



**UNIVERSITY OF GOTHENBURG**  
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**ECONOMIC SANCTIONS EFFECT ON  
MULTINATIONAL CORPORATIONS STRATEGIES**

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# Abstract

The use of economic sanctions has grown in recent years and led to increased uncertainty and turbulence in the global economy. The Ukraine conflict in February 2014 led to the implementation of sanctions and counter-sanctions between the EU and Russia which resulted in a significant loss of trade and investments between the regions. This study aims to answer how the implementation of sanctions against Russia influence the business strategies of foreign MNCs. A multiple case study approach has been adapted where semi-structured interviews have been conducted with six Scandinavian MNCs that exports to the Russian market.

The findings of this study show us that firms expand their international activities as a result of the sanctions, in order to increase the scope and scale of their internationalization to diversify their revenue and limit their exposure. Further, the result show that firms increased their flexibility, streamlined their operations and took advantage of the favorable investment environment in Russia as a result of sanctions and the downturn in the Russian economy. While exporting to the Russian market through a third country proved difficult, it was possible for MNCs to circumvent the agriculture sanctions by locating production inside Russia and using local components in their products.

The involuntary de-internationalization from the Russian market forced upon some of the case firms as a result from the sanctions isn't accounted for in majority of previous theories of internationalization. Further, the study confirm the trade destructive effects of sanctions, and how it indirectly hurt broad sectors of the Russian and European economies. This thesis highlighted the loss of revenue and exports for MNCs and the unpredictable nature of economic sanctions that will continue to be challenging for managers to foresee.

**Keywords:** Internationalization, Emerging Markets, Economic Sanctions, Market Turbulence, Strategy Adjustments, Uncertainty, Risk Management

## List of Abbreviations

- BG Born Globals, page 10
- CEO Chief Operating Officer, page 1
- CFO Chief Financial Officer, page 25
- CIS Commonwealth of Independent States, page 58
- EU European Union, page 1
- FDI Foreign Direct Investment, page 33
- GDP Gross Domestic Product, page 31
- IB International Business, page 15
- IJC The International Court of Justice, page 35
- MNC Multinational Corporations, page 4
- NATO The North Atlantic Treaty Organization, page 35
- NOK Norwegian Krone, page 45
- PPP Purchasing Power Parity, page 31

SME Small and Medium Sized Enterprises, page 19

UN United Nations, page 31

VP Vice President, page 26

WTO World Trade Organization, page 3

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# Chapter 1

## Introduction

*This chapter provides an introduction to the subject's background and the implementation of sanctions, which leads to the problem discussion where previous theories and research gaps are outlined. Following the problem discussions, the research question and purpose of the study is presented. Lastly, the outline and structure of the study is summarized.*

### 1.1 Background

*“Since the second quarter of 2014, the export has been completely dead. It's hard when you can't influence anything, you just have to wait and see.”*

- Patrik Johansson, CEO of Swedish firm Engtex, commenting on the European Union sanctions against Russia (Lek, 2014).

The proposed EU Association agreement with Ukraine in November 2013 had been a decade long inquiry which implementation goal was to integrate Ukraine into European Union and open its economy for European actors. Although a highly corrupt and poor country, a potential EU membership for Ukraine with its fertile soils, natural resources and large population was seen by many European corporations as a positive move that would offer increased business opportunities and trade (Sakwa, 2014; Parliament, 2017; BBC, 2014). However, what unfolded in the coming months became the biggest European crisis since the



end of the cold war and resulted in badly damaged political and business relations between the EU and Russia (Sakwa, 2014; Cohen, 2017; BBC, 2014).

The EU association agreement was supposed to be signed in November 2013 by the then president Viktor Yanukovich. However, the economic implications of the EU membership was still unsure for the Ukrainian leadership, and Russia had offered their own counter economic proposal, which included favorable loan guarantees and heavily subsidized gas prices for the struggling Ukrainian economy. The president decided to postpone the decision for a EU membership and proposed a three-way trade commission between Ukraine, the European Union and Russia that would resolve trade issues between the sides (Sakwa, 2014; BBC, 2014).

What then started out as peaceful protests at the Maidan Square in Kiev against the governments possible move away from EU membership quickly turned unpleasant. Violent deaths amongst protesters and police led to the overthrow of the elected government of Viktor Yanukovich on February 22, 2014. The events at the Maidan sparked a pro-Russian uprising among the population in eastern Ukraine, which culminated with the Russian Federations disputed annexation of Crimea in March 2014 (BBC, 2014).

As a response, the US, the EU and other western countries swiftly implemented sanctions against certain Russians officials and an import ban of goods originating from Crimea in April 2014 (BBC, 2014; Parliament, 2017). The conflict escalated further with the war in the *Donbass* region of Eastern Ukraine between separatists and anti-government groups supported by Russia against the new Ukrainian Government (Sakwa, 2014; Mearshaimer, 2014). A more comprehensive package of economic sanctions (See appendix A) was therefore later implemented on the 29th on July that especially targeted Russia's access to EU capital markets (Parliament, 2017).

As a responding measure towards the western countries, the Russian president Vladimir Putin signed the presidential decree no. 778 on the 7th of August in 2014 that imposed a ban on several agricultural products coming from the countries originally imposing sanctions on Russia (See Appendix B). Example of the EU products that became banned from imports were vegetables, fruits, fish, pork, beef, milk and other diary products. Although both measures of sanctions were supposed to be implemented for a short period of time, the sanctions have been added and extended several times and are at least in place until the summer of 2018. US and EU officials argue they will not lift the sanctions until the agreements of the Minsk-accord is fulfilled (Parliament, 2017).

The European Union's sanctions against the Russian Federation in the summer of 2014, and the responding counter-sanctions by Russia struck certain business sectors hard. The total exports from the EU to Russia decreased from €120 billion in 2013 to €72 billion in 2016, an almost 20 % annual decline (EP, 2017; World Bank, 2018). Approximately 40 % of the total loss in trade is directly attributed to the sanctions, whereas the implementation of the sanctions coincided with the downturn of the Russian economy as a result from the sanctions, falling oil prices and the ruble depreciation (EP, 2017).

Economic sanctions is a controversial international policy tool, yet widely used in recent decades (Leenders, 2014; Marcus, 2010; Drezner, 2018). Economic sanctions include various forms of trade barriers, tariffs, and restrictions on financial transactions that are applied by one country against another country, organization or individual. The use of economic sanctions to strictly achieve an economic advantage over a country is illegal under WTO-law , and are therefore mostly used for a variety of political, social and military reasons to change a certain adversaries policy (Leenders, 2014; Marcus, 2010; WTO, 2018).

Economic sanctions success as a policy-changing tool is debatable and in many cases ineffective, but its trade destructive effects are obvious (Leenders, 2014; Marcus, 2010; Drezner, 2018; Parliament, 2017). For example, earlier Western sanctions against Iran, North Korea and Cuba have proved unsuccessful in its political goal and in some cases strengthen the adversary's policies, but it has nevertheless had severe trade and economic consequences (Leenders, 2014). While the implementation of sanctions is easy, there are often difficulties in predicting the termination of them, the still on going American sanctions placed on Cuba in the 1960s being the main example (Marcus, 2010; USDT, 2017). M. Johanson (2003) defines the term market turbulence as institutional changes that are frequent, unpredictable and extended over a long period of time, a description that fits the main characteristics of economic sanctions.

During market turbulence, the business and institutional landscape drastically changes and could disrupt the internationalization strategy of a multinational corporation. The many and diverse uncertainties that affect firms in their international business operations, and the risks that they pose, can cause the firm to fail in its strategic objectives (Liesch, Welch, & Buckley, 2011; Ghoshal, 1987). Because after the market turbulence, companies will face a new business reality with a change in demand and preferences from the consumers, but also new governmental regulations they need to adapt to (Kao, 2013; Santangelo & Meyer, 2011). The adjustment in strategy as a response to the institutional changes increases the possibility of changes in not-yet-implemented expansion plans, reversing decisions of earlier

investments, and even the discontinuation of operations in response to not achieving strategic objectives set out by the firm (Santangelo & Meyer, 2011; Ghoshal, 1987).

In the case of the Ukraine conflict and following sanctions, the agriculture export to Russia was almost completely shut down for European actors (Parliament, 2017). European firms were also indirectly affected by the EU sanctions on Russian energy and finance sectors, since Russian banks were expelled from the European capital which made it more difficult for firms to get investment capital (Parliament, 2017; Giumelli, 2017). The overnight change in regulations and the downturn of the Russian economy left some Scandinavian MNCs exposed, and faced with major strategic decisions to make in regards to their internationalization strategy and operations in Russia.

## 1.2 Problem discussion

Majority of internationalization theories have focused on the company's incremental process, whereas a firm's internal strategies, knowledge and resources are the important determinants of its internationalisation (J. Johanson & Vahlne, 1977; Cavusgil, 1980). The Uppsala model (J. Johanson & Vahlne, 1977) is one of the most cited internationalization theories, which states that it's a company's experiential knowledge that determines their international behavior, thus a firm's international activities are expected to grow in line with their knowledge of the foreign markets. These theories undertake the presumption that the market is consistent, and they do not account for external turbulence and sudden institutional changes that effects economies (Cantwell, Dunning, & Lundan, 2010; Gelbuda, Meyer, & Delios, 2008; Vahlne & Johanson, 2013)

During the last decades there has been a dramatic change in the world economy, whereas emerging markets have come to play a more central role for MNCs (Cantwell et al., 2010; Santangelo & Meyer, 2011; M. Johanson & Johanson, 2006). As emerging markets began opening up, they have frequently been the scene for political reforms and institutional changes (Khanna & Palepu, 2010; Santangelo & Meyer, 2011). Therefore, these emerging markets present a more complex and turbulent internationalization process than before (Khanna & Palepu, 2010; Santangelo & Meyer, 2011; Karhunen, 2008).

M. Johanson and Johanson (2006) study found that firms entering emerging markets are generally ignorant about those markets, and consequently the internationalization process

into the market involves discoveries that were not known, and could not have been predicted in advance. Russia and similar emerging countries with fast growing markets usually have a weak supporting system and institutions, which make them more frequently exposed to market shocks. These shocks are generally exogenous to companies and cannot be controlled by them (Santangelo & Meyer, 2011; Cantwell et al., 2010; Yim, 2008).

J. Johanson and Vahlne (1977) argue that with increased knowledge, the perceived uncertainty in a market will decrease. The study of Hilmersson, Sandberg, and Pourmand Hilmersson (2015) showed that previous experience and knowledge will be less relevant in the case of market turbulence, since the accumulated knowledge can become obsolete after dramatic changes in institutional regulations (Hadjikhani, 1997; Jansson, 2008; Hilmersson et al., 2015). Firms will therefore face a situation where the managers don't know, and a cannot know how to adjust to the turbulence, since previous experience only deal with the past, whereas turbulence is expected to change the future (Tsoukas, 1996).

Therefore, the ongoing institutional changes in the emerging market may require the MNC to adjust their strategies which differs from their intended internationalization strategy (Cantwell et al., 2010; Santangelo & Meyer, 2011). Mintzberg and Waters (1985) separate between the concepts of intended and realized strategy in their study on strategic theories. They suggest that the intended strategy derives from the strategic plan prepared by the company's top management. On the other hand, the realized strategy is the strategy that an organization actually follows. The realized strategy derives from the intended and deliberate strategy, but also from an emergent strategy that could arise as a result from unexpected opportunities and challenges in the environment that changes the planned strategy. In an imperfect and unpredictable external environment, intended strategies are therefore unlikely.

Santangelo and Meyer (2011) examined under which external circumstances MNCs increase or decrease their commitment and how the realized strategy differs from the intended strategy at the outset. Their paper is built upon J. Johanson and Vahlne (1977) internationalization model and Mintzberg and Waters (1985) framework of strategy formation. Santangelo and Meyer (2011) study was conducted in emerging markets where the institutional environment has been evolving and changing rapidly, and MNCs are forced to adjust their strategies more frequently. Santangelo and Meyer (2011); Kogut and Zander (1993) argue that MNCs can respond to uncertainty and institutional change in the host market through two adjustments in their strategy implementation, by either increase or decrease their internationalization commitment. Santangelo and Meyer (2011) findings confirmed that institutional factors leads to commitment changes, which drive the divergences between intended

and realized strategy. During institutional uncertainty, investors are induced to design their strategies “for flexible responses to new opportunities, and hence increases the chance for entrepreneurial opportunity recognition and commitment increase.”

In the last years, there had been major institutional changes in the world economy and not only on emerging markets. For example, the financial crisis of 2007-08, the United Kingdoms decision to leave the European Union and the election of Donald Trump in 2016, with its potential trade protectionist policies (Horsley, 2018; Drezner, 2018). There are few qualitative studies that have examined the changes in regulations in the host market and how these changes may influence MNCs internationalization (Kao, 2013; Karhunen, 2008; Cantwell et al., 2010; Gelbuda et al., 2008), and there are no previous qualitative studies that investigates how economic sanctions influence MNCs and their business strategies. Previous studies (Leenders, 2014; Parliament, 2017; Giumelli, 2017) have shown that economic sanctions led to trade destructive effects on a country to country level, and also that the trading patterns changes between nations. However, the EU-Russia sanctions has not been explored beyond the macro level, and the consequences are less understood and explored how corporations operate and adjust in such environment (Giumelli, 2017).

What is know from the literature is that the strategy of a firms internationalization is a relevant predictor of its performance during market turbulence (Hilmersson, 2014), but also that previous experience and knowledge will be less relevant in the case of market turbulence. Studies have shown that emerging markets are volatile with higher uncertainty due to frequent institutional changes and market turbulence, that leads to the firms realized strategy often diverts from its intended strategy (Santangelo & Meyer, 2011; Kao, 2013). The definition of market turbulence matches the characteristics of economic sanctions, but the behaviour of firms operating in this specific circumstances has not been explored. There are firms that benefit from sanctions and its opportunities. In the case of an import ban, domestic actors are the obvious beneficiaries, but the challenges and possible opportunities faced by foreign MNCs and their ability to circumvent the effects of sanctions is less clear. Here is a gap in the current literature that this thesis will focus on, i.e how firm’s adjust their strategies to overcome the effects of market turbulence in the form of sanctions on the emerging Russian market.

### 1.3 Purpose and Research Question

The purpose of this study is to explore how institutional changes in the form of economic sanctions influence the business strategies of MNCs. With the increasing tendencies to use economic sanctions, it is the authors ambition to increase the understanding of sanctions implications and unpredictable nature for a MNC operating under these institutional changes. The empirical findings and analysis from this case study will lead to increased understanding of the successful strategies companies can apply to counter market turbulence, the thesis therefore strives to answer the following main research question:

*How did the implementation of sanctions against Russia influence the business strategies of foreign MNCs?*

To solve the presented research gap and following research question, the study will focus on a theoretical framework developed on previous literature from three different areas of study. Since this study examines MNCs operating towards Russia, previous literature on internationalization is a relevant field of theory which gives a background and explains firm's behaviour and performance in their international activities. Hence economic sanctions similarities to the characteristics of market turbulence, previous studies of market turbulence in relation to internationalization will also be presented. The theoretical framework concludes with changes in strategy that firms can adapt in their international activities as a result of uncertainty and market turbulence.

### 1.4 Outline for the study

The thesis is divided into six segments, including the previous introduction chapter, and is outlined as follows.

#### **Theoretical framework**

The theoretical framework covers large extents of earlier studies in the field of internationalization, market turbulence and adjustment of strategies. This create a theoretical framework for the researcher and the reader which is used for comparison with the empirical results in the analysis.

**Methodology**

The methodology chapter outlines the methodological approach to conducting this multiple case study. It will present the methods and techniques applied to gathering empirical data, the analyses and conclusion.

**Empirical Findings**

At the start of chapter four on empirical findings, in order to further enhance the readers understanding of the subject and the authors analysis, the author will present the economic and geopolitical background regarding Russia and the sanctions. Thereafter, the findings from each case firm will be presented. The empirical findings consists of data gathered from interviews and relevant second hand materials.

**Analysis**

This chapter relate the earlier studies on the subject presented in the theoretical framework to the empirical findings, where it will be compared and analyzed with the research question in mind.

**Conclusion**

The paper ends with an answer to the research question and summary of the thesis main findings. Limitations and suggestions for further studies in this area will also be presented.

## Chapter 2

# Theoretical Framework

*The following chapter will start by presenting the theoretical framework in three various fields. Firstly, a summary of the current literature on internationalization theories will be presented. Thereafter, market turbulence within emerging markets and a chapter regarding risk management is presented. Lastly, different adjustment of strategies as a response to market turbulence will be outlined.*

### 2.1 Internationalization

Internationalization and foreign market entry have been a prominent topic in international business studies during a long time (P. J. Buckley & Ghauri, 1999; P. J. Buckley, 2002). Internationalization is generally described as the process where a company gradually expands and increases its international activity, and is usually driven by an opportunity in a foreign market (J. Johanson & Vahlne, 2009; Schweizer, Vahlne, & Johanson, 2010; L. S. Welch & Luostarinen, 1988). One of the most well-known internationalization theories is J. Johanson and Vahlne (1977) Uppsala Model, which key concept is that firms expand to markets that are physically close and then are expected to continue expand stage wise with their increased knowledge of foreign markets. J. Johanson and Vahlne (1977) cover the concept of *physic distance* that was developed by earlier internationalization theories (J. Johanson & Wiedersheim-Paul, 1975), which argues that a firm expand to a market with low country-based diversities and dissimilarities from their home market. Further international



expansion then progresses into markets with successively greater psychic distance which also adds greater uncertainty and liability of foreignness (Vahlne & Nordström, 1992; Vahlne & Johanson, 2013).

Internationalization is seen as a process which exposure to different foreign markets increases the firms experience, which can later be transformed into experiential knowledge. By generating experience, uncertainty is reduced for the firm (Hilmersson & Jansson, 2012; Santangelo & Meyer, 2011). Market uncertainty is therefore a central concept in internationalization and is defined by J. Johanson and Vahlne (1977) as the perceived lack of ability to estimate market-influencing factors both in the present and future. The main source of uncertain is with regard to decisions for committing resources to a foreign environment (Hilmersson & Jansson, 2012; Figueira-de Lemos, Johanson, & Vahlne, 2011).

Some of the criticism towards the earlier internationalization theories is that it is not applicable to all firms. With the increasing globalization, the phenomenon of *Born Global* firms has challenged the traditional views of internationalization (Liesch et al., 2011; J. Johanson & Vahlne, 2009). BG firms are emerging in sizeable numbers and despite the limited resources that characterize new businesses, BGs internationalize their operations in a very early stage of their development and leapfrog the theories of psychic distance and gradual internationalisation through experiential knowledge (J. Johanson & Vahlne, 1977; Cavusgil, 1980; Vahlne & Nordström, 1992). BG also differs from the traditional pattern where large, experienced and well-resourced multinational corporations generally conducted international business (Jansson, 2008; J. Johanson & Vahlne, 2009).

