Managing Challenges in an Unfamiliar Business Environment
- A Study of Scandinavian Companies in Russia

“Russia is a riddle wrapped in a mystery inside an enigma.” Winston Churchill

Copenhagen Business School
Master of Science in Economics and Business Administration,
International Business
November 2010

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Number of pages: 115
Characters: 272 262
Executive Summary

Saturated markets in the western world compel companies to seek new opportunities. For Scandinavian companies operating within the business-to-consumer segment, Russia constitutes great potential, foremost due to its increasing affluent middle class who has a fondness for western-branded goods. However, it is evident that Scandinavian companies face challenges when operating in the Russian market. The aim of the research project was therefore to investigate why Scandinavian companies, operating within the business-to-consumer segment, face operational challenges in Russia, and how the Scandinavian companies should manage these challenges. In order to answer the research questions, a qualitative study was conducted, which included interviews with respondents from Scandinavian companies and experts within the subject field. The collection of data was partly executed through a field trip to Moscow.

Based on the findings, it is evident that the operational challenges have to be understood by taking on a wider context-specific perspective. The development of the ISC framework\(^1\) hereby resulted from the analysis. According to the ISC framework, the formal and informal rules in the Russian business environment influence the corporate behaviour of Russian stakeholders. In turn, the unfamiliar behaviour of Russian stakeholders creates challenges for the Scandinavian companies, since Russian corporate behaviour differs from Scandinavian corporate behaviour. Managerial implications on how to handle the challenges where identified on three levels: the individual, the company and the country level. On the individual level it is crucial for Scandinavian companies to find a balance between the number of expatriates and local staff members employed, as well as to create appropriate compensation for them. On a company level it is essential to take on a stakeholder approach in order to understand how the Russian stakeholders may impact the operations of the Scandinavian companies. On a country level, the findings emphasise a thorough investigation of the Russian business environment and long-term investments, whereas Scandinavian companies may ultimately influence the norms and rules regulating economic exchange.

It is argued that the findings from the research project are significant for Scandinavian companies wanting to operate on the Russian market. Hereby, it is fair to state that a deeper understanding of the findings is crucial, whereas the research project is deemed essential.

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1. Introduction

1.1 Problem Field

“IKEA does not, under any circumstances, engage in bribery in Russia or corrupt behaviour in any of the countries in which IKEA is present” (Sveriges Radio, 2009). These are the words of Ingvar Kamprad, the founder of the global Swedish furniture producer IKEA. The statement goes well in line with the company’s proclaimed policy, the ‘Rules of Prevention of Corruption’, in which it is stated that IKEA takes an active part in preventing both direct and indirect corruption and that this involves all employees and suppliers in contact with the company (IKEA, 2010). However, in February 2010, it was revealed that IKEA had failed to maintain its corruption policy in Russia. Internal IKEA-documents showed that the company’s two senior managers in Russia had approved bribes related to energy supplies. Within hours, both managers were discharged. (Dagens Nyheter, 2010)

The case illustrates a situation where the company was unaware that their managers in Russia acted against the company’s policy on corruptive acts. The situation may be understood drawing upon a theoretical explanation, founded in problems arising when one party acts on behalf of another. This is known as the principal agent problem. The problem arises when the principal (company) cannot observe the agent’s (manager) actions and therefore cannot assure that the agent acts according to the principal’s instructions. The principal agent problem has its foundation in information asymmetry, which means that the agent is more informed than the principal. According to Thomsen (2008), agency problems are the basic issue of corporate governance. A country’s history, culture, and institutions influence the corporate governance system present in that country. Hereby, countries sharing many characteristics may have a common corporate governance system. The Scandinavian countries, Sweden, Norway and Denmark, are all said to have this comparable system of corporate governance, since the countries are relatively small, with 5-9 million inhabitants, have a history of social democratic governments and all belong to a special family of Scandinavian civil law. (Thomsen, 2008) Due to these similarities, it seems fair to argue that the challenges one Scandinavian company faces in Russia, may also constitute challenges to any other Scandinavian company present in that market.
1.2 Problem Discussion

Globalisation is triggered by the saturation of markets in the western world, leaving companies to seek new opportunities abroad. In this regard, the BRIC\(^1\) countries are perceived as an attractive target for many investors (A.T. Kearney, 2008). Of these countries, Russia is clearly the one closest to Scandinavia. The capital city Moscow is no more than a two-hour flight away, simplifying the geographical reach to the market. However, the above discussed agency problem may have its foundation in context-specific situations, based on the company being present in the Russian business environment. Risks and uncertainties in a business environment must be thoroughly revised and compared to the opportunities, in order for a company to consider expanding to a new market. Too high risks and uncertainties may be associated with not entering a foreign market. Theoretically, a country will be attractive for a foreign investor if the investment is likely to generate a return higher than the cost of capital, and if the risks of operating in the country is acceptable. (Lasserre, 2007) Based on this, a company considering entering Russia has to assess the opportunities and threats present in the market.

To assess the threats, it may be useful to analyse the political, economic, competitive and operational risks existing in a market (Lasserre, 2007). The political risk of a country owes to societal crisis and unrest resulting from political action of governments (Lasserre, 2007). Public demonstrations in some 50 cities, against the Medvedev government, have shivered Russia in March 2010. All across the country, the public was demonstrating against the economical situation putting focus on high living costs, low wages, corruption and the handling of the financial crisis. (Helsingbongs Dagblad, 2010a,b) Economic risk refers to the extent that the economic drivers vary and thereby put profitability at stake (Lasserre, 2007). In the 2008 global economic crisis, the Russian economy was one of the hardest hit. This was mainly due to plummeted oil prices and the fact that foreign credits, of which Russian banks and firms relied, dried up. (CIA World Fact Book, 2010) Corruption is referred to as competitive risk, which highlights that the competitive battlefield is not even and investors who base their competitive advantage on economics and product quality are at a disadvantage (Lasserre, 2007). In Transparency International’s Corruption Perceptions Index (2010), Russia was ranked no 154 out of 178, indicating that Russia is a highly corrupt country. Operational risk appears when government regulations and bureaucracies add costly taxation

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\(^1\) BRIC refers to Brazil, Russia, India and China
or other constraints to foreign investors, or when the infrastructure is not reliable in the country (Lasserre, 2007). According to a report drawn up by the Swedish Trade Council (2008), many Swedish companies mention the heavy bureaucracy and the lack of a working infrastructure in Russia as major issues. Hereby, it can be argued that the threats of entering Russia are prevailing.

As the risks associated with entering the Russian market undoubtedly do exist, the opportunities must not be forgotten. To broadly measure the market opportunities in a particular country, it is useful to look upon a combination of microeconomic indicators including demographic, economic and sociological factors (Lasserre, 2007). Russia is the largest country in the world by surface. It consists of 142 million inhabitants, where 73% of the population is living in urban areas (Swedish Trade Council, 2010a). Hereby, foreign companies have the possibility to reach a large amount of customers in a single effort. Between 1998 and 2007 Russia had a positive economic growth of on average 7%, which resulted in a doubling of disposable incomes and the emergence of a middle class. The middle class is today estimated to constitute 20-25% of the population (Radio Free Europe/Radio Liberty, 2008; CIA World Fact Book, 2010). Demand for most mass-consumer goods are triggered by the presence of an affluent middle class, referred to as “the middle class effect”. The demand for modern branded goods emerges when disposable incomes reach a certain threshold and people beyond this threshold are considered the middle class. (Lasserre, 2007) The increase in disposable income has changed the attitudes towards shopping in Russia, with more Russians seeing it as a pleasant pastime than simply a routine task. The middle class is furthermore spending their leisure time in more sophisticated ways, were a larger amount of money is spent on non-essentials. This opens up for a significant number of lucrative investment opportunities in the Russian market. (Euromonitor International, 2010) The factors mentioned above can be argued to indicate that Russia constitutes great opportunities for foreign investments.

Based on the assessment of the opportunities found in the Russian market, it is understandable that Scandinavian companies find the country’s growth potential attractive and aim to expand its business to Russia. However, as the Scandinavian companies enter the Russian market, they face these opportunities in an untried market. The threats recognised in the Russian business environment are several, and as shown by the identified agency problem in the
introductory case, it is apparent that Scandinavian companies find it challenging to operate in the Russian market.

1.3 Research Question

Based on the discussion above, it is evident that Scandinavian companies, within the business-to-consumer segment, face operational challenges when conducting business in Russia. Taking point of departure in agency theory:

Why are Scandinavian companies facing operational challenges in Russia?
- How can Scandinavian companies manage these challenges?

1.4 Delimitations

The research project is written from the Scandinavian headquarters point of view. Meaning the final recommendations are composed to serve the interest of the headquarters, by proposing how they shall act in order to maximise profits in the Russian market. The concept of corporate governance is used to delimit the research field to focus on companies originating from Scandinavia, since Scandinavian companies are seen to have a comparable corporate governance system, assuming they face similar challenges in Russia. Market opportunities and risks vary according to line of business; hence the research project will only apply to companies operating within the business-to-consumer segment, offering products and services. It is evident that the majority of Scandinavian companies present in Russia operate within the business-to-business segment, often in strategic and heavy industries (Swedish Trade Council, 2010b: Danish Trade Council, 2010: Norwegian-Russian Chamber of Commerce, 2010). However, as the purchasing power of the Russian people increases, it is assumed that the need to investigate the challenges of companies operating within the business-to-consumer segment is evident. Even though the concept of corruption plays a central role in the introductory case, it will not be the sole focus of the research project.

1.5 Definitions
- *Scandinavian companies*: companies originating from Denmark, Norway and Sweden.
- *Corporate behaviour*: the behaviour of individuals in a corporate setting.
– *Russian business environment*: the set of political, economic, social and technological forces in Russia that are largely outside the control and influence of a company, and which can potentially have both a positive and a negative impact on the company.

– *Staff members*: a generic term for the employees and the managers within the same company.

– *Key money*: money received or offered as bribes in exchange for a favour.

### 1.6 Structure

The structure of the research project will be as follows. Chapter 2 presents a literature review, where previous research on the topic is discussed. Chapter 3 presents the scientific approach. Chapter 4 provides an account of the method of data collection and processing. Chapter 5 gives an overview of the empirics, where primary and secondary data is drawn up. In continuation, Chapter 6 lays out the theoretical framework. Chapter 7 contains the analysis of the empirics, within the theoretical framework. This leads up to the theoretical implications in Chapter 8 and the managerial implications, found in Chapter 9. Chapter 10 includes reflections of the research project, while Chapter 11 concludes and provides an answer to the research question.
2. Literature Review

Although there are different approaches on how to start up a business in a foreign country, it is crucial to realise that these strategies must be put in the context of the specific country (Porter, 1998; Meyer, 2002). In regards to Russia, the investments made by foreign companies depend on a number of factors, whereas one of the most important is the corporate governance system (Puffer & McCarthy 2003). Compared to the Scandinavian countries, which are viewed amongst the best-governed countries in the world (Thomsen, 2008), the emergence of corporate governance in Russia has not taken the same road. In fact, Russia was ranked to have a corporate governance system below average (Governance Metrics International, 2010). It is argued by Lubatkin et al. (2001) that national differences in corporate governance exist, due to variations in institutions and culture. In line with this, Puffer and McCarthy (2003; 2002) state that Russia’s evolving corporate governance system gradually may reflect the country’s unique situation, including its institutions, culture, traditions, and values. Puffer and McCarthy (2002) argue that the prevailing situation in Russia is deeply rooted in the country’s history and political structure.

Russia’s history in general, and the transition from a command economy to a market economy in particular, appears to be the foundation for many scholars’ explanation and understanding of the current conditions in Russia. Voigt (2006) focuses on the transition’s impact on Russia’s economic growth, whereas Zhuravskaya (2007), in the review of Andrei Schleifer’s book “A Normal Country?” discusses the transition’s impact on Russia today in a more general sense. McFaul (1995) focuses on the power of the Russian state and the institutional change and what results these had on the privatisation of state-owned enterprises in Russia. McFaul (1995) argues that Russia’s failure to create new institutions has to a certain extent been the consequence of the country’s neo-liberal philosophies about the market. The philosophy of neo-liberalism supports the economic policies based on neo-classical theories of economies, which minimise the role of the state and maximise the private business sector. In line with McFaul’s arguments, the economist North (1993) is critical to neo-classical theory. North’s (1993) point of departure is that if the proposition about an efficient market is true, then institutions are not needed. But institutions undoubtedly do exist. The reason for this is that people act on asymmetric information, political and economical constraints and
sometimes in an ostensibly irrational manner. Therefore, economical theory must be complemented with institutional theory. (North, 1993)

North (1997) has implemented his theory of new institutional economics on Eastern Europe and the former Soviet Union. According to North (1993), if people or organisations act in a way that is unproductive for society, it is a result of an inefficient institutional environment. This environment may result in corrupt behaviour, such as organised crime, tax fraud, and cartel formation (North, 1993). Rodriguez (2004) focuses greatly on corruption in Russia, by reviewing three books within the subject field. Focus is put on the bureaucratic structures and cultural characteristics and their influence on the conversion of institutions, aiming to effectively restrain and combat corruption. It is concluded that corruption emerges relatively natural as individuals seek security and fortune in a non-authorised, institutional void. This is supported by Peng (2001), who states that weaknesses of formal institutions, leads informal constraints to play a larger role in regulating economic exchange in emerging markets.

The acknowledged and important interaction between the society, the political and economic systems, the actors in the market, and the presence of both formal and informal institutions are heavily discussed by Mygind (2007; 2009) who has developed the PIE-model in order to explain how politics, institutions, and economics in transitional economies, for example Russia, are intertwined. The model has been developed with the aim to point out the main reasons for the fall of the command economy, as well as to identify the barriers for converting the institutional system and restructuring the economy.

In previous research on emerging markets, three sets of theories - organisational economics theories (transaction cost theory and agency theory), resource-based theories, and institutional theories - have been identified as leading perspectives. The main challenges for scholars have been how to incorporate the specific contextual influences into a theoretical reasoning. The research has evolved into two different lines of study, where some studies aim at a detailed analysis of governance structures to explore the independence of managers and the influence of stakeholders other than shareholders (Meyer & Peng, 2005). Buck et al. (1998) mean that
understanding the linkage between governance structures and corporate performance requires careful considerations of the informal and formal governance structures in the organisation, as well as which position and how much power various stakeholders hold. Buck et al.'s (1998) research on Russian companies operating in the local market is hereby mainly concentrated to the relationship between agency theory and stakeholders and does not take into account other contextual factors. However, in his later studies on the emergence of corporate governance in Russia, Buck (2003) shows that the institutions, which shape corporate governance, are grounded in the history of society. This is in accordance with the second line of research, which aims at incorporating contextual variables, mainly institutions, into already existing theories, such as agency theory (Meyer & Peng, 2005). On the background of these two lines of study, Meyer and Peng (2005) conclude that a key challenge is to develop theoretical tools for analysing how much influence relevant institutions, hierarchies, stakeholders, and control mechanisms may have on private companies strategies. Hereby, it is assumed that the prevailing agency problem for Scandinavian companies in Russia cannot only be explained by making use of traditional agency theory. One also has to take into consideration influential contextual variables.

2.1 Explorative Relationship
By identifying the agency problem in the introductory case, and based on the discussion that followed, it is assumed that the problem may be evident to other Scandinavian companies operating in the Russian market as well.

The prevailing agency problem concerns the owner-manager relationship, and is therefore identified on an individual level. However, a broader view on how to incorporate the specific contextual influences must be employed in order to explain why this problem arises (Meyer & Peng, 2005). Scandinavian companies enter the Russian market due to the great opportunities identified in Section 1.2. However, according to the same section, they will face unfamiliar situations, which will present the companies to risks. These situations are recognised in the direct environment and affect the company as a whole, thereby imposing challenges to the company. Hence, the opportunities and risks of the company are addressed at a company level. Furthermore, the reigning business environment in a country must be put in relation to
the specific circumstances in that country (Porter, 1998). Thus, the structure of the Russian society is considered at a country level. In order to illustrate the three levels discussed, a model has been developed. The model will constitute the foundation for the data collection.

![Diagram](image)

**Figure 1.** The Explorative Relationship
3. Scientific Approach

The scientific approach chosen for the research project is social constructionism. Constructionism is an ontological stand, which is in opposition to objectivism. The standpoint purports that social phenomena and the meaning of those are continuously created through the interaction of social actors. Constructionism is connected to an interpretative epistemology as opposed to a positivistic one and is in line with an inductive approach to the role of theory; meaning generation of theory as opposed to testing of theory as in a deductive study. (Bryman, 2001)

Social constructionism is chosen in front of social constructivism, since social constructivism has a positivistic epistemology. It is believed that the objects of study in social science – humans and institutions – are elementary different from the objects of study in natural science. Therefore, the study of social reality requires a different logic than the positivistic logic found within natural science. The hermeneutic tradition, which social constructionism is based upon, stresses the importance of interpretation of human behaviour. The difference hereby lay in the belief that human behaviour should be understood as opposed to described. (Bryman, 2001) Since the problem of investigation in the research project circles around the understanding of human interaction in different contexts, social constructionism is seen as an appropriate scientific approach.
4. Methodology

4.1 Data Sources

Data was collected from both primary and secondary sources. Secondary data was gathered from Internet sources and newspaper articles, as well as from research and literature within the field of study. Primary data was collected through qualitative research.

Qualitative research was chosen since the objects of study were humans and their interpretation of the world. The aim was therefore to view events through the eyes of the people being studied. Hereby, qualitative research emphasise the importance of the context in which people behave. The process is furthermore central, whereas focus is put on the fact that sequences of individual and collective actions unfold over time. The qualitative approach is in accordance with the chosen scientific approach, since it is characterised by an inductive approach to the generation of theory, an interpretative epistemological orientation and a constructionist ontological stand. (Bryman & Bell, 2003) However, according to Bryman and Bell (2003), qualitative researchers do not always subscribe to all three of these methods.

Since the problem of investigation in the research project was an identified fact, as seen in the introductory case, and not a formulated hypothesis to be tested, deduction was not appropriate. However, an inductive approach was neither seen as suitable. According to social constructionism, humans possess preconceptions about phenomena in the world based on previous experiences, which makes it impossible to conduct entirely inductive research. On this background and based on the aim, which was to create an explanation to the identified fact, abductive reasoning was seen as more appropriate than induction or deduction.

Walton’s (2004) dialogue-based abductive reasoning was seen as suitable, given that it is in accordance with the chosen scientific approach. Wertanen (2007:4), who based her work on Walton, states: “abductive reasoning is a dynamic process, involving an interpretative construction of meaning in response to some unknown or unobservable phenomenon.” Several descriptions of abductive processes exist, however a number of key components have been identified. Wertanen’s (2007) six transactional phases of the abductive method was used. The first phase includes the initial question or wonder about a unique or surprising sign or fact.
(Wertanen, 2007). In the research project, the introductory case represented this initial wondering about a surprising fact. This wondering led to the creation of the research question. In order to find a meaningful answer, the second phase includes observation of the situation, collection and verifying of facts, as well as finding a common starting point (Wertanen, 2007). Based on the literature review, Figure 1 was developed to show the starting point to explain the initial question. The third phase is characterised by creative, interpretative and critical thinking. It firstly involves imagining and questioning and secondly assessing and finding plausible hypotheses. (Wertanen, 2007) Collection of secondary data and conduction of an unstructured interview with an expert within the subject field acted as the foundation to assess and find a plausible hypothesis of the explorative relationship, described in Figure 1. This hypothesis was thereafter used to develop the interview guide for the collection of primary data. Phase four comprise the consideration and awareness of alternative explanations. It hereby includes the examination of possible explanations in order to find the most compelling one. (Wertanen, 2007) In order to examine different explanations and to find the most compelling one, collection of primary data was essential. The collection of primary data led to the finding of theories, presented in Figure 2, which could answer the research question. In the fifth phase, critical analysis and synthesising of information should be made in order to either confirm or disconfirm the possible solution (Wertanen, 2007). This phase corresponds to the analysis, in which secondary and primary data were assessed based on the chosen theoretical framework. Hereby, the aim of the analysis was to confirm or disconfirm the relationship in Figure 2. The final phase is characterised by interpretative completeness, which happens when a useful explanation is found. The ISC framework hereby resulted from the analysis. An absolute confirmation is however impossible due to the fact that all phenomena cannot be observed, since that would require an observation of everything in the universe (Wertanen, 2007). The conclusion found in the research project is therefore held until further information induces a re-evaluation of the findings. It was hereby the researchers’ interpretation that defined the results and decided when abduction ended (Pagnucco according to Wertanen, 2007).

4.2 Qualitative Method

Kvale’s (1997) framework on qualitative research projects was applied on the data collection and data processing. The framework was seen as appropriate, since it is created around the semi-structured interview, which was the chosen data collection method. Kvale’s (1997) focus
on the importance of interpretation of data collected is furthermore in line with the social constructionist approach.

### 4.2.1 Data Collection

The collection of primary data was done through semi-structured qualitative interviews. The choice of this method was based on the purpose of the project, where openness and flexibility were seen as needed to obtain the desired in-depth knowledge of the respondents’ experiences of the Russian business environment. The semi-structured interview was seen as more appropriate than the unstructured one, since the model in Figure 1, indicates an intuition that some seemingly unrelated facts were connected. To be able to use the data found in the interviews to investigate the explorative relationship in the model, it was believed to be necessary to prepare an interview guide beforehand. The guide made it possible to point the interview in the desired direction and thereby receive answers to critical questions.

The foremost strength of the qualitative interview is its openness; there is no standard technique or rule of how to conduct the research. Qualitative interviewing is seen as a realistic method in the sense that the actual research process is never as logical and linear as it is often urged to be in scientific papers. Due to its openness, qualitative interviewing makes it possible to get in-depth and gradate descriptions as well as to explore new angles on issues not considered beforehand. (Kvale, 1997) On the negative side, the method is time-consuming and the results cannot be generalised to the same extent as the findings from a quantitative study (Bryman & Bell, 2003). However, since understanding and interpreting the respondents’ situation is the purpose, generalisation is not the goal of the qualitative study (Kvale, 1997). Kvale (1997) refers to interviewing as a craftmanship; therefore, the results depend on the competences of the interviewer. The openness and flexibility demands that the interviewer is well prepared and possesses good interpersonal skills (Bryman & Bell, 2003). To be able to motivate even the more difficult respondents to give exhaustive answers, it is essential that the interviewer is well informed about the topic. The interpersonal skills required include being distinct, friendly, sensible and open-minded (Kvale, 1997). Despite this, it is important to keep control of the interview, to be critical towards what is being said and to remember what the respondent says during the interview to be able to follow-up.
Even though it is an un-standardised process to conduct a qualitative research project, Kvale (1997) identifies five emotional phases, which the researcher normally goes through; the enthusiastic phase, the quotation phase, the work intensive phase, the aggressive phase and the exhaustive phase. These are characterised with the researcher starting out with being enthusiastic and showing great interest and sympathy with the respondents. Later on the process develops to become drawn-out and to be all about patience and tidiness. It thereafter ends up with a chaotic and stressful state. The intensity of the phases varies and ultimately it may result in a situation where the researcher is not capable of finalising the survey in a satisfactory manner. To handle these emotional phases and thereby minimise the intensity of the negative phases, Kvale (1997), proposes an approach to the project, with seven stages; thematising, design, interview, transcription, analysis, verification and reporting.

**Thematising**

Due to the openness of the qualitative research project, “Thematising” and “Design” is seen as two of the most important phases. However, since the enthusiasm is high in the beginning of the project these phases are often overlooked. (Kvale, 1997)

It is essential to start out by finding the answers to *what* the project should examine, as well as *why* this should be done. It is not until these two questions are answered that it is meaningful to answer *how* the knowledge should be obtained. (Kvale, 1997) It is at all times difficult to know if the findings of research will be novel and thereby have any scientific value, hence the literature review was executed. An explorative relationship between the individual level, the company level and the country level, in regards to Scandinavian companies’ challenges in the Russian market, was developed. Hereby, the literature review enabled to answer *what* the project should examine. However, knowledge within a field is not solely obtained through theoretical and literature studies. In accordance with Kvale (1997), who points to the importance of being located in the environment of study, a visit to Russia was planned in the early phases of the research project. The benefits of a visit like this are to get a deeper understanding of the local culture, the power structures in society and the daily life of the inhabitants (Kvale, 1997).
The visit to Moscow\(^2\), Russia, commenced on the 29\(^{th}\) of May and lasted until the 2\(^{nd}\) of June. Apart from obtaining the knowledge mentioned above, the purpose of the visit was to meet with Scandinavians to hear about their experiences of operating in the Russian business environment. Moscow was seen as an appropriate destination, since most of the Scandinavian companies operating in Russia are located in the capital city. An alternative destination could have been St Petersburg, which is another common location for Scandinavian companies, due to its geographical and to some extent cultural proximity. Four interviews were executed during the stay, which was seen as reasonable for a stay of three workdays, due to the size of the city and its heavy traffic. Apart from achieving fruitful information from the interviews, getting the experiences of being in the environment in which these managers operate were seen as highly valuable for the future phases of the project, especially for the interpretation of the data. The answer to *what* should be studied was therefore obtained both through the literature review and through the visit to Moscow. The primary data indicated several challenges of operating as a Scandinavian company in Russia, whereas the explorative relationship in Figure 1 was seen as highly relevant to investigate.

