The Continuing Boom in the Russian Economy and The Changes in the Russian Market Entry Modes and Export Channel Strategies of Japanese Companies (Part II) [1]

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Similarities and differences between the cases in terms of export channel structure patterns were listed, with cases being categorized into groups based on these. Following the analysis of 11 major Japanese companies, their export marketing channel strategies for the Russian market can be typified as follows.

Pattern A: Use of a local distribution agent in the target country→Use of a local distribution agent: Mitsubishi Heavy Industries, Daikin Industries

Both Mitsubishi Heavy Industries and Daikin Industries use local distribution agents in the target country for their exports. In this group, manufacturers entered the market by exporting through various agents, then continued to use agents at the market penetration stage. With this form of distribution, the company does not have to invest in fixed capital and can just pay commission to traders who have a local sales network, so exports via a local distribution agent are particularly important for companies that have only just entered a foreign market. The advantage of using a local distribution agent is that the sales network of the local partner can be used.

Pattern B: Use of a trading company (indirect exports)→Establishment of a wholly owned sales subsidiary: Yokogawa Electric, Amada, Honda, Olympus, Komatsu

Unlike representative offices or overseas branches of companies, the local corporations that Yokogawa Electric, Amada, Honda, Olympus and Komatsu established in Russia are incorporated in that country, so they can carry out all necessary activities. Their establishment of sales subsidiaries in

Russia can be viewed as the construction of a company-wide vertical marketing system. This is because the head office's wishes can be reflected in the local corporation directly and rapidly, and be developed into full-scale marketing activities. With regard to the Russian marketing channel policies of Yokogawa Electric, Amada, Olympus, Komatsu and Honda, in addition to direct channels selling goods to the end-user, they also use distribution agents. This is because they are developing the market using multiple marketing channels in order to reduce transaction costs arising from specific characteristics of the commodity or region.

In this group, manufacturers started exporting via a trading company (indirect exports). At the market penetration stage, the manufacturers set up their own sales subsidiaries in Russia and began to conduct exports through these. However, in parallel with this, they are also continuing to export via agents. This tends to be a situation where distribution in the Russian market takes place through home country agencies -trading companies- or agents in the first instance, and is followed at some stage with the establishment of a sales subsidiary. Relating this progression to theoretical models, the progression from agent/distributor to sales subsidiary is a classic situation, which may be explained by the establishment chain approach to internationalisation. The development of experiential knowledge of the country market and the willingness to increase commitment to the market encourage the formation of a subsidiary. Motives include a desire to increase market share, to move closer to the customer and to increase control of the channel.

Motivations for establishing a subsidiary include gaining access to the "knowledge-intensive assets" held by the agent to facilitate the establishment of an integrated and cost-efficient distribution channel and to implement the parent company's desired marketing strategy. Where the costs of running the subsidiary (ownership assets) outweigh the benefits of channel efficiency, ownership may be divested. For a period of time, the benefits of having had a subsidiary will remain due to support provided to the agent/distributor by the former parent. Through the relationships developed, therefore, subsidiary influence will persist (the strength of weak ties (Granovetter, 1973)), transaction costs will remain low (small numbers bargaining (Williamson, 1975)) and the risks and costs of ownership are eliminated

Pattern C: Use of a trading company : indirect exports →Establishment of a sales subsidiary as a joint venture with a trading company: Fanuc, Ricoh

Fanuc and Ricoh conducted their exports to Russia via a trading company at the market entry stage (indirect exports). They then established sales subsidiaries as joint ventures with Japanese trading companies at the market penetration stage. By making use of the human resources and networks that trading companies have built up in the CIS countries over many years, manufacturers can save time and money in gathering information about local markets, forming local sales networks and investing in sales activities. What is more, given the differences in language, customer needs, distribution systems, trade practices and the competition situation in Russia, the investment of a great deal of time and resources is required in order to cultivate specialist human resources with know-how about local sales and the ability to gather information about foreign markets, and to build a local sales network. The trading companies' resources are complementary resources for Fanuc and Ricoh. Furthermore, the establishment of a local corporation in the form of a joint venture enables the risk to be diversified.

