

General Management MBA



Strategic Analysis: Identifying opportunities for entering the Russian food market for an Austrian automation technology company in the situation of economic instability.

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Abstract

This thesis aims to analyze the feasibility of entering the Russian food market for a small Austrian automation company, particularly in the light of the recent economic crisis and import substitution campaign. To this end, the company's profile and product portfolio have been studied and a preferable mode of entry selected. Apart from that, Russia's business environment has been assessed with a particular focus on the meat, bakery and confectionery industries. Finally, a theoretical framework for an internationalization strategy has been developed and specific recommendations with regard to the implementation of this strategy have been provided. The study has been carried out based on the information obtained from a large body of theoretical and empirical literature. Additionally, a series of semi-structured expert interviews have been conducted and an online survey created to gain an insight into the specific challenges associated with doing business in Russia. This study can be of particular value to small companies that are interested in exploring the Russian market, especially in the food industry.

Keywords: exporting, Russian market, food industry, automation, import substitution

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Executive Summary

After the dissolution of the Soviet Union and Russia's joining the world economy, the country has become one of Austria's main trading partners. Today it represents a large market with strong potential and a myriad of opportunities for foreign manufacturers.

This thesis aims to analyze the feasibility of entering the Russian food market for a small Austrian automation company, particularly in the light of the recent rouble crisis and import substitution campaign. To this end, the company's profile has been studied, its core products identified and a preferable mode of entry selected.

Apart from that, Russia's business environment has been assessed with regard to potential challenges and macro risks a foreign entrant may face while doing business in this complex market. A particular focus has been placed on the meat, bakery and confectionery industries, as they represent key strengths of the researched company.

At the end of this work, a theoretical framework for developing an internationalization strategy for a particular company has been developed. Furthermore, specific recommendations with regard to the implementation of this strategy have been provided.

The study has been carried out based on the information obtained from a large body of theoretical and empirical literature. Apart from the literature review, a series of semi-structured interviews with representatives of Austrian companies operating in the Russian market and Austrian Economic Chamber have been conducted. Moreover, an online survey has been created in order to gain more information on specific challenges associated with doing business in Russia.

The analysis has revealed that Russia's food industry has remained strong despite a slowdown most industries have endured in the wake of the economic crisis. The meat industry has shown particularly stable results in the recent years. Similarly, bakery and confectionery industries have also maintained their solid positions in the market.

With regard to the import substitution policies that have raised deep concerns among foreign players, an Austrian company with profound expertise in mechanical engineering and process automation has stronger potential in the Russian market compared to foreign manufacturers in other industries. This can be explained by the fact that Russian food manufacturers have been forced into the conditions of increasingly unsatisfied demand due to countersanctions; thus they have to increase and/or modernize their manufacturing capacities. In this situation Austrian expertise in production process optimization and automation may be particularly welcome by Russian manufacturers. Thus despite the currently fragile economic situation in the country, it is deemed sensible to explore the opportunities in its food market and establish necessary contacts in order to secure future demand.

One inevitable challenge a small company faces in the process of internationalization is the lack of financial resources required for entering a foreign market. Therefore, it is advisable to solicit state funding for expansion activities, particularly due to the fact that Austria has a well developed system aimed at promoting local manufacturers in the foreign markets.

Apart from that, government organizations in Austria provide excellent advisory support with regard to potential partners that can help establish business cooperation faster and safer, employing their expertise and knowledge about the Russian market. Thus a number of potential partners that can help the company significantly increase its chances for success in Russia's food industry have been identified.

Ultimately, the currently difficult economic situation in Russia does not diminish its long-term potential, particularly for an Austrian automation company, as the market offers many opportunities for process automation in the food industry. Therefore by entering the market shortly before the economic upswing, the company can build a better competitive position for the future when the economic crisis subsides and demand increases again.

1. Introduction

The end of the Cold War and the following rapid integration of the previously closed economies of the former Soviet Union and later China have catapulted the world into the new reality of the interconnected hypercompetitive global market. The new favorable conditions for doing business on a larger international scale have paved the way for an ever-increasing number of enterprises to the diverse markets around the globe that promise lucrative gains which, nevertheless, often come with significant risks.

In the past decades, enterprises have become more market oriented. They have obtained access to new attractive market opportunities that transformed those willing to venture on the path of international expansion into global players. Under the changed circumstances some sectors have been experiencing the need to internationalize at a more rapid pace accelerated due to the small size of domestic markets, slowing demand and increasing international competition (Hisrich, Peters, Shepherd, 2013). However, the predicament of being trapped in one marketplace that in many cases inevitably becomes too small or unprofitable can now be overcome by exploring overseas markets. Certain regions have profited even more by removing existing economic barriers among neighboring nations such as the European Union, or by uniting themselves into various trade organizations and introducing favorable conditions for trade among partner countries, such as North American Free Trade Agreement (NAFTA), Association of South East Asian Nations (ASEAN) or South Asian Association for Regional Cooperation (SAARC).

This development has revealed the importance of the emerging economies that steadily become the main driver of the future growth. However at their transition stage, they struggle from the lack of major investments in advanced technology, infrastructure, training and education that are essential to support their burgeoning development and growth and unleash their potential. These areas are offering immense potential for cooperation, and an ever-increasing number of European enterprises realize it, trying to incorporate international trade into their business model early on.

The positive impacts of internationalization of business are indisputable. It creates wealth and employment that benefit individuals and nations all over the world. Therefore, it is sensible for present day entrepreneurs to explore the possibilities of expanding their businesses beyond their local markets at a certain stage of company's development or even consider such expansion from the start. Thus, through the thorough analysis of the business environment and corresponding risks and development of effective mitigation strategies, it is possible to create significant economic impact for the benefit of the enterprise and both domestic and international economies.

1.1 Scope and objectives

Within the **scope** of this study, the business environment in Russia has been analyzed and specifically its food industry addressed. Moreover, the feasibility of business expansion into the Russian market for the Austrian automation technology company ProAutomation GmbH has been evaluated, particularly in the light of the current economic crisis in Russia.

The main purpose of this study is to elaborate a theoretical framework for developing an internationalization strategy for ProAutomation GmbH with particular regard to the specifics of its business and the company's size and in the context of resources available for expansion. Thus, the research **objective** is to analyze economic feasibility of entering the Russian market of food production, processing and packaging for ProAutomation GmbH. A further aim is to identify the best entry strategy into this market and provide recommendations as to its implementation.

1.2 Research questions

Russia has a large underexploited market that offers a myriad of lucrative business opportunities in various industries. Thus this paper attempts to address the question, whether a small Austrian automation company can economically benefit from tapping into the Russian food

production, processing and packaging market, despite the associated macro risks.

Therefore, three main **research questions** lie at the heart of this study: *Is it economically feasible for ProAutomation GmbH to expand its business into the Russian market that is struggling with an economic crisis? What macro risks are associated with the international business expansion? What is the best expansion strategy for the selected company?*

1.3 Methodology

The following **methods** have been chosen to approach the topic. The necessary information for this thesis paper has been obtained through a thorough review of theoretical and empirical literature. The data have been collected from primary and secondary sources. Primary data have been obtained through semi-structured expert interviews and standardized online surveys (Mayring, 2014), while secondary data have been acquired from public sources, analytical reports, professional articles, relevant websites, and professional literature.

An analysis and synthesis of the existing research data and findings has been performed. Based on the collected and synthesized data, a theoretical description of the selected research areas, e.g. market entry strategies, has been provided. Based on the collected and analyzed theoretical and empirical data, practical recommendations with regard to the expansion strategy have been provided.

The research has determined that there is a large body of theoretical literature that provides a general overview of socio-economic and political climate in Russia, as well as many empirical studies, i.e. analytical reports, statistics, public opinion surveys, focus group interviews that further illustrate the business environment in Russia. However, there is a lack of public information on the challenges of doing business especially in the machine engineering and automation sector that foreign companies face, particularly in the wake of the international sanctions. This gap has been closed by contacting and interviewing the selected companies that specialize in machinery and automation engineering and operate in the Russian market,

analyzing and systematizing the obtained information and presenting it in this paper.

1.4 Structure

The paper is divided into six parts. The introduction provides a general overview of the paper. The second chapter focuses on the theoretical framework, covering the recent developments in the global economy, the motivation for international expansion, analysis of the market entry strategies and the instruments used to analyze strategically important markets, particularly CAGE and PEST frameworks. The third chapter dwells on the Austria's business climate with particular regard to the machinery and automation engineering sector. It also includes the description of the ProAutomation GmbH company profile and the information on its core business and sectors of operation. Moreover, preferred market and mode of entry for the addressed enterprise are identified. Chapter 4 is devoted to the Russian economic situation and business environment. In this chapter, the key challenges of doing business in Russia based on the combination of PEST analysis and CAGE framework are addressed. Moreover, the investment climate in Russia is described, Austrian-Russian bilateral trade relations characterized and a description of the Russian food production, processing and packaging industry is provided. Chapter 5 summarizes the results of the market assessment and offers recommendations with regard to the preferred expansion strategies and relevant considerations. Conclusion is presented in the final Chapter.

2. Theoretical framework

2.1 Motivation for the international expansion

2.1.1 Austria as an export-oriented country

After joining the EU, Austria seized the opportunity to become a prominent member of the global economy and started actively establishing itself as an export-oriented country. According to the Austrian Economic Chamber¹, at least 10 per cent of all national enterprises are active in international business, while every second workplace is dependent on exports, either directly or indirectly.

Located in the heart of Europe, Austria has a most convenient access to the emerging economies in the East and the developed ones in the West, while its excellent infrastructure makes it a reliable partner in international trade. Thus, not only does Austria utilize its domestic competitive advantages such as cutting-edge technology and well-trained labor force to name a few, but also turns its exceptional location into a strategic strength for the local companies that want to take their business globally.

Since the EU acceptance, the number of Austrian exporters rose from 12,000 to 52,500 companies (see Figure 1). Today the country exports to around 220 countries, and its export rate amounts to 54 per cent of GDP, which means that almost six out of ten euros are earned through export.

¹ Wirtschaftskammer Steiermark (2016): Export ist unser größter Trumpf, <https://www.wko.at/Content.Node/Interessenvertretung/st/Export-ist-unser-Trumpf.html> [20.07.2016]

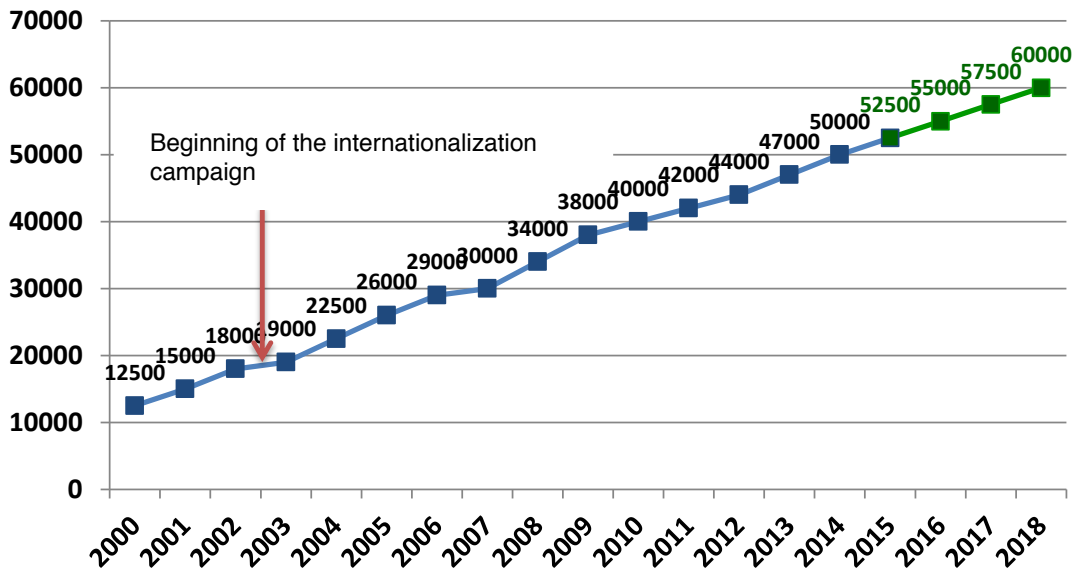


Figure 1 Number of Austrian export companies². Source: Aussenwirtschaft Austria

In 2015, export volume passed 130 billion euro mark; in 2016 it is forecasted to reach 135 billion euros and in 2017 it is expected to amount to 140 billion euros³ (see Figure 2). Therefore, there is a distinct positive trend for a steady increase in export volumes, which has withstood a number of recent global economic shocks.

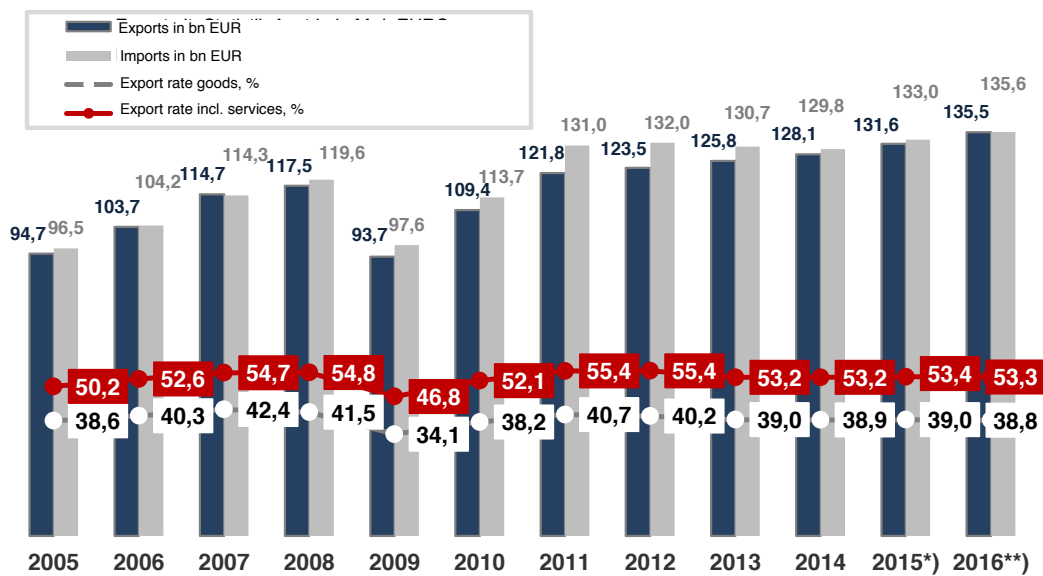


Figure 2 Austria's international trade 2005-2016, *) Statistik Austria, **) WIFO Forecast. Source: Statistik Austria / Aussenwirtschaft Austria

² Aussenwirtschaft Austria (2016): *Österreichische Exportwirtschaft 2016. Österreichischer Aussenhandel und Direktinvestitionen Export-Hot Spots*. Aussenwirtschaft Austria, p.5

³ Ibidem

Austria is particularly strong in the wood and paper industry, mechanical engineering, the automotive supplies, food production and the pharmaceutical industry ⁴ (see Figure 3). These industries contribute significantly to job creation and are responsible for almost one-half of all jobs in Austrian manufacturing. Among these industries, mechanical engineering is by far the strongest export driver.

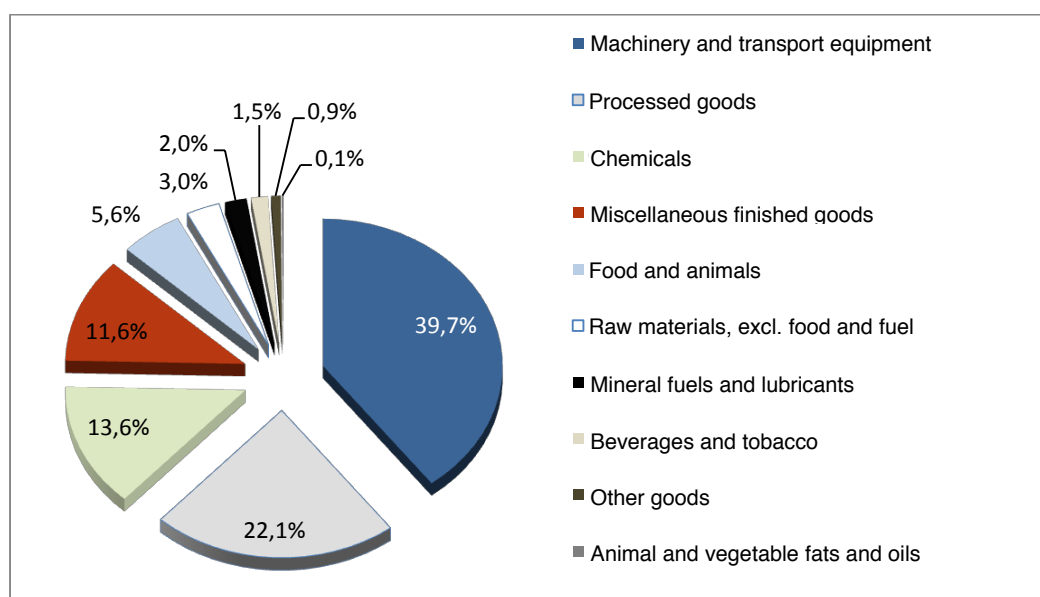


Figure 3 Austria's goods export 2015. Source: Statistik Austria/ Aussenwirtschaft Austria

Despite the fact that Austria cannot boast a large number of world famous multinational corporations, its companies are very competitive in niche business. Thus, some of the main strengths of Austrian companies are their flexibility and customer-oriented approach.

It is important that today not only large Austrian corporations are engaged in international trade, but also Austria's tech start-ups and SMEs – the so-called “born globals” – seek to exploit the opportunities created by entering foreign trade at the early stages of their operation. This trend has been accelerated by the significant state support for those companies that decide to expand their business internationally. For instance, the Austrian Economic Chamber has launched the “go international” program with a

⁴ Pudschedl, W. (2011): *Exports experience successful run. The joys and sorrows of Austria's export strengths*. Bank Austria's Economics & Market Analysis Austria, (3) 2011. UniCredit Bank Austria AG

budget of 56 million euros for the period between 2015 and 2019⁵ to encourage Austrian companies to explore new markets.

2.1.2 Austria's most important trade partners

Austria is naturally closely connected with the EU economies due to the removed trade barriers and similar business environment. For Austria, international trade with these countries is accounted for over 69 per cent⁶.

Germany has traditionally been Austria's largest trading partner despite its recent challenges. Although market penetration in Germany is high, Austrian manufacturers are successful in supplying high quality niche products to the German market.

Thirty percent of Austria's exports go to Germany, which makes it by far Austria's largest trading partner (see Figure 4). Largest exports to Germany include machinery and equipment. Therefore, it is common for Austrian SMEs from the mechanical engineering industry to enter the German market first.

