who does not possess Russian language skills.

## 8 RECOMMENDATIONS

As that the project covers several subtopics, such as research of potential subcontractor supplier, contract importance, Incoterms, transport mode and custom duties, business behaviour and habits, I would follow the corresponding order in “Recommendations” chapter.

The process of supplier research is one of the most significant activities of any company. Taking into consideration the nature of industry the case company operates in, its status, and the nature of the product, the importance to find the right supplier became higher. The procurement policy of the case company is based on reliable and comprehensive tools, moreover, the company has experience of supply from many countries all over the World. Nevertheless, the nature of the Russian market assumes additional knowledge, because of the policy, cultural differences, complicated access to the data and availability of these data in English language.

Consequently, it would be reasonable to use knowledge and experience of local partners or representatives, because they often aware of current situation in the industry and conditions in particular companies. Furthermore, such people can have

well-established contacts with other enterprises, authorities and media, which is useful for supplier research. Referring to the research findings, such contacts are known as personal networks (which can be also called “relationships” and “connections”), and even though such conclusion can be perceived as a cliché or stereotype, the fact is that this networks are inalienable part of personal and business life in Russia.

Based on this research, among the most potentially suitable subcontractor suppliers in point of capacity could be Baltiysky Zavod, Vyborg Shipyard, and Severnaya Verf.

Vyborg Shipyard has the most favourable location, it has been recently modernised and possess comprehensive technological capabilities. Severnaya Verf has enough capacity to implement the order as well, however, the question is if Severnaya Verf is able to supply the customer without delays, because it is already overloaded with the orders (as well as Admiralty Shipyards).

The capabilities and experience of Baltiysky Zavod make it able to implement the orders of any complexity, and it has fewer orders than other shipyards, consequently, it can be more responsive and are willing to collaborate. Furthermore, Baltiysky Shipyard is the only company from other described in this project, which is positioning itself as a producer of components for propulsion systems in “Shipbuilding/Navigation catalogue”.

The situation emerged around Baltyiski Zavod and Severnaya Verf can affect the efficiency of the potential collaboration, however, according to Mr. Gubkin this matter will not have any palpable consequences within at least next five years. Other shipyards, located in Saint-Petersburg and Leningrad region, have enough experience and technological capability to manufacture the product, however it depends on the dimensions and weight of the good.

Almost all the represented shipyards have international experience, but it does not imply, that majority of their workers possess foreign language skills. Even though the level of English skills in general is rising, the process of collaboration can be

often embarrassed by lack of English skills. At the same time, Russian enterprises, represented at IMDS 2011, are interested in and willing to collaborate with foreign partners. The majority of exhibitors were provided with the English-based materials, and several specialized translation agencies were represented there. Nonetheless, based on research findings, the knowledge of Russian language is an advantage in doing business in Russia.

After all, I can assume, that majority of the companies described in this research, are willing to collaborate with such enterprise as case company. Nonetheless, there are no guaranties that the deliveries will be made without any delays. The reason is that the enterprises are dependent on the authorities a lot, and many shipyards are busy with governmental orders. Furthermore, the delivery itself can be challenged by road infrastructure and custom clearance, which means that the close geographical location of the suppliers is not the pledge for regular deliveries. Consequently, the long-term subcontracting in that case can have high risk factor, while already known partners and forwarders can facilitate effective collaboration.

The description of the most important clauses of the contract gives general overview of contracting culture in Russia. Obviously, the parties concluding the agreement, have well-established practices and rules for contract development, so, the clauses described in the research should not be considered as a determinative factor.

Nevertheless, agreements applied in Russia quite often include large number of pages and require additional documents, signatures and stamps for the verification. It is conditioned by legal system of the country, requirements of authorities and bureaucratic culture in general. Consequently, the customer should be ready for the large number of documents following the contract, and requests for the additional appendices and other documents.

The research of such topics as Incoterms, transport mode and custom duties, has not explored any specific information, which relates to shipbuilding sector or the product. As steel do not belong to the strategic reserves of Russia, it is not imposed to any extra custom duties, furthermore, as the product is not raw material itself, it should be exported on a general basis. In the same time, it does not guarantee that the

good will be delivered though the border without difficulties, because detention can be caused by matters which are hardly predictable, and concern custom office's policy. The choice of transport modes is wide, and, probably, the most suitable is lorry. In case the product is oversized, there can be used sea transportation. Moreover, there is a large number of logistics companies, which specializes in delivery of oversized loads.

