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## **Institutional, industry-level and firm-level determinants of foreign ownership strategies: Finnish investors’ views of strategic sectors in Russia**

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### **Abstract**

This article advances the institutional perspective of business strategy by showing how institutional, industry-level and firm-level factors affect foreign ownership strategies. This is done by empirically analyzing the ownership decisions of eight Finnish companies operating in Russia in sectors, which can be defined as strategic. Our results show that industry-level determinants are central in the ownership decision. Institutional constraints faced by enterprises vary along strategic importance and value-creation logic of the industry, which in turn affects the perceived importance of local assets as a firm-level determinant.

**Keywords:** institutions, ownership strategy, Russia

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## INTRODUCTION

The increasing role of state in the business in Russia has raised concerns among foreign investors, in particularly those operating in so-called strategic industries. The re-definition of rules for foreign investment in industries of strategic importance to the Russian state started in President Vladimir Putin's second term in power, and culminated to the signing of a law on foreign investment in strategic enterprises in May 2007. The law lists 42 industrial sectors, where foreign ownership share in selected enterprises will be restricted. These include nuclear energy, natural monopolies, exploration of strategic mineral deposits, aviation, space and other defense-sensitive industries. In addition, parts of sectors such as telecommunications and media are included in the list through ownership restrictions in major companies in these fields. The law has been on the one hand welcomed as clarifying the rules of investing in Russia, where a lack of mature legislation has led to political risks. On the other hand, investors have complained that the law limits access to more than half of the country's economy.

The increasing state control over business in Russia and its implications to foreign firms has been analyzed from different viewpoints in recent years. It has been proposed that the business-state relationship in Russia has moved from "state capture" in which powerful firms have great sway over the state (Hellman and Schankerman, 2000; Frye, 2002; Hellman et al, 2003) towards "business capture" by the authorities (Yakovlev, 2006). Here, the different strategic importance of different sectors to the state has been one dimension of analysis. For example, Puffer and McCarthy (2007) proposed that the institutional change in Russia has resulted in different types of capitalism, varying along industries. These range from market capitalism in the consumer sector to state-led capitalism in natural-resource based sectors (ibid). Moreover, Liuhto (2008; 2007) presented a typology of industries in Russia varying along two dimensions, economic and military sensitivity. Consequently, he arrived to four different categories of industries ranging from non-sensitive to top-sensitive ones. As a result, the institutional context faced by foreign entrants varied across industries, some of which are more open and transparent than others. However, the above-referred studies either empirically focus on domestic firms only (Hellman and Schankerman, 2000; Frye, 2002; Hellman et al., 2003; Yakovlev, 2006) or base their argumentation on secondary data and anecdotal observations without empirical rigor (Puffer and McCarthy, 2007; Liuhto, 2007). Therefore, the question of how the change in power relations between business and the state manifests in foreign investors' strategies remains largely unanswered.

Moreover, the constantly growing body of research focusing on the impact of institutions on foreign ownership strategies in transition and other emerging economies has paid scant attention on industry-level aspects (cf. Karhunen, 2008). Main body of existing research has focused on the linkage between national institutions and investment strategies (Dikova and van Witteloostuijn, 2007; Delios and Beamish, 1999; Delios and Henisz, 2000; Uhlenbruck et al., 2006), whereas sub-national institutions' impact on entry strategies has been addressed rather in geographical than industry terms (Meyer and Ngyuen, 2005). Finally, scholars have often selectively focused either on formal (e.g. Dikova and van Witteloostuijn, 2007) or informal institutions (e.g. Uhlenbruck et al., 2006). Hence, the interplay of formal and informal institutions as factors influencing foreign entry strategy calls for more research attention.

This paper seeks to contribute to the existing literature by empirically exploring ownership strategies of Finnish firms operating in Russia in sectors, which can be defined as strategic. In doing so we take an institutional perspective of firm strategy (Peng, 2003), maintaining that the choice of ownership strategy is contingent to both formal and informal institutional constraints, and firm ownership preferences. Moreover, we argue that institutional constraints and firm ownership preferences are largely industry-specific, the former pending on the strategic importance of the industry for the host government, and the latter on industry characteristics such as the linkage of ownership and control in the operations.

The paper is structured as follows. After theoretical and methodological considerations we analyze a qualitative dataset on executive interviews to illustrate how institutional, industry-level and company-level factors manifest in corporate ownership strategies. Finally, we discuss our findings, and draw conclusions and recommendations for future research.

