

Factors Affecting the Investments of Finnish Forest Industry
Production Units in the European Part of Russia

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TABLE OF CONTENTS

1 INTRODUCTION	1
1.1 Background of the Study	1
1.2 Purpose of the Study and Research Objectives.....	3
1.3 Previous Research	4
1.4 Research Approach	6
1.5 Theoretical Framework of the Study.....	6
1.6 Structure of the Study	8
2 THEORETICAL BACKGROUND OF THE STUDY	9
2.1 Foreign Direct Investment (FDI)	9
2.1.1 General Motives for FDIs.....	10
2.1.2 Motives to Invest in Russia and Risks.....	12
2.1.3 Investment Barriers in Russia	13
2.2 Core Competencies	14
2.2.1 Strategic Business Unit (SBU)	15
2.2.2 Importance of Infrastructure and Logistics in Russia	17
3 DATA AND ANALYSIS	18
3.1 Primary Data	18
3.2 Secondary Data	18
3.3 Analysis of the Collected Data.....	19
4 RESULTS	19
4.1 Investments of Finnish Forest Industry in Russia.....	19
4.1.1 UPM in Russia.....	21
4.1.2 Stora Enso in Russia.....	22
4.1.3 Other Finnish Forest Industry Companies in Russia.....	24
4.2 The Role of Russia for Finnish Forest Industry Companies.....	24
4.3 Choosing the Facility Location in Russia.....	25
4.3.1 Production Technology.....	25
4.3.2 Competition Environment	26
4.3.3 Different kind of Benefits (taxation etc)	27
4.3.4 Local Demand (volume, growth, special requirements).....	28

4.3.5 Political and Macro Environmental Risks	29
4.4 Potential Facility Location by Area in Russia	29
4.4.1 Infrastructure.....	30
4.4.2 Production Systems.....	30
4.4.3 Educated personnel.....	31
4.4.4 Supply	32
5 CONCLUDING DISCUSSION.....	33
5.1 Summary.....	33
5.2 Major Findings	35
5.3 Suggestions for Further Research.....	36

LIST OF TABLES

Figure 1. Imports and exports of wood raw material 1995-2005.....	2
Figure 2. The Framework of the Study.....	7
Figure 3. The total volume of forest in Northwest Russia, million m ³	32

LIST OF TABLES

Table 1. Factors of choosing the location of investment.....	11
Table 2. Physical forest investments of Finnish origin in Russia	20

1 INTRODUCTION

The Russian forestry sector has become the focus of increasing attention by the global forest industry. Finnish forest industry companies have already built few production units in Russia. Currently, they are sawmills or paperboard production units and Russian government is waiting for larger investments such as pulp or paper mills. It is clear that successful investments in forest industry in Russia become a significant competitive advantage in future. The main drivers to invest in Russia are great wood raw material (fibre) resources and growing markets. Companies' well-managed planning before building production units in Russia becomes more and more important. Usually companies are aware of the many problems related to doing business in Russia, e.g. changing legislation, economic and political instability as well lack of good infrastructure.

1.1 Background of the Study

Russia is especially important for Finland, because of the geographic location; Finland and Russia have a long common border and long history in trading. In this study the term "roundwood" is used as a common name for forest raw material intended for pulpwood or saw timber. Following things are important to take into account when analyzing different aspects which are relating generally the Finnish forest industry investments in the Russian forest sector. First, have to remember the role of Russian forest sector to Finland. Second, understand the current role of foreign investments in Russian forest sector and the problems which foreign investors are facing in Russia. Third, observe the current aim of the forest policy in Russia which is to promote domestic value-added production and to attract more both domestic and foreign investments in the forestry sector. Russian government is planning to raise remarkably roundwood export tariffs in future. Imported roundwood from Russia is a very important to Finnish forest industry and thus the increased price of imported roundwood makes long term plans more difficult and increases the uncertainty of successful roundwood procurement. All this of course affects strategies and operational decisions of Finnish forest industry companies in Russia.

For Finland, the role of Russian forest sector is manifold. On one hand, it acts as an important foreign supplier of roundwood; on the other hand, it is a competitor in the markets for sawnwood. At the same time, Russian market with its own growth potential is a lucrative target for ongoing and future export and investment activity for Finnish forest industries. A main strength from the Finnish point of view is the proximity to the large forest resources and large population base that still has a very low per capita consumption level in wood industry and paper products. Also, high cost competitiveness of roundwood and labour, as compared to western economies, provide possibilities to transfer and allocate production technology to Russia (Mutanen et al. 2005, 30-31).

Over 80 per cent of Finnish total wood raw material imports are from Russia and the rest primarily from the Baltic countries. (Toppinen & Toropainen 2004, 15). The dependency on imports of Russian roundwood in some wood species is an actual issue, because Russia government wants to reduce roundwood exports and pressure foreign forest industry companies to invest more in Russia (Paper and Wood yearbook 2006).

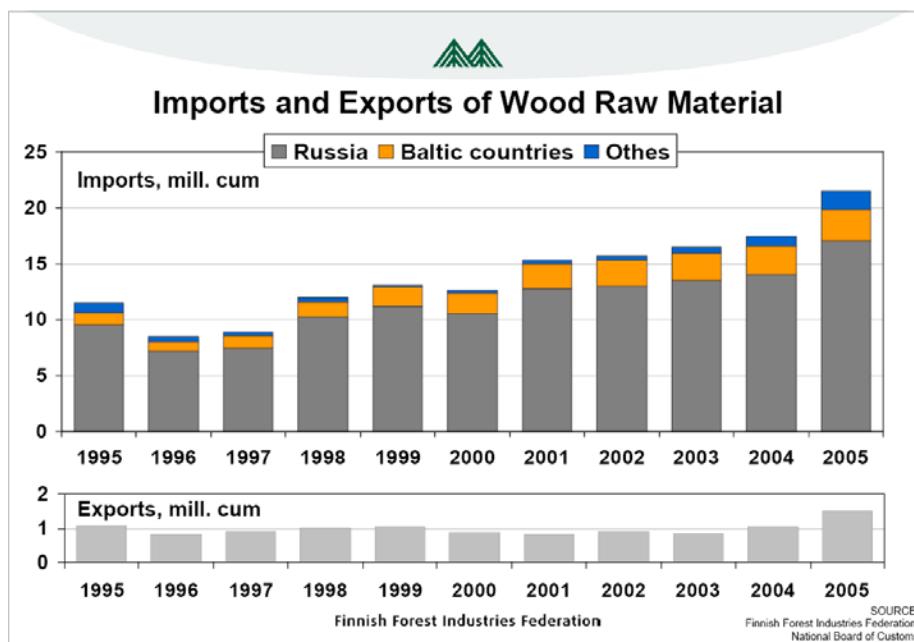


Figure 1 Imports and exports of wood raw material 1995-2005 (Paper and Wood yearbook 2005)

Figure 1 shows the importance of imported roundwood from Russia to Finnish forest industry. The new export tariffs, which went into effect in June 2006, increased the tax on Russian log exports by €1.5 to €4 per m³ or to 6.5 percent (Finnish Forest Industry Federation 2006). There have been plans to raise tariffs step by step in the near future and this will of course affect Finnish forest industry companies wood supplying strategies.

Finnish wood processing industries are likely to be particularly hurt by the increased export tax, because imported wood has been vital to the Finnish industry. Especially imported sawlogs have been important for mills in coast and near Finland's border with Russia. The possible negative impact on Finnish sawn softwood and paper exports is not yet clear. However, as the Finnish forest industry is highly export-oriented, selling 70 to 90 percent of production abroad, the increased Russian tax can only have a negative impact on Finland's international competitiveness. Especially the new taxes complicates supply of raw material in Finnish sawmill industry (Finnish Forest Industry Federation 2006).

