

Logistics of Finnish Food Companies in Russia. In house development or outsourcing?

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ABSTRACT

This thesis is concerned with Finnish food companies and their logistical strategies regarding doing business in Russia. However it is not intended solely for food companies per se, rather it is a compilation for companies interested in expanding into Russian markets of diverse best practices and applications describing ways to deal with arising trials and tribulations in terms of logistics after the 1998 crisis in Russia.

Unique trading and business relations of Finnish companies, especially food companies in Russia can be traced to the times of Czar, when Finland was an autonomous region, but a part of the Russian Empire. It was always of great concern for Russia and subsequently for its business partners to develop reliable distribution networks and systems, which is why this writing presents an overview of developments of Finnish food companies in the context of Russian culture, as well as in the context of popular and approachable theories and frameworks of logistics.

The essential question of the study was to understand if there is a correlation between the types of operations Finnish food companies and their logistics arrangements in Russia. The findings include a model proposition. This model states that due to the nature of the fast paced business environment in Russia it is viable for Finnish food companies to develop a combination of local presence in the form of own production and outsourcing techniques, while primarily focusing on the core activities of the firm. Other types of activities are however subject to more flexible logistical considerations. These outcomes were concluded based on secondary research and primary research based on interviews, questionnaires and personal discussions with knowledge holders of the industry.

Additionally, various problems are discussed regarding logistic operations of Finnish food companies in Russia. The major concerns were reported to be traffic congestions in the metropolitan areas, such as St. Petersburg and Moscow.

Keywords: Logistics, Finnish food, Russia, Internationalization, Outsourcing

Total number of pages: 68

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1 INTRODUCTION

1.1 Background

The purpose of this thesis is to describe logistic patterns of Finnish food producing companies in Russia after the 1998 economic crisis, as well as explain their reasons for choosing such distribution methods; and their approaches to tackling arising obstacles on the way of adding value to the overall chain. This study utilizes the empirical case research method, where the foundation of the findings is based upon a case study of a company. The primary information was gathered by the means of interviewing respective knowledge holders in a particular case company.

1.2 Research Problem

The research problem of this writing could be formulated as a simple question – “How does choosing a specific organizational structure of Finnish food companies in Russia affect their logistical considerations?”

1.3 Research Questions

To follow up on this question the following inquiries come to mind:

1. What organizational structures are in use by Finnish food companies in Russia? Why?
2. What logistical maneuvers do these companies undertake compared to their organizational structure?
3. Is there a correlation of the two? If yes, what and how strong it is?
4. What is the value added within these logistic structures?

Overall this study will try to pin-point the main facts of the industry experience so that other Finnish players could build on the knowledge gathered and put it into practice with maximum benefit and minimum risk. All of the potential answers will be presented in the Conclusions section of this thesis.

1.4 Limitations

The limitations of the study were few, but they represented a minor share of difficulty with the project thus causing only slight nuisance regarding its preparation. One critical limitation though was the primary research availability. Interviews needed to be prepared in advance with the corresponding knowledge holders; however the project was scheduled to be commissioned during the summer, the time when many of the people selected for interviews were absent from their workplaces. Thus not all of the interviews could be concluded in the first few months of the project. Yet, in the end only two companies did not follow up on the interview possibility, leaving seven major Finnish food producers involved in the Russian market to participate and provide quality feedback. Additionally some of the interviewees were not physically present in Finland or Russia, which would present a hassle should the author opted for a face-to-face interview. But this was resolved by substituting personalized interview with an emailed questionnaire. Of course the answers were not as full and elaborated; still they provided the necessary data required for the project. Another constraint that was obvious, as with other general research papers was the enormous information base, which made it more difficult to search and select applicable studies for this writing.

1.5 Structure

Initially, I describe the context of past and existing structures that guided Russian and Finnish logistics food systems. I introduce and compare Soviet & Pre-Crisis and Post-Crisis situations concerning the overall food sector, then I present a brief introduction of the Finnish food companies in Russia and describe their development history. Later this study presents collected theoretical frameworks, i.e. review of existing literature on the current topic, notably the Internationalization of the firm theory, Porter's Competitive Strategies model, as well as I include multiple findings from the expansive work done by Reijo Luostarinen and other authors in the fields of Logistics, Outsourcing, and International Business. Additionally, preceded by methodology explanations a series of interview summaries and key findings is presented to test the theories in practice. Following are conclusions, which give an analysis of the combination of secondary and primary information gathered, as well as evaluate future research potential.

2 CONTEXT

Years 1997-1998 have caused many countries to revise their views on many matters earlier deemed insignificant. In this case, the Russian Federation – a state, which gained its independence only several years before this major break down of its economical, political and ideological frameworks, was hit hard. Factors that influenced this turnout were numerous. However as the situation stabilized, with the help of a more liberal government, rising oil prices and a trend towards globalization Russian economy began picking up.

Today Russia is the 10th largest economy in the world (Appendices: #1), with a steady GDP growth, quickly adjusting to the realities of open market capitalism. Foreign direct investments (FDIs) are growing at a very optimistic pace even compared to other developing countries of the BRIC (Brazil, Russia, India, China) abbreviation. Following this enormous expansion of opportunities and capital in all of its forms, the need for supporting services like logistics unsurprisingly sprung like mushrooms after rain.

2.1 Food sector

2.1.1 Soviet & Pre-crisis

Compared to the Western foodstuff markets the Soviet system was largely different. Mainly two types of trade existed – government and cooperative (Радаев 2007, 42). Three characteristics were distinguishable of the Soviet food production: massive volumes, centralized control, and lack of competition (Kaipio & Leppänen 2005, 36). The government organizations were viewed by the consumers mostly through Gastronom's - large shops where one could find a wide assortment of food products. Gastronom's were primarily present in the large and medium sized cities of the USSR. The supply chain that was behind these enterprises was that few massively large manufacturing plants would produce certain kinds of products for almost all of the countries Gastronom's, and transported by a government transportation firm specializing in food distribution, which were subject to a particular food, like MolokoTrans (moloko = milk). Gastronom's were essentially over-the-counter shops that sold products by giving the consumer his product as opposed to the Do-It-Yourself model, where customers are freely allowed to select their products at their own pace.

The cooperatives, which from a Western perspective were private enterprises owned by three

or more persons were also over-the-counter stores but a lot smaller in size and variety of products, mostly targeting the essentials or sometimes focusing on a specific product. The share of these two types of trade fluctuated from time to time, reaching a crucial difference in major cities in favor of cooperatives during the beginning of the 1990s (B.B. Радаев 2007, 44). The supply chain of these stores was mostly built around personal connections of the owners of cooperatives, where that owner would negotiate a deal with and/or through close contacts engaged in either kolkhozes (see below) and/or in those government production plants. The actual transportation was usually done by the owners mostly due to the fact that a Soviet entrepreneur had to do everything himself as well as due to the lack of trust between the owner and the contractor with the merchandise; in that during volatile 1990s food was of much greater importance than money, thus giving an opportunity of criminal activity, i.e. stealing.

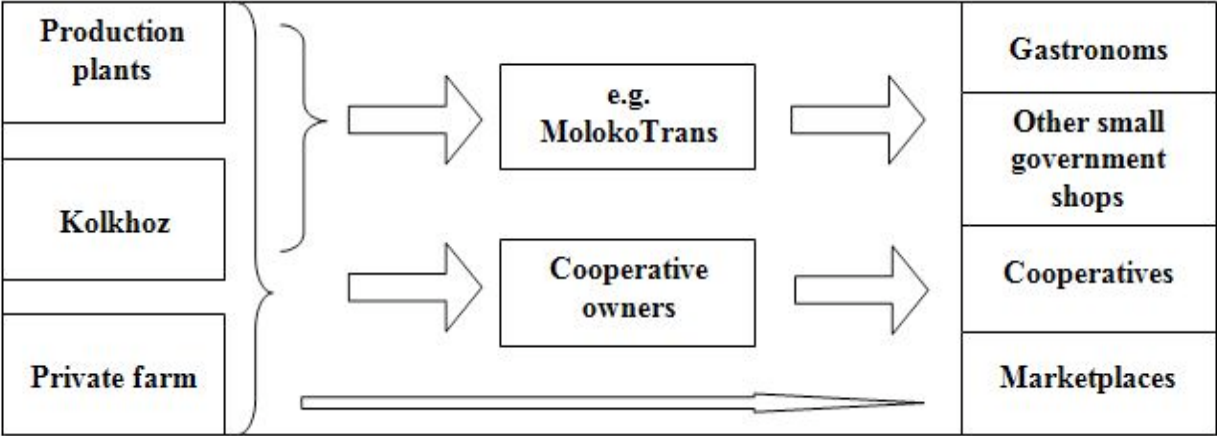


Figure 2-1 Supply Chain in USSR

Additionally there were several types of production/distribution systems in the USSR – kolkhoz and marketplaces or otherwise called open markets. Kolkhoz can be described as a “collective economy” or “collective farm”, which essentially was a farm, but had no direct owner (the government was the owner), which made it sometimes difficult for people working there to actually value their output. Kolkhoz appeared in the beginning of the Soviet era, when peasants and farmers were forced by collectivization to submit to a communal farm, which would then employ these farmers as government workers (Gregory & Stuart 1998, 79). This type of market activity provided for the local community, since in almost every even smallest city there was a collective farm. Of course in the case of larger and more developed kolkhozes, they also catered to a wider area, yet not so much as up to the country-wide coverage. Marketplaces were and are basic bazaars that primarily provided consumers with

basic-needs products, where people sold homegrown and/or kolkhoz provided produce. The government did not control these markets as tightly as the local mobs and gangs, which up to this day extract great profits from this system.

In general the food product range in the Soviet Union was highly standardized for the public, except in the specialty stores like Berezka that provided imported goods as well as USSR made but of much better quality for the elite and persons who were entitled to the status of no-hassle outside travel. Consumer goods as well as trade in general was given the least attention during the communist era, which proved to be crucially negative in the start of the 1990s and amounted to an enormous necessity product deficit.

After the collapse, especially in the years of 1992-1993 Russian food market was practically paralyzed. The situation that occurred during that time was both horrible and trivial – Russia was on a verge of a food catastrophe. As opposed to China, which slowly, step-by-step opened up itself to foreign investments and market economy, Russia seemed like pressed some button and overnight the Soviet adage of "lots of money – nowhere to spend" turned into "lots of products – no money." Although by the mid 1990s the situation on the food market began slowly improving, it did not show clear signs of growth until the big "shake up" of 1998.

2.1.2 Post-crisis

Today the food sector in Russia is primarily characterized by the advancements coming from St. Petersburg, Leningrad region, Moscow, and Moscow region, thus when referring to the "Russian" food sector the above mentioned regions are the ones to play key roles in the food business.

The economic crisis was a dramatic event in the lives of many people. Yet it was not obvious until several years later that not only it was supposed to happen anyway, but also that it brought various benefits to the transition of Russia onto the market economy tracks in general. For instance, with foreign product suddenly turning hugely expensive, most of the consumers turned to more cheaper, i.e. Russian made products, which was a green light to many Russian key players that were and are operating in the food industry today, like retail chains, distributors and manufacturers.

On some accounts, although marketplaces are still the dominant means of delivering products to consumers, retail chains in Russia are developing at a fast pace and are expected to take the lead over the marketplaces in the future (Kaipio & Leppänen 2005, 25). Other sources state that local over-the-counter stores seemed to be the most popular providers of food products for Russians (66%) according to a RLMS study done in 2006. Following were the marketplaces (46%) and retail chains (46%). Additionally it was mentioned that the older the consumer the more often he/she visits marketplaces rather than the newly established retail chains; which could be explained by the nature of a human being, where in general the older a human gets the harder it is for him/her to change buying and other habits (Радаев 2007, 101).

2.2 Logistics in Russia

2.2.1 Soviet & Pre-Crisis

Throughout the years Soviet distribution systems were based on tightly controlled organizational hierarchy, where for the majority of cases, every institution knew which particular segment or industry they were responsible for. The schedules of almost any type of product in the Soviet Union were centrally planned and closely regulated, which according to market economy principles resulted in dreadful consequences like overproduction, inefficiency of labor as well as other factors. On the other hand this leverage provided for high degree of transparency, which in turn made a great deal of tasks, like supplying, storing, and delivering various products, much less complicated for all the members of the supply chain and everyone else who was interested, given of course the security clearances. Without a doubt there were miscalculations that simply put delivered redundant results. It is no secret that a great proportion of resources went into the military complex. Yet logistics as a science dates back to the Roman, Greek and other empire periods, when armed forces were not only important but essential to a nation's existence. Soviet Union was a highly militarized and unpredictable country, thus the major investment swings into railway networks, air link developments etc. during several Five-Year Plans; whereas during others there were little or no inflows of resources into these fields of interest, which is why many regions in Russia were and today still are practically disconnected from the outside world.

Nevertheless, production was done at a national level, meaning someone at the office in Moscow calculated to produce X amount of certain product in some region over the course of say a year. Once this decision has been embedded into the yearly planning process, the region

was supposed to produce the given number of X or more. Managing the flow of goods, information and resources in this situation was not particularly difficult because for the most part it was about following the plan, especially in the food business. There were no supermarkets and mega-mall chains like today – simply small scale shops with a warehouse design that would stock up on essential products from the nearest factories or Sovkhoz; or open markets where Kolkhoz representatives would drive up and sell the products from the back of their trucks. There were no demand fluctuations – everything would sell, due to great product shortages.

In the mid eighties with Gorbachev and perestroika came some changes that would ignite the process of USSR dissolution. Several important laws were passed during that time, which stipulated permission of 1) private ownership as well as 2) transfer of state enterprises from strictly government subsidized conglomerates to companies that were more or less free to do as they wish (Gregory & Stuart 1998, 299). The latter posed various threats for large enterprises and the USSR economy as a whole, because many of them were actually on the verge of bankruptcy and were supposed to stay afloat based on their own performance rather than State help.

Unfair privatization began. Due to lack of quality information and knowledge of market economy principles almost everyone in Russia was left over board. The people who designed the system were the ones to profit (Earle 1999, 38). For several years gigantic enterprises were unable to not only make a profit or at least break even, they could not function properly and hence pay salaries, support neighboring regions etc. Logistics has played a major role in this scenario. Soviet Union was strategically separated into various areas where certain products would be manufactured/harvested and then distributed all over the USSR. Once the Union stopped existing it was legally impossible to transport anything anywhere even at a basic level because there were no regulations in place. Commonwealth of Independent States was established shortly after the collapse, but the initial effects were devastating, which would improve only slightly before the next hit.

2.2.2 Post-crisis

With the collapse of USSR, many of the larger organizations quickly vanished into the free, but very cruel air of the market veracity. Some were privatized. Few actually became viable

businesses that built on the knowledge of previous years and could manage to combine that with the lessons learned about competition, price control, and extensive supply chain management techniques of the modern days.

In August 1998, then prime-minister Sergei Kirienko delivered a message that would shock not only regular Russians, but most importantly the international investment community. Russian government has announced its inability to pay on its debt. This caused a colossal uproar around the world. Some say this Russian crisis was caused by the 1997 Asian crisis that resulted in the same astonishing effect, yet the causes of it are not to be described in this paper.

The 1998 crisis seemed to have destroyed what was merely a hope for the Russian economy. Yet, by the beginning of the new millennium statistics started showing signs of actual progress within several industries at once. Due to increasing oil prices, better harvests and improved handling of the country, when Vladimir Putin took over as Prime Minister, Russia quickly reverted to the path of development and growth. Today, almost 10 years after the crisis major multinational corporations, as well as small and medium enterprises are making their way into the Russian market. Many companies set up their operations in Moscow, St. Petersburg and other large cities from scratch, however a noticeable share of firms are returning after the crisis blow. This demonstrates that Western world has gained more confidence in the Russian economy, policy and will to provide for globalization (recent events of the crisis between Georgia and Russia will of course influence this position, but only to some extent due to cancellation of sanctions from the EU and the U.S.).

2.3 Finnish food companies in Russia

2.3.1 General

Finland's share in Russian economy in general has been tremendous over the course of history. Throughout the Czarist and Empire times to the modern day Russian Federation, Finland continues to play the role of a friendly neighbouring country interested to work together and create partnerships with representatives from the East. A reasonable way to look at exactly how friendly Finland is in terms of business opportunities, a concept of foreign direct investments (FDI) and overview of exporting can prove to be interesting.

