

**Paper to be presented at the EACES 10th Conference “Patterns of Transition and
New Agenda for Comparative Economics”
Higher School of Economics, Moscow, Russia, August 28-30, 2008**

Session CSF-07: “Business-State Relations in Transition Economies under Global Competitive Pressure”

Managing the Relations of Business Firms with the State across Spatial Institutional Discontinuities: Finnish Firms in the Rapidly Developing Markets of Russia, Estonia and China

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Abstract

The paper analyses the relations of transnational companies with the state in their host countries. The focus is on foreign firms operating in the rapidly changing markets of former state socialist countries. In more detail, we investigate and compare the relations that Finnish companies have with the state in Russia, China, and Estonia. The three rapidly developing economies are challenging for foreign investors as they have considerably reorganized their formal institutional framework and the role of the public sector in business. Theoretically, our study contributes to the governance approach of institutional economics, especially to the discussion on formal and informal institutions in the organization of social relations of foreign companies, as well as relational economic geography. The study identifies the challenges and problems in the relations that foreign firms have with the state in the three host countries. Furthermore, we point out successful mechanisms of governance, i.e. the ways in which problems arising from the institutional context in the host country have been solved in the companies under investigation. Empirically, our analysis is based on a database of interviews with transnationalized Finnish companies that represent various company sizes and lines of business. The findings reveal similarities and differences in the governance mechanisms in terms of the three emerging economies. Drawing from evidence from the three economies with different processes of restructuring, the study points to the diverse roles of formal (e.g. rule-based) and informal (e.g. relationship-based) institutions in business.

Keywords

State relations, governance, institutions, emerging markets, foreign companies

This paper results from the project “Companies’ Social Relations as a Component of Local Business Strategies: Innovative Integration Strategies of Finnish and Russian Companies”, funded by Academy of Finland (grant No. 118538) and Russian Foundation for Humanities.

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Introduction

As a fundamental element of the globalization of the world economy, there has been an intensifying tendency in recent years for companies from Western European countries to relocate their operations to the rapidly developing markets of Eastern Europe and Asia. In theoretical terms, such situations open up possibilities to discuss the relations of two very different ways of investigating the transnationalisation of firms: the approach that pays attention to differences in institutional contexts, and one of relational economic geography. Sunley (2008) has recently argued that while the recently blooming relational approach in economic geography definitely has its merits, it should not be seen as an overriding ontological perspective that does not leave space to discuss other ontological approaches, that are, for Sunley, most notably represented by critical realism. In this paper, we address the issue of what would a combination of the two perspectives, that of a relational network approach and an institutional regionally specific approach turn out to be like in the analysis of the transnationalisation of firms. The core idea of such an exploration is to emphasise that regional formations, that are conceived of as products of extensions of networks rather than pre-given territorial entities, guide the extension of networks to certain extent. In his examination of transnational law firms, Faulconbridge (2008), as well, takes a step towards this direction, and emphasizes the roles of case-specific practices, and workers, managers, and professionals, in shaping the behaviour of transnational firms in new contexts by stating that 'Negotiations between contending parties who are trying to deal with clashes in institutionally informed perspectives determine the approaches that are used to manage business practices. Only by understanding the nature and outcome of such negotiations can we understand the reciprocal effects of host countries and TNCs on one another. Hence, mapping the degrees of difference between national business systems as a way of understanding these impacts without analyzing the influence of the actors involved is simplistic' (ibid., 206).

The relational approach definitely has opened up new avenues for improving our understanding of the transnationalisation of firms and understanding the essence of regions (e.g. Amin 2002). Yeung (2000) has made an effort to reconceptualise the transnational company (TNCs) from a command-and-control type of organisation into a networked entity. His focus is on intra- and inter-firm networks as a part of the operations of foreign companies in the relocation of their businesses to new socio-economic contexts. As Yeung (2002) has rightly argued, globalisation should not be so much used as an explanatory factor for occurrences, but as a process

to be analysed: ‘globalization is a spatial phenomenon worthy of further explanation, but it is certainly not a spatial explanation for empirical outcomes’ (ibid., 301). He develops a geographical perspective for analysing globalisation as an empirical, material and discursive phenomenon. It is this process of globalisation or ‘transnationalisation’ into which we seek to contribute in this paper by analysing the ways in which business firms, during their transnationalisation activities, aim to manage, control, adapt to and adjust their social environment.

On the other hand, recent criticism toward relational economic geography has pointed out that ‘relational insights should be developed within an evolutionary institutionalism that is informed by critical and pragmatic realisms’ (Sunley 2008, 3). Furthermore, Sunley argues that ‘The pressing task is to blend and combine network approaches with other institutionalist and evolutionary approaches’, and that ‘it would be productive to examine how economic relations and networks vary among different national, regional, and local expressions’ (ibid., 11).

In this paper, we seek to elaborate on this theoretical niche falling between institutional and relational micro-level analyses by exploring, through a specific empirical case, the process of transnationalisation of firms. We focus particularly on one specific form of relation in business activities: that between firms and the state. Our empirical aim is also to analyse the ways in which Finnish business firms have been (and are) adapting to new social and economic settings in countries with rapidly growing markets. These economies either are post-socialist, or applying a version of socialism in which the transition into the market economy is guided by a considerable intervention by the central state. Such economies have also been labelled as transition economies or emerging markets. Our regional focus is in post-socialist Eastern Europe and emerging Asia. Specifically, we explore the complex process of organization of the relations that companies have to state authorities at various levels of administration, ranging from the local through the regional and national to the transnational. Our comparative focus is on three countries: Estonia and Russia in Eastern Europe, and China in emerging Asia. Despite superficial similarities of former socialism, these countries form a complicated variety of societal settings. The Russian Federation is politically and economically by far the most significant successor of the Soviet Union and represents a combination of post-Soviet market liberalization and re-increasing state control under President Putin’s regime since the turn of the 21st century. Estonia simultaneously represents a post-Soviet context and, since 2004, it has been a member country of the European Union. China, in turn, has been rapidly transforming into a state-controlled market economy. In all the three countries, the central state has, during the past 15 years, been restructuring from a strong state

towards a situation in which there is either less state control over the markets, or towards a different form of state, that still aims to maintain a strong control over businesses. Nevertheless, it is clear that in all these countries the state has been evolving towards a more freely functioning market economy that is more open to the global economy. This has created space to new state practices at the local and national scales. At the same time, in recent years the countries have provided increasingly lucrative investment locations for companies from a member country of the European Union, Finland. In this paper we seek to explore the socio-spatial patterns incorporated in the processes of relocation of companies from Finland into these countries and, specifically, the management of the relations that the companies have to the state institutions and organizations in these destination countries. Within this context, we aim to theorize the issue of how do spatial institutional settings guide the extension of networks by networked firms.

In terms of empirical analysis, the study draws on a longitudinal qualitative analysis of interview data. The qualitative analysis of this material aims to point out the aspects that Finnish companies have found most challenging in their relations with the state when they have been operating in the reforming countries of Russia, Estonia and China. The primary data consists of interview records from the database of the Centre for Markets in Transition of the Helsinki School of Economics in Finland. This study yields data from Finnish companies of which 51 were operating in Russia, 47 in Estonia and 37 in China. The data collection was performed by interviewing respondents between 1995 and 2005 with semi-structured open-ended questions. The open in-depth interview was chosen as the data collection method to allow the respondents themselves to identify the key problems and solutions in managing the relations that the firms have with the state. The data was transcribed and handled anonymously. In addition, secondary data such as companies' annual reports, other documents, and newspaper articles were used as supplementary information. As in qualitative analysis in general, the research process involved the coding of the interview material. In this study, data that referred to problems and solutions in the relations of the firms with the state were picked out from the empirical database. The relevant data was coded, i.e. broken down into discrete chunks (Malhotra & Birks 2005), and analytical categories were produced from the respondents' statements. Findings were grouped according to relevant categories related to challenges and solutions, and were then compared between Russia, Estonia and China. We do not differentiate in this paper between firms in different lines of business, but analyse these issues on an aggregate level.

Spatial institutional discontinuities and the challenges of the contexts of rapidly developing markets to Western firms

It is an essential element of the globalization of the world economy that companies from Western European countries are seeking to relocate their operations to the rapidly developing markets, as we call them, of Eastern Europe and Asia. The relocating firms are in search for lower production costs or new markets for their products in the rapidly developing markets. The state administrations of these countries are, at the same time, competing for globally circulating capital. Finland, a member country of the European Union since 1995, is among the countries that have been losing production of bulky goods to countries with low production costs, and Finnish enterprises have also been aiming to extend their operations to new markets².

