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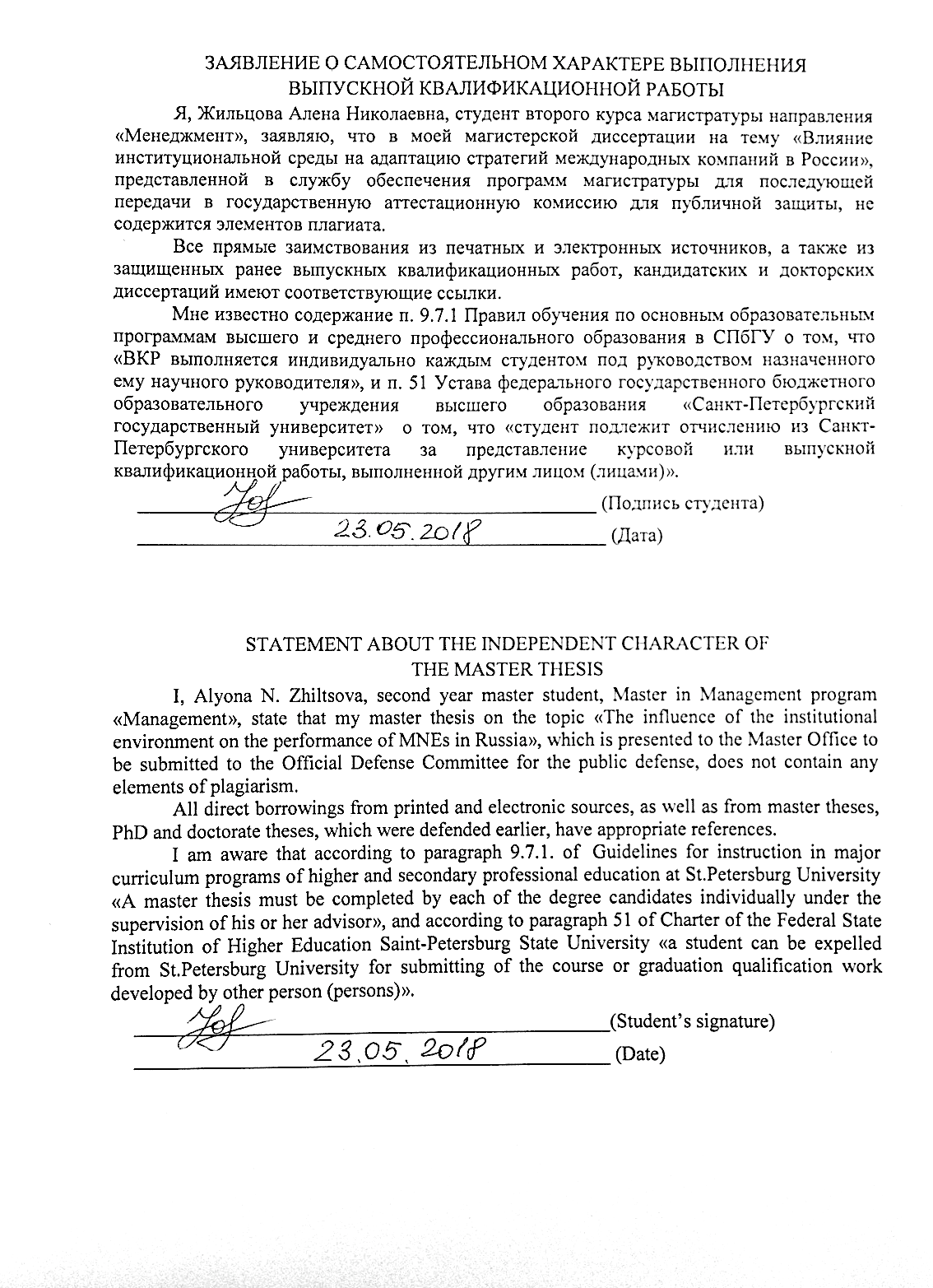
THE INFLUENCE OF THE INSTITUTIONAL ENVIRONMENT ON THE PERFORMANCE OF MNES IN RUSSIA

Master’s Thesis by the 2nd year student Concentration — marketing Zhiltsova Alyona

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**АННОТАЦИЯ**

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| --- | --- |
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| Название ВКР | «Влияние институциональной среды на адаптацию стратегий международных компаний в России» |
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| Научный руководитель | Верховская Ольга Рафаиловна, кандидат экономических наук, доцент, доцент, Кафедра стратегического и международного  менеджмента |
| Описание цели, задач и основных результатов | Цель данной работы – выяснить какие институциональные факторы влияют на деятельность многонациональных компаний в России, и каково их влияние. Задачей данной работы было исследование российского рынка и институциональных факторов, присущих этому рынку, и выявление их воздействия на финансовые результаты международных компаний. Для достижения цели исследования были представлены теоретические аспекты институциональной среды, выделены основные факторы, влияющие на бизнес в России. На основе выделенных факторов были поставлены и протестированы гипотезы с помощью статистических исследований, в результате которых были определены факторы, оказывающие влияние на финансовые результаты компаний в России, которые могут быть использованы международными компаниями при стратегическом планировании выхода на российский рынок. |
| Ключевые слова | Институциональная среда; Россия; многонациональные компании; институциональные факторы; результативность деятельности компании |

**ABSTRACT**

|  |  |
| --- | --- |
| Master Student's Name | Alyona N. Zhiltsova |
| Master Thesis Title | “The influence of the institutional environment on the performance of MNEs in Russia” |
| Educational Program | Master in Management |
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| Academic Advisor’s Name | Olga R. Verkhovskaya, Associate Professor, Department of Strategic and International Management |
| Description of the goal, tasks and main results | The aim of the master thesis is to investigate and analyse how a MNEs’ subsidiaries are affected by a host country’s institutional environment when entering this market. The thesis is focused on Russian market. The purpose of the analysis is investigation of Russian institutional environment and its effect on the performance of foreign companies. For doing so, the theoretical background was investigated, and particular Russian factors were identified. Based on these factors, several hypotheses were tested by using statistics tools. As a result particular factors were stated being the most significant for doing business in Russia, which can be used by any company when making the decision about entering Russian market. |
| Keywords | Institutional environment; Russia; MNEs; institutional factors; company performance |

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# Introduction

In today’s era of globalization there are more and more new companies producing a big variety of goods in order to satisfy customer’s growing demand. When company feels that it grew enough to expand its presence, usually it makes a decision to enter foreign market where there is or might be a demand for this particular product. Internationalization is being researched now a lot as it became the trendiest phenomenon on global market since it helps not only to access new customers, strategic assets and extra resources, but also helps to achieve economy on scales, to overcome trade barriers and to diversify risks.

For applying internationalization strategy successfully it’s very important for company to identify country’s peculiarities like culture, politics and economic situation of the market they want to enter. That helps company to decide whether it’s strategy suits particular country and to adapt their existing strategy to customers’ tastes. Since developed and developing countries are quite different in terms of strategy implementation and perception, it is necessary to create suitable strategy depending on the area. A great number of papers were written studying the institutional environment in different countries and the s between institutional factors and how they influence doing business. Most of them were focused on developed countries, but only a few explored the developing ones and emerging.

Russia’s economy is growing at a very fast pace and it has an enormous potential for the international enterprises. Although Russian market has a huge potential for international enterprises, at the same time it has challenges and pitfalls that need to be addressed before getting into the Russian market. Often international enterprises fail in Russia due to the reason that they are not fully aware of the challenges and difficulties of the market. Entry mode of foreign companies is affected by the challenges and pitfalls of the Russian market and network relationships play vital role for the success of foreign companies in the Russian market.

The reason why this topic is interesting is that there is no systematic research in this field, which can be used to determine overall tendency. Most companies fail to consider all the issues and challenges of the Russian market.

As my master thesis I would like to continue the research in companies’ internationalization since I studied internationalization strategies for my bachelor thesis. In my paper I would like to explore the influence of institutional environment in developing countries on multinationals.

Many paper were dedicated to entry strategies and country factors that affect entering, but only a few papers were written about entering emerging markets. Thus, this paper attempts to advance knowledge in it, and to understand how country conditions in Russia affect the decision-making processes of multinationals. As a result, this study the research of particular factors influencing doing business in Russian market.

**Research gap**

The research gap lies in the fact that there is no clear understanding how the differences between institutional factors in Russia and other countries correlate with the performance of the companies. Some companies are successful in Russian market, but some of them face difficulties which lead to loses and failures. The institutional environment was chosen due to the reason that companies deal with institutions everyday, as they are inalienable parts of business world.

**Research field:** institutional environment, company performance.

**Research problem**

Identifying and formulating what institutional factors should be taken into consideration by multinational companies when entering Russian market.

**Possible research questions:**

1. What issues of Russian market considered to be challengeable for foreign companies?
2. What factors influence company’s performance in the Russian market?
3. How do these institutional factors correlate with the performance?

**Possible methods**

Theempirical methods and existing literature review were used to analyze existing entering and marketing strategies. To obtain information about institutional factors and their importance in company’s performance the data from “The world competitive report” was taken in order to conduct the quantitative analysis.

**Expected findings**

As a result of the work it is expected to find the distances in institutional factors between Russia and other countries, which will help to understand what market indicators contribute on company’s performance.

**Literature review structure**

* Internationalization and emerging markets definitions;
* Institutional environment and institutional distances;
* Investigation of Russian market issues;
* Conclusion.

The paper is composed of three chapters. Chapter 1 describes the theoretical background of the research. Also, the chapter brings the idea about institutional environment and institution distances.

Chapter 2 brings the light on the research method, which was chosen for the research. All the characteristics are described in this part of the thesis.

Chapter 3 describes the results of empirical research. As has been already mentioned, the aim of this paper is to analyze the influence of the host country’s institutional environment on adapting strategies when coming to Russian market.

In order to find the relationships between factors and company’s performance, five hypotheses are analyzed in chapter 3. Based on collected data, which was described above, multiple regression analysis was conducted to find these relationships using several independent variables and one dependent variable.

In chapter 3 all results of regression analysis and descriptive statistics are drown as well. The paper finishes with main conclusions made on the research.

# The relationships between internationalization, institutional theory and multinational companies

## 1.1. Internationalization: evolution of the concept

For the last three decades the global situation has significantly changed bringing many changes to economies and business lives. The disintegration of the Soviet Union, the abolishment of the Berlin Wall, the integration of Europe in 1992, and the liberation of Eastern Europe, washed away the borders between countries making it a Global village (Zuidhof, 2003). This Global Trade approach brought a lot of both opportunities and challenges. Thus, more and more firms are getting involved in international activities with their own strategies of internationalization. So, on the base of their internationalization study, many lessons can be learnt to identify main failures and succeeds for better understanding of entry mode strategies of companies (Grant, 2013). Nevertheless, the motives to go across their own border differ from firm to firm. Thus, some firms can find the domestic market inadequate for doing business, while others persuade internationalization as economy on scale and possible opportunities. Though, in past years firms remained happier when staying within their borders, nowadays the situation changed a lot towards the global trend demand.

As a result of an increased globalization, many countries opened their trade borders, eliminated barriers and joined WTO, transportation and communication have been improved, faster widespread of new technology across borders appeared, that together boosted the process of internationalization. This process is considered to be not only a huge opportunity for companies, but also a potential destroyer. Internationalization occurs through two mechanisms: trade and foreign direct investments (Grant, 2013). Moreover, many firms started to feel threat of insecurity by just staying in domestic market or by the market penetration by foreign firms, what forces them to go international or at least to expand their activities across their national borders. Some companies may consider export as an appropriate approach in internationalization; many other firms can use more aggressive strategies, like acquiring other firms, forming alliances or joint ventures, or establishing their own subsidiaries.

The term of internationalization is commonly used in present days when describing the current rapidly changed market situation, and has been widely researched for the past three decades. It started to be investigated in 1970s when companies began to expand their presence abroad. It’s not that easy to find the exact definition of internationalization as it includes continuous process of activities. The definition changed through years. Luostarinen (1979) further stated internationalization when a company becomes international by establishing its first contact abroad. This claimed that internationalization is the product of a series of incremental decisions. According to Welch and Luostarinen (1988) internationalization is a process when a company increases its international involvement in cross-border operations – more dynamic concept. Thus, according to Uppsala model by Johanson and Vahlne (1997) internationalization is a process when a company gradually increases its international involvement.

Later Beamish (1990) proposed another comprehensive definition: “…the process by which firms both increase their awareness of the direct and indirect influences of international transactions on their future, and establish and conduct transactions with other countries” (Beamish, 1990; Coviello et al., 1997). In 1990s further definitions were proposed including adapting firm’s operations like strategy, structure, resource to international environment (Calof J. et al., 1995). Consequently, internationalization started to be viewed as a chain of developments based on learning process. Another definition by Andersen (1997) stated: “Internationalization is the process of adapting exchange transaction modality to international markets”. This definition includes entry mode strategies and selection of international market.