Russia is a part of the International Monetary Fund (IMF), meaning it accepts the definition and measurement system of FDI (see Foreign Direct Investment Statistics 2001 for more information). Total FDI inflows in 2007 into Russia doubled to almost USD 29 billion from 2006 (UNCTAD 2007). According to Central Bank of Russia FDIs of newly created shares from Finland into the Russian non-financial sectors amounted to USD 173 million, or about 0,6% of the total capital inflow (see Appendices # 6). On the other hand this is somewhat of a large figure, considering that the Inward Foreign Direct Investments in Nonbanking Corporations from Finland were USD 787 million.

In order to find pertinence to this writing we must examine the food processing sector of the economy and its share of FDIs. Table 2-1 shows the break-down of the sectors before and after the crisis and their percentage shares of FDI received. It shows a decrease from 19% to 13%, which was due to the consequences of the crisis. However today, the overall FDI into Russian food manufacturing (including tobacco production) accumulates almost USD 1,2 billion (see Appendices #7), which equals to a little over 4%. Such a decrease in several years is most likely due to the echoing benefits of the crisis of 1998, where foreign food produce suddenly became greatly expensive, so consumers started switching to more cost-appealing products, which were predominantly Russian made.

N	Industry	Before crisis: 1995-1998	After crisis: 1999-2003
1	Industry	42	49
2	Electric power	0	0.23
3	Fuel industry	8	20
4	Ferrous metallurgy	2	1
5	Non-ferrous metallurgy	2	1
6	Chemical and petrochemical	2	2
7	Machine-building and metal cutting	3	5
8	Logging and woodworking, pulp and paper	4	4
9	Building materials	1	1
10	Light industry	1	1
11	Food	19	13

Table 2-1 Industrial composition of FDI in Russia 1995-2003 in % (Adapted from: Ledyeva 2007)

Regarding exports, even though overall food exports have been diminishing in turnover since 1994 (see Table 2-2) and does not constitute a very large proportion of the overall trade between Finland and Russia today – about three percent (Ollus & Simola 2006, 28) - Russia has been championing the title of Finland’s largest trader in terms of the foodstuff exports (see Figure 2-2) with nearly 300 hundred million euros in value (see Appendices #5).

Structure of Finland's Merchandise Exports to Russia, %									
Product group	Exports to Russia								Share of total 2002
	1992	1994	1996	1998	1999	2000	2001	2002	
0 Food and live animals	11.5	21.5	13.7	10.6	8.2	7.0	6.2	5.8	1.7
04 Cereals and cereal preparations	6.3	0.9	2.2	1.5	1.4	1.3	1.3	1.1	0.3
05 Vegetables and fruit	1.1	9.3	1.6	1.0	0.3	0.2	0.2	0.1	0.1
1 Beverages and tobacco	0.5	1.8	1.4	0.8	0.8	0.5	0.4	0.5	0.2
2 Crude materials, except fuels	0.9	1.3	1.7	1.3	1.8	2.2	2.2	2.0	6.6

Table 2-2 Structure of Finland's Merchandise Exports to Russia, 1992 – 2002 (Adapted from: Kotilainen 2004)

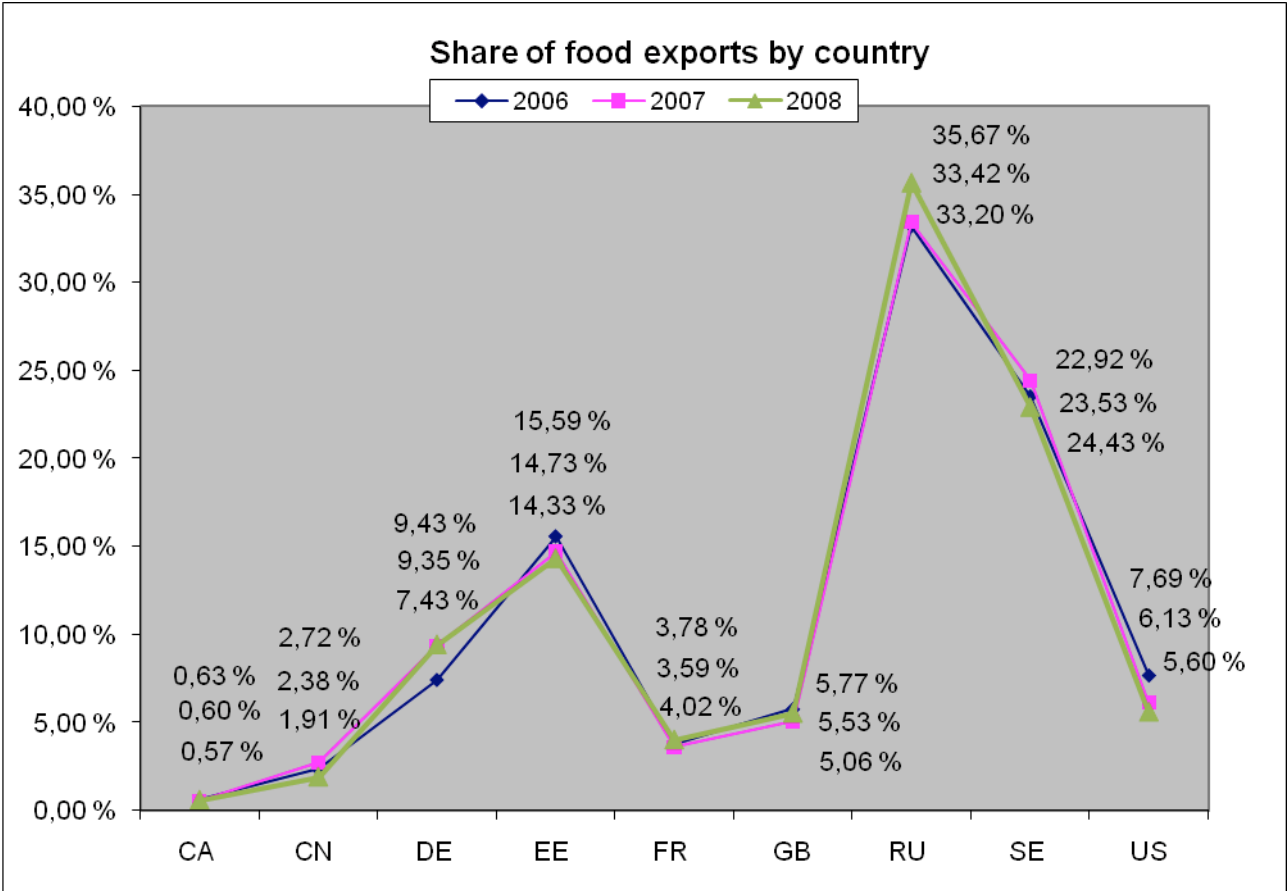


Figure 2-2 Share by country of Finnish food product exports 2006, 2007, and end-July 2008 (Finnish Board of Customs 2008)

Today's situation regarding the food industry in Russia is in part due to strong foundation that was built on the colossal work undertaken various Finnish food companies. The history of many Finnish food companies engaging in business activity in Russia is known to have its beginnings in the Tsarist Russian Empire and as well as Soviet Union. Atria, for example has been established in 1903 as a cooperative and supplied various near-by regions; Valio began its operations in 1908 and Fazer started with confectionary produce in 1891, both at the time of rule under the Russian Empire. Notable evidence of strong relationships between the USSR and Finnish representatives can be remembered when in 1980 Moscow hosted the Olympics, yet food produce was at colossal shortage. Russian Olympic Committee in the shortest of times was able to organize enough food supply for over five million attendees not including the locals, all thanks to the prompt ability of Finnish suppliers to deal with this unexpected demand efficiently, partially because of the supply chain management methods utilized at the time (Forum MSK 2008).

For the majority of the transactions Finland and USSR developed special barter transaction agreements that allowed Finland to have major energy supplies at a cheaper price than everyone else as well as push products of its companies into the Soviet market. Later this became known as the clearing barter, which significantly added to the Finnish economic boom in the early 1980s (ИИнаак 2003). This can be seen through exports as well (Figure 2-3).



*All the former Soviet states in 1992–2004

Source: Bank of Finland, National Board of Customs.

Figure 2-3 Share of Russia and the USSR in Finnish foreign trade 1860–2005, % (adapted from: Ollus & Simola 2006)

Over the past couple of decades cooperation between Russian and Finnish companies has had its ups and downs. Today, almost all of the major Finnish food corporations are established one way or another in the Russian market, due to the booming economy and great business opportunities. Many of these firms represent true Finnish traditions of cuisine by delivering quality products to its customers through various distribution techniques that require great deal of time and skill to be properly set up and managed.

A great deal of food companies in Finland previously saw Russian market and its customers as an area of huge, yet still under-realized potential. Currently the situation is changing drastically – opportunities for Finnish food producers are enormous, e.g. Russian GDP and disposable incomes are growing at an average rate of 7% and 11% respectively (Figure 1), where the demand for groceries is booming, with an average Russian spends about 40% of his/her income on foodstuffs (Ekonomilehti 2006).

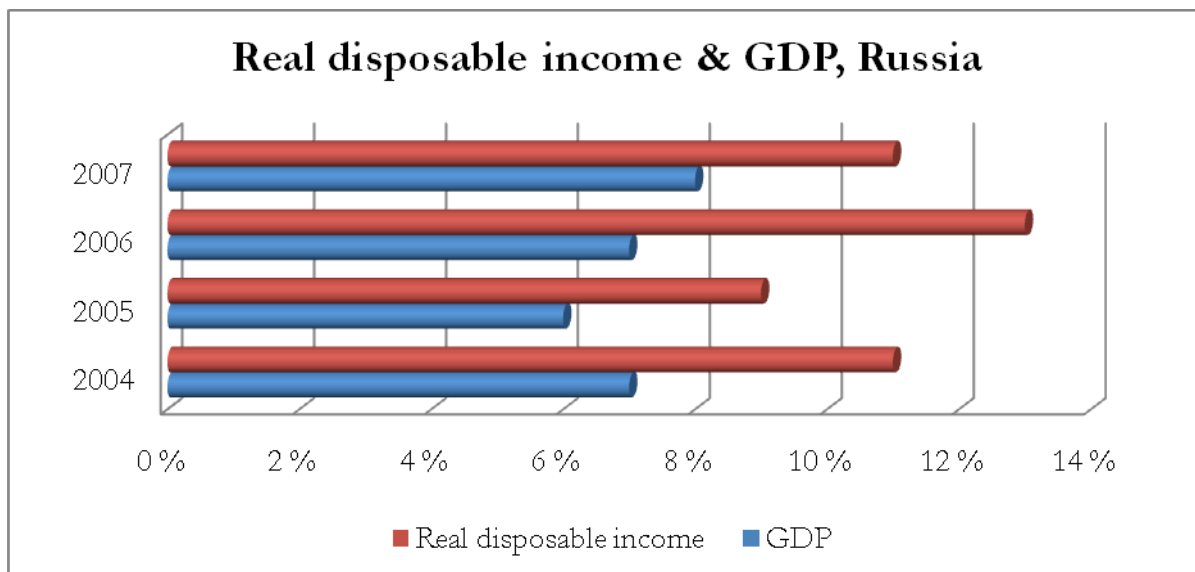


Figure 2-4 Real Disposable Income in Russia compared to Russian GDP, years 2004 - 2007 (Bank of Russia & ATKearny 2005)

2.3.2 Customers

As many interviewees claim and as is obvious by looking at the world map – Russia is a large country. Meaning any deliveries into the less developed regions of Russia are subject to risk, cost and other factors negatively influencing the overall price of the delivery. For that matter, a great majority of the interviewees state that their primary business areas in Russia are essentially the richest regions – Moscow and St. Petersburg. Not even so much Moscow, because of its relatively far distance as compared to cultural capital of Russia. The primary clients of Finnish food companies in Russia for delivering products within these two favorable regions could be broken down into the following major segments: HoReCa and large supermarkets, hypermarkets etc.

The size of Russian Hotel, Restaurant and Catering business segment was to be worth approximately USD 12 – 13 billion as was estimated by the Russian State Statistics Committee. Several interviewees indicated that this sector is an important part of their business activities in Russia, for example Paulig exclusively supplies Moscow McDonalds with its coffee (FlexNews 2008). Supermarkets and alike focusing on retail food trade, i.e. the market of fast moving consumer goods in Russia in 2006 generated 46% of all the retail trade or USD 146 billion (Радаев 2007, 11).

3 LITERATURE REVIEW

This section is concerned with describing main frameworks that specialize in determining expansion strategies of companies from multiple industries as well as the reasons for their use in a wide area of fields. At the same time I have tried to align these theories to be pertinent to the general topic of this study.

3.1 Theories

In order to properly grasp why Finnish food companies do business in Russia today as they do, we must pay attention firstly to the frameworks provided on a general level to any company that is interested in broadening its operations and participating in the globalization “slumber party.”

Several definitions must be first described:

- Home country – the country of headquarters location, i.e. Finland;
- Target country – the country of exporting and manufacturing activities involved, i.e. Russia;
- A company – a food production company.

The following theories and concepts are introduced in part based on the research questions outlined earlier, i.e. this section should introduce and describe the answers to research questions as well as provide an understandable overview. Firstly I present the Stages of Internationalization, which is supposed to lay the groundwork of the available foreign operations to any company. This conception brings us to the Principal-Agent model, which describes the relationship between the company in home country and its operation in target country. In other words, Stages of Internationalization is the introduction, whereas Principal-Agent is a 100% zoom into any of the Stages. Supply chain concept explanation follows to familiarize the reader with the basics of Supply Chain architecture. An important part of this thesis is the focus on the concept of Core activities or processes as well as other theories that are touched by it directly or indirectly, mainly Logistics Outsourcing.

3.1.1 Stages of Internationalization

At a certain critical point like recession in local & national markets, unattractive growth rate, low profit margins etc., companies understand that it is in their best interests to expand their operations across the border to profit from such advantages as low taxation, skilled labor force, dynamic market etc. This is certainly true for companies that reside in Finland, because favorable geographic position and close historical and cultural ties allow Finnish companies to perpetuate Russian business and develop long lasting trading relationships. However, due to differences in e.g. language, education, business practices, culture, and industrial development problems might arise. Johanson & Vahlne (1977, 24) define this pattern as the “concept of psychic distance”, or the sum of factors preventing the flow of information from and to the market.

Additionally Johanson & Wiedersheim-Paul (1975) as well as Johanson & Vahlne (1977) identify four major stages of internationalization, or as Johanson & Wiedersheim-Paul refer to the sequence of stages – the establishment chain:

- 1) No regular export activities,
- 2) Export via independent representatives (agent/joint venture),
- 3) Sales subsidiary, and
- 4) Production/Manufacturing.

In the first stage, a company mainly operates in its own “start up” environment. There is no need for a company at this stage to engage in full scale expansion projects; rather by fulfilling occasional orders from outside of its region it acquires highly important knowledge on the customs and traditions of such transactions. In the future when a company decides to expand into other markets this know-how will be useful in dealing with unexpected obstacles at least in an intuitive way. Because of Finland’s small, outlying home markets, companies are actually compelled to expand their markets abroad and seek growth potential there (Saralehto 1989, 103).

When a company accepts the challenge to finally move out of its comfort zone and conquer an attractive market, the easiest, i.e. with the least risk undertaking is by forming a joint venture (JV) with a company that has been established on the market of interest. Starting regular exporting operations brings more aggravation to the business, especially due to

increase in obligations before the company’s JV partner. Significant amount of time should be devoted to building solid trading relations. A JV assumes various forms of logistical operations, e.g. exporting finished products from home country to target country or exporting semi-finished goods from home target for final stages of manufacturing in the target country.

Subsequently, once a company has outgrown a JV and is ready to incorporate an independent office in a foreign land, it has reached stage three – sales subsidiary. A subsidiary, besides sales, can be responsible for multiple functions, such as marketing, logistics, financials etc. However, as the authors state, this is a simplified model, where many inner correlations can take place, e.g. it is not always obvious whether a firm has established relations with an agent or not, while a joint venture with an earlier representative can be placed in the second or the third stage (Johanson & Wiedersheim-Paul 1975, 307).

Following the representative office is the fourth stage of international expansion – production in the host country. By far subject to the most risk and cost way of delivering product to the final point of sale. The risks are multiple; the most important ones – not knowing enough about the business arena and culture of the country/region, as well as possible political and economical instability.

