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**Internationalization of Dutch  
SME to Russia, Case: MPC Indus-  
tries B.V.**

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## ABSTRACT

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This thesis was commissioned by a Dutch company MPC Industries, specializing in the production of clamps and fixing devices. Currently the company has plans to enter the Russian market, but lacks information about the market and the country's special requirements. The purpose of the paper was to provide MPC Industries with the basic information regarding the Russian market of the devices manufactured by the company, as well as offer an optimal mode of entry.

The theoretical part of the thesis is based on the Dunning's Eclectic Framework of internationalization, which proposes that an overseas expansion of firms is mediated by three factors: ownership specific advantage, location specific advantage and internalization advantage. For analyzing all these aspects, the author used the VRIO framework, PEST analysis and Porter's Five Forces.

The methodology of the thesis includes qualitative and quantitative methods. In the qualitative part, the author researched secondary sources and in the quantitative section the structured interview was applied. Based on the acquired information an optimal method of entry was proposed.

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## LIST OF SYMBOLS

% - percentage

CETOP - European Fluid Power Committee

FCS - Federal Customs Service

GDP - gross domestic product

GDP (PPP) - gross domestic product (purchasing power parity)

JV – Joint Venture

MNE – Multinational Enterprise

MW - megawatt

OLI - Ownership, Location, Internalization advantages

PEST analysis - Political, Economic, Social, Technological

R&D – Research and Development

SA – Strategic Alliance

SME – Small and medium size enterprise

USA – United States of America

USSR - The Union of Soviet Socialist Republics

VAT – Value added tax

VRIO analysis – Value, Rarity, Imitability, Organization

# 1 INTRODUCTION

The thesis is written for a Dutch SME called MPC Industries B.V. which operates at many European markets and wants to exploit opportunities in other countries. This paper should provide the company with information about threats and opportunities it might face at Russian market.

## 1.1 Brief history and description of the company

MPC Industries was established in 1981 as a subsidiary of the Swedish firm Hjalmarson en Soner under a name of Jalmarson Continental BV. It separated from the parent company in 1986 and after several takeovers it became independent again in 1994. Nowadays the firm consist of approximately 50 employees and has branches in different European countries including Britain, Sweden, Germany, Poland, France, Italy and others. (MPC Industries.)

## 1.2 Product range

MPC Industries designs and produces hose clamps and alike products for fixing hoses, pipes and other objects (MPC Industries B.V. n.d.). Hose clamps are used particularly in any industry. Depending on the type and size, clamps can be applied in households for fixating a hose to a tap or in oil and gas industries for repairing pipelines and mounting heavy equipment (MPC Industries B.V n.d.). The company offers eight hundred standardized clamps. One of the simplest and most widely used product is a worm gear clamp (see Picture 1 Worm gear clamp). Its utilization is ranged from washing machines to wind turbines (MPC Industries B.V n.d.). The other device, which is called superclamp (see Picture 2 Superclamp), is similar to the usual worm gear clamps but it is designed for heavy and stiff high-pressure hoses.



*Picture 1 Worm gear clamp*



*Picture 2 Superclamp*

MPC also produces other clamps, which have different specific applications, and calls it special clamps. For example, OKD clamp (see Picture 3 OKD clamp) is designed explicitly for the air and liquid tubing. ( MPC Industries B.V. n.d.) Also, MPC Industries produces pipe couplings (see Picture 4 Pipe coupling), which are used for connecting and repairing pipes (Industries n.d.).



*Picture 3 OKD clamp*



*Picture 4 Pipe coupling*

### 1.2.1 Accumulator clamp

An accumulator clamp (see Picture 5 Accumulator clamp), is the other kind of fixing equipment that MPC produces. It is a product which is specifically designed for the hydraulic industry. To be more precise, it is used for mounting



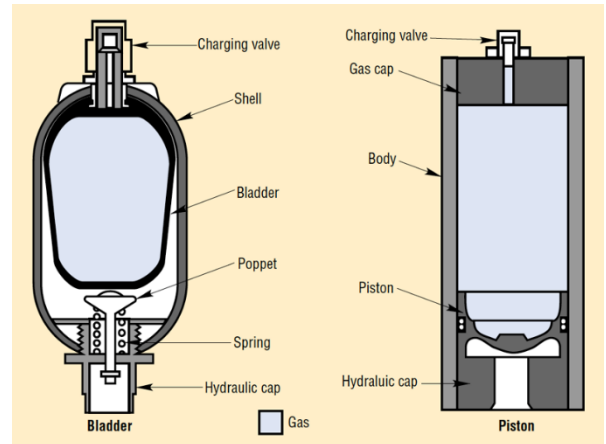
*Picture 5 Accumulator clamp*



*hydraulic accumulators* (see Picture 6 Hydraulic Accumulators) - a special device that is applied in many hydraulic systems. It is used for storing hydraulic energy, dumping pulsations, avoiding damages due to sudden stops in the hydraulic circuit, intensifying the power in the system, and maintain pressure in the same level of pressure in systems in general.



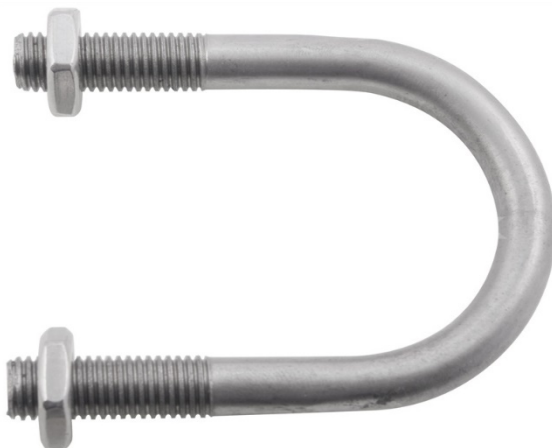
Picture 6 Hydraulic Accumulators



Picture 7 Accumulators' structure

There are four kinds of hydraulic accumulators. However, nowadays only two of them, bladder and hydro-pneumatic piston types, are mostly applied. Although there are some technological differences between them, they both perform the same function of storing hydraulic energy, which means that there is a high pressure inside the devices. Therefore, an accumulator's shell cannot be modified or

reshaped since it might lead to its deterioration and, consequently, an explosion due to instant release of high pressure. As a result, the only way to fix the device is to use special equipment.



Picture 8 U-bolt

In general, all the accumulators have a cylindrical shape regardless the type (see Picture 7 Accumulators' structure). Hence, they all are mounted either with accumulator clamps (see Picture 5 Accumulator clamp) or u-bolts (see Picture 8 U-bolt).

MPC Industries is specialized on producing accumulator clamps. The company perceives this type of brackets as more reliable and convenient for mounting and dismantling the accumulators.

### 1.3 Research task

At present moment MPC is striving to expand to untapped foreign markets. Currently it seeks opportunities for entering Russia. The firm's management supposes that the best product for initial market entry is the accumulator clamp.

Since MPC Industries lacks the knowledge of the country's culture, language, legal and political systems the company cannot choose a right approach for entering Russia. Hence, the task of this research is to provide the company with information about Russia and advise an optimal entry mode to Russian market.

To accomplish this task, the researcher should answer the following questions:

- What kind of skills, resources and capabilities does MPC Industries have?
- What are the propertities of accumulator clamps market in Russia?
- What are political, legal, sociocultural and economical environments in Russia?

## 2 THEORITICAL BACKGROUND

### 2.1 Description of entry modes

Companies have a wide variety of options of expanding internationally. Scholars still do not agree on certain classification of the foreign entry modes (Brouthers & Hennart 2007, 397). However, for a better understanding of available options, it is possible to categorize all the entry modes into three categories: exporting modes, intermediate modes, and hierarchical modes (Hollensen 2012, 215-216).

#### 2.1.1 Export modes of entry

Export is the most used method for primary international expansion (Hollensen 2012). It is widely accepted since it allows to avoid high costs and gives a company opportunity to gain international experience (Hill & Hult 2015, 378).

It is possible to distinguish two types of export: direct and indirect. The latter one is arranged with the help of exporting agents that have skills, knowledge and assets for delivering product to overseas markets. The direct export is accomplished by omitting intermediaries and serving customers from abroad or via firm's own sales subsidiaries in the host countries. (Johansson 2008, 131-132.)

Although this entry mode is inexpensive and provides the company with international experience, in some cases it is not feasible to use it. For instance, export might be economically insufficient due to extra costs of transporting products and tariff barriers set by the host country. Besides, this mode gives particularly no control over marketing and distribution activities, what limits the company from comprehensive implementation of its strategies. (Hill & Hult 2015, 379.)

## 2.1.2 Intermediate modes of entry

### **Licensing**

Licensing involves granting rights for using the firm's intangible property, such as technological know-how. In return, licensee should pay fees to the licensor. (Hill & Hult 2015, 380.)

The advantage of licensing is that this entry mode helps to overcome governmental restriction towards foreign companies, which increase costs and make the company less competitive. Besides, the absence of knowledge about a foreign market becomes less relevant since licensee can be responsible for marketing and distribution. (Johansson 2008, 159-160.) However, at the same time, it might lead to excessively fast dissemination of the company's know-how and consequently decreasing the value of its firm-specific resources. (Johansson 2008, 159-160.)

### **Contract manufacturing**

Using this entry mode, the company outsources production to the host country's partner. Contract manufacturing provides the entrant with ability to focus on marketing and R&D activities. (Hollensen 2012, 228.) Besides, in case the contractor is not satisfied with the contractee performances, it can find another manufacturer. On the other hand, the absence of control over production processes demands establishing quality verification instruments, otherwise poor products might adversely affect firm's performances. (Hollensen 2012, 230.)

### **Strategic Alliances (SA)**

Strategic alliance is a non-equity based union between foreign and local companies established for achieving certain goals. This type of market entry is relatively new and has already become quite prominent. The main reason for the alliances' acceptance is the possibility to reach foreign markets without significant investments and time-consuming development of relationships and channels. (Johansson 2008, 163-164.)

Apart from fast market reach, scholars identified other reasons for alliances existence. The first one is high costs of R&D (Research and Development) that one MNE (Multinational Enterprise) cannot cover, so it should find a partner for sharing the expenses. The second reason stems from the need to efficiently coordinate the resources between international markets. (Dunning; Lundan 2008, 282.)

### **Joint Ventures (JV)**

Joint ventures can be defined as an equity-based long-term alliance in which both partners have substantial enough shares that allow them influencing important decisions (Dunning; Lundan 2008, 269).

JVs are established for different reasons. In some cases, this entry mode is required by the regulations posed by a host government. In other cases, JV might be the optimal option for entering foreign market in terms of production and transaction costs. (Dunning; Lundan 2008, 279.)

#### 2.1.3 Hierarchical mode of entry

### **Wholly Owned Subsidiaries**

The main reason for establishing wholly owned manufacturing subsidiaries is to get access to cheaper raw materials and work force, avoid tariff barriers or to tailor product to the local needs. Besides, unlike in case with other modes of entry, the firm has a total control over its know-how and threat of copying is minimal. At the same time, a wholly owned subsidiary is associated with high costs and risks. (Johansson 2008, 166.)

The establishment of wholly owned subsidiaries can be done in two ways. The first one is called greenfield venture and it involves building production facilities from the scratch. The second way is an acquisition of already established enterprises. Both ways have their pros and cons. (Hill & Hult 2015, 387.)

Acquisitions are preferred because it is possible to quickly capture a share at the market. Unlike in case with greenfield venture, there is no need to build factories

and establishing distribution channel for generating income. (Hill & Hult 2015, 387.) Besides, when the firm purchases another company in the host country, it not only enters the new market but also eliminates one of the competitors. The other argument in favor of acquisitions is that it is less risky. Acquiring an already established business, the firm gets assets that already generate revenues and profits, while in case with green ventures it is hard to predict financial performances. (Hill & Hult 2015, 387.)

Despite all the pluses of acquisition, they often fail to increase profits of the firm. Firstly, there is a risk of overpaying for a purchased company. Secondly, it may be not successful due to cultural issues emerged in the process of acquisition. Thirdly, the differences in business approaches and viewpoints might lead do disagreements and delays merging two companies. (Hill & Hult 2015, 388.)

Unlike acquisitions, greenfield ventures usually cost more and it is associated with greater risk. However, on the other hand, it is easier and less expensive for the company to establish new rules and culture in the recently established subsidiary rather than changing it in the already acquired company. (Hill & Hult 2015, 389.)

## 2.2 Dunning's Eclectic Framework

Economists and international business academics established several theories which are used for explaining an optimal entry mode choice (Andersen 1997, 28). Since it is impossible to apply all of them to the research, it was decided to use The Eclectic Framework, also known as Dunning's OLI paradigm, since it is the most comprehensive model that includes all possible factors that might influence the entry mode.

OLI paradigm is comprised of such theories of MNE as international trade theory, resource-based theory and transaction cost theories (Andersen 1997, 34).

OLI paradigm suggests that three factors influence an entry mode: ownership-specific advantage (O), location-specific advantage (L) and internalization factor (I) (Andersen 1997, 34).

### ***O-specific advantage***

Ownership specific advantage refers to the company's assets and capabilities that form competitive advantage. This part of the paradigm is grounded on the resource-based theory, accordingly to which the firm can outcompete its rivals only in case it obtains a stronger competitive advantage than other companies. OLI paradigm, borrowing this idea, posits that the organization can be successful in foreign markets only in case it has a greater competitive advantage than the local competitors.