While the ultimate reason for the relocation of business operations may vary, companies are always faced with the challenge of managing their relations to the various institutions of the destination countries. This can be seen as a basic feature in the processes through which firms transnationalise themselves, and even if drawing from a relational network perspective, sensitivity to the issue of differences institutional contexts will help in understanding the moments of transnationalisation of firms (cf. Faulconbridge 2008). Sunley (2008, 11) states that ‘it is [...] fruitful to see institutions as sets of durable systems of social rules and conventions that are constituted by habits and that structure social interactions’. Consequently, ‘such a perspective allows us to search for the rules that underlie different varieties and types of economic connections and try to understand how these rules evolve over time’. In our empirical setting, transnationalizing Finnish firms are relocating their businesses from an institutionally stable corporatist market economy of their home country to the institutional turmoil in the rapidly developing markets. As a result, the firms face situations that we call spatial institutional discontinuities: as the firms set up new operations in new countries, they have to adapt their operations to new institutional environments. These spatial institutional discontinuities, however, can be seen as two-dimensional: not only do they take place across territories, but also across scales. It has become usual to take for granted that national institutional contexts vary, but

² Finland itself emerged from an agriculture-dominated economy into an industrialised Nordic welfare state in the decades following the Second World War. This development culminated in its EU membership in 1995 at the same time with two other geopolitically neutral countries, Sweden and Austria. Finland was also able to develop into a global technological leader in sectors such as paper production and, later on, mobile phone technology.

discontinuities in institutional coherence can be conceived of as occurring also across scales from local through regional and national to the transnational. Evidently, scales do have characteristics that drive them towards coherence, even if such coherence is always challenged and it should be dealt with critically as an criterion for an analytical category (cf. Amin 2004; Faulconbridge 2008).

The situation in the rapidly developing markets is complicated by the fact that in the host countries the institutional setting is being restructured at a very fast pace. Furthermore, spatial institutional discontinuities have particular implications for the relations of firms with the state, labour, and other firms in the host countries. In the relations with labour, for example, the various institutional environments in the emerging markets have created diverse needs for the Finnish parent companies to hold control over the operations in the host countries (Karhunen et al 2008; Kettunen et al 2007). In other words, the relations of the firm to the public sector of the host country are potentially challenging especially in rapidly developing markets, where the state sector may be transforming from a planned economy towards a more liberal market economy (e.g. Kosonen 2002; 2004). This may create specific problems for foreign companies operating in the host economy, and a need to adapt to the local business environment. Often the solution is related to networking and even personal relations with local authorities.

Since Finnish firms come from a very different institutional environment than the one that is in place in their host countries in the rapidly developing markets we are particularly interested in exploring what is the adaptation like that is needed in firm-state relations in the rapidly developing markets in question. We specifically wish to focus on the adaptation of the relations of firms and the state in such new conditions, for transnational businesses do have relations with the state in their home country as well. Furthermore, it is not only the firm that has to modify its activities according to the conditions in the host location, but the state as well has to modify its own institutions and activities if it wishes to attract foreign capital, as is the case with rapidly developing economies. Due to the spatial institutional discontinuity, the relations between the firm and the state are necessarily different from what they are in the home countries from which the firms originate and in which their headquarters are located. The relations consist of the ways in which firms have to take into account the regulations of particular states, but also the more unofficial ways of proceeding in the context, that is, with specific authorities and also other firms. On the other hand, the relations work also other way, as the state has to take into account the expectation of firms. An example of modification of state institutions is tax concessions for foreign direct investments.

In order to get deeper into an analysis of the processes through which firms aim to solve the problems of spatial institutional discontinuity, we define four sets of issues we will explore in more detail. They begin with an overview of the macro-scale situations in the rapidly developing economies, and proceed step by step towards a closer micro-scale analysis of the ways in which the companies seek to overcome problems of spatial institutional discontinuities in the new institutional settings.

The first set of issue concerns the transformations that have been taking place at the governance systems of the state in the host countries. This is an macro-scale overview of the situations that the firms face. The main question is how formal institutions have transformed at each spatial scale. We are particularly interested in exploring, on one hand, how goal-oriented has the restructuring of the central state been and, on the other hand, what is the role of state practices in organising relations with business at the local and transnational scales. Second, based on the first point, we aim to investigate what are the state-related institutional challenges that firms face at each spatial scale due to the supposed spatial institutional discontinuity. The third set of issues deals with the ways in which companies have been able to come to terms with the new institutional environment. For the analysis of this issue, formal and informal problem solving are both relevant points of focus, as countries in institutional turmoil are often characterized by various informal forms of production and governance (Moulaert 1996; Peck 2000). Finally, we wish to explore which scale is decisive for organising business-state relations. For example, we examine whether local practices can mitigate problems caused for firms by the central state in its dealings with the business environment. Moreover, there is a question of whether state practices at an international scale can alleviate problems caused by the central state. Throughout, these issues are also questions of networks, as the encounters of firms and the state take place through concrete practices that are carried out by agents: managers, workers, and officials (cf. Faulconbridge 2008). Therefore, our analysis concerns a specific form of relation: one between firms and the state, and the relational networks that make this relation possible in particular situations.

Encounters of networked transnationalising firms with institutions

There has recently been relatively much discussion within economic geography on how firms transnationalise. This discussion has focused on topics such as how firms organize their relations with their subsidiaries (Yeung 2000), how enterprises organize their internal knowledge transfer

and information flows (Beaverstock 2004), and what is the role of face-to-face interaction in transnationalising firms (Jones 2006). What we wish to bring more light into is a focus on the relations of firms to the state at its various scales. These relations are important as a transnationalising firm is necessarily faced with the question of how to organise its management practices to the authorities in the host countries, since various forms of regulation of business activities are always practiced by the state.

We argue that although scales have been downplayed as an analytical category in some debates drawing from relational analyses (e.g. Amin 2002), they are important for understanding how a networked firm encounters a particular settings while it is extending its networks. Hence, we approach the process of relocation of business operations, and the resulting relations of companies to state institutions and organizations, through an analysis of multi-scalar governance that is informed by an understanding of relational networks. We wish to argue that a conceptual division between institutions and actors or organizations that have essentially spatial characteristics is still useful. An institutional perspective on business strategies focuses on the dynamic interaction between organizations and their institutional environment, and considers strategic choices as the outcome of such an interaction (Peng 2000). Therefore, strategic choices are driven not only by firm-specific resources and capabilities that traditional strategy research emphasizes (Barney 1991; Porter 1980), but are also reflections of the formal and informal constraints of a particular institutional framework that decision-makers confront (North 1990; Oliver 1997; Peng 2000; Scott 1995). Hence, the institutional perspective on business strategy does not question the role of enterprises as exercising strategic action, but points to the importance of institutional constraints for such action. Enterprises as organizations may to a certain degree select to which institutional pressures to respond and how (Oliver 1991). However, gaining a firm foothold in a challenging institutional environment, such as a transition economy, requires often a major strategic adaptation from a foreign enterprise. Given the constraints and enabling structures of particular institutional frameworks in particular locations, we are faced with the question of how, exactly, firms interact with the state in a new institutional setting. We engage with this question in what follows.

From a non-networked spatial perspective, North (1990, 3) defines an institutional framework of a nation as ‘the rules of the game in a society’. Institutions can be divided into formal institutions that include, for example, laws and regulations, and informal institutions that point to customs, norms and cultures. Both provide constraints for actors when they pursue their

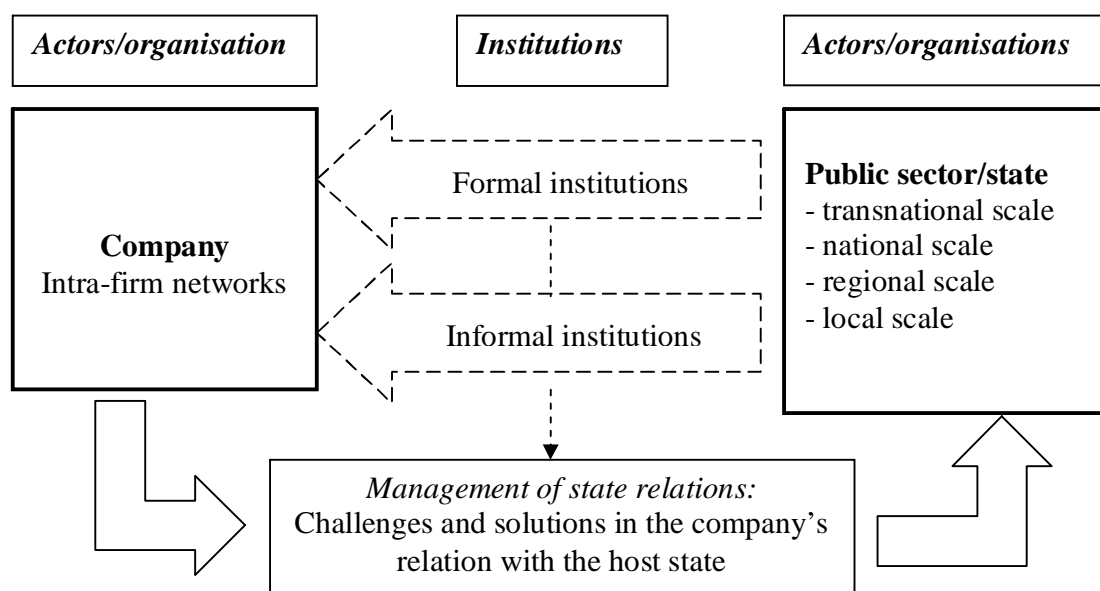
own interests. The formal rules provide the 'rule book' for the game, whereas informal practices represent a commonly understood way in which the written rules are interpreted and applied when playing the game. A few qualifications are needed, however, in order to build the framework for the analysis of institutions. To a certain extent, institutions are spatially bounded: they are limited by state boundaries and by boundaries of social groups, as is implicated by the notions of nation and society. Institutions such as legal regulations are, indeed, often formally limited by state borders (Faulconbridge 2008). Even if the creation of institutions may take place over time as a networked activity, they are temporarily stabilized as territorially bounded rules. It can be argued that it is a prescriptive aim of institutions to have effect within certain territories. Informal institutions do not have such formally defined prescriptive qualities. However, customs, values and norms may also be limited to certain spatial, often territorial, formations. This is something that occurs in people's perceptions rather than formal pronouncements. Moreover, both formal and informal institutions are scaled entities. Formal institutions may be seen as varying at different levels of organisation of the state: regional and local regulation may, especially in turbulent contexts such as post-socialist transformations, appear to be in contradiction to national regulation. Informal institutions may draw from people's perceived identities in relation to places they inhabit, be it local community, region or nation, even if such identities are understood as social constructions and they may be even abused for purposes of defining the limits of groups of people (Amin 2004). Moreover, institutions should be understood as being constructed with certain scalar relationality. Occurrences and institutional transformations at one scale have repercussions on transformations on other scales.