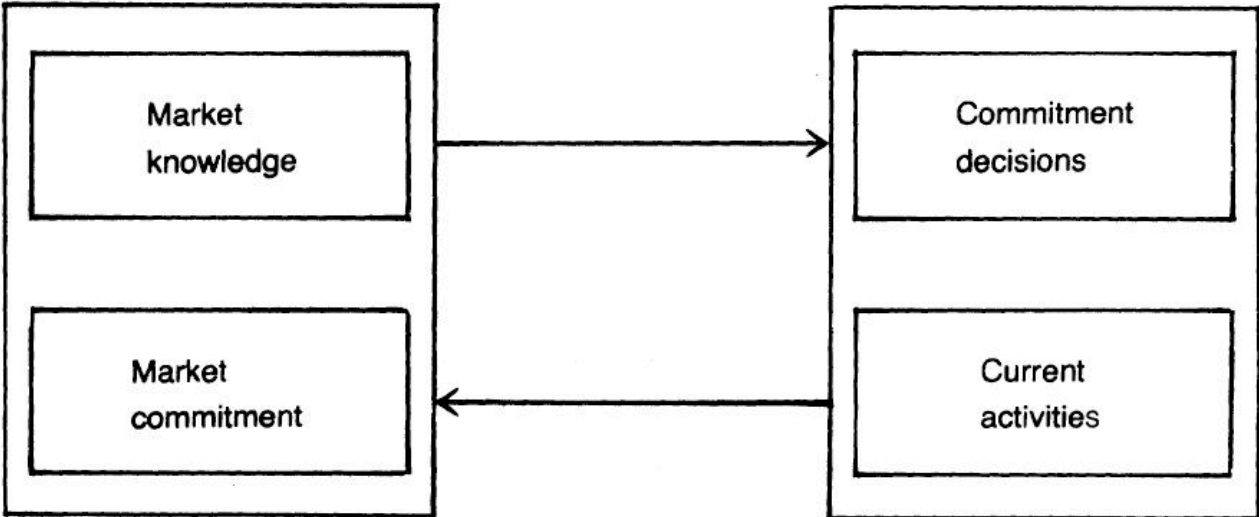


Figure 3-1 The Basic Mechanism of Internationalization - State and Change Aspects (adapted from: Johanson & Vahlne 1977)

Internationalization process is a process where an enterprise gradually increases its international involvement, which in part is an interplay between the development of knowledge about foreign markets and operations on one hand and an increasing commitment of resources to foreign markets on the other (Johanson & Vahlne 1990, 11). Thus the basic

assumption here is that market knowledge and market commitment affect both commitment decisions and the way current decisions are performed - and these, in turn, change market knowledge and commitment (Andersen 1993, 211).

One of the loudest criticism remarks directed at this theory is the sequential, i.e. step-by-step following of the recommendations given. These stages are not necessarily to be gone through by order. Evidence exists that enterprises in fact do not need to retrace the steps of internationalization suggested above. In fact companies that are extremely successful in globalizing their operations quickly and most profitably or companies that are established from day one so that they are servicing various markets at once are referred to as the Born Globals (Mathews & Zander 2007, 390). Sometimes a fifth stage is included, called Development, which describes the total assimilation of a company in a foreign land by beginning to participate in supportive projects like infrastructure planning, i.e. this concept is similar to what the state enterprises in the Soviet Union used to do in the populated areas they worked. Also, a number of enterprises engage in multiple stages at the same time to minimize the risk as well as explore potential opportunities. Other critics regarding the Stages model are more of complaints rather than actual criticism. For example, Anderson (1993, 217) referred to it as “tautological.” Internationalization of the Firm has been developed based primarily on the empirical data collected from four individual industrial manufactureres in Sweden, thus excluding the services industry as well as neglecting the network effects (Bradley 1991). However, empirical studies proved that many firms around the world have followed the incremental process as described by the Stages or Upsala internationalization model, thus proving acceptance of the overall structure of the model, even though many of the studies regarding this matter were performed in Scandinavian countries (Cavusgil 1984, Sullivan and Bauerschmidt 1990). Additionally, it is mentioned that the Upsala model does not provide for predictions of the movements of the firms from one stage to the other, rather only possible to characterize the firms that have been classified into different stages (Anderson 1993, 224).

Additionally to the mentioned descriptions there are numerous other studies that draw from the conclusions described, like Yadong Luo’s and Rosalie Tung’s International expansion of emerging market enterprises: a springboard perspective of 2007, where instead of the four stages above there are niche entrepreneurs, world-stage aspirants, transnational agents, and commissioned specialists. This study focuses on the Multinational Enterprises, as well as their

ownership (governmental, non-governmental, part/part). However the main idea behind this theory is closely related to the one depicted above. Also there are other studies that contribute to the thought discussed in this chapter (Wickramasekera & Oczkowski 2006, 39-56). Further I will present more analysis regarding the Upsala model in a different context, mostly drawing from conclusions of Reijo Luostarinen and his doctoral thesis on Foreign Operations.

3.1.2 Principal - agent

The principal agent theory (PAT) is concerned with the separation of ownership and control of economic activities between the agent and the principal (Halldorsson et al. 2007, 287). In the case of this study, an example could represent local enterprise in target country and headquarters in home country respectively. Unavoidably, when two parties of hierarchical dependancy are engaged in business activities, a relationship occurs. PAT, in the words of Eisenhardt (1989, 58) in part I exists to account for resolving two problems that might be present in that relationship. Firstly, a problem arises when the principal’s and agents’ goals conflict; and secondly, when it is expensive/difficult for the principal to verify if the agent is acting according to the agreed to guidelines.

Agency Theory Overview

Key idea	Principal-agent relationships should reflect efficient organization of information and risk-bearing costs
Unit of analysis	Contract between principal and agent
Human assumptions	Self-interest Bounded rationality Risk aversion
Organizational assumptions	Partial goal conflict among participants Efficiency as the effectiveness criterion Information asymmetry between principal and agent
Information assumption	Information as a purchasable commodity
Contracting problems	Agency (moral hazard and adverse selection) Risk sharing
Problem domain	Relationships in which the principal and agent have partly differing goals and risk preferences (e.g., compensation, regulation, leadership, impression management, whistle-blowing, vertical integration, transfer pricing)

Figure 3-2 Agency Theory Overview (Eisenhardt 1989, 59)

In order to mitigate the risks of failure to perform on the agent side as well as the risks of being remunerated accordingly from the principal’s perspective, a contract is undersigned to develop an agreement that is tangible, legal and verifiable. Which in part solidifies the

relationship between the interested parties. It however should be noted that the contract needs to be properly structured to accomplish that goal. Jensen & Meckling (1976, 317) for example state that “the most important conflict arises from the fact that as the manager’s ownership claim falls, his incentive to devote significant effort to creative activities such as searching out new profitable ventures falls.” Meaning, when the contract is outcome based the agent is more likely to act in the interest of the principal. Additionally, should a principal be capable of verifying the actions of the agent, the agent in part will be less likely to perform not in accordance with the principal’s interests (Eisenhardt 1989, 60). The “most efficient contract” includes the right mix of behavioral and outcome-based incentives (Halldorsson et al. 2007, 287).

Eisenhardt (1989, 71) proposes that PAT is most relevant in situations in which contracting problems are difficult. This brings us to a concrete example, regarding current thesis. Based on primary research it was evident that trust-worthy 3PLs are somewhat of a pain to find. According to Logan (2000, 21) the question is no longer whether outsourcing makes strategic or financial sense, but how to develop mutually beneficial relationships. Meaning that companies currently engaged and/or looking to expand their operations in Russia, as well as Russian 3PLs, should focus more on compromising and working together towards a common goal, established in a properly underwritten contract.

Additionally, risk sharing is also of an importance to the PAT, due to the nature of contractual obligations and objectives. Key finding regarding risk in terms of agency theory is that behavioral management techniques, such as supplier certification and development, quality management programs etc., which try to limit the difference in received information by multiple parties will actually align organizational objectives and program supplier activities for the enterprises that are considered to be purchasing (Zsidisin & Ellram 2003, 25).

3.1.3 Supply Chain

The supply-chain — a term now commonly used internationally — encompasses every effort involved in producing and delivering a final product or service, from the *supplier's supplier* to the *customer's customer* (Supply Chain Council, 2008). Due to fierce competitiveness of business environments, the concept of Supply Chain, amongst others, has emerged as a powerful tool for boosting efficiency and profitability by e.g. reducing inventory levels,

improving customer service and flexibility of the firm and others (Farmer & Ploos van Amstel 1991, 1-2).

However, the crucial point is not for a company to simply have a supply chain that does its job; the idea is to integrate the supply chain into the overall value chain of the company so that it becomes more agile in terms of responding to market pressures . Hutchinson (1987) mentions that already in the 1950s there was a “drive toward integrated approach” predominantly caused by the technological breakthroughs as well as volatile economic market conditions. Yet, after almost half a century great deal of companies are far away from delivering value to their customers at the fullest rate (Spekman et al. 1998). To follow up a Supply Chain needs to stress the importance of building relationships and business process that deliver value to customers by ensuring the value is created at each stage of the supply chain (Lambert et al. 1998).

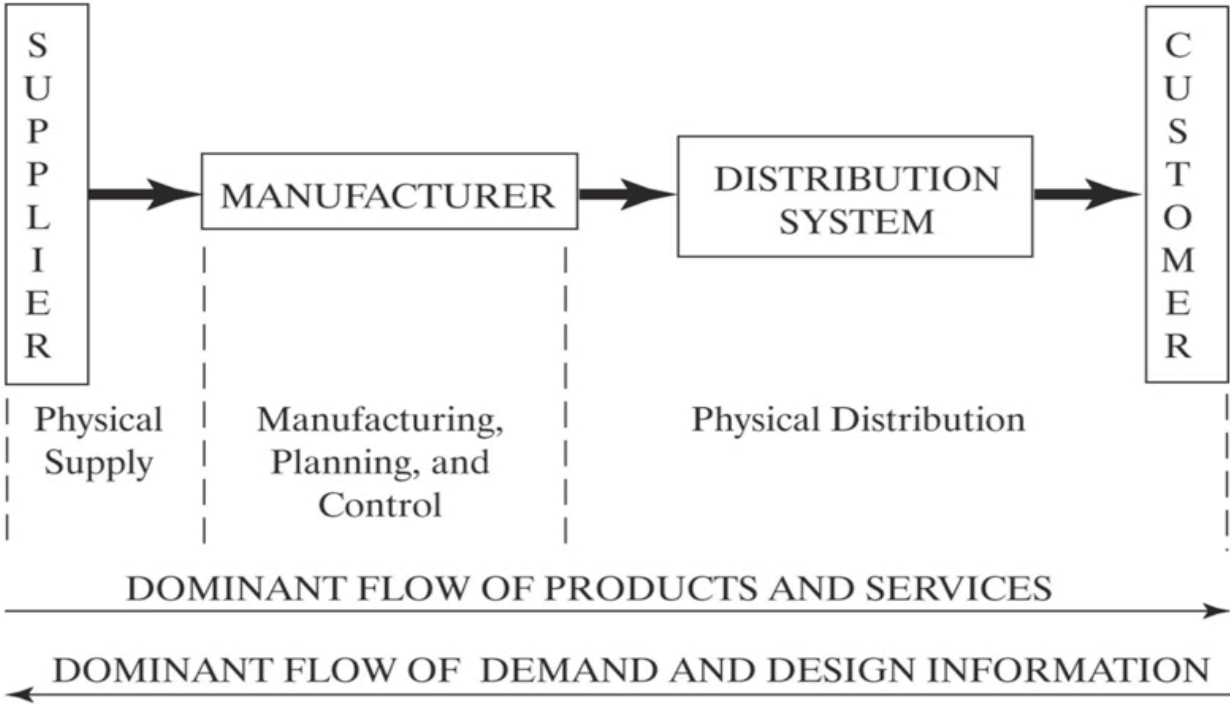


Figure 3-3 The Supply Chain Concept (adapted from: Arnold, Chapman, Clive 2007)

The figure above presents an explanation of a theoretical Supply Chain model. Of course in real life the majority of enterprises follow a more complex and distributed framework, for example where a Manufacturer is also responsible for the Distribution System and provides a combination of the two. However, drawing from conclusions of the interviews it can be stated that Russian retail chains are acting as one of the main drivers of logistics development by cutting through the myriad partnerships in order to gain access to the initial provider of goods,

thus lowering costs and increasing service levels. This in part is facilitated by the initial provider by outsourcing all activities not related to core competencies of the firm, which will be discussed shortly below.

In the figure above, the arrows represent the value that an entity adds to the Supply Chain. Initially a Supplier is in charge of the actual supply of the materials. A Manufacturer then plans, controls and produces the end-product or good for a customer. The Distribution System is the entity that generates great concerns due to its obscurity, i.e. usually it is not simply one enterprise, but a combination of many companies working from different perspectives and levels, often creating conflict of interests between the involved parties. The Distribution System can comprise of various structures, like a company can be responsible for all of the Supply, Manufacture and Distribution procedures, making the company the owner of the Distribution System. On the other hand, the Supply Chain can be broken down into even more parts than mentioned on Figure 3-1, where a company might see multiple opportunities in having large phases of outsourced distribution. Various structures are available within the Supply Chain concept. It all comes down to the company deciding whether investing in ownership in logistics services is going to bring more value than an third party provider. Finally, the Customer through Physical Distribution receives the product he/she wanted.

3.1.4 Porter's Competitive Strategies

In order to properly grasp the subsequent sections, it is necessary to understand where such notions were introduced. Over the years the term Competitive Strategy has become synonymous with practically any advantageous situation for an entity that is competing in a highly aggressive environment. Michael Porter (1980) was the one who introduced this term and classified its different aspects. There are several strategies commonly accepted by the business world in for achieving and maintaining competitive advantage, which is a relative advantage of a firm against its competitors in a particular field of business. Below are the brief descriptions of those strategies:

- 1) Cost leadership. If the main advantage of an enterprise in the whole industry is to sell products cheaper than everyone else, which is mostly attributed to the concept of economies of scale, then this company is known to be a cost-leader, like e.g. Kopeika retailer stores in Moscow;

- 2) Differentiation. Should a company be a leader in an industry based on its unique combination of great industry sense and other highly valued services/products by its customers, the company is a differentiator, for instance Fazer Group with its bakeries, restaurants, and chocolate business;
- 3) Focus or market segmentation. When a firm is primarily concerned with one or very few certain products/services, while paying less attention to other functions, it is known to be a focus company, like Paulig, a company that mainly specializes in producing its main product – coffee.

The last point is crucial in proceeding. As I have gathered from interviewees there exist various tendencies as to how to streamline a firm's processes as well as what processes should be touched upon first. Most of the interviewees agreed that focusing on their core competencies at the same time establishing more relationships with the supply chain networks is a successful mix of duties and responsibilities to approach the problem of doing business in Russia.

3.1.5 Core capabilities

Core capabilities are those that differentiate a company strategically (Leonard-Barton 1992). A clear definition of core capabilities has been provided by Teece et al. (1990, 28), where core capabilities are a set of differentiated skills, complementary assets, and routines that provide the basis for a firm's competitive capacities and sustainable advantage in a particular business.

Prahalad & Hamel (1990) have introduced this term, though referring to it as core competencies, by focusing on a comparison based on empirical data of various businesses, primarily from American and Japan. The study was concerned with determining why firms equal in their strategic composition had drastic divergence patterns – some strategically failed, other strategically won. For example, during the 1980s and technological boom in computing and communications, NEC, a communications, switching and transmission systems firm at the time, envisioned that computing, communications and their subsequent components would be an area of great potential in the years to come. To perpetuate this vision NEC undertook many strategic initiatives including over 100 alliances in only seven years, to gain cheap and easy access to the competencies of the markets NEC thought would flourish. GTE, a much larger competitor of NEC by all parameters at the time, on the other hand did

not hold such a strategic intent in mind, causing NEC to overtake GTE in terms of annual sales by more than 25%, even though 7 years before NEC's sales were only 38% of that of GTE. However it should be noted that cultivating core competencies does not mean outspending rivals on Research and Development (R&D) or getting business to become more vertically integrated. Yet, there are three factors that need to be fulfilled in order to identify core competencies – firstly, a core competency provides access to various markets economically; second, it should make a significant contribution to the perceived customer benefit within the end product; and lastly, a core competence should be difficult to imitate (Prahalad & Hamel 1990, 83-84).

By economics of markets it is understood that a company should not necessarily simply produce one product or deliver one service – certain degree of diversification is acceptable. However, firms that are diversified across a set of 'related markets' where the strategic assets are either few, or the processes required to improve and create them are context-specific, cannot be expected to out-perform unrelated diversifiers (Markides & Williamson 1994, 150).

In other words, to increase its competitive advantage, a firm needs to identify its core activities, subsequently filter these capabilities into context of the market environment, and then deliver its end product/service to the customer (see Figure 3-4).