Accordingly to the Dunning, the stronger the ownership specific advantage of the firm, the greater the chances that it will engage in foreign market entry. Besides, this aspect effects the entry mode that the company chooses: the firm tends to select more hierarchical types of foreign market entry if it has stronger O-specific advantage.

It is possible to distinguish different categories of the ownership-specific advantages. The first one, intangible asset advantages ( $O_a$ ) include product innovations, accumulated knowledge and managerial, financial, marketing, and international experience etc. (Dunning; Lundan 2008, 100.) The second type, transaction cost-minimizing advantages ( $O_t$ ), refer to the ability of a firm to effectively coordinate diverse and geographically wide-spread activities. Institutional assets ( $O_i$ ) refers to the formal and informal institutions in the company that might effect value-added processes in the company. (Dunning; Lundan 2008, 100.)

### ***L-specific advantage***

Location-specific advantage (L) is the second factor and it describes the attractiveness of a certain foreign market in terms of size and growth rates of markets, costs and quality of the country's factor endowments, policies of host governments. (Dunning; Lundan 2008, 101.)

### ***I-specific advantage***

The “I” letter in OLI acronym stands for internalization advantage. This factor is concerned with optimizing transaction costs and choosing an optimal degree of internalization. (Dunning; Lundan 2008, 103.)

Since it is hard to evaluate this factor even in the qualitative terms it is not included into the research.



### 3 FRAMEWORK FOR CHOOSING ENTRY MODE.

The framework for choosing the entry mode is based on the OLI-paradigm. There are three factors that influence the entry mode choice, two of which (O-advantage and L-advantage) were chosen for identifying optimal type for MPC.

#### 3.1 Internal environment evaluation

O-specific advantage refers to the company's internal resources and capabilities. It includes many aspects, ranging from the firm's physical assets to the company's marketing and financial experience, thus it might be quite complicated to assess MPC's ownership advantage. However, scholars singled out the most important aspects that influence the way companies enter the foreign markets. For instance, firms tend to adopt more hierarchical modes when they are more *internationally experienced*. (Pinho 2007, 727.) The other factor related to the ownership-specific advantage that significantly affects the entry mode is the ability to *innovate and create differentiated products*. Positive correlation between this aspect and hierarchical modes of entry was identified. (Nakos & Brouthers 2002, 56.) *The size of the firm* is also a major indicator of the amount of resources available to the company. So, the bigger the company, the greater the possibility that the firm chooses a hierarchical mode of entry. (Hollensen 2012, 206).

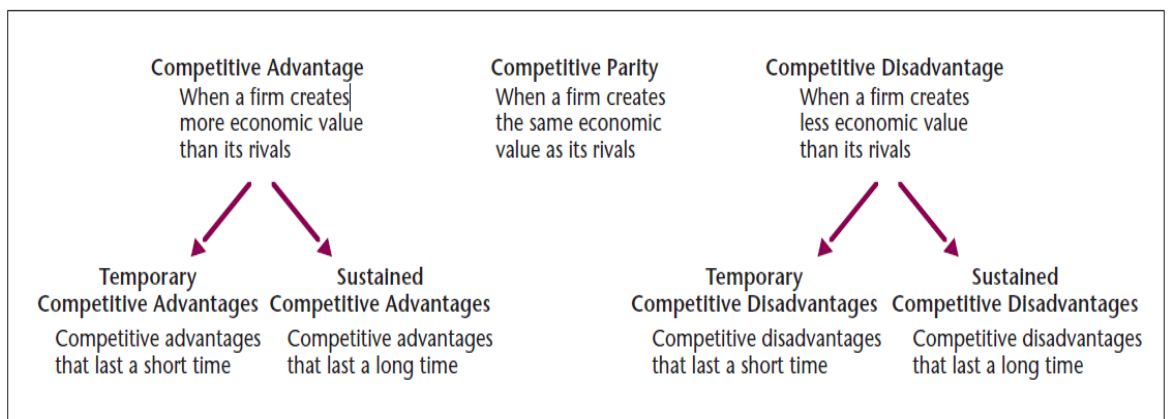
Grounding on that information it is necessary to answer the following questions:

- Does MPC have enough international experience to enter Russian market?
- Does MPC manufacture highly differentiated and competitive product or is it a commodity-like good that can be easily duplicated and substituted?
- Is MPC big enough and has sufficient resources to start operating in Russia?

As it was mentioned earlier the O-specific advantage of the firm is linked to the resource-based theory. Therefore, for researching this aspect it is necessary to

use a tool that can assess the firm's competitive advantage. A method for evaluating this aspect is called VRIO framework. VRIO evaluates company's internal resources from four perspectives: value, rarity, imitability and organization. (Barney & Hesterly 2015, 88.)

Accordingly to the scholars who established resource-based theory and created VRIO framework, a strategic goal of the firm is to obtain competitive advantage (Barney & Hesterly 2015, 26). Competitive advantage is the ability of the firm to "create more economic value than its rival firms" (see Picture 9 Competitive advantage) (Barney & Hesterly 2015)(Barney & Hesterly 2015)(Barney & Hesterly



Picture 9 Competitive advantage

2015)(Barney & Hesterly 2015)(Barney & Hesterly 2015)(Barney & Hesterly 2015). There are two types of competitive advantage: temporary and sustained. The difference is that the former one is available for the company only for a short amount of time. However, not all the companies manage to achieve competitive advantage, and get only competitive parity, which means that the firm produces as much economic value as competitors. If firms accumulate less economic value than rivals, then they suffer from competitive disadvantage, which also can be temporary or sustained. (Barney & Hesterly 2015, 31.)

To establish competitive advantage, resources should be valuable. For telling valuable resources from others, it is necessary to answer the question: "Do resources and capabilities enable a firm to exploit an external opportunity or neutralize an external threat?". If answer is positive, then resources are valuable. (Barney & Hesterly 2015, 89.)

Next important aspect of the resources is its rarity. If capabilities of the firm are valuable but not rare, then a company cannot obtain competitive advantage but instead achieves competitive parity. For assessing rarity, it is necessary to clarify how many competing firms already have them. It is hard to state definitively how many competitors should have the same resources, so it is no longer rare. It depends on the industry and type of the business. (Barney & Hesterly 2015, 93-94.)

If resources are only valuable and rare, the company still can reach only temporary competitive advantage. To obtain sustained advantage a condition of imperfect imitability should be met. To rephrase, it means that resources should be sophisticated and expensive enough that competitors cannot easily copy them. To understand whether resources are hard to imitate or not it takes to answer the question: "Do firms without a resource or capability face a cost disadvantage in obtaining or developing it compared to firms that already possess it?" (Barney & Hesterly 2015, 95.)

To complete assessment of the company's resources, it is necessary to evaluate *organizational aspect*. In other words, it takes to understand whether the firm can exploit full potential of the owned resources or not. The company's ability to use capabilities at the maximum capacity, depends on how well formal reporting structures, management control systems, formal and informal management control systems operate. A question "Is a firm organized to exploit the full competitive potential of its resources and capabilities?" helps to understand whether the organization uses its resources in and optimal way. (Barney & Hesterly 2015, 100-101.)

### 3.2 External environment examination

The second factor, L-specific advantage, has a significant effect on the entry mode selection. For example, the government's actions in the political and economic environment might be unpredictable to a certain degree. The higher the unpredictability of the actions, the higher the investment risk for the foreign companies. *When the firms assume that the country's environment is risky, it tends to commit less resources and select non-hierarchical modes.* (Hollensen 2012, 208.) The

other aspect of location-specific advantage that influences the entry mode is *the market size, growth and competition intensity* (Hollensen 2012, 208-209). It was proven that the larger the size of the market, the higher the probability of choosing equity entry modes (Pinho 2007, 728). On the other hand, the greater the competition at the market, the less the chance that a firm chooses the equity entry mode (Hollensen 2012, 209.)

Grounding on that information, for identifying the most suitable entry mode, it is necessary to answer the following questions:

- Is Russia stable enough country to establish a wholly-owned subsidiary or is it necessary to use entry mode that demand less commitment?
- Is hydraulic accumulators' market large enough for MPC Industries?
- How high the competition intensity at the market?

All the above-mentioned L-factors can be distinguished into two groups: general environment and task environment aspects. General environment in this paper refers to the country's political, economic, technological and sociocultural aspects, while task environment factors indicate industry's characteristics that might influence the entry mode of the firm.

### 3.2.1 General environment research

For investigating risks that MPC might face in Russia PEST analysis is the most appropriate tool. PEST stands for the political/legal, economic, socio/cultural and technologic analysis (Hollensen 2012, 165).

Investigating political and legal situation in Russia, it is necessary to describe what kind of import restrictions, tax controls, labor restrictions, and nationalization threat the government pose to foreign firms (Hollensen 2012, 122).

The economic analysis will include general description of economic situation in Russia by examination of the key economic indexes. Apart from economic parameters it is necessary to understand the level of institutional environment in Russia.

Technological analysis is meant to evaluate technological advancement of the country. In case of this study, technological analysis is mostly devoted to evaluating Russian hydraulic industry and industries where hydraulics is applied, because the commissioner is specifically interested in them.

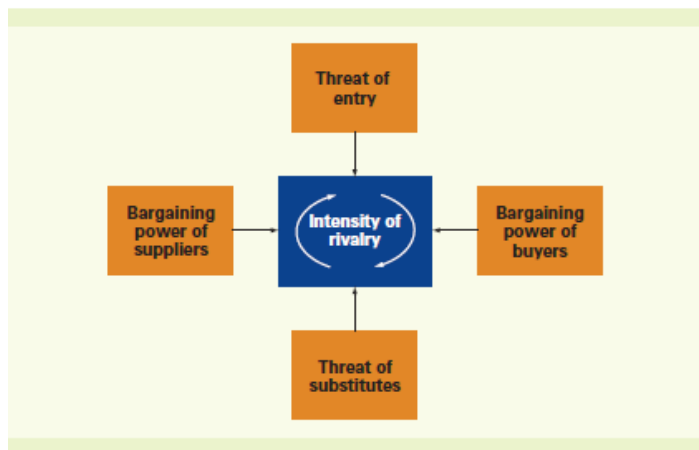
Social factors include the cultural aspects and health consciousness, population growth rate, age distribution, career attitudes and emphasis on safety. High trends in social factors affect the demand for a company's products and how that company operates. In case of MPC Industries, this factor does not significantly impact the business of commissioner, thus it is omitted by the author.

### 3.2.2 Task environment research

The second part of external research is concerned with the evaluation of the accumulator clamp market and hydraulic industry in Russia. Accordingly to OLI paradigm, two aspects of the market should be evaluated: market size and competitive structure.

Market size can be defined as sum of sales performed at the present moment. Competitive structure is "the number and size distribution of incumbent firms in an industry" (Hill 2008, 36).

The task environment refers to the specific characteristics of an industry incumbents such as competitors, suppliers, customers, and producers of substitute products (see Picture 10 Five Porter's Forces). For evaluating these aspects, it is necessary to apply Five Porter's Forces model. It is a comprehensive tool that helps to assess competition intensity in the industry (Hill & McShane 2008, 25)



Picture 10 Five Porter's Forces

The Porter's model posits that the company's performance is influenced by five competitive forces: threat of entry, bargaining power of buyers, bargaining power of suppliers, and the intensity of rivalry between that are already in the industry (Hill & McShane 2008, 29-30.)

**Threat of entry** refers to new companies that plan to enter the industry. They might gain a market share and resources, decrease prices, and, consequently, lower the profits of existing players. The degree of this threat depends on the barriers to entry. The higher the barriers, the lower the chance that new companies enter the industry. (Porter 1980, 7)

The first barrier is an *economy of scale*. Economy of scale means that the higher the number of units the company produces, the lower the cost per item. If there is a firm in the industry that produces in large quantities, the newcomers should manufacture in the same amounts, what puts the firm at a bigger risks and makes it harder for the new entrants to start the operations. (Porter 1980, 7) The other barrier for the entry is *product differentiation*. This term denotes that the firm's brands are widely known and customers are loyal to it. Since, products of recently appeared companies are unfamiliar to consumers, they are less likely to buy them. This aspect might also be an obstacle for the entering the industry. The other barrier is a *capital requirement*. It means that the firm should make a significant and risky investment. Since not all the companies have necessary resources, they are not likely to enter the industry. *Switching costs* is another barrier for new entrants. This term refers to the costs that a firm should bear to switch from supplier to

another. The companies that would like to start operating in the industry might face problems with *accessing distribution channels*, which can be another obstacle for them to start making profit. Usually all the existing channels are already occupied by the existing firms and new ones are not welcomed, so there is a necessity to persuade the distributors to sell its product. Another challenge that the new entrant has to deal with is the fact that existing firm might possess *cost advantage*, which is not available to the company that wants to do business in the industry. This advantage can be expressed in the form of proprietary technology, access to the raw materials, favorable locations, government subsidies, learning experience curve (in some industries unit costs decline as employees learn to manufacture goods in a more efficient way). The last obstacle is the *governmental policies* that protect incumbent firms from new competitors. For instance, for entering certain industries it is necessary to obtain licenses and other legal documents.