## **THEORETICAL BACKGROUND**

The determinants of ownership structures of foreign subsidiaries have been extensively studied in the recent decades. The dominant theoretical perspective applied is the transaction cost theory, which views the choice of ownership structure for a subsidiary as a result of firm's preference to minimize transaction costs. This approach has been applied specifically to multinational enterprise's choice between whole and joint ownership (see, e.g. Anderson and Catignon, 1986; Hennart, 1991). This approach has, however, been criticized for its ignorance of environmental factors, which may result in the firm choosing a less optimal ownership mode

(see, e.g. Gomes-Casseres, 1990). Consequently, a number of scholars have begun extending TC entry mode theory by including institutional variables in the analysis (Delios and Beamish, 1999; Meyer, 2001; Brouthers and Brouthers, 2000; Brouthers, 2002,; Meyer and Nguyen, 2005; Dikova and van Witteloostuijn, 2007).

The institutional perspective is particularly promising in the context of emerging economies, where the importance of institutions for firm strategy is underlined (Hoskisson et al. 2000; Meyer and Peng, 2005). Consequently, researchers focusing on transition and other emerging economies have been in the forefront when searching for institutionally derived explanations for foreign ownership strategies. The institutional advancement has been found to affect level of foreign ownership, although in conflicting manner. On the one hand it has been shown that i.e. institutional progress makes full ownership more likely (Meyer, 2001), on the other hand it has been argued that positive institutional advancement prompts investors to trade full subsidiary ownership for local partnerships (Dikova and van Witteloostuijn, 2007). This shows that institutional variables are not necessarily sufficient as such when searching for explanations for ownership strategies but they need to be examined jointly with firm- and industry-level factors.

In this paper we take an institutional perspective of business strategy, which takes both firm- and industry-specific considerations and environmental factors in the analysis. This is due to its focus on the dynamic interaction between institutions and organizations, and consideration of strategic choices as the outcome of such an interaction (Peng, 2000, 2003; Peng and Heath 1996). Hence, this perspective sees strategic choices as driven not only by firm-specific resources and capabilities, which traditional strategy research emphasizes (see, e.g. Porter, 1980), but also as a reflection of the formal and informal constraints of a particular institutional framework that decision-makers confront (North, 1990; Oliver, 1997; Scott, 1995). The institutional constraints for foreign ownership are in this paper analyzed building on North's definition of institutions as "the rules of the game in a society or, more formally, the humanly devised constraints that shape human interaction" (North 1990: 3). The formal constraints include political rules, judicial decisions, and economic contracts. Informal constraints include socially sanctioned codes of conduct and norms of behavior, which are embedded in culture and ideology. (North, 1990) In addition, we draw on the TC approach to identify firm and industry-level factors that determine firm ownership preferences.

The remainder of this section is structured along the three dimensions of the paper: institutional approach on foreign ownership strategy, existing knowledge on industry-

level factors that affect foreign ownership strategy, and research on the relationship between firm-level preferences and choice of ownership strategy.

### **Institutions and choice of foreign ownership strategy**

The institutional constraints for foreign ownership strategies have most often been studied in terms of formal institutions (Dikova and van Witteloostuijn, 2007). A key formal institution with direct impact on foreign entrant's ownership strategy has been found to be host country restrictions on foreign ownership, i.e. legal limits on foreign equity participation, which reflect in lower ownership levels (Delios and Beamish, 1999). Moreover, there are institutional factors, which have an influence in both formal and informal terms. In particular, the level of property rights protection is an aggregate of the status of property rights legislation (formal) and its enactment and enforcement (informal). In general, it has been shown that foreign entrants tend to use high ownership level under weak intellectual property rights regimes (Delios and Beamish, 1999).

Moreover, high political risk has been viewed as an institutional factor causing foreign companies to favor low ownership modes (Delios and Beamish, 1999). Political risk is, however, a relatively vague concept. A more precise term, which has been suggested in the literature is the government intervention risk, encompassing the probability of political decision that will have a substantial impact on foreign investor's operations and strategy (Poynter, 1982). Consequently, such risk arises from public expropriation hazards that are a function of the ability of a host country's institutional environment to credibly commit to a given policy or regulatory regime (North, 1990). Hence, it can be classified as informal institutional constraint. Such risk is to a large extent industry-specific, which will be discussed more in detail in the next section of this paper. Another informal institutional constraint on foreign ownership strategy, which has been addressed in existing research is the extent of corruption. It has been shown that under conditions of pervasive and arbitrary corruption foreign entrants are likely to use partnerships (contracting or joint ventures) with local enterprises as adaptive strategy (Uhlenbruck et al., 2006).

### **Industry-level factors and choice of foreign ownership strategy**

The role of industry in the decision for foreign ownership strategy can be addressed from two complementary viewpoints. First, it can be argued that the institutional constraints for foreign

ownership vary along the relative importance of the industry for the host government. Consequently, the state policy is a combination of regulatory and market policy, representing the host country's use of laws and regulations to control foreign companies' activities and the host government's intervention and participation in an industry, respectively (Nygaard and Dahlstrom, 1992). The state policy can vary along sectors from laissez-faire to administered intervention (ibid), which in the Russian context have been identified as market capitalism in the consumer sector and state-led capitalism in the natural-resource based sectors (Puffer and McCarthy, 2007). Moreover, a key measure in the state market policy is the stimulation of national capital investments (Nygaard and Dahlstrom, 1992), which in Russia is undertaken by the creation of "national champions" –holdings with state financing or state administrative control- in sectors considered as strategic to the national economy and security (Liuhto, 2008).