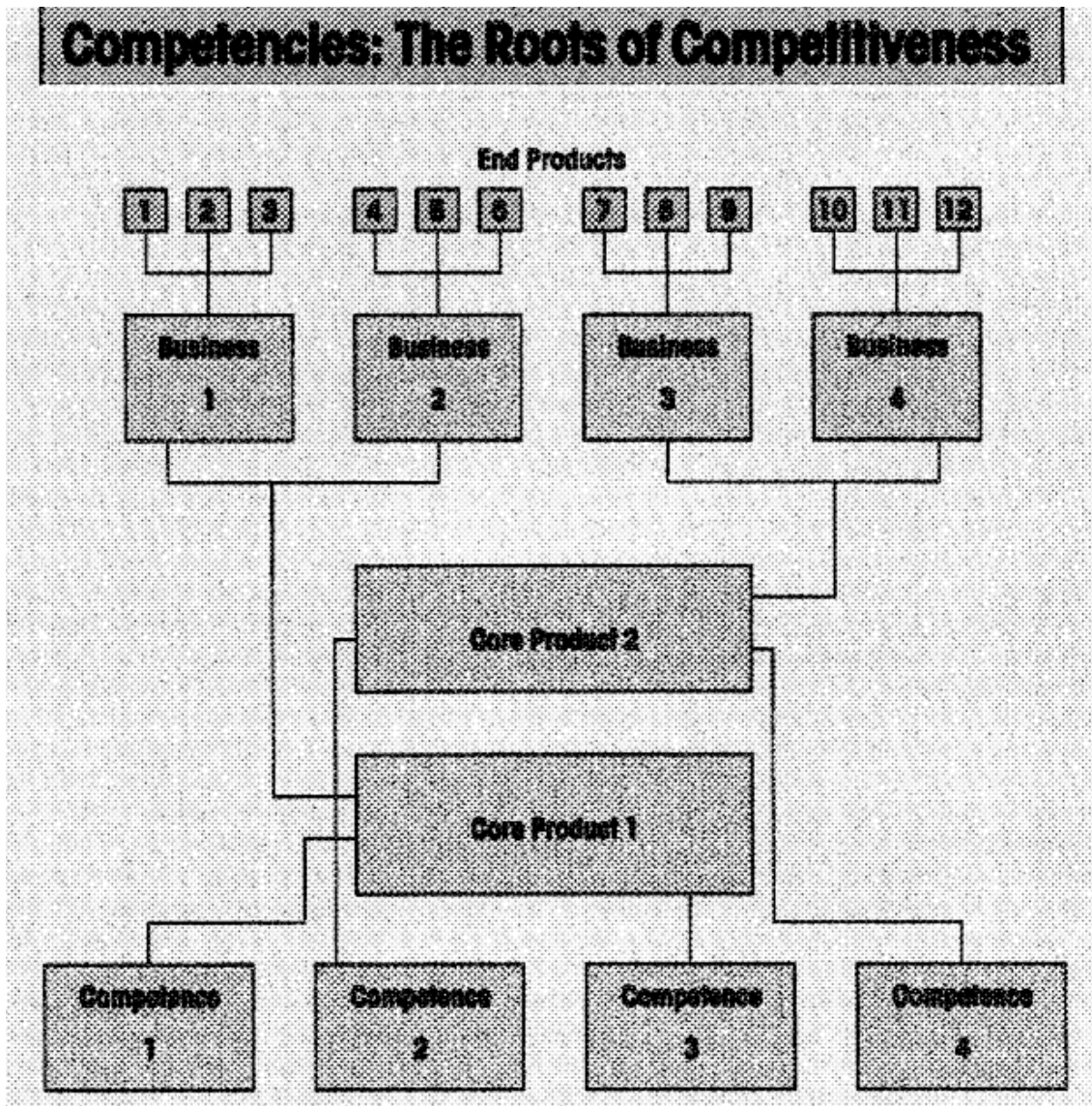


Figure 3-4 The roots of Competitiveness (adapted from: Prahalad & Hamel 1990)

Somewhat shifting away from the strict academic approach to the problem, a highly practical concept was introduced by Jim Collins (2001) – the hedgehog concept (see Figure 3-5).

Collins (2001) draws a comparison between a fox, a cunning creature, and a hedgehog, a genetic mix-up between a porcupine and a small armadillo and then transcending their differences onto the real business-world. Foxes can devise myriad schemes to reach their goals, but when they aim at catching the hedgehog – it fails. Because hedgehogs always focus on a single idea: if attacked, roll up into a ball with their spikes protecting them. Since they have only one simple strategy, they are free to perfect it, whereas “foxes pursue many ends at the same time and see the world in all its complexity”. Similarly, many enterprises, when trying to deal with multiple business tasks, maintaining minimal resource commitment and lowest risk aversion rates – get caught up in the complexity. By stripping non-core activities

from its business, a firm will save a great deal of resources like time and money, as well as have more opportunities to invest in the actual core activities, in order to boost their market focus and subsequently competitive advantage.

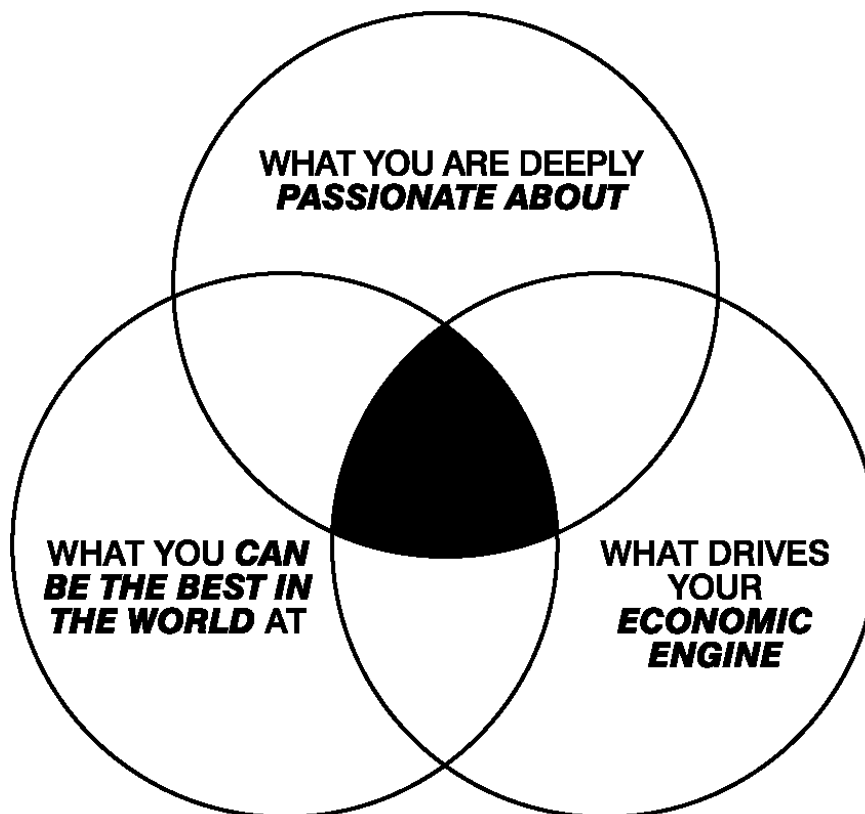


Figure 3-5 The hedgehog concept (adapted from: Collins 2001)

However, simply focusing on one particular activity is just not enough in the long run. A company needs to base its decisions not only on the type of activity, but also on the economic and human resources available; hence the questions in the figure above. The Economic engine is similar to the “various markets” concept, where the competencies should have enough room to be applied to in terms of financial reward; otherwise the company might cease to exist very quickly. The other aspect is the human resource available to the company. Collins (2001) goes in-depth regarding this issue, but on a general level, it can be explained as the following. Companies’ success rates depend on how productive the people working for them are, which in part comes down to how motivated those workers are. Should they be highly interested in their jobs – the company will perform like a steamroller, given it is provided with the correct

or proper course of action. Thus, as depicted above, a firm needs to position itself between the three circles to achieve the hedgehog’s agility.

3.1.6 Logistics Outsourcing

Outsourcing is the practice of charging external service providers with the task of performing in-house activities (Bolumole et al. 2007, 35). The overall objectives of outsourcing logistics of a company can be multiple, e.g. cut costs, increase efficiency, focus on core activities, etc., yet the main goal is to deliver value from outside sources that is either too costly or simply unavailable for delivery within the actual firm per se (Barney 1991).

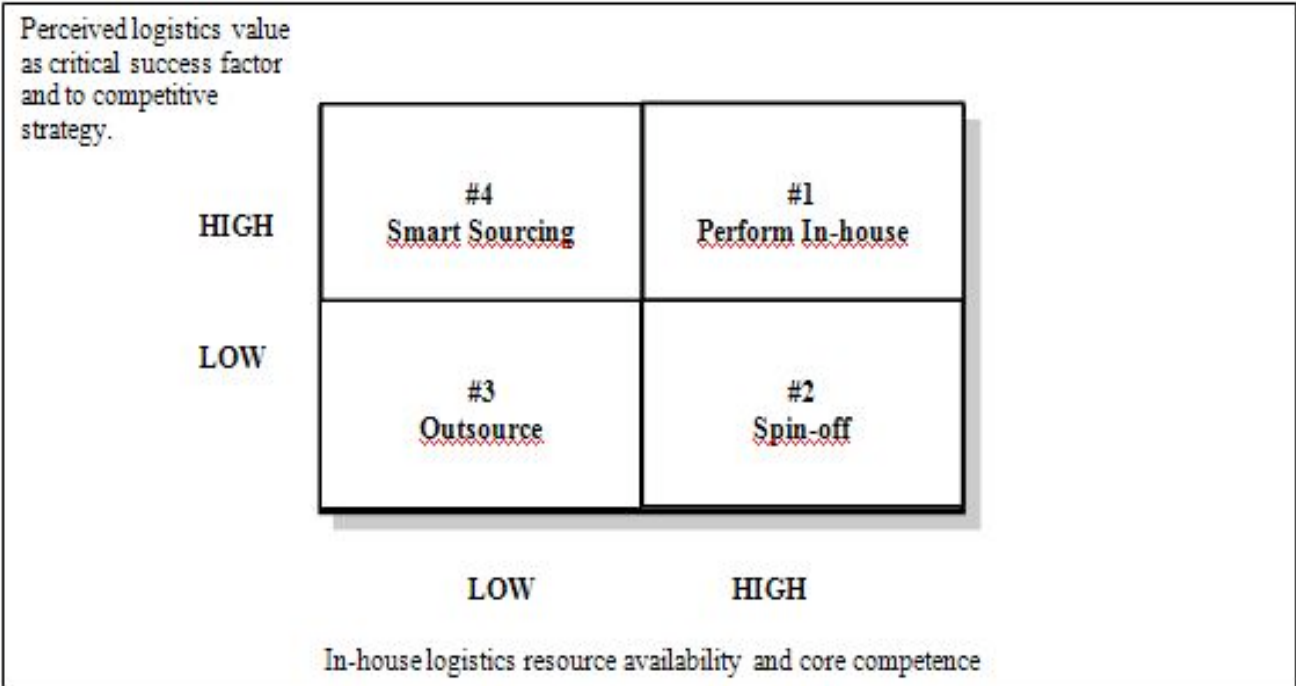


Figure 3-5 Logistics Outsourcing Matrix (Bolumole et al. 2007, adapted from: Earl 1996, Spear 1997)

In the figure above, Earl and Spear identify the various conditions, which are commonly referred to as outsourcing from the perspective of a focal firm. The authors of the figure look at these conditions through a prism of availability of resources and core competencies, as well as perceived value of the logistics within a firm.

Firstly, in-house operations are closely related to the Porter’s Focus concept, where a company engages itself in processes that are thought to be its core activities, thus have no reason to be given away to a third party for development. A Spin-off, however, is a situation, when there is high resource availability in-house, yet the thought-of value is low, i.e. the firm determines that logistics is not a critical success factor overall even though there is potential

on its own. Quadrant #3 is primarily interested with situations when logistics is of low perceived value to the company and there are little resources available for its development. This is the case of logistics being a so-called commodity service, where there are minimal value-added processes involved and those that are - generally are essentially influenced by cost. Should an enterprise find logistics critical to its success on the market, yet lack the necessary capital, another approach could be regarded as an opportunity – Smart Sourcing. Smart Sourcing is a combination of company's interest in developing an area of business and its ability to direct a third party logistics service provider (3PL) to do it.

From the point of view of actual 3PLs, the critical factors that influence the outcome of a relationship between them and a focal firm in actual fact contribute more to the soft characteristics, e.g. communication, reputation, rather than to the hard characteristics, e.g. firm size (Knemeyer & Murphy 2005).

3.2 Foreign Operations

According to Reijo Luostarinen (Foreign operations, 1982) there are several types of foreign operations available for companies that wish to do business abroad, these are: indirect/direct/own export, licensing, contract manufacturing, co-production, own assembling and own manufacturing. Each of the operations has its advantages and disadvantages over others. Furthermore, these procedures need the following limitations:

- There is a flow of goods (finished, semi-finished, parts, raw materials) from home to target country;
- There is a flow of physical capital (equipment, tools) from home to target country;
- There is a flow of human capital (know-how, personnel) from home to target country;
- There is a flow of financial capital (equity, loans) from home to target country, but capital in the form of fees, royalties, and profits run in most cases in reverse flows, i.e. from target to home country.

Marketing operations abroad or exporting can represent multiple forms. Indirect export is when a manufacturing company uses a home country middleman, i.e. export agent or association, government agency, as the first link in the distribution chain. On the other hand, direct export takes place when a company engages a target country middleman, i.e. import

firm or agent. Own exporting is described as selling company's products through own sales, i.e. subsidiary company or branch.

It should be noted that this classification of exporting is somewhat of a breakdown of the first three stages theory of Internationalization of the Firm, in that 'no regular exporting activities' might also assume test exports, where the home country exporting agent delivers the company's products to a target country to "test the waters"; export via agent could be presented as the direct and indirect exporting activities; whereas during the third stage a company decides to establish own subsidiary office by the means of own export arrangements.

Manufacturing operations are those operations that do not include flow of completely finished goods from home to target country, i.e. licensing, contract manufacturing, co-production, own assembling and own manufacturing.

Licensing occurs when a home company sells a license or a right to manufacture and sell its products in the target country under the licensee's name. Contract manufacturing is to some extent similar to licensing, but differs in two aspects: 1) under contract manufacturing are sold by means of arrangements of the home country, where in licensing the actually manufacturer sells the products; 2) financial capital flows are reversed, i.e. in licensing the home company receives fees for the sale of license, yet in contract manufacturing the home company actually pays the target company for the productions of goods.

Co-production represents a type of manufacturing, where the target company typically provides the raw materials, labor and manufacturing facilities and the home company delivers advanced technology, equipment and management to lead the production processes. Own assembly is determined by the shipment of parts, components and semi-finished products from home to target company for assembling.

Own manufacturing is represented when the home company has established production facilities in the target country. In the case of own manufacturing, the flow of goods can be multiple. For instance, a home company can manufacture goods in the target country as well as its initial manufacturing plant and engage in the cross-shipment of these products due to potential quality, cost and other concerns.

This situation is especially significant, because a great deal of Finnish food companies take on the Russian market through a third link – Estonia. Various companies have their presence in manufacturing and/or different types of marketing operations in Estonia because of the beneficial political, economical and social conjunctures for the Finnish companies.

3.3 Theoretical Framework

A framework is a particular set of rules, ideas or beliefs, which you use in order to deal with problems or decided what to do (English Dictionary 2001, 625). In our case there are several sets of questions needed to be answered, thus posing as the problem or problems. The framework outlined in Figure 3-6 will be used to describe and answer those questions on a general level for easier access and understanding. Since this study is a combination of explorative and descriptive purposes the framework will be pertinent in the corresponding areas of research. This model was put together by examining and utilizing the theories gathered from Literature Review as well as by assuming several features.

Based on the descriptions mentioned in the interviews by the company representatives I have modified Luostarinen's as well as Vahlne's work insignificantly; simply for the purpose of better grasp. In other words when explaining the Type of Operations, instead of quoting direct/indirect and own export as simply export, representative and subsidiary. Thus export is when a company delivers its products to a foreign country without having any local presence in that country. A representative is a sales office, on a general level responsible for sales of the products, some marketing and custom's clearance procedures. A subsidiary is a daughter company that is fully functional in terms of major administrative decisions, yet is attached to a certain type of local operations, i.e. manufacturing or exporting. Meaning that a daughter company of a Finnish food company in Russia is very likely to either be engaged in following and controlling the manufacturing processes in a production plant in Russia or completely manage the flow of incoming goods from Finland and then supervising the distribution activities. The arrow pointing upwards on the left is a depiction of gradual build up of market knowledge and experience. Also by thinner and thicker borders of the boxes in the Types of Operations section, I tried to convey the message of less and more market commitment respectively (Vahlne & Johanson 1977, 27).