**Intensity of Rivalry** refers to the competition intensity among existing firms. Depending on certain factors the intensity of rivalry might vary from “warlike” to “polite”. (Porter 1980, 18)

The first factor is *the presence of large number of the firms in the industry or the fact that they possess equal competitive advantage*. For instance, when there are many companies at the market the probability that some of the players might start competing more forcefully is greater. In case there are several equal companies in the industry they might start fighting for the scarce resource, what might affect increase a competitive pressure. (Porter 1980, 18) The second factor is the *slow industry growth*. The market grows not fast enough, the companies start to fight with each other for the existing market shares instead of increasing profits by serving new customers.(Porter 1980, 18.) The other factor stems from *absence of differentiation or switching costs*. When the product is perceived as commodity and a customer chooses a good only with accordance of the price, the competition in the industry is more likely to be tougher.(Porter 1980,19.) *High fixed or storage costs* might lead to a more intense rivalry, since the firms are forced to fill the capacity, which results in the price escalation (Porter 1980, 18). The last factor is *high exit barriers* or, in other words, various aspects that prevent the firm to leave a business. Exit barriers high fixed costs of exit (labor agreements, resettlement

costs), specialized assets (machinery for producing specific goods), government and social restrictions. When these obstacles are high, capacity abundance does not leave the industry for a long time, what leads to a more severe competition.(Porter 1980, 20-21.)

**Threat of the substitute product** denotes a possible competitive pressure from the products that are not identical with the original good but performs the same function and satisfies the same need. The substitute products should be at the greater scrutiny if they tend to cost lower than original product or manufactured by high profit industries. (Porter 1980, 24)

**Bargaining power of buyers** refers to the ability of the buyers to force down prices and increase competition in the industry. Buyers are strong in the following conditions:

- *When they large quantities of goods*
- *The product is undifferentiated*
- *Small switching costs*
- *It earns low profit*
- *Buyers have an ability for backward integration*
- *Industry's product does not affect the buyer's goods quality*
- *The buyer has full information concerning the product (price, demand, production costs) (Porter 1980, 24-26.)*

**Bargaining power of suppliers** denotes the ability of the suppliers to increase the prices for the materials and reduce the quality of goods. Bargaining power of suppliers is high under the following conditions:

- *Few suppliers sell to buyers from fragmented industry*
- *Absence of substitute products*
- *The industry in not an important customer to the supplier*



- *The suppliers' good is an important part of the buyer's product*
- *The supplier enjoys switching costs or differentiated its product*
- *The supplier has a potential for forward integration (Porter 1980, 27-28.)*

## 4 RESEARCH METHODOLOGY

It is possible to pursue three different research strategies. The first one, quantitative research strategy, refers to the collection and analysis of numerical data for investigating relationships between different concepts (Given, 2008, 713). Using a quantitative research, a researcher usually applies such methods as structured interview (social survey), structured observation and content analysis. The second strategy, which is called qualitative research, is bothered with analyzes of words and narratives rather than numbers (Bryman & Bell 2011, 27.) Qualitative strategy offers such methods as ethnography observation, qualitative interviews (both unstructured and semi-structured), focus groups and desk research. (Bryman & Bell 2011, 68.) The third strategy, mixed-methods research, might be applied. As the name suggests, it implies a usage of both qualitative and quantitative strategies in one research. (Bryman & Bell 2011, p.628.) In this thesis the author applied the last of the three strategies. Such methods as, structured interview and secondary data analysis were applied.

Structure interview or survey is a typical form of interview, in which questions are very specific and provide a respondent with limited number of answers. This kind of survey is applied when a quantitative strategy is pursued because the standardized questions and answers allow a researcher reliably measure a chosen concept. (Bryman & Bell 2011, p.202)

The secondary data analysis means exploring and interpreting relevant research papers, reports, articles in specialized journals and magazines. The sources that used for the analysis might significantly vary depending on the information that is necessary for the study. (Alvin C. & Bush 2013, p. 74)

### 4.1 The structured interview

The purpose of the survey was to obtain information regarding competition intensity that MPC Industries might face in Russia. Accordingly to the Porter's Forces framework competition consists of two elements: *threat of substitute product* and

*rivalry intensity*. Correspondingly, the questionnaire was designed to gather information regarding existing MPC's competitors and substitute product for accumulator clamps at the Russian market.

MPC Industry's product is widely applied in hydraulic industry. Hydraulic equipment is used particularly in every branch of machine-building industry. It means that the number of the potential respondents is abundantly high for the researcher to process. However, the commissioner was particularly interested in companies of heavy-duty vehicles, petroleum, wind power, and hydraulic industries. Therefore, the population of the survey consisted of firms from this sector.

The survey was firstly sent via email to the companies but only three of them answered the questionnaire. After that the author conducted by the telephone.

Based on MPC Industries' demands, the author identified 70 companies that became a sample for a survey. Since all these companies represent different industries and have diverse business specialization, the questions could not be formulated identically for all the firms. For a higher consistency of the questionnaire, all the respondents were divided into two groups. The first group includes the companies that *manufacture, sell and use the accumulators as component in the machinery*. This group is represented by large firms that produce wide range of various hydraulic components, including the accumulators, and provide complicated hydraulic solution. The second group includes the firms that *distribute and/or use the accumulators as a component in their machinery*. This category is a rather broad one and consists of small companies that produce simple hydraulic equipment and large firms that use hydraulic devices as components for more complicated machines such as heavy-duty vehicles.

The purpose of the survey was to find out prospect MPC Industries' competitors and substitute products at the Russian market, so the questions for the both groups were aimed at getting that information.

The questions for the accumulator manufacturers were the following:

Question	Answer options
Do you sell/use the fixing appliances for hydraulic accumulators?	1.) U-bolts 2.) Accumulator clamps
What kind of fixing appliances do you produce the most?	1.) U-bolts 2.) Clamps
Does your company produce the fixing appliances or buys it from the third companies?	1.) Produce by ourselves 2.) Purchase from the third firms 3.) I do not know
Do you buy the fixing appliances from foreign or local company?	1.) Foreign company 2.) Local company 3.) I do not know
Please, write the name of the company which sells you hydraulic accumulators.	Blank space for the answer

*Table 1 - Questions for accumulator manufacturers*

The questions for the end-users:

What kind of fixing appliances do you mostly use?	1.) U-bolts 2.) Clamps
If you use other fixating equipment, write its name here	Free answer
Do you use fixating equipment produced by the hydraulic accumulator manufacturer or by the third company?	1.) Produced by the same company 2.) Produced by the third company

	3.) Produce by ourselves
Do you use the fixating equipment produced by local or foreign company?	1.) Local company 2.) Foreign company 3.) I do not know
Please, write the name of the company that supplies you with the fixating equipment	Free answer

*Table 2 - Questions for end users*

Unfortunately, the author did not manage to collect enough data for conducting valid statistical analysis. The lack of gathered data is associated with reluctance of the respondents to answer the questions and lack of time for conducting the survey. Nevertheless, the collected information provides a general understanding of Russian market of accumulator clamps.

#### 4.2 Secondary data analysis

##### Data for PEST analysis of Russia

For analyzing risks posed by country's environment it is important to describe political and economic systems, degree of property rights protection, strength of legal system of the country and its general attitude towards international trade and foreign investments. For an objective assessment of the political and legal environment it is necessary to study both Russian-originated and independent sources.

For a general overview of the country's environmental advantages and disadvantages the author decided to use Economic Freedom Index. It is a comprehensive tool that allows to evaluate the degree to which it is safe and easy to do business in the country.

## 5 RESEARCH FINDINGS AND ANALYSIS

### 5.1 VRIO analysis of MPC's resources

As it was mentioned earlier in the thesis, there are several major aspects that influence the choice of the foreign market entry such as international experience of a company, ability to create differentiated products and the size of firm.

For assessing these aspects VRIO framework is applied. It was thoroughly described previously in the paper.

#### **International experience**

##### *Valuable?*

Since the author spent some time in company and got familiarized with the employees, it is possible for him to draw a conclusion that MPC Industries is highly experienced in international business operations. In the headquarters each employee speaks at least one foreign language additionally to a native one. It helps to serve clients from all over the Europe. Besides, the firm has its representatives in all major European countries with employees from local cultures, which helps to work closer with the customers from those countries. Moreover, people in those offices are able to follow all the latest information regarding the market and deliver it directly to the head office. All these aspects allow MPC Industries to exploit maximum opportunities and deal with threats on time.

##### *Rare?*

During the research the author was not able to find any companies that specialize on production of accumulator clamps. So, entering the Russian market MPC Industries will be the only company operating at this market. Therefore, any resources obtained by the firm is rare by default.

##### *Costly to imitate?*

Establishing relationships with overseas customers and partners is always risky and associated with a great degree of uncertainty. Therefore, gaining international experience consumes time and financial resources. MPC Industries has been operating in the foreign countries for a long time and it is still expanding its

geographical presence. For instance, it recently established a subsidiary in the USA. Considering abovementioned facts, MPC Industry's international experience can be considered costly to imitate.

*Exploited by organization?*

Considerable income percentage comes from its foreign subsidiaries. Besides, conducting internship in the company the author observed that different branches of the company communicate with each other and share valuable information via internet or by travelling directly to the office. So, the company takes full advantage of this asset.

### **Ability to create differentiated products**

*Valuable?*

Creation of a product is a sophisticated process which involves pre-production engineering and designing work and manufacturing of the good itself. MPC has a capability of doing both operations: the company has its own engineering department and production facilities.

MPC Industries produces wide range of clamping devices. The majority of the products, like worm gear clamps, are standardized commodities that have no superior characteristics over competitors' products. Such kind of goods do not require any considerable engineering or research efforts. At the same time, the firm also produces more sophisticated, customized clamps. These fixing appliances are usually tailored to the specific needs of a client and require from MPC considerable engineering capabilities to supply a customer with that kind of a good. Since these devices require significant time, financial and production resources to be manufactured, it is viable to state that MPC Industries makes differentiated products.

*Rare?*

Since there was not found any other competitors that specialize on the clamping appliances in Russia this asset can be considered rare.

*Costly to imitate?*

Clamps might seem as a rather simple device that does not require significant R&D commitment. However, some clamps that are produced by MPC Industries, especially ones that are made for the specific needs of the clients, might take some time to design and manufacture. These tasks require training and specific

competencies that other firms might not be able to easily imitate. Therefore, this MPC Industry's ability is costly to imitate.

### **Firm's size**

#### *Valuable?*

MPC Industries is a company that accomplishes all the steps necessary for manufacturing the fixating equipment from the designing the good to producing it. This is a complicated and expensive process that demands engineering department, manufacturing and testing facilities. Currently, MPC Industries has only one small production amenity and designing department at the headquarters in the Netherland, from which it exports all the produced goods to the other countries. This model works well and allows the firm to exploit most of the opportunities in the Europe and the USA. Although the manufacturing facilities allow the firm to be profitable, they are not productive enough for serving a considerable share of the market. Therefore, the size of MPC Industries cannot considered to be a valuable asset.

#### *Rare?*

Such firm size and structure is not rare in Russia. Since establishing new production facilities is an expensive and time-consuming venture, many local businesses open sales offices but produce goods at one manufacturing site.

#### *Costly to imitate?*

Even though MPC Industries is a small firm it is still an international organization that have offices all over the Europe and in the USA. It took the company twenty years to turn a local micro business into international small-sized enterprise. Therefore, there is a great probability that the competitors might spend the same amount of time to establish a business of the same size.



## 5.2 Country data collection

For assessing attractiveness of Russia for possible MPC Industries' investment, it is necessary to conduct PEST analysis and evaluate Russian political/legal, economic, socio/cultural and technological environments.

### 5.2.1 Economic environment

Russian is an industrial market-based economy, which is seriously influenced by the government intervention. Around 70% of the market is occupied by state-owned enterprises. (Ekaterina Mereminskaya, 2016) Accordingly to International Monetary Fund GDP (PPP) per capita in 2016 accounted for around 26500 US dollars, which made Russia 48<sup>th</sup> economy in the world. (World Economic Outlook Database, 2017)

Russia's economy is driven by abundance of natural resources. Accordingly to the World Bank, Russia's natural resources value account for 75 trillion US dollars. (Martin Russell 2015) Export of the oil and gas is the main source of revenue for the Federal Budget and in 2017 it accounted to for 39% of income. (Ministry of Finance of the Russian Federation 2018). The other indicator that shows the significance of fossil fuels for the economy is the country's export structure. Accordingly to Russian Ministry of Economic Development, 59% of all the exports accounts for petroleum products. At the same time, various types of machinery constitute around 8% of the export.

### 5.2.2 Political and legal environment

Russia is a market economy, where a freedom of economic activity and protection of private property is guaranteed by the constitution. However, in many instances the freedoms that stated in the documentation do not match with real

practices. To estimate the real degree of economic activities freedom and private the author applied Economic Freedom Index.

The Economic Freedom Index provides analytical information for examining country's legal and political environments. The Index measures four crucial aspects that establish economic freedom such as Rule of law, Government size, Regulatory efficiency, and Market Openness (Macuacua 2010, p.453). These are sophisticated indicators that consists of measures.

**Rule of law** is comprised of Property Rights, Judicial Effectiveness and Governmental Integrity.

Property Rights component asses how good the local laws protect the private property and the probability of its expropriation by the government. Judicial Effectiveness component evaluates how law defends people's rights in general. Government Integrity evaluates the degree to which the government is corrupt.

**Government Size** consists of Tax Burden, which is a measure of "marginal tax rates on both personal and corporate income", Government Spending, which indicates all the expenditures made by the state, and Fiscal Health, which specifies the amount of governmental debt.