Most of the Scandinavian companies present in the Russian market operate within the business-to-business segment, due to the vast amount of natural resources found in the country. However, Russia consists of 142 million inhabitants, with a growing middle class, increasing the purchasing power in the market. The focus of the research project therefore lied on the business-to-consumer segment, since it was believed that more and more Scandinavian companies aiming at this segment want to operate in the Russian market. Hereby, answering *why* research within the field was necessary. It can be argued that the positive responses from companies within the business-to-consumer segment, regarding participation in the research project, further confirmed the need for the research. Some of the respondents mentioned that they normally do not participate in these types of projects.

Answering the final question of *how* to obtain the knowledge, the semi-structured interview was chosen. Interviewing can have either an explorative purpose, or be used in order to test a hypotheses (Kvale, 1997). The explorative interviews are fairly unstructured, with a purpose to encourage open-ended answers, whereas interviews with the purpose to test a hypothesis are well structured. Since this is an abductive research project, which in a way has both of

\(^2\) See appendix for Travel Guide
these purposes, semi-structured interviews were seen as appropriate. Qualitative interviewing was furthermore used based on the complexity of the Russian business environment and the importance of understanding tacit knowledge. The collection of data was supplemented with secondary sources.

**Design**

The design phase regards the planning of the research project, which includes considering the time available, the type of interviews to conduct, how many respondents to include and the resources available (Kvale, 1997).

The time frame of the research project was set to seven months. In order to get an overview of the process and the different stages, a detailed time schedule was set up. According to Kvale (1997), it is important to keep the end result in mind during the entire process, since the decisions made in one phase is affecting the ones following. Since it is part of the qualitative research project to learn and discover new angles during the process, it is essential to be as clear as possible about the purpose of the project already from the start, in order to keep focus. (Kvale, 1997)

Semi-structured interviewing was, as mentioned, seen as suitable. The number of respondents depends on the purpose of the interview. If the number is too small it is impossible to make any generalisations or test any relationships between groups, and if it is too large it is impossible to make any deeper interpretations. (Kvale, 1997) Since the research requires both deep interpretations as well as some kind of generalisation to the two groups of study, the Russians and the Scandinavians, it was essential to consider the number of respondents carefully. Kvale (1997) believes that a common mistake is to confuse the criteria of a qualitative study with the criteria of a quantitative study and thereby include too many respondents. It is argued that you should interview as many people as needed to answer the question at hand and that you should keep interviewing until you do not find any new information. After conducting eight in-depth interviews, of approximately one-hour duration, the information received was regarded to be sufficient to answer the research question, since the amount of new information obtained was marginal. In order to acquire more background information on the Russian business environment, an unstructured interview with Professor Hans Aage, expert in Eastern Europe and planned economies at Roskilde University Centre,
was conducted. Interviews with Andreas Nilsson, Consultant, at the Swedish Trade Council and Peer Munkholt, Senior Investment Manager, at IFU further deepened the knowledge of the Russian business environment and opened up for more specific questions. In order to get detailed information, six Scandinavian managers were interviewed. The respondents were: Arild Hovland, Senior Vice President Russia & CIS, at Rezidor Hotel Group; Filip Engelbert, part-owner of Yellow Pages; Håkan Pehrsson, Deputy General Director, at IKEA Real Estate Russia & CIS; Martin Lundvall, Head of Sales Department, IKEA Russia & CIS; Jakob Kjærgaard, Business Development Director Eastern Europe, at Carlsberg and Jens Veino, former CEO at OA Jysk Russia. It was a criterion that the respondents should be Scandinavian and that the company respondents should hold a managerial position either in Russia or in Scandinavia, being responsible for operations in Russia. Furthermore, the companies should be present in Russia, have a Scandinavian origin and operate within the business-to-consumer segment, offering goods or services.

The time frame of seven months allowed for the conduction of field research, whereas the visit to Moscow was arranged. The monetary resources this required were seen as reasonable compared to the extensive gains. It was discussed whether a third party should do the transcription of the interviews. However, since body language, personality and other contextual factors should be taken into consideration when transcribing the data it would not have been appropriate. Furthermore, money was saved that could be used for the field research. As mentioned, Kvale (1997) argues that interviewing is a craftsmanship. Since you learn by doing, only one person had the role of the interviewer, thereby ensuring continuity and a high quality. The other person thereby took notes about the atmosphere and body language and made sure that the interviewer did not miss out on any areas of questioning. It was furthermore appropriate in a language aspect, since the chosen person speak both Danish and Swedish, making it easier for the respondents to fully understand the questions and to express themselves in their native language. This way, only one interview was made in the respondent’s second language, English.

**Interview**

The semi-structured interview is an interactive process between the interviewer and the respondent. Since the purpose is to obtain qualitative descriptions of the respondents’ experiences, it is important that the interviewer is creating an atmosphere where the
respondents feel comfortable. However, there is a clear imbalance of power, meaning the interviewer defines the situation, introduces the topic of discussion and steers the interview in the desired direction trough the questions. (Kvale, 1997)

The preparation made in previous phases has a vast impact on the quality of the interview (Kvale, 1997). Determining the “what”, “why” and “how” of the research was therefore essential. According to Kvale (1997), interviews can differ in the openness about the purpose. In the research project the respondents got introduced to the topic beforehand, in order for them to prepare for the interview and to assess whether they had the required experiences. By introducing the topic it becomes easier to pose more direct questions early on in the interview (Kvale, 1997). For ethical reasons every respondent was to approve the use of a tape recorder. All but one interview was recorded, since this took place in a loud restaurant. For the respondent to feel comfortable to talk freely the respondent always chose the location. The respondents further got the opportunity to ask a few questions before the interview started. After every interview the respondent was asked if he or she had any questions or comments, since after the interview there can be a certain tension or anxiety, due to the fact that the respondent has been open about personal experiences (Kvale, 1997). Furthermore, the respondents spoke on behalf of a company increasing their anxiety of misunderstandings.

Every question in the interview guide was assessed on both its thematic and dynamic character. For a question to be good in a thematic sense it should be related to the topic of study (Kvale, 1997). In this case, all the questions were formed on the basis of the explorative relationship in Figure 1. For a question to be good in a dynamic sense, it should consider the interpersonal aspects of the interview by being short and easy to understand (Kvale, 1997). The thematic research questions created, were therefore translated into interview questions, which fostered the thematic knowledge creation at the same time as they contributed to the dynamic dialogue. The semi-structured interview has character of a normal conversation, but with a specific purpose and a specific structure (Kvale, 1997). The interviewer therefore followed up on relevant dimensions found in the answers. To be able to follow up on the right issues, it is essential that the interviewer is able to understand the meaning of what is being said (Kvale, 1997). This was made possible due to the preparatory work done, including the literature review, the unstructured interview and the collection of secondary data.
Kvale’s (1997) nine types of interview questions were used to create the interview guide, according to thematic and dynamic requirements. The nine types of questions are: introducing questions, follow-up questions, probing questions, specifying questions, direct questions, indirect questions, structuring questions, interpreting questions and the ninth “type of question” is to leave room for silence. Structuring the interview around the different types of questions simplified the analysis, since it made sure that the required depth was reached. It was furthermore decided to divide the interview guide into the individual, the company and the country level, found in Figure 1. This made sure that all necessary questions were posed in order to answer the research question.

4.2.2 Data Processing
Transcription
The process of translating the spoken words into a written report is not a simple task. It is not purely typing what is being said, it is an interpreting process. Central is the differences in the spoken and written language. (Kvale, 1997)

Kvale (1997) points to the advantages of tape recording for future analysis of the data collected. Hereby, the interviewer can focus all its attention on the topic of discussion and the dynamic interaction with the respondent. However, Bryman and Bell (2003) point to an important drawback of recording interviews: the risk that the respondents can become self-conscious about the fact that their words will be recorded. In the research project some of the respondents might have felt that questions regarding corruptive acts in Russia were sensitive and would have talked more openly if the interviews were not recorded. In the case when recording was not possible, it was necessary to trust the memory and write the findings down immediately afterwards, minimising the loss of details. Having the interview guide at hand facilitated this work and as Kvale (1997) mentions, an advantage of using this method is that the memory acts as a filter, where only the most important statements are being reminded.

Bryman and Bell (2003) argue that transcription helps to correct the natural limitations of memory, it allows more thorough analysis and permit repeated examination of the answers. It is furthermore argued to open up the data to public scrutiny by other researchers, increasing the reliability of the research. The main drawback, on the other hand, is that transcribing interviews are time-consuming. The time spent on transcribing came to be around 40 hours. Hereby, it took approximately five hours to transcribe one hour of speech.
Analysis

Kvale (1997) points to five different methods of how to analyse primary data: concentration, categorisation, creation of a narrative, interpretation and ad hoc analysis. In concentration analysis, narrative analysis and interpretation analysis the end result will include a written text. The categorisation analysis, on the other hand, will be presented in numbers and the ad hoc analysis might be presented either in numbers, figures or words. The interpretative analysis was chosen in this case. As opposed to the categorisation analysis, which de-contextualise the findings, the interpretative analysis re-contextualise the findings within broader frames of reference. The frame of reference in the research project was the theoretical relationship, found in Figure 2.

Kvale (1997) differentiates between analysis and interpretation, by emphasising the search for a deeper meaning in the latter. The researcher interprets the interviews from a certain perspective, in this case the relationship in Figure 2. Hence, it is possible to go beyond what is being said in a direct sense and to create structures and relations, which are not immediately evident in the transcribed text. To be able to do this, it is required to have a certain distance, which is created through the specific theoretical stance. Hereby, re-contextualisation of what has been said can be made from the chosen perspective. Hence, different frames of reference will create different results from the same set of data. (Kvale, 1997) Bryman and Bell (2003) emphasise the importance of coding findings from qualitative interviews. Grouping statements into categories is seen as structuring the data to easier find connections between the different interviews. Even though this seems like an appropriate approach, it has the problem of loosing the context of what has been said. Therefore, Kvale’s interpretative analysis discussed above is seen as more suitable. However, the primary data was organised according to the individual, the company and the country level, in accordance with the structure of the interview guide.

Verification

In order to decrease the bias due to a single subjective interpretation of the findings, both researchers have interpreted the data. Having two or more researchers to interpret the data leads to an intersubjective agreement on the correct meaning of the statements (Kvale, 1997). Apart from making use of more than one interpreter, a thorough explanation of the different
steps of the analysis was made. This can be found in the “Analysis” section above. A description of the process makes it easier for the readers to trace and control the different steps in the analysis (Kvale, 1997).

By discussing the findings thoroughly, it is believed that the final meanings of statements and the found correlations between the interviews are cleared out, ultimately leading to a richer analysis. Combined with access to the transcriptions, it is argued that other researchers with the same frame of reference would reach the same conclusions, which is the central criterion of qualitative research (Kvale, 1997). Hereby, the reliability of the analysis increases and confirms that the research project is replicable (Bryman & Bell, 2003). However, having the social constructionist approach in mind, the findings are context-specific, meaning an identical interview situation will not occur again. Hence, a different interview situation would arise if someone else were to conduct the interviews again. Hereby, repeatability is not seen as a suitable control mechanism for the research project. In accordance with this, Bryman and Bell (2003) argue that reliability is particularly at issue in connection to quantitative research.

It can be argued that some types of validity are easier to apply to the qualitative research project than reliability. According to Bryman & Bell (2003), ecological validity is concerned with whether the research captures the daily life conditions and the natural habitat of the respondents. By travelling to Moscow to conduct interviews, the ecological validity is seen as satisfied. Other types of validity include measurement validity, internal validity and external validity (Bryman & Bell, 2003). However, several scholars argue that they are not applicable to qualitative research. Hammersley, according to Bryman and Bell (2003), therefore proposes relevance as a criterion. As discussed in the “Thematising” section, the research project is seen as highly relevant.

**Reporting**

Many research reports are dull, long-drawn and characterised by a large amount of quotations presented in a fragmented way (Kvale, 1997). Kvale (1997) argues that the reason for this might be that the extensive amount of transcribed texts overwhelms the researcher, leading to every personal perspective being lost. At the opposite extreme, the researcher might identify too much with the respondents and thereby “go native”. Thirdly, the researcher might fear to subjectively interpret the findings too much. In order to create a good report, Kvale (1997)
therefore directs attention on representing the exciting histories found in the interviews, without cutting them into isolated variables. An appropriate structuring of the report is according to Kvale (1997) “Introduction”, “Method”, “Result” and “Discussion”. In the research project, this structure has overall been used, however with more subsections, aiming to make the report more reader-friendly. This is in line with Kvale (1997), who states that the researchers should put more focus on writing for the reader. Kvale (1997) points to the importance of correctly using quotations in the reporting of results. Since these should be used carefully (Kvale, 1997), focus has been put on relating them to the written text, to include the context in which they have been said and to interpret them to decrease the fragmentation. Furthermore, only the best quotation in every situation has been used.

A research project should contribute with new knowledge within the field of study and should be formulated in a way, which makes it possible for the reader to control the results (Kvale, 1997). In order to contribute to the field of study, a somewhat neglected area of Scandinavian companies operating within the business-to-consumer segment in Russia was looked upon. Taking point of departure in the empirics, it was furthermore chosen to analyse this segment through a combination of theories, which had not been applied to this subject area in previous research. The extensive methodological considerations are seen to make it possible for others to control the results.

In accordance with the scientific approach chosen, Kvale (1997) refers to the writing of the report as a social construction. This can be explained by the post-modern shift from seeing knowledge as reflecting an objective reality towards seeing knowledge as a social construction of reality. In the latter, the conversation and the interaction with reality are in focus. The language used in the research project is herby not transparent, but it has a constituting force. In the same way, the researchers should be seen as storytellers, speaking on behalf of the respondents.
5. Empirics

5.1 Secondary Data

In order to create a fundamental understanding of how and why Russia looks the way it does, a basic review of Russia’s political and economical history is presented. By analysing decisions made in the past, and the consequences they have on the future, one is better off when grasping the concept of cause and effect (North, 2005). North (1997) points to the fact that political decisions shape the direction of long run economic change.

5.1.1 Political History

Throughout history, Russia has long been ruled by powerful leaders, from the oppressive rulers during the medieval ages, to the powerful princes and Tsars, and later the authoritative presidents of modern time. The history of Russia is known to begin with a Slavic ethnic group, the East Slavs. They are said to be the forefathers of the Great Russians (Russians in modern terms), the Ukrainians, and the Byelorussians. Later, the Khazars, a race of Turkic origin, who exercised a very loose political control over Russia, conquered the Slavs. Several historians argue that this underlines a major feature of the early history of Russia: the country was never part of the Roman Empire with its sophisticated mechanisms of centralised control, and the country was the only one of geographical Europe that owed almost nothing to the common cultural and religious heritage of the west. (Neville, 2000) After the 13th century, Moscow evolved as the dominant cultural centre and by the 18th century it had become the largest state of the Great Russian Empire, which stretched from Poland in the west to the Pacific Ocean in the east. During these centuries, the Russian Tsars ruled the country. The Tsars were powerful, autocratic rulers and the first Russian ruler to officially crown himself Tsar was Ivan IV. During his governing the country saw several changes in the transition from a medieval nation state to a powerful empire. The period followed after Ivan IV consisted of civil wars and foreign intrusions. However, the Russian state survived this and the ruling of weak or corrupt Tsars, because of the strength of the central bureaucracy. Between the ending of selfdom and the beginning of World War 1, notable changes to Russian economics and politics were introduced. (Elgklou, 1992)
The Russian Revolution in 1917 was triggered by a combination of economic breakdown, war weariness, and discontent with the autocratic system of government. Military failures during World War I and bureaucratic inefficiencies of the state turned large groups of the population against the government. It resulted in the Communist Bolsheviks taking power in October 1917 after the failed policies of the liberals and moderate socialists. The leader of the Bolsheviks, Vladimir Lenin, led the Soviet state during its initial years fighting to establish control of Russia in the Russian Civil War, and to create a socialist economic system. The time from 1917 until 1921 is known as the period of war communism. All land, industry and small businesses were nationalised and the money economy was restricted. (Service, 1997)

Following Lenin's death, Joseph Stalin fights to gain control of the Soviet Union in order to put a radical program of industrialisation into action. It was a period of immense industrialisation and internal struggles and Stalin later establish near total control over the Russian society. This program was presented as the first Five-Year Plan. It was the first of a number of plans aimed at shifting accumulation of capital resources through the build-up of heavy industry, the collectivisation of agriculture, and the restricted manufacturing of consumer goods. This was the first time in history a government controlled all economic activity in a country. Since the Soviet Union had no mechanism for appointing a leader, Stalin’s death, just like Lenin’s, was followed by a succession crisis. Nevertheless, the government of the Soviet Union was still within the Communist Party and based on the one-party rule. (Neville, 2000)

In the 1980’s, the weaknesses of the economic and political structures became acute and when the communist leader Mikhail Gorbachev came to power in 1985, he embarked on major reforms, which later led to the collapse of the Soviet Union (Service, 1997). Gorbachev came to power when the need for reform was unavoidable. He criticised the command economy, by introducing the policy of Perestroika, transformation, which started a gradual change of the political structure in a democratic direction (Mygind, 2009). Marginally less important was the policy of Glasnost, openness in the press and broadcasting media (Neville, 2000). Aage (2010) argues that Gorbachev’s attempt to accelerate economic growth and to combine socialism and democracy was overruled by the eagerness for utopian liberalism and private property as a shortcut to copy the western world. During the late 1980’s, Gorbachev’s and his colleagues’ attempts at economic reform were not sufficient, and the Soviet government left intact most of the original elements of the communist economy. Suffering from low pricing of
petroleum and natural gas, ongoing war, outdated industry and persistent corruption, the
Soviet planned economy proved to be inefficient, and by 1990 the Soviet government had lost
control over economic conditions. During this time, the tension between the Soviet Union and
the Soviet Federative Socialist Republic (SFSR), the largest and most populous of the fifteen
Soviet republics of the Soviet Union, was extensive. Boris Yeltsin, who challenged the
authority of the Communist Party of the Soviet Union, represented the Russian SFSR. He
insisted in the end of 1991 on both Gorbachev’s resignation as Union President, as well as the
dissolution of the Union itself (Neville, 2000). Yeltsin was elected by the people to lead the
newly established Russian Federation, and he aimed at fostering capitalism more than
socialism. During the initial parts of the transition, Russia changed from a command economy
to a market economy based on a 500-day plan, imposed by the Yeltsin government (Clines,
1990). This plan constituted of rapid implementation of price and trade liberalisation, as well
as large-scale privatisation. By the mid-90s, Russia found it self in a depression, where the
central government had lost control of the localities, bureaucracy, and economic fiefdom. The
financial crash in 1998 further hit the country, and just hours before the first day of 2000,
Yeltsin suddenly resigned as president. The governing of the country was left in the hands of
Vladimir Putin, who believed that a strong Russian state was essential for the modernisation
of the country. This included centralised control of the earlier liberalised industries, including
the oil industry. Putin’s ultimate goal was to stabilise the country’s economy. (Yakovlev &
Zhuravskaya, 2006) Since May 2008 the chief of state has been President Dmitri Medvedev
and the head of government has been Premier Putin, both from the political party United
Russia. President Medvedev has outlined a number of economic priorities for Russia,
including improved infrastructure, innovation, investment, and institutions, reducing the
state's role in the economy, reforming the tax system and banking sector, combating
corruption, and improving the judiciary. (CIA World Fact Book, 2010)

5.1.2 Economic History
In accordance with North’s (1997) observation that societies of today result from their
historical development, an analysis of the events leading up to the Russian transition, and its
progression as a market economy is therefore central. A thorough analysis of the economic
situation before the transition is regarded to be outside the scope of the research project, since
this is not seen to critically affect the operations of Scandinavian companies in Russia today.
The economy of the Soviet Union can be argued to have been based on two main political essentials. Firstly: use of control, where the state owned all property and decided on how to use it. Secondly: economic growth, where rapid industrialisation was the main focus. (Granville & Oppenheimer, 2001) According to Mygind (2009), extensive growth was possible as resources of labour were moved from unemployment or low productive agriculture to industry. The Soviet state essentially owned everything, hence it was in the position to fully decide what to produce, whom to produce to, and how to produced it. The rapid industrialisation was a direct result of mobilising resources to the military industry, the heavy industries, the exploitation of energy sources and raw materials. The production levels were based on short-term plans, so-called Five-Year Plans. (Granville & Oppenheimer, 2001) However, the extensive growth started to meet its limits in the 1960s, which explains the lower growth rate in the 1970s, and the stagnation in the 1980s. Most of the labour force was employed, and the only way to increase growth would be through intensive growth – by using existing resources more effectively. Intensive growth is based on innovation, higher motivation, and improved organisations. This requires an institutional framework built on decentralisation and flexibility, which did not exist in the Soviet Union at that time (Mygind, 2009). In the late 1980s, the planned economy was still working, but as the growth rate further declined and discontent amongst the population rose, the dissolution of the planned economy was unavoidable. It was furthermore hastened by aspirations for prosperity, democracy and national independence (Aage, 2010).

The transition to a market economy started in January 1992, immediately after Russia had emerged as an independent country. It hereby began in the midst of a severe economic crisis in Russia, and in the aftermaths of the collapse of the Soviet Union. The economic crisis had its roots in the long-term decline in the growth rate. However, the final breakdown of the Soviet planned economy was triggered by a combination of external shocks, badly implemented reforms, and political unrest. The attempts to implement reforms in favour of a market economy merely made matters worse. They undermined the traditional structures and disciplines of the economy without putting anything effective in their place. (Ahrend & Tompson, 2005) In 1991, the price system was in a state of complete confusion. In order to deal with this situation, the Russian authorities rapidly implemented price and trade

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3 The Chernobyl nuclear accident, the oil price collapse in 1986, and a sharp decline in the value of the dollar in 1986–87.
liberalisation and large-scale privatisation. In the beginning of 1992, Russia undertook the basic transition to free market prices, formed under the influence of demand and supply on producer goods, consumer goods, services, and labour. This triggered a fear amongst the Russian people. In general, they seemed to believe that the world would fall apart, and only the sky was the limit for unregulated prices. Even the reformers themselves did not truly believe in the transition to a free market and feared that trade would altogether collapse. (Åslund, 1995)

Apart from the liberalisation of trade and prices, the privatisation had a vast impact on the Russian economy. The concepts and practise of the privatisation turned out to be much more complex than anticipated. (Lavigne, 1999) The economic reforms privatised most industry, with notable exceptions in the energy and defence-related sectors (CIA World Fact Book, 2010). The privatisation of large state-owned enterprises was mainly done via a voucher scheme. This voucher scheme was meant to enable the whole adult population of Russia to own assets, and hereby create a broad class of shareholders that would support further reforms. Ultimately, the intention was to create a population of real fail-or-succeed companies whose managers would have the incentives to make use of resources efficiently (Ahrend & Tompson, 2005). According to Hedlund and Sundström (1996), this mass-privatisation process unfortunately came to be an ‘insider-privatisation’, were company managers bought shares at nominal prices, since the people did not understand their true value (Puffer & McCarthy, 2003). The ownership of shares hereby came to belong to a small number of people. The immediate response of the reform package was a spike in inflation and a drop in GDP of 15 % in 1992. To decrease the inflation, an exchange rate based strategy was implemented. During 1995-1997 some of the largest companies, in which the state initially had kept strategic stakes, were privatised through highly controversial “loans for shares” auctions. These further increased the concentration of equity ownership with the “oligarchs”. (CIA World Fact Book, 2010)

When the current account turned negative in 1997, due to growing imports and falling oil prices, in the aftermath of the Asian crisis, the government had to accept a devaluation of the currency, which followed the stock market into free fall. Even though the fiscal crisis significantly increased poverty, the devaluation of the rouble kick-started the economy. However, liberalisation and privatisation also played a large role in the recovery. In 2001 the
oil sector took over as the main engine of growth, and in 2009 Russia was the largest exporter of natural gas and the second largest exporter of oil in the world. The dependency of these exports makes Russia vulnerable to shifting business cycles following volatile swings in global commodity prices. To reduce this reliance the government has, since 2007, embarked on an extensive program to build up Russia’s technology sector, however with few results. The average economic growth rate has been 7% since the 1998 financial crisis, which has resulted in a doubling of real disposable incomes and the emergence of a middle class. However, due to Russia’s continued dependence on global oil prices, the Russian economy was one of the hardest hit by the 2008-2009 global economic crisis. Russia had to spend one-third of its $600 billion international reserves, which was the world’s third largest, to slow the devaluation of the rouble in 2008. Another $200 billion was devoted to increase liquidity in the banking sector and to aid Russian companies. (CIA World Fact Book, 2010) Based on the World Bank’s 23rd Russian Economic Report (2010), the Russian economy is estimated to grow 4,5% in 2011, due to expansion in domestic demand and improvements in labour and credit markets. Regions with a larger share of small- to medium-sized enterprises, better investment climate, more foreign direct investment and stronger financial sector presence are estimated to show a more robust recovery. (World Bank, 2010)

5.2 Primary Data

In the following chapter, a summary of the collected data will be presented. The full transcriptions are hereby to be found in the appendix. As mentioned, the responding companies were: Carlsberg, IKEA, Jysk, Rezidor Hotel Group and the Yellow Pages. The responding experts came from: Roskilde University Centre, IFU and the Swedish Trade Council. Throughout the research project, all quotations and statements made by the respondents will be anonymous and the respondents will be referred to as Company or Expert.

