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Opportunities in Russia: Internationalization of Danish and Austrian Businesses

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**Opportunities in Russia:
Internationalization of Danish and Austrian Businesses**

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Abstract¹

Danish businesses appear to be less active in the emerging Russian market than those from other small economies in Western Europe. Therefore, this study surveys Danish and Austrian firms to compare their business activities in Russia, and factors in the home environment that may impact on this business.

The results show that Danish firms can draw upon less Russia-specific human capital and fewer expanding business networks. In particular, Managers have less experience ‘on the ground’, and Russian language skills are less developed in Denmark.

The study points to the importance of experiential knowledge in the internationalization process, not only for firms but for national economies. Policy to support East-West business may thus focus on the acceleration on partner-country specific learning processes.

Keywords: East-West Business, Internationalization Process, Market Entry, Russia, Denmark, Austria.

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Opportunities in Russia: Internationalization of Danish and Austrian Businesses

1. Introduction

Russia has emerged as a major partner for international business in the 1990's. Despite the financial crises of 1998, it can be expected that Russia will develop into a key market for West European businesses. Foreign investment in Russia accelerated from US\$ 700 million to US\$ 6.2 billion in 1997, temporarily overtaking even Hungary and Poland who became major destinations for business in the early 1990s (Meyer and Pind 1999).

The long-term potential of the Russian economy as market of 148.2 million potential customers, or as location for low cost production, is huge. So far, business is inhibited not only by the financial crises, but also by the legacy of the past, notably the undeveloped institutional framework. Yet businesses are positioning themselves for future growth in the next decade, when first-mover advantages are expected to pay off. Besides this, many businesses report profitable operations even during the current difficult times.

Russia offers opportunities for small and medium size businesses from small open European economies like Denmark and Austria. They can build on some historical relationships and geographic proximity, and may thus gain considerable competitive advantage in the long-term. However, to be able to build a strong position in the Russian market, they need to establish their businesses early, both by positioning themselves in Russia and by building Russia specific competence in their home base.

Over the past decade, companies from many countries have established operations in Russia, not only firms from the main players in the global economy, like the US, UK, Germany and France, but also from smaller European economies such as Belgium, Austria and Finland (table 1). Denmark, however, appears to be lagging behind. Foreign direct investment (FDI) reached only a cumulative total of US\$ 33 million in 1997. According to Russian statistics, Austria ranks third as source country for foreign investment in 1996 after the US and Germany, while Denmark is not in the top ten. Danish firms appear less present in Russia, with notable exceptions such as Dansk Tyggegummi (Dandy), Great Northern Telecom, Novo Nordisk and Danfoss. We have been able to identify about 75 Danish firms active in Russia, most contained on a list provided by the Danish embassy in Moscow. Yet 686 Austrian firms are reported to be active by the Austrian Chamber of Commerce.²

² Of these 686 companies, 446 companies have some kind of direct investment, whereas an estimated 220 firms have a representative office [Wirtschaftskammer Österreich: Aussenwirtschaft, Länderblatt Rußland L/30 März 1997, p. 7].

Table 1: Small West-European Economies and the Russian Market

Country	Direct Investment		Exports, mill.US\$		Firms with operations in Russia.
	cumulative stock	Share in FDI	1996	1997	
	million US\$, 1992-97, source country data	1996 Russian data			
Austria	110.0	6.7	2418	592	686
Belgium	221.6	1.8	1040	1077	n.a.
Denmark	32.9	< 0.7	652	743	ca. 75
Finland	178.9	< 0.7	1934	2367	n.a.
Sweden	n.a.	1.9	665	724	n.a.
Switzerland	192.6	5.2	310	345	n.a.

Sources: International Direct Investment Statistics Yearbook 1998 (OECD); Meyer and Pind [1998], Direction of Foreign Trade Statistics Yearbook 1997 (IMF), own estimates.

Why is it that Danish firms appear not to be taking full advantage of the new opportunities emerging in the East? In this paper, we analyse the national competitive advantages of Denmark and Austria with respect to business in Russia. We surveyed enterprises in Denmark and Austria, and asked them about their business activities in Russia, and their assessment of the Russian business environment and of selected aspects of their home business environment.

Austria is an interesting case to compare Denmark with, because these two economies are not only of similar size in terms of population and of GDP (Denmark US\$ 66.3 billion, Austria US\$ 76.9 billion in 1995) but they also have similar business structures. The economies are dominated by small and medium size businesses; inward foreign investors have an important role; and manufacturing contributes a major share to GDP (21% / 24%). Both economies can build on some historical relationships and business contacts in Russia itself, and both are very active in developing business relationship with their immediate Eastern neighbours, Poland and the Baltics for Denmark, and Hungary, Czech Republic and Slovenia for Austria. Yet both countries do not share a common border with Russia, and thus cannot benefit from local cross-border trade as for instance Finland can.

We start with a brief historical introduction. The next section introduces national competitive advantages as theoretical foundation of the study. Section four introduces the questionnaire survey. Section five presents the key results on the pattern of activity, and business assessments of country of origin effects and of the Russian economy. Section six interprets the findings and points to the internationalization process that small economies are going through when entering Russia. Section seven concludes with managerial and policy recommendations.

2. Historical Context

Danish business relationships with Russia were very extensive until the time of World War I. In 1914, Russia was the third most important export market for Denmark (after Germany and Sweden), especially for the shipbuilding, engineering and cement industry. Business flourished even during the war, and in 1917 the total of Danish investment in Russia was estimated at 400 million Danish kroner, equivalent to the annual budget of the Danish state [Jacobsen 1998]. With the revolution, Danish businesses in the Soviet Union were expropriated, with the notable exception of Great Northern Telecom [Jacobsen 1997]. During the cold war, Denmark has been exporting to the Soviet Union on small scale through the state trading agencies, accounting for less than 1% of Danish trade from 1918 to 1988.

Austrian business began internationalization later than other European economies. They focused on expansion within the Austro-Hungarian empire before WW I and on maintaining business relationships in the successor states thereafter. Russia entered the Austrian economy as occupying force in 1945. The Soviet command defined the firms in their zone as extraterritorial entities, took direct control, and exported most output and repatriated profits [Bellak 1998]. After regaining full sovereignty, Austria nationalized the basic industries and the banks as a means to regain control. Yet from the ten year period of partial Soviet occupation, Austria retained special business contacts with Russia, in addition to its historical relationships with its neighbours. A major share of East-West trade during the cold war was administered through neutral Austria, with the communist party and related entities as key intermediaries. Although Austrians may not cherish the memory, that period in history provided Austria with contacts and language skills that became valuable for business in the 1990s.

Both Danish and Austrian businesses expanded eastwards after the fall of the iron curtain. Austria reestablished business links with Hungary and other neighbouring countries and was at an early stage in 1990 the largest investor in the region [e.g. Meyer 1998]. Many small and medium size firms were quick to realize new opportunities while Austrian affiliates of MNE invested on behalf of their parent firms. Austrian businesses invest more than US\$ 500 million annually (table 2). However, Austrian investment did not grow in line with the acceleration of East-West business. Austria thus lost its lead position to Germany and the USA, in part because businesses focused on the integration with the EU after Austria became member in 1995 [Neudorfer 1997, Altzinger and Winklhofer 1998, Altzinger et al. 1998].

Danish investment increased in the 1990's reaching US\$ 250 million of new FDI in 1996. Businesses focused on countries around the Baltic sea, notably Poland and the newly independent Baltic states. This is for instance reflected in the portfolio of investment projects supported by the Danish Investment Fund for Central and Eastern Europe (IØ funden): 91 projects are in Poland, while the number of projects in Russia equals that of Lithuania: 18 [IØ 1998]. Frequently, Danish aim at the Russian market through their operations in the relatively more stable Baltic countries. Both, Austrian and Danish firms have entered the Russian market in a second stage of their

eastward expansion; and they committed far less investment capital - a wise precaution in view of recent macroeconomic events.