**Regulatory Efficiency** includes such three factors as Business Freedom, which to what degree the governmental regulations and quality of infrastructure circumscribe business operations, Monetary Freedom or, in other words, the extent to which the government intervenes the market to control prices, and Labor Freedom, which indicates how strictly the labor market is regulated.

**Market Openness** contains such aspects as Trade Freedom, that indicates the extent to which tariff and non-tariff barriers influence flow of goods in and out of country, Investment Freedom, what signifies how strongly restricted an ability of foreign companies to invest in the country, and Financial Freedom, which denotes the extent to which the state regulates financial institutions such as banks and credit allocation.

Each of these aspects consists of sub-components. The arithmetic average of all the four aspects provides the final score for a country. Russia scores 58.2 points which puts it on in the "mostly unfree" category (Macuacua 2010).

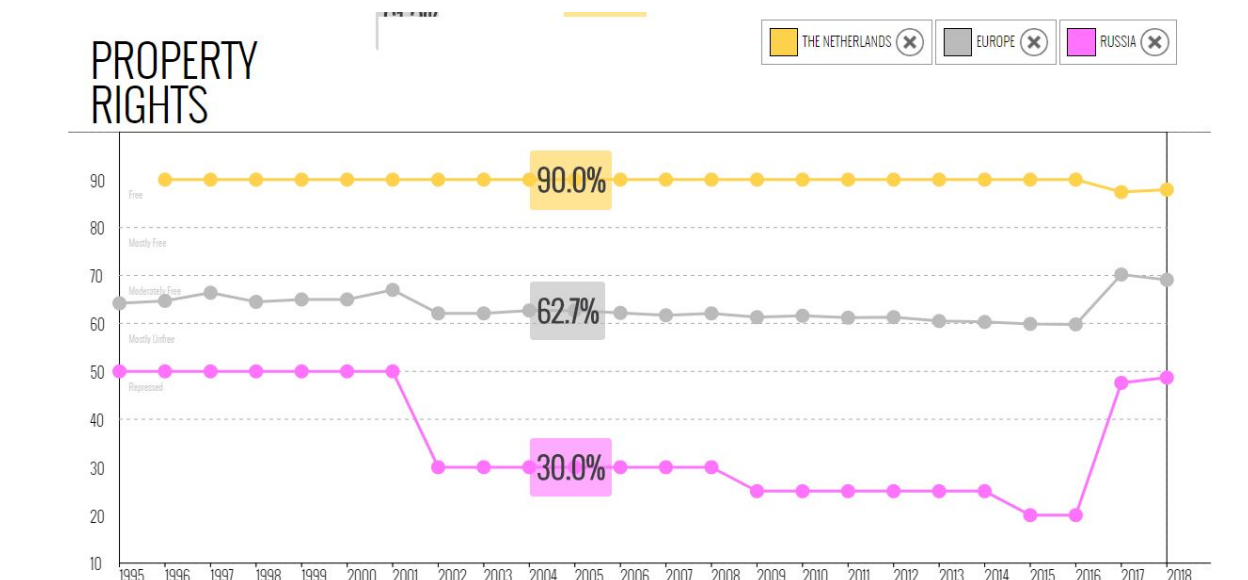
### **Rule of law in Russia.**

Accordingly to the Economic Freedom Index, Russian judicial system works poorly, property rights are not protected well enough, and degree of corruption in the government is very high.

#### *Property rights*

At Property rights scale Russia reached less than 50% (see Figure 3 - Property rights), which, accordingly to Economic Freedom Index classification, signifies that property rights in Russia are repressed. In other words, there are rather high chances that organization's assets might be expropriated by government. In Europe in general the Property rights scale is significantly higher than in Russia and reaches nearly 70%. In the Netherlands the private property is highly secure, so the country got nearly 90% at the scale.

A Dutch company that is accustomed to the fact that its assets are totally secure might be surprised by a high vulnerability of its possessions and a need to protect it in Russia.



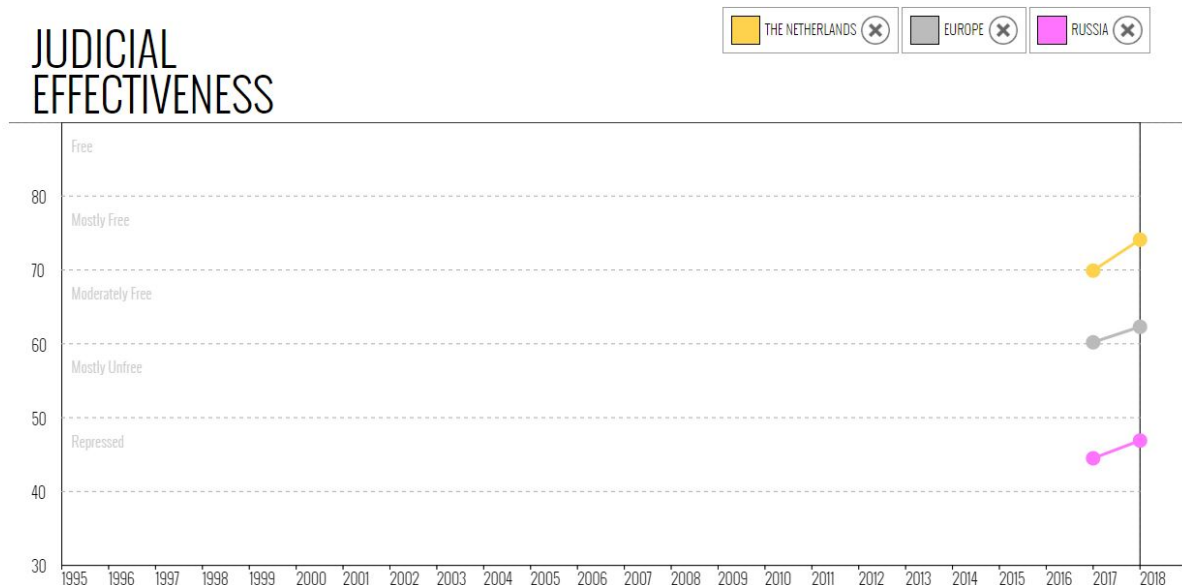
Picture 11 Property rights

#### *Judicial Effectives*

In this sub-category Russia does not show high performance neither. It does not reach 50%, what signifies that the judicial institutions are at a very low level. (see Figure 4 - Judicial Effectiveness) People and organizations are poorly protected against powerful groups. In case MPC Industries gets in confrontation with a

governmental body or another organization that has more power, the chances to win the dispute are low.

In comparison to Russia, the Netherlands has a very high quality judicial institution, thus it reached nearly 75%. In other words, the law has significantly more power in Dutch society than in Russian, so the rights of citizens of the Netherlands are protected better.



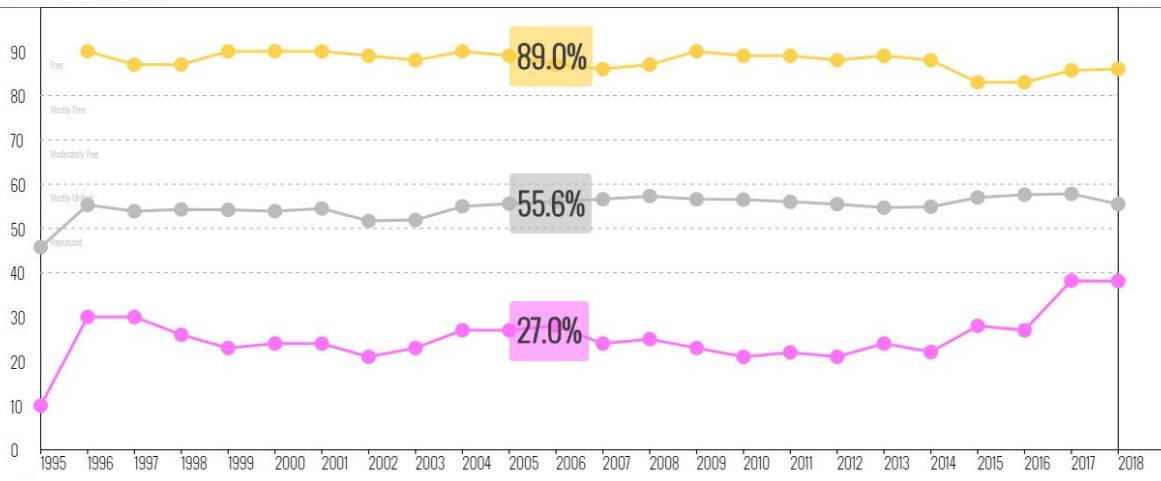
Picture 12 Judicial Effectiveness

### Government Integrity

In this sub-factor Russia got less than 40%, which is significantly lower average in Europe. (see Figure 5 - Government Integrity) The data demonstrates that Russians mostly do not trust its politicians, that the government policymaking and civil services are not transparent, and the high level of corruption in government. All these aspects might create additional obstacles to operate business in Russia. For instance, opaque and unpredictable governmental policymaking increases the degree of uncertainty in the country, so the businesses become unable to plan strategically.

The Netherlands shows excellent results in the Government Integrity and achieves nearly 90%. Understandable governmental policies and low levels of corruption makes it easier for businesses to make long term plans and prosper.

## GOVERNMENT INTEGRITY

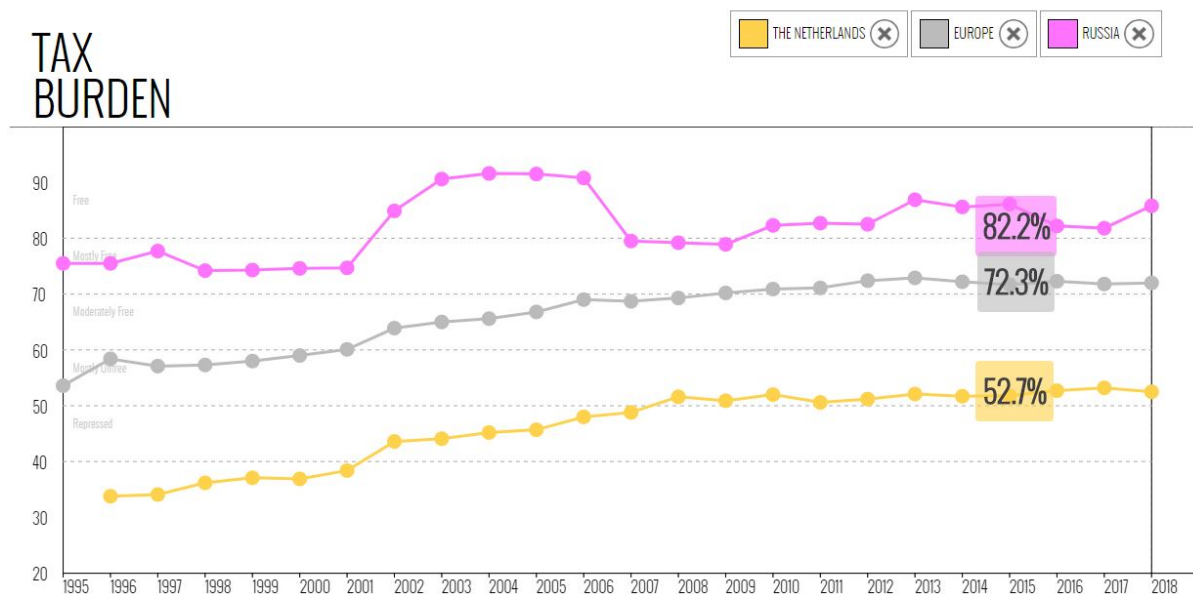


Picture 13 Government Integrity

## Government Size

### Tax Burden

## TAX BURDEN



Picture 14 Tax Burden

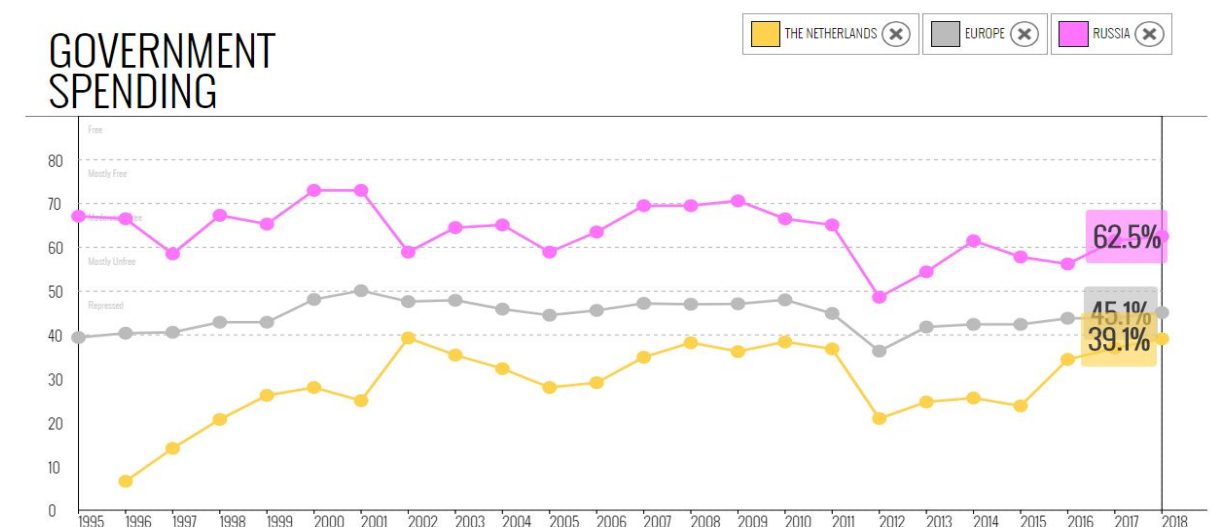
The Tax Burden sub-factor signifies how significantly the taxation policies influence the company's profits.