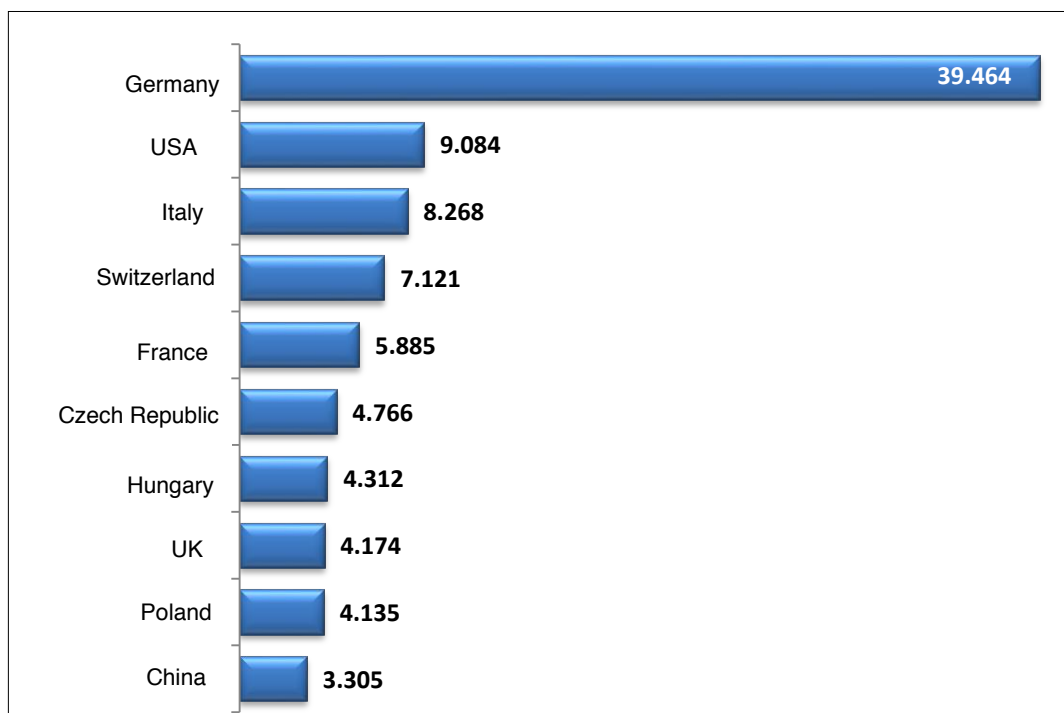


Figure 4 Austria's top 10 export partners, 2015 (million EUR). Source: Statistik Austria / Aussenwirtschaft Austria

⁵ Bundesministerium für Wissenschaft, Forschung und Wirtschaft (2016): *Wirtschaftsbericht Oesterreich 2016*, p.53

⁶ Aussenwirtschaft Austria (2016): *Österreichische Exportwirtschaft 2016. Österreichischer Aussenhandel und Direktinvestitionen Export-Hot Spots*. Aussenwirtschaft Austria, p.9

Among the non-EU countries, the most important export markets for Austria are the USA, China, Japan, Canada, South Korea, the UAE, Mexico and Australia⁷.

In the recent years economic growth has been slow in most parts of the world. Nevertheless, it is still reasonable to maintain trade relations with promising emerging markets. Russia, for instance, remains one of the most important trading partners for Austria despite its recent economic and geopolitical challenges. Approximately, 50,000⁸ Austrian jobs depend on the trade relationships with Russia, either directly or indirectly.

Due to the country's most recent economic and geopolitical struggles, the export volume to Russia plummeted by 39.9 per cent in the first quarter of 2015⁹. This decrease has resulted from the currency crisis that has had a negative impact on the willingness of Russian industries to invest in new machinery and equipment. The impact of the rouble crisis was intensified by the EU sanctions and the subsequent countersanctions. This combination has resulted in a decrease in foreign trade volumes from USD 805.8 billion in 2014 to USD 543.2 billion in 2015¹⁰. Thus, from the 10th place among Austria's most important export markets in 2014 Russia dropped to the 15th place in 2015.

Despite recent fluctuations in the Russian economy, the presence in its market is still considered reasonable, as it offers much potential in the long term. Not only is the vast market characterized by a large middle-class layer, but also by the industry with numerous vacant niches that can be filled by foreign suppliers. Apart from that, when it comes to preferences of the Russian market, "made in Austria" quality has always been highly esteemed, especially in the mechanical engineering industry. This fact alone makes this market particularly interesting for an Austrian automation company.

⁷ Bundesministerium für Wissenschaft, Forschung und Wirtschaft (2016): *Wirtschaftsbericht Oesterreich 2016*, p.53

⁸ Aussenwirtschaft Austria (2016): *Österreichische Exportwirtschaft 2016. Österreichischer Aussenhandel und Direktinvestitionen Export-Hot Spots*. Aussenwirtschaft Austria, p.23

⁹ Ibidem

¹⁰ Ibidem

2.1.3 Current trends in the global economic environment

The global economic environment in the past three years has been marked with lower development rates than expected. This can be explained by the still ongoing recovery from the global financial crisis and the long-term implications thereof on the one hand, and by a number of unexpected geopolitical shocks in different parts of the world and certain country-specific challenges¹¹ on the other hand.

For Austria some of the most relevant developments that affect its business include currency crisis in Russia due to the falling oil prices and the EU imposed sanctions, instable situation in neighboring countries such as Turkey and the Ukraine, the European migrant crisis, and pending Brexit. These events have resulted in weak aggregate demand and increased level of uncertainty and investment reluctance.

2.2 Market entry strategies

Upon deciding to expand its business internationally, every company has to determine its entry strategy and identify a particular market of interest. Based on the answers to these questions, the company can choose a strategy that will determine its further success or failure in the foreign market.

2.2.1 Entry modes

If a company has decided to bring its products or services to a foreign market, it has to determine the most advantageous mode of entry based on the goals it wants to achieve and the resources available for this purpose. Hirsch, Peters and Shepard (2013)¹² put different entry modes into three categories: exporting, non-equity arrangements, and foreign direct investment (FDI).

¹¹ United Nations New York (2015): World Economic Situation and Prospects 2015, http://www.un.org/en/development/desa/policy/wesp/wesp_archive/2015wesp_full_en.pdf [23.07.2016]

¹² Hirsch, R. D., Peters, M. P., Shepherd, D. A. (2013): *Entrepreneurship*, 9th edition. New York: McGraw-Hill Education, pp. 139-144

There are six most common entry modes for an international expansion (Hisrich et al., 2013; Hill 2003), namely exporting, turnkey contracts, licensing, franchising, joint ventures and wholly owned subsidiaries.

Typically a company initially turns to exporting, i.e. sale and shipping of products manufactured in the home country to a customer located in the foreign country. Exporting can be either indirect, involving a foreign purchaser in the local market or an export management firm, or direct through independent distributors that take care of all technicalities or through a company's own overseas sales office (Hisrich et al., 2013).

By entering a foreign market through non-equity arrangements, it can obtain sales and profits without direct equity investment. Under licensing a company gives a foreign manufacturer the right to use a patent, technology, production process, or product in return for the payment of a royalty. In a franchising model, the company allows its foreign business partner to use its successful business model and brand name also for the payment of a royalty (Hisrich et al., 2013).

Another method that belongs to this category is a turnkey project. In this case a company supplies the manufacturing technology or infrastructure for a business and then turns it over to local owners (Hisrich et al., 2013).

FDI typically implies establishing a subsidiary in a foreign market or entering a joint venture. A subsidiary is preferred in a situation when a company wants to keep full control over its business operations. Joint venture, on the other hand, allows a company to gain local knowledge about the market and access to technology, supply chains, useful contacts, etc.

Each method has its positive sides and drawbacks. The advantages and disadvantages of each entry mode are illustrated in Table 1.

Table 1 Most common entry modes¹³

Entry Mode	Advantages	Disadvantages
Exporting	Ability to capitalize on experiences in location selection	<ul style="list-style-type: none"> • High transport costs • Trade barriers • Problems with local marketing agents
Turnkey projects	Ability to earn returns from process technology skills in countries where FDI is restricted	<ul style="list-style-type: none"> • Creation of efficient competitors • Lack of long-term market presence
Licensing	Low development costs and risks	<ul style="list-style-type: none"> • Lack of control over technology • Inability to realize location and experience curve economies • Inability to engage in global strategic coordination
Franchising	Low development costs and risks	<ul style="list-style-type: none"> • Lack of control over quality • Inability to engage in global strategic coordination
Joint ventures	<ul style="list-style-type: none"> • Access to local partner's knowledge • Shared development costs and risks • Politically acceptable 	<ul style="list-style-type: none"> • Lack of control over technology • Inability to engage in global strategic coordination • Inability to realize location and experience curve economies
Wholly owned subsidiaries	<ul style="list-style-type: none"> • Protection of technology • Ability to engage in global strategic coordination • Ability to realize location and experience curve economies 	High costs and risks

Source: Hisrich R. D. et al. (2013), p.139

It is important to remember that there is no one-fits-all formula for entering a foreign market. Each case should be considered individually, and what works for one company, industry or market may not necessarily bring

¹³ Hisrich, R. D., Peters, M. P., Shepherd, D. A. (2013): *Entrepreneurship*, 9th edition. New York: McGraw-Hill Education, p.139

success to another one. Based on these considerations, a decision about the selected entry mode for ProAutomation GmbH will be discussed in more detail in Chapter 3.3.

2.2.2 Market selection and the CAGE Distance Framework

The decision to take business internationally is naturally associated with one question: What market to choose? Thus, the competitive success of a company depends on a favorable combination of the macro-economic and industry-specific environment in the considered market. Therefore, it is necessary to conduct a thorough analysis of the market to identify measures that would help exploit the existing opportunities and mitigate potentially harmful conditions. In order to carry out such analysis, a company can use several tools.

If there is long-term market potential for a particular product in a foreign country, the other factors to consider are associated with the so-called psychic distance (Nordstrom and Vahlne, 1994), the term that explains what factors can disturb successful business cooperation between two countries. It can be analyzed using the CAGE Distance Framework (Ghemawat, 2001 & 2007) that focuses on the cultural, administrative and political, geographic and economic distance.

Cultural distance reflects shared values in the society, similar customer behavior, approaches to doing business and willingness to engage in business with foreign counterparts. Moreover, culture distance may affect the ability of potential customers and consumers to correctly receive and interpret the intended message about a product or service.

It is worth noting that one common approach to measuring cultural distance was suggested by Kogut and Singh (1988) and is based on Hofstede and Bond's (1988) five dimensions of national culture that include both "hard" dimensions, such as legal, economic and political characteristics, as well as "softer" dimensions such as cultural norms and values. Despite its popularity, this approach was criticized by some scholars (Kirkman, Lowe, and Gibson, 2006; Shenkar, 2001), advising against combining all five dimensions to measure culture distance.

Administrative distance is also referred to as political distance, which reflects different bureaucratic and political culture that exists in a foreign country. Government stringent control mechanisms, protectionist policies and high entry barriers, ambiguous regulations, different quality standards or pervasive corruption may cause insurmountable challenges and result in significant time and money expenses when conducting business in a particular market. Hence, a large administrative distance may be a hindrance to successful operation in a selected market, or a decisive factor against entering it in the first place.

Geographic distance between the home market and the host market may affect successful operation due to distance from the customers or consumers, hence increased time of reaction to a change in demand or requirements, or in case of urgently needed customer support due to failures or malfunctions. Apart from that, the distance within the country can become an issue, as for example in Russia that has nine time zones, which makes it more difficult to reach business partners on the same workday. Also logistically it can be difficult to reach some regions in a timely manner within one country due to large distances between cities and/or insufficiently reliable infrastructure.

Economic distance refers to the difference in levels of economic development of two countries. The smaller the gap between the countries, the easier it is for them to do business together. This is reflected not only in the ability and willingness of the host country to invest in new projects or equipment, for instance, but also in the level of infrastructure in the host country, which can either simplify or complicate business processes, and moreover in the quality of human resource needed for successful operation in the foreign market.

Therefore, company's success depends on a strategic match between its resources available for international expansion and favorable environment in the selected market. In practice, companies usually tend to first establish cooperation with the markets they understand best, i.e. there is minimal psychic distance between the two countries. After gaining experience in these markets, they may consider moving further into markets with larger psychic

distance, as they feel more prepared to deal with challenged that arise from larger distance in the mentioned dimensions.

2.2.3 PEST analysis

The CAGE Framework is a good tool to use when selecting a market for international expansion. Another useful analytical tool to determine potential of a foreign market is PEST analysis.

This framework also focuses on four macro-environmental factors that should be considered when making a business decision, i.e. political, economic, social and technological ones.

Political dimension includes state regulations and legal issues; economic dimension focuses on economic growth, inflation rates, and other factors relating to a country's economic situation; social dimension addresses, among others, population growth rate, health trends, and age distribution; and technological dimension focuses on such factors as the level of technological advancement in the country, R&D activity and the level of automation to name a few.

This framework can be further expanded into different variations thereof such as PESTLE, where additionally legal and environmental factors are addressed. It can be applied if a company's operations may have a negative impact on the environment, or alternatively if the environmental issues and regulations may affect successful operation of a company in a particular market.

2.2.4 Internationalization challenges of SMEs

Approximately 99.7 per cent of all Austrian enterprises¹⁴ belong to the category of small and medium-sized businesses (SMEs). With 63 per cent revenue, this group is also responsible for more than two thirds of the Austria's employment.

Similarly to large corporations, SMEs also see immense opportunities in taking their business global. However, they often face bigger challenges than large corporations do.

¹⁴ Bundesministerium für Wissenschaft, Forschung und Wirtschaft (2016): *Wirtschaftsbericht Oesterreich 2016*, p.50

Miessgang (2014) distinguishes three key challenges that particularly a small enterprise is likely to face during its internationalization:

- Limited capital resources

Any internalization strategy is usually associated with high expenses. In order to mitigate potential risks and at the same time be competitive in a new market, a company should set aside special-purpose funds. For instance, in order to win new customers in the initial stages, a company often offers lower prices and larger service packages. In this case, potential losses should be covered by the company itself.

Apart from that, due to the comparatively low equity ratio, it is oftentimes difficult for a small company to obtain a loan to implement its internationalization strategy. Thus, limited capital resources force smaller companies to approach their investment decisions with more caution. Thus, this difficulty may hinder the company from expanding its business especially into markets with high levels of uncertainty, and furthermore from reaching more advanced internationalization stages (Westhead et al., 2001 & 2002).

- Knowledge about foreign markets

Small companies usually have limited knowledge about and experience with foreign markets. This gap prevents many SMEs from early international expansion. That is why they often start with export, as at this stage country background knowledge is required. But after the company has entered a market via export, it can gain valuable experience that can be exploited for more advanced internationalization strategies in the same market, or stimulate the company to expand to further markets (Miessgang, 2014).

- Workforce

One of the crucial success factors in any business is professional workforce. Finding excellent team to support business operations in a foreign market may pose a significant challenge, due to different factors. For instance, different levels of education and practice-oriented training can result in decrease in quality. In this case, a company engages expatriates that should bring different cultures and levels of expertise closer together, while locals are responsible for establishing useful contacts and partnerships in the host market (Miessgang, 2014).

Nevertheless in order to compensate for their weaknesses, SMEs can utilize their specific competitive advantages (Pleitner et al., 2014; Buckley, 1998). Some of them may include flexibility and focus on niche markets.

3. Machinery and automation engineering industry in Austria

Mechanical engineering¹⁵ is the branch of engineering that involves the design, construction and operation of machinery. The field of mechanical engineering includes many subdisciplines such as mechanics, mechatronics and robotics, design and drafting, and more. Often the concepts of those sub-branches are based on the synergies of multiple disciplines, which gives them interdisciplinary status.

A large focus in mechatronics and robotics is placed on automation technologies. Automation or automatic control implies the use of control systems to operate equipment, machinery and various processes to reduce human intervention (Rifkin, 1995). The processes with the highest degree of automation do not involve any human interaction, and are thus fully automated.

As the world is entering the Fourth Industrial Revolution (Schwab, 2016) which implies the development of a wide range of new technologies that utilize synergies of physical, digital and biological concepts and impact all disciplines, economies and industries, particularly automation technology opens many opportunities for the manufacturers.

Automated processes allow companies to increase productivity and improve quality by increasing accuracy and precision and reducing negative consequences of the human factor. Moreover, they help to increase robustness of processes and save costs, time, energy and material.

3.1 Trends and growth potential in Austria's machinery engineering sector

With the population of 8.6 million people, Austria has consistently been ranked among the most prosperous countries worldwide, according to the Legatum Prosperity Index¹⁶. The country also showed best performance in the Entrepreneurship and Opportunity index, where it ranked 7th. Moreover, it

¹⁵ Collins English Dictionary, "Mechanical Engineering," <http://www.collinsdictionary.com/dictionary/english/mechanical-engineering> [02.08.2016]

¹⁶ Legatum Prosperity Index (2015), <http://www.prosperity.com/#!/ranking> [25.07.2016].

continuously shows good results in R&D expenditure¹⁷ with 2.6 per cent of the GDP, whereas the world average lies at 0.9 per cent. This fact allows it to be named among the most innovative nations in the world.

Based on the economic sectors¹⁸, industry (27.9 per cent) is the second largest contributor to the country's GDP after services (70.7 per cent). Austria's main industries include construction, machinery engineering, vehicles and parts, food, metals, chemicals, lumber, and tourism.

The country has earned a solid reputation¹⁹ in machinery engineering and industrial equipment manufacturing, as well as in industrial plant engineering. Thus, the machinery industry remains Austria's largest industrial employer with approximately 77,500 employees. In 2014, its turnover²⁰ was 21 billion EUR and it contributed 14 per cent to the revenue of the industry sector, which was 3 per cent more than the average EU-27 rate of 11 per cent.

Machinery sector can be considered a driving force of Austrian economy, as it has one of the largest sales volumes in the country. From the machinery produced in the country, almost two thirds is exported. In 2015, machinery export share of Austria's total international trade was 23.6 per cent, which makes it one of the top export articles.

The success in this sector relies on several factors. Firstly, it is due to Austria's highly qualified labor force that ensures excellent product quality and boasts high productivity. The country's skilled employees rank among the best in the world due Austria's excellent technical practice-oriented education that prepares highly qualified specialists and close cooperation between businesses and educational institutions that offers a myriad of internship opportunities. Thus the excellent quality of goods compensates for relatively non-competitive high prices.