Table 2: Outward Foreign Direct Investment

in million US\$

	Denmark				Austria			
	1994	1995	1996	1997	1994	1995	1996	1997
Total FDI	4162	2969	2510	3240	1203	1046	1391	1437
FDI in CEE	48	197	247	n.a.	540	515	560	n.a.
FDI in Russia	0	3	6	24	7	5	10	74

Note: CEE does not include the CIS countries.

Sources: UNCTAD (1998, p. 367), correspondence with the Danish and Austrian National banks (3.2.98 / 20.5.98), Neudorfer (1997).

3. National Competitive Advantages

The pattern of outward FDI is determined by the competitive advantages of the businesses in the economy. Firms require ‘ownership advantages’ [Dunning 1978, 1993] to compete successfully in other countries, where foreign firms are at a natural disadvantage. Their ownership advantages are strongly influenced by the national competitive advantages of the country from which they originate. Characteristics of the national economy thus influence outward FDI via firms’ ownership advantages. Differences between Danish and Austrian outward FDI are thus a function of national aspects of their firms’ competitive advantages.

The concept of ownership advantages has been broadened since it was first introduced. In addition to various tangible and intangible assets of the firm, Dunning [1993, chapter 4] also considers advantages arising from combining multiple plants under common headquarters, and from the synergy of multiple international operations. To explain business with a particular partner country - rather than international production as such - we need to consider furthermore advantages of the firm related to the specific partner country, here Russia. These include firstly the knowledge of the Russian business environment, and secondly participation in business networks expanding to Russia.

Country-specific knowledge is a crucial competitive advantage because it improves the investment decision, and all subsequent strategic and operational decisions. Lack of information is a particular serious obstacle for small firms [Seringhaus 1987] because information is an indivisible resource, and small firms cannot spread its costs across a large volume of exports in the way that a large firm can. The information sought includes hard facts as well as *experiential knowledge* that can only be acquired through active involvement but not by reading blueprints or consultancy reports. Furthermore, the relevant information may be *confidential* and difficult to

verify, for instance concerning the strategies of key-host country players [Burke and Casson 1998]. Therefore it is crucial for international business to gain access to the most knowledgeable and reliable sources of information.

Beyond this, experiential knowledge, such as understanding of a foreign business culture, can generally best be obtained in the host country itself. Such knowledge forms part of the capabilities of the organization, or its individual members, that cannot be conveyed in codified form. Therefore, the first step of entry requires expensive search for information and transfer of experiences from different business context. Most firms then follow a path of gradual deepening of their commitment in foreign markets, in the line with their accumulation of experiential knowledge - a pattern known as the *internationalization process* [Johansen and Vahlne 1990]. The process occurs for starting business in general as well as for the entry into any new market. In this paper, we use the term internationalization process to refer to the process of entering a particular country, i.e. Russia.

Country-specific knowledge includes, in the case of Russia, the understanding of the specific business culture that has been formed during the Russian history, and amended by the socialist experience of the 20th century [Vlachoutsicos 1998]. It is the foundation of organizational culture not only in privatized, former state-owned firms but also in all other organizations in Russian society. In addition, the economic conditions and the developing legal and institutional framework pose specific challenges for unsuspecting newcomers [e.g. Thornton and Mikheeva 1996, Meyer and Estrin 1998]. Last not least, command of Russian language is considered essential for business success [Holden et al. 1998].

The survey study focuses on two aspects of knowledge: the access to information, and the managerial capabilities. They form part of ownership advantages that firms may possess with respect to Russia, and that are grounded in the institutions and capabilities in their home country.

Secondly, we focus on national and international business networks as a source of competitive advantages, especially for smaller firms. Business networks are long-standing relationships between legally independent firms, that exploit mutual complementarities and exchange information. They include for instance horizontal cooperation between firms developing joint marketing or distribution channels, as well as vertical supplier-customer relationships. Industrial networks are an important source of knowledge especially for smaller firms. Their interaction with partners is a major aspect of their learning process. Internationalization of a firm can therefore facilitate the international expansion of its network partners [Johansen and Vahlne 1990].

In many cases, major multinational manufacturers lead a business network of SMEs who act as their suppliers and distributors. The lead firm possesses core competences of the network, but its effective utilization of these competences also depends on the partners, creating a mutual dependence [Borras and Zysman 1998, Rugman and D'Cruz 1997]. An international expansion of the network may then be initiated by the lead firm, which is followed by its partners. Smaller

firms may thus internationalize to follow their customer, as observed for instance in the automotive supplier industry in Central Europe.

The ownership advantage, that permits competitiveness abroad, may in such cases reside in the business network rather than in the individual firm, as long as the firm is an essential contributor to the network. We therefore requested information about firms' network relationships and their impact on the internationalization decision.

4. The Survey Study

We surveyed Danish and Austrian businesses to develop a deeper understanding of business perspectives on both the Russian business environment, and the Russia specific capabilities in the firms' home environment. We chose to contact all firms that we could identify as being active in Russia, and for whom we could identify the necessary contact information. In this, we went beyond other studies in that we consider not only companies that have traditional FDI in the area but all that have any kind of international business activity.

A total of 50 Danish and 144 Austrian firms were contacted in May 1998.³ The questionnaire was translated into local language⁴ and send to key informants in the firms, as far as we were able to identify such persons. 62 completed questionnaires were returned, 32% of those send out. The return rate was 50% for Danish firms and 26% for Austrian firms.⁵ The difference reflects international experiences with cross-cultural questionnaire surveys,⁶ and may have been increased by more precise contact information for Danish firms.

³ The Danish firms are those for which details were provided by the Danish embassy in Moscow. The Austrian firms are those contained in a list by the Wirtschaftsforschungsinstitut Österreich of 686 firms active in Russia, and for whom contact details could be identified in the Austrian company guide published on CD by Austrian Telecom. Contact persons in the Danish companies have been identified in 'Kraks virksomhedsdatabase on CD' as responsible either for the former Soviet Union or for international investment. In some cases, the CEO was contacted.

⁴ The questionnaire was first designed in English and translated into German and Danish by independent translators and verification through backtranslation. As both authors understand all three languages, we are confident that the translations are precise. The questionnaire was send along with a cover letter containing a confidentiality statement, and a pre-paid return envelop. Respondents were offered a copy of the results if they included a business card with their response.

⁵ Of the letters to Austria, nine were returned with the post stamp "recipient moved". Deducting these, the actual return rate is 28,2%.

⁶ Return rates differ internationally due to, among other, cultural differences. On a systematic cross-cultural study on return rates, Harzing [1998] found Danish firms to return 42.1%, the return of all countries. Austrian firms completed only 19.0% of the questionnaires. Being aware of the different return pattern, we send Austrian sample firms a reminder fax, which led to additional returns. Altzinger and Winkelhofer [1998] obtained a return 16.8% for a similar study within Austria. By these comparisons, our return rates are more than satisfactory.

The respondents represent a variety of industrial sectors. Of 55 firms providing industry information, 36 are in manufacturing (13 of them consumer goods), 15 firms are in services (of which 6 in transport services) and 4 in construction. This includes many small and medium size firms, that have an important role in both economies (table 3). 30% of the responding firms indicated that they themselves were affiliated to a multinational enterprise located outside Denmark / Austria.

The questionnaire survey was complemented with interviews, most in informal settings, with business persons experienced in Russia. We draw on these interviews, where appropriate, when interpreting the survey evidence.

Table 3: The sample, by number of employees in the firms

	under 100	100-1500	over 1500	n.a.	total
Danish firms	21%	25%	42%	13%	24
Austrian firms	45%	18%	24%	13%	38
Total	35%	21%	31%	13%	62

5. Results

5.1. Business Activities of the sample firms

The firms in the sample are engaged in a variety of different business activities (table 4). The most common types of operations are import/export (47%), services (39%), and the establishment of sales offices (40%) or representative offices (37%). Austrian firms appear to prefer the former, whereas Danish firms prefer the latter type of office, which may reflect the earlier stage of their entry process. 11 firms (19%) have established production in Russia, and only five firms (9%), mostly Austrian, source raw materials in the region. Some of the Austrian firms in the sample have a very large exposure to the Russian market and sell more than half of the turnover in Russia (table 5). These firms appear to be established specifically to take advantage of East-West business.⁷

The technology employed in the Russian operation is at the same level as in the home country for half the responding firms (table 6). Almost as many firms employ a lower level of technology, some of which using considerably lower levels of technology. Three respondents (6%) indicated that the level of technology employed in Russia is actually higher than in the Western operations. Among the 11 firms with production in Russia, the same pattern emerged with all but one respondent indicating that they employed the same level or one level lower in Russia.