Individual Level

All of the companies have at some point in time had Scandinavian managers present in Russia, or still have it. When asked why the Scandinavian companies have decided on having expatriates in Russia, several reasons are given. Company A states that their reason for keeping Scandinavian managers in Russia, was that:
“[…] it is impossible to have only Russians on all the positions in the company, even if that would be an ideal solution, since the company is present in Russia. The Russians do not have the experience of doing business, and that is why expatriates are needed.”

According to Company E, it is important in order to get the Scandinavian values incorporated, to get the reporting structure going, as well as to get the entities to meet. Company E believes that they should have sent expatriates at an earlier point in time, in order to foster the integration of the Russian company and the Scandinavian company, since barriers between the entities do exist. Whenever Company B starts up a new project in Russia it brings in a number of expatriates:

“These people are predominantly there to establish the company culture in the new business and to train the local people. Then we gradually change this. [...] As soon as the skills and competences are there, we would rather have a Russian manager than a Scandinavian manager in Russia. Because if you have the combined skills of the business and the local knowledge, you are better off.”

Company E states that in 99 % of the cases it would be suitable in the start-up phase to place a Scandinavian in the management team, either as a CEO or a CFO. Company E points to some difficulties of keeping the management control with the Russians. The local CEO is looked upon as a “God”, whereas it can be problematic to implement decisions from headquarters in Scandinavia. The hierarchical structure is furthermore seen to hinder the staff members to enfold and take initiatives. Company E believes that it has improved, during the past 15 years, but it is still deeply rooted that employees seek approval from superiors. In line with this, Expert C states that the Russians are used to be controlled and told what to do, historically. Company A furthermore states that Russians are not very entrepreneurial, which results in great opportunities for Scandinavian entrepreneurs. Company A continues by arguing that Scandinavians are proactive, have a desire to work and make things right. Furthermore, they care about the company. Russians are seen as being the opposites of all these, however not by malice. Company D continues by stating that the efficiency is low:
“Scandinavian companies are good at rationalising in Russia. For example, a chicken farm in Siberia had 850 employees. After the Scandinavian company took over operations, there were only 10 employees left.”

According to Company A, the Russians need written directions, hence it is very important to follow-up and to have clear routines for operations. The follow-ups are necessary, since the Russians are not regarded as driven and as they oppose change:

“If you have a big company with a lot of Russian employees, it is extremely difficult to implement change. [...] This resistant to change probably has a lot to do with their history, the Tsars, and the communists. It is stuck in generations.”

Company E states that the Russians have a very different work moral than Scandinavians. They are seen as individualistic and short sighted with a preference for short-term payoffs. Company A continues by underscoring the differences:

“It is indeed possible to cooperate with Russians, it is just that it takes time and you learn what to do and what to avoid. It is learning-by-doing, you cannot come to Russia with the implication that you know what you are doing and that you understand how to do it. Unfortunately, you have to make mistakes and only hope that it does not cost you too much and that it does not take too long.”

Most of the respondents state that expatriates have extensive authority in decision-making concerning operations in Russia. However, they act within frames set by the board. According to Company B, within these frames, the expatriates make 95% of the decisions, and it is more or less formalities when reports are sent to the board. According to Company A, it is not difficult to get the board on track regarding activities in Russia. Company E acknowledges that the Russian staff members might perceive the extensive authority of the Scandinavian managers as control.

According to Company A and E, it is very important to have Russian partners that you can trust. The problems of trust are predominantly seen to be evident when Scandinavian
companies acquire or enter into Joint Ventures with family-owned enterprises. The Russian owners have a tendency to hire family members and thereby let the personal relations instead of the professional competences drive the development of the company.

*Company A* furthermore states that it is important to be aware of the systems of network that are present in Russia, and that it has to be a Russian manager who handles these networks and connections. *Company A* takes the importance of relationships into consideration when hiring Russian staff members: “*Between Russians the relationships mean everything. We definitely think of this when we hire people, we are very careful with whom we employ.*” Moreover, *Company D* discusses a potential strategy on how to divide the management positions between Scandinavians and Russians:

> “I think that it is a good idea to combine local employees with expatriates. If I had a Scandinavian company, I would send my Scandinavian CEO to Russia, and I would send my Scandinavian CFO […] The Russians are not embarrassed to present false invoices or derive money from the company; this is very normal. […] However, you need local staff in positions such as sales managers, because if you take a Scandinavian sales manager and send him to Siberia, it would take many years before he understood how the business structure worked in that part of the world. Furthermore, he does not speak the language.”

Moreover, *Company B* discusses the importance of having skilled personnel to handle the bureaucracy in Russia, which is seen as mind boggling. According to *Expert C*, there are two ways to deal with the bureaucracy, either you handle it yourself, or you hire an external Russian consultant who manages it for you. *Expert C* continues by stating that it is common that the Scandinavian managers in Russia hire an external consultant to handle these issues and to speed things up. The board is almost certainly not too involved in these decisions, and the Scandinavian managers are pleased if they do not have to deal with the system themselves.

**Company Level**

According to *Company B*, the Russians are adapting fast to the so-called western style and the requirements of products are therefore similar to the rest of the world. *Company D* continues
by stating that the Russians love luxury, and if a foreign company is to succeed in Russia, it must offer products and services that will enhance the quality of life for the Russians. *Company E* agrees and states that as long as something is perceived as high-end, even customers with lower purchasing power are ready to use a large share of wallet to buy the products. If you have a consumer-oriented company, Moscow is definitely the place to start, *Expert C* concludes. Amongst the respondents, different entry modes in Russia were used, including exports, acquisitions and Greenfield investments. According to *Expert C*, Joint Ventures are not very common, which probably has to do with uncertainty; “the Scandinavian companies do not feel that they have the right connections with a Russian partner, since they have not established a required long-term relationship.” *Company C*, who states that it is important to select the right partner if entering into a Joint Venture in Russia, supports this. *Expert C* and *Company C*, furthermore mention the importance of thoroughly investigating the market before entering Russia.

According to *Expert C*, the stakeholder group that is of most concern to foreign companies is the government officials. *Company E* confirms this by stating that a power game exists with the authorities, whereas it is an advantage to be a large company. “[...] it is not fun to be the government official who stops the acquisition or the building of a new production site.” *Company C* mainly concentrates on the governmental institutions in Russia. Accordingly, some of the larger companies lobby the government and thereby actively try to improve the situation in Russia. However, *Company C* states that stakeholders, such as suppliers of water and electricity, may constitute a large problem, whereas in Scandinavia these supplies are taken for granted.

In terms of competition, *Expert C* expresses the opinion that Scandinavian and Russian companies do not compete on mutual terms. This is largely due to high tariffs on foreign goods, as the government is trying to encourage domestic companies. However, *Company C* states that they have not noticed the government favouring domestic companies. Although, it is believed that the Russian companies have other advantages:

“[...] since the local firms have the connections to get in front of the line, the bureaucracy proceeds faster for them. Furthermore, they have the advantage of speaking the language, knowing the culture and knowing the system.”
Therefore, it is important for Scandinavian companies to know the system very well."

Company E also recognise the benefit Russian companies have in knowing the administrative system by pointing to the dirty tricks that are being used: “I know that some Russian companies take advantage of this. They might arrange for a foreign company to get a tax inspection all of a sudden.” However, Company B does not view competition as a problem, mentioning that it is doing a lot better than their Russian competitors. The reason for this is believed to be that the Russians lack the competences needed:

“What we do here in many ways is that we act as a role model for the local businesses. [...] this creates a competitive environment. You pick up what your competitors do, and hereby we are not only transferring knowledge within our company, but to those who observe as well. Of course, this is both good and bad, however by trying to keep a competitive advantage you stay alert.”

All of the respondents mention the importance of networks and relationships in Russia. Expert C argues that relationships in Russia matters a lot, but believes that it is industry-dependent. However, even though the respondents acknowledge the importance of networks and relationships, they do not actively try to establish them. Company C mentions that because of its size and well-known brand, it does not have to focus resources on creating networks. However, it is believed to be more important for smaller companies. In regards to networks, Company A states that they have chosen to “[...] forget about everybody else and do what we are good at. We do not actively seek any collaborations and are not trying to understand what Russia really is.”

Country Level
The most evident answer to why the Scandinavian companies decided to enter the Russian market was the great opportunities Russia constitutes. Russia is seen as one of the fastest growing markets in the world, as fascinating and lucrative, and according to Company B, it has a large potential for growth. Company C states that it sees Russia as a strategic market in terms of the growing middle class, and as a country having the potential of becoming the largest consumer market in the world. However, according to Expert A, managing businesses
in Russia is not an easy task and Scandinavian companies should not think that Russia is the same as their home market.

Enforcement of laws and the courts constitute large problems according to Company C, and Company E states that the lack of transparency in the jurisdiction definitely is a problem. Company B furthermore points to the lack of independence of the courts, where economically powerful people often influence the functions. However, Company B argues that the Russian legislation is evolving. Russia legislates continuously, but Company C mentions that the new laws often contradict older legislation. Company E agrees that the Russians are working on improving the jurisdiction, however, since the administrative burden is high and the governmental organisation is not working properly, the jurisdiction is not seen as effective in regulating economic exchange. Company B points to the importance of knowing the laws and rules of the Russian society, and a way of doing this is to employ reliable local expertise. Expert C continues by stating that companies entering Russia believe that everything will proceed a lot faster than it does.

The respondents all point to challenges connected to the bureaucracy. In accordance with this, Company E states that the largest challenges in the Russian market are connected to the entry and they concern all the approvals needed and the vast bureaucracy. Expert A believes that functioning institutions are lacking: “There is no one in Russia who knows anything about how institutions emerge and how to build them.” Expert C discusses how different companies approach the bureaucracy when establishing a new business:

“Some Scandinavian companies just disregard all stamps, documents, and permits needed in order to get started, they just continue with their process. This is possible to a certain extent, but after a while the permits and stamps are unavoidable.”

Expert C recommends Scandinavian companies to have the necessary papers and documents in order before the start-up of a business, even though it is very time-consuming. Company B continues:
“[...] there are a lot of permits, approvals from city governments and so on. In Moscow I think you need something like 82 stamps in order to get going. Unfortunately, this is an area where corruption comes into play, because every time you need a stamp there is someone who could either speed the process up or slow it down.”

The problem of corruption was hereby mentioned. According to Expert B, the government officials and local authorities try to pressure foreign companies, based on their unfamiliarity with the bureaucratic system in Russia, to engage in corruptive acts. In line with this, Company C states that business-to-business corruption decreases, while business-to-government corruption increases. All the respondents acknowledge that corruption is a large problem Russia. However, none of the companies admit taking part in receiving or offering key money. Expert C believes that it is rather difficult for companies to stay completely ethical, and “It will take very long if everything is to be done the correct way. It is definitely possible, but it will be a lot harder.” Company A states that it is first and foremost the authorities that make it difficult for them to operate freely. Company D continues:

“[...] all Russians agree that the real criminals in the Russian society today are the staff within the municipality. It is the police, the customs administration, the Inland Revenue department, the licence providers; the ones that in one way or another interfere in companies’ operations, these are the criminals in Russia today.”

Company A mentions the example of government officials demanding higher taxes or even creating new taxes. When this happens, the Scandinavian companies have to negotiate the tax issue, and it ends up with them paying some sort of tax. According to Company A, this cannot be viewed as corruption: this is just how the system works. Company C furthermore states that if one knows the right person, one will get first in line and everything will proceed a lot faster. However, it does not have anything to do with monetary compensation.

Company A argues that the culture and the heavy bureaucracy are much intertwined. In Scandinavia trust is generally high, but when trust disappears, as in Russia, it requires a vast amount of documents to secure that things will proceed correctly. “This is why there is a lot of red tape, stamps, and documents. Coming from Scandinavia we are spared from this.”
Company E continues by arguing that in the entry phase the bureaucracy is the largest problem, but after you have set up the business, the cultural challenges become evident. Company D agrees to culture being a challenge:

“I believe that the culture is more challenging than the bureaucracy, for Scandinavian companies doing business in Russia. There is a structure in the bureaucracy; it is just a question of figuring out what kind of requirements you have to live up to, in order to reach the desired goals. Hereby, the bureaucracy is something that is fairly easy to find out.”

Company E argues that Russia is much more volatile than Scandinavia countries. The extremes are seen as more extreme in Russia. When something fails in Russia, it is more severe and it becomes more expensive. Company D continues by discussing the characteristics of Russia:

“Russia is a very strange country, since it is not Europe and neither is it the Far East. Russia has always been characterised with a high degree of closeness. It was closed during the Tsar period and during communism, which means that Russia has never got the same influences internationally as other countries. They hereby stick a lot to their own systems and traditions.”
6. Theoretical Framework

Based on the introduction and the literature review, Figure 1 was developed. The model constitutes three levels that need to be addressed by Scandinavian companies operating in the Russian market. The primary data identifies challenges at each level. In order to answer the research question on the basis of the primary data, the following theories have been appointed at each level. At the individual level, challenges rooted in the agency problem have been recognised, which was also evident in the introductory case. At the company level, the primary data suggests that Scandinavian companies in Russia face new and unfamiliar situations in regard to stakeholders, whereas stakeholder relationships have been identified as a challenge. At the country level, the findings indicate that several differences can be identified between the Scandinavian and Russian institutions regulating economic exchange. Hence, the institutional environment in Russia possesses challenges to Scandinavian companies. Hereby, agency theory, stakeholder theory, and institutional theory are incorporated into Figure 1. Figure 2 is the frame of reference for the exploration of the link between the levels and the challenges these present.

![Figure 2. The Theoretical Relationship](image_url)
The theoretical framework will hereby start out with a review of the aspects of agency-theory found relevant for the research project, which will be supplemented with a discussion of stakeholder theory and institutional theory.

### 6.1 Agency Theory

According to Thomsen (2008), agency problems concern the conflicting interests of the principal and the agent. The underlying assumption of the theory is that individuals are rational, risk averse and act in their own self-interest (Thomson, 2008; Lubatkin et al., 2005). The latter assumption induces a potential conflict of interest between the principal and the agent (Besanko et al., 2007), which increases the risk of opportunistic behaviour.

According to Thomsen (2008), the principal-agent problem deals with the difficulties that arise under situations of asymmetric information, where the agent acts on behalf of the principal and where the motives of the agent is not in line with the principal’s objectives. Thomsen (2008) looks upon agency-theory from different angles. He identifies three types of agency problems, type 1, the owner-manager problem, type 2, the majority-minority investor problem and type 3, the shareholder-stakeholder problem. The introductory case identifies information asymmetry, and Thomsen (2008) identifies two particularly important types: moral hazard, also referred to as hidden action, and adverse selection, also referred to as hidden knowledge. Moral hazard occurs when the activity of the agent cannot be completely observed by the principal. More specifically, moral hazard occurs when the agent, with more information about its actions or intentions, has a tendency or incentive to behave inappropriately from the perspective of the principal with less information. For example, it is impossible to measure if a staff member exerts his or her “best effort”. Adverse selection occurs when there are some elements in a situation, which is known to the agent but not to the principal. A manager may for example know more about the characteristics of a potential market. (Thomson, 2008)

#### 6.1.1 Governance Mechanisms

Many governance mechanisms exist, which serve to mitigate agency problems. These include moral standards, reputation, legal protection, large owners, boards, incentive systems, media pressure, and more. (Thomson, 2008) Thomsen (2008) further argues that good corporate governance consist of the tailoring of these mechanisms to the individual company. The reason for this is that there are benefits and costs connected to each of them. “Up to a certain
point, most corporate governance mechanisms will improve company performance, for example because the mechanisms pressure managers to work harder or to enable the shareholders to make better choices. Beyond this point – which is difficult to define and varies from mechanism to mechanism and from firm to firm – the costs start to kick in.” (Thomsen, 2008:42) In line with this, Besanko et al. (2007) discuss the costs and benefits of tying pay to performance, a widely used governance mechanism according to the primary data. The reason for tying pay to performance is to motivate staff members to take actions that advance the company’s strategy and increase its profits. The company hereby has to devise performance measures that allow it to reward exactly the activities it wants its staff members to pursue. Hence, agency problems could easily be solved if a complete contract was written. However, complete contracts are very often not feasible, since many situations suffer from hidden action and hidden knowledge.

Due to the problems of complete contracts, explicit and implicit incentive contracts are used. Implicit incentive contracts are enforced by reputation, whereas explicit incentive contracts must be based on information that can be observed and verified by a third party. As for explicit incentive contracts, the principal hereby has to provide incentives based on performance measures that can be incorporated in a contract. Such performance measures can be both input and output based. Sales is an output based performance measure, since it is directly related to the gross payoff to the principal coming as a result of the agent’s action. Input based incentives cannot be directly connected to payoff and include, for example, the amount of customers served. (Besanko et al., 2007)

It is assumed that without any means of providing incentives, the agent will prefer not to put in extra effort (Besanko et al., 2007). Putting in extra effort is associated with costs for the agent. The marginal cost of effort increases as the agent works harder. If commission is used on top of the base salary, the staff member will increase his or her effort until the marginal benefit of effort is equal to the marginal cost. Linking pay to performance measures, hereby helps solve agency problems arising from hidden action and hidden knowledge. However, Besanko et al. (2007) points to two main costs connected to tying pay to performance. The first cost may arise if the performance measure is affected by random factors, beyond the control of the staff member. The second cost may arise if the performance measure fails to capture all facets of the desired performance. The first type of cost is closely connected to
individuals’ perception of risk. Most people are risk averse, hence most people prefer a safe outcome to a risky outcome with the same expected value. As long as the agent places a lower value on the consumption associated with each additional dollar of wealth, he or she will be risk averse. However, there is a cut-off point were the decision maker is indifferent between the safe and the risky outcome. This point is the decision maker’s certainty equivalent. The difference between the expected value of a risk and the decision maker’s certainty equivalent is defined as the risk premium. Different decision makers will apply different certainty equivalents to the same amount of risk, meaning individuals vary in terms of their risk preferences. The more risk averse an agent is, the lower the certainty equivalent. For a given decision maker, the certainty equivalent is lower and the risk premium higher when the spread in payments are greater. Furthermore, when a decision maker has to choose between two risky outcomes he or she will select the one with the higher certainty equivalent. (Besanko et al., 2007) Hereby, more risk aversion necessitate that a higher risk premium must be paid to the agent in order to make him or her indifferent about receiving an uncertain income and the same average income for certain (Hendrikse, 2003).

Since random factors make performance depend only in part on the agent’s actions, linking pay to performance connect the agent’s pay to random factors. Due to the risk aversion mentioned above, the agent will dislike having his or her pay vary randomly. Therefore the principal has to compensate the agent for the cost of bearing this risk. The company hereby has to weigh the costs of imposing risk onto risk-averse staff members to the benefits of providing additional incentives, meaning there is a trade-off between risk and incentives. Optimising on the incentive solely leads to a commission rate of 100%, while optimising only on the risk leads to a commission rate of 0%. (Besanko et al., 2007) Hereby, the optimal contract is a compromise between incentive and risk sharing, meaning it is second best in terms of efficiency. The principal will bear part of the risk, in order to reduce the risk premium. Hence, the agent has reduced incentives to perform, which results in a smaller total surplus. (Hendrikse, 2003)

The second major cost of using pay-for-performance incentives can be explained by the multitask principle, which states that when there is a variety of tasks to be done, managers tend to put more effort into the task that is rewarded. This reveals two main problems. Firstly, performance measures do sometimes not capture all the activities the principal wants the
agent to perform. Secondly, performance measures do sometimes reward activities that the principal does not want the agent to undertake. In these cases, stronger incentives will only lead the agent to pursue even more of the counterproductive activities. (Besanko et al., 2007) Several activities can be undertaken to mitigate the costs. The company can aim to make use of performance measures that are less affected by random factors, which allows the company to tie pay closely to performance without introducing much variability into the staff member’s pay. Furthermore, using a measure that reflects the activities the company wants the staff member to perform, allows the company to make use of strong incentives without distracting the staff member’s attention away from important tasks. Finally, make use of performance measures that cannot be improved by actions that the company do not want the staff member to perform, hereby decreasing the risk of counterproductive performance. Alternatively, the company can introduce implicit incentive contracts, or make use of implicit incentive contracts as a supplement to explicit contracts.

In complex job descriptions, explicit incentive contracts are seldom suitable, whereas companies rely on other means to connecting pay to performance. Implicit incentive contracts may therefore be used to mitigate the costs of explicit incentive contracts. Companies using implicit incentive contracts must ensure that the staff members perceive the company to act in accordance with those contracts. Hence, the enforcement mechanism is reputation, meaning a company not fulfilling its promises will loose its reputation as a good employer. Subjective performance evaluations, threat of termination and career concerns are examples of performance measures in implicit incentive contracts. Subjective performance measures are suitable in order to measure the quality of information transferred. This requires a general agreement between the principal and the agent as to what constitutes valuable information. In regards to threat of termination, the probability of termination and the cost of shirking (choosing not to work hard), are central. The principal may increase the agent’s cost of shirking, by raising the agent’s wage or increase the probability of termination by increasing monitoring. High wages and monitoring are hereby substitutes. Career concerns act as a performance measure, because if the agents can regularly “test the market” for their skills, their current actions may affect their future market value. Hereby, the agent will select current actions that will keep their market value high. However, there are costs involved with implicit incentive contracts as well. For example, in regards to subjective performance evaluation, the supervisor may find it personally unpleasant to reward some staff members, but not others.
Furthermore, subordinates may attempt to affect evaluations by creating good personal relations with the supervisor. When it comes to threat of termination, the level of unemployment may affect the cost of shirking and if there are restrictions on companies’ abilities to let off staff members, the probability of termination decreases, making the incentive less useful. Career concerns furthermore have the disadvantage of making staff members less willing to acquire company specific skills, which might require the offering of long-term employment relationships. (Besanko et al., 2007)

Choosing the correct mechanisms for the contextual environment is essential. Based on Thomsen’s (2008) argument that the choice of governance mechanisms is company-specific, it can be argued that the external environment affect the appropriateness of the chosen governance mechanisms. The stakeholders in a certain business environment will influence the amount of random factors present in the market for a particular company. Since the random factors affect the variability of the manager’s pay in explicit contracts, the stakeholder environment will affect the risk premium the company has to pay to its agents. It can hereby be argued that stakeholders and the institutional environment determine, together with the company’s internal processes, if explicit, implicit or a combination of the two incentive contracts should be used.

