Spillover effects of foreign entry on local firms and business networks in Russia – A case study on Fazer Bakeries in St. Petersburg

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1 INTRODUCTION

1.1 Multinational enterprises in the world economy

The role of multinational enterprises (MNE)[1] in the world economy has increased significantly over recent decades (see e.g. UNCTAD 2012; Forsgren 2008; van Tulder & van der Zwart 2006). Whereas there were approximately 7,000 registered MNEs at the end of the 1960s (van Tulder & van der Zwart 2006), by the early 1990s, the amount had increased to approximately 37,000, with at least 170,000 foreign affiliates. In 2008 the number of MNEs had risen to more than 80,000, with approximately 810,000 foreign affiliates (UNCTAD 2009; 2005). The growing importance of MNEs is reflected in the increase of foreign direct investments (FDI)[2] as illustrated in Table 1.

Table 1 Selected indicators of foreign direct investment (FDI) 1982–2011, USD billions (UNCTAD 2012; for 1982 figures, UNCTAD 2005).

Item	1982	1990	1998	2006	2011
FDI inflows	59	207	706	1,463	1,524
FDI outflows	28	241	690	1,415	1,694
FDI inward stock	637	2,081	5,763	14,300	20,438
FDI outward stock	627	2,093	5,941	15,697	21,168
Cross-border M&As	-	99	406	625	526

As indicated by Table 1, the world outflow of FDI grew by more than 5,000 percent from USD 28 billion to USD 1,415 between 1982 and 2006. At the

[1] *A multinational enterprise* (MNE) can be defined "as an administrative/legal unit that includes several business firms, subsidiaries, located in at least two countries" (Forsgren, Holm & Johanson 2005, 78). The terms MNE, multinational corporation (MNC) and transnational corporation (TNC) are considered synonymous and employed interchangeably in this report.

[2] *Foreign direct investment* (FDI) is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity (i.e. foreign investor or parent company) in an economy other than that of the investor. FDI implies that the investor exerts a significant degree of influence on the management of the enterprise resident in the other country (UNCTAD 2003, 231). In other words, FDI represents a purchase of physical assets such as plant or equipment or business operations in a foreign country to be managed by the parent enterprise. An investment should comprise ownership of at least 10% of the foreign affiliate enterprise's voting power for it to be considered a direct investment (OECD 2008).

same time, the world's exports increased by 565 percent and the world's production by 300 percent. Table 1 also reveals that FDI is, to a large extent, conducted by one company buying another. The high proportion of mergers and acquisitions (M&A) in the total FDI flows can largely explain why the increase in FDI is so much higher than the increase in world production (UNCTAD 2005; 2007; 2012; Forsgren 2008).

Indeed, the figures in Table 1 clearly indicate a dramatic increase in terms of MNEs' expansion across national borders, a phenomenon that is an essential part of the globalisation process of the world economy (Forsgren 2008; Wilska 2002). During the 1990s and early 2000s the business environment almost globally became more favourable for companies to enter foreign markets and operate (UNCTAD 2005; Wilska 2002). Simultaneously, developing and transition economies[3] began to attract an increasing share of FDI, although FDI remained heavily concentrated in developed countries (UNCTAD 2003; Wilska 2002). Since then, there has been a clear shift of FDI inflows to developing and transition economies (UNCTAD 2010) and, as a result, these countries accounted for more than half of global FDI inflows in 2011 (UNCTAD 2011; 2012). Especially, the so-called BRIC[4] countries, (i.e. Brazil, Russia, India and China) have attracted the attention of multinational corporations (MNC), which is reflected also in FDI inflow: according to UNCTAD's (2012) global FDI inflow statistics for 2011, China ranked second (after the USA), Brazil fifth, Russia ninth and India fourteenth among all economies.

The increasing role of MNEs has evoked many conflicting views in the economic and political debate on globalisation. On the one hand, MNCs are considered important agents of change, demonstrating and diffusing new technologies throughout the global economy and thus contributing to economic growth and national welfare. On the other hand, especially in developing countries, multinational enterprises have been accused of having negative impacts on, for instance, the environment and labour and human rights; for example, by taking advantage of lax environmental standards or contributing to the employment of forced or child labour (Dunning & Lundan 2008; Forsgren 2008; Kinley & Joseph 2002; Hymer 1970). Furthermore, in developing countries, MNEs have been connected, for instance, to crowding out local firms and local employment, and the reduction of domestic capital stock

[3] The country grouping (developed, developing and transition economies) is based on the United Nations' country grouping and presented in more detail in Appendix 1.In brief, developed economies refer to Western market economies, transition economies refer to successor countries of the Soviet Union and former socialists countries in Europe, and developing economies refer to all the rest; thus, most countries in Asia (including China), South America and Africa.

[4] The acronym BRIC, referring to Brazil, Russia, India and China, was coined by Jim O'Neill in 2001. BRIC countries are among the largest and fastest growing emerging markets and their role in the global economy is expected to increase substantially in the future (O'Neill 2001).

and tax bases due to transfer price manipulation and excessive profit repatriation; thus, possibly causing more, rather than alleviating, poverty (e.g. Oetzel & Doh 2009; van Tulder & van der Zwart 2006). Nevertheless, despite the possible negative effects of FDI, many developing countries have, over recent decades, introduced policies encouraging both inbound and outbound FDI as a means to achieve structural upgrading and sustainable growth (Dunning & Lundan 2008, 295–296).

1.2 The role of foreign direct investment in transition economies

The role of foreign firms in enhancing a host country's economic development has been emphasised in the context of post-socialist transition economies (e.g. Kalotay 2010; Marinov & Marinova 1998; 2000). As firms in planned economies were separated from the global economy and foreign trade was conducted by government monopolies, companies suffered from a lack of knowledge exchange with foreign firms and a lack of foreign competition. As a result, most industries in transition countries were lagging behind the technological development of the Western world (Yudaeva, Kozlov, Melentieva & Ponomareva 2003; Buck, Filatotchev & Wright 1998). The upheaval of institutions and policies at the beginning of the economic transition in the early 1990s required firms to adopt new market-based practices (Roth & Kostova 2003). As local firms had little or no knowledge of such practices, the role of foreign firms as a potential source of both advanced technologies and managerial expertise was emphasised (Jormanainen 2010; Roth & Kostova 2003).

Hence, FDI was considered a major source of sustainable economic growth in European transition economies (Yudaeva et al. 2003). International organisations and many experts advocated FDI as an engine without which successful transition from socialism would be unlikely (Bandelj 2002). Policymakers in most transition economies placed attracting FDI high on their agendas, expecting FDI inflow to bring new technologies and know-how and, as such, to contribute to improving productivity and competitiveness of domestic industries (Smarzynska 2002).

Indeed, according to Williams (1997), FDI has played an important role in the restructuring process of transition economies. However, there are also many potential problems resulting from FDI inflow in the transition economy context; for instance, potential withdrawal of investment, uneven regional development, fiscal and balance of payments deficits, cultural conflicts and increased unemployment (Vissak & Roolaht 2005). Although, in transition economies, inward FDI has played a role in strengthening private sector and market economy behaviour and in enhancing industrial restructuring, output

and employment have often suffered setbacks after foreign takeovers. However, firms seem to have become more efficient and resistant to subsequent competitive pressure. Thus, the issue is complex and there is no simple correlation between the amount of FDI and the rate of economic growth in transition economies (Hunya & Geishecker 2005; see also Cernat & Vranceanu 2002).

Russia, of all post-socialist transition economies, has attracted by far the most FDI (UNCTAD 2012). Indeed, mainly due to its large market and rich natural resources, Russia can be considered an attractive host economy for FDI (Kuznetsov 2012). However, in comparison with China and other BRIC economies, Russia has not been particularly successful in keeping pace with developments in market competitiveness (World Economic Forum 2012). Problems in the Russian investment climate, especially the high level of corruption, are considered major reasons for Russia not having attracted FDI on the scale and to a range of industries in line with its full potential (Kuznetsov 2012/2010). Figure 1 illustrates FDI inflows of all BRIC countries over the last two decades.

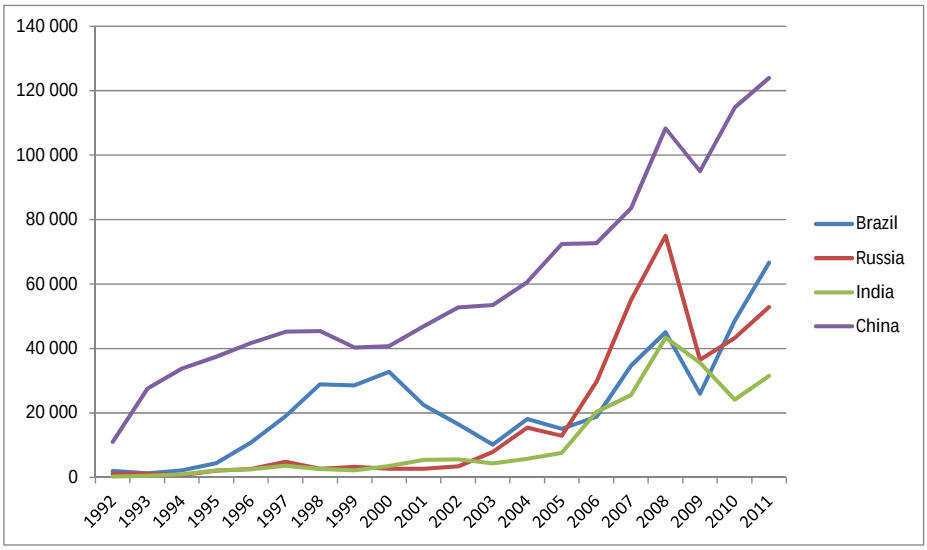

Figure 1 Inward FDI flows in the BRIC countries, 1992–2011, USD millions (UNCTAD 2012)

As shown in Figure 1, Russia attracted substantial amounts of FDI in the 2000s. Due to the global economic crisis in 2008, the FDI inflow and stock in Russia also declined drastically although they have since been recovering (UNCTAD 2012; Kuznetsov 2012). However, despite the significant amount

of inward FDI that Russia attracted in the 2000s, the study by Ledyaeva and Linden (2006) suggests that FDI is hardly a significant factor in explaining economic growth in Russia at a regional level. Indeed, FDI inflow to Russia has concentrated on only a few regions, mainly Moscow, St. Petersburg and oil-rich Sakhalin (Kuznetsov 2012).

According to Kalotay (2010), among various transition economies, FDI has had the smallest impact on structural change in Russia. This is due to both the later start of FDI inflows to Russia in comparison with some other European transition countries and also the sector composition of FDI. In Russia, FDI has contributed to the country's continuing dependence on extractive industries (Kalotay 2010) although, since 2005, inward FDI to manufacturing and services has grown faster than to mining and quarrying (Kuznetsov 2012; Rostat 2012). It is also worth noting that a significant part of inward FDI to Russia comes from Cyprus and Caribbean territories, thus representing round-tripping capital investment originating from Russia itself (Rostat 2012, Kuznetsov 2012; 2010). Therefore, especially in Russia, the relationship between quality and quantity of FDI should be better understood to improve the link between investment promotion and industrial policy (Kalotay 2010). Hence, this study aims to contribute to understanding FDI's impact on local companies and industries in the context of Russia.

1.3 Identifying the research gap

FDI and its impact on the recipient country's economy have interested researchers since the 1950s (Vernon 1992). The effects of foreign firms on local companies have often been analysed as spillovers from FDI (e.g. Caves 1974; Globerman 1979; Chen 1983; Kokko 1992; Buckley, Clegg & Wang 2002). FDI spillovers can be defined as indirect effects that FDI might have on the structure of the host economy, and the conduct and performance of locally owned companies (Blomström, Kokko & Zejan 2000). Spillovers arise as FDI includes the capitalisation of technology, knowledge, skills and other intangible assets of MNEs that can be transferred or diffused to host countries (Meyer 2004; Blomström et al. 2000). The terms indirect effects, externalities, external effects or involuntary diffusion of technology have also been employed to describe the phenomenon (Blomström 1989; Kokko 1992).

Numerous empirical studies on FDI spillovers have been conducted both in developed and developing countries, often in manufacturing sectors, employing large panel data and statistical tests (see e.g. Caves 1974; Globerman 1979; Blomström 1986; Kokko 1992; Buckley et al. 2002). These studies have focused on whether FDI spillovers occur at a particular time, in a particular

place or in a particular branch of industry. However, despite the large amount of research on FDI spillovers to a host economy, many aspects of the phenomenon remain poorly known. Empirical work conducted shows contradictory results both in the context of developed economies and of emerging markets including European transition economies. While many studies indicate clear positive spillovers from the presence of MNCs (e.g. Chen 1983; Dries & Swinnen 2004), some find no spillovers (e.g. Haddad & Harrison 1993; Kinoshita 2001) and other studies even find some that are negative (e.g. Aitken & Harrison 1999; Djankov & Hoekman 2000).

Thus, previous assumptions concerning spillovers being, to a great extent, automatic contagion-type externalities arising from the mere presence of foreign firms through demonstration and imitation can be, at least partially, discarded (cf. Kokko 1992). Indeed, more recent studies have shown that many situation and context specific determinants such as, for example, absorptive capacity of local firms, host country and host industry characteristics, the foreign investor's home country, the type of and motives for investment, and the strategy of MNEs can all have a substantial impact on the extent and nature of spillovers (see e.g. Oetzel & Doh 2009; Spencer 2008; Enderwick 2005; Javorcik, Saggi & Spatareanu 2004). However, the role of different determinants impacting on spillover effects remains largely unknown and there is insufficient evidence on the external influence of FDI in different circumstances (e.g. Crespo & Fontoura 2007; Javorcik 2007). Nevertheless, knowledge on spillovers has a great impact on different countries' FDI policies that, in turn, directly influences decision-making in MNEs (Meyer 2004).

Most studies on spillovers have examined the matter from the perspective of the host country. Both economists and policy analysts have been interested in the effect of FDI on the host economy and treated the existence of positive spillovers as a favourable occurrence from the host country's perspective. However, when regarded from the perspective of an MNE, spillovers have often been considered a negative phenomenon, a failure to keep knowledge and technology internalised within the MNE (e.g. Caves 1971; cf. Oetzel & Doh 2009; Kugler 2006). Nevertheless, a spillover effect might also be considered a positive phenomenon by managers of MNEs as positive externalities on the host country can help a foreign company build a favourable reputation as an actor concerned for its stakeholders, including local policy makers (Oetzel & Doh 2009; Meyer 2004; cf. Turcan, Marinova & Rana 2012).

Until recently, research on spillovers has been conducted mostly by economists and the subject has received only limited attention from international business (IB) scholars (Ghauri & Yamin 2009; Meyer 2004). Furthermore, researchers within IB have addressed the subject in a manner similar to economists. Thus, in attempting to generalise on whether or not spillovers

occur, these studies have also relied on econometric models (Hallin & Holmström Lind 2012; Meyer 2004). However, these methods have specific shortcomings. First, some spillovers are not necessarily industry specific but can diffuse across industries. Thus, conventional econometric studies based on industry-level panel data are unable to identify all spillovers (Gachino 2010; Spencer 2008). Second, even studies that find clear evidence on spillovers can usually only offer assumptions on how they occur (see e.g. Blomström & Kokko 1996; Blomström 1986). For example, to date, the role of linkages in facilitating spillovers is largely unexplored (Kippenberg 2005; Smarzynska 2002; Blomström et al. 2000) and understanding on how spillovers actually occur at the micro level is limited (Enderwick 2005; Meyer 2004). Thus, there have been calls for studies on not only whether spillovers occur or not but on understanding the exact mechanisms[5] behind them (Gachino 2010; Spencer 2008; Javorcik 2007). Hence, the focal study aims to fill these knowledge gaps by focusing on identifying the ways and mechanisms through which a foreign entry affects local companies. The research objectives and the research approach applied in the study are detailed in the following section.

1.4 Research objectives and approach

According to Meyer (2004), studies taking the individual company as a starting point will enhance understanding on the interaction between MNEs and the local environment. Meyer also states that the theories and research methodologies of IB research could provide new insight on the dynamics of MNEs in emerging economies. In response to these suggestions, this study aims to increase understanding on the phenomenon by focusing on *how a single foreign entry can influence local companies in a transition economy's context*.

The dissertation concentrates on equity-based entry modes (i.e. FDI). Non-equity entry modes (e.g. exporting through agents or licensing) are not involved in the discussion of the focal study. Thus, the term "foreign entry" is employed here to represent equity-based entry modes through greenfield investments or acquisitions (cf. Harzing 2002). In this study, a local company refers to another locally operating firm regardless of its ownership structure

[5] According to Elster (1998, 45), mechanism can be understood as "intermediate between laws and descriptions". Mechanisms "allow us to explain but not to predict". They provide better explanations by "understanding the details of the causal story" (ibid. 49) and help to avoid mistakes in mixing correlation for causation. Mechanisms also enable explanations when generalisations break down (ibid. 45-49).

(e.g. whether wholly or partially locally, domestically or foreign owned). The overall aim of the study can be divided into three more specific sub-objectives:

- To describe changes in local companies following a foreign entry in a transition economy's context.
- To identify the mechanisms through which the changes are transmitted to local companies.
- To identify conditions having impact on the transmission of changes to local companies.

The focal study aims at theory development and, thus, its main contribution is *theoretical.* Although the aim of this study is academic, it also puts forward *managerial and policy implications*. MNCs should have an interest in understanding their impact on local companies for two reasons: first, to maintain their competitive advantage, they might aim to control possible spillover effects to, for example, their local competitors (Görg & Greenaway 2003). Second, they might have an incentive to demonstrate the potential positive impact they have on the development of indigenous businesses to local policy makers (Meyer 2004). In addition, understanding the impact of MNEs on local companies can help policy makers design best policy practices to help their regions' economic development (e.g. Spencer 2008; Enderwick 2005; Meyer 2004).

As the purpose of the study indicates, the focus of this research is on an individual MNE and its impact on local companies. Prior studies on FDI spillovers are utilised to gain preliminary understanding on influences that foreign enterprises can have on local companies. However, according to Möller and Wilson (1995a), an economic perspective is insufficient to perceive business relations in their realistic complexity, a combination of aspects is needed. This study aims to find a new perspective on the phenomenon under scrutiny and, thus, is inherently *explorative* (cf. Kinnear & Taylor 1987). As spillovers can be considered to occur through relationships that form complex business networks, the industrial network approach (see e.g. Easton 1992) is utilised to bring new insight on studying the phenomenon. Based on network-level analysis of the changes caused by an MNE's entry, it is possible to set new propositions for further studies on the effects of MNCs' entries also at the macro level.

Thus, to acquire deep understanding on the phenomenon under investigation, *theoretical pluralism* is applied in studying an empirical case (cf. Dwyer, Dahlström & DiNovo 1995; Möller & Wilson 1995a). In other words, the approach here can be termed *multiparadigmatic research* that fits well with *the qualitative case study strategy* in the focal study (cf. Makkonen 2009; Lewis & Grimes 1999; Gioia & Pitre 1990). The empirical phenomenon is investigated through qualitative data obtained mainly from interviews. The

dissertation focuses on a single case comprising the entry of Finnish Fazer Bakeries to St. Petersburg, Russia. However, the role of the case study is not to test the developed framework, nor is the framework built solely on the empirical perceptions of the case study. Instead, the study applies an *abductive* logic of reasoning in building the framework, which was constructed in a constant dialogue between empirical findings and theoretical perspectives (cf. Andersen & Kragh 2010; Dubois & Gadde 2002). As such, the empirical context of the study is also incorporated into the research process and reporting. Thus, *contextualisation* plays and important role in the focal research (cf. e.g. Poulis, Poulis & Plakoyiannaki 2013; Welch, Piekkari, Plakoyiannaki & Paavilainen-Mäntymäki 2011; Rousseau & Fried 2001). The two different perspectives employed as "theoretical lenses" (cf. Lewis & Grimes 1999) and the role of context in the focal study are discussed in more detail in the next section.

1.5 Theoretical perspectives and the role of context

Corresponding to the field of IB to which it belongs, this study can also be considered interdisciplinary due to its theoretical foundations. The overall research question of "*how can a single foreign entry influence local companies in a transition economy?"* is addressed from two different theoretical perspectives: while the empirical case of a foreign entry into Russia and its effects on local companies is perceived as a potential source of FDI spillovers, following the industrial network approach, the same foreign entry is perceived as an initiator of network change affecting local firms. The positioning of the study is illustrated in Figure 2.

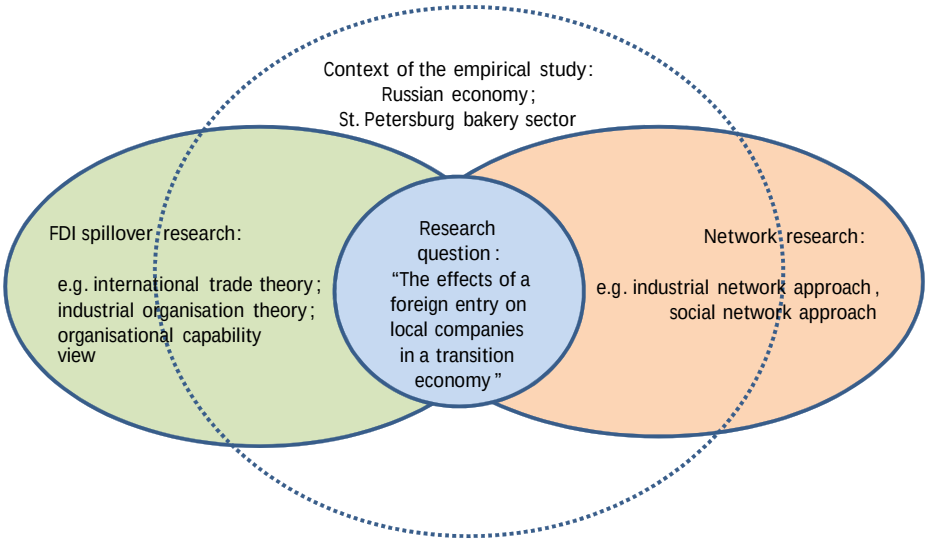

Figure 2 Research question and positioning of the study

As the above figure illustrates, the research question is studied in its context through two theoretical lenses (cf. Lewis & Grimes 1999; Gioia & Pitre 1990): through an FDI spillover perspective, the roots of which are in economics and IB research, and through the industrial network approach, originating from the field of business to business marketing.

According to Lewis and Grimes (1999), a study following a multiparadigmatic approach should begin with a multiparadigmatic review to reveal the underlying and often readily accepted assumptions of the theoretical perspectives. One of the best-known schemes for such a meta-theoretical analysis is provided by Burrell and Morgan (1988), by which theories can be effectively characterised through four sets of assumptions: concerning the nature of the phenomenon under investigation (i.e. ontology); the grounds of knowledge (i.e. epistemology); human nature; and the methodology (Möller & Wilson 1995b). Across these dimensions, Burrell and Morgan (1988) define two meta-theoretical orientations, subjectivist and objectivist[6], which, according to Möller and Wilson (ibid.), provide a valuable analytical dimension for meta-analysis. Thus, Burrell and Morgan's (1988) classification is utilised in the following sections, in which the theoretical perspectives of this dissertation are described and analysed. After that, the focus turns to the role of context in the focal study.

[6] Subjectivist orientation combines nominalist ontology, antipositivist epistemology, voluntarist human nature and ideographic methodology. The objectivist orientation assumes realist ontology, positivist or logical-empirist epistemology, determinist human nature and nomothetic methodology (Möller & Wilson 1995b; Burell & Morgan 1988).

1.5.1 Research on foreign direct investment spillovers

As, until recently, IB research has mostly looked into, instead of out from, an MNE, the debate on FDI's impact on host societies has been dominated by economists (Ghauri & Yamin 2009; Meyer 2004; cf. Singh 2007). According to Blomström (1989; also Blomström & Kokko 1997) economic theory offers two approaches for studying the effects of FDI on host countries. One approach is based on *the standard theory of international trade* and dates back to MacDougall (1960). MacDougall's model predicts that inflow of foreign capital, both as FDI and portfolio investment, will raise the marginal product of labour and reduce the marginal product of capital in the host country (Blomström & Kokko 1997). In addition, MacDougall (1960) identified other important sources of benefit to host countries resulting from FDI: local companies acquiring know-how from foreign firms and foreign competition forcing domestic firms to adopt more efficient methods.

The other approach for studying the effects of FDI on host economies departs from the *theory of industrial organisation* pioneered by Hymer (1976/1960)[7], and to which, for instance, Kindleberger (1969), Caves (1971), Buckley and Casson (1976) and Dunning (1973) contributed. According to this approach, to be able to invest abroad, a firm must possess some asset that can be employed profitably in the foreign affiliate. Thus, firms investing abroad represent a distinctive kind of enterprise, the characteristics of which are pivotal when analysing the impact of FDI on host countries. Consequently, entry of an MNE represents something more than only import of capital into a host economy. (Blomström & Kokko 1997.)

Although not mutually exclusive, the traditional trade theory and industrial organisation approaches vary in emphasising different aspects of capital movements: while trade theorists have mostly been interested in the direct effects of foreign investment on factor rewards, employment and capital flows, those following the industrial organisation approach have put more emphasis on the indirect effects (i.e. spillovers) resulting from FDI (Blomström 1989; Blomström & Kokko 1997). As the focus of this study is on the impact of FDI on local companies, previous research following the industrial organisation approach is more relevant in building the analytical framework. However, the approach has weaknesses, especially in theoretical analysis, as the empirical school has predominated in studies on costs and benefits from FDI and no clear theory on FDI spillover effects exists (Fan 2002; Blomström 1989).

In addition to the two approaches of economic theory, Forsgren (2008) suggests in his analysis of different theories on the multinational firm, that the

[7] Hymer's dissertation from 1960 was first published as a book in 1976.

organisational capability view including *the evolutionary theory of the multinational corporation*[8] (see e.g. Kogut & Zander 1993; Cantwell 1989; 1991) offers yet another perspective on the role of MNEs in host societies. This approach perceives the multinational firm as a repository of knowledge embedded in individuals. Therefore, direct investment made by multinational firms, for instance, in developing countries, is considered to benefit the recipient countries because they acquire knowledge as a result of the investments. (Forsgren 2008.)

Whereas empirical research on spillovers has been dominated by economists who have mostly applied the industrial organisation approach to their studies, knowledge-based and organisational capability views to spillovers have recently been employed by IB scholars (e.g. Spencer 2008; Singh 2007; Cantwell & Piscitello 2005). Nevertheless, often in these studies the focus has been on knowledge spillovers to an MNE and not from it to domestic firms (e.g. Mariotti, Piscitello & Elia 2010; Cantwell & Piscitello 2005; cf. Singh 2007; Meyer 2004). However, the conceptual study by Spencer (2008) applies the perspective of firm as a repository of knowledge on spillovers from MNEs to indigenous companies and Singh (2007) utilises the knowledge-based view together with the transaction cost approach (see e.g. Williamson 1975; 1979; 1981; Rugman 1980) to study simultaneously both knowledge inflows and outflows from MNCs. Also, in their recent study, Hallin and Holmström Lind (2012) investigated knowledge spillovers from MNC subsidiaries to local host country firms.

Irrespective of the applied approach, empirical studies on FDI spillovers seem to rely "on the objective and deterministic world view of economics" (cf. Möller & Wilson 1995b, 599). Spillover studies are conducted through nomothetic methodology emphasising systematic protocol and technique focusing on the process of testing hypotheses (cf. Burrell & Morgan 1988). In these studies, spillovers are conventionally measured by employing industry-level panel data or data on patent citations (Hallin & Holmström Lind 2012; Singh 2007). Within these models, the world is treated as an external and objective reality (cf. Burrell & Morgan 1988).

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[8] In the 1990s, several researchers analysed the essence of firm-specific advantages under different labels; for example, knowledge-based view, organisation capability view, dynamic capability view and evolutionary theory of the multinational firm. These approaches vary in emphasising different aspects but also have common characteristics: first, the advantage is linked explicitly to the individual firm; second, the symbiotic relationship between creation and exploitation of an asset is stressed; third, a more sociological perspective of firms is applied; fourth, firm-specific knowledge can be spread throughout the organisation; fifth, crucial knowledge is perceived primarily as capability; and sixth, the behaviour of a firm should be understood also as a need to create, preserve and extend competitive advantage. Thus, value creation is a key term common to them all. (Forsgren 2008.)

However, more recently, some researchers (e.g. Hallin & Holmström Lind 2012; Javorcik 2007) have studied spillover effects of MNCs on local firms based on perceptual data collected by company surveys. Indeed, some trends within the knowledge-based view maintain a less positivist perception of knowledge and adopt a more pluralistic epistemology, redolent of social constructivism (Acedo, Barroso & Galan 2006). As such, these trends can be considered to serve as a bridge to the other theoretical lens of this study, the network approach. Indeed, the study by Hallin and Holmström Lind (2012) showed that the degree of spillovers was connected to subsidiary embeddedness in the local network. Thus, they claim that the industrial network perspective offers "a useful tool for future research on how interfirm linkages provide potential spillovers for host country firms" (Hallin & Holmström 2012, 176).

1.5.2 Industrial network approach

Over recent decades, various network perspectives[9] have become popular in business research (see e.g. Järvensivu & Möller 2009; Slotte-Kock 2009; Araujo & Easton 1996). Various types of network research have developed in different contexts and on different continents, but many of the various perspectives have several common interests pertaining to, for instance, network processes, dynamics and network management (Slotte-Kock 2009). However, it is considered that the various network ideas are remarkably poorly networked among themselves, with very little dialogue between different traditions of network thinking (e.g. Slotte-Kock 2009; Knox, Savage & Harvey 2006). However, as pointed out by Araujo and Easton (1996), there is a degree of cross-referencing among researchers within different network approaches; for instance, Hoholm and Olsen (2012) and Mattsson (2003) have combined actor-network theory with the industrial network approach, and Slotte-Kock (2009) integrated three different network perspectives in her dissertation: the industrial (i.e. business) network approach, the social network approach and the network approach within entrepreneurship. Nevertheless, network research remains a disunited field of study.

[9] For instance, Araujo and Easton (1996) distinguish between ten different perspectives on networks in socioeconomic systems: social networks research, actor-network theory, inter-organisation theory, networks of innovators, network organisations, policy networks, networks in economic geography, comparative network studies, entrepreneurship studies and industrial networks research, whereas, in their study concerning network management, Järvensivu and Möller (2009) mention five different fields of network research: industrial and business networks, strategic networks, innovation and development networks, health care networks and public policy networks.

From the different network perspectives, the industrial network approach (e.g. Johanson & Mattsson 1987; Håkansson 1989; Håkansson & Snehota 1989; Easton 1992) was chosen for the other theoretical lens of this study, although some authors following, for instance, the social network approach (e.g. Granovetter 1973; 1985; 1992; Uzzi & Gillespie 2002; Rooks, Raub, Selten & Tazelaar 2000) are also employed as references. However, whereas the social network approach is mostly interested in individuals and their social contacts (Slotte-Kock 2009), the industrial network approach focuses on networks of inter-organisational relationships (Slotte-Kock 2009; Halinen, Salmi & Havila 1999) and, as such, offers a more suitable perspective with which to study the effects of foreign entry on local companies (cf. Hallin & Holmström Lind 2012).

The roots of the industrial network approach lie in research conducted by the IMP (Industrial Marketing and Purchasing) Group. The IMP Group demonstrated the existence of stable long-term buyer-seller relationships and the richness and diversity of their characteristics (see e.g. Ford 2004; Easton 1992). More recently, the focus of the IMP Group has moved from research on dyadic relationships to studying triads and larger networks of interdependent relationships (see e.g. Hadjikhani & Thilenius 2009; Ford 2004; Havila, Johanson & Thilenius 2004; Easton 1992). The network approach has been widely employed in business research in Northern Europe, especially in the Nordic countries, in a variety of contexts and by a large number of researchers in various disciplines. The network approach has been employed in studies on various aspects of marketing and technological development such as product development, market entry, competition, and decision-making, and also in other areas; for example, management, purchasing, regional development and FDIs (see e.g. Ford 2004; Axelsson 1992).

Rather than being a strictly defined theory, the industrial network approach offers a way to view markets and the interconnected (business) relationships within them. Whereas Håkansson (1989, 16) defined an industrial network as comprising “companies that are linked together by the fact that they either produce or use complementary or competitive products”, a broader perspective that industrial networks also contain other types of relationship (i.e. political) has since been suggested (e.g. Easton & Araujo 1992; Welch & Wilkinson 2004; see Hadjikhani & Thilenius 2009).

According to Möller (1994; also Möller & Wilson 1995b), the theoretical basis of the industrial network approach lies primarily in the inter-organisational resource dependence theory (e.g. Pfeffer & Salancik 1978), systems theory (e.g. von Bertalanffy 1973; Churchman 1968) and the theory of social structure and exchange (e.g. Homans 1958; Thibaut & Kelley 1959). These theories represent diverse lines of research originating mainly from sociology,

social anthropology and organisation research; however, some concepts relating to interpretive sociology, such as hermeneutics, have also been influential (Tikkanen 1997). Whereas background theories for the industrial network approach can be classified as objectivistically oriented and, thus, they especially utilise hypothetical-deductive methodology, the orientation of the industrial network approach itself is more subjectivistic; the approach has developed towards accepting a voluntarist nature of an actor and a more relativistic world view. Consequently, studies following the network approach often apply ideographic methodology and various forms of case studies have been the most commonly employed method (Easton 2010; Halinen & Törnroos 2005; Möller & Wilson 1995b). The case study strategy is also applied in this empirical research.

An important element of the industrial network approach is its emphasis on contextuality and time. Particular events and relationships cannot be understood without knowledge on their context (Halinen, Medlin & Törnroos 2012; Halinen & Törnroos 2005; Möller & Wilson 1995b). Thus, understanding the context of the empirical research, the Russian transition economy in the late 1990s and beginning of the 21st century, plays an important role in this study.

1.5.3 The role of context in the study

In addition to network research being inherently context specific (e.g. Halinen & Törnroos 2005), the need for contextualisation has recently been emphasised also in connection to IB research in general (e.g. Poulis et al. 2013; Welch et al. 2011). Indeed, cross-country differences in institutional environments and cultural assumptions need to be taken into account when making methodological choices and, consequently, in theorisation (Poulis et al. 2013; Whetten 2009; Rousseau & Fried 2001). Thus, especially, there is a need to develop context-sensitive theories in the field of IB (Welch et al. 2011).

As a Central and Eastern European (CEE) transition economy, Russia forms the empirical context of the study. Although macro-level transition has been officially completed in most of transition economies including Russia, which was recognised as a market economy by the European Union and the U.S. in 2002 (Karhunen 2007), the special characteristics of the Russian economic transition are of importance to this study. This is because the empirical case study covers a time span of approximately ten years from 1997, when the case company, Fazer Bakeries, entered the Russian market by an acquisition. Hence, in the first few years of Fazer Bakeries' operations in Russia, the country was still in the process of economic transition. Furthermore, Mattsson and Salmi (2013, 191) argue that "the Russian transformation into a market

economy is not fully accomplished and important changes in management and business are still occurring". Thus, the special characteristics of Russia as a transition economy need to be taken into account in the focal study.

CEE transition economies have been considered special cases, even among emerging economies, due to their radical switch from central planning to market competition and the high degree of industrialisation (Marinova & Marinov 2011; Meyer & Peng 2005; Svejnar 2002). Indeed, it has been argued (e.g. Meyer & Peng 2005; Marinova 2001; Törnroos & Nieminen 1999b) that the theories and concepts applicable to Western economies might require considerable modification in the context of European transition economies. In the context of CEE, theory development has often combined various theoretical perspectives; for instance by incorporating institutions and radical environmental change into other extant theories (Karhunen 2007; Meyer & Peng 2005).

According to Tretyak (2013), there is a need for "more fine-grained theories that help understand how firms in networks adapt to an emergent environment" (cf. Sheng, Zhou & Li 2011). Developing such theories in the context of Russia is especially justifiable; In comparison with other major emerging economies such as China and India, Russia has seldom been included in international research concerning business relationships (cf. Tretyak 2013), although many such scholarly works have been published in Russian (e.g. Radaev 2009; Tretyak & Rumyantseva 2006). Similarly, FDI spillovers have often been studied in the context of China, whereas international scientific publications on FDI spillovers in Russia are rare.

Thus, the focal study increases knowledge on the effects of FDI on local firms, business relationships and networks in the context of Russia. The empirical context is incorporated in theory development and also in research reporting (cf. Rousseau & Fried 2001). The contextual theory development is discussed in more detail in chapter 2. The Russian economic transition and development, and also the development of its bakery sector, are described in section 3.1. The next section describes the process and the structure of the focal study.

1.6 Research process and structure of the thesis

Learning is the essence of all research (Dubois & Gadde 2002) and, not least, of studies for a doctoral dissertation. Whereas *what* is learned is generally considered to be the most important outcome of the research process and presented, for instance, in the form of a theoretical framework and a matching case, the question of *how* we learn is only occasionally discussed in research

reports (Dubois & Gadde 2002). In the field of IB, the style of writing research reports still seems to be influenced by positivist methodologies and, consequently, the well-established conventions of "scientific" representations of findings and process. Passive voice and dispassionate and objective rhetoric seem to be cornerstones of scientific writing through which knowledge is constituted as problem-centred, linear and straightforward. (McGaughey 2004.) Although learning occurs in the interplay between search and discovery, the combined efforts of successive steps in the learning process are rarely explicitly presented to readers (Dubois & Gadde 2002). Thus, Dubois and Gadde (2002, 560) argue "that learning in the research society as a whole would be improved if more of the processes of how we have learned were revealed to the reader".

However, in some recent academic writings, the authors have also described their research processes and personal learning (e.g. Makkonen 2009; Slotte-Kock 2009). For instance, in her dissertation, Slotte-Kock (2009) employed Van de Ven's (1992) and Van de Ven and Poole's (1995) typology of different change process theories to describe her personal development process. Some of these theories are also useable in describing the research process behind this thesis.

The life-cycle theory of change describes development as a linear and prescribed sequence of events (Van de Ven 1992; Van de Ven & Poole 1995). This is probably the theoretical expectation on the research process, one step leading to the next in a particular, planned and logical way (Slotte-Kock 2009). However, this does not describe particularly well how this study proceeded. Rather, the development process of this study is better portrayed by the teleological approach, which argues that an end-goal is obtained through a discontinuous and adaptive approach (Van de Ven 1992). Indeed, the whole process of writing the dissertation has been discontinuous as other matters, both personal and professional, have required a significant amount of time and commitment. Furthermore, this study applies an abductive approach to theory development resembling that named by Dubois and Gadde (2002) as systematic combining. As the main characteristic of the abductive approach is the constant movement between an empirical world and theoretical models, the research process is inherently more iterative than linear. In systematic combining, theoretical framework, empirical fieldwork and case analysis evolve simultaneously. The evolving framework directs the search for empirical data, and the empirical data can, in turn, necessitate further redirection of the existing theoretical framework through expansion or change to the theoretical model (Dubois & Gadde 2002). Thus, as the teleological approach suggests, this research process has inherently been emergent and creative (cf. Van de Ven & Poole 1995).

The research process also includes characteristics of Van de Ven's (1992) dialectic theory of development. The dialectic approach argues that a discontinuous sequence is driven by constant conflict or contradiction that resolves itself by a balance of power between opposing forces. As this study utilises theoretical triangulation (cf. Möller & Wilson 1995a; Denzin 1978), the research perspectives employed in the analysis of the empirical case seemed on many occasions to be in conflict with each other. This can be sensed in some "minor issues" such as the usage of particular terminology and also in such profound issues as ontological, epistemological and methodological tenets. Thus, developing a coherent piece of work was often a challenging process that had to be balanced between the two research fields' traditions employed as theoretical lenses in the study. However, hopefully the result of this study, the thesis, can also be characterised as a dialectical process "resulting in a new entity that is an original rather than the reproduction of some prior state or entity" (Van de Ven & Poole 1995, 524).

As this study is based on theoretical triangulation and an abductive, and thus iterative, research approach, the actual research process might be difficult to perceive from the structure of the report. Thus, Figure 3 illustrates both the research process and the structure of the research report. The research process began in spring 2004. The starting point of this study was the researcher's interest in the impact of foreign firms on local business development in transition economies. Thus, the first step was to conduct a literature review on the impact of FDI on host economies and local firms. This revealed some research gaps and directed the interest to actual change mechanisms and micro-level analysis. The first preliminary analytical framework was developed based on previous FDI spillover research, as illustrated by the two left upper boxes in Figure 3.

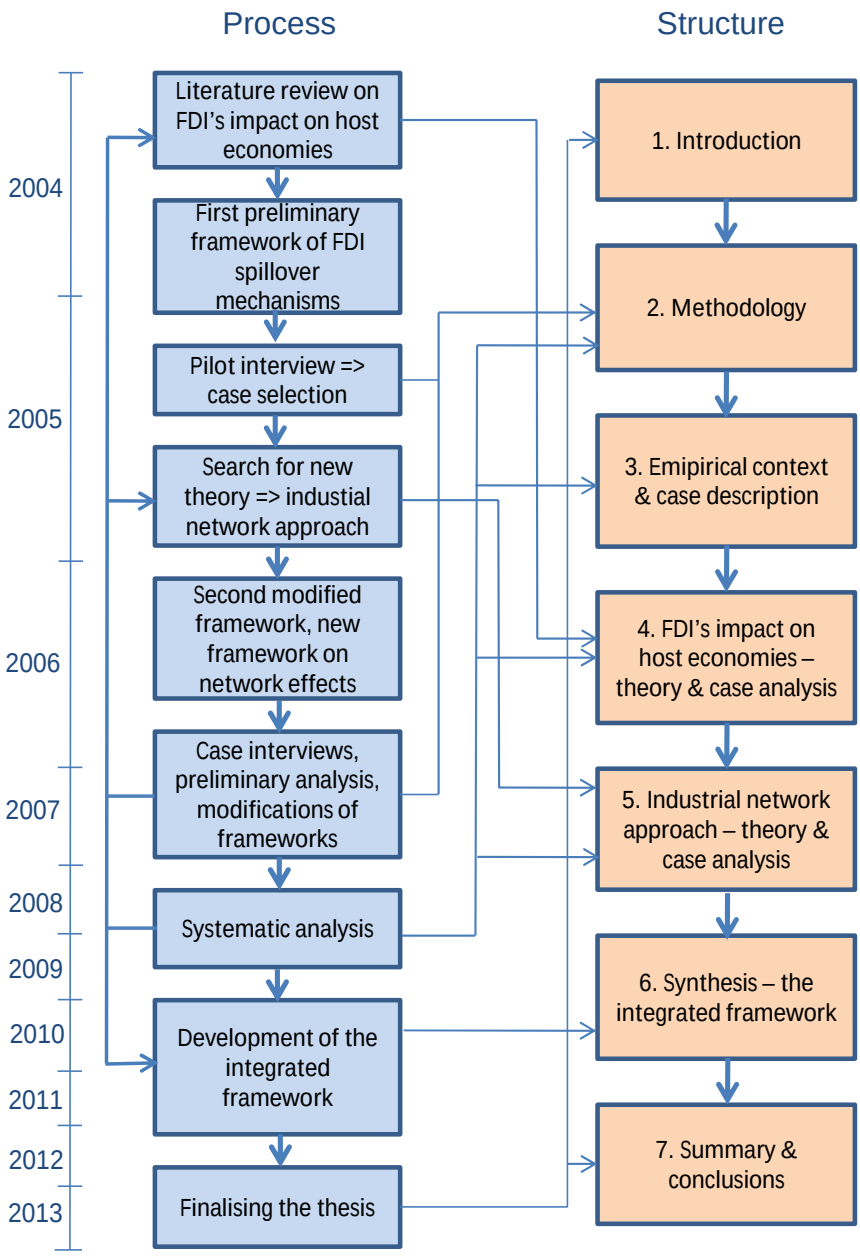

Figure 3 The process and structure of the study

After some methodological considerations, the next step was to find a suitable case for the study. A pilot interview was conducted in 2005 that led to the case selection. Empirical data gained in the interview led to a search for a new theory that could better explain some of the phenomena present in the empirical case. The concepts and ideas of the industrial network approach

were found to offer novel insight on the study, and the first preliminary framework was modified by introducing some aspects of the network theory. As a result, a preliminary conceptual framework for studying foreign entry-triggered network changes was developed.

These two frameworks directed the following case interviews that were conducted in 2006 and 2007; however, the frameworks were constantly modified over the simultaneous data collection and preliminary analysis phases. The process of returning to search for more theoretical literature both on FDI spillovers and industrial networks is illustrated by the lines and arrows connecting the respective boxes on the left in Figure 3. The search for more literature also continued during the systematic analysis of all empirical data in 2008 and 2009, and subsequently when the integrated framework was developed based on the theoretical literature and empirical observations. The first draft of the whole dissertation manuscript was completed in 2012 and slightly modified in 2013.

Following the abductive approach, the study's processes of theoretical framework development and data collection and analysis were more or less mingled, which made the structuring of the thesis somewhat problematic. Although a significant share of all current research seems to be more inductive than deductive in character, the structure of the reports are usually more in accordance with deductive approaches. First, the problem is identified and discussed in the light of relevant theory, then a proper research method is developed, empirical data collected and analysed and, finally, the results, conclusions and implications are put forward (Dubois 1994; McGaughey 2004). Writing the report following this traditional format seemed almost impossible in this study. Presenting the empirical case analysis as if based on a priori theoretical framework instead of guiding the framework development, would have led to the loss of much of the empirical case's richness. Furthermore, presenting the research in such an order might have begged the question: if a framework that explains the empirical phenomena can be developed without empirical data, what would be the role of the empirical case? Clearly, a single case cannot be employed to test a theory, nor can a theory be generalised to a larger population based on only one case. As the purpose of the study is to develop a contextually sensitive theoretical framework and not to test one, a less traditional structure for the report was adopted.

After the introduction, *chapter 2* describes the research design by discussing first the methodological choices, abductive approach and case study strategy. Next, the case selection and empirical data collection and analysis are described. Finally, the chapter concludes with an evaluation of the research.

The description of both the empirical study's context and the case itself are presented in *chapter 3*. However, the case analysis is detailed later in chapters

4 and 5. *Chapter 4* first offers theoretical discussion on the role of FDI on host countries' economic development. Then, the extant literature and research on FDI spillover effects are reviewed, also with regard to Russia and other transition countries. As a synthesis, a framework of the mechanisms of potential FDI spillovers to local companies is presented. The chapter continues by applying the developed framework on the analysis of the empirical case. As such, the report follows the logic of the research process: the phenomenon was first studied based on the preliminary framework. However, some of the findings of the empirical case could not be thoroughly described or explained by the framework and a new theory was sought to explain better the empirical phenomenon.

Thus, *chapter 5* introduces the industrial network approach, discusses the characteristics of Russian business networks and presents a framework of the impact of foreign entry on business networks. Similar to chapter 4, chapter 5 also continues by applying the framework to the analysis of the empirical case. The chapter also presents two sub-cases as examples of how foreign entry triggered network change and affected local companies.

Chapter 6 presents an integrated framework for analysing the effect of foreign entry on local firms and networks. The framework is developed as a synthesis of the two very different perspectives on the phenomenon; namely, the FDI spillover literature and industrial network approach and also the empirical findings. Finally, in *chapter 7* the study is summarised, conclusions are drawn and contributions and limitations of the study and future research avenues are discussed.

2 RESEARCH DESIGN

The research design and methodology employed in the study are described in this chapter. First, the philosophical underpinnings of the methodological choices are discussed and after that, the abductive and multiparadigmatic approach for theory building is described. Then, the strategy utilised in the case study is discussed, and the case selection as well as the collection and analysis of the empirical data are described. Finally, the trustworthiness of the study is evaluated.

2.1 Methodological choices

Methodological decisions always relate to the researcher's assumptions concerning the phenomenon itself (i.e. ontology), grounds of knowledge (i.e. epistemology) and the relationship between human beings and their environment (Burrell & Morgan 1988). Furthermore, methodological choices are guided by the aim of the study. As suggested by the overall purpose of this study, to determine *how a single foreign entry can influence local companies in a transition economy's context*, the goal is to comprehend the complexity of the phenomenon in its context.

A frequently employed classification of methodological approaches for business studies has been presented by Arbnor and Bjerke (1997). They delineate three alternative approaches for business research: the analytical approach, the systems approach and the actors approach. These approaches differ in their perspective on reality and also in their aim for knowledge creation although, as illustrated in Figure 4, they can partially overlap.

The analytical approach seeks general, time and value-free causal explanations on objective reality. It is closely related to the positivistic research tradition, thus quantitative data analysis through statistical procedures is a frequently employed method (Gammelgaard 2004; Arbnor & Bjerke 1997). At the other end of the continuum, the actors approach is based on a totally different, subjectivistic view on reality. Here, reality is perceived as a social construction created, modified and interpreted by its observers. Thus, information is perceived as relative, subjective, fragmented and ambiguous. (Arbnor & Bjerke 1997; cf. Pihlanto 1994; Burrell & Morgan 1988.) The actors approach seeks not to explain but to understand the intentions of actors

and, in so doing, primarily qualitative research methods are employed (Gammelgaard 2004).

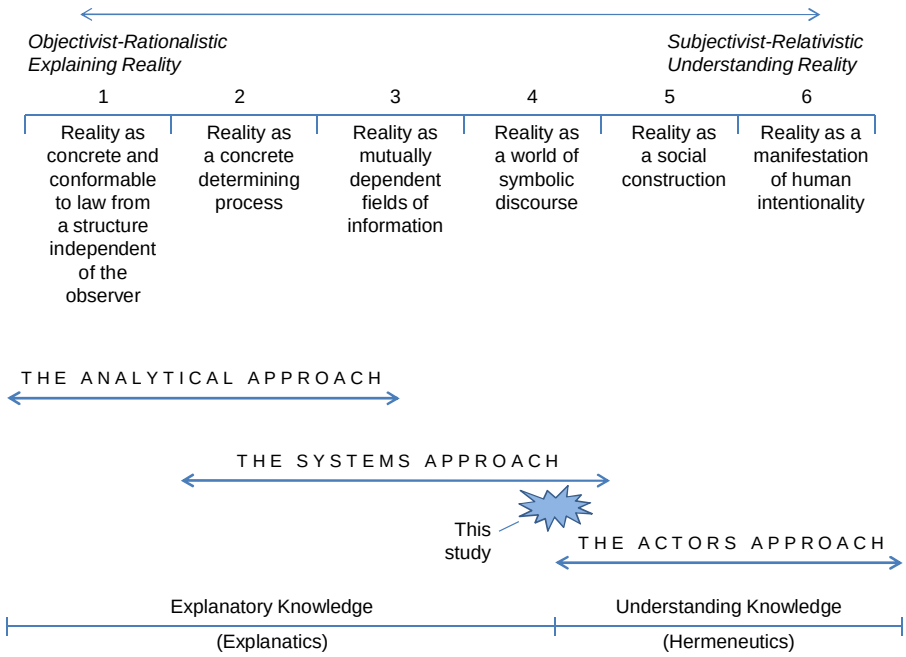

Figure 4 Positioning the study within the three methodological approaches for creating business knowledge (cf. Arbnor & Bjerke 1997, 27, 44–46)

As presented in Figure 4, the focal study can be positioned closest to *the systems approach*, which lies between the analytical and actors approach. In accordance with the analytical approach, it assumes the existence of an objective or at least objectively accessible reality (Arbnor & Bjerke 1997). However, the systems approach is based on systems theory with a holistic perspective; reality is considered to comprise components that are mutually dependent, and parts, links, goals and feedback mechanisms are important units of analysis. Thus, instead of seeking universal cause-effect relations, the systems approach is contextual and both quantitative and qualitative case studies are commonly employed. (Gammelgaard 2004.)

As presented in Figure 4, the aim of the focal study lies between explanatics and hermeneutics, even though explaining and understanding have been posited as epistemologically two different aims leading to different methodological approaches (e.g. Arbnor & Bjerke 1997; Stake 1995; Neilimo & Näsi 1980). Nevertheless, from the perspective of *critical realism* (e.g. Sayer 2000; Bhaskar 1998a), which is a relatively new orientation to ontological and

epistemological issues (Easton 2010), explanation and understanding can be reconciled (Welch et al. 2011; Sayer 2000). Indeed, *the focal study can be perceived as following the critical realist approach*.

Critical realism assumes that there is a reality independent of observers while, simultaneously, accepting that the world is also socially constructed (Welch et al. 2011; Easton 2010). This is because observations, which can be fallible, include subjective interpretations of reality (Easton 2010; Sayer 2000). However, those observations are often the only method by which reality can be studied: "Hence there is always an interpretive or hermeneutic element in social science" (Sayer 2000, 17). Nevertheless, critical realism aims to explain; however, not in the form of universal cause-effect linkages but in the form of causal mechanisms (Welch et al. 2011). "A causal explanation is one that identifies entities and the mechanisms that connect them and combine to cause events to occur" (Easton 2010, 122). However, the critical realist explanation is contextual by acknowledging that, dependent on the context (i.e. spatio-temporal conditions), the same mechanism can produce different outcomes and, conversely, the same result can be caused by different causal mechanisms (Welch et al. 2011; Sayer 2000). The critical realist view on causation is illustrated in Figure 5.