⁷ Similar firms from Denmark are identified by Riis (1998) and Tind (1999).

Table 4: Type of operations in Russia*in % of respondents*

	Austria	Denmark	Total
Import-export	51%	41%	47%
Consultancy	20%	5%	14%
Representative office	29%	50%	37%
Sourcing raw materials	11%	5%	9%
Sales subsidiary	49%	27%	40%
Production Subsidiary	20%	18%	19%
Service	40%	36%	39%
Other	11%	9%	11%

Note: Percentages do not add to 100% as the respondents could tick multiple options.

Table 5: Exposure to the Russian market*Turnover in Russia relative to total turnover*

	1-5%	5.1-20%	20.1-50%	50.1-100%	observations
Danish firms	43%	29%	29%	none	21
Austrian firms	36%	20%	20%	24%	25

Table 6: Level of Technology Employed in Russia

	+1	same level	-1	-2	-3	observations
Danish firms	5%	45%	30%	15%	5%	20
Austrian firms	7%	50%	20%	20%	3%	30

Note: The table indicates the difference of the responses to two questions on the level of technology employed firstly in Denmark/Austria and secondly in Russia. Both questions originally had a 5-point scale.

5.2. Sources of information

Firms were asked to what extent they experienced problems in obtaining information about business conditions in Russia prior to the engagement. On a scale from 1 (no problems) to 5 (very large problems), the average score of 3.0 indicates ‘some problems’. However, Danish firms report to have more problems in obtaining information (score 3.4) than their Austrian counterparts (score 2.7), and thus find themselves at a competitive disadvantage when considering entry in Russia..

To overcome their information barriers, firms use a wide array of sources [e.g. Burke and Casson 1998]. In our sample, almost all respondents indicated personal contacts as a source, and three out of four report business connections as important sources (table 7). This may imply that much of the information required is either of tacit nature, or highly confidential, and therefore difficult to obtain through official institutions. The institutions that provide information vary between the two countries. While the chamber of commerce is important in Austria, Danish firms are more likely to contact the ministry of foreign affairs, which provides information from and

contacts with Danish embassies abroad. One fifth of the respondents also used their bank to obtain information. We return to the role of banks below.

Table 7: Sources of Information

in % of respondents

	Austria	Denmark	Total
Personal connections	89%	91%	89%
Business connections	80%	73%	77%
Chamber of commerce	46%	5%	30%
Ministry of foreign affairs	14%	36%	23%
National bank	11%	none	7%
Other government agency	3%	none	2%
Banking connections	23%	23%	22%
Other	6%	14%	9%

Note: Percentages do not add to 100% as the respondents could tick multiple options.

5.3. Human Capital

a) Required Skills

The theoretical considerations in section 3 suggest that human resources specifically educated or experienced to work in the Russian business environment are important for the establishment of business relationships in the country. To verify this proposition, and to identify which kind of qualifications are particularly relevant, we asked firms to rank the importance of various qualifications for taking the decision to establish operations in Russia. Table 8 shows the results in two ways, the average rank assigned to each aspect, and the frequency with which respondents included an aspect in their ranking. The results indicate that the most important qualification is actual experience in doing business in the country. Having ‘worked with Russia and Russian for more than three years’ has been mentioned by twenty respondents who assigned it on average rank 1.8. Practical experience is thus considered more important than formal education. These responses lend support to the emphasis on experiential knowledge in the internationalization process model. This has implications for how one might think of accelerating foreign entry.

Table 8: Perceived Importance of Management Qualifications

	Average Rank			Number of Mentions		
	Danish	Austrian	Total	Danish	Austrian	Total
They have been working with Russia and Russians for more than 3 years	1.8	1.8	1.8	11	9	20
They speak Russian	2.7	2.0	2.4	7	7	14
They have lived in Russia for one year or more	2.7	2.4	2.6	7	5	12
They are having private visitors from Russia regularly	2.9	3.0	2.9	7	4	11
They have close personal friends from Russia	3.3	3.6	3.5	6	5	11
They are Russian expatriates	2.0	3.9	3.7	1	9	10
They have taken university courses which focus on doing business with Russia	4.2	5.5	4.8	5	4	9
They have relatives from Russia	4.3	5.0	4.8	3	5	8
They know the Russian partner from their university studies	2.6	3.5	2.9	5	2	7

Note: Respondents were asked to rank the importance that these qualifications had for the companies decision to invest in Russia. For each qualification, the table reports the average rank (most important = rank 1) and the number of respondents that included it in their ranking.

The second most important qualification, by rank and by number of mentions, is the command of the Russian language. Languages have an important role in multinational companies, that is often underrated by the leadership [Marschan et al. 1998]. They facilitate or inhibit the communication between individuals in different business units. While the leadership in headquarters and affiliates may adopt a common language, for Scandinavian companies frequently English, this language is often not used by middle management and shop floor employees. In extreme case this can lead to inability of expatriate managers to communicate directly with local employees, and can become a serious obstacle to organizational performance - as in the case of the joint-venture in Russia described by Michailova [1998]. Russian language skills are therefore widely seen as an essential qualification for managers based in Russia or communicating with a variety of institutions in Russia. However, we encountered also a view contrary to this:

‘Most important for international business is very good command of *English*, ... Local language skills are secondary. Most of the people we are dealing with - even in Russia - do speak good English’ (former vice-president, major Danish multinational firm).

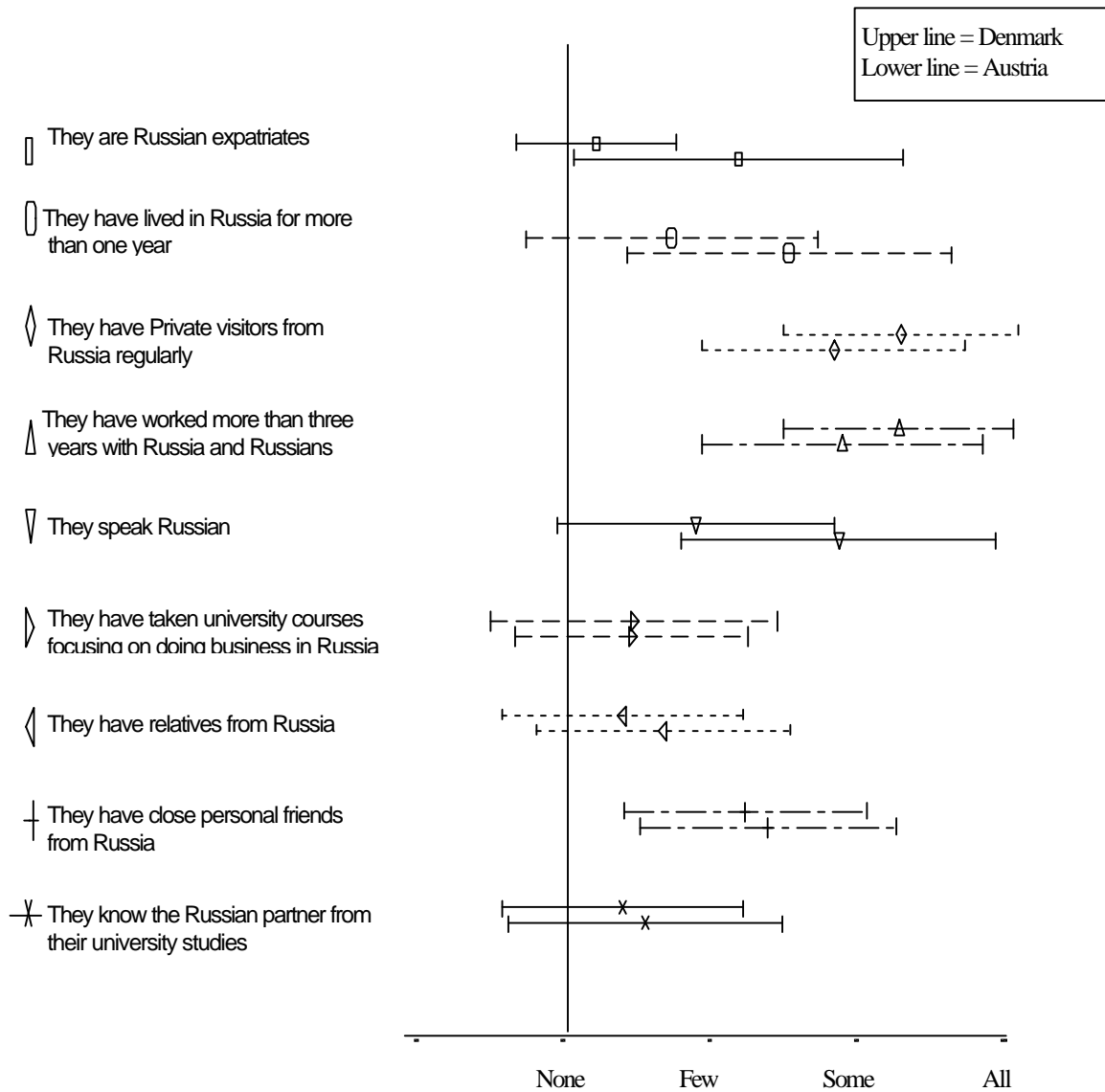
English is becoming the leading language of international communication in business as well as academia (this paper being example of the latter). Fluency in English is thus becoming a precondition for any successful international career. It is also basis for international trade, and for board-level international communication which the above citation primarily refers to. Yet English