Environment where companies are operating in Russia is under changes. Instead concentrating only developing sawmilling and wood products industry on regional level, Russian government wants to attract more investments primarily to establish pulp and paper mills. The more government pressures foreign companies, including Finnish forest industry companies the more interesting would be describe the factors which are affecting choosing the facility location and main motivation for investments of Finnish forest industry in Russia.

1.2 Purpose of the Study and Research Objectives

The purpose of this study is to describe what kinds of factors are affecting the Finnish forest industry investments in European part of Russia. The forest industry is chosen as the research target, because Finnish forest industry companies have invested and will invest in Russia in future (see Table 1). The objectives of the study are to describe **what kinds of factors are affecting the location of investments to new production units in European part of Russia**. The study will be gathering from

different sources the factors which are affecting the investments seen from Finnish forest industry view and to provide also information of the current situation of Finnish forest industry investments in Russia. Research is concentrating on sawmills and paperboard mills investments. Furthermore, this study find out shortly what kind of challenges and opportunities companies have, and how the companies plan to develop their forest industry business in Russia.

This study addresses the following specific questions:

- How do the investments of production units in Russia are linked with companies' competitive strategies?
- What were the most important reasons for choosing current production unit location in Northwest Russia?
- What are the main challenges and future opportunities concerning Finnish forest industry companies in Northwest Russia?

The analysis of the most relevant factors concerning Finnish forest industry investments in Russia forms the skeleton of the study. To examine how do investments of production units in Russia are linked with companies strategies, it is needed to define shortly the current goals of companies' supply chain strategies.

1.3 Previous Research

From the previous studies that come closest to this research are Toppinen et al. (2007), Holopainen et al. (2006), Dudarev et al. (2002) and Laakkonen et al. (2005). Toppinen et al. (2007) were studying resources and capabilities and their utilisation to support business and marketing strategies in the case of small and medium-sized wood industry companies in the Leningrad and Vologda regions. Results of the study showed that forest resources and availability of wood raw material or price of wood raw material were not considered as particularly significant sources of competitive advantage. The overall reliability, good image and reputation of the company and its qualified and skilled personnel were the most important factors in which the interviewed managers of case companies estimated to be in the best competitive

position against their rivals. High taxation, corruption and lack of capital strongly characterised the problems present in their business environment.

The aim of Holopainen et al. (2006) survey was to shortly consider the factors behind the slow progression of direct forest investments in Northwest Russia, and evaluate the convenience and rationally behind this policy. Unlike many other foreign forest enterprises, Finnish forest companies have avoided several essential problems and conflicts related to social responsibility of investments, cultural. The study emphasized that domestic possibilities to finance forest investments in Russia are still under developing, and the forest sector is not attractive among Russian investors due to the more profitable sectors such as energy, technology and metal clusters. According to a survey conducted by Holopainen et al. (2006) concluded that the local Russian forest sector calls urgently for forest investments to develop, to create more value added production and to survive in international competition in final product markets.

Holopainen et al. (2006) study emphasized that from foreign investors' point of view, issues such as availability of property rights, leasing contracts, forest management and silviculture, labour legislation, customs policy, taxation system and main features of trade policy are essential criteria while planning investments and establishment to Russian market. Forest resources, competitive other factors of production and developing domestic final product markets can be seen as supporting factors for forest investments in Russia. Also, the vertical integration strategies and wood procurement of international forest companies over the national borders are important factors to determine the location of investments. The impeding factors in Russia are incompleteness of Forest Code giving at the moment unclear rules for forest leasing, management and silviculture, unpredictable political system and trade policy, deteriorating external price competitiveness in international markets, business culture and weak infrastructure.

According to Dudarev et al. (2002), the transition to the market economy and privatization have left their mark on the local industry. Demand and markets have changed, requiring new strategies, operation models and industrial policy. The study emphasizes that the competitiveness of the Northwest Russian forest industry is

currently based on production factors, whose conditions have deteriorated during the reform process. Machinery and equipment are outdated, productivity is low and production consists mainly of products with low value added. Laakkonen et al. (2005) study concentrated on the different factors which were affecting the investments of Finnish companies. The study consisted of data from interviews which were sent to 464 different companies.

1.4 Research Approach

This is a descriptive study and research bases on qualitative approach. The qualitative approach suits for this study, since the purpose is to observe the factors which are affecting the forest industry investments in Russia. The research gives also a general overview of Finnish forest industry companies and their business units in Russia and this study is mostly based on secondary data, gathered from various sources, such as: publications, articles, statistics, other sources, including forest industry companies' internet pages and their annual reports. The material for the empirical part is gathered from the interviews. The empirical research was conducted in the form of descriptive study. Factors concerning the forest industry investment in Russia were examined. Because of study viewpoint, this research is concentrating on only aspects of "choosing the facility location", i.e. the factors that are relating the process when Finnish forest industry companies are choosing the place for investments in Russia. This study also deals with the companies' wood supplying strategy and existing strategic production units in Northwest Russia. Wood supply strategy is important to forest industry companies, because wood and wood fibre is the main raw material source for the companies.

1.5 Theoretical Framework of the Study

This study will give a quick view of different factors relating the investments in Russia. The framework of the study bases on "the phases of network planning" model (Chopra 2001), which highlights different factors affecting the facility location choosing process.