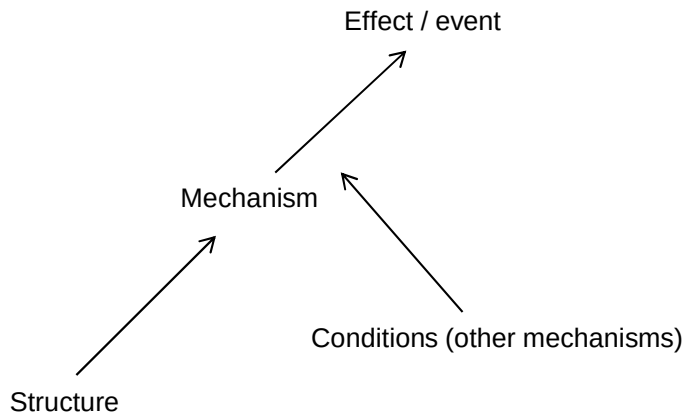

Figure 5 Critical realist view of causation (Sayer 2000, 15)

Indeed, the interest of this study lies in identifying spillover effects caused by a foreign entry and the mechanisms that connect these effects to cause changes in local firms in the Russian context. Furthermore, this study seeks to understand the conditions and other mechanisms that affect the transmission and occurrence of spillovers. Thus, the critical realist approach suits extremely well the aims of the focal study.

The focal study aims at theory development with the help of a case study. Also, in this regard, it follows the critical realist approach: critical realism is compatible with a wide range of research methods (e.g. Sayer 2000) and has been considered to suit ideally case research (Welch et al. 2011; Easton 2010). Indeed, business network case studies often seem to subscribe to a methodology based on critical realism (Järvensivu & Törnroos 2010). With regard to theory development, critical realism differs from other schools of thought by challenging the possibility of both pure induction and deduction (Welch et al. 2011; Easton 2010; Bhaskar 1998b). Instead, critical realist research often follows an abductive process (e.g. Welch et al. 2011; Easton 2010; Järvensivu & Törnroos 2010). Thus, the next section describes the abductive approach to theory development in this research. The case study strategy applied to the focal study is discussed in the subsequent section.

2.2 Abductive and multiparadigmatic approach to theory building

As they are based on two alternative cognitive styles of reasoning, deductive and inductive methods are generally perceived as the two main theories of scientific method (e.g. Haig 2005; Blaikie 1993). The former, also often termed the hypothetico-deductive method, calls for testing theories and hypotheses indirectly by deriving observational predictions from them that are amenable to direct empirical tests (Haig 2005); whereas, the inductive method refers to construction of new theories by generalising from empirical observations (e.g. Blaikie 1993). Also, theory building through qualitative empirical research is mostly classified as following either inductive or deductive reasoning (e.g. Carson, Gilmore, Perry & Grønhaug 2001; Ghauri, Grønhaug & Kristianslund 1995). However, presenting these two methods as alternative ways to develop theories is not unanimously accepted; especially, "pure" induction has been questioned (Niiniluoto 1983; Grönfors 1982) and critical realism is sceptical concerning both purely inductive and deductive process of theory development (Welch et al. 2011).

Indeed, the critical realist perspective on the process of research is essentially abductive (Welch et al. 2011; Easton 2010). Abduction was adduced by Peirce[10] as a third way of reasoning that, according to him, is the only way by which novel ideas are brought to science (Paavola & Hakkarainen 2006; Blaikie 1993). Abduction combines induction and deduction by theoretical

[10] For example, C.S. Peirce (2001): Johdatus tieteen logiikkaan ja muita kirjoituksia. [Introduction to the logic of science and other writings]. A collection of articles first published between 1868-1910. Selected and translated into Finnish by Markus Lång.

thinking (Niiniluoto 1983). It refers to 'backward' inference as it involves the creation of a hypothesis to explain what has been observed; often, some unexpected or interfering phenomenon (Welch et al. 2011; Easton 2010). Thus, it is closely connected to finding a new way to perceive particular issues that have been previously detected (Paavola & Hakkarainen 2006; Blaikie 1993).

According to Paavola and Hakkarainen (2006), abductive strategy guides to search for phenomena that seem unexplained or poorly understood, either by the whole research community or by an individual researcher him/herself. This corresponds to the starting point of this study: the phenomenon of FDI spillovers had been previously studied but there seemed to be a gap in understanding how they occur in the real world. Thus, it seemed quite natural or even the only option to follow an abductive approach to the research. Abduction takes into account the possibility that a researcher's interest might suddenly be drawn to things that are assumed important. A new lead might appear somewhere in empirical perceptions, the theoretical literature or intuitively and guide the research further towards new theories (Grönfors 1982). Unlike induction, abduction accepts extant theory. However, it also allows for a less theory-driven research process than deduction and, thus, enables data-driven theory generation. (Järvensivu &Törnroos 2010.)

In this study, the theoretical framework is built abductively incorporating previous knowledge on foreign direct investment (FDI) spillovers and business networks with the empirical data of the case research. Thus, in this respect, the focal study can be considered to aim at theory development and not at theory generation (cf. Dubois & Gadde 2002). According to Dubois and Gadde (2002), theory generation refers to inventing new theories through an inductive process, whereas theory development builds more on refinement of extant theories. Hence, in this study, extant theories were utilised as bases for the theory-building process, even though the presence of a preliminary theoretical framework is considered to inevitably mean that some issues are disregarded while others arise (Miles & Huberman 1994). However, creating a preliminary theoretical framework for this study was considered useful for several reasons.

First, while there are only a few previous studies on the mechanisms of FDI's external effects on local business development, there are many studies that suggest several possible channels for FDI spillovers. Thus, incorporating existing work into the basis of this study seemed reasonable (cf. Miles & Huberman 1994). Second, it is particularly difficult to study change over time without a theoretical framework (Halinen 1994). A framework helps to focus the analysis, to recognise links between content and context and also to explain the unfolding temporal processes of change (Dawson 1997; Halinen 1994; Pettigrew 1990; Van de Ven & Huber 1990). Furthermore, according to

Lukka and Kasanen (1995), a priori theoretical knowledge on the subject area and prior empirical results are preconditions for the generalisability of results of case studies to broader contexts (see also Yin 1984). Halinen (1994, 32), sharing the viewpoint of Miles and Huberman (1994), even argues "that better science happens with an explicit framework rather than by pretending some kind of inductive purity". However, it is often suggested that a priori framework guiding the empirical investigation should be left open for ideas and modifications emerging from the empirical data (e.g. Carson et al. 2001; Halinen 1994).

According to Weick (1989), theory building proceeds through either interpolation or extrapolation. Interpolation means that concepts and partial explanations are gradually deepened, building on broad outlines of theory that can be refined and complemented as research progresses. Conversely, extrapolation refers to a process by which concepts and theories are developed and modified by their subjection to alternative theoretical perspectives that have different explanatory abilities. (Andersen & Kragh 2010.) Building on the differences between interpolation and extrapolation in employing theories, Andersen and Kragh (2010) identify two approaches of theory-building case research: (1) the *in vivo* approach, where an overall theoretical framework is taken as a point of departure, but the framework is constantly modified when confronted with empirical data (cf. Dubois & Gadde 2002); (2) the *ex ante* approach suggesting that theoretical tensions and oppositions should be employed to develop theory (cf. Midgley 2010; Lewis & Grimes 1999; Poole & Van de Ven 1989). This study can be positioned somewhere between these 'ideal type' descriptions of the two perspectives (cf. Andersen & Kragh 2010) as illustrated in Figure 6.

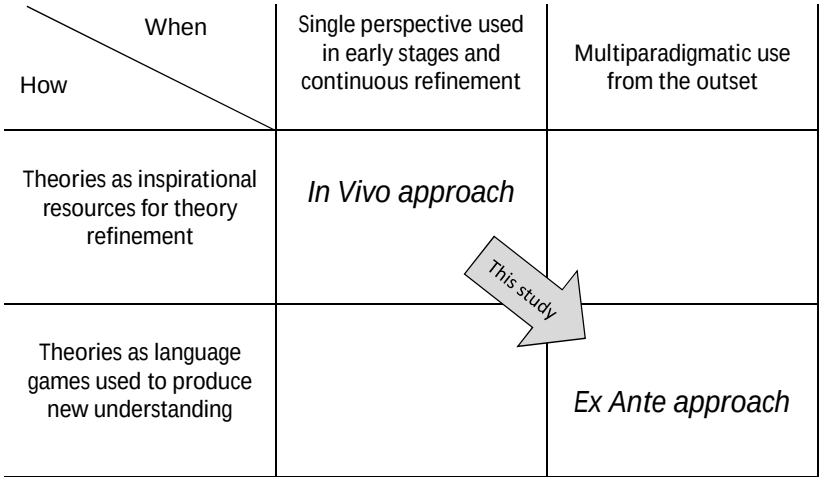

Figure 6 Positioning the focal study in relation to in vivo and ex ante approaches to employing theory (cf. Andersen & Kragh 2010, 51)

On the one hand, the approach adopted in this study resembles the in vivo approach or 'systematic combining' as termed by Dubois and Gadde (2002) (cf. Andersen & Kragh 2010). It is an abductive approach to case studies "where theoretical framework, empirical fieldwork and case analysis evolve simultaneously, and it is particularly useful for development of new theories" (Dubois & Gadde 2002, 554; see also Dubois & Gibbert 2010). In systematic combining, the empirical case is addressed with a preliminary analytical framework that comprises articulated 'preconceptions'. However, the preliminary conceptual framework is constantly modified during empirical data collection and analysis as new insights are obtained. These can lead to new concepts being added to the framework. (Dubois & Gadde 2002.)

Here too, the whole research process began with an extensive literature review on FDI spillovers. The spillover literature was the basis of building the first preliminary analytical framework. However, a subsequent pilot interview led to a search for new theory and modifications were made to the original framework. Thus, at the beginning of the research project, a single theoretical perspective was utilised as suggested by the in vivo approach. However, thereafter, this study also has characteristics of the ex ante approach.

The ex ante approach adopts the idea of a multiparadigmatic, paradoxical or dialectical approach to developing truly novel insights (Andersen & Kragh 2010). As such, it has common features of both multiparadigm research and the metaparadigm approach as defined by Lewis and Grimes (1999). The purpose of the ex ante approach is to employ divergent theoretical perspectives as vantage points for creating new insights or for challenging assumptions taken for granted within a specific research paradigm (Andersen &

Kragh 2010; Poole & Van de Ven 1989; cf. Lewis & Grimes 1999). Indeed, according to Möller (1994) a multiparadigm perspective can enhance understanding on theories and also theory building.

In this study, the network approach was added for the theoretical basis of further data collection and analysis. In many ways, spillover studies and the network approach offer diverse perspectives for studying the empirical phenomenon at hand. In this study, the perspectives of the two research fields are considered complementary, both perspectives revealing something that the other would have overlooked (cf. Poole & Van de Ven 1989). Thus, in this study, the empirical case analysis follows more the logic of the ex ante approach (cf. Andersen & Kragh 2010). First the case is analysed separately from the spillover and network approach perspectives. Later, a synthesis of these different perspectives is created. (cf. Lewis & Grimes 1999; Poole & Van de Ven 1989). The final framework of the study is based on the spillover literature, theoretical concepts and ideas of the network approach and also on the empirical findings of the case study. The case study strategy applied in this research is described in the next section.

2.3 Case study strategy in the focal study

According to Eisenhardt (1989), a case study is a research strategy that focuses on understanding the dynamics present within a single setting. In a recent review on international business (IB) studies, case study strategy was found to be the most popular qualitative research approach (Piekkari, Welch & Paavilainen 2009). Indeed, case studies can be employed to achieve various aims; for example, to provide description, to test theory or to generate theory (Eisenhardt 1989; cf. Bonoma 1985). As the focal study takes a new perspective on the studied phenomenon and aims at theory development, the case study strategy was considered the most suitable approach. Indeed, the case study strategy is considered especially useful "when the area of research is relatively less known, and the researcher is engaged in theory-building research" (Ghauri 2004, 109). However, this does not suggest that case study should be perceived as a tool solely for inductive theory building. Instead, case research can be employed also for generating causal explanations and contextualising theory (Welch et al. 2011) and, as such, can be considered to suit particularly well the critical realist approach (Easton 2010). According to the typology of theorising from case studies (see Figure 7) constructed by Welch et al. (2011) the critical realist case study can be termed *contextualised explanation.*

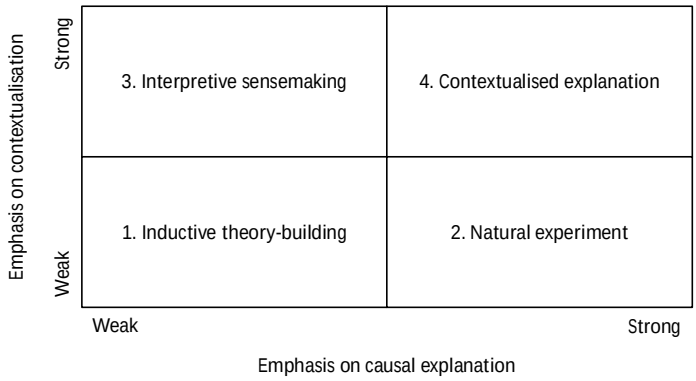

Figure 7 Four methods of theorising from case studies (Welch et al. 2011)

Indeed, of the four methods of theorising from case studies shown in Figure 7, this study follows the contextualised explanation[11] approach. As the philosophical foundation of contextualised explanation lies in critical realism, theorisation follows an abductive approach (Welch et al. 2011). Case studies following the contextualised explanation method "are concerned with accounting for why and how events are produced" (Welch et al. 2011, 749). Thus, a case study strategy following the contextualised explanation approach is consistent with the purpose and philosophical orientation of this study.

The case in this research is the entry of a foreign company to a transition economy's market and its effects on local firms and business networks. As business networks are characterised with different forms of embeddedness (e.g. Halinen & Törnroos 1998) and network studies are always bound and limited to the specific context and situation, the case study strategy has been stated as the most suitable for studying business networks (Halinen & Törnroos 2005; cf. Piekkari, Plakoyiannaki & Welch 2010). Furthermore, according to Easton (2010), a critical realist case approach is especially suitable for studying such complex phenomena as inter-organisational relationships and networks.

However, the case method also includes various challenges for network research. In line with Easton (1995), Halinen and Törnroos (2005) distinguish four major challenges of case research aiming at theory development: the

[11] As theorisation is often understood as generalising away from context, "explaining" and "contextualising" might seem to be fundamentally opposed. However, according to the critical realist view, explanation "needs to account for the spatio-temporal context in which causal mechanisms operate" (Welch et al. 2011, 748). Hence, critical realism offers a way to reconcile explanation and understanding. In this study, the term "contextual explanation" is employed as described by Welch et al. (2011).

problem of network boundaries; the problem of complexity; the problem of time; and the problem of case comparison. The first two challenges, network boundaries and complexity, both refer partly to the same problem; networks are difficult to define. The network setting extends without limits through connected relationships making network boundaries arbitrary and causing difficulties in separating content and context. Thus, it is never possible to study an entire industrial network (Easton 1995). Networks are complex in structure, as they comprise several actors with various direct and indirect connecting links. The complexity and embeddedness makes it difficult to describe all actors and the characteristics of every link between the actors. (Halinen & Törnroos 2005.) The challenge of network boundaries and complexity was also present in this study. Although, to a large extent, the study applies *a focal actor perspective* (see Halinen & Törnroos 2005), no definite limits to the scope of the research subject were set beforehand. Instead, as suggested by the explorative nature and the abductive approach of the study, the network boundaries were allowed to expand over the course of the study (cf. Dubois & Araujo 2004; Dubois & Gadde 2002).

Networks are dynamic and constantly changing, which poses a challenge of incorporating the concept of time into the research (Halinen et al. 2012; Halinen & Törnroos 2005). Case research on business networks is *process research* in its character (Halinen & Törnroos 2005), as is the critical realist case research in general (cf. Welch et al. 2011). Process research investigates a sequence of events or activities describing how things change over time and why they change in that way (Halinen et al. 2012; Langley 1999; Van de Ven 1992). Thus, the focal study can be characterised as processual case study research. Pettigrew (1997, 338) defines a process as "a sequence of individual and collective events, actions, and activities unfolding over time in context". However, the task of a researcher is not only to describe sequences but also to identify patterns (Langley 1999; Pettigrew 1992) and the underlying mechanisms that shape these patterns (Pettigrew 1997). The search is for holistic explanations, where causation is neither linear nor singular. Instead, it is often a combination of conditions that produces change. (Pettigrew 1990; 1997; cf. Sayer 2000.) Thus, the search is for multiple intersecting conditions linking features of process and its context to particular outcomes (Pettigrew 1997; Ragin 1987; cf. Sayer 2000). As processes of change are always embedded in particular contexts and can only be studied as such, process research and also network research often include multi-level elements (Blazejewski 2011; Pettigrew, Woodman & Cameron 2001; Langley 1999). Indeed, the different levels of context in the focal study introduce issues to the analysis relating to changes within an organisation, links between firm-level behaviour, changes within industrial sectors and, to some extent, also the effects of macro-

economic conditions; thus, micro, meso and macro phenomena (cf. Blazejewski 2011; Pettigrew et al. 2001).

As the focus of this study is on the effects of an FDI and processes of network change, it is inherently *longitudinal*[12] (cf. Blazejewski 2011; Jones & Khanna 2006). Longitudinal research can be based on either real-time or retrospective data (e.g. Blazejewski 2011). However, as the aim of the contextualised explanation is in reconstructing causal chains of events, a historical approach is suggested (Welch et al. 2011). Hence, this study relies mostly on *retrospective* data. However, as the study examines a ten year period beginning in 1997, some real-time data from the last years of the period were also available (cf. Blazejewski 2011; Langley 1999). Thus, the case time in this research is the period between 1997 and 2007, while the research time (i.e. time spent in the field for gathering case study data) spans 2005–2007 (cf. Blazejewski 2011).

By producing longitudinal contextual accounts of the past, retrospective research is able to identify and analyse continuities and changes, patterns and trends of events that, together with their context, create understanding on how events actually developed (Halinen & Törnroos 1995; cf. Soulsby & Clark 2011). The idea is not to identify exactly when something happened but to reveal what else happened at the same time, before or after, to show how events appeared and developed. The emphasis is thus on building interpretation from a contextual ground (Halinen & Törnroos 1995; Gillette 1985). As reconstructing histories depends on the researcher's personal judgments and interpretations, it is necessarily subjective (Kalela 1972). Retrospective studies also face many challenges in data acquisition and collection that can influence the trustworthiness of the research (Blazejewski 2011; Halinen & Törnroos 2005; Leonard-Barton 1990; Simmons 1985). These are discussed in chapter 2.6.

In case research, the primary distinction is typically made between single and multiple-case designs (e.g. Yin 1984). This study applies *a single-case design*, although it is often argued that a multiple-case study with case comparisons provides a better basis for theory building (e.g. Perry 1998; Miles & Huberman 1994; Eisenhardt 1989). However, comparison of cases in network research is problematic; due to context specificity and historical backgrounds, each network case is unique and therefore difficult to compare with others (Halinen & Törnroos 2005). Indeed, Dubois and Gadde (2002, 557) disagree with the claim that multiple cases provide better explanations

[12] Longitudinal research can be defined as "techniques, methodologies and activities which permit the observation, description and/or classification of organizational phenomena in such a way that processes can be identified and empirically documented" (Kimberly 1976, 329; also Miller & Friesen 1982, 1013-1014).

than a single-case design and state "that such attitudes are relics of the times when situation specificity was considered a weakness". Furthermore, according to Easton (1998, 82), case researchers often "seek to do a number of case studies as if greater numbers, by and of themselves, increased the explanatory power of what they have been doing". This sort of 'quasi-deduction' has been identified as an associated pitfall in multiple-case designs (Dubois & Araujo 2007; Easton 1998). Easton (1998, 83) also points out that "researching greater number of cases, with the same resources, means more breadth but less depth". Indeed, multiple-case research has been accused of providing rather 'thin' descriptions and, possibly, a distorted picture of the underlying dynamics of a case (Dyer & Wilkins 1991, cf. Piekkari et al. 2009). A single-case design was considered favourable for this study aiming at theory development, due to its ability to take into account the specific context and, thus, to provide more contextual insight (cf. Piekkari et al. 2009; Dyer & Wilkins 1991).

In addition, according to Yin (1984), a single case can, under particular circumstances (e.g. as a critical, unique or revelatory case), represent a significant contribution to knowledge and theory building. Similarly, Ghauri (2004) contends that, on many occasions, one case is sufficient, depending on the research problem and objectives. When the research problem is directed to analysis of several interdependent variables in complex structures, it is better to go deeper into one case instead of increasing the amount of cases (Dubois & Gadde 2002). It must be borne in mind that generalisation in qualitative research is always analytical, not statistical (Yin 1984). In this sense, one case can be sufficient to generalise, not to any population but to theoretical propositions (Easton 1998; see also Yin 1984). Furthermore, according to Järvensivu and Törnroos (2010, 104) "neither single nor multiple-case studies should be evaluated in terms of the generalisability of the resulting knowledge (i.e. universality of the theory) but rather in terms of whether the results contribute to contextual insight". Indeed, following a critical realist case study approach, this study aims for contextual explanation and not to create a universal law-like theory (cf. Welch et al. 2011). Thus, a single-case design was considered to serve well the purpose of this study. Furthermore, as suggested by Siggelkow (2007), this study focuses on conceptual contribution and employs the case as an additional, but not sole, justification for the theoretical arguments.

According to Yin (1984), there are two variations of single-case design: *holistic* and *embedded* case study. This study began as a holistic single-case study as no logical sub-units could be identified prior to empirical data collection (cf. Yin 1984). However, over the course of empirical data collection and analysis, two embedded sub-cases of network change were included in the case study design. These two sub-cases serve as examples presenting

sequences of network change that began in two separate dyadic relationships of the focal company in its local business network. Thus, this study also has characteristics of an embedded case study design.

Embedded design can be a useful device for focusing a case study enquiry (Yin 1984). Here, it also became evident that to deepen the network level analysis, the study needed to focus on particular sub-cases representing different sequences of network change. However, the embedded single-case design has the drawback of only focusing on the sub-units level and failing to return to the larger unit of analysis (Yin 1984). In this study, the two sub-cases serve purely as examples of different change sequences. The aim is not to compare them with each other but to describe variations among them (cf. Dubois 1994). The sub-cases provide more detailed descriptions and deeper understanding on the complexity of network change and, thus, benefit the case analysis as a whole.

2.4 Case selection and empirical data collection

In case studies aiming at theory building, case selection relies on theoretical rather than statistical sampling (Eisenhardt 1989; Glaser & Strauss 1967). Selecting the object for a case study has to be consistent with the research problem. The case has to correspond to the theoretical framework and the variables under study. (Ghauri 2004.) As the research interest in this study lies in identifying and understanding the mechanisms behind the changes caused by a foreign entry into a local business network in a transition economy, finding an appropriate research case seemed somewhat challenging. A potential case had to fulfil the following criteria:

- A Western company that had entered a transition country.
- The entry should not be too recent for possible changes to be visible, but it should be sufficiently recent for informants to remember the events.
- The entry should be to a market in which no other significant foreign direct investments have been made, so that it is possible to evaluate the effect of that particular entry on local companies.
- The foreign entrant should have created linkages with local firms and, thus, probably have affected local companies in some way.

Following these guidelines, a potentially suitable case of a Finnish company's investment into a Russian company was identified. The empirical case study began with a pilot interview in the Finnish investor company. The objective of the pilot interview was to determine whether the case corresponded with the preliminary framework and its variables and, thus, offer

a fruitful object for the study. Based on the information gained in the interview, the investor company, Fazer Bakeries, and its investment in Hlebny Dom, a bakery in St. Petersburg, Russia, was chosen as the research object of the empirical study.

The case was selected as it fulfilled the above mentioned criteria. First, it was an entry of a Western firm to a transition economy. Second, the investment was made in 1997 and, thus, as some time had elapsed, any changes it has caused were likely to be detectable. Third, there was no other foreign owned bakery in St. Petersburg, which made it easier to assess the influence of this particular investment on local companies. Fourth, an FDI in the food sector that is home market oriented can be assumed to be more embedded in its local network than, for example, a car manufacturing assembly factory; thus, it was expected to have more likely created some significant changes in the local network. Fifth, the practical aspect of gaining access also influenced selection of the case company (cf. e.g. Halinen & Törnroos 2005; Ghauri 2004).

Gaining access became a significant factor also in determining the perspective of the research. The original plan to include several local companies (i.e. customers, suppliers and competitors of Fazer Bakeries' local subsidiary) in the study had to be changed because access to many of those companies was denied. According to Michailova and Liuhto (2000) and Michailova (2004), difficulty in gaining access to companies is a common problem in conducting qualitative research in Eastern Europe. This is largely due to the fact that organisation members in former socialist countries are not at all familiar with being objects of academic research and, thus, are highly suspicious and resistant (Michailova & Liuhto 2000).

In the Russian context, personal networking plays an important role in gaining access to the field (Michailova 2004). Being a Finn, the researcher had very limited personal connection in Russia, based on which it was impossible to try to gain access. However, a Russian colleague helped with the data collection and his personal connections were employed in approaching particular companies. As Michailova (2004) points out, having to rely on personal connections can force a researcher to conduct a study in organisations that might not be the most appropriate for investigating particular research issues. This was also partially the case in this research. Nevertheless, access to 'second or even third best' companies provided the study with some valuable data or, at least, verification of particular insights acquired from other companies.

However, the general difficulties in gaining access to Russian companies directed the study to adopt predominantly *a focal company* (i.e. the investor's) *perspective* on changes following its entry into the local business network.

However, the General Director of Fazer's subsidiary in St. Petersburg was also interviewed and it has been argued (see Hallin & Holmström Lind 2012; Holm, Malmberg & Sölvell 2003) that, due to experience of conducting business in a local market and interacting with different counterparts, subsidiary managers understand well and are in a good position to assess the impact of their subsidiaries' presence and activities on local companies. Nevertheless, information obtained from local supplier and customer companies was also valuable, and its collection at least served data triangulation purposes.

In this study, *interviews* were employed as the key method of data collection. Interviewing on past events gives a researcher insight on how these events and their contexts were experienced, and the insiders' perceptions can also be employed in explaining real processes (cf. Soulsby & Clark 2011). However, retrospective interviews especially pose a challenge as interviewees are fallible due to memory loss or personal reinterpretation of past events (e.g. Soulsby & Clark 2011; Halinen & Törnroos 1995; Leonard-Barton 1990; Gillette 1985; Simmons 1985). The only way to at least partially overcome these difficulties is by triangulation of evidence, which implies usage of multiple informants and complementary written material (Halinen & Törnroos 1995; cf. Blazejewski 2011; Soulsby & Clark 2011).

Eight face-to-face interviews were conducted in total between 2005 and 2007, five in Finland in Finnish and three in Russia in Russian. In addition, one interview was conducted via email. The first interview (i.e. pilot interview) was conducted in 2005 at Fazer Bakeries to facilitate case selection. The respondent for the pilot interview was identified simply by asking the company's telephonist for a person knowledgeable on the company's Russian operations. As the pilot interview indicated that the company was indeed a suitable case for the purpose of the research, the selection of other respondents followed, to a large extent, so-called snowball sampling (e.g. Biernacki & Waldorf 1981). Thus, respondents themselves suggested other colleagues who might also be interviewed for the purpose of the study. Interviewees within the case company also gave information on other companies within their business network in St. Petersburg, which were then approached. However, some other companies were also approached based on the researcher's knowledge and the personal networks of the Russian colleague who helped with data collection. Table 2 lists the research interviews conducted for the case study and also the main characteristics of each interview.

Table 2 Research interviews and their main characteristics

Date	Interviewee	Position	Firm	Role of the firm	Place	Language	Duration
28.6.2005	Kalle Inki	Business Controller	Fazer Bakeries	Investor / parent company	Vantaa, Finland	Finnish	1 h 20 min
22.3.2006	Juha Karimaa	Director, International Projects	Fazer Bakeries	Investor / parent company	Vantaa, Finland	Finnish	1 h 30 min
6.10.2006	Max Oker-Blom	Senior Vice President, Legal Affairs and M&A	Fazer Group	Investor / parent company	Helsinki, Finland	Finnish	1 h
15.11.2006	Alexei Timchenko	General Director	Hlebny Dom (HD)	Acquired company / foreign subsidiary	St. Petersburg, Russia	Russian	2 h
15.11.2006	Milina Mikulova	Commercial Director, Fresh Food	Lenta	A retail chain / HD's major customer company	-	Russian	Email question-naire
16.11.2006	Nadezda V. Panteleeva	Marketing Director	JSC ConFlex SPb	A packaging supplier to Fazer's subsidiary in Moscow	St. Petersburg, Russia	Russian	0 h 45 min
29.1.2007	Maria Leskinen	Product Manager	Tradeka International, ZAO Renlund SPb	A retail chain / HD's minor customer company	Helsinki, Finland	Finnish	0 h 40 min
16.2.2007	Anne Mykkänen	Vice President, Sourcing	Fazer Group	Investor / parent company	Helsinki, Finland	Finnish	1 h 10 min
28.3.2007	Anatoli Kabardaev	General Director	OOO Grand-Prestige	HD's supplier of fresh and frozen berries	St. Petersburg, Russia	Russian	0 h 45 min

As the Russian respondents did not speak English, interviews in Russia were conducted together with a Russian colleague due to the researcher's limited Russian language skills[13]. A lack of common language between informants and the researcher can naturally complicate the interview situation; however, a good interpreter can be an important asset in research. As pointed out by Wilkinson and Young (2004, 212), "good interpreters become your eyes and ears. They help with translation and interpretation of both verbal and non-verbal communication and they guide in terms of cultural sensitivity issues".

Thus, having a Russian colleague interpreting also had some positive impact. First, in this study, all interviewees were able to speak their native language. This is not always the case in cross-cultural interviews in which English is often spoken although it is neither the mother tongue of the interviewer nor the interviewee. Marschan-Piekkari and Reis (2004) identify many difficulties in such cases; for instance, the interviewer might have difficulty in understanding the different accents of respondents and interviewees might feel uncomfortable speaking a foreign language in an interview situation and, thus, only give short and superficial answers.

Second, having an extra pair of eyes and ears during interviews made it possible to make more observations that, together with impressions, were discussed after the interviews. This helped to form a richer and, hopefully, a more accurate picture of each interview. Third, as previously mentioned, the Russian colleague employed his personal relationships to find and contact the Russian interviewees. Thus, he was a valuable resource both for locating appropriate interviewees at the pre-interview stage and in the post-interview stage for interpreting what had occurred during the interview (cf. Marschan-Piekkari & Reis 2004).

All interviewees were initially contacted by phone and, in most cases, they were sent by email a short project description together with interview themes prior to the interviews. All interviews were conducted in the premises of the interviewees' firms, either in their own offices or in small conference rooms. The interviews lasted from 40 minutes to two hours and, apart from one, were audio recorded and later transcribed to increase the trustworthiness of the study. With assistance from the Russian colleague, interviews conducted in Russian were transcribed directly into English.

As noted by Michailova (2004) and Michailova and Liuhto (2000), the use of tape-recorders when conducting interviews in Eastern Europe is problematic; requesting permission for its use will probably elicit a refusal and, even

[13] The researcher has a reasonably good command of the Russian language for everyday life but not the vocabulary needed for the research interviews.

when permitted, tape-recording can make respondents nervous or overly serious. This also became evident during the study. One interview in Russia was not recorded due to the interviewee's refusal; however, notes were taken during the interview. In another interview in Russia, the interviewee was clearly reserved when the tape-recorder was in operation, but relaxed and talked more freely on the research topics after the interview was formally concluded and the tape-recorder had been switched off (cf. Wilkinson & Young 2004).

In addition to face-to-face interviews, one 'interview' was conducted via email. This was because the Russian company refused to give any personal interviews apart from those given by their Public Relations (PR) staff. As personnel working in the PR department were not considered able to give any information relevant to the study, interviewing them would not have been productive. Eventually, a person from the PR department agreed to pass on the questions via email to the person with whom an interview had originally been requested.

Due to the explorative nature of this study, it was essential to allow new issues and ideas to emerge during the interviews. This suggested the use of *semi-structured interviews* as the main data collection method. The interviews were conducted with the help of interview guides that varied depending on who was interviewed (see Appendix 2 for an example). For instance, interviews in the investor company naturally addressed partly different issues than interviews with suppliers and customers of the subsidiary. The interview guides included themes that were previously determined, although interviews did not adhere precisely to the form and order of the pre-determined questions (cf. Hirsjärvi & Hurme 1991). The themes were based on the initial framework although they were modified along the study. The interview guides were employed as checklists during the interviews to ensure that all topic areas were covered and to direct conversations so that they remained on course (cf. Daniels & Cannice 2004). Afterwards, when necessary, the interviewees were also asked additional and clarifying questions.

According to Yin (1984), the strength of case study data collection is in providing the opportunity to employ multiple sources of evidence. The major advantage of employing multiple sources of evidence lies in the process of triangulation (see Denzin 1978). The findings and conclusions are more convincing and accurate if they are based on several different sources of information (Yin 1984). The different sources of information utilised in data triangulation in this study are illustrated and briefly characterised in Figure 8.

In addition to interviews, several types of secondary written material and also, to a small extent, observation, were employed in the study (see Appendix 3). According to Pettigrew (1990), the aim of data triangulation is to draw on

the particular and different strengths of various data collection methods. Whereas interviews can provide depth and personal feeling, secondary sources can provide factual information and observation might indicate discrepancies between what is said in interview situations and what is actually occurring within the organisation (also Eriksson & Kovalainen 2008).

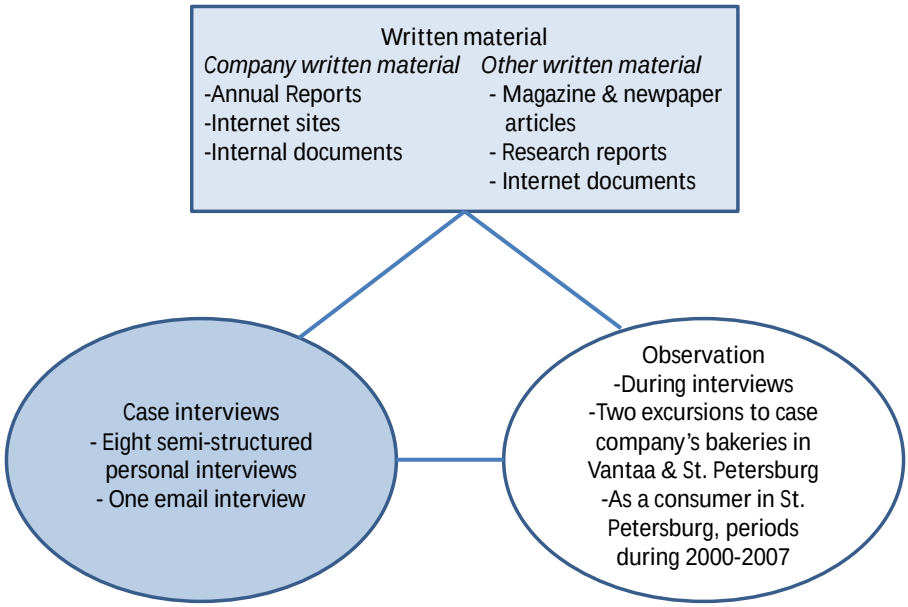

Figure 8 Data triangulation in the study

In this study, secondary written documents were utilised both in preparing for the interviews and in complementing the information gained from them. The secondary material employed in the study can be roughly divided into two categories. The first category comprises the case companies' own documentation including Annual Reports, Internet sites, press releases, and also some internal documents concerning the suppliers of the case company's Russian operations. Although company documentation was valuable for the study, limitations of its usage are acknowledged. The company documents were treated as context-specific with the notion that they might be subjective and not necessarily accurate records of events or processes (cf. Forster 1994). Thus, as suggested by Forster (1994) these documents were scrutinised carefully and triangulated with other sources of data.

The other category of secondary documents includes articles published in magazines and newspapers, Internet documents and also previous research reports concerning the case company. It was recognised that this material had also been produced for different purposes and, thus, was employed with

caution. Nevertheless, magazine and newspaper articles have also been rated high in authenticity due to the short time period between events and their reporting. Furthermore, reporters generally have an interest in reporting events accurately and the public nature of their sources leaves them open to corrections. (Golder 2000.)

In addition to interviews and secondary written material, observation was, to a small extent, also utilised in the study. However, observation was not planned as a data collection method in advance and, on some occasions, it could be considered a by-product of the interviews. Thus, observation was non-structured as no checklist was prepared beforehand to determine what to observe (cf. Eriksson & Kovalainen 2008). Nevertheless, the study took advantage of three different types of observational situation. First, personal interviews naturally also offered opportunities to make observations during the interviews. Thus, after the interviews, notes were written concerning the researcher's impressions on the interviewees and their openness and also the interview situations in general. Second, in connection to two interviews, the researcher was invited on excursions to the case company's two bakeries; one in Vantaa, Finland and the other in St. Petersburg, Russia. These excursions provided the opportunity to make observations on the two production facilities and also compare them to each other. Third, the researcher was able to observe the St. Petersburg bread market from the perspective of a consumer prior to this study commencing and also, over its course, during her numerous visits and stays in the city. These visits were made between 2000 and 2007 and varied from short trips to a four-month stay.

Although the observation played a minor role in data collection for the study and was applied in a rather spontaneous or possibly 'unscientific' manner (cf. Hirsjärvi, Remes & Sajavaara 2001), data obtained by observation served data triangulation well. Observations and impressions were compared to data from other sources, especially from the interviews (cf. Eriksson & Kovalainen 2008), and they were utilised later in the case analysis to confirm the results. The next section describes data analysis of the case study in more detail.

2.5 Data analysis

Qualitative data analysis can be considered one of the most challenging aspects of qualitative research as, unlike quantitative analysis, it has no well formulated methods (Yin 1984; Miles 1983). Instead, it depends greatly on a researcher's own style of rigorous thinking, together with a sufficient presentation of evidence and thorough consideration of alternative interpretations

(Yin 1984). The fact that a researcher is a key instrument in qualitative data analysis poses challenges for reporting; it is not always possible to identify or describe in detail from where a specific insight originated (Langley 1999). Furthermore, especially as this study follows an abductive approach, the analysis of the data is not a separate function but runs in parallel with data collection and guides it in new directions (cf. Dubois & Gadde 2002; Stake 1995; Miles & Huberman 1994). Thus, in this study, data analysis was conducted during each step of the study. Nevertheless, a more systematic analysis was conducted after all data were collected. Thus, the description of data analysis in this section mainly concerns the more systematic later phase of analysis.

To facilitate a comprehensive analysis, all interviews were transcribed verbatim into literal form (cf. Miles & Huberman 1994). This transcription was conducted in parallel with data collection. The transcribed data were transferred to a CAQDAS[14] software program, QSR Nvivo, which was employed in the data analysis. Although the amount of data in the study was not too large to be handled without a specially designed software, utilising one was considered beneficial as it makes immediate access to data easy and code generation simple and flexible (cf. Eriksson & Kovalainen 2008). However, although CAQDAS software facilitates the management, organisation and analysis of data, it is the researcher who decides the theoretical concepts and ideas employed to frame the study (Eriksson & Kovalainen 2008; Lindsay 2004). Nevertheless, Sinkovics, Penz and Ghauri (2008) argue that employing CAQDAS helps formalise the analytical process and, thus, contributes to more reliable research findings. As suggested by Eriksson and Kovalainen (2008), the analysis in this study was based on analytical frameworks that were developed prior to the analysis.

It has been suggested (e.g. Halinen & Törnroos 1995; Van de Ven 1988) that the analysis of longitudinal qualitative data should begin by arranging it in chronological order. Thus, initially a time-line of major events in the case company and its environment was outlined. Mason, McKenney and Copeland (1997, 317) state that "the penultimate step in an historical study is to tell the story". Hence, to write the story in the form of a general case description on changes in the case company's subsidiary in St. Petersburg, the interview data were coded. However, the whole data of the study were coded two more times. First, the coding and analysis was performed following the theoretical framework based on the spillover literature and then again based on the network approach. This multiparadigmatic coding procedure, followed by writing

[14] CAQDAS is an acronym for *computer-assisted qualitative data analysis* and is employed to refer to special computer software for handling qualitative analysis (see Eriksson & Kovalainen 2008, 106).

paradigm accounts, is suggested by Lewis and Grimes (1999). Thus, the study includes three descriptions of the case: first, the general description of the case company, its entry into the Russian market and the changes it made in its local subsidiary; the second description concerns potential sources of spillover effects to local companies caused by the foreign entry; and the third describes the network embeddedness and network position of the case company and also network changes influencing local companies.

Especially in describing network changes, a strategy of temporal bracketing was employed. Temporal bracketing refers to a method of structuring descriptions of events (Langley 1999; 2010). Thus, the data were ascribed to successive periods, or phases, enabling the examination of how actions or events in one period led to changes in the context and affected actions in subsequent periods (cf. Denis, Lamothe & Langley 2001; Langley 1999). This strategy was considered to suit the purpose of the study well, as it incorporates the context into the analysis and, therefore, enables a more contextual approach. Furthermore, in temporal bracketing, the form of sensemaking is to identify mechanisms (Langley 1999), which corresponds to the aim of this study. In addition, according to Langley (2010, 920), "temporal bracketing also generates variety within a single-case study by creating embedded units of analysis, offering analytical power that may be missing in more holistic treatments". Thus, temporal bracketing was considered a useful analytical strategy also due to the single-case design utilised in the focal study (cf. Langley 1999; 2010).

The case data were linked to the theoretical perspectives of the spillover perspective and the network approach by following a pattern-matching logic (cf. Yin 1984). Thus, the a priori frameworks based on the two different research fields were separately employed in the data analysis. However, new themes arising from the empirical data were also carefully taken into account. To justify the interpretations, strengthen the chain of evidence and also to enliven the text, the case descriptions include interviewee citations in their translated form.

After writing the two separate paradigm accounts, one based on the spillover perspective and the other on the network approach, in the final phase of the research, a synthesis of these two perspectives was created and the main theoretical and empirical findings were linked to wider bodies of the literature (cf. Lewis & Grimes 1999). Thus, an overarching framework was developed as a result of the iterative process between the theoretical frameworks, empirical fieldwork and case analysis (cf. Dubois & Gadde 2002). This type of synthetic process can be termed theory development (cf. Langley 1999). However, the theory development phase is difficult to describe in detail as it involves inspiration that is driven by creativity and insight, the roots of which are often untraceable (Langley 1999; cf. Weick 1989).

2.6 Evaluation of the research

Eriksson and Kovalainen (2008) distinguish three different ways to employ evaluation and assessment criteria in qualitative research: some authors (e.g. Silverman 2001; Yin 1984) suggest adoption of the classic criteria[15] of good quality research, which originally stems from quantitative research, while others (e.g. Patton 1990; Lincoln & Guba 1985) have developed alternative but common criteria more suited to qualitative research. Nevertheless, although the terminology differs, the contents of the various criteria seem to resemble each other. The third option for evaluating qualitative research is profoundly different, as it abandons the idea of common evaluation criteria altogether. This approach is built on the argument that each research project and publication should be assessed from its own position, instead of employing any universal criteria. Especially within post-structural and cultural studies, the common evaluation criteria have been considered ill-suited to qualitative research (Eriksson & Kovalainen 2008).

However, for this particular study, the common guidelines for evaluation were considered appropriate and the evaluation criteria of Lincoln and Guba (1985) were considered to suit assessment of the focal study better than classic guidelines. These criteria have been widely employed in qualitative studies and suggest that the trustworthiness of a qualitative study should be evaluated by considering the credibility, transferability, dependability and confirmability of the research.

Credibility refers to how well the findings and interpretations, at which the researcher arrives, correspond to the multiple constructions of reality perceived by the subjects of the enquiry (Lincoln & Guba 1985). Thus, the concept of credibility is close to that of internal validity, which is widely employed in evaluation of quantitative studies (Tynjälä 1991; Lincoln & Guba 1985). However, due to different perspectives on the nature of reality, unlike validity, the concept of credibility does not refer to a correspondence of a single tangible reality as the 'truth' but aims to demonstrate a perspective (Patton 1990) or the 'truth value' by adequately representing the multiple constructions of realities (Lincoln & Guba 1985).

According to Lincoln and Guba (1985), it is not possible to understand any phenomenon without understanding the context in which it is embedded. In this case, the researcher was familiar with the context of the Russian transition economy due to her previous studies on the subject and also to her numerous

[15] The classic criteria comprise three concepts, namely reliability, validity and generalisability, that provide a basic framework for the evaluation of research in social sciences and business studies (Eriksson & Kovalainen 2008, 291).

visits and stays in the country. Thus, she had a pre-understanding on how bread was sold in St. Petersburg at the beginning of 2000 and how the bread market and retail trade had changed over the early years of the 21st century. She also aimed to increase the credibility of the study by familiarising herself with the theoretical background and by forming a preliminary framework before conducting the field study (cf. Miles & Huberman 1994). A pilot interview was conducted, based on which the theoretical background and framework were extended and the interview guide modified. Thus, the researcher tried to accumulate a sufficient pre-understanding on the phenomenon in every possible way.

In this study, limited access to network actors might pose a risk to the credibility of the research as the perspective of the investor company is emphasised. However, data were collected also from other organisations and from secondary sources and this triangulation of data improves the credibility of the findings (cf. Miles & Huberman 1994; Lincoln & Guba 1985; Denzin 1978). Furthermore, different data sources seemed to emphasise the same issues as the most important ones, suggesting that, to an extent, data saturation was achieved, although further interviews, especially in other organisations, would probably have provided more examples and detailed descriptions on the phenomenon under examination.

In addition, relying on secondary data and retrospective interviews can pose a risk to the credibility of the results (Blazejewski 2011; Halinen & Törnroos 1995; 2005; Leonard-Barton 1990; Gillette 1985; Simmons 1985). However, as suggested by Thompson (1988), trustworthiness of a retrospective study can be enhanced by assessing the internal consistency of each interview, by cross-checking the information obtained with other oral and written sources and by placing the evidence in a wider historical and theoretical context. These guidelines were followed by the researcher and triangulation of sources was employed to improve the credibility of the interpretations (cf. Miles & Huberman 1994; Lincoln & Guba 1985). In general, the interviewees seemed able to recall past events surprisingly well and their replies were mostly in line with each other. Furthermore, the large number of secondary sources (see Appendix 3) made it possible to cross-check information obtained from the interviews and also to place it in its wider context. Thus, the limitations of the retrospective approach were acknowledged and every attempt was made to increase the credibility of the empirical data analysis.

However, in addition to retrospective alteration, other possible distortions were also possibly introduced by the respondents, some of which might be intended to deceive or confuse (Huber & Power 1985; Lincoln & Guba 1985). As this research did not focus on particularly sensitive issues or business secrets and the discussions with interviewees mostly concerned past events

and not future plans, respondents had little reason to deceive or lie. Nevertheless, the interviewees from the case company might have had a motive to exaggerate the positive implications of their company's entry into Russia. However, the interviewees seemed to be modest and careful when evaluating their company's role in the Russian market, and the interviewees from other (e.g. customer) companies seemed to have a similar perception on the role of the case company's entry into the local bakery market. Thus, there is no reason to believe that any of the respondents intentionally deceived. In any event, triangulation of different oral and written sources would most probably have revealed such attempts.

Interview data can suffer also from unintended distortions when respondents, for instance, misunderstand the interview questions or want to please the investigator (Tynjälä 1991; Lincoln & Guba 1985). In this study, the researcher formulated the interview questions so that they would not include any "difficult" theoretical concepts and would enable the respondents to describe events with their own words. The researcher avoided leading questions but employed follow-up probes to ensure that the original questions were understood and the answers complete (cf. Huber & Power 1985). Furthermore, in interviews with customer companies, to avoid leading the interviewees to overestimate or exaggerate the role of the case company, the researcher did not mention that the focus of the study was the impact of Fazer Bakeries entry on the local market. Instead, the study was introduced as concentrating on the development of the St. Petersburg bakery business and the researcher did not mention the names Fazer or Hlebny Dom until they were introduced by the interviewees themselves. Thus, it seems evident that the interviewees did not mention the case company and its role in the local bakery market development to please the researcher, but because they really thought it had played a significant role in the market.

The credibility of a study increases if interviewees are motivated and trust the researcher (Huber & Power 1985; Lincoln & Guba 1985). The interviewees in the focal company and its Russian subsidiary were apparently motivated to participate in the study and to give correct answers. Many of them expressed the opinion that the study dealt with an interesting and important issue. Conversations with them felt open and at least some trust seemed to develop during discussions as the researcher was also given some confidential internal documents. Conversely, the atmosphere in interviews with the Russian supplier companies was less open and the interviewees were clearly suspicious at the beginning of the interviews (cf. Michailova & Liuhto 2000). However, as the interviews proceeded and the respondents realised that the issues discussed were not particularly sensitive, they seemed to relax and provided longer and more detailed answers to questions. Thus, the general

mistrust of Eastern European managers to outside researchers (see Michailova 2004; Michailova & Liuhto 2000) might have prevented some of the interviewees from providing all possible information. Nevertheless, due to the nature of these interviews, this did not create a significant threat to the credibility of the research. As this research adopted, to a large extent, a focal actor perspective (see Halinen & Törnroos 2005) to the studied phenomenon, these interviews served more the purpose of data triangulation and, as such, seemed to provide sufficient information.

The credibility of research can also been improved by member checks (Lincoln & Guba 1985). Informal member checks (see Lincoln & Guba 1985; cf. Miles & Huberman 1994) occurred to a small extent during the investigation; for instance, one interviewee wanted to read the transcribed interview data and, based on it, added and emphasised particular issues. Furthermore, in some interview situations, the researcher raised particular issues previously mentioned by another interviewee and asked whether the respondents shared the same perspective. Unfortunately, systematic member checks could not be conducted by all interviewees as the Russian interviewees, both in the focal company's subsidiary and its customer and supplier companies in Russia, lacked the required English language skills. Thus, they would not have been able to read and give feedback on the descriptions and analysis written in English. However, the case descriptions were sent to representatives of the focal company.

In addition to credibility, trustworthiness of a qualitative research should also be evaluated based on its *transferability*. The concept of transferability refers to the extent to which the findings of a study are applicable to other empirical or theoretical contexts and, thus, relates to the concept of external validity employed in quantitative studies. (Lincoln & Guba 1985.) However, according to Lincoln and Guba (1985) questions concerning generalisability of the results cannot be discussed in connection with qualitative studies in the same way as to quantitative studies.

The transferability of findings depends on the similarity between a studied context and the one in which the results are intended to be applied. Naturally, this cannot be evaluated alone by the researcher who only knows the studied context, but should be evaluated by those who seek to apply the findings elsewhere. (Tynjälä 1991; Lincoln & Guba 1985.) Nevertheless, to improve transferability of the findings, the researcher should provide sufficiently thick data descriptions to enable judgments on similarity (Lincoln & Guba 1985). In this study, the researcher has done her best to provide accurate and rather detailed descriptions on the empirical case and its context, which hopefully enable the reader to assess the transferability of the findings to other contexts.

The third evaluation criterion suggested by Lincoln and Guba (1985) is *dependability*, which indicates how dependent the findings of the research are on the enquiry itself. Thus, dependability can be perceived as a substitute criterion for the concept of reliability employed in quantitative studies (Miles & Huberman 1994; Tynjälä 1991; Lincoln & Guba 1985). The underlying issue concerning dependability is whether the process of the study is consistent; in other words, are the research questions clear and congruent with the design of the study (Miles & Huberman 1994)?

An abductive approach, characterised with an emerging framework and iterative research process, can create challenges for maintaining consistency and transparency of the research design (cf. Dubois & Gibbert 2010). However, the researcher has actively presented the research process and preliminary results of the study to the academic community in the form of reports and conference papers and received feedback on them. Thus, the dependability of the study has been enhanced by peer reviews (cf. Miles & Huberman 1994). However, it has been argued that as there is no credibility without dependability; demonstrating credibility is sufficient also to establish dependability (Lincoln & Guba 1985). Consequently, as the researcher has demonstrated above how credibility of the findings has been improved, it should, in turn, enhance trustworthiness of the study also by the dependability criterion.

Lincoln and Guba's (1985) fourth and last evaluation criterion, *confirmability* is a qualitative counterpart to the concept of objectivity employed in quantitative studies (see e.g. Miles & Huberman 1994; Tynjälä 1991). In qualitative field studies, there are inherent distortions caused by a researcher's selective perceptions. Thus, the way in which an event is perceived, interpreted and recorded can vary between different investigators (McKinnon 1988). Consequently, unlike objectivity, the concept of confirmability does not refer to the investigator's characteristics but emphasises the characteristics of the data (Lincoln & Guba 1985). In addition, confirmability concerns linking findings and interpretations to the data in a manner that can be understood by other researchers (Eriksson & Kovalainen 2008).

