

Golikova, Victoria; Karhunen, Paivi; Kosonen, Riitta

Conference Paper

Internationalization of Russian firms as institutional arbitrage: The case of Finland.

53rd Congress of the European Regional Science Association: "Regional Integration: Europe, the Mediterranean and the World Economy", 27-31 August 2013, Palermo, Italy

Provided in Cooperation with:

European Regional Science Association (ERSA)

Suggested Citation: Golikova, Victoria; Karhunen, Paivi; Kosonen, Riitta (2013) : Internationalization of Russian firms as institutional arbitrage: The case of Finland., 53rd Congress of the European Regional Science Association: "Regional Integration: Europe, the Mediterranean and the World Economy", 27-31 August 2013, Palermo, Italy, European Regional Science Association (ERSA), Louvain-la-Neuve

This Version is available at:

<https://hdl.handle.net/10419/124133>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Internationalization of Russian firms as institutional arbitrage: The case of Finland

Victoria Golikova¹ & Päivi Karhunen² & Riitta Kosonen²

*The authors want to thank the following institutions for financial support for this research:
Academy of Finland (Grant No. 264948), Basic Research Program at the National Research
University Higher School of Economics (HSE), and Paulo Foundation.*

1. Main determinants of internationalization of Russian firms and outward FDI from Russia

The internationalization of firms from Russia is a relatively recent phenomenon. The *perestroika* policy included the liberalization of foreign economic activities, and led to the emergence of entities based on participation of private capital to the OFDI field previously monopolized by the state. The inability of the Soviet and later the Russian government to control the capital movements of its firms and citizens led to a significant capital outflow from Russia abroad in the 1990s (Marinova et al., 2012). In addition to officially recorded OFDI, this outflow included non-recorded capital transfers, which according to different estimates (e.g. Loungani and Mauro, 2001) considerably exceeded the official OFDI stock (Liuhto and Vahtra, 2007). Part of the capital transfers from Russia abroad was motivated by illegal schemes, such as tax evasion or laundering the proceeds of corruption (Ledyeva et al., *mimeo*). After the turn of the millennium, however, the Russian OFDI started to grow rapidly and reached its record of \$370 billion in 2007. The global financial crisis, which hit the Russian economy in October 2008, interrupted the growth trend. The Russian OFDI stock in the end of 2011 had not yet returned to the pre-crisis level (CBR, 2012).

Furthermore, the above-illustrated characteristics of Russian capital outflows abroad are demonstrated in the geographic and industrial structure of Russian OFDI. Offshore financial centers, such as Cyprus, British Virgin Islands and the Netherlands are among the main destinations of Russian OFDI. This demonstrates “institutional escape” behavior, where firms seek more favorable institutional environment such as better functioning financial markets (Witt and Lewin, 2007; Kalotay and Sulstarova, 2010). Part of such OFDI is so-called roundtrip investment made by Russian firms to their foreign affiliates registered in offshore financial centers and then re-invested back to Russia (Kuznetsov, 2011). In addition, other countries of the former Soviet Union are also among main recipients of Russian OFDI due to cultural and language ties, developed industrial chains, business contacts from the Soviet period and other advantages of the so called

¹ National Research University Higher School of Economics, Institute for Industrial and Market Studies, Moscow, Russia

² Aalto University School of Business, Center for Markets in Transition, Helsinki, Finland

“neighborhood effect” (Kuznetsov, 2011). This effect is to some extent visible in the case of Finland as well, which is neighboring Russia in the Northwest and has historically close economic relations with Russia³.

As regards the sectorial structure of Russian OFDI, it very much reflects the structure of the Russian economy as a whole. The combined share of industries, directly linked to the exploitation of natural-resources⁴ in Russia’s OFDI stock in the end of 2009 was nearly 75% (Kuznetsov, 2011). Correspondingly, the company structure of the Russian OFDI is dominated by large natural-resource firms, many of which have state ownership. The motives of these firms, which are supported by the Russian governmental OFDI policy introduced in 2004, include resource-seeking and obtaining access to modern technologies through mergers and acquisitions (Marinova et al. 2012). The flagships of this policy Some of the Russian multinational companies (MNC) are among the largest foreign investor companies in the world (UNCTAD, 2012: 25).

On the other hand, nearly half of the Russian medium-sized and large manufacturing firms operate only on the domestic market (see e.g. Avdasheva et al., 2010), and small and medium-sized enterprises (SME) are even less active in internationalization. This can be in part explained by the large size of the home market, which provides opportunities for business growth without going international. Moreover, for those Russian SMEs which have international operations, the direction of internationalization is inward (Karhunen et al., 2010; Ekspert/CESSI, 2010). Outward internationalization, such as export or FDI, is undertaken by few SMEs.