Nowadays Uppsala model is still considered to be one of the commonly used (Johanson and Vahlne, 1997). According to this model, there are four sequential steps in internationalization process:

1. No regular export activities;
2. Selling via agent;
3. Sales subsidiary;
4. Production subsidiary.

In 2009 Uppsala model was updated by offering a dynamic model of internationalization process. Networking was added as characterizing by developing networks of business relationships in other countries as a center of the process. The knowledge of market and commitment started to be considered to influence both current business activities and commitment decisions, which, as a sequence, influence market commitment and market knowledge. Later, the model was updated because of the changes in economic and regulatory environments and the behavior of companies (Johanson and Vahlne, 2009). Thus, internationalization depends on the relationships and networking of the company, and that there are still some parts of the international market, which are unfamiliar and can help to explain the difficulties of the internationalization. Today’s market consists of networks, so that companies are linked together in a complex system difficult for understanding. Thereby, it is essential to obtain knowledge about it and market participants in order to be successful while internationalization process. Being apart from the network is very dangerous for a company. Opposite, as a part of network, the company can obtain new experience from others, built trust and loyalty for the success of the firm.

Thus, basically internationalization has no particular definition but knowing all aspects mentioned above can help to understand the meaning of this process. Generally, the internationalization goes beyond the marketing of products and services on a global stage. It is a strategy that supposes to reflect company’s current business model and country’s specifics and reflect future model and role that company wants to play in the global market.

As has been described above, the process of firm internationalization is a set of key decisions – what country the firm should enter, what entry mode to choose, how much it should invest, and how the foreign operations should be controlled and managed. These strategic decisions are very important as any mistake can have a detrimental effect on company’s performance, including the potential failure. When entering abroad, companies face difficulties and additional costs due to political and economic risks in the host country (Maitland et al., 2015) as well as legitimacy challenges and the so-called liability of foreignness (Eden et al., 2004). The reason is the lack of familiarity with the entering country’s specifics of the way to organize and conduct business there, of information regarding risks and opportunities, lack of capabilities to deal with these risks, and the local market competition.

In addition, foreign market entry strategies are the most important strategic tools to expand outside. Environmental factors and risks should be taken into account when choosing the way to expand to the particular market, alternatives have to be considered as well as different modes to enter (Deresky, 2000). Thus, the decision of entry mode is a very crucial part of the internationalization (Morschett, 2010).

## 1.2. Internationalization and emerging markets

With the expansion of global business activity due to internationalization, it becomes very important to analyze the key issues of potential entering countries and to reduce unfamiliarity with the host country, which was described in the previous paragraph, to increase the chance of successful performance. In order to make entering successful, it’s vial to understand the differences between conditions that exist when comparing one market with another. Among more than 150 countries in the world, not all of them have the same level of development and cultural issues. Some countries are considered to be leaders in the global arena setting high standards of economic development – developed countries, but some are sill at the stage of development improving their institutional indexes – developing countries. As a result, the difference between developed and developing countries plays huge role in dealing with internationalization.

Apart from countries with developed economy there are markets which economy has some characteristics of a developed market, but does not meet standards to be a developed market – emerging markets. Emerging markets are broadly defined as nations in the process of rapid growth and industrialization, so that companies are moving away from traditional economies that have relied on agriculture and the export of raw materials. Mainly, the definition of emerging markets includes two main aspects: institutional contexts are turning into more market-oriented from less market supporting, and GDP and income are stimulating economic growth (Xu and Meyer, 2013).

There are at least five agreed upon characteristics defining emerging markets. Thus, according to the World Bank, countries with ***low or lower than average per capita*** income of less than $4,035[[1]](#footnote-1) is listed as developing country. This factor is very important because it provides the further information regarding ***rapid growth***, the second emerging markets characteristic. This criterion shows that such markets are willing to adapt changes to a more industrialized economy. To compare, in 2015 the economic growth of most developed countries, such as the United States, Germany, the United Kingdom and Japan, was between less than 3 percent; growth in Egypt, Turkey, and the United Arab Emirates was 4 percent or more and China and India both saw their economies grow around 7 percent. Moreover, emerging markets are characterized as moving from a closed economy to an open market economy.

The third criterion for emerging markets is ***high volatility*** meaning high susceptibility to volatile currency swings, such as the dollar, and commodities swings, such as oil or food. The reason for that is that such countries don’t posses enough power to influence these changes. Sometimes when actions to industrialize economy are taken, other sectors may suffer, like farmers who can lose their lands. Sometimes it can lead to social unrest, rebellions, and, as a result, in a regime change.

In order to help this growth, a lot of investments are required. But the capital market in developing countries is ***less mature*** than in developed markets so it’s not that easy to obtain information about recorded foreign direct investment and sometimes difficult to get information on companies listed on their stock markets. These increases risks linked to investments, so that also means there's greater reward for investors willing to do the ground-level research.

In case of successful outcome, ***higher-than-average return******for investors*** is the fifth characteristic of emerging markets due to the fact that many of these countries focus on an export-driven strategy. Since they don’t have enough demand at home country, they produce lower-cost consumer goods for developed markets. Moreover, it means a higher return on bonds.

According to The Morgan Stanley Capital International Emerging Market Index[[2]](#footnote-2) these countries include Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Thailand, and Turkey. Together they represent almost one fifth of global GDP and equal to around half of the world’s population.

While developed countries are still the main destinations for foreign direct investments, emerging markets became very important locations for transnational companies. Nowadays more and more companies are expanding to emerging markets despite such markets are less developed (Khanna and Palepu, 2000). Emerging markets attract international companies due to having a lot of opportunities. Economic indexes like GDP growth and FDI show that emerging markets (for example, China and India) have a high-growth potential (Elfrink, 2014). Another reasons for attractiveness are the big number of potential customers with growing incomes and relatively low number of competitors (Prahalad and Hart, 2002). Nevertheless, emerging markets also bring challenges for companies when entering. Uncertainty and complexity are their main characteristics (Khanna et al., 2005). Thus, political forces are the main influences being a part of macroeconomics forces. Also, economic factors, like inflation rate and interest, challenge international companies as well. Together these forces may affect risk premium or depreciation expectancy what in turn influence the interest rate of developing markets (Fregert and Jonung, 2008).

Russia is one of the emerging markets, which attracts more and more attention from foreign investors and foreign firms as a destination to enter and put money to. As has been said in the beginning, the aim of this paper is to examine the influence of institutional factors in Russia on the performance of foreign countries in Russian market. Thereby, it is highly important to investigate this market in terms of institutional factors and specialties for better research. According to The Organization for Economic Co-operation and Development, Russian labor market is flexible enough with a well-educated population, what provide opportunities for foreign companies in this market. Still there are challenges: high level of state involvement, weak law policy, and foreign trade and investment rules are restrictive enough. So, that proves the importance of the institutional context influence on foreign firms when entering Russia and the need for further research.

## 1.3. Institutional environment and institutional distances

Today the world market is full of transnational companies expanding their presence wider outside their own borders. Mostly researches are concentrated on multinational enterprises (MNEs) as being the most growing in terms of internationalization. The definition for MNEs is following: “A multinational corporation (MNC) has facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they coordinate global management”. In this paper MNEs are also considered as objects of the research.

The main aim of this paper is to analyze the impact of institutional distances of emerging markets on the performance of transnational companies coming from developed markets. The study contributes to understand deeper the degree of influence of institutional environment in emerging market with regard to entering of more and more MNEs in such markets.

Thus, in order to be successful in foreign markets, companies have to adjust their strategies according to the institutional context of the host country (Estrin et al., 2009). Institutional environment rules the doing business by considering to be predictable and be ruled by laws, so that companies can rely on these strong institutional factors. On the other hand, weak institutions are those being restricted and constrained (Peng, 2009). So, adapting strategies and economic behavior regarding the existing institutional environment is the most important step in order not to fail in the host market.

In the last years the institutional theory found its strong place in the theoretical discussions on MNEs. These studies describe the cross-cultural aspects of MNE’s involvement in international operations, explore the pattern for entry mode strategies, how legitimate their subsidiaries, and many other issues related to internationalization. The institution-based theory helps for a country-level conceptualization of the national institutional environment (Kostova et al., 2002). It also helps to explain the large-scale transformation process at the national level in terms of institutional transformation and path dependency (Wright, 2005). In addition, institutional theory enables to compare different business systems through the institutional framework. Institutional research helps to address the constraints appear across multinationals’ units at the process of institutionalization of organizational practices (Kostova et al., 2002), and to explain liability of foreignness and company’s legitimacy in a host country.

According to traditional institutional theory, the environment of the firm is the main determinant of its structure and behavior. The institutionalism is linked to company’s structure, activities and organizational routines regarding the government pressure, expectations of employees and collective norms. Therefore, in order to expand, firms have to adapt to the current institutional structures of the host country. It is important as these structures impact FDI decisions. Thus, in the case of MNES, the organization in different spaces, in country of origin and host country, poses both opportunities and challenges. So, opportunities come from the possibility to reduce transaction costs with the differences in regulations and with economy on scale. Challenges arise from the need to adapt constraints to different institutions, and the need to interact with multiple actors having their distinct interests (Ang et al., 2008). The institutional theory is highly applicable on MNEs as they operate in more than one institutional environment and under different institutional pressure.

For the last decades several researchers used institutional environment in their studies, what proves the importance of this framework for better understanding of the performance of MNEs. The recent studies adapted the framework to explore the behavior of transnational firms. Thus, Ang et al. (2008) studied the effect of institutional factors on the adoption of equity alliance modes and proved that institutions explain the adoption and effect the alliance location. Santangelo and Meyer (2011) used institutional theory to investigate how institutions determine entry mode decisions. They found out that in case of lower development of formal institutions companies prefer through the greenfield and acquisitions instead of the joint ventures. Quer et al. (2012) and Kang and Jiang (2012) separately used institutional environment as a base to research FDI location, and came to the conclusion that institutional environment better explains FDI location than economic factors. They concluded that multinationals preferably enter countries with lower institutional distances comparing to their home country. Later Arregle et al. (2013) explored the degree of internationalization of MNEs using institutional factors and came to the conclusion, that the region’s diversity plays a huge role in internationalization process of the firm. The most recent studies were focused on company’s performance. Thus, Cuervo-Cazurra and Genc (2011), and Ma et al. (2013) investigated the influence of institutions on MNEs subsidiaries’ performance. As a result they concluded that institutional development has a negative effect on the performance of subsidiaries. They claim that MNEs coming from developing countries have higher advantage than those from developed countries.

When companies invest overseas, they face the high level on unfamiliarity with the host country environment. Nevertheless, company’s performance depends not only on formal factors, which were described above, but also on informal institutions, including the culture, norms, traditions and ideologies (North, 1990).

Thus, one of the concepts of institutional environment, influencing company’s performance, was proposed by Whitley (1997), who developed the older studies. He adapted the National Business Systems framework, which is composed of four factors: political system, financial system, education and labor system and cultural system (Whitley, 1999).

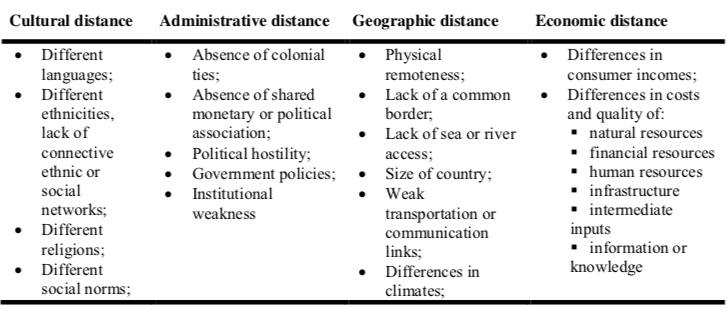
Political system is represented here as a power of the government – “the extent to which states dominate the economy and share risks such that businesses become dependent on state policies and actions”. It evaluates whether the government “directly or indirectly regulate market boundaries, entry and exit, as well as set constraints on the activities of economic actors” (Whitley, 1999) through laws and regulations. These laws and regulations are very important in facilitating the engagement of companies with the states and with the key stakeholders. Also, some of laws are aimed at promoting the competition within firms. Corruption was also included in this field of research as being dictated by the strength of legal policy within the country.

Financial system is classified in two types: market-based (e.g., the United States), where the capital is mobilized and distributed through large and liquid markets, and credit-based (e.g., France and Germany), where capital markets are weak or thin, and play only a minor role in mobilizing and pricing investment funds (Whitley, 1999). As a rule, the dominant institutions are large banks or ministries, which make decisions on allocation financial resources based on administrative processes instead of open market operations. Generally the system refers to the process with which capital is made available and is priced.