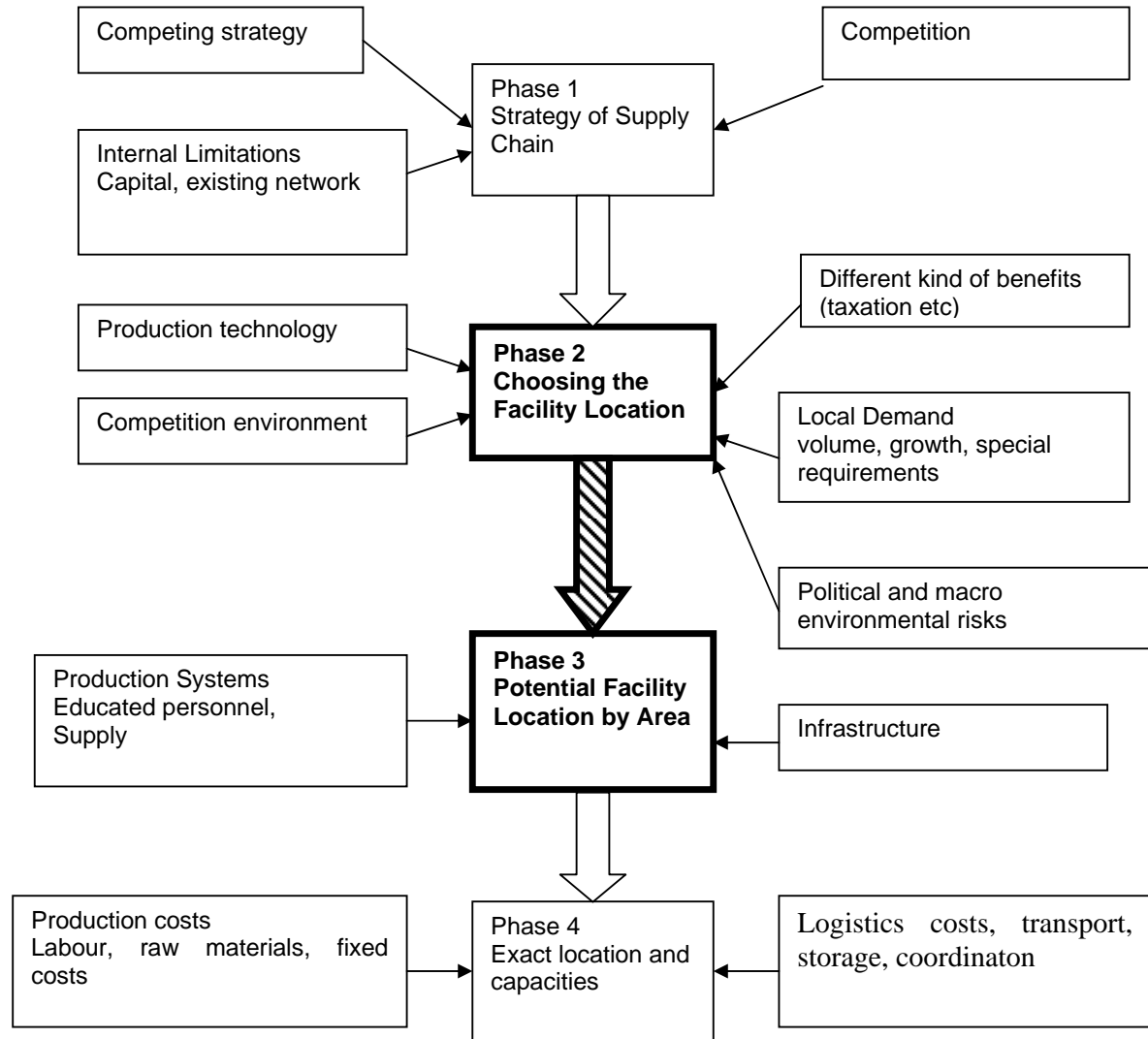


Figure 2. The Framework of the Study (adopted from Chopra & Meindl 2001)

The study focuses on analysing **Phase 2** and **Phase 3** which can be seen in Figure 2. This helps to concentrate on factors relating choosing the facility location and analysing potential facility locations. The frame of reference illustrates the whole facility location process. In the background of the business environment are the macro and micro environments. They define the possibilities and limitations the company and its customers have on market. The study does not examine deeply the environment where companies are operating. Macro and micro environments are of course important to the company, but they will not study deeply in this study.

Fahey and Narayanan (1986, 25-26) describe the levels of the environment where companies are operating and competing. They propose that the three levels of environment influence company's operations: macro, industry and a firm specific environment. The broadest level is macro environment. Macro environment includes all factors that can influence to organization, but that are out of their direct control. Surrounding environment is continuously changing, and the company needs to be flexible in order to adapt. In this study, the macro and micro environment are not under examination. They are understood as background factors, having affected the chosen strategies.

Existing strategies are mentioned only incidentally, because current operations and decisions are anyway related to them. Since the perspective of the study is the network configuration and facility location decision, the study focuses on analysing those factors that affect choosing the location of production unit in Russia.

1.6 Structure of the Study

This study is divided into five chapters. The study begins with the introductory chapter which presents the background of information, which illustrated the problem of the study. It clarified the general issues affecting in Russian forest sector. First chapter also gives the motivation and objectives of the study and research questions, limitations and general study approach. The framework of the study is presented in the first chapter. The framework is used as a basis for analysis of the factors affecting on the choosing the facility location. The framework was tested by conducting an empirical research and complemented on the basis of the results. The second chapter reviews foreign direct investments (FDI) and strategic business unit (SBU) literature and examines what kind of factors affect on the choosing the facility location process. The third chapter presents sources of primary and secondary data. Chapter four presents the current Finnish forest industry's strategic business units in Russia and results of the study. The last Chapter includes the conclusions and suggestions for the possible future research themes.

2 THEORETICAL BACKGROUND OF THE STUDY

Foreign direct investments are studied topic and there is a wide range of literature concerning foreign direct investments ranging from FDI's as part of the internationalisation process to the employments effects of FDIs. In this study the theoretical discussion is limited to include only investments motives and barriers to investments concerning Russian forest sector. Other aspects of FDIs are not discussed.

According to Niskanen et al. (2003, 26), there are some general aspects, which forest industry companies take account into when they choose the location for investments. It is important that the prospects of for good return of the investment are possible and the stability of economic environment as well as the current infrastructure are good.

There could be also some home country related factors that act as push forces for foreign direct investments. These could be such as difficulties on home market, difficulties in supplying the foreign market or diversification of risk. These push factors will not be discussed with in more detail. The focus of this study is on the host country (Russia) related pull factors that attract forest investments.

2.1 Foreign Direct Investment (FDI)

Foreign direct investment (FDI) is defined as a long-term investment by a foreign direct investor in an enterprise resident in an economy other than that in which the foreign direct investor is based. The FDI relationship, consists of a parent enterprise and a foreign affiliate which together form a transnational corporation (Wikipedia 2007a).

There are different types of FDI. First, greenfield investment which is a direct investment in new facilities or the expansion of existing facilities. Greenfield investments are the primary target of a host nation's promotional efforts because

they create new production capacity and jobs, transfer technology and know-how, and can lead to linkages to the global marketplace. Greenfield investment often does this by crowding out local industry; multinationals are able to produce goods at lower cost, because of advanced technology and efficient processes and uses up resources like labour, intermediate goods, etc. Another downside of greenfield investment is that profits from production do not feed back into the local economy, but instead to the multinational's home economy. (Wikipedia 2007a.)

Second type of FDI is Mergers and acquisitions. These transfers of existing assets from local firms to foreign firms takes place; the primary type of FDI. Cross-border mergers occur when the assets and operation of firms from different countries are combined to establish a new legal entity. Cross-border acquisitions occur when the control of assets and operations is transferred from a local to a foreign company, with the local company becoming an affiliate of the foreign company. Unlike greenfield investment, acquisitions provide no long term benefits to the local economy-- even in most deals the owners of the local firm are paid in stock from the acquiring firm, meaning that the money from the sale could never reach the local economy. (Wikipedia 2007a.)

2.1.1 General Motives for FDIs

According to Dunning (1980; 1995; 1998; see Laakkonen et al. 2005, 10) and Wikipedia (2007), there are four factors which are affecting companies' motivation to go to international markets. FDI can also be categorized based on the motive behind the investment from the perspective of the investing firm:

1) Resource Seeking: Investments which seek to acquire factors of production those are more efficient than those obtainable in the home economy of the firm. In some cases, these resources may not be available in the home economy at all (e.g. cheap labor and natural resources). This typifies FDI into developing countries, for example seeking natural resources in the Middle East and Africa, or cheap labor in Southeast Asia and Eastern Europe.

2) Market Seeking: Investments which aim at either penetrating new markets or maintaining existing ones. FDI of this kind may also be employed as defensive strategy; it is argued that businesses are more likely to be pushed towards this type of investment out of fear of losing a market rather than discovering a new one. This type of FDI can be characterized by the foreign mergers and acquisitions in the 1980's by Accounting, Advertising and Law firms.

3) Efficiency Seeking: Investments which firms hope will increase their efficiency by exploiting the benefits of economies of scale and scope, and also those of common ownership. It is suggested that this type of FDI comes after either resource or market seeking investments have been realized, with the expectation that it further increases the profitability of the firm. Typically, this type of FDI is mostly widely practiced between developed economies; especially those within closely integrated markets (e.g. the EU).

4) Strategic properties and capital seeking: It is clear that successful investments in forest industry in Russia become a significant competitive advantage in future.

Table 1. Factors of choosing the location of investment (Laakkonen et al. 2005)

1. Size and growth of market
2. Nature resources and other resources and their markets
3. Production costs, quality and productivity
4. Costs of international business and communication
5. Investments motives and barriers
6. The barriers of trade
7. Current condition of infrastructure
8. Differences of linguistic, ideological, cultural, political and business culture background
9. Economy and society

Laakkonen et al. (2005, 10) concentrated to study the different factors relating to choosing the location of investment. According to Dunning (1995; see Laakkonen et al. 2005, 10), when companies are deciding the location of direct investment following factors in Table 1 should be take into account.

According to Laakkonen et al. (2005, 11), it is important to notice that Russia is not member of any international trade organization (EU or WTO) yet. However, there are

some limitations for example in banking sector insurance business. There is also protectionism, which can be seen as in the economic policy of restraining trade between nations, through methods such as high tariffs on imported goods, restrictive quotas and a variety of restrictive government regulations designed to discourage imports.