Interestingly, from the perspective of Russian businesses the internationalization seems to be closely linked to the business owner’s personal aspirations. This is demonstrated, for example, by the recent tendency of wealthy Russian businessmen to use FDI as a vehicle for emigrating to developed market economies such as the United Kingdom (Pinsent Masons, 2012). Here, the main motive for FDI is not the business expansion, but the desire to live with one’s family in a country with well-developed and transparent institutions such as legal system or education (ibid). The weak quality of Russian institutions and problematic business environment are the main motivations for ordinary Russian businessmen and entrepreneurs, who think of moving their businesses abroad. As summarized by one entrepreneur *“Businessmen leave because it is more comfortable and peaceful to live in Europe. In Russia it is easy to make good profits, but difficult to live in”*. (Ekspert/CESSI, 2010). This statement is in the core of our case analysis, which we provide in the next section.

³ Finland was a grand duchy of the Russian empire 1809-1917, and during the Soviet era the only non-socialist economy which had a bilateral clearing trade agreement with the Soviet Union.

⁴ Including mining and quarrying, manufacture of refined petroleum products, manufacture of iron and steel, manufacture of non-ferrous metals, and wholesale trade of fuels.

2. Internationalization of Russian firms to Finland: Institutional escape or institutional arbitrage?

In this section we analyze the internationalization of Russian firms based on a qualitative case study implemented in Finland. We apply the institutional approach to explain the motivations of Russian firms and entrepreneurs to establish businesses in Finland, and the ways in which they navigate in the Finnish-Russian business context. Our key argument is that in many cases the underlying motivation for Russian firms expanding to Finland is the desire to “escape” the Russian business environment plagued with corruption and other institutional problems. In our understanding of institutions we refer to the institutional theory of Douglass North (1990), who defines the institutional framework of a nation as providing “rules of the game” for economic action. The set of the rules include formal, written constraints such as legislation and contracts, and informal, unwritten constraints such as behavioral norms and dominant business practices (North, 1990).

In terms of institutional framework Finland is one of the most stable and transparent ones in the world, and the “institutional distance” between Finland and Russia is one of the largest in the world when thinking about neighboring countries. The concept of institutional distance was coined in business and management research by Kostova (1999) to illustrate the similarity of dissimilarity of institutional environments in two countries. For example, in the World Bank’s Doing Business ranking 2013 Finland was in place 11, whereas Russia occupied the 112th place among 185 countries (World Bank, 2012). Illustratively, results of a recent survey (Yakovenko, 2012) show that Russian firms increasingly prefer to execute their business transactions under foreign legislation, even when the counterpart is another Russian firm. Although such arrangement adds administrative complexity to the transactions, it is considered easier and less risky than operating under Russian legislation. There have, however, been some improvements in the Russian formal institutions governing business activity in the recent years, but what still remains problematic is the informal institutions such as weak law enforcement and ubiquitous public sector corruption. The institutional distance between Finland and Russia in terms of corruption is illustrated by the Transparency International’s Corruption Perceptions Index, in which Finland shared the 1st place with Denmark, whereas Russia’s rank was 133rd among 176 countries (Transparency International, 2012). The heavy regulation of business and corruption go hand in hand, as it increases the public sector officials’ opportunities for rent-seeking.

Taken the institutional differences summarized above, it is easy to understand why Russian businessmen tired of Russian business environment would want to “escape” to Finland. However, one needs to keep in mind that developed institutional framework does not guarantee

business opportunities. On the contrary, in the developed economies the stable business environment goes hand in hand with low business risks and consequently smaller profits. In the case of Finland, the profit opportunities are further limited by the small home market. Although Finland is a high-income country in global comparison, it has population of only five million people. We, however, argue that the geographical location of Finland as Russia's neighbor provides Russian firms with the opportunity to benefit from the stable institutional environment in Finland while building their business strategy on Russian demand. In addition, an important institutional feature of Finland is that it is a member state of the European Union (EU), and thereby provides a stepping stone to the single market of the EU.

Here, we apply the construct of institutional arbitrage (Gaur and Lu, 2007; Boisot and Meyer, 2008), which refers to the situation where a firm is provided opportunities to exploit differences between two institutional environments. Gaur and Lu (2007: 88) argue that a firm is most familiar with its domestic institutional environment, although it would be the most favorable one for its business activities. The unfavorable home country institutions may prompt the firm to search for a more favorable institutional environment in a different country through OFDI. Boisot and Meyer (2008) call such behavior strategic exit from the domestic market, and argue that it may explain the internationalization of many Chinese firms better than the conventional view of the pursuit of an entry strategy to foreign markets. Similarly, Russian firms may select the neighboring Finland as the "home base" for their operations, or at least, "a gateway" to further internationalization due to the better quality of institutions, and at the same time base their strategy on exploiting the demand originating from the Russian market. Interestingly, the same institutional forces that push Russian firms away from the country generate demand for these firms. This is the case in for example tourism services, where there are large tourist flows from Russia to Finland.