¹⁷ Legatum Prosperity Index (2015), <http://www.prosperity.com/#!/country/AUT> [25.07.2016]

¹⁸ CIA Factbook (2016): Austria, <https://www.cia.gov/library/publications/the-world-factbook/geos/au.html> [25.07.2016]

¹⁹ Advantage Austria, <http://www.advantageaustria.org/international/zentral/business-guide-oesterreich/importieren-aus-oesterreich/branchen/maschinen-und-anlagenbau/index.en.html> [27.07.2016]

²⁰ Wolf, G. (2014): Maschinenbau. Branchenbericht: Bank Austria Economics & Market Analysis Austria. UniCredit Bank Austria AG, p.3

Apart from that, Austria's machinery engineering industry is considered among the most innovative ones in Europe due to its continuous involvement in R&D projects and large investments in innovation development. All this secures high demand for the "made in Austria" goods. Mechanical engineering industry is accounted for 12 per cent of all investments in R&D in Austria's business sector²¹. Among the European countries, only Germany remains ahead of Austria with regard to innovations in machinery engineering.

Moreover, Austria focuses its expertise on niche markets. It develops cutting-edge customized machines that distinguish Austrian manufacturers with their highly innovative and flexible approaches in engineering.

Nevertheless, the industry has been affected by the global economic slowdown, increased investment reluctance and consumer fatigue in 2011-2012 when it saw only moderate output growth of less than one per cent. This trend has been intensified by the geopolitical crises from 2014 onwards that have had adverse effects both on Austria's economic growth as well as on the economies of Austria's export markets lowering export volumes to those countries, for instance to Russia. The slowdown did not come to a halt even in 2015; however it is expected that 2016 will show signs of increasing economic growth, as the Austrian Institute for Economic Research (WIFO) forecasts that GDP growth will increase from 0.5 per cent in 2015 to 1.3 per cent in 2016²², although it is still unclear how pending Brexit may affect these forecasts.

However despite the fragile economic conditions, mechanical engineering sector has stayed strong throughout the crises, outperforming all other industries²³. This has been reflected by the stable export rate of Austrian machinery. Around 80 per cent of the revenue in this sector comes from export compared to 55 per cent on average in the industry²⁴. This

²¹ Wolf, G. (2014): Maschinenbau. Branchenbericht: Bank Austria Economics & Market Analysis Austria. UniCredit Bank Austria AG, p.13

²² Österreichs Maschinenbau und Anlagenbau 2015, <http://oesterreich.ahk.de/news/einzelansicht/artikel/oesterreichs-maschinenbau-und-anlagenbau-2015/?cHash=2f4c3108907422be6bd29b2a39ad4bb8> [03.08.2016]

²³ Pudschedl, W. (2012): Austria: Industry Driving Growth... currently under pressures but well positioned for the future. http://www.bankaustria.at/files/Fokus_PudWolf_04-12_e.pdf [03.08.2016]

²⁴ Wolf, G. (2014): Maschinenbau. Branchenbericht: Bank Austria Economics & Market Analysis Austria. UniCredit Bank Austria AG, p.5

reaffirms the sound competitiveness of Austrian machine engineering in the international market.

3.2 ProAutomation GmbH

3.2.1 Company profile

ProAutomation GmbH is a limited liability company founded in 2010 with headquarters in Vienna, Austria. The company specializes in automation technology solutions offered for different types of industries.

During its six years of operation, the company has implemented a number of process automation projects in the automotive, electronics, food, metal, pharmaceutical and recycling industries. Apart from that, the company has developed a very strong focus on R&D. Its annual rate of investment in R&D has been 25 per cent. Over the years, it has secured strong cooperation with the leading Austrian and European research institutes, such as Fraunhofer and Vienna University of Technology (TU Wien), and successfully implemented many research projects independently and in partnership with these renowned research institutions. As a part of a number of EU-wide research projects, ProAutomation has earned a solid reputation of an innovative research company and advanced automation solution developer.

The company aims at providing comprehensive innovative solutions that integrate complex robotic, control and quality concepts with advanced image processing technology. The developed systems enhance process efficiency and allow manufacturers to simplify their production processes, while increasing their flexibility and productivity²⁵.

Today the company employs 14 people, two thirds of whom are software developers and mechanical and electrical engineers. Over the years, its size varied between 10 and 20 people. After the management reorganization in late 2015, ProAutomation is currently led by its original founder who is also the sole owner of the company.

²⁵ ProAutomation GmbH corporate website, <http://proautomation.at/en/content/proautomation> [05.07.2016]

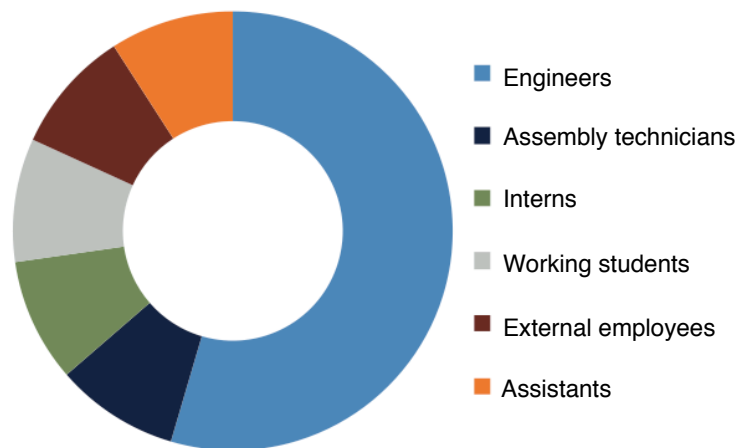


Figure 5 ProAutomation team. Source: ProAutomation GmbH

In the past two years, the turnover of the company has only slightly passed the EUR 1.5 million mark. It had been growing steadily in the first years of operation until it slatted in 2015 due to the slowdown in the industry and subsequent reduction in the number of orders.

In late 2014-2015, the company went though its first significant crisis ignited by conflicting management style and technological challenges that eventually led to the aforementioned management reorganization and team restructuring. On top of that, the overall economic slowdown in the Austrian market and in the automation sector in particular has decelerated company's growth. Thus, apart from the internal challenges, this crisis has revealed that the size of the Austrian market is comparatively small for this type of business, and it is becoming increasingly difficult year by year to grow and expand the customer base.

This can be explained by the fact that, first of all, the frequency of renewing automated systems is low. On average, a robot cell or a production line can last for a minimum of 10 years. Consequently, only maintenance and minor add-ons may be required over this period of time. Another factor is market saturation driven by existing competition. There are numerous automation companies offering similar products and services. But the biggest hindrance is the competition from the large, well-established market players, such as ABB, Rockwell, and Haas Group to name a few.

Due to the instability in demand in the national market, the company naturally started to seek opportunities in foreign markets. It has had a number

of projects in the European countries (Germany, the Netherlands, Czech Republic and Slovakia) and former Soviet states (Belarus). However, the company is eager to explore emerging markets with particular preference for Russia.

3.2.2 Company establishment and customer acquisition

In its early days the company relied heavily on cold sales, or the so-called “cold calling”, i.e. contacting company representatives that have not had any prior contact with the company before and most likely have not even heard of it. Thus, it was necessary to introduce the company and explain what services it offered. Naturally, without a solid record of successful reference projects it was difficult to solicit projects from reputable companies.

However, due to the fact that ProAutomation chose the right time of entering the automation market in Austria, this tactic proved more effective than anyone expected. Approximately 30 per cent of customer acquisition was successful through cold calling, which is a rather high rate for a newcomer company in the industry.

This can be explained by the fact that at that time, in 2010-2011, there were not many small companies that developed cutting-edge comprehensive solutions in a vast range of fields (from food production to automotive industry and packaging), offering high level of flexibility and excellent customer service.

Nevertheless, due to a missing track record, the company had to take on only small projects in the first year of operation to establish itself on the market. On the other hand, the company itself did not have enough resources to finance large projects. Therefore, its turnover in the first year did not exceed EUR 100,000.

However starting from the second year, ProAutomation could already rely more on “warm contacts” and referrals. A significant amount of customer traffic in the earlier days was brought through one of company’s advisors who had a vast network among research institutions and also industry players. In the second year the company more than tripled its turnover (see Table 2).

Table 2 ProAutomation Financial Data

Year		2010	2011	2012	2013	2014	2015
Turnover	Thousand EUR	>50	>100	>500	>1,000	>1,500	>1,500
Export rate	%	31,7%	48,3%	2,3%	10%	30%	20%
Operating result	Thousand EUR	-10	>100	>200	>200	>200	>50

Source: ProAutomation GmbH

In 2013-2014, ProAutomation went through a period of boom in the industry and had to handle an ever-increasing number of enquiries and subsequent projects. This was the time when the company started investing heavily in the marketing. It employed such inbound marketing strategies as content marketing, having created an appealing website as the first point of contact for potential customers. Despite the fact that it is one of the first priorities for any company when starting a business, in the Austrian market it is a rare case when a mechanical-engineering firm has a professional and appealing website with sufficient amount of information, according to the collected customers' feedback.

Additionally, the company has implemented search engine optimization techniques to ensure that the relevant information about the company appears among the top search results for the relevant enquiries. This has also proved successful, as many potential customers from as distant markets as the USA name search result as the way of learning about the company and its services.

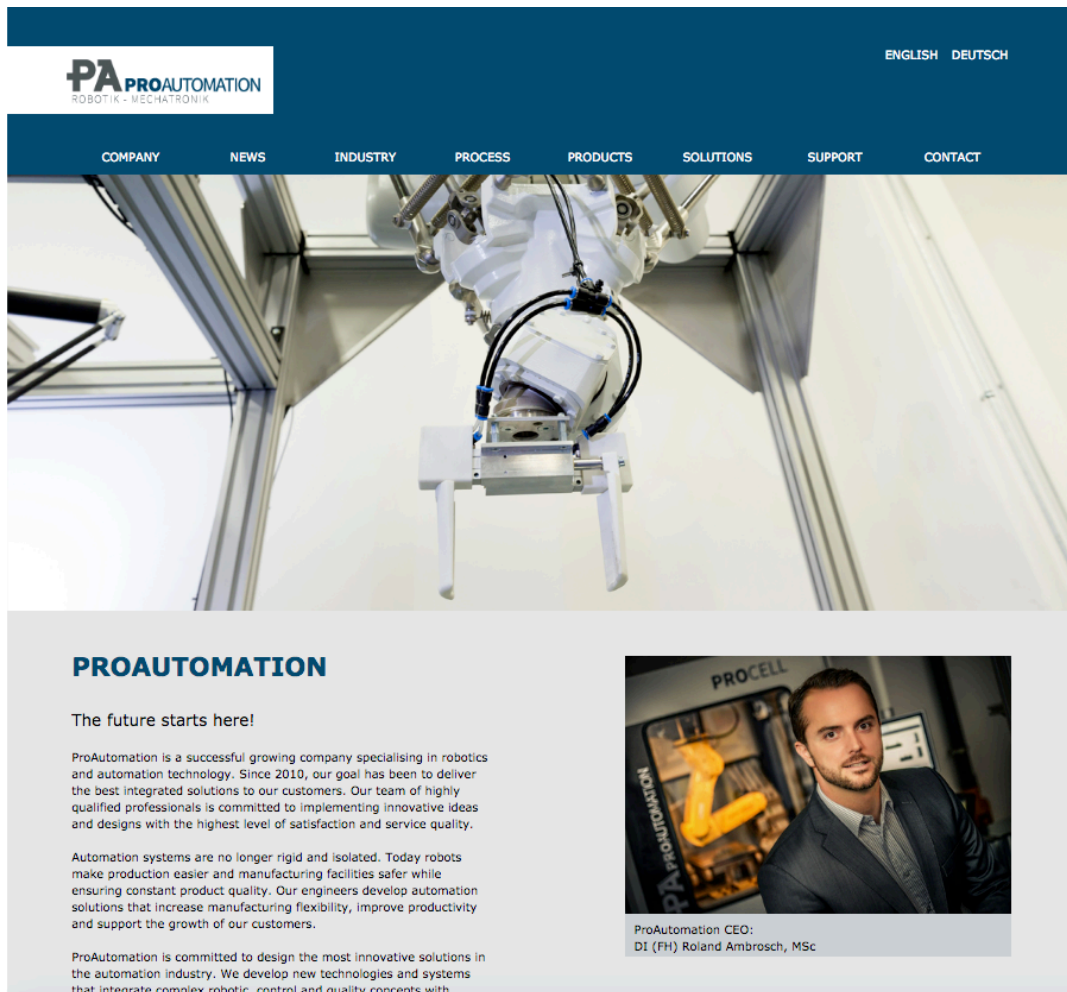


Figure 6 ProAutomation homepage. Source: www.proautomation.at

To reach a larger audience, ProAutomation is planning to develop an online shop that would offer its standard robot cells with certain configurations. The offer will extend to leasing to make financing options more attractive. This step is perceived to generate larger turnover through its simplicity and convenience for customers.

Moreover, ProAutomation polished its newsletter content and became more active in the social media, creating appealing up-to-date content for its existing and potential customers. Currently the company is active in the two major professional networks, i.e. Xing²⁶ and LinkedIn, as well as on Facebook, a social networking platform most widely used in the Western countries, and YouTube, where it created a channel with videos demonstrating its recent developments.

²⁶ Xing is an online platform for professionals, especially popular in the German speaking countries.

Apart from that, the company continued sponsoring social events, such as the annual Ball of Mechatronics, Automation and Robotics in Vienna (Ball der Mechatronic), and participating in different professional events, such as Crescendo business event, where it was nominated as the most innovative company two years in a row. Organized by the Austrian Economic Chamber, such events draw much publicity and serve as an excellent platform to expand professional network and get in touch with potential clients.

As Table 3 illustrates, the biggest impact on raising awareness and generating enquiries and subsequently signed contracts has been created by PR activities (mostly cooperation with research institutions) and participation in trade fairs. Therefore ProAutomation especially values participation in trade fairs in the context of entering foreign markets.

Table 3 Employed marketing strategies

Marketing strategy	Impact on generated awareness	Impact on generated enquiries	Impact on generated orders
Website	high	low	low
Newsletter	high	medium	medium
Search engine optimization	medium	low	low
Social media (Facebook, YouTube, Xing, LinkedIn)	high	medium	low
Sponsoring	low	low	low
PR activities (e.g. cooperation with universities and	high	high	high

research institutions (lectures, seminars, job fairs, etc.), Crescendo Business Award, etc.)			
Interviews and publications in professional magazines	high	medium	low
Trade shows	high	high	high
Online shop*	n/a		
* planned			

Source: ProAutomation GmbH

Due to successful marketing coupled with the overall boom in the industry, which brought in a significantly larger number of enquiries, the management was overwhelmed with a rapid increase in the amount of projects and had to source additional workforce. Consequently, it employed ever more engineers to complete the tasks. However, as the result showed in the long run, it was a period of a too fast growth that was followed by a swelling protracted slowdown in the industry and hence overcapacities in the company that contributed to its later financial struggles.

In the long term, the company had employed much unneeded workforce waiting for the number of projects to pick up again after the unforeseen boom. However, due to a combination of both national and international economic and industry-specific factors, as well as following economic and geopolitical crises, the demand in the industry had slowed for a longer period of time and this resulted in unnecessarily high fixed costs for the company.

This experience has shown that a better strategy is to have a core team of indispensable experts, while outsource certain tasks to external specialists, should the need in them occur. This is the strategy that the company is committed to today and plans to follow in the future.

3.2.3 Company portfolio

As the company specializes in developing comprehensive solutions to automate production processes, mainly its systems are intended to substitute or decrease human participation in various manufacturing tasks. The activities of ProAutomation rely heavily on the Industry 4.0 concepts, namely the goal to provide manufacturers with more precise and reliable systems than manual labor. Thus before offering machines in other countries, it should be considered whether it is sensible to substitute human labor there with automated processes in the context of the existing salary levels. For instance, China has for a long time been the center of global manufacturing due to the low wages of factory workers. Therefore there was no need to change the system to save costs because they were low enough.

Russia has a similar situation particularly with regard to factory workers' wages. According to the Federal States Statistics Service²⁷, in 2016 average gross salary for workers in manufacturing officially amounts to 21,533 RUB or 295 EUR²⁸. Unofficially, this figure is often much lower, especially outside the European part of Russia. This is significantly lower than wages in the western countries. Therefore, the need to substitute manual labor is not that pressing in countries like Russia or China.

With this in mind, the company should analyze its portfolio and determine what products can be required in the market of choice. Despite the fact that expensive machines that substitute manual labor and consequently save high accrued costs in the long run may not be in high demand in Russia in particular, especially in the situation of a fragile economic situation in the country, ProAutomation can spark interest among potential Russian clients by the appealingly high quality of its machines. On the other hand, in emerging

²⁷ Federal State Statistics Service (2014): Accrued average monthly nominal wages of employees of organizations by economic activity, http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/en/main/ [20.08.2016]

²⁸ Exchange rate: 1 EUR = 72.87 RUB (Sept 2016)

economies, and particularly in Russia, large value is placed on having an edge over competition and having latest advanced technologies that distinguish them from other Russian companies. In this context, new systems developed by ProAutomation especially for the baker/confectionary industry that boast unique technology solutions and can to put the owner of this system above the competition has the potential to be well accepted in the market.

Currently ProAutomation focuses on the following core areas of operation:

1. Assembly

ProAutomation has developed a range of assembly systems that are mainly designed for the automotive industry and include processes such as assembly of LED modules for autos, gluing of LED components, screwing of components, inspection for quality and more. ProAutomation focuses on processes that require high precision and process safety. Its assembly systems eliminate laborious changeover procedures and ensure excellent quality of high-speed production.

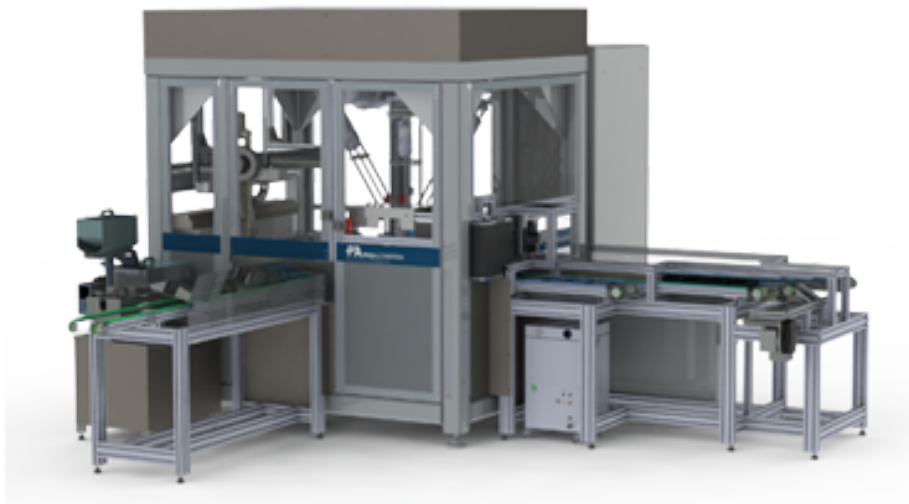


Figure 7 ProCheck system for transmission controllers assembly. Source: ProAutomation GmbH

These systems mainly serve the purpose to substitute manual workers. ProAutomation plans to focus more on the food industry, it does not see the delivery of these lines to the Russian market sensible, as its current target

client group is German car manufacturers that delivery already fully assembled goods to Russia.