Accordingly to the data provided by the Index of Economic Freedom report, Russian state does not tax company's and personal profits excessively. So, personal income tax in Russia is flat and accounts for 13 percent, while the corporate tax

rate equals 20 percent, what makes the overall tax burden equal 29.8 percent of total domestic income. Therefore, in Tax Burden sub-factor Russia achieves around 85 percent and performs better than European countries on average (approximately 72 percent) and the Netherlands, which barely exceeded a threshold of 50 percent (see Figure 6 - Tax Burden).

### Government Spending

This sub-category aims to show how significantly government expenditures influence local businesses. Theoretically, the high government spending negatively influences the economic freedom (Macuacua 2010, p.456).



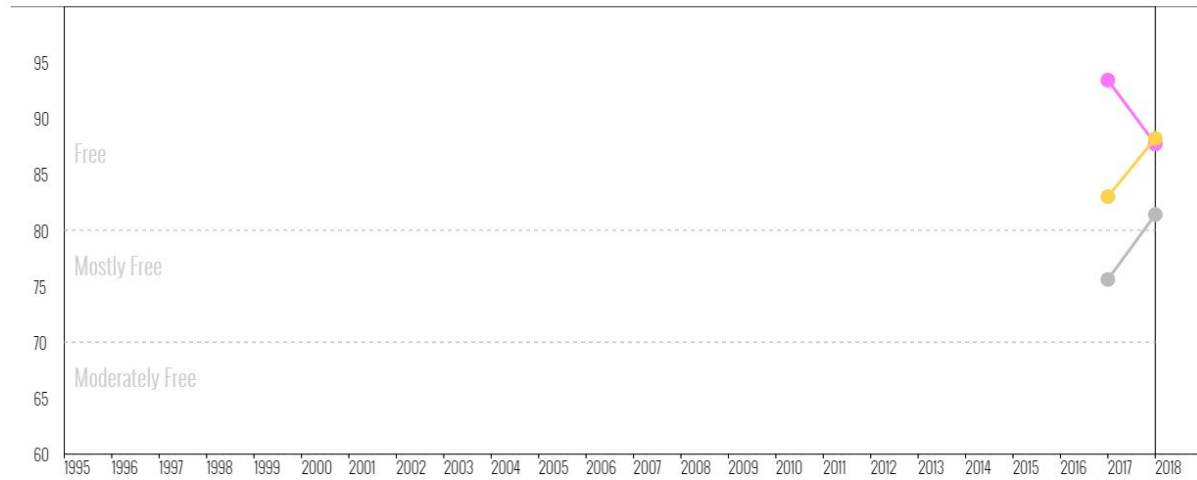
Picture 15 Government Spending

In this sub-category Russia performs rather good: spending 35.3 percent of GDP output on government expenditures, the country attains 62.5 percent in the Economic Freedom Index(The Heritage Foundation n.d.). It makes Russia more efficient in this sense than the Netherlands, which spends on approximately 45 percent of the total GDP output (Anon n.d.).

### Fiscal Health

This sub-category reflects the country's public debt. The higher the debt, the higher the probability that the macroeconomic instability and uncertainty.

# FISCAL HEALTH



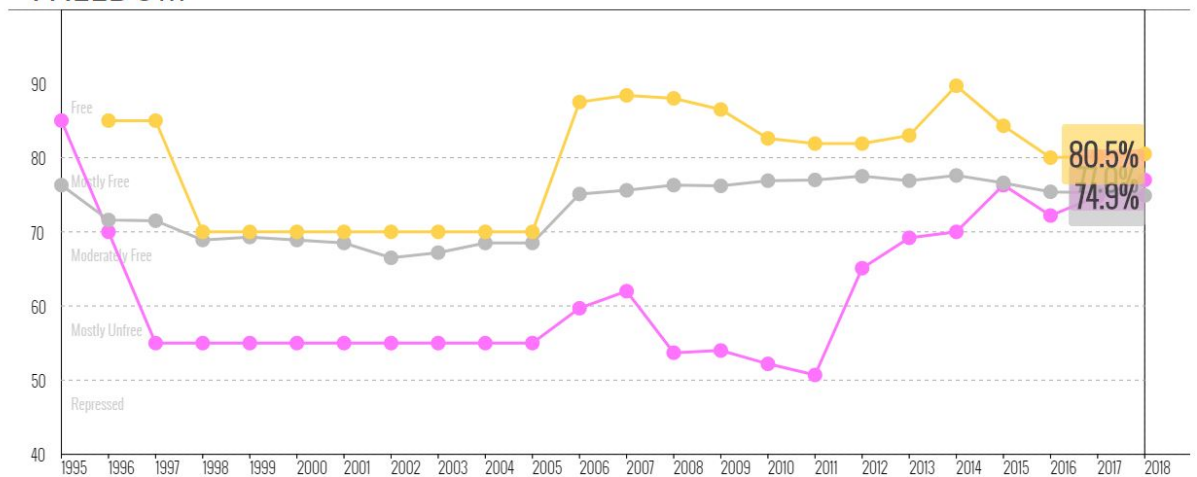
Picture 16 Fiscal Health

Accordingly to the data provided by the authors of the Index, Russian and Dutch public debt situation are both good and accounts for roughly 88 points.

## Regulatory efficiency

### Business Freedom

# BUSINESS FREEDOM



Picture 17 Business Freedom

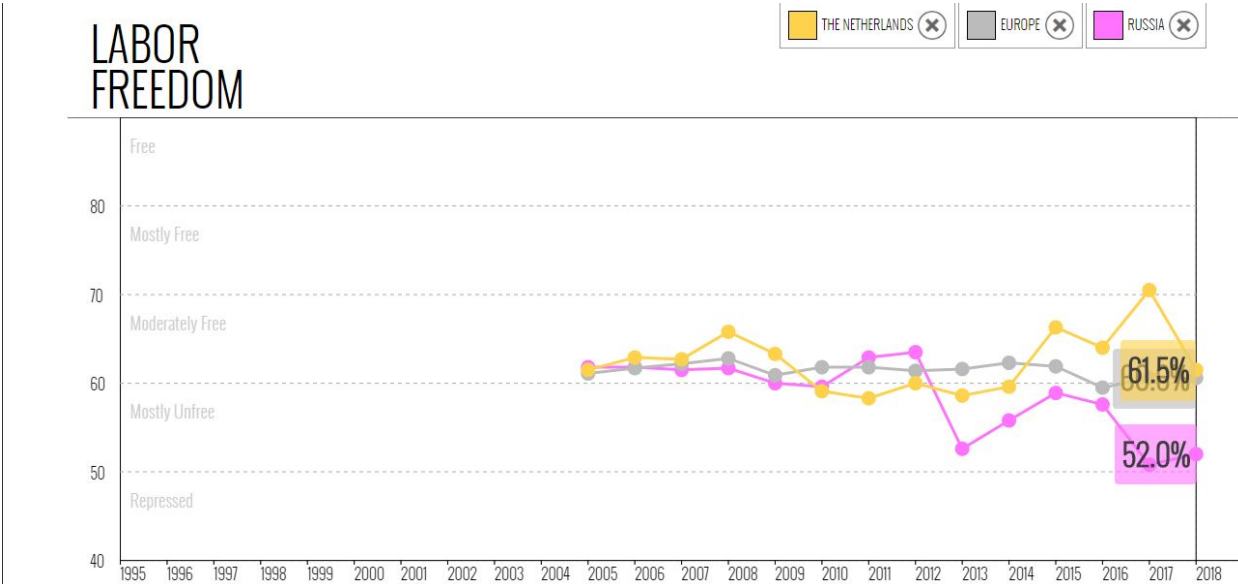
Business freedom is meant to measure how easy it is in the country to establish business operations in a certain country. In other words, this aspect denotes the amount of financial and time resources to open a new company.

Accordingly to this parameter, the Netherlands and Russia are approximately at the same level. Both countries attained around 80 percent and it matches an average European level.

*Labor Freedom*

This measurement is aimed at reflecting different aspects of country's regulations regarding the labor market. It takes in account a wide variety of issues such as minimum wages, regulatory restraints on working hours etc. (Macuacua, 2010, p. 459.)

Accordingly to this parameter Russia performed worse than European countries on average and then the Netherlands in particular. That way, Russia barely exceeds the 50 percent threshold while the Netherlands scored around 60 percent.



Picture 18 Labor Freedom



## Monetary freedom

The factor is based on the country's inflation rates and price control. If the prices

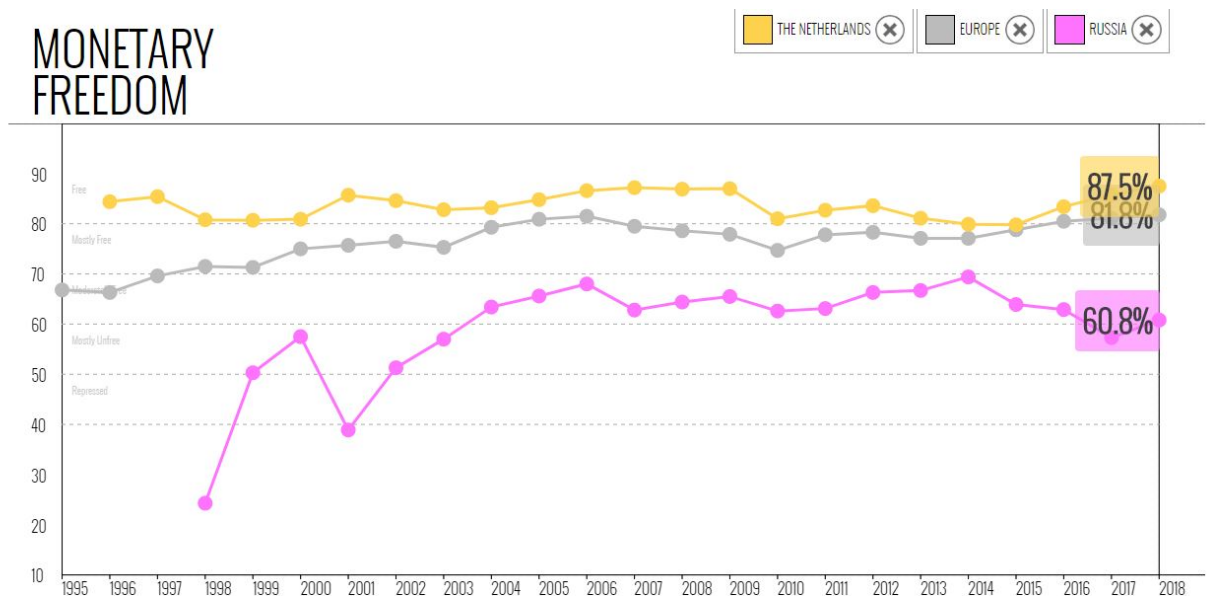


Figure 1 - Monetary Freedom

are stable without any microeconomic involvement of the government, a situation with monetary freedom is perfect.

Accordingly to the data provided by the *Index*, the situation with the prices in the Netherlands is close to perfect. The country is 2.5 percent short from reaching 90 percent of monetary freedom. For Russia the indicator shows worse results but still it is higher than 60 percent, what makes the country stable in terms of price growth.

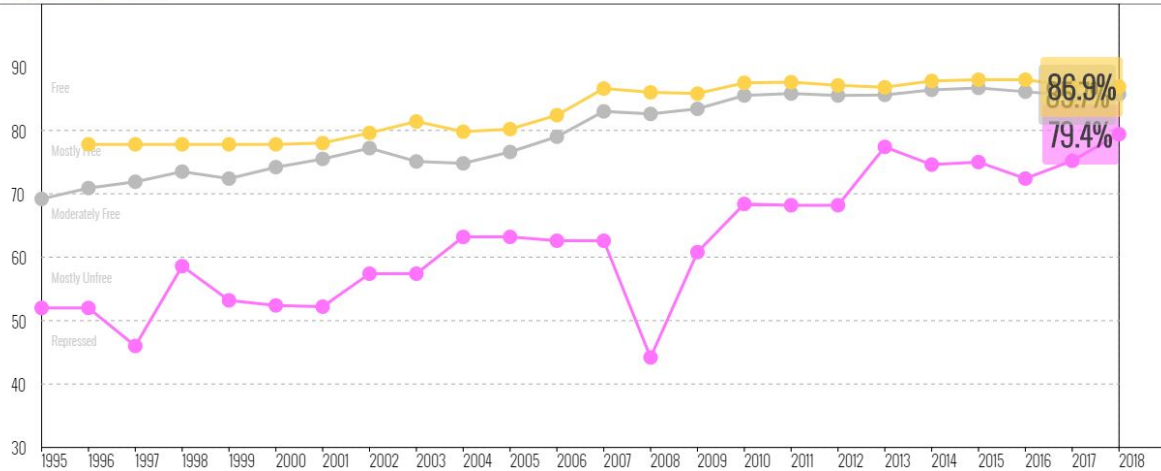
## Open Markets

### Trade Freedom

This indicator measures how strictly tariff and nontariff barriers affect flow of goods inside and outside the country.