In the remaining sections of this paper we empirically elaborate the concept of institutional arbitrage on the basis of interview data collected during 2010-2011 among 12 Russian-owned firms located in Finland. The discussion with the interviewees was based on a thematic interview guide, which addressed the internationalization process and degree of integration of the firm to the Finnish business environment from the institutional perspective. Most interviews were conducted in Russian. All interviews were taped and transcribed for further analysis.

The profile of the firms included in our study varied from subsidiaries of large MNCs to small firms established by entrepreneurs immigrating to Finland. According to data sources available the latter group seems to dominate in the number of Russian-owned firms in Finland: There were only 39 subsidiaries of Russian firms registered in Finland in 2010 (Statistics Finland, 2012), but when taking into account firms owned by individuals with Russian nationality, the

number of Russian-owned firms approaches 3,000 (Ollus, 2008). Most of these firms are small and operate in wholesale or retail trade, whereas there are few manufacturing firms. Moreover, although most Russian-owned firms have entered Finland only after the collapse of the Soviet Union, there are some large firms that operated in Finland already as part of the foreign economic system of the Soviet Union.

Our following empirical analysis applies the concept of institutional arbitrage to internationalization in two ways. First, we analyze the entry process, including the motives of the firms to internationalize to Finland. Second, we examine how the navigation between two institutionally distant environments shows in the degree to which the firms' operations are embedded in the Finnish business environment and to what extent they have linkages to stakeholders and resources originating from Russia. In doing so, we pay specific attention to the institutional differences, including the ways of overcoming them.

Institutionally driven motives for internationalization

The motives of the firms to enter the Finnish market varied according to the size and industry of the firm. For large and medium-sized firms the motivation was clearly related to knowledge-seeking and learning, which are motives characteristic for MNCs from emerging economies to invest in developed economies (Dohse et al., 2012). The knowledge-seeking investors included firms in high technology industries, which were attracted by Finnish technological knowledge. From the institutional perspective, the motivation of these technology-intensive firms to establish production in Finland was the opportunity to get governed under the EU legislation, which makes the export of high-tech products to the global market much easier from Finland than from Russia. In addition, the protection of intellectual property rights was considered more effective in Finland.

Furthermore, the learning motive was mentioned in our interviews at large Russian firms operating in wholesale or retail trade. The interviewees representing such firms described Finland as a “test laboratory”, where the company can learn how to operate in a competed market with transparent institutional framework, which supports our institution-based argumentation. The Finnish market potential as such was of lesser importance for these firms. Instead, the location in Finland was considered as a stepping stone to other Nordic or European countries. One of our interviewees described the motivation of the Russian MNC to acquire a Finnish firm as follows: *“This is really a place where you can proof your skills and how you can manage. We feel that Finland, and business in Finland, is a good example of how the European business should be run. This is because the rules are very clear. The law is very transparent and the government is treating*

all the companies from a very equal way.” The learning motivation showed in the Finnish subsidiary’s role in the MNC as well, which was described as more independent than in other countries.

In contrast, for small firms included in our data market-seeking was a common motive. However, the market opportunities for these firms were in most cases generated by the geographical proximity to Russia, which provided the possibility to serve Russian customers in Finland. Among our firms there was only one example, where the business idea was solely based on demand by Finnish customers. This particular subsidiary provided programming services, which were produced in the Russian mother company in St. Petersburg. In this case, the knowledge assets of the firm were of Russian origin. The owner of this company illustrated his operations as a “bridge” between Finland and Russia, as his Finnish customers that had also business operations in Russia were then able to “re-import” the solutions originally developed in Russia back to the Russian market.

From the institutional perspective the motivation for most small firms in our study was to exploit the market potential generated by the Russian customers’ interest in the safe and reliable institutional environment in Finland. This included construction and real estate business, which was serving wealthy Russian individuals who were looking for safe investment targets in Finland, and logistics services to Russian firms having foreign trade. Finally, there were entrepreneurs in our data who named personal motives for establishing a firm and consequently one’s own residence in Finland. This included getting tired of the chaotic Russian business environment, and the desire to improve the family’s quality of life in terms of settling to a safe environment with clean nature, out of stressful metropolises. Such attributes compensated the lack of possibilities to make high profits in Finland, as summarized by an interviewee *“We did not come to Finland to make big money, it is not possible here. Our business here gives us the opportunity to live in a more peaceful and happy country than Russia”*.