The issue of cultural differences is an integral part of any international collaboration, and is deeply examined by different authors. The Internet provides large number of materials, such as blogs, guides, researches and overviews. The content of these materials varies from indexes of economic performance of the countries to the description of specific business customs. The explanation of such matters can take number of pages, and not all the suggestions will be useful and objective.

Thus, the best way to adjust to these differences is to study materials in order to be aware of misunderstandings that can arise, and to be prepared for negotiations and further collaboration based on that. In that context, I can assume that the most common difficulties of business relationships in Russia, concern deadlines, keeping promises and comparable understanding of conditions of the deal.

Among the questions the case company was interested in were the issues about preferable channel of communication and frequency of contacts with potential supplier. This information was not retrieved during the research, and the only way to obtain it is to make an assumptions based on own experience. Thus, I can insert that the most reliable channel of communication is the phone. Of course, an e-mail is very common as well, however in many cases the phone calls still to be preferable, especially if the question is urgent. The frequency of the contacts depends on particular situation, and, commonly, it is reasonable to check how the matter proceeds in advance, and contact the partner several times before the dead-line or delivery.

Finally, I can resume, that the case company has a great advantage in its position and employees, working in Russia. It means that the process of supplier research can proceed more effectively with the assistance of company workers familiar with

Russian business environment. Furthermore, as the company is well-known all over the world and large, the potential subcontractors will put an effort in the development of long-term relationships with it.

## 9 CONCLUSION

The intention of the company to find alternative suppliers in Russia is quite reasonable and justified, because there are a large number of enterprises, which possess required technological capabilities and have enough capacity to manufacture the product the client is interested in. Furthermore, majority of these shipyards is concentrated in Saint-Petersburg and Leningrad region, while other in Severodvinsk and Kaliningrad, which are also relatively close to Finland. Such location assumes favourable delivery schedule and wide choice of transport modes. However, even though today Russia is one of the most attractive markets, doing business there is still to be challenging and risky.

Consequently, in compliance with the purpose of the thesis, there were proposed several potential subcontractor suppliers, which have experience in manufacturing different types of vessels, equipment for ships, castings and components. Nowadays Russian commercial shipbuilding is not as developed as shipbuilding industry in many other countries, however the position of Russia in naval shipbuilding is still to be competitive.

At the same time, the manufacturing of the specified product does not imply application of advanced technologies. Therefore, taking into consideration the nature of the product and criteria for suppliers discussed in the theoretical part of this project, the enterprises proposed in this work, can match basic requirements of the company in point of capacity, capabilities, location and experience in international projects. The compliance with other criteria could be hardly defined at this stage of research, because the limitations of the project have not supposed the contacting with potential suppliers, and the information available in the Internet is not profound enough to make relevant conclusion.



Among the most known obstacles, which complicate the process of effective purchasing from Russia, are poor road infrastructure, inconsistent custom policy and dependency of the business from governmental decisions. One of the most problematic factors for doing business in Russia is corruption, which are in the focus of many researches and reports. In relation to that, I could assume that the corruption itself will hardly concern the purchasing operations of the company in Russia; the only effect it can have is difficulties in delivery process.

According to the research, other challenges of doing business in Russia concern differences in business culture and habits. The most notable effect of these differences can be experienced during the contract development and order implementation. In general, business habits can be understood and adjusted during negotiations, and do not have the direct effect at the outcomes of the deal.

At the same time, lack of language skills of some representatives can lead to misunderstandings, while bureaucratic culture and postponed deadlines - to the delays and breakages in the process. Nonetheless, as any mutual relationships, relationships with Russian supplier require proper project management, and, probably, more regular contacts in order to ensure that schedule and conditions are complied.

As it was already mentioned earlier, many obstacles the foreign companies face in Russia, will hardly concern the purchasing operations of the case company (in contrast with investing and company's establishment). However, according to the recommendations of many authors, the process of research and negotiations can be more effective with the participation of Russian-speaking person, who have an experience of working there and have the network of contacts.

Therefore, taking into consideration the nature of operations the case company is going to implement and availability of several branches of the company in Russia, I suppose, that the outcomes of this intention can be favourable in case it will be based on the proper and regular examination of the market trends and supplier's backgrounds.