As the data show, Russia is a rather opened country in this sense. It scored nearly 80 percent, which puts it very close to the Netherlands.

# TRADE FREEDOM



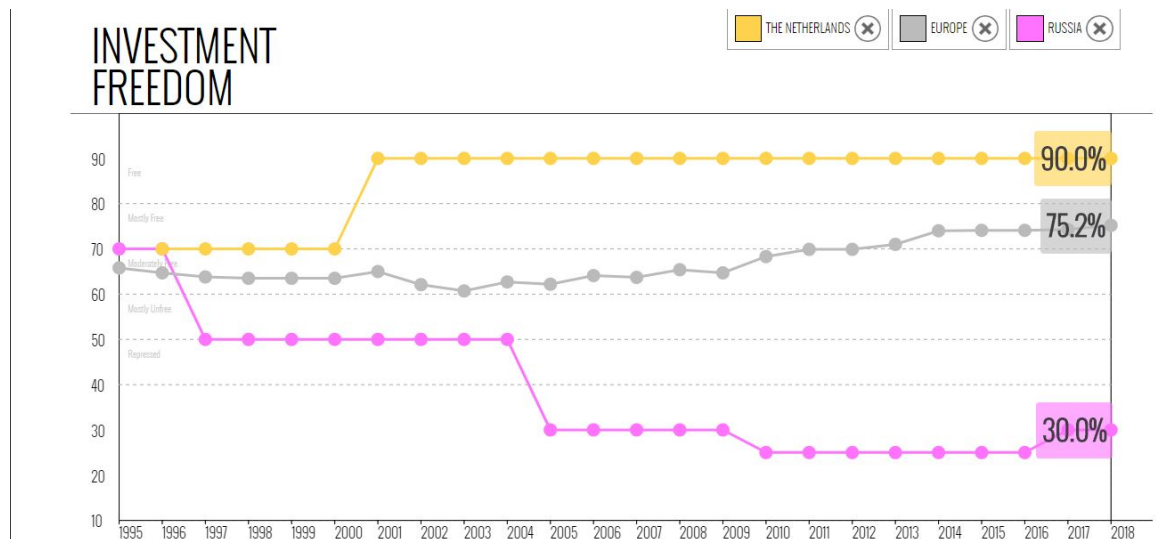
Picture 19 Trade Freedom

As the Trade Freedom Index indicates, Russia is a rather opened to the inflow of foreign goods. Nevertheless, it is important to understand whether MPC Industries' products are allowed to be imported to Russia and what fees should be paid for crossing the border.

## Investment Freedom

This aspect signifies an openness of the country to the foreign investment. Accordingly to the authors of the index, in ideal circumstances there is no constraints for the foreign capital to enter a certain country. (Macuacua 2010, 462) Restriction on the foreign investment limits effective resource allocation, decreases the market growth and diminishing entrepreneurial opportunities. (Macuacua 2010, 15)

The data shows that Russian is repressed in terms of investment freedom. Non-tariff barriers impede trade. Sectoral restrictions and the prevalence of state-owned enterprises limit foreign investment.



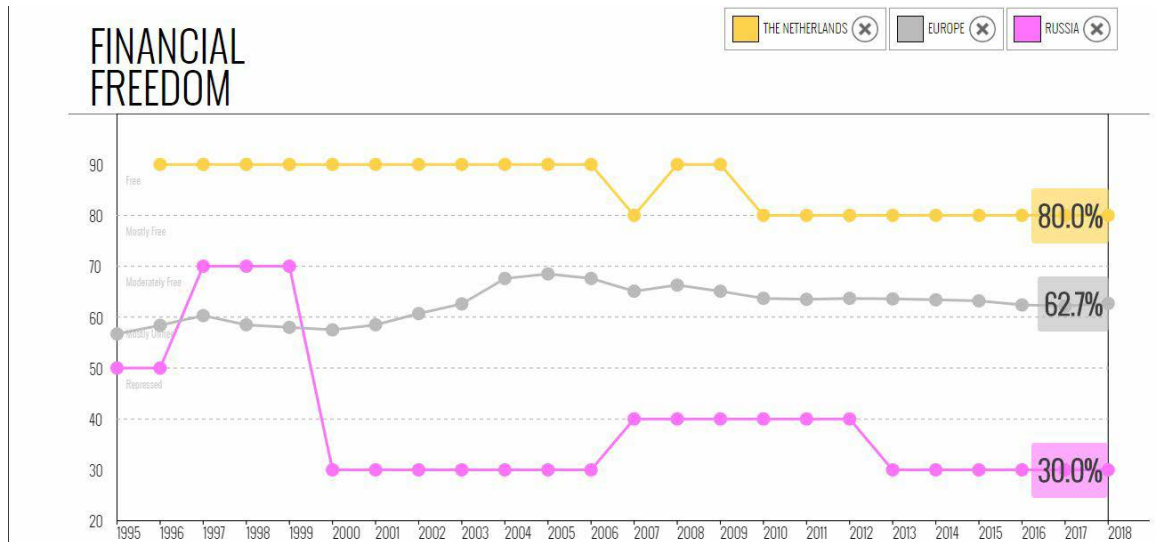
Picture 20 Investment Freedom

### Financial Freedom

This indicator measures efficiency of the financial institutions and the country's banking industry and its independence from the governmental control. The authors of the index perceive a financial free country where governmental involvement into banking industry is restricted to the enforcing compliance to contractual obligations. Financial resources allocated on the market basis and foreign banks are allowed to operate freely. (Macuacua 2010, 463)

Accordingly to the survey Russian financial institutions are significantly influenced by the governmental interference and credits are allocated in many cases by the state rather than by market principles. Therefore, Russia scores only 30% (see Figure 14 - Financial Freedom) in Financial Freedom index. In comparison, the Netherlands' rate is 80 percent.

Russian financial institutions have a little impact on the commissioner. MPC Industries always has access to the Dutch banks and can account get financial support in the home country.



Picture 21 Financial Freedom

### 5.3 Russian accumulator clamps task environment

The product that MPC Industries sells is directly related to the hydraulic industry. The main specificity of the hydraulic equipment is that it is complementary to the other industrial machinery. So, the potential buyers of the accumulator clamps might be any company that produces hydraulic accumulators or uses it.

According to the information provided by the commissioner, hydraulic accumulators are mostly applied in the heavy-duty vehicles industry, oil and gas, and wind power industries. Needless to say, that hydraulic industry is also on the list since it produces the accumulators.

For gathering data about the task environment, the author used applied survey and desk research.

### 5.3.1 Desk research findings

The desk research was conducted to gather information regarding the industries that MPC is interested in. The results of the desk research should give the commissioner a general understanding of the current situation at the certain markets in Russia.

#### Hydraulics manufactures

Russian market of hydraulic equipment is dominated by foreign companies. It can be explained by the fact that local companies are not as technologically advanced as their foreign counterparts. It results in a more poor quality of the products and even inability of Russian firms to manufacture certain pieces of hydraulic equipment. (Ivanova Anastasia 2016, p.24.)

Accordingly to the European Fluid Power Committee, the volume of the European market of hydraulic equipment accounts for €9,75 billion what equals 29% of the world market volume. Russia's market volume accounts for 1% of the world hydraulic equipment sales. It seems rather small comparing to the USA (30%) and China (26%). However, in Europe it is the seventh biggest market. (Ivanova Anastasia 2016, 22.) As far as market of hydraulic accumulators concerns, accordingly to the information provided by PSM-Hydraulics, its size accounts for 35 000 units a year.

The biggest Russian company at the market is PSM-Hydraulics. It is the only firm that is comparable by production quality and size to its European competitors. The firm's share at the power hydraulics market accounts for 80%. Its products are used by the most prominent Russian heavy-duty machinery manufacturers such as RM-TEREX, Rostselmash, UVZ, and others.

In general, the Russian market of hydraulic accumulators is split between several big companies most of which are of European origin. The author identified only 15 firms that produce hydraulic accumulators, ten of which were foreign companies. Some of them are already MPC's customers. For instance, Parker, Hydac and FOX are buying accumulator clamps from MPC. The customers that are currently

purchasing accumulator clamps from MPC are large companies that focus specifically on designing and manufacturing hydraulic components and hydraulic machinery for various industries.

In Russia, the producers of hydraulic accumulators do not always focus on hydraulics only. Some firms might specialize on production of specific equipment for certain industries and manufacture hydraulic components at the same time since they are a part of the equipment. For instance, RemStankoMash is a company that mostly focuses on production of the blowout preventing equipment for the oil industry. This kind of machinery demand hydraulic accumulators, so they produce them on their own. The other example is a firm called Severo-Zadonskiy Eksperimentalnyy Zavod. This company produces hydraulic accumulators but does not focus solely on hydraulic equipment. Instead, it designs and manufactures machinery for mining industry. Intehros is the other company that makes the accumulators but does not specialize exclusively on hydraulics but also makes robotic devices.

Among five Russian companies that manufacture hydraulic accumulators there are only two firms that specialize only on production of the hydraulic equipment. They are Lyudvinovskiy Agregatnyiy Zavod and PSM-Hydraulics. They both produce wide variety of hydraulic equipment including hydraulic accumulators. However, PSM-Hydraulics is the largest and the most technologically advanced producer of hydraulic equipment in Russia.

End-users

End-users comprise a very large group of companies since hydraulic equipment is applied particularly in any industry. The commissioner decided to focus on heavy-duty vehicles, oil and gas industry, and wind power industry.

#### ***5.3.1.1.1 Heavy-duty vehicles***

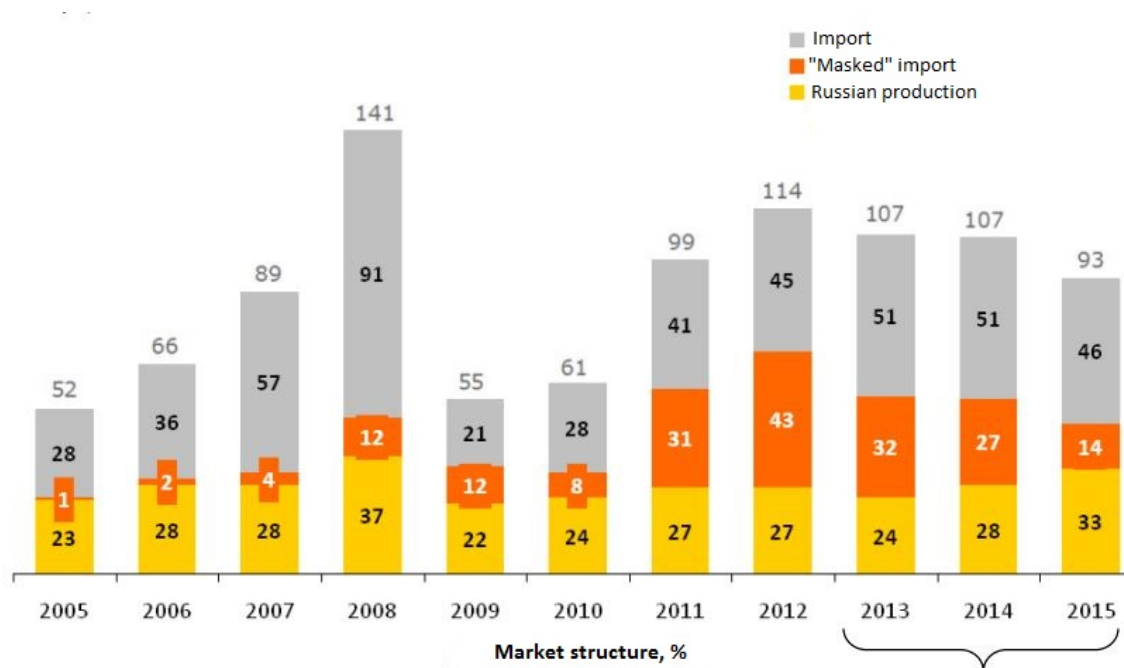
The whole industry can be split in two: construction machinery and agricultural equipment. Since some kinds of machinery, for instance tractors, can be used in both sectors, some companies can be mentioned as in the first part, as well as in the second.

The majority (66%-74%) of the construction machinery used at the market is imported to the country. The biggest foreign suppliers are Komatsu, Caterpillar, Hitachi, JCB, Volvo, XCMG, Shandong Lingong, Shantui, Bobcat Company, Doosan Infracore, Liebherr. (Янукович, 2016) The key local companies are Chelyabinsk Tractor Plant (ChTZ), Tractor Plant Concern, RM-TEREX, Comatsu Manufacturing Rus and Caterpillar-Tosno. (Янукович, 2016)

The industry has been in decline for the last four years (“Рынок дорожно-строительной техники ожил – ВЕДОМОСТИ,” n.d.). From 2013 to 2016 the aggregated supply dropped two times from 208.7 billion rubles to 90 billion rubles (=1.291 billion euros) (Breus Vladimir, 2017). The slump was caused by an adverse economic situation in Russia, devaluation of ruble, high loan rates, and newly introduced utilization tax that significantly increased prices for the machinery. At the same time, since companies could not afford new equipment, they were trying to extend the lifetime of the old machines buying more spare parts. Therefore, the production of hydraulic and pneumatic units and engines increased by 64 percent. (Янукович 2016.)

Nowadays, the crisis has already hit the bottom and now the industry started to recover. At the end of the first quarter of 2017, sales of the heavy-duty machinery increased by 29% what resulted in 1536 sold units. Experts predict that this trend in short term will continue. (“Рынок дорожно-строительной техники ожил – ВЕДОМОСТИ,” n.d.)