Process of internationalization: Informal institutional barriers

In this section we illustrate how the institutional differences between Russia and Finland and the possibilities for exploiting them in one’s own business reflects in the internationalization process of our companies. The selection of entry mode was solely driven by firm-specific factors, including motives for entering Finland. This illustrates the role of institutions in developed market economies; the institutional framework is there to regulate economic activity, but it does not pose any particular constraints on foreign entry mode choice as in many emerging economies. However, an interesting

feature in our data is that some entrepreneurs preferred to establish a new, independent firm in Finland instead of a subsidiary of their Russian company. This created the situation where the two businesses of the same owner were operating as independent legal entities, each being subject to the “rules of the game” of its own operating environment. Such arrangement is as a matter of fact common not only in the international context but also within Russia, i.e. small independent firms may be members of an informal group of companies owned by one owner (see, for example, Golikova and Ermilova, 2006). Such artificial separation of business directions into formally independent businesses is often used to minimize risks of being more noticeable for the corrupted authorities as the firm grows in size and profits and becomes a subject of administrative pressure. Hence, it represents another form of institutional escape.

The willingness of the Russian entrants to comply with the local institutional framework was shown in their comments regarding the formalities related to the establishment of the firm in Finland: They wanted to do everything by book, although in some cases it demanded a substantial effort from the entrant. For example, to make sense of the Finnish taxation system – based on information available mostly on Finnish - required either in-depth studying of the subject by the entrepreneur him or herself or outsourcing all red-tape of the firm to a professional service firm. One interviewee described his attempts to navigate the Finnish bureaucracy as follows: *“You need to pay a lot of taxes, and there are so many different ways in which you can decrease your tax burden. Maybe the locals know them, but how can a foreign investor ever make sense of the tax law which is cunning to the smallest detail?”*

Interestingly, the option to outsource the bureaucracy was found to be the preferable one in our firms, which is behavior not typical for Russian firms operating in their home environment. The outsourcing of business services in Russia is still not very common, partly due to the unwillingness of firms to share information on their businesses with outsiders. This indicates that Russian-owned firms in Finland want to be as transparent as the local ones, and adapt to the local way of organizing. This was stressed in a number of interviews, as shown in the following quote: *“We are of course acting in accordance with the company act and we are obeying all the legal provisions of the company act applied in Finland.”* In other words, when established in a business environment with clear and transparent formal rules of the game, these rules are taken as given. Here, our findings confirm the results of Shirokova and McDougall-Covin (2012) on Russian entrepreneurial firms. They showed that the commitment to honest business practices is a key factor in the internationalization of such firms.

In contrast, the institutional differences between Russia and Finland showed in the adaptation to the informal rules. In Finland with a developed institutional framework the formal and

informal institutions are mutually supportive, whereas in Russia informal rules in many terms compensate and sometimes even contradict the formal rules. This is reflected in the Russian firms' comments about the interaction with Finnish authorities during the entry process. On the one hand the transparent and clear formal rules were appreciated, but on the other some interviewees found it difficult to communicate with the authorities through formal channels only. For example, it was difficult to adapt to the fact that one just needs to fill in and send all formal registration documents to the authorities and the decision will follow, without any personal interaction with the state officials. On the other hand, it was acknowledged that such impersonalized system of interaction minimizes the opportunities for corruption..The whole question about corruption seemed for many of respondents irrelevant, although some pointed out that corruption exists in some form in any society but it is not always as visible as in Russia.

Furthermore, the high institutional distance between Russia and Finland on the one hand, and the peculiarities related to Russian OFDI on the other, reflected in challenges that some firms had encountered in the relation to Finnish financial institutions. The formal registration procedure of the firm was considered as very simple, but problems occurred in the opening of a bank account for the firm. These included refusals without explanation of reasons and long checking procedure of the documents provided to prove the source of the capital. This was vividly described by one interviewee: *"I sold our apartment in St. Petersburg, which my wife had inherited and wanted to invest it into my business here in Finland. I came with 15,000 Euros in my pocket to the local bank, and they were close to arrest me."* Our respondents attributed such practice as the consequence of the negative image of Russian investments abroad, which led to their treatment as potentially having a criminal origin. Interestingly, this obstacle was overcome successfully by applying either to another bank - or anecdotally to another branch of the same bank – which had Russian-speaking personnel.