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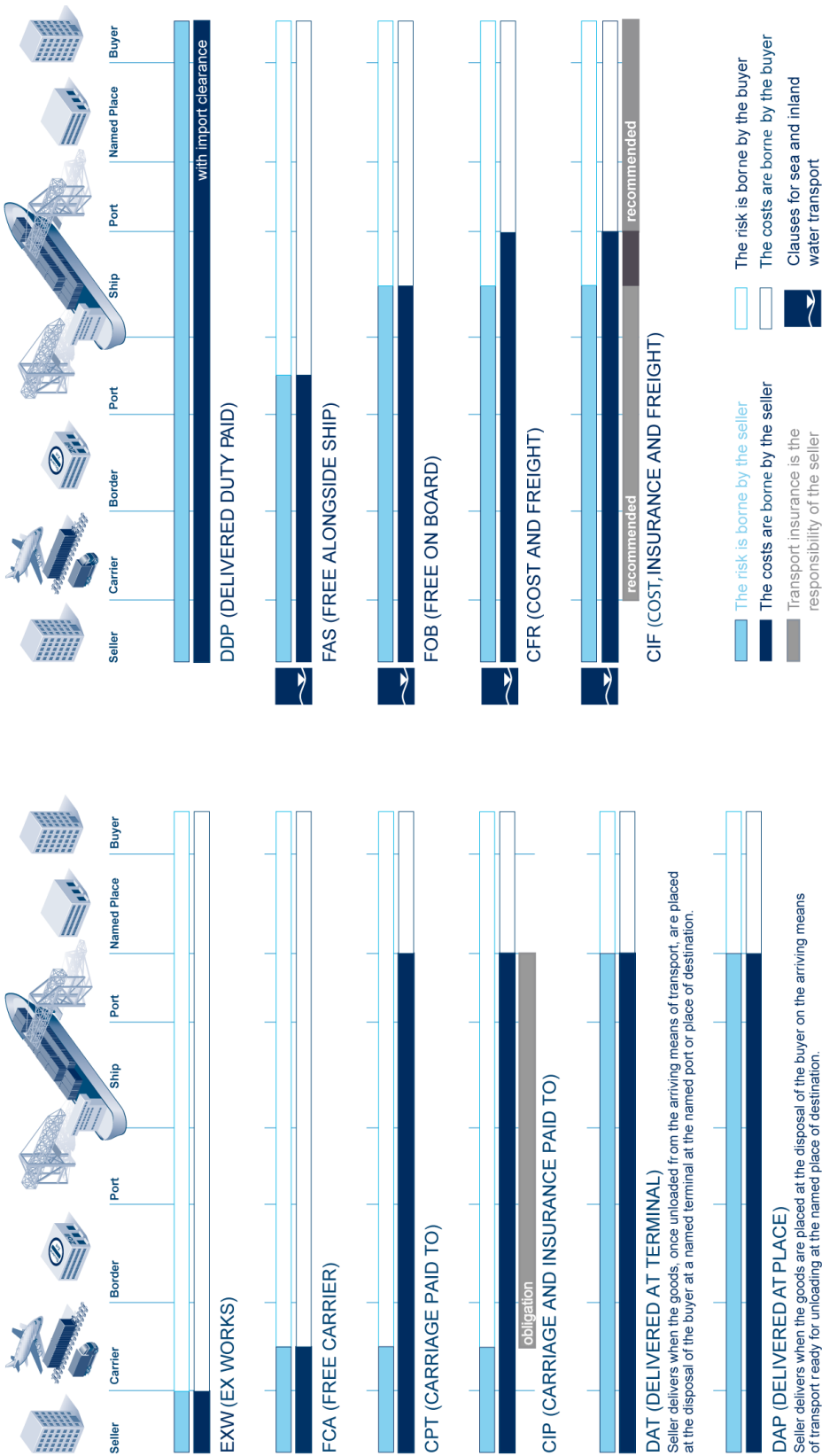
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## APPENDIX 2

