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ABSTRACT

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Abstract

The literature on agency suggests different implications for the use of export intermediaries. However, only few studies provide a view on import intermediaries. This thesis tries for its part to fill this research gap by studying the import intermediaries in the EU–Russia trade from a Russian industrial company's point of view. The aim is to describe import intermediation and explain the need for import intermediary companies in the EU–Russia trade.

The theoretical framework of this thesis originates from an article by Peng and York (2001), in which they study the performance of export intermediaries. This thesis applies resource-based theory, transaction cost theory and agency cost theory, following the idea of Peng and York. The resource-based theory approach is utilised for describing an ideal import intermediary company, and transaction cost theory provides a basis for understanding the benefits of using the services of import intermediary companies, while agency cost theory is applied in order to understand the risks the Russian industrial company faces when it decides to use the services of import intermediaries.

The study is performed in the form of a case interview with a representative of a major Russian metallurgy company. The results of the study suggest that an ideal intermediary has the skills required specifically for the imports process, in order to save time and money of the principal company. The intermediary company helps reducing the amount of time the managers and the staff of the principal company use to make imports possible, thus reducing the salary costs and providing the possibility to concentrate on the company's core competencies. The benefits of using the services of import intermediary companies are the reduced transaction costs, especially salary costs that are minimised because of the effectiveness and specialisation of import intermediaries. Intermediaries are specialised in the imports process and thus need less time and resources to organise the imports. They also help to reduce the fixed salary costs, because their services can be used only when needed. The risks of being misled by intermediaries are minimised by the competition on the import intermediary market. In case an intermediary attempts fraud, it gets replaced by its rival.

Key words	Import intermediary, resource-based theory, transaction cost theory, agency theory, Russia, imports, EU-Russia trade
Further information	

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TIIVISTELMÄ

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Tiivistelmä

Välitystoimintaa käsittelevä kirjallisuus esittää erilaisia malleja vientivälittäjäyritysten käytölle. Tuontivälittäjäyrityksistä on sen sijaan tehty vain vähän tutkimuksia. Tämä pro-gradu työ pyrkii omalta osaltaan täyttämään tätä tutkimusaukkoa tutkimalla tuontivälittäjäyrityksiä EU–Venäjä -kaupassa venäläisen teollisuusyrityksen näkökulmasta. Tutkimuksen tarkoitus on kuvailla tuontivälitystä ja selittää tuontivälittäjäyrityksen tarvetta EU–Venäjä -kaupassa.

Tämän työn teoreettinen viitekehys on peräisin Peng ja Yorkin (2001) vientivälittäjäyritysten menestystä käsittelevästä artikkelista. Tämä tutkimus seuraa Peng ja Yorkin työtä käyttämällä lähestymistapoina resurssipohjaista teoriaa, transaktiokustannusteoriaa sekä välityskustannusteoriaa. Resurssipohjaisen teorian avulla pyritään kuvailemaan ihanteellista tuontivälittäjäyritystä, transaktiokustannusteoria auttaa ymmärtämään tuontivälittäjäyritysten palvelujen käytön etuja ja välityskustannusteoriaa hyödynnetään tuontivälittäjäyritysten käyttöön sisältyvien riskien ymmärtämisessä.

Tutkimus on suoritettu tapaustutkimushaastattelun muodossa. Tutkimuksessa haastateltiin suuren venäläisen metallialan yrityksen edustajaa. Tutkimuksen tuloksista käy ilmi, että ihanteellisella tuontivälittäjäyrityksellä on osaamista, jota tarvitaan nimenomaisten tuontitehtävien suorittamisessa. Tällä säästetään asiakasyrityksen rahaa ja aikaa. Tuontivälittäjäyritys vähentää johtajien ja työntekijöiden tuontiprosessiin käytettävän työajan määrää ja pienentää tällä tavoin palkkakustannuksia sekä mahdollistaa keskittymisen yrityksen ydinosaamiseen. Tuontivälittäjäyrityksen käyttö auttaa vähentämään transaktiokustannuksia, varsinkin palkkakustannukset laskevat tuontivälittäjäyrityksen tehokkuuden ja erikoistumisen seurauksena. Tuontivälittäjäyritykset ovat erikoistuneet tuontiprosessin järjestämiseen, joten ne tarvitsevat siihen vähemmän aikaa ja resursseja. Ne myös auttavat kiinteiden kulujen vähentämisessä, sillä niiden palveluja voi käyttää vain silloin, kun siihen on tarvetta. Kilpailu tuontivälittäjämarkkinoilla vähentää tuontivälittäjäyritysten mahdollisesta harhaanjohtavasta toiminnasta johtuvia riskejä. Mikäli tuontivälittäjäyritys yrittää johtaa asiakastaan harhaan, se voidaan korvata kilpailevalla yrityksellä.

Asiasanat	Tuontivälittäjäyritykset, resurssipohjainen teoria, transaktiokustannusteoria, välityskustannusteoria, Venäjä, tuonti, EU-Venäjä-kauppa
Muita tietoja	

THE ROLE OF IMPORT INTERMEDIARY COMPANIES IN THE RUSSIAN IMPORTS FROM THE EU

A case study of a Russian industrial company’s point of view on import intermediaries

Master´s Thesis plan
in International Business

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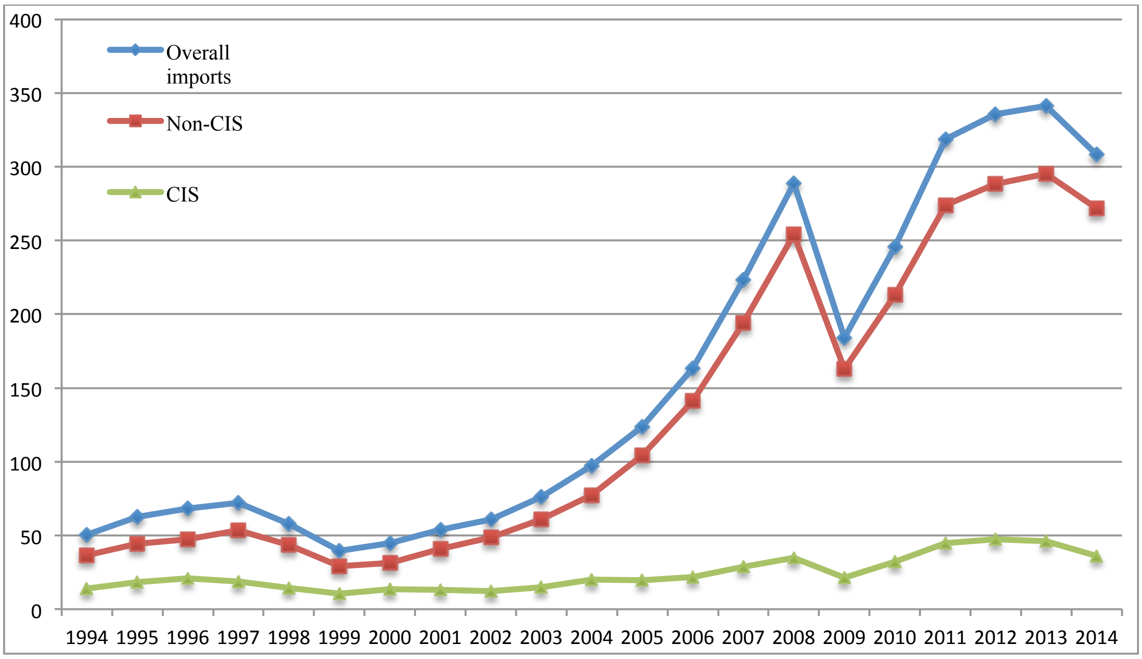
1 INTRODUCTION

1.1 The development of Russian imports in the post-Soviet era

The history and the background: This research primarily focuses on the EU trade with industrial companies in Russia, and it is thus important to give a brief insight on the history of the post-Soviet development and the current state of Russian imports. In this thesis the author will only take a look at the post-Soviet era, as during the Soviet period the economy and foreign trade were primarily driven not by market, but by USSR's state-level plans and politics. The import contracts with foreign countries and companies depended on the decisions of the country leaders rather than economic factors. The USSR was disintegrated in the end of 1991, which lead to a change in the whole economic system of the country. The economy had to be rapidly changed from the centrally planned economy to a market economy (e.g. Pagè, 2011). This chapter will give a glance at the development of the economy and imports in general and of the imports from the EU in particular.

Figure 1: Development of Russia's imports 1994–2014, USD billion



Source: Central Bank of Russia, 2015.

Figure 1 provides a view on the development of Russia's overall imports starting from 1994, the earliest year the data was available. The graph shows the overall imports as well as the share of CIS[1] and non-CIS imports in the overall picture. In this figure it is easy to see the development of Russia's import market after the collapse of the Soviet Union. (Central Bank of Russia, 2015.)

In the early post-Soviet period of 1992–1996 the state companies had to be sold to private owners. This process is called 'privatisation' and it is seen to be one of the most important elements of Russia's transition to the capitalist model. The number of Russian enterprises privatised from the state ownership exceeds the number of privatised companies in the rest of the world altogether. The overall impact of the privatisation is seen to be positive, though the economic results are not necessarily very notable in the short run. (Perevalov, Gimandii & Dobrodei, 2000.)

The overall process of transition, which basically still continues, has been long and difficult. Pagè (2011) suggests a division into two periods of the transition process. The first period that lasted from 1992 to 1998 was a negative experience; the country was driven into disorder and chaos. The chronic inflation led to barter trade, when companies exchanged goods for goods instead of exchanging goods for money. In the end of this period in 1998, the economics of the country collapsed. The next period that started from 1998 has been a reviving period for the economic situation. Exporting natural resources and rising oil and gas prices has provided money, the devaluation of rouble has helped reviving the national business; also the rise of metallurgic industry has been a significant boost to the economic growth.

However, all the problems are not yet solved. The banking system is weak, small and medium businesses are underdeveloped, and the industry has a low level of diversification (Pagè, 2011). Corruption and bureaucracy, especially regarding permissions and customs, are also seen as significant problems both in the economic situation inside Russia and in the international trade. To sum up the transition and privatisation processes it must be noted that most of the large Russian industrial companies have their roots in the Soviet Union and have later been privatised.

Statistical information on the Russian imports could only be obtained starting from 1994 (see Figure 1). The early 1990's import structure relied severely on imports from the CIS countries – the republics that used to be parts of the Soviet Union. However, the share of the CIS imports has been shrinking since 1991 (Oxford Analytica Ltd, 1997).

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[1] CIS (The Commonwealth of Independent States) is a regional organisation founded by former Soviet republics after the breakup of the Soviet Union in 1991. In the early 1990's, every former Soviet republic except the Baltic States participated in the CIS, totalling to 12 member states. Currently CIS includes nine members: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan and Uzbekistan; and two participating states that have never ratified the charter: Ukraine and Turkmenistan. Georgia has left the CIS in 2008 as a result of the conflict with Russia.

By 1994 the CIS countries accounted for circa 30% of all imports, by 2013 the amount was down to 13.5% (Central Bank of Russia, 2015). Still, in the 1990's, the CIS countries remained significant trade partners, Ukraine being the single most important trade partner of Russia (Oxford Analytica Ltd, 1997).

The currency crisis of 1998 had a significant impact on the imports and the overall performance of the Russian economy. The crisis lead to the devaluation of the rouble and default on both private and public debt, which Russia has singlehandedly inherited from the USSR (Chiodo & Owyang, 2002). The impact of this crisis on the imports has been severe (e.g. Oxford Analytica Ltd, 1999; Central Bank of Russia, 2015) and the pre-crisis imports amounts were only completely regained in 2003 (Central Bank of Russia, 2015). However, some researchers suggest that the impact of this crisis was not at all that severe, pointing out that the power and economy of Russia have been growing since the crisis (e.g. Robinson, 2007).

In the early Putin era of 2000's, there was a notable focus on integration into the international economy. In particular, this was seen when Russia accelerated the WTO-membership negotiations that started already in 1994, but had been almost completely put on hold for several years (Oxford Analytica Ltd, 2001). Aside from those intentions, according to Secrieru (2006), the CIS countries became a priority again. However, this statement does not get any significant support from the statistics by Central Bank of Russia (2015), as the import share of the CIS countries has shown a continuous decreasing trend.

Overall, the early 2000's is a period of relevant stability and growth of the economy, including imports. The steady growth was only interrupted by the financial crisis of 2008, followed by a drawback in imports amounts in 2009. However the impact of this crisis on the imports numbers proved to be relatively short lived, as the pre-crisis numbers were exceeded already in 2011. (Central Bank of Russia, 2015.)

The WTO integration has not been smooth despite enhancing of the negotiations and the overall growing economy. During president Putin's second term (2004–2008), the negotiation process was delegated to the Ministry of Industry and Trade of the Russian Federation and was slowed down. The strong oligarch lobby is seen to be one of the primary reasons for that: a small group of rich businessmen called oligarchs controlled a major share of energy and raw material export sector, and there was a concern that the prices of raw materials would go down. Another problem was the WTO regulation, according to which in order to join the organisation, every state must have a bilateral agreement with every other WTO member, and any country can place a veto on a new member entry. (Åslund, 2010.)

In the late 2000's, Russia had severe political problems with Georgia, resulting in a war in 2008, and as a WTO member, Georgia had the right to place a veto on Russia's entry. Another problem was Poland that had been threatening Russia with a veto in case the latter does not lift the agricultural product imports embargo set against Poland in 2005 (RIA Novosti, 2007). However, those problems were solved and Russia finally joined the WTO in August 2012 (WTO, 2013). The accession was seen to be beneficial for the steel industry and other metal industries, as well as food and drink businesses, especially due to cheaper imports into Russia (De Gucht, 2012). However, the numbers show a slight stagnation in the imports growth during that period (2012–2013), the growth being lower than in several previous years; although the WTO accession of Russia was only ratified in August 2012 and it has barely had any effect by 2013 (Central Bank of Russia, 2015).

Aside from the WTO accession process, in 2009 Russia also formed a Customs Union together with Belarus and Kazakhstan. The attempts to form such a union had started already in the 1990's, but the final agreement was only achieved by 2009. The union includes a free trade zone between those countries and partly harmonised the tariffs for imports from the rest of the world. (Tochitskaya, 2010.)

Logically the formation of Customs Union should have had a positive impact on the imports figures from the CIS countries. The figures show a slight improvement in 2010–2011 compared to the imports from the rest of the world, but the growth slowed down significantly in 2012 and the figures started to drop in 2013. Still, by the end of 2013, the share of the CIS imports among all Russia's imports is larger than in 2009, rising from 11.5% to 13.5% of all imports. (Central Bank of Russia, 2015.)

Situation in 2014–2015: The year 2014 has proven to be tough for Russia, both on the economic and political fronts. The conflict in Ukraine has endangered the political relationships with the European Union as well as with the United States of America; the economic sanctions that followed have put the whole Russian economy at test. Additionally, Russia placed import sanctions for several Western countries on a number of products, which had an immediate effect on the imports numbers. (Dynkin et al., 2014.) The crude oil barrel price had also sunk from circa USD 110 in July 2014 to circa USD 50 by the end of December 2014 (NASDAQ, 2015).

By the end of 2014 economic growth slowed down significantly, both exports and imports were affected (Dynkin et al., 2014). The overall imports in 2014 dropped almost by 10% and the imports from the CIS countries dropped by over 22%. CIS imports share dropped from 13.5% in 2013 to 11.7% in 2014. (Central Bank of Russia, 2015.)

The Customs Union took a step forward and was transformed into Eurasian Economic Union (EAEU) in May 2014. The Customs Union members Russia, Belarus and Kazakhstan formed the new union, followed by Armenia in October 2014 and the Kyrgyz Republic in December 2014. The aim of the EAEU is to provide a higher level of integration between the economies of the member states. (Eurasian Economic Union, 2015.)

The first two months of 2015 looked even more alarming than the end of 2014. Compared to the same period in 2014, the overall imports had sunk by 40.7% in January and by 35.4% in February. Especially notable was the difference in the CIS imports in February 2015 in comparison with February 2014: the overall amount of CIS imports had diminished by more than 43%. (Central Bank of Russia, 2015.)

The imports structure: The latest information on the overall imports structure of Russia could only be acquired starting from 2012. That year, the most notable imports articles were cars (7.3% of all imports), packaged medicaments (3.4%), vehicle parts (3.2%) and computers (2.2%). Machines, cars and related imports together formed 46.6% of all imports, the other important categories being chemical products (10.0%), metals (6.9%) as well as plastics and rubbers (5.0%). (Observatory of Economic Complexity, 2014)

Russia is one of the most important trading partners of the European Union. It is the third most important partner in the EU imports and forth in the EU exports as of 2014. The imports from Russia are dominated by natural resources, primarily fuels, while the most important EU export category to Russia is machinery. (European Commission, 2015.)

The European Union is the most important trading partner of Russia and the amount of trade is growing every year. EU is responsible for 75% of foreign direct investments in Russia (Central Bank of Russia, 2015). However, this does not represent the whole picture, as there are several round tripping countries in the EU, such as Cyprus, that are constantly used to forward the Russian domestic investments (e.g. Banks, 2013). The EU–Russia trade has been regulated by the Partnership and Cooperation Agreement signed in 1997. Currently a new agreement is being processed, but there are obstacles that have prevented it from being developed and signed. Those are primarily the Customs Union as well as some WTO rules that Russia has failed to follow. (European Commission, 2014.)

In 2013, the imports from the EU accounted for 42.6% of all Russia’s imports. However, China was the single most significant import partner of Russia: in 2013 the imports from China accounted for approximately 17% of all Russia’s imports (see Table 1). An interesting observation is that of the 20 most valuable importers 12 countries are members of the EU. (Federal Customs Service of Russian Federation, 2014)

Table 1: The top 20 imports partners of Russia in 2013

Rank	Country	Imports USD bil.	Share of all imports
1	China	53.2	16.8%
2	**Germany**	**37.9**	**12.0%**
3	USA	16.5	5.2%
4	Ukraine	15.8	5.0%
5	**Italy**	**14.6**	**4.6%**
6	Belarus	14.0	4.4%
7	Japan	13.6	4.3%
8	**France**	**13.0**	**4.1%**
9	South Korea	10.3	3.3%
10	**Poland**	**8.3**	**2.6%**
11	**UK**	**8.1**	**2.6%**
12	Turkey	7.3	2.3%
13	Kazakhstan	5.9	1.9%
14	**The Netherlands**	**5.8**	**1.9%**
15	**Finland**	**5.4**	**1.7%**
16	**Czech Republic**	**5.3**	**1.7%**
17	**Spain**	**4.9**	**1.6%**
18	**Belgium**	**4.0**	**1.3%**
19	**Sweden**	**3.9**	**1.2%**
20	**Austria**	**3.8**	**1.2%**

Note: The EU members are accented in bold font. Source: Federal Customs Service of Russian Federation, 2014.