6.2 Stakeholder Theory

According to Freeman (1984), external environmental changes presents the company with new groups, events, and issues, which demand that the view on stakeholders and their influence on the company have to be broadened. The unfamiliar stakeholders cannot be readily incorporated into the comfortable relationships a company has with its familiar stakeholders. (Freeman, 1984)

Various definitions of what a stakeholder is have emerged, and the one reviewed in the research project is Freeman’s (2004:58): “those groups who are vital to the survival and success of the organization”. Even though this definition of stakeholders is the most common one, it has been criticised for being broad and difficult to translate into practical managerial tasks. Within this definition nearly anyone and everything becomes a stakeholder and the boundaries of stakeholder management becomes unclear. However, the broad definition is
seen as necessary to apply in the research project, since the primary data revealed that the interpretation of stakeholders varied among the respondents.

Since the definition is broad, scholars such as Johnson and Scholes (2002) have given considerable attention to how companies should manage their stakeholders and how the stakeholders may influence the company. They argue that companies should manage their stakeholders by mapping them. This enables the company to identify stakeholder expectations and power and to understand the companies’ political priorities. According to Johnson and Scholes (2002), the stakeholder concept is valuable when trying to understand the political context within which specific strategic developments take place. Johnson and Scholes (2002) continue by stating that global companies may have several added complications compared to national companies, as they are operating in multiple arenas. For example, an overseas division is part of the parent company, which implies certain expectations about corporate behaviour and performance. However, the division is also part of the local community, which has different expectations, and these to “worlds” may not comply with each other. The headquarter expects the division to behave “like any other division”, even though this may conflict with the divisions ability to meet local expectations of behaviour (Johnson & Scholes, 2002). According to Friedman and Miles (2006), adopting a stakeholder approach leads companies to develop expertise in understanding how stakeholder groups arise, the key issues of their concern, and their willingness to mobilise resources either to help or harm the companies.

By mapping the company’s stakeholders according to the power/interest matrix (Johnson & Scholes, 2002), two important issues will be analysed: How interested each stakeholder group is to impose its expectations on the company’s purpose and choices of specific strategy, and whether the stakeholder group has the power to do so. The power/interest matrix hereby seeks to describe the political context within which an individual strategy would be pursued.

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4 Political context reflects the environment in which something is produced, indicating its purpose or agenda. Knowing who created the message and what their relationship is to others reflect how you interpret that message. (www.stanford.edu)
The matrix indicates the type of relationship that companies typically establish with different stakeholder groups. By making use of the power/interest matrix, companies can more easily identify which stakeholders that will have the largest influence on strategic decisions. According to Johnson and Scholes (2002), stakeholder mapping may generate “typical” maps of how the political context frequently occurs for companies. Under these circumstances, the political dangers and prioritise are well understood and managers can hereby learn from earlier experiences. There are many different sources of power, by which stakeholders are able to influence companies’ purposes and strategies. The power held by stakeholders may be derived from the status of a stakeholder, which could be job description or reputation. Another indicator could be resource dependency, which is the degree of which the company’s business is tied up with any customer or supplier. Furthermore, symbols are valuable clues about power, which may be use of titles and names, or whether a manager wines and dines with a customer or supplier. Evidently, adopting strategies to key players is of major importance, but often the most difficult issues relate to the stakeholders that should be kept satisfied. Even though these stakeholders in general are passive, an unfortunate situation can arise when their level of interest is underrated and they suddenly reposition themselves as key players. Companies may address the expectations of stakeholders that should be kept informed, through information. These stakeholders can be significantly important allies in
influencing the attitude of more powerful stakeholders, for example through lobbying. (Johnson & Scholes, 2002)

By influencing how companies perform, stakeholders indirectly affect national welfare (Gelauff & Broeder, 1996). In turn, stakeholder behaviour is influenced by institutional arrangements in a particular country. Peng’s (2001) work on the institution-based view of business strategy supports this. Differences in national institutional characteristics create unfamiliar stakeholder environments for companies entering a market. This creates challenges for the managers, since they have to take these stakeholders into account when making decisions. Gelauff & Broeder (1996) further argue that certain institutions to a larger extent support the commitment between managers and stakeholders. When companies move away from their familiar home markets, focus must hereby be put on the underlying institutional framework in the new country, in order to understand stakeholder behaviour and thereby make the correct strategic choices, assuring the survival of the company.

6.3 Institutional Theory

Several scholars have emphasised the importance of institutions in economic exchange, since it is believed that they give stability and meaning to society (Mygind, 2007; North, 2005; Peng, 2001; McFaul, 1995; Scott, 1995). According to North (2005), societies are complex systems of humans interacting in order to make a living. Understanding these societies can therefore be argued to be crucial for international companies, whereas an analysis of the society in the country of interest is necessary. According to Mygind (2007), many of the existing models for analysis of societies are often too simplified, static, and without sufficient emphasise on the institutions, which he sees as key determinants for these societies. On this background, an analysis of the Russian society should include an investigation of its institutional environment.

6.3.1 Regulative System

Concerning institutions and its implications for society, Scott (1995) argues that institutions consist of normative, cognitive, and regulative systems, which provide stability and meaning to social behaviour. The regulative aspect of institutions accentuate that institutions constrain and regulate behaviour. In this conception, regulative processes involve the ability to establish rules, inspect and review rules, and, if necessary, impose sanctions in an attempt to influence future behaviour. These processes may operate through both formal mechanisms, such as the
police and court system, and informal mechanisms, which may involve traditions of shaming and shunning (Scott, 1995). Based on the primary data, it can be suggested that the institutions in the Russian society are regulating economic exchange. Both the formal regulations and the informal traditions are viewed to impose sanctions on behaviour. It can therefore be argued suitable to take on a regulative approach to institutions. North (1991; 1993; 1997; 2005) has a view of institutions adherent with the regulative approach, since he views institutions as humanly created constraints that structure political, economic, and social interaction (Scott, 1995). According to North (1991), institutions consist of both formal constraints: laws, regulations, and property rights as well as informal constraints: customs, traditions and code of conduct. New institutional economics is therefore identified as the appropriate choice of theory to be used at the country level.

6.3.2 New Institutional Economics
The new institutional economics is attempting to incorporate a theory of institutions into economics. It retains and builds on neo-classical theory’s fundamental assumption of scarcity and thereby competition, while it abandons neo-classical theory’s instrumental rationality, which makes neo-classical theory an institution-free theory. (North, 1997) In a world of instrumental rationality institutions are unnecessary, since it assumes that it is possible to see the world as it really is. Hereby, it is not necessary to distinguish between the real world and the actor’s perception of it. Without subjectivity all decisions will be rational, meaning it is possible to predict the choices that will be made. However, as discussed in the introduction, information is not complete and there is limited capacity by which to process information. Ideas and ideologies play an important role in decision-making and transaction costs result in imperfect markets. According to North (1997), the subjective perceptions of the world can be explained by the mental models individuals possess to interpret the world around them. These models are in part culturally derived and established through generations, which makes them vary radically among different societies and ethnic groups. Individuals make choices based on their mental models. It is possible for individuals to learn, and changes in mental models stem from outcomes inconsistent with expectations. (North, 1997) However, it is customary that actors never encounter events, which lead them to shift their perceptions (Hahn according to North, 1997).

According to instrumental rationality, the requirements of an efficient economy are stringent. Actors must have objectives and know the right way to achieve these. Neo-classical theory
states that even though the actors may initially have erroneous models, information feedback processes and arbitraging actors will lead survival actors to the correct models. Hence, if there are significant transaction costs, institutions will be designed to induce the actors to acquire the essential information to achieve effective outcomes. Hereby, the institutions are not seen as playing a central role in economic performance, since the competition in the market regulates economic exchange. However, new institutional economics recognises that these stringent requirements of the efficient economy are realised only very exceptionally. Individuals typically act on incomplete information, since information is costly and asymmetrically held, leading to transaction costs in business exchange. The cost of measuring characteristics of products and services exchanged, of the performance of agents as well as the cost of enforcing agreements determine these transaction costs. To minimise the transaction costs and to structure exchange, humans are therefore imposing constraints on human interaction. Hereby, institutions are formed to reduce uncertainty in economic exchange, which means institutions matter when it is costly to transact. (North, 1997)

6.3.3 Path Dependency
According to North (2005), the key to understanding the process of change in a society lays in the intentions of the actors and their perception of the environment. He argues that a political-economic system can never be known to the human players beforehand, however the players construct certain beliefs about how this system should be. The dominant beliefs, which are those of the political and economic actors in a position to make policies, result over time in a complex structure of institutions. (North, 2005) North (1991) argues that institutions evolve gradually, connecting the past with the present and the future, and that history is mainly a story of institutional evolution. North (1997) points to the fact that institutions shape the direction of long run economic change. Institutions are not necessarily formed to be socially efficient, since at least the formal rules are created to serve the interests of those with bargaining power to create new rules. In a zero transaction cost world, bargaining power would not affect efficient outcomes, but in a world of positive transaction costs it does. “It is exceptional to find economic markets that approximate the conditions necessary for efficiency. It is impossible to find political markets that do” (North, 1997:51) Hereby, once an economy is on an “inefficient” path, which produces stagnation, it can persist due to the nature of path dependency. Page (2006) broadly refers to path dependency as, history matters. There are two types of path dependency processes, reactive sequences and self-reinforcing
sequences (Mahoney, 2000). Reactive sequences are chains of temporally ordered and casually connected events, where each event in the sequence is in part a reaction to previous events. Self-reinforcing sequences on the other hand are characterised by the formation and long-term reproduction of a given institutional pattern. Within self-reinforcing sequences the periods of institutional formation is referred to as critical junctures. They are critical because the reinforcing characteristics of the sequence make the choice of a particular institutional framework difficult to reverse. (Mahoney, 2000) The critical juncture framework has been used to explain the development and persistence of welfare states, and the variations in economic development between countries (Page, 2006). The mental models of actors form the informal constraints that define the institutional framework. These are passed down through generations, which provide the continuity of culture and are therefore determinants of path dependency.

Furthermore, as humans are seen as opportunistic (Thomsen, 2008), dominant actors in society act in order to maximise their own gain, and might therefore have no incentives to change the prevailing economic and political system. The dominant actors support and are supported by both the formal and the informal institutions, hereby setting the institutional framework. If the institutional framework makes productivity raising activities the highest pay-off, the organisations in a society will learn this and the economy will grow. However, if corruption has the highest pay-off, organisations will learn how to become better at offering and receiving key money. Hereby, it is essential that a polity will be developed that enact and enforce the rules of the game that fosters growth (Chandler according to North, 1997). North (1997) refers to game theory, to explain why these institutions are difficult to establish. Game theory argues that cooperative solutions foster the greatest growth. These solutions are most likely to arise when the play is repeated, when the players have complete information about each other’s past performance and when the number of players is small. However, the economic development has led to an economic world of impersonal markets, characterised by asymmetric information and a large amount of players. North (1997) argues that in order to handle this, flexible political and economic institutions have to be created, which alter pay-offs to induce cooperative solutions. (North, 1997)

6.3.4 Institutional Change
Paths might get reversed, but due to path dependency it is a difficult process (North, 1997). In order to change institutions and reverse an inefficient path, North (1997) defines five essential
characteristics of change. Firstly, a key to institutional change is the continuous interaction of institutions and organisations in the economic setting of scarcity, and hence competition. Secondly, the skills and knowledge organisations have to acquire, due to competitive forces, will shape evolving perceptions of opportunities that will incrementally change institutions. Thirdly, the institutional framework dictates what kind of skills and knowledge that are perceived to have the maximum pay-off. Fourthly, perceptions originate from the mental constructs of the actors. Fifthly, economies of scope, complementarities and network externalities of an institutional matrix make institutions tremendously incremental and path dependent. Economic change is the consequence of the choices individuals and organisations make every day. To a large extent these decisions are routine, however some involve altering of contracts between organisations and individuals. These alterations might be accomplished within the existing structure of property rights and political rules, but sometimes modifications of rules are required. In a similar way informal norms and values that guide exchange, might be gradually modified or wither away. In both of these instances institutions are gradually being revised. These modifications occur since individuals perceive that they will be better of by restructuring exchanges. Another fundamental source of change is learning by actors of organisations. “The rate of learning determines the speed of economic change, the kind of learning determines the direction of economic change” (North, 1997:55). The kind of learning is determined of the above-mentioned pay-offs of different kinds of knowledge.

Identifying the characteristics of economic change, is however not equal to recommending the correct way to improve the performance of economies. North (1997) states that it is simply not known how to transform ailing economies into successful ones. It is the mixture of formal rules, informal norms and enforcement characteristics that determine economic performance. It is possible to change formal rules overnight, while the informal norms are changed only gradually. According to Williamson (2000), it may take as long as 100 years to change any informal institution. According to Mygind (2007) it may be impossible, or take many years, for foreigners to learn the informal norms. It is the informal norms that “legitimise” the formal rules, whereas revolutionary change is never as revolutionary as expected (North, 1997). In this regard, North (1997) points to the inappropriateness of transferring the formal political and economical rules of western European countries to Third World and eastern European economies. It is not seen as sufficient, since the norms and the enforcement
characteristics in these countries are different. According to North (1997) it is the polities that shape economic performance, since they define and enforce the economic rules of the game. Hereby, development policy has to focus its efforts on creating polities that will create and enforce efficient property rights. Even though very little is known of the consequences of altering the institutional framework in central and eastern European societies, North (1997) points to some implications. Since political institutions will only be stable if they are supported by organisations interested in upholding them, an essential part of politic-economic reform is the creation of these organisations. Since it is the mental models of the actors that shape choices, it is necessary to change both the institutions and the belief systems for successful reform. Economic growth can hereby be achieved in the short run with autocratic regimes, but in order to create long run economic growth it is critical to develop the rule of law and the protection of civil and political freedoms. Finally, informal constraints on behaviour, such as conventions and Codes of Conduct are necessary, but not sufficient, for economical performance. The key to good economic performance is therefore flexible institutions that can adapt to changes in technology and demographics as well as to shocks of the system. (North, 1997)
7. Analysis

The introductory case indicates that agency problems arise when Scandinavian managers present in Russia gain access to information and act on this information without the owners knowing of it. It is assumed that this agency problem is a result of the expansion of the company to an unknown market. The Scandinavian companies face situations associated with higher uncertainty and thereby risk than would be the case in a Scandinavian country, due to new and influential stakeholders present in the Russian market. Thomsen (2008) argues that agency theory cannot explain all behaviour since ethics and prestige sometimes are more important to people than monetary gain. According to North (1991) laws, regulations, ethics and prestige are all part of the formal and informal institutions created by humans in a society to structure political, economic and social behaviour.

7.1 Corporate Behaviour

Due to the impact of the above-mentioned theories on the behaviour of parties in business exchange, it can be argued that differences in corporate behaviour exist between Scandinavia and Russia. The following part of the analysis aims to explain why corporate behaviour differs between the countries and how this influences the corporate behaviour of Scandinavian companies operating in Russia, thereby, analysing potential agency problems. The primary data suggests that very few similarities prevail in corporate behaviour, whereas these will not be discussed. It can be argued that the most important differences, for Scandinavian companies to consider when operating in the Russian market, are: the perception of the managerial role, the motivation of staff members, the concept of trust in business exchange and the structure of official procedures.

7.1.1 Identified Differences

Expert A states that Scandinavian companies in Russia should definitely not think that Russia is the same as the home market. The World Bank rates\(^5\) the Scandinavian countries consistently high\(^6\), on all governance indicators, including voice and accountability, government effectiveness, regulatory quality and control of corruption. Russia on the other

\(^5\) Country’s Percentile Rank, which indicates rank of country among all other countries in the world. 0 corresponds to lowest rank and 100 correspond to highest rank.

\(^6\) 80\(^{th}\)-100\(^{th}\) Percentile
hand, is ranked consistently low\(^7\), on the same indicators. (Worldwide Governance Indicators, 2010)

**Managerial Role**

Through the collection of the primary data it became evident that the role of the manager in Russian and Scandinavian companies differs remarkably. *Company E* states that a CEO in Russia is looked upon as a God. *Company A* further argues that, “*A CEO in Russia has far more authority than a Scandinavian CEO and the Russian CEOs are more or less allowed to do everything, since the Russian law protects them.*”

In accordance with North (1997), the power of Russian managers can be understood by studying the development of the transition. In 1985, President Gorbachev initiated Perestroika, economic restructuring, which included the passage of key laws. Through Perestroika, the traditional system of accountability was broken down without the presence of institutions of a market economy, leading to no enforcement of the new laws. This increased managers’ power over companies, since it became easy for them to take illegal advantage of the freedom. Since agency-theory assumes that both managers and owners are rational and self-interested (Thomson, 2008), managers could be motivated to act in their own self-interest. Before the transition, the managers were accountable for their actions and results as they answered to industrial managers, the communist party, other state organisations, as well as to the worker collectives. The corrective mechanisms at that time included personal fines, criminal prosecution, firing, public humiliation and so forth. (Puffer & McCarthy, 2003) Some of the same governance mechanisms found in Scandinavia today.

The power of managers increased even further during the Yeltsin’s administration, since the freezing of the formerly state-controlled prices in 1992 allowed managers to set prices on their output. The voucher privatisation also led to more concentration of power, since it failed to accomplish its purpose of widespread ownership of companies (Puffer & McCarthy, 2003). *Expert A* states, “*[…] the workers during the privatisation were supposed to get a piece of the cake, but it ended up with the managers getting everything.*” It is estimated that more than 70% of the shares ended up with the company managers (Economist, 1994, according to Puffer & McCarthy, 2003). This situation prevailed since the managers bought additional shares at

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\(^7\) 10\(^{th}\)-50\(^{th}\) Percentile
nominal prices from workers and other citizens. Hereby, ignoring their accountability to other stakeholders, including Joint Venture partners, minority shareholders and employees, creating type 2 and type 3 agency problems (Thomsen, 2008). Even though agency theory suggests that the Russian managers should have had similar objectives as other shareholders, their personal interests predominated in some cases, abusing the rights of minority shareholders and foreign investors (Puffer & McCarthy, 2003). Owner-managers normally work in the interest of the company and manage the money well, since the interests of owners and managers are aligned. Hereby, addressing the moral hazard problem. The adverse selection problem is normally addresses as well, since the owner has every incentive to hire someone else to run the company if that leads to better results. (Thomsen, 2008) However, according to Thomsen (2008), a risk involved with owner-management is that minority investors can get exploited, especially in countries with low investor protection, as in Russia. Another problem is tunnelling, when owner-managers withdraw money from the company for personal gain. These problems correspond to the actions of managers in Russia during the privatisation stage, whereas it can be argued that the negative effects overruled the positive effects of owner-management, ultimately creating very powerful managers. During the second phase of privatisation, managers’ power in Russia increased even further through the scandal around the government’s loans-for-share plan (Puffer & McCarthy, 2003). In late 1995, in exchange for supporting the re-election of Yeltsin and offering low-interest loans to the government, the oligarchs could make almost unchallenged bids for Russia’s major companies. Through their banks, the oligarchs both ran the auctions and bid on the companies (Freeland; Hoffman, according to Puffer & McCarthy, 2003).

The power the Russian managers possess within the Russian society is seen to create problems for Scandinavian managers operating in Russia. Company E states that it causes problems in the implementation of decisions made at headquarters in Scandinavia. Since a lot of diplomacy and insistency is needed to convince the Russian managers to listen and to take action it is seen as time-consuming. Company E states, “Even though a Scandinavian manager has a managerial role superior to the Russian manager, the Russian manager is controlling operations.” This emphasises the extensive power the Russian mangers have in the local business environment. In line with this, Company E points to the difficulties of controlling the actions of the Russian managers, creating a type 3 agency problem. This problem with control concerns the difficulty of creating complete contracts. Complete
contracts are not feasible since many situations suffer from hidden action and hidden knowledge (Besanko et al., 2007). It is impossible for the Scandinavian headquarters to observe all actions of the Russian managers and thereby to know if they perform at their best. As for hidden knowledge it is problematic for the Scandinavian headquarters to have the same insight as the Russian manager in the productive environment, such as characteristics of the Russian market. Due to this information asymmetry, incentive contracts are needed to accurately reward the managers and to solve the type 3 agency problem. Company E mentions, “We have a very clear CSR strategy and Code of Conduct of how to handle different situations.” The Russian top managers are involved in the creation of these guidelines, whereas Company E believes that the commitment on both parties increases. The company is hereby making use of explicit incentive contracts, with input based performance measures. It can be argued that the company is putting effort into making the CSR strategy and Code of Conduct as explicit as possible, in order for a third party to be able to assess whether the manager lives up to the standards or not.

**Motivating Staff Members**

The hierarchical system, which has evolved in Russian organisations, where the top management has extensive power, is seen to affect the motivation of staff members. According to Company B, the “[...] hierarchical structure of society, [...] has been built up over a long period of time, ever since the Tsars.” Both Company A and E believe that the hierarchical organisation that permeates the Russian society, influences the way Russian staff members work, and it creates one of the largest behavioural differences between Scandinavians and Russians. Company A believes that the most common mistake Scandinavian companies do is to be unspecific about what they require from the Russian staff members. Company E agrees and states that a lot of Scandinavian companies have failed due to a fear of setting requirements regarding objectives and budgets. This can be tied to the hierarchical organisation of the Russian society, where very clear guidelines are required. Company A continues by saying that job description is very important in Russia, since the Russians tend not to take own initiatives. “It is a very big deal that she brought you water, since that is not part of her job description” (Company A). Company A further states that Scandinavians care about the company they work for, they are proactive, they wish to work and do things the right way. The Russians on the other hand, are seen to act in the opposite way. However, Company E challenges this view and states that there is a large talent pool in
Russia with very competent and ambitious people, but it is culturally decided that they continuously seek approval from superiors.

The Scandinavian company and its Scandinavian managers in Russia are hereby faced with a new situation, when managing the Russian staff members. “It is given that it is impossible to make use of Scandinavian methods concerning the Russian employees. They would simply not understand” (Expert B). Therefore, agency problems may not only arise between the Scandinavian headquarters and the Scandinavian manager, but also between the Scandinavian headquarters and the Russian staff members, and between the Scandinavian manager and the Russian staff members. In order to decrease the agency problems and to motivate the Russian staff members to act according to the Scandinavian company’s wishes, incentive systems, such as pay for performance, may be used (Thomsen, 2008). However, Company A argues that the Russian staff members are not motivated by money in the same way as Scandinavians. This might be explained by the political history of communism, where salaries were not related to the amount of effort put into an assignment. Furthermore, Besanko et al. (2007) states that as long as the agent places a lower value on the consumption associated with each additional dollar of wealth, he or she will be risk averse. Based on this, it can be argued that tying pay to performance does not motivate the Russians because they are risk averse (Besanko et al., 2007). Russians hereby have a lower certainty equivalent than Scandinavians, when confronted with the same amount of risk (Besanko et al., 2007). Hence, it can be assumed that the transaction costs, related to controlling staff members, are higher in Russia than in Scandinavian, since the costs of motivating the Russian staff members increase in terms of higher risk premiums. However, the increase in disposable income has changed the attitudes towards shopping in Russia, where the middle-class is consuming larger amounts on non-essentials (Euromonitor International, 2010). It can therefore be argued that the value the Russians place on consumption will increase, making them more willing to take on risk. Hereby, monetary compensation might become more effective as an incentive in the future.

Implicit incentive contracts or a combination of implicit and explicit incentive contracts may be appropriate to make use of in Russia. Due to lack of enforcement of laws, following the transition, it can be argued that reputation may have more power in regulating corporate behaviour than formal rules and regulations. Hereby, it can be argued that implicit incentive contracts, which are enforced by reputation as opposed to a third party, are more effective in
motivating the Russian staff members. Hence, it can be assumed appropriate to make use of threat of termination, where monitoring motivates hard work, since the probability for the principal to detect shirking increases. Accordingly, the primary data suggests that monitoring the Russian staff members is essential. However, since monitoring and high wages are substitutes, the Scandinavian companies can alternatively increase the wages of the Russian staff members, in order to increase the cost of shirking. Hereby, the second best job alternative will become less attractive.