The industry, where the foreign investor is operating in is thus an important determinant of state intervention risk (Bradley, 1977; Poynter, 1982). Not surprisingly, the strategic importance of the industry where the foreign investor operates increases the state intervention risk (Bradley, 1977; Poynter, 1982). Consequently, foreign firms have minimized the risk for expropriation by shared ownership with a local partner, which eliminates the stigma of 100% foreign ownership and establishes a local voice with a vested interest in speaking out against expropriation (Bradley, 1982).

Secondly, industries differ in terms of value-creation logic, i.e. what activities are vital to a firm's competitive advantage (Stabell and Fjelstad, 1998). The TC perspective addresses this issue with the concept of asset specificity, i.e. the assets which the value created by transaction is based on. The dimensions include for example site specificity (e.g. natural resource available at a certain location) and human specificity (i.e. specialized human skills and knowledge) (Williamson, 1983). The nature of asset specificity contributes to ownership structure in terms of whether control over physical assets is critical for a foreign investor. The separation of ownership and control occurs particularly in service industries (Erramilli et al., 2002). For example, local investors often without industry experience often purchase land and build facilities for the service firm to manage (Brown et al., 2003). The key asset of the service firm is therefore its know-how of running the operations. Moreover, in natural-resource based industries the key question is access to physical resources. This does, however, not always require ownership of the physical assets *per se* but rather the ownership of immaterial assets such as a license guaranteeing the right to use the resources. In an economy where the licensing procedures are not completely transparent, the importance of a local partner with access to such immaterial resources may thus be of critical importance (Khanna and Palepu, 2000)

## **Firm-level factors and choice of foreign ownership strategy**

The advantages and disadvantages of alternative ownership modes from the firm's strategic viewpoint have been extensively discussed in existing research. From transaction-cost perspective firms devise ownership strategies that minimize the cost of exploiting proprietary assets while protecting the rent-generation potential of those assets (Delios and Henisz, 2000). In terms of ownership strategy, the firm needs to balance the benefits and risks of partnering with a host country firm vis-a-vis entering on its own. The risks associated with partnering with a local firm have been conceptualized as private expropriation hazards, consisting of technological leakage (e.g. Teece, 1992) and hazard of free riding on brand name and reputation (e.g. Anderson, 1985). The extent of such risks correlates with the degree of specificity of these technological and marketing assets. It has been shown that under conditions of high asset-specificity and consequent high private expropriation hazards foreign companies are likely to increase their equity share to safeguard their specific assets (see, e.g. Gatignon and Anderson, 1988; Gomes-Casseres, 1990; Oxley, 1999).

Another perspective of examining the firm-level factors related to choice of ownership strategy is to view it as trade-off between the firm's need for resources and its need for control (Gomes-Casseres, 1990). It has been proposed that the firm would prefer shared ownership when the first is larger than the second and a wholly-owned subsidiary otherwise. It has been shown that joint ventures are preferred when they rely on local inputs of raw material, and when local firms can contribute skills to a joint venture (ibid). In addition to technological skills and market knowledge, the knowledge of governmental policies is a key asset that a local partner can contribute (Barkema and Vermeulen, 1998; Lu, 2002). In the institutional context of emerging economies crucial local resources include access to local authorities and business networks because competition is often distorted by licensing regimes, industrial regulation and tariff structures that favor local firms (Khanna and Palepu, 2000). The access to such resources implies often sharing ownership with a local partner. Consequently, the need for acquire such complementary assets is as an important determinant of foreign ownership level as the need to safeguard assets transferred to the foreign investment (Delios and Beamish, 1999).

## Conceptual tool of the paper

To empirically address the question of ownership strategy of Finnish investors in strategic industries of Russia, the contribution of institutional, industry-level and company-level factors in the ownership structure selection was integrated in the following conceptual model.