In our study, the state sector of the three emerging markets is characterized by various territorially bounded configurations of formal and informal institutions at all spatial scales. These configurations affect the operation of foreign firms. Such configurations range from international trade and investment agreements at the supranational scale to national and regional regulation of business. The configurations also include institutionalized practices at the local scale when the formal institutional framework derived from the national scale is being applied locally.

In order to analyze the impacts of formal and informal institutions on foreign firms in given locations, we need to draw from the governance approach (Jessop 1995; 1997; Amin and Hausner 1997; Jessop 1995; Kosonen 2002; 2005; Kettunen et al 2007). Governance refers to the various coordination mechanisms that actors use in order to mitigate problems in mutual relations, and to create shared understanding and joint practices in cooperation. In other words, governance

is a process where disparate, but interdependent agencies are coordinated to achieve specific economic, social and political objectives. In our analysis of governance in economic action, we focus on the various challenges that undermine relations between actors, and the practices they develop for dealing with these challenges. Hence, our study on the relations of foreign firms with the public sector is based on a conceptual framework in which organizations include business firms and public sector authorities, and the relations of these organisations are mediated by institutional practices in which actors operating within the organisations take part (figure 1). As public sector authorities are structured at multiple scales, companies' relations with them must also be organized at and through several spatial scales.

Figure 1. The governance of state relations in the host economy



Source: Modified from Kosonen 2002; 2004; Kettunen et al. 2007

The coordination of the relations of a company with the state sector is affected by both formal institutions, that is, state-centred rules, and informal institutions that incorporate the enforcement of formal rules, practices, and socio-cultural characteristics. These rules are not only specific to each host country but may also vary according to other spatial and social divisions. As an example, a Chinatown in a specific city may have a different informal institutional setting compared with

the mainstream informal institutional structure of its surroundings. These formal and informal institutions impact on the coordination of the relations that a foreign firm has with the public sector. Problems induced for a firm by formal and informal institutions of the host economy give rise to challenges in the relations with the state that are specific to each business environment. From the perspective of the firm, success in the governance practices that concern the relations of the firm with the state depends on the ability of actors to solve the problems: governance fails when problems remain intact, and it succeeds when problems are solved.

As is illustrated in figure 1, the relations between the company and the host state are an outcome of the interaction within a framework in which the organizations operate at several spatial scales. These relations result in challenges and potential solutions in the overall relation of the company with the public sector. Institutional theory is well-equipped for providing insights on a general level into these relations but lacks middle-level conceptions that would help understand how firms develop their relations with public authorities. What needs to be done is to analyse the concrete processes through which transnationalising corporations interact with public authorities in the host countries. On the daily level of interaction, institutions are also constantly being reproduced by networks. Moreover, institutions are dependent on networks in order to be able to have effect on actors over space. In this sense we can conceive of them as institutionalised networks. Therefore, for the purpose of understanding the daily interactions of businesses with state institutions, we introduce the concept of management of state relations. It refers to the ways in which companies communicate with and take contact to public authorities in locations where they are establishing operations.

The management of state relations includes at least four issues. Firstly, there is creation of knowledge concerning formal rules at the national, regional and local scales in the host countries. This includes especially national and regional legislation. Beaverstock (2004) has explored the issue of knowledge management in multinational firms. Secondly, setting up of networks is important in order to cover linkages to public authorities. The issue of how transnational companies organise relations to their subsidiaries by networking has been explored by Yeung (2000). Thirdly, face-to-face contacts are important (cf. Jones 2007). Firms are often dependent on good personal relations to state authorities. This applies with different intensities in different cultures. Finally, this interaction has to lead to creation of trust between parties. We wish to argue that such a conceptual framework helps to break down the relatively abstract and general theoretical equipment of formal and informal institutions. It also helps to analyse what actually

takes place in the interaction of firms and the state in the process of transnationalisation of firms. In short, it turns the focus on the practices of firms in their endeavours to control the situations in which they operate (cf. Faulconbridge 2008).

Finnish firms in rapidly developing markets

Next, we focus on the experiences Finnish firms on their relations with the state at several spatial scales in the host countries. Especially, we examine the problems and challenges that managers of the firms identify in the relations of their companies with the state, and the means that have been created for dealing with these challenges. Our aim in this empirical analysis is to highlight the most relevant issues that the firms have with the public sector in the emerging markets of China, Russia and Estonia, rather than provide a full account of all the dimensions included in the conceptual model. In our investigation of the practices, problems and solutions in the relations of business firms with the state, we remain sensitive to dimensions of temporality. The empirical analysis includes not only information on the current situations in the relations that the firms have with the state in the host countries, but also pays attention to practices during the past 15 years, after the turning point from state socialism toward market capitalism in Russia and Estonia. The inclusion of such a historical perspective will help evaluate the persistence of country-specific features.

Scalar transformations of state governance

Our first set of issues outlined above deals with the transformations of formal institutions at several spatial scales. In all three national economies in question, the formal institutions of the nation-state have been significantly restructured since the turn of the 1990s. In all of these countries, China, Russia and Estonia, the state has transformed its behaviour towards private foreign firms. There has been a transformation from a strong presence of the state to either less state involvement in the operation of firms, or to a different kind of a state. However, there is considerable country-specific variation in the ways in which interaction occurs between firms and the state across spatial scales. This variation is related to four issues. The first difference concerns goal orientation. Estonia and China have clearly been goal oriented in their restructuring processes. With its prospective membership in the European Union, Estonia adopted a liberal

market economy at once during the 1990s, while China decided to employ a socialist market economy that would, it was assumed, bring benefits for the national economy. Russia, in contrast, was less oriented towards clear goals in its restructuring, and it floated through several economic crises since the collapse of the Soviet Union. The government lacked a clear vision of reform and was hampered by political conflicts especially in the 1990s. As a result, the Russian context has been largely characterized by economic and political instability. Only by the time of coming of Putin's regime into power in the 2000s, and backed by the globally increasing oil prices, the Russian economy started to recover from the crises and started an upward trend that has since continued. However, the political instability has left its marks, and the relations that firms have with the state are still seen as risky by representatives of firms from the neighbouring Finland.

We can also compare the strength of the nation states in the case countries in organising relations with foreign companies. There are vast differences in this respect. While Estonia has chosen an approach characterised by minimum state intervention in the markets, China's central state retains its powerful position in controlling the market. In order to achieve its goal of economic growth it has launched the concept of socialist market economy. In Russia, the strength of the nation state has varied considerably during the post-socialist period in the past 15 years.

We can draw similar comparative conclusions concerning the role of the local states. Russia became virtually a regional mosaic during Yeltsin's era in the 1990s, after the president of the Russian Federation had encouraged the local level to take all the power they can to survive in the political and economic turmoil. This is still reflected in today's Russia, although the local level has lost some of its relative power in politics and the economy after the re-strengthening of the federal administration in the 2000s. In contrast, Estonia, while being a small country and having adopted a goal-oriented policy, has very little regional variation in state practices. The only exception is eastern Estonia that is largely inhabited by the Russian minority and, therefore, its informal institutional context differs from the rest of the country. As a part of its regionalization strategy, the Chinese central government has gradually let the local level administrations increase their relative power.

Variation can be seen in the roles of the international state and international formal institutions between the case countries. Of the three countries under study, the role of international institutions is decisive in Estonia and China. This is also illustrated by the memberships of the countries in international organizations: Estonia is today a member of the European Union, while China is a member of the World Trade Organization (WTO). These international formal

institutions have put considerable pressure on the economic transformations in these countries. Russia, in contrast, is only negotiating for its potential membership in the WTO. A question can be posed whether state practices at an international scale can mitigate the challenges caused to foreign firms by the central state. Some of the evidence points to that direction, as for example Finnish firms transnationalised to Latvia and Lithuania only after these countries had joined the EU. Prior to that, the public sector had been regarded as too difficult for foreign firms to cope with.

Institutional challenges faced by firms in their interactions with the state

Nevertheless, irrespective of the above differences, there are specific state-related challenges that Finnish companies face due to the spatial institutional discontinuity. Our second set of issues seeks to analyse the state-related institutional challenges that Finnish firms face and whether there is difference in this respect between what is experienced of the state at its different spatial scales. According to our findings, companies report of relatively similar state-related challenges in each of the case countries. First, all the three countries have been characterized by unstable legislation during their restructuring. Due to its goal-orientation, Estonia quite rapidly developed a stable legislative framework for companies after the turbulent conditions with the state in the early 1990s. Russia, in contrast, became more goal-oriented only during Putin's regime, as there was a decade of political and economic turmoil and a sequence of disputed political reforms since the early 1990s. These experiences are still reflected in the perceptions of Finnish firms on Russia. Not only has the legislation been unstable, it has also been retroactively valid, thus risking the operations of Finnish firms in the country. In China, the legal framework has been changed relatively rapidly due to the commitments to the WTO, the restructuring after the Asian financial crisis, and the perceived need to open the market for foreign direct investment.