Perception of Trust

It is argued to be important to have Russians on your team for several reasons. However, Company A, D, E and Expert B point to potential problems connected to trust. Company D states that the business environment in Russia is not built on trust. Expert B continues by arguing that Scandinavians are much more contract-oriented than Russians. “Scandinavians believe and trust what is stated in a contract and respect this. In general Russians are a bit more relaxed when it comes to written agreements” (Expert B) Company A stresses the importance of trusting the Russians on your team, based on an experience where their Russian manager stole everything from the company, including domain name and trademark. The identified problems with trust might be connected to the low degree of trust in the Russian society. Expert C mentions that the Russian people do not trust the political and economical system, since the government has promised them several improving reforms during the years, without many actions.

According to Company E, trust is particularly considered to be a problem if a Scandinavian company enters into a partnership with a family-owned Russian entity. “If the Scandinavian company lets the local manager continue to operate the business in the way he has always done, by hiring his cousins and brothers in law, the personal relations drive the development of the company instead of the professional competences, which is seldom good enough” (Company E). The asymmetric information in this situation leads to hidden action where the Scandinavian company cannot observe if the Russian entity is acting in the best interest of the company (Besanko et al., 2007). Due to this potential type 3 agency problem, Company E argues that it is essential to get a professional in the leading position early in the process, in order to assure that the interest of the company is put first. Expert B agrees, and states that a professional should be placed on the board. This is in accordance with Thomsen (2008), who
remarks that boards are a generic governance mechanism, with the explicit aim of conveying the requirements of the shareholders and thereby to assure that their interests are put first. Hereby, the lack of trust in the Russian business environment enhances the need for control of the Russian staff members.

**Official Procedures**

Throughout history, autocratic leaders have ruled Russia, controlling the people by developing a bureaucratic society. Today, the Scandinavian companies find it difficult to operate within this society. **Expert B** states that the largest challenges for Scandinavian companies in Russia are the bureaucracy, the corruption and the contact with local authorities; factors, which increase the transaction costs of operating in the Russian market. **Company B** mentions that the permits and approvals from city governments are extensive. This is an area where corruption is seen to come into play, since every time a stamp is needed, someone could either speed the process up or slow it down. According to **Company D**, the real criminals in the Russian society today are employed within the municipality. **Company C** agrees and states that business-to-government corruption is more evident than business-to-business corruption. **Expert A** continues: “It is very important to stay on good terms with the government officials and to create networks, since the country is more or less lawless.”

It can hereby be argued that the close relationship created between government officials and businessmen during the transition (Puffer & McCarthy, 2003) is still evident in the Russian economy today. However, during the transition the Russian companies benefited from the closeness to the authorities, but today it seems like the authorities have increased the power over companies. Supporting this argument, **Company D** states: “The bureaucracy of today is unfortunately to a large extent concerned with milking companies for money”. An explanation of this change might be found in the increased influence of the government in economic activity commencing in 1998. The enlarged interference was the result of the 1998 financial crisis and President Putin’s objective to be accepted into the World Trade Organisation (WTO). (Puffer & McCarthy, 2003)

**Company D** highlights the necessity of having a local sales manager, since it would take a Scandinavian sales manager several years to understand the business structure in Russia, which is explained as, “[…] a local corruption language”. **Expert B** and **Company D** further
believe that staff members working on a fulltime basis are needed to handle the demanding and complicated environment surrounding the law and the tax system. Expert C continues by arguing that it is common that Scandinavian companies hire local consultants to handle the issues of the bureaucracy and to speed things up. Company A and E agree and believe that local staff members should handle all work in regards to the authorities and the market, since they know how the system works and can handle the contacts the Russian way. The hiring of local consultants is hereby both a mean of handling the complicated and unknown bureaucracy and a way to avoid getting in contact with corruptive acts. Company D states that even though it should be an ethical problem to make use of external consultants, it is not believed that Scandinavian companies think so. The respondent explains the situation as follows, “If you want to enter a specific market you have to follow the rules that apply in that market.” However, the outsourcing does not address the agency problems of moral hazard and adverse selection. Due to the lack of transparency it actually increases the possibilities of the agent to act in a way of which the principal do not approve (Thomsen, 2008). However, the lack of insight is at the same time the purpose of the outsourcing. The Scandinavian companies actively choose to let someone outside the company handle the situation, to minimise the transaction costs. According to the respondents, the jurisdiction is not seen as effective in combating corruptive acts. Therefore, the companies find alternative solutions to avoid getting in personal contact with the problems, in order to keep the transaction costs down. The respondents all believe that it is possible to avoid corruption, but that it is costly. The costs are foremost connected to the increased amount of time spent on navigating the bureaucratic system.

Agency Relationships
By analysing the defined differences in corporate behaviour it is apparent that besides the type 1 agency problem, between the Scandinavian headquarters and the Scandinavian managers, which was exemplified by the introductory case, a type 3 agency problem exists as well. Viewing the Russian staff members as stakeholders to the Scandinavian company, the sections “Managerial Role”, “Motivating Staff Members” and “Perception of Trust”, show that a type 3 agency problem arise between the Scandinavian headquarters and the Russian staff members. Company E argues that the headquarter finds it difficult to control the Russian staff members and that expatriates are needed to mitigate this agency problem. In accordance with this, several respondents state that it would be impossible to run the Russian operations
without expatriates. However, by analysing the type 3 agency problem further, it is evident, in
the “Motivating Staff Members” section, that another important agency problem arises, which
is the one between the Scandinavian managers and the Russian staff members. Hereby,
sending expatriates, as suggested by the respondents, will not necessarily make the type 3
agency problem disappear, as the problems may move to another level of the organisation. It
can therefore be argued that a “type 4” agency problem, between the Scandinavian managers
and the Russian staff members, will arise.

![Diagram of Agency Relationships]

Figure 4. The Agency Relationships

Based on the identification of a “type 4” agency problem, which can be recognized as a
manager-stakeholder problem, it can be argued that the need for expatriates has to be
investigated further in order to assess its importance.

### 7.1.2 Need for Expatriates

All the respondents emphasise the importance of having Scandinavians physically present in
Russia, in order to succeed with operations. *Expert B* and *Company E* believes that it would
be completely impossible for a Scandinavian company to control the Russian operations from
Scandinavia. *Expert C* continues by stating that the most successful Scandinavian companies
in Russia have been physically present, which has lead to success due to the creation of
extensive knowledge of the market. *Expert C* hereby points to the importance of
understanding the market. *Company D* and *E* argues that it would be suitable for Scandinavian
companies to send their own CEO and CFO when starting operations in Russia. *Company A*
continues: “From a risk perspective you always need one or two expatriates on location to
see things through”.
As mentioned in Section 7.1.1, the respondents believe that Russians are needed to handle some parts of the operations. However, differences in corporate behaviour between Scandinavians and Russians are evident. Based on this, and as argued by Company E, having expatriates, compared to solely having a local management, will decrease the amount of type 3 agency problems. It is seen to decrease the information asymmetry since the headquarters communicate to Scandinavian managers having the same corporate behaviour. This can be argued to make it easier for the Scandinavian company to control the operations in Russia, since the Scandinavian managers have a more predictive corporate behaviour, based on them coming from the same country of origin as the principal. Referring to the differences in “Motivating Staff Members”, it may be easier for the Scandinavian company to create suitable incentives and thereby to motivate Scandinavian managers to act according to the company’s demands. Moral hazard and to some extent adverse selection is therefore seen to decrease.

Organisational Culture

It is widely believed that expatriates are needed in order to incorporate the organisational culture in the Russian operation. Company B and C state that whenever a new operation is set up in Russia a number of expatriates are brought in with the prime purpose to establish the organisational culture. Company E believes that sending expatriates is important, “The reason for this is to get the Scandinavian values incorporated, to get the reporting structure working, as well as to make the entities meet.” Company E states that when acquisitions take place expatriates should be sent early in the process in order to reach a good integration of the Russian and Scandinavian entities. However, the respondent mentions that a trade-off exists between achieving a fully integrated organisation and reaching the fiscal goals. A risk of confusion is believed to prevail, which can be argued to arise due to the differences in corporate behaviour between Scandinavians and Russians.

The type 3 agency problems are seen to increase if integration is not achieved. If the Scandinavian values are not incorporated it becomes more complex to communicate and the risk of adverse selection increases. If integration is not emphasised, it becomes difficult for the Scandinavian headquarters to stay informed about elements of the operation. Company E furthermore states that it is difficult to control the Russians managers if integration of the Scandinavian and Russian entities does not take place. Since it becomes complicated to
follow the actions made by the agent and to make sure that the agent acts in the interest of the principal, moral hazard is also seen to increase. *Company E* believes that Scandinavian companies tend to fail in Russia if they leave the control of the operations entirely to the Russians. Problems arise since the Scandinavian companies have different corporate behaviour and thereby different requirements on how to run the business. The lack of communication and integration hereby leads to type 3 agency problems, which according to *Company E* normally result in the Scandinavian company dismissing the Russian management team. The respondent sees this as an expensive learning experience, which can be avoided if expatriates are sent to integrate the organisational culture of the Scandinavian company, thereby incorporating the Scandinavian corporate behaviour.

**Competences**

Several of the respondents mention lack of competences in the Russian labour force as a reason for sending Scandinavian expatriates. *Company A* and *C* mention that Russians do not possess entrepreneurial spirit; neither do they have the experience of operating large size projects. *Company B* further mentions, “*The expatriates are predominantly there to establish the company culture in the new entity and to train the local staff.*” It is believed that the Russian staff members lack the skills and competences needed to live up to the company’s standards. *Company D* states that it is less expensive to send Scandinavian expatriates than to hire locally, since the competences needed are not to be found within the Russian entity. It might be argued that the hierarchical structure of Russian organisations influences the competencies of the Russian staff members, since hierarchies may have the drawback of not fostering learning within the organisation. *Company E* supports this view and argues that the Russian staff members do not dare to unfold and always seek approval from superiors, resulting in them not exploiting their full potential.

Even though the respondents acknowledge the importance of having expatriates, the majority believes that the number of Scandinavians should decrease gradually. *Company B* states that their goal, after five years, is to have only one or two expatriates in Russia. It is seen as superior to have a Russian management team later on, since they will possess the combination of skills and local knowledge. In accordance with this, *Company A* argues that it would be ideal to solely have Russian staff members since the company is present in Russia. *Company*
A and Expert B furthermore points to the fact that it is less expensive to have Russian managers than expatriates.

Since it is believed that the Russian staff members do not have the required competences, sending expatriates hereby decrease type 3 agency problems. The probability that the expatriates act according to the headquarters requirements is seen to be higher. In the short-term, it can therefore be argued that sending expatriates decrease type 3 agency problems. However, in the long-term the respondents see it as more beneficial to train the Russians staff members to live up to the Scandinavian standards. If the Russian managers become more competent and understand the requirements from the Scandinavian headquarters, it is more efficient to have a Russian manager since he or she possesses expert knowledge of the market. However, training of competences is not enough. As mentioned, the integration of an organisational culture based on Scandinavian values is essential. If this succeeds, agency problems between the Scandinavian headquarters and the Russian managers may be minimised in the long run. Company E agrees with this approach and states that they have benefited from having a Russian top manager who has lived in Scandinavia. “[...] he is Russian, but he knows the management disciplines from the Scandinavian societies, which we demand.”

**Power of Resistance**

According to the primary data, Scandinavian expatriates in Russia have extensive authority. Company B states, “The expatriates have a lot of authority when it comes to the operations in Russia. [...] about 95% of the decisions are made by the expatriates.” The respondent further argues that it is more or less formalities when reports are sent to the board for acceptance, and according to Company A, it is not difficult to get the board on track. According to Company A, B and C, the Scandinavia headquarters make strategic decisions, while operational decisions are made locally.

Even though Company E believes that it is positive that the expatriates have extensive authority in decision-making, Expert B note that problems may arise. It is observed that Scandinavian managers in Russia have a tendency to get too absorbed into the Russian corporate behaviour, which is seen as unacceptable. It is believed that the respondent is referring to actions by the agent, which are not acceptable to the principal, such as corruption.
Expert B states, “If the pressure from the company back home is too high, it is easy for the managers to fall victim for corruption, since they want to show that the operations in Russia are successful.” This can be argued to be an explanation for the situation in the introductory case. Company A emphasises the importance of the Scandinavian headquarters understanding the business environment in Russia. The misalignment between expectations and results might therefore be grounded in the headquarters lack of understanding the business environment. Expert A and C argue that many Scandinavian companies are surprised that the business environment in Russia is that different from Scandinavia, and many companies entering Russia believe that operations will proceed faster than they actually do. Furthermore, Expert B argues that the authorities are actively trying to inveigh foreign companies in corruptive acts by demanding more and more from them, enhancing the probability that Scandinavian managers engage in corruptive acts. Based on this, it is evident that type 1 agency problems are present, and that “type 4” agency problems enhances the information asymmetry between Scandinavian headquarters and Scandinavian expatriates.

Agency theory states that it should be possible to mitigate moral hazard and adverse selection problems with the usage of governance mechanisms (Besanko et al., 2007). Pay-for-performance is a widely used mechanism in Scandinavian companies (Thomsen, 2008), however Expert B believes that, “[...] you cannot use high salaries to keep the Scandinavian managers from engaging in bribery.” According to agency theory, the agent take actions that maximises personal gain and if commission is used on top of the base salary, the agent will increase his or her effort until the marginal benefit of effort is equal to the marginal cost (Besanko et al., 2007). However, Besanko et al. (2007) points to two main costs for the company when tying pay to performance in explicit incentive contracts. The first cost may arise if the performance measure is affected by random factors, beyond the control of the agent. The second cost may arise if the performance measure fails to capture all facets of the desired performance. In the case of expatriates in Russia, both these costs are plausible. Since powerful stakeholders exist in the Russian business environment, the number of random factors influencing the managers’ performance, and thereby their pay, increases. As a proof of the extensive number of random factors in Russia, Expert B states that it is difficult to attract competent expatriates, due the high-perceived risks. Based on risk aversion, the agent will dislike having his or her pay vary randomly and the risk premium hereby increases. (Besanko et al., 2007) The simple answer to why higher salaries would not keep Scandinavian managers
from engaging in corruption could therefore be that the managers perceive the reward to be insufficient to compensate for the risk. However, a more plausible explanation might be that the performance measures fail to capture all facets of the desired performance. Pay-for-performance is hereby not the wrong mechanism, but the performance measures used are not the correct ones. This can be explained by the multitask principle. If the Scandinavian headquarters solely focus on output based performance measures, such as sales and profit, a risk prevails for counterproductive behaviour, since the managers might disregard the companies’ policies on ethical behaviour in favour for better results.

To mitigate the cost related to random factors, the company can aim at making use of performance measures that are less affected by random factors. (Besanko et al., 2007) It can however be argued that it is challenging to find performance measures that are not affected by random factors, since the Russian business environment constitutes several external challenges of which the Scandinavian managers have no impact. Based on the primary data, the challenges include the heavy bureaucracy, hidden action by stakeholders, such as the Russian staff members, and the perception of trust in society. It can therefore be argued more appropriate to mitigate the costs by making use of measures that reflect the activities the company wants the expatriates to perform, which cannot be improved by actions the company does not want the expatriates to perform (Besanko et al., 2007). Since the primary data indicates that counterproductive acts, such as corruption, are positively correlated with output based performance measures, the inappropriateness of these is evident. Supporting this, Company D states that in order to get a project started, a lot of permits, and approvals from local authorities are needed. “[…] Unfortunately, this is an area where corruption comes into play, because every time you need a stamp there is someone who could either speed the process up or slow it down” (Company B). The Scandinavian companies hereby have to find performance measures that are not solely output based and increasingly make use of input based performance measures. To decrease the type 1 agency problems resulting from the expatriates becoming too absorbed in the Russian corporate behaviour, rewarding them based on how precisely they follow the Code of Conduct might be appropriate. Alternatively, implicit incentive contracts with subjective performance evaluations can be used. Company A states that it is important that the headquarters understands the business environment in Russia, in order to put adequate pressure on the expatriates. Hereby, rewarding the expatriates based on the amount of valuable information shared, the headquarters’ understanding of the
Russian business environment may increase. Adverse selection and ultimately type 1 agency problems might therefore decrease. Another important incentive for the Scandinavian managers to perform well may be career concerns. It can be assumed that a good performance in a challenging market, such as Russia, will enhance their market value. Hereby, the risk of an unfavourable reputation will motivate the expatriates to perform actions in line with the principals’ directions. However, this requires that the headquarters do not set unrealistic requirements.

Referring to Figure 4, it can be argued that the “type 4” agency problem, between the Scandinavian managers in Russia and the Russian staff members in the Scandinavian company, enhance the type 1 agency problem. However, it can be argued that the type 1 agency problem is easier for the headquarters to handle than the type 3 agency problem. It is believed that the Russian managers are more prone to behave in a way that the Scandinavian headquarters do not accept, due to differences in corporate behaviour. It can therefore be argued that in the short-term, expatriates will decrease the amount of type 3 agency problems, since they have the same corporate behaviour as the principal. Today, Scandinavian companies let their Russian staff members or external Russian consultants handle relations with some external stakeholders, since these have the corporate behaviour needed to reach the best result at the lowest cost. However, the “outsourcing” will not decrease agency problems since it can be assumed to be more difficult for the Scandinavian headquarters to control the Russians than the Scandinavian managers. “Outsourcing” can therefore be argued to be an unsustainable solution. In the long-term, it is therefore only possible to decrease type 3 agency problems if the expatriates sent incorporate an organisational culture based on Scandinavian corporate behaviour and teach the Russians the competences required.

Concurrently, as mentioned, it is essential for the Scandinavian headquarters to understand the business environment in Russia, in order to decrease the misalignment between expectations and results, thereby decreasing the type 1 agency problems. Due to differences in corporate behaviour, the “type 4” agency problem between Scandinavian managers and Russian stakeholders, has been identified. Hereby, it can be argued to be highly relevant to investigate other stakeholders’, than the Russian staff members’, influence on the operations of Scandinavian companies in Russia as well.
7.2 Stakeholder Environment

7.2.1 Identifying Stakeholders
Based on the assumption that Russian stakeholders influence the performance of Scandinavian companies, the following part of the analysis will investigate the stakeholder environment. The definition of a stakeholder used is somewhat broad and basically defines anyone and everything in contact with the company as a stakeholder (Freeman, 1984). However, since the aim of the interviews was to grasp the entire context in which the respondents are conducting business, making use of Freeman’s definition allowed the companies to freely interpret the concept and definition of a stakeholder. Based on the respondents’ experiences, several stakeholders have been identified in the Russian business environment: the suppliers, the government, the local authorities, the competitors, the customers, the employees and the managers.

It is evident that the Russian market constitutes great potential. However, the Russian business environment raises novel sources of uncertainty and risks, in an environment new to the Scandinavian companies. In accordance with this, Johnson and Scholes (2002) argue that large global companies may have several added complications when operating in various markets. As Freeman states (1984), these new external changes a company is facing, present new groups, events, and issues which demand the company to broaden its view on potential stakeholders and their influence on the company. Accordingly, Company C states that Russian suppliers of basic needs, such as water and electricity, constitute a large problem to them. General supplies of this kind are taken for granted in Scandinavia, but in Russia they are not “passive” stakeholders. The expectations the company has on the stakeholder are therefore suddenly revised.

Furthermore, the Russian government and the local authorities are mentioned as influential stakeholders in the Russian market. Company E states, “The stakeholder who has had the largest impact on our decisions, during the previous year, is the government.” Accordingly, Expert B and C state that the government and local authorities definitely constitute the biggest challenges to Scandinavian companies. In line with this, the responding companies mention that the bureaucracy and the legislation affect their operations in Russia. Based on this, it can be argued that the government constitutes an important stakeholder for
Scandinavian companies in Russia, as they have the possibility to set the formal rules that the companies have to comply with. The Russian local authorities furthermore play an important role for Scandinavian companies as they wish to set up new operations in Russia. *Company C* states, “ [...] the local authorities often want us to make use of a specific supplier, which they personally have a relationship with.”

Besides recognising the importance of the government and the local authorities, Russian competitors are identified as a stakeholder group. *Company A* states that it is common for companies to spread rumours. In line with this, *Company E* states that ‘dirty’ tricks are used between companies in Russia. However, the responding companies believe that Scandinavian and Russian companies compete on mutual terms. Since all of the responding companies are within the business to consumer segment, the importance of the Russian customers as a stakeholder group was discussed. *Company B* argues, “The Russians are adapting extremely fast to the so-called western trends [...]” Several respondents agree, whereas it is believed to constitute a great opportunity for the Scandinavian companies.

It became evident that both Russian employees and managers are viewed as stakeholders in relation to the Scandinavian companies. The difference between Scandinavian and Russian staff members is discussed in Section 7.1.1. For example, *Company A* and *C* point to the importance of creating clear guidelines and follow-up on what the Russian employees do, indicating that they are not very proactive. Regarding the Russian managers, *Company A* and *E* states that the Russian managers are very powerful and take pride in what they do. *Company B* concludes that it is crucial for a foreign company to employ trustworthy Russians, since the foreigner does not speak the language and do not know how the system and culture works.

Even though the identified stakeholders are not unfamiliar to the Scandinavian companies, their behaviour is unfamiliar and according to Freeman (1984), they cannot be readily incorporated into the comfortable relationship the company has with its familiar stakeholders. By adopting a stakeholder approach, the company develops an expertise in understanding how these stakeholders arise, which issues that are of their concern, and if they are willing to help or harm the company (Friedman & Miles, 2006). Therefore, the Scandinavian companies should develop an extensive understanding of which their stakeholders in the
Russian business environment are, and what kind of impact they have on the company’s operations in Russia.

7.2.2 Power and Interest of Stakeholders
By solely identifying the stakeholders, no real understanding for how influential they are and how much power they hold, is developed. If this is not understood, the Scandinavian companies will have difficulties managing potential “type 4” agency problems, and ultimately developing appropriate strategies for the Russian market. Making use of stakeholder mapping (Johnson & Scholes, 2002), the company can classify the stakeholders in relation to the power and expectations they hold and the extent to which they are likely to show interest in supporting or opposing a particular strategy. Therefore, in the following section the stakeholders identified by the Scandinavian companies are mapped in the power/interest matrix. Even though every company has specific stakeholder relationships, the Scandinavian respondents are viewed as synonymous as they have a similar corporate behaviour and operate within the business-to-consumer segment, offering products and services. Due to this, the stakeholders, for example the suppliers, have been incorporated in the same stakeholder group, even though the nature of the single supplier might vary. The result of the stakeholder analysis is therefore seen to be applicable to Scandinavian companies with similar characteristics as the respondents. Company-specific strategies will hereby not be considered, as this would be outside the scope of the research project. The matrix will be used in regards to the presence and operations of the Scandinavian companies in Russia. The identified stakeholders have been mapped as follows and will be analysed one by one.
**Minimal Effort**

The customers are placed in the minimal effort section. As stated by the responding companies, the Russian customers have rapidly adapted to western trends and the demand for western-branded goods is increasing. According to Company D, “Russians love luxury and to succeed in Russia, you should offer products that enhance their quality of life.” The purchasing power in Russia furthermore increases, due to the growing middle-class. Based on this, it can be argued there is an interest from the customers. However, this interest rather has to do with demand than with an interest to influence the Scandinavian companies’ strategic operations. Since the demand for western goods and services are larger than the supply, the Russian customers have low power to influence the Scandinavian companies. However, since the customers are a fairly homogenous group, their power might increase if they start to show an interest in the company behind the product. According to Johnson and Scholes (2002), resource dependency is an indicator of power in terms of the proportion of the company’s business tied up with any one customer. The significant size of the group and its homogeneity can therefore to some extent be argued to result in resource dependency, as the customers, as a group, demands the same products. The power may therefore arise if the customers’ preferences suddenly change, since the switching costs are low.
The Russian employees in the Scandinavian companies are also viewed to require minimal effort. As discussed by Company A, the Russian employees are not proactive and require clear directions in order to perform accurately. Company D furthermore points to the low efficiency of Russian employees: "What a Russian can spend an entire day figuring out, a Scandinavian can do in half an hour." Company D continues by giving an example: "[...] a chicken farm in Siberia had 850 employees. After the Scandinavian company took over operations, there were only 10 employees left.” Against this background, it seems fair to argue that the Russian employees do not have a high interest in the company they work for, nor do they have the power to influence the company. However, based on the discussion in Section 7.1, where the “type 4” agency problem is identified, it can be argued that the Russian employees possess an indirect power to influence the operations of Scandinavian companies. The power is indirect since it has its foundation in their corporate behaviour. It creates operational challenges for Scandinavian companies as it enhances the type 1 agency problems. On the other hand, any direct power of the Russian employees may be connected to the fact that they know the system, the language, and the business environment. Hereby, if the Russian employees achieve higher positions within the Scandinavian company, it will be easier for them to capitalise on the valuable knowledge they hold as being Russians. Thereby practising their power over the Scandinavian company. Accordingly, Johnson and Scholes (2002) argue that a higher position or any formal status is indicators of power. If this becomes reality, the Russian employees become a stakeholder group to be kept satisfied.