Finally, there was one component of the entry strategy in which our firms were mostly operating according to the Russian rules of the game. This component was financing, which mostly originated from Russian sources. The largest firms were, of course, an exception as they had access to the international financial market. Smaller firms, in contrast, used their own financial resources generated in business activities in Russia, or acquired through personal networks there. What was interesting is that none of the entrant firms had exploited state financial support available in Finland, which many of which would have been entitled to as foreign-owned firms registered in Finland. The application of such support was perceived as complicated, and some interviewees did not perceive the attitude of Finnish state support organizations very positive towards Russian entrants: *"When I met the representatives of one such organization, I had the feeling that the*

support system as telling me to get back to the country I came from.” “On the other hand, the general suspicion among the Russian business community towards state intervention in the business may also explain the lack of interest in applying governmental support, and difficulties in communicating with state organizations. The preference to keep distance to the authorities was aptly summarized by one of our interviewees, who appreciated the Finnish business environment because *“here nobody disturbs you”*.”

Post-entry operations: Navigating between two institutionally distant environments

As discussed earlier in this paper, the business idea for entering Finland for many of our companies was based on the opportunity of benefiting from the demand originating from Russia. This included the need of international Russian firms for logistics services, services for Russian real estate investors, and accommodation and other services for Russian tourists. Therefore, the Russian entrants had an evident competitive advantage vis-à-vis their Finnish competitors in terms of knowing the customer’s language, culture and preferences. On the other hand, there were hardly any firms that had made a deliberate decision to focus on Russian customers only. Most of them had started from Russian customers and then expanded their business to serve the local market as well. An interesting example was a real estate and construction firm, which has started from designing luxury cottages in Finland to wealthy Russians seeking for investment targets abroad, and later on, developed a “budget version” to serve the local market.

In contrast, those firms which were motivated by learning and/or invested in Finland to get easier access to the global market did not emphasize their Russian origin as a competitive advantage. Rather, it was a disadvantage which the firm wanted to overcome with Finnish managerial and technological knowledge, rooted in the experience of operating in a highly competed and open market. For example, when entering via acquisition the old brand was kept with minor changes to the business processes of the firm: *“I would say that our strategy was not to damage the business model that was used here for many years.”* Similarly, when establishing high-tech production in Finland the goal was to get the status of “Made in the EU” for the products, which was considered to remove not only regulatory trade barriers but also prejudices towards Russian high-tech products on the global market.

Whereas many of our firms relied on Russian customer base in their operations in Finland, their supplier relations demonstrated a high degree of integration to the local business environment. As discussed before, many firms had outsourced their bookkeeping and other red tape to service firms, which usually were purely Finnish firms. Interestingly, although one could assume

that the Russian-owned firms abroad would prefer other Russian-owned firms (or firms established by Russian immigrants) in their business networks, our data did not confirm this assumption. In contrast, the reason to outsource the bureaucracy of the firm was to make sure that the things are done in a proper way, and there was a perception that “native” firms are more competent in this sense. On the other hand, there were informal networks among Russian-owned firms, which were used not for business transactions, but for exchange of information, recruiting channel and “moral support”.

Furthermore, the issue of trust was in the core of the interviewed Russian firms’ supplier relations in Finland. On the one hand, many of our firms preferred to work with Finnish suppliers, because they were considered as reliable. This implied keeping their promises in terms of schedule and quality. The different philosophy between the Finnish and Russian supplier culture is illustrated in the following quote: *“It is common practice here [in Finland] that you come to the supplier company, say what you want, collect your order, get the invoice and pay within 15 days. In Russia, you say what you want, get the invoice and pay it, and in 15 days your order may be delivered.”* On the other hand, to establish mutual trust with local firms was considered as challenging for an “outsider”. Such liability of being foreign was experienced not only in bilateral relations but also in the possibilities for integrating to the local business community as a collective. Whereas the largest firms had positive experience from their participation in industry unions as members equal to others, smaller firms had experienced the feeling that they are not welcome to local business associations because of their Russian origin.

The impression that a foreign entrant needs to gain trust whereas between locals it exists as given was common among our informants. However, the need to show one’s trustworthiness is very much true for the Russian business culture as well, where the business networks are very much based on interpersonal trust. The difference is that in a business environment where institutions are not developed enough to protect businessmen from misbehavior of others, such “given” trust does not exist. There needs to be some kind of a basis for this trust, including recommendation from other partners of the network. In contrast, in Finland our Russian informants were not afraid of trusting even new Finnish partners, perceiving that they are not inclined to cheating. The main issue what to get the Finnish counterpart convinced about one’s own trustworthiness. Therefore, the institutional barrier between Finland and Russia seems to work on one direction only.

The human resource strategies applied at our firms are in part explained by the entry motives and business idea. The firms motivated by learning and knowledge-seeking had mostly local personnel. For the high-tech firms the qualified technical personnel in Finland was actually

one of the main motivations to enter the country. For the largest firms the balancing between two institutional environments however showed in the staffing of executive and managerial positions. As Russian remains to be the official corporate language in Russian MNCs, such positions were occupied by Russian expatriates who also had knowledge in the requirements of the Russian bookkeeping system and other formal reporting requirements to the headquarters. Smaller firms, exploiting the “Russian connection”, in contrast predominantly had Russian-speaking personnel. This was justified by the need for communication with Russian-speaking customers, although the need to have also someone fluent in Finnish to deal with local stakeholders was acknowledged.