Second, the countries have been characterized by bureaucracy that has been a complex mixture of licenses and registrations required from foreign firms. It has been difficult to apply such bureaucratic norms if the firms have not known whose signature they would need for the licence. Estonia simplified the procedures quickly due to its goal orientation and the need to harmonize state practices to be compatible with EU standards. As an example, it takes only two hours to establish a company in Estonia, whereas Finnish firms in Russia still hire extra staff whose main task is to queue for licenses in various state offices. The same complicated nature of bureaucratic

procedures apply to China, where the problems with bureaucracy are among the most frequently mentioned by the firms under study.

Third, Finnish firms have faced considerable problems in the ways authorities have enforced formal rules in each country. Not only have the skills of the authorities been perceived as inadequate in performing their tasks, but their attitude towards companies has varied from ignorance to suspicious stating that companies exist for the bureaucrats rather than vice versa. In this respect, Estonia is a model of rapid modernization of state practices. In the views of the Finnish firms, Estonian authorities have become neutral and professional. Once again, Russia stands as the opposite. In fact, there are cases of Finnish firms that have left the country due to the unpredictable interpretations of unstable laws and opportunism by the bureaucrats. China, as perceived by the Finnish firms, stands in the middle of these two extremes. It has been reported that China would have significant regional variation in the implementation of formal rules.

Fourth, there is the difficult issue of corruption. In the perceptions of the Finnish firms, China, Russia and Estonia have all been characterized by relatively similar corruption. The Finnish firms have faced situations of corruption especially in their interactions with the tax authorities, police forces, customs officials, fire and health inspectors, and cases of various tenders where deals are won by companies who deliver brown envelopes to state authorities. In Estonia, however, corruption was rooted out swiftly thanks to the EU membership, while in Russia bribery has lengthy traditions despite attempts to abandon it from the state authorities since the times of Peter the Great. The turbulence of the 1990s, i.e. political crises and economic turmoil, resulted in a general loss of faith in the future, and the authorities felt they needed to 'milk the cows' immediately instead of waiting for tomorrow that seemed to be really uncertain. In addition, the officials' wages were often paid late, so the authorities had to find other ways of income to be able to support their families. The situation started to improve only during Putin's era after legislation was changed. China appears to fall between the two extremes of Estonia and Russia as to the problems of corruption. According to the Finnish interviewees, corruption exists, but the sums usually are not large. In sum, the state-related challenges that Finnish companies have experienced have been relatively similar in all the three countries, but there has been some variation as to the spatial scale.

Solutions to challenges caused to firms by state actors

Our third research question deals with the ways in which the Finnish companies have solved the challenges explored above they have faced with the public sectors of the host countries. Based on the interview data, informal institutions have been crucial for finding successful solutions to the challenges. Companies have learnt that in these business environments, problems are solved with informal ways and practices. Therefore, personal relations and personal impact are perceived as central for finding solutions. This is where we start moving to networked conceptions of institutions. Moreover, this situation highlights the significance of the spatial institutional discontinuity in the more territorial sense, as personal relations are often experienced as difficult for Finnish firms who are used to dealing with authorities in an impersonal and faceless manner, and with an expectation that authorities will be punished if they favour someone over others.

Nevertheless, there is variation in what, when, with whom, how, how much, for what and why informal solutions are practiced. This is linked to the effects of informal institutions on how a networked firm operates in a specific institutional context. This variation also demonstrates the ways in which a territorially bounded institution nevertheless takes the form as informal networks. In China, for example, relations between companies and the public sector are based on *guanxi* (connections and relationships), a central concept in the Chinese society for building trust between actors. This practice is based on a personal connection between two individuals, and a favour is paid back with a favour in return and thus *guanxi* develops automatically into a network of favours. In Russia, the relations of a company with the state are affected by *blat*, which means an exchange between persons or commodities. In the Russian society people are also categorized as being in the inner circle or outside it, and authorities will help those who belong in the inner circle. In comparison, Estonia is small with only 1.3 million inhabitants and its public sector and business circles have developed during the last 15 years. Consequently, all economic actors virtually know each other – especially since 90 per cent of the FDI is located in the Tallinn region. This shows that institutional context, which itself is networked in character, has many ways of affecting the extension of business networks.

There is variation in whom should foreign companies try to impact on when solving problems related to the state. In Estonia, Russia and China alike it is important to build relations with the local authorities since they are the ones to either enhance or impede the operations of foreign businesses. In addition, in China the so-called authority services include, for example,

presidential and ministerial level visits that may provide new business opportunities for foreign companies. There is also variation in what can be accomplished by building relations with authorities. In today's Estonia, personal relations may, at best, shorten the processing times of the needed documents. In China, local authorities are prone to help companies only if they personally know the representatives of those companies. In Russia, foreign companies have to build relations with authorities in order to seek advice and help, and to shorten the times that the processing of applications takes. Moreover, the decisions of authorities may be positive or negative on solely on the basis of their specific relations with foreign companies.

What also varies are the ways of practicing personal relations and informal influence. Informal communication and informing about the company and its operations, arranging events for the authorities, as well as wining and dining are practiced in all the three countries. However, the nature of direct lobbying is changing at least in Estonia and to some extent in Russia. Instead of personal lobbying, collective action is emerging and various associations have started to lobby authorities especially in Estonia. In China, lobbying is based on the building of relations through *guanxi*. This means that personal relations remain the key to informal influencing. There are other country-specific ways of informal influence on state authorities. It is important for the companies to show that they are 'good citizens'. In Estonia, Finnish companies are willing to do sponsoring, as even with a small input their image can be improved significantly. This is based on the fact that the public sector offers little for the population in Estonia. In Russia, Finnish companies negotiating about investment licenses may, for example, be proposed by local authorities to renovate an old neighbourhood school as a precondition for proceeding with the investment license. The reason behind this demand is that during the socialist period companies used to provide the social infrastructure in local communities. After privatization, the responsibility was given to the public sector, which, in practice, resulted in the vanishing of investments on infrastructure. Sometimes the organization of the company's subsidiary is literally adapted to local conditions. In China, some of the Finnish companies have established a department for relations with the local political party, in the same way as local companies have, in order to 'speak the same language' with local authorities.

Coming from a country with one of the least amount of measured corruption in the world, Finnish firms easily take a negative stance towards corruption and they are not willing to bribe authorities. Therefore, companies often let their local contacts take care of such questions. In this way they may passively accept the practice. The other solution is to refrain from giving money to

the officials, and instead support organizations that they represent, for example by donating computers, printers, and other equipment that the authorities need.

Conclusions

In this paper, we have discussed the ways in which especially Finnish companies organise their relations with the state in the three rapidly developing markets of Estonia, Russia and China. Foreign companies in general face various kinds of challenges in their relations with the public sector in the host countries that have gone through major transformations of the state. Furthermore, these challenges are related to various geographical scales of the state sector, including the international (e.g. WTO), national, regional, and local levels. We have drawn from two theoretical directions in order to elaborate on the ways in which companies solve the state-related problems they face: the governance approach of institutional economics, and the relational analysis of economic geography. The notion of formal and informal institutions has been central, that is, legislation and formal rules on the one hand, and practices and socio-cultural characteristics on the other hand.

According to the empirical findings, informal institutions tend to become transparent when institutional turmoil eases, the economy grows, and the need to resort to emergency measures decreases. In this process, national stability and international pressure are central. There are country-specific paths towards transparency. Informal institutions become transparent under, first, national stability. This is clearly visible particularly in Russia. The practices of barter, lobbying, and corruption had been the rule of the game for decades; however, they have recently eased somewhat. The main reasons are the economic growth after the 1998 currency crisis; political and economic stabilization and reforms of Putin's regime; weeding out corruption; and increased faith in the future among government officials. Second, there has to be international pressure. The impact of formal supranational pressure is evident in Estonia, for example. The country became a member of the European Union in 2004, but the interviewed Finnish companies reported of not observing major changes in the Estonian policies at that time. Instead, Estonia had started to reform the economy already in 1997 when the decision of its future membership in the EU was made.

In sum, and to answer our fourth research question, according to the empirical findings in our research, the nation state has turned out to be the critical level in the company-state relation on

the several spatial scales. The persistence of the nation state –or in contrast, the possible lack of goal orientation –creates the framework in which the local level operates. The local level may be under strong direction of the nation state, where there is not much room for solo action. In contrast, the local level may also create good local operational environment in spite of a national level crisis, as occurred in Russia in the 1990s. Formal institutions at the international scale support the processes of change, as was the case when China applied for a membership in the WTO. Institutional turbulence is more manageable in countries with goal-orientation, which, furthermore, have harmonized the state practices at several spatial scales. This is best demonstrated in Estonia and with goal orientation; Russia stands as stark contrast, and China falls in between these two ends.

As a conclusion, we argue that companies need to manage their relations with the state in the rapidly developing markets through the creation of knowledge concerning formal rules, setting up of networks to cover linkages to public authorities, acknowledging the importance of face-to-face contacts, and creating trust between parties. These relate to the multi-scalar governance of companies' state relations in emerging markets. A geographical analysis helps us elaborate on the specific ways to manage the challenges. It also gives tools to companies to adapt to various business environments, and to the public sector in finding best policies for companies and regions to succeed.