2.1.2 Motives to Invest in Russia and Risks

There are market related, raw material, production and supporting related factors to invest in Russia. Sales and market related motives have clearly been the dominant reasons for FDIs in Russia. The main reason for making FDI's for Finnish companies without depending on companies' background or branches of industry in Russia was the need to look new market areas (Laakkonen et al. 2005, 20). The study also showed that low production and labor costs have generally not been viewed as important factors determinants by Finnish investors. According to Laakkonen et al. (2005, 21, 28) study, over 80% of interviewed Finnish companies, especially manufacturing companies have decided to increase their operation in Russia during next five years. The interviewed Finnish companies pointed out the proximity to the home market as important factor and the companies did not choose location between different regions relating to nearness of available natural resources.

Finnish forest industry tries to achieve competitive advantage with their Russian production units. Toppinen et al. (2007, 7) emphasized that the low costs in wages, stumpage and energy prices together with high potential in consumption growth make Russia a very lucrative target for investments in forest sector. In addition, investing in Russia includes risks, among with widespread corruption and difficult legal environment. Current Russian industrial policy favors developing processing industry instead of exporting roundwood by threatening to increase tariffs on exported roundwood. Companies have to also take into account these factors when building production units in Russia.

According to Filippov et al. (2005, 214), Russia and Finland have different specialities in trade. Russia imports to Finland energy and raw material and Finland exports

technology. There are lots of possibilities for foreign companies in Russia. In many cases the possibilities are connected to remarkable risks. The biggest risks are related to the condition of making business in Russia. Especially legislation system and government is bureaucratic and slow and most of institutions in Russian business life are undeveloped.

Competitive price and availability of labour are among the reasons for forest industry enterprises to start co-operation projects with Russian partners, or to invest and participate in modernisation of Russian factories. (Holopainen et al. 2006, 29.)

2.1.3 Investment Barriers in Russia

There are a number of barriers that can stand in the way of making FDIs. Investment barriers are divided into three groups: 1) market related barriers, 2) production related barriers and 3) institutional barriers. Russia has vast but relatively under-utilized roundwood resources. There are also several problems such as how to supply wood raw material in economic way, because availability of forest areas is sometimes difficult. Therefore, lacking infrastructure and limited road network cause challenges to roundwood procurement.

According to Filippov et al. (2005, 214), the biggest barriers of Finnish small and medium scale companies are usually relating as well as co-operation with Russian partners, ineffective of organizing and management or undeveloped business environment.

Karjalainen et al. (2005, 52) identified market related barriers which include the observation that domestic investment is prevented by the undeveloped nature of the banking sector, the difficulty in obtaining credit, and the general lack of interest in the forest sector among investors. Foreign investment therefore has a potentially key role in the development of Russia's forest sector. Other factors deterring investors are such as production related barriers as the undeveloped infrastructure, obligations related to forest use and logistics. Identified institutional barriers were lack of clarity on forest ownership rights and right of use, cultural differences, bureaucracy,

obligations to society that come with making investments, and the lack of general agreements protecting investments.

Finnish companies have to also be aware of the development in Russia in future. The future growth of forest industry will depend on Russian's success in improving the institutional framework as new forest legislation, effectiveness of developing the infrastructure, increasing investments in expansion and modernisation of production capacity by domestic and foreign owners and a clarification of the role of different public organisations in the forestry sector. (Nilsson & Kleinhof 2001.)

According to Pihlajamäki & Romanovsky (2003), the future growth will depend on Russian's success in improving the institutional framework (new forest legislation), effectiveness of developing the infrastructure, increasing investments in expansion and modernisation of production capacity by domestic and foreign owners and a clarification of the role of different public organisations in the forestry sector. In spite of the industry's good cost-competitiveness, poor logistics and complex as well as continuously changing regulations harm its capacity to serve international markets efficiently.

2.2 Core Competencies

A core competency is something that a firm can do well and that meets the following three conditions specified by Hamel and Prahalad (1990, 79, 80): it is a source of competitive advantage in that it makes a significant contribution to perceived customer benefits, it has a potential breadth of applications to wide variety of markets and it is difficult for competitors to imitate. According to Hamel and Prahalad, a core competency is an area of specialized expertise that is the result of harmonizing complex streams of technology and work activity. Competitive advantage also accrues to companies that possess distinctive capabilities. Whereas core competences tend to refer to areas of special technical and production expertise, capabilities tend to describe excellence in broader business processes.

To be competitive, a company needs to have a superior performance in comparison with its competitors. Usually, superior performance is connected with superior quality of products and services, or other means of differentiation. The second option is to gain such cost-advantage that facilitates cost-leadership. The third alternative is to be a niche-company and focus on a certain very small market segment (Porter 1985, 56)

Strategic strengths, core competencies, and the competitive advantages connected to them are central issues strategic thinking. To operate profitably in the long term, a company must have competitive advantages based on its own unique characteristics and conditions. Operations are then based on these competitive advantages. A core competency is a characteristic of the company, production process, product, or features of marketing based upon which the company is able to beat competition. Total fit between company resources, products and customers create a sustainable competitive advantage. (Juslin & Hansen 2002, 259, 300)

A core competency can take various forms, including technical/subject matter know how, a reliable process, and/or close relationships with customers and suppliers. It may also include product development or culture such as employee dedication. Modern business theories suggest that most activities that are not part of a company's core competency should be outsourced (Wikipedia 2007b).

2.2.1 Strategic Business Unit (SBU)

It is important to understand the background strategies of the companies when discussing their current operations. Juslin & Hansen (2002, 248-249) are separating the corporate strategies and marketing strategies. They are planned and implemented on totally different organizational levels. Marketing strategies are planned and implemented on a business unit and product level. Corporate strategy should be planned so that resources are used most efficiently way to convert distinctive competencies into competitive advantage. A business unit is the basic unit for which business and marketing strategies are created. The term "profit unit" is used if independent responsibility for returns or profits is emphasized. The terms

SBU and SBA have been created for strategic planning purposes (Juslin & Hansen 2002, 259).

Strategic business unit has three characteristics: it is a single business or collection of related businesses that can be planned separately from the rest of the company. It has its own set of competitors. It has a manager who is responsible for strategic planning and profit performance and who controls most of the factors affecting profit. The purpose of identifying the company's strategic business units is to develop separate strategies and assign appropriate funding. Every business must tailor a strategy for achieving its goals, consisting of marketing strategy and a compatible technology strategy and sourcing strategy (Porter 2000, 68, 80). To be competitive, a company needs to have superior performance in comparison with its competitors. This study is concentrating the different factors concerning the forest industry companies investment decisions. Strategic decisions are based on companies' competitive strategy and linked to their operations and strategic business units in Russia.

Fahy and Smithee (1999; see Toppinen et al. 2007, 10) described that improvement in the competitive position may also be searched through transfer or enlarging operations to a new location. The new location may allow the company to gain a higher market share through increasing sales or lower production costs. Understanding companies' resource base is central to effective positioning of the company in the market and highlight important differences between company-specific and country-specific resources. Pye (1998; Toppinen et al. 2007, 10) lists the main motivating factors for companies to invest in new locations as follows:

- markets (size, growth, export platform opportunities),
- resources (raw materials and other similar inputs),
- employment factors (work force, such as availability and abilities of work force,
- working culture such as reliability and attitude towards working, and its costs),
- financial efficiency (cost advantages, free trade),
- know-how (embodied in technology) (technology, abilities, possibility to use new company to gain technical knowledge),

2.2.2 Importance of Infrastructure and Logistics in Russia

The main material for forest industry is wood and wood fibre. Secured delivery of wood raw material is condition to any successful operation. It requires well organized wood procurement and a network of much needed forests roads. According to Inkiläinen (1998, 13) modern distribution is more than just a effective movement of goods from manufacturing locations to the end users. Logistics services include processes such as purchasing, transportation and warehousing, the support services provide product, marketing and technical know-how.