In this study, the researcher has enhanced the confirmability of the study by describing the whole research process in detail so that readers are able to evaluate how the study was conducted and conclusions drawn (cf. Miles & Huberman 1994; Tynjälä 1991; McKinnon 1988). Also, the usage of CAQDAS facilitates transparency in the process of conducting qualitative analysis and, therefore, improves confirmability of the study (Sinkovics et al. 2008). Furthermore, interview citations are included in the case descriptions to show links between the data and their analysis to the reader. The names of the interviewees are openly reported and secondary sources are carefully

documented in Appendix 3, thus making it possible for the reader to trace and check the information. Together, these actions are likely to increase the confirmability of the study.

In sum, the researcher has endeavoured to enhance the trustworthiness of this study in a number of ways. The four criteria put forward by Lincoln and Guba (1985) for evaluation of qualitative studies (i.e. credibility, transferability, dependability and confirmability) have all been discussed in this section. The researcher has transparently contemplated both strengths and weaknesses of the study and has made every attempt to decrease weaknesses over the research process.

3 DESCRIPTION OF THE EMPIRICAL CASE: FAZER BAKERIES' ENTRY INTO ST. PETERSBURG

The case in this study comprises a cross-border acquisition made by a Finnish company, Fazer Bakeries, of a local bakery, Hlebny Dom, in St. Petersburg, Russia, and the changes it has induced in the local bakery sector. The examination period in the case study spans the first ten years, 1997 to 2007, of the case company's presence in the St. Petersburg bakery market. This chapter offers descriptions on both Fazer Bakeries and Hlebny Dom and also changes caused by Fazer's entry to the acquired company and its business relations. However, before the case description, brief overviews on the development of the research contexts are given; namely, the Russian economy and bakery sector.

The case description in this chapter is mainly based on case study interviews; however, secondary sources comprising company Annual Reports, Internet pages and magazine and journal articles were also employed. The role of this chapter is to describe the case under scrutiny, whereas analysis on the broader impact of Fazer's entry into the St. Petersburg bakery market is conducted in chapters 4.3 and 5.3, after theoretical discussions.

3.1 Context of the empirical research

3.1.1 Economic transition and development in Russia

The socialist system collapsed in Europe in 1989 after economic stagnation in the 1980s and lack of democracy had caused social unrest and increasing dissatisfaction in the Eastern bloc. The first socialist country in the world, the Soviet Union, disintegrated two years later in 1991. (Tiusanen & Karhu 2009; Solanko 2006; Strayer 1998.) Thereafter, as an independent state, the Russian Federation began its reforms towards a market economy[16].

[16] The Soviet leader, Mikhail Gorbachev, had already introduced some market reforms during the late 1980s that left "the economy with neither plan nor market" (Åslund 2007, 48-49).

The process of building capitalism in the Central and Eastern European (CEE) post-socialist countries was a challenging task as such a transition from central planning to a market economy had never before occurred in the world. Thus, there were no guidelines to follow. Furthermore, due to political and social tensions, it was generally thought that major changes needed to be implemented as quickly as possible to make the transition process irreversible. (Sutela 2004; Åslund 2002; Fischer 1994; Sachs 1990.) In Russia, this led to the application of so-called "shock therapy", which was later ironically termed "shock without therapy" as it did not lead to the adoption of a market economy as rapidly as expected (Karhunen 2007).

The economic reform programme for Eastern European former socialist countries was termed the 'Washington Consensus' after the location of its main advocates, the IMF, the World Bank and their dominant owner, the US Treasury (Sutela 2004). According to the Washington Consensus and many researchers, the transition to market economy comprised four key steps (see e.g. Åslund 2007; Solanko 2006; Sutela 2004; Lavigne 1995): the first and most important step was *liberalisation* (i.e. deregulation) of prices and trade so that the market could be formed. Second, macroeconomic *stabilisation* was needed to halt hyperinflation resulting from deregulated prices and excess demand. Third, large-scale *privatisation* was required to obtain private owners and more efficient corporate governance for the nominally public (i.e. state owned) enterprises. (Åslund 2007.) In addition to these relatively well-defined first generation transition policies (i.e. liberalisation, stabilisation, privatisation) aiming to create a market economy, much more remained to be achieved. Thus, the fourth step of transition comprised second generation transition policies, often succinctly termed *structural reform* (e.g. Sutela 2004; Lavigne 1995), that addressed issues concerning the kind of market economy preferred. These included, for instance, ensuring efficiency of the market, bases for sustainable growth and building a new social safety net (Åslund 2007; Sutela 2004; Lavigne 1995).

In Russia, the implementation of transition policies began at the beginning of 1992 by price *liberalisation* (Åslund 2002; Fischer 1994). The need for liberalisation of prices was evident but challenging: under central management, prices were set by the authorities and were often employed as a social policy tool. Thus, for social reasons, prices of, for instance, baby food, medicines, energy and transportation remained controlled (Sutela 2004; Åslund 2002). In Russia, price liberalisation led only to the gradual disappearance of shortages due to the indirect state control of many commodity prices. Indeed, significant price differences emerged between state and private trade, official and informal trade and between different regions (Åslund 2002).

As with price liberalisation, the liberalisation of entrepreneurship was also rapidly implemented (Sutela 2004). In Russia, as in other transition economies, hundreds of thousands of new small enterprises emerged during the early years of transition (Åslund 2002). The most controversial liberalisation was the deregulation of foreign trade and payments (Sutela 2004). Russia liberalised its foreign trade system in the early period of transition while simultaneously introducing trade in foreign currencies at market-determined rates. This led to a dramatic decline of the rouble (RUB) exchange rate, which declined from RUB 22.0 to USD 1.0 in 1991 to an average of approximately RUB 2,200 to USD 1 in 1994 and up to RUB 5,000 to USD 1.0 in April 1995. (Tiusanen 2003.) In July 1995, Russia introduced a system of "managed floating" by which the rouble was allowed to fluctuate within a predetermined band. This system contributed to the stabilisation of prices and exchange rates. (Åslund 2002.)

However, in general, *stabilisation* of the economy was not an easy task, and the first few years of the economic transition were extremely difficult in Russia. The economy suffered from stagflation, which means a combination of economic decline and high inflation. The overall economic activity measured by gross domestic product (GDP) declined by approximately 40 percent between 1991 and 1996. (Tiusanen 2003; Roland 2000.) However, it should be borne in mind that decline of output does not give a totally accurate picture on Russia's economic deterioration. It has been argued (e.g. Åslund 2007; Roland 2000) that a substantial part of the decline was due to mismeasurement, expansion of the unregistered economy and elimination of value detraction[17].

Nevertheless, the economic output did fall in Russia, although probably not by as much as official figures suggest (Åslund 2007). The steep slump, in turn, led to accelerated inflation when officials began pumping money into the economy. In such a situation, forecasting economic conditions became virtually impossible, making solid investment decisions difficult. (Tiusanen 2003.) Thus, practically no investments were made in many industries. Furthermore, investments were financed from retained earnings as only very short-term finance, if any, was available from the banks. Companies continued the Soviet tradition of self-reliance and barter trade together with payment arrears increased (Karhunen 2007; Sutela 2004). Poverty increased as wages and pensions could not keep up with the high inflation and, over the decade, Russia turned from a relatively egalitarian country to one with income disparities as great as those in large Latin American countries. (Sutela 2004.)

[17] It has been argued that much of Soviet industry destroyed value rather than creating it. The value detraction process means that the value of the final product on the world market is less than the value of the raw material employed in its production. (Sutela 2004; Tiusanen 2003.)

At the same time, capital flight from Russia also rapidly increased (Tiusanen 2003).

Of the three key elements in the first generation transition policies, *privatisation* is the one that had the most direct impact on enterprises (Karhunen 2007). In general, the small-scale privatisation of shops and small enterprises was not problematic and occurred swiftly (Sutela 2004; Åslund 2002; World Bank 2002; Fischer 1994). The same cannot be said of large-scale privatisation concerning large state owned enterprises and monopolies. Large-scale privatisation policies differed from country to country (Sutela 2004; Åslund 2002). In Russia, large-scale privatisation was initially conducted by voucher give-aways which began in 1992. However, this first stage of privatisation by vouchers often resulted in insider ownership and continued political control. (Solanko 2006; Fabry & Zeghni 2002; World Bank 2002; Boycko, Shleifer & Vishny 1995.)

The second privatisation phase occurred through large auctions. The aim was to attract major investors into the economy and bring in much needed revenue to the budget. However, this part of the privatisation programme failed due to a lack of potential buyers and also insider resistance (Karhunen 2007; Sutela 2004). The third stage of privatisation occurred in 1996 when the government initiated a loans-for-shares scheme. The remaining state shares in major natural resource companies were pledged to private banks against credits. As the state never repaid the credits, ownership of these major companies transferred to the banks, which then sold the shares to the banks' owners (Karhunen 2007; Sutela 2004). Hence, the system contributed to the rise of oligarchs, which raised significant criticism both in Russia and abroad (Solanko 2006).

Thus, Russian large-scale privatisation resulted in many negative consequences for enterprises (Jormanainen 2010; Fabry & Zeghni 2002). Most importantly, privatisation failed to generate the technological, financial and managerial resources needed for the restructuring of enterprises (Fabry & Zeghni 2002; cf. Liuhto 1999). In addition, the restructuring of enterprises in Russia was not accelerated by foreign direct investments (FDI). On the contrary, despite the introduction of policies welcoming FDI that were expected to contribute to economic growth and development, the FDI level in Russia remained low in comparison to other transition economies (Jormanainen 2010; Yudaeva et al. 2003; Buck, Filatotchev, Nolan & Wright 2000). The Russian investment climate was perceived as extremely risky by foreign firms, which led to lower aggregate foreign capital inflow to Russia than to other transition economies during the early years of economic transition (Buck et al. 2000).

Whereas enterprise restructuring has been a considerably long process, first generation transition reforms (i.e. liberalisation, stabilisation and privatisation)

were, to large extent, conducted in Russia during the early transition, thus between 1991 and 1997. In these early years, Russia's economy declined substantially; 1997 was the first year of positive growth, albeit at only 1.4 percent. The hyperinflation[18] at the beginning of the 1990s reduced to two digit figures by 1997. However, the decrease of gross fixed investment continued into 1998, although labour productivity had started to grow again in 1995. Nevertheless, it can be stated that economic decline ended and inflation abated by the end of 1997, suggesting that the difficult period of stagflation was over. (BOFIT 2012; Tiusanen 2003.) The end of high inflation was emphasised by re-denomination of the rouble, removing three zeros from its nominal value at the beginning of 1998 (Sutela 2004).

However, the difficulties were not over as a new crisis, the rouble crisis, awaited in August 1998. The relative stability of the Russian economy led to usage of a semi-fixed exchange rate policy, according to which the central rate for the rouble was fixed at RUB 6.2 to USD 1.0, allowing for fluctuation of 15 percent. However, the system of managed floating collapsed in August 1998, when the financial crash hit Russia. This resulted in devaluation from approximately RUB 6.0 to RUB 24.0 per USD 1.0 and inflation of approximately 85 percent in 1998 (BOFIT 2012; Tiusanen 2003; Åslund 2002). Thus, Russia was in a situation of classic financial crisis comprising debt, currency and banking crises that led to the collapse of most major banks in Russia (Sutela 2004). Nevertheless, over the longer term, the crisis seemed to have positive effects. Table 3 summarises the economic development of Russia by main economic indicators during selected years between 1992 and 2007.

[18] Hyperinflation means inflation that is very high or out of control. Usually it is defined as inflation exceeding 50% per month (see e.g. Sutela 2004; Åslund 2002). However, precise definitions can vary considerably; for example, the International Accounting Standards Board describes it as a cumulative inflation rate approaching 100% over three years.

Table 3 Main Russian economic indicators, selected years during 1992–2007, annual percentage change (BOFIT 2012; IMF 2009; Tiusanen 2003; author's calculations)

	1992	1997	1998	1999	2000	2005	2007
GDP	-14.5	1.4	-5.3	6.4	10.0	6.4	8.5
Inflation	2,509.0	11.0	84.4	36.5	20.2	10.9	11.9
Gross fixed investment	-40.0	-5.0	-12.0	5.3	17.4	10.9	22.7
Productivity in industry	-16.0	1.0	-4.8	8.9	8.7	5.1	6.8
Retail trade turnover	-	4.7	-3.5	-6.3	8.8	12.8	16.1
Export	-	8.3	-13.3	6.5	60.5	33.0	16.7
Import	-	18.2	-18.4	-28.5	30.0	28.6	36.1

As indicated in Table 3, Russia's gross domestic product, which declined in the year of rouble crisis (i.e. 1998) by approximately five percent in real terms, increased after the financial crisis in 1999 and throughout the early years of the 2000s (BOFIT 2012; IMF 2009). However, it should be noted that, due to many previous years of decline, it was not until 2001 that Russian GDP, based on purchasing power parity (PPP) valuation, exceeded the GDP level of 1992[19] (IMF 2007). Inflation, which was more or less under control before the crisis in 1998, accelerated steeply after devaluation of the rouble in 1998 and reached a level of almost 85 percent (BOFIT 2012).

Devaluation was reflected also in the significant decline of imports and diminishing retail trade turnover in 1998 and 1999. However, positive consequences following the crisis began to show in 1999; gross fixed investment that had continued to decrease since the beginning of transition finally turned around and experienced an increase of 5.3 percent. However, the real economic miracle in Russia occurred in 2000, when GDP increased by ten percent. At the same time, retail trade also recovered after diminishing for two years and increased by almost nine percent. (BOFIT 2012.)

Thus, Russia experienced very rapid recovery soon after the devaluation crisis with a historical turnaround in the Russian investment scene. Indeed, the devaluation of the rouble made locally produced goods price-competitive in comparison with imported products and created an entirely new basis for profitable activities in Russian "import-substituting" industries (Karhunen 2007; Tiusanen & Jumpponen 2005). Hence, home market production

[19] When measured in constant prices, Russian GDP reached the level of 1992 as late as 2004 (IMF 2009).

increased after early 1999; food production, light industries and machinery production began to boom while imports dropped sharply (Sutela 2004).

Nevertheless, the remarkable growth of the Russian economy was also closely linked to the increase of the world oil price[20] (Oomes & Kalcheva 2007; Tiusanen & Keim 2006). However, high investment rates are also needed for long-term sustainable growth and, although investment growth was significant in 2000, low investment rates during the transition had left Russian industry with technologically and physically outdated machinery (Tiusanen & Jumpponen 2005; Tiusanen 2003).

Nevertheless, Russia experienced rather high levels of investment over the following years and development of the Russian economy was positive by most main economic indicators until 2008, when the next crisis hit the country[21]. After 2000, positive economic development was also reflected to rapid real wage growth in all sectors (Oomes & Kalcheva 2007) and, consequently, to a significant increase in retail trade turnover.

However, it should be borne in mind that there were enormous regional variations in economic growth rates in Russia during the transition; thus, even when Russian GDP grew substantially, it did not mean that all regions experienced increasing gross regional product (GRP) (Solanko 2006). However, in St. Petersburg, which is the focus of this research, the economic growth was high from 2000 until the economic crisis in 2008.

Selected economic indicators of the city of St. Petersburg between 1997 and 2007 are shown in Table 4, which shows that St. Petersburg's GRP grew substantially after the 1998 economic crisis until 2007. Strong economic development during the early years of the 21st century was seen also in the rapid increase of industrial production, real wages and, consequently, in the volume of retail trade (see Table 4).

[20] The oil price grew approximately three-fold in 1999-2000, helping Russian export value to skyrocket by 60%. Also, over the following few years, oil and natural gas on the global market were rather expensive, which maintained high value of Russian exports (Tiusanen 2003).

[21] The financial turmoil originating from the U.S. subprime mortgage market hit Russia in early September 2008 and created a severe financial crisis in the country (e.g. Desai 2010). This, together with lowering prices of oil and other Russian export commodities, led to serious problems in the real economy (Economic Monitoring of Northwest Russia 2013). However, as the case study covers only the years 1997-2007, the effects of the 2008 crisis are not discussed here.

Table 4 Selected economic indicators of St. Petersburg, 1997–2007, annual percentage change (Economic Monitoring of Northwest Russia 2013[22]; author's calculations)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
GRP	0.2	-1.7	6.8	10.0	3.6	5.7	5.3	7.1	8.3	7.7	9.7
Industrial production	7.0	-1.0	6.0	26.2	0.2	31.4	5.8	14.1	4.2	-7.0	10.0
Real wages	14.0	-14.0	-20.0	22.1	23.8	19.2	15.7	8.8	12.4	14.9	15.8
Retail trade volume	7.6	14.6	55.0	6.8	15.0	9.2	12.9	12.1	12.9	14.5	15.1

The dramatic decline in household purchasing power during the economic transition had shifted consumption to basic needs. Thus, the share of food products accounted for nearly 60 percent of total household consumption in St. Petersburg in 1999. However, the share diminished substantially in the early 2000s. In 2000, food products accounted for 53 percent whereas two years later, in 2002, this had reduced to approximately 43 percent, indicating a significant increase in purchasing power. This development continued and in 2007, the share of food stuff in retail sales accounted for 36 percent in St. Petersburg. At the same time, there was a shift in customer preferences towards higher quality products. (Economic Monitoring of Northwest Russia 2013.)

The Russian transition to a market economy and overall economic development has naturally had a significant impact on the country's bakery sector. Thus, the next section offers a brief overview on the development of the Russian bakery sector.

3.1.2 The Russian bakery sector

The term 'sector' is often employed interchangeably with the term 'industry'. However, the sector concept can be considered to include the entire value chain; for instance, suppliers, manufacturers, distributors, retailers and customers. Thus, it differs from the term industry which is confined to direct and indirect competitors centred on a common product. (Eriksson, Fowler, Whipp & Räsänen 1996.) The aim of this section is to provide some background understanding on how bread was and is produced, sold and consumed in Russia.

[22] Original source: Petrostat 2000; 2004; 2006; 2008; and 2009

Traditionally, the consumption of bread has been very high in Russia. Both due to traditions and low price, a lot of bread is consumed. As much as 40 percent of total daily calories was obtained by eating bread, even as late as in 1997. (Ylä-Kojola 2006; Helanterä 1998.) Table 5 shows the development of the production of bread and bakery products in Russia from 1992 to 2004 and consumer expenditure on bread and bakery products in Russia from 1995 to 2004.

Table 5 Production of and consumer expenditure on bread and bakery products in Russia, 1992–2004 (Ylä-Kojola 2006[23])

Year	1992	1995	1998	2000	2002	2004	Change 1992/1995–2004, %
Production of bread and bakery products (1,000 tons)	16,800	11,300	8,500	9,000	8,400	8,100	-51.8%
Consumer expenditure on bread and bakery products (% of total consumption)	-	8.2%	8.2%	8.1%	7.1%	6.5%	-20.7%

As Table 5 shows, the production of bread and bakery products decreased dramatically in the 1990s but recovered somewhat at the turn of the century. In the Soviet era, artificially low bread prices caused extensive waste and a significant proportion of bread sold was used as fodder. Thus, the deep drop in bread production figures at the beginning of transition can be partly explained by this senseless waste during the Soviet era. (Helanterä 1998.) Since 2000, bread production volume has declined by approximately four percent annually (MMTs "Kaluga" 2008).

Despite the slightly diminishing total bread consumption also in the 21st century, the value of the Russian bakery and cereals market grew at a Compound Annual Rate Growth (CARG) of 4.5 percent from 2001 until 2008; annual growth rates from three to five percent are also expected in the future (Food & Drink Business Europe 2009). Especially, some segments have grown rapidly within the bakery sector. Although traditional Russian bread still dominates the market, the trend has shifted towards pre-packaged products and Western-style bakery goods (Food & Drink Business Europe 2009; Partos 2008). Hence, the value of bakery products is increasing as

[23] Original source: Goskomstat 2004 & 2005.

Russians change their habits and move to more premium products such as pastries, croissants, baguettes and ciabatta (Food & Drink Business Europe 2009; Partos 2008; Ylä-Kojola 2006). For instance, overall sales of baked goods (i.e. bread, pastries and cakes) increased by 21 percent in 2006 while the volume of sales remained static, which indicates a dynamic increase in unit prices. (Euromonitor International 2007a.) In 2007, the growth of prices for bread and baked goods in Russia was 22.4 percent and in 2008 as much as 25.9 percent. However, due to the difficult economic situation, the rise of prices was estimated to slow down considerable for bakery products and to be approximately six to nine percent in 2009. (Ernst & Young 2009.)

Despite their increasing prices, household expenditure on bread and bakery products decreased during the economic transition. Whereas bread and bakery products accounted for 8.2 percent of total consumption in 1995, their share was down to 6.5 percent in 2004. The same development also occurred with other foodstuff. In 1995, 49 percent of Russians' disposable income was spent on foodstuff whereas the figure had dropped to 36 percent in 2004. The figure was 40 percent if alcoholic beverages were also included. However, that is a relatively high share of expenditure spent on foodstuff in comparison to, for instance, Finland (e.g. approximately 25 percent). In general, expenditure on food, in relative terms, is expected to decrease in the future as housing and transportation costs rise. (Ylä-Kojola 2006.)

In 2004, Russian consumers spent most of their foodstuff expenditure on meat products (i.e. 10.5%), the next highest being on bread and bakery products (i.e. 6.5%). Although, in general, bread and bakery products are relatively inexpensive, they are an essential part of the Russian diet. (Ylä-Kojola 2006.) An average Russian consumes approximately 100kg of bread per year, which is the highest per capita rate of bread consumption in Europe (Food & Drink Business Europe 2009). However, regional differences are large; whereas, in Moscow, the per capita annual bread consumption figure is 70–90kg and, thus, close to the average European level (i.e. 70–80kg), in some regions it reaches 260kg (MMTs "Kaluga" 2008). Nevertheless, as the Russians' purchasing power increases, the consumption of bread along with, for example, potatoes and pasta decreases and consumption shifts to good quality meat, fish products and also processed milk products. However, there are tremendous differences in Russians' purchasing power and, consequently, on consumption patterns. Whereas people in major cities and regional centres might move to consume more expensive foodstuff, the majority of the population cannot afford more than basic food supplies. (Ylä-Kojola 2006.)

During the Soviet era, bread was mass produced with the sole purpose of feeding people. Thus, little, if any, consideration was given to the taste or quality of the products. In every city, bread production was concentrated to

only a few big bakeries feeding the local community. (Ylä-Kojola 2006; Taylor 1994.) Bakeries were specialised to produce particular types of product according to the state's Gosplan (i.e. the committee responsible for various aspects of the planned Soviet economy). There were only a few types of bread, produced in accordance with Gosplan standards, on the market and bread was sold as a bulk product (Kropotov 2002). Thus, end customers did not know from which bakery the bread they bought had come (Mäkinen 2005).

Small private bakeries, destroyed in the revolution, began to appear again after 1991. They are now popular in rural and sparsely populated areas and also have their niche markets in major cities. Although they cannot achieve the same economies of scale as large bakeries and have higher prices, there are people who prefer fresh bread without preservatives. (Ylä-Kojola 2006). The Russian bakery market comprises approximately 1,000 bread factories, each of which produces between 30 to 50 tons per day, and some 10,000 small and medium-sized firms (Food & Drink Business Europe 2009; Partos 2008).

However, the Russian bakery market is, in fact, divided between large and small bakeries; medium-sized bakeries hardly exist. Medium-sized bakeries face difficulties as they lack the financial resources for investments and also the necessary negotiating power with suppliers and retailers. Instead, the share of large bakeries in the market constantly grew as consolidation occurred. For example, the combined market share of the two largest bakeries in St. Petersburg was approximately one third of the market in 1997; however, ten years later, they held over 50 percent of the market. (Ylä-Kojola 2006.) Both of these companies increased their market share together with the number of their production facilities by acquiring other bakeries in the city. Nevertheless, the bakery market in Russia remained local with no really significant national bakeries (Ylä-Kojola 2006). In 2006, 43 percent of sales at the national level belonged to artisanal bakery products, while the largest bakery's share of the total Russian bakery products market was only three percent (Euromonitor International 2007a).

The Russian bakery industry has not been as popular a target for foreign investors as some other branches of food industry and the bakery business is predominantly occupied by numerous local bakers. In fact, the only significant foreign player, and also one of the largest companies in the field, is the Finnish Fazer Group. (Food & Drink Business Europe 2009; Euromonitor International 2007b.) However, to gain access to foreign capital, many Russian companies have recently begun to look for foreign partners while, simultaneously, an increasing number of European bakeries have been looking for opportunities in Russia as the bakery market in Europe is saturated (Food & Drink Business Europe 2009; Ylä-Kojola 2006). As Russia has been one of the fastest growing packaged or industrial bread markets is the world, with an

average annual growth rate of 16.4% between 2000 and 2006, its growth potential is also likely to attract foreign investors (Partos 2008; Euromonitor International 2007b). Thus, more foreign involvement and intensifying competition can be expected in the Russian bakery industry in the future, although the recent economic recession might have changed the investment plans of many companies for the near future.

In comparison to many other countries, the bakery business in Russia has some peculiarities. First, the price of the industry's key raw material, grain, has been state-regulated (MMTs "Kaluga" 2008). Russia is totally self-sufficient in grain production, which is concentrated in the south of the country. Nowadays, the transportation infrastructure functions sufficiently well to make grain available all across the country. For bakeries, all other necessary ingredients are also available domestically, except for some high quality or specially processed ingredients and additives. (Ylä-Kojola 2006.)

The second peculiarity is a common division of bread types and market segments into mass bread offerings or "social" bread, which covers a major part of bakeries' product ranges and alternative bread offerings including, for instance, low-calorie varieties, enriched bread and puff pastry. Although the bread market is driven by alternative offerings due to an increasing demand for new kinds of bread product, bread is still a "social" product for the majority of Russians. Thus, the consumption of so-called social bread has remained at the same level for the last few years and accounts for approximately 50 percent of total bread consumption. (MMTs "Kaluga" 2008.) As bread is considered a social commodity that everybody has to be able to afford, the price of basic types of bread was government regulated in the majority of Russian regions during the economic crisis of 1998 (Ylä-Kojola 2006; Helanterä 1998). Nevertheless, whereas low price remained the most important factor for bread buyers into the 1990s, leading to the use of cheap ingredients by the industry, quality is more important today. Thus, nowadays in Russia and especially in St. Petersburg, the quality of bakery products is good. (Ylä-Kojola 2006.)

The third particularity in the Russian bakery business is that in Russia, unlike many countries where bakeries concentrate only on their core business, many, especially large bakeries, also manage their distribution. This is due to the lack of sufficient enough logistics service providers. As the shelf life of bakery products is relatively short, it is important to get them into the stores as quickly as possible. In addition, smaller shops often have very limited shelf space and need daily deliveries . (Ylä-Kojola 2006.)

The retail sector in Russia and, thus, also bread selling, changed tremendously over the early 2000s. Today, both traditional and modern retail concepts coexist in the Russian market (Belaya & Hanf 2010; Lorentz,

Häkkinen & Hilmola 2006). Traditional retail types (see Menkhaus, Yakunina & Herz 2004; Ruohonen 1999; Taylor 1994) include, for example, Soviet-style departmentalised stores, speciality stores, individual vendors, kiosks and city markets. Modern retail concepts refer to different types of self-service store such as supermarkets, hypermarkets, discount stores and cash & carry hypermarkets. (Lorentz et al. 2006; Louhivuori 2006.)

During the economic transition, food retailing has been a popular field in which small private entrepreneurs have experimented with capitalism. As a result, the food retail sector has been characterised by a large number of small, undercapitalised firms with little ability to ensure supplies of consistent quality or quantity. (Menkhaus et al. 2004.) However, the share of modern retailing in the Russian retail market has been rapidly increasing since the early 2000s. For instance, the market share of modern retail outlets almost doubled from 11 percent in 2003 to 20 percent in 2004. This exemplifies the underlining trend in Russia: the rise of modern retail chains. As purchasing power increases, Russian consumers increasingly favour quality and service. (Radaev 2009; 2013; Lorentz et al. 2006; Lorentz 2005.) Nevertheless, the Russian retail market has remained rather unconsolidated. At the beginning of 2005, only 4.2 percent of total food retail sales were controlled by the top five players in the market, whereas the same figure, for instance, in France was 88 percent and in another transition economy, the Czech republic, it was 17–27 percent (Louhivuori 2006).

Modern retail formats are preferred by the authorities over unorganised trade in city markets and kiosks due to the greater tax revenues they generate. Indeed, retail chains are growing faster than the whole sector and also faster than the purchasing power of consumers, which means that they are gaining market share from open markets and individual grocery shops. (Louhivuori 2006.) This trend can especially be seen in Moscow and also St. Petersburg, where the retail chains' share was estimated to be up to one-third in food retailing in 2005 (Lorentz et al. 2006; Lorentz 2005).

The trend has also affected bread selling. In 2002, the majority (i.e. 63%) of consumers in St. Petersburg bought their bread at traditional bread stores, 40 percent in kiosks and 32 percent in general grocery stores (Kropotov 2002). However, a few years later, discounters and hypermarkets were considered the most efficient trade formats for bread distribution and promotion. Retail chains have also started to sell bread under their private labels. In addition, many retail chains have introduced their own in-house bakeries offering freshly baked hot bread (MMTs "Kaluga" 2008; Partos 2008). Nevertheless, these can never totally replace the products of large industrial bakeries offering a wide range of less expensive traditional bread (MMTs "Kaluga" 2008).

In sum, the bakery market in Russia, and especially in St. Petersburg, has experienced dramatic changes over the last two decades. These changes are, to a large extent, caused by the economic transition from a planned to a market economy and the rapid modernisation of the retail sector characterised by the appearance of retail chains. However, it is also likely that the entry of a major foreign bakery into the local market has been a significant source of change. The next section describes the entry of the focal company, Fazer Bakeries, to St. Petersburg and also the changes it has initiated in its local subsidiary, Hlebny Dom. The influence of the foreign entry on local companies will be discussed later in chapters 4 and 5.

3.2 The focal company and its entry into St. Petersburg

3.2.1 Fazer Bakeries

The focal company of this study, Fazer Bakeries, is a division of the Fazer Group, the origins of which lie in a family business founded in 1891 when Karl Fazer opened his first café in Helsinki. Since then, the company has grown and is now a major industrial and service company offering food services and also confectionery and bakery products in eight countries.

The Fazer Group began its international operations in Sweden in 1920 when it opened a shop in Stockholm. Karl Fazer AB, Sweden was established in 1967 and in 1975 Fazer acquired Mazetti, a Swedish chocolate and confection manufacturer. Sweden was also the first foreign market in which the bakery business expanded when Fazer Bröd AB (Fazer Bread) was established in 1982. At the beginning of the 1990s, the collapse of communism and the Soviet Union created opportunities to also enter other neighbouring markets. Fazer Bakeries made a greenfield investment in Estonia and Fazer Eesti's bakery in Tallinn commenced operations in 1994. In 1997, Fazer Bakeries acquired shares in a Russian bakery, Hlebny Dom, in St. Petersburg and, in 2001, it began operations also in Latvia and Lithuania. Fazer Bakeries continued to expand further its operations in Russia in 2005, when it acquired the Zvezdney bakery in Moscow.

The internationalisation of its bakery operations has made the Fazer Group one of the leading bakery companies in the Baltic region. The company manufactures bread and pastries in Finland, Sweden, Russia and in all three Baltic countries (i.e. Estonia, Latvia and Lithuania) and exports to over 15 countries. In addition to the Fazer brand, other brands of the company are Oululainen, Häää, Druva, Gardesis, Hlebny Dom, Zvezdny and Casa Nostra, of which the latter three are in the Russian market.

At the end of 2007, Fazer Bakeries had a total of 7,166 employees, of which 3,690 worked in Russia in its St. Petersburg and Moscow bakeries. In 2007, Fazer Bakeries' turnover was EUR 490 million, of which 47 percent originated from Finland, 34 percent from Russia, ten percent from Sweden and two to three percent from each of the Baltic countries. At the time, Fazer's operations in Russia comprised four bakeries, of which three were located in St. Petersburg and one in Moscow. Fazer was also involved in operational cooperation with the Volzhky Pekar bakery located in the Tver region. However, this study focuses on the St. Petersburg market and the investment in the Zvezdny bakery in Moscow in 2005 and the cooperation in the Tver region are excluded from this research.

Russia has been Fazer's largest growth area and the bakery business there has grown on average by 37 percent per year over the last few years. Due to the increasing importance of the Russian bakery business, it was separated from Fazer Bakeries and became its own division, Fazer Russia, at the beginning of April 2007. Fazer Russia contributed approximately 14 percent to the Group's turnover in 2007; however, in 2007, the figures of Fazer's Russian bakery operations were still included in Fazer Bakeries' figures. Furthermore, as this study approximately spans a ten-year period, starting from Fazer Bakeries' entry into Russia in 1997, the Group's Russian operations are considered to belong to Fazer Bakeries in this study, the focus of which is solely on the bakery branch of the Fazer Group. Unless otherwise specified, the name Fazer is employed here to refer to Fazer Bakeries.

3.2.2 Fazer Bakeries' entry into St. Petersburg by an acquisition

Fazer Bakeries made a decision to enter the Russian market in the early 1990s, soon after the dissolution of the Soviet Union. Figure 9 presents a timeline of major events prior to and during Fazer Bakeries' presence in Russia and especially in St. Petersburg.

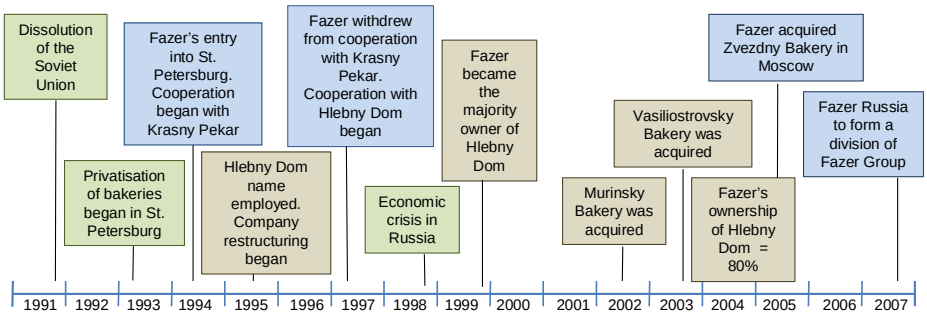

Figure 9 Timeline of the major steps in Fazer's entry into and expansion within the Russian bakery industry from 1990 until 2007

The main motivation behind the investment decision to enter Russia was slow market growth, hard competition and also the strong position of the retail industry in Fazer Bakeries' traditional markets. Thus, the newly opened Eastern markets were considered to offer potential profitable growth for the company. Furthermore, the company felt it had the required knowledge and financial situation to take the risk and invest in the new markets. In 1994, approximately a year after entry into Estonia, Fazer Bakeries also began to look for investment possibilities in St. Petersburg:

> "We had started with a greenfield investment in Tallinn and concluded that even in that market situation it is not easy to buy market from others. It is much better to get the existing staff, get the existing production facilities, get existing market share." (Director, International Projects, Fazer Bakeries)

Thus, an acquisition was chosen as the entry mode into St. Petersburg from the outset. However, finding the right target company was not initially easy:

> "We went [to St. Petersburg] for the first time when privatisation of the bakeries began, and there we visited almost all bakeries. And, in that situation, such a bakery as Krasny Pekar, red baker, was chosen as a first target because it was an old nomenklatura's[24] bakery and, at the time, it was in much better shape than the other units. We thought that we would start to develop cooperation with them. The CEO at the time – he's still the CEO – had a positive attitude about us coming in, and we agreed that we would start to buy their shares, in different ways…for instance they had this voucher-auction privatisation model. Well, we bought 18 percent of the company's capital and 21 percent of the voting right. And for some reasons our partner, or candidate, changed his tune quite a lot. We had said from the

[24] Nomenklatura refers to a small elite group in the Soviet Union and other Eastern Bloc countries who held various key administrative positions in all spheres of their respective country's activities (e.g. government, industry, agriculture, education) whose positions were granted only with approval by the communist party.

> beginning that we wouldn't start making any investment before we knew that we had 51 percent. That we must have, and then we will start. And then they said that they won't make any agreements with us unless we invest first. And this continued until early '97. We were there with our Group's president at the time, meeting the company's management and we thought to discuss once more whether this would work out or not. And it turned out that there wasn't a starting point any more, after which we began a new round in St. Petersburg bakeries." (Director, International Projects, Fazer Bakeries)

After withdrawal from the unsuccessful cooperation with Krasny Pekar in early 1997, Fazer Bakeries began to look for a new partner with the help of the SIAR-Bossard consulting company. This time, Hlebny Dom was considered the best option. The company was established in 1934 and was known as the *"Bread Plant of Moskovsky district"* until 1995 when the company changed its name to *OAO Hlebny Dom* (i.e. Bread House). The company was privatised in 1993 in accordance with the so-called second scheme of privatisation; the working collective was given 51 percent of the shares for free and 29 percent went for voucher trade. The majority ownership was soon acquired by the company's existing managers. Although a management buyout as a privatisation model has often been criticised, in the case of Hlebny Dom, it turned out to be a good solution as the management was determined to develop the company. In 1997, Hlebny Dom was the second largest bakery in St. Petersburg with a market share of approximately 15 percent. It had already begun to restructure production and had invested almost USD 20 million to three new Western production lines and a forming line.

The team of managers, who were also the major owners of Hlebny Dom, thought that finding a good foreign partner would be the best option for the development of the company and, thus, on this occasion, negotiations were straightforward:

> "In 1997, we understood that something was going on in the market, the market was stable which was unusual and it felt threatening, because before it had grown. It was stagnant and mature and it was impossible to do something new. So we decided to accept Fazer's offer that the others had rejected, according to which we had to sell 51 percent of the shares to Fazer." (General Director, Hlebny Dom)

> "It was an unusually fast negotiation process: we started the negotiations in March, in June we had the cooperation agreement and at the beginning of October the company decided on the share issue directed to us. And, considering the size of the contract price, which was 18.5 million dollars, it was indeed an exceptionally fast process." (Director, International Projects, Fazer Bakeries)

The whole contract price was paid through directed share issues, which meant that all Fazer's invested money remained inside the company. The issue was paid according to Hlebny Dom's needs. However, the acquisition process faced some practical difficulties when the economic crisis hit Russia in 1998, at which point Fazer had invested approximately USD 5 million, slightly less than a third of the contract price. According to Russian law, the agreed special issues had to be paid within a year; however, the value of the rouble was anything but stable. In August 1998, with the crisis approaching, the managers of Hlebny Dom saw the signs and warned Fazer. The issue was halted and Fazer did not lose financially during the crisis:

> "What was particularly exceptional in '98, was that the slump taking place in Russia led us to change from directed issue to capital contribution, meaning that we gave machines and equipment and got shares in return. Because otherwise our monetary input would have soon diminished to being negligible, as the administrative process in Russia was so slow at the time. When you put foreign currency in there that had to be converted into roubles, it would have withered away to a negligible sum along the way. Then we decided that we would make it in equipment, and the whole process took a bit longer but, at the same time, it created quite a lot of trust from our Russian partner, because many Western companies left Russia at that stage." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

> "Then the crisis of 1998 came, and this crisis showed that major changes were taking place, that business could not be done as before in Russia. Peter Fazer, then still alive, came to St. Petersburg, and said that 'it is another crisis in Russia but eventually it will be over. We came to Russia for the long term and the crisis is not a reason to change our strategy.' And they did not change their long-term strategy despite the crisis. Together, we successfully lived through the crisis and became larger in the market. The basic resource was mutual trust, this is our common business and we make all efforts jointly." (General Director, Hlebny Dom)

Thus, Fazer's decision to continue with the investment at a time when many Finnish and other foreign businesses were leaving Russia was an important factor for the success of the investment in two ways: first, it built up trust between the partners and, second, it gave the company a head start on many competitors that were not able to invest during the crisis. In total, there were three directed share issues and Fazer had acquired the intended 51 percent of Hlebny Dom's shares by the end of 1999. Later, Fazer further increased its ownership to 60 percent via directed issues and, subsequently, by buying additional shares directly from the three major owners and the workers' collective. In 2004, Fazer's ownership of the company reached almost 80 percent and it remained around this percentage until the end of 2007.

Mutual trust between the partners was the key for successful cooperation. In fact, cooperation between Fazer and Hlebny Dom has been without conflict.

Although, during the negotiation phase, detailed partner agreements were made defining the use of voting power and the situation when consensus between the parties is required and when it is not, there has never been a need to rely on these partner agreements. Fazer and the management of Hlebny Dom had very similar ideas on the development of the company:

> "Our local management, thus the minority shareholders, have been ideal partners in the sense that they themselves have wanted to develop the company further, and not only wanted to cash everything out." (Business Controller, Fazer Bakeries)

> "When Fazer first came, there were rumours in the yellow media and among the competitors, that foreigners will take out capital from the company, create a capital flight from Russia. This was a natural reaction from envious people and competitors. In reality, only twice have some dividends been paid, first in 1994 before Fazer came and the second time in 2005. So after Fazer came, only once have dividends been paid out to the owners. In all other years, the profits have been reinvested in the company." (General Director, Hlebny Dom)

From the outset, the company has been run by Russian managers and no expatriates have been employed. Initially, the board of directors comprised three Russians who were co-owners of the company and three Finns who were representatives of Fazer Bakeries. Later, as Fazer increased its ownership, the structure of the board of directors was changed to comprise two Russians and four Finns. This change was not opposed by the Russians. On the contrary, decision-making in the board of directors is based on mutual understanding between the partners. Previously, the Russian bakery business was channelled through Fazer Bakeries; however, at the beginning of 2006, Fazer's Russian board was formed to coordinate Russian operations. Fazer's Russian board also comprised four Finns and two Russians. The new board was created to serve as a direct channel to the management of the Fazer Group due to the increased importance of the Russian bakery business to the Group. As previously mentioned, further changes were made in 2007 and the Russian bakery business became a division (i.e. Fazer Russia) of the Fazer Group.

Since Fazer's involvement in Hlebny Dom, the company has developed significantly; it received an award for being the best company in St. Petersburg's food sector in 1999 and, in 2004, the company was given a "Russian National Olympic Medal" in the Kremlin. To serve better the market, Hlebny Dom has also expanded within St. Petersburg and acquired two further bakeries: in 2002, the Murinsky bakery was purchased and, in 2003, the majority stock of the Vasileostrovsky bakery. Both bakeries became part of Hlebny Dom; thus, in 2007, the company had three production units in St. Petersburg that were conveniently located in different parts of the city.

In 2007, the company was the market leader in St. Petersburg and its surroundings with a market share of over 30 percent. It was also the leading company within the bakery industry in the whole of Russia. It is the only major foreign owned bakery in St. Petersburg and the largest Western bakery in Russia. Changes in Hlebny Dom since Fazer's involvement are described in the next section, in which a more detailed picture of the company is also given.

3.3 Changes in Hlebny Dom since Fazer's acquisition

3.3.1 Changes in the organisation and personnel

After the company was privatised in 1993, the managers of Hlebny Dom began to develop the company themselves. They created a team of managers including the economic director, the technical director and the chief accountant. Although the existing team of managers continued to run the company after Fazer's acquisition, the organisation was significantly changed. A major change was the implementation of Fazer's financial administration system on the organisation. In a traditional Russian system, a chief accountant plays an important role but, above all, he/she works facing outwards. Although the position of the chief accountant continues to be important in Hlebny Dom, Fazer introduced a new kind of financial management perspective and hired a person who views the whole financial administration in its entirety, including for example, accounting, financing and payroll administration. Significant organisational changes were also made in production management:

> "There were a slightly unclear command relationships. Traditionally in Russia, there were technologists and then technology and production personnel, but we made it so that there is a production manager who is responsible for the whole production, whether it is about production or technology. And we created our own product development departments. […] Thus, we renovated the organisation. It took years, gradually. If you now look at the organisation it has a very Western structure." (Director, International Projects, Fazer Bakeries)

Thus, Fazer renewed the organisational structure according to the Western style. Major changes were made in the financial administration system and also in production management; product development departments were created. Nevertheless, from Hlebny Dom's perspective, the most significant changes were made in the sales department. After privatisation of the company, the management team had formed a commercial department, something that was not needed during the Soviet era when there was no market competi-

tion between bakeries. However, commercial management remained weak before Fazer's involvement:

> "The biggest problem was that we did not know how to sell well at the time. […] It was, we produce and you buy, and quality was not given much emphasis, nor sales. The idea was to produce and that demand was guaranteed. […] In principle, we knew that the better the quality the better you sell but the sales department wasn't so good. After Fazer came, first we changed the sales director, we totally changed the sales department and searched for new staff, a director and other personnel, and we wanted to learn from Fazer how to sell." (General Director, Hlebny Dom)

Thus, after Fazer's involvement in Hlebny Dom, a new sales organisation was created and, soon afterwards, a marketing organisation. New staff were recruited as restructuring proceeded. All recruited persons are Russian and no Finnish expatriates have been employed. Nevertheless, the management in St. Petersburg is very competent:

> "And when evaluated by Western or any criteria, the management in St. Petersburg is top class. For instance, our marketing manager has worked as a marketing manager in several international corporations, in much bigger ones than us…The production manager [to Hlebny Dom in St. Petersburg] came from Capper and to [Zvezdny in] Moscow from Mars, so there is know-how there." (Director, International Projects, Fazer Bakeries)

Fazer has also offered training to Hlebny Dom's staff; for instance, Fazer Fast training was organised at the executive level for all units is every country in which Fazer operates, and a similar type of training, Fazer Way, was organised for the management level. Training has also been organised in St. Petersburg, in some of which Finns also participated; for instance, the Petersburg office of the Helsinki School of Economics' Small Business Centre. Some managers participated in a so-called Putin's special training programme, a high quality programme including work placements in different parts of the world: for example in Japan and in the USA. Fazer has also conducted in-house training for their managers, especially in the spheres of sales and marketing and also on product development. Despite the different training programmes organised and offered to Hlebny Dom's personnel, a lot of learning, especially in technical matters, has occurred through less formal tutoring:

> "Well, it doesn't take place through training in a traditional sense but our bakers from here, Finland, have visited and seen what equipment is needed, and shown hands-on how the equipment works and so on. Thus, it is very practical. It is not training in the sense that you would sit in a seminar or something like that. Instead, it takes place – to use a modern buzz world – as knowledge transfer, which is from one person to another, hands-on." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Hlebny Dom's educated and trained staff have also interested other employers; several persons have been hired by other foreign companies and also by local competitors. As the company has been so successful, recruitment companies also monitor Hlebny Dom's staff members and, occasionally, approach them with job opportunities. Although some movement of personnel is inevitable, in addition to competitive salaries, Hlebny Dom has incentives to retain talented people in the company:

> "Our chief technologist moved to Petrohleb[25] where he got a much higher position than he had in Hlebny Dom. It is natural that people want to rise in the hierarchy, and it is impossible to stop them as people are free to choose. But we try to avoid that [employee turnover] and offer our people something better, better incentives. Of course, it is important to motivate people and allow them to move up in the hierarchy. Salary is not the only thing that matters. People want higher status and power. We are a big company with three production facilities so we cannot offer a way up to everybody as fast as smaller companies. But Fazer is an international company and that motivates people as it is possible to move and work in Europe. We introduced the idea to Fazer that Russian managers would also be included in this rotation of jobs within the corporation. That is something that other companies cannot offer and it motivates people to stay with Hlebny Dom." (General Director, Hlebny Dom)

> "And so it is that when you have trained the staff, they leave. […] The level of salaries for academically educated persons, presuming that they speak English, has been high. And Western companies have bought them, thus that traffic has been quite heavy […] But now we are in a slightly new situation with the academically educated people, that if you have the correct kinds of incentive, like helping them to get apartments − the prices of which are skyrocketing these days – then they commit themselves maybe more than before, they do not chase after money all the time but settle down." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Thus, non-monetary incentives play an important role in keeping talented employees in the company despite the active recruiting efforts of other companies. However, production personnel in St. Petersburg have not been that eager to change jobs as long as their wages are at the market level. In this respect, Hlebny Dom is probably in a better position than many local competitors, as being a market leader and having a foreign owner makes it seem to be a secure employer in employees' eyes. According to the General Director of Hlebny Dom, among the workers' collective at Hlebny Dom, Fazer is considered a socially oriented company that takes good care of its workforce. The investor's good relations with the workers' collective are important for the smooth operation and success of the cooperation.

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[25] A bakery company in the Leningrad region.

Although Fazer's investment in Hlebny Dom has been followed by a number of changes in the organisation and personnel that make the organisational structure more "Western", company culture has remained more or less the same. This is especially shown in the role of the General Director:

> "One should bear in mind that the exercise of power is very central in the Russian corporate world. It is not a myth, it really is so. When our late director, Valeri Fedorenko, he passed away recently… […] Valeri called the staff every morning and gave orders. And there were basically no decisions made unless Valeri knew about them. Thus, it was very centralised. In addition, and this is not a myth either, it is very important for Russians that someone decides and leads. They don't sit much in meetings or do group work. It is changing little by little now that our culture has come to Hlebny Dom, but it is still noticeable that they wonder about how we meet and do so-called team work, because in Russia the company culture is a bit different, and will remain so probably for a long time." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

> "[B]ut of course the role of the General Director is different there than what we have. Sure, the jurisdiction is similar but the exercise of power is different. It is a question of culture; there the General Director has all the votes. […] And we have thought, or realised, that we are way too small a country and too weak to change the culture of that kind of country. It is better to accept it as such. If a country has a particular culture, succeeding is more likely if you act in the same way rather than starting to do things totally differently. A Russian needs a clear leader in front." (Director, International Projects, Fazer Bakeries)

Thus, Fazer has not particularly tried to change the organisational culture of Hlebny Dom although, with everyday contacts between the partners, Fazer's company culture might gradually become more familiar to Hlebny Dom's staff. However, despite their different cultural backgrounds, cooperation and decision-making have worked without any conflict between the parent and its subsidiary company.

3.3.2 Changes in production and product range

In the Soviet era, all bakeries were specialised in producing particular types of product according to the state's Gosplan. Hlebny Dom was specialised in bread production. At that time, Hlebny Dom's product range comprised only a dark and a light bread together with *pryaniks*, traditional Russian ginger bread. The production machinery was outdated; apart from the 1960s and 1970s equipment for making pryaniks, all other production equipment dated back to 1934 when the company was founded. After the privatisation of bakeries in 1993, Hlebny Dom's managers understood that they had to produce a range of

bakery products to be able to compete with other bakeries. New products required new machines. In technological terms, Hlebny Dom was lagging behind many of its new competitors, some of which had newer Czech or German equipment.

In 1994, bread prices were deregulated and decided by the market. For the first time, it was possible to profit from bread production. Hlebny Dom's managers decided to invest in a new production line that was bought from a German company for DM 3 million. However, the first major investment was not a big success:

> "It was our mistake; we did not consider how we would sell the bread. It was German bread and had a harder crust. Inside it was good and soft but it had harder crust. Customers were not used to such a crust so it became obstacle problem to sell. Bread sellers pressed the bread with a special fork and it seemed hard and they thought it was not fresh. Thus, the demand was not high for that bread. We made a mistake as we did not predict how the bread would be bought, it was our mistake. But the new line was working and producing bread." (General Director, Hlebny Dom)

In 1995, the company bought two more production lines from Italy and, this time, the investment was successful. Although the seller had some difficulties with the deliveries and the lines were received as late as 1996 and 1997, the products were what customers wanted and the investment soon started to create profit. Thus, some restructuring had already occurred in the company before Fazer's investment. However, with Fazer's entry, Hlebny Dom received more capital for new production lines and know-how on modern Western production technology.

At the time of Fazer's investment, the bread market in St. Petersburg, and also in the rest of Russia, remained vastly undeveloped. Bread was mostly manufactured following the old Soviet Gosplan standards. In practice, this meant that there were only a few types of bread on the market and it was neither packaged nor branded. Thus, end customers did not know from which bakery the bread they bought had come. Fazer decided to begin producing sliced and packaged bread. Although Hlebny Dom's new production lines were good, they lacked the two final steps, cooling and packaging. Thus, new machines, for example, for dosing, cooling and packaging were acquired from Switzerland, Austria and Germany. The parent company was greatly involved in the purchasing and implementation processes. Engineers from Finland visited St. Petersburg often to train staff to operate better the machines.