The 'chelnoki' – shuttle-traders as a form of import companies: When addressing the imports development in Russia in the 1990's, it is peculiar to note the phenomenon of 'chelnoki' – the English term is 'shuttle-traders' – which was pointed out by the Oxford Analytica Ltd. report (1994). The word 'chelnok' refers to a small boat that was used for local trading in Russia in the medieval times. The 'chelnoki' or the 'shuttle-traders' were small companies or individuals, who imported goods in small batches, mostly from European and Asian countries, thus constituting one type of intermediary companies. They primarily imported clothes and electronics that were purchased from regular wholesale companies abroad, typically in Turkey, and sold them at a higher price either to individuals or to small shops. (Oxford Analytica Ltd, 1996.)

The roots of this phenomenon go back to the late 1980's, when the economics of the Soviet Union showed first signs of liberation and some types of private trade were legalised. However, only the financial crisis that followed the breakdown of the Soviet Union in 1991 became a significant springboard for the Russian citizens into entrepreneurship. The amount of entrepreneurs increased almost fourfold between 1992 and 1993, the 'shuttle-traders' forming a significant part of them. (Yakovlev, Golikova & Kapralova, 2007.)

Due to a significant amount of such companies and individuals, 'chelnoki' played an important role in the overall imports situation, yet this role diminished as new import tariffs were imposed in 1994 (Oxford Analytica Ltd, 1994.) This kind of trade was not entirely legal, as the shuttle traders chose to evade some of the import tariffs in order to make more profit. This form of trade was significantly different from traditional export or import intermediation, as the 'chelnoki' did not normally have a contract with any exporting or importing company; they rather bought the goods from different suppliers and sold them in Russia to different wholesalers or individuals at a higher price. (Oxford Analytica Ltd, 1996.)

After significant changes in the Russian legislation in 1994, the 'chelnoki' aimed to legalise their business, especially in terms of tariffs and taxes. Their importance in the satisfaction of the consumers' needs and providing jobs was significant in the late 1990's. The 1998 crisis, new chain-owned shops and markets, as well as the development of other retail models diminished the impact of the 'chelnoki' and forced most of them to change their business model. In the 2000's, the 'shuttle-traders' formed only a marginal group of entrepreneurs and their incomes had dropped significantly from 1990's. (Yakovlev et al., 2007.)

Though the 'shuttle-traders' play a very minor role in Russian imports now, that phenomenon is an interesting part of the development of Russian imports. The 'chelnoki' not only affected the economy of transition period in 1990's, but also were an early form of import intermediary companies on the Russian market.

1.2 Review of earlier empirical studies on trade intermediaries

Most of the studies on the intermediary companies found by the author focus on export intermediaries. This chapter presents the earlier studies on the subject.

Burton, Cross and Rhodes (2000) test the influence of exogenous factors on the form of organisation of companies that plan their export activities. The aim of the study is to point out the factors that make companies choose between exporting directly and relying on intermediary companies. The study was performed using a postal survey with UK franchising companies. 240 letters were sent but the number of replies was as low as 15, making it difficult to draw reliable results due to a very low population. The authors propose that using an intermediary creates additional negotiation costs and reduces the revenue of the exporting company; serving several franchisees might also be difficult, thus the franchising companies are presumably more likely to export directly. The findings suggest that the companies with more managerial resources tend to export their franchise directly, while smaller companies are more likely to rely on intermediaries. The authors expected that companies with large franchising networks at home country, as well as the companies with more experience in franchising at home, would be more likely to export directly. However, the study proved this not to be the case.

Petersen, Benito and Pedersen (2000) look into a problem of replacing an export intermediary by conducting a survey with 346 Danish manufacturing companies. The results of this study show that for the most part the export intermediaries are replaced with foreign direct investments (FDI), because the manufacturers accumulate knowledge about the foreign markets and thus lose the need for intermediaries. Other reason to switch to FDI is the overall dissatisfaction with the performance of the intermediaries. However, the switching costs are important impediments to this process.

Balabanis (2001) conducted a survey on 135 British export intermediaries in order to figure out the relationship between diversification and performance in export intermediary firms. His study points out that product diversified export intermediaries, as well as the intermediaries focusing on undifferentiated products, show more stable export patterns than the rest. Geographical diversification of intermediaries did not seem to make any difference, however the companies that focused on economically developed markets showed more stable sales and export patterns, while those focused on developing markets showed better growth rates. Focusing on culturally similar markets provided higher rates of exports, while focus on geographically distant markets appeared to provide stable export patterns but lower growth rates than the others. Physical presence in the distant markets also showed higher profitability levels. Also, unrelated functional diversification appeared to be related to higher rates of growth for sales, more stable levels of profitability, but at the same time decreasing the stability of export levels.

Peng and York (2001) test the performance of export intermediaries. The proposition originally presented by Peng and Ilinitch (1998) states that the performance of an intermediary is stronger the more knowledge it has about the foreign market, the greater ability it has to handle export negotiations and to lower negotiation costs, and the more it is willing to take title to goods in order to lower monitoring and enforcement costs. Peng and York (2001) conducted a mail survey on 166 companies. According to this study, the impact of knowledge and ability to take title to goods on the intermediary company's performance received strong and fairly strong evidence respectively, while negotiation ability was not seen as an important factor in terms of performance. However, Suwannarat (2011), who analysed 102 intermediary companies in Thailand, suggests that negotiation skills do have a significant positive effect on performance by decreasing the transaction costs of intermediary's clients.

Trabold (2002) tests the relation between geographical and psychical distance of domestic and foreign markets and the probability of selecting export intermediation as a means to enter the market. He also tests the relation between the commodity content of the products and the probability of selecting the export intermediation as a model of foreign expansion. The results were controversial. The author was unable to proof the effect of geographical distance on the likelihood of choosing an export intermediary; the results regarding the psychical distance also were insignificantly better and thus could not prove the second part of the first proposition. However, the commodity content of the products seemed to be a trigger to choosing export intermediation in most industries, although in some industries there was no correlation. Thus the second proposition was only partly proved. It is worth noting that the results of this study are based on old empirical data collected between 1985 and 1990, and the situation may have changed significantly since then.

Fung, Chen and Yip (2007) performed a study on correlation between relationship coordination and performance of trade intermediaries. The aim of the study is to provide a more complete understanding of the relationships in different supply chains. The authors use a database of 3422 textile and clothing companies. 220 companies were randomly picked and received the mail survey, 112 provided answers. The study points out that intermediaries facilitate the flow of materials, information and resources, thus acting as relationship managers for other members of the supply chain.

Ha-Brookshire and Dyer (2009), who look into the key determinants of import intermediary performance, present the only empirical study on the import intermediaries found by the author of this thesis. They conducted a survey and received a response from 159 US-based wholesale companies. The authors found that market interpretation, sourcing and service capabilities had an important positive influence on competitive advantages of the products and services, which in turn resulted in better relationship performance with the partners. The authors also found a negative impact of sourcing capabilities on the service advantage, which may be explained by a request conflict between the domestic and foreign partners of the import intermediary.

Gogineni, Linn and Yadav (2010) perform a study on trade intermediaries from the agency costs point of view. The purpose is to both look into the behaviour of agency costs over the complete spectrum of ownership, as well as to inspect the costs associated with the horizontal agency problem. The cross-sectional study of ownership structures using data from the FAME database was performed. The results suggest that in the companies that were not managed by the owners, agency costs were higher within each ownership structure. The costs were in turn lower in companies with a shared control of ownership. In companies with contestable control, the horizontal costs appeared to be lower than in the other companies. Also bank monitoring proved to have a positive and significant impact on the private companies' performance.

Theingi and Purchase (2011) look into the influence of the exporters' and intermediaries' resources on the export performance. The survey of 320 small and medium-sized enterprises was conducted in Thailand. According to the findings the companies in the high performing cluster use their resources to a greater extent than those in the lower performing clusters. The authors also point out that developing marketing capabilities of the manufacturer is not a substitute for using an export intermediary, but it is important in order to understand the foreign market conditions and be effective and efficient in the marketing activities there.

There are two notable research directions in this review. While some studies (Burton et al., 2000; Petersen et al., 2000; Trabold, 2002; Theingi and Purchase, 2011) focus on a choice between using intermediation and investing directly, the rest of the studies look into the performance of the intermediary itself. The studies suggest that both the use of an intermediary and foreign direct investments have their own benefits and may be used by companies in different situations. The studies describe both the switch from foreign direct investments to the use of intermediary and vice versa. There is no clear consensus among researchers on what exact features are key to intermediaries' performance, but the subject is definitely seen as an important research direction in the literature on intermediation.

It is notable that this review does not contain any qualitative or case-based study, as the author of this thesis did not succeed in finding any. This is one of the reasons for this thesis to be based on a case study. Only one of the many studies the author found (Ha-Brookshire & Dyer, 2009) concentrated on the import intermediation, which was also seen as a research gap and has had an impact on the thesis theme selection. Appendix 1 sums up this review of the studies.

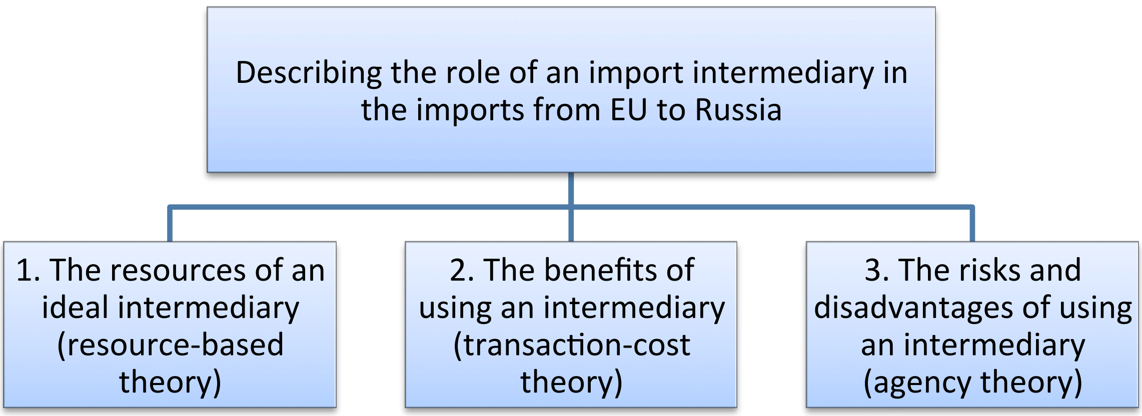
1.3 The objective of the thesis

The purpose of this thesis is to get an insight on the imports specifics from the EU to Russia and to explain the phenomenon of the import intermediary as seen from a point of view of a Russian manufacturing company. The primary focus is on industrial machines spare parts imports.

The use of export intermediaries in international business is a subject of various theoretical frameworks. However, this is not the case with intermediaries that specialise on imports. As a single suitable framework was not found, it was decided to combine three separate theories in order to provide a better insight on the topic. The article by Peng and York (2001) works as a basis for the selection of frameworks and the point of view that proved to be the most suitable in order to provide the best insight on the matter of import intermediation. The frameworks discussed in the article and used in this thesis are the resource-based theory, the transaction cost theory and the agency theory.

The main research objective is to describe why a company might need an import intermediary in their business instead of importing the products itself. The three research sub-objectives are based on the three theoretical frameworks. The first sub-objective aims to analyse the set of resources that the company expects intermediaries to possess. The second sub-objective intends to explore the benefits of using an import intermediary instead of organising the import process by the company itself. The third sub-objective concentrates on revealing the possible risks and disadvantages of using an import intermediary.

Figure 2: Main objective and the sub-objectives of this research



1.4 Key definitions

Companies that buy products from one company and sell it to another one, thus not producing anything themselves, are commonly called the ‘trade intermediaries’. Intermediary companies are seen to play an important role as a link connecting individuals or organisations that could not be connected otherwise (Cosimano, 1996). Root (1987) divides intermediary companies into two categories: agents and distributors. The difference between those two is that agents only connect manufacturers and buyers while not taking title to any goods during the process, and distributors buy products themselves and only afterwards resell them to the buyer. (Root, 1987.) A more thorough division comprises seven different intermediary types: (1) export merchants, (2) export agents, (3) export managers, (4) buying houses, (5) confirming houses, (6) export finance houses and (7) factors. (British Exporters Association, 1994, for reference see Balabanis, 1998.)

The literature typically focuses on intermediary companies in the foreign trade, as the role of the intermediary is seen to be especially important when going abroad, since in this case buyers and sellers are separated both geographically and culturally (Perry, 1992, for reference see Peng & Ilinitch, 1998). Those companies are commonly called the ‘export intermediaries’ (e.g. De Noble, Castaldi & Moliver, 1989; Peng & York, 2001) or ‘export agents’ (e.g. Root, 1987). As the name suggests, those companies are used in order to export products to a country different from the country of origin of the manufacturer. The purpose of such companies is to make an entry into a foreign market easier for the manufacturer by taking over downstream value-chain activities, such as logistics, marketing etc. in the foreign markets (De Noble et al., 1989; Balabanis, 2001). This is aimed to help the manufacturer reduce their costs in the new market entry (Suwannarat, 2011).

This study focuses on a different phenomenon, which has been given significantly less attention in the literature. In some cases the intermediary companies are needed not to export the products but to import them. The term ‘import intermediaries’ used for such companies is rare and is mostly used meaning partly the same as export intermediary (e.g. Karunaratna & Johnson, 1997; Ha-Brookshire & Dyer, 2009). The aim of those companies is to link foreign manufacturers with domestic wholesalers. The difference with export intermediaries is that import intermediaries specialise in finding different exporters for the domestic wholesaler rather than finding different foreign wholesalers for the domestic manufacturer.

In this study the aim is on a different kind of import intermediary companies. Rather than concentrating on providing the goods for a wholesaler those companies sell the items needed directly to the client who needs those goods in their production. For instance, most of the Russian major industrial companies use equipment, manufactured outside of Russia and thus need replacement parts and new machines to be imported from abroad. In some cases it makes sense to use an intermediary company in order to facilitate the imports process and handle customs procedures, language barriers and other occurring issues. In this thesis the term ‘import intermediaries’ is used to describe such companies.

Simply put, an export intermediary is a company that works with a manufacturer in one country and sells its products to various companies in other countries. An export intermediary may either buy the products and then resell them, or it can only work as an agent and connect the supplier and its clients abroad. An import intermediary, in turn, works in opposite direction, providing the client with necessary goods from companies located abroad. It can also work either as an agent or a distributor. The difference with the export intermediary is that the import intermediary works with several suppliers and only one buyer, while export intermediary has only one supplier and several buyers.

2 THEORETICAL FRAMEWORK

2.1 Resource-based theory

Core concepts: Resource-based theory is built upon the concept of ‘resource’. Wernerfelt (1984) defines resource as anything that can act as a strength or a weakness of a company. In his definition resources comprise all the tangible and intangible assets that the company possesses. This includes for example brand names, technology, contracts, procedures, and knowledge in general or even the personnel. Barney (1991) stresses that the assets need to enable the company to improve the efficiency and effectiveness to be called resources, he thus does not include the possible weaknesses into his understanding of a resource.

Originally the concept of resource included mostly the physical resources, such as land (e.g. Ricardo, 1817, for reference see Barney & Clark, 2007), labour or capital (e.g. Wernerfelt, 1984). Penrose (1959) presented the first broad definition of resource. Apart from the physical resources it included managerial teams, top managerial groups, entrepreneurial skills as well as technological skills. She presented a division into physical and human resources. The physical resources contained plant, equipment, land and natural resources, raw materials, semi-finished goods, waste products and by-products as well as unsold stocks. The human resources included labour, both unskilled and skilled, clerical, administrative, financial, legal, technical and managerial staff.

Barney (1991) divides the resources into three categories, adding the organisational capital resources to the two categories by Penrose (1959). The ‘physical capital resources’ include physical technology, plants and equipment, geographic location and access to the raw materials. The ‘human capital resources’ comprise training, experience, judgement, intelligence, relationships and the insight of individual managers and workers in a firm. The third category, ‘organisational capital resources’ contains the formal reporting structure of the company, formal and informal planning, controlling and coordinating systems as well as informal relations among groups within the company and in its environment.

Different companies have different sets of resources that have different efficiency (Peteraf, 1993). Based on this idea we can summarise the basics of the resource-based theory: different resources give different companies different competitive advantages or disadvantages and companies compete with each other using the variety of resources they possess.

Another important concept in the resource-based view is the concept of ‘competitive advantage’, which is one of the most commonly used terms in strategic management

(Ma, 2000). Barney (1991) states that company has a competitive advantage when it has a value creating strategy that is not being simultaneously used by another company.

Porter (1985) suggests that the competitive advantage builds up from many discreet activities that the company performs in the whole production chain starting with designing, through producing, marketing and delivering to supporting the final product. He presents two different types of competitive advantage: lower cost and differentiation. Companies with economies of scale, low-cost labour, proprietary technology and preferential access to raw materials may succeed in producing the same products as the competitor at a lower cost, thus selling more products and gaining more income. Differentiation means that a company builds its strategy on providing a product that is somewhat different from the products of its competitors. The differentiation may also be based on marketing approach, delivery system or any other aspects connected with the product or with the means of providing it to the customer. This allows the company to sell more of its products not because they are cheaper, but because they satisfy different needs than the products of its competitors. In addition to the two strategies, Porter also presents a strategy of focus, which means that the company concentrates on a small competitive scope within its industry. The focus may be both on cost and differentiation within the narrow competitive scope. This strategy is based on the difference between the segment that the company focuses on and the other segments in the industry (see Figure 3).

Figure 3: Three generic strategies for the competitive advantage

		Competitive advantage	
		Lower cost	Differentiation
Competitive scope	Broad Target	1. Cost Leadership	2. Differentiation
	Narrow Target	3A. Cost Focus	3B. Differentiation focus

Source: Porter 1985, 12.

The classic definitions are, however, considered poor and difficult to operationalise (Ma, 2000; Sigalas & Economou, 2013). According to Ma (2000), competitive advantage does not equate to superior performance and is a relational and context-specific term. The author points out that the term ‘competitive advantage’ needs to be specified better and defined more clearly in order to be used correctly in the theoretical discussion.

Summarising the earlier paragraphs, the competitive advantage is the ability of the company to generate more value than its rivals on the market. The aim of a company is to maximise the income by being somehow more efficient in selling the product to the customers than the competitors within the same industry. This can be achieved in various ways using different methods.