2. Disassembly

ProAutomation disassembly systems are designed mainly for the electronics industry. The focus lies on mobile phone-, tablet-, PC-disassembly and disassembly of other electronic devices.

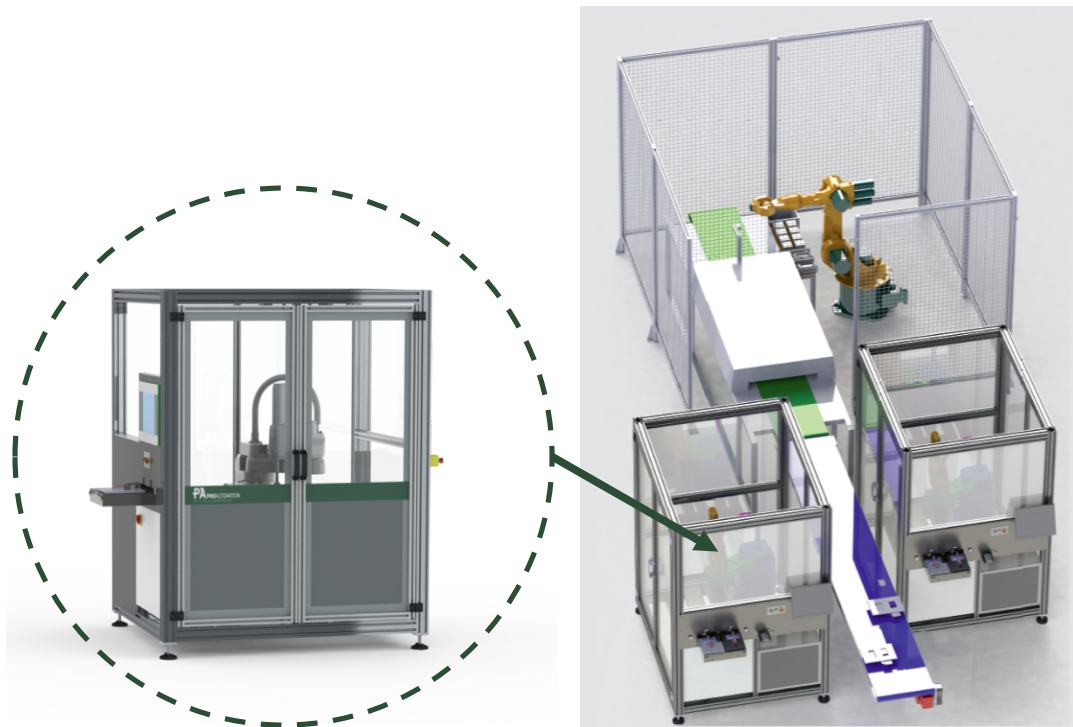


Figure 8 ProMobile T5 mobile phone recycling system. Source: ProAutomation GmbH

In the last two years this area of operation has been the key research domain, involving cooperation with one of the biggest European research institution, Fraunhofer, and large EU investment into this project. In cooperation with a number of EU high-tech companies and research institutions, ProAutomation has been working on the EU-wide project that is aimed at developing a comprehensive solution for electronics recycling within the Horizon 2020²⁹ framework.

Currently, the recycling line is in its development stage, but Europe is planned as the initial market for the rollout. In this context, Russian market is deemed not ready yet for this concept, therefore before its potential

²⁹ Horizon 2020 is the EU Framework Programme for Research and Innovation. Programme's website: <https://ec.europa.eu/programmes/horizon2020/>

introduction to the Russian market, an extensive promotion campaign has to be initiated. Therefore, at the moment the company does not see it reasonable to focus on introducing recycling projects in Russia.

3. Packaging

Pro Automation's packaging systems are mainly designed for the food industry, particularly for the bakeries and confectionary manufacturers. The specifics of this industry imply that packaging of the fragile backed products requires delicate handling and is oftentimes done by hand. This requires much manual labor, which results in increased labor costs. In countries like Russia, where labor costs for this type of work are typically low, it can be difficult to persuade manufacturers to switch to the automated packaging processes, unlike in the western countries.

The experience of the interviewed foreign companies operating in the Russian market proves the reluctance of Russian manufacturers to substitute cheap labor force in favor of automated production, unless these systems can prove their superior quality. Therefore, ProAutomation sees this area as a potential trade point in the future, but not its initial selling product in Russia.

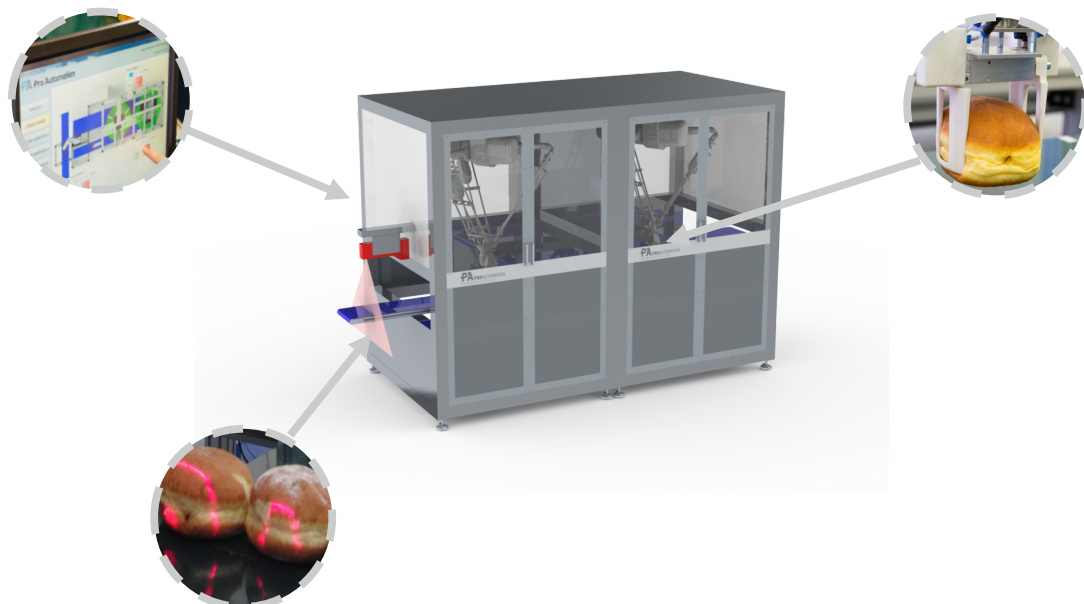


Figure 9 ProPack 2000 packaging system. Source: ProAutomation GmbH

4. Waterjet technology

Waterjet system is the latest patented development of Pro Automation. The system is designed for the bakery industry and is intended to automate the process of dough scorching in different patterns. This is a unique system that allows for the fast, precise realization of most sophisticated patterns on various dough pieces. Until this system was developed, it was not possible to perform this procedure automatically; it had to be performed manually. The system was patented in 2015 and is already sold in Germany.

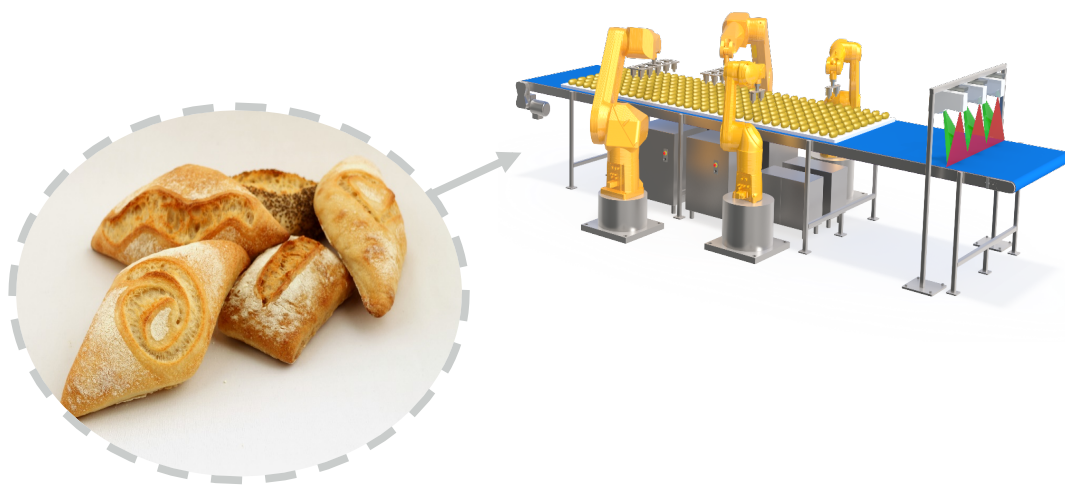


Figure 10 Pro Waterjet system. Source: ProAutomation GmbH

Waterjet system is also intended to substitute manual labor. However its USP lies in its uniqueness. The system has no analogues in the Russian market; hence it is able to give an edge to certain bakeries over competition.

In the future, ProAutomation is planning to sell this system worldwide. Therefore, if the company enters the Russian market, this is the product that it will primarily promote.

5. Meat processing factory automation

So far, ProAutomation has had only limited experience in the meat processing industry. However, the expertise gained from projects in adjacent areas and the know-how developed in the company, allows it to design any

required system for complete process automation in this field. Particularly valuable is ProAutomation's experience in developing hygienic systems that guarantee safe operation.

In the context of entering the Russian market, the choice has been made in favor of this industry, as the ProAutomation has been contacted by an Austrian company that belongs to the voran® holding and has been active in the Russian market. The company is searching for partners to fully automate meat production and processing factories in Russia. After a series of negotiations, it has been agreed that ProAutomation has sufficient expertise to take on this challenge.

Therefore, ProAutomation intends to enter the Russian market with the two key areas in focus: automation of specific bakery processes and full automation of the meat processing processes.

3.2.4 Company sales statistics

During the six years of operation the amount of proposals has been steadily growing. It has almost quadrupled between 2010 and 2015. One of the biggest challenges with regard to outgoing proposals in the first years was the time-consuming nature of the process, as every proposal required precision in time and cost calculations and technical expertise. This responsibility lay mainly on the CEO of the company, who had to combine this task with other administrative and operating activities. With the additional support for this task, proposal compilation became more efficient; more time became available for follow-up contact with potential customers, which resulted in an increasing number of signed contracts (see Figure 11).

With the growing expertise, the overall success rate has been also growing in the first four years. With the climbing number of contracts and subsequent staff increase that happened too fast for the management to be able to efficiently adjust control mechanisms, the company faced its first oversight crisis that resulted in a considerable drop in the rate of success of completed projects and had a long-term effect on the company's financial situation (see Figure 11). This experience showed that the team required another layer of control, namely a project manager who would oversee operating tasks and lessen the workload for the executives.

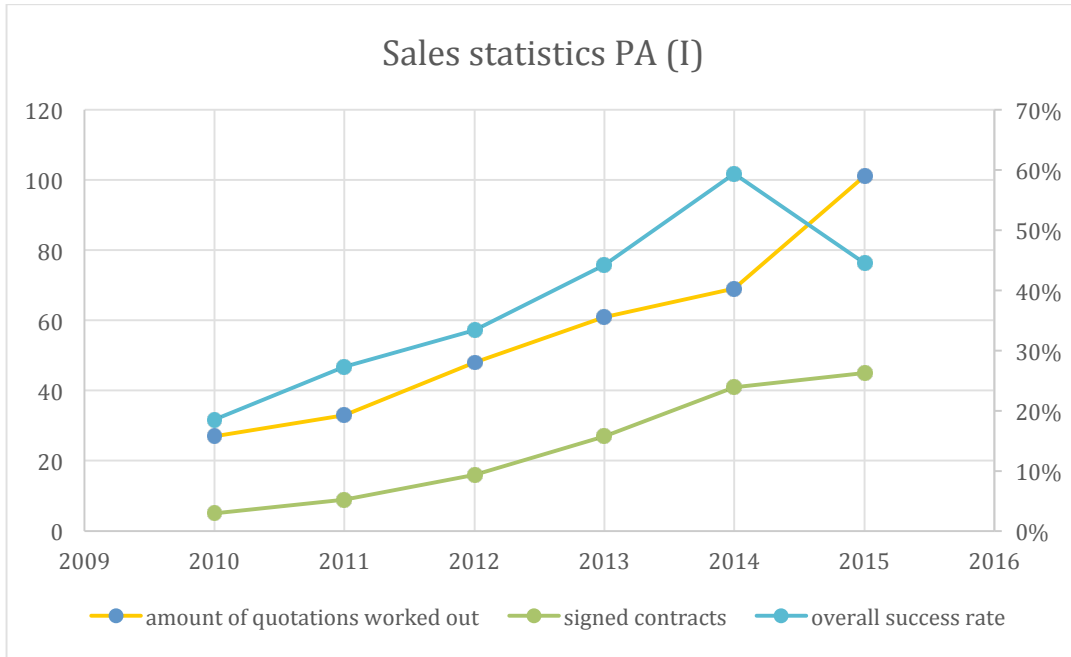


Figure 11 Sales Statistics PA (I). Source: ProAutomation GmbH

With regard to export, despite the low rate of annual export proposals, most of them resulted in signed contracts. The company has exported its systems to Germany, the Netherlands, Slovenia, Czech Republic and Belarus. The overall export success rate has varied over the years, with projects exported to European countries mainly being more successful than, for instance, the project in the former Soviet State Belarus due to a number of challenges from transportation, customs, and communication issues to the lack of proper due diligence investigation that resulted in partially unpaid delivery, as the company went bankrupt (see Figure 12).

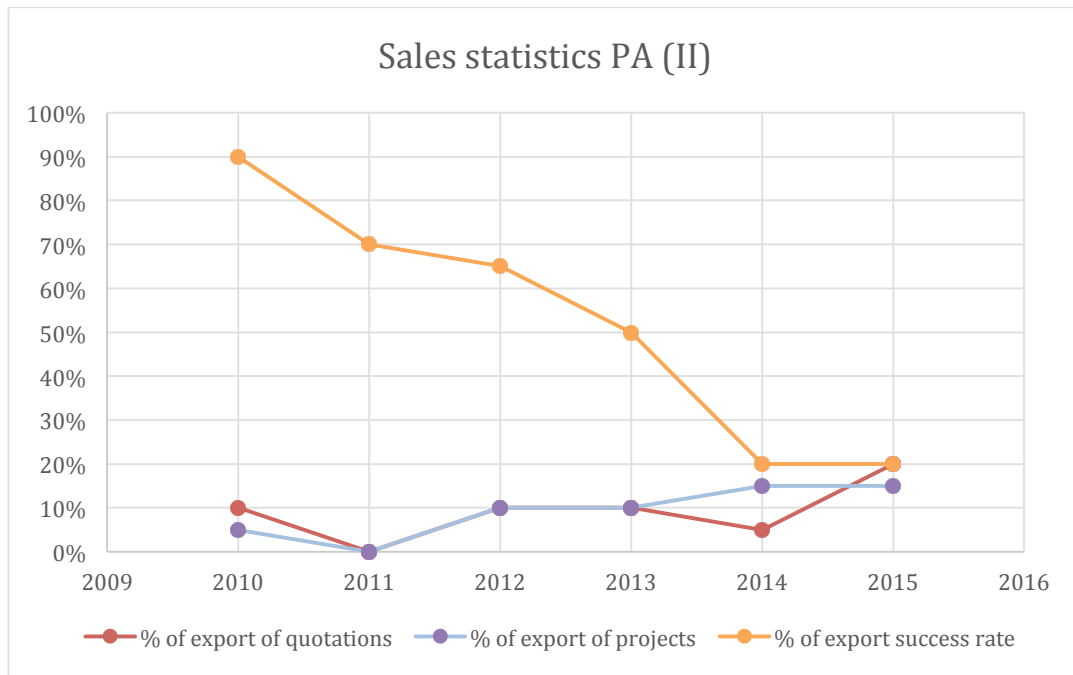


Figure 12 Sales Statistics PA (II). Source: ProAutomation GmbH

3.3 Selected mode of entry into Russia

Russia has always been an interesting market for ProAutomation. In the early days of company's existence it participated as a subcontractor in an international project, curated by Haas Group, which implied installing a food production line in Russia. This experience offered a glimpse into the magnitude of the Russian market and a myriad of opportunities for automation technology providers.

Based on the company's experience, its current standing and all considerations described in Chapter 2.2. ProAutomation has made a decision to elaborate a strategy for international expansion into the Russian market as the next step of its development. The preferable mode of entry is exporting, as it is the most convenient method for a small company with limited resources. At the current stage of development, considering internal financial constraints, the company does not have resources to invest into subsidiaries or other forms of market entry.

This particular mode of entry has been also selected, as ProAutomation wants to focus on two key industries, i.e. food, namely bakery and confectionary, and meat processing, and in both these sectors it has

potential partners that are interested in cooperation with the company. These two particular focus industries have been selected due to the increasing trend toward population growth, urbanization and increasing income of people in developing markets. Therefore, there is an ever-increasing demand for packaged food and drinks and general innovations in the food production and processing. Consequently food manufacturers are striving for constant quality improvement of their products and processes and are willing to invest in new equipment and machinery or modernization thereof. Hence, there is a large potential in the various sectors of the food industry for a company specializing in development of cutting-edge concept for food production and processing machinery.

With regard to the potential partners, Haas Group is the agent ProAutomation can cooperate with in the bakery/confectionary sector to bring its machines on the market. Both companies have past experience of successful cooperation together in the Russian market, where ProAutomation was a subcontractor for a food production line installation.

Conversely, in the meat industry the company has recently established a cooperation with voran® holding, an Austrian group that operates worldwide in the machinery sector, manufacturing, plant construction and metal structures, producing and distributing machinery and equipment. The company is particularly interested in satisfying the demand for process automation and excellent quality equipment in the meat processing industry in Russia, offering European machines.

Therefore instead of direct exporting, ProAutomation prefers to rely on strategic partners that have already experience in the market and are familiar with the Russian business culture, norms, standards and regulations, and can advise with regard to other relevant technicalities. In this case, it can capitalize on the experience of its partners by avoiding many difficulties associated with export into Russia such as going through laborious export procedures.

3.4 Interviewed Austrian manufacturers present in the Russian market

Based on the online survey carried out for this research, most companies in the mechanical engineering industry both SMEs (turnover up to EUR 6 million) and big corporations (turnover above EUR 5 billion) that have entered the Russian market chose export as their entry mode. One respondent, a multinational, named establishing a subsidiary as its entry mode. This can be explained by its large size and vast experience in doing business worldwide.