### 2.1.1 Internationalization effect on firm performance

In IB and strategy research, a generally held assumption suggests there is a positive relationship between international involvement and firm performance. Recent research strengthen this assumption that internationalization can be seen as a growth strategy undertaken to improve the firms performance (Khavul, Pérez-Nordtvedt, & Wood, 2010; Yip, Biscarri, & Monti, 2000). In assessing this assumption, Hilmersson (2014) study looked at the dimensions of speed and the degree of internationalization and how it effects the firms performance during market turbulence.

The degree to which the firm is involved in international activities consists of two main dimensions, the scale of internationalization and the scope of internationalization (Hilmersson,

2014; Kuivalainen, Sundqvist, Saarenketo, & McNaughton, 2012). The scale of internationalization is the degree of the companies revenue that derives from foreign sales, and therefore is a measure of the dependence and exposure towards foreign markets (George, Wiklund, & Zahra, 2005; Bartlett & Ghoshal, 1998). With increasing foreign sales, there is therefore a lower dependence on the domestic market in favour of international markets (Hilmersson, 2014). The scope of the internationalization refers to the geographical reach of the business, i.e the number of different markets that the firm operates in. When the firm gets exposed to new a new number of markets, it contributes to the firm learning and experience, which can later be absorbed into knowledge (J. Johanson & Vahlne, 1977; Hilmersson, 2014).

Whereas the scope and scale of the internationalization refers to the firm's internationalization process, a more popular focus of recent research, mainly driven from the increase in high tech start ups and phenomena of BGS, have been towards the speed of internationalization (Hilmersson, 2014). The speed assesses the dynamic aspect of the growth strategy and is the time at which firms spread their international activities, and by undertaking a high speed of internationalization, firms are likely to gain a first mover advantage provided it is the first significant occupant to enter (Johansson, Landström, & Palmer, 2013). By being first, the firm can access resources earlier and gain a head start towards its rivals. This could lead to strong performance and profits and its therefore presumed that the higher the speed of internationalization, the greater the performance of the company (Hilmersson, 2014).

## 2.2 Market turbulence and Internationalization

Hilmersson (2014) study concluded that the firms internationalization strategy is a relevant predictor of its performance during market turbulence. The study argues that the geographical scope and speed of the internationalization is more important than the scale of internationalization during market turbulence for SMEs. Kao (2013) mentions that during times of market turbulence, firms often feel vulnerable and resort to make as little investment as possible, since the previous experience and preparation for dealing with the changing of regulative institutions is small. However, Hilmersson (2014) conclude in his study that managers should diversify the risk between different countries during market turbulence and not 'put all their eggs into one basket'.

By diversifying the risk to different countries the firms will get more flexibility and reduce sales fluctuations and therefore handle the market turbulence better. This somewhat contra-

dicts the notion that internationalization is a risky strategy (Figueira-de Lemos et al., 2011), and could instead be seen as a risk-reducing strategy during market turbulence (George et al., 2005). Hilmersson (2014) conclude that the scope and speed of the internationalization effects is more important than the scale of internationalization during market turbulence. This was also supported by Oviatt and McDougall (2005) that the through speed of the internationalization firm can achieve potential first-mover advantages in different countries and perform positive performance effects in times of market turbulence.

The consensus in earlier studies by Santangelo and Meyer (2011); M. Johanson (2003); Hadjikhani (1997), is that during times of market turbulence earlier learning and knowledge about the political environment in a foreign market does not reduce the uncertainty, and previous experiences are therefore of limited use. Hilmersson et al. (2015) study showed that increased levels of political turbulence would further increase the perceived uncertainty in the market. Throughout market turbulence, managers should instead develop a flexible organization that can help reduce the uncertainty, instead of highlighting previous experiential knowledge. Especially in emerging markets, foreign subsidiaries need to re-adapt their strategy to the recurring changes in legislation and institutions. Khanna and Palepu (2010) argue that firms need to adapt their strategies in changing markets, because strategies that have been successful in stable market environments are not likely to be successful in unstable environments and therefore flexibility is important.

Kao (2013) study looked how firms adopted their market entry behaviour to occurring institutional changes. He found that regularly occurring institutional changes in emerging markets may require entering firms to make a lot of adjustments that are both time consuming and costly. Even though institutional changes are common, and business managers continue to stress the importance of observing changes in regulations and laws in the host market, there are few studies on the subject. Karhunen (2008); Soh and Yu (2010) looked at how foreign firms responded to institutional changes in Russia and China. In their findings they concluded that foreign entrants must continually adapt to institutional changes due to transitions and liberalizations in the host market. Kao (2013) study showed that companies form stronger collaborations with other customers, distributors and government officials after market shock and following institutional changes. The markets shocks could also enable firms to work more closely and directly with governmental agencies and exercise their influence towards favorable institutional changes in the future. However, to form stronger collaborations with different actors in the host market after a market shock, the MNC must have acquired sufficient experience in the market and also have a good reputation with local actors to enable trust (Kao, 2013).

### 2.2.1 Managing risk in internationalization

Managing the internationalization process of the firm is managing under conditions of uncertainty (J. Johanson & Vahlne, 1977; Jansson, 2008; Johansson et al., 2013). There are risks associated with every business, however firms operating outside their national boundaries face not only opportunities for growth, but also additional challenges. The last decade changes in the world economy, with the opening up of emerging markets have made the internationalization process more complex and turbulent than before (Santangelo & Meyer, 2011; Khanna & Palepu, 2010). Emerging markets usually have a weak system supporting their institutions, which make them more frequently exposed to certain political risks and market shocks (Santangelo & Meyer, 2011).

Wells (1998) defined political risk as “risks that are principally the result of forces external to the firm and which involve government action or inaction.” Previous studies have shown that political risks assessment historically been somewhat neglected by MNCs. One of the earliest studies in this subject, conducted by Root (1968) found little support that US managers systematically assess political risks on a headquarter level. This study has been supported by later studies, where most of the assessments of risk was a reactive response to an unfolding event rather than proactive, and often based on personal judgments and expert opinions (Oetzel, 2005; De Mortanges & Allers, 1996). Only a few firms use scenario planning or certain standardized checklists for assessing potential risks (Oetzel, 2005; De Mortanges & Allers, 1996).

However, studies have shown that large MNCs is well aware of political risks, which is evident from the level of resources that large organizations deploy to strengthen the relationship between the policy makers and business activity (Oetzel, 2005). For example, United States exceed \$30 billion per year in corporate spending in political lobbying activity, and there are over 10.000 lobbyists operating in the European Union halls in Brussels (Wang, Tiong, Ting, & Ashley, 2000; Henisz & Zelner, 2003; Oetzel, 2005).

Oetzel (2005); Culp (2012) study showed that headquarters assessment of political risks is also consistent with managers on a subsidiary level as well, who generally don't engage in political and economic risk assessment and seldom in coordination with headquarters. Although Oetzel (2005) study showed that many of the firms she observed experienced a variety of political and economic risk, only one out of fourteen managers interviewed used one or more commercially available risk measures for assessing country risk on an on-going basis. Organizations can make serious mistakes if they neglect, underestimate or ignore

political risks in their strategic planning (Culp, 2012).

There are different kinds of political risks that need to be considered for a firm. Their could be strictly economical and financial, which is prominent in governments efforts to reducing inequality and handling of high sovereign debt as in the the still on-going euro zone crisis (Culp, 2012). Companies have increasingly focused their attention on these financial risks, but also market and operational types of risk, especially since the economic crisis of 2007 (Culp, 2012). However, during the last years escalation in sanctions and the on-going debate regarding tariffs and protectionism, other kind of political risks have emerged. This has been described as other types of political risks by Culp (2012), and it is mostly directed towards state actions that try to promote their own state-owned companies and to tap into the cash flow. This has resulted in the increase of trade barriers, most notably seen recently in the United States after the election of Donald Trump (Horsley, 2018). It is also relevant in the tit for tat sanctions between the US/EU and Russia, which both have political and economic agendas and has led to increased barriers to trade (Parliament, 2017).

Culp (2012) argue that their is a three-step process for firms to identify key political risks that helps firm predict their possible impact and the best method to deal with its consequences. The first step is to identify possible risks in each geographic location, ranging from government policies on taxation to the possibility of wars and terrorism. Some of these risks will not affect businesses, will other might provide both opportunities and challenges. By identifying the risks the risk management team and managers can build different cases of possible scenarios.

After identifying the potential risks, the team can measure the impact from each scenario. This could be done with a discount cash flow analysis but also measure the strictly operational risks for the firm. Its important for the firm to quantify the different scenarios in real terms, numbers, indexes etc so the firm can measure and asses the acceptable level of risk. For example, by providing a framework of the acceptable risks in dollars its easier for the firm to take certain decisions if the risk scenario emerges. The last step of the three-step process is to manage the risks. Constructing a framework towards the handling of the different scenarios creates a effective system to manages these risks. By providing a clear identification, measure and management process of risks, the firms are enable to tap in to opportunities that arises from political risks that might without right risk management process deemed to risky.

## 2.3 Adjustment of strategies

The growing numbers of studies on internationalization in IB studies focus mostly on the internal process of a firm in its choice of market. However, there are only few studies focusing on the adjustment of strategies in the internationalization process such as Santangelo and Meyer (2011); Figueira-de Lemos et al. (2011), and barely any research done if these theories are applicable to economic sanctions specifically. Liesch et al. (2011) argued that more research is needed in regards to risk and uncertainty, and little knowledge is known about the relationship between institutional changes and foreign market entry decision and operations of a firm according to Kao (2013).

Santangelo and Meyer (2011) concludes that multinational enterprises change of strategy in a country after their initial entry is mainly driven by environmental changes that influences the processes of learning, creating opportunities and trust building, and firms may therefore increase or decrease their commitment in divergence from the intended strategy. What is generally agreed upon is that the adjustment of a firms intended strategies are more common in businesses operating in a volatile emerging market (Khanna & Palepu, 2010; Kao, 2013; Karhunen, 2008; Soh & Yu, 2010).

Mintzberg and Waters (1985) study presented the divergence process in strategy, whereas intended strategy is described as the the strategic plan generated for a company that suggests clear and articulated intentions by its top management. Due to unexpected opportunities and challenges, there could arise emergent strategies that deviate from the planned intended strategy by the firm. The emergent strategy could turn out to be a success or a failure for the firm, but is implemented as a response to the changing environment and are realized despite or in absence of earlier intentions. The deliberate strategy taken by the firm is the parts of the intended strategy that the firm continues to pursue, and in combination with the emergent strategy is what comprehends the realized strategy.

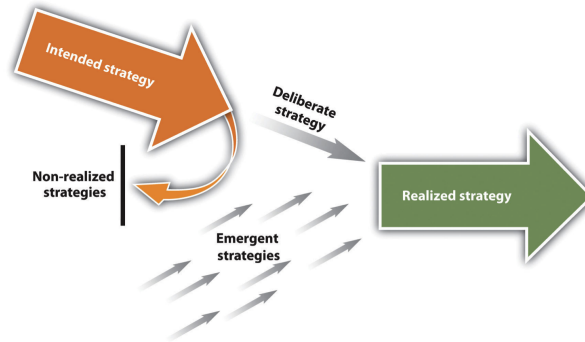


Figure 2.1: Mintzberg concepts of intended and realized strategy, Source: Santangelo and Meyer (2011)

For a strategy to be perfectly deliberate, which means that the realized strategy are exactly as the intended strategy, there are certain conditions that needs to be fulfilled. The precise intention of the firm must be described and concrete in its level of detail, and these views must be commonly shared or at least collectively accepted from virtually all the actors. The collective intentions by the firm must then be realized exactly as intended, whereas no external forces interfered, i.e the environment must be either perfectly predictable or under full control of the organization. According to Mintzberg and Waters (1985) description for a strategy to be perfectly emergent, “there must be order-consistency in action over time-in the absence of intention about it.” The total absence of intention is however unlikely and it is expected that firms use tendencies of deliberate and emergent strategies rather than perfect forms of either.

The scope of operations also determine the realized strategy, for example most financial institution are entrusted with public funds and scrutiny, and most be very clear and careful in their planning and have minimal room for deviation from the set objectives (Santangelo & Meyer, 2011). However with internationalization and globalization and increasing unpredictable and dynamic markets, firms must be able to accommodate emerging strategies as well (Santangelo & Meyer, 2011). Each strategy approach has advantages, whereas a deliberate strategy provides clarity and a stable set of objectives. The emergent strategy provides more flexibility and is able to adjust to different environmental challenges and have the benefit of experimenting with different approaches before arriving with the solution that most likely leads to the realization of their intended strategy (Santangelo & Meyer, 2011; Mintzberg & Waters, 1985).

### 2.3.1 De-internationalization

The internationalization process model accommodates de-internationalization, and even withdrawal from international operations as possible strategies for a firm to undertake in their international activities according to J. Johanson and Vahlne (2009). While the internationalization process have got a lot of attention in IB research, the field of de-internationalization is less covered (Benito, 2005; L. S. Welch & Luostarinen, 1988; Mellahi, 2003). Mellahi (2003) describes de-internationalization as “a voluntary process of decreasing involvement in international operations in response to organizational decline at home or abroad, or as a means of enhancing corporate profitability under non-crisis conditions”. What his definition lacks is the inclusion of the involuntary process of leaving a market, since their might be unexpected conditions that makes further internationalization not feasible in a certain market.

Benito and Welch (1997) further mentions de-internationalization options and different strategy adjustment towards a market, such as ”de-investments, pulling-out of a market, downsizing foreign operations, and/or switching from high to low commitment modes of operation”. In addition to these acknowledged possibilities, firms may also decide against making any changes in commitments to their business network relationships, and in doing so, they pursue a *wait-and-see* strategy. Wait-and-see strategy is described by Sull (2005); Clarke and Liesch (2017) as a strategy resulting from a measured decision in the firm to maintain current commitments to its business relationships in international markets. It is seen as a strategy of active waiting for more favorable outcomes in the possible future(Sull, 2005; Clarke & Liesch, 2017).

The current form of the internationalization process does not fully explain the wait-and-see strategy in firm internationalization according to Clarke and Liesch (2017). The internationalization model assumes that firms manage the risk that they encounter only by changing the relationship commitments in their business networks. Clarke and Liesch (2017) found that the firm pursues a wait-and-see strategy in response to a risk disequilibrium. Risk disequilibrium refers to an imbalance between the amounts of risk that the firm experiences in its existing situation and the amount of risk that it is able to tolerate. The pursuit of a wait-and-see strategy instead of further internationalization with increased commitments is risk avoidance. In the case of a wait-and-see strategy instead of de-internationalization with reduced commitments, the strategy in seen as risk maintenance.

Withdrawal from the international operation is the most radical form of commitment de-



crease (Benito & Welch, 1997; Benito, 2005). However, the withdrawal from one market does not describe the relationship between internationalization theory and commitment in a sufficient way. If a firm downgrades its operations or even exits a market, its overall exposure to cross-border operations can remain constant due to a simultaneous increase of commitment to other markets (Vahlne & Nordström, 1993). The de-internationalization can therefore be full or partial, often depending on which stages the firm is in its internationalization process (Trapczyński, 2016; Benito & Welch, 1997).

Benito and Welch (1997) suggest that de-internationalization is more likely during the first stages of internationalization and the probability of reducing its involvement lowers when the commitment into foreign markets is increasing. However, partial de-internationalization is more likely to occur in the first or late stages of the internationalization process. After the de-internationalization process, it was in previous studies argued to be followed by a re-internationalization (C. L. Welch & Welch, 2009). However, recent studies suggest that with the increased global competition and institutional changes, withdrawals from a foreign market are not necessarily followed by re-internationalization into the market again (Reiljan et al., 2004; Gelbuda et al., 2008; Trapczyński, 2016; C. L. Welch & Welch, 2009).

Reiljan et al. (2004) build a framework with the four motives influencing the decision to de-internationalize. The first motive is what she argues the *lack of international experiences*, which for example include insufficient pre-internationalization analysis, poor choice of target market and operational mode and a too rapid and/or early expansion strategy. The second motivation could be a *change of strategy* by the firm, whereas the focus is shifted towards its core markets and activities. It could be a result from a new manager's different strategic perspective or inadequate growth in the target market. This change in strategy is most likely to occur in later stages of internationalization.

The third influence that motivates the firm to de-internationalization is the overall *poor performance* and increasing costs for the firm. This could derive from an increased production costs, tariffs and competition. The last motive that influences the decision to de-internationalization could be *external shocks* in the market, for example government interventions.

### 2.3.2 Strategies to copy with uncertain business environment

Despite market turbulence and uncertainty in the market, the firm can decide to maintain their commitment and try to manage the uncertainty facing them. Mascarenhas (1982) conducted a multiple case study to find out what methods firms and managers are using to cope with uncertain business environment without leaving the market. He found that the general methods applied are strategies based on control, flexibility, predication, avoidance and insurance. However, there is no best method for coping with all sources of uncertainty and not all methods may be applicable to a particular type of uncertainty. Mascarenhas (1982) study provides a framework for which method to use to cope with uncertainty, where you identify the sources of uncertainty, the assessment of its impact and if the uncertainty can be tolerated or if you need to implement some protection strategies. The most commonly used methods by multinational companies are exerting political control and flexibility according to (Bradley, 1977), and these strategies will be discussed below as presented in (Mascarenhas, 1982) study.

When managers choose a strategy that extracts control, they try to control the environment from changing in a way that will adversely affect their businesses. This can be done through integrating backward and forwards, to control sources of supply and the market. Integration also controls competition because it discourages potential competition from entering at any stage, both downstream and upstream. In case of an international integration the political uncertainty will also be reduced because the firm controls the assets externally, the assets are therefore not under the control of the host market and less attractive for that government. The firm could also exert control by influencing and lobbying the government and make certain questionable payments, which can result in favourable political legislation.

Flexibility for a firm often come at a financial cost, and a common held view in the internationalization literature, as described by Hadjikhani (1997); Ghauri (2004) is that SMEs suffer from less resources than large firms, and are therefore constrained in their abilities to adapt to market turbulence. While resources affect the possibility to adjust, also the previous expectation of the firm toward the regulative institution of the host market will influence the market commitment a firm is willing to take during turbulent changes. Hilmersson et al. (2015) advised firms to focus on flexibility instead of relying on previous experience and knowledge to handle the uncertainty.

Strategies for flexibility as described by (Mascarenhas, 1982) involve increasing the firm's adaptability to a changing market and could be made through selling each product in mul-

tiple markets and undertake more exporting, leasing, licensing, franchising, and subcontracting. By incorporate short notice termination clauses in agreements, more flexibility is added so that long-term commitments are avoided. Through obtaining a financial cushion, composed of for example liquid assets, emergency borrowing and stock issuing power, the firm will be able to respond quickly to environmental changes. To help monitor and respond to new environmental developments, the implementation of an intelligence system could be beneficial in order to foresee and address the uncertainty at an earlier stage.