**Figure 1: Conceptual Model of the Study**

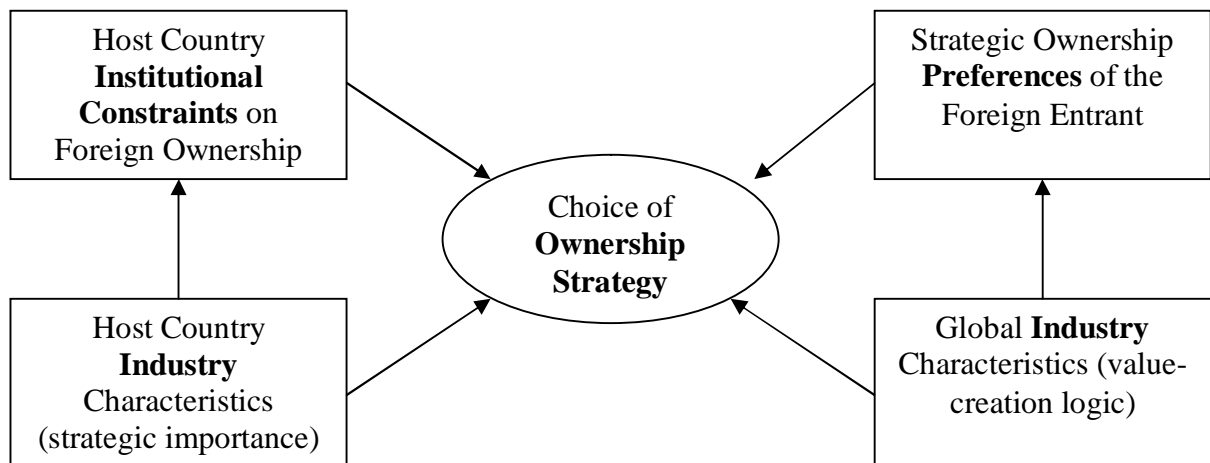


Figure 1 summarizes the basic assumptions of the article as regards to choice of ownership strategy. We view the foreign entrant's choice of ownership strategy as an outcome of host-country, industry and firm-level factors. First, the *host country* (Russian) institutional framework affects the decision of modal choice through formal and informal constraints on foreign ownership. The former include, for example, legal restrictions concerning foreign ownership share, whereas the latter are represented by administrative practices (e.g. corruption) that are applied when interpreting the formal rules.

Moreover, we maintain that *industry* characteristics have an influence on the choice of ownership strategy in two ways. First, industries vary in their *strategic importance* for the host government, which manifests in the institutional constraints posed to foreign entrants. This is illustrated by the arrow from the lower box on the left side to the upper one. Second, the *value-creation logic* varies among different industries, which has an impact on the choice of operation mode of the foreign entrant, part of which is the ownership strategy. Here, the nature of asset-specificity is a key factor.

Finally, we examine the choice of ownership strategy against firm-level factors, i.e. the foreign entrant's strategic ownership preferences. These include traditional TC based factors, which manifest in company perceptions of the relative risks and benefits of full versus shared ownership modes. Industry characteristics in turn are viewed as a background factor explaining ownership preferences, which is illustrated by the arrow from the lower box on the right to the upper one.

After having presented the theoretical foundations for the study, the article now moves to the empirical analysis. The following section gives an overview of the research methods and empirical data applied in the study.

## **METHODOLOGY**

This section describes the methodological choices of the paper, i.e. research design, data collection process, and data analysis methods.

### **Research Design**

This study is based on an critical realist paradigm (Sayer, 1992), which aims at developing a non-fusionist approach that considers actors' actions and structures as two separate ontologically different but related levels of reality (Leca and Naccache, 2006). Consequently, critical realism answers to the challenge of institutional analysis: how to consider simultaneously the influence of both actors' actions and the structures in which they are embedded (ibid). This is done by distinguishing between three domains that constitute reality (empirical, actual and real) and employing a research strategy that addresses all of them. Consistent with the critical realist paradigm, we adopt the strategy of retrodution, in which events are explained by postulating and identifying structures and causal powers that are capable of generating them (Sayer, 1992:107). This strategy involves three steps, each of which addresses different domain. Table 1 illustrates how these steps are taken in the present study.

**Table 1: Research strategy: Three steps**

Step	Domain(s)	Purpose	Implementation in this study
1	Actual & Empirical	To observe connections between phenomena and to identify how such connections occur (causal powers)	To explore the co-development of foreign ownership regulation and foreign investor's ownership strategies in Russia
2	Real	To build a hypothetical model, involving structures and causal powers	To provide a list of the different causal powers related to foreign ownership structure from previous literature, and integrate them into a conceptual model
3	Empirical	To subject the postulated model to empirical scrutiny	To establish, which causal powers work and how in the case of Finnish investors' selection of ownership strategy in Russia's strategic industries

Source: Adapted from Leca & Naccache, 2006

To implement the empirical part of the research strategy, a qualitative approach was taken. A qualitative approach enabled us to gain deeper insights of the causal mechanisms working in our empirical case. The components of our research strategy were operationalized into the following concrete conceptual measures, which provided the guidelines for empirical data collection and analysis (Table 1).