Hlebny Dom was the first to introduce packed and sliced bread onto the market. The products were warmly welcomed both by consumers and especially by large retailers. Hence, new investments to increase the amount of packed and sliced bread were made faster than originally planned. Whereas in

1999, 90 percent of bread products were sold unpacked, four years later the share of unpacked products was only ten percent. Thus, the share of unpacked products soon diminished in the market; for instance, in one of the biggest retail chains in St. Petersburg, Lenta, all bread was packed and 80 percent sliced in 2006. The new production equipment also impacted on product quality:

> "[A]nd then the beginning of the process, everything, especially the flour and raw material dosage systems, we have renewed. Big investments, absolutely, because proper quality requires that the same amount of raw materials are measured out every time.…Now it is of uniform quality, and in my opinion – I might be a bit subjective – but, if compared to the quality in Finland, we keep up completely, even better in some respects." (Director, International Projects, Fazer Bakeries)

> "Good new equipment[…] has brought quite good uniform quality. There has been good quality bread in Russia before but it used to be that one day it was good quality, and another day maybe not so good. But with us, a sort of quality concept has been introduced to the bread business. Hence, when you buy bread from us you know for sure it is always tasty and good quality. And this is naturally extremely important for big customers, the chains". (Business Controller, Fazer Bakeries)

Fazer's initial investments in Hlebny Dom were worth approximately EUR 20 million, and later investments of more than EUR 8.5 million were made in the production facilities of Murinsky and Vasileostrovsky that were acquired in 2002 and 2003. In 2005 three new production lines were launched in Hlebny Dom. New equipment made it possible to widen significantly the product assortment. Whereas the product range of Hlebny Dom comprised less than 30 different product titles at the time of Fazer's acquisition, by 2006, in less than ten years, it had grown more than tenfold to 320.

Part of the increase in product range was due to introducing products to Russia from Finland. For instance, in 2001, Fazer's single portion bread *Puikula* was introduced to Russia with the name *Krayushka* and with a slightly modified recipe to suit local taste. Fazer also added a whole new line of products, (i.e. pastries) to Hlebny Dom's assortment. This was initially achieved by product transfers from Finland; however, later, Hlebny Dom developed its own pastry products. A well-known product in Finland for over 30 years, Fazer berry pie, was introduced to Russia with basically the same recipe as in Finland. However, Hlebny Dom has since introduced new products also to the *Yagodnoe Lukoshko* (i.e. berry pie) product family:

> "Now we have introduced a new product; it is a success, *Cloudberry Pie*. In this case, we are ahead of Fazer in Finland. In Finland they don't have the same with cloudberry, although it is the national berry of Finland and everybody likes it." (General Director, Hlebny Dom)

Both single portion bread and berry pies were completely novel and unique products in the Russian market. However, being a market leader, Hlebny Dom's actions were carefully followed by competitors which have since brought similar products to the market. In the increasingly competitive environment, product innovations and new launches have been a significant competitive advantage. One recent and successful product transfer and launch was the introduction of toast rolls in October 2007; by December 2007, every fifth roll sold on the market was Hlebny Dom's toast roll. Over the years, several new products, alongside the traditional bread loaf, have become popular; for example, the single portion bread *Litseisky*, the healthy tin loaf *Herkules* and various flat breads. The company is also traditionally known as one of Russia's largest manufacturers of pryaniks. New products have also been launched in this product category; for instance, a new pryanik filled with caramel was brought to the market in 2007 that helped to increase sales of the product group.

As a result of modern production equipment and knowledge transferred from the parent company, production in Hlebny Dom became more efficient. In fact, the efficiency in St. Petersburg has exceeded that of Fazer Bakeries in Finland:

> "The efficiency is terrific, and the fact that in St. Petersburg we have 2,400 employees and made there last year [2005] 115,000 tons of goods, while in Finland we have the same number of staff and made 75,000 tons. Thus, the productivity per person is 1.5 times higher in St. Petersburg." (Director, International Projects, Fazer Bakeries)

In sum, Fazer brought major changes to Hlebny Dom's production technology, product range and product quality. This development has made the company a market leader imitated by its competitors in the St. Petersburg area.

3.3.3 Changes in sales, marketing and distribution

Fazer has made major changes in sales, marketing and the distribution system of Hlebny Dom. As previously mentioned, one of the first things Fazer did after the acquisition was to create sales and marketing organisations:

> "And another significant change or a significant matter was that we moved from passive sales to active sales. Thus, we built up our own sales organisation. Whereas before ordering took place in such a way that stores called and placed orders and then they were delivered, now we take the initiative. First we built the sales organisation and soon after that the

> marketing organisation, which both were certainly new. I think that at the time, to consider the food industry, only BBH[26] worked with the same system." (Director, International Projects, Fazer Bakeries)

> "When we went to St. Petersburg, the situation there was a bit like in Moscow at the moment[27], thus no branded bread and a lot of bulk bread. And we brought the idea to St. Petersburg that it is indeed possible to start packaging bread and adding some value to it, and to put a brand on top of the package and create market share. That it is not just some bread but it is bread with a specific brand. Fazer has brought this thinking to St. Petersburg" (Business Controller, Fazer Bakeries)

Thus, Fazer Bakeries introduced the idea to start actively selling and marketing bread. It brought know-how on marketing and branding to Hlebny Dom, which was also noticed by retailers:

> "Well, bread was never marketed in Russia until Fazer went in there. They invest in advertising; they supply stores with their own sales furniture, a sort of basket shelves and so on." (Product Manager, ZAO Renlund)

Even though Fazer began to pay attention to branding, the Fazer brand that was well-known in Finland and also employed in Estonia and Latvia, was not introduced to Russia. The use of a foreign brand for food stuff, and especially for bread that is important for Russians, was not considered a good idea. Instead, a local image was believed to be beneficial. Thus, the company name Hlebny Dom (i.e. Bread House) was chosen to be employed also as the product brand in Russia. Indeed, the brand name Hlebny Dom is considered to be successful by local people and Fazer's aim is to further strengthen the Hlebny Dom brand in Russia.

At the time of Fazer's entry into St. Petersburg, the retail sector was still underdeveloped and dominated by traditional retail concepts. However, as modern retail concepts began to appear, the decision to treat retailers as the most important customer category was taken early, before the competition. New products based on Fazer's knowledge transfer to Hlebny Dom were welcomed by the modern retailers. In addition, Fazer had brought key account management knowledge to the company, due to which Hlebny Dom was able to serve retail chains better than their competitors. In 2006, the share from retail chains in Hlebny Dom's sales was well in excess of 60 percent. Today, when more chains have appeared and expanded their operations to other Russian regions, the role of key account management has become crucial to success as chains with operations in many Russian regions conduct very centralised purchasing negotiations.

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[26] Baltic Beverages Holding, a foreign owned brewery company.

[27] At the time of the interview, in 2005, Fazer Bakeries had just acquired a bakery in Moscow.

Negotiations with large chains having strong bargaining power are tough and the chains constantly try to depress prices. It has become vital to have large volumes in the current competitive environment. Hlebny Dom produces up to 400 tons of bread per day, which from a Finnish perspective is an incredible amount of bread in comparison with, for instance, Fazer's bakery in Vantaa, Finland that produces approximately 100 tons per day. Due to its large volumes, Hlebny Dom is an extremely important supplier to retail chains in St. Petersburg as there are not many other bakers that are able to supply such volumes. In some chains, the share of Hlebny Dom is much higher than 30 percent, which is its market share in the whole St. Petersburg bakery market.

St. Petersburg and its surroundings are clearly Hlebny Dom's main market area. However, a relatively large part of production, approximately 50 tons per day, is delivered to Moscow where many of the largest retail chains have their warehouses. From there, part of the goods is transported to other Russian regions in which the chains have a presence. Despite the long distances, Hlebny Dom also has some direct transport to other Russia cities; for instance, to Krasnodar where a large retail chain is not satisfied with the quality of local bread and prefers to buy it from Hlebny Dom in St. Petersburg.

Whereas individual small shops often pay in cash and pick up the goods from the baker themselves, large chains negotiate payment terms of 30 to 45 and, occasionally, up to 90 days. Clearly, they do not pick up the goods themselves but require deliveries from the baker. However, the preferred No. 1 supplier status among key customers is considered an important goal for Hlebny Dom:

> "Concerning the relationships with the bigger chains we have our aim: we want to become critically important to the chains. […] We want to become an influential partner for the chains, irreplaceable. […] We can offer cooperation at all levels, in production, quality and so on." (General Director, Hlebny Dom)

Hlebny Dom tries to fulfil the modern retail sector's emerging requirements concerning the timeliness, quality and accuracy of product deliveries, and the company tries to establish partnership-type relationships including product information sharing and merchandising support with major retail chains. Hlebny Dom's most important customers include such retail chains as Pyaterochka, Lenta, Metro, Diksi, Okei, Perekrestok, Paterson and Tander.

Probably the most significant change that Fazer initiated in St. Petersburg, and which greatly contributed to the Hlebny Dom's success among modern retailers, was the creation of a new distribution system. At the time of Fazer's entry, the products of all bakeries in St. Petersburg were distributed by a monopolistic transport service provider, HlebTrans, a joint company of many local bakeries in which the city government also had a stake. The bread was

distributed in wooden crates that were loaded on metallic trolleys and into trucks. The wooden crates had to be manually emptied onto store shelves which required a lot of work; some smaller stores, when receiving deliveries, even had to close their doors to their customers:

> "And when we started to look at the situation and improve our activities we noticed that distribution didn't work at all as it should. Of course, it is distribution that is the closest contact with every customer every day, and we figured out that we had to take care of it much better. And at first we thought that we couldn't distribute with such a system, we had wooden crates and whatever spoke trolleys. And when we calculated how much bread and how much iron and wood we transported every day, when 25 percent was bread and the rest in the truck was something else, we figured that it was extremely inefficient and unhygienic and so on." (Director, International Projects, Fazer Bakeries)

As the existing distribution system was inefficient and reliability of deliveries was poor, Fazer decided to create its own distribution system for Hlebny Dom in 1998. In 1999, a EUR six million in-house logistics system was launched. Instead of utilising the traditional wooden boxes in bread deliveries, new specially designed stackable plastic crates were introduced and distributed with the company's own fleet of modern delivery trucks. The redesign of the logistics system involved the entire crate movement process, including such functions as returns from customers and cleaning.

Bread in the new crates is ready to be put on sale and the crates are picked up when empty. The new system is also more hygienic than the old one as, unlike wooden boxes that cannot be washed, the plastic crates are washed after every delivery. Hlebny Dom's new logistics system enabled higher levels of customer service and instantly became the company's major competitive advantage. However, the system has since become a "Russian standard" as domestic competitors, not only in St. Petersburg but also in Moscow and other regions, have imitated the concept.

3.3.4 Changes in supplier relations and sourcing

From the beginning of their cooperation, Fazer was greatly involved in acquiring new machinery for Hlebny Dom. The involvement of a Western company impacted on building trust with foreign machinery suppliers:

> "About suppliers, they became more calm, less anxious and worried. […] Before, they wanted 50 percent prepayment and a bank guarantee. Now they act as in the civilised developed world, from 10 to 15 percent in advance, no bank warranty; next we pay when delivery is complete and the last part when lines are installed and start working. Before it was difficult, and

> considered risky to supply to Russia. Of course it is not only because of Fazer, it is the change in the overall economic situation in Russia. But when Fazer came, immediate changes took place: we needed to pay less in advance, and Fazer gave its own guarantee to the suppliers." (General Director, Hlebny Dom)

Thus, although Russia's improved economic situation was probably the most important factor in improving payment terms required by machinery suppliers, Fazer's role was also significant, especially at the very beginning of the cooperation. Equipment suppliers were almost solely foreign, only some production equipment for biscuit rusks at the Vasileostrovsky bakery had been acquired in Russia. However, employing mostly foreign machinery suppliers was not only due to the foreign investor's involvement, new production lines acquired by Hlebny Dom before Fazer's investment were also foreign.

As Fazer introduced new types of products to Hlebny Dom's product range, there were difficulties initially in finding suppliers for particular products in Russia. For instance, St. Petersburg had no suppliers of bread packaging that at the beginning was imported from Finland. However, as new suppliers appeared in Russia, the majority of raw materials were acquired locally:

> "In packaging materials, a good example is this Suominen who we use in Finland and who is today the biggest supplier, but they didn't dare put up a unit in Russia …even when we had negotiations guaranteeing a certain purchasing volume for a certain time, and now they are out. […] As Russia's own production rises, the little that we import is always replaced with that. Simple price competition". (Director, International Projects, Fazer Bakeries)

Finding good suppliers has not been easy and the company has, in a way, developed suppliers for themselves; for instance, by setting strict quality requirements and introducing systematic quality control. Although no formal training or technology transfer has been offered to local suppliers, Hlebny Dom wants to have close cooperation with their suppliers and has been able to help them by utilising its network relations, for instance, in Finland:

> "We try to engage our suppliers and customers in our production plans, so mainly we set the goals and requirements and how to meet them, it is their own task. But we want to share common goals and integrate suppliers and customers to the entire production process.[…] We have good relations inside Finland, and we can advise with whom to cooperate in order to solve problems, so together we try to find solutions and find companies in our network to help them. Thus, they can make connections via us with Finnish companies with good technological levels. Some suppliers have been to Finland or Estonia in order to learn at their own expense." (General Director, Hlebny Dom)

Even though Hlebny Dom has actively looked for domestic suppliers there remains a lack of sufficiently good suppliers in Russia for some product categories:

> "Russia is a developing market and a lot of spheres need to develop throughout the bakery industry. It is more reliable also to develop the supplying industry since customs are unstable. Now we have a packaging supplier from Lithuania, our main supplier, they produce plastic packages out of oil that comes from Russia. […] It would be better to have Russian suppliers and rely on them but there is no supplier that meets our requirements." (General Director, Hlebny Dom)

Nevertheless, in some cases, local suppliers have even made substantial changes in their production to meet increasing quality requirements set by Fazer. Today, approximately 90 percent of raw materials are acquired in Russia and only some special additives have to be bought from Finland. In general, relationships with raw material suppliers have become more long-term oriented and systematic. Whereas at the time of Fazer's entry into Russia, payment for all raw materials had to be made before receiving the deliveries, relationships with suppliers now have become tighter and good payment terms are offered. Contracts with suppliers are usually negotiated for a period of a year. However, a special characteristic of Russian operations is that also many shorter contracts (e.g. three months) are agreed and there is also spot trade; thus, for example, raw materials are sometimes bought at the day's spot price, regardless of whether there is a longer-term deal with some other supplier. This is not a preferred situation from the parent company's perspective as longer contracts are usually more profitable in the long run. Buying outside the established contracts can lead, for instance, to diminishing delivery reliability.

Apart from machinery and production material purchases, with which the parent company was strongly involved from the beginning, Hlebny Dom managed most of its purchases relatively independently until a few years ago. During the last few years, Fazer has gradually begun to make changes to the sourcing activities of its Russian subsidiary:

> "We try to develop and make more strategic sourcing there as it is very operational. It is what we here once had. […] We didn't have contracts either; we had many suppliers with whom we had no contracts. Now we aim to have written contracts with all major suppliers with all terms agreed. Just normal practice.…If someone is a very small actor, it might not require any big contract, it can be small-scale but, anyway, the major ones have to be agreed on paper, and there [in Russia] they are not necessarily, the contractual usage is unfamiliar." (Vice President, Sourcing, Fazer Group)

The Fazer Group launched a large development project concerning its sourcing activities in 2004 and introduced a category sourcing model. Thus, sourcing that was once performed separately by different divisions and in different countries is now concentrated into particular categories that are managed jointly for all divisions and units. With regard to the most important categories, for instance, sugar, flour and packaging material, the Russian operations are also integrated into the category sourcing model. Suppliers are selected for each category in accordance with the sourcing strategy of the company and based on large tenders. Russian supplier companies have also taken part in competitive bidding to become suppliers to the Fazer Group. Thus, whenever possible, the purchasing power of the whole Fazer Group is utilised. With the backing of a large foreign corporation and with large volumes, Hlebny Dom has in many cases been able to negotiate better contracts for itself than its local competitors.

3.3.5 Summary on changes in Hlebny Dom following acquisition by Fazer Bakeries

Since acquiring Hlebny Dom, Fazer has initiated a number of changes to its structure and processes. The most important of those are summarised in Table 6. Fazer's involvement in Hlebny Dom has necessarily caused changes to its organisational structure and personnel. From the investor's perspective, important changes were made to the financial administration system that was renewed in accordance with the Western style. Also, changes in production management and the creation of product development departments were emphasised by the investor's representatives. However, from the perspective of the acquired Hlebny Dom, the most important changes were those concerning the sales and marketing organisations. This was quite natural as, due to the Soviet past, there was a significant lack of knowledge on these areas.

Although many changes in personnel have occurred, the acquired company remains managed by its old management and no Finnish expatriates have been sent to Russia. Instead, Fazer has offered training at different levels of Hlebny Dom's organisation. Furthermore, there has been no attempt to drastically change the existing organisational culture, which probably in part explains why cooperation between the investor and the acquired company has been so smooth and successful.

Table 6 Summary of changes in Hlebny Dom resulting from the foreign acquisition

Changes concerning:	
Organisation & personnel	- Renewing the organisation structure to Western style: changes in financial administration and in production management, creation of product development departments, sales and marketing departments. - Recruiting new local staff, no expatriates sent from Finland. - Training of Hlebny Dom's (HD) staff. - No rapid changes to organisational culture suggested by Fazer. - Acquisition of two local production facilities.
Production & product range	- New production lines and machines bought from Western Europe, including dosing, cooling and packaging. - Increasing the quality and hygiene of production. - Introduction of packaged and sliced bread to the market. - Significant increase in product range, both by product transfers from Finland and local product development.
Sales, marketing & distribution	- Building sales and marketing organisations. - Introducing branded bread to the market. - Treating nascent retail chains as the most important customer category. - Creation of a new distribution system with a new type of plastic crate, automated crate handling and its own transport fleet.
Supplier relations & sourcing	- Fazer's involvement in HD increased trust of machinery suppliers and resulted in better terms of payment. - At first, difficulties in finding local suppliers in particular categories, e.g. packaging materials. - Strict quality requirements with more systematic quality control introduced to local suppliers. - To date, the share of local suppliers of raw materials has increased to 90 percent. - Moving towards more formal and longer contracts with suppliers with longer payment terms. - Russian operations included in the Fazer Group's comprehensive category sourcing model.

Since Fazer's acquisition, Hlebny Dom's production capacity has been increased by acquiring two further, formerly independent, bakeries. Production capacity has also been enhanced by new production lines in all production facilities. The new lines include such previously nonexistent functions as cooling and packaging. Thus, Hlebny Dom was the first company to bring packaged and sliced bread to the market. Fazer's know-how has been of cru-

cial importance both to introducing new types of product to the St. Petersburg market and to improving the quality and hygiene levels of production.

Fazer's influence in Hlebny Dom has been extremely important on the sales and marketing functions. In addition to Fazer's notion of bringing branded bread to the market, its experience in serving large retail chains in other markets was a major competitive advantage for Hlebny Dom. Thus, Hlebny Dom chose the nascent retail chains as its most important customer category prior to its competitors. A new modern distribution system that fulfils the needs of the retail chains has further strengthened Hlebny Dom's position as the most important supplier to many chains.

Belonging to the Fazer Group has also improved Hlebny Dom's position with suppliers. The parent organisation's reputation has increased the trust of machinery suppliers towards Hlebny Dom. Furthermore, employing the purchasing power of the whole group has given Hlebny Dom, for example, better payment terms in comparison to its local competitors. At the beginning of Fazer's activities in Russia, there was a lack of suppliers in many product categories, for instance in packaging materials, and foreign suppliers were utilised. However, as soon as local suppliers with sufficient quality appeared to the market, sourcing has been directed to those. Thus, the vast majority of all raw materials and packaging materials are purchased locally. Fazer has also contributed to the development of related industries by setting detailed specifications and quality requirements for local suppliers. In general, Fazer has tried to develop the sourcing activities of Hlebny Dom although it is an ongoing process. However, the tendency has been towards longer and more formal contracts than was previously the case.

Despite the large number of changes following Fazer's acquisition of Hlebny Dom, many of these have been rather gradual. Developing the company is perceived as a long-term and ongoing process. Indeed, it seems that the changes resulting from the acquisition were not experienced as "shock-therapy" by the acquired company's management. Rather, in most cases, there seemed to be a common understanding between the acquirer and the acquired company on the necessary changes.

This chapter described the changes in Hlebny Dom caused or initiated by the foreign investor, Fazer Bakeries. However, changes occurring in the acquired company also affect other organisations in the local market. Thus, the effect of Fazer's investment in St. Petersburg is further analysed in the following two chapters, which first introduce the respective theoretical perspectives that are subsequently utilised in the empirical case analysis. The next chapter discusses the impact of foreign enterprises as sources of spillovers to local companies.

4 THE EFFECT OF A FOREIGN ENTRY ON THE HOST COUNTRY'S LOCAL BUSINESS DEVELOPMENT

A foreign company's impact on host economies has been widely studied in the fields of economics and international business (IB). One way to examine the phenomenon is to assess the impact of foreign investment on the host countries' economic development. This chapter presents both a theoretical framework for assessing the impact of foreign entry on local businesses resulting from possible spillover effects and also its application to the empirical case data.

The chapter begins with theoretical considerations on foreign direct investment's (FDI) impact on host economies and proceeds to discuss spillover effects in more detail. Next, an analytical framework is presented and, finally, it is applied in the case analysis. However, the case analysis is not limited to this chapter alone but continues from the network perspective in the subsequent chapter.

4.1 Impact of foreign direct investment on host economies

The effects of FDI on host countries were first seriously discussed in the 1950s when neo-classical economists began to analyse implications of capital movements (Blomström et al. 2000). In the neoclassical tradition, the movement of all capital across national borders was perceived as a result of different interest rates prevailing in those countries and FDI was considered an equilibrating capital flow until interest rates were finally at the same level[28] (Weisfelder 2001). According to Blomström (1989), the standard theory of international trade offers a possible approach to studying the effects of foreign investment on host countries. According to the traditional trade theory, foreign investments were considered to be substitutes for trade and both trade and investments were perceived as welfare improving[29]. The liberal attitude

[28] This was first argued by Bertil Ohlin (1933): *Interregional and International Trade*, Cambridge. Mass.; Harvard University Press.

[29] Original source: MacDougall , G. D. A. (1960): The benefits and costs of private investment from abroad : a theoretical approach. *Economic Record* 27, 13-35.

towards FDI in the early post-war period was consistent with this theoretical perspective and FDI was believed to bring benefits to host countries through tax revenues, economies of scale and external economies. (Blomström et al. 2000; Blomström 1989.) The role of foreign capital was emphasised also in the context of developing countries as it was perceived to be more important than domestic capital for economic growth and development to occur (Hirschman 1958).

The unreservedly positive view of the influence of FDI on host country welfare changed radically by the end of the 1960s, when the academic literature began to emphasise the connection between market imperfections and foreign investment (Blomström et al. 2000). The theory of industrial organisation pioneered by Hymer (1976/1960) offers another basis for studying FDI and its impact on a host economy (Blomström 1989). In his dissertation, Hymer (1976/1960) argued that a corporation's desire to control foreign operations was the main motive for direct investment. He perceived this control as a strategic move to eliminate competition between the investing company and companies in other countries. (See e.g. Weisfelder 2001; Chen 1983; Cohen, Felton, Nkosi & van Liere 1980.) As FDI was perceived to be a result of oligopolistic home country markets, the research focused on transfer pricing, uneven development and dependency in general. Host governments began to regulate operations of foreign multinational corporations (MNC) and some foreign-owned firms, especially in the primary sector, were even nationalised during this period. (Blomström et al. 2000.)

Hymer's work can be considered the beginning of a new tradition, whereby the focus was changed from capital movements to FDIs and the neoclassical assumption of a perfect market was abandoned (Weisfelder 2001). However, the neoclassical postulate remained in the perspectives of many scholars as they perceived increased competition within a national market caused by MNCs clearly as a positive attribute (Cohen et al. 1980). An entry by a foreign subsidiary was expected to produce more rivalrous behaviour and, consequently, improvement in market performance than a domestic entry at the same initial scale (Caves 1971). Indeed, FDI was considered to be beneficial for the host country, especially for one that was 'less-developed', as it would bring in needed capital, technology and managerial skills (Cohen et al. 1980).

However, Dunning (1970) argued that "the balance of advantage will depend on many factors, such as the type and ownership of capital invested, its character and its industrial distribution". For example, investment for exploiting the host country's natural resources and exporting them to the investor country offers little benefit to the host country's economy (Caves 1971; Dunning 1970). Unlike some other economists who perceived investment barriers as ultimately harmful to global welfare (Cohen et al. 1980), Dunning

(1970; 1971) suggested that the host government should indeed develop suitable regulations and policies to minimise the harm and maximise the advantages of FDI inflow. Although MNCs were considered to transmit knowledge, technology and resources effectively across national borders and, thus, contribute to global welfare, they were also feared to undermine the capacity of nations to work for the welfare of their people as the rise of international corporations could cause a decline of national sovereignty (Cohen et al. 1980; Vernon 1971).

Thus, whereas the traditional trade theory perceived foreign investment merely as a capital inflow to the host country, the theory of industrial organisation recognised the distinctive characteristics of multinational enterprises (MNE) being pivotal in analysing the effects on host countries. This was considered to be especially important in cases of developing countries that differ greatly from capital exporting countries by the structure of their economy. Enterprises in many less-developed countries are relatively small, weak and technologically backward. Thus, the foreign entry can have both negative and positive effects on the host economy that are very different from the effects of foreign entry into a more developed host country. (Blomström 1983.)

Attitudes towards MNEs changed again in the early 1980s as a 'debt crisis' emerged for developing countries, the import substitution in Latin America and Africa failed and the more open Asian newly industrialised countries (NICs) showed success (Blomström et al. 2000; Lecraw 1992). Academic writings began to suggest that various positive external effects or 'spillovers' resulting from FDI were indeed important determinants on the development of a host country's industry. MNCs were perceived as important vehicles for international diffusion of technology and their central role in world trade was emphasised. (Blomström et al. 2000.) Simultaneously, policies concerning MNCs of most governments in developing countries changed from regulation and restriction to openness and promotion (Lecraw 1992).

However, it has been surprisingly difficult to identify conclusive evidence supporting the widely held view that FDI spurs economic development in developing countries (Nunnenkamp & Spatz 2004). The current understanding on FDI's welfare consequences to the host country offers a more complex picture on the matter. More recent studies have combined the analytical tools of both trade theory and industrial organisation, incorporating, for example, economies of scale, learning by doing and externalities to their analyses. (Blomström 1989.) Positive effects resulting from foreign investment are no longer considered automatic, although FDI is perceived as connected to potentially significant welfare gains (e.g. Yamin & Sinkovics 2009; Crespo & Fontoura 2007; Meyer 2004). Many researchers find that the degree to which FDI influences the upgrading of domestic companies depends, for example, on

the existing level of host country economic development, on the strategies of foreign MNEs and on the extent of interaction between foreign and domestic firms (e.g. Yamin & Sinkovics 2009; Scott-Kennel & Enderwick 2005; Meyer 2004; Blomström et al. 2000). The complex nature of FDI impact on its host economy is illustrated in Figure 10.

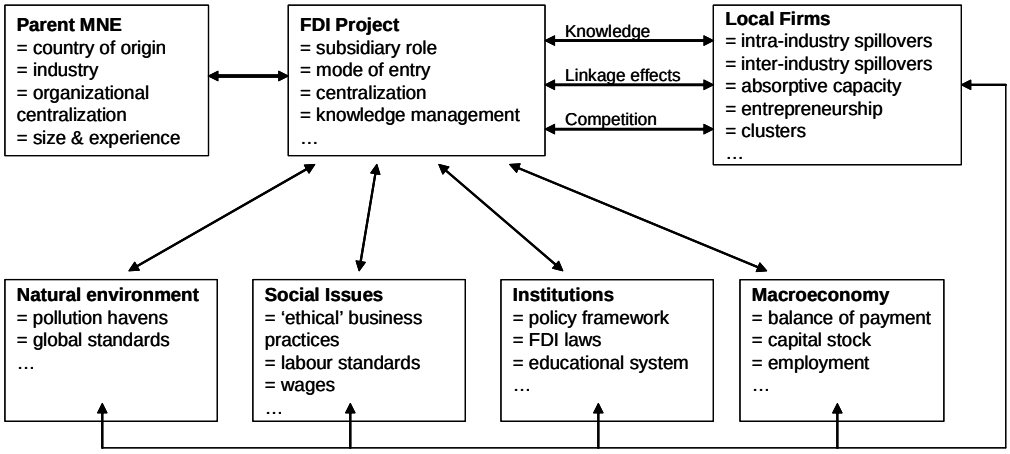

Figure 10 An organisational framework for FDI impact on emerging economies (Meyer 2004, 261)

Figure 10 by Meyer (2004) refers to FDI impact on emerging economies and indicates the different agents involved. It illustrates how both parent company and host country characteristics (i.e. natural environment, social issues, institutions and macro economy) influence an FDI project and vice versa. An FDI project impacts on local companies through knowledge transfer, linkages and competition, which can all create spillovers. The various forms of spillovers to local firms are discussed in more detail next.

4.2 Spillover effects of foreign direct investment

When analysing the influence of MNCs on host countries, it is useful to draw a distinction between direct and indirect effects of foreign investment. FDI directly influences the macro economic variables of a host economy; for example, capital formation, employment, tax revenues and trade. Trade theorists have mostly been interested in these direct effects of FDI. However, FDI can also indirectly affect the structure of the host economy and the conduct and performance of locally-owned companies. Researchers following

the industrial organisation approach have put more emphasis on these indirect effects (Blomström et al. 2000; Blomström 1989).

Although direct effects can be important in particular situations and in particular countries, it is generally considered that a significant share of FDI's long-term influences is likely to occur through indirect effects or 'spillovers' as they are often termed. This is due to the fact that, in addition to capital inflow, FDI includes capitalisation of technology, knowledge, skills and other intangible assets of MNEs that might be transferred or diffused to host countries. (Blomström et al. 2000.) "Spillovers arise from non-market transactions when resources, notably knowledge, are spread without a contractual relationship, so-called externalities" (Meyer 2004). Previously, Dunning (1970, 42) claimed that FDI brings the host country "all the elements necessary to create new production units: improved technology, new products and marketing methods, patents and trade-mark rights, managerial expertise and entrepreneurial initiative". Figure 11 illustrates the division of direct and indirect effects of FDI on a host country's economy.

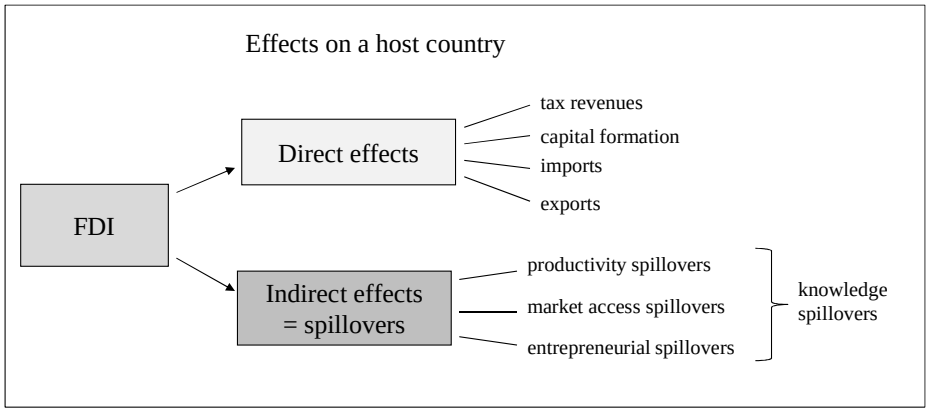

Figure 11 Direct and indirect effects of FDI on a host country

Figure 11 divides the effects of FDI on a host country roughly into two categories: direct effects on the host country's macro-economic variables, for instance, tax revenues, capital formation and foreign trade, and into indirect effects on the host country's local enterprises. This paper concentrates on the indirect, or spillover, effects of FDI and omits direct host country effects from the discussion.

Kokko (1992, 2) employs the term 'spillover' to "describe situations where the operations of foreign affiliates lead to improvements in the technology or productivity of domestic firms, and where affiliates are not able to extract the full value of the gains". Also, the terms 'indirect effects', 'externalities',

‘external effects’ or ‘involuntary technology diffusion’ have been employed to describe the same phenomenon (Kokko 1992; Blomström 1989). Also in this thesis, these terms are considered synonymous and employed interchangeably to avoid repetition. However, the term spillover is employed most often.

As the definitions above suggest, spillovers are often understood as unintended effects that a foreign enterprise has on local businesses, as a foreign subsidiary is unable “to capture the full social product resulting from the capital, managerial skills and technological knowledge that it transplants to the host country” (Caves 1971, 24). However, MNEs can also have an incentive to transfer knowledge deliberately, for instance, to their local suppliers (Hallin & Holmström Lind 2012; Javorcik 2004). Thus, in this study, “intentional knowledge diffusion” (cf. Hallin & Holmström Lind 2012) is also considered part of the FDI spillover phenomenon.

The spillover definitions above emphasise the dominant role of technology transfer in spillover studies. However, spillovers can be perceived more broadly to cover all external effects on business development in a host country; for instance, on entrepreneurial development or on market access of local companies. These spillover effects often result when local companies are able to absorb technological or business knowledge from an MNE (cf. Huber 2012). Thus, they can all be considered a result of knowledge spillovers (cf. Meyer 2004). The various spillover effects on local companies are discussed in the following subsections.

4.2.1 Productivity spillovers

Often, FDI spillovers to a host country are understood as productivity spillovers. Productivity spillovers are said to occur when the entry or presence of an MNC’s subsidiaries lead to productivity or efficiency benefits in the host country’s local companies and the MNC is unable to internalise the full value of these benefits (Blomström et al. 2000). As the increased productivity is usually connected to technological improvements, the terms *technology spillover* and *productivity spillover* are often employed interchangeably (see e.g. Kokko 1992).

According to Caves (1971), there are two sources of leakage that are especially interesting: labour training and productivity gains to local firms induced by the subsidiary’s market behaviour. Quite similarly, Blomström (1990) recognises several ways by which spillovers might occur; for instance, an MNC can increase the level of competition in host-country markets and, thus, force existing firms to become more efficient. A foreign company can also provide training of labour and management, which then becomes available to

the economy in general. Furthermore, the training of local suppliers provides another channel for spillovers to occur, as the MNC can train its suppliers to become faster, higher in quality and more reliable. Thus, the influence of a foreign firm on the efficiency of a host country's companies can impact both the foreign firm's local competitors, creating intra-industry spillovers, and the foreign firm's local suppliers and customers, creating inter-industry spillovers. (Blomström 1990.) Both impacts will be discussed in more detail in the following sub-sections.

4.2.1.1 Intra-industry productivity spillovers

An MNC's external effects on domestic enterprises in the same industry, thus to the MNC's local competitors, are referred to as *intra-industry or horizontal* spillovers. These leakages can occur through many channels. One such potential channel is competition. As MNCs usually have advantages with which to overcome barriers to entry such as capital requirements, risks and research and development intensity, their entry is likely to increase competition in a host country even on markets where barriers to entry for newcomers are high. Thus, intra-industry productivity spillovers can result from increased competition that forces inefficient local companies to adopt more efficient methods. Moreover, increased competition can lead to crowding out the least productive local companies, thus releasing their resources to more efficient operators. (Blomström et al. 2000; Blomström 1990.)

Another source of intra-industry spillovers to a host economy is the training of labour and management that occurs in MNEs. Trained workers and managers can later move to local companies and benefit them or start up their own entrepreneurial businesses. This channel of spillovers is supposed to be especially important for developing countries that often have shortages of skilled workers, managerial talent and scientists. (Blomström 1990.)

Transfer of technology from an MNC is a third possible source of spillover efficiency benefit to local companies. A foreign subsidiary's advanced technology can hasten local firms' access to a specific technology on which they otherwise would not have knowledge or would not consider profitable to try to acquire. (Blomström 1990.) Pure imitation and copying an MNC's technology is probably the simplest way in which spillovers can occur. However, obtaining a particular technology might not be easy for a local company as MNCs are often reluctant to license technology but rather keep it internalised. For local enterprises, hiring former MNC workers can be one of the few ways to gain access to new technology. However, the demonstration and imitation factor is likely to be more important in technology spillovers in developed

countries or industries which usually have the required technical skills available for imitation. (Blomström et al. 2000.)

Early empirical studies on intra-industry productivity spillovers came to rather straightforward conclusions: the statistical studies by Caves (1974) on Australia, Globerman (1979) on Canada, Chen (1983) on China, Blomström and Persson[30] on Mexico, and Liu, Siler, Wang and Wei (2000) on the UK all indicate that foreign presence has a consistently positive impact on the productivity of local companies in manufacturing industries. However, some subsequent studies challenge their findings by arguing that spillovers vary between industries or that they do not occur at all. (See Blomström & Kokko 1996; Kokko 1992.) For instance, Cantwell (1989) identified in his study on the entry of U.S. firms to Europe, that countries are likely to experience spillovers only in fields in which they have previously been successful. He concludes that "it is the technological capacity of indigenous firms that was the major factor in determining the success of the European corporate response to the expansion of innovative firms, even if the size of local markets made an additional contribution" (Cantwell 1989, 86). Haddad and Harrison (1993) conclude in their study on Moroccan manufacturing industry that technology spillovers do not occur at all, at least not in all industrial sectors. Furthermore, Aitken and Harrison (1999), by studying the Venezuelan manufacturing sector, came to conclusion that FDI causes negative spillovers to the productivity of domestically owned firms. They assume this to be due to a "market stealing effect", meaning that demand for local companies decreases as a result of increased competition.

Also, numerous studies on FDI spillovers in European transition economies indicate mixed results. For instance, Dries and Swinnen (2004) studied the impact of FDI on the Polish dairy sector and found strong and rapid horizontal spillover effects as local companies began to copy foreign firms' strategies. Conversely, the results of the study by Jensen (2002) on the Polish food industry showed an absence of horizontal spillovers from MNCs to domestic firms. The study by Gorton and Guba (2001) on the Hungarian dairy processing sector points to a more nuanced perspective: while foreign owners had indeed restructured the Hungarian dairy industry, some evidence on negative external effects in the form of crowding out of the largest domestic producers and smallest suppliers was also detected.

Negative spillover effects were also found by Djankov and Hoekman (2000) in their study on the impact of FDI on productivity performance of

[30] Original source: Blomström, M. & Persson, H. (1983) Foreign investment and spillover efficiency in an underdeveloped economy. Evidence from the Mexican manufacturing industry. *World Development*, Vol. 11, 493–501.

firms in the Czech Republic between 1992–96. Contrary to what was predicted, the study indicated that greater foreign participation in an industry had a significant negative effect on the performance of domestic firms. However, the short time frame of the study should be taken into account as spillovers can require more than four years before they become apparent in total factor productivity (TFP) growth rates (Djankov & Hoekman 2000). On the other hand, in Kinoshita's (2001) study on Czech manufacturing sectors, negative spillovers were not detected, while the rate of technological spillovers from FDI were found to vary greatly across sectors: a significant rate of spillovers from a large foreign presence was found to exist in oligopolistic sectors such as electrical machinery and radio & TV, whereas less oligopolistic sectors, such as food and non-metallic minerals, showed no evidence of spillovers despite the large presence of foreign investors in them (Kinoshita 2001).

In the study by Sinani and Meyer (2004), spillovers from technology transfer were found to be of considerable magnitude in Estonia although they seemed to depend on the characteristics of incoming FDI and also on the recipient firm's size, trade orientation and ownership structure. It was detected that domestic firms fail to catch up with foreign firms in most industries and this was inferred as the overly low absorptive capacity of the domestic companies to acquire the advanced technology of foreign firms. However, competition was found to promote sales growth for domestic firms. (Sinani & Meyer 2004.) In the context of Russia, Yudaeva et al. (2003) found that characteristics of the host region influence the degree of spillovers from FDI. Their study showed strong evidence on positive intra-industry spillovers with the size and quality of human capital in the regions seeming to be one of the most important determinants of the size of the spillover effect. It has also been stated that the extent of effective spillovers from FDI depend on ownership structure, the transfer of technology and also on the host country's policy. These factors, in turn, depend on both country and industry specific determinants. (Müller & Schnitzer 2006.)

In addition to having somewhat contradictory results on the occurrence of FDI spillovers, most spillover studies fail to indicate the mechanisms of intra-industry productivity spillovers. Although some case studies claim that spillover effects from demonstration are an important force behind local manufacturing sector development, it is impossible to state exactly how important they are or whether they are more important in particular industries and countries than in others. The reason for this is that it is practically impossible to separate the demonstration and imitation factor from the effects of competition; increased competition can be a reason why local firms are forced to improve their technology by imitating that of a MNC. (Blomström et al. 2000.) Also,

spillovers from an MNC through increased competition can be difficult to identify as the level of competition is not determined by the presence of MNCs alone but by the interaction between an MNC and local firms. Thus, it is possible that spillovers are larger in industries in which a few MNCs stimulate a former protected market than in cases where many MNCs hold large market shares but avoid intensive competition with local firms. (Blomström & Kokko 1996.)

In addition to the effects of increased competition and the effects of demonstration and imitation, productivity spillovers can result also from the training of staff in an MNC's affiliate, as trained workers and managers might later move to local companies. The empirical evidence on spillovers from an MNC's training activities is incomplete and mostly derives from developing countries. (Blomström et al. 2000.) Taking into account the weaker public education system in developing countries, the role of training in an MNC subsidiary in the creation of spillover is likely to be greater in comparison to developed countries. In his study of technology transfer to Hong Kong, Chen (1983, 61) identified that foreign firms indeed provided their workers with more training than local companies and concluded that "the major contribution of foreign firms in Hong Kong manufacturing is not so much the production of new techniques and products but the training of workers at various levels." Although it seems clear that MNCs offer a substantial amount of training to their local employees that can spill over to local companies through labour mobility, there is insufficient empirical evidence to draw any clear conclusions on the extent to which this occurs and what sort of skills (e.g. managerial or technical) are especially transferable (Blomström et al. 2000).

As MNCs clearly have an incentive to prevent information leakages that could improve the performance of their competitors, although they might have an incentive to transfer technology to their local suppliers, spillovers from FDI are more likely to be vertical than horizontal (Kugler 2006; Javorcik 2004). Thus, spillovers can be assumed to be more common in benefiting local actors in other related industries than the competitors of an MNC affiliate. This is confirmed, for example, by Kugler (2006) who found in his study that while intra-industry externalities are limited, *inter-industry* spillovers from FDI are indeed widespread. Inter-industry productivity spillovers will be discussed in the next sub-section.

4.2.1.2 Inter-industry productivity spillovers

Inter-industry or vertical spillovers refer to spillover benefits that migrate through linkages that an MNC has with its local suppliers and customers.

However, empirical studies have found sectoral differences in relation to linkage effects. For instance, the results of the study by Kippenberg (2005) on the linkage effects of FDI in the Czech economy show that linkages of FDI firms to the indigenous economy depend strongly on sectoral characteristics. In the case of the Czech Republic, FDI inflows did not generate significant linkages on the host economy in aggregate although FDI had a strong influence on labour-intensive and manufacturing sectors (ibid.).

In general, vertical spillovers occur when local suppliers or customers gain benefits from the foreign subsidiary's superior knowledge of product or process technologies or markets (Kokko 1992). Case studies have shown that an MNC can transfer techniques for inventory and quality control and standardisation to its local suppliers and distribution channels (Blomström & Kokko 1996). Thus, inter-industry spillovers can occur through both backward and forward linkages.

Backward linkages are those through which spillovers are most likely to occur (Javorcik 2004) and refer to direct relationships that an MNC has established with local suppliers. Spillovers through backward linkages occur as the new technology that an MNE brings can stimulate local suppliers to improve product quality or diminish costs to compete in the MNC's market (Blomström 1990). For instance, the study by Dries and Swinnen (2004) on the impact of FDI on the Polish dairy sector showed that the spillover effects from FDI led to improved access to finance, increased investments and dramatic quality improvements for small local suppliers.

Empirical studies on spillovers through backward linkages indicate several ways by which MNCs can contribute to enhance the productivity and efficiency of local suppliers. In his study on Indian truck manufacturers, Lall (1985) identified, for instance, the following ways in which MNCs can contribute to spillovers:

- Through *establishment linkages*, i.e. by helping prospective suppliers (domestic and also foreign) to establish production facilities.
- Through *technical linkages*, i.e. by providing technical assistance or information to raise the quality of suppliers' products or to facilitate innovations.
- Through *financial linkages*, i.e. by granting concessional loans or accelerating payments to ensure suppliers' abilities to meet their commitments.
- Through *raw material procurement linkages*, i.e. by providing or assisting in purchasing raw materials and intermediaries.
- Through *managerial linkages*, i.e. by providing training and help in management and organisation.

- Through *diversification linkages*, i.e. by assisting suppliers to diversify by finding additional customers to increase their financial stability.

Additionally, spillovers to an MNC's suppliers can occur as local suppliers are forced to meet the MNC's higher standards of quality, reliability and speed of delivery. There are some, although a limited number, of empirical studies indicating the importance of such 'forced linkage effects' on local suppliers. (Kokko 1992.) However, whereas some studies on spillovers via backward linkages show positive spillover effects on local suppliers, there is also evidence on negative spillovers. In their 1991 study on Venezuelan manufacturing industries, Aitken and Harrison[31] found generally negative effects from FDI on the productivity of upstream local firms (see Blomström et al. 2000; Kokko 1992). They state that foreign companies redirect demand from domestic inputs to imported ones, leaving local suppliers without any benefits from economies of scale. In the context of Russia, Yudaeva (2003) found similar results as her study showed a negative effect of foreign entry on firms in vertically related industries, especially for the suppliers. This is assumed to be due to the dissatisfaction of foreign companies with the quality of local suppliers. However, this negative effect is likely to become less significant over time as the increase in local content occurs (cf. Blomström et al. 2000; Kokko 1992).

Contrary to the findings of Yudaeva et al. (2003), Smarzynska (2002) found evidence on positive spillovers from FDI occurring through backward linkages in Lithuania. Firms in industries that supply sectors with greater multinational presence were found to enjoy higher productivity. However, the results suggested that spillovers only occur if the technological gap between foreign and domestic enterprises in the supplying sector is moderate in size. The degree of vertical spillovers can also depend on the nationality of foreign investor (Markusen & Venables 1999; Rodriguez-Clare 1996). For instance, in their study on vertical spillovers in Romanian firms, Javorcik et al. (2004) found positive association between the presence of American and Asian companies and the productivity of Romanian firms in supplying industries, but negative correlation between the presence of European companies and the productivity of Romanian supplying sectors. Thus, their study offers support for the theoretical assumption that foreign investment from a greater geographic distance tends to create more linkages with local suppliers and, thus, leads to greater vertical spillovers (see e.g. Rodriguez-Clare 1996).

Forward linkages through which spillovers can occur include linkages between an MNC and its local distributors, sales organisations and customer

[31] Original source: Aitken, B. & Harrison, A. (1991) Are there Spillovers from Foreign Direct Investment? Evidence from Panel Data for Venezuela, Mimeo, MIT and the World Bank, November.

companies. However, there is substantially less evidence on forward linkages than on backward ones. Blomström et al. (2000) mention the study of Reuber et al. from 1973[32], in which only a minority of firms are stated to have contributed significantly to the development of local distributors or sales organisations. Conversely, some other studies report similar growth in forward linkages as in backward linkages, and Aitken and Harrison[32] even claim that spillovers from forward linkages are more important in most industries than those from backward linkages. (See Blomström et al. 2000; Kokko 1992.)

In sum, both backward and forward linkages can be considered to facilitate spillovers from FDI to local firms. There is more evidence on the existence of backward linkages; however, forward linkages can be considered also to grow in importance. A host country characteristic such as market size, local content regulations and the size and technological capabilities of local firms are likely to influence the extent of linkages and, thus, spillovers (Blomström at al. 2000). According to Blomström et al. (2000) linkages between an MNC affiliate and local firms are likely to grow over time as the skills of local entrepreneurs increase, new suppliers are spotted and local content in inputs increases. Thus, over time, it is also likely that positive spillovers to local companies increase. In addition to productivity increases in local firms, the linkages can also enhance export activities of local companies. These market access spillovers will be discussed in the next section.

4.2.2 Market access spillovers

MNCs that are export oriented can produce externalities that enhance the export prospects of domestic firms (Buckley et al. 2002). These spillovers can be roughly divided into those that are direct and indirect. Direct spillovers are those occurring as local companies act as suppliers or subcontractors to MNCs and benefit from access to foreign markets as the MNC exports its products. (Blomström et al. 2000, 108–109.) Nevertheless, the output increase and economies of scale that might result from this should not necessarily be termed spillovers as the MNC might be able to internalise the cost reduction benefits of the suppliers by negotiating lower prices (Blomström et al. 2000; Aitken, Hanson & Harrison 1994).

However, linkages with an export-oriented MNC also bring about indirect spillover effects that can be termed “market access spillovers”, which might occur in many ways as the linkages provide knowledge on product and process technologies and foreign market conditions such as foreign preferences on

[32] Original source: Reuber et al. (1973) *Private Foreign Investment in Development*, Oxford.

product design, packaging and quality. Knowledge gained by a local company by acting as a supplier to an MNC can help it to build its own export activities to foreign markets. (Buckley et al. 2002; Blomström et al. 2000.) Thus, linkages between local companies and MNCs are also important facilitators for market access spillovers.

Spillovers enhancing local firms' export performance can, however, occur without direct linkages. In the simplest way, this happens as local firms can learn how to succeed in foreign markets by copying MNEs. Also, as in the case of productivity spillovers, training inside an MNC can also act as a channel for market access spillovers as local export managers trained by the MNC can later move to local firms and introduce acquired skills and knowledge. Furthermore, diffusion of information on foreign market conditions can occur in trade associations and other industrial organisations, in which MNCs are often active members. (Blomström et al. 2000.)

There is a considerable number of studies showing that foreign MNCs help the exports of local firms. For example, Aitken et al. (1994) concluded from panel data on Mexican manufacturing plants that MNCs act as export catalysts. Furthermore, they determined that locating near a multinational exporter increases the likelihood of exporting for an individual firm, whereas locating near a domestic exporter did not have the same effect. Buckley et al. (2002) also found positive market access spillovers from MNCs to Chinese manufacturing firms. However, spillovers depended on the local company's form of ownership: collectively-owned firms seemed to be able to absorb spillovers considerable better than state-owned companies. Also, Varblane and Ziacik (1999) and Vissak (2001) in their studies on FDI's impact on export activities of Estonian firms recognised positive effects. However, they stress that the benefits are likely to depend on the investment type. Following Dunning's (1988) division of main investment types, Varblane and Ziacik (1999) argue that an efficiency-seeking investment has the greatest positive effect on a host economy and its export sector.

Thus, studies on market access spillovers claim the existence of positive effects on local firms export behaviour. However, market access and productivity spillovers, although discussed separately here, can in practice be difficult to distinguish from each other. This is because breaking into new foreign markets takes more than just knowledge on market conditions, entry modes and marketing skills. It also requires efficient production that also can be improved by spillovers from FDI. (Blomström et al. 2000.)

Nevertheless, FDI can contribute not only to local companies' productivity but also to their access to foreign markets. In addition, FDI is likely also to influence entrepreneurial development in the host country. Spillover effects to local entrepreneurship are discussed next.

4.2.3 Entrepreneurial spillovers

FDI also has an influence on a host country's entrepreneurial development. For example, Dunning (1970) claimed that FDI brings all necessary elements for the creation of new production units, including entrepreneurial initiative, to the host country. Here, the terms local entrepreneurship and entrepreneurial development are employed interchangeably. They refer to the formation and dissolution of domestic entrepreneurs (i.e. firms) that are usually measured by the entry of new and the exit of existing enterprises (see e.g. de Backen & Sleuwaegen 2003). FDI is likely to influence local entrepreneurship in two ways: first, through the competition effect that prevents entry of domestic firms and, second, through positive market externalities that foster the development of local industry (Barrios, Görg & Strobl 2005).

Positive externalities or spillovers to a host country's domestic entrepreneurship are expected to occur through the same channels as market access spillovers; thus, through demonstration and learning, labour and management training and network linkages. For instance, training offered by foreign companies to its personnel can spill over and benefit local entrepreneurial development as trained managers start their own businesses (e.g. Chen 1983). This assumption has been supported by some empirical studies; for example, Katz[33] reports that many managers of local companies in Latin America have indeed started their careers in MNC subsidiaries (see Meyer 2004). In addition to labour mobility, spillovers to entrepreneurship can occur through demonstration as local entrepreneurs learn by simply observing successes or mistakes of foreign firms (de Backen & Sleuwaegen 2003). Furthermore, MNC affiliates can also assist the development of local firms by increasing the demand for intermediate inputs, some of which might be sourced from local suppliers, and provide a kick-start for the development of domestic industry (Barrios et al. 2005). Similar to backward linkages, forward linkages can also foster the development of local businesses (de Backen & Sleuwaegen 2003).

However, a foreign presence can also bring about negative effects on local entrepreneurs. One of the most common concerns of host country governments towards FDI, especially in developing countries, is the possible *crowding out effect* that foreign companies might have on local firms. The increased competition caused by foreign entry can crowd out local business in two ways: first, local firms might disappear due to the higher efficiency and product quality of foreign subsidiaries and, second, domestic companies might

[33] Original source: Katz, J. M. (1987) *Technology Creation in Latin American Manufacturing Industries.* St. Martin Press. New York

be wiped out because the foreign affiliates have better access to financial resources or might engage in anti-competitive practices. (UNCTAD 2003.)