When discussing competition and advantage in the resource-based theory, ‘sustained competitive advantage’ is a more commonly used term. It is typically defined as the competitive advantage that persists for a significant period of time (e.g. Jacobsen, 1988). However, Barney (1991) disagrees with the typical definition and proposes that competitive advantage depends on the possibility of competitive duplication and continues to exist after the efforts to duplicate the source of advantage have succeeded. That does not mean that the advantage is eternal, but it can survive the efforts to duplicate it by another companies.

Barney (1991) suggests that in an industry where companies are identical to each other in terms of possessed resources, it is not possible to gain a sustainable competitive advantage. Kangas (2000) adds that gaining a sustainable competitive advantage in this kind of industry is impossible even if the company is the first mover. However, according to Porter (1980), in case entering such industry is difficult, the companies of the industry may gain a sustained competitive advantage against the companies that are not participating in the industry but are still considered competitors.

Barney (1991) lists four indicators for the company resources that may build a sustainable competitive advantage:

1. Value – the resources need to have value to allow for improvement of the efficiency and effectiveness of the company;
2. Rareness – some strategies cannot be easily implemented and require a specific mix of resources that is rarely found;
3. Imitability – the resources should not be easy to imitate by another company. The author lists the following reasons, any combination of which can make the resource imperfectly imitable: the resource, responsible for generating the competitive advantage of the company is socially complex, the resources and the competitive advantage are linked causally ambiguously, or there are some unique historical conditions; and

4. Sustainability – no strategically equivalent resources exist, or they are themselves either not rare or imitable.

Kangas (2000) sums up that in order to achieve competitive advantage, the heterogeneity of resources is a necessary condition. According to Barney (1991), the companies within an industry may be heterogeneous given the respect to the resources they control. These resources also may not be perfectly mobile across companies, which in turn may make the heterogeneity long lasting.

The development of the resource-based theory: The name used to refer to the resource-based theory has changed depending on the author and the time of publication; the theory has been called the theory of the growth of the firm, resource-based approach, resource-based perspective and resource-based view (Kangas, 2000). The currently used name 'resource-based theory' has been presented by Conner (1991). However, the vocabulary is not finally established and different terms can be used meaning the same theory (Kangas, 2000).

Kangas (2000) suggests that the theory was originally developed by Penrose (1959), who noted that in order to exist a company needs to grow continuously, while being limited by the administrative and productive resources it possesses. However, Barnes (2003) gives the credit of developing the resource-based theory to Wernerfelt (1984), who recognised that the companies' ability to gain competitive advantage depends on the resources they possess. Barnes (2003) also stresses the role of the 'strategic theory of the firm', developed by Rumelt (1984), in the developing of the modern resource-based view.

Barney and Clark (2007) note the role of the resource-based theory as an efficiency-based explanation of sustained superior firm performance. According to them, the modern form of the resource-based theory originates from four sources. The first one is the 'traditional study of distinctive competencies'. The authors give an example of general manager comparison between two companies. The one that has high-quality general manager is likely to outperform the one with a low-quality general manager. However, they note that the general manager is not the only distinctive competency the company may have, though they are mostly the ones that are responsible for the success or losses.

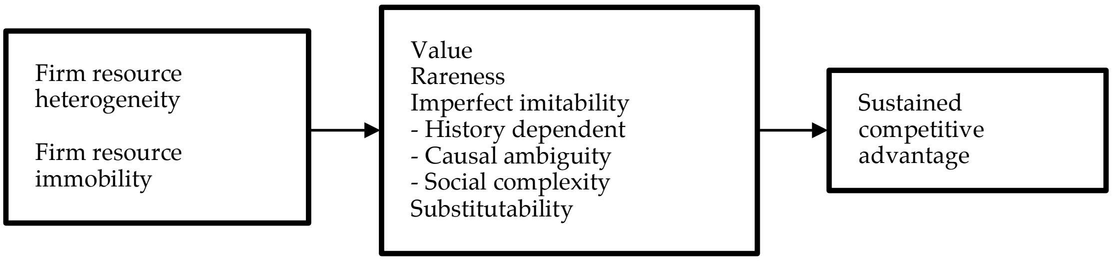
The second source is 'the analysis of land rents' by Ricardo that was originally issued in 1817. It suggests that the company that owns the land that is more fertile is more likely to get more income from the rents – and generally perform better. The fertility of the land in this analysis is not seen as a final state and it is possible to improve it at a relatively low cost. However Ricardo's study does not provide any answer to how and at what price did the company originally acquire the more fertile land. (Ricado, 1817, for references see Barney and Clark, 2007.) Though in the original study the land was a specific type of resource, the basic idea can be transposed also to other resources: the resources the company already controls are more likely to provide a source of success than the resources acquired from outside (Barney, 1986).

Barney and Clark (2007) agree with Kangas (2000) on the third source, which is Penrose's (1959) 'analysis of firm growth'. The analysis sees the growth to be limited by the productive opportunities as a function of the bundle of productive resources controlled by a company, as well as the administrative framework used to coordinate the use of the resources. The bundles of resources may be different in different companies. This source has provided the theory with the view of managerial and entrepreneurial skills as resources.

The forth source is the study of 'antitrust implications of economics', which pointed out the meaning of uncertainty in the competition and thus promoted the information to be one of the competitive resources of the firm. Extra information compared to the competitor may well lead to better results in the industry with limited information and high uncertainty. Also the role of managerial skills as an important resource is stressed in this study. (Barney & Clark, 2007.)

Barney (1991) points out the change of focus from external (opportunities and threats) to internal (strengths and weaknesses) resources of the firm, he distinguishes between 'competitive advantage' and 'sustained competitive advantage'. The sustained competitive advantage may only be achieved in the situation of imperfect imitability and non-substitutability of the resources. Barney presents a framework that shows the relationship between the heterogeneity and immobility of resources and the sustained competitive advantage (see Figure 4).

Figure 4: The relationship between resource heterogeneity and immobility, value, rareness, imperfect imitability, and sustainability, and sustained competitive advantage



Source: Barney 1991, 112.

This framework leads to the VRIO[2] framework that is intended to be used for evaluating the value of the resources in the competitive advantage of a company (see Figure 5). The VRIO framework suggests the sustained competitive advantage is only achieved when the resources and the capabilities the company possesses are valuable, rare, costly to imitate and efficiently organised. (Barney, 1994.)

[2] VRIO – Value, rareness, imitability and organisation (Barney, 1994).

Figure 5: The VRIO framework for evaluating the competitive implications of firm’s resources and capabilities

Valuable?	**Rare?**	**Costly to imitate?**	**Efficiently organised?**	**Competitive implications**
no	–	–	no	competitive disadvantage
yes	no	–		competitive parity
yes	yes	no		temporary competitive
yes	yes	yes	yes	sustained competitive advantage

Source: Barney 1994, 4.

Barney (1994) proposes three questions for companies in order to evaluate the competitive implications of firm’s resources in accordance with Figure 5. The ‘question of value’ asks a company whether it is possible to respond to external environmental opportunities and threats with the resources the company possesses. The answer to this question links the analysis of resources and capabilities of the company with the analysis of external opportunities and threats. The ‘question of rareness’ enquires how many of the competitors possess the same valuable resources and capabilities as the company itself. This question points out the importance of the rareness of a resource, but the author also stresses that resources valuable yet common are nonetheless important for the company that possesses them. Those resources however, regardless of their importance, are not likely to provide the company a competitive advantage over its rivals on the market. The ‘question of imitability’ investigates whether the acquisition of resources or capabilities that the company does not already possess, causes it a cost disadvantage. Barney suggests two ways of imitating a resource: duplication and substitution. Additionally to the three previous questions the author presents a ‘question of organisation’ that stresses the importance of company’s organisation in order to support and utilise its resources that have value, are rare and are hard to imitate by other companies.

The assumption in the resource-based view is that the sources of a competitive advantage of the company are in the bundles of service-creating resources that could be exploited, rather than in the product-market combinations that are chosen by the company to deploy those resources. Every company has tangible and intangible resources that generate added value, or as it is usually called in the literature, rent. The resource-based approach links the analysis of the resources and capabilities of the company to the analysis of environmental opportunities and threats. (Barney, 1994.)

An interesting view on the resource-based theory was presented by Collis and Montgomery (1995). They suggest that the primary aim of the theory is to predict the future performance of companies. As the resources the companies possess are connected to their potential performance, it is possible, knowing the resources, to predict the future performance of the companies in their competitive and dynamic environments.

Kangas (2000) suggests that different companies control different resources needed for implementing strategies to different extents. Those differences are seen to be relatively stable. Also, as companies are trying to increase their economic performance, the performance differences are caused by differences in companies´ resource endowments. The objective of the resource-based theory is to be responsible for the creating, maintaining and renewing the competitive advantage of the company from the resources side.

Warnier, Weppe and Lecocq (2013) express critique of the traditional resource-based theory, suggesting it does not take other than strategic resources into account. They present a division into three resource categories: strategic, ordinary and junk resources. The ‘strategic resources’ are in line with the VRIO model, although the authors use the abbreviation VRIN[3]. Those resources are rare on the market and are positive for the performance of the company, as their expected level of productivity is higher than their price. The strategic resources are thus a potential source of added value for the company that possesses them. The ‘ordinary resources’ are common on the market and are considered neutral for the performance of the company, as their expected level of productivity is somewhat equal to their price. In terms of competition they at best ensure the competitive parity. The ‘junk resources’ are overlooked or ignored by the company and their value is low on the market. They are seen to be negative for the performance, as the expected level of productivity of such resources is lower than their price. The junk resources are thus a source of destroying the value for the company. The authors note that in the original definition by Wernerfelt (1984) the concept of a resource included weaknesses of the company, while in the later works this definition disappeared and only strengths were considered resources (e.g. Barney, 1991). It is

[3] VRIN – valuable, rare, inimitable and non-substitutable (Warnier et al., 2013).

however important to note other than strategic resources, as those are extremely rare and most of the companies need to make use of the ordinary and even junk resources.

To summarise this brief review of the resource-based theory and its background, the notion by Peteraf (1993) may be presented. He stated that the value of the resource-based theory is that it can explain the differences in performance that are not related to the differences in the industry conditions. A company's competitive advantage and thus performance are closely related to the resources the company possesses. Mahoney and Rajendran (1992) present three reasons for the viability of the resource-based approach: it is in line with the traditional strategy insights describing the company's competencies and capabilities that differ from their competitors', it fits within the organisational economics paradigm, and it is complementary to industrial organisation research. In addition to that they stress the importance of the theory as a framework provider for dialogue between scholars. The value and rareness of the resources (Newbert, 2008), as well as their inimitability and effective organisation (Barney, 1994) provide the grounds to the sustained competitive advantage. Some of the resources may be irrelevant or even harmful for the company (Wernerfelt, 1984; Warnier et al., 2013) and the companies need to manage their resources in order to generate higher income and perform within industries with high competition. In this thesis the resource-based theory will be used to determine why an industrial company might be interested in the services of an import intermediary from the resource point of view.

2.2 Transaction cost theory

Core concepts: In order to explain the theory, we need to define terms 'transaction' and 'transaction cost'. This chapter provides a comprehensive insight on the terminology and the origin of the terms 'transaction' and 'transaction cost'.

A transaction takes place when services or goods are transferred across an interface that is technologically separable (Williamson, 1981). Encyclopaedia Britannica suggests that transactions "*serve to transmit economic values such as materials, products, and services from those who want to exchange them for another value, usually money, to those who need them and are willing to pay a countervalue*" (Encyclopaedia Britannica, 2014). Crook (2005) defines a transaction as goods or services transfers between workgroups that are technologically separable at the moment when one economic activity stage ends and another begins. He suggests that the transactions are governed either by markets, hierarchies or hybrids. By hierarchies the author means companies and by hybrids he means alliances, franchises or joint ventures. Williamson (1975) presents three transaction attributes: asset specificity, uncertainty and frequency. These attributes influence whether the transaction will be governed by market, hierarchy or hybrid (Crook, 2005).

The earliest mentions of the term ‘transaction costs’ was found by the author of this thesis in the 1950’s papers (e.g. Bliss, 1951; Owen, 1958; Rosett, 1959; Schimp, 1954). Kissell Glantz and Malamut (2003) point out that the authorship of the term cannot be traced to any particular author, while Wei and Ou (2011) suggest that the authorship of this concept belongs to Coase (1937).

Transaction costs are the costs that are incurred in the process of an economic exchange. Frauendorf (2006, 53) describes transaction costs as the costs of resources used to create, maintain, use and change the institutions, including the costs of defining and measuring resources or claims, as well as the costs of acquiring and transmitting information, negotiation and enforcement. According to Frauendorf the transaction costs also contain costs from using and constructing the structural uncertainties. Kissell and the associates (2003) suggest another definition of transaction costs, used primarily in the equity markets. There the transaction costs are the costs that arise while implementing an investment decision and include all expenses that occur to facilitate the transaction. However, this view could also be easily transferred to other than equity markets. Witner and Casten (2011) agree with Kissell and colleagues (2003) on the facilitating function of transaction costs. They list the contents of transaction costs, including commissions, advertising fees, transfer fees, meals, travel and professional fees, such as accounting and legal fees. Summing up the previous definitions, transaction costs arise from negotiations and acquisition of information, as well as information exchange between companies; they also arise from taking uncertainties into account and facilitating the transaction in general.

The costs are also seen to be arising from the coordination of economic activities through utilisation of market mechanisms, company’s organisational structure and both inter- and intra-activities of the firm, affecting both the provider of the service and the customer (Frauendorf, 2006). Those costs apply to all forms of organisation (Williamson, 1981). According to Peng and York (2001), transaction costs arise because the rationality of decision makers is limited, the environments are complex and uncertain, and the distribution of information between parties is asymmetric. Crook (2005) simplifies the reason for the transaction costs to firm’s efforts to discover the fair prices on the market, negotiate and make market contracts.

Bowen and Jones (1986) point out two general dimensions of transaction costs’ sources, which are ambiguity and goal incongruence. Ambiguity arises when either of the parties has difficulties to evaluate the actual performance of their counterpart. Goal incongruence is apparent when the main objective of one of the parties is to promote its own interests, even if that harms the interests of their counterpart. In this case, the expected profit from such behaviour exceeds the possible return from co-operation.

Both ambiguity and goal incongruence are seen to be increasing the transaction costs, because it is notably difficult to achieve agreements, which in turn raises the expenses.

Kissell and associates (2003) state that typically the transaction costs amount for 1% of the transaction, but may often rise to 2–3%, which makes them a significant part of company's expenses. The authors divide transaction costs into nine components: broker commissions, exchange fees, taxes, bid-ask spread, investment delay, price appreciation, market impact, timing risk and opportunity cost. These costs are either visible or hidden, with hidden costs constituting the largest share of total transaction costs. Another important notion by the authors suggests that generally transaction costs refer to the costs that are paid by a buyer and not received by a seller, or vice versa, paid by seller and not received by a buyer. The transaction costs can also be divided into two categories, as they may be fixed or variable. Fixed costs are independent of the strategy of implementation, whereas variable costs can be controlled and reduced during the implementation process.

The roots of the transaction cost theory: The consequence of transaction costs is that every company aims to minimise such costs in their business (Peng & York, 2001). The transaction cost theory is based on this supposition and sees the transaction as the basic unit of analysis (Williamson, 1981; 1985).

Frauendorf (2006) defines the transaction cost theory as a basic theoretical framework formed in order to analyse the service provider and the customer process relations. The theory thus embeds and governs both sides of this process, as well as provides an explanation why the process should be seen as a single comprehensive process entity. Williamson (1981) points out the meaning of the transaction cost analysis as an interdisciplinary approach to the organisational study including economics, organisation theory and aspects of contract law.

The roots of the transaction cost theory concept are in the classic papers of the 1930's and the 1940's (Williamson, 1981). Commons (1934, for reference see Williamson, 1981 and Chavance, 2012) introduced the concept of a transaction as the basic unit of the economic analysis. He saw the harmonisation of relations of different structures and assessing the capabilities of different structures as a central matter of the study of institutional economics. Commons announced that the unit of economic investigations is rather transactions between individuals than the commodities and the individuals. He saw transactions as a correlating mechanism between law, economics and ethics.

Coase (1937) in his widely cited classic work "*The Nature of The Firm*", brings up the concept of the costs resulting from transactions. He suggests that different companies have different capabilities for the economic exchange management and that markets are seldom optimally efficient, and the partial reason for that is the transaction costs. He noted that the acquisition of something on the market actually costs more than the actual cost of the product. The idea was further developed by Hayek (1945), who pointed out that economic activity is mostly planning and it is aiming to utilise knowledge in the best way possible. He saw that the most interesting part of economics is the uncertainty that also results in transaction costs. His notion was that effective adaptation to changes is important in order to perform well on the market.

Coase (1960) continued his input into the formation of the transaction cost theory in his 1960 paper "The Problem of Social cost" that originally concentrated on the harm one company may cause to another one. However, one of the sections of the paper was entirely dedicated to the problem of the cost of market transactions. In this section, the author points out that the costs of transactions are notable and that companies try to minimise these costs by minimising the amount of transactions. This in turn leads to a certain inflexibility of the decision making: as the transactions are expensive, companies take that in consideration and act differently than if the transactions were free. The author lists some of the costs that in his opinion are related to the transactions, those being negotiation costs, inspection costs, costs of drawing a contract and the price of acquiring the necessary information. He also mentions the administrative costs of organising transactions, especially in case a company has various different activities under its control. In case of the administrative and inspection costs, the author indirectly states that insecurity is one of the important triggers of transaction costs. He thus provides a logical definition of the 'transaction cost' concept and is hence among the first to specify the sources of transaction costs and to emphasise that they play a notable role in the economic activity of companies.

Miller (1965) gives a brief, yet comprehensive explanation of the transaction costs, as they were seen at his time. He mentions a term 'transaction friction' that is used alongside 'transaction costs', yet the author of this thesis has not encountered this term in any other publication. Miller explains the transaction costs as wealth loss that occurs while transferring money to other assets and back. He mentions three factors that lead to transaction costs, those being time, distance and imperfect information. Contrary to the modern understanding and the earlier presented concept by Coase (1960), Miller does not see information imperfection or costs of acquiring the information as the most important factors that lead to transaction costs; in his understanding the most notable contributor to transaction costs is the time needed for the decision making and for the actual transactions.

Arrow (1969) follows Coase (1960) and stresses the importance of information in the transaction costs discussion. He proposes two main sources of transaction costs: exclusion costs and the costs from communication and acquiring information. The author also notes the importance of learning, which may aid in minimising the transaction costs that originate from imperfect information. In the same article Arrow also points out the core difference between transaction costs and production costs: while transaction costs may be altered by changing the mode of resource allocation, production costs only depend on the production technology and cannot be altered as easily. Production costs are thus similar in every economic system, whereas transaction costs are different in different economic systems.