Education and labor system is the system for developing and controlling skills. In this system employees are the main stakeholders, so that any decisions regarding changes are contingent on the strength of the trade unions, which directly control skills and capabilities in the economy (Whitley, 1999). Thereby, this factor explains the extent to which practical learning are encouraged through collaboration within firms and educational institutes.

Cultural system means that “the norms governing trust and authority relations are crucial because they structure exchange relationships between business partners and between employers and employees. They also affect the development of collective identities and prevalent modes of eliciting compliance and commitment within authority system”.

Table 1. The CAGE framework



Source: Ghemawat P. (2001). *“Distance Still Matters”*. Harvard Business Review 79(8): 1-11.

In addition, to analyze the attractiveness of foreign markets a CAGE framework is commonly used, which was created by Ghemawat (2001). The framework uses four basic distances between home and host countries: cultural distance, administrative (political) distance, geographic distance and economic distance.

Culture is influential in terms of interaction between actors. Also, different languages, ethics, religions and social norms can create barriers for business exchange. Generally, cultural distance associates with uncertainty, which restricts the ability to share information and knowledge among countries, increasing costs of doing business outside the home country. Administrative distances are related to historical and political relationships between countries meaning the distance between formal and informal institutions across countries. Trade agreements, common currency and shared political union are also included as factors influencing trade and investment decisions. The smaller the distance, the greater the probability that subsidiary will meet the demands and institutional norms of the host country (Campbell et al., 2012). Geographic distance means that the further countries from each other, the higher transportation and communication costs. It includes countries size, common borders, time zones, weather conditions, access to the see, transport infrastructure and distance between internal borders. Economic distance is the extent to which countries differ according to wealth and consumer income (Ghemawat, 2001). It is related to macroeconomic stability in the country, investment focus, and the level of openness for foreign capital, credit availability and qualified workforce. Generally, the economic distance provides the difference between economic developments of countries. This measure is estimated using income, inflation and trade flows between countries (Berry et al., 2010).

The increasing interest in institutional theory develops new issues for the research. For example, how companies deal with the weak institutional framework and “institutional voids” in emerging markets (Khanna et al., 2005). In the emerging markets there is a lack of intermediaries, which connect sellers and buyers, so it becomes difficult to operate in this market (Khanna and Palepu, 2010). This is called “institutional voids”. Thus, politics, culture and history are the main influencers on the development of institutions creating voids. So, firms have to develop their capabilities to identify voids to be successful on the market. That led to may modern researches in the last decade.

For the recent years most institutional distance studies had less broad about institutional environment. Thus, based on North’s classification of institutes of formal and informal institutional distances were investigated (Arslan and Larimo, 2011). The study described formal institutional distance as the difference between the legal institutions, laws and regulations in the home and host country. Thus, laws and rules of the host country may dictate certain business behaviors and strategies by restricting others. Formal institutions are explained to be different due to the different origins of legal systems, different level of legal development (Pistor et al., 2000), and effectiveness of legal environment for business (Trevino and Mixon, 2004). Formal institutes can influence MNEs strategy implementations due to the risks and penalties associated with deviances in legal rules (Estrin et al., 2009). Informal institutional distances show the differences between norms, values and beliefs in home and host country (Estrin et al., 2009). Informal aspects may influence the management of the subsidiary in many aspects, like understanding the aspirations of local partners, transfer and management organizational routines and knowledge across subsidiaries, and the degree of adapting to the host country environment (Arslan and Larimo, 2011).

The modern view on institutional theory (Hotho and Pedersen, 2012) includes three main determinants:

1. New institutional economics;
2. New organizational institutionalism;
3. Comparative institutionalism

According to institutional economists, institutions are explained by habits and cultures (Hotho and Pedersen, 2012). The exchange processes and friction are dictated by institutional context in which they appear. For instance, the transaction level may be explained by the extent of property rights protection and how easy it is to enforce contracts. The new institutional economics claim that the efficiency of the institutional framework influences the market, company and economies performance (Hotho and Pedersen, 2012).

In general, an institutional efficiency result from coherent regulation executing and leads to firm’s better performance and export growth rates (Li Puma et al., 2013). Thus, institutional distances influence company’s objectives of internationalization (Moore et al., 2015), as well as the entry mode in the new markets (Xu and Shenkar, 2002), the adoption of policies and practices (Kostova and Roth, 2002) and their performance. The concept of institutional environment as a measure of determinant of company’s performance lies in the method of institutional distances between institutes in country of origin and host countries. The concept was developed by the school of Uppsala (Johanson and Vahlne, 1997), when they tried to explain the internationalization of Swedish enterprises in 1970. The authors applied the psychic distances concept, defined as the sum of factors influencing the flow of information between MNEs and the subsidiaries abroad. Further research by Kostova (1999), who applied the distance approach to the extent of differences between institutions in home and host country, showed that the higher the institutional distance, the more difficult it is for the MNE to establish legitimacy in the host country and to transfer strategic routines to foreign operations. Distances may influence the investment decisions of MNEs, which seek to achieve competitive advantages by the small institutional distance or by mitigating possible negative impacts on distances. Broadly speaking, the institutional difference is the difference between individual and collective in regulatory, normative and cognitive aspects of a home and host countries (Moore et al., 2015). Measuring institutional distances is essential in order to understand the entry mode strategy that can be used to match the distance, so that the company is able to create competitive advantage (Hernandez and Nieto, 2015). Moreover, it helps to analyze the company’s complexity level in emerging market, due to the reason institutions there are much weaker and complex (Moore et al., 2015). Following, the greater the institutional distance, the more difficult for foreign companies to transfer routines from headquarters to subsidiaries and to institute legitimacy. According to Xu and Shenkar (2002), MNEs tend to less control their subsidiaries abroad in case the institutional environment of the host country is significantly different from the home country, same they prefer majority control in the same institutional environment.

Hernandez and Nieto (2015) showed that institutional distances have the directions: negative in case the company enters country with better institutions, and positive when subsidiary is established in better institutional environment than in home country.

One of the most recent researches implied another classification of institutional factors. Sambharya and Musteen (2014) proposed three dimensions of institutional environment – normative, regulatory and cognitive. The regulatory pillar was defined as a formal system of rules and regulations that influence firm’s behavior. The pillar of normative institutions has referred to less formal socially driven models of behavior. Finally, the cognitive pillar is about culturally constructed rules, which shape behavior (Bruton et al., 2010). In their study they explored three dimensions by regulatory quality, market openness, and cultural practices related to uncertainty avoidance, power distance, and collectivism. Despite, the results were different. Thus, Lim et al. (2010) argued that impacts are apparent by firm’s cognitions and attitudes. Opposite, Bowen and De Clercq (2008) did not find any influence of regulatory environment on the firm’s business activity. McMullen et al. (2008) found the positive correlation between the efficiency of property rights and opportunity-driven entrepreneurship. One of the reasons for such findings is that studies rarely included three dimensions in one model (Bruton et al. 2010), and investigated relatively small number of institutional contexts.

## 1.4. Investigation of Russian institutional environment

After years of subdued expectations there is a confidence, surrounding the Russian economy, as it combines its economic potential with economic growth. But despite positive steps it has made, many challenges for doing business in this diverse and notoriously challenging economy still remain.

Traditionally considered as a resource-reliant economy, notable growth in retail, telecommunications and real estate development in recent years has led to an expansion of the consumer base of the country. Incomes are increasing and consumer credit also became more common, that has allowed the country to withstand the economic storm much better than other export-reliant countries making Russia an emerging market with huge potential.

As market is becoming more mature, and open market policies are getting more favored over a protectionist state, the international business community is starting to consider Russia as an investment destination target. However, the obstacles are difficult to overcome without any local help. After many years of doing business in Russia, there were highlighted several challenges that occur in business environment.

Although Russia has the smallest population among the BRIC countries, it has the richest per capita of significant reserves. This means that it has a large and growing middle class – consumers, who are looking for quality and innovation, – as well as a growing retail sector. Domestic supplies of consumer goods and services in Russia are still underdeveloped, so there are opportunities for developing of a new business, for example, e-commerce. Russian business, especially with export revenues in sectors such as metals and chemicals, continues to invest. There are also higher growth rates in some sectors, for example, agriculture.

The government tension and focus on import substitutes making it more difficult for companies to introduce their products in Russian market. Nevertheless significant opportunities still exist, for example, consumer goods, luxury, education and machine tools, which are difficult to substitute.

According to the World Bank’s Doing Business 2018 rating, Russia ranks 35th ahead of China, India and Brazil[[3]](#footnote-3). To calculate the rank factors such as starting business, dealing with physical resources, taxes, registering properties and trading across borders were taken. OECD (2013) stated that Russia needs to strengthen its formal institutions, judicial mainly, and enforce the international arbitration to boost investors’ confidence. In general, researches oh the economical success of companies in Russia stays under-developed even though Russia became one of the biggest economies worldwide (Puffer and McCarthy, 2011).

Institutional environment in Russia is considered to have not fully developed legal and financial infrastructure, high level of corruption, and resistance to make changes in bureaucracy and administrative discretion. Still, one of the main characteristics for Russian market is uncertain legitimacy of formal institutions, so leading to the dependence on informal institutions (Puffer and McCarthy, 2011). Thus, Bowen and De Clercq (2008) claim that uncertainty in business development was influenced by corruption preventing new companies to enter. The barriers when investing in Russia are often shocking for investors due to changing tax regime, unpredictable and uncoordinated government policies, poor rule of law, absence of contract law, unforeseen and constant changes in legislation, poor property rights and lack of international accounting standard. According to the survey «Evaluation of Russia’s business environment» by Russian Union of Industrialists and Entrepreneurs (RSPP) on the status of business climate in Russia, which is conducted every year since 2011, the situation in 2017 improved comparing to the previous year. Thus, the main problems of the Russia’s business environment were the lack of qualified personnel (47% in 2016, 49% in 2015, 27% in 2014), high administrative barriers (47% in 2016, 41% in 2015, 27% in 2014) and price increases (45% in 2016, 55% in 2015 and 2014)[[4]](#footnote-4). They were followed by governmental corruption (35% in 2016, 34% in 2015, 18% in 2014), insufficient protection of property rights and contract rights (29% in 2016 and 29% in 2015, 36% in 2014).

Every country has its own particulars in doing business in this country. Some of these particulars might significantly differ from those country owns. Thus, they should be taken into account when deciding about entering. As the aim of this paper is to investigate peculiarities of Russian market as influencers on company’s performance in Russian market, the number of institutional factors was chosen, which were developed on the base of described frameworks and investigated challenges and opportunities of internationalization in Russia. As a framework, the new institutional theory was chosen as being the most modern in the fast-paced world where the environment changes along with the business demand and processes. It is essential to consider the most recent studies to be able to link the current market situation with up-to-date theories to conduct the most effective empirical research.

***Government policy***

The government limitations on foreign firms are regulated by different policies, laws, marketing and advertising restrictions, safety and health requirements, which together can restrict the competition. So, a as result, the entry mode strategy directly depends on the level of protectionism within the host country. According to the number of studies, the most influential government policy conditions are: limited trademark and patent protections, still-evolving judicial systems, foreign investment restrictions, price controls, tariff and non-tariff barriers, trade agreements, privatization, and market reform.

One of the main concerns for companies when entering foreign market is the level of protection of their properties, like operations, assets and personnel, which may be influenced by local law. The situation of limited trademark and intellectual property protection is very dangerous for companies as it jeopardizes their technological advantages, since it might become easier to copy them, thus, reducing the economic advantages by losing sales. There is no well-specified and protected property rights system in Russian market (Maryin-Ostrovskiy, 2008). The reason is that companies do not have clear rules of interaction with authorities, as the authorities have not been separated from property legislation. The instability, undeveloped judicial system and poor protection of property rights caused a turbulent environment for companies in Russia. Thus, the privatization became the main factor for weak legislation (Puffer and McCarthy, 2011). It was conducted to create a new formal institute, which, together with clear rules of the game, could increase investments. Nevertheless, property rights can be protected not only by laws, but also by the informal institutions, like religion, morals (Maryin Ostrovskiy, 2008). It was claimed that the property rights institution was emerged with a help of two groups: the state authorities and the business actors. The interaction between these two groups was built on the basis of “black”, “white” and “grey” schemes. The “black” scheme strategy is about interaction only within informal institutions, in some cases violating legal norms. The “white” schemes represent the interaction within the law limits. Lastly, the “grey” schemes are the most used ones where formal institutes are used informally. So, all these schemes are aimed at realizing particular interests of both authorities and business actors.

Despite Russia is potentially one of the most valuable markets for western companies, country is a difficult market to operate because the Russian state government too often adopts contradictory policies on property rights. Registration of property is relatively cheap in Russia, and registering fees are the lowest in the world and highly below the OECD average. Nevertheless, it still requires on average about 4 procedures and over 35 days to complete this procedure. Establishing intellectual property rights in Russia is still a tedious business despite the fact that some steps in simplifying the process have been taken. A specialized court for intellectual property rights has been established within the commercial courts of the Russian Federation on 1 February 2013. Thus, according to Ushakova (2013) difficulties with obtaining and protecting property rights violating the high performance of international companies in Russia.