Logistics covers the flow function of companies and supply chain networks, and is seen as the backbone of other business functions (Heinimann 2000, 269). One of the main aspects relating to the company's business operations in Russia is logistics and infrastructure. Toppinen et al. (2007, 21) underlined that communication and logistics, where generally ranked to be the most important source of competitive advantage. As mentioned in chapter 1.1, Russia has vast but relatively under-utilised roundwood resources. In practice the challenge of economic accessibility is present due to lacking infrastructure and limited road network.

The effects of logistics decisions can be widespread influencing the shape of both the profit and loss account and the balance sheet. The effective management of the logistics task can also improve cash flow as well as reduce working capital requirements. Finally by bringing logistics into the wider arena of corporate strategy many opportunities for strengthened market position can be grasped through new initiatives in customer service (Christopher 1989, 32).

Changes in the supply and distribution environment come from all directions. They can have a radical effect upon the market position of a business. The company, in its anxiety to focus its efforts upon the marketplace, will often neglect to observe the changes that may be occurring on the supply side. A strategy for supply is just as important as a market strategy (Christopher 1989, 129, 133). These kind of changes in marketing environment were discovered in survey of Nilsson & Söderholm (2002; see Toppinen et al. 2007, 7). Nilsson & Söderholm found that well-developed infrastructure and market size to be more important for investment decisions than

prices of raw materials. They concluded that foreign investments in Russian forest sector are likely to remain low until a fundamental reform takes place in the legal and political system. Thus, market seeking as the main motivation for investments is not realised until institutional issues such as property rights and proper law enforcement will be solved.

3 DATA AND ANALYSIS

3.1 Primary Data

The primary data collected specially for this study and it provides the possibility to examine the opinions relating to the current Finnish forest industry investments situation in Russia. The methodology resembles a case-study and consists of descriptive statistics on Russian forest sector, as well as the results from personal interviews. Data of the study therefore consists out of secondary and primary data. The primary data in this study consists of data gathered through interviews with experts working in the field of the study.

3.2 Secondary Data

The secondary data gives a background to this study and is also used for describing the general factors relating to the establishing production unit in Russia. It is also used for describing the general aspects of the Russian forest industry, forest resources and Russia as an investing environment. A lot of secondary data from the Russian forest sector was available. From this study the main quantitative data was derived from different publications; internet sources, statistics and data-bases.

In this study certain kind of internet web pages were also used to collect secondary data such as Finnish Forest Industry Federation, Federal State Statistic Service, and Finnish Forest Research Institute (METLA), from these web sites data which was gathered was usually related to macroeconomic performance, Russian forest

industry, financial markets, general economic development and up to date information of Russia Federation.

3.3 Analysis of the Collected Data

In order to get an understanding of the current situation of Finnish forest industry's investments in Russia, the author first combined the general information from various sources and then more specific information of investments of different Finnish forest industry companies gathered into a summary table (Table 1). Since the data received by interviews is so small, it is not possible to make statistical analysis based on it. Therefore only descriptive analysis will be made based on this data. The survey contained no direct open questions, only possibilities for open comments to each questions. Thus there is not much basis for qualitative analysis. The results will be analysed and categorized according to the operationalization of the framework of the study.

4 RESULTS

4.1 Investments of Finnish Forest Industry in Russia

The secondary data gives a skeleton for the study concerning the current situation of Finnish forest industry production units in Russia. Before moving on the analysis and the findings of the empirical study, it is necessary to get more thoroughly acquainted the current situation prevailing in the forest investments of Finnish forest industry companies in Russia. The following chapters will give information about the forest sector investments in general and examines the Finnish production units in Russia in more detail. The Russian forest sector tries actively to attract forest investments to create more local value added production. Currently Russia is mainly a roundwood source for Finnish forest industry.

Along with the global profit maximisation, many foreign forest enterprises have established especially in Northwest Russia during 1990's and 2000's. Most of these investments are of small-scale (saw- and veneer mills, packaging plants), and they

can be seen as pilot investments to test market environment and, especially, the functioning of wood procurement .(Holopainen et al. 2006, 3.)

Many Finnish companies from different kinds of economic activity have been attracted by profitable possibilities of Russian markets. According to Holopainen et al. (2006, 3) Russian forest resources, other competitive factors of production and developing domestic final product markets can be seen as supporting factors for forest investments in Russia. Also, the vertical integration strategies and wood procurement of international forest companies over the national borders are important factors to determine the location of investments. Establishment in forestry industry in Russia has been carried on by direct green field investments, purchasing existing capacity and operational chains, or by joint ventures with Russian partners.

Table 2. Physical forest investments of Finnish origin in Russia (Stora Enso 2006, UPM-Kymmene 2006, Metsä-Botnia 2006, Holopainen et al. 2006)

Company	Sawmill	Founded/ estimated	Location	Capacity, m ³ /year
Stora Enso	Impilahti	2003	Southwest Russia, about 300 km from St. Petersburg, by Lake Ladoga.	100000
Stora Enso	Nebolchi	2004	In the small village of Nebolchi	100000
			Novgorod Region, southwest Russia	
UPM-Kymmene	Pestovo	2004	Novgorod Region	300000
Botnia	Svir (Suda)	2007	In the city of Podporozhye in	100000
			Leningrad Region	
Koskisen Saha	Vologda	2007		20000
Plywood and veneer mills				
UPM-Kymmene	Chudovo	1988	Novgorod Region	
			WISA birch plywood	80000
			Craft veneer	6000
	Thsudovsky	2003	Veneer	10000000
Packaging board mills				
Stora Enso	Arzamas	2004	Corrugated packaging	90000
Stora Enso	Balabanovo	1998	Corrugated packaging	150000
Stora Enso	Lukhovitsky	2008	Corrugated packaging*	150000
Ahlström	St. Petersburg	2001	Board cells	4000

As can be seen from Table 2, foreign investments made in Russia in the recent years have been made in the wood products industry and paper and converting industries.

This can be caused by the insecurity of the business climate and companies want to first find out how business operations succeed in Russia. The investments can be also more like pilot projects and tests for the fluent wood procurement before companies are planning to invest in paper –and pulp mill.

Niskanen et al. (2003, 26) mentioned that foreign companies still expect that they should be treated at least as favourably as Russian companies. In the present situation companies have to judge for themselves what level of risk they are able to carry without protection of law. This is clearly impediment to investments of large magnitude. Another very important issue is that how the authorities interpret and apply laws and regulations. Unpredictability and constantly changing rules disrupt even the soundest of business. There seems to be great variations in the attitude of the authorities in different regions.

Along with the increased roundwood trade to Finland, Finnish forest industry has also focused on the investments of forest industry process capacity in Northwest Russia. Federal Government of Russia has started to support development towards increased domestic use of roundwood and more value added production in Northwest Russia (Holopainen et al. 2006, 13).

4.1.1 UPM in Russia

As can be seen in Table 2, UPM operates with one sawmill and one plywood and veneer mill in Russia. UPM's Forest Russian roundwood procurement was about 5 million m³ and about 1 million m³ go to UPM's units in Russian (UPM-Metsä 2006).

According to Niskanen et al. (2003, 25), the experiences of UPM-Kymmene can be presented as a case study. UPM-Kymmene started to invest in Russia already in the Soviet era, over 10 years ago. A plywood mill of 65 000 m³ was erected in the Novgorod Region as a joint venture with a Russian partner, Novgorodlesprom. In analysing the success some key factors surface: the authorities of the Novgorod Region starting from the Governor himself give full support to the industry. Bureaucracy is minimized, and all requests get the fullest attention of the authorities.

In UPM-Kymmene's case, the longstanding partnership with Novgorodlesprom has proven to be very good, with mutual respect and understanding. In Novgorod it has been possible to find committed and highly educated people, which has naturally been a key success factor. Based over 10-years' positive experience UPM-Kymmene bought 2002 the shares of the other foreign owners and built a new veneer mill 10 mill. m³ (Niskanen et al. 2003, 26).