Zabel (1973) discusses the impact of the development of the transaction cost theory on research. He points out that this adds realism to the research, because transaction costs have an effect on both individuals' consumption and portfolio choices over time. He also introduces the view that transaction costs are not proportional, as they depend not on the total volume of trading, but on the amount and type of transactions within this trade. This means that transaction costs are not connected to the amount of products or services sold, but to the amount of transactions themselves, as well as the nature of those transactions and the actions needed for preparing and performing those transactions.

The modern transaction cost theory: The modern transaction cost theory was introduced in the mid-1970's and has since become one of the most important explanations of economic activity governance (Crook, 2005). The main author and developer of the theory is a Nobel prize winner Olivier E. Williamson, who introduced the modern transaction cost theory and has developed it further during several decades (e.g. Groenewegen, 1996; Crook, 2005). Williamson (1975) re-introduced the concept of transaction as the basic unit of economic analysis and lined up the main question of the transaction cost theory: how companies manage to govern their transactions. He thus shifted the focus of the study of organisations onto transactions rather than commodities. He later underlined this notion by stating that if transaction costs were negligible, the whole organisation of economic activity would be irrelevant, as in that case it would mean that no matter how the transaction process is organised, the results will be the same as the transactions are free (Williamson, 1979). Another important impact of Williamson (1975) was the introduction of the role of human behaviour in planning and performing transactions and thus in affecting the transaction costs.

However, by the end of the 1970's there was no consensus on the subject of transaction costs. Williamson (1979, 234) states that there is a consensus only on the role of opportunism or in his words "*a variety of self-interest seeking*" with added guile, and especially in the activities involving investments in the transaction-specific human and physical capital. He also sees a general agreement on the importance of information processing and the "*comparative institutional undertaking*" character of the assessment of the transaction costs. The other aspects of the theory lacked a general consensus.

Williamson (1981) continued to develop the theory by adding three critical dimensions that were to be used in order to examine the transactions: (1) uncertainty, (2) frequency of the transactions and (3) the degree to which the investments are required for each transaction. He notes the importance of the nature of investments: in case the investments are made in general to enable the transaction, but with no attachment to the specific transaction, the actor can turn to different suppliers or buyers without any significant loss. In case the investments are made for the specific transaction, Williamson (1981) calls such investments 'transaction-specific investments' or 'transaction-specific assets', the price of the investments is a significant part of the transaction, as there is no possibility to change the contractor with no significant consequences.

In his next work on transaction cost economics, Williamson (1985) provides a comparison between transaction cost economics and other approaches to the study of organisation. In his opinion, transaction cost economics is more microanalytic, more self-conscious about the behavioural assumptions that it presents, and stresses the importance of asset-specificity. It also takes the comparative institutional analysis more into account and sees the company rather as a governance structure, than a mere production function. Williamson also stresses the importance of the influence of the organisation form on organisational performance.

Anderson and Gatignon (1986) develop the insight on the transaction-specific assets presented by Williamson (1981) by dividing them into physical and human assets and by providing examples on both. An example of a physical transaction-specific asset is a stamping machine that manufactures parts according to specifications by one manufacturer that do not suit any other manufacturers. In this case changing the contractor would be extremely costly as the machine would in this case be useless. Examples of human transaction-specific assets are knowledge obtained by the employees of the company about the counterpart and the working relationships developed over time. Both are impossible to completely transfer to another contract with another company. The authors also extend the concept of uncertainty by dividing it into internal and external. Internal uncertainty depicts the inability of the company to conclude the performance of its own agents, external uncertainty in turn means that the company is unable to predict the external environment.

Dow (1987) suggests that the development of transaction cost theory has been biased towards capital managed companies rather than labour managed companies in the selection process. He also notes that the opportunism aspect of the theory concentrates primarily on worker opportunism, thus somewhat neglecting management opportunism. Additionally, he claims that the ramifications of bounded rationality are not respected and that the theory is susceptible to functionalist excesses. Finally he states that the theorists need to give more attention to the selection processes.

Williamson (1987) agrees with the above notion, but answers to the other critique in his article that is written in a response to Dow's paper. He partly agrees with the proposition that the transaction cost theory only concentrates on capital managed companies, but he does not find the bias obvious and suggests that it is well remediable.

He also states that while it may seem that the transaction cost theory is biased towards worker opportunism, the specialised structures of government still provide mutual gains and that applies, with variations, to both capital and labour markets, and also to intermediate product markets. Williamson also disagrees with Dow’s definition of bounded rationality and finds it incomplete, thus rejecting the critique of ramification of bounded rationality. While he agrees that the selection process needs to be studied more carefully, he disagrees with Dow’s critique towards the study process.

Robins (1987) presents more critique on transaction cost economics by stating that the concept of efficiency, which is critical for the transaction cost theory, is actually not elaborated in the transaction cost literature. He also notes that the theory is unable to provide the analysis of institutional economics, but he agrees that it offers tools for understanding the use of particular social instructions in the activities in the economics. All in all, the author underlines that the transaction cost theory is an important extension and application for microeconomics.

Englander (1988) notes the close relation between transaction cost economics and the technological aspect of the costs in companies. He suggests that the original transaction cost theory does not take into account the weakness of technology when searching for the sources of the costs. He claims that in the transaction cost theory the technological determinism weakness gets substituted by the transaction costs’ determinism weaknesses. This means that companies are managerial hierarchies not because organisational efficiency demands that, but because it is requested by the need for technological efficiency.

Williamson (1989) attempts to look at the further development of the transaction cost theory and suggests directions for its development. He notes that empirical research on the theory had only begun recently, and thus there is much to learn and study. The author predicts that many of the insights presented by the transaction cost theory will in the future be absorbed by the extended neoclassical analysis. The arguments of transaction cost economics are likely to be qualified in order to aid the process values that currently appear only in an ad hoc manner. He also suggests that there are new insights and models that will be brought up in further research and that they will be adopted by the transaction cost reasoning. Finally he adds that a better bureaucracy theory is needed in order to proceed with the theory’s development.

Hill (1990) takes an insight on the transaction cost theory from the point of view of the invisible hand concept. He suggests that opportunism, which is a key element in the transaction cost economics, actually gets diminished by the market in the long run, as it is more profitable to co-operate than to mislead the partner and otherwise behave in an opportunistic manner. The author agrees on the importance of the transaction cost theory, especially when the co-operative theory fails to deal with opportunism. This happens when the outcomes are impossible to predict, reputation is hard to establish and when the benefits of short-time opportunism outweigh the benefits from co-operation in the long run. However, he finds that the transaction cost theory is static and has failed to consider the ramifications of a possible dynamic revolutionary process.

Walker and Poppo (1991) suggest that there are questions about a more preferable manner to apply the transaction cost theory to complex economic institutions with strong competition. The authors find the theory stating that asset specification is a necessary condition for lowering the in-house transaction costs and for growing of the transaction costs in the market, but according to their study this does not appear to be entirely correct. They suggest that the effect of asset specialisation on the in-house transaction costs is connected to the enduring governance practices of the supplier, as well as new policies made to improve the performance of the suppliers. The authors thus suggest that the transaction cost theory should be further developed and especially that research on the origins and consequences of in-house and market governance is needed.

Williamson (1993) replies to some of the critique presented by Hill (1990), concerning the role of opportunism in the transaction cost theory. He admits that his earlier formulation about opportunism being self-interest seeking with guile (Williamson, 1979) proved to be controversial. He notes that he does not imply that all agents on the market are acting in an opportunistic manner; however, well-socialised agents need to be protected from the minority of opportunistic agents. The author also stresses that most of the complex contracting and hierarchy forms disappear because of opportunism and that he sees economising on bounded rationality as the main issue of many organisational economics problems.

Ghoshal and Moran (1996) argue that practical use of the transaction cost theory might prove not only inefficient, but also harmful for managers. They find that the logic of the theory is basically wrong in terms of the definition of the role of organisation. The authors state that the transaction cost theory fails to recognise the difference between the role of organisation as a mere substitute for building efficient transactions in case of market failure, and the role of organisation as a possessor of unique advantages for performing certain economic activities using a logic that is different from the market's.

Williamson (1998) admits that the transaction cost theory has its limitations in explaining the whole theory of the firm and market organisation, it rather provides an alternative perspective alongside other theories and views. He also reviews the history of the transaction cost theory and emphasises the main ideas, which are: comparative economic organisation, the role of adaptation as a central problem of economic organisation, private ordering, human actors and their behavioural attributes, as well as the distinction that is made between the governance institutions and the institutional environment. He notes that most of the ideas originate from the works written in the

1930's, but they were combined together into the modern transaction cost theory only decades later.

Slater and Spencer (2000) focus on the central role of uncertainty in the transaction cost theory. They find that the assumption of uncertainty provides a vital link in the analysis of transaction, from market coordination to internal organisation. However, they state that the originators of the transaction cost theory Williamson and Coase fail to give a comprehensive definition of uncertainty and that the whole concept has been somewhat neglected in the theory. They note that in reality uncertainty occurs in and through real time, and that it leads to a need for constant agency adaptation.

Pessali (2006, 45) provides a comprehensive summary of critical elements of the transaction cost theory. These are: bounded rationality, opportunism, the primary role of the markets, and economising action. He concludes that the field of study of transaction cost economics is "*the uncertain world of incomplete contracts, inhabited by 'contractual men' – potentially opportunist people with bounded rationality*". He also points out the breach between transaction cost economics by Williamson and the mainstream of economics, especially the New Institutional Economics. However, he notes that the role of the theory has been significant, and Williamson has been an important source of citations ever since the introduction of transaction cost economics. The importance of Williamson as one of the most important contributors to business research is also noted by Dahlstrom and Nygaard (2010) in their article on the Nobel Prize in economics, which was awarded to Williamson in 2009.

Simply put, the transaction cost theory concentrates on studying costs arising from transactions and explains both where the costs originate from and how to possibly minimise those costs. Peng and York (2001) pay special attention to the nontrivial transaction costs in business that spreads across national borders, and the role of export intermediaries in minimising those costs. This is the point of view that will be implied in the case study later in this thesis. The transaction cost theory will work as a framework that aims to help understand the reasons why a major industrial company is interested in using the services of import intermediaries.

2.3 Agency theory

Core concepts: The core concepts of the agency theory that need to be explained prior to the introduction of the theory itself, are 'principal' – a company that delegates the work to an agent, and 'agent' – a company that does the work for the principal. The core problem that the theory looks into and tries to solve is the conflict between the principal and the agent. (Jensen & Meckling, 1976; Roth & O'Donnell, 1996.) Ross (1973) defines an agent as someone who acts for, on behalf of or as a representative for a principal, and respectively a principal as someone, who buys the services of an agent to achieve his own goals.

The intention of a principal may be to maximise its performance and to minimise the costs through using another company that can perform the same work more efficiently. On the opposite side an agent is interested in maximising the fee for its services and in performing the work with minimal efforts. This leads to a conflict of interests, in which especially agents are likely to misrepresent their skills and knowledge to principals. (Peng & York, 2001.)

Eisenhardt (1989) points out two problems that the agency theory is meant to resolve. The first one is the agency problem, by which the author means the conflict between the goals of a principal and an agent as described earlier, as well as expensiveness and difficulty of verifying the actions of an agent. The second problem is seen to be the problem of risk sharing, which arises when different risk preferences of a principal and an agent lead to them preferring different actions. The unit of analysis in this theory is contract governing and the relationship between the principal and the agent.

The problems between the principal and the agent lead to agency costs that include the costs of structuring, monitoring and bonding the contracts. Additionally, they include residual loss that follows the costs of enforcement of contracts exceeding the benefits. (Fama, 1983.) These costs affect the principals. They have two options to resolve the problems and subsequently minimise the costs. The principals can reduce the information asymmetry by investing in monitoring systems or structure the agent incentives in such a way that the interests of both parties are aligned. (Peng & York, 2001)

The amount of agency costs follows the statutory and common law, as well as human ingenuity in the devising of contracts (Jensen & Meckling, 1976). Mahaney and Lederer (2011) suggest that in order to increase the possibility of a project's success and to reduce goal conflicts, the contract needs to have a greater outcome-basis. They also note that monitoring may be a more effective way to reduce the costs than promising a reward for an outcome.

Peng and York (2001) suggest that the agent, which is able to minimise agency costs for the principal is likely to be performing well. This falls in line with the willingness of principals to reduce extra costs. In this case they are more likely to select an agent with lower agency costs over the others.

The development of the agency theory: The roots of the agency theory are in the 1970s. One of the oldest cited papers is the article by Ross (1973), in which he notes that the agency relationship is among the oldest and the most well-known modes of social interaction. The agency problem is also one of the most common topics in the literature that concentrates on the problems of moral hazard. The author also provides a definition for the canonical agency problem, which is simplified and digested in the following sentences. Both the agent and the principal have their own functions and act within those functions with an intention to gain maximum profit. However, the main purpose of an agent is to act in the best interests of a principal and maximise the profit gained by a principal. Yet, mostly agents are naturally more interested in maximising their own utility, which may well differ from the interests of principals on whose behalf the agents are acting. This sums up the basic reasons of agency costs: the different aims of the principal and the agent lead to the extra costs that arise in the process.

Jensen and Meckling (1976) introduced the positivist agency theory, which according to Eisenhardt (1989) is along with the principal–agent theory one of the important points of view on the agency theory. Jensen and Meckling (1976) explore the ownership structure of a company, especially the possible ownership of equity by managers, which may align their interest with the interests of the company owners. The authors seek to develop a theory of the ownership structure of companies that could be based on property rights, agency and finance. In their article they provide a definition for the agency relationship that is presented here to complete the definition by Ross (1973). They see the agency relationship as a contract in which the principal engages the agent to do something on its behalf, which leads to delegating some of the authority of decision-making from the principal to the agent. The principal needs to limit the possibility of the agent to perform other than in the interests of the principal, and to ensure this, incurs monitoring costs in order to limit the agent's aberrant activities. Another option is to pay the agent to expend the resources in order to guarantee that the agent will not take actions that might harm the principal or to ensure that in case those actions are taken, the agent will compensate the losses to the principal. The authors call such costs the 'bounding costs'. They note that it is virtually impossible to ensure that the agent acts in the best interests of the principal without incurring some costs. They note that in most cases the agency relationship involves both monitoring and bounding costs, but still the results are not ideal from the principal's point of view. Thus, agency costs comprise of monitoring costs, bonding expenditures and residual loss.

In addition to those suggestions, Jensen and Meckling (1976) find that agency costs occur not only in the typical principal–agent relationship, but also in the relationship where there are no clear principals or agents, but where there are several benefactors with different aims. They suggest that the agency problem is quite general in organisations of all types as well as in co-operative efforts on every management level. The authors also take a look at the agency problem that occurs between an owner-manager of a company and outside shareholders, when the aims of the owner-manager may differ from those of the owners of the company. Finally, the authors state that law and sophistication of contracts are the historical consequences of reducing the amount of agency costs, because this amount depends, among other things, on the law system and the effectiveness of the contracts.

Harris and Raviv (1978) approach the agency problem from the principal–agent theory point of view. They agree with Jensen and Meckling (1976) on the role of contracts in regulating principal–agent relationships. The authors describe the principal–agent theory approach as a search for the optimal contract models and explanations for the observed arrangements. The aim is to develop a theory of agency that could be applied to all possible types of principal–agent relationships, including employer–employee, lawyer–client, buyer–supplier and others.

Fama (1980) looks into the agency problem within a firm at all levels. The author investigates the role of capital and labour markets that work as information mechanisms in controlling the self-profit seeking behaviour of top managers of the firm. He notes that agency cost problems of the company arise when managers are not the firm security holders, in which case their own interests may be significantly different from the interests of the company owners. However, the author finds that separation of security ownership and company management may be an effective way to organise the company from the set of contracts point of view. In order to explain this, the author separates the concepts of management and risk bearing. He defines management as a certain type of labour that is concentrated on coordinating the activities of inputs and also putting through contracts that are agreed among inputs. This can be simply called decision-making. The role of risk bearers is explained by assuming that the company rents all the production factors and the contracts are decided before the production period with revenues at the end of the production period. The role of the risk bearers at the beginning of the production period is to accept the possibility of negative difference between the costs and the revenues that will be visible by the end of this period. In this case the risk bearers are interested in ensuring good revenue and are thus willing to invest money into better production and technology. That means that the risk bearing function is usually combined with the function of the technology and capital ownership.

Lazear an Sherwin (1981) look into the optimal award system for agents in order to provide maximum performance from the principal's point of view. They describe a situation in which there are two agents and a risk-neutral principal, and the results of both of the agents' work depend on both their own efforts and the so called 'additive shock' equal for both agents, the amount of which they do not know when choosing the level of effort. The article compares three different schemes of compensation for agents: (1) a linear price rate where the amount of compensation depends directly on the agent's output, (2) a comparison with a fixed standard when there are two fixed payments, and an agent gets one of them depending on whether its results are above or below a certain measuring point, and (3) a tournament, in which an agent gets one of the two fixed prizes depending on the result in comparison with the other agent – the agent that performs better gets a better prize and vice versa. The authors suggest that in case the agents are risk-neutral, the whole moral hazard problem can be sidestepped by delegating all risks to the agents. In case the common shock is large, the tournament is seen as the most effective scheme, in turn when the variance of the component of output that can be attributed to the effort of the agents is large, the other two schemes will outperform the tournament. This is explained by the effect of the common shock: when it is important, the other agent tries to perform better which leads to the better performance of the agent itself in order to outperform the rival, and in this case the tournament is the most effective compensation scheme. When the common shock is not important, the only determinant of the agent performance is its own effort, which in this case is random. That is why, according to the authors, the fixed standard and the linear price rate are more effective.

Holmström (1982) followed Harris and Raviv (1978) in the principal–agent theory approach. He looked into the problem of free riding in case there are several agents and one principal. The free rider problem only occurs when the output of all the agents is measured in total numbers without investigating the role of each agent in achieving the result, in this case if one or more agents cheat, this might be not visible in the overall output. The author sees that the principal needs to develop incentive schemes in order to get the best performance from the agents. He suggests that in this case capitalistic companies in which labour and ownership are partly separated, would gain advantage over partnerships with output distribution among the agents. The author also looks into the possibility of using competition between agents in order to make the output more effective. However, he finds that the competition is only important for information extraction and has no value otherwise. In turn, he suggests that the evaluation of performance may help reducing the costs from moral hazard, as in this case risk sharing is better.