Nevertheless, Braodman (2000) indicates that there is number of barriers to enter Russian market: biasness or discrimination towards licensing of business and registration of firms, limited access to distribution channels and less transparent legal system to operate in market, which is described as being very bureaucratic. The number of steps needed to get construction permissions can vary significantly from city to city. According to statistics, Novosibirsk requires only 16 steps comparing to 47 in Moscow. As a result, there is huge variation in the time to acquire permissions; in total a year in Moscow compared to only five months in Surgut.

The political situation in Russia is not that stable. As it is known the relationships between Russia and the West are increasingly hostile. Despite Russia considers being an important country in Western multinationals’ emerging markets portfolios list. While the Russian government relatively rare interferes in Western businesses’ affairs, there are several cases when it intervened. Thus, in 2014, when the Ukraine conflict appeared, U.S. – Russian relationships were so strained; The Kremlin sued McDonald's for allegedly violating government security regulations and even temporarily closed four stores for "health disorders. Only a few hours after USA in cooperation with Europe toughened sanctions against Russia just the same year, Russian authorities raided the headquarters of Ikea in Moscow.

Also other company’s clients faced the Russian government interference: they have experienced more unplanned inspections of facilities, abruptly altered labeling requirements, threats of regulatory changes from the regional and federal government, and heightened pressure to hire and manufacture locally. Russia’s main challenges are being described as government interference and the high level of monopolization. Although some actions have been made to amend problems in central government, overseas firms still find the state of governance in Russia difficult to navigate. A EU report showed a “staggering increase” in protectionist measures as governments seek to keep national industries from foreign competition in a difficult economic environment. Russia was listed as the worst offenders; the report concluded that Moscow didn’t follow its future obligations to the World Trade Organization. They were also threated with extra fines and increased delays and payments. Thus, Papa John’s, the chain of pizza restaurants closed its entire store in Saint-Petersburg in 2014 as a response to Russian sanctions. They came back to the Saint-Petersburg market in 2017 but still they lost 3 years of doing business.

Another factor to consider is currency rate. One day it night be suitable but the next day because of some politics reasons the currency might change making doing business in particular country more expensive. No one can know for sure that economic situation and politics are stable. After years of deprivation and now the strict economic sanctions from many world powers, Russia has a huge pent up demand for foreign luxury goods. However, Russia still has many high tariffs in place, including a 3 percent tariff on all goods that is in addition to the category-specific tax. The category tax can run as high as 40 to 50 percent on many products, and can even hit 100 percent on alcoholic beverages. Luxury goods may even incur a 250 percent tax. Knowing the right classifications to reduce these burdensome rates is a key skill for importers, along with knowing which payment methods incur additional fees. Nevertheless, according to the currency control laws, there is no problem for foreign companies to obtain foreign currency. The Central Bank does not ask for security deposits of foreign exchange purchasing, there are no barriers for investing abroad, but still investors have to search for expert advices of FDI decisions (Russia country report, 2014).

Hence, based on the statements above, it might be concluded that business legislation and regulations significantly influence performance. Legal issues like limited trademark and patent protection, still-evolving judicial systems, price controls, tariff and non-tariff barriers are the major obstacles to conducting business in Russia. Thus, the following hypothesis is provided.

*H1: More controlled and protective government policy in Russia negatively influences the performance of MNEs’ subsidiaries*

***Cultural conditions***

In most of western countries, institutions create trust, as individuals trust formal institutions, like government. In Russia, on oppose, formal institutes are developed worse. Additionally, individuals do not tend to trust outsiders and formal institutes in Russia, instead mostly rely on relations (Puffer et al., 2010). Companies in Russia trust informal institutes, such as networks, more to execute formal institutes voids (Puffer and McCarthy, 2011). Russian society shows low trust while formal rules are contradictory leading to uncertainty (Puffer et al., 2010).

Formal institutes voids are presented in Russia (Puffer et al., 2010). Individual and companies, which do not belong to the personal relationships, tend to be mistrustful, and it is difficult to establish relationships with such outsiders. Mostly decisions are made regarding relationships but not rules. Thus, trust is the most important issue in social networking, especially for doing business as it holds networks together. New companies entering foreign markets build such networks in order to get help in obtaining resources, gaining legitimacy and seeking for opportunities. As a result, networks increase the possibility to succeed in the new market. In Russian case, the importance of informal networking is very significant. The firm creates its own identity through its operations in the networks, as the involved actors owe their external contacts, which might be useful for firms. Generally, Russian is going through the process of transition towards the West European network model.

Some other factors of business culture conditions include some labor conditions. For example, how employees’ salaries are correlated to their productivity, the question is who usually have the management position because in some cultures usually relatives inherit the leading position while in some other countries the manager is usually chosen according to his achievements. Sometimes in Russia the salary is very low comparing to the amount of work the worker has to do. As a result many companies here face the high level of turnover as people seek to search for better labor conditions leaving companies with the lack of human resource. Moreover, the approach of talent management also could be explained in terms of cultural aspects. Thus, in some countries the most talented employees are retained within the company in order to increase the productivity with the help of such people. Opposite, there are some countries, where it is common that the company send the most talented and brilliant employees abroad in order to allow them to grow further. In Russia the most talented employees are usually reallocated to Moscow where they would be more suitable and also since most of headquarters are located there.

Based on number of surveys, many companies agreed that differences between languages, religions and others didn’t have any effect on decisions considering entry mode. The attitude toward punctuality in Russia may seem a little bit different from many other countries as well, more relaxed, so many businessmen find it difficult to get used to it. Many meetings will not follow to linear agendas used in other nations that might be disruptive for inter-business communications and be distractive for efficient decision-making process. Moreover, a lot of companies claimed that cities like Moscow and Saint-Petersburg are very western showing similar cross-cultural conditions. Nevertheless, they highlighted that still sometimes it’s difficult to copy with some cultural peculiarities when doing business in Russia.

Thus, the strong organizational culture with sustainable practices within the organization, which are used for achieving goals, has a positive influence on company’s performance in Russia (Zhuplev, 2017). Most of the companies emerged in Russia are attributed the lack of transparency and arbitrary rules. So, when coming to Russian market foreign companies create strong and transparent culture. Since western firms claim that they value employees’ opinions, they have to implement some of these idea developed by workers, otherwise, they can lose faith. As a result, many firms face the problem of becoming “too Russian”. So, it is very essential for firms to save foreign elements in their organizational culture (Zhuplev, 2017). Hence:

*H2: More informal-oriented business culture in Russia negatively influences the performance of MNEs’ subsidiaries*

***Market development and competition***

The market development has a significant effect on companies when they expand their presence abroad. Many factors have to be taken into account in order to help the decision-making process in companies. Usually market development is characterized by the development of infrastructure. According to a report by the World Bank and International Finance Corporation (IFC), an average of 9 procedures and over 23 days are necessary to establish business in Russia. Moreover, there are differences regarding region of the country. Thus, it costs on average 2.3% of income per capita, with Surgut found to be the hardest place to start a business and Saint-Petersburg ranked as the easiest to do so. Regarding the size of the country, it is important to consider the income differences in each region and to take into account that the price range is significantly different across the country, which might be determining factor of dealing with Russian market.

Also, technological environment can explain the entry mode decision and company’s performance as the impact of science and technology availability is detrimental in improving product quality and service, what are the main attributes of competitive advantage. The technological conditions in emerging markets are particularly poorer and rapidly deteriorating. Essential resources, such as water, electricity power, communications and banking services, required by commercial activities, are not always very reliable and in some cases are in a shortage. Getting electricity is an extremely laborious task in Russia and, depending on the destination, companies sometimes have to wait from four months to a year to get switched on. Design approval is a particularly complicated step, requiring several trips to public agencies and taking from 30 to 120 days. As a consequence, poor infrastructure may reduce economic advantage due to increasing operating costs, which limit entry opportunities. Specially, the bad quality of roads and railways are very challengeable for companies when entering foreign market since the delivery time depends on these transportation modes. The infrastructure in Russia is heavily centered in Moscow, with most transport channels of economic significance emanating from the country’s capital. Despite the fact that commercial transportation is insufficiently integrated into world transport systems, it is still heavily relied on rail. Being such a large nation, Russia is still considered being a country with underdeveloped air links making inter-country travel arduous.

Moreover, when entering foreign countries, firms have to assess the availability and quality of local suppliers as, combining with the undeveloped transportation infrastructure, it might create huge challenges requiring additional investments. Many companies are able to substitute needed sources using local supplier, but, due to distances in economic development, for some firms it might become problematic to find suitable supplier in the host country, or the quality of sources can be much lower than those, used in home country. In total, in influences the quality of products and services, what in turn, influence the performance of the company. In some cases international companies can easily find local supplier, like McDonald’s did when signing a contract with one of local meat and vegetable supplier in order to reduce transaction costs. Nevertheless, many companies still have to import resources from abroad since the quality of supplier in Russian market is relatively poor.

Nevertheless, some scholars have opposite point of view. Donna and Herrington (2016) state that physical infrastructure, market dynamics, commercial infrastructure, and professional education do not have a negative impact on foreign firms’ performance in Russia, but they consider state policy is one of the biggest influencers.

Competition is one of the most important factors influencing business. Whether you operate in a concentrated industry with only few main competitors or in a large industry with many competitors, it is essential to know your rivals. Sometimes companies are entering foreign markets with a stated belief that they will win the market but don’t consider customer’s loyalty to local brands and mistrust to unknown product. They might do competitive analysis but sometimes forget about cultural particulars for certain target audience.

When dealing with market development, it is highly important to consider local competition as a main determinant in decision-making process having an effect on company’s performance. Competition may dictate the entry mode decisions, as some of the modes might be inappropriate in particular countries. When the market is very saturated and has a great number of competitors, it is highly important to choose entering strategy, which will help the firm to establish its presence within the border of chosen market. Opposite, if there is no competition or it is very low, the firm can choose the entry mode, which will be beneficial for the performance and will not be costly. Moreover, the brand name recognition might be an advantage for the firm to enter, so it is needed to be investigated.

Russian market is considered to have a very low local competition and low-moderate foreign competition despite being very attractive for FDI. Anyway, the competition is growing now as more and more international firms are entering Russian market. Economic conditions are not very developed but still very promising. There are some examples of influence of market development on company’s performance in Russian market. As has been also mentioned, competition in Russia without certain knowledge of this market and its main players may create difficulties for foreign companies leading to failures. There are some examples of companies, which had to deal with serious competition with local firms and, as a result, left Russian market.

In 2010 the giant Walmart, in order to enter Russian market, acquired a local retailer, Kopeika. Nevertheless, it failed as Russia’s largest grocery retailer X5 finally bought it. A successful takeover of either Kopeika or Lenta, another store chain, would have given Walmart a strong entry point into the Russian market, with Kopeika seen as the favorite. The company also seemed unsure about which store format was right for Russia. "At the beginning of 2009 Walmart launched a tender to design two prototype shops: one a medium-sized hypermarket, similar to a Real store, and the other a large format hypermarket, similar to a large Auchan," the source said. However, in a year the company had changed its requirements. "In August 2010 there was another tender, to design a prototype for a much smaller development, something like a local neighborhood store."

By the way Walmart wasn’t the only one failed to establish its presence in Russian market. A Carrefour statement on the pull-out reads similar to Walmart's complaints: "Carrefour has decided to sell its activities in Russia and pull out of the market, given the absence of sufficient organic-growth prospects and acquisition opportunities in the short-and medium-term that would have allowed Carrefour to attain a position of leadership," the firm said.

Another example is Yandex and Google competition in the Russian market. Google launched its Russian-language search engine in 2001 while Yandex was established only in 2002. In the med 2000s Google began asserting Russian market very aggressively raising its presence.

Moreover, Yandex is very popular on Android. While Google is able to use its Android mobile operating system to grow mobile search due to the embedded nature of Google search in Android, it’s not that effective in Russia. In Russia, Android has 70 percent of the Russian mobile market; yet, Yandex still has 52 percent of the search market on these very Android devices. In order to win over Google more, Yandex launched its own fork for Android, Yandex Kit, making people to use Android without Google.

Combining together these examples with the theoretical material, the following hypothesis is proposed:

*H3: Less developed market conditions in Russia negatively affects the performance of MNEs’ subsidiaries*

***Corruption***

Russia market is characterized as dominated by informal institutes, which do not really cooperate with each other so that corruption is conducted undermining formal institutions. Corruption is defined as abusing of entrusted power for personal interests (Transparency International, 2010; Calhoun, 2011). The problem of corruption in Russia has attracted a lot of attention from a range of scholars for a long time. Russian economy still is not transparent due to he high level of corruption in the country (Gorenburg, 2013; Orttung, 2014). Also, institutional ambiguity due to incomplete transformation of institutions and incomplete reform implementation together with undeveloped legal framework and too high dependence of the economy on rules in Russia have a significant influence on the lack of transparency (van Zon 2013). Thereby, some studies state that the ambiguity between informal rules and formal is one of the main reasons for the corruption (Rozov, 2013).