In addition to market competition, the negative effects of FDI on local entrepreneurship can also result from crowding out on the labour market. Besides skimming the domestic labour market and decreasing the supply of labour to local firms by offering higher salaries, MNCs can also attract the best potential entrepreneurs to become employees by offering salaries higher than their entrepreneurial income (de Backen & Sleuwaegen 2003). Some evidence of labour market crowding out is put forward by Brown (2002) in her study on the impact of FDIs on small firm employment in northern Mexico, where a decrease in small business employment in the manufacturing sector was detected as a result of FDI inflow.

Nevertheless, empirical evidence of the crowding out effect is mixed with findings on crowding out in particular countries, for example, in Latin America, but with no effects in some other countries, for instance, in Asia (UNCTAD 2003). The differences in empirical findings might be due to the fact that different countries attract different types of FDI. One might assume that countries attracting mostly domestic market-seeking FDI are more likely to experience crowding out as the entry of foreign affiliates results in direct competition with local firms. Thus, in the case of export-oriented FDI, crowding out might be less likely. (UNCTAD 2003.)

Although many studies on FDI's impact on local entrepreneurship have been conducted in the context of developing countries, there is also some empirical evidence on developed economies. For example the study by de Backen and Sleuwaegen (2003) on the influence of FDI on the entry and exit of domestic firms across Belgian manufacturing industries showed evidence of the crowding out effect. However, their result suggested that, in the long run, negative effects can be reversed due to the long-term positive spillovers on local entrepreneurship resulting from demonstration, learning, networking and linkages between local and foreign firms. Quite similarly, Barrios et al. (2005) by studying the manufacturing sector in Ireland, state that the number of domestic firms follows a u-shaped curve, indicating that the competition effect first dominates and forces some local firms out of business but is gradually outweighed by positive spillovers making the overall impact of FDI mostly positive for the domestic industry. In the context of Ireland, the study of Görg and Strobl (2002) also found that the presence of MNCs has had a positive effect on the entry of indigenous firms both in the same industry and in downstream industries.

Thus, studies on spillover effects on local entrepreneurship have come to somewhat inconclusive results, suggesting that FDI's effect on local entrepreneurs can be both negative or positive depending on, for instance, the

type of investment (e.g. UNCTAD 2003) or the time elapsed from the foreign investment (e.g. Barrios et al. 2005; de Backen & Sleuwaegen 2003). Furthermore, the different spillovers effects discussed in the above sub-chapters seem to be in practice difficult, if not impossible, to separate from each other (cf. Blomström et al. 2000), and the actual mechanisms behind all productivity, market access and entrepreneurial spillovers seem to be more or less similar. Indeed, as all spillover types are often results of knowledge leakage or transfer from an MNE to local firms, they can all be grouped together under the concept of *knowledge spillovers.*

Whereas the previous studies on FDI spillovers have concentrated on whether or not and under which conditions spillovers occur (see Hallin & Holmström Lind 2012; Meyer 2004), the main interest of this study focuses on the mechanisms of spillover effects (cf. Hallin & Holmström Lind 2012; Spencer 2008; Javorcik 2007). Thus, the mechanisms behind knowledge spillover are discussed in more detail in the next section.

4.2.4 Knowledge spillovers from FDI

Recently, knowledge-based and organisational capability views have been employed as frameworks for studying the effects of MNCs on local firms (e.g. Gachino 2010; Spencer 2008; Singh 2007). These approaches are based on views of multinational firms as repositories of knowledge (cf. Grant 1996; Kogut & Zander 1993). Building on the resource-based-view of the firm (e.g. Barney 1991; Penrose 1959), the knowledge-based view posits that knowledge is strategically a company's most important resource (Grant 1996).

According to evolutionary theory of the multinational corporation, an MNC arises out of superior efficiency as an organisational means to transfer knowledge across borders. Thus, FDI is the transfer of knowledge or organisational principles of a firm from one country to another. (Kogut & Zander 1993.) However, some of this knowledge can also become available to local firms through *knowledge spillovers* (cf. Forsgren 2008).

Although the term 'knowledge spillover' is often employed in the literature on economic geography, economics of innovation and FDI spillovers, it often lacks a precise definition (cf. Dusanjh & Sidnu 2009). One definition offered by Jaffe, Trajtenberg and Fogarty (2000, 215) suggests that knowledge spillovers occur as "investments in knowledge creation by one party produce external benefits by facilitating innovation by other parties". Thus, this definition perceives knowledge especially as technological knowledge generated through research and development, suggesting that knowledge spillovers mean more or less the same as technology spillovers (cf. Hallin & Holmström Lind 2012;

Huber 2012). However, Huber (2012) makes a distinction between technological knowledge spillovers, which he employs interchangeably with technological spillovers, and knowledge spillovers that refer to a broader class of knowledge including, for instance, business knowledge. In this study, knowledge spillover is also understood as a wider concept including all kinds of knowledge. Consequently, knowledge spillovers can be considered a source of different types of spillover including productivity or technology spillovers, market-access spillovers and spillovers to local entrepreneurship.

Studying knowledge spillovers is not easy; as Krugman (1991, 53) points out, "knowledge flows […] are invisible; they leave no paper trail by which they may be measured and tracked". Thus, empirical studies on FDI spillovers have usually avoided the arguably difficult question concerning how spillovers actually occur. Instead, spillovers have traditionally been conceptualised as productivity gains, and empirical studies have focused on whether the presence of MNCs affects productivity in domestic firms. (Gachino 2010; Singh 2007; Görg & Strobl 2001.) Conversely, Jaffe, Trajtenberg and Herderson (1993) argue that knowledge flows occasionally do indeed leave paper trails in the form of citations in patents. Thus, knowledge spillovers from MNCs have been studied also based on patent citation data (see Hallin & Holmström Lind 2012; Singh 2007). However, neither of these studies reveal much concerning the mechanisms behind knowledge spillovers.

A new perspective for studying FDI-induced knowledge spillovers was quite recently suggested by Gachino (2010) who reconceptualised spillovers in terms of learning and capability building, and assumed that foreign presence through knowledge spillovers is likely to result in learning within local firms, which in turn triggers various forms of change in the companies. These changes, as assessed subjectively by the firms themselves, can be considered proxies for spillover occurrence (Gachino 2010). Figure 12 presents Gachino's (2010) framework model for spillover analysis.

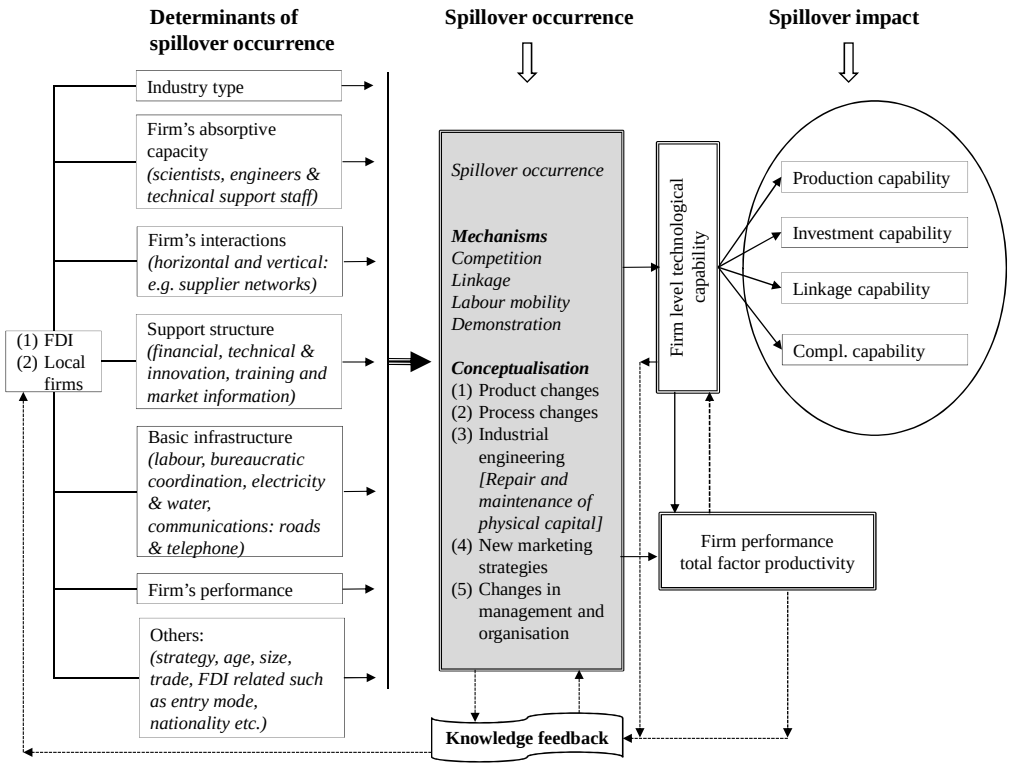

Figure 12 A framework model for spillover analysis: determinants, mechanisms and effect on technological learning and capability building (Gachino 2010, 200)

As Figure 12 indicates, Gachino (2010) considers four mechanisms of spillover occurrence that are also identified in the extant literature: competition, linkages, labour mobility and demonstration effects. For each of these spillover occurrence channels, five types of change associated with production capability are identified and considered proxies for spillover occurrence: product changes, process changes, industrial engineering, new marketing strategies, and management and organisation changes. As a result of spillover occurrence, local firms can enhance their technological capabilities.

In Figure 12, firm-level technological capabilities are categorised into production, investment, linkage and complementary capabilities. Production capability covers both basic skills, such as quality control, and more advanced skills such as adaptation, R&D and innovation. Investment capability includes skills related to, for example, project identification and feasibility studies. Linkage capability refers to skills, knowledge and organisational competence needed to transfer information, knowledge and technology to and from, for example, suppliers, subcontractors and consultants. Finally, complementary

skills include various organisation and marketing capabilities such as, for example, skills relating to coordination of organisational resources, collecting market intelligence and establishing distribution channels. (Gachino 2010.) As suggested by Figure 12, capability building in local companies that occurs due to knowledge spillovers from foreign firms is eventually likely to lead to improvements in the local companies' performance and profitability.

However, local companies often have difficulties in acquiring knowledge from MNEs (cf. Eapen 2012; Spencer 2008) as knowledge diffusion depends heavily on the type of knowledge. A company's knowledge resources range from relatively simple component knowledge to more complex architectural knowledge that links organisational practices throughout the company and is inherently tacit. (Spencer 2008.) As opposed to *codified or explicit knowledge* that is easy to convey through a simple verbal explanation or written documentation, *tacit knowledge* refers to know-how that is usually obtained through experience and is difficult to transmit to others without extensive side-by-side interaction (Polanyi 1964; see e.g. Spencer 2008; Grant 1996).

This tacit knowledge is thus difficult to copy by outsiders, which makes it an important, if not the most important, source for creating competitive advantage for a company (cf. Lubit 2001; Teece, Pisano & Shuen 1997). Hence, access to this tacit knowledge would be of great value for local companies; however, its transmission is more difficult than that of more codified knowledge (Spencer 2008). Indeed, mechanisms that facilitate the diffusion of knowledge between MNEs and local firms vary based on the level of tacitness of that knowledge, as summarised in Figure 13.

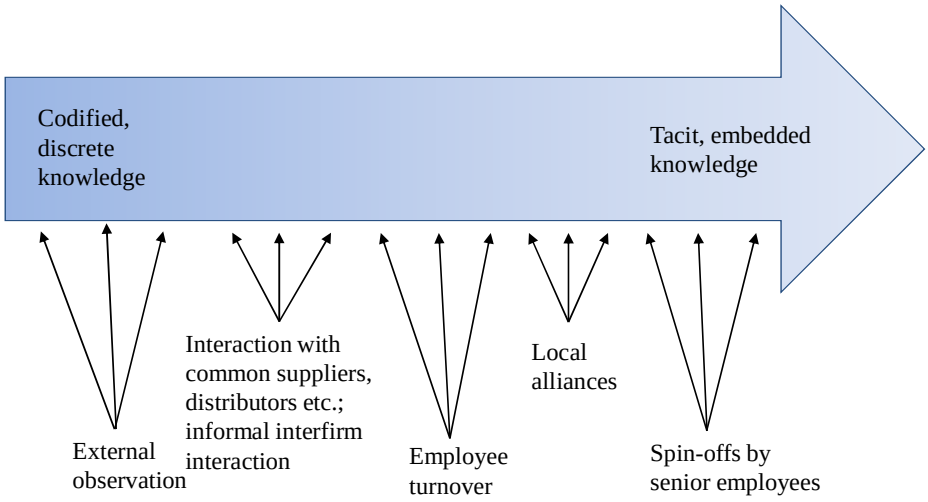

Figure 13 Examples of mechanisms for knowledge diffusion (Spencer 2008, 346)

As Figure 13 illustrates, the most codified knowledge can be transmitted simply by observation from a distance or, for instance, by examination of an MNE's end products; thus, without extensive interaction among employees of the two firms. As knowledge becomes less codified, acquiring it requires more interfirm interaction. Knowledge of moderate tacitness might be available through common suppliers or distributors who are in direct contact with an MNE. (Spencer 2008.) Relatively codified knowledge might also be conveyed via informal networks of knowledge exchange that can be present in an industry. These include, for instance, local business associations, boards of trade and chambers of commerce in which managers of MNEs and local firms can interact and share knowledge (Spencer 2008; McEvily & Zaheer 1999). Knowledge that is more tacit can be obtained by local firms when low- or mid-level employees leave MNEs to join local companies. Knowledge of a more tacit nature can be transferable only to partners in alliances working closely with an MNE. Finally, the most tacit knowledge can be diffused when senior managers leave an MNE to become entrepreneurs (Spencer 2008).

However, local firms' abilities to capture knowledge from foreign investors has been found to depend on their *absorptive capacity* (e.g. Eapen 2012; Spencer 2008; Crespo & Fontoura 2007; Kinoshita 2001). Absorptive capacity can be defined as "a set of organisational routines and processes by which firms acquire, assimilate, transform, and exploit knowledge to produce a dynamic organisational capability" (Zahra & George 2002, 186). A local firm's ability to absorb knowledge from a MNE varies based on the knowledge it already possesses and the amount of overlapping knowledge it

has with the MNE (Spencer 2008). Firms with either very low or very high absorptive capacity might not benefit from spillovers (Girma 2005); those with an overly low absorptive capacity lack the minimum threshold level of knowledge to absorb foreign technology, and firms with extremely high absorptive capacity presumably already operate near the technological frontier and, consequently, have little to learn from foreign companies. However, firms with moderate levels of absorptive capacity are better able to connect new knowledge with existing knowledge and transform it for their own application. (Eapen 2012; Crespo & Fontoura 2007; Girma 2005; cf. Meyer & Sinani 2009.)

In sum, knowledge spillovers from MNEs to local firms can occur through a number of channels depending also on the type of knowledge. The more tacit the knowledge, the more its diffusion requires interfirm (or interpersonal) interaction between an MNE and the local recipient firm. Furthermore, local firms' abilities to benefit from knowledge spillovers also depends on their absorptive capacity, suggesting that knowledge spillovers from the mere presence of multinational firms are by no means automatic or self-evident (Crespo & Fontoura 2007). The next section summarises the previous discussion on FDI spillovers and builds a framework on the potential mechanisms of FDI spillover occurrence.

4.2.5 Synthesis: A framework of mechanisms and determinants of FDI spillovers to local companies

Figure 14 illustrates, in a summarised manner, potential spillover mechanisms to local companies and factors affecting their occurrence. Similarly, as often in the spillover literature, the external effects of foreign MNEs on local companies are divided into intra-industry (i.e. horizontal) spillovers and inter-industry (i.e. vertical) spillovers in the figure.

The horizontal dimension in Figure 14 represents the possible mechanisms behind *intra-industry spillovers*; thus, external effects to firms in the same industry. Horizontal spillovers can be considered involuntary leakage of knowledge to local competitors (see Hallin & Holmström Lind 2012) that are presumed to appear mainly via indirect linkages; thus, as a result of the close proximity or agglomeration of firms within a locality (see Scott-Kennel & Enderwick 2005). Spillovers of codified knowledge can occur through *increased competition* and also through *demonstration* and *imitation* effects (see e.g. Spencer 2008; Scott-Kennel & Enderwick 2005; Blomström et al. 2000). Horizontal spillovers of rather codified knowledge can also occur through *informal interaction* in, for instance, local business associations or

chambers of commerce in which managers of the MNE's subsidiary and local companies interact (Spencer 2008; McEvily & Zaheer 1999). In addition, more tacit knowledge can spill over to local competitors through *labour and*, especially, *management mobility*, as workers and managers of the MNE subsidiary move to work in local companies (Spencer 2008; Blomström et al. 2000).

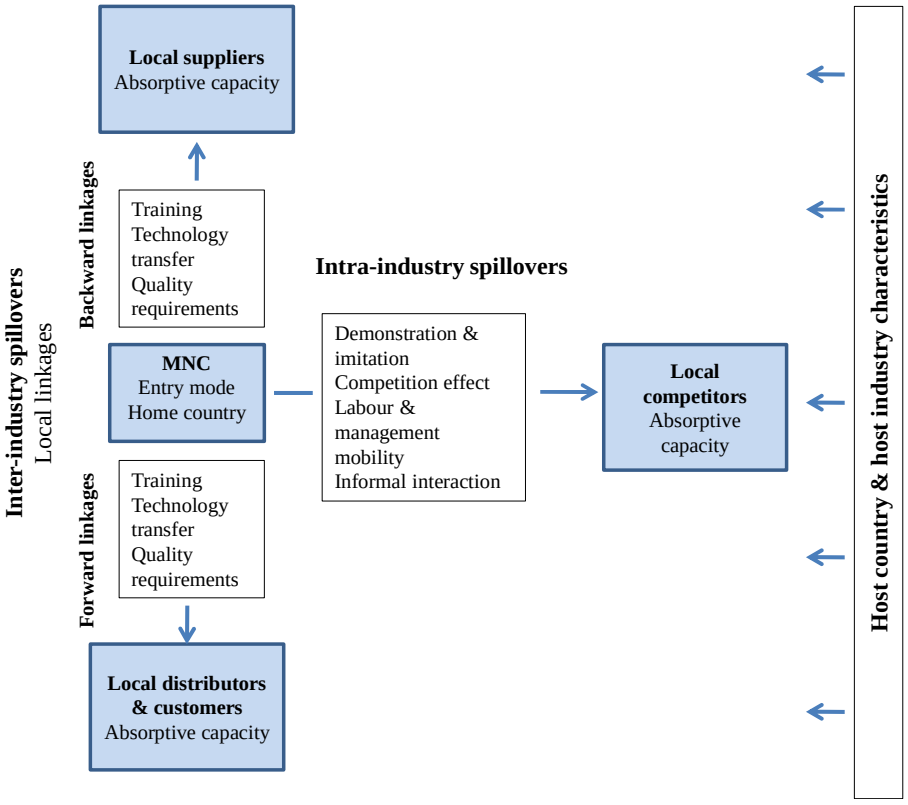

Figure 14 A framework of potential FDI spillover mechanisms

The vertical dimension in Figure 14 represents *inter-industry spillovers* occurring through direct linkages, which are the interfirm relationships that include direct transfer of resources; for example, backward linkages (i.e. buying) and forward linkages (i.e. supplying) (Scott-Kennel & Enderwick 2005). *Training, technology and knowledge transfer* and *requirements for improved quality, reliability and speed of delivery* have been suggested as possible mechanisms for inter-industry spillovers (e.g. Blomström et al. 2000; Kokko 1992; Blomström 1990). Thus, in contrast to horizontal spillovers, vertical knowledge spillovers can be perceived as intentional diffusion of

knowledge that an MNE subsidiary deliberately realises to its local suppliers and customers (Hallin & Holmström Lind 2012; Javorcik 2004). Especially *backward linkages* to MNCs' suppliers are those through which spillovers are often considered most likely to occur (e.g. Javorcik 2004), whereas previous studies show substantially less evidence on the importance of *forward linkages* to local distributors and customers (Blomström et al. 2000; Kokko 1992).

However, *local linkages* are a key factor determining the benefits that a host country can derive from FDI; the more linkages a foreign affiliate establishes with local firms, the greater the benefits that will be generated in the local economy (UNCTAD 2001). If an MNC has only very few and loose connections to local companies, it can be assumed to create relatively little, if any, spillovers to local companies. Example of such a situation might be an MNC's assembly factory that employs only imported components and exports its products. In such a case, the MNC might not have any vertical linkages to local companies, making the occurrence of vertical spillovers unlikely.

The *entry mode* of a foreign investor has been found to have an impact on local linkages and, thus, also on spillovers (see e.g. Meyer 2004). FDI in the form of a *joint venture* has been associated with more local linkages and, consequently, spillover benefits than FDI in the form of a wholly owned subsidiary (e.g. Chen, Chen & Ku 2004; Javorcik 2004). Similarly, FDI via a *merger or acquisition* is expected to establish wider inter-sectional linkages with domestic firms, due to its pre-integration in the local economy, than an entry through a *greenfield investment* (Crespo & Fontoura 2007). However, compared with acquisitions, greenfield investments are generally associated with more positive spillovers (Meyer 2004) as they are perceived to imply direct and instant inflows of know-how and technology to the host markets (Hallin & Holmström Lind 2012; Crespo & Fontoura 2007; Branstetter 2006). Instead, when an MNC enters via a merger or acquisition, technology transfer usually occurs gradually, which is asserted to restrict or at least delay the occurrence of spillovers. However, it should be noted that FDI in the form of a merger or acquisition employs the host country's technology as a starting point, creating a wider potential for knowledge spillovers through demonstration in comparison with greenfield projects, which might differ substantially from the technological systems of the host country, thus limiting the scope for spillovers (Crespo & Fontoura 2007).

The amount of linkages and, thus, occurrence of spillovers from FDI can also depend on the *nationality of the foreign investor*. Theoretical models on vertical linkages suggest that the share of intermediate inputs sourced from the host country is positively correlated with transportation costs and, hence, probably the distance between a production plant and a headquarter (see Crespo & Fontoura 2007; Markusen & Venables 1999; Rodriguez-Clare

1996). Also, the empirical study of Javorcik et al. (2004) concluded that investors from more distant countries and countries that are not part of a preferential trade agreement with the host country are more likely to be associated with positive vertical spillovers. This is because they have greater incentives to source locally than investors from nearby countries with preferential trade agreements.

Also, other investor-related factors have been considered to have an impact on possible spillover effects to local firms. For instance, the role of a subsidiary in comparison with its corporate headquarters (see e.g. Holm et al. 2003), and the degree of centralisation of an MNE's decision-making can influence the amount of linkages and, thus, possibilities for spillovers to local firms (Yamin & Sinkovics 2009; Meyer 2004). Furthermore, knowledge sharing within an MNE is clearly a precondition for knowledge spillovers to local companies (Meyer 2004).

However, knowledge spillovers do not depend alone on the amount and quality of knowledge sharing within an MNE nor on the amount and quality of linkages it builds with domestic firms, they also depend on local firms' *absorptive capacity* (e.g. Eapen 2012; Spencer 2008; Crespo & Fontoura 2007). Thus, recipient firms must have the capacity to acquire, absorb and adapt the knowledge to fit their own applications, processes and routines (cf. Narula & Marin 2003). Indeed, the study of Narula and Marin (2003) in the context of Argentina suggests that only domestic firms which have invested more in either new equipment oriented to product/process innovation or training activities receive positive spillovers from FDI. Also, in the Uruguayan context, Kokko, Tansini and Zejan (1996) found that spillovers appeared to be positive and statistically significant only to local plants with a moderate technology gap in comparison with foreign firms. However, for the occurrence of spillovers, the technology gap between the foreign and local firms should be sufficiently large for the local companies to benefit from observation and learn from the MNE's activities (Meyer & Sinani 2009).

The concept of absorptive capacity has been expressed also at the macroeconomic level, where it has been associated with the development level of a particular host country; for instance, in relation to human capital stock. In addition, other "support infrastructure" factors, such as the developed financial system in a host country, have been included in the concept of absorptive capacity. (Crespo & Fontoura 2007; Hermes & Lensink 2003.) Thus, in addition to the characteristics of the foreign investor and the local companies, also *host country and host industry characteristics* such as market size and local content regulations are likely to influence the extent of linkages and, thus, spillovers (Blomström at al. 2000). For instance, smaller markets and lower purchasing power in developing countries can constrain linkage development

and consequently the scope of spillovers (Yamin & Sinkovics 2009). In the following section, the framework shown in Figure 14 is employed in the analysis of the empirical case of Fazer Bakeries entry into the St. Petersburg bakery market.

4.3 Fazer's entry into the St. Petersburg bakery market analysed as a potential source of spillover effects

Many of the possible spillover mechanisms shown in Figure 14 are also present in the case of Fazer's entry into the St. Petersburg bakery market. Thus, the case study suggests that Fazer Bakeries' entry into St. Petersburg has had a significant impact on the local bakery business. The following sub-chapters 4.3.1 and 4.3.2 discuss first the horizontal effects (i.e. the effects on other local bakeries), then the vertical effects on local suppliers through backward linkages and also on local customer companies through forward linkages. The spillover effect of Fazer's entry on the local bakery market is summarised in sub-chapter 4.3.3.

4.3.1 Potential sources for intra-industry spillovers

The three possible sources for intra-industry effects shown in Figure 14 can also be found in the case study. In general, the entrance of a foreign firm can affect local companies through increased *competition.* In this case, also, it seems clear that the entry of Fazer Bakeries has impacted on the competitive environment in the St. Petersburg bakery industry. At the time the company made its investment in Hlebny Dom, the St. Petersburg bakery sector comprised 16 larger bakeries and a few hundred small ones. Since then, the amount of bakeries has diminished as there has been a strong trend of concentration of bakery businesses:

> "For instance, Smolninsky Bakery at the Ligovsky Avenue stopped due to competition. Another example of failing because of the competition is the united production of several small bakeries in Ivan Chernih Street. They terminated the union and most of them closed down. Yet another example is the Vasileostrovsky factory that initially produced good quality products but had bad marketing and sales departments. They failed in competition and offered Hlebny Dom the controlling stock and became our subsidiary. They realised that alone they were not able to create a system of sales and marketing that would help them survive. Thus, it was a decision between survival and independence. The final result of the deal was not closing down the operations but an acquisition that turned out positively. It is now

> producing more than in the Soviet times, thus their historical maximum." (General Director, Hlebny Dom)

With the financial support and knowledge transfer from a foreign partner, Hlebny Dom was able to invest in modern technology and restructure its activities more than most other local bakeries. Since Fazer's acquisition of Hlebny Dom, the company has further acquired three local bakeries conveniently located in different parts of the city, making it possible to serve better the whole area of the metropolis. As a result, Hlebny Dom has been able to increase its market share from slightly less than 15 percent in 1997 to approximately 35 percent in under ten years. At the same time, Hlebny Dom's biggest local competitor, *Karavai*, has increased its market share from 17 percent to approximately 22–23 percent and three other major bakeries, *Hleb*, *Zarja* and *Pekar* each cover approximately 6–8 percent of the market. The rest of the market is fragmented among a myriad of smaller bakeries. Despite the recent trend of mergers and acquisitions, Hlebny Dom is still the only major foreign owned bakery in the St. Petersburg market.

Although the restructuring of the St. Petersburg bakery industry would have certainly occurred without a foreign investor entering the market, the foreign entry has probably played a significant role in the process:

> "It did speed up the restructuring process there for sure. It is of course difficult to guess when you cannot test how long it would have taken until the situation would have changed. It would have changed at the latest when the chaining started, which began strongly a couple of years ago [around 2004] and is developing at a huge speed. But this [foreign entry] clearly accelerated it. It caused it to happen three to five years earlier." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Thus, in any event, the development of modern retail chains would have led to significant restructuring in the bakery market. However, as the foreign company in the market invested heavily in, for example, the production technology and distribution system, it forced local bakeries to follow the foreign company's example and make investments that they probably otherwise would not have made. In the face of increasing competition, only those companies which are able to invest can succeed, and many small and financially weak bakeries were forced to either merge with other companies or close down their operations altogether. Being backed by a foreign parent company, Hlebny Dom is financially in a very different situation than even its biggest local competitors:

> "Karavai, being second in the market, has to develop both technology to improve quality and its sales and marketing systems. It is very hard even for Karavai to match the requirements of the competition. They are working on the edge, even for them it's difficult as it requires a lot of money and they

> are short of money. Money is a problem in Russia. […] Loans in Russia are expensive and profit in the bakery business is not so high that you could pay for the financing. It is an obstacle for the development of many companies." (General Director, Hlebny Dom)

Whereas previously it was difficult for Hlebny Dom to obtain a loan for two or three years from Russian banks, the credit conditions of which were too tough and unfavourable for the company, the situation changed when Fazer Bakeries became the parent company. Hlebny Dom was able to enter into cooperation with foreign banks offering lower interest rates, shorter application periods and better credit conditions.

Indeed, the case gives some support to the notions of the possible crowding out effect that foreign companies can have on local firms, especially in developing host countries, due to the foreign subsidiaries' higher efficiency and product quality and also better access to financial resources (cf. UNCTAD 2003). Indeed, it seems that Fazer's investment has contributed to developing a similar sectoral consolidation as investments in other food sectors of transition economies that have become dominated by a few large and predominantly foreign players (see e.g. Larimo, Marinov & Marinova 2011).

Thus, there is a risk that a foreign actor, taking advantage of its dominating market position, might severely impede the function of the market. Nevertheless, as part of the transition from a planned to a market economy, restructuring of the St. Petersburg bakery market was inevitable and, in any event, would eventually have occurred. A foreign company entering the business apparently tightened the competition and accelerated the consolidation process; however, its external effects on the market cannot be considered mainly negative because, in many ways, it has acted as a flagship firm that local competitors imitate in developing their operations.

Hence, in this case, it is difficult, if not impossible, to separate the *demonstration and imitation factor* from the effects of competition as the increased competition is indeed the reason why local firms were forced to improve their technology by imitating that of Hlebny Dom (cf. Blomström et al. 2000). The role of a foreign investor company in improving the overall quality of bread in the St. Petersburg market has also been recognised by retailers, as shown by the following quotation:

> "[T]he quality of St. Petersburg bread is the best in the country. Not only the actual quality but the new technology, slicing, colourful packaging. But this is shown also in prices: bread here is 40–50 percent more expensive than elsewhere in Russia, including Moscow. This is connected to the fact that at the time, the Fazer Group acquired a chunk of shares in Hlebny Dom, actively invested money, made technical restructuring, developed production and planned new sorts of product. Competitors were forced to follow." (Director, Fresh Food, Lenta)

The competitors imitated the production technology of Hlebny Dom and also the product types by bringing similar new products such as packaged and sliced bread, single portion bread and berry pies to the market. New products are usually copied in approximately six months, which is the time needed to get new lines ready for production. In addition, the distribution system created by Fazer was copied by all major local bakeries and they too now have their own transport fleets and employ plastic bread crates. Although, as the transition proceeded, the product assortment on the market, sales and marketing activities and also the distribution system would have changed eventually, the example of a foreign owned firm certainly speeded up the process:

> "It certainly has had a significant effect. How big it is, time-wise surely several years." (Director, International Projects, Fazer Bakeries)

It is quite natural for a market leader's moves to be carefully followed and bench-marked by competitors. Usually, this is a job of each company's marketing department, the task for which is also to monitor the competition and all relevant market information. In the case study, yet another channel of knowledge diffusion arose as machinery suppliers were mentioned as an important channel of technical know-how to local competitors:

> "Equipment suppliers are willing to sell information, and, well, that is quite surprising. They might not dare to sell our recipe directly or anything, but they are able to sell or give advice in connection to their supply concerning a basic recipe to start with. And that is… I would say it is one of the most effective channels." (Director, International Projects, Fazer Bakeries)

As the same machinery suppliers supply both Hlebny Dom and some of its local competitors, knowledge on Hlebny Dom's production technology also reached its local competitors. Indeed, it has been suggested by Spencer (2008) that common suppliers or distributors can meditate the exchange of moderately tacit knowledge.

Informal interaction between the staff and managers of Hlebny Dom and local companies has also probably been a channel for information diffusion (cf. Spencer 2008). Competitors are often met, for instance, at European trade fairs where everybody pays attention to what sorts of machinery each company is acquiring. Furthermore, managers of different bakeries are acquainted with each other via, for instance, the local bakers' union, of which Hlebny Dom's former general manager was once chairman (cf. Spencer 2008; McEvily & Zaheer 1999). Thus, there are many readily available channels for following the actions of competing firms; simple demonstration and imitation and also informal interaction with local companies are indeed important channels for possible spillovers in this case.

In addition to simply following the market information and market actions of a foreign firm, *management and labour mobility* is another source for possible spillovers often mentioned in the spillover literature (see e.g. Blomström 1990; Caves 1971). It is suggested that trained workers and managers can later move to local companies and benefit them or start up their own entrepreneurial businesses. This channel of spillovers is suggested to be especially important for developing countries that often have shortages of skilled workers and managers (Blomström 1990). In this case too, Fazer has organised and offered many kinds of training for its staff in Hlebny Dom, and local competitors have been interested in hiring Hlebny Dom's managers to benefit from their knowledge and skills. Management and labour mobility can be also considered a way to imitate the actions of a foreign company, as not everything can be observed from the market:

> "Well, they have usually imitated us, these local firms, thus they're coming after us. […] Even as organisations. […] They have bought our people." (Director, International Projects, Fazer Bakeries)

By hiring Hlebny Dom's staff, competitors have been able also to copy the organisational structure of the company. As some managers have moved to work for competitors, the management migration can also be considered a possible source of horizontal spillovers of tacit knowledge in this case, although the most active companies in recruiting Hlebny Dom's staff have been other Western firms not in the bakery business.

4.3.2 Potential sources for inter-industry spillovers

In the case of Fazer's entry into St. Petersburg, many potential sources for inter-industry spillovers through *backward linkages* can be found. Although the company has not offered any supplier training, it significantly developed its suppliers' operations by setting stricter requirements on quality, reliability and delivery, by giving advice to its suppliers on with whom to cooperate to solve some technological problems and by integrating the suppliers closer to the company's operations and development. As a result, suppliers have, for example, significantly improved the quality of their supplies, widened their product portfolio and made investments in new technology.

However, as a foreign owned company, Hlebny Dom is able to employ its large network of foreign suppliers to replace local suppliers that do not fulfil its requirements, which could result in crowding out local suppliers and

creating negative external effects (cf. Aitken & Harrison[34]). Nevertheless, the trend in nearly all raw material and packaging material supplies has been the opposite: foreign supplies needed at the beginning of Fazer's operations in Russia were almost completely replaced by local suppliers' products as soon as they appeared on the market. Thus, in this case too, there seems to be an increase of local content over time (cf. Blomström et al. 2000; Kokko 1992), making the long-term effects for the supplying industries more positive.

However, with the exception of a production equipment supplier for biscuit rusks to the Vasileostrovsky bakery, suppliers of production machinery to Hlebny Dom have been foreign firms, which could be interpreted as a possible source of negative spillovers through crowding out local machinery suppliers. Nevertheless, the preference of foreign suppliers cannot only be considered an influence of the foreign investor, although Fazer was strongly involved in the new machinery purchases for Hlebny Dom. The company had already acquired new Western machinery prior to the foreign investor's involvement as there was a lack of Russian suppliers of modern bakery lines. Furthermore, from the beginning of the 1990s, at least one major local competitor already had Western European production equipment, thus the change by St. Petersburg bakeries to purchasing from foreign machinery suppliers was not initiated by the foreign firm entering the market as it had previously occurred.

Forward linkages are also possible routes for spillovers to occur as the entry of MNCs can have a positive impact on downstream sectors by making new or more suitable inputs available for local companies (Javorcik 2007). Forward linkages include those between a foreign firm and its local distributors, sales organisations and customer companies. However, the role of forward linkages in creating spillovers has been substantially less studied than the role of backward linkages (Blomström et al. 2000). Nevertheless, in the case of Fazer's entry into St. Petersburg, potential sources for spillovers also through forward linkages can be identified.

Clearly, replacing the former distributor, HlebTrans, with its own new distribution system can be perceived as a negative effect from the distributor's perspective, especially as the new in-house distribution system created by Fazer was welcomed by the retailers and later copied by other bakeries. Thus, the entry of the foreign investor caused, or at least strongly contributed to, the role of HlebTrans in St. Petersburg bread distribution to be diminished. However, the impact of a new distribution system is clearly positive from the perspective of customer companies; that is, retailers. Packaged bread delivered in hygienic crates is easier and faster to handle for the retail stores:

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[34] Aitken, B. & Harrison, A., (1991) Are there Spillovers from Foreign Direct Investment? Evidence from Panel Data for Venezuela, Mimeo, MIT and the World Bank, November.

> "It is of great significance as not that many people are now needed in between, like two storemen for unloading the bread, as the bread is just lifted onto a trolley, pulled into the store on the trolley and unloaded onto the shelves, so it saves time." (Product Manager, ZAO Renlund)

Thus, the new modern distribution system caused efficiency benefits for the retail stores and can be considered a source for positive inter-industry spillovers through forward linkages. The retail sector has also benefited from the enlarged product range first introduced by Fazer/Hlebny Dom, including varieties of packaged and sliced bread and many product innovations for the St. Petersburg bakery market. The margins for retailers in selling these products with more value-added are clearly significantly higher than those of the Soviet-type bulk bread. Partly due to the requirements of the retail chains, other local bakeries have also adopted similar new product types and also the same kind of distribution system as implemented by Hlebny Dom. Thus, in this case, spillovers through forward linkages have also been a possible route for spillovers to competitors (cf. Spencer 2008).

Furthermore, in the case of Fazer's entry into St. Petersburg, potential vertical external effects are not limited to those of linkages alone: *labour and management mobility* can also be considered a potential source for spillover effects to supplying and customer industries. For instance, Hlebny Dom's sales manager was recruited by one of the company's major clients, Lenta retail chain. Thus, the knowledge on sales and marketing gained through training and experience while working for Hlebny Dom will probably also benefit the new employer. Hence, labour and management mobility can also be a potential route for spillovers to companies in other industries. Although acknowledged as an important mechanism for horizontal spillovers, labour and management mobility has not been taken into account in earlier studies on vertical spillovers, which have been considered inherently voluntary knowledge transfer (cf. Hallin & Holmström Lind 2012). Potential mechanisms for both horizontal and vertical spillovers caused by Fazer's entry into St. Petersburg are summarised in the next section.

4.3.3 Summary of potential spillover effects from Fazer's entry into the St. Petersburg bakery market

Many of the possible mechanisms for spillovers put forward in the extant literature were indeed present also in the case of Fazer's entry into the St. Petersburg bakery sector. Building on the framework in Figure 14, Figure 15 illustrates, in a summarised manner, potential sources of both intra- and inter-industry spillovers present in the case study.

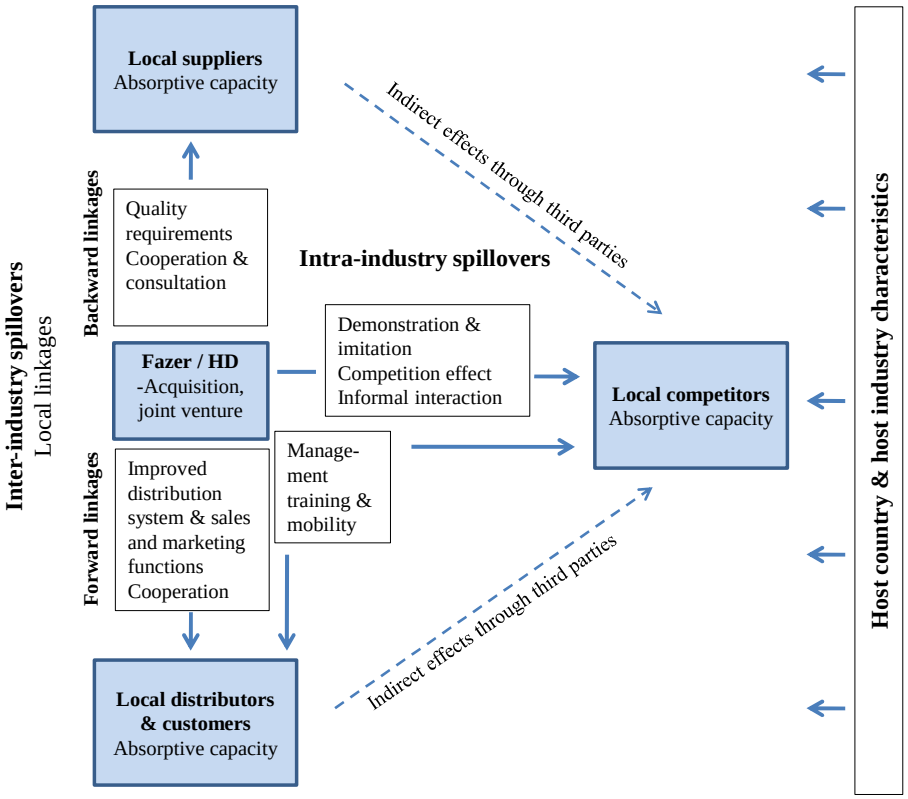

Figure 15 Sources for potential spillover effects resulting from Fazer's entry into St. Petersburg

As can been seen from Figure 15, the case study gives support to most of the spillover mechanisms identified in the extant literature and shown in the analytical framework in Figure 14. First, on the horizontal level, *demonstration and imitation* together with the *competition* effect seem to be important channels for diffusing, especially, codified knowledge from Fazer Bakeries' subsidiary in St. Petersburg to its local competitors (cf. Spencer 2008). However, the effects of competition and of demonstration and imitation are difficult to separate as increased competition can also be a reason for imitation (Blomström et al. 2000). *In the focal case, the effect of increased competition on local bakeries has been both negative and positive, depending on their absorptive capacity, and especially on their financial resources* (cf. Hermes & Lensink 2003). However, smaller and weaker companies have not had the necessary resources to develop their activities and have been forced to merge with bigger companies or even to close down their operations. Nevertheless, some companies have been able to imitate Hlebny Dom's activities and renewed their organisations, technologies and product portfolios in accordance with Hlebny Dom's example. In addition to pure external observation,

common machinery suppliers have been significant mediators of knowledge concerning products and production technology to local competitors (cf. Spencer 2008). In the course of implementing changes in their technological capabilities, local competitors have probably also enjoyed some efficiency benefits (cf. Gachino 2010).

Second, *informal interactions* have also been a potential channel for knowledge spillovers from Hlebny Dom to local bakeries (cf. Spencer 2008). Hlebny Dom's top management were well acquainted with managers of other local bakeries and the former CEO of the company had been the chairman of the local bakers' union. Managers of Hlebny Dom and local companies also meet each other regularly at, for example, trade fairs. The third mechanism for possible intra-industry spillovers of more tacit knowledge in the case study is *management mobility*, as illustrate in Figure 15. Local bakeries have recruited Hlebny Dom's managers and, thus, the management training offered by Fazer has, at least to a small extent, spilled over to competitors.

However, as illustrated in Figure 15, Hlebny Dom's managers have not only been hired by competing companies but also by firms in other fields of business. For instance, a manager moved to work for a one of Hlebny Dom's most important customer companies. This is an important notion because, although acknowledged as an important mechanism for horizontal spillovers, labour and management mobility has not been taken into account in earlier studies on vertical spillovers. *Thus, this finding would suggest that, unlike Hallin and Holmström Lind's (2012)perception, vertical spillovers are not necessarily based on intentional knowledge sharing between an MNC subsidiary and its local suppliers or customers but can also be pure knowledge spillovers; thus, inherently unintentional*.

Figure 15 shows that Fazer's entry has also impacted on local companies through both backward and forward linkages, as suggested by the literature. The fact that Fazer entered the market through an acquisition and operates as a joint venture, although majority owned, might have had a positive influence on the number of local linkages (cf. Crespo & Fontoura 2007; Chen et al. 2004; Javorcik 2004). However, in the early years of Fazer's presence in St. Petersburg, the undeveloped supplying industries forced Hlebny Dom to utilise foreign suppliers in some product categories. However, the trend has been towards utilising local suppliers whenever possible. Thus, although coming from a neighbouring country, Fazer has employed mainly local suppliers in its Russian operations. This contradicts the notions of, for instance, Rodriguez-Clare (1996) and Markusen and Venables (1999) who suggest that investors from nearby countries have fewer incentives to source locally. This might be explained by the lack of a preferential trade agreement between Finland and Russia that makes importing, for instance, raw materials

from Finland relatively expensive and also inconvenient due to many problems associated with the operations of Russian customs (cf. Javorcik et al. 2004). However, the lower cost level of Russian supplies in general makes local sourcing preferential for Fazer Bakeries.

Hence, the company wanted to integrate their suppliers into their operations and offered them some *consulting* concerning, for example, the acquisition of new production technology (see Figure 15). Also, *quality requirements* imposed by the foreign investor made suppliers develop and improve their operations. Again, whether the effects on local suppliers have been positive or negative is likely to depend on the supplier and its absorptive capacity; at least some suppliers, which were willing and able to improve their operations in accordance with the requirements of Fazer/Hlebny Dom, found the investments profitable and beneficial for their performance.

In the extant literature, empirical findings on spillover effects through *forward linkages* are scarce (e.g. Blomström et al. 2000; Kokko 1992). However, the case study suggests that *Fazer's entry has had a positive impact on modern retail companies* that have welcomed the *changes made to the distribution system, sales and marketing practices, product portfolio and improved product quality* (cf. Javorcik 2007) (see Figure 15). Based on Fazer's knowledge on the needs of modern retail chains, Hlebny Dom has been able to serve better its customers. The company cooperates closely with the retail companies and aims to be an irreplaceable partner for its major customers. However, Fazer's entry undoubtedly had a negative impact on HlebTrans, the former monopoly of bread deliveries in St. Petersburg. Many other bakeries have followed Hlebny Dom's example and now operate their own distribution, significantly decreasing the former monopoly's market share.

However, it should be noted that it is difficult, if not impossible, to separate changes caused by the foreign entry from those caused by, for instance, the general economic transition and related industrial restructuring. Thus, for instance, the development of the retail sector with the appearance of modern retail chains or the increasing purchasing power of consumers would, at some stage, have led to significant changes in bread production without a foreign investor entering the market. However, it is clear that Fazer's entry has been significant in directing and accelerating the process.

Probably the most significant difference between the earlier analytical framework of spillover mechanisms (Figure 14) and Figure 15 presenting the case findings *is the existence of indirect effects via third parties*. These are illustrated in Figure 15 with dashed lines. An example of such an effect are the quality requirements on suppliers, which have led to improved quality of their products. Better quality supplies are likely also to benefit Hlebny Dom's competitors that utilise the same suppliers. Moreover, distribution systems

similar to Hlebny Dom's have been adopted by local competitors as retailers began to require it from their bread suppliers.

Thus, the case analysis suggests that the division of external effects into those that are intra- and inter-industry is rather difficult and unclear. As the companies are interlinked, the effects that, for instance, originate through backward or forward linkages are likely to eventually also impact on local competitors. Similar findings were also detected by Hallin and Holmström Lind (2012), suggesting that embedded network relationships can act as a conduit for knowledge spillovers from an MNC subsidiary to its local competitors. Thus, business relationships with local firms seem to be important mediators also for horizontal knowledge spillovers (Hallin & Holmström Lind 2012; Spencer 2008).

Indeed, in the recent FDI spillover literature, the role of subsidiary embeddedness in local business, technology and social networks has been emphasised (e.g. Eapen 2012; Hallin & Holmström Lind 2012; Yamin & Sinkovics 2009). Thus, as network relationships and network embeddedness seem to be of great importance in transmitting external effects to local companies, analysis concerning these factors needs to be deepened. This is conducted in chapter 5, in which the effects of foreign entry are studied from the network perspective, mostly utilising key ideas and concepts of the IMP Group's industrial network approach.

5 THE EFFECTS OF FOREIGN ENTRY ON LOCAL BUSINESS NETWORKS

The IMP Group's industrial network approach (see e.g. Ford & Håkansson 2006; Easton 1992; Håkansson & Johanson 1992; Engwall & Johanson 1990; Håkansson & Snehota 1989) that perceives the business context of a company as a network of relationships rather than a market with numerous anonymous players, offers a useful perspective on studying the external effects of foreign companies: technology and knowledge do not just spill over to anonymous players in the market but are transferred via relationships within the network (cf. Abrahamsen, Henneberg & Naudé 2012; Ford, Gadde, Håkansson & Snehota 2003). Business markets often include only a limited number of suppliers, competitors and customers (Håkansson & Snehota 1989). Thus, through studying the phenomenon by concentrating on a network of companies, new understanding on the effect of foreign entry on local companies at micro and network levels and also on the role of relationships can be acquired.

This chapter begins by discussing the basic characteristics of business networks in general and also the special characteristics of Russian business networks. Next, the analytical framework for studying the entry of a foreign company is developed by paying attention especially to three central concepts in the industrial network approach: network embeddedness, network position and network change. Finally, by analysis from the network perspective, the developed framework is applied to the empirical case study of Fazer Bakeries' entry into St. Petersburg.

5.1 Characteristics of business networks

In neo-classical views of markets, the identity of parties is not a matter of concern as transactions are assumed to be perfectly replaceable across parties with a similar utility function (Easton & Araujo 1994). However, in reality, marketing exchange between organisations occurs under quite different circumstances than suggested by traditional economic models. Instead of pure market transactions, inter-organisational marketing often takes the form of relational exchange; thus, via interactive relationships formed by firms. (Ford et al. 2003; Möller 1992; 1994.) Indeed, there are usually only a limited number of suppliers, competitors and customers in business markets (Håkansson &

Snehota 1989). One way to perceive industrial markets is to regard them as networks comprising relationships (Ford et al. 2003; Easton 1992). In other words, the web of relationships can be termed a network (Håkansson & Snehota 1989). In the next section, the structure of business networks is discussed in more detail.

5.1.1 Structure of business networks

Usually, individual organisations are employed as basic elements in descriptions of network structure (Easton 1992; cf. Hamfelt & Lindberg 1987). However, Håkansson and Johanson (1992) suggest a triad of actor bonds, activity links and resource ties in descriptions of network structures.

Networks of actors, resources and activities are all closely related to each other and are interwoven in a total network (Håkansson & Johanson 1992). *Actors* can be individuals, groups of individuals, parts of firms, firms and group of firms that perform activities and control resources. Actors also develop and maintain relationships with each other through exchange processes. (Håkansson & Johanson 1992.) Relationships can be based on several types of bond between actors. Johanson and Mattsson (1987) distinguish technical, planning, knowledge, socioeconomic and legal bonds and, quite similarly, Möller (1994) identifies economic, social, legal, technical, informational and procedural bonds (cf. Tikkanen 1997; Håkansson & Snehota 1995; Easton & Araujo 1992). As firms are bonded together, they are often not entirely free to dissolve these bonds, even if they so wish. The relationships' bonds or ties can be either weak or strong (Granovetter 1973). However, it is rather difficult to measure the strength of a bond; one suggestion is to consider it the capacity to withstand a disruptive force. Weakly bonded networks are usually rather volatile, while strong bonds provide a more stable and predictable structure that is more likely to be able to withstand change. However, network structures are never static, although they tend to be quite stable. (Easton 1992; cf. Havila & Salmi 2000.)

Although relationships are often defined as those including economic exchange (e.g. Håkansson 1987; Cook & Emerson 1978), relationships based on non-economic exchange also exist in industrial networks; for instance, those between competitors (Johnston, Lewin & Spekman 1999; Easton & Araujo 1992). Interdependence between horizontal competitive relationships and vertical buyer-supplier relationships makes it important also to include competitive relationships in network analysis (Araujo & Mouzas 1997). Indirect relationships are important as they provide a direct link between dyadic relationships and networks. An indirect relationship can be defined as

"the relationship between two parties, which are not directly related, but which is mediated by a third party, with which they both have relationships" (Easton 1992). Indirect relationships can be both vertical, for example, to customers' customers or horizontal, for example, to competitors through mutual customers (Easton 1992; Johanson & Mattsson 1987). Direct and indirect relationships that connect firms make the structure of industrial networks inherently complex and borderless (Håkansson & Snehota 1989).

Indeed, the issue of network boundaries is central to network analysis (see e.g. Halinen & Törnroos 2005). In a way, the global industrial network can be perceived as one giant and extremely complex network in which any two firms can be connected through some path of relationships (Easton 1992; Håkansson & Snehota 1989). However, to facilitate analysis, it is necessary to subdivide this global network according to such criteria as interdependence between close network positions or geographic proximity (cf. Halinen & Törnroos 2005; Easton 1995). Sometimes, although not consistently, these types of subdivision are termed nets instead of networks (Easton 1992; Mattsson 1985). Anderson, Håkansson and Johanson (1994) employ the term 'network horizon' for analytical purposes to denote the extent of an actor's view of a network. However, it should be noted that all boundaries established by researchers are arbitrary and artificial in the sense that they are created for a particular research situation (Tikkanen 1997; Anderson et al. 1994; Easton 1992).