**Table 1: Causal powers and structures in the hypothetical model**

Origin of causal power	Nature of causal power	Effect on ownership structure
<i>Institutional framework</i>		
Legal limitations for foreign ownership	High	Low ownership preferred
Property rights protection	Low	High ownership preferred
Level of corruption	High	Low ownership preferred
Risk of state intervention	High	Low ownership preferred
<i>Industry-level factors</i>		
Strategic importance to the host government	High	Low ownership preferred
Industry regulation by licenses	High	Low ownership preferred
Importance of physical assets for value creation	Low	Low (or no) ownership preferred
<i>Firm-level factors</i>		
Asset specificity	High	High ownership preferred
Perceived importance of local assets	High	Low ownership preferred
Perceived private expropriation hazards	High	High ownership preferred

To summarize, our empirical inquiry focused on searching for explanations why Finnish investors operating in sectors that can be perceived as strategic for the Russian government, have chosen a particular ownership structure. In other words, we aimed at finding out whether the causal powers identified from existing literature work in this concrete case.

To gain a deep insight of the causal mechanisms working in our empirical case, qualitative approach was taken. Consequently, the selection of companies to be investigated was rather qualitative than statistical. We purportedly searched for companies that fulfilled the criteria of (1) being Finnish, (2) having invested in a Russian subsidiary, (3) operating in a sector, which can be defined as “strategic” for the Russian state, and (4) having operated in Russia for more than 10 years. As a consequence, our sample consisted of eight companies. The next section gives an overview of the data collection process.

## **Data collection**

The primary empirical data utilized in the article consists of 8 thematic interviews, conducted with the case companies’ management of Russian operations in January-February 2008. The interviewees represented companies operating in five sectors:

- Forest industry (2 companies)
- Logistics services and transportation (2 companies)
- Metal processing and metal products manufacturing (2 companies)
- Oil industry (1 company)
- Telecommunications (1 company)

All companies have a long experience on the Russian market. The interviewees as a rule had been involved in the respective company and/or Russian business for a longer time, which allowed them to comment changes in the company strategies and in the Russian business environment as well. The interviews were conducted in the respondent’s and interviewer’s mother tongue Finnish. The duration of each interview was approximately an hour. All interviews were tape-recorded and transcribed.

Three of the studied companies had entered the country already in the last years of the Soviet Union, when foreign-Soviet joint ventures became possible. Two companies had made major investments in the 1990s and gradually expanded since then. Three companies had also entered Russia in the 1990s but with a low profile, and increased their emphasis and investments only in the recent years. The ownership structure of the case companies’ Russian operations varied from partnerships to joint ventures to wholly-owned subsidiaries. The

subsidiaries had been established both as Greenfield operations and by acquisitions. Some joint ventures had been later transformed to wholly-owned subsidiaries.

The interviews were conducted according to an interview guide with thematic questions, constructed around the conceptual measures presented in Table 1. The interview questions touched upon both the factual aspects of operations, such as *What is your company's ownership share in its Russian operations?* and respondents' perceptions, such as *Do you view a difference in the treatment of foreign and local companies by the Russian authorities?*

In addition to interview materials, documentary evidence was used as additional data. This include first, information on formal institutions (legislation) governing foreign business in the selected industries and second, case companies websites and annual reports.

## **Data Analysis**

In the empirical analysis we subjected the hypothetical model developed on the basis of existing knowledge to the empirical data collected from interviews and documentary evidence (step 3 in our research strategy). Following Huberman and Miles (1994) we undertook three flows of activity characteristic to qualitative data analysis: data reduction, data display and conclusion drawing/verification. These take place concurrently in a continuous, interactive and iterative process (ibid). *Data reduction*, where "observations" were selected, focused, simplified, abstracted and transformed into "data" was performed by reducing the interview transcripts into the essential content of the conceptual model as well as retrieving relevant information from the secondary sources.

Moreover, *data display*, where information was organized and compressed in a way that permits conclusion drawing and action, was undertaken by displaying the data into a matrix. The matrix, where each data column represented data on a specific company, was constructed by two steps. First, the interview data was arranged according to thematic categories, each of which represented the origin of the causal powers identified in our hypothetical model, i.e. institutional constraints, industry-specific factors and company preferences. Second, we inserted into the matrix data concerning the actual effect of the causal powers: the observed ownership structures of Finnish companies).

Finally, *conclusion drawing / verification* completed the last step of our research strategy. The previous activities in the data analysis allowed us to draw conclusions on whether and how the hypothetical causal powers of our model work in this empirical case. The adequacy of our interpretation was verified by triangulating the data, i.e. cross-checking

information gathered through interviews with documentary evidence and existing literature on the topic.

## **EMPIRICAL ANALYSIS**

After the methodological considerations we now move on to the description of our empirical results. The description is organized according to the parts of our conceptual model, i.e. we start from institutional constraints, then move to industry-level factors and company preferences and end with implications to ownership strategy.