The vast Russian forest reserves provide ample resources both to exports of roundwood and to developing the forest industry in Russia, providing employment and income to thousands of Russians in the Northwest-Russia. It would be unwise to think that by obstructing the export of roundwood new foreign investment in the Russian forest industry could be created (Niskanen et al. 2003, 27).

4.1.2 Stora Enso in Russia

Stora Enso's wood procurement volume from Russia was 7.1 million m³ in 2006. Stora Enso also is the biggest wood supplier in northwest Russia (Stora Enso 2007b, 18). Stora Enso has similar operating history like UPM. Stora Enso has been operating in Russia since 1998, producing corrugated packaging at Balabanovo, which is close to Moscow. Especially investments to new corrugated packaging capacity are made to serve the growing Russian market. This is has been part of Stora Enso's strategy. According to the Stora Enso's annual report (2007a, 12), corrugated board and sawmill investments continue in Russia.

The market for corrugated packaging is growing rapidly in Russia and Eastern Europe. The annual growth in transport packaging is 5–10%, while the market for corrugated sales packaging is growing even faster. Based on this growth, Stora Enso has targeted becoming the leading producer of corrugated board in the European part of Russia. Stora Enso has also two sawmills in Russia as can be seen in Table 2 (Stora Enso 2007a, 26).

Stora Enso's Nebolchi Sawmill is concentrated to produce sawn timber for building industry in Europe (mostly to Germany) and delivers some of the product to Stora Enso Timber's Estonian sawmills for further processing. Therefore it can be called as an export-platform type of investment. Annual production capacity at Nebolchi Sawmill will be virtually doubled to 220 000 m³, with the potential to kiln-dry all output. A total of 100 000 m³ of output will be on-line planned after the investment. The Sawmill has a modern profiling saw line for small logs.

The main function of the Impilahti sawmill is to process Karelian spruce for Finnish and Russian sawn timber markets. The Impilahti sawmill consists of one modern small-log line report A kiln-drying facility will be added at Impilahti Sawmill, and production capacity slightly increased to 140 000 m³. These investments will upgrade sawmills to manufacture value-added products and improve Stora Enso's access to the fast-growing building material market in Russia (Stora Enso 2007a, 26).

Stora Enso is building its third Russian corrugated packaging plant in Lukhovitsy. It will be located 130 kilometres from Moscow, Russia's largest packaging market. Stora Enso has been producing corrugated packaging in Russia since the end of the 1990s, at Balabanovo, which is also close to Moscow, and Arzamas, close to Nizhni Novgorod.

Stora Enso has started building its third corrugated packaging plant in Russia, at Lukhovitsy, southeast of Moscow. Production will start up in the first quarter of 2008. Stora Enso has introduced a number of new high-quality corrugated packages on the Russian market, mainly serving the needs of the food, beverage, cigarette and electronics industries. Reliable supply, quick response times, and active product development are strong sale arguments for customers that represent both international and Russian brands. A strong presence on the market, quality products and high standards of service has made Stora Enso the market-leading brand in Russia. Stora Enso's first corrugated packaging plant in Russia started up at Balabanovo in 1998, and the second unit, at Arzamas, in 2004. The new plant will be centrally located between these facilities, and will help guarantee reliable deliveries of growing volumes to customers in the Moscow region (Stora Enso 2007a, 26).

4.1.3 Other Finnish Forest Industry Companies in Russia

The Russian sawmill OOO Svir Timber, is 100% owned subsidiary by Oy Metsä-Botnia Ab. At the beginning of operations, approximately 30 % of sales go to the Russian market. The most important customer groups in Russia are the processing industry, distribution chains and construction industry. Part of the production goes abroad (Metsä-Botnia 2006).

According to Liuhto et al. (2004; see Toppinen et al. 2007,7) Russian industrial policy favours developing processing industry instead of exporting roundwood by threatening to increase tariffs on exported roundwood . Thus, publicly announced investment plans in sawmilling have started to grow amounting over 8 mill. m³ since 2001. Although the size of ongoing wood industry investments is rather large by production volume, they are low in terms of value. For example, during 2000–2005, the three large Finnish forest industry companies have invested altogether about 350 mill. € in forest industry in Northwest Russia, which amounts to only a minor share in their total foreign investment stock. Furthermore, the share of forest industry in the total stock of foreign investments into Russia has remained rather low, 3–4%.

4.2 The Role of Russia for Finnish Forest Industry Companies

Russia has been the major roundwood supplier to Finland. Russian government's plans to increase roundwood export tariffs, will give new aspects to Finnish forest industry companies. Holopainen et al. (2006, 14) have emphasized three different alternatives how Finnish forest companies ensure wood procurement for sawmills and paper and pulp mills. The first strategy is to continue import of logs from Russia. Second, the distribution of sawmill capacity can be reorganised by processing the current import volumes in new invested plants in Russia, and by importing the sawmill residue as a by-product to pulp and paper mills in Finland. The third alternative is to centralise sawmill capacity to Finland, and purchase the needed volumes of logs from domestic market. All of these alternatives include risks and many uncertainties.

The first strategy is unlikely to be fulfilled because of many economical and political reasons discussed in more details in the following chapters. The second alternative implies lease contracts that may become more predictable in the future (depending on recent authority decisions and operating in inferior infrastructure with expensive investment requirements together with many societal and political uncertainties discussed also in the following chapters). The third alternative concerns purchasing the required log volumes from diversified NIPFO markets in Finland, where log supply can change over the time, but where the operational environment (infrastructure, TGM applied in harvest and transports) is rather stable. (Holopainen et al. 2006, 14.)

4.3 Choosing the Facility Location in Russia

The following chapters concentrate to describe the factors which are affecting forest investments in Northwest Russia. In this study, it was impossible to go any details behind the companies' investment decision, because of business secrets. Interviewees wanted to just give general answers and not to specify too much. According to the framework of the study, there are different factors, which are relating to the facility location choosing process.

4.3.1 Production Technology

Finnish forest industry companies have been upgraded sawmills to manufacture value-added products and improve their access to the fast-growing building material market in Russia. According to Holopainen et al. (2006, 1, 70) most of the equipments, machinery and capacity investments in Russian forest sector dates back to 1970's and thus they are mostly out-of-date, wastefully, environmentally damaging and the productivity of them is weak. The Russian forest sector calls for urgent investments to develop, to meet the increased domestic demand and to survive in international competition. While the possibilities for domestic investments are somewhat limited for many reasons, the development of forest sector and industry in Russia depends highly on either direct or indirect foreign investments.

The Nordic cut-to-length method is rapidly being fully established. It results in traditional Russian wood harvesting systems being used side-by-side with Nordic cut-to-length technology. The most rapid changes are taking place in the Russian cross-border regions (Gerasimov et al. 2005, 1). Benefits of the Nordic cut-to-length method include high work productivity and environmental awareness compared to other types of mechanised wood harvesting. It will make harvesting operations and roundwood procurement more effective.

Availability of factors of production can be seen as a kind of critical variable among other facts impacting on investing decision. In the areas, where infrastructure is weaker than on average, demand of roundwood is usually also lower than on average. This means lower raw material costs of wood procurement. On the other hand, constructing of needed road network and other logistical connections, and advantaging a modern technology can turn out to be remarkably expensive (Holopainen et al. 2006, 31).

In Northwest Russia, even though there are substantial differences between the regions, plywood, chipboard and cardboard production, the existing capacity is nearly in full usage. Also, a volume of paper production is difficult to increase without any substantial green field investments in capacity. The low operating rates for some products are partly due to the outdated technology, which urgently requires at least repair investments (Holopainen et al. 2006, 29).