Keep Informed
The competitors is a stakeholder group to be kept informed. According to Johnson and Scholes (2002), the expectations of these stakeholders can be addressed through information. This is in accordance with the strategy Company B has chosen. The company does not directly share information with its Russian competitors but rather acts as a role model for the local businesses by setting examples, hereby creating a competitive environment. Company B concludes, “You pick up what your competitors do, and hereby we are not only transferring knowledge within our company, but to those who observe as well. Of course, this is both good and bad, however by trying to keep a competitive advantage you stay alert.” Making use of this strategy, Company B sets a benchmark in their industry. The Russian competitors therefore show a high interest in what the Scandinavian companies do. However, they have relatively low power to influence the Scandinavian companies, since the Russians lack the
experience and knowledge of running larger companies, as well as the entrepreneurial spirit, Company A concludes. The respondents state that in most cases Scandinavian and Russian companies compete on mutual terms. However, Company C points to the fact that Russian companies have the advantage of knowing the language, the culture, and the system, which they can capitalise on. In Russia, networks are considered important in the business environment. In order to create networks and establish personal relations, you have to know the system and this is where the Russian companies have a vast advantage compared to the Scandinavian companies. This is evident when Company E describes how some Russian companies take advantage of the foreign companies’ difficulties in understanding the Russian system: “They might arrange for a foreign company to get a tax inspection all of a sudden.” Actions like these result in a type 3 agency problem, or a “type 4” agency problem if expatriates are sent. In the latter case, it may intensify the type 1 agency problem, as the Scandinavian managers have to take the Russian corporate behaviour into account when making decisions. If the Russian competitors’ power increases, they become key players. The acceptability of strategies by key players is of major importance, as they are both interested in influencing the companies’ operations and have the power to do so. Therefore, it can be argued to be important for the Scandinavian companies to stay ahead of their Russian competitors. In accordance with this, Company C states their tactic: “We need to know the laws better than the Russian themselves, and keep track of every little loophole there is.” In accordance with Johnson and Scholes (2002), another way to minimise the risk that the Russian competitors increase their power, is to view them as crucially important “allies”. This way, the Scandinavian companies can cooperate with the Russian competitors to influence more powerful stakeholders. More powerful stakeholders are the government and the local authorities, since they set laws and regulations. In this regard, it could be beneficial for Scandinavian companies to “team up” with Russian competitors and influence new legislative proposals, through lobbying.

**Keep Satisfied**

In this segment several stakeholders have been placed and they will be covered one by one. According to Johnson and Scholes (2002), the most difficult issues often relate to these stakeholders. In general, they may be relatively passive, but an unfavourable situation can arise if their level of interest is underrated.
All respondents mention the government as an influencing stakeholder and Expert C concludes: “The government is definitely the one stakeholder of most concern to the Scandinavian companies in Russia.” Company A and C furthermore state that the legal system is not up-dated, and new laws are very often contradicting older ones. Company B also mentions that the government set laws that are complicated for foreigners to understand. The legislation is an example of how the government practises its power. If the government’s interest in the Scandinavian companies’ operations starts to rise, it repositions itself as a key player. Hereby, the possibility for type 3 or “type 4” agency problems increases. Higher interest could result in the government imposing further tariffs or quotas on imported goods. The reason why the government has been placed in this segment and not as a key player, is because the government does not have an interest of solely influencing Scandinavian companies, but rather aims to influence an entire industry through laws and regulations. In support of this, Company A states “[...] this is the reality for Russians as well, one could imagine that this is only for foreigners, but everybody needs to go through the system.” Company C continues by stating that the government does not favour Russian companies, however the Russian companies have an advantage as they are familiar with the Russian business environment. Against this background, it can be argued that the Scandinavian companies should concentrate on not giving the Russian government any incentives to reposition itself as a key player.

The responding companies have chosen somewhat different strategies to cope with the contact with the Russian government. Company B emphasises the importance of surrounding oneself with reliable Russian employees, who can keep track of the Russian business environment. Company E, on the other hand, try to affect the decisions made by the politicians: “We have arranged meetings with all of the ministers, we have asked for a meeting with the President as well, which we did not get.” Company E tries to influence the government in regards to industry-specific fees, by sharing their experiences from other markets. In line with this, Company C has extensive contact with the government. In co-action with the government, the company build infrastructure in connection to their operations. This way, Company C creates a mutual dependency where the government realises the benefits of not regulating the business sector too much. As Company E states, they do million dollar investments in Russia, and: “[...] it naturally gets a lot of attention and it is not fun to be the government official who stops the acquisition or the building of a
new production site. You can make use of this in your negotiations: if they stop this operation, we will slow down the pace of operations in Russia, which of course is not what the Russian government officials want.” The mutual dependency, between large companies and the Russian government, dates back to the mid 1990s. At this time the “business-government elite” was created, increasing company managers’, government officials’, and former communist party officials’ control over the Russian economy. It can be argued that creating mutual dependency between the Scandinavian companies and the Russian government gives the Russian government fewer incentives to interfere in the business environment. The government will therefore remain a stakeholder to be kept satisfied, keeping their level of interest low. However, the government’s level of power is significantly higher. There are several indicators of power in relation to the Russian government, where the ones easiest to identify are status and symbols (Johnson & Schools, 2002). The government officials have job descriptions, which come with a well-known reputation and prominent titles. Accordingly, Expert A states that Russian politics today is based on individual power. Company E agrees, “[...] you have to play this game in Russia, it is a power game.”

Russian managers hired by the Scandinavian companies are also stakeholders to keep satisfied. As mentioned, the Russian staff members are not viewed as proactive or efficient, which according to several respondents is part of the Russian mentality. Therefore, the managers’ interest in the companies operations and strategies is assumed to be relatively low. However, as mentioned in Section 7.1.1, the Russian managers have a high level of power in the Russian society. This power, combined with their local expertise of the Russian business environment, makes the managers a stakeholder group with high power. Expert B states “It is only Russians in Russia that can compete with the Russians on their own terms.” As mentioned in Section 7.1.2, the respondents all agree that dealing with the complicated business environment in Russia requires Russians in some positions within the company. It is seen as very challenging for a foreign manager to get to understand how the business system in Russia works. “[...] I do not know how long you really have to live here in order to get this understanding.” (Company A) With the positions, held by the Russians, comes a power to influence the operations of Scandinavian companies. As discussed in Section 7.1.2, type 3 agency problems, of moral hazard and adverse selection, increase when having Russian mangers, due to differences in corporate behaviour between them and the Scandinavian
headquarters. Furthermore, a “type 4” agency problem may arise if expatriates are sent to mitigate the type 3 agency problems. Since the Russian managers have more information than the Scandinavian headquarters, the level of direct power to influence the operations in the Scandinavian companies can be argued to be rather high. Important indicators of power are the status and symbols associated with the managerial position the Russian holds. As seen in Section 7.1.1 the Russian managers’ significant power has developed throughout history. Although it is important for the Scandinavian companies to keep their Russian managers, they have to make sure that they do not become key players. If this were to happen, the Scandinavian companies would lose a substantial amount of control over their operations.

The last stakeholder group to keep satisfied is the suppliers. Company C mentions that the suppliers with the greatest impact on operations are suppliers of water and electricity. Other respondents mention suppliers of material for infrastructure. Company C points to the fact that these stakeholders of general supplies can be taken for granted in Scandinavia, hereby it can be argued that the power of the Russia suppliers is unexpected for the Scandinavian companies. The suppliers hereby constitute a relevant transaction cost, which can be argued to be minimal in Scandinavia. In many cases, the suppliers mentioned are state-owned or partly state-owned, which means that they are less dependent on their buyers. As the suppliers are less dependent on the Scandinavian companies, their interest in the Scandinavian companies’ operations in Russia is rather low. However, the suppliers are well-aware that the Scandinavian companies are dependent on them for key supplies, such as water and electricity, and that there are few competitors for the Scandinavian companies to turn to. This resource dependency is an important indicator of power as a large proportion of crucial supplies are tied up with few suppliers. According to Expert C, one way the suppliers practice their power is by requiring key money from the Scandinavian companies in order to deliver gas and water. As indicated by the introductory case, this situation arises a “type 4” agency problem, if the expatriates comply with the corruptive acts. The suppliers are hereby present within strategic industries where the Russian government has large interests, further increasing their power. As the level of the suppliers’ power may be difficult to affect, it is important for the Scandinavian companies that their interest remains low. If the interest increases, the suppliers would reposition themselves as key players, making the Scandinavian companies more dependent on them.
Key Players

The local authorities constitute a stakeholder group, which is identified as a key player. According to Johnson and Scholes (2002), it is essential for the company that the key players accept the activities the company intends to execute. The acceptability is a must, as the stakeholder both has a high level of interest and a high level of power to influence the direction of these operations. Several of the respondents mention that the local authorities interfere in their operations by demanding them to act a certain way or to pay key money in order to operate in a certain area. Company C states that local authorities often want them to make use of specific suppliers, which are suppliers whom the local authorities have a personal relationship with. Expert C furthermore argues that local authorities often refuse to help foreign companies. For example, if the infrastructure is lacking, the authorities may demand key money to make the necessary improvements, hereby type 3 or “type 4” agency problems arise. As mentioned in 7.1.1, the local authorities can either speed up or slow down the establishment process, since several permits are needed. As long as the local authorities see opportunities to earn key money, their interest in the Scandinavian companies’ operations in Russia will remain high. Several indicators of power of the local authorities exist, such as high status. Through their job description and reputation the local authorities possess extensive power to influence the operations of Scandinavian companies, by for example interfering in the choice of suppliers or by holding back essential approvals. Symbols may also give valuable clues about the power of the local authorities, which is evident as the respondents state that having close contacts with the local authorities is important. Non-business relationships are part of the important networks that all of the respondents deem central for operating in Russia. By creating a valuable network, where the local authorities are included, the Scandinavian companies may have greater access to the Russian business environment, since the information asymmetry decreases. Company C and E states that it is definitely important to create a network when present in Russia and by knowing the right people to contact, things will proceed faster. It is not about having a contact that can directly affect decisions; it is more about knowing where to go and whom to ask. According to Company E, if you have a good network “[...] you do not ask 10 to 30 different places before you reach the person who can make the decision.” Another reason for the Scandinavian companies to keep the local authorities in their network is to be able to keep track of the local authorities’ interest in their operations in Russia. It may be difficult for the Scandinavian companies to influence the level of power of the local authorities in Russia. Since several
respondents mention the lack of transparency in the jurisdiction, it can be argued to be difficult to challenge the extensive decision-making power the local authorities hold. However, by including the local authorities in their network and by creating lasting relationships, the Scandinavian companies can establish knowledge of the structure of the bureaucratic system, hence having greater opportunities to avoid being subject of corruption. Hereby, the unofficial power held by the local authorities might be decreased. Against this background, it seems reasonable to state that even though the Scandinavian companies cannot make the local authorities reposition themselves as a stakeholder, a good and lasting network in Russia can limit their influence on the Scandinavian companies’ operations in Russia.

7.2.3 Stakeholders and the Russian Society
The respondents explain that the bureaucratic system is a main reason for the different stakeholders power to affect their operations. As Expert B puts it, “[…] the bureaucratic system in Russia is very demanding and complicated.” Several of the respondents state that the problems with the bureaucracy, and the corruption that follows, are deeply rooted within the Russian society and culture, as it dates back to the suppressing times of the Tsars. The Russian society sets the “rules of the game” for everybody present in the business environment, both the Scandinavian companies and their Russian stakeholders. The stakeholders are even more subject to the “Russian system” than the Scandinavian companies, since their corporate behaviour is assumed to be a product of the Russian society. According to Gelauff and Broeder (1996), stakeholders’ behaviour is a result of the institutional arrangements present in a specific country. The differences between countries’ institutional environment mean that Scandinavian managers are exposed to several challenges in Russia, which find expression in “type 4” agency problems. As Gelauff and Broeder (1996) state, differences in national institutional characteristics imply that managers, who are supposed to maximise the value of the company, are split regarding the incorporation of the interests of the stakeholders in their decisions. This is also in line with what Johnson and Scholes (2002) argue, in regard to the possible scenario managers face when the parent company’s expectations about behaviour and performance is in conflict with the local stakeholders’ expectations on behaviour. The headquarter expects the overseas division to behave “like any other division”, even though this may conflict with the divisions ability to meet local expectations. The extensive bureaucracy and the issues of corruption make it difficult for the Scandinavian companies and their Scandinavian managers to
increase profits fast, as everything is more time-consuming than expected. *Expert C* supports this by stating, “*Very often the board and the headquarters wonder why nothing happens in Russia, and demand faster results.*” As mentioned in Section 7.1.2, this situation increases the possibility for type 1 agency problems, through the arising of “type 4” agency problems, since it increases the risk for counterproductive acts.

Gelauff and Broeder (1996) argue that it is the institutional characteristics, specific for a country, that set the circumstances under which the foreign managers must satisfy both the headquarters’ and the local stakeholders’ expectations. Then what kind of implications does the specific institutional environment in Russia have to the Scandinavian companies’ operations in the country? According to *Expert A*, there is a lack of functioning institutions in Russia and “*There is no one in Russia who knows how institutions emerge and how to build them.*” Scholars such as Mygind (2007; 2009), Puffer and McCarthy (2002; 2003), and McFaul (1995) support this statement by arguing that the formal institutions in Russia are not efficient. Peng (2001) argues that companies moving away from their home market should focus on the underlying institutional framework in the country of interest, in order to make the correct strategic choices and assure survival. Since it is evident that the Russian stakeholders influence the operations of Scandinavian companies, it seems fair to argue that it is of great importance to recognise the Russian institutional environment’s influence on the corporate behaviour of the Russian stakeholders. Thereby, an understanding of how the institutional environment in Russia influences the corporate behaviour of Scandinavian companies will ultimately be achieved.

### 7.3 Institutional Environment

#### 7.3.1 Emergence of Institutions in Russia

For a society to become stable and create meaning to the people acting within the society, institutions play an important role. The process of establishing institutions involves the ability to establish rules, inspect and review the rules, and if necessary impose sanctions in order to influence future behaviour. (Mygind, 2007) According to Scott (1995), the regulative structures are an accumulation of directions and interdictions inherited through generations. In line with this, North (2005) states that it is not possible to understand the present and the future if we do not understand the past. What constitutes the foundation for the Russian
society is hereby an effect of its history, and by analysing events and decisions in the past, one is better off trying to grasp the consequences they may cause. (North, 2005)

**Consequences of Autocratic Leadership**

When reviewing the history of Russia, from the oppressive ruling during the medieval ages to the powerful Tsars and later the authoritative leaders of the communist era, it becomes evident that dominant actors have controlled the country throughout history. The Russian people have been victims of oppressive rulers, who wished nothing else but to maximise their own wealth and power. Furthermore, the country was never part of the Roman Empire, with its centralised control mechanisms, and it was the only country of geographical Europe that did not share the common cultural and religious heritage of the west (Neville, 2000). Company D discusses the characteristics of Russia by stating, “Russia is a very strange country, since it is not Europe and neither is it the Far East.” During the years of the Tsars, powerful, autocratic leaders controlled the people with an iron hand, through the development of a strong central bureaucracy (Elgklou, 1992). After the revolution in 1917, Lenin introduced the country to communism, and the politics of the Soviet Union was set. All land, industry, and small businesses were nationalised and the money economy was restricted. (Service, 1997) During the following years, Stalin set off an immerse industrialisation, and succeeded in establishing near total control over the Russian society. This was the first time in history that a government controlled all economic activity in a country. (Neville, 2000) In connection to this, Company D states, “Russia has always been characterised with a high degree of closeness. It was closed during the Tsar period and during communism, which means that Russia has never got the same influences internationally as other countries. They hereby stick a lot to their own systems and traditions.”

The Russian society is a product of its history, where the institutions are humanly created constraints that structure political, economic, and social interaction (North, 1997). The dominant beliefs, which are those of the political and economic actors in a position to make policies, result over time in a complex structure of institutions that determine economic and political performance in that society. According to Thomsen (2008), humans are by nature opportunistic, thus it can be argued that the Russian leaders acted to maximise their own gain and not the Russian people’s. The Russian people had to adapt and act according to the political and economic policies set by the oppressive leaders. An illustrating example is the
Five-Year Plans, drawn up by Stalin, which dictated all activity in the country (Neville, 2000). Through these political and economic policies, the government built the institutional structure in the country. As the communist party had the monopoly of power, there was no opposition or free press to criticise the abuse of power, point to insufficiencies in the system, or suggest alternatives to improve the institutional structure. According to Thomsen (2008), media pressure is an important governance mechanism, since negative publicity is effective in changing the behaviour of actors. Accordingly, Mygind (2009) states that the Russian system lacked effective corrective mechanisms and thereby lost its dynamics. There were no real incentives from the political leaders to change the institutional structure, as they had created an institutional environment, which was supported by the leaders and in turn supported the leaders. Any attempts to change the system were therefore stopped within the system. The power distance between the elite of leaders and the broad group of people was tremendous, the Russian people were without influence and personal freedom, whereas a small number of leaders held great power and wealth. This power distance is still evident in the Russian society today. Company C points to the fact that Russian companies are very hierarchical and that the Russian staff members are afraid to make any decisions without the approval of superiors. Accordingly, Expert C argues, “The Russian people are used to control and to be told what to do, historically [...]”

**Nature of Incremental Institutions**

According to North (1991), a country’s history is mainly a story of institutional evolution, where these institutions evolve gradually, connecting the past with the future. During the communist years, the leaders of the Communist Party had an interest in keeping status quo. As they were strong enough, their defence of the predominating institutions was a barrier for change. Institutions are therefore a product of the dominating actors in the market and are, as mentioned, not necessarily formed to be efficient, since they are created to serve the interests of those with bargaining power to create new rules (North, 1997). The persistence of the inefficient institutions in the Soviet Union may be argued to have its explanation in path dependency. Once an economy is on an inefficient path, it may stagnate due to the fact that the previous conditions are decisive when determining the next step (North, 1991). The institutional pattern in the communistic Soviet Union can be argued to be a product of a few dominant actors with bargaining power to shape the society in their favour. Every time a new policy, such as the Five-Year Plans, was decided or implemented, the formation of institutions
was reinforced as the policies were favouring the powerful leaders. Any new policy like this or major change in the communistic governing, for example a new president, formed the institutional framework and was a critical juncture. The preceding situations allowed for conditional choices, which determined a specific path of institutional development that was difficult to reverse (Mahoney, 2000). The dominant actors in Russia, both individuals and organisations, with bargaining power resulting from the institutional framework, had a significant stake in maintaining the system. Based on this, it is argued that the self-reinforcing sequences made the “path” irreversible and inflexible, hence the institutional formation in Russia persisted. However, not only formal policies define the institutional framework in a country, the mental models of the dominant actors hold informal constrains that identify the institutional framework. These informal constraints are passed down through generations and include customs, myths and taboos that provide the continuity of culture, which are also determinants of path dependency. According to North (1997), “paths” get reversed, however it is a difficult process, as witnessed by the efforts of the transition in the Soviet Union.

**Institutional Development During the Transition**

It may be argued that the transition period started in the mid 1980’s when Russia was still part of the Soviet Union. Up until the 1960’s, the Soviet leaders had been able to achieve extensive growth by strategic movement of labour resources from agriculture to industry. However, in the beginning of the 1960’s this extensive growth strategy started to reach its limits since most of the labour reserves were employed. This led to lower growth and stagnation of the Russian economy in the 1980’s. In order to create growth, existing resources had to be used more effectively. However, due to the monopoly of power of the Communist Party and the inflexibility of the institutions in the command economy, intensive growth was hindered (Mygind, 2009). Accordingly, North (1997) states that long run economic growth cannot be achieved with autocratic regimes, but requires development of the rule of law as well as protection of civil and political freedoms. The weakness of the economic and political structures became acute in the 1980’s. Gorbachev therefore introduced Perestroika and Glasnost, when he came to power in 1985. According to Mygind (2009), politics is the driving force for institutional change. However, it can be argued that the implementation of Gorbachev’s reforms could not have been possible, if a large enough group of Russians did not support a change (Brown, 1996). A reason for this support may have been that the situation in Russia at this time was unsustainable. Both Russian civilians and businessmen
therefore supported a change in the institutions. As Gorbachev could consolidate his power with the Russians, further changes were made possible. Against this background, it is fair to state that the “path” the Russian institutional evolution had taken, gradually started ground to a halt. However, Gorbachev’s attempts to more democratic reforms were not enough. In accordance with this, Expert A states, “[...] Gorbachev actually is one of the great historical heroes. However, how it all ended is quite a tragedy. Gorbachev tried to implement the changes that were most necessary for Russia at that time [...]” Suffering from low pricing of petroleum and natural gas, ongoing war, outdated industry and persistent corruption, the Soviet planned economy proved to be inefficient, and by 1990 the Soviet government had lost control over economic conditions. This became evident in the beginning of the 1990’s, when the tensions between the Soviet Union and the other Soviet republics were extensive. Yeltsin, from the Russian SFSR, challenged the authority of the Soviet Union and demanded the resignation of Gorbachev as well as the dissolution of the Soviet Union. In 1991 Yeltsin, whose goal was to convert Russia into a market economy, was elected to lead the newly established Russian Federation (Neville, 2000). Russia started its transition to a market economy in January 1992, just after it had emerged as an independent country. Toward this end, it is reasonable to state that the former “path” reinforced by communism became truly challenged, as the country started to transform into a market economy. During the initial part of the transition, Russia changed from a command economy to a market economy based on a 500-day plan, imposed by the Yeltsin government. This plan constituted a rapid implementation of price and trade liberalisation as well as large-scale privatisation. According to Aage (2010), this plan was a hastened decision, based on aspirations for prosperity, democracy and national independency. By the mid-1990’s, the central government had lost control of the localities, the bureaucracy, and the economic fiefdom, and the country found itself in an economic depression (Yakovlev & Zhuravskaya, 2006). It may be argued that this was the result of several factors.

As the country felt an urge for shifting into a market economy, the shaping of the important institutional framework that constitutes a functioning market economy was left neglected. Lavigne (1999) argues that Russia hastened through the time-consuming process of a large-scale privatisation. During this process, time was needed for setting up institutions of privatisation, adopting the legal framework, finding buyers for the state-owned assets, and selecting which enterprises to be privatised (Lavigne, 1999). When the price and trade
liberalisation was introduced, this was a completely new situation for the Russian people, who had no experience of free trade and a free market. The institutional framework, present during the communist years, proved inefficient, as it was not created to serve a free market. With only a utopian vision of a western-like market in mind, several important institutional functions to regulate this market economy were ignored. This lack of institutions, supporting a market economy, can be argued to still be evident in Russia. Company E believes that even though the jurisdiction has improved, it is still not effective in regulating economic exchange. The complexity and lack of transparency in the jurisdiction hereby represent another transaction cost unfamiliar to the Scandinavian companies. “The administrative burden is high and the governmental organisation is simply not working properly.” In accordance with this, Expert C and Company C believe that the legislative environment is increasing the time of entering the market remarkably. It may be argued that the ignorance regarding the formation of market-functioning institutions had to do with the reformers lack of confidence in the transition (Åslund, 1995). As the change from a command to a market economy can be viewed as too radical for many of the Russians, who only had experienced the authoritarian communist state, the fear of a total economic collapse can be argued to have been imminent. The respondents point to the fact that a fear of change is still present in Russia today, and Company A states, “[...] it is extremely difficult to implement change. [...] This resistance to change probably has a lot to do with their history, the Tsars, and the communists. It is stuck in generations.”