With regard to competition, the acquired experience showed that despite existing competition, the right attitude of the foreign partners was more decisive than price. The desire to establish proper business relationships distinguished particular foreign companies as trustworthy partners. Moreover, service played an important role in soliciting business from Russian customers who expected flexibility, excellent expertise and willingness to solve problems from their foreign business partners.

On the other hand, currently the respondents see that there is still enough space for more foreign players on the market. It is still undersaturated; therefore foreign companies that are eager to fill the existing gap offering their expertise and high quality products can find their niche in Russia.

All respondents agreed that it is easier to enter the Russian market for larger companies, rather than for SMEs. This is explained by their advantage with regard to acquired international experience and sufficient resources that can be addressed to solve country-specific issues. That is why larger Austrian/multinational corporations move faster into the Russian market.

Among the biggest challenges, most respondents named the language barrier, stating that is virtually impossible to conduct business without any knowledge of Russian or at least a decent interpreter. Especially in the remote areas where industrial production is usually located, is it very difficult to get around only with the English language.

Moreover, transportation, customs regulations and bureaucracy posed considerable challenges in the smooth project implementation. It usually cost

a lot of time, patience and money to comply with all Russian customs requirements and have exported goods cleared.

Business ethics and different mentality was named among other challenges interviewed companies faced in Russia. It is not always easy to rely on the Russian partners at all levels of operation, from the management level to the blue-collar worker level. It was difficult for the Russian counterparts to accept the directives given by the foreign partners with regard to the requirements necessary to install a machine, the proper operation methods, required working conditions and more. Moreover, from the management level, the process was regularly hindered due to ever-increasing demands and expectations, often not stipulated in the contract and unwillingness to accept the final work, dragging on time and expecting to win extra benefits.

Table 4 Top five challenges in doing business in Russia

	Challenge
1	Language
2	Business ethics and mentality of workers
3	Customs procedures
4	Bureaucracy
5	Transportation

Source: Conducted online survey

In light of the current difficult situation particularly in the Russian economy, a matter of relevance is the degree to which the companies that already operate in the Russian market have been affected by the economic crisis. The answers varied from not being affected at all (no negative impact) for the companies that do not have any running projects in Russia to claiming to have experienced a slight to moderate negative impact by having fewer orders from Russia to a complete halt in business operations in some sectors (severe impact). Another concern expressed was that due to the EU sanctions, some companies find it difficult to sell their machinery and equipment to Russia due to the restrictions on certain equipment.

Despite all the challenges associated with operating in the Russian market in general and the current difficult economic and political climate in the country, all respondents remain confident that the situation will improve in the not so distant future for the international trade and that the demand in Russia will pick up again. This is also supported by the claim that all business conducted by the interviewed companies in Russia can be generally characterized as successful.

Finally, with regard to the future prospects, most companies choose a more moderate approach by deciding to maintain their current presence without expanding any further, while others have a bolder outlook, planning to expand their business operations in Russia, proceeding to a more advanced mode of operation, namely subsidiary or joint venture. But not a single company is planning to retreat from the Russian market despite the current market fluctuations and country's fragile economic situation.

4. Business environment in Russia

4.1 Background information

As the largest country in the world with 142 million consumers who have a myriad of unmet needs, Russia remains an attractive market for foreign businesses. Its immense potential still remains largely untapped partly due to the frequent economic challenges the country faces and consequent wariness of foreign investors, and partly due to country specific challenges, e.g. underdeveloped infrastructure, bureaucracy and overregulation.

Table 5 Russia: Key facts

Russia: key facts, 2015 ³⁰	
Area	17 million sq. km
Population	142 million
Official language	Russian
Time zones	11
GDP (in PPP terms)	\$3.718 trillion (7 th in the world)
GDP per capita (PPP)	\$25,400 (73 rd worldwide)
GDP real growth rate	-3.7%
Industrial production growth rate	-3.5%
Cities with a population of over 1 million (2016) ³¹	15: Moscow, Saint Petersburg, Novosibirsk, Yekaterinburg, Nizhny Novgorod, Samara, Kazan, Omsk Chelyabinsk, Rostov-on-Don, Ufa, Volgograd, Perm, Krasnoyarsk and Voronezh

Source: CIA Factbook

³⁰ CIA Factbook (2016): Russia, <https://www.cia.gov/library/publications/the-world-factbook/geos/rs.html> [25.07.2016]

³¹ Statdata (2016): Russia's largest cities, <http://www.statdata.ru/goroda-millionniki-rossii-ponaseleniu> [25.07.2016]

4.1.1 Main challenges of doing business in Russia

When assessing feasibility of entering a foreign market, it is necessary to perform a thorough analysis of the key areas that can affect a company's successful performance in this market. To this end, several analytical instruments can be used such as CAGE or PEST. For the purpose of this study, a combination of both has been used. Thus, the following framework to describe the Russian market has been applied:

CAGE		PEST
C-ultural	=	S-ocial
A-administrative	=	P-olitical
G-eographical		
E-conomic	=	E-conomic, T-echnological

Among the largest challenges of doing business in Russia, the following ones shall be mentioned³²:

1. Vast territory (G): It is not easy to do business in a market that covers such a large territory. Firstly, logistically it is difficult to reach some areas due to insufficient infrastructure. Secondly, communication with business partners becomes a challenge in itself, as the country has 11 time zones that one has to adjust to.
2. Administrative issues (A+P): Overregulation, rampant corruption spurred by pervasive red tape, burdensome bureaucratic procedures for obtaining necessary permissions to do business in the country and lack of transparency along with inadequate rule of law and IPR protection are some of the main reasons that prevent many foreign companies from entering Russian market.
3. Language and training (C+S): Despite the fact that Russia boasts one of the largest number of people with higher education the world, it still lags behind when it comes to international competitiveness of its labor force. Many people in Russia, especially outside of the largest cities,

³² The International Trade Administration, U.S. Department of Commerce (2016): Doing business in Russia, <http://2016.export.gov/russia/doingbusinessinrussia/index.asp> [25.07.2016]

do not have adequate command of the English language to be able to work in the international environment. Furthermore, the level of training of Russian workforce often does not meet the requirements of international organizations. Moreover, business ethics also oftentimes does not meet international standards. However, this can be combated through sufficient professional training organized by the foreign employer.

4. Economic situation (E+T): A high level of instability marks Russia’s economic environment. The country frequently undergoes economic crises, currently suffering from yet another one sparked by the falling oil prices, weak rouble and the EU sanctions. The fragile economic balance plays one of the main roles in discouraging foreign companies from entering the Russian market. This also results in the country’s losing its competitiveness and lagging behind the developed economies in many areas, including technology and innovation.

Apart from that, not always does Russia perform satisfactory in some of the key business rankings (see Table 6). However on the positive note, Russian government has realized that it has to improve the image of the national market and started working in this direction. For instance, Russia strives to reach 20th place globally in the “Ease of Doing Business” ranking by 2018.

Table 6 International ratings: Russia

Rating	Ranking	Year	Link
Doing business	51/189	2016	http://www.doingbusiness.org/data/explor eeconomies/russia/
	54	2015	
Doing business: Trading across borders	170/189	2016	
Transparenc	119/168	2015	http://www.transparency.org/cpi2015

y International “corruption Perceptions Index”			
Global innovation index	43/128	2016	https://www.globalinnovationindex.org/analysis-indicator

Source: Doing Business Index; Corruption Perceptions Index; Global Innovation Index

4.1.2 The specifics of Russian decision-making

Feelings and emotions have a large influence on the business decisions in Russia³³. Oftentimes Russians make decisions with their heart rather than their head. This applies both to their private as well as professional decisions. Therefore, not always what seems to be rational and sensible to a foreigner may be perceived the same way by a Russian. This can be observed on all levels of decision-making.

Many foreign companies are not prepared to face this mentality especially in business environment. This is also supported by the importance of connections and personal relationships in Russia. Most communication and hence decision-making is done on the “relational” level. This, however, does not necessarily imply heavy alcohol consumption, as was the case several decades ago. In the recent years, there has been a positive shift in attitude towards alcohol and business in Russia.

Nonetheless, where a western company logically chooses a better offer based on superior quality, expertise or technology, Russians may surprise everyone by choosing a venture that has fewer advantages, but is arranged by a good business connection that can return a favor by bringing more business in the future. Often these practices take a more illicit connotation,

³³ Kuskova. E. (2012): Erfolgreicher Markteinstieg in Russland. Chancen, Risiken und Voraussetzungen der sicheren Expansion, https://www.bundesanzeiger-verlag.de/fileadmin/AW-Portal/Dokumente/Themenseiten-Material/Maerkte_Grundlagen/Russland_2.pdf [15.08.2016]

breeding corruption that makes it difficult to stay both well-reputed and competitive in the Russian market at the same time.

Fortunately, with the growing cooperation with the western companies, Russian business players are more often confronted with their clean business practices. This makes a difference in Russian business culture, albeit slowly. There is a realization that in order to be taken seriously in the international business arena and become competitive and successful, higher business conduct standards should be adopted.

4.2 Investment climate in Russia

Investing in Russia offers great potential and promising gains, but is at same time associated with considerable challenges foreign investors should learn how to handle. According to the recent Ernst&Young study³⁴ of the foreign investors' perception of the Russian market, several main concerns have been identified.

Firstly, foreign companies see frequent legislative changes as a deteriorating factor damaging Russia's business climate. Instable policy framework, lack of policy clarifying documentation, unsatisfactory rule of law and overall lack of transparency increases wariness of the foreign companies when it comes to doing business in Russia.

Apart from that, authorities' reluctance to cooperate, rampant red tape and bureaucratic bottlenecks and consequently a very slow decision-making discourage companies from entering the Russian market. In the recent years, there has been only a slight improvement towards a dialog between government and business.

With regard to the overall business climate in the country, foreign investors share the opinion that it has deteriorated over the last two years and is currently unfavorable. According to the survey, 42 per cent of the respondents believe that it will be difficult for Russia to attract foreign investors in the next two years. Nevertheless, almost 40 per cent of the

³⁴ Ernst & Young Valuation and Advisory Services (2015): Investment climate in Russia – Foreign investor perception, E&Y, p.2

respondents plan to maintain their presence in the country and potentially expand their operations³⁵.

Expanding business geographically has gained appeal for foreign companies due to the fact that business climate across regions has improved, as there has recently developed a strong competition among regions that struggle to attract investment and cover budget deficits. Therefore, more and more regions strive to create favorable conditions especially for foreign investors.

Another recent trend is the increasing concerns among foreign companies about the state import substitution campaign that is gaining momentum in the country. This results in the fact that more and more foreign manufacturers are considering increasing local content in their production to stay competitive with the local manufacturers.

Nevertheless despite all the drawbacks and challenges – some old, some more recent, – investors still remain optimistic about Russia's economic potential. For instance, 53 per cent³⁶ of respondents expect to see growth in their industry compared to a quarter who foresee a downward tendency.

One positive trend observed by the foreign investors is concerned with the improving business culture and communication between partners. Despite still existing mutual distrust, Russian partners have become more eager to learn from their foreign counterparts and deliver a better quality that would be up to par with international standards and investors' expectations. It has been difficult to adjust the local mentality to the foreign corporate culture, but through the consistent training Russians' attitude towards compliance with standards set by foreign partners is shifting and they are more readily adapting to the established requirements.

4.3 Austrian-Russian bilateral trade relations

Trade between Russia and Austria has been dynamically developing over the past decades. As of January 2016, Russia was Austria's 15th largest trading partner. Trade volume between Russia and Austria amounted to

³⁵ Ernst & Young Valuation and Advisory Services (2015): Investment climate in Russia – Foreign investor perception, E&Y, p.4

³⁶ Ibidem

Austria's export volume to Russia increased between 2000 and 2008 from EUR 654 million to EUR 2.97 billion respectively, while import volume from Russia increased from EUR 1.2 billion to EUR 2.5 billion in the same period. Continuous growth stumbled in 2009 due to the economic crisis but picked up shortly after. Trade turnover took another tumble in 2014 as a result of the tension between Russia and the EU following the Russian-Ukrainian conflict and subsequent sanctions.

Table 7 Bilateral trade dynamics³⁷

	2000	2008	2015
Export to Russia	€654 m	€2.97 bn	€1.6 bn (- 40.5% compared to 2014)
Import from Russia	€1.2 bn	€2.5 bn	€1.9 bn (- 1.9% compared to 2014)

Source: Federal Ministry for Europe, Integration and Foreign Affairs

During his meeting with the former Austria president, Vladimir Putin characterized bilateral trade relationships with Austria as highly important for Russia and expressed his regret at the decreased trade turnover by 25 per cent in 2015³⁸ (see Figure 13).

³⁷ Austrian Embassy in Moscow: Austrian-Russian economic relations, <https://www.bmeia.gv.at/ru/oeb-moskau/bilaterale-beziehungen/russische-foederation/wirtschaft/> [20.08.2016]

³⁸ Interfax Information Services (2016): Russian-Austrian relations developing, of great significance to Russia; trade has dropped by 25% - Putin, <http://www.interfax.com/newsinf.asp?id=664229> [17.08.2016]

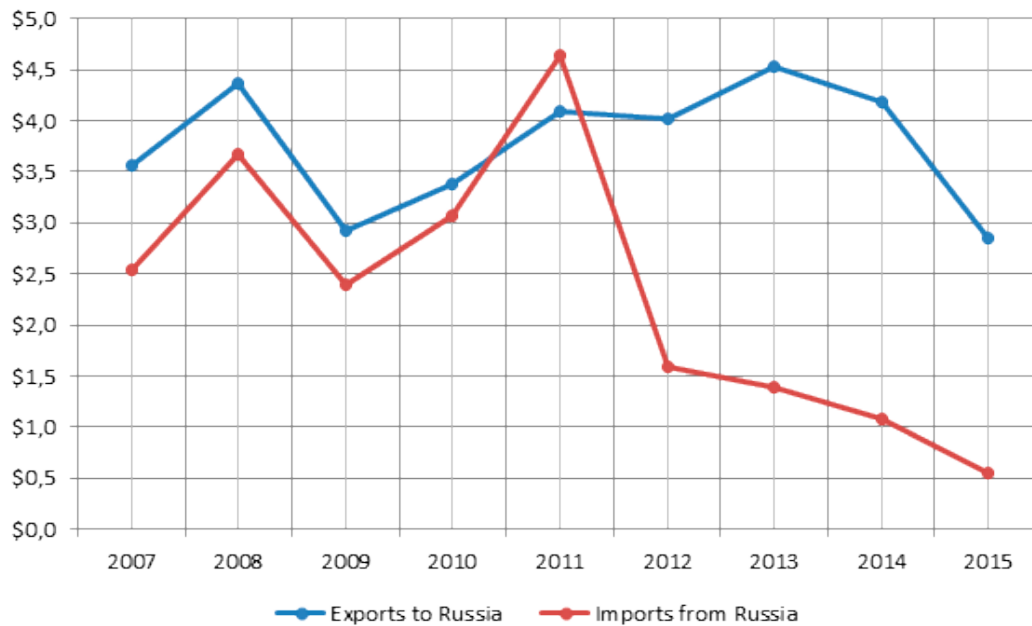


Figure 13 Austrian-Russian bilateral trade turnover (2007-2015), billion USD³⁹. Source: ITC Trade Map

Among Austrian imports from Russia, oil and gas prevail with 85 per cent⁴⁰ of all imports. It exports to Russia mainly machinery and equipment, pharmaceutical products, electrical and electronic equipment and vehicles (see Figure 14)⁴¹.

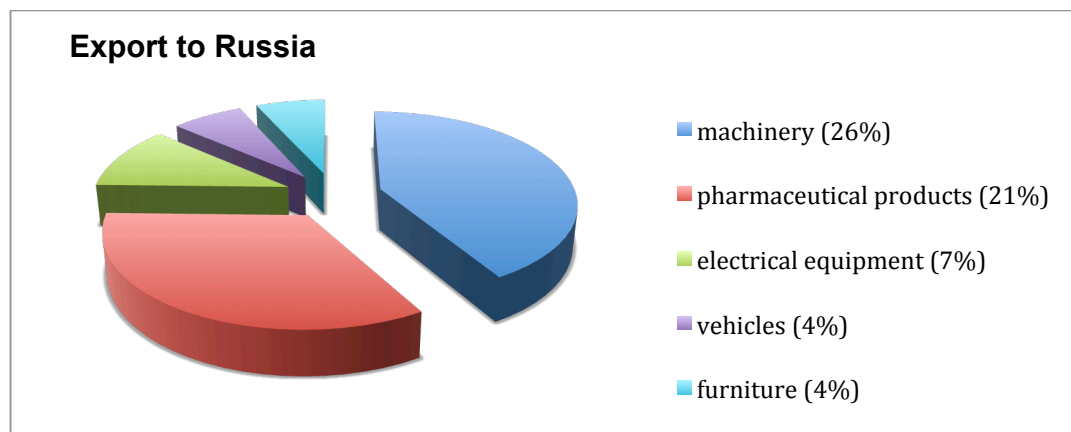


Figure 14 Export to Russia. Source: ITC Trade Map

³⁹ Russian Exports National Information Portal (2016): Austrian-Russian Bilateral Trade in 2015, <http://www.rusexporter.com/research/country/detail/4334/> [19.08.2016]

⁴⁰ Austrian Embassy in Moscow: Austrian-Russian economic relations, <https://www.bmeia.gv.at/ru/oeb-moskau/bilaterale-beziehungen/russische-foederation/wirtschaft/> [20.08.2016]

⁴¹ ITC Trade Map (2015): Bilateral trade between Austria and Russia, http://www.trademap.org/Bilateral_TS.aspx [19.08.2016]

There are currently approximately 500 Austrian enterprises in Russia that are active in wood processing and paper industry, machinery manufacturing, automobile industry, construction and finance. Today Austrian investments in the Russian market amount to EUR 6 billion.

4.3.1 Importing into Russia

One of the first stages of internationalization favored especially by SMEs is exporting. Working with Russia, a foreign company should be aware of the Russia's import policies⁴². One should also be aware that there are 28 special economic zones⁴³ in Russia that offer customs benefits. Russian SEZ include 6 industrial and production zones, 5 technology and innovation zones, 14 tourist and recreational zones, and 3 port zones and are located in most developed regions.

When exporting goods to Russia, Russian party usually bears the responsibility for the custom's clearance, all customs payments and compliance with any customs legislation requirements. Since Russia's accession to the WTO, Russia has been continuously working on reducing trade barriers for goods and services and simplification of customs clearance procedures.

In the past years, there has been a trend towards stricter control over the declared customs value. Customs valuation is based on GATT/WTO (General Agreement on Tariffs and Trade / World Trade Organization) principles. Due to the recent decrease in import volumes and subsequent budget deficit, it is feasible that the trend will remain in practice, which in its turn may result in additional audits during customs clearance and increased amount of required paperwork.