## Chapter 3

# Methodology

*This chapter aims to outline and motivate the choice of methodology approach in this thesis. Firstly, the chapter will outline the authors overall research process for this study, which is followed by the motivation behind the authors choice of an qualitative multiple case study with an abductive approach. Thereafter, the selection of case companies are discussed with motivation of the choice of data gathering and analysis. Lastly, the quality of the study is described.*

### 3.1 Research process

The Ukraine crisis and monumental loss of trade between the EU and Russia since the implementation of sanctions in 2014 was widely published in the news media and observed by the author. By revisiting the trade statistics, reports and studies on the subject for this thesis, it was further confirmed by the author. However, how the firms adapted their strategies to operate under this turbulence was neglected in most of the coverage. The author therefore began focusing on previous studies and theories in regards to internationalization, market turbulence and adjustment of strategies. Especially the works of Hilmersson (2014); Hilmersson et al. (2015); Kao (2013); Santangelo and Meyer (2011) influenced the authors theoretical framework used in this study. Although the author had a good knowledge of the subject, little was known about how the sanctions influenced MNCs operations. Hence an abductive approach was chosen, which allow the author to go back and forth between data

collection and theorization, and explore new findings which provides the flexibility needed for this study.

Early in the study the researcher began screening companies to find firms that were both accessible and interesting in order to make the study feasible. Since there were sanctions both from the EU and counter-sanctions from Russia, the researcher desired case firms that had been affected by either or both set of sanctions. The interview persons also provided additional information for the researcher in regards to the current economic situation in Russia and the effect of the sanctions which influenced the theoretical framework. The economic sanctions led to a situation that was similar to the financial crisis of 2007-08, i.e a recession with low investments and hard for firms to acquire capital. This strengthen the researcher use of literature that examined market turbulence, since the effect of sanctions showed similarities with previous market turbulence and could therefore serve as the theoretical framework for this study and provide interesting comparison for the analysis.

## **3.2 Abductive research approach**

When developing and interpreting theory in a study, there are three different approaches that are used, induction, deduction and abduction. In a deductive approach, the author uses previous literature and theories theories that will later be tested with the empirical data ((Bryman & Bell, 2015; Dubois & Gadde, 2002; Saunders & Lewis, 2009). Inductive approaches is where theory is systematically generated from the empirical data, and the research is conducted without any "preconditions" (Strauss & Corbin, 1990). Abduction is the systematic combining between an deductive and inductive approach, whereas there is a continuous interplay between theory and empirical observation (Kirkeby, 1990). Dubois and Gadde (2002) describes the systematic combining as a "process where theoretical framework, empirical fieldwork, and case analysis evolve simultaneously".

The abductive approach is useful if the researcher is to discover things that are less studied and the theoretical framework is successively modified as a result of unanticipated findings. Therefore, the abductive approach builds more on refining previous theories than inventing new ones as in a inductive approach (Kirkeby, 1990; Dubois & Gadde, 2002). Abduction start with a considerations of a fact or an particular observation (Dubois & Gadde, 2002). In this study, the monumental loss of trade between the EU and Russia since the implementation of sanctions in 2014 was observed by the researcher. The trade destructive effects

of sanctions on a country to country level are well documented, but how the sanctions and coinciding downturn of the economy have affected MNCs is less studied.

### 3.3 Qualitative research method

Given the research question and explanatory nature of the study, a qualitative research design based on semi-structured interviews was deemed as the most suitable, since a deeper understanding of decision maker behavior as well as of the underlying factors affecting the behavior is required (Ghauri, 2004; Yin, 2011).

With a qualitative study, the researcher is able to get a higher degree of freedom and a deeper understanding of a specific problem or situation. Qualitative information consists of words and descriptions and have become well represented in IB studies. For complex problem, both quantitative and qualitative data is frequently combined, whereas quantitative data consists of numbers, which is complemented with qualitative data from e.g. interviews (Ghauri, 2004). Quantitative studies are built on information that can be measured, valued and processed with statistic methods. The limitation with a quantitative study is that everything can not be measured by numbers and it's few opportunities to generalize situations (Yin, 2011; Bryman & Bell, 2015). Qualitative is suitable when there is a lack of current theories on the subject, or when the theories can't adequately explain a phenomenon (Merriam, 2009), it is therefore suitable for this study.

### 3.4 Case Study

A case study research is a very popular and widely used research design in IB studies. The collection of data in case studies often derives from multiple sources, such as interviews, observations and written and verbal reports (Ghauri, 2004; Yin, 2011). The broad spectrum of collection methods has the potential to deepen our understanding of problem or a situation (Ghauri, 2004). As argued by Yin (2011), the nature of the research question sets the used research strategy. When a research question is constructed by explanatory questions such as, "how", "what" or "why", then a case study is well suited (Yin, 2011).

### 3.4.1 Type of case study

The Multiple case study design have been increasingly common in business and management research and will be used in this paper, whereas six different MNCs representatives will be interviewed and subject to the analysis. The opportunity to examine numerous companies will allow the researcher to compare and contrast the empirical findings from each case, which promotes theoretical reflections and make it easier for the researcher to draw conclusion on what is common and unique amongst the cases (Yin, 2011; Eisenhardt, 1989; Ghauri, 2004). In other words, qualitative case research not only can provide rich, contextual information that is needed for conceptualization, it is also an effective research method for constructing theoretical frameworks and development theory (Ghauri, 2004; Yin, 2011). Case-based qualitative study is an appropriate research method to explore less-known phenomena (Yin, 2009), and is therefore suitable for this study whereas there are few previous studies on firms handling of the market turbulence in Russia.

## 3.5 Selecting case companies

In the initial stage of the study, most of the research was focused to understand how the European sanctions influenced the behaviour of MNCs in the emerging Russian market. Therefore the study targeted MNCs that were subjected to the effects of the sanctions, and that had operations in Russia before and after the market turbulence in 2014. Hence, the author chose case firms that could contribute and which experience we could learn from. Information on MNCs that operated in Russia was gathered through secondary data from the Swedish-Russian Chamber of Commerce (SRCC, 2018) and through the companies websites.

The choice of the Russian market derives from its current economic sanctions, emerging market characteristics and its numerous experience from market turbulence and is therefore well suited to study how MNCs operate and adjust their strategies in response (M. Johanson & Johanson, 2006). The choice of Scandinavian case firms was due to the fact that firms with Nordic heritage would be more likely to cooperate and give the researcher access. Given the research question, the study needed case companies that had operated in Russia during a period of time, and also interview subjects that had long experience and knowledge of the companies operations in Russia. Therefore, contact with interview subjects in the top management of the firm with long experience in the company was necessary. The following case firms was therefore included in this study:

### **Orkla Foods**

Orkla Foods is part of a Norwegian conglomerate that operates mainly within the food industry (Foods, 2018). Since the fall of the Soviet Union much of their operations have been directed towards Eastern Europe. With their background and market leading role within certain food segments, they gained an interest from the author who contacted the CFO Johan Wilhemsson through a mutual friend. Johan Wilhemsson had a long history within Orkla Foods and previously worked specifically with their operations in Eastern Europe and Russia, he was therefore a good representative for his company and a good choice for this study. The interview with Johan Wilhemsson was conducted in March, 2018 at their office in Gothenburg. The interview took one hour, and it came to the author knowledge during the interview that Orkla Foods actually divested from Russia before the market turbulence in 2014. Despite this, the author found their story interesting and it also gave the study further depth and understanding of market turbulence in Russia. Johan Wilhemsson was the first interview subject, and through his regular visits and experience of Russia it also gave the author a further understanding of the subject and of the business climate, which provided fruitful for the study and rest of the interviews.

### **Engtex**

The author gained knowledge of the Swedish textile company Engtex through their outspokenness in the media in regards to the sanctions in 2014, whereas their sales towards Russia completely halted. Engtex is involved in the development and manufacturing of highly sophisticated products in the fields of technical textiles, and sale their products mostly to the forest, oil and security sector (Engtex, 2018). After studying the firms annual reports and public statements, the author contacted the CEO of Engtex Patrik Johansson through e-mail in March 2018, and shortly after the author conducted a Skype interview with him that lasted for around 45 minutes. Patrik Johansson regularly visited Russia and had been working with Engtex for over twenty years and was a good representative for his firm in regards to this study.

### **Leroy Seafood Group**

Leroy Seagood Group is a Norwegian seafood corporation. The Group's core business is the production of salmon and trout and the firm control all parts of the processing, developing, marketing, sale and distribution of their seafood products (Leroy, 2018). With the Russian import ban of fish from the EU and Norway, one of Scandinavians biggest fisheries was obviously of interest for this study. Through due diligence, it was further



confirmed for the author that Leroy Seafood were struggling with their Russia exports and the author contacted the company's CEO Henning Beltestad through e-mail. Henning Beltestad response was fast and positive, and the day after the author contacted a Skype interview with Henning that lasted for around 40 minutes. Henning Beltestad had been CEO for Leroy for over five years and previously worked for the company since 1990 and was well informed in regards to their operations on emerging markets. The interview was conducted in a combination of Swedish and Norwegian, which made the transcript of the conversation a bit harder. When the author was not one hundred percent confident of the meaning of Hennings Beltestad words, further context and explanation in English was asked for and also provided by Henning Beltestad.

### **Company X**

Company Xs is a Finnish diary producer, and the complete halt in their exports towards Russia was widely reported in the press since it was one of the most affected companies in Scandinavia by the sanctions. Therefore, Company X was a perfect case for this study. The author contacted their current chief of their subsidiary in Russia, but was directed to the company's Vice President instead. The VP had long experience of their Russia operations, were he previously was directly responsible for their Russia subsidiary. The interview was conducted through mail exchanges, and the interview subject also provided good reading material that gave further understanding for the author in regards to Company Xs strategy in Russia. The interview subject preferred his firm and himself to be anonymous, and he was therefore giving the initials VP and the name of the firm became Company X for this study.

### **Systemair**

Systemair is a Swedish firm that produce a wide range of energy efficient fans, air distribution and heating products (Systemair, 2018). The author gained knowledge about Systemair by their participation in the Swedish-Russian chamber of commerce, where they are a paying member (SRCC, 2018). Through reading their public statements and annual reports, the author found Systemair very interesting for this case study. Contact was made through e-mail with their Vice President of Eastern Europe, Fredrik Anderson, who were responsible for their operations towards Russia. The interview with Fredrik Anderson was conducted through Skype in March 2018, and lasted for around one hour. Fredrik Anderson had been working for Systemair in over twenty years and had good knowledge about their internationalization strategy and operations with Russia. Fredrik Anderson was a very helpful

respondent and clarified certain issues and gave the author further knowledge of the overall effects of the sanctions on both a macro and micro perspective.

### Oriflame

Oriflame is a Swedish market leading cosmetics company, with large operations in Russia and the former Soviet countries (Oriflame, 2018). Oriflame were prominent in media through their success story in the former Soviet Union, but also because of their struggle on the Russian market since the Ukraine crisis. Oriflame is also a member of the Swedish-Russian chamber of commerce and the author therefore contacted them for this study. After negative response for the first two attempts, their CEO Magnus Brännström responded to the author in April 2018 that he would like to participate in this study. Magnus Brännström was previously chief of their operations with Russia which is their most important market, and became CEO of the company in 2005. The interview was conducted through e-mail, were the author mailed the questions to Magnus Brännström that he answered after a couple of days. Follow-up questions were then sent from the author to Magnus Brännström, to broaden the understanding of Magnus Brännströms answers in regards to Oriflames strategy.

The interviews were conducted by the author in the following order.

Table 3.1: Interview participants (Created by the Author)

Interviewee	Company	Position	Date	Duration	Method
Johan Wilhelmsson	Orkla Foods	Chief Financial Officer	2018-03-15	60 min	Face to Face
Patrik Johansson	Engtex	Chief Executive	2018-03-16	45 min	Skype
Fredrik Andersson	Systemair	Vice President Europe	2018-03-20	60 min	Skype
Henning Beltestad	Leroy Seafood	Chief Executive	2018-04-05	30 min	Skype
Vice President	Company X	Vice President	2018-04-10	-	E- Mail
Magnus Brännström	Oriflame	Chief Executive	2018-04-12	-	E-mail

## 3.6 Collecting case study evidence

For a case study there are naturally a number of different sources from which data can be gathered, it could be in the form of quantitative data, secondary data, observations, focus groups or interviews (Merriam, 1998). This study's empirical findings derives mainly from interviews and secondary data. There are different methods to conduct interviews, semi-structured interviews are often the chosen method in a qualitative study that seeks

to understand the questions what, how and why, and therefore the most optimal choice in this research paper (Ghauri, 2004; Merriam, 1998). A semi-structured interview means that the researcher has a list of themes and questions that are prepared beforehand, but the structure of the interview could vary depending on the interview (Ghauri, 2004). The order of the questions may be changed, some questions might be left out or additional questions may arise in order for the interview subject to further explain their answers.

The interviews conducted by the author were "respondent interviews", which means that the researcher directed the process and the interview subject answered the questions posed (Ghauri, 2004). The structure of the interview and empirical chapter with the case companies follows a time sequence where three sections are outlined, beginning with the company's background and operations in Russia before 2013. Thereafter the developments of the market turbulence in 2014 and how it affected the firm's operations and strategy. This is followed by the case firm's strategy and outlook towards the future in the Russian market. The interview questions framework is presented in Appendix C.

Two of the interviews were conducted through e-mail exchanges. First the interviewees sent relevant material, both public and internal information regarding their handling of the sanctions. This was later followed by relevant interview questions based on the framework in Appendix C. When further clarification was needed, the researcher contacted the interviewees for further corroborations.

A further background regarding the sanctions and the Russian market is collected through secondary data, in the form of institutional reports, previous journals and governmental statements and is presented at the beginning of the empirical findings chapter. This is to give the reader a further understanding and background towards the empirical findings from the case companies.

## **3.7 Quality of research**

### **3.7.1 Reliability**

A common way to ensure the quality of the thesis is to analyze the study's validity and reliability, this is especially relevant in quantitative studies (Yin, 2011, 2015; Jacobsen et al., 2002). Reliability is a way to measure the truthfulness of the study, which is often

measured through the ability for the reader to replicate the study. Merriam (2009); Yin (2009) described that reliability is achieved when it can be conducted by the same procedures in another case. By writing in an ethical manner, which includes the usage and production of reliability and valid knowledge, the truthfulness of the study is better ensured.

The author used triangulation in order to enhance the reliability of the study. As recommended and described by (Merriam, 2009; Collis & Hussey, 2014; Yin, 2015), the author triangulated the primary data from the interview, with the secondary data that was available and collected. Through a semi-structured interview where the interview subjects had no prior knowledge of the specific questions asked, the author strive to as much authenticity in the answers as possible. In the case of the interviews that there were conducted by mail, the author made sure to extensively compare the answers with what was reported, both in the public media and in the companies statements at the time. Through this process, the author found the interviewees answer to be consistent and trustworthy.

The general interview guide that was used by the author were based on the findings in the literature and theoretical review, and started with questions in regard to the company's history and organization in order to get the right context and history of each firm. This was somewhat altered based on the data gathered before the interview in concerns to the case companies history and organization. The unaltered part of the interview guide was designed to answer the authors purpose, aim and research question with the thesis and was the same for each interview subject. Yin (2015) favoured this approach because of it avoids errors and is unbiased and will lead to better reliability of the study.

### **3.7.2 External validity**

External validity is the process of generalization, and refers to whether results obtained from a small sample group, such as in a case study, can be extended to make predictions about the entire population (Yin, 2015; Collis & Hussey, 2014).

Beside the theory underlining the study and empirical findings, the author also carefully described the different contexts and background regarding the subject and the participants in the study. This form of transferability is a form of external validity, which refers to whether the study can be applied in another context or be generalized (Yin, 2015). To further strengthen the reliability and truthfulness of the study all the transcribed interviews were sent to the respondents to enable them to review the content, and also make possible addi-

tions or retractions. Yin (2009, 2015) approved of this measure in their conclusions on how to increase the validity through the respondent's validation that gives augmented credibility. Since the interviews were mostly conducted in the Swedish language and the transcripts and empirical findings were presented in English, there is the possibility of translating the answers in a way that did not match what the respondents wanted to state. Therefore by enabling the interview subject to review the transcript the author could correct certain misunderstandings. One of the interviews were conducted in Norwegian, which is understood by the author, however by reviewing the transcript with the interview subject the author could strengthen the credibility of the study in case of previous misunderstanding.

To construct validity it's important to avoid subjectivity, therefore necessary to use multiple sources of evidence. Since part of this thesis deals with politically sensitive subjects, such as economic sanctions and the relation between the EU and Russia, it is important to stay objective, unbiased and present both sides view of the unfolding events. Therefore more than two sources were used to the extent possible, and the interview subjects answers where challenged with available secondary data.

### **3.7.3 Internal validity**

In this explanatory case study, internal validity is very important, since the aim is to explain how certain events led to another event. It is therefore important for the author to stay objective and not assume that a particular event or change caused the final event without considering other factors that could have caused that final event (Yin, 2009, 2015). To ensure the internal validity, a vast number of previous literature was reviewed, such as printed books and peer-reviewed journals that covered this topic. For example, the author is consistent in stating the reasons for the downturn in Russian economy beside the sanctions.

Since the author was alone in writing this thesis, the author had regular contact with his supervisor and also undertook sessions with other graduate students not involved in this study to provide impartial views on the research. By being monitored by the supervisor and opponents groups on a regular basis it increased the chain of evidence for the study, and ensured the link between theory, the collecting of evidence and conclusions. The author also collected all of the notes for the case study, that were both handwritten, type and audio-taped during the interviews. These notes were processed into the computer and stored adequately in order to make them retrievable for later use as suggested by Yin (2009).

## Chapter 4

# Empirical Findings

*This chapter start with a summary of the Russian market and the implementation of sanctions. This is done to further enhance the readers understanding of the Russian emerging market and the strategy behind the sanctions. By providing the background, the reader will better understand the case firms strategy and operations in Russia. Afterwards, the case firms are each presented in a time chronological outline, first with a background of their Russia operations, then their experience and handling of the market turbulence concluding with their strategy towards the future.*

### 4.1 The Russian market and the implementation of European sanctions

Russia is the worlds largest country that spans over eleven time zones and have around 145 million citizens, with 77 % of these living in the European parts of the country. Russia have the world largest mineral and natural resources, which is the foundation of the economy that is classified as the world 11th largest in terms of nominal GDP , and sixth in terms of PPP . Their permanent seat at the UN security council and massive stockpile of nuclear weapons makes them an important player in world affairs (Bank, 2017).