Network structure comprises not only relationship bonds between actors but also activity links**.** *Activity* can be defined as "a sequence of acts directed towards a purpose" (Håkansson & Snehota 1995, 52). Activities occur when one or more actors combine, develop, exchange or create resources by employing other resources (Håkansson & Johanson 1992). An activity chain links several companies into a sequence in which activities of a single company build on those performed by other companies and affect those of yet others (Ford & Håkansson 2006; Håkansson & Snehota 1995). Activities constituting a chain are interdependent and relate to each other by links: the tighter the link, the stronger the interdependence. One kind of tight link arises when activities are specifically adjusted to each other; for instance, by mutual adaptation of information systems, transportation and physical handling or payment routines. (Gadde & Håkansson 2001.)

Each company is connected to several activity chains that together form an overall activity pattern. Business relationships are the mechanism by which a firm acquires its position in the overall activity pattern. Both activity chains and activity patterns are highly dynamic: they change as a consequence of adaptations in activity links between two companies. Changes at a particular stage of the chain and in a particular part of the pattern spread out to other

stages. Although there might be periods of radical changes, most often the activity pattern is considered to develop in an evolutionary way. (see e.g. Abrahamsen et al. 2012; Havila & Salmi 2000; Halinen et al. 1999; Håkansson & Snehota 1995.) Typically, a network has a rather loose structure in which no organisation is 'in charge' alone as control of activities is distributed among firms that have imperfect understanding on each other's activities and objectives, and which interfere and/or facilitate each other's activities and outcomes (Ford & Håkansson 2006; Easton, Wilkinson & Georgieva 1997). Thus, rather than a top-down managed and directed way, network structure appears in more of a bottom-up self-organising manner (Easton et al. 1997).

Resource ties form the third variable in the network structure. Performing activities requires resources. All resources are controlled by actors, either by a single actor or jointly by several . (Håkansson & Johanson 1992.) Gadde and Håkansson (1992) distinguish between five different types of resource: human, technical, financial, procurement and marketing. Human resources include, for instance, the skills, knowledge and experience of personnel. Technical resources comprise the firm's technical core as embodied in its equipment and technical knowledge. The importance of financial resources depend on the type of business: they are inherently especially important for actors in capital intensive fields. Procurement and marketing resources determine an actor's control of the input and output processes in a distribution channel. All of these different types of resource are strongly dependent on each other and change in one of them might also require change in some others . (Gadde & Håkansson 1992.)

The industrial network approach emphasises interaction that applies also to the utilisation and development of resources. Business relationships between companies connect their resources. Relationships can tie together some of their resources in a specific way as adaptations are made in resource features and in the use of combinations. (Håkansson & Snehota 1995.) Håkansson and Waluszewski (2002) distinguish four different types of resource developed in interaction and crucial to industrial development processes. The first resource is the product, features of which are often a result of interaction between the buyer and the seller. The second resource type are production facilities, which from the traditional economic perspective are not perceived as being involved in an exchange process. However, from the network perspective, facilities become part of a relationship as, for instance, production and delivery systems can be adapted to the needs of the counterpart to reduce costs or increase efficiency. In addition to physical resources, social resources are also important from an interactive perspective. The third type of resource by Håkansson and Waluszewski's (2002) classification are business units that are an important social resource including, for example, the ability to cooperate,

which is based on earlier experience and technical and commercial knowledge. The fourth type of resource are relationships that become important in interaction processes as soon as time is of consequence. Relationships are a way to connect situations over time (Håkansson & Waluszewski 2002) and can even be considered a primary resource of a company without which its equipment, real estate or technology have little value (Ford & Håkansson 2006).

In sum, a central characteristic of a business network is its *interdependence*. Similar to actors, activities and resources all being functionally related to each other (see Håkansson & Johanson 1992) and partners in business relationships being mutually dependent (Holmlund & Törnroos 1997; Johanson & Mattsson 1987), also different relationships are interdependent (Ford & Håkansson 2006; Håkansson & Snehota 1989; Cook & Emerson 1978). This interdependence forms the structure of the industrial network (e.g. Ford & Håkansson 2006). The greater the interdependence, the clearer the structure of the network and the more important it is in determining the behaviour of individual organisations (Easton 1992). However, Johanson, Polsa and Törnroos (1998) argue that business networks are constituted differently in different cultural surroundings and that, for instance, the economic transition process that has occurred in Eastern Europe has created a specific phase of network development and networking. Thus, the next section discusses the special characteristics of business networks and their development in Russia.

5.1.2 Russian business networks

The characteristics of business networks in various markets can be dissimilar due to cultural and institutional differences (Jansson, Johansson & Ramström 2007; Johanson et al. 1998; Törnroos & Möller 1993). Indeed, it has been stated that business in transition economies is based on a different logic to that in Western economies (Johanson et al. 1998). The markets in transition are often said to be characterised, for instance, by differences between old and new relations and networks, by the importance of personal relations, by changes in relations and networks and also by difficulties in managing relations and networks (Jansson et al. 2007; Johanson 2004). These characteristics of Russian business networks[35] are discussed in more detail next.

Russian business networks are strongly influenced by the heritage of the planned economy and also by the economic transition of the country (cf.

[35] Jansson, Johanson and Ramström (2007) define a Russian business network as the type of business network that is found in Russia and in other countries of the former Soviet Union.

Mattsson & Salmi 2013; Jansson et al. 2007; Salmi 1996). During the planned economy era, Eastern European companies had little freedom to make autonomous decisions relating to what to produce, which suppliers to use, to whom to sell and at what price (Nieminen 1999). Industrial activities were tightly structured and controlled through a planned hierarchical arrangement (Mattsson & Salmi 2013; Salmi 1996). However, due to constant shortages in the planned economy, Russian firms, and also private citizens, often had to handle their resource dependence problems outside the official distribution system (Hallén & Johanson 2004a; Rehn & Taalas 2004). This sort of informal networking based on personal and social relations is described by the Russian term 'blat', or connections (e.g. Mattsson & Salmi 2013; Hallén & Johanson 2004a; Peng & Heath 1996). The blat-system worked without monetary expression by exchanging 'favours of access' (Michailova & Worm 2003). While some authors state that there are great differences in the networks of the socialist era in comparison with current ones (see Johanson 2004), Salmi (1995; 1996) points out that, at least over the early years of transition, new networks were built to a considerable extent on the old hierarchical systems of organisations and relationships. In fact, it even seems that firms which managed to maintain their Soviet era interfirm networks during the economic transition performed better, at least in the short term (Davis, Petterson & Grazin 1996).

While networks in Western market economies are usually considered to be those established between individual companies, in Eastern Europe the role of personal relationships is emphasised (Nieminen 1999). This is confirmed, for example, in studies conducted by Mainela (2002) in the context of Poland, by Törnroos (1996) and Salmi (2000) in the context of Estonia and by Salmi and Bäckman (1999) and also Michailova and Worm (2003) in the Russian context. According to Johanson (2004) the importance of personal relationships is both a legacy of the planned economy and a result of the uncertainty and volatility caused by the reforms. Security and trust is sought in personal relationships as it cannot be offered by the institutional framework. Social networks are also an important source of critical market information and, thus, personal networking is a highly significant resource. (Mattsson & Salmi 2013; Michailova & Worm 2003; Nieminen 1999.) Personal relationships are especially important when market conditions are unstable and turbulent as, for instance, in times of economic crises (cf. Salmi 1995). Indeed, respondents in the study of Salmi and Bäckman (1999) during the early years of transition pointed out "that personal relations are perhaps the most stable aspect of the contemporary transitionary economy".

However, although in Russian business networks, relationships and trust of individuals are more important than legal contracts, the establishment of

relationships usually begins with an attitude of suspicion (Jansson et al. 2007). Whereas in a Western European business network, the starting point in establishing relationships is that the counterpart is presumed honest, in a Russian business network, the expectation is that one is likely to be cheated. (Johanson 2008; Jansson et al. 2007). Nevertheless, along with the economic transition from a planned to a market economy, the importance of trust and honesty in business relationships has increased (Johanson 2008). However, in comparison to Western European network relationships, in Russia, suspicion seems to prevail also in mature business relations, although it can be reduced by previous social relationships (Jansson et al. 2007).

In addition to the inefficient hierarchical governance structure and informal blat system based on social relations, business networks in the planned economy were also characterised by the absence of relationships with foreign companies as foreign trade was conducted solely by the state's foreign trade monopoly (e.g. Nieminen 1999; Salmi 1996). When the socialist regime was replaced by the market system, the increased autonomy also meant challenges for local companies in establishing business relationships. Contacts with Western firms were considered especially important by Eastern European firms (Nieminen 1999) that, since the collapse of communism, have gradually become integrated into international industrial networks (Radosevic & Sadowski 2004).

Nevertheless, the development of business networks between Western and Eastern companies differs slightly from business conducted between companies in Western countries. In addition to traditional buyer-seller relationships, there are several other important actors in Eastern European countries' markets which are critical for the development of business activities. These include, for example, distributors, suppliers, managers of other foreign firms in the market, local employees, politicians, bankers, and governmental and municipal organisations. (Nieminen 1999.) Indeed, the importance of contacts with, for instance, public officials, political decision makers and banks has been emphasised in the Russian context (e.g. Heikkilä 2011; Törnroos 1996).

Differences between the structure of Russian business networks and Western networks are due both to actor bonds and activity links. Differences in organising activity chains can be perceived especially in activities of suppliers and customers and in the level of mutual adaptation. (Heikkilä 2011.). For example, Russian customers have been reported to engage in activities usually conducted by suppliers in Western markets. Furthermore, Russian network structures have been found to suffer from gaps in activity chains. (Johanson 2004.) For instance, missing links and sectors, unavailable logistics services and missing or inaccessible high quality raw material suppliers have been found to constrain the management of supply chains in

Russia (Lorentz & Ghauri 2010; Lorentz 2009; cf. Karhunen & Kosonen 2013). However, the structure of distribution networks in Russia is complicated and contains overlapping phases. This is due to the simultaneous existence of traditional (i.e. indirect) and modern (i.e. direct) retail structures. To achieve satisfactory sales levels, it is considered necessary for food industry firms to employ both traditional and modern types of channel. (Lorentz, Wong & Hilmola 2007.)

Developing activity links between companies is often challenging in Russia due to the unwillingness of Russian firms to change their activities. This reluctance to make relationship-specific investments together with the short-term orientation and lack of trust between companies makes the termination of relationships a common feature in Russian business networks. (Jansson et al. 2007.) Thus, firms seem to be more willing to terminate a relationship than change their activities within it, which makes Russian business networks loosely structured and turbulent (Jansson et al. 2007; Hallén & Johanson 2004b; Salmi 2000).

Due to loosely structured and turbulent networks and also with rapid changes in the environment, it is clear that managing relationships and networks is not easy in Russia (cf. Mattsson & Salmi 2013). Mainela (2002) has argued that, especially in transition economies, managers need flexibility and to be constantly alert to changes, both in a relationship network and in the external environment, to react successfully in response to unexpected change and also to proactively employ relationships to avoid possible problems. The development of relationships across national boundaries is an especially time consuming and resource intensive process that involves processes of learning (Salmi 2000). However, the situation is changing and, as business networks in the Central and Eastern European (CEE) markets begin to resemble established market economies, it will become easier for Western firms to understand their operational logic (Hallén & Johanson 2004a).

The holistic network perspective has been argued to be especially useful for understanding transition from a planned to a market economy (see e.g. Salmi 1996). For instance, according to Salmi and Bäckman (1999), the Russian business context is perceived explicitly in network terms. Furthermore, Salmi (2000) argues that, as personal relations seem to be particularly important in Eastern European markets, a research approach that also encompasses social aspects of business, such as the network approach, should be applied. The network approach also provides conceptual tools for studying dynamics in business markets (Halinen et al. 1999). As extreme dynamics of networks and the environment in which they are embedded seem characteristic of Russian business networks (cf. Törnroos & Nieminen 1999a), the industrial network

approach seems particularly appropriate for studying business development and network changes in the Russian context.

5.2 Network dynamics and a foreign entry

There are three central concepts of the network approach, namely network embeddedness, network position and network change, that are especially important for understanding the dynamics of business networks (cf. e.g. Anderson, Havila, Andersen & Halinen 1998; Halinen & Törnroos 1998; Easton 1992). These concepts are first discussed in the next two sub-sections. Then, as a synthesis, a framework for analysing the effects of a foreign entry on local business networks is created.

5.2.1 Network embeddedness and network position

Embeddedness is a central concept in the industrial network approach and it is perceived as an explanation of change and development in business networks (Halinen & Törnroos 1998). However, there is great variety in how network embeddedness has been conceptualised by different scholars (Andersson, Forsgren & Holm 2002; Halinen & Törnroos 1998). Embeddedness can be simply defined as closeness in a relationship. However, in business networks, it concerns not only the content of a firm's individual relationships but also the firm's position within the whole network of relationships. (Andersson, Forsgren & Holm 2001.) Thus, network embeddedness can be considered to have two aspects: the first, termed relational embeddedness, refers to a firm's set of direct dyadic relationships (Andersson et al. 2001; Gulati 1998) and can be defined "as the interdependence between social relations, exchange of resources, and combination of resources in the relationship" (Andersson, Blankenburg Holm & Johanson 2007, 35). The second aspect, termed structural embeddedness, addresses the centrality of the firm in its business network and, thus, includes also indirect connected relationships (Andersson et al. 2001; Gulati 1998). As this study is interested in the effects of a foreign entry on both the direct business relationships and the broader business network (cf. Easton 1992), the structural embeddedness perspective is closer to the focus of this study.

In comparison with relational embeddedness, a broader contextual setting of embeddedness has received less attention (Halinen & Törnroos 1998). However, Halinen and Törnroos (1998) argue that, to understand better network dynamics, a broader perspective on network embeddedness is needed.

Thus, in this study, network embeddedness is understood as *"companies' relations with, and dependence on, various types of networks"* (Halinen & Törnroos 1998). For instance, Granovetter (1973; 1985; 1992) emphasises that economic organisations are embedded in networks of interpersonal relationships and larger social structures. As social relationships have their own histories, time is also an important concept in understanding industrial networks (Halinen & Törnroos 1998; Grabher 1993). Thus, embeddedness implies that companies and networks are both socially and historically constructed (Halinen & Törnroos 1998; Holmlund & Törnroos 1997).

Halinen and Törnroos (1998) identify six different types of embeddedness: temporal, spatial, social, political, market and technological embeddedness. They also examine embeddedness along both vertical and horizontal dimensions. However, Rooks et al. (2000) take a slightly different perspective and distinguish three dimensions of social embeddedness of interactions: temporal embeddedness, network embeddedness and institutional embeddedness. Table 7 clarifies the different perspectives on embeddedness and the contradictory use of terminology between Halinen and Törnroos (1998) and Rooks et al. (2000). The differences are due to the various network perspectives employed: Halinen and Törnroos (1998) take the IMP's industrial network approach as a starting point whereas Rooks et al. (2000) look at embeddedness from the social network perspective. This study follows more the IMP's industrial network perspective but, as the two network perspectives in many ways overlap, the social network approach literature has also been employed.

Table 7 Two perspectives on types and dimensions of embeddedness

<table>
<tr><td rowspan="8">Network embeddedness

(Halinen & Törnroos 1998)</td><td rowspan="6">Types of embeddedness</td><td colspan="2">Temporal embeddedness</td></tr>
<tr><td colspan="2">Spatial embeddedness</td></tr>
<tr><td colspan="2">Social embeddedness</td></tr>
<tr><td colspan="2">Political embeddedness</td></tr>
<tr><td colspan="2">Market embeddedness</td></tr>
<tr><td colspan="2">Technological embeddedness</td></tr>
<tr><td rowspan="2">Dimensions of embeddedness</td><td colspan="2">Vertical embeddedness</td></tr>
<tr><td colspan="2">Horizontal embeddedness</td></tr>
<tr><td rowspan="4">Social embeddedness of business transactions

(Rooks et al. 2000)</td><td rowspan="4">Dimensions of social embeddedness</td><td colspan="2">Temporal embeddedness</td></tr>
<tr><td rowspan="2">Network embeddedness</td><td>Voice network</td></tr>
<tr><td>Exit network</td></tr>
<tr><td colspan="2">Institutional embeddedness</td></tr>
</table>

Halinen and Törnroos (1998) perceive business networks as evolving social and economic systems intrinsically linked to time. However, time does not refer only to natural or physical time but should be perceived in a multi-dimensional manner. For business studies, Halinen and Törnroos (1995) propose a relational time concept, which suggests that companies are bound to past, present and future modes of time. In other words, companies, dyads and networks have their own histories (cf. path-dependence, e.g. North 1990). Quite similarly, Rooks et al (2000) consider *temporal embeddedness* to include the history of previous transactions between partners and also expected future transactions.

Spatial embeddedness refers to the spatial levels of industrial activity within a specific business setting. It can be perceived from the perspective of location theory; for instance, the manner in which business activities are located and organised. Business actors can be internationally, nationally, regionally and locally embedded in different types of network (Halinen & Törnroos 1998). Industrial districts, innovative networks such as Silicon Valley and flexible production in the networks of Japanese automobile firms are good examples of spatial embeddedness (e.g. Langlois & Robertson 1995; Malecki 1991).

Social embeddedness means that business networks are embedded in various social structures through individual actors (e.g. Granovetter 1973; 1985; 1992). Individuals act both on behalf of their organisations and on their own behalf and engage in various forms of interaction. They form social networks both inside the company and between organisations by interacting with individuals from the same company and from other companies. (Ahrne

1994.) Furthermore, individuals have their own contacts outside the company in which they work: they have family and friends and also personal contacts through, for example, hobbies and political activities. These kinds of personal connection can also have an impact on business exchange. (Halinen & Törnroos 1998). For instance, it has been stated that kinship ties are probably the most stable basis for an inter-organisational relation, although they have often been neglected by organisation theorists (Aldrich & Whetten 1981). However, Granovetter (1973) emphasises the role of weak ties in seeking to understand dynamics in social networks. He employs the weak tie concept to describe acquaintances whereas a strong tie refers to, for example, friendships.

Firms' networks of social connections can also provide benefits that will spill over into transactions with other trading partners that exist beyond the network of ties that generated the benefits (Uzzi & Gillespie 2002). The concept of network transitivity "refers to the mechanism by which a focal actor gains competencies and resources from one network tie that improves the value the actor derives from exchanges with an independent third relation" (Uzzi & Gillespie 2002), as illustrated in Figure 16.

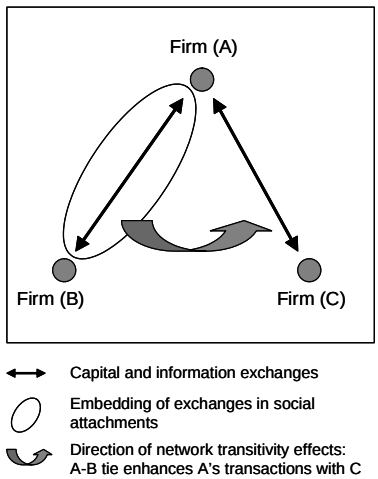

Figure 16 Network transitivity (adapted from Uzzi & Gillespie 2002, 596)

Figure 16 shows how Actor A acquires resources or competencies from actor B that are of value in its independent transactions with actor C. According to Uzzi and Gillespie (2002), the concept of transitivity explicates how firms' social embeddedness enables them to acquire network benefits that remain untapped by brokering and partnering strategies. Thus, the concept of network transitivity is useful for understanding how networks and firms acquire competitive knowledge (Uzzi & Gillespie 2002; Kogut 2000).

Firms can also be politically embedded. Halinen and Törnroos (1998) employ the term *political embeddedness* to refer to the politico-social context in which each firm, dyad or network has its relative power position with respect to other actors. Business actors can become involved with the political system at the national or local level. In particular networks and situations, for instance in Eastern European transition economies, political representatives can occupy important positions in business networks (cf. e.g. Heikkilä 2011; Nieminen 1999; Törnroos 1996). Rooks et al. (2000) employ the term *institutional embeddedness* to refer to existing institutions such as the law that makes agreements and commitments credible. In countries with less efficient legal systems, it is harder to make agreements legally enforceable (Rooks et al. 2000). For instance, in Eastern European countries, it seems that security and trust is sought in personal relationships as they cannot be provided by the institutional framework (e.g. Johanson 2004; Nieminen 1999).

Market embeddedness refers to a specific market defined in terms of products and services offered, clientele served, functions performed and the time and territory encompassed by a company's operations. Actors are connected with their suppliers, customers and distributors and, sometimes, also with their competitors; for example, through strategic alliances. (Halinen & Törnroos 1998.) Rooks et al. (2000) perceive *network embeddedness* as one dimension of social embeddedness in buyer-seller relations. They distinguish two types of network embeddedness: *Voice network* includes a company's relations with third parties such as, for example, other buyers or suppliers of the supplier, supplier's bank or lawyer. A buyer's *exit network* refers to options for buying a similar kind of product or service from an alternative supplier. (Rooks et al. 2000.)

Technological factors are critical for understanding networks of modern economies (Kogut 2000). *Technological embeddedness* means that business exchange is embedded in various technological systems and also in the development of these systems at corporate and societal levels. Companies are not only dependent on specific processes and product technologies but also on infrastructural technology, meaning the general technological level of a country including, for example, transportation and information systems. (Halinen & Törnroos 1998; see also e.g. Håkansson 1989.) A subsidiary's technological embeddedness can be evaluated, for instance, by its adaptation of product and production technology to its most important customers, suppliers and other counterparts (Andersson & Forsgren 1996).

In addition to different types, the concept of embeddedness can also be studied along both vertical and horizontal dimensions (Halinen & Törnroos 1998). *Vertical embeddedness* refers to relations between different levels in a network (Holmlund & Törnroos 1997). These levels can be distinguished in

three ways: first, by geographic levels (e.g. local, regional, national or international); second, on a basis of channel structure (e.g. supplier, manufacturer, distributor or customer); and third, within a specific business (e.g. individual, department, company or industry). Meanwhile, *horizontal embeddedness* refers to relations of the actors within a specific network level; for instance, a company's relations within a specific industry, among industries or within a certain geographic area. At a horizontal level, actors can be embedded in various competitive relationships and also in cooperative arrangements such as joint-ventures or strategic partnerships. Denoting both horizontal and vertical embeddedness helps to identify the different layers of a firm's business context from where change might emerge. (Halinen & Törnroos 1998.)

However, due to the many types and dimensions of embeddedness, evaluating overall subsidiary embeddedness is difficult. A subsidiary that is embedded in many dimensions and in many activities in its local business network is clearly more embedded than a subsidiary that is adapted in only one dimension. (Andersson & Forsgren 1996.) However, analysing the several types and dimensions poses challenges for empirical studies. In general, the external embeddedness of a subsidiary can be defined by letting the subsidiary itself estimate its relevant direct and indirect relationships with suppliers, customers and other counterparts, and also the interdependence and adaptation within these relationships (Andersson & Forsgren 2000).

Business networks with high embeddedness are likely to develop trust and facilitate a rich exchange of information between various network actors (Chen & Chang 2004). Indeed, a company's capabilities are shaped by its role in the whole network. To understand a company's operations, one should view the whole network in which the company is a part, and especially its position in that network (Andersson & Forsgren 2000). Indeed, the concept of *network position* is important for understanding dynamics in business networks (Anderson et al. 1998; Easton 1992). Mattsson (1985, 266) defines the term network position "as the roles that the organisation has for other organisations that it is related to, directly or indirectly". Anderson et al. (1994) employ a related concept, *network identity* "to capture the perceived attractiveness (or repulsiveness) of a firm as an exchange partner due to its unique sets of connected relations with other firms, links to their activities, and ties to their resources". Network identity refers to how firms both perceive themselves in a network and are perceived by other organisations.

According to Johanson and Mattsson (1985) network positions are defined, first, by the identity of the other firms with which the focal firms has direct or indirect relationships; second, by the role of the focal firm in the network; third, by the importance of the focal firm in the network; and fourth, by the strength of the relationships of the focal firm with other firms in the network.

Basically, a change in the position of one organisation will, more or less, change the position of other firms in the network. These changes are not necessarily confined to firms in direct relationship with the initiating firm but can spread through the entire network as a cascade of position changes. (Easton 1992; Mattsson 1985.) Hence, the concept of network position relates to the concept of network change as business networks are dynamic and network positions change constantly (Abrahamsen et al. 2012). The concept of network change is discussed in more detail in the next section.

5.2.2 Network change

Relationship bonds make networks stable but not static. Indeed, change is a central characteristic of industrial networks and network relationships can only be understood in dynamic terms (Easton 1992). Thus, it is not surprising that change in business networks has received a substantial amount of attention from scholars in this field. However, there have been calls for more studies to understand how networks change and to determine the underlying forces behind their changes (e.g. Abrahamsen et al. 2012; Kamp 2005; Havila & Salmi 2000; Halinen et al. 1999).

Network change has more often been perceived as an evolutionary or gradual process caused by interaction and adaptation between network actors (Håkansson & Snehota 1995; Havila & Salmi 2000). Revolution or radical change has been considered possible but unusual (Easton 1992). However, the importance of also understanding radical change has become more important as waves of acquisitions, mergers and bankruptcies have affected various business fields (Halinen et al. 1999; Easton & Lundgren 1992).

Radical change refers to situations in which a relationship between two actors is broken or a new relationship is established; for example, as a new member enters the network. *Incremental change*, however, involves change in the nature and content of single relationships. (Havila & Salmi 2000; Halinen et al. 1999.) For instance, change might concern the position of a supplier vis-à-vis the buyer, as the former single source can become either a major or a marginal supplier to that buyer. Thus, the dyadic relationship still exists but there clearly is a change in its nature (Gadde & Mattsson 1987).

Incidents that trigger radical change in a relationship or in a network are often termed *critical events* (Havila & Salmi 2000; Halinen et al. 1999), which can arise both endogenously from dyads inside the network or exogenously from the broader business environment and society as whole (Halinen et al. 1999). For instance, mergers and acquisitions can be considered potential critical events from within the network (Havila & Salmi 2000; Halinen et al.

1999; cf. Öberg, Henneberg & Mouzas 2007; Anderson, Havila & Salmi 2001). Critical events arising from the business environment can be, for instance, technological development, institutional conditions or economic recession. However, the impact of exogenous factors on a network is always transmitted within individual relationships in the network. (Halinen et al. 1999; Håkansson & Snehota 1995.)

In the network approach, single business relationship dyads are considered to play an important role in the change mechanism. In a relationship, two parties continuously adapt to each other and change occurs in the interaction. Adaptation can have various aspects: firms might adapt to each other technically by modifying products or production processes; they might adapt logistically by adjusting stock levels or developing common delivery systems; some might adapt administratively by modifying planning or scheduling systems or financially by handling payments in particular ways; and others might also adapt to each other in terms of knowledge by acting together with regard to some technical development issues (Anderson et al. 2001; Johanson & Mattsson 1987). Change always emerges at the level of dyads, where it is generated, received and transmitted to other business relationships (Halinen et al. 1999). However, as companies are embedded in a larger network context in which relationships are interconnected, a change caused by adaptation in a single dyad can have different consequences on other connected relationships (Havila & Salmi 2000; Halinen et al. 1999; Anderson et al. 1994).

Indeed, Halinen et al. (1999) divide network change into confined and connected change. *Confined change* remains within the dyad of a business relationship. It can be, for instance, a change in the character of activities performed in cooperation or a variation of trust between parties. (Havila & Salmi 2000.) *Connected change*, however, also affects other relationships and actors in the network through spillover effects (Abrahamsen et al. 2012; Halinen et al. 1999). Both confined and connected change can manifest itself either as gradual and incremental or instant and radical (Halinen et al. 1999). Due to interdependencies in a network, connected change can even be transmitted to indirect relationships at a relative distance from the focal dyad (Havila & Salmi 2000; Halinen et al. 1999; Hertz 1993). These successive changes in the network can be termed “domino effects” (Hertz 1998). A domino effect can be perceived as “a change of a relationship, triggering a sequence of changes in other relationships within a relatively short period of time” (Hertz 1998, 6–7).

Easton and Lundgren (1992) compare change in a network as a flow through nodes, whereby actors in the network are perceived as nodes that connect flows. They identify five change sequences in dyad relationships: reflection, adaptation, absorption, transmission and transmutation.

Reflection refers to situations where actor A initiates or requests a change in a relationship with actor B, which rejects or nullifies; that is, reflects the change back to the initiator, actor A. The second change sequence, *adaptation*, means that change is managed between two organisations rather than by either alone. In this case, the required change can be modified in negotiations so that the objective is met but by a slightly different means than first suggested. *Absorption* is the third change sequence, whereby nodal actor B accepts the required change and absorbs the impact within its own organisation. Absorption can be involuntary when, for instance, actor B might be unable to pass on the effects of a price increase. It can also be voluntary as, for example, in the technological development, actor B might not want to involve other network members as it might mean letting valuable information slip outside its control. (Easton & Lundgren 1992.)

The fourth change sequence, *transmission*, is largely assumed to be modal in discussions on industrial networks. In this sequence, actor B simply transmits the effect of change to one or more network members. Passing on price increases is probably one of the most common transmissions of change in a network. *Transmutation* is the fifth change sequence and it occurs as nodal actor B accepts the initiated change but changes both the transformation and exchange activities it undertakes. For instance, a requirement for shorter delivery times might lead to product redesign that demands a new set of raw materials and components. (Easton & Lundgren 1992.)

Thus, the spread of change in networks depends on how other actors respond to change initiated by one actor. Consequently, change can be observed at different levels: the single actor level, the dyadic relationship level and a broader network level. Change can also concern actors, activities and resources. (Degbey & Pelto 2013; Abrahamsen et al. 2012; Corsaro & Snehota 2012.) Figure 17 illustrates the different types and levels of change in business networks.

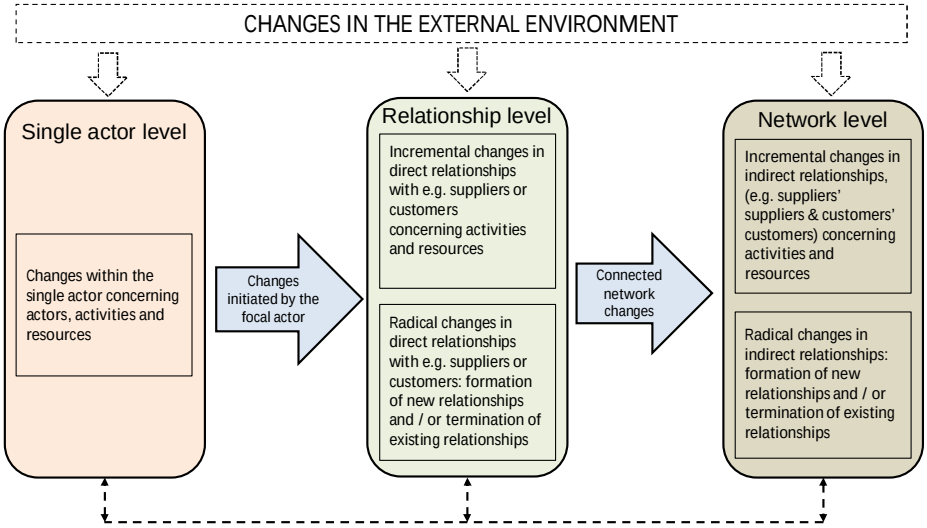

Figure 17 Three levels of change in business networks

Changes within a single actor can concern actors (e.g. individual managers or employees, units and departments), activities and resources of the focal company as it, for instance, makes changes concerning its strategy or organisational structure. Due to the interdependence of firms in a network, a change in the focal company's activities and resources is likely also to affect the activities and resources of, for example, its suppliers and/or customers (i.e. dyadic relationship level) (cf. Halinen et al. 1999; Easton & Lundgren 1992). Changes at the single actor level can trigger incremental changes at the dyadic relationship level as suppliers and/or customers try to adapt to the changed activities or resource requirements of the focal company. There might also be radical changes if existing business relationships are terminated or new ones formed due to the changes within the single actor.

Events triggering changes at different levels of business network can also be caused by changes in the external environment; economic recession or general technological development are examples of such changes. However, the impact of exogenous factors is also transmitted within individual relationships in the network. (Halinen et al. 1999; Håkansson & Snehota 1995.)

Changes initiated by the focal actor can spread further to the network level (i.e. to indirect relationships) as suppliers and/or customers of the focal actor transmit changes concerning their activities and resources to other network partners; for example, their suppliers and/or customers. An incremental dyadic change can even become a radical network change depending on how other actors respond and, vice versa, a radical change in the dyadic relationship might have only minor effects at the network level (Havila & Salmi 2000;

Halinen et al. 1999). Thus, the focal actor might have a very limited understanding on and potential to control the network change it has triggered because other companies and also the external environment in which the actor is embedded play important roles in transmitting the change. As a result, there can be both intended and unexpected effects at the relationship and broader network levels (cf. Anderson et al. 2001). The spread of change in business networks triggered by a foreign entry is discussed in the next section.

5.2.3 Synthesis: Spread of change in business networks triggered by a foreign entry

A foreign entry into a local business network can be perceived as an event triggering network change (cf. Havila & Salmi 2000; Halinen et al. 1999). An entry by a greenfield investment inevitably causes rapid and radical network change as, when a new member enters a network, it establishes new relationships with, for example, suppliers, distributors and customers (cf. Havila & Salmi 2000; Halinen et al. 1999). Alternatively, an entry through a cross-border acquisition affects established network relations (Slangen & Hennart 2008) and can trigger various types of network change. In previous studies (e.g. Öberg et al. 2007; Anderson et al. 2001; Havila & Salmi 2000) mergers and acquisitions have been found to instigate rapid and often substantial changes in the network. However, changes triggered by an acquisition can also be gradual as changes during the post-acquisition phase are not necessarily rapidly implemented (cf. Angwin 2004; Birkinshaw 1999).

Changes triggered by an acquisition can affect all three levels of a network, as illustrated in Figure 17 (cf. Degbey & Pelto 2013). First, an acquisition inevitably affects the relationship between the acquirer and acquired company as various changes are implemented in the merging organisations during the post-acquisition integration phase (cf. Anderson et al. 2001; Birkinshaw, Bresman & Håkanson 2000). In network terms, changes during the post-acquisition integration can concern actors, activities and resources of the newly merged company, the focal actor.

In addition, due to interdependence of firms in networks, various changes in an acquired company's activities and resources are likely to affect activities and resources of companies with which the acquired firm has direct relationships; for example, its suppliers and customers. Thus, the change in the focal actor can spread to the dyadic relationship level and cause both incremental and radical changes. Furthermore, through direct relationships, firms in the network also have indirect relationships with suppliers' suppliers, customers' customers, competitors and others (e.g. Johanson & Mattsson 1987), and the

changes triggered by the acquisition can thus spread further to the network level.

In addition, change at the dyadic and network level can concern actor bonds, activity links and resource ties between companies (Halinen et al. 1999; Håkansson & Snehota 1995). The change can spread along the vertical dimension to a foreign multinational corporation's (MNC) local suppliers, distributors and customers. Common suppliers, distributors and customers can act as transmitters of change to the horizontal dimension. Thus, the change can also spread along the horizontal dimension to the foreign MNC's local competitors. Possible dimensions and sequences of change triggered by a foreign entry into a business network are illustrated in Figure 18.

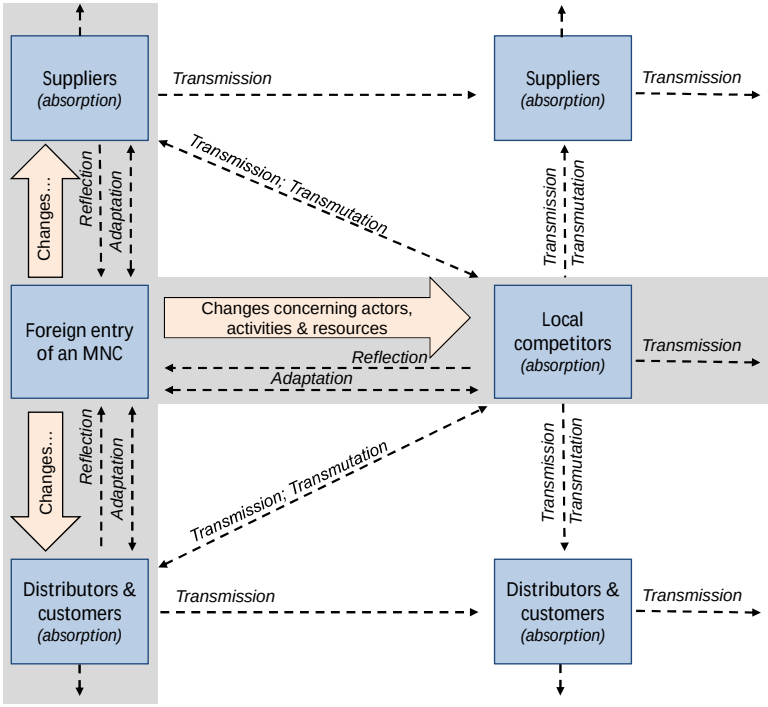

Figure 18 Sequences and dimensions of network change triggered by a foreign entry

In Figure 18, the solid arrows from an MNC to its local competitors on the horizontal level and to its local suppliers, distributors and customers on the vertical level, represent possible changes concerning actors, activities and resources in the MNC's direct relationships. Changes in direct relationships are more likely to appear on the vertical dimension, as direct relationships at the horizontal level (i.e. with competitors) are less common. However,

occasionally companies also have direct relationships with their competitors, for example, through strategic alliances (Halinen & Törnroos 1998).

The extent of possible network change triggered by a foreign entry depends on the behaviour of other actors in the network as they act as transmitters and disseminators of change (cf. Easton & Lundgren 1992). The possible change sequences following Easton and Lundgren's (1992) division are shown in Figure 18 with italic text and dashed lines. If the MNC's local competitors, suppliers, distributors or customers *reflect* the change initiated or triggered by the MNC back to it, thus refusing to make any changes in their activities or resources, change might only occur at the single actor level within the MNC or it might not appear at all. If other actors *absorb* the change initiated by the MNC inside their own organisations, the change is confined only to those companies. Also *adapting* the required change between the MNC and a local company does not necessarily create extensive effects on other network members as the change is managed between the two focal organisations. However, if local actors implement *transmission*, thus passing the change on to other network members, or *transmutation* (i.e. changing both their transformation and exchange activities), the change is likely to eventually influence many more firms in the network, even including network members distant to the focal companies.

Thus, change in a business network is partly explained by activities performed by actors, given their *position* within the network (Anderson et al. 1998). Indeed, Mattsson (1989, 34) states that a firm's ability to change depends on "its present position and strategic intentions and the positions and strategic intentions of other firms". Consequently, how other companies respond to the change initiated or triggered by the foreign entry depends upon both the foreign firm and local firms' network positions. For instance, the stronger the network position of the foreign firm, the more likely local actors are willing to adapt to its requirements. Similarly, a weak position of the foreign firm in the network can be considered less likely to trigger significant change. However, local actors with strong network position are also probably better able to transmit the change initiated by the foreign entry to other network members.

In the recent literature on external effects of foreign direct investment (FDI), the role of subsidiary *embeddedness* in local business, technology and social networks has been emphasised (e.g. Eapen 2012; Hallin & Holmström Lind 2012; Yamin & Sinkovics 2009). It has been stated that the more embedded a subsidiary is in its local networks, in other words, the more it has linkages (i.e. relationships) with local actors and the stronger the linkages, the more likely knowledge spillovers and knowledge diffusion will occur from the subsidiary to local companies (see e.g. Eapen 2012; Hallin & Holmström Lind

2012). Thus, the impact of foreign entry on a local business network can be studied by taking into account the different types and dimensions of embeddedness as identified by Halinen and Törnroos (1998).

First, *spatial embeddedness* is clearly relevant in analysing a foreign firm's possible impact on a local business network. Whereas an actor can be internationally, nationally, regionally or locally embedded in different types of network (cf. Halinen & Törnroos 1998), it can be assumed that the more locally embedded a foreign company, the higher its impact on local companies. However, if the foreign actor is also strongly embedded in international networks, it can create network relations between local and international actors that, in turn, can have significant impact on local companies.

Social embeddedness is also important in analysing the impact of a foreign actor on local businesses. As business relationships are often embedded in social networks, social embeddedness can be considered important in creating relationships between firms (e.g. Gulati 1995). This can be especially true in the context of a transition economy, in which social relationships seem also to matter significantly in business transactions (e.g. Michailova & Worm 2003; Mainela 2002; Nieminen 1999). In their empirical study, Uzzi and Gillespie (2002) found that companies which embed their exchanges in social attachments establish trust and reciprocity, facilitating the transfer of distinctive resources. Thus, social relationships can be important in transferring knowledge from a foreign actor to those that are local (cf. Spencer 2008).

Temporal embeddedness also has an impact on the creation of relationships. Many scholars have argued that social relations are path dependent in the sense that previous linkages determine the formation of future linkages (e.g. Tsai 2000; Gulati 1995). This is because the lack of information on competencies and reliabilities of potential partners makes relationship development with a new actor time consuming and uncertain (Tsai 2000). According to Gulati (1995, 646), the "historical effect is further complicated by the fact that the underlying social network is modified by the prior alliance decisions of other firms. Hence, both a firm's own past alliances and those of other firms in a network influence its future actions".

Due to social and temporal embeddedness, it might be assumed that a foreign entry in the form of an acquisition would lead to more local linkages than a greenfield investment as the acquired firm's past actions and social networks are also likely to influence future actions. Furthermore, Andersson, Björkman and Forsgren (2005) found in their study that employing expatriates seems to have a strong and highly significant negative impact on a subsidiary's local embeddedness. This might indicate that MNC subsidiaries with local managers tend to have stronger linkages to other local actors and, thus, have greater influence on local companies.

Political embeddedness can be considered to affect network development in particular situations, especially in developing and transition countries where political representatives can occupy important positions in business networks (cf. Halinen & Törnroos 1998; Nieminen 1999). Host country policies make a difference, for instance, by encouraging or even forcing foreign firms to utilise local sourcing. This can be achieved by, for example, offering investment benefits on condition that the foreign firm sources locally a particular percentage of components. Also, high customs duties for particular components are likely to force MNCs to utilise local sourcing and, thus, enhance the development of business relationships with local actors. Indeed, in Russia, due to the existing tax and customs regulations, for instance, it has been reported that international supermarket chains have been forced to utilise locally produced goods (Belaya & Hanf 2010).

The impact of foreign entry on local companies also depends on the foreign firm's local *market embeddedness.* For example, foreign entry directed to serve the local market and, thus, compete directly with local competitors can be considered to change the competitive positions of local companies. However, local competitors can learn from the foreign actor by simply observing and imitating its actions in the market (cf. e.g. Spencer 2008). However, market-seeking FDI is also more likely to be a source of negative effects as the increased competition might crowd out domestic firms, especially in emerging markets (UNCTAD 2003).

A foreign firm's *technological embeddedness* of business exchange in various technological systems can also trigger change towards local actors. As companies are dependent on specific processes and production technologies of their network partners, foreign firms can have incentives for technology and knowledge transfer to, for example, their suppliers or distributors (cf. Javorcik 2004; Håkansson & Snehota 1995). However, an MNC can also impact on the general infrastructural level of the host country or region; for example, on transportation and information systems (cf. Halinen & Törnroos 1998).

In addition to these different types of network embeddedness, both vertical and horizontal dimensions of embeddedness should also be taken into account when analysing network change triggered by a foreign entry. A foreign firm with strong *vertical embeddedness* to local companies along the whole supply chain will probably have a more significant impact on local companies than a foreign entry with low regional or local embeddedness. Similarly, strong *horizontal embeddedness* in various competitive or cooperative relations is likely to influence local actors at the same network level.

Thus, understanding connected network change and its mechanisms is important when analysing the impact of a foreign entry on local companies and in understanding how the impact spreads in the foreign subsidiary's local

business network. The above discussion is summarised in Figure 19, which shows a framework of change triggered by a foreign entry in its local business network.

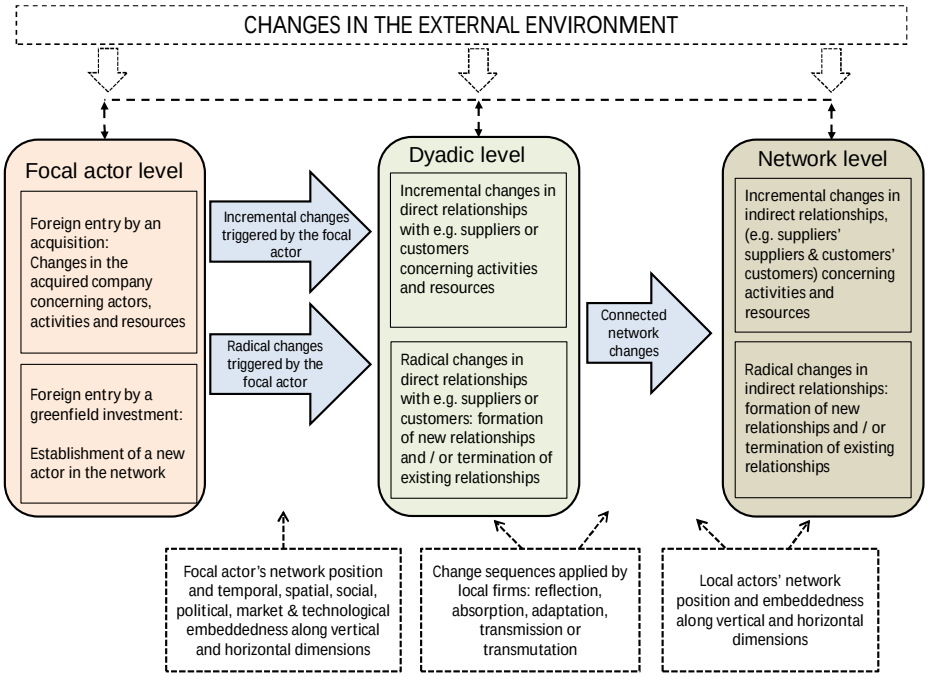

Figure 19 A framework of foreign entry-triggered network change

As indicated by Figure 19, foreign entry by acquisition causes changes at the focal actor level as various changes concerning actors, activities or resources are implemented in the acquired company. These changes can cause both *incremental changes* at the dyadic relationship level, as local actors might need to adjust to the changes in the acquired firm's activities and resources, and *radical changes* (i.e. terminations of existing or establishment of new relationships) at the dyadic level (cf. Anderson et al. 2001; Havila & Salmi 2000) as indicated by the solid arrows in Figure 19. An entry by a greenfield investment causes radical changes at the dyadic level as the new actor needs to establish relationships in the local market with, for instance, suppliers and customers.

The amount and extent of changes triggered by a foreign entry at the dyadic relationship level depends on the various types and dimensions of network embeddedness and also on the network position of the foreign firm, as illustrated in Figure 19 with the dashed boxes and arrows. Furthermore, the impact

of foreign entry-triggered change at the dyadic level also depends on the change sequences implemented by local actors as they react to the initiated change. While reflection might lead to no change and absorption and adaptation might lead to, at least, confined network change, transmission and transmutation always lead to a broader network-level change. Thus, foreign entry-triggered change at the dyadic level can spread into connected relations and become a more extensive network change (cf. Anderson et al. 2001; Halinen et al. 1999). The extent to which the dyadic change is spread to network-level change is influenced by the local actors network embeddedness and network position. The stronger the foreign firm's local customers and suppliers are interconnected with other local companies and the stronger their position in the network, the more likely the dyadic change will spread further in the network.

However, the change in the network does not only spread in one direction as change at the broader network level also influences, in turn, dyadic relationships and the focal actor. This interaction of change at different levels of the network is shown in Figure 19 by the upper dashed lines connecting the boxes representing different network levels. Furthermore, changes in the overall external business environment also affect all three levels of network, as illustrated in Figure 19. In the Russian transition economy context, there are a number of institutional changes that ultimately influence the conduct of business and, consequently, cause changes in business networks. In the following section, the framework of foreign entry-triggered network change shown in Figure 19 will be applied to the empirical case study of Fazer Bakeries' entry into the St. Petersburg bakery sector.

5.3 Impact of Fazer's entry on the local bakery market analysed from a network perspective

In this section, the impact of Fazer's entry on the development of the St. Petersburg bakery market is analysed from a network perspective, applying the conceptual framework presented in Figure 19. First, the case company's different types and dimensions of embeddedness and also its network position are discussed. Subsequently, the analysis concentrates on network change initiated or triggered by Fazer. This is achieved by examining more closely two sub-cases as examples of events causing network change and also on the overall changes in the business network of the St. Petersburg bakery sector. Finally, the effects of Fazer's entry on the St. Petersburg bakery network are summarised in sub-chapter 5.3.3.

5.3.1 Network embeddedness and the impact of Fazer's entry on local business development

Temporal embeddedness plays a role in the development of network relations which are often path dependent: past relations have an impact on future relations. This can be seen also in the case of Fazer's entry into St. Petersburg. As Fazer entered the St. Petersburg market by acquiring an existing company, it also became temporally embedded in the past actions of the acquired company, Hlebny Dom. As such, the company had a ready network of suppliers and customers when it entered the market. Through these existing network relations, the entry of a foreign actor into the market affected many local companies through actor bonds, activity links or resource ties. Fazer started to develop Hlebny Dom and changes were made, for example, to its organisation and activity structure. Some of these changes certainly influenced other companies in the network, even causing significant network change.

Furthermore, the impact of Fazer's entry on the local business network is difficult to separate from the impact of the general economic situation in Russia. At the time of Fazer's entry, economic transition was causing major restructuring: local bakeries were trying to modernise their production technology and learn the rules and practices of a market economy. The economic crisis that occurred in 1998 caused significant financial difficulties for local bakeries and Hlebny Dom, with Fazer's backing, was the only bakery that could continue with major investments during the economic crisis. Thus, the crisis played a significant role in giving Hlebny Dom a head start on its competitors and helped it to increase its market share.

Also, the general development of the retail sector has, in some ways, contributed to Hlebny Dom's success and also strengthened the effects that Fazer's entry had on local companies. Unlike other local bakeries, through Fazer, Hlebny Dom gained experience on serving modern retail chains. When the development of the chains began around the beginning of the 21st century, Hlebny Dom gained competitive advantage over local competitors. Thus, as the network approach suggests, network development cannot be separated from its context. Similarly, the impact of Fazer's entry on local business was influenced by the general development of the environment at the time.

However, the investor's own past actions, experience and its existing network relations influenced its decisions in developing the acquired company. For instance, a long-term close connection with another Finnish company operating in St. Petersburg gave Fazer know-how on Russian business:

> "If we look at the history a little bit, the Hartwall and Fazer families are quite related or at least close friends. So we had Henrik Thermann, the chair the BBH's[36] board of directors, on our St. Petersburg board of directors since the establishment of the St. Petersburg subsidiary until the end of 2001, thus practically for almost five years. And the knowledge we gained…as they were a few years ahead of us, we got to enjoy his know-how." (Director, International Projects, Fazer Bakeries)

Thus, Fazer was able to utilise the experience of BBH in its decision-making concerning the company's Russian operations. Even when Fazer had begun to look for an acquisition target in Russia, they employed the same consultant company as BBH, CapGemini, to investigate the local bakery market. Naturally, Fazer's other knowledge and experience impacted on, for example, the acquisition of new production equipment, the introduction of new types of product by direct product transfers from Finland and the development of a new distribution system. Thus, the effects that the entry had on the local business network were also influenced by the temporal embeddedness of the investor in its other networks.