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**Paper to be presented at the EACES 10th Conference “Patterns of Transition and
New Agenda for Comparative Economics”
Higher School of Economics, Moscow, Russia, August 28-30, 2008**

Session CSF-07: “Business-State Relations in Transition Economies under Global Competitive Pressure”

Managing the Relations of Business Firms with the State across Spatial Institutional Discontinuities: Finnish Firms in the Rapidly Developing Markets of Russia, Estonia and China

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Abstract

The paper analyses the relations of transnational companies with the state in their host countries. The focus is on foreign firms operating in the rapidly changing markets of former state socialist countries. In more detail, we investigate and compare the relations that Finnish companies have with the state in Russia, China, and Estonia. The three rapidly developing economies are challenging for foreign investors as they have considerably reorganized their formal institutional framework and the role of the public sector in business. Theoretically, our study contributes to the governance approach of institutional economics, especially to the discussion on formal and informal institutions in the organization of social relations of foreign companies, as well as relational economic geography. The study identifies the challenges and problems in the relations that foreign firms have with the state in the three host countries. Furthermore, we point out successful mechanisms of governance, i.e. the ways in which problems arising from the institutional context in the host country have been solved in the companies under investigation. Empirically, our analysis is based on a database of interviews with transnationalized Finnish companies that represent various company sizes and lines of business. The findings reveal similarities and differences in the governance mechanisms in terms of the three emerging economies. Drawing from evidence from the three economies with different processes of restructuring, the study points to the diverse roles of formal (e.g. rule-based) and informal (e.g. relationship-based) institutions in business.

Keywords

State relations, governance, institutions, emerging markets, foreign companies

This paper results from the project “Companies’ Social Relations as a Component of Local Business Strategies: Innovative Integration Strategies of Finnish and Russian Companies”, funded by Academy of Finland (grant No. 118538) and Russian Foundation for Humanities.

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Introduction

As a fundamental element of the globalization of the world economy, there has been an intensifying tendency in recent years for companies from Western European countries to relocate their operations to the rapidly developing markets of Eastern Europe and Asia. In theoretical terms, such situations open up possibilities to discuss the relations of two very different ways of investigating the transnationalisation of firms: the approach that pays attention to differences in institutional contexts, and one of relational economic geography. Sunley (2008) has recently argued that while the recently blooming relational approach in economic geography definitely has its merits, it should not be seen as an overriding ontological perspective that does not leave space to discuss other ontological approaches, that are, for Sunley, most notably represented by critical realism. In this paper, we address the issue of what would a combination of the two perspectives, that of a relational network approach and an institutional regionally specific approach turn out to be like in the analysis of the transnationalisation of firms. The core idea of such an exploration is to emphasise that regional formations, that are conceived of as products of extensions of networks rather than pre-given territorial entities, guide the extension of networks to certain extent. In his examination of transnational law firms, Faulconbridge (2008), as well, takes a step towards this direction, and emphasizes the roles of case-specific practices, and workers, managers, and professionals, in shaping the behaviour of transnational firms in new contexts by stating that 'Negotiations between contending parties who are trying to deal with clashes in institutionally informed perspectives determine the approaches that are used to manage business practices. Only by understanding the nature and outcome of such negotiations can we understand the reciprocal effects of host countries and TNCs on one another. Hence, mapping the degrees of difference between national business systems as a way of understanding these impacts without analyzing the influence of the actors involved is simplistic' (ibid., 206).

The relational approach definitely has opened up new avenues for improving our understanding of the transnationalisation of firms and understanding the essence of regions (e.g. Amin 2002). Yeung (2000) has made an effort to reconceptualise the transnational company (TNCs) from a command-and-control type of organisation into a networked entity. His focus is on intra- and inter-firm networks as a part of the operations of foreign companies in the relocation of their businesses to new socio-economic contexts. As Yeung (2002) has rightly argued, globalisation should not be so much used as an explanatory factor for occurrences, but as a process

to be analysed: ‘globalization is a spatial phenomenon worthy of further explanation, but it is certainly not a spatial explanation for empirical outcomes’ (ibid., 301). He develops a geographical perspective for analysing globalisation as an empirical, material and discursive phenomenon. It is this process of globalisation or ‘transnationalisation’ into which we seek to contribute in this paper by analysing the ways in which business firms, during their transnationalisation activities, aim to manage, control, adapt to and adjust their social environment.

On the other hand, recent criticism toward relational economic geography has pointed out that ‘relational insights should be developed within an evolutionary institutionalism that is informed by critical and pragmatic realisms’ (Sunley 2008, 3). Furthermore, Sunley argues that ‘The pressing task is to blend and combine network approaches with other institutionalist and evolutionary approaches’, and that ‘it would be productive to examine how economic relations and networks vary among different national, regional, and local expressions’ (ibid., 11).

In this paper, we seek to elaborate on this theoretical niche falling between institutional and relational micro-level analyses by exploring, through a specific empirical case, the process of transnationalisation of firms. We focus particularly on one specific form of relation in business activities: that between firms and the state. Our empirical aim is also to analyse the ways in which Finnish business firms have been (and are) adapting to new social and economic settings in countries with rapidly growing markets. These economies either are post-socialist, or applying a version of socialism in which the transition into the market economy is guided by a considerable intervention by the central state. Such economies have also been labelled as transition economies or emerging markets. Our regional focus is in post-socialist Eastern Europe and emerging Asia. Specifically, we explore the complex process of organization of the relations that companies have to state authorities at various levels of administration, ranging from the local through the regional and national to the transnational. Our comparative focus is on three countries: Estonia and Russia in Eastern Europe, and China in emerging Asia. Despite superficial similarities of former socialism, these countries form a complicated variety of societal settings. The Russian Federation is politically and economically by far the most significant successor of the Soviet Union and represents a combination of post-Soviet market liberalization and re-increasing state control under President Putin’s regime since the turn of the 21st century. Estonia simultaneously represents a post-Soviet context and, since 2004, it has been a member country of the European Union. China, in turn, has been rapidly transforming into a state-controlled market economy. In all the three countries, the central state has, during the past 15 years, been restructuring from a strong state

towards a situation in which there is either less state control over the markets, or towards a different form of state, that still aims to maintain a strong control over businesses. Nevertheless, it is clear that in all these countries the state has been evolving towards a more freely functioning market economy that is more open to the global economy. This has created space to new state practices at the local and national scales. At the same time, in recent years the countries have provided increasingly lucrative investment locations for companies from a member country of the European Union, Finland. In this paper we seek to explore the socio-spatial patterns incorporated in the processes of relocation of companies from Finland into these countries and, specifically, the management of the relations that the companies have to the state institutions and organizations in these destination countries. Within this context, we aim to theorize the issue of how do spatial institutional settings guide the extension of networks by networked firms.

In terms of empirical analysis, the study draws on a longitudinal qualitative analysis of interview data. The qualitative analysis of this material aims to point out the aspects that Finnish companies have found most challenging in their relations with the state when they have been operating in the reforming countries of Russia, Estonia and China. The primary data consists of interview records from the database of the Centre for Markets in Transition of the Helsinki School of Economics in Finland. This study yields data from Finnish companies of which 51 were operating in Russia, 47 in Estonia and 37 in China. The data collection was performed by interviewing respondents between 1995 and 2005 with semi-structured open-ended questions. The open in-depth interview was chosen as the data collection method to allow the respondents themselves to identify the key problems and solutions in managing the relations that the firms have with the state. The data was transcribed and handled anonymously. In addition, secondary data such as companies' annual reports, other documents, and newspaper articles were used as supplementary information. As in qualitative analysis in general, the research process involved the coding of the interview material. In this study, data that referred to problems and solutions in the relations of the firms with the state were picked out from the empirical database. The relevant data was coded, i.e. broken down into discrete chunks (Malhotra & Birks 2005), and analytical categories were produced from the respondents' statements. Findings were grouped according to relevant categories related to challenges and solutions, and were then compared between Russia, Estonia and China. We do not differentiate in this paper between firms in different lines of business, but analyse these issues on an aggregate level.

Spatial institutional discontinuities and the challenges of the contexts of rapidly developing markets to Western firms

It is an essential element of the globalization of the world economy that companies from Western European countries are seeking to relocate their operations to the rapidly developing markets, as we call them, of Eastern Europe and Asia. The relocating firms are in search for lower production costs or new markets for their products in the rapidly developing markets. The state administrations of these countries are, at the same time, competing for globally circulating capital. Finland, a member country of the European Union since 1995, is among the countries that have been losing production of bulky goods to countries with low production costs, and Finnish enterprises have also been aiming to extend their operations to new markets².