After the fall of the Soviet Union in 1991, Russias GDP declined with 50 % and vast

corruption, crime and deprivation struck the society (Bank, 2017; M. Johanson & Johanson, 2006). Market turbulence characterized the Russian market which made strategic planning difficult for companies, with institutional changes taking place continuously, in the form of major schemes of privatization and de-regulations of the market (M. Johanson & Johanson, 2006). The financial crisis in 1998 devastated the Russian economy, with the deprecation of the ruble and Russia defaulting on its debt (Bank, 2017; M. Johanson & Johanson, 2006; Cohen, 2010). However, there was a speedy recovery with the rising world prices on oil and a growing middle class began to develop at the start of the 2000s. The global financial crisis in 2008-2009 whipped out part of the increasing middle class, and despite the earlier impressive GDP growth have slowed down in the years after the crisis, the Russian economy generally recovered (Bank, 2017; Cohen, 2010).

M. Johanson and Johanson (2006) argues in their study that because of the turbulence in Russia, foreign companies doing business there “often have to face situations that were impossible to plan and to predict beforehand.” MNCs are faced with a situation in what Tsoukas (1996) called *radical uncertainty*, which is defined as when firms face a uncertainty that they “do not know and they cannot, know what they need to know”. Although the stability and wealth have increased much in the country since the 1990s, the Russian market is still seen as volatile and heavily dependent on oil and gas prices (Cohen, 2010; Sakwa, 2014; Bank, 2017). Despite the market and institutional uncertainty, the large well educated population and massive natural resources has made Russian an attractive emerging market in the recent decade (Bank, 2017; Cohen, 2010; M. Johanson & Johanson, 2006).

#### 4.1.1 The downturn of the Russian economy in 2014

The downturn of the Russian economy in 2014-2017 has been described by many observes as the *Russian ruble crisis* or a financial crisis (Dorning & Katz, 2014; Hartley, 2015; Sakwa, 2014). The crisis is the result of the loss of confidence in the Russian economy steaming primarily from two sources, the fall of oil prices and the economic sanctions as a result from the Ukraine conflict (Dorning & Katz, 2014; Hartley, 2015). The financial sanctions were troubling for the market, since Russian companies both private and state owned, have significant external debt that became increasingly hard to refinance. However, the fall in international oil prices was an even more decisive factor for the loss of confidence in the economy (Dorning & Katz, 2014; Hartley, 2015).

In February 2014, coinciding with the Maidan-protests and removal of Ukrainian president

Viktor Yanukovich, the oil prices drastically fell. Around the time of the introduction of sanctions against Russia the oil price was 100\$ a barrel, but dropped to just 60\$ a barrel six months later. Almost half of the Russian governments revenue derives from the sale of oil and therefore it struck hard on the government budget (BBC, 2016; Dorning & Katz, 2014). The oil prices continued to fall and dropped to almost 30\$ barrel in 2015 (Monaghan, 2014; Krauss, 2015). The loss of confidence in the Russian economy led to investors selling off their Russian assets and a decline in the value of the Russian ruble. The Russian stock market dropped 30% in December 2014 alone, and the ruble had lost more than half its value compared to the US dollar in March 2016 (BBC, 2016). The Russian dependency on the world oil prices is highlighted in figure 4.1.

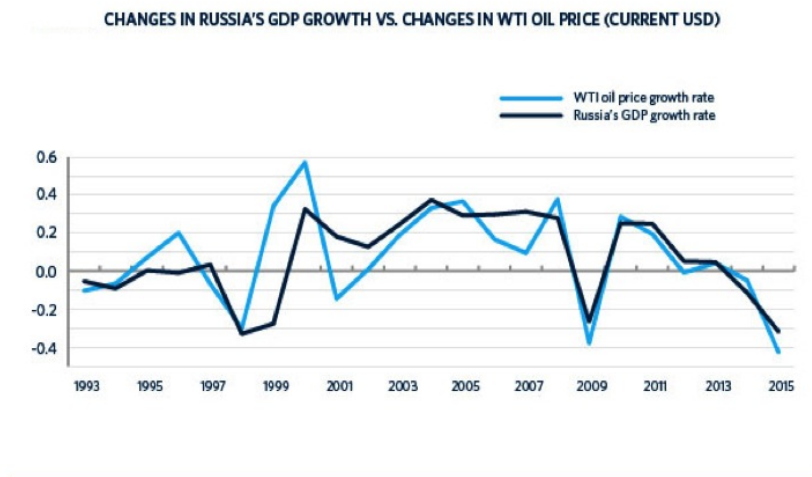


Figure 4.1: Changes in Russian GDP and Oil prices, Source: Carneige (2015)

The influx of FDI towards the country peaked in 2013 with almost \$70 billion in FDI net inflows. The downturn in the Russian economy decreased the FDI inflow significantly to around \$32 billion in 2016 (Bank, 2017). The EU is Russias biggest trading partner, and Russia was the third-largest trade partner of the EU with €339 billion trade between them in 2013, but has decreased with 40% to €191 billion in 2016. Russias GDP showed a negative growth for 2015 and 2016, but the economy has now started to recover, and there were almost 2% positive growth of the Russian economy in 2017 (Bank, 2017). The oil prices has



also started to recover, with global oil prices of around \$65 per barrel in 2018 (Bloomberg, 2018).

#### 4.1.2 Background and strategic goals behind the sanctions

With the dissolution of the Soviet Union, Ukraine became an independent country in 1991, however still reliant on the Russian economy since both markets were heavily integrated with each other (Sakwa, 2014; Cohen, 2010). Ukraine had historically been a divided country, with the western parts of the country being a earlier province of Austria-Hungary and Poland, and never being part of the previous Russian empire. A strong rooted Ukrainian nationalism have been historically present in the western parts where the majority language is Ukrainian (Sakwa, 2014; BBC, 2014). However, in the eastern parts of the country the Russian language is mainly spoken and there are almost ten million ethnic Russians in Ukraine, most of them living in Eastern Ukraine and the peninsula of Crimea (BBC, 2014). Therefore, the national elections have often been heavily split between a more nationalistic pro-European candidate supported by the western Ukraine, and a more pro-Russian candidate gathering most of the votes in the eastern parts of the country as seen in figure 4.2 (BBC, 2014; Sakwa, 2014).

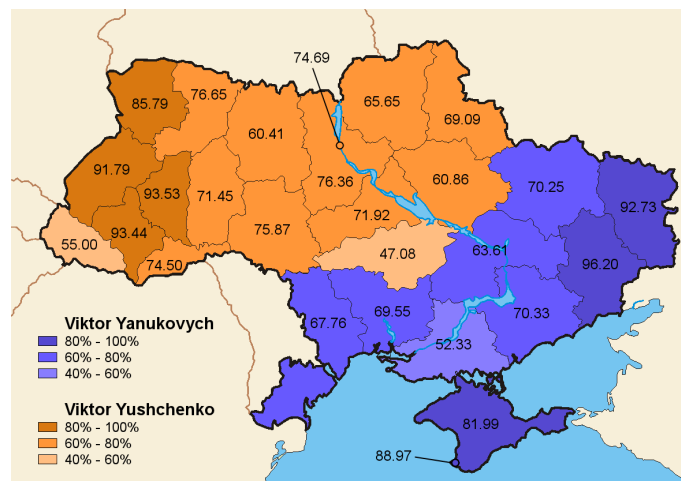


Figure 4.2: Ukrainian Election 2010, Source: BBC (2014)

Ukraine have suffered heavily from corruption, the ruling of oligarchs and outdated industries

from the Soviet era, and a European Union membership was seen as many in the country as a way towards a better future (Sakwa, 2014; BBC, 2014). However, there were concerns both in Ukraine and Russian towards a full EU membership for Ukraine, since Russia was Ukraine's biggest trading partner with a free-trade and movement arrangement between the countries, as well as the shared historical and cultural heritage (Sakwa, 2014). With Ukraine joining the EU single market, there would be an influx of European goods into Ukraine, and therefore also non-tariffed EU products into Russian territory, which would damage Russian industries. The Russian leadership made clear that tariffs was forced to be put on goods between Russia and Ukraine, which would damages both intertwined economies heavily (Rettman, 2013; Sakwa, 2014). Russia also had a serious concern over a potential NATO-membership for Ukraine, which was seen as a further military enlargement towards Russia borders and especially against the Russian Black Sea naval base in the Crimean capital of Sevastopol (Sakwa, 2014; Cohen, 2017; Putin, 2014).

Russia had a longstanding agreement with Ukraine to maintain a presence of the historical Russian naval base in Crimea, which included the stationing of Russian soldiers in Crimea (Sakwa, 2014; BBC, 2014). After the Crimean government asked Russia for support after what they viewed as a violent overthrow of the legitimate Ukrainian government by Ukrainian nationalists, the Russian soldiers intervened and arranged for a referendum of Crimeas independence in March 2014 (BBC, 2014; Sakwa, 2014). The large ethnic Russian population voted profoundly to be part of the Russian Federation, but the referendum was meet by heavy criticism by the new Ukrainian government, the EU and the United States (BBC, 2014). The EU called it an annexation in clear violation of Ukraine's sovereignty and a change of national border not supported by international law, and delegitimized the referendum (Parliament, 2017; BBC, 2014). The Russians argued it acted in response to the perceived western backed *coup d'état* in Kiev, called the transfer of Crimea into the Russian Federation as a re-unification. Russia cited the right for self-determination for Crimeans, as previously stated by the US and IJC in Kosovos declaration of independence from Serbia in 2008 (Sakwa, 2014; Putin, 2014).

Russias actions in Ukraine with the annexation of Crimea and support for the rebels in eastern Ukraine was seen as a clear breach of Ukraine's sovereignty and international law by the EU (Sakwa, 2014; Parliament, 2017). As a response to put pressure on Russia and change their policy on Ukraine, the first round of sanctions targeting Russian officials and Crimea were overwhelming supported by the EU member officials (Giumelli, 2017; Parliament, 2017). The larger economic sanctions that were implemented in July 2014 (Appendix A) was however meet by larger skepticism, especially after Russia responded with

their own counter-sanctions targeting the European agriculture industry (Giumelli, 2017). Economic sanctions are considered strong diplomatic measures and have been used to fulfill a policy goal without embargo or direct military intervention (Köchler, 1999; Leenders, 2014). Although most sanctions tries to be as specific as possible towards targeted individuals, many observers argues that trade restrictions is most hurtful to ordinary people (Leenders, 2014; Giumelli, 2017; Parliament, 2017; Köchler, 1999).

Therefore, concerns was raised primarily from countries that have large trade relations with Russia, foremost in the agriculture sector. The Spanish foreign minister called the EU sanctions "beneficial for no one" and the leaders of Austria, Hungary and Slovakia were concerned with its economic implications for Europe (Giumelli, 2017). Regional provinces in Germany, Greece, France and Italy have been strongly critical as well with their loss in agriculture exports. Greece prime minister stated that: "The counter-sanctions imposed by Russia have inflicted pain on the Greek economy. But we know the retaliations were a response to sanctions [against Russia], the logic of which we do not entirely share [...]. We openly disapproved of the sanctions' (Giumelli, 2017).

Many European leaders and business executives could not understand the course Russia was taking, since their intervention in Ukraine would damage businesses and punish the Russian population (Cohen, 2017; Sakwa, 2014; Giumelli, 2017; Reuters, 2017). Their thinking was in line with (Oetzel, 2005) study on political risks, which shows that the risk can vary based on the host government dependency on foreign capital markets. Many of the emerging economies, including Russia, are striving for foreign investment and knowledge, and should therefore respond better to certain political risks. The thinking from western officials was that the Russian leadership would change their policies in regards to Ukraine since their economy and population would not afford or tolerate otherwise.

However Stephen F Cohen, renowned American professor emeritus of Russian studies at Princeton University, was one of a number of scholars that commented that many western observers underestimated the Russian sensitivity and perception of what was happening in Ukraine (Cohen, 2017; Sakwa, 2014; Mearshaimer, 2014).

The Russian leadership, as expressed by Vladimir Putin in his *Crimean speech* (Putin, 2014), saw the events in Ukraine as a breakdown of trust with the US and EU and the crossing of a red line (Walker, 2014; Sakwa, 2014). The backing of the overthrow of the Ukrainian government, the further encroachment of the US and NATO into Russias backyard, with potential further deployment of US missile system and surveillance close to Russias border

was viewed as a matter of direct national security (Putin, 2014). It was extra sensitive with the historic ties between Russia and the large Russian-speaking population in Ukraine and Crimea that felt threatened by the new Ukrainian government, for example with the legislative proposition to forbid the Russian language (Sakwa, 2014; Cohen, 2017; BBC, 2014). The Russian response was hurtful but was seen as necessary and the Russian population shared this view. Independent opinion polls have shown a strong support from the Russian citizens towards the handling of Crimea, and regardless of the damaging effects of the undertaken actions the Russian president approval ratings increased to over 80% at the start of the crisis and have remained there since (Levada, 2015, 2017; Sakwa, 2014). The EU confirmed this and stated that *"the sanctions have not swayed Russian public opinion, which continues to staunchly back the Kremlin's actions in Ukraine"* (Parliament, 2017).

Western business people and politicians alike were also complexed over Russia's counter-sanctions, since this would punish the Russians even more economically with increased food prices, limited variation of goods and food supply that would further damaged business relations with Europe (Giumelli, 2017). The Russian goal with the implementation of the counter-sanctions was two folded. First, since the EU and US sanctions goal was to damage the Russian economy, the Russian leadership wanted to respond in equal fashion. Therefore not only the Russian economy would be damaged but also Europe's, and this would put pressure on the European community to drop the initial sanctions and their policy towards Ukraine (Giumelli, 2017; Sakwa, 2014).

The other reason was that the ban of agriculture imports would further strengthen the domestic agriculture industry in Russia. The Russian agriculture sector flourishes amid the sanctions, and is now the second largest export sector for the Russian economy, and Financial Times (N. Buckley, 2017; Foy, 2017) conclude that:

*"Around Russia, farms, fields, greenhouses and fertilizer factories are thriving as consumers turn to domestically-produced food, helped by the worst relations between Moscow and the west for a generation."* (Foy, 2017)

With increased domestic demand because of the import ban, subsidizing help from the government and the low ruble, the Russian agriculture sector have become the worlds largest exporter of grain and and has fully substituted imports with domestic production of pork and chicken (N. Buckley, 2017; Foy, 2017). Russian farmers and executives in this sector are therefore hoping for the import ban to continue as long as possible, and this view has somewhat been shared by many Russian officials (N. Buckley, 2017; Giumelli, 2017).

### 4.1.3 Future for the sanctions and the Russian economy

As the geopolitical tensions between the US and Russia were building up, the Russian leadership were convinced that the sanctions implemented against Russia as a response to the Ukraine conflict were just an excuse and if it was not for Ukraine than there would've been another area of confrontation that resulted in sanctioning by the US and their partners (Cohen, 2017; Walker, 2014). Since Russia recovered from their economic collapse in the 1990s and grew in wealth and influence, Vladimir Putin argued that the United States:

*“began to see a serious rival in Russia, they began to look for excuses to sanction Russia /.../ If there had been no Crimea or other problems, then they still would have invented something else in order to contain Russia”* (Telesur, 2017)

In Kao (2013) study on market turbulence and institutional changes in China, he argued that even without the sudden crisis in the Chinese diary industry, the following institutional changes after the turbulence may have taken place anyway but at a slower rate. Similar observations were also made in the medical deceive and automotive industry in his study. Even though the examples are not directly related, it's clear that some Russian leaders saw confrontation with the US and upcoming economic sanctions as inevitable and had planned with counter measures on their own. The Ukraine crisis was arguably the spark that caused the market turbulence, with the sudden implementation of sanctions that led to a complete ban on import of certain agriculture products. However, similar institutional changes were already underway before the Ukraine crisis. Russia had for example restricted imports of pork meat from Europe already in January 2014, before the Ukraine conflict escalated. There were also earlier financial sanctions between the US and Russia as well, for example the Magnitsky act, although not as economically damaging on a country level and more targeted against individuals (Giumelli, 2017; Sakwa, 2014).

Since the Ukraine crisis, there have been continuously additional sanctions targeting Russia from the United States. The most notable was when President Trump signed into law new sanctions that specifically target the NordStream 2 project, which is an extension of a gas pipeline between Russia and Germany (Reuters, 2017). This created a further split regarding the sanctions between the Atlantic alliance, whereas EU officials, Angela Merkel and other European leaders expressed concerns over the sanctions (Reuters, 2017; Wagstyl, 2018; Giumelli, 2017). German Foreign minister stated that the restrictions are illegal, in clear violation of WTO law and called them purely economical as he argued that their purpose is for the US to overtake Russia's place on the European energy market (Reuters, 2017).

Further diplomatic rapprochement between the countries were further hampered when the US and a majority of EU and NATO countries expelled around 100 Russian diplomats in March 2018, whereas the Russians responded with equal fashion (Wagstyl, 2018; Gould-Davies, 2018). There were also additional American sanctions against Russian businessmen and their companies in April 2014 which had a substantial effect on the Russian stock market (Gould-Davies, 2018; Drezner, 2018).

The Ukraine sanctions implemented in 2014 are currently soon on their fourth year and Russian leaders are planning for the sanctions placed on them to be permanent, and many in the business community share this view. 500 major investors and chief executives with operations in Russia were asked about the timetable for removal of the sanctions, with a majority of them believing the sanctions will be permanent (Repoza, 2017). EU officials argues that their will only be lifting the sanctions when the Minsk accord is fulfilled, which is a peace-initiative undertaken by Angela Merkel ((Sakwa, 2014). However, Russia is blaming the Kiev government for not fulfilling the accords, whereas Kiev on the other hand blames Russia, and the conflict is now somewhat frozen but still tense and dangerous (Cohen, 2017; Sakwa, 2014).

What could decrease the timetable for removal of sanctions is the European Union and the damaging impact the sanctions have on European firms (Giumelli, 2017). As previously mentioned, many European leaders expressed their concerns from the start in regards to the sanctions, and this have intensified especially in regards to the US new sanctions on Russia, whereas the EU have threaten to themselves sanction the US as a response (Reuters, 2017).

The placement of EU sanctions must have the approval from all European Union member states, and with the increasing concerns in Europe over the sanctions there could be a veto from a member state that hinders further sanctioning of Russia. In France for example, many people are souring over the sanctions, and in April 2017, France's lower house of parliament considered a resolution against sanctions renewal. There were 577 deputies supported the resolution, with only around 50 in favor of renewing them, however the resolution was not binding and the sanctions are still in place (Giumelli, 2017).