With a reigning fear of economic breakdown amongst the reformers and the Russian people, due to the complete confusion in the price system (Åslund, 1995), the second large economic reform, the privatisation of national-owned companies, was implemented. However, as mentioned in Section 7.1.1, the concepts and practise of the privatisation turned out to be far more complex than initially estimated. The privatisation of state-owned companies via a voucher scheme, meant to enable the whole adult population of Russia to own assets. The goal was hereby to create a broad class of shareholders that would support further economic reforms. However, this mass-privatisation process unfortunately turned into an “insider-privatisation” where the ownership of shares came to belong to a small number of managers within large national industrial groups. It may be argued that this was due to the Russians’ lack of experience with a market economy and the fact that humans by nature are opportunistic. Many company managers used their position in large national industrial groups
to influence the rule of the game in the economy and pursue business opportunities for private gain. This subsequently led to a concentration of power where influential business managers together with government officials controlled the state. The misrepresentation of ownership control hereby produced an ownership structure fostering economically inefficient institutions. According to North (2005), in order for political change to take place, a large group of supportive social actors are needed. The aim of the mass-privatisation, to create a broad class of shareholders that could support further reforms, can hereby be argued to have been suitable to create political change. However, as it is the beliefs of the dominant actors that establish the institutional structure, the concentration of ownership to a few actors meant that the political change could not succeed. The business managers had little incentive to change the system or support a legal framework, which limited their power. It is hereby fair to state that the formation of Russia’s formal institutional structure during this time was set to support the dominant actors and not an efficient market economy. Hence it is reasonable to argue that the formal institutions were economically inefficient.

Since it is the mental models of the actors that shape the formation of institutions, it is necessary to change the belief systems of society, and not only the formal institutions, for an economic or political reform to become successful (North, 2005). The informal institutions consist of customs and traditions, which is culturally derived and established through generations, as the actors have created mental models of what the society should look like (North, 1991). When the creation of the new formal market-based institutions was left neglected, the informal constraints came to play a larger role in regulating economic exchange in Russia. These constraints, for example, include the mental models of a hierarchical structure of society, mentioned in Section 7.1.1. It can be argued that this hindered the development of a market economy, since the Russians were used to centralised control, meaning they did not possess the entrepreneurial spirit necessary for a market economy to flourish. The informal institutions’ role in regulating corporate behaviour in Russia is still evident, as the respondents mention that the Russians are not seen as initiators. Apart from being a product of the culture, derived through generations, the informal institutions in Russia have been developed based on actors’ opportunistic behaviour. According to Zizek (2006), the transition created confusion in the complex network of informal institutions, which led to the expansion of organised crime in Russia. Since the creation of formal institutions was left neglected, it is argued that the organised crime created a structure of informal institutions in
the institutional void following the transition. It is therefore fair to state that the informal institutions were not economically efficient, as they were not created to optimise the market economy. Hereby, it can be argued that the transaction costs increased in the Russian economy as a result of the transition. Hence, the structure created by organised crime, can be argued to have decreased the transaction costs at that time, since it reduced the confusion in the network of informal institutions. However, organised crime has a large influence on the amount of corruption in a society, whereas it can be argued to have increased the transaction costs Scandinavian companies face in Russia today. It can be argued that the informal institutions played such a large role in the Russian society, since formal institutions will only be strong and stable if actors are interested in upholding them. Since the Russian people had no experience and limited knowledge of a market economy, it can be argued that their interest in supporting the creation of formal institutions was low. Due to the autocratic leadership structure in the history of Russia, the people were furthermore not used to make decisions or take initiatives, which a market economy requires. The lack of trust in governmental reforms may moreover have decreased the interest of supporting the creation of formal institutions.

7.3.2 Institutional Structure

As the Scandinavian companies enter the Russian market, they become actors in the Russian society. However, the Scandinavian companies are unfamiliar with the institutional structure in Russia, and have little knowledge of both the formal and informal constraints, which dictate the Russian stakeholders’ behaviour. Against this background, the institutional structure in Russia today will be analysed in order to see what consequences it may have on the Scandinavian companies’ operations in Russia.

In accordance with new institutional economics, complete information is impossible to obtain. Hence, actors form subjective perceptions about what the world should look like and how rules and regulations should be set in a society. As mentioned, these subjective perceptions are mental models of the actors’ own beliefs about the formation of a society, culturally derived and established through generations. Therefore, the models vary radically among societies and ethnic groups. (North, 1997) In accordance with this, it is reasonable to state that the Scandinavian companies enter the Russian market with beliefs of the business environment, based on their corporate behaviour. As discussed in section 7.1, differences in corporate behaviour exist between Scandinavia and Russia, whereas Scandinavian companies’
beliefs of how to conduct business in Russia differ from the Russian stakeholders’. This is recognised by Expert C, who states that Scandinavians often get surprised that Russia is that different. The respondents argue that the Russian market cannot be viewed as comparable to the Scandinavian market. As Company A puts it “It is learning-by-doing, you cannot come to Russia with the implication that you know what you are doing and that you understand how to do it.” In line with this, Expert C states that Scandinavian companies should try to enter the Russian market with an open mind. However, it can be argued to be non-viable for the Scandinavian companies to enter Russia with an open mind, since the Scandinavian companies’ beliefs about the structure in society have emerged through generations and are a product of the Scandinavian history, as in accordance with path dependency. Therefore, the Scandinavian companies cannot avoid entering the Russian market with certain beliefs of what they deem to be appropriate corporate behaviour. The differences in corporate behaviour between Scandinavia and Russia can be explained viewing the differences in the institutional environments. In Scandinavia the formal institutions are superior to the informal, in regulating economic exchange, whereas in Russia the opposite prevails. As mentioned in section 7.1.1, this is evident in the countries’ governance ratings.

In regards to the Russian society, it can be argued that the history and nature of path dependency have determined who the powerful actors are and, as mentioned, their beliefs have set the foundation for both formal and informal institutions in Russia. This institutional framework is the one the Scandinavian companies have to comply with, even though they have formed contradicting beliefs about how to conduct business. As the Scandinavian companies are relatively new actors in the Russian society, it seems reasonable to state that they do not possess dominant beliefs (North, 2005), meaning they do not have a direct power to change the institutional environment. Therefore, the majority of the Scandinavian companies entering the Russian market will have to adapt to the prevailing institutional framework in Russia. In line with this, Expert A states that the institutional environment in Russia today is a large concern to foreign companies and, “[...] the Scandinavian companies in Russia must adapt to the situation and do the best they can.” However, as mentioned in Section 7.1, it is essential to minimise type 1 agency problems, whereas the Scandinavian expatriates should not allow the Russian stakeholders to influence the Scandinavian corporate behaviour. Expert B states, “As a foreigner, you should not adopt the Russian way, it is better to stick to the way you are used to and know best.” However, the institutions in a society set
“the rules of the game”, hence the Scandinavian companies often find themselves in situations where the Russian institutions challenge their views on how to conduct business. This is evident when Expert B points to the widespread problem of Scandinavian managers getting too absorbed in the Russian way of doing business, as discussed in Section 7.1.2.

Formal Institutions

According to North (1997), economic growth can be achieved in the short run with autocratic regimes, as found in the political history of Russia, but in order to create long run economic growth it is critical to develop formal institutions protecting civil and political freedom. However, the primary data indicates that these do not exist in Russia. Both Expert C and Company C believe that the complicated legislative environment is increasing the time of entry and the entry barriers to the market remarkably. Company A further points to the slow processes within the Russian legal system, “When something turns into disorder, it is time-consuming to restore order again, especially if the company does not want to engage in corruptive acts.” Several respondents agree to the fact that the legislation is one of the largest challenges of operating in Russia. Company C points to the new laws being contradictive to older legislation, increasing confusion. Another problem mentioned, is the courts dependence on actors with economic power. Expert A believes that the courts and the entire legal system is corrupt and it is questioned whether President Medvedev will manage to decrease corruption within the country. However, Medvedev recently dismissed the Moscow Mayor, Yury Luzhkov, after state-controlled television had broadcasted a series of reports on corruption in the city. This was the first time Medvedev fired a regional leader because of “loss of confidence”. (The Moscow Times, 2010) The action of Medvedev can be argued to confirm that the formal institutions do not support civil and political freedom, since widespread corruption within governmental bodies is still evident. On the other hand, the action can be regarded as a step in the right direction, towards decreased tolerance of corruptive acts and increased transparency, fostering more reliable institutions supporting a market economy.

Expert C explains the differences in legislation between Russia and Scandinavia by the fact that Russia is not part of the European Union. Russia has furthermore not yet been accepted into the WTO, which can be argued to increase the differences in regulation of economic exchange. In accordance with North (1997) and the discussion of path dependency, Company
B agrees with the problems of the jurisdiction but points to the fact that it is an evolving process, and it is not realistic to believe that it can change overnight. The respondents mention the difficulty for foreigners to understand the legislation and to keep track of changes made. It may be argued the heavy bureaucracy surrounding these institutions is the reason for this. The bureaucratic system may in turn be a result of the lack of trust in the Russian society, whereas the Russians have a rather short-termed view on business relationships. *Company A* states, “...when trust disappears it automatically takes a lot of documents to secure that things will proceed in a correct way.” According to *Expert C*, the lack of trust in the Russian society is a result of the government’s utopian visions for the country, which are seldom actualised, leaving the people to doubt the system. *Expert B*, further states that the large number of extensive changes throughout history, has made the Russians disbelieve that they will benefit from long-term relationships. All of the respondents agree that the heavy bureaucracy in Russia slows down the process of expansion. *Company A* states that in order to receive every document, stamp, and permit needed to start up a business in Russia, it may take years. Due to the demanding bureaucracy and the time-consuming processes, the respondents state that there is an alternative way to conduct business, this, however includes corruptive acts. According to *Company D*, a licence application has to go through the heavy bureaucracy, but if you cannot wait for this, you can offer key money to the government official and thereby receive the licence faster. *Expert B* believes that corruption is impossible to avoid completely. In accordance with this, *Company D*, argue that dishonesty existed during the communist years and, as mentioned, the organised crime increased during the transition. Hence, it can be argued that dishonesty is included in the Russian actors’ mental models of society and plays an active role in the Russian traditions and customs. It is hereby included in the society’s informal institutions, and it can be argued that it has undermined the formal institutions. The formal institutions can be assumed to be unstable and weak due to the rapid transition. Accordingly, the neglect of creating formal institutions supporting a market economy, made it possible for organised criminality to take advantage of the situation, as mentioned by Zizek (2006). The corporate corruption furthermore increased, as mentioned in Section 7.1.1, when the Russian managers gained substantial power. It can therefore be argued that during the transition the dominant actors in society were the criminals and the managers, which is in accordance with Puffer and McCarthy’s (2003) observation that the government had less power to implement reforms in this period. Accordingly, Peng (2001) states that it is due to the weakness of formal institutions that informal institutions play a larger role in regulating
economic exchange in emerging markets.

**Informal Institutions**

*Company D* discusses that even though the bureaucratic system is demanding, foreign companies can learn to understand it, since there is a structure in the bureaucracy. However, the respondent concludes that even if a company learns the structure of the bureaucratic system, it is a vast challenge to understand the Russian culture. According to Mygind (2007), culture is part of the informal institutional environment transformed from one generation to the next. As the Scandinavian companies have not been part of the Russian society, it can be argued almost unachievable for them to fully understand the informal institutions in Russia. As, discussed in Section 7.1.1, it is therefore essential to have Russian staff members handling some parts of the operations.

When discussing the culture, several of the respondents talked about the lack of trust in the Russian society. As mentioned above, the lack of trust and the vast bureaucracy are much intertwined, which may be argued to be a reason for the strong informal institutions, where corruption has become part of the Russian stakeholders’ corporate behaviour. *Company C* states, “If you know the right person, you will get first in line”. However, *Company A* states that as a foreigner in Russia, it is difficult to know whom to contact in the bureaucracy. As mentioned in Section 7.1.1, another way of making things advance is to hire a local consultant, who makes sure all the connections needed are established. However, the Scandinavian companies often regard these activities to be in the grey-zone between the legal and the illegal. It may be argued that this informal way of navigating through the bureaucratic system and avoiding bottlenecks of decision-making, is fostering learning amongst the actors. Corruption may hereby have a higher pay-off than following the rules of formal institutions. As the actors learn this, they also learn how to become better at offering and receiving key money. (North, 1997) Even though none of the responding companies admit to offering or receiving key money, they recognise that the problem is evident in the Russian business environment. *Expert B* discusses the foreign companies and their relation to corruption by concluding that all companies will be confronted with it, however it is possible to choose not to take part of it. *Expert B* further considers what will happen if companies systematically try to avoid corruption “[...] there will be even more bureaucracy to handle. The only way to avoid being part of it is to always meet your commitments and responsibilities [...] The
Russians know that the way to get the foreign companies to be part of the corruption is to demand more and more of them, and at one point in time, the companies will give in [...]”
Against this background, it is reasonable to state that the Russian stakeholders have learnt that pressuring Scandinavian companies may yield a higher pay-off than following the formal legislation. In accordance with North (1997), the Scandinavian companies thereby learn that the fastest way of starting a business in Russia, and fulfilling the headquarters’ requirements for rapid growth and profit, is to give in to the Russian stakeholders’ demands. Hence a vicious circle is created, where one corrupt act leads to another, aggravating the first.

From the discussion above it is reasonable to argue that the informal institutions greatly influence the Russian stakeholders’ corporate behaviour. According to North (1997), it is the informal norms in a society that provide the legitimacy to the formal rules, thus it is fair to argue that the formal institutions in Russia is a product of the informal constraints. Put another way, when the formal institutions are not effectively regulation economic exchange, the informal institutions take over as the regulating force (Peng, 2001). The informal rules have grown out of the history of communism and the transition period has influenced the formal institutions. As the Russian government has regained its power and has become a more dominant actor in society, the corruption has entered the political scene. In accordance with this, Company C and D argue that the political corruption has increased. “[...] business-to-business corruption decreases, but business-to-government corruption increases.” (Company C) The above-mentioned lack of working formal institutions, especially the lack of a functioning legal framework, leads to problems for Russia to attract foreign investors (Ahrend & Tompson, 2005). On the background of this, and in accordance with North (1997), it is reasonable to state that a more flexible institutional framework is required for Russia to benefit from being part of a global market economy.

7.3.3 Institutional Change
According to North (2005), the intentions of the actors and their perception of the environment, is the key to understanding the process of change in a society. Williamson (2000) states that it may take as long as 100 years to change any informal institutions, whereas formal institutions can be changed overnight. It may be argued that the reason for the difficulties in changing informal institutions has its foundation in the culture of that society. Hereby, the development of formal institutions in Russia is complicated, since it is the dominant beliefs, held by the Russians, which set the foundation for policies. Formal
institutions will become unstable if the reinforcing norms and values, which legitimise new rules, do not exist. Therefore, it is necessary to change both the formal institutions and the belief systems in order to implement successful reforms. (North, 1997) North (1997) suggests five propositions that define the essential characteristics of institutional change. However, identifying these characteristics of economic change is, not equal to recommending the correct way to improve the performance of economies, since it is simply not known how to transform ailing economies into successful ones.

Firstly, a key to changing institutions is the constant interaction of institutions and organisations in the economic setting of scarcity, and thus competition. In this regard, it can be argued that Scandinavian companies should continue to invest in Russia, and thereby improve the competitive environment.

Secondly, the skills and knowledge organisations acquire, due to competition, will shape evolving perceptions of opportunities that will incrementally change institutions. Therefore, both the local and the foreign companies, present in the Russian market, should welcome tougher competition, as it requires them to stay alert. Company B states, “[...] the local businesses see what we have and what we do and this creates a competitive environment.” By constantly trying to keep a competitive advantage, the companies will notice new opportunities, which in many cases need to be supported by new or changed institutions in order to be realised. Hence, the requirement for Russia to develop an institutional framework supporting a market economy will increase.

Thirdly, the institutional framework dictates what kind of skills and knowledge that are perceived to have the maximum pay-off. As discussed above, many actors in the Russian business environment have learned that corruption may have a higher pay-off than following the formal rules of business exchange. However, if foreign companies persistently choose not to take part in any corruptive acts, this should encourage a change in behaviour among the other actors, and corruption will generate a lower pay-off. Hence, it seems reasonable to argue that Scandinavian companies should stay with their Scandinavian corporate behaviour, where corruptive acts are not part of the mental models. Hereby, the Scandinavian companies will foster learning amongst their Russian stakeholders, that corruptive acts do not have the highest pay-off in the cooperation with Scandinavian companies. However, Company B
states, “you do not wipe away a system built up over generations [...] It is a process, which will take a long time.” Hereby, learning is an enduring process, but since the respondents state that their investments in Russia are long-term it seems reasonable to argue for.

Fourthly, perceptions originate from the mental constructs of the actors. As Company B states, it is important to remember that only 20 years has gone by since Russia went through the transition, and the country was faced with major political and economic changes. The Russians, coming from a highly controlled environment, were overnight supposed to change their view on society and create beliefs consistent with the new Russia and its market economy. Since the Russians had no experience of a market economy, they created perceptions about a market economy, which were based on the experiences from a planned economy and the beliefs of what they thought was a functioning market economy. For Scandinavian companies it is of importance to remember that the development of a market economy in Russia is still evolving, and by being present in the country they may have the opportunity to influence the institutional framework, by challenging the prevailing belief system. Company B states that they see themselves as a role model and welcome Russian competition, whereas Company C and E actively try to improve the system by negotiating laws and lobbying the government. The latter is recommended by Expert B, “You should have the resources to run lobby activities in relation to the Russian authorities.” The lobbying activities mentioned by Company C and E can be argued to be attempts to change the beliefs of the dominant actors, in this case the government as a stakeholder. As mentioned in Section 7.2.2, it can be argued that a mutual dependency exists between the Scandinavian companies and the government. It can therefore be assumed that Scandinavian companies in some situations can affect the institutional environment and ultimately corporate behaviour.

Fifthly, economies of scope, complementarities, and network externalities of an institutional matrix make institutions extremely incremental and path dependent. Nevertheless, according to North (1997), modifications in mental models do occur, since individuals perceive that they will be better off by making restructurings. Economic change is a result of the decisions actors make everyday, and these decisions are mostly made without any afterthoughts. Some of the decisions may involve altering of contracts, where these alterations cannot be accomplished within the frames of the existing institutional structure. Restructuring of the institutions is then required and gradually the institutional framework is being revised. As
more foreign companies realise the potential in the Russian market and start up businesses there, their size as a powerful actor that have the possibility to influence policies will increase. In accordance with this, the respondents state that they are in Russia to stay, they know the potential of the market, and believe that the business climate will improve.

As mentioned, the informal norms legitimise the formal rules, whereas revolutionary change is never as revolutionary as expected (North, 1997). The failure of the transition in Russia can be argued to confirm this. It is furthermore argued that it is inappropriate to transfer the formal political and economic rules of western European economies to eastern European economies, since the norms and the enforcement characteristics in countries like Russia are different (North, 1997). However, informal norms and values that guide exchange might be gradually modified or may wither away, in the same way as formal rules, based on actors’ decisions made every day. In both of these instances institutions are gradually being revised. (North, 1997)

Based on this, and as mentioned above, Scandinavian companies should make an effort not to adapt to the Russian corporate behaviour, with the aim of gradually influencing the informal institutions in the Russian society. Several respondents argue that the Russian economy is too dependent on the export of oil and gas. Company E states, “[…] the Russian economy is very tied up to oil and gas, they lack to identify the engines of growth that can drive the development further. […] I do not think that enough effort is put into fostering local businesses. […] Russia does not have the same level of development as Scandinavia, in regards to entrepreneurship.” Based on the Russian economy’s reliance on oil and gas and the lack of entrepreneurial spirit, it can be argued that Russia will become more dependent on business exchange with the surrounding world in the future. This will occur if Russia’s natural resources dries up or if demand for oil and gas decline. Based on this, it seems reasonable to argue that foreign companies, including Scandinavian, will become a more dominating actor in the future development of the Russian economy. Hereby, it can be assumed that the Scandinavian companies, through their corporate behaviour, will take part in the progress of the economical institutions. By influencing the economical institutions it can be assumed that the Scandinavian companies will have an indirect effect on the political institutions, in accordance with North’s (2005) argument of the interdependency between political and economic institutions. Hereby, a virtuous circle may be created, since learning triggers the
creation of institutions more functional for a market economy.

Hereby, if the foreign companies as a group become larger and more influential in the economic sphere, it can be argued that they have the possibility to challenge the beliefs of the dominant political actors in Russia, in the long run. Based on the primary data, this will lower the entry barriers for foreign companies, since the institutional environment will become easier for them to manage.

7.4 Conclusive Findings

The analysis confirms the relationship between the chosen theories, displayed in Figure 2. Hereby, it is verified that a clear interdependence exist between the Russian institutional environment, the Russian stakeholder behaviour and the operations of Scandinavian companies, within the business-to-consumer segment in Russia. Hence, it is believed that a sound answer to the research question has been established. According to abductive reasoning, the conclusion found is held until further information provokes a re-evaluation of the findings.
8. Theoretical Implications

8.1 Discussion

Based on the analysis, it is evident that the identified type 1 agency problem cannot be explained by solely looking upon the owner-manager relationship. In the context of the Russian business environment, the empirical data indicates that the differences in corporate behaviour between the Russians and the Scandinavians are central. Taking on a wider stakeholder-agency theory approach, the findings imply that Scandinavian managers are sent to the Russian operations in order to mitigate a potential type 3 agency problem, between the Russian staff members and the Scandinavian headquarters. The Russian staff members are hereby viewed as stakeholders. Since the Scandinavian managers are viewed to have the same corporate behaviour as the Scandinavian headquarters, it is argued to be easier for the Scandinavian headquarters to control the Scandinavian managers, than the Russian staff members. However, when trying to mitigate the type 3 agency problem, not only a type 1 agency problem arises, but a “type 4” agency problem is identified, as displayed below.

![Agency Relationships Diagram](image_url)

Figure 6. The Agency Relationships

The “type 4” agency problem emerges between the Russian stakeholders and the Scandinavian managers, since the Scandinavian managers gets a mediating role. Hence, the type 3 agency problem does not disappear, but is merely transferred to another level in the organisation. The “type 4” agency problem even intensifies the type 1 agency problem, since a misalignment occur between the expectations Scandinavian headquarters have on the Scandinavian managers and the results that these managers are able to provide, due to influential stakeholders. The primary data hereby indicates the importance of considering how
Russian stakeholders may influence the Scandinavian companies’ operations in Russia. Stakeholders in the Russian business environment have, due to their corporate behaviour, different expectations on the Scandinavian companies, than these companies are used to, whereas type 3 or “type 4” agency problems may arise. Based on the analysis of the empires, the corporate behaviour of Russian stakeholders can be argued to be a result of the country-specific institutional environment. The structure of the institutional environment evolves throughout history, whereas the differences in the political and economic history between Russia and Scandinavia have created different views on corporate behaviour amongst the stakeholders. Hence, an interrelationship between institutions, stakeholders and corporate behaviour is apparent, as displayed below.

Figure 7. The ISC Framework – the interrelation of Institutions, Stakeholders, and Corporate behaviour

8.2 Contribution to the Field of Study
A somewhat neglected area of Scandinavian companies, operating within the business-to-consumer segment in Russia, has been looked upon through a combination of theories, which had not been applied to this subject area in previous research. Figure 6 and 7 indicates that the
research project’s contribution to the field of study is twofold. On a theory specific level, the “type 4” agency problem is identified as a contribution, since it is evident that stakeholders play a central role in explaining the identified type 1 agency problem Scandinavian companies may face in Russia. It is moreover assumed that the “type 4” agency problem is apparent for any company experiencing type 1 agency problems in an unknown stakeholder environment.

The additional contribution is characterised by the development of the ISC framework, suggesting how Scandinavian companies operating within the business-to-consumer segment may analyse the Russian business environment. It is furthermore argued that any company wanting to operate in an unfamiliar market can apply the ISC framework. Analysing the institutional environment in a country of interest will increase the understanding of how stakeholders in the particular market will behave, and hereby affect the company’s operations. The ISC framework may therefore facilitate the creation of appropriate profit maximising strategies in unfamiliar markets.
9. Managerial Implications

As demonstrated in Figure 7, the agency problems identified in Figure 6, can be explained by the influence of stakeholders on the Scandinavian companies’ operations. The expectations of the stakeholders and their ability to practice their power over the Scandinavian companies are argued to be a consequence of the institutional environment found in Russia. In order to minimise the transaction costs for the Scandinavian companies, which hereby result from the institutional environment, the following recommendations have been developed. The aim of the chapter is therefore to create recommendations on how to manage the challenges Scandinavian companies may face in the Russian market.