While the ultimate reason for the relocation of business operations may vary, companies are always faced with the challenge of managing their relations to the various institutions of the destination countries. This can be seen as a basic feature in the processes through which firms transnationalise themselves, and even if drawing from a relational network perspective, sensitivity to the issue of differences institutional contexts will help in understanding the moments of transnationalisation of firms (cf. Faulconbridge 2008). Sunley (2008, 11) states that ‘it is [...] fruitful to see institutions as sets of durable systems of social rules and conventions that are constituted by habits and that structure social interactions’. Consequently, ‘such a perspective allows us to search for the rules that underlie different varieties and types of economic connections and try to understand how these rules evolve over time’. In our empirical setting, transnationalizing Finnish firms are relocating their businesses from an institutionally stable corporatist market economy of their home country to the institutional turmoil in the rapidly developing markets. As a result, the firms face situations that we call spatial institutional discontinuities: as the firms set up new operations in new countries, they have to adapt their operations to new institutional environments. These spatial institutional discontinuities, however, can be seen as two-dimensional: not only do they take place across territories, but also across scales. It has become usual to take for granted that national institutional contexts vary, but

² Finland itself emerged from an agriculture-dominated economy into an industrialised Nordic welfare state in the decades following the Second World War. This development culminated in its EU membership in 1995 at the same time with two other geopolitically neutral countries, Sweden and Austria. Finland was also able to develop into a global technological leader in sectors such as paper production and, later on, mobile phone technology.

discontinuities in institutional coherence can be conceived of as occurring also across scales from local through regional and national to the transnational. Evidently, scales do have characteristics that drive them towards coherence, even if such coherence is always challenged and it should be dealt with critically as an criterion for an analytical category (cf. Amin 2004; Faulconbridge 2008).

The situation in the rapidly developing markets is complicated by the fact that in the host countries the institutional setting is being restructured at a very fast pace. Furthermore, spatial institutional discontinuities have particular implications for the relations of firms with the state, labour, and other firms in the host countries. In the relations with labour, for example, the various institutional environments in the emerging markets have created diverse needs for the Finnish parent companies to hold control over the operations in the host countries (Karhunen et al 2008; Kettunen et al 2007). In other words, the relations of the firm to the public sector of the host country are potentially challenging especially in rapidly developing markets, where the state sector may be transforming from a planned economy towards a more liberal market economy (e.g. Kosonen 2002; 2004). This may create specific problems for foreign companies operating in the host economy, and a need to adapt to the local business environment. Often the solution is related to networking and even personal relations with local authorities.

Since Finnish firms come from a very different institutional environment than the one that is in place in their host countries in the rapidly developing markets we are particularly interested in exploring what is the adaptation like that is needed in firm-state relations in the rapidly developing markets in question. We specifically wish to focus on the adaptation of the relations of firms and the state in such new conditions, for transnational businesses do have relations with the state in their home country as well. Furthermore, it is not only the firm that has to modify its activities according to the conditions in the host location, but the state as well has to modify its own institutions and activities if it wishes to attract foreign capital, as is the case with rapidly developing economies. Due to the spatial institutional discontinuity, the relations between the firm and the state are necessarily different from what they are in the home countries from which the firms originate and in which their headquarters are located. The relations consist of the ways in which firms have to take into account the regulations of particular states, but also the more unofficial ways of proceeding in the context, that is, with specific authorities and also other firms. On the other hand, the relations work also other way, as the state has to take into account the expectation of firms. An example of modification of state institutions is tax concessions for foreign direct investments.

In order to get deeper into an analysis of the processes through which firms aim to solve the problems of spatial institutional discontinuity, we define four sets of issues we will explore in more detail. They begin with an overview of the macro-scale situations in the rapidly developing economies, and proceed step by step towards a closer micro-scale analysis of the ways in which the companies seek to overcome problems of spatial institutional discontinuities in the new institutional settings.

The first set of issue concerns the transformations that have been taking place at the governance systems of the state in the host countries. This is an macro-scale overview of the situations that the firms face. The main question is how formal institutions have transformed at each spatial scale. We are particularly interested in exploring, on one hand, how goal-oriented has the restructuring of the central state been and, on the other hand, what is the role of state practices in organising relations with business at the local and transnational scales. Second, based on the first point, we aim to investigate what are the state-related institutional challenges that firms face at each spatial scale due to the supposed spatial institutional discontinuity. The third set of issues deals with the ways in which companies have been able to come to terms with the new institutional environment. For the analysis of this issue, formal and informal problem solving are both relevant points of focus, as countries in institutional turmoil are often characterized by various informal forms of production and governance (Moulaert 1996; Peck 2000). Finally, we wish to explore which scale is decisive for organising business-state relations. For example, we examine whether local practices can mitigate problems caused for firms by the central state in its dealings with the business environment. Moreover, there is a question of whether state practices at an international scale can alleviate problems caused by the central state. Throughout, these issues are also questions of networks, as the encounters of firms and the state take place through concrete practices that are carried out by agents: managers, workers, and officials (cf. Faulconbridge 2008). Therefore, our analysis concerns a specific form of relation: one between firms and the state, and the relational networks that make this relation possible in particular situations.

Encounters of networked transnationalising firms with institutions

There has recently been relatively much discussion within economic geography on how firms transnationalise. This discussion has focused on topics such as how firms organize their relations with their subsidiaries (Yeung 2000), how enterprises organize their internal knowledge transfer

and information flows (Beaverstock 2004), and what is the role of face-to-face interaction in transnationalising firms (Jones 2006). What we wish to bring more light into is a focus on the relations of firms to the state at its various scales. These relations are important as a transnationalising firm is necessarily faced with the question of how to organise its management practices to the authorities in the host countries, since various forms of regulation of business activities are always practiced by the state.

We argue that although scales have been downplayed as an analytical category in some debates drawing from relational analyses (e.g. Amin 2002), they are important for understanding how a networked firm encounters a particular settings while it is extending its networks. Hence, we approach the process of relocation of business operations, and the resulting relations of companies to state institutions and organizations, through an analysis of multi-scalar governance that is informed by an understanding of relational networks. We wish to argue that a conceptual division between institutions and actors or organizations that have essentially spatial characteristics is still useful. An institutional perspective on business strategies focuses on the dynamic interaction between organizations and their institutional environment, and considers strategic choices as the outcome of such an interaction (Peng 2000). Therefore, strategic choices are driven not only by firm-specific resources and capabilities that traditional strategy research emphasizes (Barney 1991; Porter 1980), but are also reflections of the formal and informal constraints of a particular institutional framework that decision-makers confront (North 1990; Oliver 1997; Peng 2000; Scott 1995). Hence, the institutional perspective on business strategy does not question the role of enterprises as exercising strategic action, but points to the importance of institutional constraints for such action. Enterprises as organizations may to a certain degree select to which institutional pressures to respond and how (Oliver 1991). However, gaining a firm foothold in a challenging institutional environment, such as a transition economy, requires often a major strategic adaptation from a foreign enterprise. Given the constraints and enabling structures of particular institutional frameworks in particular locations, we are faced with the question of how, exactly, firms interact with the state in a new institutional setting. We engage with this question in what follows.

From a non-networked spatial perspective, North (1990, 3) defines an institutional framework of a nation as ‘the rules of the game in a society’. Institutions can be divided into formal institutions that include, for example, laws and regulations, and informal institutions that point to customs, norms and cultures. Both provide constraints for actors when they pursue their

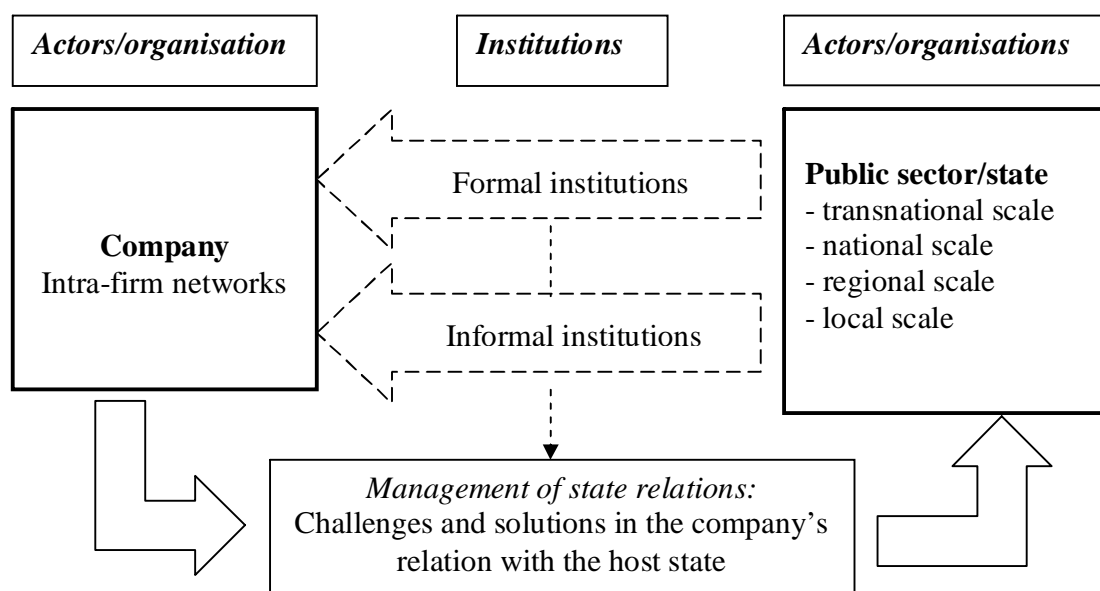
own interests. The formal rules provide the 'rule book' for the game, whereas informal practices represent a commonly understood way in which the written rules are interpreted and applied when playing the game. A few qualifications are needed, however, in order to build the framework for the analysis of institutions. To a certain extent, institutions are spatially bounded: they are limited by state boundaries and by boundaries of social groups, as is implicated by the notions of nation and society. Institutions such as legal regulations are, indeed, often formally limited by state borders (Faulconbridge 2008). Even if the creation of institutions may take place over time as a networked activity, they are temporarily stabilized as territorially bounded rules. It can be argued that it is a prescriptive aim of institutions to have effect within certain territories. Informal institutions do not have such formally defined prescriptive qualities. However, customs, values and norms may also be limited to certain spatial, often territorial, formations. This is something that occurs in people's perceptions rather than formal pronouncements. Moreover, both formal and informal institutions are scaled entities. Formal institutions may be seen as varying at different levels of organisation of the state: regional and local regulation may, especially in turbulent contexts such as post-socialist transformations, appear to be in contradiction to national regulation. Informal institutions may draw from people's perceived identities in relation to places they inhabit, be it local community, region or nation, even if such identities are understood as social constructions and they may be even abused for purposes of defining the limits of groups of people (Amin 2004). Moreover, institutions should be understood as being constructed with certain scalar relationality. Occurrences and institutional transformations at one scale have repercussions on transformations on other scales.