After the implementation of the sanctions, the European Parliament requested a report based on the effects and consequences of the sanctions, which was fully published in 2017 (Parliament, 2017). The report established in their conclusion that:

*"The specific contribution of the sanctions to the observed decline in EU trade with Russia after 2013 is difficult to determine /.../ Beyond the direct costs of specific trade restrictions,*

*which in case of the sanctions/counter-sanctions only concern a limited group of commodities, additional (and much higher) costs may arise due to the implementation of financial sanctions (restricting the availability of funds for firms in Russia engaging, for example, in investment activities) and, even more importantly, due to a severe deterioration of the business climate between the EU and Russia in the wake of the sanctions and the political conflict. ” (Parliament, 2017)*

Other main findings of the report were:

- EU exports to Russia have declined significantly in recent years, 20% annually since 2013.
- Trade diversion has mitigated the economic costs of the sanctions only to a very limited extent
- Evidence for initial non-compliance attempts and legal trade diversion. Attempts to reroute and circumvent the sanctions through certain transit countries, in particular Belarus, Serbia and Macedonia.
- The estimated sanction-specific loss of EU exports amounts to about \$ 34.7 billions for the period 2014 to 2016.

## 4.2 Empirical findings from case companies

*The empirical findings presented below derives from interviews conducted with representatives from each case firm and company data such as annual reports and financial statements. The findings are presented in a time chronological order, first with a presentation of the companies background and operations in Russia before the Market turbulence in 2014. Then the consequence of the sanctions and each case firms handling of the turbulence is presented. Lastly, the firms future strategy is outlined as well as an assessment towards its handling of the market turbulence.*

### 4.2.1 Systemair



#### Company background and earlier operations in Russia

Systemair was founded in 1974 in Sweden, and is a leading manufacturer of heating, ventilation and air conditioning products. For the financial year of 2016/2017 the company had sales of SEK 6.8 billion and have subsidiaries in 50 countries and sales to over 130 countries all over the world. Systemair followed a traditional pattern of internationalization, with operations starting in the Nordic countries in the 1970s and 80s and then began looking eastwards after the dissolution of the Soviet Union. In the early 1990s, interested retailers from the former Soviet markets contacted Systemair, and several export agreements were signed with the Baltic countries, Ukraine and Russia. Part of Systemairs strategy is to have an early presence in emerging markets, and the large emerging market of Russia had potential for growth with urgent need for re-refurbishment and modernization in the Russian society. Vice President Marketing Eastern Europe, Fredrik Anderson said that:

*” Russia had neglected demands with few offices, business centers and buildings in comparison with the west, and our ventilation products targeted these new constructions and we also had the best products.”*



Systemair had sales around SEK 50 million in Russia when the financial crisis of 1998 struck and the ruble lost two thirds of its value. Many of Systemair competitors closed their operations in Russia but Systemair adopted another approach. Systemair still had a strong belief in the Russian market and terminated their previous exclusive agreement with a single retailer and branched out to different actors. Fredrik Anderson stated that:

*"By maintaining and even increasing our commitment in the market and supporting our retailers, we believed that our firm would draw potential benefits and market shares when the market eventually turns."*

Their strategy proved fruitful and in the early 2000s, the Russian economy recovered and showed an remarkable growth. In the middle of the 2000s, Systemair had a large exposure towards Russia, where 25% of their revenue originated. With the organic growth of their company and through increasing their investment in other areas of the world it led to a decrease in dependence of the Russian market. The experiences from the earlier crisis was relevant once again when the global financial crisis 2008-09 that shocked the Russian economy. By still supporting their retailers and maintaining their commitment, for example through lowering their prices with 10% to support the struggling retailers.

*"We had a long-term strategy for Russia despite the turbulence, therefore we started to continually increase the control of our own sales and acquired one of the local Russian retailers in 2011. Through being both the manufacturer and retailer of our goods, we acquired more of the profit but also more of the risks."*

Despite the decrease in sales from the financial crisis, the economy and sales recovered for Russia and Systemair, and in 2013 the company had a record sale of around SEK 800 million in Russia which was 13% of Systemairs total revenue.

#### **The downturn of the economy in 2014**

The implementation of sanctions in the summer of 2014 that led to the depreciation of ruble affected Systemairs revenue heavily. The ruble lost half of its purchasing power, and because of the economic sanctions many of Systemairs customers put their investments on hold. Fredrik Anderson said that:

*"The European sanctions that targeted the Russian capital market made it even harder for small and medium sized business to acquire the required capital for investment. However, the large state owned companies weren't hit as hard by the sanctions, but our products mostly*

*targeted SMEs, that generally had more problem to acquire capital. When the capital market decreased for these companies, there were fewer projects launched and some of their earlier planned investments were put on a hold. ”*

The depreciation of the ruble made the domestic products cheaper, while Systemair's exports became a lot more expensive for their customers. However, Systemair decided not to lower their prices as in earlier crises, since they now had become the market leader and their competitors would only follow suite. Despite the increasing advantages for locally produced products, the sales dropped for local actors as well because of the shortage of capital for investments. With the decreasing sale volumes towards Russia, one of Systemair's fabrics in Sweden that had large exposure towards Russia was struggling. With the sudden drop in revenue and demand, it was hard for Systemair to divert their exports to other markets and certain recruitment processes were halted. Therefore in 2015, Systemair initiated restructuring programs, focusing on improving the profitability in selected areas of the business.

Despite losing 50% of their 2013 sales in Russia, Systemair maintained their long term strategy for Russia and remained committed. They continued to keep contact with the market by visiting their customers and retailers, marketing their products and attending business forums. It was described by Fredrik Andersson as a way to show their further trust and commitment for the Russian market,

*“ If other companies show restraint, there is more space for us to operate in. We work hard to build trust and commitment with our retailers, what kind of partners would we be if we just pulled out and closed shop during bad times?”*

With a long-term strategy to operate in Russia, Systemair tried to keep up and increase their market share despite the sudden drop in sales. Systemair have a broad base of over thousands of customers and since most of these are SMEs, they haven't had any particular contact with either Swedish or Russian state agencies during the sudden downturn in the economy. Systemair's long and experienced knowledge about Russia also made them less dependent on external and governmental support. According to Fredrik Anderson they did not have the power to influence political decisions as perhaps certain other MNCs could. Although Systemair have yearly risk assessments, the speed of the implementation of sanctions and its effect came as a surprise for the company.

### **Future operations**

With the decrease in real wages there is a competitive advantage with local production be-

cause of the low costs. In the earlier instances of market turbulence in Russia the wages soon increased again, but that has not yet happened in the Russian market and its much cheaper to produce in Russia said Fredrik Andersson. He also mentioned the increased preference, especially amongst state-owned companies, towards local products and manufacturing.

*"If a Russian produced good fulfills the required demands and quality, there is hard for foreign companies and us to compete in governmental projects. We still deliver to state-owned enterprises, but there are more requests for locally produced goods from this sector."*

With the currently favourable cost situation in Russia, Systemair have started more actively to investigate further investment opportunity in Russia. Beside the low production costs, the preference for "Made in Russia" products and lower transportation costs also serves as investment incentives for Systemair. Some of Systemairs products, such as ventilation aggregates, are very heavy and Systemair have naturally located production in markets where there have large sales and are committed. Systemair is therefore looking towards possible companies to acquire or a greenfield investment in Russia.

When looking back on Systemairs operations in Russia, Fredrik Andersson mentioned that the market turbulence that served as an opportunity for Systemair to start a production facility in Russia:

*"In hindsight, the unique opportunity in 2014 with the low cost situation, it would've been an perfect opportunity for us to invest, but many people were afraid of the Russian market. Having a small exposure towards Russia at that time was seen as favourable and it was hard to convince further exposure and investment in a politically very unstable region that many believed could further escalate into a more severe conflict and further damaging sanctions."*

However, Systemair are still satisfied with their current position in the Russian market where they are very strong and have a larger profitability compared to their other markets. Their brand is still strong in Russia, despite that they've become more expensive compared to local competitors. Fredrik Anderson was also satisfied with their position in case of further turbulence, with valuable experience of previous turbulence and a limited exposure towards the different markets, and concluded that:

*"Our broad, geographically diverse customer base in over 130 countries, leaves us less exposed to fluctuations in the economies within individual markets"*

### 4.2.2 Leroy Seafood Group



#### Company background and earlier operations in Russia

Leroy Seafood Group is a Norwegian, world-leading seafood corporation located in Bergen, that exports seafood to more than 80 different countries around the world. The core business is the production of salmon and trout, and all parts of the supply chain, catching the fish, processing, product development, marketing, sale and distribution are under the company's control. In 2016, the group reported revenue of around NOK 17 billion. At the start of 2000s, the Group was listed on the stock exchange, which enabled the company to develop from a seafood wholesaler to its current role as a fully integrated seafood corporation. Their operations first started in Scandinavia, but now stretches all over the globe, with production and packaging plants in all of the Nordic countries, France, Netherlands, Spain, Portugal and Turkey.

Leroy seafood Group had a strong development with their sales in Russia, which represented 10% of their total sales of salmon and trout in 2013. Their operations in Russia was somewhat of a cash cow and a very profitable market for Leroy despite financial downturn in the Russian economy in 2008-09. Regardless of the profitable Russian market, there were no strategies to open up a subsidiary in Russia. At the time, there was a more problematic emerging market for Leroy the CEO Henning Beltestad explained:

*"In 2010 China implemented measures to halt Norway's exports of salmon to the country as a response to that the Noble peace prize (awarded in Oslo) was given to a Chinese dissident (Liu Xiabo). The Chinese did not issue any official sanctions or ban of Norwegian products, but us and other fish exporters found it near impossible to sell to China after that. The Chinese import customs were holding the fish for a lengthy period of time and made it very difficult for us to operate on that market."*

The exports to China has since then decreased with 90% since 2010. The China incident

was just one instance of when governmental regulations hindered Leroy's operations. With the continuous regulations of fishing quotas and environmental requirements, Leroy often has to adapt their operations according to Henning Beltestad.

#### **Market Turbulence in 2014**

When Russia introduced a ban on imports of Atlantic salmon and trout from Norway and other products on 7 August 2014 as a response to the European sanctions, Leroy Group was heavily affected. Russia was a very important market for both Leroy and Norwegian seafood suppliers, whereas 50% of Norwegian trout exports would normally go to Russia. The management of Leroy quickly were in contact with Norwegian governmental agencies and applied for an exemption from the list of sanctioning countries and products, but was denied from Russia. The ban on imports represents a serious challenge in the short term for the Norwegian seafood industry, especially for Leroy's sales of trout, as the group was the largest producer of trouts in the world.

The exposure towards Russia was large in the trout sector, and after the sanctions were implemented it was unavoidable that the trout market would suffer, and Leroy looked for possibilities to circumvent the sanctions. After they were denied exemption from the sanctions, they looked towards the neighbouring country of Belarus, which did not have an import ban of Norwegian seafood and were not included in Russia's sanctions. Therefore exports to Belarus and then into the Russian market was an option, since direct exports to Russia was forbidden. However, as soon as the fish reached the Belorussian market, they were out of Leroy's control and they had no influence to divert or control the trade into the Russian market, and there was no success in using Belarus as a middle-step.

To abandon the circumvention-strategy was reinforced when Russia's neighbouring countries, including Belarus, introduced a similar ban on EU imports in August 2015, a ban which has subsequently been lifted though. Leroy tried a similar solution in China after the import stop in 2010, this time by exporting to the Vietnamese market and then into China, but faced similar problems and lack of success with that measure. Opening up a production and packing facility in Russia was also not an option, since the fish was still Norwegian and was not allowed for imports. CEO Henning Beltestad said:

*"We realized our only option was to divert our exports away from Russia completely, and we worked intensely to find new markets, especially for the trouts since we had a much more diversified exposure and spread with our Salmon sales towards different markets"*

The sale of Salmon was easily directed towards other markets, but 40% of Norwegian trout exports went to Russia and Leroy struggled to find new markets in the first two years since the implementation of sanctions, and the Groups earning in 2014 and 2015 had a substantial negative impact because of the sanctions

### **Future Operations**

Although easy to state in hindsight, Henning Beltestad mentioned the regret he had towards the large exposure the firm had towards Russia, but he was now much more comfortable with the geographical spread of Leroy's products.

*"Our efforts to divert trade have also started to bear fruit, with a higher growth in supply to alternative markets than would have been the case if Russia had remained a major importer"*

The European-Russian sanctions also added further experience towards Leroy risk assessment, whereas risk analysis is especially relevant in the seafood industry. Norwegian fish farming and the fish processing industry in Norway have a history of exposure to political risks, represented by the constant threat of long-term political trade quotas and barriers imposed by the European Commission. The two emerging markets of China and Russia have also embodied political risks, however Leroy sees political risks generally as short-term obstacles for the groups marketing goals and value generation, since the market for high-quality seafood is experiencing strong global growth. Besides political and environmental risks, the fishing industry also faces other financial and operational risks, including the development in prices for input factors with fish farming.

Despite the loss of sales and two hard years to divert trade away from Russia, Henning Beltestad looks positively towards the future.

*"We have grown the company substantially in other markets and this is in line with our strategy, to not have to large exposure towards a single market and to avoid a position whereas we are as big as we were in Russia."*

The Russian market is now somewhat forgotten, and Henning Beltestad don't think the lifting of the sanctions will happen anytime soon. If the sanctions are lifted, Henning Beltestad still think Leroy is in a strong position to once again enter the market. Their sale channels and distribution could easily adapt and get started in Russia again, and the loss of market share and increased competitiveness is not to big a worry for Leroy. Since the ban of European seafood, the largest exporter to Russia of salmon and trout has been Chile,

but these are frozen products and are not as competitive as the freshly caught Norwegian trout and salmon. Because of the limited quality supply, the overall demand and market of salmon and trout has decreased substantially in Russia according to Henning Beltestad.

### 4.2.3 Company X

#### **Company background and earlier operations in Russia**

Company X is a Finnish dairy-producer that was founded in 1905 and now operates in around 60 countries. Company X is a market leader or number two in all of their consumer products and their main competitive advantage is its top quality milk production which is the best in the EU. Company X produce 85% of all Finnish milk and Finland is also their biggest market in terms of revenue. Company X has 15 production plants in Finland, two in Estonia, and two plants for producing processed cheese in Russia as well as a logistics center in Moscow. They also have subsidiaries in Russia, Sweden, the Baltic, United States and China and foreign revenue accounts for 1/3 of the firms turnover.

Their operations in Russia started in the early 1900s, with an opening of a branch office in 1994 which later became its own subsidiary which has been the only importer of the companies products in Russia since 2002. For Russian consumers, Company Xs products represent high quality and is regarded as the best milk on the Russian market. Russia had until 2014 been a very profitable market for Company X, with net sales in Russia that have multiplied over the past ten years. The sales were grew from 90 million euros in 2004 to 400 million euros in 2013, and the VP of Company X stated that,

*"Russia had for a number of decades been our most largest and most important international market. We have for a number of years, even during the Soviet times, made lots of investments to make Russia a profitable market for our products, and our Russian consumer values our effort and brand very highly."*

In 2013 the sum of Company Xs exports accounted for 80% of all Finnish food exports to Russia. Despite the two previous financial crisis in Russia, X had not been heavily affected by any previous market turbulence in Russia and their experience in Russia had been for the most part been strictly positive.

### Market Turbulence in 2014

Even though Russia is seen generally as an volatile market, earlier downturns of the economy had not severely hurt Company X, and the unpredictability of the sanctions was stressed by the VP. Although measures are taken each year to evaluate the operational risks, including political risk, sanctions was not accounted for. As for most other firms, the extent to which Russia responded towards the EU sanctions, with an import embargo of agriculture products came as a big surprise for company X. The company's VP stated that:

*"The extent of it was a huge surprise. I would've never believed it could be shut down just like that. There was obviously a serious issue in Ukraine, but we never thought that we as a third party would be this heavily effected"*

Company X sales towards Russia completely halted, and the management of Company X imminently looked towards an earlier developed plan to redirect their sales. The idea to circumvent the sanctions and gain access to the Russian market for their products was considered, but the VP explained that the firm knew that it would be troublesome to go through Belarus or some other CIS countries, and most importantly they would lost control of their products. The VP stated that:

*"We did not try to circumvent the sanctions because we need to keep our reputation at the highest possible level"*

There is also a problem to circumvent the import embargo, because Russian officials have been alerted on large-scale importers trying to smuggle in embargoed goods via third countries. Countries such as Belarus most declare the country of origin of the products they transport towards Russia (Times, 2014). The Russian embargo and the abolition of EU milk quotas led to overproduction in the large Central European dairy countries resulting in a global excess of supply over demand for dairy products. The VP also explained the further damage that Company X suffered during this period on the Finnish market because of Valios position as dominant market leader, where they were fined for undercutting wholesale prices on milk products:

*"It is a very difficult situation for us, Russia is our most important international market which we've been excluded from. On top of that, the Finnish authorities prohibits us from selling the cheap milk on the Finnish market, so we face difficulties on our two biggest markets. "*



The decrease in demand and the loss of revenue from Russia decreased Company Xs revenue in 2015 with around €250 million, a decrease with 12% from 2014. However, Russia permitted exports of lactose free dairy products from the EU countries to Russia, which accounted for 10% of Company Xs exports to Russia. Nevertheless, 90% of Company Xs exports to Russia was subject for the sanctions which accounted for around 350 million euros.

Because of the sanctions, Company X had to change their strategy and operations. The VP explained how they were forced to streamline their organization , and they closed down three production plants in Finland and around 200 workers lost their jobs because of the sanctions. When the idea to circumvent the sanctions was abolished, Company X sought new export markets and managed to balance out some of the losses by diverting the trade. New global export markets were being explored and the company started working closer with industrial customers and the goal was also to develop new consumer product markets for the firm. The VP explained:

*"We put more efforts into new markets inside the EU and we also managed organic growth from our existing sales net. We also tried some "seed markets" all over the globe to see if they could fit our sales network."*

A state sponsored delegation was sent to China to promote Finnish agriculture products and Company X increased their presence in the US. Despite the embargo, Company X also remained committed towards Russia. Because of the favorable investment environment, the firm opened a second processed cheese line plant in Russia, with milk that derived from countries that were excluded from the Russian sanctions, as well as Russian milk. The VP said that

*"Before the crisis, our company had difficulties in finding Russian milk producers that matched our high quality and we had therefore never used their milk in our products"*

However, because of the sanctions they intensified their search for good milk producers and in late 2014, the company issued a statement where it confirmed their use of the "best Russian milk on the market" in some of their products. By producing inside Russia with local ingredients Company X could therefore circumvent the sanctions which increased their revenue. Company X also started export of baby food in late 2014 (which were excluded from the sanction list) which meant a return to Russia's baby food market for Company X after 15 years absence. The VP also explained that they reversed their strategy in terms of production to cope with the uncertain environment;

*" We increased the capacity of milk powders (Added value and low added value ones), to be on the safe side during any unexpected market situations like the sanctions towards Russia. And if the sanctions will be lifted, we can also get back into Russia at any time"*

### **Future Operations**

After two years of decreasing revenue (2015 and 2016) the company increased their sales in 2017 to €1708 million. In hindsight, Company Xs VP stated that the firm should've build up more capabilities in Russia before the market turbulence instead of reacting afterwards, because Company X could *"earn more market share when competitors were kicked out of the market"* as the VP explained. Company Xs also benefited on some opportunities that arrived from the sanctions, they for example looked closer towards their own organization and spending as a result of the downturn in revenue,

*"We have become much more cost driven in house. When incomes were sky high, no real attention was given to the costs. But when we started losing revenue we turned more focus towards efficiency and savings in a way we hadn't done before, and we made a lot of profitable restrictions"* .