Import duties must be paid on most goods. On average, customs duty rates vary between 5 and 15 per cent of their customs value. The import VAT rate for most goods is 18 per cent of their customs value. There are also customs processing fees to be paid for a customs declaration, which vary

⁴² PricewaterhouseCoopers (2015): Doing Business and Investing in the Russian Federation, PWC, p.12

⁴³ Ministry of economic development of the Russian Federation. Integrated foreign economic information portal: Special economic zones in Russia - which and where, <http://www.ved.gov.ru/eng/investing/sez/> [16.07.2016]

between EUR 8 and EUR 470 depending on the customs value of the shipment.

Along with the more traditional import restrictions such as permits and licenses for certain imports and anti-dumping duties on specific goods, new restrictions have been introduced as a result of Russia's countersanctions against some types of imports from EU countries and the United States such as certain foods and agricultural products.

All in all, Russian customs policies have undergone some changes that made the customs process less complicated. Nonetheless, the remaining complexities in administrative procedure and technical regulations are still named among some of the biggest obstacles for foreign companies.

4.3.2 Import substitution in Russia

In the wake of the sanctions on Russia and its countersanctions, the government has turned to a protective approach and introduced an import substitution plan to be implemented between 2016 and 2020. This program encourages domestic production to replace or limit the import of foreign-made goods in the public sector.

The state⁴⁴ plans to spend 2.5 trillion roubles or USD 38 billion to support 2,500 import-substitution projects. The largest focus is on the food industry. However, the program is also promoted for the pharmaceutical and electronics industries.

This initiative naturally causes concerns among foreign market players. The campaign⁴⁵ is based on the Industrial Policy Law that entered into force on 1 July 2015. According to this law, in the competition between foreign and domestic goods preference is given to domestic goods. This can be potentially harmful for foreign companies that do not have their offices in Russia. Hence, some foreign companies have decided to invest in establishing local sites in order to have their products classified as domestically produced. At the moment due to the currency situation, foreign

⁴⁴ Bush, J. (2015): Russia's import-substitution drive will take years - and may be misguided, <http://www.reuters.com/article/us-russia-economy-import-substitution-idUSKCN0RV4W920151001> [20.07.2016]

⁴⁵ Sigle, H. (2016): Import substitution in Russia - General Introduction, <http://www.lexology.com/library/detail.aspx?g=30e6e54c-0281-4b03-b4f1-89022f3f77d6> [21.07.2016]

companies can benefit from lower labor- and business set-up costs and rapidly acquire a larger market share in the situation of market disorientation.

Under these import substitution regulations, goods are considered domestic if they are “fully manufactured or sufficiently processed in Russia. The sufficiency of processing – an abstract wording – is achieved when one of the first four digits of the customs classification code of an imported product is changed after such a product is processed into a final product (formal criterion), or if it has undergone industrial or technical processing leading to a certain percentage of added value in the finished product”⁴⁶. The issuing of a certificate of Russian origin is considered on a case by case basis depending on a particular product. So far, these regulations apply only to the public sector; however, far-reaching implications of this campaign are likely to be felt in the private sector as well.

For the Russian economy it may have certain positive benefits by boosting domestic production and making domestic goods more competitive. However, in the words of Pascal Lamy⁴⁷, the former head of the World Trade Organization, in the long run such protectionist policies contradict the principles of free trade and eventually affect the consumer who will have to pay more.

Nevertheless as the level of economic activity in the EU is low to moderate, for Austria it is sensible to continue exploiting its potential in the foreign trade and consider other promising markets in the emerging economies to mitigate the effects of the economic slowdown in the EU and those markets that struggle with geopolitical challenges.

4.3.3 EU sanctions and their economic impact

European Union and Russia have always had strong trade relationships. Russia is the third biggest trading partner of the EU, while the

⁴⁶ Sigle, H. (2016): Import substitution in Russia - General Introduction, <http://www.lexology.com/library/detail.aspx?g=30e6e54c-0281-4b03-b4f1-89022f3f77d6> [21.07.2016]

⁴⁷ Bush, J. (2015): Russia's import-substitution drive will take years - and may be misguided, <http://www.reuters.com/article/us-russia-economy-import-substitution-idUSKCN0RV4W920151001> [20.07.2016]

EU is Russia's largest trading partner overall accounting for 48 per cent⁴⁸ of the country's foreign trade and its most important foreign investor. EU's main export positions to Russia are machinery, vehicles, chemicals, pharmaceutical and agricultural products.

Trade between Russia and the EU had been steadily increasing until 2008 when the economies suffered from the global economic crisis; it picked up shortly thereafter, but slowed again in 2014 because of the economic crisis that broke out in Russia due to the plummeted oil prices on the one hand, and the sanctions that were imposed on Russia in response to its actions in the Ukraine in the Russia-Ukraine conflict on the other hand. In 2014, total trade value fell from €326 billion to €285 billion⁴⁹.

In 2014, the EU introduced a range of diplomatic and economic sanctions against Russia supported by the United States of America and some other countries, including Canada and Australia. Russia was quick to respond with a range of countersanctions against those nations that supported sanctions against them. The EU sanctions were extended in 2015 until the full fulfillment of the Minsk agreements.

When it comes to the impacts of the EU sanctions on the Russian economy, it is difficult to separate them from the impact of the falling oil prices in the same period of time, as Russia is highly dependent on commodity exports. Nevertheless, both sanctions and countersanctions have also contributed to the recession, as the economy was unprepared to substitute many imports by local products. Certain sectors have been affected stronger than other ones.

In the EU, one sector that was affected strongly by Russian countersanctions has been agriculture. However, some of the negative impacts have been mitigated by finding alternative markets for agro-exports. On balance, the EU has been better prepared to face deterioration in the trade relationships with Russia, managing to find alternative solutions that result in slight to moderate negative impacts on the European businesses.

⁴⁸ European Parliament (2015): Economic impact on the EU of sanctions over Ukraine conflict, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/569020/EPRS_BRI\(2015\)569020_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/569020/EPRS_BRI(2015)569020_EN.pdf) [21.07.2016]

⁴⁹ Ibidem

Thus, the European Commission has reportedly estimated the effects of countersanctions at -0.3 per cent of the EU's GDP in 2014 and -0.4 per cent in 2015, i.e. €40 and €50 billion respectively⁵⁰.

On the other hand, ban on 'dual-use' technology exports to Russia intended for the exploration of oil and gas fields will likely have a negative impact on Russia's key industry in the long term, as much of the equipment used in the oil and gas industry is outdated and requires modernization.

Despite the fact that only a limited number of industries have been damaged by the direct impact of the EU sanctions, the combination thereof and a national economic crisis is likely to have detrimental spill-over effects in many other industries.

In response to the weakening economic situation, Russian government has introduced an import-substitution policy (see Chapter 4.4) to reduce the dependency on foreign goods. This policy is intended to boost local manufacturing and ignite national industry. However despite positive intentions, there are reasonable concerns that in the long run this policy will lead to the loss of market appeal among foreign investors and hence stifled competition in the Russian market.

Overall, the developments started in 2014 have had a considerably negative impact on the business climate in Russia. Fragile confidence of the foreign investors in the Russian market has yet again faltered, causing capital flight from the country. Thus the inflow of FDI to Russia in 2014 plummeted by 70 per cent to USD 21 billion, a record low since 2006⁵¹.

The crisis has once again brought to light all the flaws in the Russian system, from unstable regulation and red tape to overcomplicated business environment. Nevertheless, despite acute concerns among foreign companies engaged in the Russian market, they as before believe in the country's potential and persist in conquering its market with admirable vigor.

⁵⁰ European Parliament (2015): Economic impact on the EU of sanctions over Ukraine conflict, [http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/569020/EPRS_BRI\(2015\)569020_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/569020/EPRS_BRI(2015)569020_EN.pdf) [21.07.2016]

⁵¹ Ernst & Young Valuation and Advisory Services (2015): Investment climate in Russia – Foreign investor perception, E&Y, p.1

4.4 Russian industry of food production, processing and packaging

4.4.1 Russian food industry in the wake of sanctions

According to the representatives of the Austrian Economic Chamber contacted during this study, “food processing industry is very likely to expand remarkably”⁵² in the nearest future due to the fact the Russian government has set its course on becoming strongly independent from imports in various field in the long run. In its endeavor to become self-sufficient, it offers substantial financial support to the agricultural sector and the food industry. Furthermore, local governments strive to attract foreign investors by offering favorable conditions in their regions.

With regard to particular industries that are experiencing higher growth rates, the Russian Ministry of Economic Development and Trade distinguishes meat and poultry industry as well as confectionary and consequently packaging industry among the most promising ones in the Russian market⁵³. For instance, in the meat industry pork and poultry production is predicted to continue to grow steadily in 2016-2018 as these categories are far from reaching their import-substitution potential. Thus, pork production is expected to increase by 12.7 per cent by 2018, whereas meat and poultry production is expected to grow by 17.7 per cent by 2018. Therefore, it is reasonable to enter these industries at the first stage of export into Russia.

In light of increasing activity of the local food manufacturers, there has been an increasing interest in Western-European technologies and expertise. There is a need for cutting-edge equipment and machinery that would help Russian producers meet the demand in the local market and reach the goals towards self-sufficiency set by the Russian government.

Among the factors that hinder successful cooperation with the foreign companies, the on-going roubles crisis plays a significant role. Weak national

⁵² Interview with a representative of Austria’s Foreign Trade Center in Moscow, Russia, 15.07.2016 via email

⁵³ Koltykina, E. (2016): Production volumes in the Russian meat and poultry markets increase every year, <http://meatinfo.ru/blog/rossiyskiy-rinok-myasa-ptitsi-okrilyon-proizvodstvo-540> [15.09.2016]

currency makes Russian businesses become more reluctant to partner with foreign companies.

Nevertheless, despite tense political situation, economic downturn due to low oil prices, weak rouble and recent sanctions and high credit interest rates, investors still see long-term potential in the Russian market, as there is a strong interest in western machines and high-tech materials.

However, they acknowledge that doing business in Russia has become more difficult. One of the largest contributing factors is the difficulty with procuring financing for the projects. Especially small and medium sized companies have been affected by the weak rouble, more stringent requirements for receiving a loan and very high interest rates on borrowings.

4.4.2 Trade fairs in Russia

One way to acquire potential customers in a foreign market is through trade fairs. In some industries customer acquisition process may take several years. Therefore, it is sensible to start collecting information about potential customers and establishing personal contacts early on.

Despite the difficult times Russia has been going through in the recent years, the existing interest and trust in the market is displayed though intense presence of foreign exhibitors at major industrial trade fairs. Foreign manufacturers feel the interest in Russia in the modern equipment and advanced technology offered by western producers. Therefore, they attempt to stay close to potential customers and nurture potential business cooperation, even though many Russian companies struggle to invest in new technology at the moment, preferring to wait until the situation takes a turn for the better. For instance among the German industrial engineering companies, 70 per cent⁵⁴ stated that the Russian crisis had had a serious adverse effect on their business, resulting in less enquiries and contracts and postponed projects. Nevertheless, Russian companies realize that especially in the face of an economic crisis and new government policy towards self-sufficiency they have to stay competitive and invest in modernization to maintain their position on the market and provide alternatives for decline in import. Especially this

⁵⁴ Bortsel, P. (2015): Russia: Foreign presence is appreciated, <http://www.trade-fairs-international.com/tfi-en/international/Foreign-presence-is-appreciated.php> [15.09.2016]

applies to domestic consumer goods industry, the food industry, and the packaging industry where production processes and product quality should be optimized to manage efficient import substitution⁵⁵.

In such situation, trade fairs play an important role. Thus through participating in trade fairs, foreign companies that have had presence in the Russian market before or are interested in entering it in the near future have a chance to demonstrate their support and positive outlook to their potential customers to ensure that business relations remain sound. Moreover, trade fairs provide excellent opportunity for networking and experiences exchange.

The recent trend⁵⁶ has also revealed that there is an increasing demand from the state companies rather than from the private sector. This is another evidence of the government's commitment to boost domestic production.

For foreign manufacturers Russia still remains an interesting market, as especially western quality, i.e. "made in Germany" or "made in Austria", is highly valued. Despite the current decline in sales, western manufacturers can potentially gain advantage from the Russia's ambitions to expand domestic production.

For an Austrian automation company that has a strong focus on food processing and packaging industry, it is recommended to visit or participate in Russia's largest exhibition in the food processing industry, the Agroprod mash trade fair, held in Moscow to gain a profound understanding of the market of food processing machinery. In 2015, the fair was recognized as the best B2B exhibition in Russia in the category "Food industry: equipment and ingredients", winning the first place in four categories, i.e. exhibition space, professional interest, international recognition and market coverage⁵⁷ (see Table 10). Among the key product sectors, particularly interesting for an automation technology company, are equipment and technology for food and

⁵⁵ Interplastica International Trade Fair (2016): High level of interest despite difficult times, http://www.interplastica.de/cipp/md_ww2/custom/pub/content,oid,34208/lang,2/ticket,g_u_e_s_t/~High_level_of_interest_despite_difficult_times.html [20.08.2016]

⁵⁶ Industries support their trade fairs in Russia, http://www.metallurgy-tube-russia.com/cipp/md_ww2/custom/pub/content,oid,34632/lang,2/ticket,g_u_e_s_t/~Industries_support_their_trade_fairs_in_Russia.html [20.08.2016]

⁵⁷ Russian National Exhibition Rating, Agroprod mash, <http://www.exporating.ru/en/> [20.08.2016]

beverage production, automation in food production, packaging equipment and materials to name a few.

Table 8 Agroprod mash facts and figures

Exhibition: Agroprod mash, Moscow, Russia Format: B2B Website: http://www.agroprod mash-expo.ru/en/ Next fair: 10 -14 October 2016	
	2015
Total net exhibition area, sq. m	21,309
Gross total space, sq. m	57,213
Number of national exhibitors	392
Number of foreign exhibitors	321
Total number of exhibitors	713
Number of national visitors	18,790
Number of foreign visitors	1,860
Total number of visitors	20,650
Number of experts	19,000
Number of countries	34

Source: Russian National Exhibition Rating

Another exhibition of interest is Russia’s second largest trade fair, according to the Russian National Exhibition Rating⁵⁸, namely the Dairy & Meat Industry (see Table 9). This international exhibition focuses on the equipment and technologies for livestock farming, dairy and meat production. These sectors gain particular importance in light of the import substitution policy. Here “equipment and technologies for producing and packaging meat and dairy products” category is of particular interest, as ProAutomation GmbH has sufficient expertise working in the meat processing industry.

⁵⁸ Russian National Exhibition Rating, <http://www.exporating.ru/en/> [20.08.2016]

Table 9 Dairy & Meat facts and figures

Exhibition: Dairy & Meat, Moscow, Russia Format: B2B Website: http://www.md-expo.ru/en-GB/ Next fair: 28 February – 3 March 2017	
	2016
Total net exhibition area, sq. m	3,545
Gross total space, sq. m	8,407
Number of national exhibitors	142
Number of foreign exhibitors	80
Total number of exhibitors	222
Number of national visitors	7880
Number of foreign visitors	500
Total number of visitors	8380
Number of experts	6870
Number of countries	23

Source: Russian National Exhibition Rating

As ProAutomation GmbH is keen on bringing its latest unique dough scoring technology⁵⁹ to the international bakery market, another relevant exhibition that deserves attention is Modern Bakery Moscow (see Table 10). The fair covers all product categories in the bakery and confectionary industry from ingredients and ovens to manufacturing facilities and machinery and packaging equipment. It is a unique platform in Russia and CIS region for small to large bakeries, producers, technologists, services and trade⁶⁰.

Table 10 Modern Bakery Moscow facts and figures

Exhibition: Modern Bakery Moscow Format: B2B Website: http://modern-bakery-moscow.ru.messefrankfurt.com/moscow/en/exhibitors/welcome.html

⁵⁹ ProAutomation GmbH, ProWaterJet, <http://proautomation.at/en/news> [19.08.2016]

⁶⁰ Modern Bakery Moscow, <http://modern-bakery-moscow.ru.messefrankfurt.com/moscow/en/exhibitors/profile/product-groups.html> [19.08.2016]

Next fair: 13 - 16 March 2017	
	2016
Gross total space, sq. m	14,978
Number of national exhibitors	122
Number of foreign exhibitors	79
Total number of exhibitors	201
Total number of visitors	14,382
Number of countries (exhibitors)	18

Source: [Russian National Exhibition Rating](#)

One more exhibition that can be of interest for ProAutomation is Upakovka (see Table 11), an international trade fair for processing and packaging machines and machines and equipment for confectionary and bakery sector. This trade show is organized in cooperation with Upak Italia under the new umbrella brand “interpack alliance” for all events in the packaging industry organized by Messe Düsseldorf GmbH.

Table 11 Upakovka facts and figures

Exhibition: Upakovka / Upak Italia Format: B2B Website: www.upakovka-upakitalia.com Next fair: 24 - 27 January 2017	
	2016
Gross total space, sq. m	> 70,000
Total number of exhibitors	828
Total number of visitors	20,900
Number of countries (exhibitors)	38

Source: upakovka-upakitalia.com

Participation in any of these trade shows offers immense opportunities for gaining profound knowledge about the state-of-the-art technology in the Russian food industry and establishing useful business connections. One can obtain an insight into the needs of potential customers and moreover assess existing competition on the market.

4.4.3 Meat industry

The Russian meat and poultry industry has been steadily growing since 2010. The booming growth has been caused by both increased export and more recently the import-substitution campaign that is aimed at achieving state independency from other countries in such industries as food, meat and agroindustry.

For instance, if in 2015 the production of beef products increased 16 per cent, in the first seven months of 2016 it already showed a 9 per cent increase⁶¹. In the first half of 2016, the volume of livestock and poultry produced amounted to 4,438 million tons and increased 6.3 per cent compared to the same period in 2015⁶². Such growth is possible due to extensive government support, namely the agroindustry funding project with a budget of 224 billion roubles or over 3 billion euros. Thus, the manufacturers in this sector are turning to their full capacities to satisfy the existing national demand and close the gap created by the import substitution policies. Apart from that, meat producers extend their product lines to secure their presence in the context of ever-growing competition in the Russian meat market.

The growth rates in kind and in value terms have been increasing in the past five years (see Table 12). In 2015, the volume of meat production increased by 28 per cent year-on-year. Simultaneously, production costs increased due to the increased costs of compound poultry feed and maintenance of foreign equipment.