The Type of Logistics has also been structured based on groundwork of Logistics

Outsourcing and Supply Chain theories. The logistical procedures available are: Smart Sourcing, where a company does see necessary value in logistical expedition, yet does not have the potential and/or lacks capital to undertake this kind of venture on its own. I have added maybe somewhat of a confusing term – 100% outsourced, but this was done only in the best interest of the reader, due to the fact that during interviews with the respective knowledge holders, there was no specific classification of terms. Meaning Outsourcing encompassed Smart Sourcing, actual Outsourcing and sometimes a Spin-off, leaving it up to the author to decide which one is which. Thus to avoid confusion I will prefix Outsourcing with a 100% to denote Smart Sourcing when speaking about interviewees comments;

The actual Outsourcing is when a company does not have great capabilities within the logistical matters and does not deem it very valuable to the overall structure of the chain. This on the other hand is the broadest of all the logistical concept presented in this segment. Outsourcing is going to be denoted simultaneously as Part own/Part distributor, because companies that talked about their logistics which is done through distributors and other agents as well as through an in-house/spin-off organization within the firm, were utilizing the concept of Outsourcing;

Finally In-house logistics or 100% owned logistics is when a company completely engages in logistical procedures for reasons, like pin-pointing that logistics is a core activity, that there are no reliable partners, hence all matters should be taken into own hands or for other various reasons.

The interaction between the Type of Operation and Type of Logistics is integral and is explained the arrows in the middle. In this case Type of Operation is taken a more stable variable, i.e. Types of Operations will be developed based on the Types of Operation and not the opposite way. As market commitment increases, experience and knowledge flows are directly or indirectly, i.e. knowingly or without a specific goal respectively, take place in both directions. All of the participants of this chain, the home company, the target company, and the logistics service provider, benefit from such an exchange, because they gain valuable experience in working with a foreign enterprise, thus allowing for a balanced knowledge sharing platform.

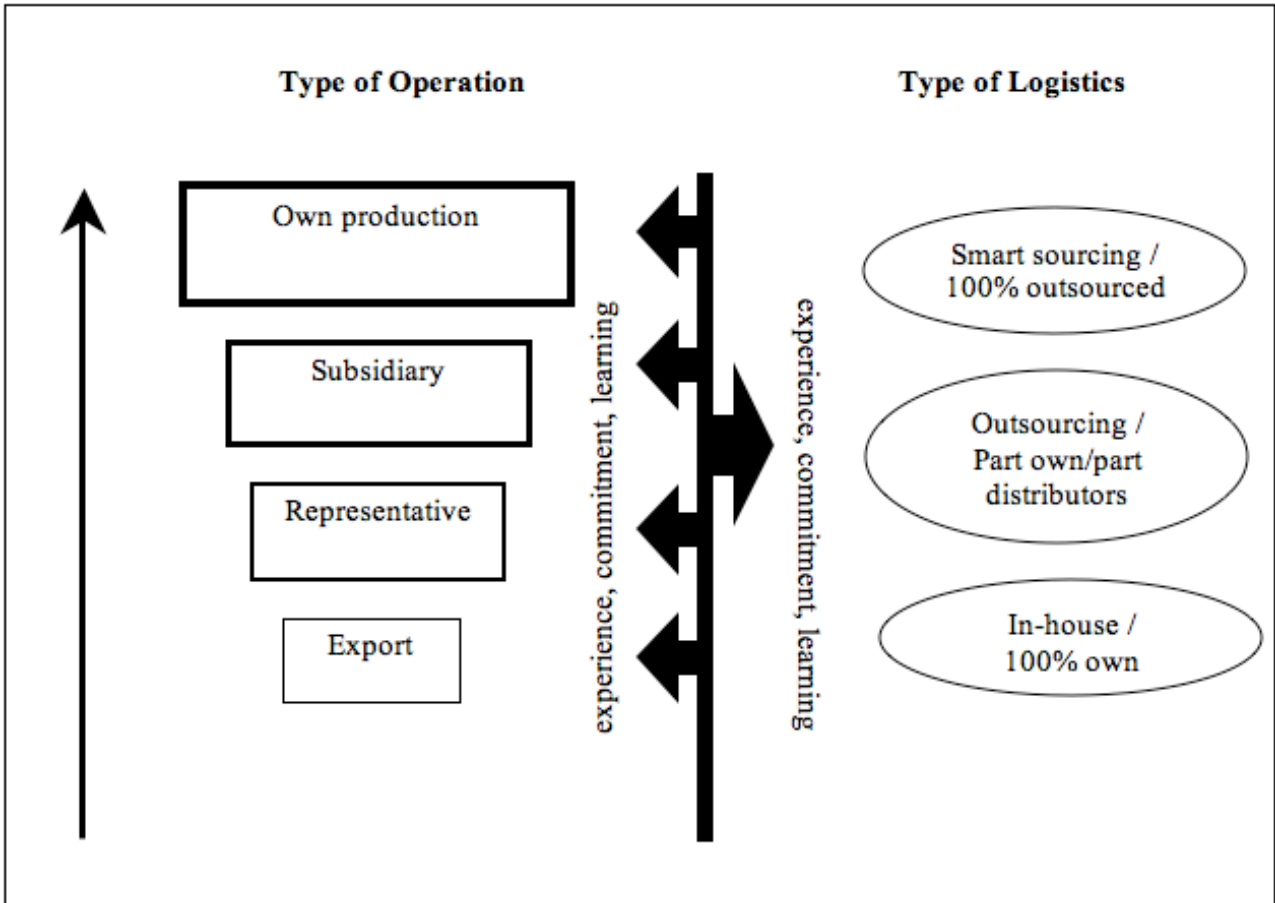


Figure 3-6 Framework model

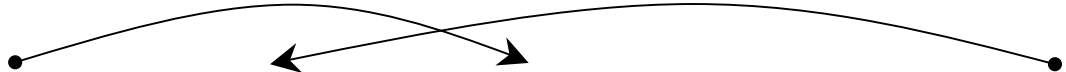
A supply chain is every effort involved in producing and delivering a final product or service, from the *supplier's supplier* to the *customer's customer*, as seen from the previous description in the Supply Chain section. The greater the effort the more responsive the overall supply chain is to the consumers buying swings and habits. The end transaction of the supply chain, delivery, or point of sale is regarded as any place where a structured sale could take place, i.e. documented sale. The most organized point of sales in Russia today are represented by the retail chains that are increasing their presence on the Russian market and are key clients of the majority of Finnish food companies.

The supply chain methods utilized by Finnish food companies are integral to the efficiency of these flows, especially in Russia, a country of great risks and uncertainty. There is nothing new in that more control of a parent company of its operations abroad equals greater benefits under optimal conditions as well as more associated risks. However it is my view that Russian market is different due to its history and developing nature of the trade - in that some functions of a company should be either outsourced completely or to the point where it would

not greatly affect the bottom line should one or several risks be realized; i.e. the distribution, storage and transportation of goods should be contracted out to expert service providers that will deliver quality and reasonably priced services. Thus building feasible logistical procedures are necessary to properly address the needs of the market.

Before proceeding several definitions must be made. A distributor is a Finnish and/or Russian agent that purchases goods from Finnish food companies for sale to another wholesaler and/or a retailer in Russia. Own distribution of a company in this case is a supply chain that is in direct ownership of that company, i.e. distribution is not a separate entity, but a part of the organization responsible for transportation, storage and delivery of products to a wholesaler and/or a retailer in Russia. By Smart sourcing and Outsourcing it is understood that a Finnish food company is engaged in various processes in Russia and third party service providers handle all of its logistics needs.

Additionally a brake down or explanation of transcended types of operation abroad based on the studies above regarding Finnish food companies in Russia, their SWOT analysis as well as available and common distribution arrangements are presented in the following:



	Own production	Subsidiary	Sales office	Export
Function	Production facility/facilities in Russia	Daughter company in Russia responsible for marketing, sales, and production or import/export	Representative office in Russia responsible for sales, import/export	Exporting activities into Russia
Logistics	<ul style="list-style-type: none"> • 100% Outsourcing, • 100% Own, • Partially outsource and own 	<ul style="list-style-type: none"> • 100% Outsourcing, • 100% Own, • Partially outsource and own, • Part through distributors/part own, 	<ul style="list-style-type: none"> • 100% Distributor, • Part through distributors / part own 	<ul style="list-style-type: none"> • 100% Distributor

		<ul style="list-style-type: none"> • 100% distributor 		
Strengths	<ul style="list-style-type: none"> • Short supply & value chain 	<ul style="list-style-type: none"> • Greater control over main functions of the business 	<ul style="list-style-type: none"> • Small amount of investment and risk, • Good 'feel' of the market 	<ul style="list-style-type: none"> • Least investment and risk
Weaknesses	<ul style="list-style-type: none"> • Great investments & risks 	<ul style="list-style-type: none"> • Great investments & risks 	<ul style="list-style-type: none"> • End product very dependent on corporate's decision 	<ul style="list-style-type: none"> • Low levels of control over distributors' actions and their consequences
Opportunities	<ul style="list-style-type: none"> • Lean manufacturing, • Efficient relationships with logistic partners 	<ul style="list-style-type: none"> • Establish Own Production 	<ul style="list-style-type: none"> • Develop relationships with employees on the spot • Establish Subsidiary / Own production 	<ul style="list-style-type: none"> • Develop relationships with distributors to gain more control • Establish Sales Office/Subsidiary
Threats	<ul style="list-style-type: none"> • Political, economical, and social risks 	<ul style="list-style-type: none"> Political, economical, and social risks 	<ul style="list-style-type: none"> • Political, economical, and social risks • Risk of unmotivated, inefficient staff 	<ul style="list-style-type: none"> • Political, economical, and social risks

The arrowed lines leading from Own production to Subsidiary and from Export to Subsidiary represent the area of involvement of two extremes – manufacture inside or outside. Should a company decide to engage in Exporting it will have the Sales Office and Subsidiary operations available to it for set-up. However should a company decide to manufacture - a production facility, a daughter company or both will be required.

The initial three research questions have been introduced with partial answers. However it is crucial to investigate the empirical side of the study before drawing conclusions, purely on theoretical basis.

It is also important to note that when a company begins to even investigate the possibility of concluding business in Russia exchange of information, knowledge, trust and capital takes place between the company and their Finnish or Russian partners regarding the respective business area. For example during the initiation stage a company can search for potential associates in Russia through existing personal networks of the firm. This in part generates the flow of information. Once a suitable Russian partner has been noticed, an exchange of knowledge on a particular topic occurs, which to some extent generates trust and companionship. To achieve these benefits a chain of reciprocal capital swaps need to take place, consequently opening prospects for future cooperation.

Thus the model framework that would need to be explored and possibly modified based on the outcomes of interviews and secondary research (see Figure 3-6).

4 INTERVIEW RESEARCH

In order to answer the concerns outlined in the Research Questions with the least amount of doubt I analyzed several interview transcripts from prior studies as well gathered own interview information from the largest Finnish food companies in terms of turnover (Talouselämä 2007).

4.1 Methodology

The methods and techniques utilized were limited to qualitative and empirical research due to the nature of the study. A questionnaire has been developed to gather enough information concerning Finnish food companies and their logistical arrangements. This questionnaire was designed for in-person dialogue; however representatives of several companies were not able to answer the prepared questions by this method due to the lack of time and/or presence within the boundaries of Finland. In these circumstances the questionnaire was sent out by email. Of course it needed to be tailored with more specific and direct questions resulting in a somewhat of a messy view of the survey. This and potentially the willingness to simply give a runaround exacerbated the matters and led to very brief and to some extent vague replies. Additionally one of the approached company's representative stated that she does not possess the asked for information, whereas another firm promised several times to get back to the topic but up until now did not follow up on the request for the interview even though multiple exchanges regarding proposed topic took place.

Overall eight companies have been interviewed. The major ones, i.e. Valio, Fazer, Paulig, and Atria delivered their input by the means of face-to-face interviews and provided the basis for the empirical research. The responses from these companies present a variation in many forms of the distribution systems described in the context of the framework and deserve a special case-by-case look into their experience and practices to view the topic more in-depth.

Other companies were both smaller in size and environment of operations in Russia or provided smaller portions of information on the subject of their logistics in Russian market. Multiple studies concerning the similar subject already collected most of the newly gathered

information (see Kaipio & Leppänen 2005 and Haimi 2007). However many of the critical areas were updated as well as important aspects generated specifically for the focus of this study. The subsequent Findings chapter discusses the main points collected from the interviews.

The Findings include description of discussions with the major companies, which are subject to three parts – History, Key Findings, and Added Value. The history section briefly introduces the company and its main operational goals. Key Findings present the main aspects gathered about the company from the interview and subsequent discussions. The Added Value part is where the author tries to identify the value a company has generated over from operations in Russia in the context of various logistical bases. Also descriptions of other companies involved in the research is discussed in the Others segment.

Additionally, during the presentation of the findings, I included several quotes directly from the interviews to emphasize the points made or to simply present the information from the angle of a company representative. For information of respective knowledge holders' from the companies that participated in the interview see the Interviews section.

4.2 Case Study Findings

4.2.1 Valio

History

Valio Ltd has operated as an exporter in international markets for almost one hundred years. The company was founded in 1905 to organize butter exports to the UK. Valio strategy has been to establish itself abroad primarily through its own subsidiaries. This includes e.g. a presence in Belgium since the 1930's, operations in the US from 1955, and subsidiaries in Sweden, Estonia and Russia since the early 1990's.

Finland became a member of the EU at the beginning of 1995. This meant a completely new kind of operating environment for the dairy industry like all others, as products were able to move freely throughout the EU without border protection, import charges or export subsidies. Valio had emphasized its customer orientation since the mid-1990's. The company has targeted closer cooperation and partnership with retailers and suppliers, in addition to meeting customer needs.

Sales responsibility has been increasingly handed over to subsidiaries. The goal is local presence in the principal market areas. Valio now has subsidiaries operating in all of its key export markets: Russia, Sweden, the Baltic States, Belgium and the United States.

The most important Valio International product groups are cheeses, butter, powdered ingredients and fresh products. Key international markets include nearby countries Russia, the Baltic States and Sweden, along with other EU countries and the United States. Valio International also has a significant presence in specifically targeted areas such as China and Middle East.

Key Findings

Valio is a very respected company with high-quality products present on the Russian market, such as Viloa spreads and others.

“...After war, we started trading business in the mid 50s. You know that at that time it was barter trade between Finnish government and Soviet Union and dairy products were included in those products. And then the third period started after the collapse of the Soviet Union when the new Russia was established. We started our operation in 1994 with the sales and marketing activities. Since then we have been present and improving and growing at the time, despite this typical times inflate 90s, with the collapse of the economy and strong devaluation of the Russia rouble. But briefly said now we can say that we are one of the leading dairy products in Russia. This year our sales will be 200 million Euros...so our main focus is production of dairy products like cheese, butter and nowadays fresh dairy products.”

Valio is engaged in primarily exporting activities in Russia. Most of the products are made in Finland and other countries, like Estonia and then shipped to Russia through Valio's St. Petersburg sales office, which is responsible for the sales/marketing functions and/or through Moscow's distribution center, which is soon to become operational. There are sales representatives in other regions of Russia as well. Also Valio is:

“...Finalizing a distribution centre in Moscow with investment of over 45 million euros.”

The distribution center was initially planned to gain a more competitive position in Russia, where big retail chains are building up their influence. However there is potential for production capabilities within Russia in the near future. Currently an increasing amount of products that are manufactured in Finland are transported directly to the big retailers opposing distributors, which should completely dominate the logistics system of Valio in long-term plans, even though the distribution and warehousing services currently are completely outsourced to 5 – 6 long term service providers.

“We have very limited own asset in distribution, because we are working through distributors and warehousing and using their physical distribution from the warehouse to the point of consumption.”