9.1 Individual Level

Managing Operations – Expatriates

“[...] to get a professional in the leading position, who puts the interest of the company first, is extremely important.” (Company E) “If I had a Scandinavian company, I would send my Scandinavian CEO to Russia, and I would send my Scandinavian CFO [...]” (Company D)

Hidden action may follow if the local manager hire relatives, and thereby let the personal relations instead of the professional competences drive the development of the company. Several respondents therefore argue that it is essential to get a professional in the leading position or on the board, early in the process, in order to assure that the interest of the company is put first. All respondents furthermore agree that it is crucial to send Scandinavian expatriates to Russia in the start-up phase, due to differences in corporate behaviour, mitigating type 3 agency problems. The expatriates are sent since the Russians are viewed to lack entrepreneurial spirit and competences to operate large size projects. Another reason is to incorporate the organisational cultures and reporting structures based on Scandinavian corporate behaviour. It is hereby seen as suitable to send at least a Scandinavian CEO and CFO. However, as the Scandinavian expatriates get a mediating role, the risk for “type 4” agency problems increases, which ultimately may intensify type 1 agency problems if too much pressure is put on the expatriates.
Managing Operations – Local Expertise

“I think that it is a good idea to combine local employees with expatriates.”
(Company D) Our idea [...] is to start with as little as four to ten expatriates and over the following three to five years this should be reduced down to maybe one or two.” (Company B)

Even though the respondents acknowledge the importance of having expatriates, the majority believes that the number of Scandinavians should decrease gradually. According to several respondents, it is essential to have local staff members to handle some parts of the operations. This includes tasks in relation to the authorities and the market, since it is believed that the Russians know how the bureaucratic system works, have expert knowledge of the market and speak the language. Thereby, they can handle it “the Russian way”. It is furthermore seen as relevant in a cost perspective. However, having local staff members will increase the risk of type 3 agency problems, whereas training and incorporating an organisational culture based on Scandinavian corporate behaviour is essential.

Motivation – Russian Staff Members

“If you are to cooperate with a Russian, you have to be very specific about what you want from them. This is probably the most common mistake Scandinavian companies do when they come to Russia.” (Company A)

Due to the hierarchical organisation of the Russian society, it is believed as essential to set up clear guidelines and requirements in regards to the Russian staff members. According to several of the respondents, this concerns following-up on daily operational tasks, strategic objectives as well as budgets.

“There is a large talent pool in Russia with competent and ambitious managers. However, it is culturally decided that they seek approval with their manager. Nevertheless, when they understand that they have the possibility to unfold and to take initiatives, it motivates them, which is very exciting to see.” (Company E)

Due to the Russians’ history of top-down leadership, it is seen as important to make the staff members understand that they have the possibility to unfold and to take initiatives, since it has showed to have a motivating effect on them.
Compensation – Expatriates

“The Scandinavian managers in Russia have a tendency to very quickly become Russian, and too emerged in the Russian way of doing things.” (Expert B)

In order to mitigate the type 1 agency problem it can be argued to be inappropriate to solely make use of output based performance measures, since it may provoke counterproductive behaviour. Sales and the number of stores opened are namely positively correlated with corruptive acts. To decrease the type 1 agency problem it may be more appropriate to increasingly focus on rewarding the Scandinavian managers based on input based performance measures, such as how precisely they follow the Code of Conduct. Alternatively implicit incentive contracts, rewarding the quality of information sent to headquarters, may be used. Adverse selection is a large problem, since it leads headquarters to pressure expatriates too hard for quick returns. Type 1 agency problem can therefore be mitigated if the headquarters have the same amount of information as the Scandinavian expatriates in Russia.

Compensation – Russian Staff Members

“The Russians are not driven by money in the same way as Scandinavians”

(Company A)

The fact that the Russians are not driven by monetary compensation makes it inappropriate to solely make use of pay-for-performance incentives in order to minimise moral hazard and adverse selection in the type 3 and “type 4” agency relationship. However, it can be argued that the market economy will make the Russians less risk averse, making pay-for-performance incentives more relevant in the future. In accordance with the power of informal institutions in regulating human behaviour in Russia, implicit incentive contracts or a combination of implicit and explicit contracts, may be useful. The implicit performance measures include threat of termination and subjective evaluation of superiors and the contracts are enforced by reputation.

“It is difficult to control the action of managers [...] where mainly Russians manage the operations, if you do not trust them. We have a very clear CSR strategy and Code of Conduct of how to handle different situations. Our Russian top manager [...] has participated in the creation of these guidelines and has signed
them. Therefore, there is a genuine back up from his side and a genuine belief from our side that he will handle this.” (Company E)

It is impossible for the Scandinavian headquarters to observe all actions of the Russian staff members and to have the same insight as them in the productive environment. This information asymmetry makes it problematic to accurately reward the managers and to solve the type 3 agency problems through output based explicit incentive contracts. However, by involving the Russian top management in the creation of a CSR strategy and the Code of Conduct, Company E believes that the commitment on both parties increases. Hereby, explicit incentive contracts, with input based performance measures are recommended.

9.2 Company Level

Stakeholder Management

“The biggest challenges in Russia, compared to Scandinavia, are the authorities and government officials. If these are seen as stakeholders to the company, then they definitely constitute the biggest challenges.” (Expert B) “There are several challenges for Scandinavian companies in Russia. For example, the lack of stakeholders providing electricity, and water.” (Company C)

The stakeholder environment in Russia is regarded to be very different from the stakeholder environment in Scandinavian. When entering an unknown market, one should bear in mind that familiar stakeholders may have an unfamiliar behaviour. Several Russian stakeholders are recognised to be of great importance to the Scandinavian companies’ operations, hence it can be argued important to adopt a stakeholder approach. This provides an expertise in understanding how the stakeholders behave, and if they are willing to help or harm the company. By mapping the Russian stakeholders in according to their power and interest, it becomes possible to analyse how these stakeholders may impact operations.

Lobbying

“We handle the situations in Russia by negotiating laws and building roads and bridges. We actively try to improve the system.” (Company C) “We are actively trying to affect political decisions.” (Company E)
The government is regarded to be one of the most important stakeholders in Russia. Different strategies have been identified to mitigate its power and keep their interest low. A strategy used by some of the respondents is to lobby the Russian government. It can be argued that the Scandinavian companies should “team up” with competitors to easier create a mutual dependency between the business world and the government.

Creating Networks

“I think it is important to create networks in the Russian market, I think it is important everywhere, but it is even more essential in Russia.” (Company E)

Creating professional and non-professional networks is mentioned as highly important in Russia. Since the local authorities have both high interest and power to influence Scandinavian companies’ operations, the Scandinavian companies should create networks where the local authorities are included. However, this does not refer to creating contacts that directly can affect decisions. It is more about knowing where to go and whom to ask, especially in regards to the bureaucratic system. By creating a valuable network, the access to the Russian business environment will be greater and it will speed up the time-consuming processes in relation to the bureaucracy.

9.3 Country Level

Market Research

“I do not think that the expectations the Scandinavian companies have before entering the market is in accordance with what they achieve.” (Company D)

Since the Russian business environment is very different from the Scandinavian, it is preferable to conduct a thorough research of the market before entering Russia. The research should be conducted as open-mindedly as possible and with a humble approach that conducting business in Russia is a learning-by-doing process. Therefore, a thorough research of the formal and informal rules regulating economic exchange, prior to the entry, should be combined with a physical presence in the market after the entry. It is important to understand the Russian business environment, in order to minimise the type 1 agency problems, which increase if unrealistic requirements are set for the Scandinavian managers.
Managing the Bureaucracy

“We need to know the laws better than the Russian themselves, and keep track of every little loophole there is.” (Company C)

Because of the heavy bureaucracy in Russia, everything takes a lot longer to accomplish. Due to the time-consuming processes, the respondents state that there is an alternative way to conduct business in Russia, which includes corruptive acts. However, it is seen as important not to fall victim for the corruption, and instead meet all the “foolish” demands. Even though the bureaucratic system is demanding, foreign companies can learn it, since there is a structure in the system. Hereby, by obtaining the required stamps and permits, the informal institutions legitimising corruptive acts will not be enforced. Hence, in the long run the informal norms dictating Russian corporate behaviour may be challenged. A way to minimise the transaction costs in relation to the bureaucracy in the short-term, is to employ Russian staff members on a full-time basis working with issues concerning the bureaucracy. However, it is essential to be aware of the fact that type 3 agency problems may arise. In order to minimise these, the Scandinavian organisational culture should be incorporated in the Russian operations.

Russian Economic Prospect

“[…] it should not be forgotten that only 20 years have gone by since the country went through the transition, both politically and economically.” (Company B)

As the Russian economy is very dependent on oil and gas, the country will probably become more dependent on the surrounding world as the natural resources dry up or the demand for the same decreases. Hereby, foreign companies, including the Scandinavian, will become more dominating actors in the future of the Russian economy. Based on this, the Scandinavian companies should take part in the progress of the economical institutions in Russia. Since change of formal institutions and belief systems in the Russian society are very incremental, long-term investments are necessary, in order to create learning that the highest pay-off is generated by the development of formal institutions protecting civil and political freedom.
10. Critical Reflection

The following chapter critically reflects upon the selected methodology, empirical data and theory, and evaluates their applicability to answering the research question. It is further considered how the results differ or resemble from similar studies within the subject field. Finally, it will be discussed whether the findings may be generalised or applied to situations outside the context in question.

In regards to the methodological choices, it can be argued that a deductive approach could have been applied. Based on the problem discussion and the literature review, a specific hypothesis could have been developed on why Scandinavian companies face operational challenges in the Russian market. Hereby, a specific theory could have been tested valid in relation to the hypothesis. However, as mentioned in chapter 3, a positivist epistemology is not seen as suitable to apply when analysing social reality. The risk of applying a deductive approach is furthermore that the chosen theory might not be the most suitable one to explain the identified problem. Hereby, given that the literature review supported the initially assumed complexity of the identified problem, and since the objects of study were humans and institutions, the deductive approach was not seen as suitable. Furthermore, in line with a deductive approach is quantitative research. This type of research would have enabled a statistically significant result, which could have been easily generalised. However, it would thereby de-contextualise the findings without generating in-depth knowledge, meaning it would only be possible to described as opposed to understand the corporate behaviour. Additionally, according to the scientific approach, humans possess preconceptions about phenomena in the world based on previous experiences. Hence, an entirely inductive research was not possible either.

It can be argued that the analysis would have been more gradate if Russian respondents would have been included in the study as well. The Russian actors’ view on differences in corporate behaviour between Russia and Scandinavia could thereby have been compared to the Scandinavian respondent’s view on differences. Hence, more accurate recommendations could have been created. However, according to social constructionism, an actor’s perception of the world is the reality for that specific actor. It is hereby not possible to define an objective
truth. Therefore, all research has to be conducted from a certain point of view, and as the research project has been written from the Scandinavian headquarters’ point of view, it is seen as less relevant to investigate the Russian actors’ perception of the situation. A study including Russian respondents can therefore rather be seen as a suitable extension of the research project, than an alternative.

Even though the explorative relationship, in Figure 1, was regarded as fairly broad, the collection of primary data, with the aim to find the most compelling explanation, narrowed down the choice of theories applicable to answer the research question. On the basis of the primary data, it was understood to be inappropriate to take on an all too broad theoretical approach, such as for example Actor-Network Theory. Nor was it suitable to apply an all too narrow theoretical stance, such as for example Game Theory. In order to answer the research question, it was hereby seen as appropriate to find a fair balance between the two extremes and to understand the interconnection between the three levels of investigation, found in Figure 1. Hereby, the chosen theoretical framework was appropriate to answer the research question.

The research project is believed to resemble previous studies in the sense that it considers the formerly studied connection between agency-theory and stakeholders as well as the relation between agency-theory and institutional theory. However, the research project differs from previous research since it does not look upon the connections separately, but considers the influence of all of the above-mentioned theories on corporate behaviour, resulting in the ISC framework found in Figure 7. Furthermore the combination of theories has not been applied to the subject area in previous research. The research project hereby aims to approach the key challenge of research within the field of emerging market economies. Meyer and Peng (2005) identified this challenge to be the development of a theoretical tool for analysing the influence of relevant institutions, hierarchies, stakeholders, and control mechanisms on private companies’ strategies.

Based on the nature of a qualitative study, it can be argued that the findings from the research project are not transferable to other contexts. Hereby, the results can only be generalised to other Scandinavian companies operating within the business-to-consumer segment, offering products and services on the Russian market. However, it can be assumed that the findings
may be useful for Scandinavian companies, within the business-to-consumer segment, wanting to operate in markets with similar characteristics as Russia. For example, in terms of similar economic-political history, lack of transparency and bureaucratic system. The ISC framework, and the recognition of a “type 4” agency problem, is furthermore seen to be applicable outside the context of the research project, since it is regarded useful to apply for companies aiming to operate in unfamiliar business environments.
11. Conclusion

The aim of the research project has been to investigate why Scandinavian companies, within the business-to-consumer segment, face operational challenges in Russia and how the Scandinavian companies may manage these challenges. Through the introductory case, an operational challenge was exemplified, which was to be explained by agency theory. Taking point of departure in agency theory, it was evident that operational challenges, for Scandinavian companies in Russia, had to be understood by taking on a wider context-specific perspective. Hereby, it was regarded suitable to address the operational challenges at three levels: the individual level, the company level and the country level. The primary data further indicated that agency theory at an individual level had to be complemented with stakeholder theory at the company level and institutional theory at the country level, in order to grasp the complexity of the Russian business environment.

Based on the analysis, the ISC framework was developed, which clarifies how the three theories explain the operational challenges found, by emphasising the theories’ interrelation. Hereby, the ISC framework aims to answer the primary research question: why Scandinavian companies face operational challenges in Russia. According to the ISC framework, the institutional environment in Russia influences the corporate behaviour of Russian stakeholders, which in turn creates challenges to the Scandinavian companies. Russia’s institutional environment is a product of its political and economic history and it is evident that the formal institutions are yet not successful in regulating economic exchange. The corporate behaviour of the Russian stakeholders is therefore a consequence of the informal institutions’ regulating power. The informal institutions created are not economically efficient, since they do not support a market economy. Hereby, the lack of effective informal institutions supporting the formal institutions enforces the transaction costs associated with the Russian market. Since the Russian stakeholders are familiar with the institutional environment, the transaction costs are argued to be higher for the Scandinavian companies. The Scandinavian companies are used to an institutional environment where the formal institutions are superior to the informal, in regulating economic exchange. Hereby, the reason why the Scandinavian companies are facing challenges in the Russian business environment is that their corporate behaviour differs from the Russian stakeholders’ corporate behaviour.
The differences find expression in the “type 4” agency problem, between the Scandinavian manager and the company’s Russian stakeholders.

In order to answer the second research question, the analysis has shown that managerial implications exist on the individual, the company and the country level. On the individual level it is crucial for Scandinavian companies to consider the balance between employing expatriates and Russian staff members. By formulating suitable remunerations in order to motivate the Scandinavian expatriates, as well as the Russian staff members, the associated agency problems will be mitigated. On the company level, the “type 4” agency problem emphasises the importance of taking on a stakeholder approach, in order to analyse how the Russian stakeholders may impact the operations of the Scandinavian companies. It is evident that a mutual dependency exists between the Scandinavian companies and the Russian government, meaning lobby activities can be fruitful to improve the institutional environment. Furthermore, creating a network including the local authorities provides greater access to the Russian business environment and is a mean to handle the bureaucracy. On a country level it is essential to thoroughly investigate the Russian business environment, in order to minimise the type 1 agency problems. By understanding the Russian business environment and the bureaucratic system, the Scandinavian companies can oppose the corruption and ultimately challenge the informal norms regulating economic exchange. This is seen as achievable, since foreign companies, including the Scandinavian, will become more dominating actors in the future of the Russian economy.

The findings from the research project show that great growth opportunities exist for Scandinavian companies operating within the business-to-consumer segment in the Russian market. The opportunities are foremost related to the increasing demand for western goods and services and the affluent middle class. However, vast challenges prevail in the Russian business environment, which are founded in the lack of efficient institutions. It is hereby argued that the findings from the research project are significant for Scandinavian companies aiming to operate in the Russian market.
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13. Appendices

13.1 Interview Guides

13.1.1. Interview Guide – Expert B and C

Introducing questions
- Can you tell us about your position in the organisation and your daily tasks?
- For how long has (the organisation) been working with projects in the Russian market?
- Why do you find Russia interesting?

Follow-up questions
- What do you believe are the main reasons for Scandinavian companies to enter the Russian market?
- How do you believe that the companies’ expectations fit with the reality of doing business in Russia?
- In what way is Russia perceived as a strategic market?
- What part of the value chain is in focus?

Probing questions
- Can you give an example of a company that has been successful in operating in Russia?
- Can you give an example of a company that has been less successful in operating in Russia?
  o Why do you believe that the first company succeeded and the other did not?
  o Do you think that this is a frequent problem for Scandinavian companies?
  o Did (the organisation) invest as a partner in any of the companies you mentioned?
  o With these experiences would you have handled the situation differently?

Specifying questions
- What do you believe are the main challenges of operating in the Russian market?
- How do (the organisation) approach these challenges?
- How do you believe that other Scandinavian companies in general handle the challenges you have mentioned?

Individual Level

Direct & indirect questions
- Do you believe that there is a difference in what is viewed as appropriate corporate behaviour in Scandinavia compared to Russia?
- Do you believe that Scandinavian managers operating in Russia find it difficult to handle these differences?
- Do you know of situations where a Scandinavian company that has had problems with upholding their ethical standards?
- Have you experienced a situation where you felt that it was difficult to uphold (the organisation’s) ethical standards?
o What is (the organisation’s) attitude towards monetary compensation in business relationships?
  o How do (the organisation) handle the situation of corruption in Russia?
  – Could you imagine a situation were (the organisation) would withdraw from Russia?
  – What difference does it make to have a Scandinavian manager in charge of the operations compared to having a Russian manager?

Structuring question: I would now like to introduce another topic…

Company Level

Direct & indirect questions
  – Compared to operating in Scandinavia, which stakeholder relationships do you believe are associated with the highest degree of uncertainty?
  – Which stakeholder relationship has shown to constitute the most surprising challenge?
  – How important do you believe it is to have a network of stakeholders to succeed in the Russia market?
    o How do you create this business network?
  – Is there a stakeholder that has crucial influence on the management of operations?
  – Do you believe that everybody compete on mutual terms in the Russian market?
    o Do you believe that Russian officials favour Russian competitors in any way?
  – Do you believe that personal relations are more important for success in Russia than it is in Scandinavia?

Country Level

Direct questions
  – How do you believe that the Russian cultural values influence the business exchange?
    o Can you think of a situation where this was evident?
  – How effective do you believe that the laws in Russia are in regulating economic exchange?
  – What do you believe is the biggest challenge, the difference in the legal framework or the difference in cultural values?
  – How would you describe the economical and the political situation in Russia?

Structuring questions
  – Getting back to...
  – I would now like to introduce another topic…

Silence
  – Allow pauses to give interviewees time to associate and reflect and break the silence themselves.

Interpreting questions
  – You then mean that…
  – Is it correct that you feel that…

Doorknob question
  – How do you view the future development of the Russian economy?
13.1.2 Interview Guide – Companies

Introducing questions

- Can you tell us about your position in the company and your daily tasks?
- For how long has (the company) been present in the Russian market?
- Have you been with the company during the entire time the company has been present in Russia?

Follow-up questions

- What was your attitude towards your company planning to conduct business in Russia?
- How did your expectations fit with the reality of doing business in Russia?
- What were the reasons for (the company) to enter the Russian market?
- In what way is Russia perceived as a strategic market?
- What part of the value chain is in focus?

Probing questions

- Can you give an example of a situation where the cooperation with a Russian stakeholder has been successful?
- Can you give an example of a situation where the cooperation with a Russian stakeholder has been less successful?
  o Could you say something more about that?
  o Can you give a more detailed description of the situation?
  o Do you have further examples of this?
- What consequences did this have for your company’s success?
- With these experiences would you have handled the situation differently?

Specifying questions

- What do you believe are the most difficult challenges of operating in the Russian market?
- How has (the company) approached these challenges?
- How do you believe that other Scandinavian companies handle the challenges you have mentioned?

Individual Level

Direct & indirect questions

- What plans do the headquarters have for the operations in Russia?
  o Do you believe that it is possible to execute these plans?
- When you make a decision on behalf of the company. In what situations do you ask for advise from your superiors in Scandinavia and when do you make the decision independently?
- Do you know of situations where a Scandinavian company that has had problems with not upholding the ethical standards?
- Have you experienced a situation where you felt that it was difficult to uphold (the company’s) ethical standards?
  o What is (the company’s) attitude towards monetary compensation in business relationships?
  o How do (the company) handle the situation of corruption in Russia?
- Could you imagine a situation were the company would withdraw from Russia?
- What difference does it make to have a Scandinavian manager in charge of the operations compared to having a Russian manager?
- You possess information about the Russian market, which your superiors do not possess. How selective are you in the report of this information to your superiors?

**Structuring question:** I would now like to introduce another topic…

*Company Level*

**Direct & indirect questions**
- Compared to operating in Scandinavia, which stakeholder relationships do you believe are associated with the highest degree of uncertainty?
- Which stakeholder relationship has shown to constitute the most surprising challenge?
- How important do you believe it is to have a network of stakeholders to succeed in the Russia market?
  - How do you create this business network?
- Which stakeholders have the biggest influence on your decision making process?
- Do you believe that everybody compete on mutual terms in the Russian market?
  - Do you believe that Russian officials favour your Russian competitors in any way?
- Do you believe that personal relations are more important than professional relations?

*Country Level*

**Direct questions**
- How do you believe that the Russian cultural values influence the business exchange?
  - Can you think of a situation where this was evident?
- How effective do you believe that the laws in Russia are in regulating economic exchange?
- What do you believe is the biggest challenge, the difference in the legal framework or the difference in cultural values?

**Structuring questions**
- Getting back to…
- I would now like to introduce another topic…

*Silence*
- Allow pauses to give interviewees time to associate and reflect and break the silence themselves.

*Interpreting questions*
- You then mean that…
- Is it correct that you feel that…

*Doorknob question*
- How do you view the future development of the Russian economy?
13.2 Travel Guide Moscow

Moscow 29/5 – 2/6

Holiday Inn Moscow Lesnaya – Гостиница
15 Lesnaya Street
Moscow 125 047
Лесная улица, 15, г.
Москва, Россия
Telephone: 7 (495) 783-65-00
Monday 31/5

**Yellow Pages – Filip Engelbert**
Тверская, 16. Бизнес-центр Galleria актер.
**Telephone:** +79261181472

**Road description:** Travelling time approx. 15 min. Walk to tube 6 min. Walk southeast on: ул. Лесная towards пер. 1-й Лесной, 280 m. Turn right at: пер. Заставный, 44 m. Tube: Замоскворецкая линия -Direction: Красногвардейская. Every 3 min. Service by: Московский Метрополитен. Departure from Белорусская. 3 min. Arrive at: Тверская Exit: в Тверской Пассаж. Walk to: Tverskaya ulitsa, 16, gorod Moskva, Russia. 6 min
Rezidor Hotel Group – Arild Hovland
Business Center “SHEREMETIEVSKY” 3rd Floor, 10 Nikolskaya Street, 109012 Moscow
10 Никольская д. 3. этаж, Москва, Московская область 109012 Россия

Road description: Travelling time approx. 15 min. Walk to tube 6 min. Walk southeast on: ул. Лесная towards пер. 1-й Лесной, 280 m. Turn right at: пер. Заставный, 44 m. Tube: Замоскворецкая линия - Direction: Красногвардейская. Every 3 min. Service by: Московский Метрополитен. Departure from: Белорусская. 5 min. Arrive at: Театральная та avfart на ул. Охотный ряд, ул. Б.Дмитровка и Театральный проезд. Walk to: 10 Nikolskaya St. 3. floor, Moscow, Moscow Oblast 109012, Russia. 10 min
Swedish Trade Council – Andreas Nilsson
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ул. Пречистенка 40/2, строение 1, 6 этаж, 119034 Москва
Telephone: +7 495 788 11 30
Wednesday 2/6

IKEA – Martin Lundvall & Håkan Pehrsson
Leningradskaya street, 39, build.5 Kimchi, Moscow Region, 141400
Ленинградская улица, 39, Химки, Московская область, 141400

Homeward Journey
Sheremetyevo Moscow Airport
Аэропорт Шереметьево