Fama and Jensen (1983) continue the work of Fama (1980) on the role of stockholders and executives in organisations from the agency problem point of view. The authors point out the function of the company board of directors as an information system that may be used by the stockholders in order to monitor the possible opportunism of the company's top executives. Following Fama (1980) the authors note that the separation of decision-making functions and risk bearing are not only typical to large corporations, but also to other organisation types, such as professional partnerships and non-profit organisations. The reason for this separation is that with such arrangement the company gets benefits of both specialisation of risk bearing and management as well as the effectiveness of the common approach to the control of agency problems. In their article the authors specify the role of the organisation as a nexus of both written and unwritten contracts, whose decision-making process is divided into decision management and decision control. The central contracts that are present in every type of organisation, according to the authors, specify two things: the nature of residual claims and the allocation of steps of the decision-making process among the agents in the organisation. The authors of the article present two hypotheses, complementary to each other that describe the relations between residual claims and the decision-making systems: (1) the separation of the residual risk bearing and the decision making functions results in a decision-making system, which separates decision-making from decision control, and (2) in case the decision management is combined with decision control in a few agents, this leads to residual claims that are restricted to those agents. In addition, the authors look into the differences between the principal–agent theory and the positivist agency theory, which were introduced earlier in this section. They see the principal–agent theory as a generally mathematical and non-empirically oriented view, in which the focus of the attention is on risk sharing and optimal contract between principal and agents. The positivist agency theory is, in turn, non-mathematical and empirically-oriented approach, which concentrates on monitoring and the contract environment of companies. The authors note that despite some tensions between the theories, especially in the literature, those theories have significant similarities and are partly supplementing each other.

Jensen (1983) continues the comparison between the positivist agency theory and the principal agent theory. He finds that those theories have much in common, for instance they have a similar view on the unit of analysis, which is the contract that regulates the actions of the principal and the agent. They also share the basic assumptions about the behaviour of people, the roles of organisations, and information. However, he picks the positivist agency theory and notes that it is enriching economics with a more complex view on organisations and reasons for certain contractual relations.

Green and Stokey (1983) report that by the time their article was published the main focus within the agency theory was on situations where there is one agent and one principal. The only diversion from this pattern that they note is the study by Lazear and Sherwin (1981), in which they described a situation with one risk neutral principal and two agents. Unlike that paper, Green and Stokey examine a situation where there are several identical risk-averse agents. They consider employer a principal and employees the agents, whose ultimate performance-related reward is the promotion at their jobs. The authors note that if a group of agents has identical random shock, the principal can acquire the information about the value of the common shock from the performance of this group. Consequently, the principal can also see the performance of every single agent. This information may then be used in different relative performance schemes, such as tournaments (see Lazear & Sherwin, 1981).

Rees (1985) repeats the critique of the traditional field of agency theory study that only considers the situations with one agent and one principal. He finds that in real life the agency relationships are significantly more complicated. In addition to the situations where there are several agents and one principal (e.g. Lazear & Sherwin, 1981; Green & Stokey, 1983), it is also possible that there is one agent and several principals. Such situation might occur for example in case a company has one manager and several stakeholders. The author also notes the problem of every agency theory model, which is to predict the actions of the agents and to maximise the profit of the principal, thus minimising agency costs.

Eisenhardt (1989) tries to sum up the development of the agency theory by the time her article was published. She notes that while the theory is widely considered important, it also has its controversies. Some researchers find that the theory is a powerful and universal tool for organisations study, others see it as narrow and even dangerous in terms of organisations' performance. The author also takes a look at the differences between the positivist agency theory and the principal–agent theory and notes that most of the criticism is concentrated on the positivist stream, especially for its lack of mathematical models. She sees that the principal–agent view is a more representative branch of the theory, as it has a broader focus and greater interest in general. The focus of the positivist research is set on the special case of the relationship between the owner and the management of a large corporation, while the principal–agent literature concentrates on finding an optimal contract between an agent and a principal, assuming the goal conflict between those two. The principal–agent theory is basically balancing between the costs of monitoring of agent behaviour and the costs of transferring risks to the agent and measuring the outcomes.

Carney and Gedajlovic (1991) return to the problem of free riding in relationships, where there are several agents that provide the combined overall output with no division into agents' personal outputs (see Holmström, 1982). Besides the actual free riding problem they look into different consequences of such arrangement of agents' work. One of those consequences is the possibility that investments made by agents might prove inefficient in case the other agents are working on the same task and their output is combined. This specifically considers advertising costs of the agents. When one agent invests in advertising, the profit might actually be distributed among all of the agents involved, and thus rivals of the agent who actually invested benefit from it. This makes agents meticulously consider their investments and in the long run might affect the overall production of all the agents combined. Another severe problem is the probability of low quality production, which is especially probable in the case when the amount of repeating customers is low.

Davis (1991) makes a comparison between the agency theory and the organisational theory. He notes that in fact the agency theory is another economic approach to the firm behaviour studies. He finds that the theories compared have several similarities and they complement each other. However, there are also differences, especially in the understanding of corporate control and managerialism. They also characterise the function and the role of directors board from a different point of view. The organisational theory approach suggests that companies have widespread managerialism, which makes it possible for the top management of the company to imply different strategies with respect to their environment. The agency theory suggests that the discretion of the management is promoted through the incentive structures and capabilities for monitoring, otherwise the company risks not surviving the agency costs. The author sees that the agency theory is correct when noting the fundamental control issues and relation of ownership structure, as well as the control issues in the capitalistic corporation. However, he does not set any of the theories above the other one, but suggests that both are needed for the modern study of corporations.

Vetschera (1998) proposes a possibility to extend the traditional agency theory into the multi-criteria agency theory, which would take the presence of multiple criteria on the agency level into account. However, the author does not present the theory itself, but only outlines possibilities for the development of such a theory. He criticises the conventional agency theory for neglecting the real life situations in its theoretical models. The author notes that the assumption of the theory, according to which if the agent maximises its function that is presumably known, the principal maximises its profit, is far from realistic and thus impedes the applicability of the agency model. He suggests that the agents' goals are not as simple as the conventional theory suggests, and that the possible multi-criteria agency theory needs to take that into account. He adds that the new theory should take into account the information that the principal possesses and the influence of this information on the possibilities to affect the behaviour of the agent. The amount of this information is central for the possibilities of the principal for controlling the agent.

Ang, Cole and Lin (2000) analyse the relationship between the ownership structure of the company and the agency costs, expanding on the works of Jensen and Meckling (1976) and Fama and Jensen (1983) presented earlier in this chapter. They find that in companies that are managed by a person from outside the company, the agency costs are higher than in companies with the management inside the company. They also find a negative correlation between the amount of agency costs and the ownership share of the company manager. Another factor that increases agency costs is the amount of shareholders who are not managers in the firm. The authors also note that the external monitoring by banks helps decreasing agency costs. However, the extent of the difference in the costs is relatively low.

Wright, Madura and Wiant (2002) take a glance at agency costs in international companies. They find that agency costs are higher in companies with more internationalised activities, and that the costs increase together with the degree of foreign exposure. The authors suggest that as well as in every other type of organisation, better monitoring and control have positive effect on reducing agency costs in multinational companies, but in those companies it is even more important than in the ones with no international activities. Accordingly, the board of directors' role and composition are also particularly important in multinational companies. Additionally, the companies with a substantial presence on international market are more likely to have higher monitoring costs. This makes improved corporate control especially beneficial for such companies.

Fontrodona and Sison (2006) present their critique of the origins of the agency theory. They imply that the concept of the company means that there are several agents, who agree to work together for the common goal without casting aside their own interest. However, the concept of the agency theory suggests that the agents only try to maximise their own utility, and it is thus in conflict with the concept of the company. The authors suggest that the reason for the existence of the companies does not come from the need to reduce costs, but rather from the need for division of labour and different competencies within the same business.

Heath (2009) concentrates on the controversial reception of the agency theory among the business ethicists. While some researchers see the agency theory as a valuable tool for the recent ethics scandals spate analysis, the others argue that studying of the theory in business schools might be the source of those scandals in the first place. The author points out two problems that the business ethicists find in the agency theory. Those are (1) the economic model that explains the rational actions and (2) the doctrine, according to which shareholders are obligated to maximise their power. The author suggests that the problem of the model is that the conception of rational action it is based on, is highly inadequate because such important category as moral action is classified as irrational in it. Consequently, it classifies all following of the rules as irrational and thus not suitable for the general rational action theory. The author notes that while the experienced practitioners of the agency theory are aware of those limitations and know how to take them into consideration, most of the researchers are not. The classical theory proposes that the consequences of the immoral behaviour are pictured as lethal for the companies, which means that the alternative of the ethically behaving organisation is no organisation at all, rather than a presence of an unethical organisation. The author finds this to be far from the real-world situation.

This thesis focuses on the work of import intermediary companies, and the relationship between an industrial company that needs replacement parts for its machines and intermediary companies that supply it with the parts can well be described as a relationship between a principal and agents. The industrial company needs the replacement parts at the lowest possible overall cost, while the intermediary companies might for example be interested in a higher price of the parts in case they are paid a fixed fraction of the price of the items they deliver. There are numerous other possible conflicts that might lead to agency costs for the principal company. They will be discussed in chapters 4 and 5 of this thesis.

3 METHODOLOGY

When performing scientific research, the author has to make choices and decisions related to the study, and one of the choices is the research method. There are several methods to perform a research and none of those can be called correct or incorrect. The most common methods are quantitative and qualitative. This thesis employs the latter, which helps in simplifying the matters and makes it possible to speculate (Alasuutari, 1995). This chapter will go through decisions and choices over the research method and the implementation of this study.

3.1 Research design

The strategy of this research represents a set of methodological decisions used in this thesis (Hirsjärvi, Remes & Sajavaara, 2004). The strategy chosen for the study depends on the main research objective, which in this thesis is to find out the role of an import intermediary in the imports from EU to Russia. As the final aim is to provide an insight on the phenomenon of import intermediaries in the EU–Russia trade, it is adequate to choose the qualitative study for this purpose (Eskola & Suoranta, 1998).

There are numerous ways of classifying different research strategies, for example dividing them into three main strategies: (1) experimental, (2) quantitative survey and (3) case study. Experimental strategy concentrates on measuring the impact of a change in one variable onto other variables. Quantitative survey provides statistical information gathered from a number of sources utilising standardised questions. Case studies in turn concentrate on one single case or a small group of interconnected cases. (Hirsjärvi et al., 2004).

Following this classification, the study performed and described in this thesis employs the case study approach. This makes it possible to present complex matters in a simple and understandable manner (Eriksson & Kovalainen, 2008). A theme interview was conducted with a representative of a major Russian industrial company. The names of the company and the representative were decided not to be disclosed in terms of this thesis.

Qualitative study: It is considered incorrect to look at the qualitative and quantitative approaches from a perspective of confrontation in terms of their credibility, as their boundaries are not clear (Eskola & Suoranta, 1998; Hirsjärvi & Hurme, 2004). The comparison is, however, important in order to select the appropriate strategy for this study. This chapter will provide a brief insight on both strategies and then concentrate on the qualitative study, as it is the strategy chosen for this thesis.

According to Uusitalo (1991), the difference between the strategies is seen in the difference of the output material, it being verbal in qualitative and numerical in quantitative study. Hirsjärvi and Hurme (2004) mention the difference of the supposition of the relationship between the researcher and the examinee: in a quantitative study the researcher has no direct impact on the responder, whereas in the qualitative approach there is a persistent interaction between the interviewer and the interviewee.

Several researchers point out two ways of making conclusions of the study, those being inductive and deductive (e.g. Ghauri & Grønhaug, 2002; Hirsjärvi & Hurme, 2004). Inductive approach proceeds from empirical observations and facts towards building a theory. The researcher cannot be sure if conclusions are correct, as sometimes even the conclusions based on thousands of findings can prove wrong. In the deductive approach, the conclusions are led from logical assumptions. The facts are first gathered in order to accept or decline the hypotheses about the relations between variables. The conclusions are not required to be true, as long as they are logically justified. (Ghauri & Grønhaug, 2002.) In other words, the inductive approach leads from detailed instances to generalisation, while deductive approach leads from generalisation to detailed instance (Tuomi & Sarajärvi, 2002).

In the quantitative approach, the researcher takes the results from earlier studies, sets hypotheses and performs numeric measuring. The researcher builds a selection and sampling plans and refines the information into a state in which it can be processed statistically. The conclusions are based on the statistical analysis and the results can be presented for example using the percentage tables. (Hirsjärvi et al., 2004.) In its core the quantitative approach usually tests the impact of an independent variable on a dependent one (Alasuutari, 1995).

The difference of the qualitative study compared to the quantitative approach is that in qualitative research the amount of items studied is severely restricted and it is impossible to apply statistical processing on the results (Alasuutari, 1995). The aim of the qualitative approach is usually to find and reveal new information, rather than confirm statements that are already known. The results of the qualitative study are thus generally subjective and it is virtually impossible to reach any level of objectiveness. As a result, the conclusions are mostly conditional explanations that are attached to a certain time and place. (Hirsjärvi et al., 2004.) As a contrary to the quantitative method, the qualitative method does not contain any hypotheses or other assumptions on the results of the study. However, the personal experience of the researcher may have an impact on the observations and it is possible to try to guess the results of the analysis. (Eskola & Suoranta, 1998.)

Hirsjärvi and colleagues (2004) present four possible purposes of a research: (1) mapping, (2) descriptive, (3) explanatory and (4) predictive. A mapping research is performed in case a researcher aims to find new ways of understanding a subject or a phenomenon that has not been thoroughly researched. As a result, he/she can then build hypotheses on the subject. The purpose of descriptive research is to provide the exact descriptions of a subject. Explanatory research aims to explain the cause–effect relationship of a problem, while predictive research tries to predict actions and events that follow a phenomenon. One research may have several purposes and the purpose can also change during the research.

The purpose of this study is explanatory and at the same time partly mapping. The aim is to explain the situation with a specific company as well as provide an insight on the previously sparsely researched subject of import intermediaries. According to Hirsjärvi and associates (2004), the qualitative approach is the most optimal for this type of study.

Case study: The concepts of case study and qualitative study and their relationship to each other are a frequent topic in the literature on performing a research. For example, according to Hirsjärvi and colleagues (2004) this is a question of terminology, as both names mean the same type of a study. In a case study the researcher chooses one or at least no more than a few cases that he then studies (Koskinen, Alasuutari & Peltonen, 2005). The purpose of a case study is not to provide statistical generalisation, but rather to expand and generalise the theories themselves (Yin, 2003). In this thesis, the author has chosen a single case of a Russian industrial company. The reason for this choice was the possibility to interview a manager of the company, who is acquainted with the author of this thesis. In terms of access it was seen that this company and this interviewee were the most suitable for this study. According to Järvinen and Järvinen (2000), the most frequently used techniques in a case study are surveys, interviews, observation and use of archived materials. Yin (2003) adds that one of the strengths of using a case study is that it allows for processing complex materials, such as documents, interviews and observation. The case study is the most suitable research strategy when one wants to answer the questions ‘how’ and ‘why’. In case of this thesis the interview is used as the technique of acquiring the information.

Yin (2003) presents two classes of a case study – holistic and embedded. Both could be used with one case or several cases in a study. Holistic means that there is one unit of analysis, even if there are several cases involved. Embedded means that there is several units analysed, which may be for example different departments of a company.

The case study approach is criticised for the lack of possibility of making generalisations based on only one case. It also takes a significant amount of researchers’ time and produces documents that are large and difficult to read. However, other research methods partially have the same kind of problems, as in any approach several studies are needed before the results can be generalised. (Yin, 2003.) However, the author chose the case study approach, because due to its describing nature it was seen to suit the research objectives the best.

3.2 Data collection

In a qualitative study it is important to collect the data the way in which the unit of research is understood correctly. It is also important to note the time and other resources required for data collection. (Hirsjärvi et al., 2004.) This study involves an interview with one person, a manager in the company studied. The interview continued for approximately two hours.

The interviewees chosen for the case study are not called sample, but rather a discretionary choice, as there will be no statistical generalisation. The aim is to find new information on the phenomenon or to search for new approaches to the subject (Hirsjärvi & Hurme, 2004). Hirsjärvi and associates (2004) suggest three questions about the study that the researcher needs to ask himself: (1) is the material already available or must it be first collected, (2) what is the object of the study, and (3) what is the time dimension of the study – does it show the current situation or does it observe the study object for a longer period of time. In this thesis the researcher collects material through an interview. The object of the study is a Russian company. This sets the perspective, from which the author observes the phenomenon of the import intermediaries. The research pictures the situation with the import intermediaries at the moment of the study, as it is the most rational approach in terms of time, resources and the purpose of this thesis.

The four basic data collection methods, as presented by Hirsjärvi and colleagues (2004) are (1) surveys, (2) interviews, (3) observation and (4) processing documents. The interview was chosen as a data collection method for this thesis, as a long interview is seen to be one of the most efficient methods in a qualitative study (McCracken, 1988). An interview provides a possibility for interaction and for observation of the interviewee (Hirsjärvi & Hurme, 2004). Eskola and Suoranta (1998) point out the importance of saturation, which in this case means choosing how many interviews and interviewees is enough for the study. Because the company this study concerns and the person interviewed are located in Russia, in terms of resources it was seen practical to choose only one interviewee.

The selection of the case company and the interviewees is an essential part of a case study (Laine, Bamberg & Jokinen, 2007). When choosing an interviewee it is extremely important to choose the right person who can provide information precisely on the subject discussed in the study (Wilkinson & Young, 2004). This is the reason why it was decided to choose the person responsible for imports in the company studied.

Because the person interviewed resides in Russia, the interview was conducted over the Interned using Skype software.

Interview as a data collection method: Interview is a common data collection method in qualitative studies. Eskola and Suoranta (1998) suggest four different types of an interview. A 'structured interview' is guided by a set of prepared questions that are asked in the set order and use same formulation. The answer alternatives are also provided for the interviewee to choose from. A 'semi-structured interview' has no answer alternatives provided and the interviewee answers in his own words. A 'theme interview' has the topics of the questions decided, but the interviewer forms the actual questions during the interview depending on the interview process. A 'free interview' reminds an ordinary conversation, and all the themes are not necessarily processed. A form of a free interview where the interviewee is interviewed several times using this technique is called a deep interview. Some researchers see a theme interview as a version of a semi-structured interview (Hirsjärvi & Hurme, 2004).

An interview may be conducted on one person at a time or at a group of interviewees; an individual interview is a more common approach and is also used in this thesis (Hirsjärvi & Hurme, 2004). The researchers point pros and cons of an interview as a data collection method. It is effective due to its flexibility and the possibility to contact the interviewee afterwards in case there are any questions left or some confirmation is required. The interviews, however, take a significant amount of time and contain numerous sources of error both on the interviewer and the interviewee sides. (Hirsjärvi et al., 2004.) An interview helps in understanding the way of thinking of the interviewees and in providing insight on the research subject from their points of view (McCracken, 1988). In this thesis interview was seen as the most suitable approach both in terms of time and other resources needed, as well as in terms of acquiring the most accurate information possible.