### **Institutions and ownership strategy**

We start our empirical description by exploring, how the interviewed companies perceived the role of different institutional constraints in their ownership strategy. Regarding *legal limitations for foreign ownership*, three companies had originally established joint ventures with local partners. Two of them (a plywood mill and service station chain) had been founded already in the Soviet period, when foreign enterprises were permitted to enter only through joint venture with a Soviet enterprise. Interestingly, both of them had been later on transferred to wholly-owned subsidiaries as it became possible after the collapse of the Soviet Union. The third one, a telecom operator, had been established as a joint venture in the early 1990s. According to the company representative it was at that time not legally possible for a foreign company to enter the Russian telecom market by majority ownership. In this case the operation mode has remained the same, although legal restrictions for foreign ownership in this sector have been since lifted. Other five companies had not been affected by legal restrictions on foreign ownership

Interestingly, interviewees' comments on *property rights protection* as an institutional constraint referred rather to situations, where the investor is acquiring property than to the protection of the company's own immaterial assets. Two companies (a forest company and a metal recycling company), which had established fully-owned Greenfield production operations, considered the underdeveloped land legislation as a considerable challenge: "*It is difficult to find for sale or for rent a site, which would have all documents in order. So that you can show that the person who offers the site is the real owner.*" This had not, however, affected their decision to enter without a local partner. Moreover, another

company, operating in metal processing business, had confronted unclear property rights when acquiring a local company. The company representative illustrated the situation as follows: “*In Russia, you have to start from finding out, whether the owners are selling are the real owners and whether there are gaps in the company history through which someone can later blackmail you or even take over the company*”. However, it can be argued that property rights issues had implicitly affected some companies’ ownership strategy. Those companies, which considered know-how of business processes as their key asset, had all entered via full ownership. The telecom joint venture was, however, an exception here. The company representative did not consider the private expropriation hazards as significant in their Russian operations, but rather highlighted the perceived benefits of the local partner.

The interviewees’ perceptions of the *level of corruption* in Russia were unanimous. All of them took the stance that “*Public sector corruption is widespread, but we as a foreign firm can’t get involved into that. If you take that road, it is endless.*” Corruption can be viewed as a background factor affecting not necessarily the ownership structure as such, but rather the need for local knowledge in general. All interviewees emphasized the importance of local partner’s or management’s contacts and local knowledge in dealing with the public sector with its requests. We return to this question later in this paper when discussing the firm-level factors affecting ownership strategy. Moreover, corruption was discussed from the perspective whether companies refusing from it get competitive disadvantage vis-a-vis companies, which agree to pay bribes. Most of the interviewees acknowledged that not all firms in their business operate transparently, but that the competitive advantage gained through corruption is not significant. The logistics operator put it as follows: “*Although our competitors would speed up administrative procedures by corruption, it does not do any harm for us.*” The interviewee from the metal-processing factory, however, had a contrasting opinion: “*We certainly lose deals because our competitors pay to the authorities [for permits] and thereby speed up the process.*”

The increasing role of the state in business had been observed by all interviewees: “*Particularly during Putin’s term in power state interests and business interests have started to mix. It’s a curious thing, a state-led free economy. I really don’t know how to call the system they use.*” However, the *risk of state intervention* in their business was perceived as low by all interviewees, although the re-definition of strategic sectors was mentioned as a factor contributing to political risks. A large-scale state intervention in terms of re-nationalization of assets was, nevertheless, viewed as highly unlikely. Moreover, some companies (in metal and forest sectors) raised the issue of the state regulative policy through export duties for raw

materials, including non-ferrous metals and round wood. In case of metals, this was viewed as being linked to the strategic importance of the industry: *“Russia has already adopted a 40% export duty for non-ferrous metals, which practically ended their exports already years ago.”* In general, however, the companies did not concern the political risks as a factor that would have made them to prefer shared ownership.

Moreover, state intervention in terms of market policy was mentioned by some interviewees. The oil retailer raised the issue of site allocation policy for service station construction: *“There are practices, where it is difficult to say whether it is corruption or just preferring locals. [...] They [local authorities] build huge packages, tens of sites, which in practice have only few potential buyers. They know that we [foreign companies] buy sites one by one, instead of packages.”* However, the interviewees had not experienced any direct discrimination by the authorities for being foreign: *“We have not been denied any permits, which we have needed or had any other problems just because of being foreign. I think that question is not relevant in our business.”* The treatment by state officials was rather viewed as case-sensitive than consistent policy, pending on the official in question.

### **Industry-level factors and ownership strategy**

The previous section illustrated the companies' views of general institutional constraints for foreign ownership in Russia. We continue our analysis by moving on industry-level determinants. As noted previously, *the strategic importance* of the industry for the host government has been found as affecting ownership choices. All interviewees had followed the discussion on the re-definition of strategic industries in Russia and had their opinions about the strategic importance of their own business to the state. Interestingly, none of the companies perceived their specific sector as strategic. Consequently, it seems that the firms had made their ownership decisions independently from the strategic importance of the industry for the state. In contrast, all companies noted that although their sector (oil industry, telecom, metals or logistics) can be considered as strategic in broader terms, their own niche is not such.