Another reason explaining the preference for native Russian-speaking staff was purely financial one. Particularly smaller firms perceived that they are not able to compete for labor with local firms, especially if the person needs to have Russian skills. Therefore, in many cases the core of the Russian-owned firms’ staff consists of Russian immigrants living in Finland. In some regard this can be considered as a win-win situation, as the position of immigrants on the open labor market is usually relatively weak and Russian-owned firms provide employment opportunities. Moreover, some firms used the Russian-speaking minority in the Baltic States, predominantly Estonia, as an additional labor pool. Using such labor was considered as cheaper than recruiting local professionals, and the membership of the Baltic States in the European Union means that their citizens can be recruited to Finland without immigration bureaucracy. The cumbersome bureaucracy related to getting working permits to Russian citizens and the associated costs was the reason why practically none of our firms had hired employees from Russia.

Finally, the institutional distance between Finland and Russia was very evident in the comments of our interviewees about the differences in the business and working culture between the two countries. Although the stable institutional framework and clear rules in Finland were in general appreciated by our interviewees, the other side of the coin was Finnish business partners’ and employees’ lack of flexibility and unwillingness to adapt to changing situations. In a country such as Russia, where the business environment is unpredictable, such features are devastating for survival. One such issue was the attitude towards working time: *“It never ceases to surprise me that in Finland when it is four p.m., everybody stops working and goes home irrespective of the situation in the project”*. This illustrates the difficulties in adapting to a different institutional framework. Although our Russian interviewees emphasized their willingness to comply with the local legislation, some of them found it difficult to understand all implications of for example labor legislation to the organization of the business. On the other hand, not all differences in the business culture can be explained by formal institutions only, but by the different attitude and philosophy of doing business and the relationship between business and leisure. For example, it was difficult to

understand for one of our interviewees why his Finnish supplier is not very delighted when receiving a phone call on Saturday evening.

Conclusion: Institutional escape as enabler for institutional arbitrage

Our empirical data on Russian-owned firms in Finland provides support for the argument that the internationalization of Russian firms in many cases is as much escape from Russia as entry to the foreign market in search for a more favorable institutional environment. Furthermore, in some cases the ultimate goal may be to enter a particular foreign market, but prior achieving this goal the firm needs to escape from Russia and gather speed in an intermediate location in order to learn how to operate in an institutional environment different from Russia. The selection of this location is therefore not motivated by market potential or other traditional pull factors for internationalization. In our case the philosophy of such firms seems to be that the farther the test environment is from Russia in terms of institutional distance, the better it equips the firm to operate on other foreign markets as well.

Furthermore, we conclude that the fact that the Russian institutional environment pushes firms and private investors to escape abroad provides also possibilities for institutional arbitrage. In our case this is demonstrated by possibilities to establish in Finland businesses, which are targeted to Russian customers seeking for safe haven for their capital in Finnish real estate, or who need support services for their international trade. Therefore, the knowledge of the Russian culture and institutional framework combined with the opportunity to govern one's business within the Finnish regulatory framework provides a competitive advantage for Russian-owned firms. Moreover, the macro-level institutional changes in the international business environment, following the collapse of the Soviet Union, have provided opportunities to access Russian-speaking human resource potential abroad. Therefore, the Russian-owned firms may find a very specific niche in the labor market without needing to compete for labor with local firms.

On the other hand, our analysis also points to the negative implications of institutional distance, and the root causes of institutional escape. The large magnitude of capital outflow from Russia, part of which has criminal origin, has made some foreign financial institutions suspicious to any Russian capital. Moreover, the trust between Russian and foreign, in our case Finnish, firms seems to work to one direction only. In this sense firms are prisoners of their home country institutions in good and bad: Russians are inclined to trust Finnish firms because them being rooted in a country with well-developed institutions and consequent high level of institutional trust. Finnish firms, in contrast, may have difficulties in trusting that Russian firms while operating in

Finland would not resort to the “wheeling and dealing”, which is needed to survive in the Russian business environment. Paradoxically, as pointed out in our interviews, Russian firms that themselves aim at operating transparently and according to the local rules of the game in Finland, do not always trust that their countrymen would do the same.