is of limited use for running operations in the transition economies where skills in English do not match those of Scandinavia or Austria. The following citation illustrates this for a Latvian operation, yet similar conditions may occur throughout the former Soviet Union:

‘We were exposed to five languages every day. ... The official language of the authorities was Latvian, and 273 of the work force and the local managing director spoke Russian only. English was so to speak our working tool ... With some of the older employees and with our German suppliers we communicated in German, ... and amongst ourselves [the Danish expatriates], we obviously spoke Danish. The daily exposure to that many very different languages tends to keep ones linguistic ability on its toes, but the constant need for translation is of course very time consuming. I was very fortunate, however, my secretart and interpreter, a young Latvian girl, was simply a linguistic talent’ (Danish businessman with interests in St. Petersburg and the Baltics).

Next to experience in Russia and language skills, further personal and professional experiences are ranked. They give managers direct contacts with the country, or people from there, and thus permit some experiential learning. ‘Russian expatriates’ are very frequently mentioned by Austrian respondents, but only by one Danish respondent. Yet their influence is not ranked very highly. On the other hand, contacts dating from university are mentioned only by seven respondents, but ranked relatively highly by them. More intensive international student exchange may thus hold high potential for further business.

Figure 1: Qualifications of managers in charge of the Russian operation at HQ



Note: The graph illustrates the mean response +/- Standard Deviation

University courses are also mentioned by several respondents as a qualification, but they rank substantially below those criteria that provide managers with a direct contact with reality of

business in Eastern Europe. This should encourage educators to develop more applied courses on business with to Russia.⁸

b) Actual Skill Profile

The actual skill profile matches in part the profile of qualifications perceived to be important. Figure 1 presents the results of the survey, noting the mean and the standards deviation for each item, separately for Austrian and Danish respondents. Numerical results are contained in the corresponding tables in the appendix. Because of the small sample size, most standard errors are considerable, and we do not wish to attribute too much weight to small differences in means but focus on the major ones.

Figure 1 shows that most managers in charge of operations in Russia have experience from working with and in Russia for at least three years, in both Austria and Denmark. Equally high is the incidence of managers with private contacts.

However, for some criteria the qualifications differ substantially between the two countries in our sample, notably for language skills. Whereas a high proportion of Austrian managers speak Russian, only few Danish firms can draw on such expertise: 63% of Austrian firms state that some or all of their managers speak Russia, while the corresponding proportion for Danish firms is 20% (appendix, table A1). Also, Danish firms employ fewer Russian expatriates and they have fewer managers who have lived in Russia. 83% of Danish firms have no Russian expatriates, and 58% have no managers who lived in Russia. In reverse, Danish respondents indicated more frequently private visitors and personal contacts. These are weaker modes of learning about the Russian environment, and we interpret this as default option that was given higher weight when more tangible options did not apply. Thus Austrian managers are ahead with respect to relevant experiential knowledge and language skills.⁹

Beyond the top management, we requested an assessment of managers in the company (figure 2), and of university graduate in the country (figure 3). Naturally, managers are rated higher, especially with respect to those criteria that require a practical business experience and thus experiential knowledge. By these criteria, understanding of the Russian business environment and of the culture and society, Austrian managers appear to be substantially better qualified than Danish managers.

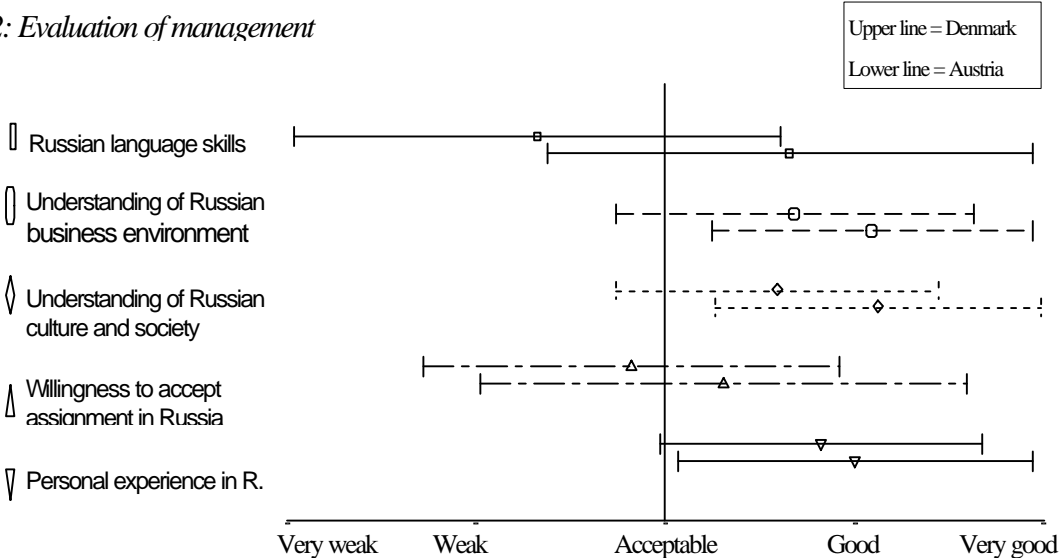
Language skills are on average in the ‘acceptable’ range for both managers and students, which implies that some firms are satisfied while others are not. However, respondents again report that far more persons in Austria speak Russian, both among managers and among university

⁸ For our own efforts see <http://www.econ.cbs.dk/institutes/cees/edu/cindex.html>

⁹ The differences in the Danish and Austrian responses are statistically significant, see appendix 1. One of the reasons for good Russian skills in the generation of the now about 50-year olds in Austria is that in the Russian occupied zone in 1945-1955, high school students had to study Russian language to achieve their Matura (high school graduation).

graduates. Many Austrian respondents rated Russian language skills as good or extremely good: 59% said this about managers and 27% about graduates. Only 18% of Danish managers and 6% of Danish graduates received this evaluation (tables A2 and A3). Similar differences emerge for the understanding of Russian culture and society: Austrians received good or very good grades for managers by 81% of respondents for students by 39%, while Danes received these scores only for 55% of managers and none (!) of the Danish respondents gave this compliment to university graduates.