Pattern D: Use of a trading company (indirect exports)→Establishment of an offshore sales subsidiary: Matsushita Electric Industrial, Canon

Both Matsushita Electric Industrial and Canon have established sales subsidiaries in Finland, while also setting up representative offices of those subsidiaries in Moscow. It is possible for local corporations to conduct sales activities in Russia, but Russian laws governing the operations of such corporations are more onerous than those governing representative offices, including laws and regulations relating to the settlement of accounts, cash transfers and tax payments. Fearing that they would be open to problems arising from the creation of new systems or the actual implementation of rules by the Russian government, both companies avoided establishing companies incorporated in Russia. Were it not for the existence of an unofficial "grey" customs system, both companies would apparently have established sales subsidiaries in Russia and built a vertical marketing system. Taking into consideration Russia's grey customs system, the construction of a vertical marketing system through the establishment of an offshore sales subsidiary could be described as a Russian-style marketing channel strategy.

In this group, exports started via trading companies (indirect exports). At the market penetration stage, the manufacturers appointed certain distributors as their exclusive distributors and dealers and they worked together as partners. The manufacturers set up offshore sales subsidiaries in Finland and representative offices thereof in Moscow, and began to export through local distributors and dealers.

There has been no research in distribution and marketing strategies in markets where bribes are paid to customs officials, resulting in cheaper tariffs for local distributors and dealers. We believe that the difference in behaviour towards the "rule of law" is an important factor that should be analysed when looking at entry strategies and marketing. Matsushita and Canon use independent distribution channels. Of course, at first, when they entered the Russian market, they were constrained by their unfamiliarity with the market. However, even when they came to know the Russian market, they could not use a direct channel strategy, because distributors, who have connections with Russian customs offices, play an important role in the Russian market. Unless Japanese photocopier manufacturers use local distributors, they would be unable to compete with the products imported by independent local distributors.

6 . FINDINGS AND ANALYSIS

(1) Market entry stage

In all four groups, exports to Russia started via independent intermediaries (trading companies or agents). Most of the manufacturers complained that partnerships between manufacturers and local distributors were difficult when both parties did not have much information about each other's reputation, integrity and capabilities at the market entry stage.

Exports via an employed sales force were not an option at this stage, while setting up sales subsidiaries in Russia was costly. Japanese manufacturers did not want to be highly committed to the Russian market at a time when they perceived high demand uncertainties and considerable environmental risks. Without country-specific knowledge and customer contacts, manufacturers were almost entirely unable to promote sales.

The results of various studies indicate that Japanese manufacturers prefer low investment, low commitment and a low control channel structure when they enter the Russian market. That is, each channel member works in their own interest and members are not committed to each other at first. Without country-specific knowledge, it is difficult for Japanese manufacturers to believe in the integrity and competence of newly emerged Russian distributors and thus they will not commit to any transaction-specific investments in partnerships. In emerging markets, the market mechanism has not yet been established and legal frameworks are weak. Without the market mechanism and strong legal frameworks, Japanese manufacturers cannot protect their transaction-specific investments in partnerships if they are committed to the wrong partners. Such transaction-specific investments include credit, training, product modification and inventory. It is almost impossible for firms to recover these investments if the partnerships fail.

Similarly, a lack of country-specific knowledge makes the hierarchical channel structure disadvantageous. Without country-specific knowledge, it is difficult for Japanese manufacturers to manage the environmental risks and uncertainties and thus they will not invest heavily in establishing sales subsidiaries at the market entry stage. At this stage, Japanese companies were at the indirect export stage and were unable to engage in direct marketing.

(2) Market penetration stage

At this stage, Japanese manufacturers developed reasonable knowledge about the Russian market. With market knowledge, manufacturers had a better perception of the risks and returns involved and therefore became more confident and aggressive, which manifested itself in a willingness to commit more resources. Managing frequent market jolts in emerging markets requires well-developed capabilities. Japanese manufacturers may not have these capabilities, which should be country-specific and cannot be transferred between firms (Eriksson et al., 1997). Manufacturers prefer partnerships when a particular distributor possesses distinctive, better, and sustainable capabilities, as the former wish to motivate the latter to be committed to their channels. In emerging markets, the economy develops fast and market jolts are frequent. Opportunism can lead to above-average profits. More importantly, a weak legal infrastructure is barely able to punish opportunism and protect the interests of victims. Information asymmetry between exporting manufacturers and resident distributors facilitates such opportunism. Consequently, manufacturers have to choose reliable distributors as their partners.