Table 12 Volume of production of meat and edible offal of poultry in kind and in value terms, 2010 – July, 2016

	2010	2011	2012	2013	2014	2015	01.- 07.2016
Production volume,	2.74	2.97	3.36	3.54	3.89	4.31	2.60

⁶¹ Kolykina, E. (2016): Russian beef market shows growth in the light of import substitution, <http://meatinfo.ru/blog/rossiyskiy-rinok-govyadini-rost-na-fone-importozameshcheniya-539> [30.08.2016]

⁶² Analytical review of the meat market, January-June 2016, <http://meatinfo.ru/blog/iyul-2016-analiticheskiy-obzor-myasnogo-rinka-537> [30.08.2016]

million tons							
Growth rate, % YoY	-	109%	113%	105%	110%	111%	105%
Production volume, billion roubles	186.29	216.25	253.75	235.45	294.05	337.62	231.94
Growth rate, % YoY	-	116%	117%	93%	125%	128%	100%

Source: Federal State Statistics Service, IndexBox analytics⁶³

At least until 2018, meat industry is expected to expand by inertia due to decreasing imports. Moreover, from 2017 the economic situation in Russia is expected to improve, which will result in growing income of the population and their increasing demand for meat products among other things. According to Gazprom analytics, meat consumption is expected to increase by 6-8 per cent until 2020⁶⁴. This is another factor that makes export into Russian meat industry more appealing.

There are a vast number of factories in Russia that specialize in meat processing and production. A recent rating performed by “Agroinvestor”, a professional magazine for investors in the Russian agroindustry, named Russia’s 20 largest meat producers⁶⁵ (see Table 13). The total amount of meat processed by these producers in carcass weight amounts to 4 million tons or 42 per cent of the total amount produced in Russia.

⁶³ Koltykina, E. (2016): Production volumes in the Russian meat and poultry markets increase every year, <http://meatinfo.ru/blog/rossiyskiy-rinok-myasa-ptitsi-okrilyon-proizvodstvo-540> [15.09.2016]

⁶⁴ Russia’s main meat producers (2016), <http://meatinfo.ru/blog/glavnie-myasniki-strani-538>, *Agroinvestor* 8 (9903), [30.08.2016]

⁶⁵ Ibidem

The production volumes of the top three producers exceed 400,000 tons. The leaders in the meat industry based on the results from year 2015 are as follows:

1. Cherkizovo Group

Total volume: 742,000 tons (live weight) / 601,700 tons (carcass weight)

Broiler chicken (live weight): 573,000 tons

Pork (live weight): 169,000 tons

Poultry farms: 15 (Central and Volga Federal Districts)

Revenue (2015): 44.6 billion roubles

Pork farms: 15

Revenue: 16.6 billion roubles

Cherkizovo is currently increasing capacities building a new pork farm cluster worth 9 billion roubles in Voronezh and Lipetsk regions; it plans to double capacities of pork production by 2018.

2. ZAO Prioskolie

Prioskolie is the largest poultry producer in Russia.

Broiler chicken (live weight): 642,000 tons (live weight) / 526,600 tons (carcass weight)

It is currently working at full capacities at all factories (Belgorod, Tambov and Altai regions).

3. Miratorg Holding

Miratorg is Russia's largest producer of pork and beef.

Total volume: 438,900 tons (carcass)

Pork: 332,800 tons

Beef: 40,500 tons

Broiler chicken: 75,600 tons

Plans to double capacities for pork production by investing over 100 billion roubles in a new complex in Kursk Region

Due to their continuous investment in production capacities and expansion thereof, as well as in modernization of equipment and extension of the product line, the aforementioned leaders are expected to keep their solid leading positions in the long-term perspective. It is naturally becoming more

difficult for small and medium sized producers to compete with such large and powerful players, therefore, especially these producers may offer opportunities for ProAutomation that can provide them with equipment and automated systems required to increase and optimize their production.

Table 13 Top 20 largest meat and poultry producers, 2015

	Producer	Website	Total volume in carcass weight, tons
1	Cherkizovo Group, Moscow	cherkizovo.com	601,700
2	ZAO Prioskolie, Belgorod	http://www.prioskol.ru/?lang=en	526,600
3	Miratorg Holding, Moscow	www.miratorg.ru/sites/en/about/	438,900
4	BEZRK-Belgrankom Holding, Belgorod	http://jasnzeni.ru/	295,700
5	Resource Group, Moscow	http://www.gapresurs.ru/	270,600
6	Charoen Pokphand Foods, Thailand	cpfrussia.ru/	226,200
7	Belaya Ptica Agroholding, Belgorod	http://www.belaya-ptica.ru/en/	193,500
8	Prodo Group	http://www.prodo.ru/	192,400
9	Akashevo Agroholding, Mari El	http://akashevo.ru/	166,500

10	Rusagro Group, Moscow region	http://www.rusagrogroup.ru/	152,300
11	Agro-Belgorye Group, Belgorod region	http://www.agrobel.ru/	127,500
12	Agrokomplex, Krasnodar region	http://zao-agrokomplex.ru/agrocomplex/	126,600
13	KoPitaniya Agroholding, Moscow	http://www.kopitaniya.ru/	113,700
14	Sibirskaya Agrarnaya Gruppya, Tomsk region	http://www.sibagrogroup.ru/	104,800
15	AgroSila Group, Tatarstan	http://www.agroforceg.com/	88,500
16	Zdorovaya Ferma, Chelyabinsk	zferma.ru/	87,000
17	Agropromkomplektatsiya, Moscow region	http://www.apkholding.ru/	79,700
18	Horoshee Delo (GK Sfera), Mordovia	http://www.sferarm.ru	73,900
19	Sitno, Chelyabinks region	http://sitno.ru/	73,000
20	Kosmos Group, Udmurtia	http://www.komos.ru/	68,400

Source: Agroiinvestor⁶⁶

Russia's largest contributor to meat production is Central Federal District that has Moscow as its capital (see Table 14). For instance, in the

⁶⁶ Russia's main meat producers (2016), <http://meatinfo.ru/blog/glavnie-myasniki-strani-538>, *Agroiinvestor* 8 (9903), [30.08.2016]

second quarter of 2016, 38.7 per cent of the overall Russia's volume of poultry was produced there. The leading position of this district can be explained by historical localization of factories producing especially poultry, the primarily demanded product in this sector on the Russian market due to its general affordability.

Table 14 Volume of production of meat and edible offal of poultry in kind by Federal Districts, III quarter 2015 – II quarter 2016.

District	2015		2016	
	III quarter	IV quarter	I quarter	II quarter
Central	39.1%	38.8%	38.1%	38.7%
North-West	8.7%	8.3%	8.5%	9.1%
South	5.6%	5.5%	5.6%	5.1%
Northern-Caucasus	6.0%	6.8%	6.0%	6.4%
Volga	21.0%	21.5%	22.0%	21.3%
Ural	10.1%	9.6%	10.0%	10.1%
Siberia	7.5%	7.5%	7.7%	7.6%
Other	2.0%	2.0%	2.1%	1.7%

Source: Federal State Statistics Service, IndexBox analytics⁶⁷

Moving into a meat processing industry in Russia, ProAutomation should decide which region to enter first, as the country is too vast geographically. Especially in the difficult economic times, it is reasonable to focus on more prosperous and productive regions. Therefore, ProAutomation should first focus on Moscow, as it the most populous and wealthiest city in

⁶⁷ Koltykina, E. (2016): Production volumes in the Russian meat and poultry markets increase every year, <http://meatinfo.ru/blog/rossiyskiy-rinok-myasa-ptitsi-okrilyon-proizvodstvo-540> [15.09.2016]

Russia, and its surrounding areas, where meat producers are striving to satisfy large existing demand.

Apart from that, Moscow is not distant from Vienna geographically compared to other regions, while infrastructure in the area is the most developed for easier transportation of goods. This is an important consideration for an exporting company as transportation costs can have a significant impact on the overall success of the overall financial result of the project.

It is essential to visit the most important trade fairs in the industry conducted in Moscow to learn more about the market and existing demand and competition. Simultaneously, contact should be established with the largest meat producing holdings and separate factories, potentially through a selected cooperation partner to find out what opportunities ProAutomation has with regard to equipment supply.

Alternatively, it is possible to contact individual meat factories that are situated in Moscow or Moscow region. Annex D shows a list of meat factories located in this area.

4.4.4 Bakery and confectionary industry

Bakery and confectionary as part of the food industry belong to some of the most fast-growing production sectors in Russia. Bakery takes the first place among food sub-industries, while confectionary takes the fourth position after dairy and fish sub-industries⁶⁸.

According to the Federal State Statistics Service, annual output in the bakery industry lies at 6.63 trillion tons⁶⁹, where bread production amounts to 80 per cent of the output. Historically bread import does not take a large share in the Russian bread market.

On balance, despite the fact that bread in Russia is one of the most essential products in every household, the demand in the bread segment has been sluggish in the recent years. Before 2014, there had been a trend toward a healthier lifestyle, therefore the overall demand for bread had slightly dropped, while an increase in demand for premium quality could be observed.

⁶⁸ Russia's confectionary factories, <http://www.wiki-prom.ru/71otrasl.html> [30.08.2016]

⁶⁹ Federal State Statistics Service (2015): Statistics of Russia, Moscow: FSSS

However, the industry was affected in 2015-2016 by price increase for bakery products due to increase in the cost of materials and maintenance of foreign equipment. Hence, the demand for premium quality bakery products has been in decline in the past two years. Nevertheless, it is expected to pick up again once the economic situation in the country stabilizes.

Another trend that is worth mentioning is the increasing number of local mini bakeries. They certainly cannot force large corporations out of market, but they are continuously winning more shares on the local markets becoming another competition force to consider. However, with regard to investment in cutting-edge equipment, these bakeries tend to maintain their investment levels low. Therefore, so far they do not represent a potentially interesting market for ProAutomation.

According to Rosstat⁷⁰, there have been approximately 1,000 industrial bakeries, however due to crisis, at least 20 of them went bankrupt in 2015 because they could not compete with large manufacturers. Nevertheless, difficult economic situation affected the investment activity of bakery producers of all sizes, which resulted in a drastic drop in foreign equipment sales in the bakery industry by 40 per cent in 2015⁷¹.

When it comes to geographical distribution as in many other industries, the largest bakery producers are situated in the Central Federal District, namely in Moscow and Moscow region. The output and sales volume in this area is the highest in the whole country and lies at 30 per cent⁷².

This can be explained by larger size of the population and higher income levels as well as standard of living in this area. Thus, the average per capita income in this area is 127 per cent higher than in other regions, while unemployment rate is one of the lowest in the whole Europe at 0.5 per cent⁷³. Therefore, large production to satisfy the needs of such populous area requires better processes and equipment, which is a good foundation for opportunity exploration for an automation company.

⁷⁰ Lunin, V (2016): Russia's bakery industry: Results of 2015 and plans for 2016, <http://lesaffre.ru/?p=3271> [30.08.2016]

⁷¹ *Ibidem*

⁷² Russia's bakeries, <http://www.agroprodmash-expo.ru/ru/articles/2016/zavody-proizvodstvu-hlebobulochnyh-izdelij-v-rossii/> [30.08.2016]

⁷³ Fazer Group (2016): Continued growth in an evolving market, <http://www.fazergroup.com/about-us/annual-review2/country-operations/russia/> [30.08.2016]

Finish giant Fazer is one of the largest players on the Russian bakery market. In 2013, its net sales in the country amounted to EUR 263 million⁷⁴. With its five production facilities, it kept its number one position in industrial bakery in 2015. In Russia, Fazer operates under its two umbrella brands Fazer and Hlebny Dom.

Nevertheless, in 2015 even a large corporation like Fazer was affected by the crisis and saw its revenue decline in Russia by 19.2 per cent compared to 2014 to EUR 189 million⁷⁵. In 2015, the growth for Fazer was observed in the frozen products sector, particularly in Moscow where it has reached number one position among modern retail bakeries with a 23 per cent market share. In comparison, in Saint Petersburg its market share reached 35 per cent.

Similar situation can be observed in the confectionary industry. There are more than 1,000 confectionary factories in Russia that produce more than 3 million tons of confectionary goods every year. More than 50 per cent of all production capacities are concentrated in Central and North-West Federal Districts, 14 per cent of which are located in Moscow⁷⁶.

United Confectioners or Uniconf Holding founded in 2002 has been the largest confectionary group in Russia and the whole Eastern Europe. With 19 confectionaries across Russia, it is also 13th largest in the world. It unites some of Russia's largest confectionary factories, including Red October, Rot Front and Babaevsky Confectionary Concern.

KDV Group is another large producer of snacks and confectionary products. Today it has 11 factories in different regions with headquarters in Tomsk, Siberia. ProAutomation already has previous experience working with this dynamically growing manufacturer as a subcontractor, automating one of the production lines in Yashkino, Siberia.

⁷⁴ Fazer Group (2016): Continued growth in an evolving market, <http://www.fazergroup.com/about-us/annual-review2/country-operations/russia/> [30.08.2016]

⁷⁵ Fazer Group (2016): Annual Review 2015, https://www.fazergroup.com/globalassets/global/fazergroup/about-us/annual-review-2015/fazer_group_annual_review_2015_gb.pdf [30.08.2016]

⁷⁶ Russia's confectionary factories, <http://www.wiki-prom.ru/71otrasl.html> [30.08.2016]

Table 15 Food producers (excl. agroindustry) in the Forbes' Top 200 Russia's largest companies.

	Food producer	Revenue in 2015, billion roubles	Position in the rating
1	Uniconf Holding (United Confectioners), Moscow	57.9	125
2	KDV Group (snacks & confectionary)	80.9	90

Source: Forbes⁷⁷

On balance, Russia's bakery and confectionary market size offers a large potential for automation companies. In the current economic situation, for ProAutomation it is deemed reasonable to explore primarily European part of Russia, namely its Central and North-West Federal Districts. However, other more remote areas have high potential as well, as evidenced by ProAutomation's experience in Siberia on the one hand, and the location of factories of one of the largest confectionary and snacks producer in this region. Therefore, once the company gains experience in central districts, it can expand farther into Russia, expanding its customer base.

Annex E offers a list of bakeries and confectionaries that operate in Russia, and particularly in the Central and North-West Federal districts.

4.4.5 Potential partners in the Russian market

A company that wants to deliver equipment to Russia should decide upon a most preferable mode of operation. One option may be to establish a direct contact with a customer and work directly with this company.

It is important to be aware that in case an Austrian company intends to deliver its machine directly to the Russian customer, the Russian partner should hold special license for conducting foreign business operations necessary to be able to perform money transaction and handle customs declarations. As there is no common register of companies that possess such

⁷⁷ Russia's 200 largest private companies in 2016, *Forbes Online Magazine*, <http://www.forbes.ru/rating/200-krupneishikh-chastnykh-kompanii-rossii-2016/2016?full=1&table=1> [08.09.2016]

a license, it is necessary to contact each company individually to obtain this information.

A list of some of Russia's large food manufacturers is included in Annex A. Apart from that there are large databases available on trade show websites that can be used to collect information about Russia's relevant market players in the food production, processing and packaging industry, both national and foreign. The links to these lists is included in Annex B.

In case the company wants to reduce organizational workload, it may conduct all operations through a distributor that will take care of all the formalities such as payment and customs declarations. There are Austrian companies operating in Russia that have established a profound business network and represent several well-reputed brands on the Russian market. Some of them, particularly recommended by the Austrian Economic Chamber, are Bertsch Holding GmbH and Matimex GmbH (see Annex C)

As mentioned in Chapter 3.3 ProAutomation has currently established cooperation with one such partner in the meat processing industry, namely voran® holding, whereas in the food/bakery industry it can potentially work with Hass Group that has extensive project portfolio in Russia, including its earlier cooperation with Pro Automation.

To sum up, there are a myriad of alternatives with regard to selecting a partner for operations in Russia. There are a number of Austrian companies that have a successful track record in introducing Austrian goods into the Russian market. Moreover, such cooperation is promoted by the Austrian Economic Chamber that offers support in connecting potential partners and providing all required consultation services.

5. Recommended business expansion strategy

5.1 Entering the Russian market

When considering an expansion strategy into a foreign market, a small automation company like ProAutomation should have several considerations in mind. First and foremost, an analysis of the company's financial situation should be performed and resources available for expansion identified. Considering different entry modes and the financial situation of ProAutomation, export is the most feasible mode of entry for the company at the moment.

With regard to the industries it wants to penetrate, an analysis of its product portfolio and expertise strengths allows to determine which products the company wants to introduce in the Russian market. Having analyzed the company's portfolio, two key sub-industries within the food industry have been identified, namely meat processing and production and bakery and confectionary with potential expansion into packaging.

In the meat industry, the focus is on full automation of production processes of large meat factories. Here the company can employ its profound expertise in developing with hygienic designs for food and pharmaceutical industries.

In bakery and confectionary industry, the primary focus is on promoting the company's latest WaterJet technology. Apart from that, ProAutomation has strong expertise in packaging technology that usually goes hand in hand with production processes and offers additional opportunities in the Russian market.

Currently Russia goes through an economic crisis that has affected many companies already operating there. Therefore, it is important to thoroughly analyze country-specific risks present in the stable times and potentially intensified in the times of crisis.

Risks like corruption and red tape have been discussed at large earlier in this paper. However, some of the initial characteristics that should be considered in the case of ProAutomation are geographical factor and market size.

Thus, it is important to select one or few regions of particular interest, especially when it comes to such territorially vast country as Russia. This factor is of utmost significance due to the fact that the country is not equally populated, hence the market size in different regions varies. Apart from that, the difference in income levels among population in different parts of Russia also varies significantly, strongly affecting population's purchasing power. Therefore, it is sensible to focus on the larger and more prosperous markets within the country, especially in the times of crisis.

It is also important to consider different financing options that ProAutomation can offer to its customers. One of them that may be particularly appealing for manufacturers with tight budgets due to the economic slowdown is leasing. This method has not been commonly practiced in the company before, but Russia's specifics require new approaches that would make projects possible.

The analysis of the meat and bakery and confectionary industries has shown that largest manufacturers are situated in the Central and North-West Federal districts that have Moscow and Saint Petersburg as their capital cities respectively. Not only these regions are most populated, but they also enjoy significantly higher living standards and consequently purchasing power of the population. Therefore, demand in these areas is much higher than in other regions of the Russian Federation. As Moscow has a leading position among other regions, it is advisable to initially enter this area, and potentially expand further once the economic situation in the country stabilizes.

Another related factor is transportation and customs costs that can affect the overall success of the projects and, thus, should be considered when choosing the primary region for expansion. Geographical factor also affects the times of response for maintenance and service, the quality of which are highly valued among Russian manufacturers and often play one of the key roles in decision-making.

ProAutomation can attempt to arrange its export business to Russia on its own. However, without profound experience in operating in such a complex market as Russia, it is more advisable to establish cooperation with an experienced partner who can help with promoting company's products and services on the market and what is arguably more important with assisting or

fully undertaking all formalities pertaining to customs, as it one of the largest challenges most companies face when entering Russia.