Figure 2: Evaluation of management



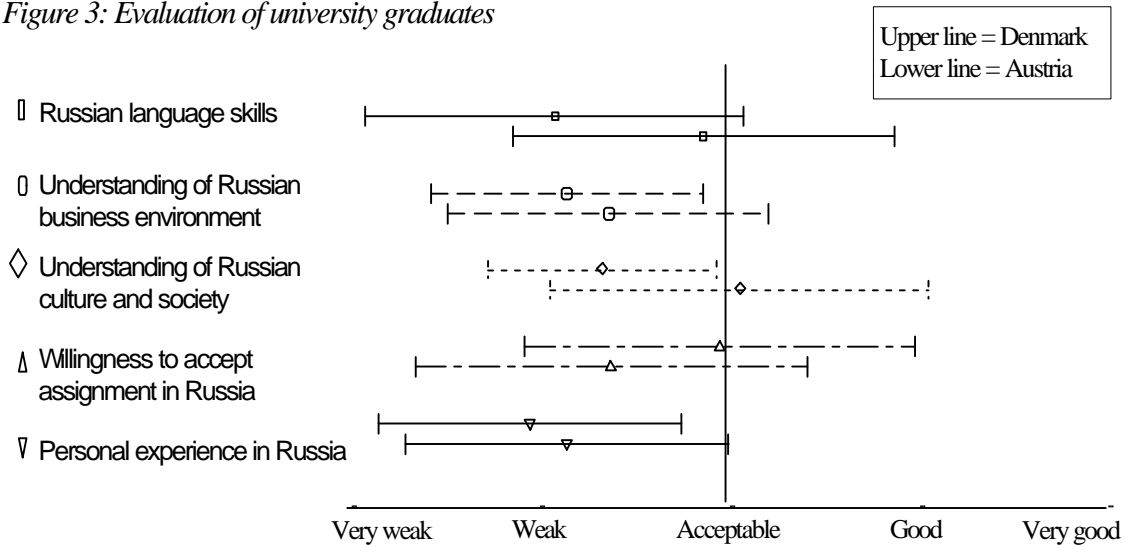
Note: The graph illustrates the mean response +/- standard deviations

The only criterion in favour of Danish graduates is their greater willingness to accept an assignment in Russia, which may be an achievement of the high degree of (outward) internationalization of Danish higher education. 27% of Danish respondents gave graduates good or very good by this criterion, compared to only 8% of Austrians.

In summary, the survey of human capital in Denmark and Austria suggests that

- ❑ Practical experience and language skills are considered the most important forms of country specific expertise.
- ❑ Danish managers and graduates are less well prepared than their Austrian counterparts to engage in business in Russia.
- ❑ Russian language skills are a particular area of concern, not only but especially in Denmark.

Figure 3: Evaluation of university graduates



Note: The graph illustrates the mean response +/- standard deviation

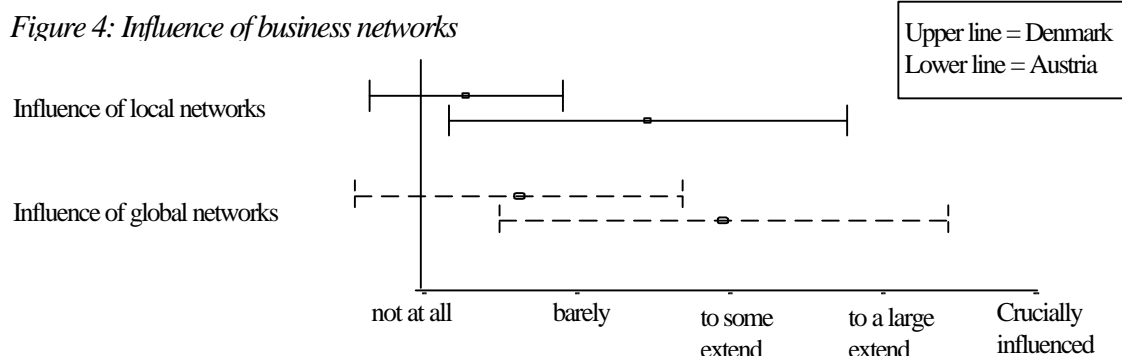
5.4. Business Networks

Business networks in which a firm participates can influence its process of entry abroad by providing information from business partners, and by initiatives involving several members of the network. We therefore asked about the importance of networks in the firms' decision process. Almost half the respondents replied that networks had no impact at all, while the other half indicated a smaller role (figure 4, table 9). Only 13% reported an important or even crucial role, although the sample contains many small and medium size firms. However, we were surprised to find very large differences in the pattern between Danish and Austrian respondents. Since Danish firms are known to operate in industrial clusters, we expected a stronger impact of networks on internationalization. Yet noone (!) indicated to be influenced to a large extent by networks, and only one Danish respondent attributed a crucial influence to the networks.

The data were therefore further analysed by differentiating the results by firms size, but no substantive differences emerged, except that larger firms are more likely to refer to their global networks rather than local ones. The country differences in table 9 can thus *not* be explained by differences in the size structure of the subsamples (table 3). One interpretation is that Danish business networks have not yet expanded to Russia, such that they do not yet encourage internationalization on that direction. However, this aspect requires further research.¹⁰ If the

¹⁰ The activities of business associations in Denmark, for instance organizing joint trade fairs, could be included as network activity. However, we presume that the question as it was posed in the questionnaire was not understood as include them.

pattern is confirmed, then Danish businesses may be foregoing major opportunities to gain from sharing experiences and from complementarities in international business.



Note: The graph illustrates the mean Mean +/- Standard Deviation

Table 9: The Impact of Business Networks on the Investment Decisions

	not at all	barely	to some extend	to a large extend	crucially influenced	observa- tions #	Mean score
	0	1	2	3	4		
<i>Partners in a local network</i>							
Danish firms	82%	9%	9%	-	-	22	0,3
Austrian firms	31%	23%	23%	15%	8%	26	1,7
<i>Partners in a global network</i>							
Danish firms	67%	14%	14%	-	5%	21	0,6
Austrian firms	24%	19%	10%	33%	15%	21	2,0

Note: t-test for the test of equality of means are significant at 1% level for both local networks and global networks.

A particular important business partner for many small and medium size firms is their bank. One in five respondents reported banks as an important source for information (see above). To what extend do banks then also provide funding for projects in Russia? The most important source of finance are internal resources, which reflects the high risk often associated with the business (table 10). The use of bank loans differs between Austrian and Danish firms as two fifth of the former but only one fifth of the latter use them.

Austrian banks have expanded very rapidly eastwards in the 1990s and may thus be better placed to support Austrian businesses in the region. Asked for a recommendation as banking partner, Danish respondents often mentioned an international bank (e.g. from Germany), while Austrians were more inclined to name a bank from their own country. Danish firms are relying more on governmental programs, such as the Investment Fund for Central and Eastern Europe (IØ 1998), which aims at overcoming the lack of Russia specific expertise in the financial sector.

Table 10: Main sources of financing Russian operations

	Austrian	Danish	Total
Internal resources	88%	95%	91%
Bank loan	36%	20%	30%
Private loan	9%	5%	8%
EBRD	6%	5%	6%
Governmental program	6%	15%	9%
Other source	12%	10%	11%

Note: Percentages do not add to 100% as the respondents could tick multiple options.