4.3.2 Competition Environment

Wood resources and procurement, other factors of production and general economic climate are important determinants to affect profitability of forest industry and to attract new investments. The other side of the coin is the final products and their markets, which can be crudely divided between domestic and foreign markets. If the final products are allocated to the foreign markets, exchange rate behaviour together with other estimated costs (logistics, custom tariffs) play an important role on profitability. Therefore, it is among the most important strategic decisions of investment planning to forecast the demand for forest products, and to decide

whether these products are allocated to the domestic markets or under the international competition abroad (Holopainen et al. 2006, 33).

According to interview with Kangas (2007), Russian local demand for high quality products is increasing in future. Russian customers are going to require more and higher quality products. For example UPM is concentrating on high value added products such as WISA-Birch plywood which is used where excellent strength/weight ratio and smooth hard surface are required. UPM exports almost all its Russian production abroad, mainly to Germany and Japan. There are many small locally operating Russian sawmills which are concentrating on to produce cheap and low-quality wood products to local markets.

Most of Russian forest industry enterprises were privatised in the beginning of 1990s, and the domestic forest products markets were opened for free competition. While the products of the Russian forest industry were rarely competitive with foreign products mainly due to the inherited lack of incentives to respond to customer-orientated demand, only low value added products, such as roundwood, plywood and timber were relatively high competitive export products (Vinokurova et al. 2005, 7).

4.3.3 Different kind of Benefits (taxation etc)

Kangas (2007) and Lahti (2007) mentioned that the effect of regional politicians and high-level authorities is also important but not the most remarkable issue for foreign investments, because politicians and authorities could be change easily. The Governor of the region and his policy has an important role to develop regions business culture and attract foreign companies. Region or city could give reduction of taxation for foreign companies when they are investing in region. In Russia, different regions are quite independent business areas. According to him, Novgorod Region and has created well-developed environment for successful business operations. UPM has operated there from the end of 1980s.

From the Finnish investors perspective, forest sector in Northwest Russia is of special interest due to its close location to the European markets and, especially,

because of the unused vast forest resources. In addition, huge growth potential of wood based product markets in Russia and geographical nearness have been incentives for Finnish firms to establish in Russia. Smaller enterprises have been more interested in lower costs and sufficient raw material resources than the international enterprises, which were more market oriented (Laakkonen et al. 2005).

4.3.4 Local Demand (volume, growth, special requirements)

The transitions to the market economy and privatization have left their mark on the Russian industry. Demand and markets have changed, requiring new strategies, operation models and industrial policy. In certain industries, the strong and rapidly growing export market and demanding foreign customers played an essential role in formation of competitive domestic producers as well. In this case access to the foreign markets played a key role in formation of the competitive advantage (Dudarev et al. 2002, 3, 25).

Local demand differ strongly from international requirements concerning to quality. There are some basic reasons behind this. The difficulties were not only financial; the old and inefficient production technology inherited from Soviet era and products that typically did not meet the demand in the international markets caused additional troubles. The Russian forest sector had an unsatisfying competitive structure to meet the challenges of world markets. As a result, the export of forest products mainly consisted of low added value products, such as roundwood and sawn timber (Vinokurova et al. 2005, 5).

The continuously growing demand for forest products and favourable future prospects could motivate the local companies to regain market power. Advances in the industrial policy, increasing interest in the forest industries and improving infrastructure are promising signs of a better future (Dudarev et al. 2002, 15).

While the production machinery in forestry sector is largely out-of-date in Russia and the domestic forest sector lacks of finance and technical innovations, it is suspected

that most of the forest investment goods are of foreign origin also in near future (Holopainen et al. 2006, 19).

4.3.5 Political and Macro Environmental Risks

While the general legislation has proceeded to give more strict rights and liabilities to operate in Russia, the enforcement of legislation is still somewhat unpredictable. Forest Code, including more detailed rules, rights and responsibilities for example for forest leasing and regeneration, has been under reconstruction for many years, and it is still uncertain if the latest version will never be ratified in its present form. Without any knowledge of the management and leasing possibilities of the forests in the future and any investment system guarantee it is a big risk to invest in infrastructure, such as forest road network and wood procurement logistics (Holopainen et al. 2006, 44).

All efforts should be focused in developing the reliable business climate where companies can rely on equal and favourable treatment in all parts of Russia. New legislation as well as consistency in applying it are key issues for the future. Future policies for the forest sector should be based on the spirit of free and open enterprise (Niskanen et al. 2003, 27).

Finnish and Russian authorities have negotiated several times about a contract that would ensure, or at least enhance, stability of circumstances of investments. Foreign investors have required that changes in legislation or in general policy should not retrospective impact on conditions of contracts. If such possibility cannot guaranteed, investors are not able to know the real character of the environment in which they are operating (Holopainen et al. 2006, 36-37)

4.4 Potential Facility Location by Area in Russia

The forest companies' own forestry and wood sourcing units are responsible for supplying wood and forest energy to the mills and for the sustainable use. There are

also many other factors than only secure the sound and economic wood sourcing. Following chapters present these different kind of factors.

4.4.1 Infrastructure

According to Kangas (2007), the three most important factors when choosing production unit location are availability of raw material, well-developed infrastructure or possibilities to develop it economic way and questions concerning the availability of energy and electricity. Lahti (2007) mentioned that it would be important to develop forest sectors an existing infrastructure. This will be more effective than developing new areas. He also emphasized that to provide continuous wood raw material flow from the forest to the mill and to markets, it is essential that the road or railroad network is working. It is also important to remember the infrastructure around the production unit.

The need for energy depends highly on the branch of forest industry. For example, sawmilling industries as well as mechanical pulp industry are energy intensive branches while chemical pulp industry can even be a net producer of energy. In Russia, the State has monopoly of transportation and energy supply. This dependence can turn out to be a risk for the forest industry (Holopainen et al. 2006, 30).

Along with the consideration of availability and accessibility of forest resources, a profitable forest investment decision includes well-designed wood procurement logistics. As well as final product logistics, a well working wood procurement process require viable infrastructure. Compared to other regions in Russia, the transportation infrastructure is relatively well developed in Northwest Russia (Holopainen et al. 2006, 31).

4.4.2 Production Systems

The specialization of the forest cluster of Northwest Russia (and of Russia as a whole) has been determined by the production of raw materials, as well as by

products with low added value. Russian sawn timber is produced primarily utilizing worn-out and outdated equipment with a low level of automation, which makes high-precision processing impossible. Sorting and packaging also do not meet the requirements of consumers in Western Europe. All of this considerably decreases the competitiveness of the sawn timber produced in Northwest Russia (Dudarev et al. 2002, 24, 55).

Majority of annual variable costs of sawnwood production are lower in Russia than in Finland. On the other hand, fixed costs are the most important costs supporting production in Finland. Investments to sawmill capacity in Finland are currently replacement investments in the existing plants diminishing the infrastructure costs of investments. In Russia, majority of investments are green field implying outlays to construct infrastructure (such as roads, roundwood storages and mill transportatio) in addition to the direct investment costs (Holopainen et al. 2006, 14). Finnish forest industries companies are increasing aggressively sawmill capacity (see Table 2).

Pulp-and-paper mills located in Northwest Russia are narrowly specialized – they manufacture a limited number of products on a large scale. Domestic producers of many other kinds of high-quality paper and paperboard are still far behind foreign competitors in terms of quality and market share (Dudarev et al. 2002, 64).

4.4.3 Educated personnel

Even though roundwood supply and well working wood procurement are among the most significant and major factors for economically sustainable production in forest industry, other factors of production such as skilled labour and energy are also important. Despite the fact that forest industry is often seen as a capital intensive sector, role of labour is significant at least in mechanical wood working industry. Relative unit costs of labour are among the criteria determining the location of new mills (Holopainen et al. 2006, 29).

Laakkonen et al. (2005, 24) mentioned in their study that well educated labour was more important for companies' investment decisions in Russia than availability of

labour. Kangas (2007) also underlined that the biggest problem when operating in Russia is challenge to find enough educated employees who are ready to commit their work. Usually people are changing quickly their work place if someone else is offering better benefits and salary.