A theme interview is based on a targeted interview and it can be adapted for each interviewee as long as it is based on the structure of the interview (Hirsjärvi & Hurme, 2004). The interview for this thesis took place in February 2015 and was conducted over the Internet. Physically the interviewer and the interviewee were both at their homes and the interview was performed using a video call function in Skype software.

Operationalisation: In order to operationalise the theoretical framework into the themes of the interview, the author of this thesis used an operationalisation table presented in Table 2. The purpose of the table is to clarify the logic of the study and to facilitate the operationalisation.

Table 2: Operationalisation of the study

The objective of the study	The sub-objectives	Theoretical frame	The themes of the study
To describe the role of import intermediaries in imports from the EU into Russia	1. Analysis of resources of an ideal intermediary	Resource-based theory	Bottleneck resources of the Russian industrial company
			What kind of resources are required from an intermediary?
	2. Analysis of the benefits of using an intermediary	Transaction cost theory	What kind of transaction costs does the Russian industrial company confront?
			What transaction costs can an intermediary minimise and how?
	3. Analysis of the risks and the disadvantages of using an intermediary	Agency theory	Possible agency costs?
			A balance between transaction costs and agency costs?

The themes of the interview are based on the theoretical framework and the topics of the study. They are intended to guide the conversation between the author of this thesis and the interviewee. The questions used were specified during the interview based on the themes presented.

3.3 Data analysis

A qualitative study can be analysed in various different ways (Hirsjärvi & Hurme, 2004), and it is possibly one of the most difficult tasks when conducting a case study, as it is not enough to simply tell the story of the company (Holstein & Gubrium, 1997; Ghauri, 2004). The analysis provides answers to the research problem and is one of the core stages of a study. First the results are described, then categorised and finally explained. In a qualitative study those stages are not specifically in this particular order. It is possible to return to an earlier stage and the stages may repeat. The material is also usually analysed during the study and the processing and analysis are often partly combined.

Eskola and Suoranta (1998) present three common analysing methods for qualitative studies. 'Categorising' is the simplest method, in which the researcher defines the categories and counts the amount of repetition in the material. 'Thematising' is close to categorising but the count of the repetitions does not matter. 'Typology' is formed by grouping the material into homogeneous groups by searching for similarities. The result is then presented as combined types of information.

Thematising is used as the method of analysis in this thesis. The results of the interview were categorised according to the main interview themes and according to the theoretical frameworks the themes were based on. Then the results were analysed using the theoretical frameworks.

3.4 Trustworthiness of the study

Proving trustworthiness of the study is aimed to convince the reader that the results and the study itself are worth their attention. Lincoln and Guba (1985) suggest four means by which the trustworthiness needs to be checked – (1) credibility, (2) transferability, (3) dependability and (4) confirmability.

Credibility means that the researcher has to show that the results are equivalent to reality (Lincoln & Guba, 1985). In this study several instruments ensure this. First is the language of the interview: it is conducted in Russian, which is the native language of both the interviewer and the interviewee. This prevents language-related misunderstanding. The answers were then translated by the author. Second is the technical aspect – the interview is recorded and is then transcribed and translated into English. Third is the interviewee choice, explained in the earlier chapters. Fourth is the preparation for the interview – all themes are written down and are related to the theory basis of the study, providing answers to the right questions. There are also limitations – it is possible that the interviewee does not provide the whole truth and chooses to hide some information.

Transferability is connected to transferring the results of the study to other contexts (Lincoln & Guba, 1985). In the case of this study, it is difficult to unconditionally apply the results of the study to other contexts because of the nature of this study: as already mentioned, the study was conducted as an interview of a single person. In this case, even assuming the interviewee answered honestly and did not hide or alter any facts, the findings of the interview only apply to the company in question and the person in question, and may not necessarily represent the general situation. Further study is required to make the results completely transferable.

Dependability shows how the research situation is affected by different factors (Lincoln & Guba, 1985). For example, are the questions asked clearly, what is the atmosphere of the interview, are there problems with connection if the interview is conducted by phone or over the Internet. As already mentioned, the interview for this thesis was conducted over the Internet. However, there were no technical difficulties, the interviewer and the interviewee could clearly see and hear each other. They also were already acquainted, thus the atmosphere was relaxed and friendly and was not likely to affect the results of the interview.

Confirmability demonstrates the objectivity and the distance of the researcher on the situation (Lincoln & Guba, 1985). In this case study, the researcher was not involved in the company, on who's representative the interview was conducted. The interest of the researcher was merely to understand and find out facts about the topic.

In order to prove that the study is trustworthy it is typical to use the concepts of reliability and validity. Those concepts are good to keep in mind, but the researcher must be cautious not to be too careful in use of those concepts so that they do not lead to excessive caution when performing the study. The use of the concepts of reliability and validity has been criticised in the context of qualitative study, yet they are widely used and no generally approved alternative has been presented. The concepts are usable in the qualitative study, but the implementation differs from its quantitative counterpart. (Koskinen et al., 2005.)

Validity: Validity describes if the study method represents what it is meant to represent. The basic concept of validity is divided in two sub-concepts of internal and external validity. (Grönfors, 1985.)

Internal validity means that the theoretical and conceptual definitions are in a logical relationship with each other. It may be improved by using a theory as a basis when making the conclusions of the study. This leads to reducing the number of alternative explanations of the conclusions. The conclusions are consistent and the study is internally valid. (Grönfors, 1985.)

External validity portrays the validity of the relationship between the conclusions, interpretations and the material. The study is externally valid, when the interviewee has given truthful information about the subject. It is checked by comparing the answers of the interviewee with other interviewees or other material on the subject. The study is also externally valid when the researcher presents the situation exactly as it is in real life. (Grönfors, 1985.)

In this study the aim was to provide internal validity by using the theory as the basis for the analysis of the interview results. The conclusions are consistent both with the interview and the theoretical frameworks. The results of the study are in line with the theoretical frameworks, which confirms the external validity.

Reliability: Validity also includes proving the reliability of the study. It is possible that the material can possess reliability but no validity, but it is impossible vice versa. (Grönfors, 1985.) In a qualitative study reliability means that the analysis and the processing of the material have been correctly performed and are trustworthy. It also means that some of the results can be categorised the same way by different observers at a different time. Reliability thus means that the results are repeatable, can be evaluated by other researchers and are not random. The possibility to evaluate the results is the core of reliability in a qualitative study, the reader has to be able to follow the judgement of the researcher and criticise it if needed. If the results are possible to repeat, it can be stated that the phenomenon is true and the interpretation of the results can be accepted. One must note that the times and the society are changing and the same results are likely not to be acquired at any other time. (Hirsjärvi et al., 2004.)

Reliability is increased by an accurate and systematic description of how the study was conducted. The description should concern all the phases of the study and be trustworthy. The researcher must describe the conditions of collecting the data, time used for the interview and the possible distractions. It is also good to report the self-evaluation of the study by the researcher. (Grönfors, 1985.)

Because this study is qualitative, the only way to provide reliability of the study is to provide the possibility for the reader to thoroughly examine the research and evaluate it. In this study this possibility was ensured by providing the description of the study process and also by providing the thorough description of the conditions of the interview as well as the possible problematic issues.

Generalisability: Generalisability is an inherent issue of qualitative studies. The results of such studies are typically more in-depth than those of quantitative studies, but are typically impossible to generalise. (Alasuutari, 1995.) This is especially problematic in case studies such as this one. The problem is the small selection of study objects, which can often be limited to just one. For this reason case studies do not usually aim for a statistical generalisation or for projecting the results onto other cases. The aim is to provide a wider theoretical generalisation of the study results. (Yin, 2003.)

The results of a case study do not have to apply to other cases than the one studied, but they can for example provide an explanation for a unique or exclusive phenomenon. As a phenomenon is usually the object of a qualitative study, generalisation of the results is usually not required. (Alasuutari, 1995.)

It is important that the researcher is careful with the theoretical generalisation of his own results (Alasuutari, 1995). The author of this thesis comprehends the limitations of the interview of a single person and thus does not aim to generalise the results theoretically. The purpose of this study is to provide an insight on the subject and possibly add new dimensions to the future studies.

4 THE ROLE OF THE IMPORT INTERMEDIARY

The company around which this case study is based is a major Russian metallurgical company. After the discussion with the company representative, it was decided not to provide the name of the company or the employees in this thesis, as the company deals with some government orders and contracts. However, the author of the thesis was provided with some accurate details about the company that were not seen to be confidential and was allowed to use them in the thesis. In order to improve readability of this chapter, it was decided to call the company ‘Company M’, ‘M’ standing for ‘metallurgy’. The interviewed manager responsible for the purchases of spare parts and for imports will from here on be called ‘Manager A’.

In the beginning of this chapter, the reader will be provided with some background information about the company, after which the case will be described in detail. The chapter is divided according to the sub-objectives described in Chapter 1.3 and the three theories described in Chapter 2 of this thesis. The interview responses are structured in accordance with the themes presented in Table 2 and divided into paragraphs according to the theoretical framework they are connected to.

The objective of this chapter is to describe the situation in which Company M has decided to turn to import intermediaries in their purchase of its equipment and some of its spare parts. Manager A is the person most responsible for the parts imports and he is also the person who could provide the author of this thesis with the most accurate details for the company’s decision to use import intermediary companies instead of importing the parts and the equipment themselves.

4.1 Case description

Company M is one of the largest metallurgy companies in Russia, its headquarters are located in central Russia, not far from Moscow, and the six factories are spread around the country. Its total number of employees is currently approaching 30,000. The company specialises in the production of crude oil and natural gas pipes as well as train wheels.

Company M was founded in the 1820’s, nearby the recently discovered iron ore deposits with an exceptional iron content of around 80%, which made the deposit enormously profitable to mine. The location and the natural resources allowed the company to concentrate on metallurgy from its very foundation. Originally, the company focused on satisfying the military needs of the country, which was constantly at war during that time. The earliest production included muskets, cannons, guns, cannonballs and other products for the army. In the late XIX century, the company extended its product range to include train wheels, while at the same time lowering the amount of its military supply production and finally quitting the military production market by the beginning of the XX century.

The iron ore deposit was used up by the 1920's and the company started importing iron ore from three mines that were located all across Russia, in Magnitogorsk, Kursk and Vologda. At around this time Company M started manufacturing different types of pipes. Originally it specialised in small-sized pipes with a diameter of 1/2 inches, later adding pipes of larger sizes to its product range.

During the Soviet period, the production of the company was regulated by the plan economy – the ministries in Moscow decided on production range and volumes, they also decided whether the production will stay in the Soviet Union or will be sold to foreign companies. This system of the decision making lead to the situation where after the collapse of the Soviet Union in 1992 the company did not have any contracts with domestic or foreign partners, as all the contracts used to be negotiated at the ministry level. After the collapse of the Soviet regime the company underwent a restructuring process, changed the name and needed to completely rebuild its supply and sales chains. However, Company M was the only company in Russia with an expertise for building the natural gas and crude oil pipes of large diameter and thus managed to close new contracts and find new partners at a very rapid schedule.

> *During the Soviet period the decision-making process at the company used to be extremely slow, everything had to be negotiated at the ministry level, was it the specifications for the new pipes or the contracts with other companies, in the USSR and abroad. The process speeded up incredibly in the 1990's with the new managers and the necessity to close new contracts quickly.*
> *(Manager A)*

As the production of Company M was unique and the demand for natural gas and crude oil pipes was high in post-Soviet Russia, the company did not collapse following the collapse of both the country and the economy. During the privatisation process of the early 1990's, the company's workers received vouchers, for which they could purchase shares of the company. The managers of the company also had an option to buy shares at below market price. However, at the end most of the shares were purchased from the workers by Moscow businessmen, and currently the ownership of the company is almost completely in Moscow.

Today Company M has its business on a solid ground, as there is a constant demand for both of its main products: pipes and train wheels. The pipes are supplied to the natural gas and crude oil pipelines that Russia is building in several directions.

Additionally, old pipelines that were built several decades ago require replacement and maintenance, providing orders for Company M. Apart from the domestic orders, a significant amount of the pipes is internationally certified and is exported worldwide. The train wheel department of the company is currently the largest train wheel producer in Europe, with annual production of around 1 million tonnes. As well as the pipes, the train wheels are sold both within Russia and are exported worldwide. Overall around 80% of the production is exported to the foreign markets.

Company M has a production cycle that covers almost every phase of the production. The company purchases scrap metal and ore, which are then smelted and processed into a steel alloy. Steel blooms are made out of this metal and are then further processed into steel sheets, out of which the pipes are made. They are then covered with either paint or a special polyethylene-based material, depending on the purpose of the pipe. The same principle goes with the train wheels. Thus, the company only purchases raw materials, and all of the production is performed at the company's own facilities. Currently Company M consists of six factories for different phases of the production cycle.

The main competition Company M is facing comes from Germany, Japan and the USA. There are only a few companies in the world that provide pipes of such diameter and with similar durability specifications. The main product of the company is the pipes with a diameter of 55.9 inches (1420 mm) and the wall thickness of 20 mm, which are costly to produce due to the unique equipment and special technology required. Company M is the only company in Russia that provides pipes of this size, its main Russia rivals in Kursk and Chelyabinsk concentrate on pipes of lower calibre. In addition to the size, the durability of the pipes is extremely important, as some of the pipelines are built to be used at the bottom of the sea and the pipes are constantly in contact with the corrosive salty water. Another challenge is the high pressure at which natural gas and crude oil stream through the pipelines.

> *Competition with the Germans, Americans and Japanese is tight, we mostly compete in the fields that are left over from them. Usually they have a significantly higher effectiveness of production and sometimes it is cheaper to purchase the products entirely from abroad than to build our own facilities and try to compete. Our main trump card is the uniqueness of the pipes we build.*
> *(Manager A)*

In order to compete on the international market the company needs to have an equipment that is competitive with the equipment of its main rivals. Very few companies in Russia produce such equipment and thus most of the machinery is imported, mostly from Europe. The equipment also needs constant maintenance, which in turn demands replacement parts. Manager A is responsible for the imports of replacement parts for the machinery. Mostly the parts come from German or Italian companies.

Recently Company M has turned to the services of several companies that according to the definition given earlier in this thesis are working as import intermediaries for Company M. Those companies are mostly located in the European Union, although some of them are also located in Russia. The function of such companies is to find suppliers for the replacement parts or the equipment according to the specifications provided by Company M, negotiate prices, purchase the products, take care of the customs formalities and deliver the parts to the warehouses in Russia, mainly in St. Petersburg, from where Company M collects them and distributes to its own facilities. The aim of this thesis is to shed light on the functions of such companies from Company M's point of view and try to explain why a metallurgy giant cannot use its own resources to perform the operations designated to the import intermediaries. The author of this thesis found Manager A to be the most competent person to be interviewed on this matter.

4.2 Resource-based analysis

This chapter concentrates on the resources of Company M and the import intermediaries the company uses. The interview themes related to this chapter included clarification of the resources possessed by Company M that are critical for the imports of the equipment, and the company's point of view on which resources the import intermediary companies need to possess in order to satisfy the needs of Company M in the best possible way. The research question of this interview section was to find the resources that the potential 'ideal' import intermediary should possess.

From Manager A's point of view, the most significant problem of the spare part imports is the extremely large nomenclature of products provided by the companies, who build the equipment and the spare parts for it. In addition to having several models and types of similar equipment the companies that produce the spare parts are constantly competing with each other, which makes them develop their products and introduce new products at a rapid rate. With dozens of such companies complete knowledge of the whole product range becomes challenging. The personnel responsible for the imports needs to have the latest information about the newest products on the market, their technical specifications, comparison with the competitors et cetera. Ideally, the company needs to have a department of employees, who are only responsible for acquisition of this information and ordering the required spare parts and equipment. In terms of financial resources, such a major company as Company M can afford having extra staff, however this personnel needs to be controlled and their activity needs to be monitored. In such large a company, the chains of command are extremely complicated, and organising control and monitoring becomes a difficult task. In this sense it is easier to outsource those functions to other companies, which can provide such service more effectively at a reasonable price for Company M.

Manager A finds the development of communication devices one of the reasons the use of import intermediaries has become easy and profitable. In the past, managers needed to contact their counterparts using telephone. It was often difficult to locate the required contact person altogether. The contracts and even the specifications for the devices needed to be sent via mail or delivered in person, which took a significant amount of time. The development of mobile phones, computers and the Internet makes it easy to contact several intermediary companies at the same time, even with the same e-mail message, and request their service. Managers can file in specifications to the intermediaries and expect their responses with prices already quoted. They can then compare the services provided by several intermediaries and choose the one that is the most suitable in each situation. This primarily spares Manager A’s time, which is a very limited resource.

> *Earlier I needed to call someone on the phone, wait for response, the person was not there, gone to a meeting or something. I sometimes needed half an hour only to ask one simple question. Nowadays I write several messages on the computer, go have lunch, come back and see the responses for all my messages.*
> *(Manager A)*

The problem of controlling the staff is also basically the problem of the managers’ time. In case the company buys services of import intermediaries, Manager A is not interested in how many people there are working for the intermediary, what they are doing in the company, what languages do they speak, how they are trained to use the communication devices and other questions of this type. He does not need to organise the staff meetings or training programmes, does not need to control the number of people employed in order to maintain the effectiveness of the imports facility. All he needs, is to compare the offers by several companies and decide which one suits him best, everything else is outsourced.

Company M uses several import intermediary companies who have their own competition on the market. This competition improves both quality of the service and effectiveness, both in terms of time and costs. According to Manager A, mostly the work with the intermediaries is organised as follows. Manager A receives a request from a department for spare parts required for replacement or maintenance of the machinery. Mostly the spare parts are requested in advance in order not to stop the production in case something breaks down. The spare parts are also required for scheduled maintenance. Manager A passes specifications for the parts to the intermediaries that he is in contact with; typically he contacts several companies with a written request via e-mail. The intermediaries then search for the parts in catalogues of the suppliers, negotiate the prices and delivery options with the parts manufacturers or resellers and reply to the e-mail message of Manager A with the offer that contains prices, delivery conditions and other details. Manager A decides which of the several offers suits him best and replies to the intermediaries, after which the company chosen for the delivery proceeds with the order. The intermediary takes care of the customs paperwork, orders the parts and the freight and ensures that the parts are delivered to the correct location within the defined time frames.