3. Theoretical and Practical Implications

Our study has provided both theoretical and practical implications. Our study is one of the first attempts to apply the concepts of institutional escape and institutional arbitrage on firm-level qualitative data. Moreover, our study contributes to the existing body of knowledge about Russian firms’ internationalization, which has so far mainly focused on analyzing the strategies of large MNCs on the basis of official documentary evidence. Our interviews with the executives of Russian subsidiaries of large firms in part complement the picture given in earlier studies. In addition, we provide new knowledge about the internationalization of small Russian firms, which has received scarce research attention until now. We show that the data on the handful of the flagships of the Russian natural-resource –based industries provides far from complete picture of Russian firms’ internationalization. Our attention towards smaller firms let us also discover how the business and personal motives of Russian entrepreneurs going international are intertwined. Therefore, some of our cases represent rather international entrepreneurship than internationalization of firms in its purest sense. Our analysis indicates that institutional constraints in Russia may drive Russian business-owners to opt for establishing a new and independent venture abroad instead of internationalizing one’s existing business via a foreign subsidiary.

Furthermore, our study provides new insights to the theoretical discussion about the role of institutions in internationalization. In particular, our elaboration of the concepts of institutional escape and institutional arbitrage provide new dimensions to the existing international business research on emerging economies, which has so far been mainly focused on the role of institutions in emerging economies as host country, or institutional distance between the investor country and emerging economy as a host country. Our study provides a mirror image of this setting by addressing Russia as an emerging economy as the home country. In addition, we provide a qualitative approach to the existing research on institutions and institutional distance, which mainly focuses on quantitatively testing their implications on entry strategy in terms of location or ownership mode choice.

Our findings regarding large Russian multinationals provide micro-level evidence on the motives for internationalization to developed economies. This including confirming the earlier

findings such as the dominant direction of knowledge flow is in the case of acquisitions from the foreign subsidiary to the Russian parent firm (Dohse et al., 2012). In addition, we provide new knowledge on how balance between the institutional demands from the home and host country.

Nevertheless, our geographic focus on Finland as a host country brings some limitations to our study. The geographical location at the EU-Russian border, long historical ties and small home market make Finland somewhat different to other developed economies. In the case of large Russian MNCs the learning motive may be less important for investing in such countries, which provide large market potential and/or production assets complementary to the company's value chain. In the case of SMEs and international entrepreneurs, we in contrast maintain that our results apply also to other countries with developed institutions and Russian-originated demand for services derived from the institutional problems in the Russian economy.

Our findings have practical implications, too. From the perspective of small Russian firms targeting to international markets, we show that the "Russian connection" may provide the easiest way to enter foreign markets. When the firm has the advantage of sharing the culture and language with its customers, it is in superior position vis-à-vis competitors not equipped with such skills. This can compensate the lack of knowledge on operating in the foreign business environment. In addition, the management or owner of the Russian firm is likely to be perfectly aware of those institutional factors in Russia that their potential customers are willing to escape, and be able to serve their needs. Starting the foreign business from this segment gives the firm time to learn how to operate in the foreign market, which enables it later to expand to serving local customers as well.

From the perspective of policy-making, our interviews at the Russian-owned businesses in Finland discovered a strong commitment to operate according to the rules of the Finnish society and economy. Therefore, the potential prejudices towards Russian investors are in many cases without real basis. In addition, although Russian-owned businesses abroad may at first glance look as isolated island employing Russians staff and serving Russian customers, they however have a strong desire to integrate to local business networks. In addition, the fact that they provide employment to immigrants can be viewed as a positive aspect. This should be taken into account in policies aimed at attracting foreign investment to developed market economies.

Finally, when drafting inward FDI promotion measures targeted to Russian investors, one should take into account the strong influence of personal motives for establishing business abroad that is characteristic for Russian entrepreneurs. It is not necessary the market potential and large profits that motivate internationalization, but rather the wish to establish one's business and personal life in an environment less stressful and unstable than the Russian one. Hence, at least in

the case of Finland it is very much the same factors: safety, stability and well-functioning society that attract Russian tourists and businesses alike.