According to Dudarev et al. (2002, 21) Northwest Russia has the most developed forest industry in Russia. More than 50% of Russian forest products are now produced in Northwest Russia and its advantages compared to other regions are:

- Vast boreal forest stock
- Relatively developed infrastructure
- Qualified labour force
- Proximity to European markets.

4.4.4 Supply

There are some important requirements when choosing the location of production unit. According to Kangas (2007), for sawmill or paper and pulp investment decision, it is essential for the investing enterprise to ensure continuous wood flow to for example sawmill. The Modern sawmill of 200 000 m³ capacity needs approximately 500 000 m³ of logs, and 400 000 ton pulp mill requires about 2 million cubic meters pulpwood or wood residue, the economic profitability calls for unbroken wood procurement together with other factors of production.

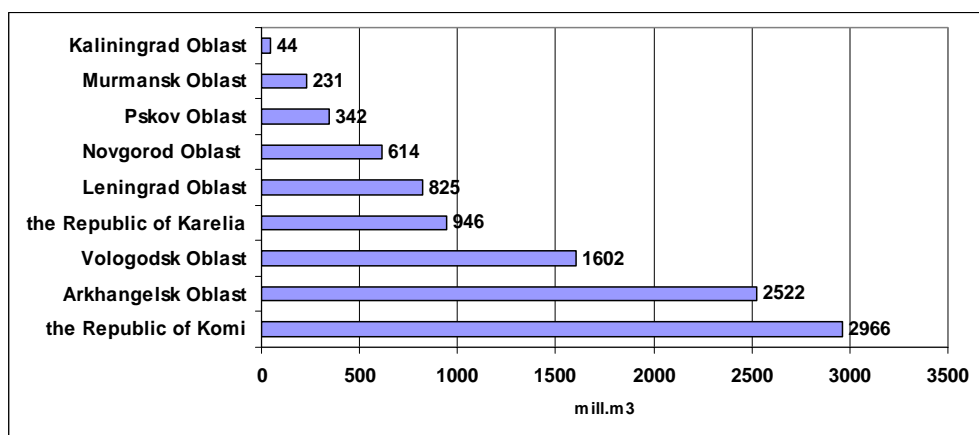


Figure 3. The total volume of forest in Northwest Russia, million m³ (Karvinen et al. 2005)

Figure 3 shows the total volume of forest in different regions. Finnish forest industry companies have their production units mainly in Novgorod Region.

In a case of pulp and paper investment, for example, the enterprise should ensure wood procurement process at least for 30 – 40 years. Therefore, the size of the forest resources and their economic accessibility, in addition to the transportation possibilities and other infrastructure, challenge the investment possibilities and determine the location of production plant (Holopainen et al. 2006, 24)

5 CONCLUDING DISCUSSION

5.1 Summary

The purpose of this study is to describe what kinds of factors are affecting the Finnish forest industry investments in European part of Russia. The research questions of the study were the following:

- How do the investments of production units in Russia are linked with companies' competitive strategies?
- What were the most important reasons for choosing current production unit location in Northwest Russia?
- What are the main challenges and future opportunities concerning Finnish forest industry companies in Northwest Russia?

First these questions were answered on the basis of previous studies conducted in this area. Especially investments to new corrugated packaging capacity to serve the growing Russian market have been part of Stora Enso's business strategy. These investments will upgrade Stora Enso's sawmills to manufacture value-added products and improve Stora Enso's access to the fast-growing building material market in Russia (Stora Enso 2007a, 26). UPM sees that the saw mill in Russia is important part of UPM's raw material and fibre strategy and the aim is to get experience from

forest industry investments in Russia and to create a basis for possible future investments.

On the basis of the review on previous research, the primary factors supporting for forest investments in Russia were found. They included the vast Russian forest resources, the market size, the growth potential, other competitive factors of production and developing domestic final product market, the vertical integration strategies and wood procurement of international forest companies over the national borders are important factors to determine the location of investments (Laakkonen et al. 2005 24, Filippov et al. 2005).

From foreign investors' point of view, Russian forest sector is attractive investment target for many reasons. The domestic demand for forest products is increasing along with the general economic growth and increase of purchasing power of citizens. The vast forest resources and their location near the final product markets give a good base for vertical integration of forest companies across the national borders. Also, other factors of production, such as labour force and energy, are competitive despite that wages and inflation are increasing in Russia (Dudarev et al. 2002, 18, Holopainen et al. 2006, 44).

Future challenges are relating to Russian legislation from foreign investor's standpoint. A couple of issues are in special emphasised when analysing the risks. Among the most important factors of investment, is the possibility of foreign enterprises to operate in Russia in general. Other important questions are related stability of regional legislation, other legislation questions which are related to enterprises, taxation, currency, labour, custom and competition policy. Logistics and infrastructure, availability of labour and region's social aspects are important (Filippov et al. 2005, 4).

Even though several foreign forest companies have established and increased their investment activity in Northwest Russia, there are still many uncertainties which hamper the willingness and establishment of further and larger scale forest investments. According to Holopainen et al. (2006, 44) Many of the recent investments, such as sawmills and veneer mills, can so far be seen as a pilot

projects to test general investment environment in Russian forest sector, especially wood procurement. Despite of promoting both domestic and foreign investments and willingness to increase value added production, many institutional settings and recent political actions by Russian Federation have rather been impeding than supporting factors to attract direct foreign investments in Russian forest sector. Especially, the support concerning continuous and predictable wood procurement is still missing, and the future development of the domestic roundwood markets is unclear.

5.2 Major Findings

The results of the empirical part were in many aspects expected and supported the findings of previous studies. It was expected that Russian vast forest resources as raw material source and large domestic markets attract investors. However, some differences were also found. On the basis of this study, it is clear that the investment climate in Russia has approved more supportive in order to attract foreign investments than it use to be. The study resulted in the following major findings: (1) Production based factors were expected to be motivating companies in the form of low cost factors, proximity of potential markets and availability skilled labour force. There are of course several factors concerning the investments and every company emphasizes own values. (2) Future challenges will be the legislation which still contains unclear points as well as possible increases of roundwood export tariffs increase the uncertainty among Finnish forest companies. (3) The relationship between the federal, regional and local administration and their responsibilities and rights to deal with foreign investments are important. The big challenge in future is relating to the personnel. (4) The role of educated labour is important which can be found also from previous studies. However, it was important to notice that Russian employees change easily their work if they can get better benefits somewhere else. This causes problems to production units if personnel are changing often and company losses important knowing how ability outside the company.

According interviews, the most important factors relating to the choosing the facility location are usually the future market potential for company's products, infrastructure,

cost-effective ways to make business and raw material and energy issues. Companies' existing strategies are affecting of course to their operational decisions.

5.3 Suggestions for Further Research

According to the results of Toppinen et al. (2007) study, it is quite clear that competition from Russia in the European markets for wood products will intensify in future. The competition may also extend to the markets of further processed and more value added wood products from commodity sawn wood and wood-based panels in the neighbouring area of Finnish border. It would be of interest to study the reasons that have influenced the choice of the mode of investment. What kind of are the factors that determine the choice of the investment mode in Russian forest sector? Why do some companies prefer to acquire an existing company even though it requires heavy investments? Could a greenfield investment operation be easier and less expensive in the end? It would be also necessary what kind of factors are existing behind the development of local Russian wood working industry and how will increased export tariffs affect local industry. The future trends should be also important to study if the logging markets will concentrate on few big vertically integrated forest companies and will there be also some big acquisition by foreign forest industry companies.

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APPENDIX. Research questionnaire

1. Name of the respondent _____

2. Position of interviewed person in the company/unit? _____

Please answer following questions

- How do the investments of production units in Russia are linked with companies' competitive strategies?

- What were the most important reasons for choosing current production unit location in Northwest Russia? Please give relevant examples.

- What are the main challenges and future opportunities concerning Finnish forest industry companies in Northwest Russia?