For most multinationals the ability to understand the nature of corruption and to differ corruption in various countries became crucial tools for entry mode decisions. It is suggested that ubiquity of corruption shows the average likelihood the firm encounter corruption on a daily base interaction with government officials. The level of likelihood varies from country to country, and therefore significantly influences FDI. Corruption and bribery are considered to be barriers to enter Russian market, which influence the investment climate.

By conducting the survey, Swedish trade council (2008) found out that companies face difficulties on the daily base when operating in Russia because of the high level of corruption. Mostly it influences obtaining certificates, as it is difficult to get them without bribing the relevant authorities and officers. Rodrigues (2005) claims that firms have to take into consideration the level of corruption in the host country, when deciding on entry strategy. It is also very essential to understand the likelihood of going through corruption when dealing with government officials. Broadman (2000) made a research on the level of corruption in Russia and compared it with East European countries. He concluded that almost every firm pays bribes to custom clearance officers, local tax and the bureaucrats to be able to survive in Russia and to have smooth daily operations. For example, he also concluded that it takes four times more to establish business in Russia than in Poland. The reason is that in Russia companies have to pay twice more to inspectors comparing to other part of Eastern Europe. Government transparency is a notoriously fraught problem in Russia, although the situation has improved significantly.

According to the data, political conditions don’t influence company’s entry strategy but effect the timing or place of enters. The Open Budget Survey 2016 set by the International Budget Partnership found that over the years Russia significantly improved its budget transparency and is now more informing public about government income and spending. Nevertheless, all of them admitted that corruption is the worst factor influencing everyday operations. Also, taking into account political situation in Russia, many firms claimed that it became more risky and unpredictable to do business in Russian market.

*H4: The high level of corruption in Russia negatively influences the performance of MNEs subsidiaries*

## Conclusion

Institutional theory has long established that business organizations are embedded within broader social structures, comprising of different types of institutions, which exert significant influence on their behavior and consequently impact the corporations’ strategic decision-making and organizational outcomes.

As was explained in examples, it can be seen that companies really don’t consider all challenges they might face while entering Russian market. As it also was stated, there are special issues of doing business in Russia, which are completely different from those in foreign countries. Combining both Russian peculiarities and factors influencing business it is possible to formulate the scheme, as a base for a research companies should do before going to Russian market.

Thus, mostly foreign companies face political factors as Russia is trying to protect domestic market from international intrusion. For most countries it is untypical but since they want to establish their business in Russia they have to take this into account. Despite Russian customers sometimes trust foreign goods more than domestic, they prefer to buy local substitutes, especially older generation.

Based on evaluation of company’s success methods explained in this chapter, the company could measure whether it managed to adapt its strategy in Russia or did it partially successful. Of course, the main criterion for every company is profitability but it is important to consider other aspect of doing business so make a research and to make decisions how to change strategy or some part of it.

To sum up, I would like to say that all issues mentioned on first chapter are very helpful to understand why companies failed in establishing their strategies in Russian market and to help to create methodology for other companies which want to enter Russian market.

# Research of internationalization of MNEs on the Russian market

All the described above factors are considered to be influencers on company’s performance in general. Nevertheless, due to the differences between institutions, some factors can influence to the different extent. Moreover, some of particulars are attributed to one country but are not to another country. In this case it is important to investigate those, which are considered to be most common in the host country. Thus, in order to find out factors, which are attributed to Russian market, the following analysis was conducted.

## 2.1. Research methodology

***Type of research***

For doing the analysis, **exploratory** research design was used. Since the goal of the thesis is to understand, to find out what institutional factors actually influence strategy adaptation and company’s performance, this research design is the most appropriate. In doing so, the quantitative data analysis was conducted in order to see trends and some statistics differences. This kind of analysis often relies on secondary data research and formal and informal qualitative researches what in my case is very appropriate.

In quantitative analysis the differences between institutional factors in Russia and other western countries depending on companies were compared, which were explore in this research. For example, to investigate government policy taking into accounts various measurements for that, like the openness of the market or government burden.

***Data sources***

As a source for the data, several different modes were used. Thus, in order to obtain data considering institutional factors satisfaction, “The World Bank” was used. By using its competitiveness analysis, the values for each country can be gathered as a mean, aggregated for the certain number of respondents – companies, having business in that or those country. Also, financial reports are the main sources to get information regarding company’s performance. Both, sources for international reports and financial statements in Russia are used.

***Type of data***

To achieve my goals I would like to set following research tactics. Firstly, I state that the most important data for my research topic is information regarding institutional environment. By this I mean their values in home country and host country – Russia. Companies’ financial indexes are very important here too because they show whether the strategy actually worked or not and also how successful the strategy was implemented. Thus, the data I need for my research is information about what factors inhibited the company growth and led to modifications in what the firm do and how it advance the product. Numbers are required as well as they can explain and confirm my hypotheses.

***Data collection***

As has been already mentioned, in order to get not only values of institutional factors, but also values for another countries, the World competitiveness analysis was used. There is a broad information provided for each country, including not only values for all factors, but also additional information like economic issues (GDP, GDP per capita, exports, imports) and the position in the ranking, as the report itself is aimed at ranking all existing countries, where the position depends on overall performance on these factors. The report contains the information for 138 countries for each of 114 indicators, which are combined into 12 pillars: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication, and innovation. For my analysis, I don’t need all of these pillars to check my hypotheses, so only some of them were chosen: institutions, infrastructure, macroeconomic environment, goods market efficiency and some criterions for market size and labor market efficiency. Almost all indicators were obtained by adopting values on the 1-7 Likert-style scale, where 1 means disagreement or dissatisfaction with a factor, 7 means the most pleasant conditions of this factor. As for the company’s performance, different Russian and international databases were used in order to get financial information from the company’s annual report.

***Data analyzing***

Since I’m planning to obtain quantitative data, I need to use methods to analyze this data, which can help to proceed flow of numbers into interpretable results. Since the existing report was used, for the qualitative analysis of indicators it is necessary to read survey’s transcript to understand how each factors was evaluated. Factors should be combined in certain groups according to their field and extent of influence.

After obtaining data for each of chosen countries, based on labeled points, comparative analysis of each point has to be conducted in order to see what is the difference, what caused the difference and how big the difference is between Russia and any of selected foreign markets. This will be helpful to find out and interpret what factor led to this variation. Together, financial indicators and factors distances are used in statistical analysis to explore their correlation in order to be able to explain their influence on each other.

## 2.2. Data collection

In order to test stated hypotheses the data regarding institutional factors was obtained from “The Global Competitiveness Report 2016-2017”[[5]](#footnote-5) done by World Economic Forum. They publish a comprehensive series of reports, which examine in details the broad range of global issues. The competitiveness report is based on twelve pillars of competitiveness, which is necessary for my paper to conduct quantitative analysis.

For my paper I used the numbers from “The Global Competitive Index”. The information in the report is presented as a mean value of every environmental factor for each country based on the statistical data. The GCI includes statistical data from internationally recognized organizations, notably the International Monetary Fund (IMF); the World Bank; and various United Nations’ specialized agencies, including the International Telecommunication Union, UNESCO, and the World Health Organization. The data was gathered from 148 countries what captured the view of 14375 business executives. The response rate was retained from 133 countries what in total were 12775 responses. The survey consisted of 155[[6]](#footnote-6) questions divided into 15 sections. The respondents had to rate aspects of the environment on a scale from 1 (the worst possible situation) to 7 (the best situation). For testing hypotheses 15 countries were taken: Belgium, China, Denmark, Finland, France, Germany, Japan, South Korea, Netherlands, Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

To test hypotheses regarding the performance of companies the information about entry modes of companies is needed. For chosen 10 European countries the number of existing multinationals, which operates in Russia, were taken, what in total gave the number of 52 companies (Table 2). The following table contains information about the company, the country of operation, which was chosen, and industry. Despite some countries are originally coming from Asian or American markets, still their subsidiaries in European countries were taken.

Table 2. Company list

|  |  |  |
| --- | --- | --- |
| **Company name** | **Country of operations** | **Industry** |
| Anheuser-Busch InBev | Belgium | Food |
| Cargill | Belgium | Retail |
| Solvay | Belgium | Pharma |
| Carlsberg Group | Denmark | Food |
| Nokian Tyres | Finland | Petrochemistry |
| Valio | Finland | Food |
| Auchan | France | Retail |
| Danone | France | Food |
| L'Oreal | France | Consumer goods |
| Leroy Merlin | France | Retail |
| Metro | France | Retail |
| Mondelez International | France | Food |
| Nestle | France | Food |
| P&G | France | Consumer goods |
| PepsiCo | France | Food |
| Renault | France | Automobile |
| Sanofi | France | Pharma |
| Adidas | Germany | Consumer goods |
| BASF | Germany | Chemistry |
| Ford | Germany | Automobile |
| Hyundai | Germany | Automobile |
| Kia | Germany | Automobile |
| Lenovo | Germany | Electronics |
| Mercedes-Benz | Germany | Automobile |
| Philip Morris International | Germany | Tobacco |
| Philips | Germany | Electronics |
| Samsung | Germany | Electronics |
| Volkswagen | Germany | Automobile |
| Heineken | Netherlands | Food |
| Mars | Netherlands | Food |
| Mitsubishi | Netherlands | Automobile |
| Royal Dutch Shell | Netherlands | Petrochemistry |
| BSH Hausgeräte | Spain | Electronics |
| Gestamp Automocion | Spain | Petrochemistry |
| LG | Spain | Electronics |
| Nissan | Spain | Automobile |
| Electrolux | Sweden | Electronics |
| IKEA | Sweden | Retail |
| JTI | Sweden | Tobacco |
| Tetra Pak | Sweden | Food packaging |
| Volvo | Sweden | Automobile |
| Glencore | Switzerland | Trade |
| Novartis | Switzerland | Pharma |
| Apple | United Kingdom | Electronics |
| BMW | United Kingdom | Automobile |
| British American Tobacco | United Kingdom | Tobacco |
| Coca-Cola | United Kingdom | Food |
| Imperial Tobacco Group | United Kingdom | Tobacco |
| Jaguar Land Rover | United Kingdom | Automobile |
| Toyota | United Kingdom | Automobile |
| Unilever | United Kingdom | Consumer goods |
| Wrigley | United Kingdom | Food |

The data regarding financial performance was gathered from two different sources. Thus, in order to get financial report of subsidiaries operating in Russia, the SPARK database was used. It provided company’s profiles like the name and type of organization for operating in Russia, and full financial report for the period of 5 years. Since the database contains information finishing in 2016, the financial indicators were taken for that year. Further, to get the financial statements for companies operating in Europe, the database of comparable financial information for public and private companies across Europe – Amadeus Bureau van Dijk. The information was also gathered for the year 2016.

## 2.3. Description of variables

In conducting analysis five independent variables were taken which stated to be the most influential according to literature review: business culture, market development and competition, government policy, economic development, and corruption. These five variables strictly linked to hypotheses.

The dependent variable is the performance of the company. Among all profitability ratios return on assets was chosen since it’s the most commonly used metric for profitability.

*Dependent variable*

In measuring productivity and profitability, many companies prefer to use number in financial indexes.

When managing the current efficiency, but not dealing with the goals themselves, instead with indicators that quantify the state and behavior of the most important economic entities for the organization and, in this connection, allowing planning, controlling and regulating the work of numerous units. Main indicators are:

1. Profit (profitability) of the product;
2. Volume of sales;
3. Scope of activities;
4. Presence of reliable partner relations;
5. Presence of client base (permanent clientele);
6. Number of revolutions of working capital;
7. Membership in associations, because, for example, membership in an association provides a variety of discounts in advertising;
8. Availability of own infrastructure (own host, vehicles);
9. Participation in government programs;
10. Reputation of the organization;
11. Turnover of staff.

The choice of the method of examination is determined by its objectives, as well as by the peculiarity of the object of research and the stage of the diagnostic process. For this, a set of criteria should be used, reflecting both existing practice and newly emerging objective processes. The most important among them:

1. General efficiency of the organization, like measuring the achievement of the goals for which it was created. The system of objectives covers economic and social, scientific and technical installations. It can be represented in the form of a "goal tree" in which the goals of different levels are linked to classification groups in such a way that the implementation of the lower-level facilities leads to the realization of a certain higher-level goal;
2. Implementation of the program of economic and social development;
3. Financial security of work. This is the most important general economic criterion of the effectiveness of activity. Its indicator is the excess of revenues over expenditures, including the costs of the established allocations to the state and the region, the development of the organization's activities and the social development of the employees;
4. Conformity of technological level of the organization and selling of works (services) to objective requirements of market development;
5. Achievement of the world level in quality and cost of the services provided;
6. Solving the main social problems of the team. The most important indicators here are the degree of satisfaction of the social needs of the team and the possibility of professional development;
7. The organization's implementation of environmental requirements.