References

- Avdasheva, S., Golikova, V., Gonchar, K., Dolgopyatova, T., Kuznetsov, B., Yakovlev, A., Yasin, Y. (2010) Russian Manufacturing Revisited: Two Rounds of Surveying Russian Enterprises in 2005-2009. HSE Policy paper, National Research University Higher School of Economics (HSE): Moscow, Russia.
- Boisot, M., Meyer M. (2008) Which way through the open door? Reflections on the internationalization of Chinese firms. *Management and Organization Review*, 4:3, 349-369.
- CBR (2012) Online statistics database of Central Bank of Russia, available at <http://www.cbr.ru/eng/statistics/>; accessed 20 December 2012.
- Dohse, D., Hassink, R., Klaerding, C. (2012) Emerging multinationals, international knowledge flows and economic geography: a research agenda. Kiel Working Papers No. 1776, Kiel Institute for the World Economy: Kiel, Germany.
- Ekspert/CESSI (2010) Ostat'sya ili uekhat'? [To stay or to go, in Russian], article by Anna Andreenkova on results of a survey made by the Institute for Comparative Social Research CESSI in Magazine *Ekspert*, No 48 (732), 6 December 2010. Available at <http://expert.ru/expert/2010/48/ostatsya-ili-uehat/>; accessed 20 December 2012.
- Gaur, A. S., Lu, J.W. (2007) Ownership strategies and survival of foreign subsidiaries: impacts of institutional distance and experience. *Journal of Management*, 33,1: 84-110.
- Golikova V., Ermilova G. (2006) *Competitiveness of Small Enterprises: Evidence from Empirical Survey in Two Russian Regions*. Tokyo, Hitotsubashi University, Insitute of Economic Research Discussion Paper Series (B), No. 34, pp. 39-65.
- Kalotay, K., Sulstarova, A. (2010) Modelling Russian outward FDI. *Journal of International Management*, 16, 2: 131-142.
- Karhunen, P., Mochnikova, E. and Vasilenko, D. (2010) Internationalization of SMEs: St. Petersburg, Results of a survey. Aalto University School of Business, Mikkeli Business Campus Publications N-92. Aalto University: Helsinki, Finland.
- Kostova, T. (1999) Transnational transfer of strategic organizational practices: A contextual perspective. *Academy of Management Review*, 24, 2: 308-324.

- Kuznetsov, A. (2011) Outward FDI from Russia and its policy context, update 2011. Columbia FDI Profiles, Country profiles of inward and outward foreign direct investment issued by the Vale Columbia Center on Sustainable International Investment, August 2, 2011. Available at http://www.vcc.columbia.edu/files/vale/documents/Profile_Russia_OFDI_-_2_August_2011_FINAL.pdf; accessed 18 December 2012.
- Ledyaeva, S., Karhunen, P., Whalley, J. (mimeo) If foreign investment is not foreign: Round-trip versus genuine foreign investment in Russia.
- Liuhto, K., Vahtra, P. (2007) Foreign operations of Russia's largest industrial corporations-building a typology. *Transnational Corporations*, 16, 1: 117-144.
- Loungani, P., Mauro, P. (2001) Capital Flight from Russia. *The World Economy*, 24, 5: 689-706.
- Marinova, S., Child, J., Marinov, M. (2012) Institutional field for outward foreign direct investment: a theoretical extension? In L. Tihanyi, T.M. Devinney and T. Pedersen (Eds.) *Institutional Theory in International Business and Management* (Advances in International Management, Volume 25), Emerald Group Publishing Limited, pp. 233 – 261.
- North, D.C. (1990) *Institutions, Institutional Change and Economic Performance*, Cambridge University Press: Cambridge.
- Ollus, S.E. (2008) Venäläinen kapitalismi ja Suomi [Russian capitalism and Finland, in Finnish]. Taloustieto Ltd: Helsinki, available at http://www.eva.fi/wp-content/uploads/files/2293_venalainen_kapitalismi.pdf. Accessed 20 December 2012.
- Pinsent Masons (2012) Number of wealthy investors obtaining visas to stay in UK rockets. Newsletter available at <http://www.pinsentmasons.com/en/media/press-releases/2012/number-of-wealthy-investors-obtaining-visas-to-stay-in-uk-rockets/>; accessed 20 December 2012.
- Shirokova, G., McDougall-Covin (2012) The role of social networks and institutions in the internationalization of Russian entrepreneurial firms: Do they matter? *Journal of International Entrepreneurship*, 10, 3: 177-199.
- Statistics Finland (2012) Foreign affiliates in Finland, available at http://www.stat.fi/til/ulkoy/2011/ulkoy_2011_2012-11-26_tie_001_en.html; accessed 19 December 2012.
- Transparency International (2012) Corruption Perceptions Index 2012. Available at <http://www.transparency.org/cpi2012/results>; accessed 20 December 2012.
- UNCTAD (2012) World Investment Report 2012: Towards a New Generation of Investment Policies. Available at

http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf; accessed 20

December 2012.

Witt, M. A., Lewin, A. Y. (2007) Outward foreign direct investment as escape response to home country institutional constraints. *Journal of International Business Studies*, 38,4: 579–594.

World Bank (2012) Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises. Available at <http://www.doingbusiness.org/>; accessed 20 December 2012.

Yakovenko, D. (2012) Za granitsu za zakonom.. Magazine *Ekspert*, No. 27 (810), 9 July 2012. [Abroad after legislation, in Russian]. Available at <http://expert.ru/expert/2012/27/za-granitsu-za-zakonom/>. Accessed 29 January 2013.