The size of the Russian agricultural machinery market accounts for 93 billion rubles (around 1,360 billion euros). At the end of the 2015 around 50% of market share belonged to the foreign importers.



Picture 22 Market Structure

Picture 1) It means that foreign companies shipped semi knocked-down equipment in the country and assembled it there. So, in total import constitutes around 65% of the agricultural machinery. (Butov Alexander 2016, 49.)

There are two major segments of the agricultural machinery market: tractors and harvesters. The most important Russian tractor producers are Peterburgsky Traktorniy Zavod (PTZ), Kamsky Tractor Plant, Agrotechmash, Chelyabinsk Tractor Plant, Elabuga Automobile Plant. Besides, John Deere and Claas localized their production in the country and currently perceived as local manufacturers. The market leader (with the 70% market share) is Rostselmash. The other harvester manufacturers are Bryanskselmash, Kranspecburmash, Claas, and John Deer. (Butov Alexander 2016, p. 54-55.)

It is important to mention changes in the market structure happened due to alterations in the general economic environment. From 2014 to 2015 Russian economy significantly declined and it effected most of the industries including agriculture. As a result, the sales of the harvesters and tractors dropped by 6% and



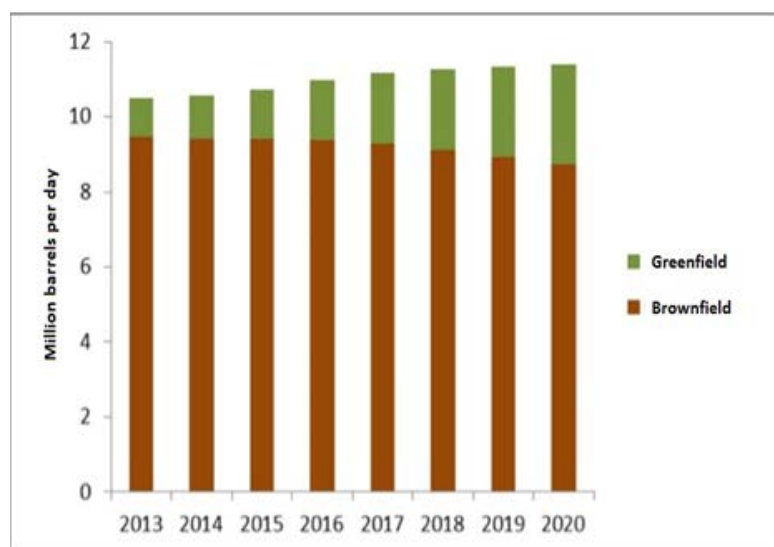
39% respectively. Although Russian producers were also affected by the economic slump (the number of sold tractors fell by 24.3% in 2015), the market share of Russian companies grew by 5%. Moreover, some firms even managed to increase the sales. For instance, Peterburgsky Traktorniy Zavod (PTZ) sold on 82% more in 2015. (Butov Alexander 2016, 11)

The growth of the Russian companies' market share was caused by the ruble devaluation, which made imported machinery less competitive and by government support program. For instance, in 2015 Agriculture Ministry signed subsidy contracts with more than 40 companies and transferred more than 5,2 milliard rubles instead of planned 2 milliards. (Butov Alexander, 2016, p. 13)

In general, Russian agricultural machinery production rates proportionally depends on the governmental subsidies. Consequently, demand for hydraulic equipment of these companies can be approximately estimated by the sums invested by the state into the industry.

### **5.3.1.1.1 Oil and Gas industry**

Oil and Gas are too main products that generate income to Russian budget. Accordingly, to the Federal Customs Service (FCS) statistical data, the crude oil and products made from it account for 62 percent of all the Russian export.



Picture 23 Oil extraction forecast

Oil and gas have been focal sources of income for Russia beginning from the Soviet Union times, during which all the business was controlled by the government. After the collapse of the USSR, the it was privatized. Nowadays, it is a mature consolidated industry that consists of several corporations most of which owned by the government or significantly influenced by it. The biggest companies in the industry are Rosneft, Gazprom and Lukoil.

The demand for the hydraulic equipment directly depends on the oil extraction rates and development of new oil fields.

Even though the Russian economy is in decline and adversely influenced by sanctions, oil industry is still growing. During first six month of 2017 the oil and gas extraction grew on 1% and reached 272,3 million tons. The amount of drilling activities grew on 12%. (Grushevenko Ekaterina, 2017) Such positive results were caused mostly by devaluation of the ruble and tax reform that encouraged business to invest in development of new oil and gas fields rather than in oil processing facilities.

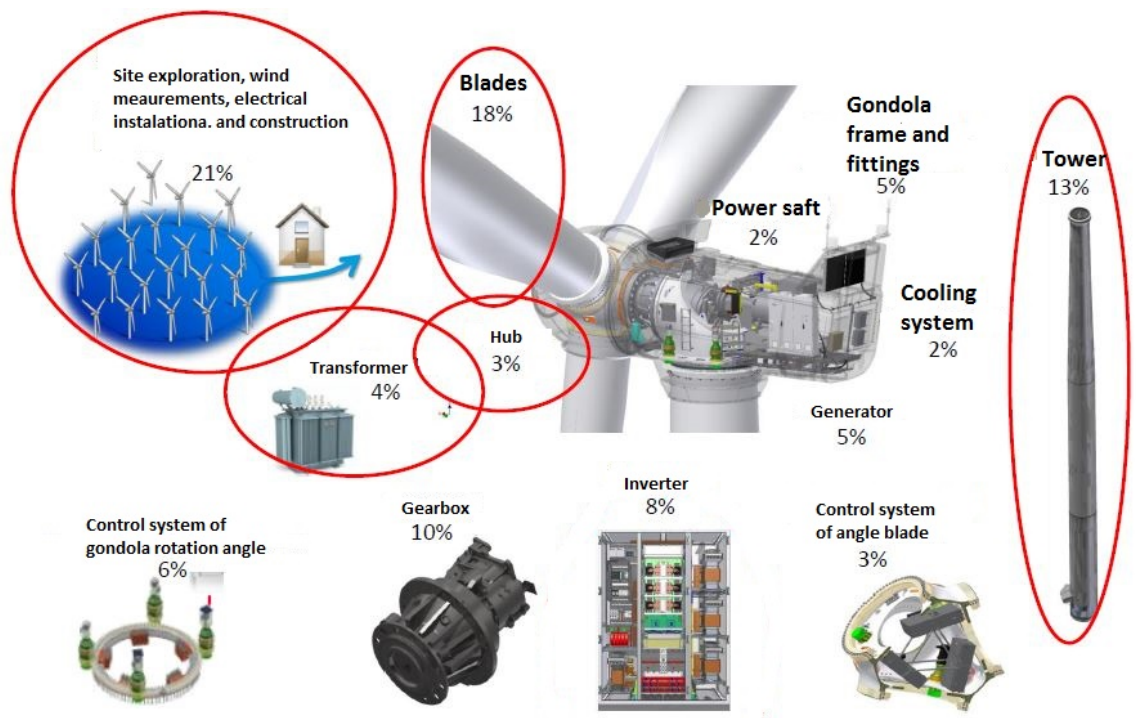
Experts claim that in following three years the oil extraction is going to grow. (Grushevenko Ekaterina, 2017) These factors should positively influence the demand of the hydraulic equipment soon.

### *Wind Power*

The wind power industry in Russia is immature. Currently there are only several wind turbines with capacity over 1 megawatt (MW) are built and in the middle of 2016 the capacity of all the wind turbines were around 11 MW (wind farms built in Crimea by Ukraine are not counted) (Гезингер Штефан, 2017). All of them are made by foreign enterprises since Russian companies do not have technological competences for producing wind turbine components at present moment. Realizing a technological backwardness in this field, the government established a set of measures for encouraging companies to install more wind turbines and to use locally produced components for the devices. The methods for improving wind power energy is regulated by the government resolution "On the Mechanism for Encouraging the Use of Renewable Energy on the Wholesale Market of

Electric Energy and Power” which was published on 28th of May 2013. The document provides that each year the government should have held a tender to choose companies that are allowed to build wind farms. Accordingly to the resolution, costs of building the wind turbines should be returned to the organizations by charging wholesale electricity buyers higher than usual prices. The main criteria for the selection is capital expenditures and percentage of locally produced components used for building wind turbines. As lower the costs for building the wind farms and the higher the percentage of locally produced components, the bigger the chance that the company win the tender.

To prevent wind generated electricity to be too expensive, the government set a limit on the capital expenditures for constructing wind farms. The limit could not be exceeded and the companies that offered the cheapest solution were selected for building the farms. The other important condition for getting investments back is the usage of locally produced components for the wind turbines. The measures were not successful. There were several reasons for that. Firstly, the capital expenditures level was too low, thus the whole venture was not profitable for the companies. Secondly, the necessity to use locally made components, demanded foreign companies to invest in Russian production facilities, which also made the whole venture very risky. These obstacles prevented the development of the wind turbine industry. After negotiation between market participants and government officials, the rules were changed in 2015. The capital expenditures limit was increased and demands regarding usage of locally produced equipment became less strict. Instead of requesting companies to implement 55% of components produced in Russia, it was asked to use only 25% of domestic parts.



Picture 24 Localization value of turbine components

In 2017 the producers of the wind turbine equipment and wind farm developers managed to come up with agreements that allow to build wind farms. In that way Russian state corporation Rosatom, a major nuclear energy company with its own production facilities, signed a licensing contract with a producer of wind turbines Lagerwey. (“Конкуренция за ветер: что привлекло инвесторов в российской энергетике :: Бизнес :: РБК,” n.d.) As a result, Rosatom was chosen to build two wind farms with total capacity of 610 MW. (Гезингер Штефан, 2017, 7.)

The goal set by the government is to reach a level of 3351,2 MW of wind generated energy by 2024. Even though, the demand for localization of components production is to be increase by 65% in 2019, experts claim that it is achievable goal, since nowadays many Russian companies are ready to produce the parts and several foreign firms are prepared to localize its production in Russia. (Гезингер Штефан, 2017, 8.)

To conclude, the wind power industry in Russia is only emerging and due to poor government regulation experienced some problems with the growth. However,

market participants and the state agencies managed to reach consensus on certain topics and in the following years the number of wind turbines is going to skyrocket.

### 5.3.2 Survey findings

#### *Manufactures*

Preparing population for the research the author identified 15 companies whose hydraulic accumulators were present at Russian market. Two thirds of them were of the foreign origin and only five local ones. However, the survey was conducted only among eight firms because four foreign companies (Fox, SAIP, HydroLeduc, EPE and Roth Hydraulics) did not have representative offices in Russia and delivered its product by distributors, so there was no one to ask. Two companies (Olaer and Bosh Rethrox) decided not to answer the questions.

Among those eight companies the half sold or used fixating equipment for hydraulic accumulators. Half of them were Russian and the other was of foreign origin. All the companies used clamps for their fixing hydraulic accumulators. Foreign companies could not specify whether they produced the clamps or bought it from the third firm. It can be explained by the fact that local branches of foreign companies are not involved in producing hydraulic components but only distribute equip-

Name of the company	Origin	Survey status
olaer	Foreign	Rejected to answer
hansa flex	Foreign	Answered
Fox	Foreign	No representative office
Hydac	Foreign	Answered
Bosh Rethrox	Foreign	Rejected to answer
SAIP	Foreign	No representative office
Hawe	Foreign	Answered
Intechros	Local	Answered
Lyudvinovskiy Agregatnyiy Zavod	Local	Answered
PSM-Hydraulics	Local	Answered
Severo-Zadonskiy Eksperimentalnyiy Zavod	Local	Answered
HydroLeduc	Foreign	No representative office
EPE	Foreign	No representative office
Roth Hydraulics	Foreign	No representative office
RemStankoMash	Local	Answered

*Table 3 Surveyd manufacturers*

ment made overseas. Therefore, they do not have information regarding the clamps. At the same time, Russian companies answered that question. Intehros purchases the equipment from the third companies while Remstankomash manufactures their own equipment. Unfortunately, Intehros could not provide tell the researcher where he purchases the clamps.

### *End-users*

End-users group is comprised of the companies that only applies hydraulic components in its machinery. The sample size of this this group accounts for 54 companies. Among them 8 firms were specialized in oil and gas equipment production,

26 manufactured hydraulic power units and 18 produced heavy machinery. Unfortunately, only 11 firms agreed to answer the survey.

Nine out of 11 firms produced fixating equipment by themselves and two of them bought it from the third companies. No respondents could specify from whom exactly they bought fixating equipment. The most popular hydraulic accumulators among the respondents are produced by the Lyudinovskiy Agregatnyi Zavod: 4 companies used the products of this manufacturer. Fox's accumulators are used by the 3 firms. Epoll and PSM are used by two companies and Hydac was applied only by one firm.

#### 5.4 Five Porter's forces

To provide an answer to the main question of this thesis, it is necessary to understand the strength of competition at the Russian market. Five Porter's forces framework is applied to conduct the analysis.