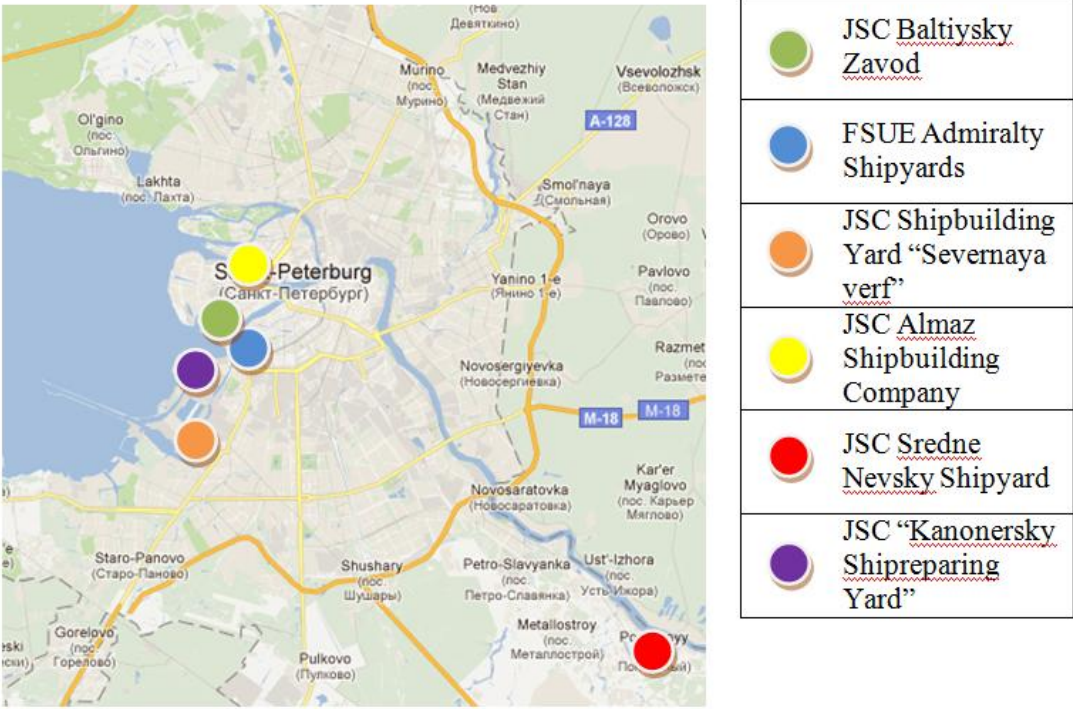
The list of potential subcontractor suppliers

<b>Name of the Company</b>	<b>Address, telephone and e-mail</b>	<b>Web-pages in English</b>
<b>JSC Baltiysky Zavod</b>	16, Kosaya Linia, St. Petersburg, Russia, 199106  +7 (812)324-93-70 info@bz.ru	<a href="http://www.bz.ru/en/index.html">http://www.bz.ru/en/index.html</a>
<b>FSUE Admiralty Shipyards</b>	203, Fontanka Emb., St. Petersburg, Russia, 190121  +7(812)714-88-63 marketing@ashipyards.com	<a href="http://www.admship.ru/en">http://www.admship.ru/en</a>
<b>JSC Shipbuilding Yard "Severnaya verf"</b>	6, Korabel'naya street, St. Petersburg, Russia, 198096  +7(812)324-29-59 info@nordsy.spb.ru	<a href="http://www.nordsy.spb.ru/sv2/index_eng.php">http://www.nordsy.spb.ru/sv2/index_eng.php</a>
<b>JSC Almaz Shipbuilding Company</b>	26, Petrovsky pr., St. Petersburg, Russia, 197110  +7(812)235-51-48 market@almaz.spb.ru	<a href="http://www.almaz.spb.ru/index.php?tema=today&amp;lang=en">http://www.almaz.spb.ru/index.php?tema=today&amp;lang=en</a>
<b>JSC Sredne Nevsky Shipyard</b>	10, Zavodskaya str., c. Pontonniy, St. Petersburg, Russia, 196643  +7(812)462-59-01 office@snsz.ru	<a href="http://snsz.ru/?lang=en">http://snsz.ru/?lang=en</a>
<b>Vyborg Shipyard JSC</b>	2b, Primorskoe Shosse, Vyborg, Russia, 188800  +7(81378)289-52 mail@vyborgshipyard.ru	<a href="http://vyborgshipyard.ru/en/">http://vyborgshipyard.ru/en/</a>
<b>JSC "Kanonersky Shiprepairing Yard"</b>	41, Kanonersky ostrov , St. Petersburg, Russia, 198184  +7(812)746-98-52 dock@ksz.spb.ru	<a href="http://www.ksz.spb.ru/about_en.htm">http://www.ksz.spb.ru/about_en.htm</a>



The location of potential subcontractor suppliers

Shipyards located in Saint-Petersburg



Shipyards, located in other cities