Market growth can be defined as the increase of demand. When an economy grows rapidly, market demand increases accordingly. Rapid market growth has a number of important implications for Japanese manufacturers. First, rapid market growth justifies investment in expanding the market. Second, it leads to promising profits and opportunities and thus makes channel opportunism possible and attractive. In other words, rapid market growth necessitates a high degree of channel control in order to suppress opportunism. Third, rapid market growth substantially increases transactions across channels and firms have to ensure the smooth coordination of distribution functions. A high degree of control is necessary for fine coordination and adaptation (Li, 2002).

7 . CONCLUSION

1 . Most Japanese companies see Russia as an extremely attractive market, in terms of its scale and potential for growth. However, there are many risks in emerging markets. Consequently, they have initially learned about the Russian market and gathered information after entering it by means of methods that do not require the investment of a large number of resources, such as establishing representative offices, undertaking indirect exports via a trading company or selling products through local distribution agents.

2 . After gaining experience of doing business in Russia and becoming accustomed to operating in such a fast-changing and unpredictable economy, these companies have become increasingly comfortable with their Russian operations and with their economic performance and outlook there. As a result, many have deepened their commitment to Russia by supplementing their lower-risk strategies with higher-risk ones, such as direct investment.

3 . As a result of Russia's recent economic growth, Japanese companies' export strategy vis-à-vis Russia has shifted towards the establishment of

local subsidiaries, which require the investment of large quantities of resources. This takes the form of capital investment in export channels to Russia. The establishment of sales subsidiaries by Japanese companies can be viewed as the true beginning of direct marketing of exports to Russia. Capital investment in export channels is investment in Russia, involving the export of capital, and is distinct from mere exports of goods. The export marketing being developed here is one form of global marketing.

4 . When Japanese companies establish sales subsidiaries in Russia, they often opt to set up wholly owned subsidiaries or split the equity contribution fifty-fifty with a trading company. The plus side of the wholly owned subsidiary is that the company can control the business completely. All the profits enter the company, and it can implement its marketing activities as it wishes. The establishment of the wholly owned subsidiary also sends the signal that it has a strong commitment to the local market. Furthermore, it can control its assets in the region, as well as monitoring major changes in the market and the activities of its competitors. In addition, it can react swiftly to market changes, build customer networks and promote better customer service. On the other hand, the establishment of a sales subsidiary with 50% ownership by a trading company can disperse risk and allows the use of the trading company's distribution network and web of personal contacts in Russia. Companies that have little commercial ability, know-how or experience in the Russian market tend to opt for this form of sales subsidiary, as do companies that wish to disperse risk through conducting large-scale projects in collaboration with trading companies.

5 . Japanese companies are making an active commitment to the Russian market. Companies have to bear the entire risk themselves with wholly-owned subsidiaries, and a great number of corporate resources are required to build a Russian sales hub without the assistance of a third party, including know-how for operating in the relevant market and experience thereof. Moreover, political risks must also be taken into consideration. There is a risk that it could be seen as a threat to the cultural and political sovereignty of the host country. Companies opting for a wholly owned subsidiary are prepared to bear the majority of the

aforementioned risks involved in setting it up, undertaking direct export marketing, and trying to build a vertical marketing system for the Russian market, because they can control the Russian marketing channel in line with the strategy of the company's head office.

6 . Upon entering emerging markets, the less country-specific knowledge a Japanese manufacturer had, the more likely it was that it preferred exports via trading companies or agents to a hierarchical channel structure.

7 . At the market penetration stage, Japanese manufacturers developed a reasonable amount of knowledge about Russia's emerging market. With market knowledge, they had better a perception of the risks and returns involved and therefore became more confident and aggressive, which manifested itself in a willingness to commit more resources. Consequently, the hierarchical channel structure is positively associated with market growth and opportunism. The transaction cost paradigm is valid when markets grow fast and partners are inclined to behave opportunistically.