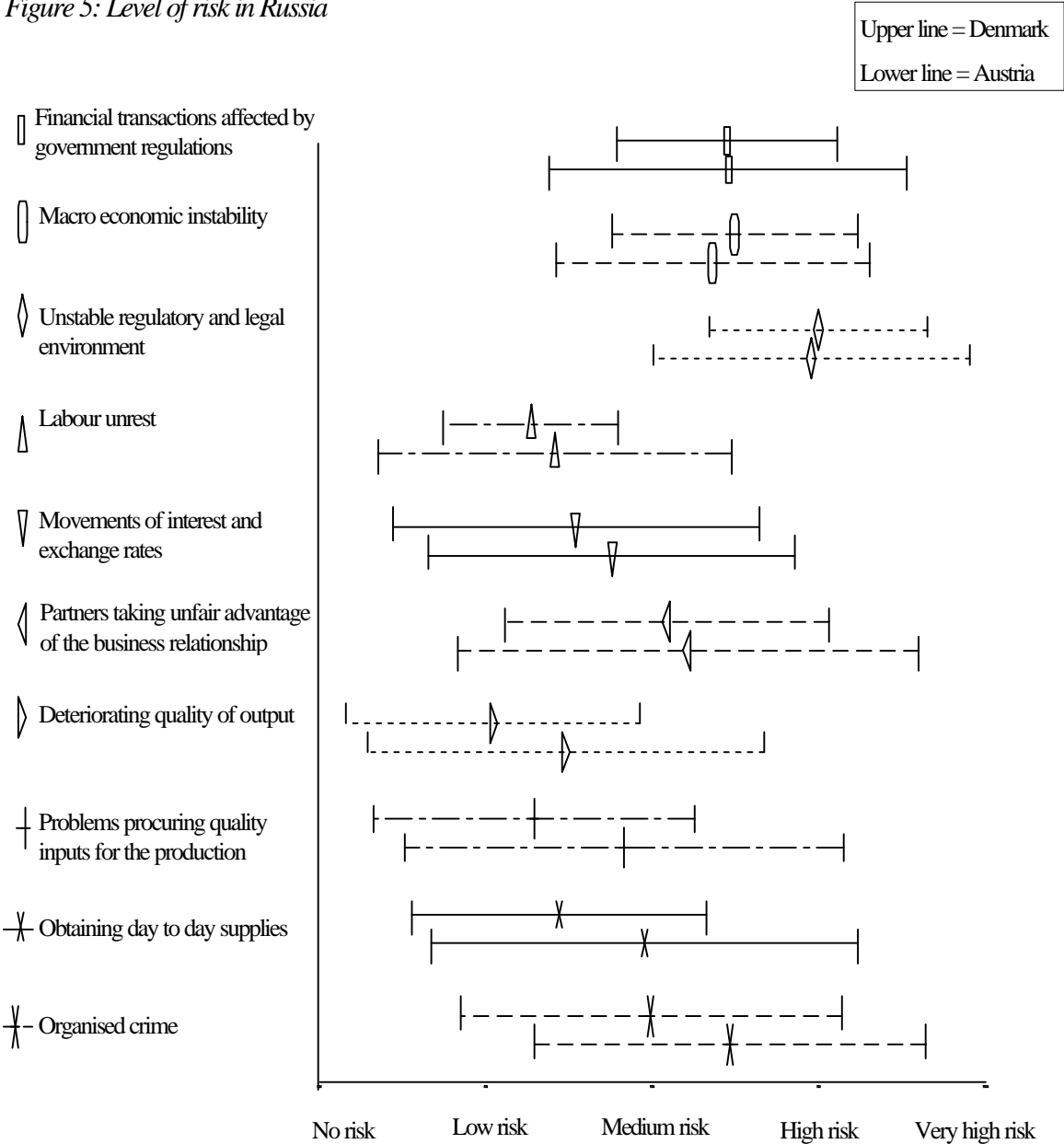
5.5. Assessment of the Russian business environment

Despite substantial differences in their business pattern and in their experiences, the respondents from Denmark and Austria provided very similar assessments of the Russian business environment. Asked about the attraction of Russia for their business, respondents rated it with an average score of 2.3 which is between ‘attractive’ and ‘average attractive’.

The attraction of Russia as a business partner is however greatly hampered by the high risk associated with the country. In the autumn of 1998, the macroeconomic risk hit the headlines after the financial crisis in August and September. Our survey was conducted in May, at a time when the sustainability of the exchange rate policy was debated in economists’ circles, and may have already influenced the perceived business risk. Nevertheless the highest score was given to microeconomic and institutional factors, not to the macroeconomic situation.

The highest risk arises from the ‘unstable regulatory and legal environment’. In Russia, local, regional and central governments frequently change laws that affect businesses. In addition, laws lack clarity and are implemented inconsistently, or even corrupt (e.g. Thornton and Mikheeva 1996, Leitzel 1997). The relationships between businesses and officials thus become cumbersome:

Figure 5: Level of risk in Russia



Note: The graph illustrates the mean responses +/- Standards DeviationMean

“Jeg forsøger at være åben over for alle de officielle instanser, der kommer og inspicerer. Fortæl, hvad vi gør galt, så retter vi det, siger jeg til dem. Problemet er, at der så kommer forskellige folk fra de samme instanser, og de fortolker lovgivningen forskelligt. De forsøger alle at fortolke den på den måde, så *de* kan få penge ud af dig” (Søren Rasmusen, Emborg Foods, Moscow, in *Berlingske Tidende* [1998]).¹¹

Particularly sensitive to such regulatory uncertainty are ‘cross border financial transactions’. This concern proved to be well founded as the freezing of financial assets and the constraints on capital export at the onset of the financial crises showed. Related to the weak legal and institutional frame are two further aspects that are considered high risk: ‘organized crime’ and ‘partners taking unfair advantage of the business relationship’.

Macroeconomic stability ranks third among the risk factors. The option on ‘inflation and exchange rate movements’ which also implies macroeconomic sources of risk, received an even lower score. In an earlier study on investors’ perception of risk in transition economies, Lankes and Venebles (1996) found macroeconomic instability and regulatory risk being rated highest, with intermediate scores for transfer risk and expropriation risk, and the lowest score for labour unrest. Apparently, the legal and regulatory concerns have increased in the past three years.

Table 11: Risk Factors influencing the Investment Decision

	Austrian	Danish	Total
Cross border financial transactions being affected by governmental interference	50%	38%	44%
Macro-economic instability	25%	25%	25%
Risk arising from unstable regulatory and legal framework	56%	63%	59%
Risk due to movements of interest and exchange rates	25%	6%	16%
Risk of partners taking unfair advantages of the business	13%	13%	13%
Risk of deteriorating quality of output	6%	6%	6%
Risk of problems with procuring inputs of western quality	6%	6%	6%
Risk of problems with obtaining regular day to day supplies	13%	none	6%
Risk due to organised crime	13%	25%	19%
Risk of labour unrest	none	none	none
Other type of risk	none	13%	6%

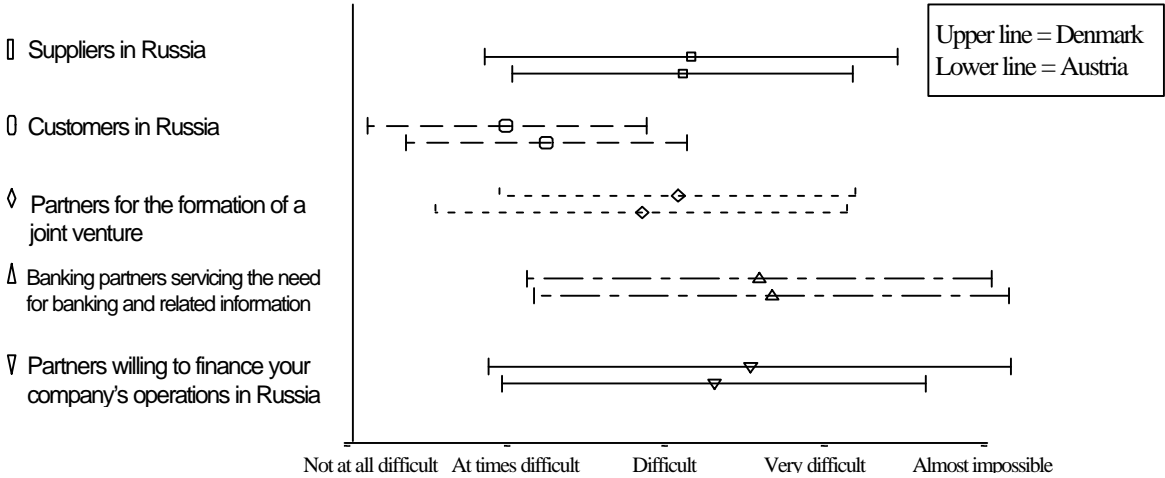
Note: Percentages do not add to 100% as the respondents could tick multiple options.