> *Let's say I need a specific motor that rotates at a speed of 1 round per minute, a very specific motor only few companies in the world produce. I give my intermediaries the specifications of this engine and they get to decide themselves how and in which language they contact the manufacturer of the motor, which model or brand they choose, at which price they can deliver it, et cetera et cetera. They provide me with the options and all I have to do is choose which one suits our company the best.*
> *(Manager A)*

Apart from Manager A's own time, the use of intermediaries helps to reduce the working time of Company M's other employees and departments. Ideally this enables the company to get the parts they need with a significantly lower amount of staff involved in the process. This is achieved because of the effectiveness of the intermediary companies – Company M may only use them when their services are required, but it does not need to pay their salaries all the time. This means that the use of intermediaries can save both time and money for the company – when the company needs to purchase the parts quickly, it can use the effective intermediaries. The rest of the time it has no extra salary costs.

> *Ideally, I could sit at my office with two–three employees, and together we could provide the company with the equipment worth millions of dollars. Otherwise I would need to have dozens of people handling the imports of the parts alone. In reality the situation is not this simple, I still need employees at the imports department for some operations, but the size of this department is significantly reduced due to our use of the import intermediary companies.*
> *(Manager A)*

Manager A lists the attributes that the intermediary needs to have in order to be effective and provide Company M with the best service possible. He notes the importance of knowing how to use modern communication devices effectively, in order to access and provide the information at a very rapid pace. Another important feature, which Company M has problems with, is the language skills of the employees of the intermediaries. As the parts suppliers are located in Europe, the main language of communication is English, though other European languages are important too. The level of intermediary's technical knowledge needs to be excellent. The intermediaries' employees need to attend technical showdowns and exhibitions, where they could both acquire information about the new products and establish personal contacts with suppliers. They need to see the equipment presented, examine its build quality, materials and other features personally in order to have comprehensive information about the manufacturers and their products. The personal contacts in turn might help with the price negotiations. Manager A sees that the intermediary needs to constantly develop its knowledge about the products by ordering technical magazines and visiting the Internet resources of the manufacturers. He notes that when there is a competition between the import intermediaries, those who provide the best knowledge and prices get the orders and the others do not. In case the intermediary is not familiar with the products, there might be problems with quality or features of the parts.

Another important resource that the intermediary needs to possess is established contacts with the spare parts manufacturers and suppliers. Though those contacts might not have a direct impact on the imports, in the long run they may help in improving delivery times or even help providing the products at a discounted price. Manager A sees that in the long run those contacts are crucial for the successful company–intermediary relationship as they help in providing the efficiency of the intermediaries' work.

To summarise this chapter it can be stated that the main resources needed from the import intermediaries, according to Manager A, are time and effectiveness, as well as knowledge. Manager A specifically pointed out the importance of technical skills and languages. Contacts with suppliers are also seen to be important. While ordering the parts using import intermediaries might be more expensive than making orders with the company's own resources on a per-purchase basis, in the long run Company M spares both time and money, due to higher effectiveness of the intermediaries.

4.3 Transaction cost analysis

This part of the case study aims to provide answers to the second sub-objective of this thesis: what are the benefits of using import intermediary companies for Company M. This part of the interview was approached from the transaction cost theory point of view, and the interview themes focused on explaining the transaction costs that Company M faces and the role of the import intermediaries in minimising these costs.

The interview began with a discussion of the costs that Company M endures and which are related to the transactions, or in other words to the import of the parts from European Union. The origin of these costs was already partially discussed in the resource-based theory Chapter 4.2, however in this part of the interview the author and Manager A particularly fixated on the costs rather than resources, ergo approaching the same matter from a slightly different point of view.

The main source of the costs related to transactions is the salaries of the employees, who handle the imports of Company M. For all the work that the company performs itself, it needs staff that is paid salary, mostly regardless of the achievements or the intensity of the work done. Another source of costs is the upkeep of the equipment used to perform this work, mostly this equipment is the computers and telephones, copying machines and printers as well as other office equipment. Additionally the company has transportation costs, in case the representatives need to be transported to exhibitions or contract negotiations.

The contract negotiations themselves are also an important source of costs for Company M. In order to make negotiations successful, the company needs to order catering service, possibly pay for hotel accommodation either of its own employees or eventually even of the employees of the partner, who pay the negotiations visit. Sometimes the company needs to rent a conference room at a hotel or a conference centre, in case its own facilities are unable to provide the required level of comfort or the space required for larger groups. Another cost related to negotiations is the time consumed by the negotiations themselves, which in turn may be directly transformed into the salary costs of the managers and other staff, which is somehow involved in the negotiations.

> *Every now and then somebody comes to my office to present his products. He bears some costs for it, but those costs are likely to be included in the price of his products. However, it also involves some costs that I bear myself, as it takes my time, I need to provide some coffee or snacks et cetera. Those are very concrete transaction costs that we face. (Manager A)*

Manager A describes his department, which among other functions deals with the imports of the equipment, because it is problematic to completely replace own staff with the import intermediaries. However, the use of import intermediaries "*helps keeping the staff at an effective size*" (Manager A). The department consists of around 50 people and the work amount of each employee is described as optimal. Manager A describes the importance of optimal work allocation among the employees. In case the employees have too many tasks and have trouble coping with all of their work, it causes additional costs in the long run. On the other hand in case the workload is too low, the costs are apparent already in short term. The problem of the spare parts imports functions is that the need for the parts is not constant. Sometimes there are many orders simultaneously, sometimes there might be none at all. In this situation it is a task of significant complexity to sustain optimal workload in the department. Manager A explains that the staff working for his department has other tasks and functions in addition to the imports functions. Though this arrangement is not necessarily optimally efficient in terms of the imports, it helps to maintain the overall efficiency of the department.

> *The problem of the efficiency of workload distribution is one of the key reasons to why we decided to use both the import intermediaries, and also the 'varyags[4]'.*
> *(Manager A)*

In addition to the costs that can be relatively easily allocated to transactions, the company naturally has some costs that are more difficult to connect to specific transactions or even functions in the company. One example of such costs in Company M is the car park owned by the company and used at all levels of business. Some of its costs can be directly allocated, for example the cost of the fuel used to drive the manager to a meeting. Others are much more difficult, yet also possible, to allocate;

[4] Varyag is a term used to describe employees that are not on the company's payroll. They are mostly employees of other companies or of labour hire organisations. The term originates from the name used by the Kievan Russians for the Vikings in the IX century. The Viking rulers were sometimes invited to Russia to become the princes and rule the principalities.

such costs can be the costs of the electricity used for the tools that are utilised to repair the vehicles. But the car park is not only used for providing the transactions of the company, it is also used for production itself, for transporting staff within the company or for private use of managers. Those costs are not directly related to the transaction costs, but are affecting them in their own way.

As the interview turned to transportation issues, Manager A explained the function of intermediaries and overall outsourcing using the example of functions of the car park. Though this is not directly applicable to outsourcing of the parts import functions, according to Manager A, the principle was easier to explain using the car park example. In case Company M outsourced its transportation functions, the only things it would need to pay for, would be the transportations themselves and only when such transportations are required. For example Company M has a truck that is only used once a day to drive the products to another facility, which is located only several kilometres away. While the truck is only in use for less than an hour every day, it needs the maintenance and the driver needs the salary also during the time the truck is parked in the garage. If the truck was not owned by Company M, but the service was ordered from another company, Company M would not need to pay for the time the truck is idle, only for the exact transportation services. The company that would own the truck could also effectively use the truck with other companies' orders, while Company M has no need for it. Though this example is simplified, it provides a good understanding of the primary reason for outsourcing in Company M, as well as of the use of import intermediaries as an outsourced service. This arrangement not only helps reducing various costs, transaction costs among them, but it also helps in allocating the costs more efficiently to exact transactions, clients or functions.

The impact of import intermediaries on the minimisation of transaction costs can also be well distinguished, yet not as obvious as in the car park example. As already mentioned, the main impact of the import intermediaries is sparing the time both for the managers of Company M and the staff, thus minimising the salary costs. The key to this is the effectiveness of the intermediaries, who only concentrate on the import of the spare parts and do not have to be concerned about any other functions.

> *The import process itself is complicated, especially when it comes to the customs procedures and other paperwork. We have tonnes of different documents to fill and it takes a lot of time to even find the correct form, not to mention filling it correctly. The company that fills those forms every day and focuses on the customs procedures of a specific country only has a few different forms and they are likely to be already pre-filled. (Manager A)*

The intermediaries specialise in certain procedures and they perform similar operations for multiple different companies. That makes it possible for them to use the working time of the staff as efficiently as possible. Company M's managers do not have to use their time to allocate the workload correctly or to perform the paperwork needed for the imports. The time is also spared in terms of the purchases and imports themselves, as the intermediaries are likely to perform the same tasks more quickly due to narrow specialisation in this field.

Manager A introduced an example of the functions of the import intermediary, together with commentary on how these actions minimise the transaction costs. The first step is receiving an order from Company M. The intermediary has catalogues of the spare parts and equipment of a magnitude of suppliers categorised by specifications, prices, delivery times and other parameters that help them seek the correct supplier and the correct part quickly. This step saves Company M both time and direct transaction costs in the form of salaries. At the next step the intermediary contacts suppliers of the parts and starts negotiations on the delivery schedule or in case of larger orders – the prices and other conditions. Those negotiations may demand language skills, sometimes personal contacts with the managers of the parts suppliers, or even visiting the suppliers in person. This step again saves Company M salary costs, but also may save representation costs, travel costs or the costs of hiring a translator. At the next step the intermediary organises the delivery of the goods to a warehouse of Company M. This step includes customs formalities and logistics challenges. The intermediary has contracts with logistics companies and the customs documents are filled effectively as it is a routine procedure. This step saves Company M time and salary costs, but also may have a positive effect on the cost of logistics.

Naturally, the costs that the intermediary company faces in order to provide Company M with the replacement parts for their equipment, are included in the price Company M pays for the services of the intermediary. However, due to specialisation and efficiency, as well as competition between the intermediaries, this price is still lower than the costs that Company M would have in case they chose to manage the entire process by themselves.

4.4 Agency cost analysis

The aim of the final part of the interview was to determine what disadvantages and risks the use of intermediaries' services holds for Company M from their management's point of view. This matter was approached from the viewpoint of the agency theory, and the interview themes reflected the agency costs that are likely to occur in a relationship with import intermediaries, as well as the balance between those costs bared by

Company M and the benefits of minimising transaction costs. According to Manager A, the risks of confronting agency costs are always present when outsourcing some of the functions to other companies.

> *Basically, it can be that simple: we order something using a single intermediary, and we set the reward of the intermediary at a certain percentage of the product's price. For the intermediary it is more profitable to purchase the more expensive product, as their profit would be higher. However, such a situation is basically impossible, because there is always competition and the intermediary reward system is much more complicated.*
> *(Manager A)*

In order to explain the possible agency costs it is important to explain the logic of the work of the intermediaries working with Company M. Manager A provided an hypothetical example of a typical interaction with an import intermediary, as well as the possible outcomes of the deal. The example is useful in understanding both the logic of Company M and the logic of the intermediary's mechanisms.

In this example, Company M needs a transformer for a power source in one of the facilities, as the old one is nearing the end of its lifespan and needs a replacement. The company has no time or resources to investigate the prices of such transformers, so Manager A orders an approximation of the price from the finance department. They provide the approximate price of the transformer based on the market situation, the price of the same transformer ten years ago when it was purchased, inflation rates et cetera. This is only a quick estimation that provides the possible price range of the equipment and helps in planning the approximate costs. Ten years ago this transformer cost Company M USD 100,000, and after the calculation the finance department predicts that the suitable replacement may be purchased today at a price of around USD 200,000. Manager A calculates the approximate price of the delivery, the reward of the intermediary and other relevant costs, and concludes that a total sum of USD 220,000 should be sufficient. This is the sum he asks from the budget of Company M to purchase a replacement for the transformer.

Next, he contacts an import intermediary, who analyses the actual transformers currently present on the market. He finds three suitable options that match the specifications set by Company M, one from Germany for USD 180,000, one from Japan for USD 195,000 and one from the USA for USD 220,000. Then the intermediary analyses the technical differences between those devices and finds out that the device from the USA is the most sophisticated, as it has alarm systems, a temperature analysis system and an automatic fire extinguisher. The German and Japanese devices lack those functions and are otherwise similar with each other.

The intermediary passes the information about the devices to Manager A and suggests the USA device, provided Company M is able to pay extra, as USD 220,000 Company M allocated would not be enough for the transformer, transportation and the reward of the intermediary. Manager A considers this option, but comes to the decision that the sophisticated options that are available in the USA product are not required, and the Company is not willing to pay extra for it, as they have their own electrician on staff, who performs scheduled maintenance of the operating device manually every day. This leaves the intermediary with two options: it is either the German or the Japanese device.

Next, Manager A explained the opportunities that the intermediary has for unfair play. In this situation if the intermediary already knows that Company M is willing to pay USD 220,000 and does not know the original prices of the transformers, it is more likely to choose the German transformer, because it is cheaper, and then provide a bill for USD 220,000, making the profit of USD 40,000 bar the transportation expenses. This situation would technically satisfy Company M, as USD 220,000 was the price they were originally ready to pay. However, in case the intermediary would provide Company M with the prices of the devices, Company M would only be willing to pay USD 200,000: USD 180,000 for the device itself, plus the transportation expenses and the intermediary reward.

Another option is that the intermediary calculates that the profit is not enough for them and they want more, they ask Company M for more than USD 220,000. As time is limited and the old transformer may fail any time leaving a part of the factory without power, the company may be forced to accept that offer, because it would not have time to negotiate with another intermediary or import the devices itself.

One more possibility for the intermediary to cheat is to ask to cover expenses that they do not actually bear. Those could be transportation costs that did not exist or the costs of negotiations that did not actually take place. This possibility depends on the agreement on the magnitude of the intermediary reward as well as the coverage of the intermediary’s expenses by Company M, but it is possible in certain cases.

This example with the probable outcomes only works if the time is extremely limited or there is low competition or no competition at all on the intermediaries market. This is, however, seldom the case. Normally basic competition between different intermediaries minimises the possibility of cheating, as the prices need to be competitive and the service efficient. In case Company M is not happy with one of the intermediaries, it can always choose another one.

Sometimes it is difficult to discover that an intermediary is cheating and charging higher prices than is reasonable. In case an intermediary's prices for specific equipment rise unpredictably, Manager A tries to find the reasons for such change. Sometimes the reasons may be in the economic situation, the inflation or prices of the raw materials; in this case the prices of Company M's products may react on the equipment's prices. In case Manager A would note that the intermediary is cheating and inflating its prices without an objective reason, he would give them a warning and turn to another intermediary.

> *In theory, an intermediary may be a monopolist in the market for some parts imports, and to be honest, I do not know what to do in case it increases its prices. But it is unlikely that I will develop the infrastructure of my own company to provide these imports, as it is too expensive and would take me too much time. The only thing I can do is to search for another intermediary. However, this situation is highly speculative and has never occurred in real life.*
> *(Manager A)*

Manager A did not have a clear opinion on monitoring the import intermediaries; at least in the situation of Company M this is difficult and for the most part unnecessary. The only information the company can obtain fairly easily is the official financial reports of the intermediary. Those reports may reveal the approximate revenue of the intermediary and shed some light on the costs, but as intermediaries may deal with several companies in several different industries, these numbers are not likely to tell anything important. However, according to Manager A, the actual revenues and costs of the intermediaries are not of an interest for Company M. Their main interest is that they are able to purchase the spare parts and devices within the price range set by the budget, thus only the profitability of using the intermediary is actually of an interest to Company M.

The profitability of using intermediaries, as well as the balance between minimising transaction costs and probable agency costs, is achieved as a result of competition between intermediaries. Manager A notes that in order to be successful, the intermediaries do not only compete with each other, but to some extent they also compete with Company M in the efficiency of the parts imports. In case Company M is able to purchase and import the parts at a lower price, quicker and easier than the intermediaries, it simply is not interested in the services of such companies. These two types of competition the intermediaries face make sure that their intention is to serve Company M as efficiently as possible, at the lowest possible price.

4.5 A summary of empirical findings

The first part of the interview intended to discover what resources present an issue for Company M when importing equipment from the EU, and what resources the import intermediaries are expected to hold in order to be maximally efficient for the company in this field. The most problematic resource for Company M appeared to be the time of the managers of the company, who do not have time to organise the staff and to effectively manage the imports process. The other problematic resource was the knowledge required for imports from abroad, mostly language skills and the effectiveness of handling the customs bureaucracy. Company M expects their import intermediaries to have high technical skills in order to be able to provide the company with the correct goods. Another important resource is the language skills that are specifically needed during the negotiations with the parts suppliers and producers. Finally, personal contacts with the suppliers are also seen to be important, as they might be useful in getting the goods faster or at a lower price. However, the most important thing for the company was that the intermediary is able to spare the time of both managers and staff of Company M by being more effective than the company itself would be.

The second part of the interview aimed to explain why the use of import intermediaries is profitable for Company M. The transaction cost theory was chosen for this approach and the interview themes focused on exploring the transaction-related costs of Company M and understanding the expertise of the import intermediaries in reducing these costs. The most significant costs reduction comes from the salary expenses, but also negotiation costs, transportation and logistics costs. The main source of the costs reduction is the relative effectiveness of intermediary companies, as well as the possibility to divide some of the costs between several clients.

The third part of the interview discussed the risks that Company M takes when it organises its imports with the aid of intermediary companies. The risks were approached from the agency theory point of view and the interview themes examined the possibility of such costs and the manner in which Company M can find a balance between risks and profits of using the services of import intermediary companies. A major source of risks was incomplete information about actual product prices and transactions. There is always a risk that an intermediary can mislead the company financially by asking for a margin too high or providing a product that does not entirely fit the criteria from Company M’s viewpoint, but that provides the best income for the intermediary. However, those risks are minimised by competition on the intermediary market. This competition promotes the effectiveness of the intermediaries and regulates the amount of unfair play.

Table 3: A summarising table of key empirical findings

The research objective	Describing the role of import intermediaries in the imports from the EU to Russia		
Sub-objectives	The resources of an ideal intermediary	The benefits of using an intermediary	The risks and the disadvantages of using an intermediary
The theoretical framework employed	Resource-based theory	Transaction cost theory	Agency theory
Key empirical findings	Adequate technical skills, language skills and personal contacts with suppliers are required from intermediaries	The transaction costs of Company M originate from salaries, negotiations, transportation and logistics	Company M is concerned that intermediaries may mislead it financially
	Company M needs intermediaries to save time of the managers and staff and to increase the efficiency of imports	Intermediaries can reduce all of those costs by being more effective and by being able to split their costs between several customers	Competition between intermediaries as well as between intermediaries and Company M ensures that significant problems do not occur and that the intermediaries are as efficient as possible

5 CONCLUSIONS

5.1 Theoretical discussion

The objective of this study was to describe the role of an import intermediary in the imports from the EU to Russia from the perspective of a Russian industrial company. In this chapter, the empirical findings presented in Chapter 4 will be looked at against the theoretical background presented in Chapter 2. First, the findings of each sub-objective will be reviewed separately and in the end of Chapter 5.1 they will be summarised.