Moreover, some of the companies explicitly mentioned that they have no interest to enter in those areas, where state intervention might be expected. A logistics operator illustrated this issue as follows: *“We are not in heavy port logistics, we are not in railway logistics, we are not in those, which are on the Russian government's list on strategic industries.[...] So, the state intervention is not very likely.”* Similarly, the oil retailer did not see any particular risk of state intervention, being in the upstream business. Finally, both forest

companies viewed that forests are not as strategic natural resource for the Russian state as some others: *“If forest industry and forest resources would be really important for the Russian state, I think that more attention would have been paid to the forest legislation reform, which was a catastrophe.”*

In contrast, the importance of different *permits and licenses* was viewed as a central factor when designing entry strategy. This considered before all rights to land use and forest resources. Several interviewees mentioned that land plots, which are planned for industrial use are scarce. On the other hand, the transformation of a plot planned for another use (e.g. agricultural land) into industrial use is bureaucratic and time-consuming. One company (logistics operator) maintained that the land question was a central factor behind the choice of ownership strategy. The company had originally planned to enter Russia by acquiring a plot and constructing its own logistics centre. It, however, failed to find a suitable plot and ended up establishing a partnership with a Russian real estate company, which rented the Finnish entrant premises. Moreover, the importance for industry-specific licenses was stressed by the telecom operator: *“Telecom business is such that you need licences, hence you need to tie the local interest in the business.”* Consequently, access to operating licence was a key reason for joint venture. In these cases the need for license had led to lower ownership. In contrast, one of the forest companies had acquired a logging enterprise to get a forest lease right: *“In Russia the forests are owned by the state, which makes leasing agreements with companies. The easiest way to get lease rights is to acquire an enterprise, which has such an agreement. This is because leasing agreement is such an immaterial commodity, which cannot be transferred to another party or to be re-leased out.”*

The companies differed also in terms of *importance of physical assets for value creation*, i.e. the nature of asset-specificity. The two forest product companies and the metal recycling company can be viewed as operations with high site specificity, i.e. operating in fields where the proximity and access to natural resources or raw materials is the key. As the metal recycling company summarized: *“In our business, if you want to operate in a country, you need to be physically present.”* Similarly, the type of production the two forest companies have in Russia (plywood and corrugated board) are such that they need to be established close to forest resources. The other five companies highlighted the knowledge of business processes as their key asset. The linkage between asset specificity and ownership level was, however, not straightforward. All resource-based companies were operating on their own without a local partner – although one of the forest companies had recently joined forces with a local partner to invest in pulp mill. The logistics operator represented a case typical for service industries,

where the service operations and physical premises are owned by two independent parties. The value-creation logic of the logistics operator was described as *“Our knowledge and business model is completely the logistics. As a rule all international players [in our business] operate in rented premises.[...] Our competitive edge is to transfer our knowledge in service logistics to Russia.”* Also the other company representing the logistics sector (passenger and cargo transportation) did not see a necessity to invest in physical property in Russia. *“Our business model based on partnerships with local companies, which have the fleet and warehouse premises. Our decision not to invest has raised from the fact that in our business you don’t need to own anything. So far the partnership model has worked alright.”* However, in both cases the service operations are wholly owned subsidiaries.

### **Firm-level factors and ownership strategy**

We end our empirical analysis with the investigation of firm-level factors that bear impact on ownership strategy. Starting from *asset specificity*, the metal-working factory justified its desire for full ownership (entry through acquisition) by its business know-how: *“Our company’s strategic direction has moved towards solution business. That is, instead of pure manufacturing we provide complex solutions. [...] If you don’t own 100% you don’t have control over how the firm is operating”*. The logistics operator described a similar issue as follows: *“We started from the very beginning that we have a Russian subsidiary, which is fully owned by us. [...] All know-how and knowledge related to the business model is transferred from here.”* The importance of brand as a key asset was highlighted by the oil retailer, which had terminated the original joint venture in order to better pursue its strategy: *“Our business is dependent on the location, of course, but before all on brand. Our competitive advantage is our strong brand.”*

The second firm-level factor, *perceived importance of local assets*, was highlighted mainly in terms of intangible assets such as relations to the public sector and general knowledge of “how things are done” in Russia. These are, however, often internalized by hiring competent local managers and legal experts to the company payroll, or by acquiring a local enterprise as in the case of the metal-working company: *“The CEO of the acquired company has very good relations to the regional and local authorities. At the acquisition state they introduced our management to the authorities.”* In addition, licenses and permits, which were discussed above, can be clearly identified as key assets that a local company can provide. Here, however, the linkage to ownership was not straightforward. One of the forest companies

had internalized these assets (acquisition of a logging enterprise with a logging license), whereas the telecom operator had got access to licences through its minority joint venture. In this case the value of local assets was explicitly mentioned as a reason for joint venture: *“Local ownership is underlined particularly in Russia. There is the market which is only developing, there is the public sector, which defines your operating conditions. Local ownership guarantees that there is always someone to defend your interests. When the local owner acts for its interests, it at the same time acts for ours.”* The importance of public sector relations was also emphasized as a motive for allying with a local partner by one of the forest companies, which had founded a joint venture for its pulp mill investment project.