8 . Comparing the dynamics of these market entry strategies with the internationalisation process proposed by the Uppsala School (Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1997; Vahlne & Nordstrom, 1988), it is clear that there are significant differences between the West and Russia. The Uppsala Model argues that internationalisation is the increasing degree of involvement by firms in foreign markets, with implications for both the size of resource commitment and the acquisition of market information (Ali & Mirza, 1996: 52-53). However if the foreign market is not entirely subject to the rule of law, as is the case in Russia, a company may establish an offshore sales subsidiary or set up a sales subsidiary in partnership with a trading company, which has more experience in the market even if the market is a sizeable one.

8 . Implications and Recommendations

Managerial Implications

What do Russia's healthy economy and the upgrading of its legal system signify for Japanese companies?

For Japanese companies, this means that Russia has become the next most attractive emerging market after China and India. With Russia about to join the WTO, Japanese companies should establish sales hubs in Russia and be proactive in building marketing channels. What, specifically, should they do?

1 . For exporters into emerging markets, the selection of the export channel structure is based on a number of factors, including their experience of and competence in managing market shifts, intermediaries' competences, market conditions, and their respective strategies in the markets. When Japanese exporters first enter Russia – an emerging market – export via trading companies or agents is a better option than the hierarchical structure. At this stage exporters do not have much information about the market structure and context. Heavy investment associated with the hierarchical structure can be risky in an emerging market, especially when the exporters do not possess the skills to manage the frequent market jolts. At the market entry stage exporters do not have much information about intermediaries' competences and reputation. Commitments to wrong partners can lead to the loss of resources, as, in most cases, it is difficult to recover any investment in a partnership if the partnership is terminated after only a short period of time. Consequently, it is better for inexperienced exporters to use trading companies or agents when they first enter an emerging market.

2 . If the market is growing rapidly, exporting through intermediaries can be costly, as exporters have to share profits with their local intermediaries. More importantly, channel control becomes an important issue when the export market grows rapidly and becomes an important market for the exporter. Swift sales increases can make channel monitoring difficult and thus encourage opportunism by local intermediaries. Therefore, if the export market grows rapidly, it is better for exporters to shift to a hierarchical structure in order to reduce costs and gain control over their channels.

3 . In emerging markets where the market mechanism is not established and legal frameworks are weak, uncertainties and opportunism may prevail. Consequently, exporters should opt for a hierarchical channel structure in their quest to manage uncertainties and suppress opportunism, as employers can impose decisions on their employees and punish opportunistic behaviour (Anderson and Coughlan, 1987).

Implications for Policy Makers

Russia's healthy economy has led to increasing interest in Russia on the part of Japanese companies. They are actively establishing sales hubs in order to conduct marketing in the Russian market and some, such as Toyota Motor Corporation and Matsushita Electric Industrial Co., are planning to invest in production in Russia.

Significant improvements have been made to Russia's legal system since Vladimir Putin became President. Laws and government ordinances such as the Foreign Investment Law, taxation laws and the Customs Law have been formulated and amended. However, there is a lack of consistency and transparency in the enforcement and operation of these laws. For foreign companies entering the Russian market, this problem is the greatest cause of concern. Russia's laws and statutes must be adapted to the WTO's rules and regulations. Furthermore, unfair treatment, such as the practice of giving preferential treatment to local (i.e. Russian) companies and collecting normal customs duties from foreign companies alone, must be abolished. If this were done, along with Russia's accession to the WTO, investment in Russia by foreign companies, such as Japanese companies, would increase further.

Limitations of the Study

This study focuses on the methods used by Japanese companies entering the Russian market and the dynamic changes in these. It was only possible to collect eleven samples. In the future, it will be necessary to increase the number of samples and make them more universal. Moreover, surveys should be implemented in the future concerning what characteristics the Russian market has compared with other CEE countries, as well as how the strategy of Japanese companies differs from those of companies from the US and the ROK.

Notes

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