Sub-objective 1: An analysis of resources of an ideal intermediary. Resource-based theory: The empirical findings of this study suggest that Company M needs the import intermediary company to save the time of its managers and staff and to make the import process more effective. The company sees that an ideal intermediary needs to have high technical skills, language skills and personal contacts with the suppliers in order to save time of Company M's employees and to provide the effectiveness needed.

All of those resources, time of managers and employees, technical skills, language skills and personal contacts, can be classified as 'human capital resources' (e.g. Penrose, 1959; Barney, 1991). In case of Company M, it can be concluded that this is the resource category that the company needs to optimise with the help of intermediaries. The other two resource categories – 'physical capital resources' (e.g. Penrose, 1959; Barney, 1991) and 'organisational capital resources' (Barney, 1991) were not discussed in the interview and thus are likely to be organised in Company M other than utilising the services of intermediary companies.

In the import intermediary companies, Company M is primarily interested in resources that it lacks itself. The main goal is to outsource the need for those resources, or in other words to 'import the resources'. Following Barney's (1991) division of the resources into valuable, rare, imperfectly imitable and substitutable it can be suggested that in case of the resources Company M requires from intermediaries, high technological skills can be classified as a rare and valuable resource, while personal contacts with the supplier are also difficult to imitate and substitute. Following another division by Warnier, Weppe and Lecocq (2013) into strategic, ordinary and junk resources, high technological skills and personal contacts can be seen as strategic resources, while language skills are an ordinary resource. However, while language skills are an ordinary and not exclusively valuable resource in the EU where the import intermediaries are located, the rareness of such skills in Russia makes them a strategic resource as well as a valuable and rare resource. Though the time of the staff and the managers is an 'ordinary resource', it is however crucial for competition. By saving this time for Company M, the import intermediaries provide it with a competitive advantage, as this time can be utilised elsewhere.

The interview made it clear that Company M possesses most of the resources it needs. It was already stated earlier in this thesis that resources can be a source of a competitive advantage, and especially heterogeneity of resources is one of the keys to achieving a sustainable competitive advantage (e.g. Wernerfelt, 1984; Barney, 1991; Kangas 2000). In case of Company M, one of the reasons for using the services of import intermediaries is achieving the competitive advantages by making use of the resources that are rare and difficult to imitate. Though the company does not possess those resources itself, outsourcing the import activities makes it possible to profitably use those resources and thus achieve a competitive advantage over the rivals of the company.

Sub-objective 2: The benefits of using an intermediary. Transaction cost theory: The interview results suggest that the costs that in Company M can be categorised as transaction costs primarily arise in form of salaries, but also negotiation, transportation and logistics cause costs that are transaction-specific. In other words, in order to purchase a single spare part, Company M needs to pay salaries to the staff, who makes market research, governs the transaction process, organises the transportation, clarifies the customs formalities et cetera. In addition to that, Company M needs to negotiate over prices for some larger purchases and pay for transportation and other logistics, such as storage. Although some scholars do not include those costs into the classic concept of transaction costs (e.g. Miller 1965), the costs described can hardly be classified otherwise, as they only occur in case Company M needs to perform a purchase, and are mostly related to the specific purchase. This makes it possible to address those costs as transaction costs, which is also in line with several transaction cost theory researchers' ideas (e.g. Kissell et al., 2003; Crook, 2005).

The theoretical discussions on the sources of transaction costs usually mention insecurity as one of the main factors (e.g. Coase, 1960; Arrow, 1969; Bowen & Jones, 1986). However, this seems not to be the case in Company M. The insecurity of any kind was not mentioned during the second section of the interview. It was only brought up in regards to the possible agency costs, when the company cannot be sure if the agent – in this case the import intermediary partner – acts in the interests of Company M. However, the insecurity of the agency relationship is the consequence, not the cause of the import intermediary relation and thus is not a part of this theoretical discussion section.

Another commonly mentioned source of transaction costs is the acquisition of information (e.g. Arrow 1969), which is definitely the case in the situation of Company M, where most of the transaction costs are, directly or indirectly, related to the acquisition of information. The company needs to find the suppliers and the equipment itself in the suppliers' catalogues, it then needs the information about feasible transportation scenarios, customs documents et cetera. This is, however, not the result of acquiring the information to fight the insecurity of the transaction. Those actions are rather inevitable in order to make those transactions take place.

Williamson (1981) describes transaction costs using three categories: uncertainty, frequency of the transaction and the degree to which the investments are needed for each transaction. This approach is used here to describe the utility that Company M gains from using the services of import intermediaries. As already mentioned earlier, the insecurity, or uncertainty, is not an important source of transaction costs for Company M, and can thus be dismissed in this chapter.

The frequency of the transaction is a key factor in the use of import intermediaries. The imports of equipment are vital for Company M and such imports occur frequently, although they do not occur at a constant, predictable rate. The employees responsible for handling the imports cannot be provided with a steady amount of work. The number of employees required to make the transactions possible is, however, significant. This leads to the situation, where the employees sometimes have nothing to do, and thus the use of the labour force is inefficient. This is the reason the services of intermediary companies are valuable: they provide efficiency to the process of importing the equipment. Their services can be used only when there is a need for them, and they do not incur in costs when the services are not required. Additionally, due to specialisation, the intermediary companies may be able to perform the import-related tasks in general more efficiently than the staff of Company M.

The degree to which each transaction demands investments depends on the specifics of each unique transaction. The salary costs, which are the main source of transaction costs, are present not only in all of the tasks, but also between those tasks. The transaction-specific costs, such as negotiation and logistics costs, vary depending on the purchases. The import intermediary company faces most of those transaction-related costs, depending on the overall efficiency and human capital resources, and forwards them to Company M in form of the price for its services. Some of the transaction-related costs may be lower for the intermediary companies, for example due to the physical location of the companies, their personal contacts with the suppliers, and technical expertise. However, Company M mostly benefits from the efficiency of the intermediary companies and especially from the lack of the constantly endured salary costs and other fixed costs between the import events.

Another way to approach the transaction costs, which was partially used in the previous paragraphs, is the division into fixed and variable costs, presented by Kissell and associates (2003). The authors suggest that the fixed costs are those that do not depend on the implementation strategy and the variable costs can be reduced depending on the strategy. In the case of Company M the purpose of the import intermediaries is to actually reduce the costs that would otherwise appear fixed, such as the salary costs. Outsourcing the imports process shifts a part of those costs from the fixed to the variable category. Additionally the desirable better overall effectiveness of the import intermediary companies helps in reducing other variable costs.

Sub-objective 3: The risks and the disadvantages of using an intermediary. Agency theory: The third part of the interview reveals the risks of using the services of import intermediaries that Company M sees in such relationships. The empirical findings suggest that the main risk considered by Company M is the possibility that an intermediary company can in some manner mislead Company M financially, for example by not offering the most optimal alternative for Company M in order to gain more profit for itself.

The import intermediary companies do not completely fit into the classic definition of an agent as someone, who acts for, on behalf of or as a representative for the principal (Ross, 1973). It can be seen that Company M simply buys the services of import intermediaries. However, after more thorough observation, the intermediaries' role as agents between the suppliers and Company M is obvious. This is especially notable when the agency conflicts are concerned: the purpose of the intermediary companies' business is to provide utility for Company M, however their aim is also to maximise their own utility in this relationship.

Eisenhardt (1989) describes two issues of the agency relationship: conflict between the goals of the principal and the agent, and the problem of risk sharing. The traditional agency conflict is obvious in this case: Company M wants the equipment acquisition process to cost as little as possible, while intermediaries want to maximise their own profit in this process. It follows that intermediaries aim to maximise their margin, which is effectively paid by Company M. However, according to Manager A, the situation is not completely conventional, as due to certain specifics of their budget planning, Company M is satisfied when the price of the spare parts including all transaction costs is within the price range set by the company. This gives intermediary companies more space for manoeuvre in setting their margins. However, this is effectively an agency conflict, as the intermediaries still want to maximise their share, and Company M wants the equipment as cheap as possible. The only difference is that Company M is not that concerned with this conflict, as long as the final price fits its budget.

The risk-sharing problem is practically absent in this case. The financial risk, the risk of failure of the purchase or the risk of transportation problems are all outsourced to the intermediaries. Company M only pays for the final result regardless of the problems the intermediaries might encounter. The risk for Company M is that the actions of the intermediary companies might cause additional costs or losses.

Peng and York (2001) suggest that the agent that provides its services with the lowest agency costs is more likely to be chosen by the principal. That suggestion finds full support in this case study. The competition between intermediaries is instrumental to minimising agency costs for Company M. In case an intermediary is not being effective enough, it is replaced with one of its competitors, which is able to provide the same services on better terms. This is in line with Peng and York's proposition.

Wright, Madura and Wiant (2002) point out the importance of monitoring agents, especially in the case of companies that have international activities. The interviewed manager of Company M does not entirely agree with this notion, at least in the case of his company. He found monitoring of intermediaries ineffective and extremely difficult to implement, especially given that there is a number of intermediary companies on the market. The traditional competition is seen to be a significantly more effective tool for ensuring that the intermediaries act in the manner that is profitable for Company M.

Summary: Fontrodona and Sison (2006) suggest that the use of agents in business is caused not by the strategy of cost reduction, but rather by the need for labour division and different competencies. That notion finds some support in this study, yet in case of Company M, the purpose of using intermediaries is actually cost reduction through division of labour and different competencies.

An ideal import intermediary company is specialised in the imports process of Company M, has the skills that are required specifically for this process and has contacts with relevant suppliers. It is thus more effective in this process than Company M would be if it conducted the process itself. This saves time for Company M and subsequently reduces some of its costs.

The effectiveness and specialisation of the intermediary company also reduce the costs for negotiations, transportations, customs bureaucracy and logistics. Additionally, the flexibility of using import intermediary companies helps to reduce the fixed costs, especially the salary costs of Company M. The intermediaries are only used when needed and only paid when used.

The competition between intermediary companies ensures that the intermediaries aim for maximum efficiency in order to simultaneously provide Company M with lower prices for the import of equipment, and gain the highest possible profit in the process. The competition also ensures that the agency costs are minimised. The combination of these factors provides Company M with the costs reduction that results from the effective labour division and specialisation of the intermediary companies.

5.2 Managerial recommendations

The case study performed for this thesis describes an actual company that utilises intermediary companies in order to import spare parts and equipment from the EU to Russia. The most obvious implementation of the study results is to apply them in a similar situation, where an industrial company uses intermediary companies to import the products it needs, while looking to decrease costs and improve efficiency. Although this case specifically considers the EU–Russia trade, it is possible that similar logic could also apply in other environments. This might especially be the case when the country to which the products are imported, has no free trade or other customs agreements with the country, in which the import intermediary is located and from which the products are imported. In such situation, the imports process is more complicated due to the customs regulations and transportation issues, which makes the expertise of intermediary companies more valuable, and the cost reduction that follows the use of import intermediaries even more significant.

Theoretically, import intermediation in the form described in this thesis could work for any organisation, not only major industrial companies, given that there are companies that specialise on import intermediation in their field. This strategy could work with companies that import a significant amount of expensive products. In this case the negotiation skills and other specialisations of import intermediary companies can provide significant costs reduction. However, it is possible that companies, which only import small volumes of products and do so infrequently, might also benefit from import intermediation. This could especially be the case, if the imports process is not common for the company, and thus the company has neither experience nor the knowledge required to perform the task efficiently. In such case, it could be significantly more profitable to outsource the whole imports process and focus on the core activities of the company.

The results of this study can also be reviewed from the intermediary companies' point of view. The interview and the theoretical discussion provide some ideas on the features that principal companies would want their import intermediary partners to possess. The manager of Company M specifically noted the importance of technical skills of the intermediary company as well as their negotiation abilities and personal contacts with the supplier. Though the situation described in this thesis is the specific case of Company M, the same skills of the intermediary companies could also be valuable in other fields and with other principal companies. The results of this study could provide intermediary companies with a possible direction for developing their skills and lead to achieving competitive advantage over their rivals. One of the important notions is that the intermediary companies need to keep in mind the competition with each other, and try to ensure that their services are not exchanged for the services of their rivals.

5.3 Limitations of this study

The nature of this study as a case interview with a single manager of a single company sets certain limitations. Although the person interviewed was the most suitable person to interview on the topics of this thesis, his own opinions do not necessarily represent the complete truth about the situation within the company or the reasons for the use of import intermediaries' services. However, there is no doubt in the competency of the person interviewed, and given that both financial and organisational resources of this study were limited, this interview is seen as the most efficient way to provide the answers to the research questions of this study.

The data on the case company, which is here called Company M, was limited and it was thus not possible to find the exact share of import intermediary companies' impact on the import process, or to get any additional information about the market of those intermediary companies. Many other organisational and financial details were also not available or were decided not to be disclosed within this study.

The research questions have also limited the study to the theoretical side of import intermediaries' service utilisation. This has led to neglecting some of the practical aspects of import intermediation in the imports process from the EU to Russia. For example, the effect of recent sanctions on the imports has not been discussed at all. Corruption issues were also left outside of the frame of this study.

5.4 Suggestions for further research

As it appears from Chapter 1.2, the number of studies regarding import intermediaries is limited. This study focuses on a very specific case, and though it provides some understanding of the nature of import intermediaries, there is still a significant research gap to fill. Thus any research that specialises in this particular kind of intermediation would be welcome.

In the field of research of intermediaries in the EU–Russia imports, there is a major need for a study that would describe the market of import intermediary companies. Unfortunately, the scale of such market and the overall ubiquity of such practice in the EU–Russia trade remain unclear and need further research. The study presented in this thesis could be expanded with more Russian industrial companies and more respondents included. Another research could focus on the same subject from the import intermediaries' point of view.

Another apparent study direction could be the import intermediation on other than EU–Russia markets. The study performed for this thesis did not reveal any information about possible import intermediation outside the EU–Russia trade, but it can be concluded that there is possibility that such companies exist elsewhere. Smaller companies with smaller amounts of imports might also benefit from import intermediation. This could be a possible direction for the further study.

One of the main conclusions of this study was the competition between import intermediaries, which according to the manager of Company M, is key to productivity and efficiency of those companies as well as a barrier for the possible misbehaviour of import intermediary companies. This competition needs to be studied further in order to determine the underlying factors of import intermediary performance and the optimal ways for principal companies to utilise the competition between import intermediaries. For example, one of study topics could adapt the research by Peng and York (2001) to the case of import intermediaries rather than export intermediaries.

This brings us to the next subject of the possible future studies, namely the differences between import and export intermediaries. Literature provides only a very limited outlook on those differences (e.g. Karunaratna & Johnson, 1997; Ha-Brookshire & Dyer, 2009) and further research is required in order to understand how the types of intermediation differ in practise. Further research could also determine whether there are significant differences in the competition between export intermediaries and competition between import intermediaries, or in the success factors of both intermediary types.

One of the important topics that was given only minor attention in this thesis is the overall state of EU–Russia trade under sanctions and other political problems that have appeared recently. This subject has a significant importance, as a notable number of businesses are involved in this process and are affected by the political and the financial situation in Russia. There is, however, no doubt that this situation will be researched from various points of view in the future.

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APPENDIX

Review of earlier empirical studies on trade intermediaries

Authors and year	Objective	Method	Key findings
Burton, Cross and Rhodes, 2000	To test the influence of exogenous factors on organisational form, when going on export	Survey on 15 franchising firms in the UK	Small companies and companies with large networks at home and experience at franchising at home are likely to use an intermediary, the companies with more managerial resources are more likely to invest directly
Petersen, Benito and Pedersen, 2000	To look into a problem of replacing an export intermediary	Survey on 346 Danish manufacturing companies	The intermediaries are mostly replaced with FDI, after the manufacturer obtains knowledge of the market. Switching costs are important impediments.
Balabanis, 2001	To figure out a relationship between diversification and performance in the export intermediary firms	Survey on 135 British export intermediaries	Intermediaries with diversified and undifferentiated products show more stable export patterns. Geographical diversification does not make difference.
Peng and York, 2001	To test the impact of knowledge, ability to handle export negotiation and willingness to take title to goods on the intermediary performance, proposed in a model by Peng and Ilinitch (1998)	Mail survey on 166 companies	Knowledge and the ability to take title to goods has positive effect on the intermediary performance. Negotiation ability is not that important in terms of performance
Trabold, 2002	To test the impact of geographical and psychical distance as well as commodity content of the products to the export intermediary selection, proposed in a model by Peng and Ilinitch (1998).	Qualitative analysis, data collected between 1985 and 1990	The greater the geographic distance, the more likely it is for the company to select an intermediary. The psychical distance was not proven to have that effect. The commodity content led to choosing an intermediary only in some industries
Fung, Chen and Yip, 2007	To examine the impact of relationship coordination on the trade intermediary performance and to provide a broader understanding of relationship in the supply chain	Mail survey with 112 textile and clothing import/export companies	Trade intermediaries are significant in the facilitation of international exchange and business development

Authors and year	Objective	Method	Key findings
Ha-Brookshire and Dyer, 2009	To look into the key determinants of import intermediary performance	Mail survey on 159 US-based wholesale companies	Market interpretation, sourcing and service capabilities had a positive influence on competitive advantages of products and services. Sourcing capabilities had negative impact on service advantage
Gogineni, Linn and Yadav, 2010	To address how agency costs behave over the complete ownership spectrum and to investigate the costs associated with the horizontal agency problem	Analysis of the data from FAME database, cross-sectional study	Within each ownership structure the costs are significantly higher when the firms are not managed by the owners. Agency costs are lower in companies with shared control of ownership. Horizontal agency costs are lower in firms where control is contestable. Bank monitoring has a positive and significant impact on the performance of private companies
Suwannarat, 2011	To test the impact of negotiation skills on the intermediary performance, proposed in a model by Peng and Ilinitch (1998)	Survey on 102 intermediary firms in Thailand	Negotiation skills have a significant positive effect on intermediary performance
Theingi and Purchase, 2011	To look into the influence of the exporter's and intermediaries' resources on the export performance	Survey on 320 SME's in Thailand	The companies in the high performing cluster use their resources to a greater extent. Developing marketing capabilities is not a substitute for export intermediary, but is important.