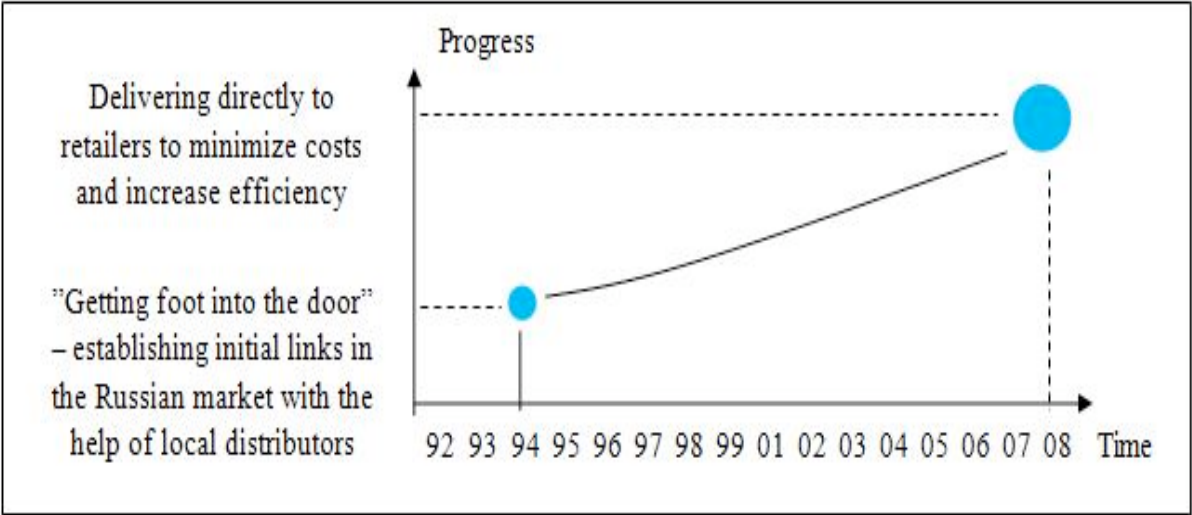


Figure 4-1 Development trend of Valio

Shortly after the Soviet Union broke up and Valio began its operations in new Russia, local partners, 3PLs were chosen to battle the problem of the time – open markets, where accountability and integrity was an issue.

“...In the beginning of the 1990s the chain was very undeveloped in Russia...Most of the products were sold on the open markets. And that was a real challenge how to sell on the open markets and our strategy was that we choose few distributors and also that they took care of the distribution and sales with this open market system and you know that there are many levels in between the distributors and the final point of sale could be some babushka selling on the corner on the street. It has been very complicated. But since of the

90s it is a very fast evolution towards the normal system how it's working everywhere else."

From Valio's perspective there are several problems that are presently making it difficult to operate at a desired level. One of them is the traffic within Valio's key target markets – St. Petersburg and Moscow. The traffic conditions are very much congested, which leads to inefficiencies regarding Valio's overall business model in Russia. Also there is a need for more and tighter control over the distribution systems in place, due to the hard facts of the general economic principles, like constant price negotiations. On a broader scale, it is Valio's view that Russian logistics, like the retail market is developing fast and well.

Value

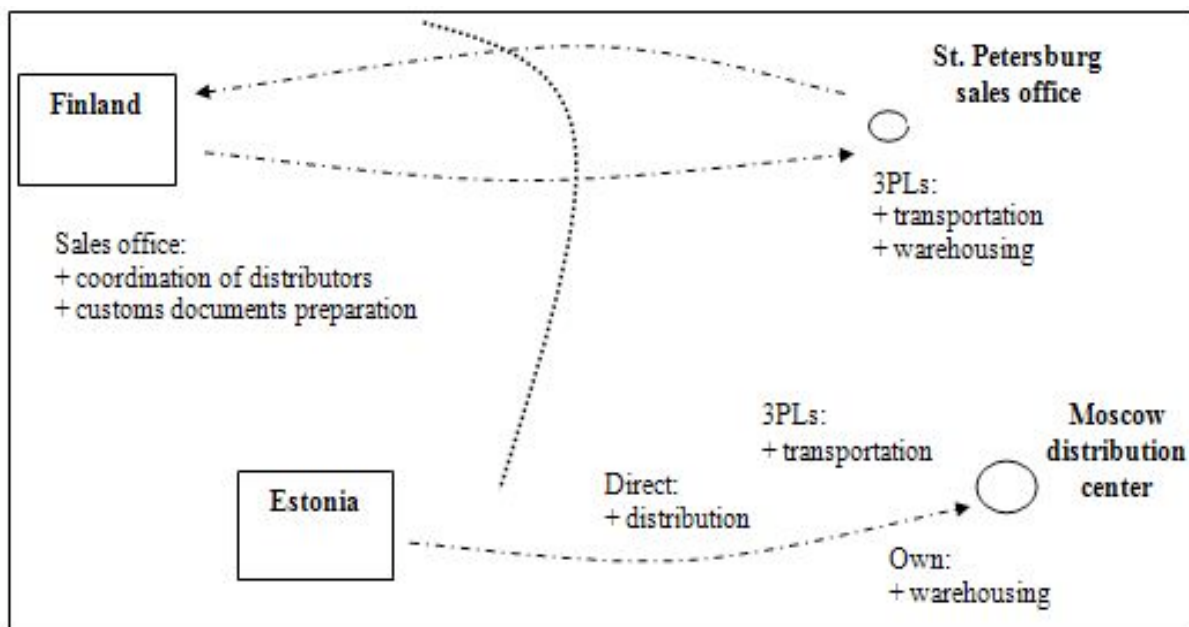


Figure 4-2 Added value of Valio's operations in Russia

The primary value services are concentrated in the distribution and warehousing services of 3PLs. Additional value-added services come from the sales office established in St. Petersburg and the newly established warehouse in Moscow.

4.2.2 Fazer

History

Fazer Group originates from a family business founded in 1891. Today the Group offers

meals and bakery products and operates in a total of eight countries. The mission of Fazer Group is to offer taste sensations. Its operations are based on passion for customer, quality excellence and team spirit.

The Group operates in three divisions, which are all committed to offering taste sensations: Fazer Amica, Fazer Bakeries and Fazer Russia. Fazer Amica is a leading contract catering company in the Nordic and the Baltic countries, offering customers delicious food and tailor-made service solutions. The company operates in the Nordic countries, Estonia, Latvia and Russia. Fazer Bakeries offers fresh and tasty bakery products and operates in Finland, Sweden, Russia, Estonia, Latvia and Lithuania. Fazer Russia is responsible for Fazer's bakery operations in Russia and is one of the leading bakery companies in Russia. Fazer's most important associated company is Cloetta Fazer AB, which is the leading confectionery company in the Nordic countries.

Key Findings

Fazer's entrance into the Russian market can look improperly timed at first, with the acquisition of Hlebniy Dom in St. Petersburg in 1997. However for Fazer this proved to be a major competitive advantage and a potential development platform for the future, due to the nature of the crisis, when domestically produced goods in Russia were cheaper. As well, just last spring Hlebniy Dom finished acquisition procedures of Svosnii bakery in Moscow establishing a solid, but for now underdeveloped presence on the Moscow market. Logistics play an important role for Fazer:

“Logistics is one of key elements, factors, especially in bread. Because bread is fresh product. And it has to be distributed at least once a day, but in many cases we have distribution twice a day. Customers want their products fresh. So logistically it is a key element, how competitive the company is.”

Logistically, Hlebniy Dom was organized through a distribution system of its own called HlebTrans. Yet, even with multiple negotiations, due to constant underperformance, Fazer decided to disregard HlebTrans and start off with a clean slate, by taking control of half of the distribution system in direct ownership of Hlebiy Dom, while outsourcing the other half to reliable partners and distributors. Parallel setting a standard in the Russian bakery business by employing new methods of organization and value delivery, e.g. switching from metal racks

to plastic crates, which increased the amount of products being shipped and the overall hygiene level of deliveries.

“...Since 1998 the distribution happened so that there were metal racks with wooden boxes and you pushed this metal racks to the cars and at the shop, they picked from these racks from the wood crates. But this system does not serve the customer at all. And at the time it was owned by, the whole distribution system was organized by Hleb Trans. We had a few discussion with them about the service that we expected but they didn't listen to us and then we decided to get the distribution of our own. Also at the same time we decided to change these metal racks and wooden crates to plastic crates.”

Currently, Hlebniy Dom owns 80 trucks in St. Petersburg; while in Moscow the total breakdown of owned and outsourced trucks is 40 to 50. However it was noted that for Fazer/Hlebniy Dom it is of course more efficient to outsource all of the logistics processes in order to focus on the core activities. This is why Fazer envisions that with developments on the Russian logistics and retail markets, all of the logistics operations will be outsourced completely to 3PLs in approximately a period of five years while training their current transportations staff.

“We even have told that we will train our own staff that they can establish their own companies, own companies to start this kind of business, because that is what we did in Finland. We trained our own drivers to start their own businesses. And then of course with retail and producer, management IT system they develop quite similar. But it depends of course.”

The challenge for Hleniy Dom's distribution, both own and outsourced is the bad traffic conditions. Although St. Petersburg's traffic is not so much of a problem, compared to Moscow's traffic jams, yet it is slowly beginning to show signs of congestion and instability. Compared to Finland, Russian markets are still underdeveloped in terms of available services, volumes and elaborate techniques, like electronic ordering. However in upcoming years, due to increased knowledge transfer from Western companies, Russian enterprises will be able to reach a level, close to their Western counterparts.

“If you look at the development of retail in Russia - it has been fast. But to get the same operation standards what are in Western Europe - it will take time. So, I don't know how many years it will take but I believe not many.”

Value

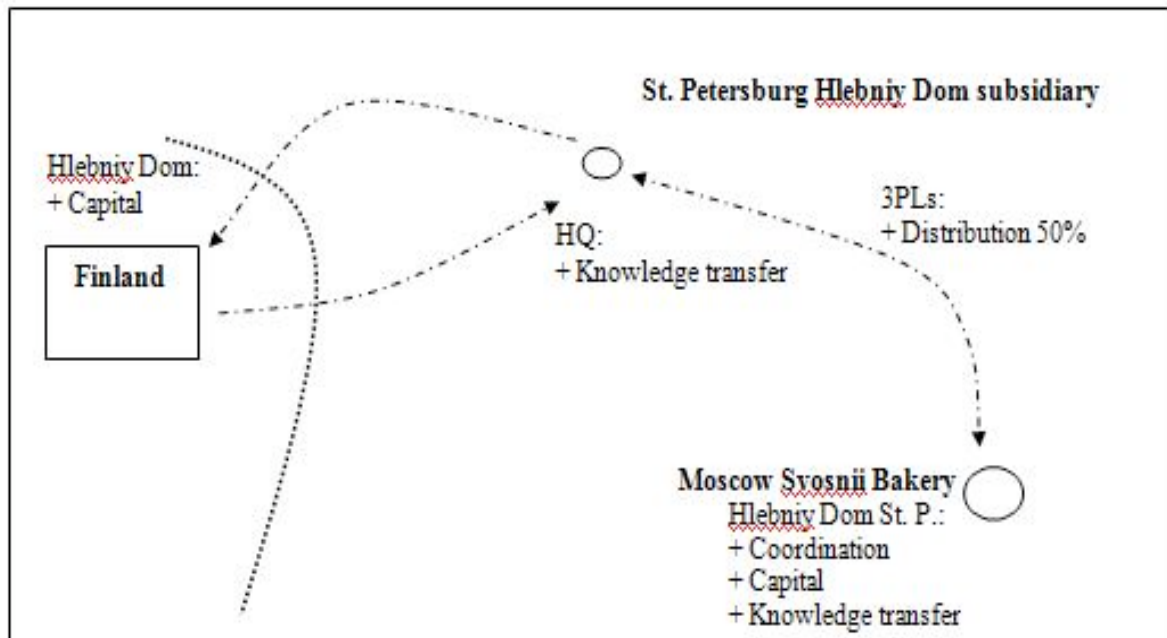


Figure 4-3 Added value of Fazer's operations in Russia

The initial value provided to Hlebnii Dom from Fazer's HQ was knowledge transfer and innovations within the bakery business. Additionally this knowledge is passed onto the other layers of the organization like Svosnii bakery in Moscow. In return the daughter company delivers capital in various forms back to the HQ. Also, value is created in distribution since part of Hlebnii Dom's distribution system is outsourced to 3PLs. Because Fazer understands that owning distribution is not core activity, but because of the circumstances cannot disregard it – it is not counted as a value creation process.

4.2.3 Paulig

History

Gustav Paulig Ltd is part of the Paulig Group, and its premises are in the Vuosaari district of Helsinki. The company was founded in 1876 and is still family-owned. Gustav Paulig Ltd engages in high quality coffee production as well as sales of coffee and hot chocolate products. Paulig has had coffee roasting operations since 1904. The vision of Gustav Paulig Ltd is to be a leading coffee roaster on selected markets.

Today Finland's leading coffee company also operates in the Baltic countries, Russia and Russia's neighboring countries. Paulig is particularly noted for its high-quality coffee and their brands.

“That the day we compromise on quality we can close our factory gates.”

The wide coffee range offers flavour sensations for consumers who appreciate light and dark roast filter coffees, coffees beans or espressos. Paulig supplies Horeca professionals with a number of product and service concepts as well as up-to-the-minute training programs at the Paulig Institutes.

Key Findings

Paulig was involved in coffee business already during the Soviet Union times. When the USSR collapsed, Paulig decided to not only decrease, but rapidly increase its presence on the newly established Russian market. This was not a greatly difficult move to undertake, since majority of competitors from outside of Russia simply pulled the plug and fled in all aspects risky Russian Federation.

“...We just had to stay there and then we gained big market share. And even today we are second biggest in real coffee.”

Up until recently Paulig had a representative office in Russia that was responsible only for the sales of Paulig products. The logistics Paulig utilized included three good-relationship partners from Russia that imported goods from Finland and Estonia, as well as distributed them among the clients of Paulig. This in part created a “black hole” for the company because these distributors were simply buying Paulig products from Finland and/or Estonia and then selling to other agents and/or retailers, generating a lack of knowledge on Paulig's part of the operations occurring.

However now, Paulig opened a logistics center and an office in Moscow that will be responsible for marketing and all client contacts in Russia; where Paulig will own the products, making it easier to track price mark-ups and fluctuations accordingly. Currently the situation with the distributors of Paulig is that they are beginning to play more the role of an actual distributor as opposed to an importer that buys the products and owns them until the end of the supply chain. By switching to such operations, and putting into work the newly

established logistics center Paulig will be able to simpler take clients' requests into account.

Overall Paulig's attitude towards logistics can be summarized in the following:

“Now in logistics distribution globally there is this outsourcing philosophy, that you concentrate your core business that is managing these flows. So it is not necessary any more according to latest thinking to own the trucks, own the warehouse, not to need invest in that but invest into core business. You can buy these services and make the fixed costs variable costs. But what is of course is important in this philosophy that your management and your buying skills that you get good service for your money. Because when you are buying these services there are huge amount of other customers who are also buying these services. And those customers who are not putting the attention to the partnership they are getting lousier service. So our philosophy is that we put lots of energy and work between the relations with our partners, because we are getting the biggest attention...Capital costs, methods of dealing with customers, but physical processes can and are outsourced.”

Additionally, Paulig is developing its local presence by building a manufacturing plant as a part of its establishment strategy in Russia, which should be ready by 2009. This manufacturing plant will be located between St. Petersburg, which is logistically a good location, Tver, for following up on the two major markets of Paulig – Moscow and St. Petersburg. Also this manufacturing plant in cooperation with the new logistics center in Moscow should serve as a hub, as a gateway to other cities in Russia as well.

“...Nowadays in Russia everybody wants that you are coming in and be closer so we want to be with Russians. Then local presence there also. And it will come, not from Helsinki, but major of the products will come from Tver to Moscow and from Tver to St. Petersburg, because this is only first starting point, maybe we will have more presence in regions and St. Petersburg. Ok, depending on what our retail customers demand. Because now we have to hear our customers wishes and what they expect from us and then we are following and trying to find out some economic ideas by working together with some other partners, because in Russia you can not survive by having own cars and own

warehouses, because there is no economical... you can not make any formula to justify. You have to be clever and modestly work with somebody else."