¹¹ Translation: “I try to be open for all the official institutions, who come on inspections. Tell us what we are doing wrong and we will correct it, I tell them. The problem is that different people are coming from the same institutions, and they interpret the law in different ways. They try to interpret the law in such way that *they* can get money out of you”.

However, which of these risks actually affect business strategies, and which of them are simply perceived as ‘background noise’? Table 11 shows that the institutional factors affect business for more than the macroeconomic uncertainty. Two in five respondents adjusted investment decisions due to the unstable regulatory and legal framework, compared to only one in four adjusting due to macroeconomic risks.

We content that also in the autumn of 1998, after the financial crises, the microeconomic and institutional factors are a prime concern for Western businesses. The financial crises and the subsequent devaluation as such would lead only to a temporary setback of FDI flows, as in East-Asia (UN 1998). However, the attraction of business in Russia is severely hampered by the slow

Figure 6: How difficult has your company found it to find the following in Russia?



Note: The graphs illustrates the mean response +/- Standard Deviation

institutional development. This is probably one of the most important differences between Russia and other emerging markets. Yet for those who understand the context of Russian business, it still holds promising opportunities:

“Man kan undre sig, hvor ordet russisk roulette stammer fra? Ét er i hvert fald tilfældet: at handle med Rusland er ikke let. Men de, *der forstår at begå sig dér*, har udsigt til gode handler, og på længere sigt vil dette kæmpemæssige marked for alvor tage fra - og så er det om at være der!” (Ole Christoffersen, chefkonsulent, Det Danske Handelskammer [Christoffersen 1998]).¹²

¹² Translation: “One can wonder about the origins of the word ‘Russian roulette’. One thing is for sure - to do business in Russia is not easy. Yet those *who know how to get around there*, can expect some good deals, and in the long run the huge market is going to take off - and then it is important to be there”.

Figure 6 shows a different obstacle to business in Russia: the lack of suitable partners. Customers are plentiful, though their purchasing power may be weak. Yet it is difficult to identify local firms with whom to form a joint-venture or who can supply raw materials and intermediate goods at acceptable levels of quality and reliability [as also found in Meyer 1998, chapter 5]. Personal contacts are still very important in Russia, and it is important to know a partner well before committing an major investment in the business relationship, or the formation of a joint-venture.

Even poorer ratings are given to financial services by respondents from both Denmark and Austria. This, together with the low proportion of projects financed through bank loans, suggests that there is a major need for the development of the Russian banking system and the operation of Western banks in the country.

6. Interpretation: National Internationalization Processes

Taking the various empirical results together, they illustrate an internationalization process at a national level. The internationalization process, which Johansen and Vahlne [1977, 1990] describe for firms, evolves with stepwise commitment to a foreign market, according to their learning about the local environment and the accumulation of knowledge.

National economies learn in similar ways as knowledge is exchanged to a high degree between firms within an industrial or regional cluster. Especially small and medium size enterprises draw upon the expertise in the local economy and its supporting institutions when considering a commitment to a foreign market. This leads to a gradual deepening of the international business by an industry from a given country (also see Luostarinen 1978).

The internationalization process model can in this form explain the entry of Danish and Austrian businesses in Russia. Firms take their decisions over entry into Russia based on knowledge and contacts that *they, or other partners in the home economy*, have. The relevant Russia-specific knowledge is often experiential and therefore difficult to communicate between unrelated partners. Other knowledge may be highly confidential or difficult to verify and can therefore only be obtained if a high level of trust relates the partners (Burke and Casson 1998). Trust is however higher within small communities, and for instance higher between two Danes than between a Dane and local consultants. The existing knowledge-base within a community therefore influences the commitments that members of the group make to the foreign market, which in turn promotes further learning.

This leads to a cumulative process of knowledge acquisition and deepening of the business. Since it is *experiential knowledge* that is essential in this process, it can only to a limited extent cross the boundaries of organizations, and of (national) industrial clusters. The process is reenforced by the evolution of national business networks. One partner may enter a foreign market, and draw its partners along as local turnover grows. While global multinationals may be able to tap into several clusters and networks, small and medium-size firms are to a large extent part on the internationalization process of their national economy.

Institutions, like embassies, chambers of commerce or industrial associations, can provide certain kinds of information, including some confidential information. They can also take introductory initiatives, for instance by organizing trade fairs. They too 'learn' primarily from the businesses they work with and which are from their own country. Therefore, they too reinforce the national element in the internationalization process.

Austria had a favourable starting position with respect to the Russian market for two reasons:

- Austria occupied an essential role in the East-West trade during the cold war, which - albeit small - equipped Austrian businesses with contacts and human capital valuable for business with Russia. The Danish-Russian business has been interrupted for too long, since 1917, to provide a similar impetus (except for Great Northern Telecom).
- Austrian businesses have expanded more actively into the nearby transition economies after 1989, which permitted a learning process and transfer of experiences to business further East.

From this basis, Austria could soon build a *critical mass* of business with Russia. This critical mass implies that knowledge on Russia is so widespread that the entry process becomes self-reinforcing. Having reached a certain threshold level, it becomes profitable for support services, e.g. banks or chambers of commerce, to invest in partner-country-specific expertise. This expertise then greatly facilitates the entry of further firms, accelerating the process of firms entering Russia. Early entrants thus draw other businesses after them, especially those in their own business networks. This process was strengthened by multinational firms locating in Vienna who both benefit from and contribute to Vienna as hub for business with Central Europe and further East.

7. Implications

7.1. The West

Danish businesses stand at early stages of their internationalization process in the Russian market. Having fewer recent historical relations than Austria, Denmark has so far not build a comparable base of business expertise in Russia. Yet, the expansion of Danish-Russian business is a cumulative process of investment and knowledge acquisition (notwithstanding temporary setbacks like the loss of business by Danish exporters after the Russian crises of August 1998 [e.g. Riis 1998, *Børsen* 1998]).

The *main objective* for governmental institutions as well as for businesses in Denmark - or any other small economy - should thus be to *accelerate the knowledge accumulation process*. Since Russia will be an attractive market in the medium to long term, they should now take initiatives to build a relevant expertise to benefit from future opportunities. Specific measures to facilitate this process may include:

- ❑ Organization of meetings (workshops, export-missions) that facilitate the exchange of experiences between businesses. This takes place currently for instance in the Danish ‘Baltic Sea Network’.
- ❑ Expansion of cooperation between Danish and Russian institutions, for instance in the fields of management training and student exchange.
- ❑ Support of the development of Russia-specific expertise in the financial sector.
- ❑ Facilitation of experience transfer from Danish operations in Poland and the Baltic states to Danish businesses establishing business operations in Russia.
- ❑ Encouragement of the study of Russian language. Opportunities exists, yet few students currently choose a Russia specialization.

7.2. Russia

Our survey points to the broad nature of obstacles to international business in Russia. They include weaknesses of the human capital as well as the institutional framework. Managers and employees in transition economies have to close the knowledge gap with the West, which requires intensive learning. As for international business, it is primarily experiential knowledge they need to acquire [Swaan 1997]. In other words,

“Don’t spend all your money on consultancy reports ... they have too many of them already .. go there and work *with* the people, achieve results together ... that’s what they need” (Danish businessman with interests in St. Petersburg and the Baltics).

The prime concerns of Western business partners relate however to microeconomic structures and institutions, which confirms similar results in earlier studies on Russia. The policy implication thus is that Russia has to advance its microeconomic transformation from plan to market. Crucial in this process are the development of market-based institutions and a consistent and stable legal framework. This will support the development of both local and foreign businesses. Until this happens, international businesses will limit themselves to short-term profit opportunities and to toe-hold strategies, but restrain from the commitment of larger amounts of capital.