The most valuable lesson learned, and what attributes is favorable during the market turbulence was according to the VP;

*"To always keep a plan B updated and well trained. Keeping doors open to many other countries and large scale customers, even if your one market could cover all and you feel that "old friends" are not needed anymore"*

The VP remain confident that if the sanctions are lifted, they will once again start exporting to Russia since it has been a very profitable market for them. Finland is one of the countries that has suffered most from the sanctions between EU and Russia and the criticism towards the sanctions have at times been vocal. The Finnish Prime Minister Alexander Stubb stated that *"Finland in general isn't of the opinion that now is the right time for the sanctions"* (Times, 2014). This was expressed by many others in the European political and business community, but Company X operate under the presumption that the sanctions will be in place for a further number of years.

#### 4.2.4 Orkla



##### **Company background and earlier operations in Russia**

Orkla foods is part of the Norwegian conglomerate *Orkla Group*, which operate in the branded food consumer goods, aluminum solutions and financial investment sector. Orkla Foods had a leading positions on a number of branded consumer food categories in Scandinavia, the Baltics and eastern Europe. The company had operating revenue of around NOK 15 billion in 2016.

Orklas internationalization started with the acquisitions of strong consumer brands in the Scandinavian countries, and in the early 2000s they started to look towards further expansion eastwards. Johan Wilhemsson, who back then worked with Orklas international business operations, explained that;

*"Orklas internationalization strategy is to acquire local companies, with strong brands and presence in their market, which led to a number of acquisitions in Central and Eastern Europe for us in the early 2000s."*

Orkla foods continued their internationalization process with their strict code of conduct policy, which was highly formed after a Scandinavian model with zero tolerance for corruption and high standard of food and health safety in their products. What interested Orkla Foods about Russia was the large emerging market with an increasing middle class that had improved capital and demand for quality brands. In the early 2000s Orkla bought a local Russian company, that were strong around the Yekaterinburg area. A year later Orkla acquired another company, this time in the St Petersburg region. However, the revenue fluctuated and the company was insecure about further commitment to the Russian market.

However, in the middle of 2000s there were some promising aspect of growth in the market, and Orkla Foods, now with Johan Wilhelmsson as CFO started to look towards further possibilities of expansion through further accusations in Russia. Orkla visited some companies in Russia and Ukraine that were of interest, but then the global financial crisis in 2007-08 struck, which completely halted any further expansion plans. When the loss of revenue started to accelerate further, the management was forced to act and came up with two alternatives, to either further commit or to de-invest from Russia. The confidence of the Russian market had somewhat left Orkla, and with the continued struggle for their Russian subsidiaries, Orkla Foods made a strategic decision to completely divest from the Russian Market in 2012-13. CFO Johan Wilhelmsson explained that:

*"We had tried to breakthrough into the Russian market, but with limited success for a number of different reasons. The financial crisis was basically the nail in the coffin, and we decided to pull our loses and look towards other markets instead"*

Orkla exited the Russian market, and also their other investment in eastern and central Europe, following the strategic decision to focus more on the Scandinavian market instead. Orkla therefore acquired a Norwegian company, which Nordic operations were strong and became the primary focus for Orkla, but the Norwegian company also had a number of subsidiaries in Poland and in the Czech Republic. This coincided with a new management of Orkla that did not mind some exposure and business in eastern and central Europe.

#### **Market Turbulence in 2014**

By pulling their losses the years prior to the Russian market turbulence in 2014, Orkla avoided further decrease in revenue that most certainly would've been leveled upon them. Johan Wilhelmsson stated his strong confidence that the decision to leave Russia in 2013 was the right one.

Despite their divestment from Russia, they now had other acquired other companies with a presence in central and eastern Europe. In 2016 they found another interesting company to acquire, this time a Czech firm that also had some positions in Russia and Ukraine. It was primarily their strong brand and presence in the Czech Republic and Slovakia that Orkla were after, but through that company's subsidiary in Russia they were once again back in the Russian market.

Despite Orklas strategy to rather be a big player in a small market than scattered on a number of markets, the small presence and exposure in Russia didn't trouble the management

of Orkla. The preferable cost situation in Russia as a result from the economic downturn, with the low ruble and costs of production, the Czech subsidiaries production was located in Russia. Despite not being a local company, the products were locally made and their brands was seen by Russians as basically Russian. This has also benefited Orkla since their locally produced food products are therefore excluded from the import-ban of agriculture goods that were implemented in the summer of 2014.

### **Future operations**

Orkla now have a small exposure towards Russia (around 1%) with around SEK 140 million in sales, which is something the company is comfortable with. The performance of their subsidiary in Russia is good but Orkla is currently not looking for expansion or further commitment in the region.

The middle-class that Orkla targeted in their earlier internationalisation attempt in Russia in the early 2000s have somewhat been eradicated according to Orklas managers present in Russia. The growth of the middle class has halted and in some cases retracted with increasing personal debts and financial insecurity. Orkla wants to be a major player in the markets they operate in, according to Johan Wilhemlsson.

*"For a further expansion in Russia to be interesting it will require huge amount of capital and commitment, which our strategy and management at the moment don't account for"*

With the current small exposure to Russia and no current ambitions to further acquire companies, Orkla is looking more towards organic expansion in Russia. With a small exposure, but still a presence in the Russian market, Orkla have a advantage to sense the direction of the market and demand of the population, and in a possible future there might arrive opportunities to further capitalize and expand in the market according to Johan Wilhemlsson. There is currently now major hinder in terms of sanctions:

*" The Ukraine conflict hasn't changed much for us in terms of risks, since the market has now started to adapt. However, Russia will always be Russia, and there are cases of corruption but we have a strict code of conduct policy and there are generally now problems in doing business there."*

He also explained Orkla Foods assessment of risks:

*"We do on-going risk assessments for every market and subsidiary, where we cover the five*

*to ten largest risks facing us. However, the political risks that we encountered in Russia and Eastern Europe is not existent in our major markets in Scandinavia. Therefore most of our risk focus are towards food safety, prices and new technology.”*

The political risk have been more relevant though in Orkla Foods risk assessment of Russia and Johan Wilhemsson stated the unpredictable nature of sanctions and its complications, but that it didn't hinder their current operations. With the exclusion of certain EU food producers from the market, it has rather improved Orkla Foods position on the market.

#### 4.2.5 Engtex



##### **Company background and earlier operations in Russia**

Engtex is a Swedish firm founded in 1939 based in Småland, Sweden. The company focus on the development, manufacturing and supply of technical textiles, whereas Engtex is a world leading manufacturer of warp knitted textiles for personal protective equipment for chainsaw protective garments and trousers. The protective clothing for the chainsaw industry is Engtex's biggest and most prominent sector.

Engtex's operations in Russia started around 2008, where they were visited from a Russian governmental official interested in protective equipment for their industries. What interested Engtex about Russia was the vast supply of forest in Russia and that sector's related industries. After a promotional visit to Russia they were contacted by an interested distributor, and Engtex's exports towards Russia started during the aftermath of the financial crisis in 2008. Despite the financial downturn in the Russian economy as a result from the global financial crisis, Engtex's sales was hardly affected and their sector actually saw an increase of revenue during these years. CEO Patrik Johansson said with a mixture of seriousness and pleasantry that:

*”Our sales actually increased during this period, we drew the conclusion that when the Russian market went into recession, our sector grew because people seemed to flee into the forests when bad times arrive and therefore the demand for our products increased”*

Despite positive sales, Engtex did not have any large exposure or sales towards Russia and the company were happy with their limited presence on the Russian market. The previous financial crisis did not negatively effect Engtex, quite the opposite and they had a position as the market leader. Nevertheless the Ukraine conflict and coinciding downturn of oil prices and deprecation of ruble in 2014 completely halted Engtex exports towards Russia in a way that previous turbulence did not.

#### **The market turbulence in 2014**

The previous stable exports were completely disrupted in 2014, and CEO Patrik Johansson was declaring his frustration in Sveriges Radio (Lek, 2014) :

*Since the second quarter of 2014, the export has been completely dead. It's hard when you can't influence anything, you just have to wait and see*

He elaborated for this study that hardly a single order was ordered from their Russian distributors for more than a year, and the abrupt stop in sales ended with Patrik Johansson personally visiting his retailers in Russia. Despite their product being excluded from the European sanctions , the consequences of the sanctions still effected Engtexs customers. Many of Engtexs products are delivered to large regional and governmental infrastructure projects, such as gas pipelines, which was somewhat put on hold because of the insecure access to capital because of the sanctions. The depreciation of the ruble made Engtexs products very expensive for their Russian customers, which was the foremost message put forward to CEO Patrik Johansson from their Russia retailers. However, the retailers expressed their continued belief in the Russian market and stated that the downturn in the economy have happened earlier and the demand for their products will soon increase again. Engtex have yearly risk assessments but did not have the resources, knowledge or contacts to foresee or control the institutional changes from the sanctions. Like most firms, Engtex were taken by surprise from the turbulence, and they didn't have any outside contact to Swedish or Russian state or consulting agencies, as expressed by Partik Johansson:

*"Our sales towards Russia weren't that extensive as other firms and we neither have the resources or the contacts to talk directly with the government in a way to influence our sales"*

Despite the complete stop in sales, Engtex maintained their confidence in the Russian market and expressed their commitment through further contact with their retailers, and also with a small lowering of prices for their products during a limited period. During the last two

years the market has recovered and Engtex sales have doubled from their pre-2014 sales, and they now have businesses with the biggest actor in the Russian market.

### **Future Operations**

The downturn of the economy that struck Russia gave Engtex further market share since a previous Finnish rival lost some of their competitiveness in the market because of the economic downturn. By now being in business with the biggest actors in the sector that also distributes towards state-owned enterprises, Patrik Johansson express belief in the Russian market for Engtex. Engtex also sell their clothing together with products from large Swedish companies such as Huskvarna, which further promotes and strengthen their brand in the Russian market.

The strategy that Engtex adapted, to just wait out the turbulence, and maintain and strengthen their relationship and commitment with their retailer have been positive and there is not much Patrik Johansson would change in terms of strategy. Despite the increasing sale and confidence in the Russian market, Patrik Johansson said there are no plans to establish production in Russia.

*"We now delivers to the largest actors, and there is no foreseeable need for expansion. There is also the issue with the language barrier, that is an obstacle for every foreign firm operating in Russia."*

However, there is a belief that further investment in Russian infrastructure will serve Engtex well, and Patrik Johansson is optimistic about the future for Engtex operations in the Russian market.



#### 4.2.6 Oriflame



##### Company background and earlier operations in Russia

Oriflame is a Swedish cosmetics company which was founded in 1967 and operate in around 60 countries, with revenue of around of €1.4 billion in 2017. Their production centres are located in Sweden, Poland, China, Russia and India and focus mainly on innovative beauty products.

Their internationalization process started in the neighbouring Scandinavian countries, and after the fall of the Soviet union, the company entered Eastern Europe and Russia in the early 1990s. Russia and the other CIS countries fast became Oriflames most important markets, and the company had a remarkable organic growth in the area. CEO Magnus Brännström explained that what attracted Oriflame with Russia was:

*"The huge growing market, and the strong place in society for women, which is our targeted group. We have around 3 million consultants who sell our products, most of them women and therefore Russia have been historically very profitable for us"*

However, Oriflame had previous experience of market turbulence, the Russian financial crisis of 1998 effected Oriflame heavily when their stock prices plummeted. In order to save the company, the two owners who started the company bought the firm back from the London stock exchange with the help of outside investors. However, Oriflame remained focused on Russia and as CEO Magnus Brännström said:

*"When the Russian market collapsed, we remained committed. I believe it created a big trust for us amongst our retailers and the Oriflame brand has been highly seen inside Russia ever since."*

There were also turbulence on the Russian, Belorussian and Ukrainian market in 2008, where the whole cosmetic market decreased in size at the same period. However, while the market size decreased with 5%, Oriflames overall market share increased with 15% and have

since the last decade been market leader on the Russian market. The large profitability and revenues from Russia decreased Oriflames dependency of the Scandinavian market, where 1/4 of sales came from western Europe and only around 10% from Scandinavia. In 2010 over 60% of Oriflames revenue came from Russia and 2/3 of the profits, which illustrated Oriflames large exposure towards Russia.

#### **Market Turbulence in 2014**

The Ukraine conflict became very serious for Oriflames operations, since both Russia and Ukraine were two of the firms biggest markets. The Maidan protests and the uprising in eastern Ukraine led to a very tense situation and there were fears inside Oriflame management that the conflict would escalate further. After the Minsk accord, the conflict became somewhat frozen but the economic hardship had just started for the consumers in Ukraine and Russia.

Oriflame took notice from previous knowledge and did not lower the price of their products. Instead, they increased their prices even if it meant volume drop in order to secure income levels for their consultants explained Magnus Brännström. Oriflame also bore more cost in ruble to balance currency fluctuations. Magnus Brännström realized that even if they still show further commitment towards Russia, their exposure towards that market was too extensive and plans were rapidly put in place to increase their commitment in other areas of the world, Magnus Brännström stated:

*"It is hard to stay cool and passive when the whole Russia and CIS market fell apart, so we put more focus on other markets. In 2010 60% of our business were in the CIS and now we have less than 25% towards Russia"*

Despite Oriflames rapid increase of internationalization into other markets, the favorable investment environment in Russia gave Oriflame the incentive in 2015 to also open a new fabric in the Noginsk Area. Magnus Brännström stated however that:

*"Not all components are being produced in Russia, which unfortunately limits the upside with local production as you often has to import the ingredients and components. As a natural consequence of the production start in the new factory, we sold the manufacturing sites in Ekerö, Sweden and will consolidate the production in the new factory. But the building of the factory is an important milestone for Oriflame, and a statement that the Russian market will continue to be essential for us."*

### Future Operations

CEO Magnus Brännström explained that the most beneficial consequences of the turbulence were the cost reductions in general that Oriflame had to adapt:

*”Since our operations had been going in a positive direction for twenty years in Russia, not much attention had been given to efficiency and cost reduction inside the company. However, the financial hardship that we suffered made us reorganize our operations, and we became more flexible with very low levels of fixed cost and infrastructure to drive the Oriflame business model.”*

Oriflame's current strategy is to continue streamlining their organization and to further penetrate its six strategic markets they already operate in: Mexico, Russia, Turkey, India, China and Indonesia. Over time, Oriflame will also expand into new geographical markets, primarily through organic expansion. 40% of their revenue now derives from Asia, which is in sharp contrast from before the downturn in Russia, where 60% of their earlier revenue came from, which is now only 26% in 2017. Their Asian operations (especially Turkey) showed a 24% increase in 2017, compared to only 2% growth in CIS and Russia. Their sales growth are lower than before the crisis, but through their cost reductions in the organization they now have much better operating margin and profit. Oriflame see huge potential for growth in China, India, Vietnam and Nigeria, and their commitment towards internationalization have increased. The US market is interesting but requires a lot of resources and are therefore not one of their primary market at the moment.

Oriflame conduct regular risk assessments, and have previously experienced political risks inside Russia with an earlier sensitive tax claim, and Magnus Brännström expressed his desire for the Russian business landscape to be more transparent. However, the European sanctions came as a surprise and so was its effect on the Russian economy and Oriflame according to Magnus Brännström. He is however of the belief that the market has now started to adapt and think it's unclear if the sanctions will be lifted in the foreseeable future.

## Chapter 5

# Analyzing the sanctions influence on MNCs strategies

*This chapter compares and analyses the empirical findings to the theoretical framework in order to provide a better understanding of the researched subject and draw parallels and conclusions between the two chapters. The concepts of internationalization, market turbulence and adjustment of strategies that were presented in the theoretical framework guides the analysis with the research question in mind. The analysis ends with a summary of the successfully strategies that were implemented to counter the effects of the sanctions.*

### **5.1 Internationalization strategies effect on firm performance**

Previous theories presented in the theoretical framework suggest that a firms internationalization strategy effect the firms performance during market turbulence, and it is therefore relevant to analyze in context to this study. In Hilmersson (2014) study the scope and speed of the internationalization were the primary dimensions that explained firms better handling of market turbulence. Although that study differs from this one, for example Hilmersson (2014) examined Swedish SMEs response towards a global market turbulence (the Financial crisis and recession of 2007-08), whereas this study examines Scandinavians MNCs perfor-

mance in the market turbulence in Russia in 2014. The empirical findings of this study supports the overall conclusion that firms internationalization strategy in terms of scope, scale and speed effects its performance during market turbulence. However, the author argues that the primary predictor of a firms handling of the market turbulence in Russia were the scope and scale of their internationalization strategy rather than the speed.

### 5.1.1 Speed

Hilmersson (2014) stated that when a firm undertakes an international growth strategy at a high speed, it is likely to gain a first-mover advantage if it is the first significant occupant of a market segment, and therefore the higher the speed of the internationalization the better the firm perform during market turbulence. This statement is somewhat challenged by the empirical findings of this study. In the case of the firms that were targeted by the Russian agricultural sanctions, Leroy and Company X, both firms were market leaders in Russia with their products, but were regardless of that excluded from the Russian market during the market turbulence of 2014. Despite also having favorable positions in their other export markets, the oversupply of their products because of the shutdown in Russian led to the prices of milk and trout decreasing. Fredrik Andersson of Systemair stated that as a market leader who sets the general industry price, other firms follow suit and the advantages of lowering prices is not always possible. In the previous market turbulence in Russia (the financial crisis of 2007-08 foremost), Systemair were in a better position to adjust their prices since they were not as dominant in the Russian market yet and therefore lowered their prices to help their retailers. Company X were also constrained by the Finnish authorities from lowering their prices because of their strong position on the market.

It is therefore suggested by the author, that by being first and achieve a market leader position, it often generates further exposure and capital towards that market since it is often profitable as in the case of Leroy, Oriflame and Company X. This was also the case with Systemair that were market leader and had much previous success in Russia, but therefore also large exposure and dependency on that market which did not compensate with their first-mover advantage in the case of market turbulence. Whereas the overall market size decreased for Systemair and their competitors, the local firms became more attractive because of their favorable production costs and the increased preference towards Russian products. Therefore Systemairs, Oriflame, Leroy and Company X position as market leader became somewhat irrelevant because of the sanctions, since they themselves were either excluded from the market, or more damaged by the sanctions than the domestic Russian

companies irrelevant of their first-mover advantage.