In our study, the state sector of the three emerging markets is characterized by various territorially bounded configurations of formal and informal institutions at all spatial scales. These configurations affect the operation of foreign firms. Such configurations range from international trade and investment agreements at the supranational scale to national and regional regulation of business. The configurations also include institutionalized practices at the local scale when the formal institutional framework derived from the national scale is being applied locally.

In order to analyze the impacts of formal and informal institutions on foreign firms in given locations, we need to draw from the governance approach (Jessop 1995; 1997; Amin and Hausner 1997; Jessop 1995; Kosonen 2002; 2005; Kettunen et al 2007). Governance refers to the various coordination mechanisms that actors use in order to mitigate problems in mutual relations, and to create shared understanding and joint practices in cooperation. In other words, governance

is a process where disparate, but interdependent agencies are coordinated to achieve specific economic, social and political objectives. In our analysis of governance in economic action, we focus on the various challenges that undermine relations between actors, and the practices they develop for dealing with these challenges. Hence, our study on the relations of foreign firms with the public sector is based on a conceptual framework in which organizations include business firms and public sector authorities, and the relations of these organisations are mediated by institutional practices in which actors operating within the organisations take part (figure 1). As public sector authorities are structured at multiple scales, companies' relations with them must also be organized at and through several spatial scales.

Figure 1. The governance of state relations in the host economy



Source: Modified from Kosonen 2002; 2004; Kettunen et al. 2007

The coordination of the relations of a company with the state sector is affected by both formal institutions, that is, state-centred rules, and informal institutions that incorporate the enforcement of formal rules, practices, and socio-cultural characteristics. These rules are not only specific to each host country but may also vary according to other spatial and social divisions. As an example, a Chinatown in a specific city may have a different informal institutional setting compared with

the mainstream informal institutional structure of its surroundings. These formal and informal institutions impact on the coordination of the relations that a foreign firm has with the public sector. Problems induced for a firm by formal and informal institutions of the host economy give rise to challenges in the relations with the state that are specific to each business environment. From the perspective of the firm, success in the governance practices that concern the relations of the firm with the state depends on the ability of actors to solve the problems: governance fails when problems remain intact, and it succeeds when problems are solved.

As is illustrated in figure 1, the relations between the company and the host state are an outcome of the interaction within a framework in which the organizations operate at several spatial scales. These relations result in challenges and potential solutions in the overall relation of the company with the public sector. Institutional theory is well-equipped for providing insights on a general level into these relations but lacks middle-level conceptions that would help understand how firms develop their relations with public authorities. What needs to be done is to analyse the concrete processes through which transnationalising corporations interact with public authorities in the host countries. On the daily level of interaction, institutions are also constantly being reproduced by networks. Moreover, institutions are dependent on networks in order to be able to have effect on actors over space. In this sense we can conceive of them as institutionalised networks. Therefore, for the purpose of understanding the daily interactions of businesses with state institutions, we introduce the concept of management of state relations. It refers to the ways in which companies communicate with and take contact to public authorities in locations where they are establishing operations.

The management of state relations includes at least four issues. Firstly, there is creation of knowledge concerning formal rules at the national, regional and local scales in the host countries. This includes especially national and regional legislation. Beaverstock (2004) has explored the issue of knowledge management in multinational firms. Secondly, setting up of networks is important in order to cover linkages to public authorities. The issue of how transnational companies organise relations to their subsidiaries by networking has been explored by Yeung (2000). Thirdly, face-to-face contacts are important (cf. Jones 2007). Firms are often dependent on good personal relations to state authorities. This applies with different intensities in different cultures. Finally, this interaction has to lead to creation of trust between parties. We wish to argue that such a conceptual framework helps to break down the relatively abstract and general theoretical equipment of formal and informal institutions. It also helps to analyse what actually

takes place in the interaction of firms and the state in the process of transnationalisation of firms. In short, it turns the focus on the practices of firms in their endeavours to control the situations in which they operate (cf. Faulconbridge 2008).

Finnish firms in rapidly developing markets

Next, we focus on the experiences Finnish firms on their relations with the state at several spatial scales in the host countries. Especially, we examine the problems and challenges that managers of the firms identify in the relations of their companies with the state, and the means that have been created for dealing with these challenges. Our aim in this empirical analysis is to highlight the most relevant issues that the firms have with the public sector in the emerging markets of China, Russia and Estonia, rather than provide a full account of all the dimensions included in the conceptual model. In our investigation of the practices, problems and solutions in the relations of business firms with the state, we remain sensitive to dimensions of temporality. The empirical analysis includes not only information on the current situations in the relations that the firms have with the state in the host countries, but also pays attention to practices during the past 15 years, after the turning point from state socialism toward market capitalism in Russia and Estonia. The inclusion of such a historical perspective will help evaluate the persistence of country-specific features.

Scalar transformations of state governance

Our first set of issues outlined above deals with the transformations of formal institutions at several spatial scales. In all three national economies in question, the formal institutions of the nation-state have been significantly restructured since the turn of the 1990s. In all of these countries, China, Russia and Estonia, the state has transformed its behaviour towards private foreign firms. There has been a transformation from a strong presence of the state to either less state involvement in the operation of firms, or to a different kind of a state. However, there is considerable country-specific variation in the ways in which interaction occurs between firms and the state across spatial scales. This variation is related to four issues. The first difference concerns goal orientation. Estonia and China have clearly been goal oriented in their restructuring processes. With its prospective membership in the European Union, Estonia adopted a liberal

market economy at once during the 1990s, while China decided to employ a socialist market economy that would, it was assumed, bring benefits for the national economy. Russia, in contrast, was less oriented towards clear goals in its restructuring, and it floated through several economic crises since the collapse of the Soviet Union. The government lacked a clear vision of reform and was hampered by political conflicts especially in the 1990s. As a result, the Russian context has been largely characterized by economic and political instability. Only by the time of coming of Putin's regime into power in the 2000s, and backed by the globally increasing oil prices, the Russian economy started to recover from the crises and started an upward trend that has since continued. However, the political instability has left its marks, and the relations that firms have with the state are still seen as risky by representatives of firms from the neighbouring Finland.

We can also compare the strength of the nation states in the case countries in organising relations with foreign companies. There are vast differences in this respect. While Estonia has chosen an approach characterised by minimum state intervention in the markets, China's central state retains its powerful position in controlling the market. In order to achieve its goal of economic growth it has launched the concept of socialist market economy. In Russia, the strength of the nation state has varied considerably during the post-socialist period in the past 15 years.

We can draw similar comparative conclusions concerning the role of the local states. Russia became virtually a regional mosaic during Yeltsin's era in the 1990s, after the president of the Russian Federation had encouraged the local level to take all the power they can to survive in the political and economic turmoil. This is still reflected in today's Russia, although the local level has lost some of its relative power in politics and the economy after the re-strengthening of the federal administration in the 2000s. In contrast, Estonia, while being a small country and having adopted a goal-oriented policy, has very little regional variation in state practices. The only exception is eastern Estonia that is largely inhabited by the Russian minority and, therefore, its informal institutional context differs from the rest of the country. As a part of its regionalization strategy, the Chinese central government has gradually let the local level administrations increase their relative power.

Variation can be seen in the roles of the international state and international formal institutions between the case countries. Of the three countries under study, the role of international institutions is decisive in Estonia and China. This is also illustrated by the memberships of the countries in international organizations: Estonia is today a member of the European Union, while China is a member of the World Trade Organization (WTO). These international formal

institutions have put considerable pressure on the economic transformations in these countries. Russia, in contrast, is only negotiating for its potential membership in the WTO. A question can be posed whether state practices at an international scale can mitigate the challenges caused to foreign firms by the central state. Some of the evidence points to that direction, as for example Finnish firms transnationalised to Latvia and Lithuania only after these countries had joined the EU. Prior to that, the public sector had been regarded as too difficult for foreign firms to cope with.

Institutional challenges faced by firms in their interactions with the state

Nevertheless, irrespective of the above differences, there are specific state-related challenges that Finnish companies face due to the spatial institutional discontinuity. Our second set of issues seeks to analyse the state-related institutional challenges that Finnish firms face and whether there is difference in this respect between what is experienced of the state at its different spatial scales. According to our findings, companies report of relatively similar state-related challenges in each of the case countries. First, all the three countries have been characterized by unstable legislation during their restructuring. Due to its goal-orientation, Estonia quite rapidly developed a stable legislative framework for companies after the turbulent conditions with the state in the early 1990s. Russia, in contrast, became more goal-oriented only during Putin's regime, as there was a decade of political and economic turmoil and a sequence of disputed political reforms since the early 1990s. These experiences are still reflected in the perceptions of Finnish firms on Russia. Not only has the legislation been unstable, it has also been retroactively valid, thus risking the operations of Finnish firms in the country. In China, the legal framework has been changed relatively rapidly due to the commitments to the WTO, the restructuring after the Asian financial crisis, and the perceived need to open the market for foreign direct investment.