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Appendix 1: Statistical Tables

Table A1: Qualifications of managers in charge of the Russian operation at HQ

	None		Few		Some		All		total	Mean		StD		signif.
	A	DK	A	DK	A	DK	A	DK		A	DK	A	DK	
They are Russian expatriates	41%	83%	13%	11%	34%	6%	13%	--	50	3,2	2,2	1,1	0,5	0,00
They have lived in Russia for one year or more	25%	58%	18%	16%	36%	21%	21%	5%	47	3,5	2,7	1,1	1,0	0,74
They are having private visitors from Russia regularly	8%	--	24%	20%	44%	30%	24%	50%	45	3,8	4,3	0,9	0,8	0,89
They have been working with Russia and Russians for more than 3 years	10%	5%	20%	5%	40%	48%	30%	43%	51	3,9	4,3	1,0	0,8	0,94
They speak Russian	13%	38%	25%	43%	25%	10%	38%	10%	53	3,9	2,9	1,1	0,9	0,23
They have taken university courses which focus on doing business in Russia	68%	76%	21%	10%	7%	5%	4%	10%	49	2,5	2,5	0,8	1,0	0,55
They have relatives from Russia	54%	75%	29%	15%	14%	5%	4%	5%	48	2,7	2,4	0,9	0,8	0,74
They have close personal friends from Russia	18%	19%	32%	43%	43%	33%	7%	5%	49	3,4	3,2	0,9	0,8	0,81
They know the Russian partner from their university studies	67%	75%	19%	15%	7%	5%	7%	5%	47	2,6	2,4	0,9	0,8	0,78
Other reasons	--	--	--	33%	--	33%	100%	33%	4.0	5.0	4.0	--	1.0	--

Note: signif = level of significance of a t-test of the equality of means of the Austrian and Danish sub-samples.
(0,00 = very low probability of error in saying that 'the mean is different')

Table A2: Evaluation of management

	Poor		Unsatisfactory		Acceptable		Good		Extremely good		total	Mean		StD		signif.
	A	DK	A	DK	A	DK	A	DK	A	DK		A	DK	A	DK	
Russian language skills	6%	32%	16%	32%	19%	18%	25%	9%	34%	9%	54	3,7	2,3	1,3	1,3	0,00
Understanding of Russian business environment	--	5%	--	5%	30%	23%	30%	55%	39%	14%	55	4,1	3,7	0,8	0,9	0,11
Understanding of Russian culture and society	--	--	6%	9%	12%	36%	45%	41%	36%	14%	55	4,1	3,6	0,9	0,9	0,03
Willingness to accept assignment in Russia	9%	9%	18%	36%	30%	23%	18%	27%	24%	5%	55	3,3	2,8	1,3	1,1	0,14
Personal experience in Russia	--	--	9%	9%	15%	18%	42%	55%	33%	18%	55	4,0	3,8	0,9	0,9	0,46

Note: signif = level of significance of a t-test of the equality of means of the Austrian and Danish sub-samples.

Table A3: Evaluation of university graduates

	Poor		Unsatisfactory		Acceptable		Good		Extremely good		total	Mean		StD		signif.
	A	DK	A	DK	A	DK	A	DK	A	DK		A	DK	A	DK	
Russian language skills	8%	38%	31%	25%	35%	31%	23%	6%	4%	--	42	2,8	2,1	1,0	1,0	0,02
Understanding of Russian business environment	15%	19%	42%	50%	35%	31%	8%	--	--	--	42	2,3	2,1	0,8	0,7	0,37
Understanding of Russian culture and society	4%	6%	31%	56%	27%	38%	35%	--	4%	--	42	3,0	2,3	1,0	0,6	0,01
Willingness to accept assignment in Russia	24%	7%	28%	27%	40%	40%	4%	20%	4%	7%	40	2,4	2,9	1,0	1,0	0,10
Personal experience in Russia	25%	33%	42%	40%	29%	27%	4%	--	--	--	39	2,1	1,9	0,9	0,8	0,48

Note: signif = level of significance of a t-test of the equality of means of the Austrian and Danish sub-samples.

Table A6: How difficult has your company found it to find the following in Russia?

	Not at all difficult		At times difficult		Difficult		Very difficult		Almost impossible		total	Mean		StD		signif.
	A	DK	A	DK	A	DK	A	DK	A	DK		A	DK	A	DK	
Suppliers in Russia	4%	5%	32%	37%	21%	16%	36%	21%	7%	21%	47	3,1	3,2	1,1	1,3	0,09
Customers in Russia	22%	32%	38%	41%	34%	23%	6%	5%	--	--	54	2,3	2,0	0,9	0,9	0,31
Partners for the formation of a joint venture	15%	8%	33%	23%	15%	31%	26%	31%	11%	8%	40	2,9	3,1	1,3	1,1	0,58
Banking partners servicing the needs for banking and related information	8%	12%	25%	12%	4%	24%	17%	12%	46%	41%	41	3,7	3,6	1,5	1,5	0,87
Partners willing to finance your company's operations in Russia	9%	20%	26%	7%	13%	20%	30%	7%	22%	47%	38	3,3	3,5	1,3	1,6	0,66
Other partners	50%	--	50%	--	--	--	--	--	--	--	2	1,5	--	0,7	--	--

Note: signif = level of significance of a t-test of the equality of means of the Austrian and Danish sub-samples.

Table A4: To which extent did the establishment in Russia by partners of your business network, influence your company's decision to establish operations in Russia?

	Not at all		Barely		To some extent		To a large extent		Crucially influenced		total	Mean		StD		signif.
	A	DK	A	DK	A	DK	A	DK	A	DK		A	DK	A	DK	
Partners in your local Network	31%	82%	23%	9%	23%	9%	15%	--	8%	--	48	2,5	1,3	1,3	0,6	0,00
Partners in a Global Network in which your company participates	24%	67%	19%	14%	10%	14%	33%	--	14%	5%	42	3,0	1,6	1,5	1,1	0,00

Note: signif = level of significance of a t-test of the equality of means of the Austrian and Danish sub-samples.

Table A5: Please estimate the level of the different types of risk influencing your company's operations in Russia

	No risk		Low risk		Moderate risk		High risk		extremely high risk		total	Mean	StD	Mean	StD	Mean	StD	signif.
	A	DK	A	DK	A	DK	A	DK	A	DK		Austria	Denmark	Total				
Cross border financial transactions being affected by government regulations	3%	--	18%	9%	32%	41%	29%	50%	18%	--	56	3,4	1,1	3,4	0,7	3,4	0,9	0,99
Macro economic instability	4%	--	11%	9%	46%	41%	29%	45%	11%	5%	50	3,3	0,9	3,5	0,7	3,4	0,9	0,58
Risk of problems arising from unstable regulatory and legal environment	--	--	9%	5%	23%	9%	37%	73%	31%	14%	57	3,9	1,0	4,0	0,7	3,9	0,8	0,85
Risk of labour unrest	17%	5%	49%	68%	20%	27%	9%	--	6%	--	57	2,4	1,1	2,2	0,5	2,3	0,9	0,50
Risk of losses due to movements of interest and exchange rates	14%	18%	31%	36%	26%	27%	26%	14%	3%	5%	57	2,7	1,1	2,5	1,1	2,6	1,1	0,48
Risk of partners taking unfair advantages of the business relationship	11%	5%	26%	24%	23%	38%	14%	29%	26%	5%	56	3,2	1,4	3,0	1,0	3,1	1,2	0,70
Risk of deteriorating quality of output	28%	32%	25%	42%	25%	21%	19%	5%	3%	--	51	2,4	1,2	2,0	0,9	2,3	1,1	0,14
Risk of problems with procuring inputs to the production of western quality	21%	25%	21%	35%	27%	30%	18%	10%	12%	--	53	2,8	1,3	2,3	1,0	2,6	1,2	0,09
Risk of problems with obtaining regular day to day supplies	18%	15%	21%	40%	21%	35%	30%	10%	9%	--	53	2,9	1,3	2,4	0,9	2,7	1,2	0,09
Risk due to organised crime	9%	5%	12%	35%	21%	35%	42%	10%	15%	15%	53	3,4	1,2	3,0	1,1	3,2	1,2	0,16
Other type of risk	--	--	27%	44%	73%	44%	--	--	--	11%	20	2,7	0,5	2,8	1,0	2,8	0,7	0,89

Note: signif = level of significance of a t-test of the equality of means of the Austrian and Danish sub-samples.