In determining the criteria and performance indicators of the organization, it is necessary to take into account the worldwide approaches, according to which at least seven evaluation criteria are singled out:

* Effectiveness;
* Economy;
* Quality;
* Profitability (income / expenses);
* Productivity;
* Quality of working life conditions;
* Introduction of innovations.

**Effectiveness** is the degree to which the system achieves its goals. To measure it, compare the intended results with the actual ones (the resources used are not taken into account, if they did not figure as a goal). The most common method of measurement is the calculation of indices of effectiveness, showing the degree of achievement of a goal in one period compared to another.

**Economy** - the degree of use of the system "necessary" things. Economic efficiency is determined by comparing the resources that were supposed to be spent to achieve certain goals and performance of specific works (services), with resources that were actually consumed.

**Quality** - the degree to which the system meets the requirements, specifications and expectations of customers. Traditional methods of determining the quality of the work (services) provided include the establishment of compliance with the specifications and timeliness of the provision of work (services) - in time and at a time that is convenient for consumers.

**Profitability** - the ratio between gross revenues (or estimates) and total costs (or actual costs). Specific indicators of profitability are:

* Level of profit attributed to the volume of sales;
* Ratio of profit and total assets (ROA);
* Ratio of profit to equity (ROE).

**Productivity** - the ratio of the number of works (services) and the costs of their implementation.

**Quality of working life conditions** - the prestige of work, a sense of security, confidence, satisfaction of employees, including management personnel. The methods of measurement are aimed at determining the degree to which personal perceptions of workers correspond to the socio-psychological conditions in the work collective and the actual state of working conditions.

**Introduction of innovations** is the real use of new achievements in the field of modern technology and management in the organization to achieve the set goals.

In order to evaluate the performance of the companies in foreign market it is better to use the measurement of profitability. Among all ratios, which are used to evaluate company’s profitability, return on assets was taken to use in the research as it better measures company’s performance comparing return on sales and how effective firm’s management use assets to generate earnings. ROA analyzes long-term profitability and is calculated as the ration of net income to total assets. Since the aim of the paper is to analyze how distances between institutions influence the company performance, dependent variable is the difference between ROA in Russian market and another European country. The data was obtained from firm’s financial statements for the year 2016 for each of 53 firms both in Russia, using SPARK database, and in one of the European countries of their presence through Amadeus Bureau van Dijk database.

*Independent variables*

The independent variables were obtained from the mean values of factors in World Competitiveness analysis. Based on the values of several question for each pillar, the mean value from 1 to 7 was calculated for each variable. The higher mean value for a variable, the more favorable the institutional environment of the host country. In the analysis independent variables are taken as distances between the value in Russian market and host country market, in some cases any other European market, because it’s a bit problematic to obtain financial data for Asian and American markets.

The variable *business culture* was calculated based on indicators from Competitiveness report, which, in my opinion, are linked to cultural aspects of doing business. Thus, I added following factors: ethical behavior of firms, effect of taxation on incentives to work, pay and productivity, reliance on professional management, country capacity to attract talent, and willingness to delegate authority, mostly taken from the labor market pillar of WCA.

The variable *market conditions* was obtained by calculating the average value of factors, like the quality of infrastructure, intensity of local competition, extent of market dominance, effectiveness of anti-monopoly policy, effect of taxation on incentives to invest, number of procedures to start a business, time to start a business days, and quantity and quality of local suppliers coming from the infrastructure and goods market efficiency pillars of WCA.

The variable *government policy* was obtained from number of factors linked to legal conditions and government interference. Such factors include property rights protection, judicial independence, favoritism in decisions of government officials, burden of government regulations, efficiency of legal framework, transparency of government policymaking, and etc., mostly taken from the institutions pillar of WCA.

The variable *corruption* was calculated as a weighted average of three factors: diversion of public funds, public trust in politicians, and irregular payments and bribes. Moreover, in order to better explain the influence of this variable on dependent variable, the level of corruption taken from the Competitiveness Report was taken for each country from the institutions pillar. It will help to evaluate the strength of linkage.

*Control variables*

Three control variables were added to the analysis: duration of operations in Russia and industry type.

Table 3. Variable description

|  |  |  |
| --- | --- | --- |
| **Variable** | **Value** | **Source** |
| Independent | ***Business culture:***   * Ethical behavior of firms * Effect of taxation on incentives to work * Pay and productivity * Reliance on professional management * Country capacity to attract talent * Willingness to delegate authority | World Competitiveness analysis 2016 |
| ***Market conditions:***   * The quality of infrastructure * Intensity of local competition * Extent of market dominance * Effectiveness of anti-monopoly policy * Effect of taxation on incentives to invest * Number of procedures to start a business * Time to start a business days * Quantity and quality of local suppliers |
| ***Government policy:***   * Property rights protection * Judicial independence * Favoritism in decisions of government officials * Burden of government regulations * Efficiency of legal framework * Efficiency of government spending * Reliability of policy services * Protection of minority shareholder’s interests * Transparency of government policymaking |
| ***Corruption:***   * Diversion of public funds * Public trust in politicians * Irregular payments and bribes |
| Dependent | Differences between ROA | Financial reports (2016):   * Amadeus Bureau Van Dajk * SPARK (Russian subsidiaries) |
| Control | Duration of operations in Russia (years) | Company’s annual report 2016, SPARK |
| Industry type |

## 2.4. Data analysis

The dependent variable in the analysis was calculated as net income divided by total assets. The independent variables in the analysis are 4 types of factors: business culture, market development and competition, government policy, and corruption, representing both formal and informal institutional factors.

First, in order to combine all the factors in components regarding their influence on dependent variable, factor analysis was used. This step shows how big the influence factors have in standardized view. Thus, variables were saved in the regression style in order to be used in further analysis. Since there is more than one independent variable, multiple regression analysis has to be conducted to identify the influence between one dependent variable and several independent variables. All the estimations were made using SPSS package.

## Conclusion

The chosen analysis is the most suitable for such kind of investigation. The chosen sources of data help to obtain required information, which is important to analyze the differences between institutional environments in host and home country.

The chosen dependent variable – return on assets – combining with independent variables, which were taken for the institutional environment, helps to provide the statistical research, which allows achieving the goal of the master thesis. Indeed, on the base of investigation of Russian market and its challenges for multinational companies, it can be assumed that these four groups of factors affect companies and create obstacles for them when dealing with market parties. It is important to know how companies use their assets to create earnings when challenged by Russian market. Since companies from different countries and industries were taken, it is possible to see the broad results, not biased by particular country or industry.

Nevertheless, all the chosen factors are linked as they influence not only the performance of the company, but also affect each other. Thus, as has been described, judicial policies sometimes involve corruption, high level of informal institutions leads to paying bribes and favoritism in decision-making. It is difficult to isolate them one from another, but to analyze them together.

To sum up, it is expected to find the correlation between four institutional factors and company’s performance in Russia by providing the regression analysis based on the described above data.

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# Research findings

The purpose of this study is to analyze how the performance of the multinational companies is influenced by the host country’s institutional environment when they make a decision to enter Russian market. This research is focused on the institutional theory perspective and proves its importance. Still, this perspective is not sufficient alone, so other aspects from foreign market’s influences have to be considered. It is highly essential for international companies to learn characteristics of Russian market before entering it. Generally, Russian emerging market challenges new foreign companies by its formal and informal institutes. Thereby, those companies, which learn about these institutions, are likely to succeed in this market.

## 3.1. Analysis of descriptive statistics

The sample consists of large-sized enterprises with more than 250 employees dominated by food manufacturing and automobile manufacturing industries, 25% and 20% respectively. Regarding geographical spread, the analysis was dominated by France and Germany, which accounted to 20,75% each, followed by the United Kingdom, which represents 17% out of the sample. On average companies operate in Russian market for almost 16 years, with the range of only 5 years (BASF) to 26 years (Tetra Pak). More than a half of companies, 55%, operate in Russia for 15 years or more, while 45% from 5 years to 14.

The mean value for differences between ROA is 1,47%, showing that on average the performance in Russian market is better than in European. Nevertheless, the range equals to 94,9% meaning that in reality ratios are extremely various so in some cases the conditions in Russia market are significantly worse than in other markets.

The majority of factors are less developed in Russia than in European countries what was obtained by calculating institutional distances. While in some case the distances were less significant – the distance is less than 1 – meaning the conditions are close to those in Russian market, for other institutions the analysis showed the big gap stating that factors are much more different in that country. Thus, the difference of more than 2 out of 7 among majority of countries is for following factors: property rights, intellectual property rights, quality of roads, railway and air transport, prevalence of foreign ownership, local supplier quality, efficiency of legal framework, and favoritism in decisions of government officials. The least distances – less than 1 – were possessed by intensity of local competitors, effect of taxation on incentives to invest, prevalence of non-tariff barriers, effect of taxation on incentives to work, and pay and productivity. As can be concluded, the biggest differences are in governance policy factors and infrastructure issues, while least – mostly in business culture institute.

## 3.2. Model development

The main aim of this study is to analyze the influence of institutional factors on MNEs in Russian market. The number of institutional factors was chosen as independent variables to test their effect on company’s performance. Thereby, the multiple regression analysis is the most suitable tool to use in this kind of research. The general model is following:

, where

Y – dependent variable,

Xn – independent variables

Since a great number of factors were taken for the analysis, it is important to combine them into main factors. Since they are measured using different scales (e.g. most of them are measured with 1-7 Likert-scale while some very obtained in natural values like dollars or percentage) the most suitable form of analysis is factor analysis as it combines factors regarding their common variance on dependent variable. On a base of factor analysis, factors were combined into four components, according to their effect on total variance. First, figure 1 in Appendix identifies four most influential factors, which together explain more than 80% of variance. Figure 2 in Appendix shows which factors were attributed to which group. The analysis combined factors regarding their influence on variance. All the values less than 0,4 were eliminated being insignificant leaving on average from 1 to 0,5 being most influential. Each component has more than 4 factors, so it can be used in further analysis. Thus, 23 institutional factors were combined in one group: ethical behavior of firms, judicial independence, government favoritism in decision-making, irregular payments and bribes, reliance on professional management, diversion of public funds, protection of minority shareholders’ interests, burden of customs procedures, public trust in politicians, effectiveness of anti-monopoly policy, property rights, willingness to delegate authority, efficiency of legal framework in settling disputes, transparency of government policymaking, wastefulness of government spending, business impact of rules on FDI, intellectual property protection, prevalence of non-tariff barriers, corruption, GDP per capita, burden of government regulation, quality of railways, efficiency of legal framework in challenging regulations. Other group 2-4 have 9, 8 and 7 factors respectively. The results of each component were saved in regression form in order to use them in regression analysis.

Table 4. Correlations of regression model

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | | difROA | Factor 1 | Factor 2 | Factor 3 | Factor 4 |
| Pearson Correlation | difROA | 1.000 | -0.375 | 0.213 | 0.071 | 0.182 |
| Factor 1 | -0.375 | 1.000 | -0.017 | 0.139 | -0.133 |
| Factor 2 | 0.213 | -0.017 | 1.000 | 0.042 | -0.040 |
| Factor 3 | 0.071 | 0.139 | 0.042 | 1.000 | 0.328 |
| Factor 4 | 0.182 | -0.133 | -0.040 | 0.328 | 1.000 |
| Sig.  (1-tailed) | difROA |  | 0.003 | 0.065 | 0.310 | 0.099 |
| Factor 1 | 0.003 |  | 0.452 | 0.163 | 0.173 |
| Factor 2 | 0.065 | 0.452 |  | 0.384 | 0.388 |
| Factor 3 | 0.310 | 0.163 | 0.384 |  | 0.009 |
| Factor 4 | 0.099 | 0.173 | 0.388 | 0.009 |  |

Using saved results of factor analysis, the regression analysis was conducted, where dependent variable is the difference between ROA and independent variables are values of each of four components from factor analysis represented in standardized value for regression. The analysis showed that, using differences between ROA as a dependent variable, only one factor 1 was significant at the level less than 0,1 (table 4), containing 23 variables. Thereby, three other factors were excluded from the analysis with Sig.>0,05, where factor 2 showed significance of 0.065, factor 3 - 0.310, and factor 4, with the highest significance, was evaluated as 0.099.