Second, the countries have been characterized by bureaucracy that has been a complex mixture of licenses and registrations required from foreign firms. It has been difficult to apply such bureaucratic norms if the firms have not known whose signature they would need for the licence. Estonia simplified the procedures quickly due to its goal orientation and the need to harmonize state practices to be compatible with EU standards. As an example, it takes only two hours to establish a company in Estonia, whereas Finnish firms in Russia still hire extra staff whose main task is to queue for licenses in various state offices. The same complicated nature of bureaucratic

procedures apply to China, where the problems with bureaucracy are among the most frequently mentioned by the firms under study.

Third, Finnish firms have faced considerable problems in the ways authorities have enforced formal rules in each country. Not only have the skills of the authorities been perceived as inadequate in performing their tasks, but their attitude towards companies has varied from ignorance to suspicious stating that companies exist for the bureaucrats rather than vice versa. In this respect, Estonia is a model of rapid modernization of state practices. In the views of the Finnish firms, Estonian authorities have become neutral and professional. Once again, Russia stands as the opposite. In fact, there are cases of Finnish firms that have left the country due to the unpredictable interpretations of unstable laws and opportunism by the bureaucrats. China, as perceived by the Finnish firms, stands in the middle of these two extremes. It has been reported that China would have significant regional variation in the implementation of formal rules.

Fourth, there is the difficult issue of corruption. In the perceptions of the Finnish firms, China, Russia and Estonia have all been characterized by relatively similar corruption. The Finnish firms have faced situations of corruption especially in their interactions with the tax authorities, police forces, customs officials, fire and health inspectors, and cases of various tenders where deals are won by companies who deliver brown envelopes to state authorities. In Estonia, however, corruption was rooted out swiftly thanks to the EU membership, while in Russia bribery has lengthy traditions despite attempts to abandon it from the state authorities since the times of Peter the Great. The turbulence of the 1990s, i.e. political crises and economic turmoil, resulted in a general loss of faith in the future, and the authorities felt they needed to 'milk the cows' immediately instead of waiting for tomorrow that seemed to be really uncertain. In addition, the officials' wages were often paid late, so the authorities had to find other ways of income to be able to support their families. The situation started to improve only during Putin's era after legislation was changed. China appears to fall between the two extremes of Estonia and Russia as to the problems of corruption. According to the Finnish interviewees, corruption exists, but the sums usually are not large. In sum, the state-related challenges that Finnish companies have experienced have been relatively similar in all the three countries, but there has been some variation as to the spatial scale.

Solutions to challenges caused to firms by state actors

Our third research question deals with the ways in which the Finnish companies have solved the challenges explored above they have faced with the public sectors of the host countries. Based on the interview data, informal institutions have been crucial for finding successful solutions to the challenges. Companies have learnt that in these business environments, problems are solved with informal ways and practices. Therefore, personal relations and personal impact are perceived as central for finding solutions. This is where we start moving to networked conceptions of institutions. Moreover, this situation highlights the significance of the spatial institutional discontinuity in the more territorial sense, as personal relations are often experienced as difficult for Finnish firms who are used to dealing with authorities in an impersonal and faceless manner, and with an expectation that authorities will be punished if they favour someone over others.

Nevertheless, there is variation in what, when, with whom, how, how much, for what and why informal solutions are practiced. This is linked to the effects of informal institutions on how a networked firm operates in a specific institutional context. This variation also demonstrates the ways in which a territorially bounded institution nevertheless takes the form as informal networks. In China, for example, relations between companies and the public sector are based on *guanxi* (connections and relationships), a central concept in the Chinese society for building trust between actors. This practice is based on a personal connection between two individuals, and a favour is paid back with a favour in return and thus *guanxi* develops automatically into a network of favours. In Russia, the relations of a company with the state are affected by *blat*, which means an exchange between persons or commodities. In the Russian society people are also categorized as being in the inner circle or outside it, and authorities will help those who belong in the inner circle. In comparison, Estonia is small with only 1.3 million inhabitants and its public sector and business circles have developed during the last 15 years. Consequently, all economic actors virtually know each other – especially since 90 per cent of the FDI is located in the Tallinn region. This shows that institutional context, which itself is networked in character, has many ways of affecting the extension of business networks.

There is variation in whom should foreign companies try to impact on when solving problems related to the state. In Estonia, Russia and China alike it is important to build relations with the local authorities since they are the ones to either enhance or impede the operations of foreign businesses. In addition, in China the so-called authority services include, for example,

presidential and ministerial level visits that may provide new business opportunities for foreign companies. There is also variation in what can be accomplished by building relations with authorities. In today's Estonia, personal relations may, at best, shorten the processing times of the needed documents. In China, local authorities are prone to help companies only if they personally know the representatives of those companies. In Russia, foreign companies have to build relations with authorities in order to seek advice and help, and to shorten the times that the processing of applications takes. Moreover, the decisions of authorities may be positive or negative on solely on the basis of their specific relations with foreign companies.

What also varies are the ways of practicing personal relations and informal influence. Informal communication and informing about the company and its operations, arranging events for the authorities, as well as wining and dining are practiced in all the three countries. However, the nature of direct lobbying is changing at least in Estonia and to some extent in Russia. Instead of personal lobbying, collective action is emerging and various associations have started to lobby authorities especially in Estonia. In China, lobbying is based on the building of relations through *guanxi*. This means that personal relations remain the key to informal influencing. There are other country-specific ways of informal influence on state authorities. It is important for the companies to show that they are 'good citizens'. In Estonia, Finnish companies are willing to do sponsoring, as even with a small input their image can be improved significantly. This is based on the fact that the public sector offers little for the population in Estonia. In Russia, Finnish companies negotiating about investment licenses may, for example, be proposed by local authorities to renovate an old neighbourhood school as a precondition for proceeding with the investment license. The reason behind this demand is that during the socialist period companies used to provide the social infrastructure in local communities. After privatization, the responsibility was given to the public sector, which, in practice, resulted in the vanishing of investments on infrastructure. Sometimes the organization of the company's subsidiary is literally adapted to local conditions. In China, some of the Finnish companies have established a department for relations with the local political party, in the same way as local companies have, in order to 'speak the same language' with local authorities.

Coming from a country with one of the least amount of measured corruption in the world, Finnish firms easily take a negative stance towards corruption and they are not willing to bribe authorities. Therefore, companies often let their local contacts take care of such questions. In this way they may passively accept the practice. The other solution is to refrain from giving money to

the officials, and instead support organizations that they represent, for example by donating computers, printers, and other equipment that the authorities need.

Conclusions

In this paper, we have discussed the ways in which especially Finnish companies organise their relations with the state in the three rapidly developing markets of Estonia, Russia and China. Foreign companies in general face various kinds of challenges in their relations with the public sector in the host countries that have gone through major transformations of the state. Furthermore, these challenges are related to various geographical scales of the state sector, including the international (e.g. WTO), national, regional, and local levels. We have drawn from two theoretical directions in order to elaborate on the ways in which companies solve the state-related problems they face: the governance approach of institutional economics, and the relational analysis of economic geography. The notion of formal and informal institutions has been central, that is, legislation and formal rules on the one hand, and practices and socio-cultural characteristics on the other hand.

According to the empirical findings, informal institutions tend to become transparent when institutional turmoil eases, the economy grows, and the need to resort to emergency measures decreases. In this process, national stability and international pressure are central. There are country-specific paths towards transparency. Informal institutions become transparent under, first, national stability. This is clearly visible particularly in Russia. The practices of barter, lobbying, and corruption had been the rule of the game for decades; however, they have recently eased somewhat. The main reasons are the economic growth after the 1998 currency crisis; political and economic stabilization and reforms of Putin's regime; weeding out corruption; and increased faith in the future among government officials. Second, there has to be international pressure. The impact of formal supranational pressure is evident in Estonia, for example. The country became a member of the European Union in 2004, but the interviewed Finnish companies reported of not observing major changes in the Estonian policies at that time. Instead, Estonia had started to reform the economy already in 1997 when the decision of its future membership in the EU was made.

In sum, and to answer our fourth research question, according to the empirical findings in our research, the nation state has turned out to be the critical level in the company-state relation on

the several spatial scales. The persistence of the nation state –or in contrast, the possible lack of goal orientation –creates the framework in which the local level operates. The local level may be under strong direction of the nation state, where there is not much room for solo action. In contrast, the local level may also create good local operational environment in spite of a national level crisis, as occurred in Russia in the 1990s. Formal institutions at the international scale support the processes of change, as was the case when China applied for a membership in the WTO. Institutional turbulence is more manageable in countries with goal-orientation, which, furthermore, have harmonized the state practices at several spatial scales. This is best demonstrated in Estonia and with goal orientation; Russia stands as stark contrast, and China falls in between these two ends.

As a conclusion, we argue that companies need to manage their relations with the state in the rapidly developing markets through the creation of knowledge concerning formal rules, setting up of networks to cover linkages to public authorities, acknowledging the importance of face-to-face contacts, and creating trust between parties. These relate to the multi-scalar governance of companies' state relations in emerging markets. A geographical analysis helps us elaborate on the specific ways to manage the challenges. It also gives tools to companies to adapt to various business environments, and to the public sector in finding best policies for companies and regions to succeed.

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