Fazer entered the St. Petersburg market by an acquisition and chose to continue the activities there with local managers running its subsidiary. Again, the decision not to send any expatriates to Russia was based, among other things, on the experience of BBH:

> "It is expensive; the adjustment of a Finn to Russian circumstances doesn't happen overnight. It is difficult to find such skilled persons in Finland who would be ready to live in Russia: you have to have excellent language skills, have to get along with Russians, and you should not keep a distance but really be part of that society. That is one reason. Another one is that there are a lot of skilled persons there, and a third might be that, of course we talked to BBH, and they also had a team that – like we did too – visited weekly and spurred on the Russians. The practical activities have been managed by Russian as they have the same know-how and knowledge as us, and we have spurred on. This has proven to be a good model." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Since the existing management continued to run the Russian subsidiary, it was clearly *socially embedded* to the local market from the outset. The company had stable relationships with suppliers and customers and the social embeddedness of Hlebny Dom can also be considered important in spreading

[36] Finnish Hartwall and Swedish Pripps Bryggeriet formed a company named Baltic Beverages Holding (BBH) in 1991that acquired and invested in breweries; at first, in the Baltic countries. In 1993, BBH acquired the Russian Baltika Brewery and soon became a market leader in Russia. After many mergers and reorganizations in the international brewery business, BBH has been owned by the Carlsberg Group since April 2008, whereas Hartwall is part of Heineken N.V.

knowledge on, for example, new production equipment and new types of product to local bakeries:

> "I would estimate that it [the role of Fazer's investment] in the St. Petersburg area has been quite significant, especially taking into account that Valeri Fedorenko[37] was, for a long time, the chairman of the local bakers' union, and it is clear that it has had an influence. And to go back to the washable plastic crates and to packaging, and that new products have appeared on the market […] it is obvious that when one sees it subjectively one might overestimate it, but I would argue that it has been of crucial importance. […] But you have to keep in mind that these other bakers have visited and seen the changes and so on.[…] I would say that, to a large extent, it has happened that you go to visit, meet each other at trade fairs in Europe and watch what equipment each one is buying and so on. Just like in any other industry, you monitor what competitors are doing". (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Valeri Fedorenko's successor in leading Hlebny Dom, Alexei Timchenko[38], also personally knows the competitors:

> "I started my career in Zarya, moved to Karavai[39], and also worked as a state inspector and visited all the enterprises. So I already knew a lot of people personally from those times and, of course, all the directors in the competing companies. We have normal relationships, when we meet, we shake hands and so on. But when it comes to business, business is business, everybody understand that." (General Director, Hlebny Dom)

Thus, the management of Hlebny Dom is very familiar with the management of competing bakeries. Furthermore, the bakeries in St. Petersburg have also had some joint discussions on the increasing bargaining power of the retail chains. Hence, the company can be considered socially embedded at the horizontal level to its competitors. However, based on channel structure, personal contacts have also been important in transferring knowledge to the local market at the vertical level:

> "Alone, the fact that our purchasing managers in Russia adopt these words and discourses and speak on a higher technical level, they talk about e-programs. So awareness spreads out from there, and suddenly it becomes a normal practice, and the technology spreads to there as well, they start to acquire it. Now we are a forerunner in that." (Vice President, Sourcing, Fazer Group)

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37 Valeri Fedorenko was the General Director of Hlebny Dom from 1989 until his death in 2006.

38 Alexei Timchenko has worked for Hlebny Dom since 1990. Prior to becoming the General Director in 2006 he worked as a Director of Logistics and a Director of Sourcing in the company.

39 Zarya and Karavai are bakeries in St. Petersburg.

Social and *market embeddedness* are difficult to separate from each other in Russia, where social relationships and networks play crucial roles also in creating business relationships. This has also been noticed by Fazer's managers:

> "The activities in Russia are like that, they often sneer at us since we are so task oriented and they are people oriented. And business is part of that. […] In Finland you think that there are working hours and leisure time, and you spend leisure time with your family or a particular circle of people. In Russia, you have to invest in these human relations, which means that you spend this, your Finnish leisure time on that. […] You either do it, build these [relationships] or otherwise, I would say, the possibilities to succeed are weaker." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Thus, whereas in many Western countries, business relationships are usually considered to be those established between individual companies, in Russia the role of personal relationships is emphasised (cf. Michailova & Worm 2003; Nieminen 1999; Salmi & Bäckman 1999) and business and personal lives are more intertwined.

Fazer's investment in Russia was domestic market oriented. Thus, it is natural that Hlebny Dom continued to be strongly embedded in the local market. The company mainly serves retail customers in the St. Petersburg area but its products are also delivered to Moscow and to some other major Russian cities. In addition to the Russian market, a small amount of traditional Russian *pryanik* biscuits is exported to the Baltic countries, Germany and the USA but, in total sales, the share of exports is rather insignificant. Also, Hlebny Dom relies mainly on domestic and, in many product categories, even on local suppliers for its raw material supplies. However, in addition of Hlebny Dom being *spatially* strongly *embedded* in the local market, in some product categories (e.g. packaging material) the company employs Fazer's network connections to international suppliers that often also have operations in Russia. Thus, Hlebny Dom has been able to take advantage of the parent company's embeddedness in international networks. The geographic proximity of Finland and St. Petersburg has made it easier for Hlebny Dom also to utilise Fazer's supplier network in Finland when needed. For instance, when negotiations with flour mills in St. Petersburg were not going well for the company, it had the option of importing flour from Fazer's mills in Finland. However, this option has rarely been employed as trade across the border is expensive.

In sum, the main competitors serve the same customers as Hlebny Dom and also utilise more or less the same suppliers. For instance, there are three mills in St. Petersburg that supply flour to all local bakeries, and the local bakeries also buy other technical raw materials such as additives from the Finnish company, Leipurien Tukku. Thus, there are a number of indirect network connections through suppliers to local competitors.

In acquiring new production machinery, Hlebny Dom has relied almost entirely on foreign suppliers. In making investment decisions on new production equipment, Fazer's previous experience and knowledge on modern production technology has been of crucial importance. However, through indirect network relationships, local competitors have also been able to acquire knowledge on production technology and new types of product:

> "And certainly many equipment suppliers boast about having sold to us, that it is good equipment. So they use us as a reference, and you can't help it. […] Of course our moves are followed carefully, and we are watched to see which products we bring to the market, and when a new product comes, certainly it is noticed by the competitors. And then there is the fact that equipment suppliers are such a bad jungle in a sense that, through them, all stories get around." (Director, International Projects, Fazer Bakeries)

Hlebny Dom's equipment suppliers are eager to sell also to the company's local competitors and even to give advice on how to manufacture similar types of product that Hlebny Dom has launched onto the market. However, many smaller local bakeries have not had the financial resources to acquire modern production technology or technological know-how and are struggling to compete with Hlebny Dom and Karavai that are technologically at a higher level.

As companies are *technologically embedded* to different systems both at corporate and societal levels, changes in other companies (i.e. suppliers) are often also required for a company to improve its own technological level. Hlebny Dom has introduced strict specifications and quality requirements for many of its local suppliers which have been forced to improve their technological level. However, in some cases, the quality of raw material supplies is still lower than those received by Fazer in Finland, although it might be higher than Russia standards. Also, the general level of information technology (IT) in Russian companies is considerably lower than in Finland. However, Fazer is trying to develop IT in their Russian operations. In general, Hlebny Dom has actively tried to improve the quality and technological level of their network partners. In this, the company has taken advantage of the parent company's network connections in Finland and, for instance, given advice concerning from which company a particular technology can be acquired. Through technological embeddedness of business actors, change in technological systems of a firm also often affects many other companies. Thus, the distribution system developed by Fazer for its Russia operations has become a Russian standard as retail customers have begun to require a similar system from other bakeries.

Political embeddedness is also present in the case of Fazer's entry and activities in St. Petersburg. Although geographically close to Finland, the intervening EU-Russian border encourages serving only the Russian market.

In addition, the poorly functioning Russian customs and high tariffs in many product categories have been reasons for locally sourcing as much as possible. Thus, there are factors in the general political environment that have contributed to the strong local market embeddedness of Hlebny Dom.

Fazer's entry into Russia has required a lot of interactions with local authorities; for instance, with competition authority and the customs. Working with the local authorities has sometimes, especially at the beginning, been slow and even problematic. However, in general, the relationships of Hlebny Dom and Fazer with the authorities in St. Petersburg are good:

> "In general, the relationships [with authorities] are rather close. From the very beginning, the start of each new production line has been visited by the governors. All heads of the city have been at our plant: first Sobchak, then Yakovlev and Matveyenko. Moreover, bread is a social product and bread production is a socially oriented business. Thus, we have participated in special projects of the city administration, one of which was "a Social Product". It included a number of items, and was introduced by the city government when the price of bread was rising. This included a list of goods from Hlebny Dom, white bread from 1st category flour and black bread called Rzhanoy. The project was aimed to support the poorest, socially weakest people in the city, and the majority of the population was poor during the crisis. When prices were increasing, the prices of these two products were fixed. Other products, like sliced bread and other bakery products didn't have fixed prices, so it didn't cause any problems for us because there were always people who consumed these more expensive goods.[…] Other bakeries fixed the prices too because we said 'yes' and they had no choice but to follow our example. So we influenced others to agree too. That is because we are the biggest, we are the fashion makers in the industry; thus if we decide to take part in some programmes, others follow." (General Director, Hlebny Dom)

Hence, Hlebny Dom has been active in participating in the city's social programmes and Fazer has also supported these programmes. The example of the market leader has also encouraged other bakeries to participate in the projects. Being active in such projects clearly helps good relationships with the city's administration to be maintained. Furthermore, Fazer has also been politically active by lobbying at meetings of the Finnish and Russian intergovernmental committee.

Table 8 summarises the types and dimensions of embeddedness that were considered relevant in analysing the case. However, as the different types and dimensions of embeddedness are difficult to separate from each other in the empirical case, many of the relevant expressions of embeddedness in the case study might be listed under several types of embeddedness. Nevertheless, the table endeavours to provide an overview on the ways Fazer and its Russian subsidiary, Hlebny Dom, are embedded in various networks and how the embeddedness can influence other actors in the local business network.

Table 8 Expressions of network embeddedness in the case study

Type of embeddedness	Dimension of embeddedness	Relevant expressions in the case study
Temporal embeddedness	Horizontal and vertical	Hlebny Dom's existing network & past actions. Fazer's existing network & past actions. General development in the Russian economy and bakery market. Development of retail trade.
Social embeddedness	Horizontal	No expatriates sent to Russia. Relationships of HD's management with competitors' management. Fazer's social network.
	Vertical	No expatriates sent to Russia. Social relationships important in business transactions in Russia.
Market embeddedness	Horizontal	Fazer's domestic market-oriented investment > direct competition. Also, some cooperations with competitors.
	Vertical	Local and domestic customers only. Mainly domestic and local suppliers. International suppliers in some product categories; foreign equipment suppliers. Local competitors have same customers and suppliers.
Spatial embeddedness	Horizontal and vertical	Hlebny Dom's strong local embeddedness. Fazer embedded also in international networks. Geographic proximity of St. Petersburg to Finland increases possibility of supply from Finland.
Technological embeddedness	Vertical	Technological level in Russia lower than in Finland. Fazer/Hlebny Dom has actively tried to improve the technical level of its suppliers. Creation of a new distribution system.
	Horizontal	Competitors have also improved their technical level. Indirect connections through both suppliers and customers important in transferring technology to competitors.
Political embeddedness	Horizontal and vertical	Customs' performance encourages local sourcing. Good relationships with local authorities. Involved in social programmes. Strong position in the local business network.

In sum, the network position of Fazer's subsidiary Hlebny Dom in the St. Petersburg bakery market can be considered very strong. In addition to having good relationships with authorities, the company's management has been active in the local bakers' union. Thus, relationships are good with competitors, with which there is even some cooperation. Being a market leader and having the biggest volumes, Hlebny Dom is also the most important customer of and supplier to many local companies in related industries. Due to Fazer's strong position in the market, its influence on local business development has been significant: Fazer has introduced new types of product to the market,

increased the product quality by improving the technological level of production and created a new distribution system that has also significantly raised the level of hygiene in the bakery business. How these changes have been transmitted to other actors in the local business network is described and discussed in more detail in the next section.

5.3.2 Network change triggered by Fazer's entry

In this section, two sub-cases of network change triggered by Fazer's entry into St. Petersburg are described and analysed. One sub-case describes a change first initiated to a distributer and later transmitted along forward linkages. The other sub-case describes a network change resulting from Fazer's requirements on one of its suppliers and, thus, transmitted along backward linkages. The two sub-cases function as examples of how network change is passed along network connections and how it depends on the change sequences implemented by other network members. The third sub-section summaries the overall changes in the St. Petersburg bakery sector's network.

5.3.2.1 Sub-case 1: Creation of a new distribution system

When Fazer Bakeries bought a share of Hlebny Dom in 1997, Hlebny Dom's products were distributed in the same manner as all other local bakeries' products by a monopolistic transport service provider, HlebTrans, a joint company of many local bakeries in which the city authority also had a stake. Customers were individual retail stores, as retail chains did not exist in 1997. Bread distribution at the time of Fazer's entry into St. Petersburg is illustrated in Figure 20.

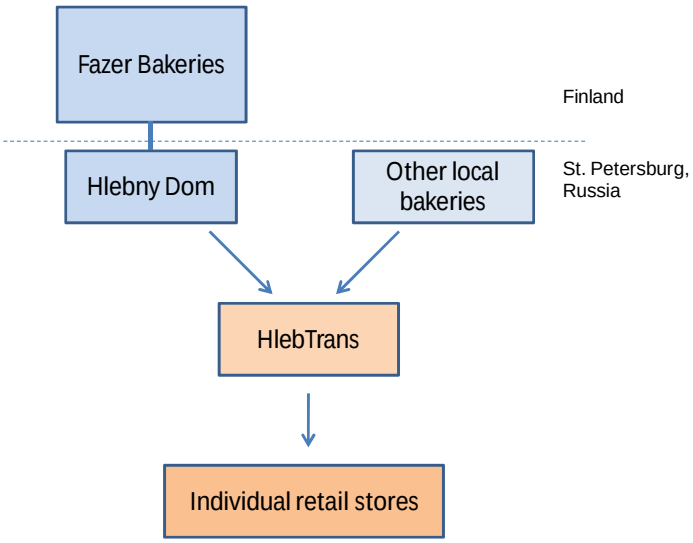

Figure 20 Phase 1: Hlebny Dom's bread distribution in 1997

Thus, when Fazer entered St. Petersburg, bread was distributed in wooden crates that were loaded onto metallic trolleys and put inside the trucks. The wooden crates had to be manually emptied onto store shelves, which required a lot of work and necessitated some smaller stores having to close their doors to customers when receiving bread deliveries. Hence, the distribution system was inefficient; also, the reliability of deliveries was poor. At first, Fazer Bakeries tried to get the distributor to improve its operations:

> "We had negotiations with HlebTrans on the need for them essentially to improve their operations. No significant improvement occurred so we decided to invest in our own transport equipment, and so we did which, of course then in '98, was a major move." (Director, International Projects, Fazer Bakeries)

Thus, Hlebny Dom/Fazer suggested changes to HlebTrans' operations although HlebTrans did not make any significant improvements. It can be assumed that when an actor implements reflection as a change sequence, thus reflecting the change back to its initiator, no network change will occur (cf. Easton & Lundgren 1992). However, in this case, the fact that HlebTrans refused to make the required changes led to the creation of a completely new distribution system for Hlebny Dom (see Figure 21).

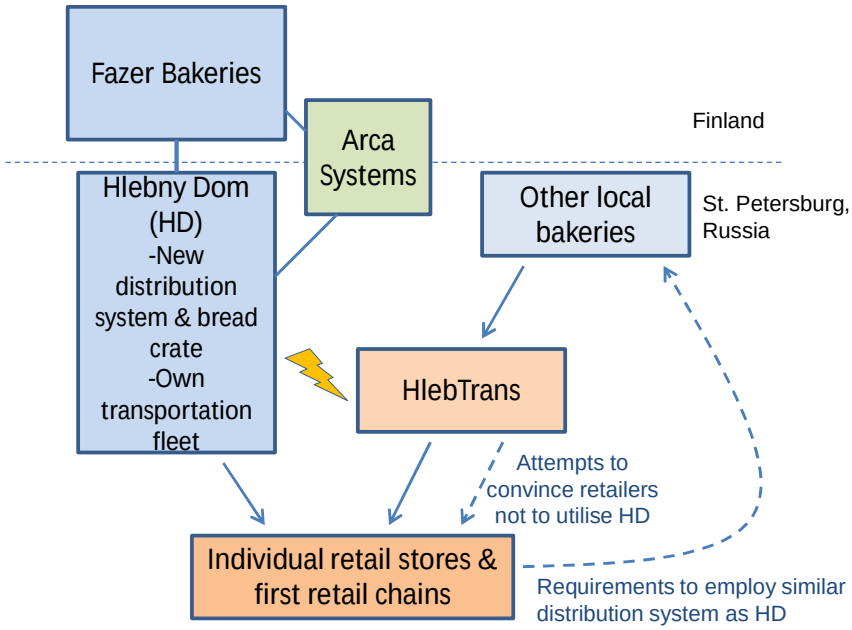

Figure 21 Phase 2: Bread distribution in St. Petersburg since 2000

Fazer decided to create its own distribution system for Hlebny Dom and, in 2000, the new in-house logistics system was launched with several new-to-the-market features:

> "We decided that, to begin with, we would have to change the crate, develop our own bread crate there. […] We worked with Arca Systems, which could make crates in St. Petersburg, so we developed a new bread crate, a plastic box which in a sense is much smarter than the ones we have in Finland, since when empty, they can be nested into each other." (Director, International Projects, Fazer Bakeries)

> "And we improved the level of hygiene there, something that was obviously new for them. The bread crates that were in use then, and still are in many bakeries around Russia, those are wooden. And we made a plastic crate, and a plastic crate can be washed. And it was such a selling point that when the stores heard that they would get the bread in a washed and hygienic crate, it had a decisive influence. And it was Finnish equipment." (Senior Vice President, Legal Affairs and M&A, Fazer Group)

Thus, a new washable bread crate was developed with Arca Systems, with which Fazer cooperated in Finland and which also had operations in St. Petersburg. A Finnish company, Pesmel Oy, supplied the automatic crate handling system, which comprised such functions as the handling of crate stacks, the stacking and unloading of piles of crates, the storage of crates and the crating of products. Whereas moving crates had previously required a large

labour force and was a bottleneck in Hlebny Dom's processes, the new automated system significantly enhanced the crating and transportation of products and also the handling of returned crates.

Furthermore, in addition to modernising the distribution system, Hlebny Dom acquired its own transportation fleet and began to distribute its products directly to its retail customers. At first, the former distributor HlebTrans attempted to harm Hlebny Dom's operations by trying to convince the retail stores not to buy from the company. However, retailers welcomed the new, more hygienic and efficient distribution system. Gradually, the biggest individual retailers and the first chains that had appeared began to require a similar distribution system from their other bread suppliers; thus, transmitting the change that emerged in the relationship with Hlebny Dom to other network members (see Figure 22).

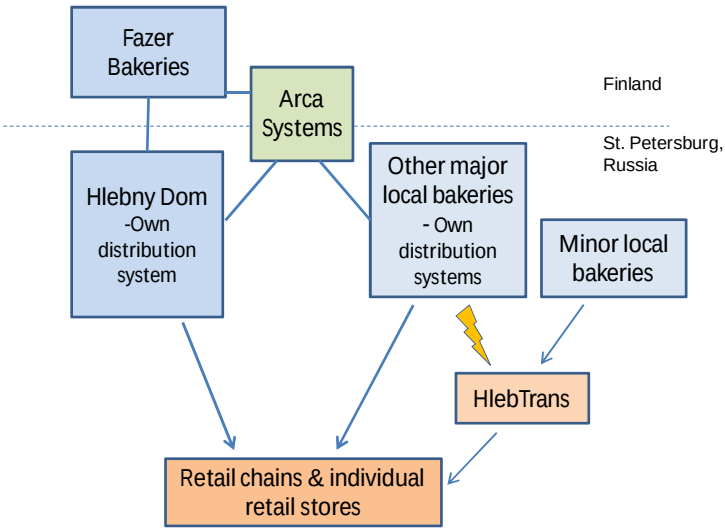

Figure 22 Phase 3: Bread distribution in St. Petersburg since 2002

In 2002, Hlebny Dom's biggest competitor, Karavai, acquired its own transport equipment and implemented a similar distribution system to that of Hlebny Dom. Since then, other major bakeries in the city have also adopted the same kind of distribution system. Arca Systems also became a network partner to other major bakeries in St. Petersburg as they began to deliver bread in similar plastic crates as employed by Hlebny Dom (see Figure 22).

> "Now it has turned out that our box has become the Russian standard. It is in use in probably all bakeries, at least in all significant ones, in St. Petersburg and also in quite a few bakeries in Moscow." (Director, International Projects, Fazer Bakeries)

Hence, all other major bakeries in St. Petersburg now have a distribution system similar to Hlebny Dom and their own delivery trucks, and the role of the former monopoly HlebTrans has become minor. Furthermore, the distribution system is spreading to other Russian regions as retail chains expand their operations:

> "For instance, the retail chain Okay moved to Talyatsi near Samara and opened a retail chain there. And there is a local bread producer there who then came to St. Petersburg to learn how bread is sold here in these crates as Okay required the same system as we have in St. Petersburg. So the system is now spreading everywhere in Russia". (General Director, Hlebny Dom)

The retail networks require a similar type of distribution system with washable plastic crates from their local supplier bakeries in other Russia regions. Thus, as suggested by the network approach, due to the interconnectedness of actors in networks, the connected network change can be transmitted to indirect relationships and eventually spread far from the companies in focus (cf. Halinen et al. 1999; Hertz 1993). Figure 23 illustrates the role of retail chains in transmitting the change in the distribution system to other actors.

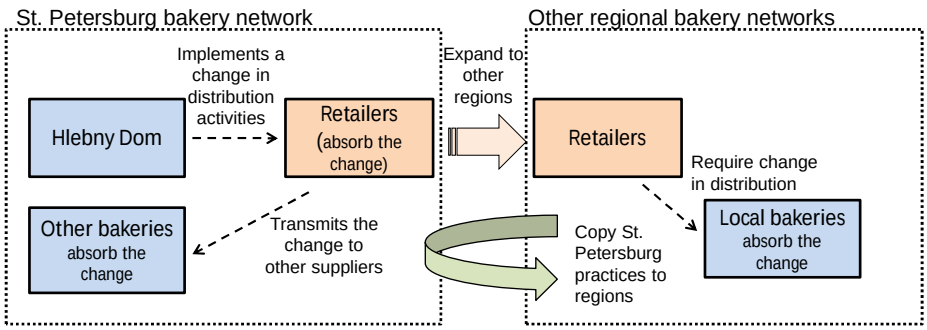

Figure 23 Retailers transmitting network change

As shown in Figure 23, the retail chains seem to play a crucial role in transmitting the change in the distribution system to actors in other regional networks. Thus, as retailers expanded their operations and required change in bread distribution, also actors distant from the dyads where the change originally emerged (i.e. between Hlebny Dom and local retailers) have been affected and, thus, a similar distribution system has been adopted in some other Russian regions.

This sub-case demonstrates well how a change initiated to another company in a dyad can eventually affect many other companies, even if geographically distant from the companies in which the change first emerged. The change in

network positions of each actor involved can explain the extent of the change. Initially, the position of HlebTrans was strong as it practically had a monopoly in St. Petersburg's bread transportation. At the time, retail stores were small individual shops with rather weak positions in comparison to the distributor. However, the situation was reversed when the retail chains began to appear and grow in St. Petersburg, they soon became stronger and began to require better delivery standards. Hlebny Dom began to treat the chains as the most important customer category before any of its competitors and, based on Fazer's experience in other markets, it could fulfil the need of the modern retail chains better than other companies. Creating its own distribution system is a good example of this and it strengthened the position of Hlebny Dom in the St. Petersburg bread market, whereas the position of HlebTrans, either unwilling or unable to improve the quality of its deliveries, declined.

5.3.2.2 Sub-case 2: Quality improvement requirements for a berry supplier

Since Fazer bought the majority share in Hlebny Dom, the company has invested in improving its quality; for this, the quality of raw materials also has required improvement. Thus, the company has made suggestions to and imposed requirements on its suppliers for quality improvements. In some cases, local suppliers have made substantial changes in production to meet Fazer's increased quality requirements.

A good example of such a case is the company Grand Prestige, Hlebny Dom's sole supplier of fresh and frozen berries. The company began its operations in 1999 when all of its production was exported to the Netherlands and Poland. Later, the company moved to serve mainly local bakeries in St. Petersburg. Figure 24 shows the main customers of Grand Prestige since 2002.

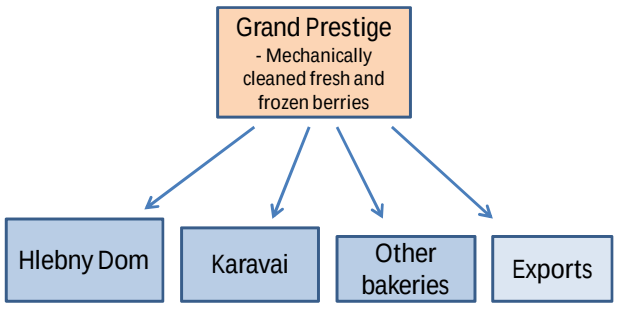

Figure 24 Grand Prestige's main customers since 2002

Grand Prestige's cooperation with Hlebny Dom began in 2002, since when Hlebny Dom has been its most important customer. The second most important customer is Hlebny Dom's biggest competitor, Karavai, and the company also supplies other local bakeries that utilise berries in their products. Exports have become strategically unimportant as the company has changed its focus to serve local bakeries. However, there remains a small share of production that is exported, although not on a regular basis.

Fresh and frozen berries supplied by Grand Prestige are utilised in Hlebny Dom's berry pies, a popular product category also in Russia. A berry pie was originally a straight product transfer from Finland where the same products have been popular for years. When Hlebny Dom introduced a new production line manufacturing berry pies, it set new requirements concerning the purity of berries on the supplier:

> "We also set a condition to the supplier to provide clean berries without any leaves or sticks. The supplier was not happy with us and said "for Karavai I supply berries with leaves and sticks and it is fine with them, so why should I give clean berries to you?" And, he said that I cannot supply to you. We asked him to calculate how much Karavai buys and how much we buy, calculate how much you will lose if you stop cooperating with us. Eventually, as we are the biggest client, he agreed to meet our requirements and increased the standard of berries. Thus, we introduced the new quality standard of berry supplies. Even the state's Gos-standards allow some rubbish in the berries, but we demand higher quality. […] So the supplier bought a new production line and the berries are clean. Thus, quality was a major problem but, as you can see, we solved it,." (General Director, Hlebny Dom)

Figure 25 illustrates the change sequences occurring first in the dyad between Hlebny Dom and Grand Prestige and also in the relationships between Grand Prestige and its other customers.

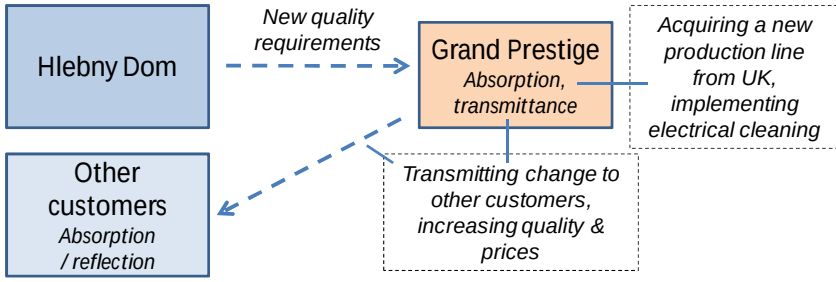

Figure 25 Change sequences in the dyads between Grand Prestige and its customers

After Grand Prestige realised the importance of Hlebny Dom as a customer, it made a decision to invest EUR 350,000 in a completely new production line with an electrical cleaning system. The new production line was acquired from the UK in late 2005 and began to operate in the spring 2006. Before that, Grand Prestige had tested similar lines offered by Russian equipment suppliers for a year. However, the quality and service of the domestic suppliers did not meet the requirements of the company and the decision was made to rely on a foreign supplier.

The new cleaning line was calibrated according to the colour and size of berries, with deformed berries being automatically rejected. The quality of the supplied berries thus increased and, consequently, so did the price of the products. Transmitting the change initiated by Hlebny Dom by increasing the quality and price to all customers was not welcomed by everybody:

> "Most bakeries are not as keen on quality as Hlebny Dom. Their policy is different; price is first and quality only second. However, we shifted to higher quality and almost all production comes in higher quality. Many bakeries are not interested in us anymore because of the pricing. But we supply only high quality, one standard." (General Director, OOO Grand-Prestige)

Thus, moving to a higher quality made some bakeries switch to cheaper suppliers. However, the higher quality achieved with the electrical cleaning system also helped the company to gain new customers:

> "With this electrical cleaning, we also conquered the confectionary niche that was satisfied with our quality and started to cooperate with us. […] Moreover, the berries that do not satisfy the new requirements, those are sold to a cannery". (General Director, OOO Grand-Prestige)

Figure 26 illustrates the changes in Grand Prestige's customer network resulting from changes made in accordance with Hlebny Dom's demands. Hlebny Dom is clearly the most important of Grand Prestige's 280 customer companies and it accounts for approximately 60–70 percent of Grand Prestige's sales. In other words, of the company's total 250 tons volume, 75 tons are sold to Hlebny Dom. The Karava bakery is Grand Prestige's second biggest customer, to which approximately 20 tons of production is sold. In addition to the two major bakeries in St. Petersburg, Grand Prestige also sells to other local bakeries, although some of them stopped the cooperation as a result of the changes made to the quality and price of the products. The company also sells irregularly to export customers.

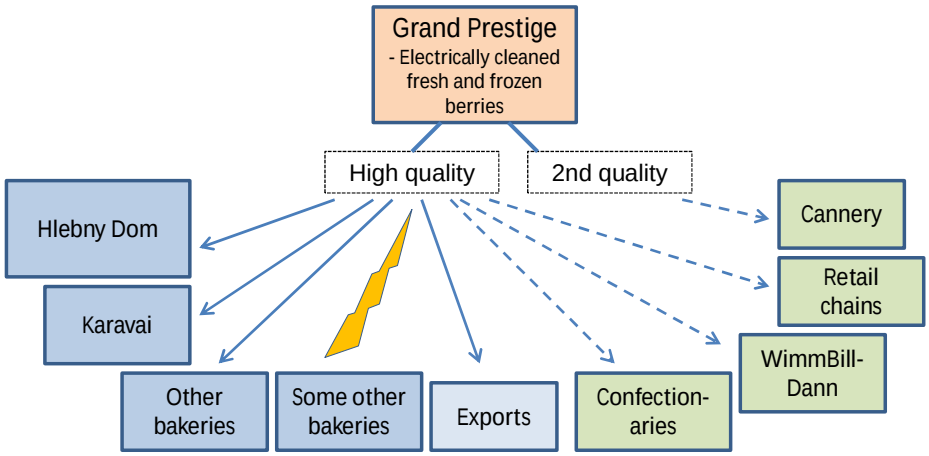

Figure 26 Grand Prestige's customer network after product quality changes

As can be seen from Figure 26, increased product quality also facilitated the acquisition of new groups of customers (shown with dashed arrows). The company now serves the confectionery niche and also sells frozen berries directly to the retail chains Lenta and Okay. In 2007, Grand Prestige also began supplying WimmBillDann, Russia's largest dairy and baby food producer. Furthermore, berries not meeting the required quality are rejected by the electrical cleaning line and sold to a cannery to be utilised in preserves.

In sum, the change in Grand Prestige's production technology had a significant effect on the whole network. The change was initiated by Fazer/Hlebny Dom but, clearly, the increased prices and quality also influenced other customers as Grand Prestige was able to pass on the cost of investment by increasing prices. Although some old customers did not accept the higher price and changed their berry supplier, many customers absorbed the change and eventually utilised a higher quality raw material than before in their products. This is probably due to Grand Prestige's strong position in its network:

> "The demand is growing, and the sector is growing. In the beginning, we were the first and only one in the business, and had no competitors. Now we have competitors, but they can offer only one or two product items whereas we offer the whole range. Moreover, they cannot guarantee their delivery times." (General Director, OOO Grand-Prestige)

Thus, Grand Prestige had many advantages over its competitors which made it an important and not easily replaced supplier to many bakeries. Indeed, the company is also the sole supplier to Hlebny Dom in its category; thus, there is mutual dependence between Grand Prestige and Hlebny Dom. However, the position of Hlebny Dom is superior due to its size. It is by far the most important customer of Grand Prestige, which ensured Grand Prestige

agreed to Hlebny Dom's quality requirements, even though Grand Prestige anticipated that the change was likely to cause it to lose some of its other customers. However, the required investment for a new production line was profitable and also helped the company to gain new customers. Cooperation with Grand Prestige and Hlebny Dom has continued to be tight and negotiations on moving to even higher quality corresponding to European standards, which again requires new technology, have also occurred between the two companies.

5.3.2.3 Business network changes in the St. Petersburg bakery sector

As the above two sub-cases indicate, changes initiated by Hlebny Dom to its local network partners have spread to other members in the network. These network changes have altered the structure of the St. Petersburg bakery sector's network. The changes are illustrated in the following two figures. Figure 27 shows a strongly simplified picture of the business network of Hlebny Dom and the St. Petersburg bakery sector around 1997, prior to Fazer Bakeries' acquisition of the company, whereas Figure 28 draws an equally rough picture of the bakery sector some years later, around 2005, when Fazer's ownership of Hlebny Dom had reach 80 percent.

In 1997, when Fazer Bakeries acquired Hlebny Dom, Karavai was the largest bakery in the market with approximately 17 percent market share. Hlebny Dom was the second biggest with a market share of approximately 15 percent (see Figure 27). It should be noted that Figure 27 is significantly simplified with regard to the amount of bakeries; in reality, there were 16 larger bakeries and a few hundred small ones. In the figure, only the names of the two biggest bakeries (i.e. Karavai and Hlebny Dom) are shown and capital letters of the alphabet are employed to include some competitors as examples.

Almost all bread on the market was produced to the old Soviet Gosplan standards and there was no packaged bread on the market. Consequently, packaging material suppliers were not part of the bakery sector's network. Fundamentally, all raw materials such as flour, sugar and fats were acquired domestically and, more or less, the same suppliers supplied all local bakeries. In 1997, the Soviet era machinery of most local bakeries was outdated, including, to large extent, also Hlebny Dom. Some bakeries had newer machinery from domestic suppliers but, in general, modern bread lines were not manufactured in Russia. Since the beginning of 1990s, the largest bakery at the time, Karavai, had modern Dutch equipment; also, some other local bakeries had newer Czech or German machinery. However, prior to investing in modern machinery, Hlebny Dom mostly had very outdated Soviet machin-

ery from 1934. Between 1994 and 1996, the company bought several new production lines from Germany and Italy and, thus, already had some modern production equipment before Fazer Bakeries' involvement in the company.

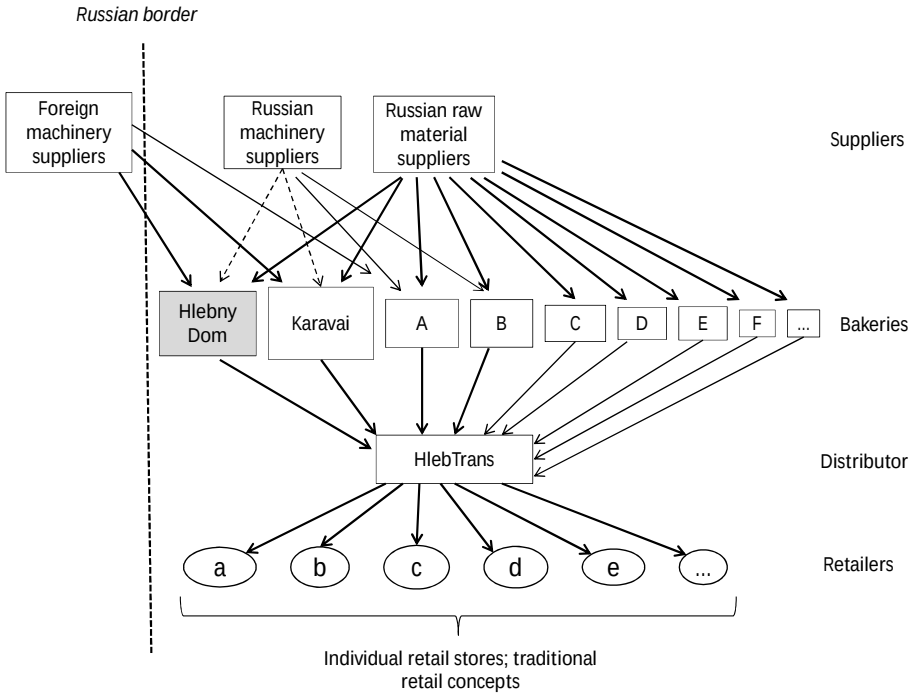

Figure 27 St. Petersburg bakery sector's business network in 1997 (prior to Fazer Bakeries' entry)

In 1997, all bread in St. Petersburg was distributed to retail stores by a monopolistic delivery company, HlebTrans. Bread was sold through individual stores which, at that time, were mostly traditional Soviet types; modern retail chains did not exist in the market. As all bakeries' products were sold unpackaged and unbranded, consumers did not the producer of the bread they bought.

The St. Petersburg bakery sector changed significantly during the first few years after Fazer Bakeries entry by acquisition of Hlebny Dom. Fazer developed the acquired company in many ways relating to, for example, its organisation, production, product range, product quality, R&D and also sales and marketing including branding, distribution and key account management practices. Many of these changes also affected other actors in the network. Thus, by approximately 2005, the business network of Hlebny Dom and the

St. Petersburg bakery sector already looked quite different, as shown in Figure 28.

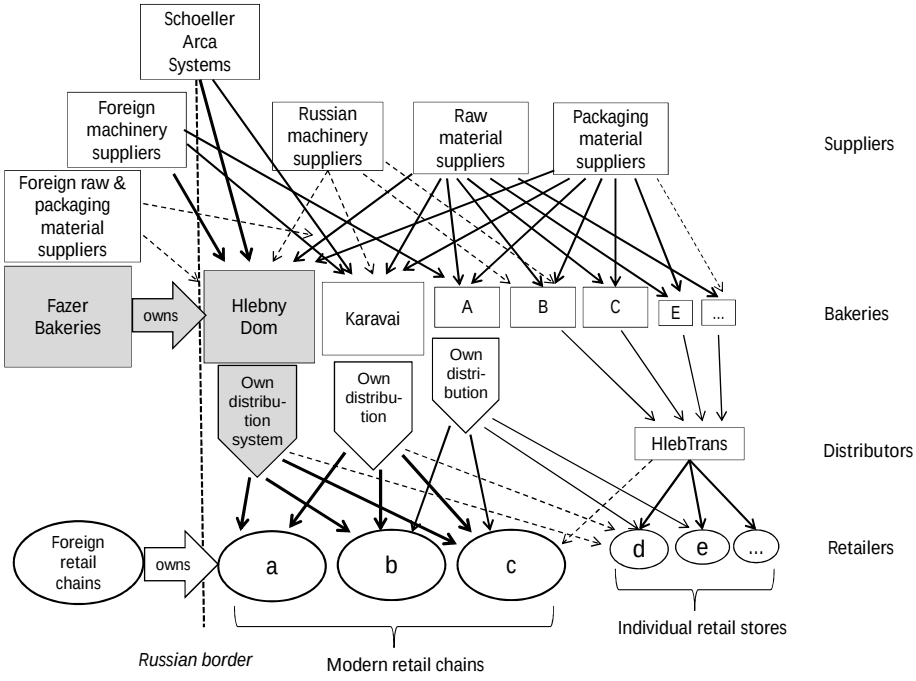

Figure 28 St. Petersburg bakery sector's business network around 2005

Fazer Bakeries acquired Hlebny Dom at the end of 1997. Later, in 2002 and 2003, Fazer Bakeries acquired two more local bakeries, Murinsky and Vasileostrovsky bakeries, which were organised under Hlebny Dom. Thus, by 2005, the bakery industry in St. Petersburg had become more concentrated due to Fazer's, and also other companies, mergers and acquisitions. Due to the increased competition that was further enhanced by the foreign entrant, some local bakeries had stopped their operations. Hlebny Dom's market share had grown significantly to almost 35 percent, making it the market leader. The former market leader, Karavai, was now the second biggest bakery in the market with approximately 23 percent market share. The following three bakeries with market shares of approximately 6–8 percent each were Hleb, Zarya and Pekar. The rest of the market was fragmented among a myriad of small bakeries. In sum, consolidation of the market was rapid as waves of mergers and acquisitions occurred in the bakery sector. Thus, actors in the market were changing rapidly from 2005 to 2007.

Fazer's acquisition of Hlebny Dom had significantly raised the technical level of the company. Fazer had made large investments in Hlebny Dom and acquired new modern production lines with the cooling, slicing and packaging steps needed for selling packaged and sliced bread. New lines were acquired from Western European countries except for a new line for making traditional Russian pryaniks that was bought from a Russian machinery supplier. Also, other local bakeries were increasingly investing on Western production lines as they imitated the new types of product launched by Hlebny Dom. However, lack of financial resources hindered the technological development of many local bakeries.

Another problem relating to new types of product was the lack of local suppliers in particular product categories. For instance, at first there was a lack of packaging material suppliers operating in Russia; thus, Hlebny Dom imported packaging material. However, by 2005, the situation had changed and most packaging materials could be sourced domestically in Russia. Indeed, the development in the packaging material industry in Russia was rapid and new companies appeared on the market during the first years of the 21st century. The situation with other raw material supplies was similar; whereas, immediately after Fazer's entry, there was a lack of high quality raw material suppliers, in 2005, approximately 90 percent of all raw materials utilised by Hlebny Dom were locally sourced. Only some special additives could not be bought in Russia and those were acquired by Hlebny Dom and other local bakeries from abroad, mostly Finland. Fazer's strict quality requirements for local suppliers had increased the quality of many local suppliers' products. As the same raw material suppliers also sold to other local bakeries, the overall quality of St. Petersburg bakery products increased.

A major change in Hlebny Dom's business network was its withdrawal from relationships with the bread delivery company, HlebTrans, and the creation of its own modern distribution system soon after Fazer's entry. Fazer developed its own bread crate for Hlebny Dom together with Schoeller Arca Systems, with which it had a relationship in Finland and which could also operate in Russia. By 2005, the Hlebny Dom's bread crate had become a local standard as other local bakeries had also started to utilise exactly the same crate in their deliveries. Other major bakeries in St. Petersburg had also launched their own distribution systems similar to that of Hlebny Dom and the position of HlebTrans' former monopoly had become significantly weaker.

The rapid changes in bread distribution were accelerated by radical changes in St. Petersburg retail business during the first few years of the 21st century. The retail sector in St. Petersburg had modernised itself significantly and a number of retail chains, mostly Russian but also foreign owned, had appeared in the market. As Hlebny Dom was the first to offer large volumes of

packaged and sliced bread delivered in hygienic plastic crates more reliably than its competitors, it was natural that modern retail stores and chains preferred Hlebny Dom. Thus, the company soon became the number one supplier to retail chains and, in some chains, Hlebny Dom's share was significantly higher than its overall market share. Thus, around 2005, Hlebny Dom's customers were predominantly retail chains such as Peterochka, Kopeika, Lenta, Metro, Okay, Diksi and Auchan. However, the company also distributed to some individual shops. In addition, small retailers might occasionally collect products in their own vans directly from Hlebny Dom's production facilities.

In sum, the St. Petersburg bakery sector's network experienced many significant and radical changes during the latter years of the 1990s and the early years of the 21st century. Although Fazer Bakeries was the only foreign actor that entered the market, other radical changes also occurred in the bakery industry as old actors disappeared and new ones emerged due to numerous domestic mergers and acquisitions. Radical network changes also affected supplying industries, for instance, as new actors appeared in the packaging material industry. Further, many local suppliers changed their activities in accordance with the quality requirements set by Fazer for its subsidiary, Hlebny Dom. The retail sector modernised itself dramatically and both Russian and foreign retail chains appeared in the market. The main findings of the empirical case study are summarised and the effects of Fazer's entry on the development of the St. Petersburg bakery sector from the network perspective are discussed in the next section.

5.3.3 Summary on the effect of Fazer's entry on the St. Petersburg bakery sector analysed from the network perspective

The case study of Fazer's entry into the St. Petersburg bakery sector by a cross-border acquisition illustrates how changes implemented in the acquired company, Hlebny Dom, spread to immediately connected business relationships and, consequently, also to the broader network level. Table 9 summarises the levels and types of change present in the empirical case study. The table is based on the framework presented in Figure 19 on page 156, and, hence, provides an overview on the changes at focal actor, dyadic and network (i.e. industry) levels and, with their respective forms of change, also in the external environment.

Table 9 Summary on the main findings of the empirical case study

Level of change	Type of change
Focal actor level	*Concerning actors:* Changes in organisational structure. *Concerning activities:* Changes in e.g. production, packaging, quality control, R&D, distribution, sales and marketing. *Concerning resources:* Improved financial resources, knowledge, acquisition of new production equipment, and human resources.
Dyadic level	*Concerning actors:* Both rapid and gradual radical changes, e.g. termination of relationships with the delivery company; formation of new relationships with e.g. production machinery suppliers, distribution system supplier, crate provider, packaging material suppliers and new customers (i.e. retail chains). *Concerning activities:* Both rapid and gradual incremental changes, e.g. strict quality control and new quality requirements towards suppliers; improved sales and marketing activities, new distribution system and key account management practices towards customers. *Concerning resources:* Both rapid and gradual incremental changes concerning financial resources, knowledge and network resources (e.g. references on possible machinery suppliers given to local suppliers) and new product types offered to local retailers/customers.
Network level	*Concerning actors:* Gradual radical changes, e.g. the network position of the delivery company HlebTrans and the customer network of the berry supplier Grand Prestige changed; new actors entered the network, e.g. the crate provider. *Concerning activities:* Both rapid and gradual incremental changes in e.g. packaging, branding, sales, marketing and bread distribution. *Concerning resources:* Both rapid and gradual incremental changes, e.g. availability of higher quality of raw materials and finished products.
External environment	Economic transition in Russia, financial crises, the development of related industries (e.g. packaging material producers and retail chains' appearance in the external environment) affected the development of the local bakery sector at all three levels (i.e. focal actor, dyadic and network).

Fazer Bakeries implemented a number of changes in the acquired firm, Hlebny Dom, concerning organisational structure and activities; for instance, production, sales and marketing, R&D, quality control and distribution. There were major changes also with regard to Hlebny Dom's resources as the acquirer brought in finance, knowledge and other resources, and made modifications to, for example, Hlebny Dom's production equipment, product range and human resources by recruiting new managers (see chapter 3.3).

Changes implemented at the focal actor level had a direct impact on dyadic relationships with supplier and customer companies. There were *radical changes* in dyadic relationships, which were relatively rapid, during the early post-acquisition integration phase (cf. Angwin 2004); new relationships were

formed with equipment suppliers and the relationship with the delivery company HlebTrans was terminated. However, some of the radical changes in Hlebny Dom's dyadic relationships seemed to be gradual, especially as the post-acquisition integration phase deepened or officially came to an end. An example of a gradual radical change was the formation of a new relationship with the berry supplier Grand Prestige when production began of Fazer's traditional berry pies at Hlebny Dom.

The acquisition also triggered many *incremental changes* at the dyadic level that were rapid, gradual or both. For example, rapid incremental changes in distribution, sales and marketing activities towards Hlebny Dom's customers, and both rapid and gradual incremental changes in quality requirements towards suppliers. The cross-border acquisition also brought incremental changes concerning resources at the dyadic level; for instance, as local suppliers were given advice on potential foreign network partners to overcome some technical problems in production. Also, Hlebny Dom's improved financial resources after the cross-border acquisition eased its relationships with foreign suppliers of production equipment.

Changes triggered by the foreign entry at the dyadic level spread to the network level as connected changes began to appear (cf. Halinen et al. 1999; Hertz 1998). As Hlebny Dom's suppliers made changes to their own activities, the enacted changes in turn impacted their respective suppliers and customers. Gradual incremental changes affected the local bakery industry; for example, as the quality of a raw material was raised in accordance with Fazer's requirements. Consequently, retailers began to benefit from improvements in product quality and from an enlarged product range. Competition and the higher quality of local raw materials also improved the offerings of a number of local bakeries.

In addition, radical network changes emerged as other local bakeries adapted their distribution systems to retailers' requirements and dissolved their relationship with the delivery company HlebTrans. As a consequence, the former monopolistic provider of bread deliveries became a minor actor in the local bakery sector. The focal study also found that incremental changes in a dyad between Hlebny Dom and its berry supplier, Grand Prestige, generated a radical network change among Grand Prestige's customer network (cf. Halinen et al. 1999; Havila & Salmi 2000).

However, network dynamics are impossible to separate from events and change processes in the external environment as forces of environmental change are channelled through business relations (Halinen et al. 1999; Håkansson & Johanson 1993). Thus, in addition to endogenous changes triggered by the foreign entry, changes in the external environment such as the Russian economic transition to a market economy, the Russian economic

crisis in 1998 and the modernisation of the retail sector also had significant impact on the changes at all three levels. It is likely that forces from the external environment would eventually have led to the significant changes observed in the Russian bakery sector. However, the foreign entry certainly served as a catalyst for these changes within the sector by triggering a series of changes in dyadic relationships that gradually spread to other connected relationships at the broader network level.

An interesting finding from the empirical case study relates to the speed and degree of network changes triggered by the acquisition. Halinen et al. (1999) state that change can manifest itself as either gradual and incremental or instant and radical; thus, they bundled the speed and degree of change together. However, according to the definition (see Halinen et al. 1999), radical and incremental changes do not refer to the speed of change but to the degree of change: 'radical' expresses a termination of an established relationship or the creation of a new one and 'incremental' expresses a change in the nature or content of a relationship. Indeed, the empirical case study shows that the temporal dimension (i.e. the speed of change) creates additional combinations of network change: rapid incremental and gradual radical changes (see also Degbey & Pelto 2013). These different forms of change are illustrated by the typology of change shown Figure 29. The figure also gives examples of each type of change from the empirical case study.

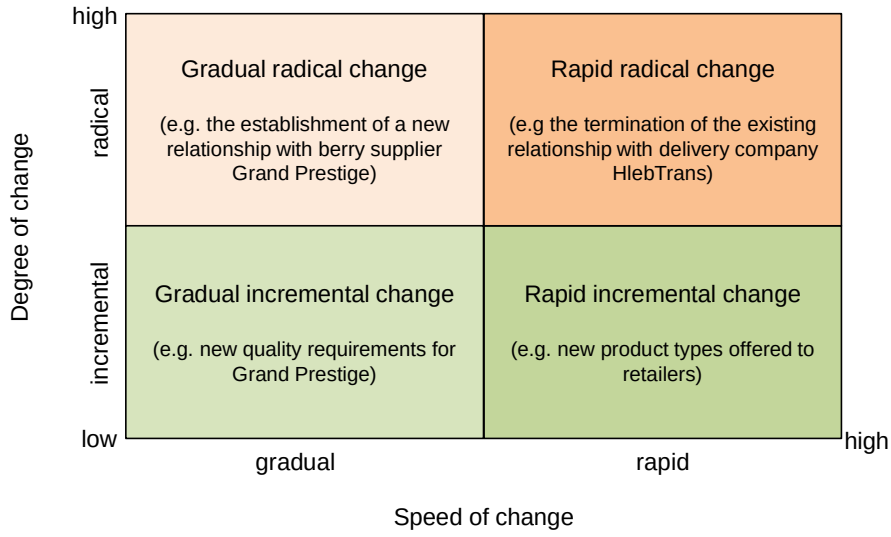

Figure 29 Typology of network change derived from the empirical case study (adapted from Degbey & Pelto 2013)

The network change typology presented in Figure 29 rests on two axes: speed and degree of change. The speed of change refers to the temporal dimension of the forms in which both radical and incremental changes can be manifest. The issue of the temporal dimension is important due to the fact that events triggering change, such as mergers and acquisitions, can come in phases (cf. e.g. Appelbaum, Gandell, Yortis, Proper & Jobin 2000a; 2000b). For example, the empirical case study focused on network changes at the post-acquisition phase; thus, the rapid or gradual nature of the specific form of change can partly depend on the phase of the acquisition. In addition, the speed of change can also be influenced at different actor levels; that is, whether the change occurs at the level of a focal actor, at a dyadic level or at a network level. For example, at the dyadic level, both incremental and radical changes can occur rapidly, whereas at the network level, radical changes often appear at a lower speed, that is, gradually.

The typology's degree of change axis illustrates incremental and radical changes. Incremental change can be considered to affect network relations to a lower degree as the change only affects the nature and content of a relationship. Radical change represents a higher degree of alteration in the network as it means that extant relationships are dissolved and/or new ones built (cf. Halinen et al. 1999). In sum, the typology identifies four different quadrants: gradual radical change, rapid radical change, gradual incremental change and rapid incremental change. All of these four forms of network change can be identified in the empirical case. Thus, an example of a foreign entry-triggered gradual radical change would be the creation of a new relationship with the berry supplier Grand Prestige. The relationship was formed rather slowly after Fazer's entry by the acquisition of Hlebny Dom, when Fazer decided to begin producing berry pies similar to those in Finland also in Russia. However, termination of the relationship with the delivery company HlebTrans is a good example of a rapid radical change, as the decision to create its own distribution system was made soon after the acquisition. The case also offers examples of incremental changes; for instance, in the form of new quality requirements on suppliers. Some new quality requirements were set soon after entry, whereas some, for example, on the berry supplier Grand Prestige, were set after a few years' cooperation. Another example of an incremental change occurring rapidly after the entry of Fazer Bakeries concerns renewed product offerings and services provided to customers (i.e. local retailers) in the form of the new distribution system.

The spread of change from the focal actor to other network members in the case study was probably significantly enhanced by *various types of embeddedness* of the focal actor in the local bakery sector. For instance, Fazer Bakeries' investment was market-seeking and the acquired company, Hlebny

Dom, served almost solely Russian domestic markets and especially the local St. Petersburg region's market. The company utilised mainly local suppliers; thus, it is vertically embedded to both suppliers and customers. Hlebny Dom can be considered also strongly embedded socially in the local bakery sector, especially as Fazer Bakeries decided not to send any expatriates to St. Petersburg. Hlebny Dom's local managers have been active, for instance, in the local bakers' union and many of them personally know the managers of, for instance, competing bakeries. Thus, at least via such informal interaction, the company can also be considered horizontally embedded in the local bakery sector.