##### **Threat of entry**

First barrier for entry is an *economy of scale*. Conducting desk research and the survey, the author did not identify any firm that specializes on production of the hydraulic accumulator clamps or similar equipment. The companies produce certain mounting appliances in case they need to fix the accumulators. Therefore, new firms will not face any significant competitors at this market. The second barrier of entry is a product differentiation. The author did not identify any brands that are known for production of the accumulator clamps. Thus, MPC Industries should not overcome this obstacle to establish business in Russia. The remaining four threats of entry do not significantly impact MPC Industries since there are no competitors at the market and no governmental regulations were found regarding fixating appliances for hydraulic accumulators.

**Threat of the substitute product** is quite high. Most of the firms do not purchase specialized equipment for mounting hydraulic accumulators but rather produce their own appliances. They do not always fall into a category of clamps or u-bolts

but might be just stripes of metal that are welded to a rack. Therefore, entering the Russian market, MPC should be able to convince the buyers that their equipment is superior than what the customers are using at the moment.

**Bargaining power of buyers** is a complicated issue for MPC Industries. The bargaining power of buyers might vary depending on which group of companies is considered to be potential customers. Currently MPC Industries sells the clamps to the manufacturers of the hydraulic accumulators and do not work directly with the end users. If the commissioner decides to approach the same group of customers in Russia, then the bargaining power of buyers is rather high, since all the conditions are in favor MPC Industries' customers.

Condition	Satisfies or not
<i>When buyers purchase large quantities of goods</i>	Satisfies
<i>The product is undifferentiated</i>	Satisfies
<i>Small switching costs</i>	Satisfies
<i>It earns low profit</i>	Satisfies
<i>Buyers have an ability for backward integration</i>	Satisfies
<i>Industry's product does not affect the buyer's goods quality</i>	Satisfies
<i>The buyer has full information concerning the product</i>	Satisfies

*Table 4 Bargaining power of buyers, if MPC serves the manufacturers*

As it was mentioned earlier in the paper there are six conditions that influence bargaining power of buyers. Firstly, there are only two big Russian companies that MPC Industries can approach, PSM-Hydraulics and Lyudvinovskiy Agregatnyiy Zavod. Since there are only two possible customers they will buy all the clamps in



big quantities. Secondly, the product itself is more on the commodities side and it is hard to differentiate it. Besides, the switching costs that buyer might bear choosing the other supplier can be easily neglected. Besides, the buyers can assess cost structure of the product and demand to decrease the prices, so that profits might become close to break even.

However, MPC Industries might choose the other way and approach the end users. In this case, the situation changes slightly. The bargaining power of buyers becomes weaker, although not significantly. All the conditions of the bargaining power of buyers remain the same except MPC Industries gets access to more customers and the firm does not get depended on several big customers. There is also the third way, accordingly to which MPC supplies to both groups. This scenario is identical with the second one.

Condition	Satisfies or not
<i>When buyers purchase large quantities of goods</i>	Does not satisfy
<i>The product is undifferentiated</i>	Satisfies
<i>Small switching costs</i>	Satisfies
<i>It earns low profit</i>	Satisfies
<i>Buyers have an ability for backward integration</i>	Satisfies
<i>Industry's product does not affect the buyer's goods quality</i>	Satisfies
<i>The buyer has full information concerning the product</i>	Satisfies

*Table 5 Bargaining power of buyers, if MPC serves end users*

**Bargaining power of suppliers** signifies the ability of a supplier to demand higher prices for its goods for less quality. There are six conditions which determine the

power degree of the suppliers. In case they are satisfied the supplier has an advantage over the buyer.

The MPC's bargaining power is rather low. Depending on the customer group the firm wants to server, the situation slightly varies. So, if MPC Industries decides to serve only the manufactures, it has no bargaining advantage at all (See Table 3).

As the research data indicated, Russian hydraulic accumulator industry is extremely consolidated. Only several firms are involved in the production of the hydraulic components. Moreover, the customers have an easy access to the substitute products, which range from u-bolts to simple metal stripes that fix the accumulators by being welded to a rack. The importance of the MPC's product for the end users can be also considered quite low, since it is possible to fix the accumulators using other appliances. While for the potential customers the clamps are not an essential component for the machinery they construct, MPC Industries is totally depended on the market of hydraulic accumulators. Besides, since an accumulator clamp is commodity type of product, it is hard to differentiate the product by marketing effort. The switching costs are low as well and MPC Industries does not have enough capacity for forward integration.

Condition	Satisfies or not
<i>Few suppliers sell to buyers from fragmented industry</i>	Does not satisfy
<i>Absence of substitute products</i>	Does not satisfy
<i>The industry in not an important customer to the supplier</i>	Does not satisfy
<i>The suppliers' good is an important part of the buyer's product</i>	Does not satisfy
<i>The supplier enjoys switching costs or differentiated its product</i>	Does not satisfy

<i>The supplier has a potential for forward integration</i>	Does not satisfy
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*Table 6 Bargaining power of MPC, if it serves the manufacturers*

If MPC industries decides to sell to the end users as well, the situation becomes slightly better. Some of the industries that the firm might serve are quite fragmented. For example, hydraulic power units are produced by a great number of small companies. However, apart from number of potential customers, the other conditions remain the same.

**Intensity of rivalry** denotes the strength degree of the competition among the firms. There are several conditions depending on which, the rivalry might range from severe to mild. However, the researcher was not able to identify any company that specializes on the same product. Therefore, there is no rivalry whatsoever at the market right now.

**To conclude**

The market of the accumulator clamps in Russia is close to non-existent. No local companies that specialize on the manufacturing of this product were identified. The foreign firms that supply fixating equipment for the hydraulic accumulators, apparently do not sell any significant number of clamps because, according to the research the end users do not buy the clamps from the third parties but produce their own fixating equipment instead. Besides MPC Industries is already an original manufacturer for the majority of the foreign companies that sell the accumulator clamps.

## 6 CONCLUSION

Accordingly to the established framework, a choice of the entry mode depends on the internal environment or, in other words, the company's capabilities and the external environment such as foreign country political and economic stability, and market proprieties. Both aspects were summarized in six questions, answers to each of them should provide MPC Industries with an optimal Russian market entry method.

### 6.1 Internal environment

- Does MPC have enough international experience to enter Russian market?

The research discovered that the firm managed to establish numerous branch offices in foreign countries. It allowed the company to accumulate considerable international experience. The research demonstrated that there is no other firm in the clamp industry in Russia with the same level of international experience. It gives the company a great advantage and allows to choose more hierarchical mode of entry.

- Does MPC Industries manufacture highly differentiated and competitive product or is it a commodity-like good that can be easily duplicated and substituted?

The study showed that some of MPC industries' products are highly differentiated and cannot be easily copied by other firms. It also provides the company with a significant advantage that might facilitate the entrance to Russian market.

- Is MPC Industries big enough and has sufficient resources to start operating in Russia?

It was identified that although MPC Industries is an international firm, it is still rather small. It employs only around 50 workers. What is more important, the company expands internationally by establishing overseas only sales offices, so the design

and production departments are in the headquarters in the Netherlands. In other words, the company does not have enough resources to establishing fully-owned subsidiary in Russia. So, MPC Industries' size provides an opportunity to establish a representative office in the chosen country, although the hierarchical method might be too risky and expansive for the company.

## 6.2 External environment

- Is Russia stable enough country to establish a wholly-owned subsidiary or is it necessary to use entry mode that demand less commitment?

The author decided to evaluate economic and political stability of the country by means of Economic Freedom Index. It should compare the stability of Russia, the Netherlands and the rest of Europe.

As it was mentioned earlier, the authors of the Index graded the countries on a scale from 0 to 100. The economies that scored 80 and more are put in category "free", the countries within 70 to 80 range are considered to be "mostly free", the states that scored between 60 to 70 are called "moderately free", "mostly unfree" countries are those that got 50-60 points, all the other countries are considered to be "repressed".

Russia scored 58.2 points, which means that it falls mostly unfree category, although only 2 points separates it from moderately free category. A more detailed study of the Index showed that property rights in the country are poorly protected, judicial institutions do not perform well neither and due to governmental low transparency and high corruption levels, Russian people do not trust the state. Besides, labor market is stifled by government regulations, financial institutions are not independent and suffer from state intrusions, investment freedom is significantly deteriorated by the prevalence of state-owned enterprises.

On the other hand, corporate tax rates is 20 percent in Russia, which is significantly lower than in the rest of the Europe, in terms of governmental spending the

country is quite efficient, the public debt rate is lower than regional average, Russian business freedom parameter is at the same level with European average, the country's inflation rates and price control is worse than Dutch ones but still considered to be moderately free by the Index authors, low import tariffs makes Russia score high at trade freedom aspect.

To conclude, Russian political, legal and economic environment is not perfect for setting up a business. Insecurity of MPC Industries' assets in Russia should be a great concern for the company, since, accordingly to the data, the property rights are not considered to be highly important in Russia. Besides, the judiciary system is rigged, so sometimes it is impossible to win a case against more powerful organization. Also, MPC Industries should note that corruption rates in Russia are very high and bribery is a rather common thing. So, the company should expect to be asked to pay extra money to get things done. On the other hand, the corporate taxation is very low, so MPC Industries can benefit from higher margins. Moreover, establishing a company in Russia is as easy as it is in the other European country and a foreign firm can found its representative in the country without dealing with governmental barriers. It is also worth noting, that the import tariffs are very low, and they do not significantly influence the costs for the product, from which MPC Industries can benefit. All in all, it is definitely quite risky to open an office in Russia but still it is worth trying to due to significant benefits and exploration of a new market.

- Is hydraulic accumulators' market large enough to for MPC Industries?

MPC Industries was interested in investigating hydraulic, heavy-duty vehicles, oil and gas and wind power industries. The investigation demonstrated that all the chosen industries except for wind power are quite developed in Russia.

Accordingly to the research, hydraulics market is the seventh biggest in the Europe. Many European and American hydraulics firm are present at in Russia and consider it to be quite a promising market. There are also one

big local company that involved in production of hydraulic components including the accumulators. All in all, the experts assess the size of the hydraulic accumulators market to be of 35 000 units per year.

The same situation can be observed in the heavy-duty vehicle industry. There is an abundance of foreign companies, which produce and sell machines in Russia, and several local firms usually smaller in size. A significant percentage of heavy duty machinery is imported to Russia. The market experienced a slump in 2014-2015 although now it started to recover. Despite all the ups and downs of the industry, the size of the heavy duty machinery market in Russia exceeds 3 billion euros, which makes it excessively large for MPC Industries capabilities.

Oil and gas industry is growing quite fast in Russia since these resources constitute a significant share of income to the budget. Despite an overall negative economic situation in Russia during last several years, the industry has been growing nevertheless. A lot of resources is invested in a development of new oil extraction sites. The experts predict that such positive trend will last for at least for the next three years.

The only industry that is underdeveloped is wind power. Russian firms particularly do not produce any equipment for the wind turbines due to lack of technological competencies. Alternative sources of energy are not so widespread in the country and traditional ways of energy production are used. Nevertheless, it was explored that the state is encouraging development of green energy industries, including wind power. Therefore, in the following decade, the wind turbines might become quite common mean of energy generation

To top it all, the current size of hydraulics, including the hydraulic accumulators, is large lucrative enough for MPC Industries to enter.

- How high the competition intensity at the market?

The research demonstrated the following aspects of competition environment at the market. Firstly, it was identified that there were apparently no other firm that

specializes on the production of the accumulator clamps. At the same time, the users of hydraulic accumulators make their own fixating devices or use substitute products. Therefore, the main threat for the company is alternative mechanisms for mounting the accumulators.

The other issue concerns the bargaining powers of MPC Industries. Accordingly to the research, the company can serve to types of clients: hydraulic components' manufacturers and the end users of the hydraulic systems. Depending on which group of customers MPC Industries decides to focus, the bargaining strength of the firm differ significantly. In case it chooses the manufactures, the negotiation advantages of the company are vanishingly small, while if the firm starts to serve the end users the situation becomes slightly more favorable.

To top it all, the company should not be afraid of other competitors at the market since no other firm has not tapped into this niche. On the other hand, the absence of the accumulator clamp manufacturers in Russia can be explained by the fact that bargaining power of buyers and popularity of substitute is rather high in the industry. So, entering the country, MPC Industries should make sure that their product is competitive with the substitutes options and should not focus solely on manufacturers but also go directly to the end users.

### 6.3 Preferred method of entry

The main problem of the research is to offer the commissioner the optimal method of entering Russian market. Accordingly to the study, the recommendation for MPC Industries is based on the firm's capabilities and the country's advantages.

The framework of the study implied that the firm can enter the market choosing one of the six entry modes such as export (direct and indirect), licensing, contract manufacturing, strategic alliances, joint ventures and wholly-owned subsidiaries.

Some of the entry modes are not viable for MPC Industries. Licensing is not an option because the company's brand and product is not in a such demand, so someone agrees to buy it and pay back royalty fees. Contract manufacturing is not



viable because the firm intent is to sell in the clamps in Russia but not to produce. Strategic alliances and joint ventures are the methods meant for huge multinational enterprises which want to share the knowledge and resources. The only two viable options for MPC Industries are export and wholly-owned manufacturing subsidiary.

The usual way of entering new markets for MPC Industries is establishing a sales office in the preferred country. The company has never established manufacturing facilities overseas. Considering the fact that the firm did not manage to set up a wholly-owned subsidiary in European countries that are more politically and legally stable than Russia, the author strongly advises not do that in this case neither. Therefore, the best method for MPC Industries is starting to export the goods to Russia. Since the company has a great experience of direct exporting of goods, it should do the same in this case as well.

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