The implementation of sanctions from Russia against the European agriculture sector was a blessing for the Russian domestic food industry. With the loss of European companies that often were number one or two in the market segments there was an decrease in competition for the Russian firms. Systemair also faced increased competitiveness, since their products became more expensive than their Russian counterparts and they were also neglected in favour of products that were made in Russia. In the case of Engtex and their role as a market leader in a very specified segment, they noticed no noticeable increase in competition but more a complete stop in certain infrastructure projects that effected all firms in the sector, domestic or foreign. Their sales towards Russia are now increasing again and they have further strengthen their position in the market since their competitors have left or lost in competitiveness, and this strengthen Hilmersson (2014)theory that firms with first-mover advantage often perform better during market turbulence.

### 5.1.2 Scale

The scale of firm internationalization is defined as the degree of firms activities that are depended on foreign markets, and the less dependent a firm is on its home market the greater the scale of internationalization (Hilmersson, 2014). Leroy and Company X all had large sales towards Russia, but around 85% of Leroy's revenue derive from foreign markets where it was only 30% of Company X's revenue stream. 75% - 85%of Systemair's and Oriflame's revenue were outside their Scandinavian market before the sanctions as well which limited their loss of revenue when the Russian market went into turbulence. Although all companies suffered from the sanctions in Russia, Company X's significant loss of revenue, closing down of three productions plants and hundreds of terminations supports Hilmersson (2014) conclusion that the firms with greater scale of internationalization performs better.

### 5.1.3 Scope

The scope of the internationalization is the number of markets the firm operates in, the geographical spread, and is therefore defined as the companies exposure and ability to diversify risks between different countries. Hilmersson (2014) concluded that the larger scope of internationalization the better the firm perform, and this is supported by this study. The representatives from Leroy, Company X, Oriflame and Systemair all emphasized their large

exposure towards Russia, and thereby suffered heavy loss because of the sanctions and the downturn of the economy. However, Company X and Oriflame operated in less than fifty markets in 2014 and with a substantial exposure to Russia and a few number of other markets. The spread and exposure of markets for Systemair, Leroy and Engtex were much larger and these firms could also mitigate the losses better despite having lost substantial revenue from Russia during the market turbulence as well. The scope of the internationalization is therefore a strong indicator of a MNCs performance during market turbulence with the implementation of sanctions.

The author argues that the flexibility that comes with a great scope and scale of internationalization are more important than the speed of the internationalization in order to perform better during market turbulence in the case of sanctions. The geographical spread and exposure, i.e to operate on a number of markets with limited exposure and avoid large dependency on a single market is very important and strengthens Hilmersson (2014) conclusion not to "put all eggs in one basket". Leroy, Company X, Oriflame and Systemair all increased their scope of operations as a result of the sanctions, to mitigate the losses and to be in a better strategic position for future instances of market turbulence.

## **5.2 The unpredictable nature of sanctions**

The characteristics of internationalization in emerging markets as complex and turbulent, as described in previous literature (Santangelo & Meyer, 2011; Figueira-de Lemos et al., 2011; Hilmersson et al., 2015; M. Johanson & Johanson, 2006), were all supported by the case firms in this study in regards to their experience in Russia. During the last two decades, there have been three major downturns in the Russian economy that all have been described as financial crisis by various commentators, which supports the notion of the Russian market as volatile. What often characterize the downturn of the Russian economy is the falling prices of oil, which the Russian economy still rely heavily on. The need to lower the dependency towards oil revenue have often been stated by the Russian leadership but the country still have heavy exposure towards the oil prices which is an ongoing risk for the Russian economy.

Culp (2012); Oetzel (2005) mentioned the danger of neglecting political risks in their strategic planning whereas most focus on financial, market and operational types of risk. This was also the case in this study, whereas most of the case firms performed yearly risk assessment, but the political risks were not much focused upon. The case firm that have most

experience from political risks is Leroy Seafood group, which frequently have to adapt their strategies because of political decisions, both on a national and supranational level. Leroy was the only firm that previously had been subjected towards a ban of exports to a market and have continuously been operating under political uncertainty, foremost in regards to environmental decisions and fishing quotas. However, none of the case firms had developed an extensive risk scenario framework as mentioned by Culp (2012), and the events that unfolded in Ukraine with the implementation of sanctions were all unforeseen by the case firms. This was especially highlighted by the VP of Company X;

*“The extent of it was a huge surprise. I would’ve never believed it could be shut down just like that. There was obviously a serious issue in Ukraine, but we never thought that we as a third party would be this heavily effected”*

Western countries have generally been the sender of economic sanctions, and often towards countries that generally don’t have extensive trade relations with the west. In the case of Russia, both markets have been heavily reliant on each other, with Russia striving for European capital, investment and goods and Russia as the main supplier of energy towards the EU. The tit for tat sanctions between the countries is therefore unusual in a historical sense, and understandable hard for Scandinavian MNCs to have experience from. This study present some scholars (Mearshaimer, 2014; Cohen, 2010) that had somewhat foreseen the events in Ukraine. However none had calculated the extensive measures of economic sanctions as a fallout of the conflict and it’s hard for business managers to predict something that not even acclaimed scholars of geopolitics and international relations could foretell. What differed the implementation of sanctions towards other major political events such as elections and referendums, is with the later, firms can make risk and strategy scenarios well in time of the event and adapt to the outcome. The swift and unforeseen implementation of sanctions in the spring and summer of 2014 made scenarios to divest or change business strategy in time harder for the case firms.

Based on the empirical findings, the author argues that the implementation of economic sanctions is very hard to predict, since it is often determined by complex geopolitical events. Mascarenhas (1982) argued that to help monitor and respond to new environmental developments a firm can implement a intelligence system to help foresee and address uncertainty. However, this requires an abundance of resources possible only accessible for the largest corporations and was not something the case firms had thought about.

The effects of the sanctions have now started to diminish for the case firms Russia operations,



with the exception of Leroy and Company X, and all firms have seen continuous growth in their Russian revenue since 2014. The Russian market have adapted and the case firms see the implementation of sanctions no longer as a major challenge, and more as a potentially opportunity if the sanctions are lifted and European capital once again is accessible for Russian firms which will arguably led to further investments in the country. In the case of the Russian import ban, Leroy and Company X obviously follows the political development since a removal of the import ban would once again open up a very large and previously profitable market for those companies.

## 5.3 Case firms adjustment of strategies

### 5.3.1 How previous experience influence the adjustment of strategy

The earlier studies by Hilmersson and Jansson (2012); Figueira-de Lemos et al. (2011) stated that the greater the turbulence in the market, the less useful are the firm previous experiences. Therefore, the firm's earlier experiences are less relevant for predicting firm behaviour during market turbulence.

Despite operating in an environment with economic sanctions that were previously unfamiliar for the case firms, some of their behavior were based upon the experiences and knowledge of previous instances of market turbulence in Russia. Systemair had been through two earlier financial crisis in Russia before the downturn of the economy in 2014, and despite losing 50% of their revenues in Russia they relied upon their previous experience of market turbulence and remained committed to the market. Fredrik Andersson of Systemair stated that although the effect of sanctions was unfamiliar, with the limited access to capital for Systemairs customers, they had confidence in the Russian market to once again recover. Although they were shocked about the sudden downturn of the economy, their commitment towards Russia did not change, just as it had not in the earlier instances of crisis because they believed the Russian market had the ability to bounce back.

Leroy also had previous experience of market turbulence on emerging markets, with the import ban from China in 2010. Their behaviour during the market turbulence in Russia was similar to their actions in China. However, their attempt to circumvent the effect of the sanctions through exports with a third country, this time Belarus, proved unsuccessful just as their previous attempt to use Vietnam to reach the Chinese market in 2010. This supported

Hilmersson et al. (2015) study, that managers should instead develop a flexible organization that can help reduce the uncertainty, instead of highlighting previous experiential knowledge. Leroy quickly abandoned their circumvention attempt and instead focused on flexibility through streamlining their organization and finding new markets which gave a better result.

It's fair to say that these firms earlier experience of market turbulence made their behaviour more predictable and influenced their strategies, and in the case of Systemair, their previous experience and knowledge proved valuable since their Russian operations have once again become successful.

The other case firms were more troubled by the market turbulence and their previous internationalization experience proved less relevant, and their actions followed similar steps of process that were suggested by Hilmersson et al. (2015). Hilmersson et al. (2015) stated that during the first phase of the turbulence a "wait-and-see" strategy is most likely in this situation, which was the approach adapted by Engtex. The sudden stop in Russian revenue for Engtex left them in a situation that their previous internationalization experience had not accounted for. As suggested by Tsoukas (1996) that in an unknown situation the firm has difficulties in predicting a highly uncertain future, which is reverberating Patrik Johansson, CEO of Engtex experience of the first year after the implementation of sanctions.

The accumulated knowledge can become obsolete after dramatic changes in institutional regulations stated Hadjikhani (1997); Jansson (2008); Hilmersson (2014) and this is supported in this study by the Russian counter sanctions which were specifically targeted against the European agriculture and food industry. Regardless of their previous knowledge and experience, Leroy and Company X were excluded from the Russian market. These firms had long and successful experience and knowledge of Russia, even managing successfully through earlier crisis, but the consequences of targeted sanctions made their accumulated knowledge obsolete. The European sanctions that hampered all Russian companies access to capital have been somewhat manageable and show similarities with previous theories of market turbulence and recession (Kao, 2013; Hilmersson, 2014).

### **5.3.2 How to cope with the uncertain environment**

#### **Political control and flexibility**

In the months following the Ukraine crisis, with the implementation of sanctions and the

sudden drop in the Russian economy, all of the case firms expressed their concern and uncertainty over the Russian market. Bradley (1977); Mascarenhas (1982) theories that were presented in the theoretical framework state that to exercise control is one of the most common methods to handle market uncertainty. By exercising control, the firm tries to control the environment from changing in a way that will adversely affect your businesses.

However, to exercise control of the sanctions and the following downturn of the economy proved hard for the companies. An alternative for Leroy and Company X that were targeted directly by the sanctions, was to circumvent the sanctions. Through exporting their goods through a third country into Russia, they would however lose control of their operations, in contrast to what Mascarenhas (1982) suggested, in that firm should increase control of their operations backward and forwards, not outsourcing it. This concern was raised by both Leroy and Company X, and was the reason for them not to participate in any committed circumvention attempt. According to Mascarenhas (1982) the firms could also exert control by influencing and lobbying the government for them to make favorable legislation. Although some contact was made with representatives from the Scandinavian governments, none had any effect on reducing the uncertainty.

All firms except Engtex and Orkla had substantial sales towards Russia, but the case firms don't have the financial and political leverage that perhaps certain other powerful MNCs have to influence political decisions such as sanctions. Fredrik Anderson of Systemair mentioned that despite operating a big firm, they did not have the kind of contacts that some firms have either with the governmental hierarchy in Russia or Sweden to influence such a decision. Therefore, exerting control to reduce and control the uncertainty proved difficult for the case firms. The case firms did not have the resources or influence for lobbying political decisions in their favour, which been proven hard for every MNC in this aspect, since both the EU and Russia have been very firm in their positions with few exceptions.

When exerting control proved less successful or not even possible, more focus and success to manage the sanctions came from the improved flexibility of the firm. Leroy, Company X, Systemair and Oriflame all increased their activities in other markets as a result from the turbulence and supports the theories of Mascarenhas (1982); Hilmersson et al. (2015). Some of the case firms also streamlined their operations, and in the case of Systemair put certain hiring freezes of personal and did not prolong contracts with consultants. Magnus Brännström of Oriflame specifically stated that flexibility is the most important factor during turbulence and have therefore further committed their strategy towards more flexibility. Based on the empirical findings the researcher argues that exerting control and relying on

previous experience proved difficult in the case of sanctions, whereas the increase of firms flexibility was more feasible and successful as stated by Hilmersson et al. (2015).

### 5.3.3 Adjustment of strategies

Santangelo and Meyer (2011) study based on the intended strategy concept by Mintzberg and Waters (1985) concluded that firms may increase or decrease their commitment as the implementation of intended strategies is subject to environmental influences. Their study looked at the environmental drivers that make foreign investors deviate from their intended strategy, and found that institutional uncertainty induces investors to design their strategies for flexible responses to new opportunities.

#### **De-internationalization from Russia**

What the empirical findings from this study found was that the firms that were effected by the sanctions and started a process of de-internationalization in Russia, rapidly expanded their businesses in other areas that were not targeted by the sanctions. Leroy and Company X were both targeted directly by the Russian counter sanctions and went into a process of de-internationalization from the Russian market, and swiftly increased their commitment in other consumer markets. Leroy invested in new facilities in Norway, France, Spain and Denmark, whereas Company X opened a sales office in America and increased their commitment towards China. In the case of the implementation of agriculture sanctions, it can be concluded that it led to a clear divergence of the case firms strategy. Its realized strategy became the substantial and unwilling decrease in commitment towards the Russian market, but an intact overall commitment towards internationalization in line with Vahlne and Nordström (1993). The attempt by Leroy and Company X to circumvent the sanctions through a third country proved unsuccessful, but Company X managed to still supply some of their products to Russia by using local ingredients and opening up another production center inside Russia. By locating the production in Russia and with Russian milk, the company managed to circumvent the sanctions, although still not capable to match their earlier production and revenues from Russia.

Because of the implementation of sanctions, Leroy completely de-invested from the Russian market. Mellahi (2003) described de-internationalization as a voluntary process of decreasing involvement in international operations in response to organizational decline at home or abroad, or as a means of enhancing corporate profitability under non-crisis conditions.

What his definition lacks is the inclusion of the involuntary process of leaving a market, since their might be unexpected conditions that makes further internationalization not feasible in a certain market as experienced by Leroy and Company X. The Russian market was very profitable for Leroy and de-internationalization and exit from the market was forced upon them through the introduction of governmental regulations on Leroy's products, which is one of the exit motives mentioned in Reiljan et al. (2004) de-internationalization framework. However, as Vahlne and Nordström (1993) mentioned, that the withdrawal from one international market does not describe the relationship between the overall commitment towards internationalization, since its overall exposure to cross-border operations can remain constant due to simultaneous increase of commitment to other markets.

Orkla who left the Russian market before the crisis, made a voluntary de-internationalization, whereas the focus shifted towards its core markets and activities to be more committed to a fewer number of countries. This follows Reiljan et al. (2004) framework of change of strategy as a result from a new managers strategic perspective or inadequate growth in the target market which was both the case for Orkla. This change in strategy is most likely to occur in later stages of internationalisation which fit the de-internationalization process of Orkla.

The de-internationalization pattern of the case firms subjected to the targeted counter sanctions differs from Benito and Welch (1997) earlier study that suggest that de-internationalisation is more likely during the first stages of internationalization. Both Company X and Leroy had been operating outside their borders since the start of the 20th century, and so had their business in Russia.

### **Re-internationalization**

The previous literature (Reiljan et al., 2004; C. L. Welch & Welch, 2009) were divided upon the re-internationalisation process after the de-internationalisation, whereas recent studies suggested that withdrawals from a foreign market is not necessarily followed by re-internationalisation. Of the case firms in this study that underwent a de-internationalization process, all three were planning towards re-internationalization. Orkla, that underwent a complete exit from Russia in 2010 have already re-entered the market, and both the CEO Henning Beltestad of Leroy, and the VP from Company X expressed their strong desire to operate on the Russian market again as soon as the sanctions are lifted. This has arguably much to do with their de-internationalization was not voluntary and is another case where the consequences of sanctions is unlike those in previous theories of market turbulence.

Systemair and Oriflame were not forced away from the Russian market by the sanctions as

in the case with Company X and Leroy, but their realized strategy resulted in an increased internationalization towards other markets as a response to the market turbulence. This process of rapidly exploring and investing in new markets were a response to the market turbulence in Russia. However, they remained committed towards the Russian market, with deliberate strategies to maintain a strong market leading presence in Russia as presented in the empirical findings through their adjustment of prices and further investment inside the country.

The case firms adjustment in strategy as a response to market turbulence is line with Santangelo and Meyer (2011); Ghoshal (1987) studies, in that it increases the possibility of changes in not-yet-implemented expansion plans which was the case for Orkla Foods. Orkla Foods had looked towards future investments inside Russia but the financial crisis of 2007-08 tarnished those plans and Orkla left the market. Santangelo and Meyer (2011); Ghoshal (1987) also mention the discontinuation of operations in response to market turbulence was similar to the decision made by Company X and Leroy.

Based on the findings, there are three major adapted strategies by the case firms in Russia, either an increase or decrease in commitment as suggested by Santangelo and Meyer (2011), or a situation when the firm adapt a wait-and-see strategy (Clarke & Liesch, 2017; Hilmersson et al., 2015) to handle the turbulence.

#### **Wait and see strategy**

Both Engtex and Systemair adapted a wait and see strategy. Systemairs based this strategy on their previous experiences of market turbulence in Russia. Systemair remained committed to their long-term strategy in Russia, and despite the significant loss of revenue, it changed little in their stance towards Russia. Engtex remained confident in the Russian market through their visit to Russia, where they were assured by their retailers that this was just a short downturn and that orders would continue to be demanded in the near future. With their small exposure towards Russia, they were not forced to make any large strategic decision.

#### **Increased commitment towards Russia**

The CEO Magnus Brännström of Oriflame mentioned the opposite, since Russia was such an large and important market for Oriflame, they felt forced to adjust their strategy. Besides increasing their scope on international markets and streamlining their organization, they also further invested inside Russia. Orkla Foods, who had left the market as a result of the

earlier market turbulence, now reentered the country again and therefore increased their commitment towards Russia.

#### **Decreased commitment towards Russia**

Company X and Leroy adapted a forced de-internationalization from the Russian market. Because of the sanctions, they did not have much of a choice. However, Company X also invested in Russia and was therefore divided in their strategy adjustments with both increased commitment towards the market but also a forced de-internationalization.

However, the author concludes based on the empirical findings, that although there were forced de-internationalization from Russia, the overall commitment towards internationalization was rather increased. Leroy, Oriflame, Systemair and Company X all increased their international activities as a response to the sanctions. Therefore, the author argues in line with Vahlne and Nordström (1993), that the de-internationalization from Russia does not describe the relationship between internationalization theory and commitment in a sufficient way

## **5.4 Opportunities from market turbulence**

Despite the difficulties for MNCs operating in Russia during the times of sanctions, there were also certain opportunities that arrived as a result from the market turbulence. The empirical findings presented opportunities that the case firms exploited, or highlighted as a possible business opportunities in the future. Some of these adjustments of strategies might have taken place without the market turbulence, but their implementation process were accelerated because of the market turbulence in Russia.

### **5.4.1 Favorable investment environment**

The Ukraine crisis and the following EU sanctions created high uncertainty towards the Russian market, and this coincided with the low oil prices and investors therefore lost their confidence in the Russian market. This was explicitly expressed by Fredrik Andersson of Systemair who described the anxiety towards the Russian market in especially 2014 and 2015 from investors and parts of the management. However, in hindsight when the Ukraine

crisis became somewhat frozen and did not escalate into a large scale regional conflict, Fredrik Andersson described the situation in Russia as favorable in terms of investment opportunities. The low price of the ruble decreased the investment and production costs in Russia, but because of the still uncertainty of the market, Systemair did not further commit into a production center in Russia. However, the workers wages are still low in the country and a possible expansion for Systemair in Russia is being discussed according to Fredrik Andersson.