Table 5. ANOVA

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Model | | Sum of Squares | df | Mean Square | F | Sig. |
| 1 | Regression | 2003.229 | 1 | 2003.229 | 8.190 | ,006b |
| Residual | 12229.084 | 50 | 244.582 |  |  |
| Total | 14232.314 | 51 |  |  |  |
| 1. Dependent Variable: difROA 2. b. Predictors: (Constant), Factor 1 | | | | | | |

Table 6. Results of model summary

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | | | Durbin-Watson |
| R Square Change | F Change | df1 | df2 | Sig. F Change |
| 1 | ,375a | ,141 | ,124 | 15,63911 | ,141 | 8,190 | 1 | 50 | ,006 | 2,146 |
| 1. Predictors: (Constant), Factor 1 2. Dependent Variable: difROA | | | | | | | | | | |

Further, the regression model was conducted for only one factor, which were retained. The R-value represents the simple correlation and is 0,375, which shows the medium degree of correlation. The result of significance of 0,006 proved that the model itself significantly predicts the outcome variable and explains 14,1% of the variance (R2 = 0.141) in the difference between ROA in home and host country (Table 6).

Table 7. Coefficients of regression

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. | 95,0% Confidence Interval for B | |
| B | Std. Error | Beta | Lower Bound | Upper Bound |
| 1 | (Constant) | 1,264 | 2,170 |  | 0,582 | 0,563 | -3,095 | 5,622 |
| Factor 1 | -6,379 | 2,229 | -0,375 | -2,862 | 0,006 | -10,856 | -1,902 |

The final Table 7 provides information overall model with both constant value and Factor 1 coefficient of correlation value. Taking everything together with the excluded factors, the regression equation is following:

The regression equation gives an information regarding changes in return on assets. Thus, it states that if Factor 1 changes by 1, differences between ROA in home and host country is expected to decrease by 6,379. That also proves the negative effect of this factor in company’s performance.

Table 6. Correlation coefficients

|  |  |  |  |
| --- | --- | --- | --- |
|  | B | Sig. | N |
| Proprights | -,293\* | 0,035 | 52 |
| DivFunds | -,331\* | 0,017 | 52 |
| Bribes | -,397\*\* | 0,004 | 52 |
| Judical | -,324\* | 0,019 | 52 |
| GovFav | -,326\* | 0,019 | 52 |
| LegalFrameDisp | -,275\* | 0,049 | 52 |
| Ethic | -,355\*\* | 0,010 | 52 |
| ProtShare | -,368\*\* | 0,007 | 52 |
| QRailways | -,313\* | 0,024 | 52 |
| Antimonopoly | -,332\* | 0,016 | 52 |
| NTBarriers | -,347\* | 0,012 | 52 |
| FDI | -,413\*\* | 0,002 | 52 |
| BurdenCust | -,406\*\* | 0,003 | 52 |
| ProfManag | -,322\* | 0,020 | 52 |
| DelAuthority | -,280\* | 0,044 | 52 |

\*p<0,05, \*\*p<0,01

Table 6 provides information regarding correlation for each of institutional factor, which is significantly effect on dependent variable. Some of institutions from the Factor 1 of factor analysis were eliminated as being insignificant so that out of 23 factors, which were combined in a group, only 15 factors were retained for representation of correlation.

Factors like property rights, judicial independence, government favoritism in decision-making, protection of minority shareholders’ interests, and efficiency of legal framework in settling disputes all have negative coefficient and at significant level of 0,05. They are combined in a “government policy” variable, so the less favorable government policy conditions, the bigger the difference between ROA in home and host country, leading to worse company performance. Hence, hypothesis 1 is supported by the analysis.

The test of hypothesis H2 states the variable “business culture”, which consists of willingness to delegate authority, ethical behavior of firms, and reliance on professional management, has negative and statistically significant influence on the dependent variable. According to the results of analysis, the worse business conditions in host market, the worse company’s performance in this market. Thus, the hypothesis is also supported.

Quality of railways and effectiveness of anti-monopoly policy were components of the variable “market development and competition”. The analysis shows the significant negative effect of these factors on the dependent variable. The conclusion is that the less developed market conditions, the bigger gap between ROA in host and home countries, which leads to poorer performance. It can be concluded that hypothesis 3 is proved.

The “corruption” variable, possessing irregular payments and bribes and diversion of public funds, is significantly negative towards the dependent variable. Thus, the worse the regulation of corruption, the worse companies perform in host country. That conclusion goes along with the hypothesis 4, thus, supporting it.

## 3.3. Discussion

The empirical study was conducted by using factor analysis and multiple regression analysis. The regression was developed to test stated hypotheses and to assess the influence of institutional factors on company’s performance. The overall quality of the model is very high: it is statistically significant at 0,006 level with R2 =0,141. The model was used to examine the influence of differences between institutions in home and host countries on the performance. The following Table 7 provides results of hypotheses testing.

Table 7. Results of testing hypotheses

|  |  |
| --- | --- |
| Hypothesis | Result |
| H1: More controlled and protective government policy in Russia negatively influences the performance of MNEs’ subsidiaries | Hypothesis was supported |
| H2: More informal-oriented business culture in Russia negatively influences the performance of MNEs’ subsidiaries | Hypothesis was supported |
| H3: Less developed market conditions in Russia negatively affects the performance of MNEs’ subsidiaries | Hypothesis was supported |
| H4: The high level of corruption in Russia negatively influences the performance of MNEs subsidiaries | Hypothesis was supported |

The Russian institutional factors mainly were assessed as worse that those in other European countries. The main reason is that Russia is still considered to be emerging market with less developed institutions. But the descriptive statistics showed that for the past 25 years more and more international companies entered Russian market. Since Russian market tends to be less developed regarding institutional environment, it seems that MNEs cannot increase their return on assets in this market. Nevertheless, the overall analysis indicated that in some cases companies managed to generate better performance in Russia than in their home European country. Still they faced challenges when doing business in Russian market.

The analysis shows that truly institutional environment can be used to explain the differences between company’s performances in various markets as it highlighted the significance of particular factors as influencers on return on assets. Thereby, it supports the main conclusion made by Quer et al. (2012) and Kang and Jiang (2012) described in the first chapter, that institutions are useful to choose FDI location better than just economic conditions, as regarding the analysis they were a part of institutional environment. Also, the analysis supports the conclusion made by Cuervo-Cazurra and Genc (2011), and Ma et al. (2013) from the first chapter, who stated that institutional development has a negative effect on the performance of subsidiaries. As can be seen from the research in this paper, the obtained result is exactly the same.

In the investigated factors the differences were mostly negative meaning that conditions in Russian market are worse than those in European countries. It also depicts that on average the distances range from -1,4 to -2,5 (out of 7), so that it can be concluded that institutional factors in Russia are significantly worse regarding development. This supports the idea by Hernandez and Nieto (2015) described in the first chapter, as the negative direction truly exists in case the company from the more developed market enters Russia.

Contrary, it was said in the first chapter that, on the base of institutional environment investigation, Bowen and De Clercq (2008) did not find any influence of regulatory conditions of firm’s activities and performance. Nevertheless, this research shows that regulatory policies influence the performance, moreover, if not the most severe influencers on doing business in Russia for multinational firms.

The biggest challenge for MNEs is dealing with Russian judicial policy and the terms of property rights protection. Government supports Russian companies but for multinationals it is usually quite problematic to protect their interests through the legislation. As has already been mentioned, the attitude towards property rights protection is Russia is also quite different from this European countries possess. Since property rights are one of the most important assets in the company, it is essential to protect copying. But according to Russian policy, it is difficult to assure duplication by competitors. As a result, this research goes along with previous researches (e.g. Ushakova, 2013) and also proves that truly when international firms can’t easily obtain and protect their property right, it creates a lot of challenges for them to achieve desired results. Since property rights are one of the resources for the long-term economic development for the company, the higher its development, the bigger positive effect on the performance it is. Also, it was proved that the judicial policy in Russia is indeed negatively linked to firm’s performance creating obstacles for companies to perform successfully in Russian market.

Russian market is highly controlled with entering barriers. Many companies indicated difficulties when crossing the country borders. But not only tariff barriers make it difficult to enter, but also non-tariff, which are rarely considered by firms as an obstacle. Unpredictability of regulatory environment imposes barriers on internationalization of European countries in Russian market. Probably the most severe challenge is the impact of rules on FDI. Russian restrictions make it much more difficult for companies to invest in this market, making them to change their decisions. MNEs face the lack of support from the Russian government, as it is not a common practice there. That was proved by the analysis where business impact of rules on FDI shows the significant correlation with ROA as one of the institutional factors, which shows the highest coefficient of correlation. Thus, it has the highest influence among all the factors.

The root of underdeveloped transportation quality in Russia comes from the lack of economic development what is the determining factor in achieving better performance as Russia mostly depends on the railway to be able to deliver on time. This is one of the crucial factors achieve better results. The analysis proves that indeed some of indicators of undeveloped infrastructure have a significant effect on company’s performance. Companies in general rely a lot on infrastructure. The development of railways or roads is the main contributors for the speed of the delivery. Russia is highly spread geographically, and diverse in regional development with the infrastructure centered in Moscow. So, it is important to have well established transport system to be able to deliver resources and goods on time not to create delays. According to analysis, quality of railways has a moderate effect on firm’s performance. Regarding the opposed view by Donna and Herrington (2016) of no negative effect of physical infrastructure, market dynamics, commercial infrastructure, and professional education on the performance, this paper shows reverse result. Infrastructure and market particulars like non-tariff barriers, effectiveness of anti-monopoly policy and burden of customers procedures contribute a lot to the performance. Thus, non-tariff barriers prevent companies from investing in Russia as Russian market is described being overprotected by the government against foreign firms.

The presence of corruption, which is not familiar to many European markets, makes it almost impossible for MNEs to be fully involved in the internationalization and operating in the Russian market again listing some limitations. By the dominance of informal institutions and undeveloped formal institutions the high level of corruption became a part of Russian business culture. As Gorenburg (2013) and Orttung (2014) concluded that Russian economy is not transparent because of the high level of bribery, this research supports their idea by stating that indeed irregular payments and bribes cause the performance in Russia being lower comparing to their home country’s results. The ambiguity between formal and informal institutes have to balanced in order to reduce the level of corruption in Russia but nonetheless the government does not try to solve this problem, what causes more obstacles for foreign companies when investing in Russian market. This also reduces the investment climate for Russia preventing companies to enter. Thereby, the government should adopt judicial policy in favor of foreign companies, as it might be beneficial not only for investors but also for the country itself bringing more resources, innovations and knowledge for domestic business.

As has been stated, Russia is a market where the networks play a huge role in doing business with a trust being the most important issue. Thus, according to the analysis the reliance and trust to professional management was evaluated as significant influencer on company’s performance supporting the conclusion made by Puffer (2010). Thereby, before entering Russian market it is essential for companies to establish some necessary networks to make processes easier and to be likely to bring desired results by being supported by external and internal working power. Another issue, which belongs to Russian market is that the practice of delegation of authority is very unpleasant meaning that managers tend to make decisions by themselves not willing to consider ides proposed by their employees. This policy is very common outside the Russia but not within the country. Despite Moscow and Saint-Petersburg became very western cities, the Russian mentality still exists in peoples’ minds who are a part of western company. As has been stated by Zhulepov (2017), many companies cannot accept allowing employees to interfere in decision-making processes as it may violate company to become “too Russian”. Thus, such cultural elements indeed affect the performance of the western companies in Russian significantly.

Overall, the analysis revealed that there is no possibility for MNEs to actively internationalize in the Russia, so that it takes time, resources and extra knowledge of the market to develop business operations there. As has been shown, Russian formal institutions are indeed undeveloped to the sophisticated extent, what repeats the idea of Puffer (2010) who proclaimed formal institutions voids in Russia.

Thus, when coming to Russian market MNEs have to try to adapt to this market conditions and to be ready to set a business with implementing some of Russian practices in daily duties. For example, as has been said, networking became one of the most important issues of successful business in Russia. Consequently, right before entering Russian market, multinational companies have to send their representatives to Russia in order to negotiate with local business actors like possible suppliers for resources, government to get the required information regarding obtaining permits, local business and judicial laws, and potential customers in order to find out their attitude towards the brand and its products, so that this networking would be helpful and beneficial for the multinational company in Russian market. If the company has a well-developed networking and has established relationships with the government, it is likely to set a business in Russia without any problems and be able to operate more effectively through the set distribution channel. Also, in doing so company can obtain trust and reliance, which is very important factor of successful business in Russia. Company stops being outsider on the market, so that customers and other business counterparts tend to interact fully and deeply. In addition, it has been discussed that judicial policy in Russia are not in favor for foreign companies and many local businesses what leads to the need of paying bribes as some firms want to overcome laws and keep on doing their business. Also, government favoritism in decision making sometimes plays not in favor for companies so established trustful relationships could be beneficial for international company’s business as government is willing to deal with such companies and make decisions which could be supporting their business.