The position of Hlebny Dom in the local market was strengthened after Fazer's acquisition of the company: Hlebny Dom's market share increased from approximately 15 percent prior to the acquisition to approximately 30 percent in 2005. Since then, its market share has increased, which is partly due to Fazer's further acquisitions of local bakeries in St. Petersburg and also to improvements in, for instance, production, product range, distribution, sales and marketing and key account management practices towards major retail chains. Initially, Hlebny Dom's strong position probably contributed to the spread of change at the dyadic relationship level and, later, also to the broader network level. Many local actors have adapted their activities in accordance with Hlebny Dom's initiatives, and many of them have also managed to transmit the change to their network partners; for example, the berry supplier, Grand Prestige, has transmitted both higher quality and higher price to many other local bakeries. The retail chains also provide a good example of such behaviour; as the position of modern retail chains became stronger (cf. Radaev 2013), they began to require from their other bread suppliers a similar modern distribution system to that introduced by Fazer for Hlebny Dom. As the retail chains have expanded their operations to other Russian regions, the new bread distribution system has also spread to regions distant from St. Petersburg, thus, indicating changes at the broader network level.

The effect of Fazer Bakeries' entry into the St. Petersburg bakery sector will be further discussed in the following chapter. It draws together both spill-over and network effects that the foreign entry has triggered towards local companies. As a synthesis of the two theoretical perspectives, an integrated framework of the effects of foreign entry on local firms will be presented in chapter 6.

6 SYNTHESIS – AN INTEGRATED FRAMEWORK OF THE EFFECTS OF FOREIGN ENTRY ON LOCAL COMPANIES

This chapter offers a synthesis of foreign direct investment (FDI) spillover and network perspectives on the effects of foreign entry on local companies. First, the two perspectives are compared in section 6.1 and then, as a result of the whole study, an integrated framework is developed and presented in section 6.2.

6.1 Comparing theoretical approaches for studying the effects of foreign entry on local companies

6.1.1 Level of analysis

The two theoretical perspectives utilised in this study to analyse the empirical case offered rather different perspectives on the phenomenon under scrutiny. One major difference between the approaches is the level of analysis[40]. FDI spillover studies usually concentrate more on macro-level analysis of the effects of FDI inflows to a particular country and particular industrial sector. Thus, the focus has been upon the aggregate consequences of FDIs on the productivity of local firms, whereas the understanding on how spillovers occur at a micro level has been limited (cf. Enderwick 2005; Meyer 2004).

However, for studying change, macro-level analysis is seldom sufficient as the mechanisms of change are considered to work through micro pathways (e.g. Jepperson & Meyer 2011; Hedström & Swedberg 1998; Coleman 1990).

[40] Although not necessarily mutually exclusive, the three general levels of analysis on which research is often considered to fall are micro, meso and macro levels (e.g. Jepperson & Meyer 2011; Dopfer et al. 2004). *Micro level* refers to individuals or small groups of individuals or, in business research, individual firms. *Macro-level* units of analysis include, for instance, nation or society; thus, macro-level analysis focuses on "aggregates of micro" (cf. Dopfer et al. 2004; Dopfer & Potts 2004). However, the question: "how much aggregation is needed for an analysis to be called macro-level?" remains unanswered (cf. Dopfer 2012). *Meso-level* analysis, in general, focuses on population size that falls in between the micro and macro levels (see e.g. Jepperson & Meyer 2011). According to Dopfer et al. (2004, 268), "meso is a thing that is made of complex other things (i.e. micro) and is an element in higher other things (i.e. macro)". Industrial districts, interfirm industrial organizations or networks with weak and strong ties are examples of meso-level entities (Dopfer et al. 2004).

In other words, causal social processes work through the ideas and behaviours of individuals, and it has been posited that change at the macro level can be explained only by changes at the micro level (Hedström & Swedberg 1998; cf. Jepperson & Meyer 2011). Consequently, even when focusing on whether spillovers occur in a particular country's particular industry (i.e. at the macro level), previous studies on FDI spillovers offer possible micro-level explanations for the occurrence of spillovers. Figure 30 illustrates the change mechanisms between micro and macro levels.

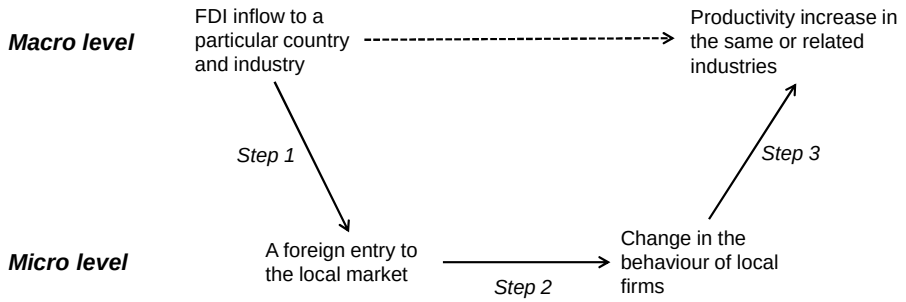

Figure 30 An example of change mechanisms between micro and macro levels (adapted from Hedström & Swedberg 1998; Coleman 1990)

As suggested by Figure 30, FDI inflow to a particular country and industry can been perceived as a macro-level occurrence that can lead to increased productivity of local firms in the same or related industries (see e.g. Blomström et al. 2000). However, the connection between FDI inflow and increased productivity is marked with dashed arrow in the figure, as this macro-macro connection does not explain why and how this might occur. Hence, according to Hedström and Swedberg (1998), instead of analysing relationships between phenomena only at the macro level, one should always try to establish how events or conditions at the macro level affect an individual actor (i.e. Step 1), how the individual actor assimilates the impact of the event (i.e. Step 2) and, finally, how a number of individuals, through their actions and interactions, generate macro-level outcomes (i.e. Step 3).

Indeed, at the micro level, FDI inflow can be perceived as a foreign firm entering into the local market (i.e. Step 1 in Figure 30). The entry can cause changes in the behaviour and actions of local firms as they, for instance, imitate the actions of the foreign entrant or improve the quality of their products in accordance with requirements set by the foreign entrant (i.e. Step 2). Finally, improvements in activities and knowledge of local firms can lead to improved productivity in the focal and related industries (i.e. Step 3).

However, the focus of this study is not on macro-level outcomes but more on the micro-level mechanisms shown as Step 2 in Figure 30. Nevertheless, previous research on FDI and knowledge spillovers has provided this study with a valuable pre-understanding on the mechanisms of spillover effects to local companies at the micro-level.

The other theoretical lens of the study, the network approach, focuses especially on meso (i.e. network) level analysis (see e.g. Easton 1992) and, as such, offers a complementary perspective on the effects of foreign entry on local companies. Indeed, meso-level analysis has been posited to capture best the evolutionary mechanisms in an economic system (see Dopfer 2012; Dopfer, Foster & Potts 2004; Dopfer & Potts 2004). According to Dopfer et al. (2004), meso populations constitute the elementary units of the economic system and the relation between change processes in both micro and macro structures can only be clearly understood by focusing explicitly on the meso level. In short, economic evolution begins at the micro level when new knowledge (e.g. an innovation of an entrepreneur) enters into the economic system and diffuses across organisational contexts. As the knowledge is adopted, adapted, diffused and retained in interaction between different micro agents (i.e. actors), the structure of the system also transforms, leading to changes at the meso level. However, the knowledge can be diffused to many distinct local environments. Finally, at the higher macro level, the changed meso populations affect the deep structure of these connected populations as associated with, for instance, an institutional or technological regime. (Dopfer & Potts 2004; Dopfer et al. 2004.)

Thus, two macro properties can be connected both through micro and meso pathways (cf. Jepperson & Meyer 2011). Figure 31 illustrates the mechanisms of change between micro, meso and macro levels. The figure illustrates how the meso level plays an important role in transmitting change between the micro and macro levels. FDI inflow, which can been perceived as a foreign firm entering a new market at the micro level, can also be perceived to cause changes in the structure of a specific business network at the macro level. Even a single foreign entry can cause changes at the meso or network level as firms in the network are interdependent (cf. Havila & Salmi 2000; Halinen et al. 1999). Similarly, changes at the meso level often affect firms at the micro level, as illustrated by the two-way arrows in Figure 31.

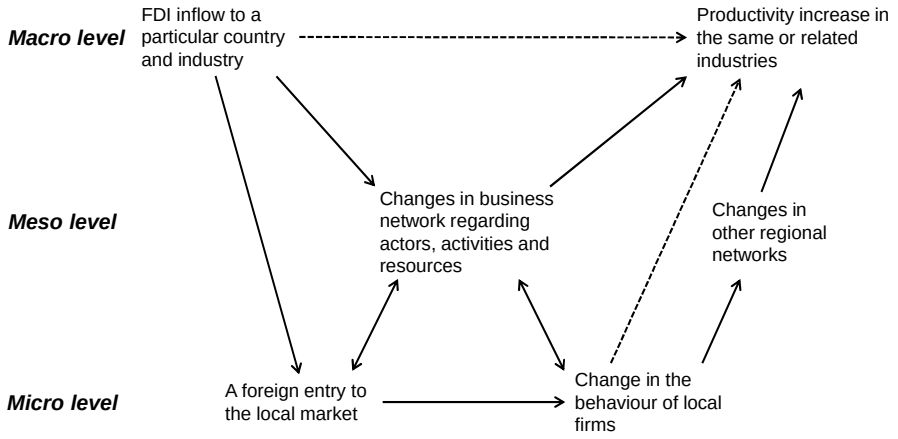

Figure 31 An example of change mechanisms between micro, meso and macro levels (adapted from Jepperson & Meyer 2011)

How much and what sort of change a foreign entry triggers at the network level (i.e. meso level) depends both on the actions of the foreign entrant and the local firms. For instance, a foreign firm entering the network can create new relationships, trigger change in the positions of existing network members or bring in new knowledge and resources to the whole network. The entrant can initiate changes in the activities of, for instance, its local suppliers that can further transmit the change to other network members by altering their own activities (cf. e.g. Easton & Lundgren 1992). The change can even be transmitted to other local networks, as occurred in the empirical case when the expanding retail chains began to require similar distribution systems from their suppliers also in other regional markets (see sub-section 5.3.2.1). Finally, macro-level change is caused by changes in many meso-level populations, such as different regional business networks (cf. Dopfer et al. 2004).

This study focuses on change mechanisms both at micro and meso levels. Thus, whereas the FDI spillover literature offers knowledge on possible change mechanisms at the micro level (i.e. from the foreign entrant firm to local companies), the industrial network approach offers valuable understanding on the connected change spreading from the dyadic level through indirect relationships towards the meso (i.e. network) level. In other words, the two theoretical lenses employed in this study offer a complementary perspective on changes caused by a foreign entry on local companies. The FDI spillover perspective focuses on mechanisms by which knowledge diffuses from the foreign multinational corporation's (MNC) subsidiary to local firms, while the network approach contributes to understanding on how knowledge diffuses further from local companies to other network members or even other networks.

6.1.2 Intended versus unintended consequences

Another difference between the two theoretical approaches employed in this study for analysing the effects of foreign entry on local companies relates to the intended versus unintended consequences of the foreign entry. According to Cowen (1998), the concept of transaction enables the classification of economic events into two categories: outcomes generated by encompassing contracts and externalities that are not covered by contracts. Contracted outcomes can also be termed intended, whereas non-contracted outcomes, thus externalities, are termed unintended outcomes (Cowen 1998).

By definition (see chapter 4.2), FDI spillovers, also termed 'externalities', 'external effects' or even 'involuntary technology diffusion' are usually understood as unintended effects of a foreign enterprise on local businesses (see e.g. Meyer 2004; Kokko 1992; Blomström 1989; Caves 1971). Especially studies on horizontal spillovers (i.e. spillovers to competing firms in the same industry) focus on unintended FDI consequences. However, vertical spillovers (i.e. to suppliers and customers) should not be perceived as pure unintended externalities as multinational enterprises (MNE) can have an incentive deliberately to transfer knowledge; for instance, to their local suppliers (Hallin & Holmström Lind 2012; Javorcik 2004). However, studies on vertical spillovers also often treat them as pure externalities. Only recently, Hallin and Holmström Lind (2012) emphasised the conceptual distinction between horizontal and vertical spillovers and considered horizontal spillovers to be largely unintentional, whereas vertical spillovers were perceived as intentional knowledge diffusion.

The intentionality of actors is emphasised in the industrial network approach (see e.g. Anderson et al. 1998; Mattsson 1989). Thus, whereas the FDI spillover literature has often perceived spillovers as unintentional and negative phenomena from the perspective of an MNC, a failure to keep knowledge and technology internalised in the MNC (see e.g. Caves 1971; cf. Oetzel & Doh 2009; Kugler 2006), the network approach offers the opposite perspective on the spillover phenomenon. In relation to knowledge spillovers, the network approach concentrates on common benefits (Kogut 2000). From the network perspective, the know-how of a company is based both on the knowledge of its personnel and on the knowledge of other organisations within its network context. Much of a company's knowledge becomes available through its relationships with others outside the company; for instance, to its suppliers and customers (Håkansson & Snehota 1995). However, these knowledge spillovers are not necessarily considered negative from the focal company's perspective as, due to the interdependences between firms in a network, the more the company can help its counterparts to develop and become successful, the

greater its own chances of becoming successful (Håkansson & Snehota 1995). Thus, to analyse the effects of a foreign entry on local firms from a network perspective, more attention is given to intended effects arising from the interaction, interdependence and mutual adaptation between the foreign affiliate and its local counterparts.

However, change initiated by the foreign entrant, for example, to its local suppliers or customers, can spread further through indirect relationships as suppliers or customers transmit the change to other network members (cf. Halinen et al. 1999; Hertz 1993; Easton & Lundgren 1992). Thus, due to connected network relationships, the foreign entrant can have a very limited understanding on and potential to control the network change it has triggered. As a result, there can be both intended and unintended or even unexpected effects, especially at the broader network level (cf. Anderson et al. 2001; Havila & Salmi 2000).

In sum, the two theoretical approaches employed in this study complement each other also with regard to intended and unintended effects resulting from a foreign entry. The FDI spillover literature provides knowledge especially on the mechanisms of unintended effects (e.g. labour mobility, demonstration and imitation), whereas the network approach increases understanding on intended effects (e.g. adaptation of resources and activities in dyadic relationships). In addition, the network approach also offers valuable insight on how the intended effects at the dyadic level can, in fact, become unintended effects at the larger network level, depending on the actions of other firms in the network and also on events in the broader external environment. Intended and unintended mechanisms of change are illustrated in Figure 32, which is shown and discussed in the following section 6.2.

6.2 Integrated framework of the effects of foreign entry on local companies

Figure 32 presents an integrated framework for analysing effects of foreign entry on local companies. The figure is developed as a synthesis of the FDI spillover literature, the industrial network approach literature and the findings of the empirical case study on Fazer Bakeries' entry into the St. Petersburg bakery sector.

As illustrated by Figure 32, a foreign entry through a greenfield investment or a cross-border acquisition can influence local companies both unintentionally and intentionally. The extent to which the foreign entrant influences local firms depends on its position and embeddedness in the new market network (cf. Eapen 2012; Hallin & Holmström Lind 2012).

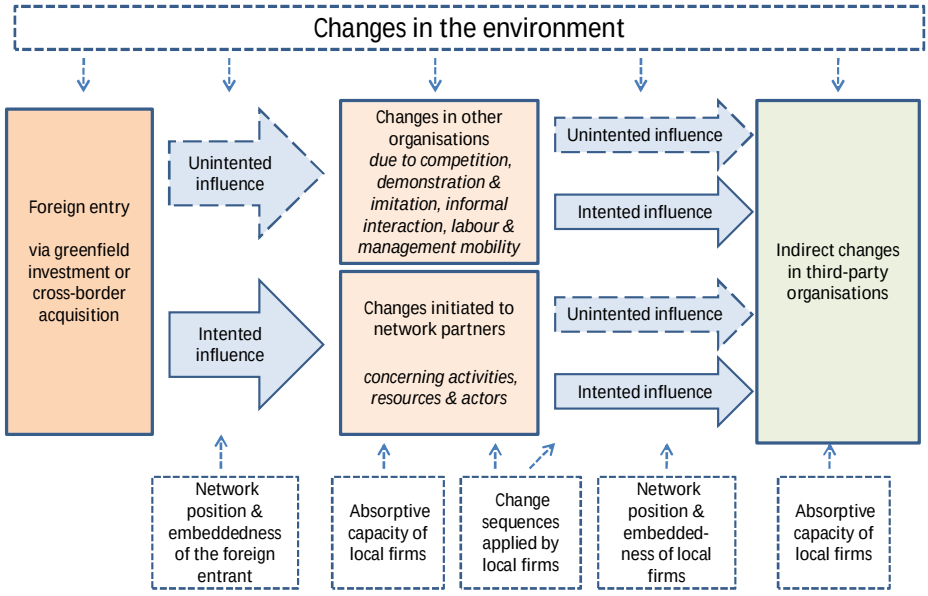

Figure 32 Integrated framework of effects of foreign entry on local companies

A strong actor with many relationships with local actors is likely to have a stronger effect on local firms than a small and weak entrant which is not embedded in the local market. Furthermore, the effect a foreign entry on local companies depends also on local firms' absorptive capacity; not all local companies are necessarily able to benefit from, for instance, knowledge spillovers or knowledge diffusion from the foreign firm (e.g. Eapen 2012; Spencer 2008; Narula & Marin 2003).

Unintentional influence of a foreign entry on local firms can occur through various mechanisms. For instance, the resultant increase in competition can cause local competitors to change their activities; some might be able to become more efficient while others might not survive the increased competition (e.g. UNCTAD 2003; Blomström et al. 2000). Competitors might also imitate the foreign entrant's activities, as occurred in the empirical case when local bakeries began to imitate Hlebny Dom's product range. More tacit knowledge can spill over to local companies through informal interaction in, for instance trade and industrial associations and also when workers and managers move to work for other companies (e.g. Spencer 2008; cf. Blomström et al. 2000). These two possible mechanisms of knowledge spillover were present in the empirical case; Hlebny Dom's local managers were active in the local baker's union and some had indeed been employed by local companies. Thus, strong social embeddedness of the foreign subsidiary's managers in the local business network can be considered probably to lead to unintended knowledge spillovers.

Although labour and management mobility is usually only considered a source for horizontal knowledge spillovers to competitors in the FDI spillover literature (see e.g. Spencer 2008; Blomström et al. 2000), it can also be a source of knowledge spillover to other industries. For instance, in the empirical case, some managers had left to work in other local companies which were not Hlebny Dom's competitors but, for example, in the retail business. However, even when moving to another industrial sector, the managers are likely to benefit the new employer with, for instance, managerial or marketing and sales related knowledge that they have acquired while working for Fazer's subsidiary, Hlebny Dom.

Even to a greater extent than unintentionally, a foreign entrant can also purposefully influence local companies (cf. Hallin & Holmström Lind 2012; Kugler 2006) as it initiates changes to its business partners concerning resources, activities or actors (cf. Håkansson & Johanson 1992). Thus, the foreign entrant can, for instance, impose new quality requirements on or transfer knowledge to its suppliers or customers (cf. Kugler 2006; Javorcik 2004; Håkansson & Snehota 1995). Indeed, in the empirical case study, the foreign entrant set new and stricter quality requirements for its local suppliers and also offered some advice on how to solve related technical problems. As a result, some suppliers changed their operations significantly by acquiring new production technology. The company also presented new types of activity to its local customers; for instance, sales and marketing activities, key account management practices and, above all, a new distribution system that expedited operations for retailers. Indeed, a strong market embeddedness of the foreign entrant is likely to lead to more intended effects on the local business network.

However, the effects of foreign entry are not limited to companies that have direct relationships with the foreign subsidiary or that are the foreign subsidiary's direct competitors in the same market. Instead, through the local companies' relationships with other companies, the effects can spread to third-party organisations, even if they are geographically distant from the foreign entrant (Halinen et al. 1999; Hertz 1993; 1998). Whether the effects spread further and to what extent depends on the change sequence applied by local companies. For instance, if a company absorbs the initiated or unintentionally triggered change or adapts to it, the change can remain confined in that particular organisation or relationship (Havila & Salmi 2000; Halinen et al. 1999; Easton & Lundgren 1992). However, the local company might be able to transmit the change further (see Easton & Lundgren 1992) as, for example, was done by the berry supplier, Grand Prestige, when it passed on the increased price to other companies with which it had relationships. In such cases, the effects of an entry will also affect companies not directly connected to the foreign entrant (see e.g. Hallin & Holmström Lind 2012). The spread of change also

depends on the network position and embeddedness of local firms. The stronger a local firm's position in the market and the more embedded its relationships with other local actors, the more likely it will spread changes further to other relationships. Therefore, the local company can create both intended and unintended effects on third-party organisations.

Thus, broader-level consequences of a foreign entry on local companies are difficult for the foreign company to anticipate as they also depend on the actions and positions of other firms in the network. Even intended effects (i.e. changes initiated to business partners) can result in unexpected changes at the larger network level (cf. Anderson et al. 2001; Havila & Salmi 2000). The introduction of a new distribution system with a new type of plastic bread crate developed by Fazer together with the crate provider Arca Systems is an example of such an event in the empirical case: the intended effect was to serve better the customer companies (i.e. the retailers) and consequently strengthen Hlebny Dom's position in the market. The intended outcome was achieved and Hlebny Dom became the most important bread supplier to many local retailers and retail chains. However, the event also had unintended consequences as the retailers also began to require a similar distribution system and similar bread crates from other bread suppliers. Thus, the crate became a local standard that was later spread also to other Russian regions by the expanding retail chains. Had Fazer anticipated this development, it could have bought the crate model and received royalties. However, at the time, the company did not anticipate such a development.

The development of any sector or network is also influenced by changes in the external environment (see e.g. Halinen et al. 1999; Steele 1992). In the empirical case, there were a number of external events that enhanced the impact of the foreign entry on the development of the local bakery sector. Examples of such are, for instance, the economic transition of Russia with, for example, privatisation of state owned companies that made the foreign entry possible in the first place; the general economic development of Russia and, especially, the economic crisis in 1998 that gave the foreign entrant competitive advantage as local companies became unable to invest; the economic growth following the economic crisis and the modernisation of the retail sector as both foreign and domestic retail chains entered the market and strengthened the position of the foreign entrant in the bakery sector, as it was the only bakery company at the time that was able to adequately serve the modern retail chains. Thus, the effects of the foreign entry are impossible to totally isolate from effects caused by changes in the surrounding environment.

7 CONCLUSIONS

7.1 Summary

The current debate on globalisation includes many contradictory views on the increasing role of multinational enterprises (MNE) in the world economy (see e.g. Forsgren 2008). While MNEs are perceived as important change agents without which, for instance, economic transition would not have been possible (e.g. Kalotay 2010; Bandelj 2002), the expansion and operations of MNEs are also connected to a number of negative impacts including, for instance, crowding out local firms and employment (e.g. van Tulder & van der Zwart 2006). Similarly, the large body of academic research on external effects of foreign direct investment (FDI) show mixed results, also in the transition economies' context (e.g. Dries & Swinnen 2004; Kinoshita 2001; Djankov & Hoekman 2000).

Thus, there remains a lack of understanding on how FDI actually affects local companies (cf. Gachino 2010; Spencer 2008; Javorcik 2007). It has been suggested that studies taking an individual MNE as a starting point would enhance understanding on the interaction between MNEs and the local environment (Meyer 2004). Thus, the aim of this study is to increase understanding on *how a single foreign entry can influence local companies in a transition economy's context*. This aim can be divided into three more specific sub-objectives:

- To describe changes in local companies following a foreign entry into a transition economy's context.
- To identify the mechanisms through which changes are transmitted to local companies.
- To identify conditions that impact the transmission of changes to local companies.

To acquire deep understanding on the phenomenon under investigation, *theoretical pluralism* was applied in empirically studying the case of Fazer Bakeries' entry into St. Petersburg, Russia in 1997 and its effects on local companies over a ten year period; thus, from entry until 2007. The empirical case was analysed separately from the perspectives of two different theoretical approaches: first, the extant literature on *FDI spillovers* was utilised to gain preliminary understanding on influences that foreign enterprises can have on local companies. A framework was developed on the potential mechanisms

and determinants of spillover effects to local companies and it was applied to the analysis of the empirical case. Second, to deepen the empirical analysis, the case was also studied from the perspective of the *industrial network approach* by focusing on changes triggered by the foreign entry at various levels of the network. Finally, an *integrated framework was developed to analyse the effects of foreign entry on local companies*. The study applied an *abductive* logic of reasoning in building the framework. Thus, the integrated framework was constructed in a dialogue between the empirical findings and the two different theoretical perspectives utilised in the study.

Based on the case study, it seems clear that *the entry of Fazer Bakeries into St. Petersburg has contributed significantly to the development of the local bakery sector*. For instance, the distribution system Fazer developed for its Russian subsidiary, Hlebny Dom, has become a new standard in the local market and even in other Russian regions; Fazer brought several new types of product to the market that were imitated by competitors; and the improvements Fazer introduced to the production system and product quality has made St. Petersburg bread, in general, the best but also the most expensive in Russia. The foreign entry has also intensified competition in the St. Petersburg bakery market and contributed to consolidating the sector.

Hence, the case study shows that, at least in the context of a transition economy, *even a single foreign entry can contribute significantly to the development of the host sector*. Due to interconnected network actors, the effects triggered by the foreign entry can also reach companies that are not in direct contact with the foreign entrant. In fact, via indirect network connections, *the effects can even reach other regional networks* geographically distant from the regional market entered by the foreign firm.

The effects of the foreign entry can be divided into two categories, unintended and intended effects. Unintended effects include, for instance, the imitation of the foreign entrant's products and managerial practices by local competitors. Knowledge on these aspects became available to local competitors by simple observation of the foreign entrant's market, by informal interaction, for instance, in the local industry association and by management mobility. Quality requirements imposed on local suppliers and improved services offered to local customer companies are examples of intended changes in the empirical case study. However, even intended effects can turn into unintended or even unexpected effects as they spread further to other companies in the business network. The new distribution system created by Fazer turning into a local standard and spreading along the retail chains' expansion also to other Russian regions in an example of such an event in the empirical case.

The extent to which a foreign entrant, in fact, influences local firms depends on its position and embeddedness in the local business network and

also the absorptive capacity of local companies. Similarly, the network position and embeddedness of local firms impacts on the extent to which the effects are further spread to other companies in the network or even to other regional networks. However, it should be also noted that effects triggered by the foreign entry cannot be isolated from effects caused by changes in the surrounding environment. Thus, in the empirical case, the general economic situation in the Russian transition economy and, for instance, the entry and appearance of modern retail chains in the market also had a significant impact on the development of the local bakery sector.

The theoretical and methodological contribution, managerial and policy implications and also the limitations of the study will be discussed in more detail in the following sub-chapters. Suggestions for further research are also outlined at the end of this chapter.

7.2 Theoretical conclusions

In this study, the phenomenon under scrutiny and the empirical case were examined through two different theoretical lenses (cf. Lewis & Grimes 1999), the FDI spillover perspective and the industrial network perspective. As a synthesis of both of these theoretical perspectives and the case analysis, an integrated framework on the effects of foreign entry on local companies was created (see Figure 32 on page 191). In the following sub-sections, theoretical contributions of the study are discussed first with regard to FDI spillover and then to the industrial network approach literature. Subsequently, propositions arising from the integrated framework are put forward in sub-chapter 7.2.3.

7.2.1 Contribution to the literature on FDI spillover mechanisms

Most FDI spillover studies have concentrated on whether spillovers occur or not, whereas understanding on the exact mechanisms behind them has only received little attention (see e.g. Gachino 2010; Spencer 2008; Javorcik 2007). This study focuses on the identification of potential spillover mechanisms from a foreign entry to local firms (see Figure 14 & Figure 15). The chosen research strategy for the focal study (i.e. qualitative case study strategy), has been employed extremely rarely in FDI spillover research in which positivistic approaches with quantitative analyses have predominated. However, the empirical case study brings several theoretical contributions to the extant literature on FDI spillovers.

First, in the extant FDI spillover literature, labour and management mobility has been recognised as a possible mechanism for spillovers, especially in a developing market context, although it has usually been so considered only for horizontal spillovers to competitors (see e.g. Spencer 2008; Blomström 1990). However, based on this study, it can be argued that labour and especially *management mobility can also create spillovers to companies in supplying, customer or even unrelated industries*. While working in a MNE, managers can gain valuable knowledge through experience and training that is not necessarily industry-specific but related to, for instance, more general managerial, marketing, sales, supply chain management, financial and technological know-how and skills. These types of knowledge can very well benefit the recipient firm in almost any sector.

Consequently, as labour and management mobility can be perceived also as a mechanism for vertical spillovers and not only for those that are horizontal, treating vertical spillovers as intentional knowledge diffusion, as suggested by Hallin and Holmström Lind (2012), might be overly simplistic. In other words, it can be argued that *vertical spillovers can also be inherently unintentional*.

Furthermore, the case study shows that *interconnected network relationships are of great importance in transmitting knowledge spillovers further to other companies*. For instance, the equipment suppliers of the multinational corporation (MNC) were found to transfer knowledge of its production technology to local companies who employed the same supplier. Indeed, the results of the empirical analysis suggest that the often utilised *division of spillover effects into those that are horizontal (i.e. intra-industry) and vertical (i.e. inter-industry) can be difficult and even inadequate* as companies are interlinked. Hence, vertical spillovers to supplier and customer companies are likely to eventually also affect local competitors (see Hallin & Holmström Lind 2012; Spencer 2008). Thus, it seems that *vertical spillovers can act as mechanisms for horizontal spillovers and vice versa*. In future, interconnected and interdependent relationships of firms should be better taken into account in studies on FDI spillovers.

7.2.2 Contribution to the industrial network approach literature

The industrial network approach was utilised in this study as another theoretical lens for studying the effect of a foreign entry on local companies in Russia. In comparison with other large emerging economies, Russia has rarely been the focus of international research concerning business relationships (Tretyak 2013). Hence, by focusing on network change in the context of the St.

Petersburg bakery sector, this study contributes to the understanding on business relationships and their dynamics in the Russian context.

However, in addition to the contextual insight on the development and change in Russian business networks, this study also makes a more general theoretical contribution to the network approach literature. Indeed, the network effects of foreign entry have not previously been widely studied. There are some studies on changes caused by mergers and acquisitions (M&A) on business networks (see e.g. Degbey & Pelto 2013; Öberg et al. 2007; Anderson et al. 2001; Havila & Salmi 2000) and, as cross-border M&A is an equity-based entry mode, the focal study partly builds on these previous works. In so doing, this study contributes to the industrial network approach literature and, especially, to understanding on network change in a number of ways.

A major contribution to the industrial network literature is the *development of a framework for analysing network change triggered by a foreign entry* (see Figure 19). Instead of focusing only on M&A-triggered network change (cf. Degbey & Pelto 2013), the framework can also be applied to changes triggered by greenfield investments. Furthermore, whereas previous studies on network change caused by M&A (e.g. Öberg et al. 2007; Anderson et al. 2001; Havila & Salmi 2000) focused on changes in the merging parties' dyadic relationships with suppliers and customers, this study and the created framework also address changes at a focal actor level and the broader network level. Thus, *the created framework acknowledges all three different levels: focal actor, dyadic and network* (see Corsaro & Snehota 2012). Indeed, the empirical case study also suggests that change at the focal actor or dyadic level can, via connected relationships, even cause significant changes at the broader network level (cf. Havila & Salmi 2000; Halinen et al. 1999).

In previous studies, acquisitions have often been perceived as critical events in networks and attention has mainly been given to radical network change (see Havila & Salmi 2000). However, in this study, *foreign entry by an acquisition was considered an event causing both radical and incremental changes*. Thus, in the analysis of the empirical case study and theory building, equal recognition was given to both incremental and radical network change triggered by the foreign entry. Indeed, an incremental change at the dyadic level can trigger radical change at the broader network level. Hence, focusing only on radical changes (e.g. Havila & Salmi 2000) and/or changes at the dyadic level (e.g. Öberg et al. 2007; Anderson et al. 2001) in empirical analyses can lead to the omission of potentially significant network changes.

The empirical case also reveals a need for a new conceptual typology of network change. Thus, another major theoretical contribution of the study is *the creation of a typology of network change* (see Figure 29, cf. Degbey &

Pelto 2013). Whereas Halinen et al. (1999) connect the speed of change to the degree of change by stating that change can be either gradual and incremental or instant and radical, this study *identifies additional combinations of network change: rapid incremental and gradual radical changes* (see also Degbey & Pelto 2013). It should be noted that these concepts do not contradict the original definition of radical and incremental change, in which 'radical' expresses a termination of an established relationship or the creation of a new relationship and 'incremental' expresses a change in the nature or content of a relationship (Halinen et al. 1999; also Havila & Salmi 2000). Instead, the developed typology of network change adds a temporal dimension to the concepts of both radical and incremental change. The typology of change with concepts of rapid incremental and gradual radical change will be useful in future studies on network change.

7.2.3 Propositions based on the study

This study aims at theory development by creating a framework for analysing the effects of foreign entry on local companies (see Figure 32, p. 191). The integrated framework developed as a synthesis of the FDI spillover literature, the literature on industrial network approach and the findings of the empirical case study is explorative. Although effects of foreign entry have been widely studied as FDI spillovers, the understanding on how they actually occur at the micro level and how they spread among local firms has been limited (cf. Gachino 2010; Spencer 2008; Javorcik 2007; Meyer 2004). Thus, this study applies a novel approach to studying the effect of an MNC's entry on local companies.

Given its explorative nature, the propositions arising from the integrated framework can be considered the most important theoretical contribution of this study (cf. Sandberg 2005). The study reveals that a foreign entry can have both intended and unintended effects on local firms (cf. Hallin & Holmström Lind 2012; Anderson et al. 2001) and that there are a number of factors influencing both types of effects. Hence, the following propositions are put forward:

- *Proposition 1: Both intended and unintended effects of foreign entry on local companies depend on the network position and network embeddedness of the foreign entrant in the local business network.*
- *Proposition 2: Both intended and unintended effects of foreign entry on local companies depend on the absorptive capacity of local companies.*

However, it has also been found in this study that mechanisms and determinants causing intended and unintended effects on local firms vary. Intended

effects are usually the results of interdependence due to resource ties, activity links and actor bonds between the foreign subsidiary and its local business partners. Thus, these effects occur as the companies adapt to each other in interaction and as the foreign subsidiary intentionally shares knowledge with its local suppliers and customers. Alternatively, unintended effects occur as local firms imitate the actions of the foreign entrant, hire workers and managers from the foreign entrant's local subsidiary and as the workers and managers of the foreign subsidiary interact with local companies' staff members in informal situations. Consequently, the following propositions can be put forward:

- *Proposition 3: Strong vertical local market embeddedness of a foreign subsidiary is likely to lead to more intended effects on local companies.*
- *Proposition 4: Strong local social embeddedness of a foreign subsidiary is likely to lead to more unintended effects on local companies.*

Based on these prepositions, it can be assumed that the employment of expatriates in managing a foreign affiliate would lead to fewer effects on local companies as the usage of expatriates has been connected to strong and highly negative impact on subsidiary local embeddedness (see Andersson et al. 2005). Thus, it can be assumed that MNC subsidiaries with local managers tend to be more strongly embedded, especially socially, to other local actors and, consequently, have a greater influence on local companies. Thus, the following proposition is put forward:

- *Proposition 5: The employment of local managers in a foreign subsidiary is likely to lead to more unintended effects on local companies in comparison to the employment of expatriates.*

However, the extent to which a foreign entry affects other actors in the local business network does not depend only on the characteristics of the foreign entrant and its subsidiary. Instead, local companies in the network play an important role in transmitting the effects further to other actors in that network or even to other networks. Thus, the following propositions are put forward:

- *Proposition 6: The extent to which effects triggered by a foreign entry spread depends on network positions and embeddedness of local firms in various networks.*
- *Proposition 7: The extent to which effects triggered by a foreign entry spread depends on the absorptive capacity of local firms in various networks.*

Indeed, the role of other companies in transmitting the effects to third-party companies should be taken more into account when studying the impact of foreign entry on local firms. Due to interconnected relationships of firms in a

network, even intended effects in dyadic relationships can cause unintended effects at the network level, making analysis of effects triggered by a foreign entry challenging.

Furthermore, the general environment and its change processes have a significant impact on companies. Thus, effects triggered by endogenous factors in a network cannot be completely isolated from effects caused by exogenous factors in the external environment. The interlinked nature of endogenous and exogenous change in networks has been previously recognised, although it has mostly been stressed that the impact of exogenous factors on a network is always transmitted within individual relationships in the network (e.g. Halinen et al. 1999; Håkansson & Snehota 1995). However, the results of this study emphasise the fact that *in practice it can be difficult to identify a single event that has triggered a particular change process in a network.* Instead, changes in the general environment can intensify a change triggered by a particular event and vice versa. Thus, both endogenous and exogenous change factors can cooperate and lead to extensive changes in a network.

7.3 Methodological contribution

Whereas previous studies on the effects of foreign entry on local firms have mostly been conducted by quantitative analyses based on positivistic philosophy, the focal study applied a qualitative analysis based on critical realisms. In this respect, the study can be considered to have the value of novelty and to make a methodological contribution. However, as the critical realist research process is inherently abductive, the theory, method, context and empirical analysis constantly interact with each other. This type of interconnectedness makes it rather challenging to separate the contributions into those that are theoretical and methodological (cf. Paavilainen-Mäntymäki 2009).

However, as the methodological choices of this study are based on critical realisms, it differs from previous FDI spillover research in a number of ways. First, this study does not aim to determine whether spillovers occurred or not, nor does it aim to form any universal cause-effect linkages relating to them. Instead, the aim of the focal study is to increase understanding on the phenomenon by identifying causal mechanisms, which are explanatory means in critical realist research (cf. Welch et al. 2011). Studies focusing on spillover mechanisms are rare and, recently, there have been a number of calls for such research (e.g. Gachino 2010; Spencer 2008; Javorcik 2007).

Also, the chosen research strategy (i.e. the qualitative single-case study), has seldom been employed in FDI spillover research; however, it is considered

to suit the critical realist approach especially well and also network and process research (Welch et al. 2011; Easton 2010; Halinen & Törnroos 2005). The aim of the case study is to develop theory and, in so doing, contextualised explanation was employed as a method of theorisation. Whereas inductive sensemaking has dominated as a method of theorisation in international business (IB) research, the recent calls for more contextualisation suggest the employment of contextualised explanation in theory development (cf. Welch et al. 2011).

In this study, the methodological approach of contextual explanation with an abductive reasoning and multiparadigmatic analysis were valuable for a number of reasons: first, the contextualised explanation offered a way to incorporate the context into the analysis without losing the aim of developing a theoretical model of spillover mechanisms. The value of this sort of an approach is in the fact that it can offer more "realistic" explanations by taking the complexity of the social world into account. Hence, FDI spillover research, which has traditionally aimed at universal explanations but resulted in many contradictory empirical results, would undoubtedly benefit from a more contextual approach.

Second, probably better than a traditional deductive approach, the abductive approach facilitated the creation of new insight on the phenomenon under scrutiny. Had the empirical study concentrated solely on predetermined concepts in the theoretical framework arising from the extant spillover literature, many interesting findings would probably have been omitted. Hence, by also allowing the empirical findings to guide the search for new theoretical explanations, the abductive approach is likely to lead to a deeper and more holistic understanding on the effects of foreign entry on local firms and business networks. However, instead of relying only on inductive reasoning, the utilisation of existing theories and preliminary frameworks as the basis of the empirical study helped to achieve a more thorough comprehension on the phenomenon under scrutiny.

Third, the separate application of two theoretical lenses on the empirical case analysis led to richer case descriptions and, consequently, also enhanced the development of deeper understanding on the empirical phenomenon. The FDI spillover perspective and the industrial network approach offered complementary perspectives on the empirical case. Hence, the combination of these two approaches led to a multi-level analysis that focused on both intended and unintended outcomes of foreign entry.

In sum, the focal study employed a novel approach in studying the much investigated but poorly understood phenomenon of FDI spillover effects. The critical realist approach enabled this study to focus on causal mechanisms and to offer contextualised explanations on the phenomenon under scrutiny, thus

enhancing the development of holistic insight on the phenomenon. Hence, the method of contextualised explanation based on critical realism will also provide good ground for further theory development on foreign entry spillovers.

7.4 Managerial and policy implications

The effects of an MNE's entry on local companies have usually been studied from the perspective of the host country. However, MNEs can also benefit from understanding their impact on local firms for a number of reasons (see Meyer 2004; Görg & Greenaway 2003). Thus, various *managerial implications* can be derived from the findings and theoretical discussion of this study.

First, MNCs should note that their entry can trigger both unintended and intended effects on local firms. Naturally, an MNC has the incentive of maintaining its competitive advantage to control possible unintended effects of its entry, such as knowledge spillovers to its competitors (Görg & Greenaway 2003). As management mobility to local companies is a possible spillover channel of tacit knowledge, *an MNC should pay attention to retaining talented and trained managers in the company*. One means for achieving this is a suitable system of reward, not only including financial incentives, for the particular environment that would enhance the commitment of local subsidiary's managers to the MNC. This seems to be especially important in the context of emerging markets in which there is often a lack of available trained staff. *MNCs should also be aware of the role of social relationships and embeddedness on tacit knowledge spillovers*. One possible way to try to control knowledge spillovers through informal interaction is the employment of expatriates, which has earlier been detected to diminish the subsidiary's local embeddedness (see Andersson et al. 2005).

Furthermore, *MNCs should be conscious of the effects of indirect and interdependent network relationships in transmitting possible spillover effects further beyond dyadic business relationships*. Thus, intended effects initiated by the foreign entrant can also cause unintended or even unexpected effects in the business network. Although anticipating such effects is difficult and controlling relationships even impossible, foreign entrants should pay attention to the connected business relationships while building and managing its dyadic relationships with local companies.

However, *MNCs should not treat potential spillover effects to local firms only as a negative phenomenon*. Knowledge diffusion to suppliers and customers can clearly also benefit the foreign entrant itself (cf. Kugler 2006; Javorcik 2004; Håkansson & Snehota 1995). Furthermore, *MNEs should themselves acknowledge their potential positive impact on the development of*

local businesses and demonstrate that, for instance, to local policymakers to build a favourable reputation among local stakeholders (see e.g. Oetzel & Doh 2009; Meyer 2004). This might be especially important in the context of Russian business networks in which the role of public officials and political decision makers has been emphasised (see e.g. Heikkilä 2011; Törnroos 1996).

Understanding mechanisms by which foreign entry can affect local companies is also clearly beneficial for policymakers which design the most suitable policy practices to enhance their regions' economic development (see e.g. Spencer 2008; Enderwick 2005; Meyer 2004). Hence, this study also has *policy implications*. Most importantly, local policymakers should not pay attention to only attracting as much FDI as possible but also to the characteristics of particular FDI projects, to maximise the benefits of the investments. For instance, *MNCs' entry into sectors with relatively strong local actors can create more positive external effects on local companies in comparison to sectors with only relatively weak local actors, which might even be crowded out by a foreign entry*. Furthermore, local actors with strong connections to other local actors and which are strongly embedded in the local network are likely to spread effects triggered by foreign entry further to other local firms.

To create positive effects on local firms, *policy makers should encourage MNCs to establish business relationships with local firms (e.g. suppliers and customer companies).* Local content laws, taxation and customs are such means by which this can be achieved, although policymakers should also develop regulations and support systems to create local business environments that facilitate decent opportunities for local entrepreneurs successfully to launch and conduct their businesses; importantly, there must be suitable local firms in the market with which a foreign entrant can build relationships.

As local managers tend to increase a subsidiary's local embeddedness and, hence, enhance knowledge spillovers through informal interaction (cf. Spencer 2008; Andersson et al. 2005), *policymakers should pay attention to the availability of qualified and skilled managers who can be hired by MNEs' subsidiaries*. Thus, in regions' education policies, sufficient training on, for instance, business administration and foreign language skills should be taken into account. Especially in the context of emerging markets, the availability of skilled workers and talented managers is often a problem (e.g. Blomström 1990) that can lead to the employment of expatriates in MNCs' subsidiaries.

Education also plays an important role in enhancing the absorptive capacity of local firms. Thus, to benefit from MNC spillovers, local firms must have a minimum threshold level of knowledge to absorb, for instance, foreign technology (see Girma 2005). "Support infrastructure" such as developed financial systems also play an important role in the absorptive capacity of local firms

(see e.g. Crespo & Fontoura 2007; Hermes & Lensink 2003). Indeed, in the empirical case study, the lack of inexpensive financing opportunities was recognised as a problem for local bakeries' investments and upgrading systems. Thus, for local companies to survive in competition with MNEs and even benefit from potential spillover effects, *policymakers, especially in emerging markets with a relatively undeveloped banking sector, need to consider offering some financial support schemes for the development of local companies*.

In sum, local policymakers should acknowledge that foreign entries can have both positive and negative effects on local firms. Thus, policymakers should try to create conditions in their local business environments by which positive effects are enhanced. Under the correct conditions, the effects of an MNC entry can spread far and not only within a particular industrial sector. This is especially true in the context of emerging markets to which MNCs often bring general business knowledge that is novel and potentially beneficial to firms in almost any sector of the economy.

7.5 Limitations of the study and suggestions for further research

This study applied a qualitative approach with a single-case design in the empirical research and, as such, has particular limitations, especially for the generalisability of the findings (cf. Lincoln & Guba 1985). In addition, due to the explorative nature of the focal study, further research aiming at developing a more thorough understanding on the complex phenomenon of foreign entry effects on local companies will be beneficial. Thus, both the limitations of the study and the potential future research avenues that they create are discussed in this section.

First, the perspective of the case study was limited due to difficulties in gaining access to local companies, especially competitors. Data collection relied mostly on interviews within the foreign entrant and its local subsidiary; thus, the local competitors' perspective is missing while the local suppliers' and customers' perspectives play a relatively small role, mainly serving data triangulation purposes in the focal study. This can be considered a major limitation of the study, although a subsidiary's managers are considered to be in a good position to evaluate the impact of their companies' activities on local businesses (Hallin & Holmström Lind 2012; Holm et al. 2003). However, in the future, *local firms' perceptions on the extent to which they have been affected by a foreign entry* will offer interesting research avenues (cf. Hallin & Holmström Lind 2012).

Second, the case selected for the empirical study is unique and, as such, it offers interesting possible future research avenues. Fazer's acquisition of Hlebny Dom offers *an excellent target for research focusing on cross-border mergers and acquisitions*. Furthermore, conducting another round of empirical case data collection in the focal companies will provide *an excellent ground for further longitudinal analysis* on the development of the case company and its business network in Russia.

However, single-case design has been criticised for its limitation regarding generalisability (e.g. Miles & Huberman 1994). Thus, in future, *multiple-case studies* on the effects of foreign entry on local companies might be beneficial for further understanding the causal mechanisms. However, neither single- nor multiple-case studies aim at generalisability of the findings but rather to contribute to contextual insight (Järvensivu & Törnroos 2010). Consequently, instead of generalisability, the focal study should be evaluated based on transferability of its findings (cf. Lincoln & Guba 1985). The transferability of the study has been enhanced by the transparency and detailed descriptions regarding the case, its context and the research process. However, the context of the study, the Russian transition economy, has several special characteristics and the findings might not be transferable to other country contexts. Thus, for comparative purposes, it would be interesting also to conduct similar types of case study *in other country settings*; for instance, in both developed and developing countries.

Nevertheless, even with limitations regarding the generalisability or transferability of the empirical findings, the theoretical frameworks on potential mechanisms of FDI spillovers, on foreign entry-triggered network change and the integrated framework for analysing the effects of foreign entry on local companies created in the study might be applicable in future studies in other contexts, especially in emerging economies. However, *the created frameworks would benefit from being tested and further developed in future research endeavours*.

Indeed, although it is acknowledged as challenging, it would be interesting *to evaluate the propositions* put forward in this study (see sub-section 7.2.3) *according to additional, preferably quantitative survey data* collected from both MNCs and local firms. However, more understanding on the mechanisms of foreign entry spillovers is needed and the network perspective, with the concepts of network position and network embeddedness, offers interesting future research avenues for their study in a more extensive manner than was achieved in this study.

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Appendix 1: Country grouping of developed, developing and transition economies

The grouping is based on a list of country groupings and sub-grouping for the analytical studies of the United Nations World Economic Survey and other UN reports (retrieved 5th November, 2012 from http://unpan1.un.org/intradoc/groups/public/documents/un/unpan008092.pdf). The designation of country groups is intended solely for statistical or analytical convenience and does not necessarily express a judgement on the stage reached by a particular country or area in the development process.

Developed economies (developed market economies):

- Europe, excluding European transition economies.
- Canada and the United States of America.
- Japan, Australia and New Zealand.

Economies in transition:

- *Central and Eastern European transition economies (CEETEs, sometimes contracted to "Eastern Europe")*: Albania, Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia and successor States of the Socialist Federal Republic of Yugoslavia; namely, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Slovenia.
- *Baltic States*: Estonia, Latvia and Lithuania.
- *Commonwealth of Independent States (CIS):* Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Developing economies:

- Africa.
- Asia and the Pacific (excluding Japan, Australia, New Zealand and the member States of CIS in Asia).
- Latin America and the Caribbean.

Appendix 2: Example of an interview guide

Interview at Hlebny Dom (HD), St. Petersburg, 15th November 2006 at 14:00:
Alexei Timchenko (General Director)

1. Respondents background:
    a. How long worked for Hlebny Dom?
    b. In which positions?

2. Bakery business in St. Petersburg ten years ago:
    a. Companies and their market shares?
    b. Competition?
    c. Products?
    d. Distributors?
    e. Customers?
    f. Suppliers?
    g. Technology and investments?

3. Hlebny Dom at the time of Fazer's acquisition (1997):
    a. Market share?
    b. Organisation?
    c. Products?
    d. Production technology? Was HD already a technological leader at that time?
    e. Distribution?
    f. Customers? (How strong were relationships?)
    g. Suppliers? (How strong were relationships?)
    h. Marketing knowledge?

4. Fazer's investment in HD from HD's perspective:
    a. Reasons for seeking a western partner?
    b. How did the acquisition work out?
    c. How has the cooperation worked out?
    d. Decision-making between HD and Fazer?

5. Changes in HD since the investment:
    a. Organisation?
    b. Production technology?
    c. Products (i.e. quality, assortment)?
    d. Packaging? The share of packaged bread now and previously?
    e. Distribution?
        i. Why its own distribution system was created?
        ii. Was it easy?
        iii. Customers' reaction?

iv. Resistance from the established distributor?
v. How important has it been for HD's competitiveness?

f. Sales and marketing?

6. Changes in HD's relations to…
   a. Suppliers? (e.g. are they local, their shares, strength of relationships?)
   b. Machinery suppliers? (e.g. who, local, foreign)
   c. Distributors (i.e. are there any others or is its own distribution system the only one employed?)
   d. Customers (e.g. who, their share, how long-term and strong are the relationships?)
   e. Competitors (e.g. who, their market share, cooperation? Personal relationships?)
   f. Officials (how important are relationships to e.g. city officials?)

⇨ critical events causing changes in business relations?

7. Current St. Petersburg bakery business:
   a. Bakeries/competition?
   b. Technology?
   c. Products?
   d. Packaging?
   e. Distribution?
   f. Suppliers? (i.e. local / foreign?)
   g. Customers?

⇨ how much has the investment of a foreign firm (Fazer) influenced the development of the St. Petersburg bakery business; for example, in comparison to Moscow, where major foreign firms have not been present?

<u>Possible sources of spillovers:</u>

8. Horizontal:
   a. Have competitors imitated HD's products, production, marketing or other activities? How? How have they gained knowledge on it? Observation?
   b. Has the competition on the market increased due to Fazer's entry and its many investments? How has this influenced competitors?
   c. Have competitors increased their efficiency due to the competitive situation?
   d. Have some competitors disappeared from the market due to more intense competition?
   e. Have HD's staff/managers moved to work for competitors?

f. Are there cooperations with competitors? How are personal relationships between HD's management and competitors' management?
g. Company visits etc. as a source of information on modern technology?

9. Vertical:

a. Has HD suggested new quality requirements to suppliers? Any other requirements; for example, concerning deliveries etc.? Have they been accepted?
b. Has HD transferred knowledge to suppliers or customers?
c. Has HD suggested any requirements to distributors or customers? Or offered some training?

10. Indirect spillovers:

a. Does HD utilise the same suppliers (e.g. raw material, packaging material or machinery) as its local competitors? How common is this?
b. Have HD's initiated changes indirectly influenced its competitors due to linkages?

Appendix 3: Publications complementing the case study

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