Value

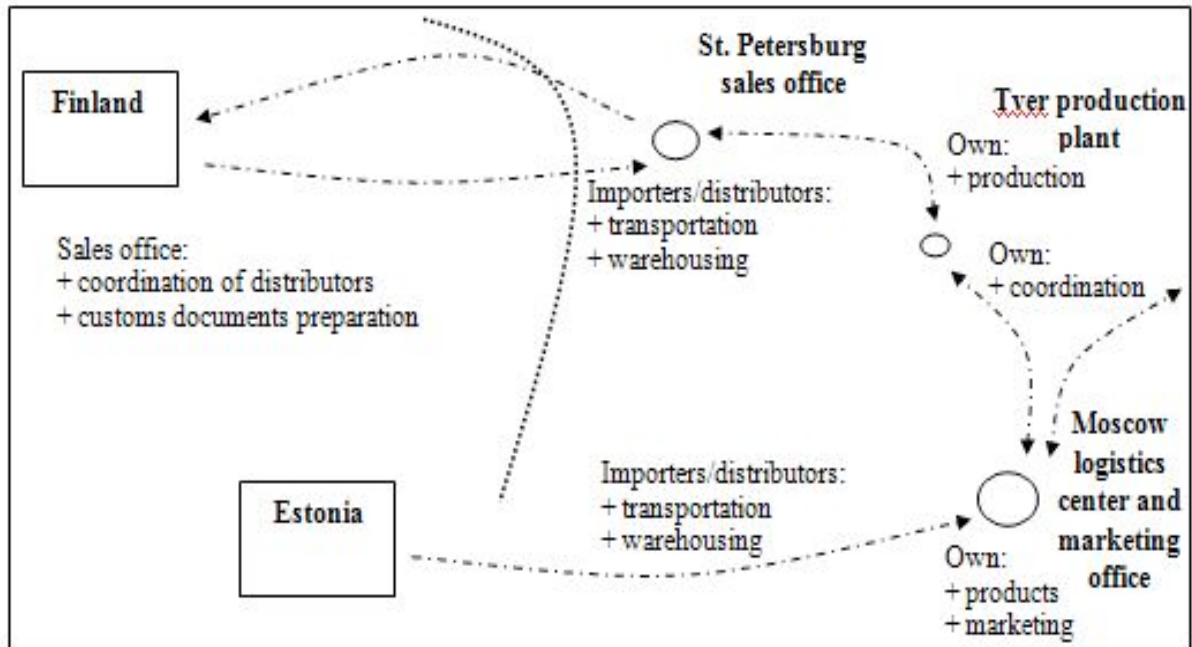


Figure 4-4 Added value of Paulig's operations in Russia

The figure above is a combination of the value added currently and in the near future, with Paulig's manufacturing plant in use. The initial value now is generated with the coordinated work of the sales office, marketing office, logistics center and importers, who by 2009 would have to seriously reconsider their offerings and probably switch to providing simple transportation services, i.e. serving as distributors, as opposed to importers. However now, these 3PLs play a major role because of their high involvement in the operational processes of Paulig by providing import, transportation and warehousing services. Also, the Moscow office will deliver coordination to other cities in Russia. When the Tver manufacturing plant becomes working, another value stream will be created, where Paulig will not have to rely on importers and will have direct access to its products and better marketing.

4.2.4 Atria

History

Atria Plc is a forward-looking, strongly internationalizing food-processing company. Atria was Finland's largest meat processor in 2007 in terms of turnover, and one of the industry's

leading companies in the Nordic countries, Russia and the Baltic countries. The Atria Group's turnover in 2007 was approximately EUR 1,270 million.

The Atria Group employs approximately 5,900 people. The Group is centered in four geographical areas: Atria Finland, Atria Scandinavia, Atria Russia and Atria Baltic. Listed on the Helsinki Stock Exchange, Atria Plc's roots go back to the year 1903, a time when its first owner cooperative was founded.

Key findings

Atria established itself on the Russian market long time ago, in the beginning of the 20th century, but established a solid local presence only in 2005, when it bought Pit-Produkt of St. Petersburg and made it into a wholly owned subsidiary. Pit-Produkt has a factory near Murmansk highway, with another factory being built by Pulkovo airport. By the end of 2008 Pit-Produkt should finish construction of a large logistical center, which is envisioned to centralize all of Pit-Produkt's logistical operations in Russia. Also, Pit-Produkt has recently acquired Kampomos, a Moscow-based enterprise, which will equal Pit-Produkt to a total value of 150 million EUR.

Atria, compared to previous companies, is strongly in favor of owning all the distribution channels, because it sees it as a core activity of the company and a process, which is preferable by major clients.

“We do believe that logistics is one of our core competencies and we count on direct distribution for our major clients. For some small clients we do have distributors, I mean small clients like kiosks, pavilions and so on. It is not profitable to deliver small 1-2-3 kg packages of sausages to them but it is more profitable to use distributor...75% – 80% of our deliveries are own directed distribution with our own trucks.”

“...First of all we can be sure that the quality of the delivery chain would be good, because we can control that chain; secondly, when we have to have our own direct distribution, we have all information, we can go from our logistics center to the point of sales. So we can control better the information flow and deliveries. And the third one is that we do know and we can control the costs concerning deliveries.”

From Atria’s perspective increasing raw material prices, gasoline prices and traffic congestion in St. Petersburg and Moscow regions are the major issues, otherwise Atria is satisfied with Pit-Produkt’s performance and its current state.

Value

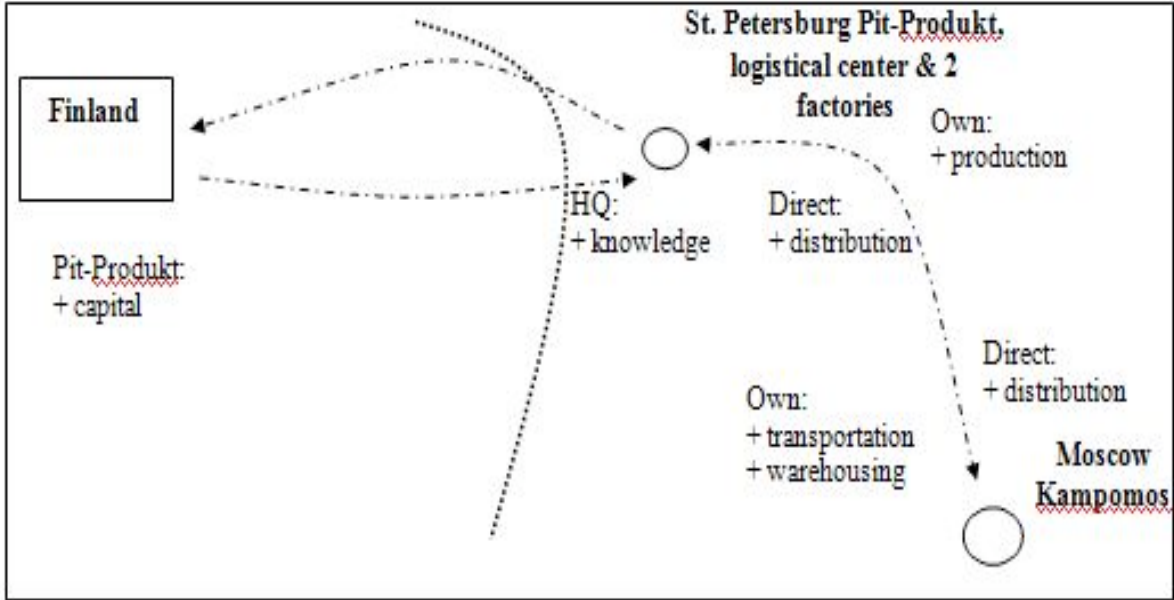


Figure 4-5 Added value of Atria’s operations in Russia

The most value is generated from having a significant local presence on both the St. Petersburg and Moscow markets, where with the help of wholly owned distribution systems through logistical center Pit-Produkt is able to directly deliver the products and satisfy its customers.

4.2.5 Others

The other companies involved in the research, Raisio, Saarioinen, and HK Scan also have recent history of presence on the Russian market. This history involves primarily export and import operations with some help from a sales representative located in Russia. Up until four years ago, the named above firms were all involved in export operations. In 2004 Raisio has established a strong local presence by opening up a production facility of one of its products – margarine. However in 2007 Raisio chose a subcontractor to run its margarine operations in Russia because it was not cost efficient to do it on their own. Raisio also is involved in other ventures indirectly, like agricultural firm Zolotoi Kolos. Saarioinen, a company with a wide range of products, is primarily exporting into Russia its jams and dressings. They do this

through a co-operative company called Fintorus that is concerned with importing food products to the Russian market on behalf of many small – medium sized Finnish food companies. HK Scan has an established but small import office in St. Petersburg that deals solely with a limited number of local wholesalers, who operate most of the logistics on HK Scan's behalf.

The value added by these companies includes exporting products through distributors as well as in Raisio's case through 3PLs, should Raisio follow up on its goals and attain 100% outsourcing logistic possibilities in the several years to come.

Additionally to the food companies I have spoken with the manager of Fintorus regarding the position that local presence in the form of manufacturing plant or plants is promising for business, especially when a synergy can be created by combining core operations of a company with understandable outsourcing procedures, in this case logistical procedures.

“Those who have own production or some kind of activity on the Russian side they are quite good and their perspectives are quite good. But companies that have only export activities from Finland they are surviving. But not doing well.”

Fintorus is responsible for distributing the products of about 20 small Finnish food companies that are incapable of delivering their products to the Russian market themselves, primarily because of the cost (Laitimo Tea, interview, 18.09.2008). There are two sides to this operation, the first being Fintorus; Fintorus buys products from the small Finnish food producers. On the other side there is Finprod, a subsidiary of Fintorus. Its primary function is to import and essentially buy all the products from Fintorus, subsequently actually delivering all the products from Finland to its key markets of St. Petersburg and Moscow.

According to Ms. Laitimo, Fintorus and Finprod are pitching their business to small food producers so that they are “delivering and distributing the goods as much as we can from the same truck, which we are using for importing.” This should definitely cut costs, but however is not quite enough; not to mention that it does not always happen in the way everything was originally planned. Furthermore it was noted that clear focus of where a company can and cannot generate enough revenue.

“You do as much as you can by yourself and other things you just outsource.”

This is important due to the fact that having full control over firms operations through direct ownership of its activities is essential for most cases in Russia because of underdevelopment of the logistic market and its current players. However, in the words of Ms. Laitimo: “if you can find a good and reliable partner, why should you do it by yourself? The key question is to find a partner and rely on. It can be another Finnish company, a Russian company, it can be something else, but you need a partner you can trust.”

4.3 Summary

Overall, there were two clear tendencies drawn from the interviews and subsequent discussions. Firstly, establishment of local presence in the form of a production facility is of great importance to the Finnish food companies. This is in part explained by the market conditions in all of its conditions, e.g. political, economical, social etc. Second, those companies that did have manufacturing facilities in Russia (except Atria) were in great favor of outsourcing logistics activities into the management of 3PLs.

According to the interviews Russian logistics market is not yet developed in terms of technological advancements, infrastructure, and social applicability aspects. It is essential to keep in mind that outsourcing logistics today is primarily about managing relationships, thus building up trust and other necessary factors for the foundation of relationships is necessary to initially allow for the development to happen.

The outsourcing relationships are both greatly important when dealing with distributors as well as inside 3PLs. Fazer and Raisio both partially own their distribution, but this system is expected to change in the next 5-10 years, when Russian logistics’ market has more to offer in terms of scope of services, price, quality etc. Atria is the ‘white crow’ in the total sample of the interviewed companies, because its directors believe that apart from being a producer Atria is also an efficient logistics service provider, which allows it to reap the benefits of this deal in the form of quality, information flows and costs, while maintaining local manufacturing plants.

Below are two tables encompassing the overall outcome of the study – local operations by company and logistic arrangements by company:

	Valio	Atria	Fazer	Raisio	Paulig	Saarioinen	HK Scan
own production							
subsidiary							
sales office							
export							

	Valio	Atria	Fazer	Raisio	Paulig	Saarioinen	HK Scan
100% distributor							
own distribution							
part own/part dist.							
100% outsourcing							

Out of sample size of seven (n=7) we can see that four Finnish food companies have their own production facilities. Out of these four one already has opted, while two others are moving towards complete outsourcing of logistic operations because it is not a core competence of those firms. Focusing on non-core activities is considered ineffective thus causing unefficient management of resources and missed opportunities in areas where it would have been possible to work had there not been core activities involved drawing away capital and labor tools. Alternatively, one company is engaged in logistical operations on its own due to the fact that it views the overall supply chain management as a core process of the firm that is able to differentiate it from others while adding value to the customers (large retail stores do not want to deal with 3PLs, rather with the actual suppliers, for example) and boosting its competitive advantage.

The three companies that are not manufacturing products in the target country have export activities in place, sales office representation or a combination of both approaches. It is unanimously agreed that these enterprises engage distributors for the role of logistics service providers in order to get their products to the point of sale in Russia.

5 CONCLUSIONS

From observation and research we can conclude that the type of operation does indeed correlate with the logistical arrangements utilized. Through discussions with representatives it was obvious that all of them are completely sure of their decisions to outsource, develop logistics in-house and so on. There were several correlations regarding the interviews, like traffic and distribution concerns, main target markets of Russia for Finnish food companies being St. Petersburg and Moscow, as well as clear signs of development for the Russian supply chain management market with future positive prospects expected in the following 5-10 years. These aspects were viewed in light of the interesting parts regarding the secondary research in the Prior Research section, like the theories of Internationalization of the Firm and Porters Competitive Advantage, as well as Supply Chain and Logistics Outsourcing concepts.

Hence, Prior Research combined with the Interview Research, and integrated into the framework presented in the Framework section, the model for Optimal Operations looks like the following:

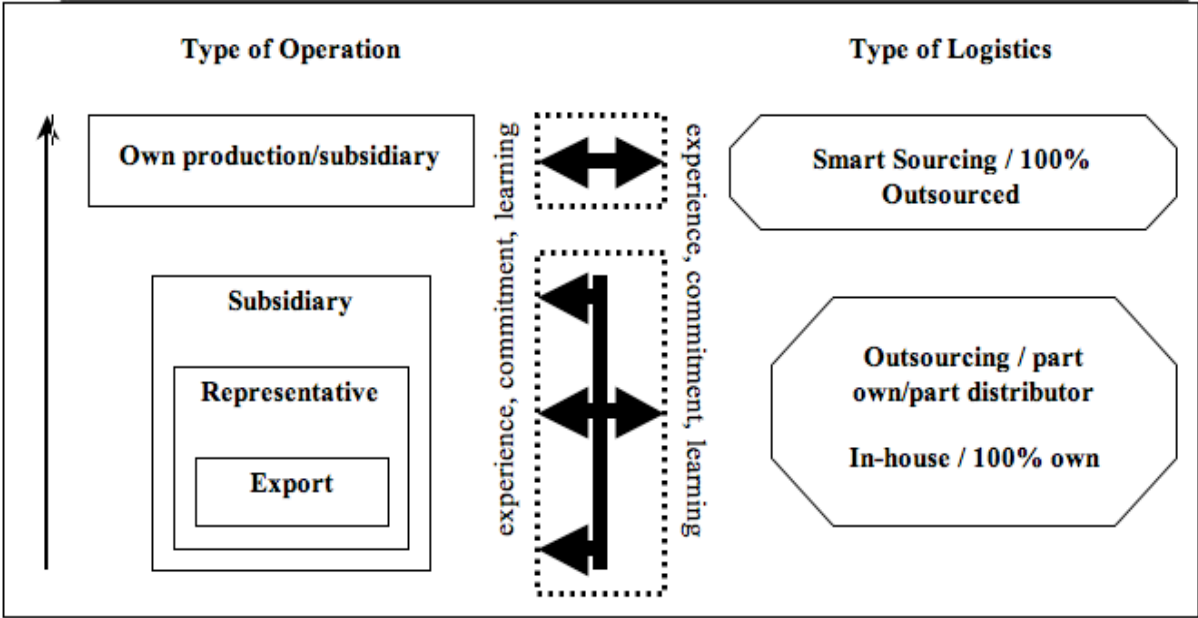


Figure 5-1 Framework model, revised

Meaning, should a Finnish food company establish a production facility in Russia, it should be exploring the possibilities and thinking of attaining the Smart Sourcing / 100% outsourcing

policy in the following years, or it should develop clear and trustworthy relationships with initial partners to primarily establish outsourced logistics operations. Why establishing own production is crucial for many businesses including Finnish food companies in Russia? Even though the physical distance is relatively short, the actual business distance might be significant should there not be a local presence involved. By utilizing the means of production in Russia, Finnish food companies are achieving the opportunity of having a ‘feel’ for the market, which feeds more useful information into the data flow of the company thus allowing more valuable and value-added judgements and decisions to take place within that particular company. Outsourcing is simply a logical additive to this combination, due to the conclusions obtained from the Prior Research segments, in particular that a food producing company should outsource because it is not its core activity and focus primarily on the business agenda directly involving company’s resources and/or revenue streams.

The other forms of local presence as defined in the Prior Research section, are more flexible and concerning their logistical arrangements, however few patterns are evident there as well. Should a Finnish food company export through an agent or through its own sales office, it is best to utilize 3PLs as distributors, as opposed to directing own supply chain operations due to the costs of transportation as well as concept of Porter’s Competitive Strategies.

The dotted boxes represent the value streams between a particular type of operation/operations in a target country and the distribution methods. Thus by dealing with the manufacturing/outsourcing model there are efficiency improvements, cost reductions and more allocation of resources towards the core activities. In the case of other local presence operations there is easy access to the market, with small number of controllable variables however; also custom’s clearance up until recently was determined as a problem area, where corrupt distributors and/or agents exploit the flaws of the system causing the overall plan to turn towards the ‘grey area.’ Now however, more and more partners understand how important it is to perform custom’s clearance with full responsibility, integrity and attention avoiding illegal and grey area matters aside.