Nevertheless, everything mentioned above together with the peculiarities of Russian market requires additional payments. Thus, many entrepreneurs pay bribes to speed up many processes like getting permissions, protecting property rights apart from the law, also in case of different disputes companies might pay bribes to be sure their case will win. Also, in order to make processes less bureaucratic, there is high possibility that the company has to pay bribes to complete the setting process and to establish relationship with authorities to avoid future government interference and checking. In such cases MNEs should be ready to the very bureaucratic and long processes, and be patient when waiting for getting permissions and other required documents if they avoid paying bribes.

Personal networking of the firm plays important role in establishing trustful image for all counterparts in certain business. It is not only outside the organization, but also inside. So, as has been already mentioned, the trustful and reliable professional management is influential factor in doing business in Russian market. Since reliance on the professional management influences on the company’s performance in Russia, it is important for companies to consider this issue when coming to Russian market. For example, making employees, as a part of decision-making process could be a solution, nevertheless, it should be adapted to western business policies in order not to make foreign organization “too Russian”. Moreover, when coming to Russian market companies set foreigners as top managers in the subsidiaries. Despite cultural aspects like language or nationality do not influence the performance, it was proved that reliance is an important part of organization insights. It is obvious that people tend to trust foreigners less since they do not know his or her approaches. Thus, network between top management and employees becomes the most crucial one for future success. As reliance on professional management is stated as one on the significant factors of company’s performance, right before starting working together, top manager has to provide special corporate events for employees both to make them better himself what will help to establish efficient relationships, and to allow employees to know their boss, to see his leading approach, to know him as a person for the business interaction. The good corporate climate helps to create the fast information exchange, effective team works, helpful cooperation. Additionally, when employees trust their manager, they are willing to perform tasks without hesitation, thereby, reducing time and costs.

It is crucial for foreign companies to establish good networks with different parties in Russia. Thus, relationships with supplier should be worked out as it not only allows obtaining required resources, but also to establish processes efficient without any breakouts and delays. As has also been mentioned, the quality of railways is of the main issues of successful business in Russia as the country is big regarding size. Railway is the best way to deliver goods and also get sources for producing. So, sometimes, in order not to deliver resources from other parts of the country, it is better to establish working relationships with local suppliers so that companies do not have to wait for a long time to start producing goods, and also to deliver their products to other cities in Russia. When having proper networking system, company is likely to succeed in its business. Despite the need for railways can be solved by the contract with local suppliers, the railway itself is inalienable part of doing business in Russian market. So, when entering Russia, MNEs should consider this issue both by thinking about other delivery method, like airways, or by having a reserve to cope with delays. Another possible solution is find supplier closer to the production place, for example, if the company produces its goods in Vladivostok, it’s possible to deliver resources from Asian countries as they are much closer than any European, and also, if the company is concentrated in Moscow, it will take a lot of time to deliver from Moscow to Vladivostok. But some surrounded Vladivostok countries could be much faster in delivery and, sometimes, even cheaper than within the Russian transportation. Thus, all these challenges of doing business in Russia should be taken into account when starting operating in this market.

***Managerial and public implementations***

The results of this study have some insight information for top managers of MNEs involved in the internationalization. They are able to understand of what institutional distances between their home countries institutions and those in the host country influence the overall performance, and, moreover, what is the impact. That is highly important for them when making decisions about entering Russian market by knowing, which factors they should consider in order to make the most appropriate decisions and implement the most efficient strategy in Russian market. So, the study provides managers with a framework that can be used a basic tool for strategic management. The framework highlights the importance of taking into account all institutional distances pillars.

The study showed that generally Russian market is very hostile towards MNEs entering Russia, so it does not prevent international companies from investing there. The results of the study can also be beneficial to policymakers to attract foreign investments. It is essential to understand that investors tend to invest financial resources in countries with higher level of regulatory development. Policymakers should concentrate on institutional reforms related to improvements in the rule of law, the quality of regulations and the state of corruption. Thereby, government has to create better legal conditions and maintain stability, increase the protection of property rights to make transactions more secure, so that to encourage foreign investments, which will help Russian market to grow. The importance of supporting international enterprises in Russia was highlighted. They could organize events where some experience and knowledge regarding doing business in Russia and Russian institutional environment could be provided along with some insights to make it easier for companies to deal with Russian market. MNEs are willing to invest in Russia because there is a big market potential.

In addition, not only short-term policies should be developed but also those, aimed at long-term. These programs might include some changes in legislation supporting MNEs and their operations in Russia. Also some local or regional state programs could be developed to link local and foreign companies in creating innovative products and services in Russian market. Since foreign companies tend to invest a lot in innovations, such collaboration would be beneficial not only for the foreign company, but also for the country. Another initiative is to make bureaucratic procedures easier and less time consuming what might be detrimental for MNEs when deciding about entering Russian market.

***Theoretical contribution***

A number of researches regarding the influence of institutional factors on degree of internationalization, using multiple regression analysis, was conducted. Most of them were attributed to any specific foreign markets and. However, the issue of host institutional environment and its influence on MNEs entering Russian market was not studied enough yet. Institutional distances were broadly researched but, nevertheless, they focused on the differences between developed and developing countries. Moreover, the emerging markets have not gained enough attention from researches as an object for investigating institutional environment. Also, not all the selected in these study institutional factors have been used to investigate host country environment.

As a result, this study makes a contribution to internationalization process with the indicated influence of researched institutional factors on company’s performance in Russian market.

***Limitations and future research***

The limitations of this research can be linked to several aspects: sample size, measurements, and chosen institutional factors.

Thus, the sample size is limited to MNEs, which have registered subsidiaries in Russian market rather than internationalized to Russian market through export or dealers. For this study 53 companies were taken, but truly there are more than this number, operating in Russian market. Some of these companies were eliminated due to unavailability of financial data in databases like SPARK and Amadeus. This led to significantly lower sample size, which in turn slightly reduced the reliability of the model.

As a choice of company’s performance there is more than one possible measurement. ROA was chosen as being the good indicator of company’s asset usage, which indicates how good the company uses them to bring better efficiency. Nevertheless, many scholars argue that ROE or return on sales can be better measurements of international operations.

Additionally, the chosen institutional factors were generalized taken from the country profile but not directly from companies. That made the analysis less specific, and calls for the need to investigate this case in more subjective approach, for example, by conducting a survey to these companies to provide comparative analysis.

The studied institutions were developed on the base of Whitley’s study and the CAGE framework together with World Bank data, so that some of institutions like geographical distances or education and labor policy were not included in the research calling for further research.

***Future research***

The discussed above limitations build the ground for further research about the influence of institutional factors in Russian market on MNE’s performance.

Firstly, only European countries were investigated and no Asian countries were taking into account. As Russia is not that far from Europe regarding environment, Asian market might be much more interesting to include in analysis, since its environment is considered to be significantly different from Russian. That might bring more interesting results.

Since only ROA was investigated as a measurement of company’s performance, usage of other measurements of internationalization could make analysis deeper, or show opposite result, for example, that distances do not influence the performance regarding other indexes.

Also, the analysis can be conducted with adding more institutional factors or with using absolutely other factors as independent variables to understand even better what actually dictates company’s success of failure in Russian market.

Moreover, in future research more control variables can be used to investigate whether some other factors rather institutions conduce company’s performance and internationalization in Russian market.

## Conclusion

The study itself proves that institutional environment indeed affects companies when they starting business in the new market. Anyway, every country can have its own challenges depending on the level of development, culture and many other issues. Knowing what company can expect entering any market, it is easier for them to plan strategies and be prepared to react to particulars. Specially, due to the institutional differences it might be easier or much more difficult for firms to adapt strategies in chosen market. Thereby, the regression analysis, which was conducted to explore this correlation, was proved to show the interrelation between institutional environment and the performance. So, provided theoretical analysis, the analysis of Russian market and regression analysis helps to answer the research questions, which were stated at the beginning of the work.

The study demonstrates Russian market as being one of the most attractive emerging markets for foreign investments. It shows how different the institutional environment are there comparing to the western markets, and that these big institutional distances significantly influence company’s performance and can explain the variance in different performances. As has been stated at the beginning of the research, the purpose of the study was to identify what factors influence companies in Russia and what is their influence. Thus, the empirical research managed to answer both of these questions helping to understand Russian peculiarities and their contribution to firm’s business results.

The empirical study shows that the institutional environment of the host country affects the performance of the MNEs in Russia. The weak property rights protection, undeveloped infrastructure, the high level of corruption and networking-oriented business culture were stated as institutions that companies face when entering Russia market.

The study also demonstrates that, like in many other emerging markets, the institutional voids exist in Russia due to not fully developed formal institutions. One of the most important issues for successful business – property rights policy – creates the need for improved functioning of property legislation. That leads to dependence on informal institutions for MNEs. Thus, both formal and informal institutions play an important role for foreign company’s performance in emerging markets.

The thesis concludes that networking indeed is one of the main parts of doing business in Russia giving an opportunity establish relationships with counterparts and suppliers, in some cases with the government, to make business processes easier and to obtain required resources. Since formal institutional factors are weak in Russia, informal institutes substitute them to cover the institutional voids. Anyway, both should be considered when dealing with Russian market.

Together with the new institutional theory, the results of the research can be beneficial for many parties, which were described above. Also, this research covers some gaps, which were identified on the base of literature review. This paper covers MNEs, which were not explored enough by previous researchers, and their performance in Russian market, since no paper were found to combine Russian market and the financial results of firms operating in this market.

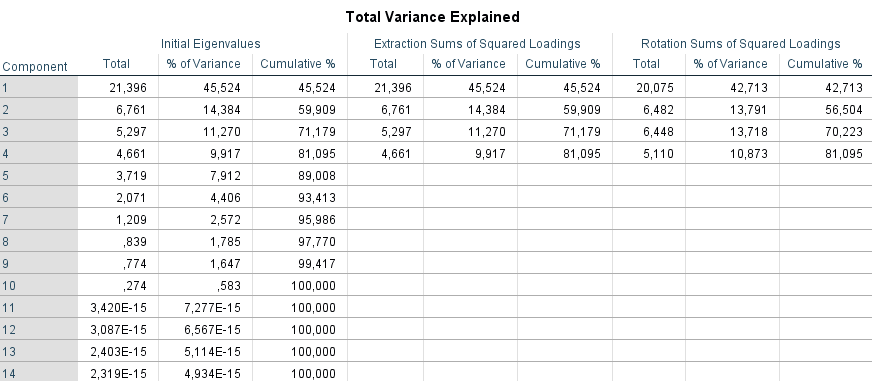
To sum up, the results of this study are very contributed for the developing the institutional environment in Russia, thus, helping to increase the investment climate here and boost the development of infrastructure, innovations and trade relationships.

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# Appendixes

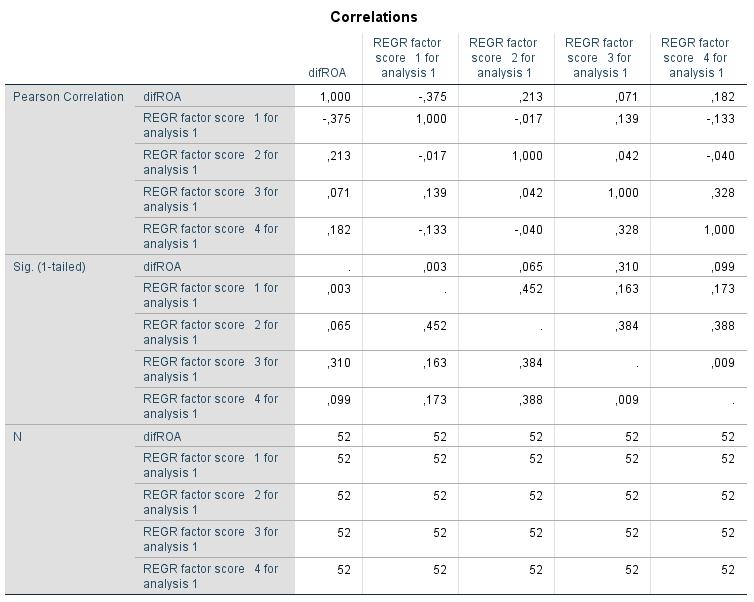
## Appendix 1. Total variance table



## Appendix 2. Factor analysis table

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## Appendix 3. Correlation coefficients table



1. https://blogs.worldbank.org/opendata/new-country-classifications-2016 [↑](#footnote-ref-1)
2. https://www.msci.com/emerging-markets [↑](#footnote-ref-2)
3. http://www.doingbusiness.org/data/exploreeconomies/russia [↑](#footnote-ref-3)
4. http://fhv.ru/2017/03/evaluation-russias-business-environment-foreign-investors/?lang=en [↑](#footnote-ref-4)
5. http://reports.weforum.org/global-competitiveness-index-2016-2017/ [↑](#footnote-ref-5)
6. http://www3.weforum.org/docs/GCR2017-2018/eos2017\_questionnaire.pdf [↑](#footnote-ref-6)