Orkla, Company X and Oriflame seized on the opportunity and expanded their operations in Russia during the market turbulence. Orkla who had exited the Russian market before the market turbulence, now acquired a company with operations inside Russia where they also located some of their production. Company X was hit hard by the Russian counter sanctions and lost almost all of its exports towards Russia, but the favorable investment environment made Company X open another production center inside Russia for their products that were not included in the sanctions. They also used local Russian ingredients for their products, and therefore able to circumvent the sanctions. Oriflame opened another factory in the Noginsk area and also bore more costs in ruble to balance currency fluctuations, however many of the components to their products still needed to be imported to Russia.

In the case of Leroy there was no strategic sense in further expanding inside Russia since all their products were banned, and Engtex did not need a production or sales center in Russia and cited the problem with starting a business (foremost the language) in Russia as one of the main reasons for not investing in the country. Therefore, this study argues that the European Sanctions against Russia further escalated the downturn of the Russian economy, but the market turbulence also led to favorable investment environment in the country.

#### **5.4.2 Increased flexibility, diversity in markets and streamline of the organization**

As a response towards the sanctions, the case firms realized that flexibility and diversity in markets was important for the firms to balance the market turbulence. Magnus Brännström of Oriflame stated that the best attributes for overcome the market turbulence is flexibility, and the company now has very low levels of fixed cost and infrastructure to drive their business model. When the firms suffered difficulties in maintaining their revenue stream, they were forced to streamline their organization, which Oriflame, Company X and Systemair stated was a good thing that derived from the market turbulence which will benefit their



firms in the future.

Oriflame were not excluded from the market but suffered heavy losses which they compensated with impressive growth in other markets and through cost reductions. Oriflame intensified their operations in Asia, which is now their biggest market. Their large exposure against Russia has been adjusted, whereas in 2010 60 % of Oriflame business were in the CIS, where it is now less than 25%. Because of their almost full exclusion from the Russian market, Company X and Leroy started to streamline their own organization which led to cost reductions for the company in other areas. They also further increased their internationalization by expanding towards new markets to diversify their market sources of income. Systemair sought new markets and also initiated a cost restructuring program as a result from the downturn in Russia revenue. Therefore, the author concludes that the streamline operations conducted by the firms are beneficial in the long term, in future cases of market turbulence and also compensated some of the losses in revenue from Russia.

### 5.4.3 Increased knowledge and building of trust

The case firms had experienced market turbulence before in their internationalization process, but never in the form of the strict economic sanctions implemented by both the EU and Russia. With the increasing tendencies to use sanctions (Leenders, 2014), the case firms will be better prepared and have a better understanding of its fallout. Although predicting future economic sanctions will be very hard, there is an increased understanding of its consequences according to the case firms. Although previous knowledge proved less useful, firms realized the importance of flexibility in regards to the sanctions and it will arguably be further enhanced in terms of future turbulence for the firms.

The firms that remained committed towards the Russian market despite the downturn, gained increased trust and strengthen their relationship with their suppliers and customers, as was suggested in Kao (2013) study. The increased relationship were confirmed by Fredrik Andersson of Systemair, who continuously in the earlier instances of market turbulence had focused on maintaining a strong relationship with their partners. Engtex also visited their local Russian consumers to build their trust and keep an dialogue which was appreciated. Oriflame increased the prices on their products in order to give their sales consultants maintained income during the crisis. All of these efforts by the case firms increased the collaboration and built trust with their partners according to the interview subjects.

#### 5.4.4 Successful strategies applied by the case firms

Since it is only four years since the start of the Ukraine crisis and the implementation of sanctions, it's hard to draw long term conclusions of the firms strategy to cope with the uncertainty and sanctions. However, what the empirical findings showed was that the change in strategy to increase the internationalization in other markets proved successfully. By decreasing the dependency on Russia, Company X, Leroy, Oriflame and Systemair managed to divert some of their trade, increase their revenue and mitigate their losses from the Russian market. Firms that had large exposure towards Russia and had few markets to divert their trade, as in the case of Company X, suffered heavily.

The change in strategy that proved unsuccessful was the half-hearted attempts by Leroy and Company X to circumvent the sanctions through a third country. Although this strategy did not cost much in time and resources, the strategy quickly proved unsuccessful. However, Company X managed to circumvent the sanctions by further investing inside Russia and using local contents in some of their products, this proved more successful then the attempt to export through a third country. A good strategy was also facilitating production in Russia because of the low costs which also enables a firm to circumvent the sanctions by using local Russian components and production.

The interview subjects all regarded their increased flexibility and price adjustments as a good strategy, where both Engtex, Systemair and Oriflame had either increased or decreased the price of the products during market turbulence. Oriflame increased the price in order to secure income levels for their consultants, whereas Engtex and Systemair lowered their prices in an effort to offer competitive prices and support their retailers. Where the case firms were dominant in their domestic market, as for Company X, price adjustment were less successful and the company were punished by the governmental authorities. There was also no success in lobbying efforts or to make contact with governmental representatives.

#### **The economic sanctions, a success or failure?**

Analyzing the implementation of economic sanctions in terms of macroeconomics and politics, the author argues that this study strengthen previous studies conclusion of sanctions as an ineffective policy tool. Russia has not changed their stance in the conflict of Ukraine, and it is therefore fair to argue that the economic sanctions has failed in terms of its stated policy goal. Although Russia have suffered from the sanctions and there has been further

reluctance from outside investors, the Russians has arguably strengthen its stance on the Ukraine conflict and rallied the population around their leadership. This was supported by the EUs own conclusions, and the pattern of opposite policy effects deriving from sanctions was visible in this case as well.

The worst impact of the sanctions has now diminished for the Russian economy and it has started to recover and adapt with the sanctions still in place. Through the Russian counter sanctions, the European economy was badly hurt themselves, in massive loss of trade and termination of jobs for European firms and workers. Although the Russian counter-sanctions against the western countries has not change their stance on Ukraine either, it has increased the competitiveness of the domestic Russian economy. This has been one favorable outcome of the sanctions for Russia.

## Chapter 6

# Conclusion

*This chapter answers the research question and presents the main conclusions from the empirical findings and analysis in this study. The author also presents this thesis limitations and recommendations on further research on the subject.*

### 6.1 Conclusion

The purpose of this study is to investigate how economic sanctions have influenced MNCs business strategies. While previous studies have examined market turbulence in form of recession or general institutional changes, this paper has looked towards the implementation of economic sanctions between Russia and the EU in 2014 specifically. A multiple case study with an abductive research approach was used, where the data was gathered from semi-structured interviews with representatives from six Scandinavian MNCs. The research question aimed at bringing further clarification on economic sanctions effect and how this influenced MNCs adjustment of strategies, which led to the following research question:

*How did the implementation of sanctions against Russia influence the business strategies of foreign MNCs?*

The empirical findings and analysis in this study showed that as a result from the sanctions, MNCs diverted from their intended strategies and rapidly increased the scope and scale of

their internationalization activities. This was done in order to limit their exposure towards Russia and diversify their revenues. Therefore, MNCs increased their commitment towards internationalization which strengthens earlier theories that internationalization can be seen as a growth strategy and risk reducing process during market turbulence. Through increasing their scale of operations, the case firms found new markets to divert some of their earlier Russian export towards. The decrease in revenue from Russia also forced the case firms to streamline their own organizations, which mitigated some of the loss in revenue and benefited the companies for the future. The most successful strategy to manage the sanctions proved to be flexibility in the firms operations. However, it proved difficult to exercise control of the turbulence and to circumvent the sanctions.

The implementation of sanctions attributed to the downturn of the Russian economy, which provided a favorable investment environment that case firms benefited from. Through locating production centers inside Russia, the case firms could benefit from the low personal and production costs. In the case of Company X investment in a production center in Russia, it also allowed them to circumvent the import sanctions through local Russian manufacturing and ingredients. However, they were also forced to an general de-internationalization of the market because of the Russian import ban on most of their products.

Oriflame exercised the depreciation of the ruble, and further invested and expand their operations inside Russia with a new production center. Engtex and Systemair adopted a wait-and-see strategy and maintained their commitment towards Russia, whereas Leroy divested from the Russian market completely. Orkla Foods had left the Russian market before the turbulence in 2014, but reentered the Russian market in 2016 despite the sanctions and downturn of the Russian economy.

The findings from this study also strengthens the notion that emerging markets are volatile and more frequently exposed to market turbulence. However, economic sanctions differs in certain areas from some earlier studies of market turbulence and internationalization. The sanctions led to an involuntary forced de-internationalization process for two of the case firms which is not accounted for in many of the theories. The study also showed evidence of re-internationalization in the case of Orkla Foods, and also a future planned re-internationalization into Russia when the sanctions are lifted by Leroy and Company X. The study strengthen previous theories in that firms form stronger collaborations with other actors, retailers and consumers as a result of market turbulence. Also previous experience and knowledge became less relevant for some firms in the case of sanctions as suggested by earlier theories, since the accumulated knowledge become obsolete after the dramatic changes in

the institutional regulations in Russia.

This thesis findings reinforce the earlier reports of the trade destructive effects between the EU and Russia, and the sanctions damaged directly and indirectly a number of different economic sectors inside the EU and Russia. Despite most firms conducting risk assessments, even though political risk are somewhat neglected, the implementation of sanctions is very hard to predict. With the increasing use of economic sanctions as a policy tool in international affairs and its large impact on MNCs, this study is important in highlighting strategies that companies can apply in order to limit the damage and utilize the opportunities that may arise. This study also add further findings to theories on firm behaviour and performance in regards to internationalization and market turbulence.

## **6.2 Limitations and recommendations for future research**

During the process of writing this thesis in the spring of 2018, numerous other events of economics sanctions and trade barriers have unfolded, which has further strengthen the relevance of this study. The influence sanctions have on MNCs could therefore also be examined in other areas of the world to strengthen the conclusions in this study. With the US withdrawal from the Iran-deal, further American sanctions will be placed on Iran and businesses that deal with them. This will arguably effect European MNCs that have large investments and trade with Iran.

The Russian-European sanctions were implemented in the summer of 2014, and is therefore in its four year of practice. Although some conclusions can be drawn during this short period of time, for example the adjustment towards more scope in firms internationalization strategy, the time perspective will enable a researcher to make further conclusions. For example, if or when the sanctions are lifted, it would be interesting to see how it will effect foreign MNCs. Will for example firms that were targeted by the Russian counter-sanctions be able to reoccupy their market leading position and market share inside Russia? The domestic Russian agriculture industry have grown profoundly in recent years and have became more competitive than before the crisis. Therefore a re-internationalization process could be challenging for foreign firms.

The researcher, if given the time and accessibility, would also find it interesting to contact a larger number of case firms in a questionnaire for example. It would gain further perspective

on how the sanctions have affected foreign firms since only Scandinavian firms were contacted for this study. Beside Finland, most of the Scandinavian countries have relatively little trade with Russia compared to other EU nations. Therefore, the damage of the sanctions were not as substantial as for other countries. To give a broader picture and perhaps different empirical findings on the strategies adapted, MNCs from other European countries would've been preferable as well.

Previous studies of market turbulence have mostly focused on financial crisis, which in turn led to a recession in the economy. This study diverts somewhat from that in its focus on economic sanctions, even though it caused a downturn in the Russian economy. However, it would be interesting to do further research on different kind of market turbulence. Is it possible to generalize regarding all forms of market turbulence, or do certain types of turbulence differ from earlier theories? This study showed that there are certain dissimilarities, and there could perhaps be further differences in other areas of turbulence. For example, in the future there might be environmental issues that cause market turbulence and will certainly effect MNCs internationalization and business strategies in an adverse way.

# Chapter 7

## Appendices

### 7.1 Appendix A

#### **EU sanctions against Russia over Ukraine crisis**

*In response to the illegal annexation of Crimea and deliberate destabilisation of a neighbouring sovereign country, the EU has imposed restrictive measures against the Russian Federation.*

#### **Measures targeting sectoral cooperation and exchanges with Russia (Economic sanctions)**

EU nationals and companies may no longer buy or sell new bonds, equity or similar financial instruments with a maturity exceeding 30 days, issued by:

- five major state-owned Russian banks;
- three major Russian energy companies;
- three major Russian defence companies;
- subsidiaries outside the EU of the entities above, and those acting on their behalf or at their direction.



Assistance in relation to the issuing of such financial instruments is also prohibited.

- EU nationals and companies may also not provide loans with a maturity exceeding 30 days to the entities described above.
- Embargo on the import and export of arms and related material from/to Russia, covering all items on the EU common military list, with some exceptions.
- Prohibition on exports of dual use goods and technology for military use in Russia or to Russian military end-users, including all items in the EU list of dual use goods. Export of dual use goods to nine mixed end-users is also banned.
- Exports of certain energy-related equipment and technology to Russia are subject to prior authorisation by competent authorities of Member States. Export licenses will be denied if products are destined for oil exploration and production in waters deeper than 150 meters or in the offshore area north of the Arctic Circle, and projects that have the potential to produce oil from resources located in shale formations by way of hydraulic fracturing.
- The following services necessary for the abovementioned projects may not be supplied: drilling, well testing, logging and completion services and supply of specialised floating vessels.

## 7.2 Appendix B

**On measures for implementation of the Decree of the President of the Russian Federation dated August 6, 2014 № 560 "On the application of certain special economic measures to ensure the security of the Russian Federation"**

Pursuant to the Decree of the President of the Russian Federation on August 6, 2014 № 560 "On the application of certain special economic measures to ensure the security of the Russian Federation", the Government of the Russian Federation decrees as follows:

1. To introduce for one year a ban on imports into the Russian Federation of agricultural products, raw materials and food, originating from the United States, the countries of the European Union, Canada, Australia and the Kingdom of Norway, in line with the annexed list.
2. The Federal Customs Service to ensure control over the implementation of Item 1 of this Resolution.
3. The Governmental Commission on Monitoring and Rapid Response to changing conditions on food markets together with the high executive authorities of the subjects of the Russian Federation to ensure a balance of commodity markets and to prevent the acceleration of growth in prices of agricultural products, raw materials and foodstuffs.
4. The Ministry of Industry and Trade of the Russian Federation and the Ministry of Agriculture of the Russian Federation together with the high executive bodies of the subjects of the Russian Federation to organize the implementation of the daily operational monitoring and control over the state of the markets of agricultural products, raw materials and food
5. The Ministry of Agriculture of the Russian Federation together with interested federal executive authorities and with participation of associations of producers of agricultural products, raw materials and food to develop and implement a set of measures aimed at increasing the supply of agricultural products, raw materials and food in order to prevent a rise in prices
6. The Ministry of Industry and Trade of the Russian Federation, the Ministry of Agriculture of the Russian Federation, the Ministry of Economic Development of the Russian Federation and the Federal Antimonopoly Service with participation of retail chains and trade organizations to ensure the coordination of activities in order to curb rising prices.
7. This Decision shall enter into force on the day of its official publication.

D.Medvedev

Chair of the Government

Of the Russian Federation

**List of agricultural products, raw materials and foodstuffs originating from the United States, countries of the European Union, Canada, Australia and the Kingdom of Norway, and that are banned for imports to the Russian Federation for a period of one year**

CN CODE	List of products *) ***)
0201	Meat of bovine animals, fresh or chilled
0202	Meat of bovine animals, frozen
0203	Pork, fresh, chilled or frozen
0207	Meat and edible offal of the poultry indicated in line 0105, fresh, chilled or frozen
Out of 0210 **	Meat salted, in brine, dried or smoked
0301, 0302, 0303, 0304, 0305, 0306, 0307, 0308	Fish and crustaceans, molluscs and other aquatic invertebrates
0401, 0402, 0403, 0404, 0405, 0406	Milk and dairy products
0701, 0702 00 000, 0703, 0704, 0705, 0706, 0707 00, 0708, 0709, 0710, 0711, 0712, 0713, 0714	Vegetables, edible roots and tubers
0801, 0802, 0803, 0804, 0805, 0806, 0807, 0808, 0809, 0810, 0811, 0813	Fruit and nuts
1601 00	Sausages and similar products of meat, meat offal or blood; final food products based thereon
1901 90 110 0, 1901 90 910 0	Finished products, including cheese and curd(cottage cheese) based on vegetable fats
2106 90 920 0, 2106 90 980 4, 2106 90 980 5, 2106 90 980 9	Foods (milk containing products on the basis of vegetable fats)

\* For the purposes of the application of this list, one should be guided solely by the CN CODE, name of product is shown for convenience.

\*\* For the purposes of the application of this position, one should be guided both by a CN CODE, and the name of the product.

\*\*\* Except for goods destined for baby food.

## 7.3 Appendix C

# Interview guide

## First subject: Why Russia

- What interested your firm about Russia?
- What where your internationalisation strategy in regards to Russia?
- Choice of Entry mode, why?
- Any previous instances of market turbulence that effected your business or changed your strategy in regards to Russia?
- Can you tell me some of the challenges your firm has experienced in doing business in Russia before the sanctions?

## Second subject: Operations before the market turbulence

- How was your operations in January 2014? Good? Bad?
- What were the strategies for the future in terms of internationalization and Russia?
- Was/is Russia an important market for Orkla? Large exposure towards the Russian market?

## Third subject: Risk Management

- Does the organisation have a mechanism for assessing political risks?
- Where you closely following the events in Ukraine/EU/Russia?
- Previous experience of Economic Sanctions?
- What are your opinion regarding the economic sanctions in general?

## Fourth Subject: Sanctions influence on strategy

- Did you firm change your intended/planned strategy in regards to the Russian market as a result from the sanctions/downturn in the economy?
- How did you try to reduce the impact of the sanctions/downturn in economy?
- Are there any planned strategies/investments that you have reconsidered, adjusted or abandoned?
- Would you say that you have increased, decreased or maintained your commitment and belief in the Russian market?
- Have you seen any potential opportunities for your firm as a result of the sanctions/downturn in the economy?
- Can you tell me, with whom outside your company (person, company, gov, organisation) that you have worked to solve this challenge?

## Fifth Subject: Strategies for the future

- How do you evaluate your current business in Russia?
- How do you evaluate the business environment in Russia in relating to your business?
- What are your Predictions in regards to the Russian market and the sanctions?
- In your opinion, for the coming 5 years, what are the biggest challenges affecting doing business in Russia?
- What are your future internationalization strategies?

## Sixth Subject: Final thoughts

- What are the advantages of your company? Any disadvantages? (in regards to Russia)

- In retrospect, is there anything specific you wished your firm would've done differently in regards to your internationalization strategy and operations in Russia?
- Any specific advice you would give to companies doing business or starting doing business with Russia?



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