On the other hand, some companies viewed that in their business a local partner would not provide such assets that founding a joint venture would be justified. Here one company (the oil retailer) pointed out that the need for local partner has diminished when compared to the early years of transition: *“Originally we had a local partner, but then we separated. In the beginning [of the 1990s] the situation was so chaotic that you needed a local partner. The ownership rights and practices were unclear. Also, local partner shared the risk. In current situation we are quite happy doing on our own.”* In case of valuable local assets related to production it was perceived that these assets are better to internalize through acquisition (the metalworking factory). Moreover, immaterial assets such as public sector relations and knowledge of how to deal with bureaucracy could be acquired also through partnership. For example, for the logistics operator the local partner as the owner of physical premises took care of all permit bureaucracy related to opening the logistics centre.

Finally, *perceived private expropriation hazards* were illustrated in terms of risks associated with having a local partner. The interviewees did not explicitly mention expropriation hazards, but implicitly addressed them by discussing the importance of control in joint ventures. The telecom joint venture was a classical case, where the ownership control does not correlate with managerial control (cf. Karhunen et al., 2008). As illustrated by the interviewee, who is the Chairman of the joint ventures management board: *“Our position in the company is good, which is due to other aspects than the ownership share. We have three out of seven members of the board and I’m the chairman. Disputes among other partners have given us the opportunity to impact the company strategy more than our ownership share would indicate.”* An equivalent case was the joint venture of one of the forest companies, which had been since transformed into fully-owned subsidiary. *“In formal decision-making it is of course so that the majority shareholder decides. [...] It does not, however, directly influence how you can control the operations. We had since the very beginning contractual obligation to carry the*

*responsibility for sales and marketing. If you are minority owner but have the responsibility how the production is sold, it in practice means that you can pretty much set the direction of the operations.”*

## **DISCUSSION AND CONCLUSION**

This paper analyzed ownership strategies of Finnish companies in Russia in sectors, which may broadly be defined as strategic. Taking an institutional perspective of business strategy, we constructed a conceptual model encompassing institutional, industry-level and firm-level determinants that have been identified in existing research. In doing so, we resorted to institutional theory and transaction cost approaches. This model was applied to qualitative interview data on eight Finnish companies operating in Russia. Rather than testing specific hypotheses about causal relationships between exact variables, we explored the interplay of different factors as contributing to the ownership decision. Here, qualitative analysis was applied to search for the interviewees' perceptions and interpretations.

Our results show that first, the impact of the three levels of factors (institutional, industry-level and company-level) affecting ownership strategy can be viewed as mutually connected. The institutional framework provides the basic constraints for modal choice, which vary along industry. Here, the strategic importance of the industry for the state is one aspect, and the nature of assets critical for value-creation is another one. The regulation of property rights was viewed as a central element in many businesses. This ranged from land ownership to telecom licenses and forest lease agreements. When moving to firm-level, licenses and lease rights can thus be considered as a key asset that a local partner can provide. Its connection to ownership is not, however, straightforward. Some of the studied companies had accesses necessary assets through contractual partnerships, others through joint venture or acquisition of a local company.

Second, we maintain that corruption is an informal institutional constraint that cannot be overlooked by any foreign company. However, our empirical analysis shows that it is not necessarily the presence of local ownership *per se* but the availability of local assets (here, public sector relations) in general, which promotes foreign company's capability to cope with corruption. Such assets can be employed through high ownership mode (acquisition of local enterprise) or non-equity partnership as well. Here, a common strategy is to delegate public sector relations to a local manager or partner, which enables the foreign company to keep its own transparency (cf. Karhunen et al., 2008; Kosonen, 2005).

Finally, our results highlight the importance of industry-level determinants when analyzing ownership strategies. A key question, which was raised by our interviewees as well, is whether there is need to own physical assets at all in order to conduct business. Particularly in service industries one should analyze separately the ownership decision in terms of ownership of operations versus physical premises as Brown et al. (2003) suggest. A firm may emphasize full ownership of the former and decline to invest in the latter at the same time.

### **Limitations of the study and suggestions for further research**

Like all academic research, our paper has its limitations. First, our dataset consisting of eight interviews was relatively narrow in order to make any generalizations. This was, on the other hand, the strength of our approach, which was to qualitative analyze the nature of phenomena identified in existing, mainly quantitative research. On the other hand our paper provides guidelines for the construction of survey instruments for future research. Second, our approach was retrospective, where the ownership decisions of companies were discussed with a delay. Therefore, the factors that had contributed to the ownership strategy at the time of decision-making may have been perceived differently now than then. Hence, future research would benefit from the longitudinal examination of investment projects from planning to implementation phase.

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