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INTERVIEWS

Juha Kaarimaa, Managing Director, Fazer Russia, Helsinki, 12.06.2008.

Ronny Reijonen, Logistics Manager, Paulig Gustav Oy, Helsinki, 19.06.2008.

Jacek Dziekonski, Eastern Europe Food Division Manager, Raisio, email, 08.07.2008.

Mari Jämsén, Key Account Manager, Russia, Saarioinen Oy, email, 12.06.2008.

Veijo Meriläinen, E.V.P. International Operations and Innovations, Valio Ltd., Helsinki, 13.06.2008.

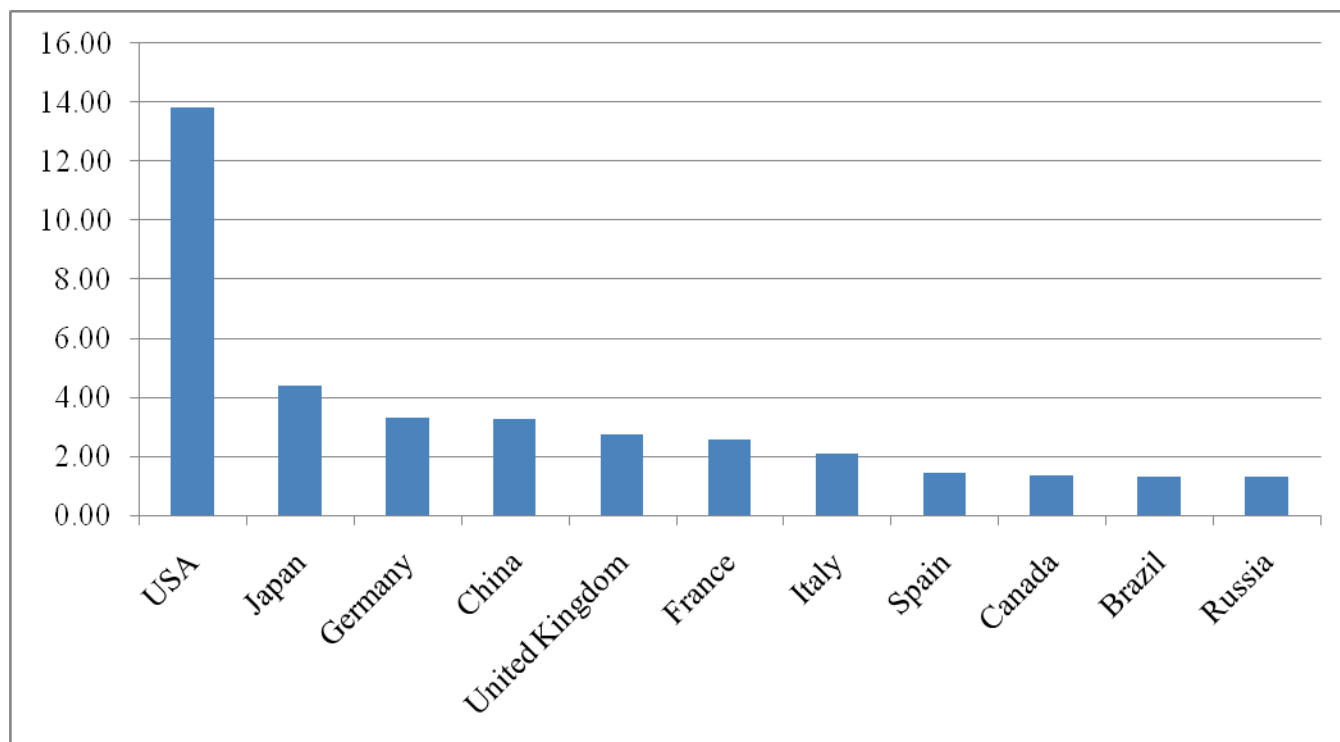
Kai Seikku, CEO (chairman), HK Ruokatalo Oy, Finland, email, 18.06.2008.

Tea Laitimo, Managing Director, Fintorus, Lappeenranta, 18.09.2008.

Juha Ruohola, Managing Director, OOO Pit-Produkt (Atria Russia), telephone.

APPENDICES

#1. Top 10 countries* by GDP (trillion), World Bank, 2007



*Note: Eurozone (second in World Bank) has been excluded

#2. List of interviewees

#	Company	Contact person	Telephone	Email	Status	Type
1.	Valio	Veijo Meriläinen		veijo.merilainen@valio.fi	completed	meet
2.	Fazer	Juha Kaarima	040 500 46 19	juha.karimaa@fazer.fi	completed	meet
3.	Atria	Juha Ruohola	0400 647160	juha.ruohola@atria.fi	completed	telephone
4.	Saarioinen	Mari Jämsen	050 597 93 18	Mari.Jamsen@saarioinen.fi	completed	quest
5.	Raisio	Jacek Dziekonski		Jacek.Dziekonski@raisio.com	completed	quest
6.	HK Scan	Kai Seikku		kai.seikku@hkscan.com	completed	email
7.	Paulig	Ronny Reijonen	040 589 27 99	Ronny.Reijonen@paulig.fi	completed	meet
8.	Fintorus	Tea Laitimo	0400 156 677	tea.laitimo@fintorus.fi	completed	meet
9.	Vaasan&Vaasan	Marina Korhonen	020 446 21 27	marina.korhonen@vaasan.com	not answer	
10.	MyllynParas	Pekka Savola	044 557 34 20	Pekka.Savola@myllynparas.fi	reading	
11.	Elintarvikeeturisuksliito	Irmeli Mustonen	09 1488 7206	http://www.etl.fi/yhteys/Mustonen.asp		
		Interview done (by meeting, telephone, or questionaire)				
		No interview was done - answer by email				
		Not yet accomplished				
		Unable to reach				
		No information				

#3. Questionnaire 1 – Food Companies

General

1. Tell us about your current business in Russia.
2. Was logistics a major factor in determining to do business in Russia as you do today?
3. How does your logistic work in the Russian market? Why? How has logistics changed over time in Russia?
4. How successful has this practice been?
5. Do you think this approach should be changed somehow?
6. What are your main problems with Russian logistics?
7. What is the state of Russian logistics and how does that affect the Finnish companies doing business in Russia?

Detailed

1. Tell us about your current business in Russia. Plants (how many)/growth.
2. Was logistics a major factor in determining to do business in Russia as you do today? Why?
3. How has logistics changed over time in Russia and how does your logistic work in the Russian market today?
4. Why do you use this specific logistical structure, i.e. what are the main reasons for this?
5. How successful has this practice been? Any problems with this structure? Would you like to see anything change – distributor/supplier relationships, better infrastructure, value added services?
6. The price of oil/foodstuffs (especially in Russia) is on the rise. Do you feel the effects of these market tendencies and how do they affect your business?
7. What do you see happening right now in the logistics industry in Russia? What are the current trends/fads used? At what evolutionary stage is Russian logistics currently? How does that affect now and will affect in the future the Finnish companies trying to penetrate the Russian market?
8. How does the Finnish logistics differ from the Russian logistics market? How did you adapt to the existing logistics environment?

#4. Questionnaire 2 – Fintorus

1. Tell me what is the business of Finnpro. How much does Finnpro involves itself in logistic matters?
2. How successful do you think Finnish companies in general in Russia? What about in terms of their supply chain? Where do you see the biggest challenges and problems?
3. What do you think would be an efficient supply chain model for Finnish companies in Russia? Should there be more outsourcing? Or maybe more of combination of outsourcing and own transportation?
4. How important do you think is local presence for Finnish companies? What are the main factors Finnish companies need to be aware of when considering building this local presence?
5. Do you think that for Finnish companies logistics systems are influenced by the type of local presence in Russia? If a company has a production plant in St. Petersburg would it be a good idea to deliver its products by a third party service provider, sell it through an agent or maybe deliver the products themselves?
6. What is the state of Russian logistics and how does that affect the Finnish companies doing business in Russia?

#5. Break-down of Finnish foodstuff exports by country in euro (collected from Finnish Board of Customs)

	2006	share	2007	share	2008	share
CA	4 560 470 €	0,63 %	4 849 803 €	0,57 %	3 247 296 €	0,60 %
CN	17 157 508 €	2,38 %	23 289 853 €	2,72 %	10 390 036 €	1,91 %
DE	53 550 835 €	7,43 %	80 114 082 €	9,35 %	51 292 014 €	9,43 %
EE	112 284 086 €	15,59 %	126 308 841 €	14,73 %	77 969 779 €	14,33 %
FR	27 246 970 €	3,78 %	30 770 784 €	3,59 %	21 866 004 €	4,02 %
GB	41 567 775 €	5,77 %	43 402 222 €	5,06 %	30 096 326 €	5,53 %
RU	239 198 115 €	33,20 %	286 502 512 €	33,42 %	194 101 624 €	35,67 %
SE	169 512 013 €	23,53 %	209 403 920 €	24,43 %	124 757 970 €	22,92 %
US	55 367 470 €	7,69 %	52 579 311 €	6,13 %	30 487 208 €	5,60 %
TOTAL	720 445 242 €		857 221 328 €		544 208 257 €	

#5. Geographical Breakdown of Foreign Direct Investment in newly issued shares of Russian Nonfinancial Sectors, selected countries, mln. USD (Central Bank of Russia)

	2007					2008
	Q1	Q2	Q3	Q4	Total	Q1
Bermuda	\$818	\$1 093	\$1 186	\$951	\$4 048	\$893
Cyprus	\$526	\$1 087	\$569	\$3 039	\$5 221	\$1 049
Finland	\$25	\$81	\$39	\$27	\$172	\$16
Germany	\$28	\$64	\$168	\$2 012	\$2 272	\$116
Netherlands	\$28	\$2 272	\$42	\$69	\$2 411	\$3 262
United Kingdom	\$73	\$995	\$78	\$178	\$1 324	\$61
Virgin Islands, British	\$177	\$144	\$443	\$1 581	\$2 345	\$67

#6. Inward Foreign Direct Investments in Non-banking Corporations, Balance of Payments Data, inflows minus outflows, selected countries, mln. USD (Central Bank of Russia)

	2007					2008
	Q1	Q2	Q3	Q4	Total	Q1
Bermuda	\$2 047	\$2 235	\$2 102	\$1 985	\$8 369	\$2 388
Cyprus	\$3 657	\$218	\$2 239	\$5 498	\$11 612	\$4 640
Finland	\$131	\$264	\$244	\$148	\$787	\$174
Germany	\$1 025	\$212	\$404	\$6 054	\$7 695	\$839
Netherlands	\$7 087	\$948	\$761	\$587	\$9 383	\$5 364
United Kingdom	\$294	\$937	\$617	\$1 435	\$3 283	\$2 015
Virgin Islands, British	\$150	\$375	-\$914	\$15	-\$374	\$708

#7. Foreign Investments into Russian Economy, by sector, mln. USD (Rosstat)

FOREIGN INVESTMENTS IN THE ECONOMY OF RUSSIA										
	Received in 2007					Accumulated by the end of 2007				
	mln. USD	of which			%	mln. USD	of which			%
		direct	portfolio	other			direct	portfolio	other	
Total investments	\$120 941	\$27 797	\$4 194	\$88 950	100	\$220 595	\$103 060	\$6 728	\$110 807	100
of which by kinds of economic activities:										
agriculture, hunting and forestry	\$468	\$224	0.0	\$244	0.4	\$1 407	\$913	\$3	\$491	0.6
fishing and fish farms	\$49	\$26	0.0	\$23	0.0	\$172	\$40	\$1	\$131	0.1
mining and quarrying	\$17 393	\$13 933	\$24	\$3 436	14,40	\$41 281	\$29 767	\$62	\$11 452	18,70
of which:										
mining and quarrying of energy producing materials	\$15 860	\$13 670	\$18	\$2 172	13,10	\$37 496	\$29 020	\$55	\$8 421	17,0
mining and quarrying except of energy producing materials	\$1 533	\$263	\$6	\$1 264	1,30	\$3 785	\$747	\$7	\$3 031	1,70
manufacturing	\$31 948	\$4 101	\$2 713	\$25 134	26,40	\$66 588	\$40 391	\$3 313	\$22 884	30,2
of which:										
manufacture of food products, including beverages and tobacco	\$2 907	\$1 147	\$23	\$1 737	2,40	\$7 472	\$5 481	\$88	\$1 903	3,40
manufacture textile and textile products	\$57	\$49	\$1	\$7	0.0	\$156	\$129	0.4	\$27	0.1
manufacture of leather and leather products, footwear	\$3	0.2	-	\$3	0.0	\$21	\$20	-	\$1	0.0
manufacture of wood and wood products	\$528	\$234	0.0	\$294	0.4	\$2 367	\$1 493	\$1	\$873	1.0
manufacture of pulp, paper products; publishing and printing	\$934	\$178	\$2	\$754	0.8	\$1 493	\$1 051	\$29	\$413	0.7
manufacture of coke and refined petroleum	\$4 353	\$21	\$471	\$3 861	3,60	\$10 395	\$5 104	\$473	\$4 818	4,70
manufacture of chemicals, chemical products	\$1 637	\$371	\$9	\$1 257	1,40	\$2 734	\$1 257	\$247	\$1 230	1,20
manufacture of rubber and plastic products	\$324	\$273	\$9	\$42	0.3	\$1 250	\$1 004	\$9	\$237	0.6
manufacture of other non-metallic mineral products	\$865	\$550	0.0	\$315	0.7	\$2 816	\$2 129	\$8	\$679	1,40
manufacture of basic metals and fabricated metal products	\$15 229	\$565	\$2 156	\$12 508	12,60	\$32 546	\$20 058	\$2 247	\$10 241	14,80
of which manufacture of basic metals	\$14 904	\$491	\$2 156	\$12 257	12,30	\$31 760	\$19 338	\$2 247	\$10 175	14,40
manufacture of machinery and equipment	\$927	\$77	\$2	\$848	0.8	\$1 413	\$683	\$5	\$725	0.7
manufacture of electrical, electronic and optical equipment	\$276	\$118	\$22	\$136	0.2	\$772	\$386	\$24	\$362	0.3
manufacture of transport equipment	\$3 015	\$353	\$19	\$2 643	2,50	\$2 243	\$1 151	\$180	\$912	1.0
including:										
manufacture of motor vehicles, trailers and semi-trailers	\$2 894	\$350	\$19	\$2 525	2,40	\$2 107	\$1 105	\$171	\$831	0.9
manufacture of ships, aircraft and spacecraft and other transport equipment	\$121	\$3	0.0	\$118	0.1	\$136	\$46	\$9	\$81	0.1
electricity, gas and water supply	\$822	\$152	\$474	\$196	0.7	\$1 898	\$519	\$931	\$448	0.8
construction	\$2 911	\$891	0.2	\$2 020	2,40	\$3 583	\$1 400	\$4	\$2 179	1,60
wholesale trade and commission trade; repair of motor vehicles, motorcycles; personal and household goods	\$47 310	\$3 256	\$6	\$44 048	39,1	\$58 146	\$8 583	\$45	\$49 518	26,40
hotels and restaurants	\$59	\$49	-	\$10	0.1	\$378	\$295	\$3	\$80	0.2
transport and communication	\$6 703	\$591	\$439	\$5 673	5,50	\$16 107	\$3 720	\$1 070	\$11 317	7,30
of which communication	\$3 295	\$327	\$390	\$2 578	2,70	\$9 236	\$795	\$861	\$7 580	4,20
financial intermediation	\$4 450	\$1 123	\$467	\$2 860	3,70	\$9 110	\$5 048	\$806	\$3 256	4,10
real estate, renting and business activities	\$8 414	\$3 273	\$70	\$5 071	7,0	\$20 634	\$11 652	\$487	\$8 495	9,40
including:										
maintenance of housing stock	\$17	\$16	-	\$1	0.0	\$43	\$42	-	\$1	0.0
research and development	\$395	\$27	0.0	\$368	0.3	\$511	\$119	\$2	\$390	0.2
	\$48	\$3	-	\$45	0.0	\$92	\$8	-	\$84	0.0
public administration and defence; compulsory social security										
education	\$3	\$3	-	-	0.0	\$7	\$7	-	0.2	0.0
health and social work	\$68	\$32	-	\$36	0.1	\$137	\$72	0.0	\$65	0.1
other community, social and personal service activities	\$295	\$140	\$1	\$154	0.2	\$1 055	\$645	\$3	\$407	0.5