In both preferred industries of operation, ProAutomation has already potential partners that can support its entrance into Russia. In the meat industry, it can partner with voran® holding, while Haas Group can provide support in the bakery and confectionary industry. Alternatively, there are a number of other Austrian companies that have been successful in Russia promoting Austria's equipment and machinery.

Two particular channels of support are of particular interest for ProAutomation's business expansion. With regard to advisory matters, Austria's Economic Chamber offers comprehensive support to all Austrian companies willing to expand their business. The invaluable information helps in market analysis, partner search and other matters that are essential when entering a foreign market.

Apart from that, Austria boasts a well-developed system of state support for SMEs that want to expand their business internationally. ProAutomation GmbH already has extensive experience working with government organizations that support business expansion of the Austrian companies. Thus in 2013, it obtained state grant to enter the German market.

Therefore, the company should solicit state support for expanding further and entering the Russian market. It is an excellent way to reduce costs associated with partnership establishment, marketing and transportation to name a few.

This funding can also be used to participate in some of the crucial trade shows in the industry as exhibitors, as this is associated with expenses that are currently too high to bear alone for Pro Automation. On the other hand, participation in large trade shows is an excellent way to raise awareness about the new company on the market and generate enquiries from potential customers. This tactic proved successful in the company's previous experience in Germany, where it exhibited its robot cells at Automatica, one of the largest trade fairs for automation and mechatronics, supported by the "go international" initiative, thus generating a large number of enquiries and valuable business contacts.

It is unquestionably a difficult time for Russia and its many industries affected by the sanctions crisis and weakened rouble. The concerns associated with entering the market as such a time are well-founded. However, if a company manages to solicit state support and put foot in the door now, by researching market opportunities and establishing contacts with Russian companies, for instance, through trade fairs, or with state funding potentially exhibiting its equipment at some of the most important trade shows, ProAutomation will have a chance to create awareness of its brand and prepare solid ground for the future when the crisis passes and demand accelerates again.

Russia is a very dynamic market. Despite being hit by frequent crises, it still has immense potential that has always attracted international companies. Its market size and oftentimes unsatisfied needs in various industries provides enough room for larger presence of foreign businesses including ProAutomation.

5.2 Other considerations

There are several considerations that a company should be aware of when entering the Russian market. These considerations apply to any form of cooperation with Russians, export included.

Entering the Russian market is a very resource-intensive process regardless of the selected entry mode. Even if the recommended mode of entry for ProAutomation is export, it should be ready to invest much time, but also capital in establishing successful cooperation with Russian partners, as in the machinery industry export does not end with product delivery, but also implies commissioning and potentially maintenance.

As Russia ranks very low in the Ease of Doing Business report for trading across borders (see Chapter 4.1.1), it is important to find a trustworthy partner, who can take care of all technicalities of the export and distribution process and understands Russian business culture and country specifics well. This partner can help establish contact with the Russian party and, what is very important, overcome laborious customs procedures that can slow the process significantly. This has also been confirmed in the survey of some of

the most reputable companies from the mechanical engineering industry in Austria that named customs complications one of the biggest challenges in doing business in Russia (see Chapter 3.4). Suggestions from the Austrian Economic Chamber about some reputable partners are shown in Annex C.

Another consideration pointed out by the Austria's Economic Chamber is the fact that not all Russian enterprises have the right to conduct business with foreign companies. Hence, it is important to find out, whether a particular Russian company possesses such right. Unfortunately, there is no unified register that contains information about this matter. Therefore, it would be necessary to research this question on a case-by-case basis. Usually, larger corporations have all necessary state permissions, but this should be clarified with a particular company before entering into any agreements with it.

The issue of trust can become a serious problem in conducting business for foreign companies. Therefore, it is important to conduct thorough due diligence to ensure the reliability of Russian business partners at all stages, as ProAutomation has already had negative experience when an ordering party in one of the CIS states could not pay for the delivered goods, as it was in the midst of going bankrupt. This can also happen in Russia, especially now in the times of an economic crisis, when many large and small manufacturing companies have been hit by the economic slowdown.

Moreover, it is important to maintain regular communication with the Russian party to ensure that there are no misunderstandings about mutual expectations, as this can become an issue at the final stages of the project. Many surveyed companies mentioned that during the final stages of the project, Russian managers put off final acceptance of the commissioned work for as long as they could, coming up with presumably unfulfilled expectations that were, however, not stipulated by the contract. This usually costs much time and money and is very unproductive for the delivering company. Moreover, it is advisable to control the correct implementation of the project, e.g. at the commissioning stage, in order to avoid any deviation from the established course, which without control may happen often in Russian companies.

Apart from that, a foreign company should show some flexibility and be ready to accept the Russian way of doing business. With regard to business

ethics, business culture and the way of doing things, Russia has different standards to those acceptable in the West. This does not imply that a western company should bend the rules, but it would most certainly have to be ready to show flexibility and adjust its own understanding of business conduct. This can be often observed during the commissioning. Inexperienced western companies are oftentimes baffled by the lack of compliance with, for instance, international safety standards, but this and other differences require time to adjust to if a company wants to operate in Russia. On the other hand, potentially a foreign company can make a difference for the better in the way Russian factories operate by manifesting its high standards in all operations.

6. Conclusion

In the past decades mainly large corporations have been ambitious enough to take on the challenge of expanding into foreign markets. Today an ever-increasing number of small and medium-sized companies are ready to take their business global at the early stages of their operation. It is certainly an intricate and laborious process that requires large investment of time, money and human resources.

Nevertheless, local markets often become too small for companies that want to maintain sustainable growth in the long run. This applies to the case of ProAutomation GmbH that feels the need to move beyond its local and neighboring Western European markets and venture further into a largely untapped Russian marketplace that offers much potential despite its currently fragile economic situation.

With the extensive state support available in Austria for companies that wish to take their business to the next level and expand internationally, ProAutomation has the opportunity to tap into a largely promising Russian economy. This step will also allow the company to overcome its current challenges associated with shrinking local market. The market size in Russia particularly for automation systems in the food industry makes it an irresistibly appealing place to explore either individually or, what is more advisable at least at the initial stages, with the help of a reliable strategic partner that can bring in knowledge about the market and expertise with regard to export technicalities, thus significantly reducing the probability of errors in establishing new export channels.

Despite the rising concerns of foreign producers associated with the recent national course towards import substitution, the currently effective import restriction policies in Russia may in the long run also serve for the benefit of ProAutomation. As the country is aiming to become self-sufficient in many sectors, including food production, Russian manufacturers are forced to increase their output in order to cover the existing gap created by the embargo. This means that manufacturers would need to increase existing capacities and / or modernize their equipment to meet the building up unsatisfied domestic demand. In spite of the current wariness among Russian

manufacturers with regard to capital investments, investment readiness is expected to increase once the economic situation stabilizes starting from 2017.

This especially applies to the food industry, as it is one of the strongest and most important industries in Russia. People will always need to have their demand for food satisfied, particularly in regard to meat and bakery products. Therefore, it is reasonable for ProAutomation to enter this continuously growing market to meet the existing and future production needs of food manufacturers. Moreover, aside from the primary focus industries that ProAutomation intends to tap into, i.e. meat and bakery/confectionary, its expertise in packaging technology offers another potential market for its systems.

It is also beneficial for a foreign company that Russia has a strong positive attitude toward the products manufactured in the western countries. Therefore, ProAutomation can capitalize on the “made in Austria” effect, selling its existing automation systems. Thus, despite the fact that labor costs are relatively low in the country, and oftentimes it is considered not reasonable to switch from manual labor to automated systems, Russian manufacturers place much value on the quality of offered systems and their ability to provide competitive edge over other local manufacturers.

On the other hand, the competitive edge can come not only from the excellent quality machines that optimize production processes, but also from novelty systems that add uniqueness to certain products. In this context ProAutomation is ready to offer its unique patented automation system for the bakery industry.

Therefore, there are specific aspects that ProAutomation should emphasize in its expansion strategy. It is novelty and quality of the systems combined with flexibility of a smaller company that can add particular competitive advantage to ProAutomation’s strategy in Russia.

As for competition in the Russian food industry, the recent crisis has forced a number of small and medium-sized producers from the market. Thus, mainly large and well-established manufacturers have been able to stay afloat in the difficult economic times, despite experiencing losses and other kinds of setbacks. Therefore, it is important to adjust company’s strategy to consider

this aspect. For instance, flexibility in financing plans may take some pressure off Russian manufacturers and increase their willingness to invest despite the overall difficult economic conditions.

As in the Austrian industry, the role of trade shows is important in the Russian market. Thus, the first contact with potential customers can be established through trade fairs, as they serve as an important platform for manufacturers to learn about innovations in the industry. Conversely, ProAutomation can learn more about technology state-of-the-art in the market, customers' requirements and preferences and existing competition. This essential knowledge is invaluable in order to adapt company's strategy and range of offers for the Russian manufacturers.

Moreover, in the current economic conditions it is important to choose the entry region wisely. As Russia is distinguished by large disparities among regions in regard to levels of prosperity and economic activity, it is deemed reasonable for ProAutomation to explore primarily the European part of Russia, i.e. its most populous and prosperous Central and North-West regions. The production capacities in these regions are much higher than in other regions, particularly in the food industry. Thus, these areas offer higher potential for ProAutomation's equipment export.

In conclusion, by choosing the right partner, soliciting state support, selecting the most advantageous product mix, determining the entry point with highest potential and adapting its strategy towards more flexibility in various aspects from financing plans to the general business conduct, ProAutomation can take advantage of the currently difficult economic situation in the otherwise promising market and establish a solid foundation for future growth in Russia once the crisis subsides. Substantial growth implies risks and challenges along the way. This is the new reality of a hyper-competitive globalized world. But those who see opportunity in every crisis and are ready to take on complex challenges can come out as winners in the long run, reaping multiple benefits globalization offers.

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Online survey: Ulbrich Maschinenbau und Export Import BetriebsgmbH, 22.08.2016

ANNEX

A. Russia's large food manufacturers

Company	Website	E-Mail
Iceberry	http://www.iceberry.ru	Eremenko@iceberry.ru
Rusholod	http://www.rusholod.ru	secretar@rusholod.ru
Alterwest	http://alterwest.ru	info@alterwest.ru
Peko	www.peko-msk.ru	peko@mail.ru
SI Group	http://www.makaroni.ru/contacts	info@makaroni.ru
Fillini	http://fillini.ru	marketing@fillini.ru
Mafka	http://www.makfa.ru	makfasale@makfa.ru
DeCecco	http://www.dececcorussia.com	info@dececcorussia.com
Smakhleb	http://www.smakhleb.ru	smakhleb@mail.ru
Vseslav	http://www.vseslav.org	ehk@ehk.e-burg.ru
Verola	http://www.verola.ru	verola@samtel.ru
Dobrodeya	http://www.dobrodeya.ru	priemnaya_omf@mail.ru
Rusprod	http://www.rusprod.ru	info@rusprod.ru
Almac	http://www.almac.ru	almac@almac.ru
Vyatskaya Konditerskaya Company	http://www.vyatkond.ru	info@vyatkond.ru
Zolotoy kolos	http://www.zolotoykolos.ru	n.a.
Storkos	http://www.stokros.ru	stokros@mail.ru
Ferrero Russia	https://www.ferrero.ru	russia_reception@ferrero.com
Inforum Cocoa	www.inforum.ru	cocoa@inforum.ru
Ruskiye Produkti	www.rusprods.ru	info@rusprods.ru
Asterik	http://www.asterik.ru	sbit@asterik.ru
Mondelez Russia	http://ru.mondelezinternational.com/home	online form
Aidigo	http://www.aidigo.ru	aidigo@yandex.ru
Miroslada	http://www.miroslada.ru	info@miroslada.ru

B. Participants of largest trade shows in Russia

	Exhibition	List of Participants
1	Agroprod mash	List of participants: http://www.agroprod mash-expo.ru/en/exhibitors/ Participants by goods and services: http://www.agroprod mash-expo.ru/en/catalogue/bygoods/?tov_i_usl4=39382
2	Dairy & Meat	http://www.md-expo.ru/en-GB/about/exhibitor-list.aspx
3	Modern Bakery Moscow	https://online.messefrankfurt.ru/eng/info/MB16/companies/
4	Upakovka	http://messe.unipack.ru/eng/exhibitors/

C. Austrian partners in distribution

Bertsch Holding GmbH
Herrengasse 23
6700 Bludenz, Austria
+43 5552 6135-0
bertschgroup@bertsch.at
<http://www.bertsch.at/>

Haas Group
Industriestraße 8
84326 Falkenberg, Austria
Contact Form: <http://haas-group.com/hp948/Kontakt.htm>
<http://haas-group.com/>

Matimex GmbH
Großbauerstraße 8
1210 Vienna, Austria
+43 1 2905173
matimex@matimex.at
<http://www.matimex.at/de/>

voran® holding
Inn 7
A-4632 Pichl bei Wels, Austria
+43 (0)7249 / 444-0
office@voran.at
<http://www.voran.at/holding/kontakt/>

D. Meat factories in the Central Federal District

	Factory	Contact information
1	Biryulevskiy Meat Processing Plant	Ul. Biryulevskaya 38 Moscow 115372, Russia +7 495 786 20 00
2	Vegus Meat Processing Plant	Ul. Mironovskaya, D. 33 Str. 23 Moscow 105318, Russia +7 499 166 05 00 www.vegus.ru
3	Velkom Meat Processing Plant	Ul. Lenina 75 Pavlovskaya Sloboda, istrinskiy r-n Moscow region, Russia +7 495 992 15 10
4	Kirovskiy Meat Processing Plant	Ul. K. Marxa 4a, Kirov 610006, Russia +7 8332 231 562 mark@beef.kirov.ru
5	Mikoyanovskiy Meat Processing Plant	Ul. Talalikhina 41 Moscow, Russia +7 495 676 07 47 www.mikoyan.ru
6	Ostankinskiy Meat Processing Plant	Ogorodniy proezd 18, Moscow, Russia +7 495 980 53 90 info@sosiska.ru www.ompk.ru
7	Ramenskiy Meat Processing Plant	Ul. Krasnoarmeyskaya 131 Ramenskoe 140100, Russia +7 926 100 56 89
8	Rublevskiy Meat Processing Plant	Ul. Gorbunova 4 ft4 Moscow, Russia +7 495 448 32 56 info@rublevskiy.ru www.rublevskiy.ru
9	Tsaritsyno Meat Processing Plant	58 Kavkazsky Moscow 115516, Russia +7 495 325 09 72 www.tsaritsyno.ru
10	Cherkizovo Meat Processing Plant	Ul. Lesnaya 5B Moscow 125047, Russia +7 495 660 24 40 info@cherkizovo.com www.cherkizovo.com

E. Bakeries and Confectionary factories

	Factory	Contact information
1	1 Maya Confectionery	Ul. Dolgopolova 77 Nizhniy Novgorod 603002, Russia +7 831 277 99 56
2	Azovskaya Confectionery	D. 8 Kv. 53, 4536-i Pr Mytishchi, 141006 Russia +7 863 426 70 62
3	Babaevsky	Ul. Malaya Krasnoselskaya 7 Moscow 107140, Russia +7 499 264 43 10 info@babaev.ru
4	Red October	Ul. Malaya Krasnoselskaya 7 Moscow 107140, Russia +7 495 982 56 32 ko@redoct.biz
5	RotFront	2 Novokuznetskiy p-k 13/15 Moscow 115184, Russia +7 495 951 84 78 rotfront@rotfront.ru
6	KDV Yashkino	Mira ave., 20 Tomsk 634057, Russia +7 3822 70 65 90 info@kdvm.ru
7	Hlebny Dom Bakery	Ul. Smolenskaya 18A Saint Petersburg 196084, Russia 8 800 700 78 16 www.hlebydom.ru
Further info: Directory of Russian confectioneries and bakeries http://www.konditer.com/list/list.php?cid=1		

F. Interview and survey questions

I. Online survey

Doing Business in Russia, created on SurveyMonkey.com

<https://de.surveymonkey.com/r/CYR6FLR>

1. Please enter your company name.
2. When did your company enter the Russian market (year)?
3. What was your company's entry mode?
 - a. Export
 - b. Subsidiary
 - c. Joint venture
 - d. Other (please specify)
4. What are some of the biggest challenges your company has faced while doing business in Russia?
5. What are your company's focus industries in Russia?
 - a. Food industry
 - b. Automotive industry
 - c. Electronics
 - d. Recycling
 - e. All of the above
 - f. Other (please specify)
6. How can you characterise competitive environment in your company's field of operation (in Russia)?
 - a. Very intense competition; it is difficult to get in for a newcomer.
 - b. There are enough business opportunities for everyone.
 - c. Don't know
 - d. Other (please specify)
7. In your opinion, is it easier for a big company or a small one to enter the Russian market? Why?
 - a. It is easier for small companies, because they are more flexible.
 - b. It is easier for big companies, because they have more resources and experience.

- c. There is no difference.
 - d. Other (please specify)
8. Has your company's business been affected by the current economic crisis in Russia?
- a. No, it has not affected us at all. (No negative impact)
 - b. Yes, we have fewer orders from Russia, but we expect the situation to improve soon. (Slight to moderate negative impact)
 - c. Yes, many of our projects in Russia resulted in financial losses. (Moderate to severe negative impact)
 - d. Yes, our business in Russia has come to a complete halt. (Severe negative impact)
 - e. Other (please specify)
9. Can you say that expansion into the Russian market has been a success for your company?
- a. Yes
 - b. No
 - c. Other (please specify)
10. What is your company's long-term strategy in the Russian market?
- a. Maintain current presence / continue doing projects in Russia
 - b. Expand business further using a more advanced mode of operation (subsidiary, joint venture, etc.)
 - c. Withdraw from the Russian market
 - d. Other (please specify)

II. Interview with the CEO of ProAutomation GmbH

1. Describe your company and its core activities.
2. Describe the early stages of company's development. What were the challenges? How did you acquire new customers? How did you build customer awareness?
3. Describe the competitive environment in the domestic market.
4. Describe your motivation for internationalization. Do you have any previous experience operating in foreign markets? Please describe.

5. Please explain your interest in the Russian market. Do you have any previous experience operating in the Russian market?
6. What is your preferred mode of entry into the Russian market?
7. What particular products are you planning to introduce into the Russian market? Why?
8. What are some of the challenges you expect to face in the Russian market?
9. What are some of the results you expect to achieve from expansion into the Russian market?
10. How do you expect to achieve those results?

III. Interview with a representative of Austria's Foreign Trade Center in Moscow, Russia

1. How can you describe business opportunities for comprehensive automation solutions offered by an Austrian company in Russia?
2. How can you describe the economic-political environment in the country?
3. How can you describe the impact of the state import substitution campaign on foreign business with particular regard to the automation industry?
4. What are some of the main trade fairs in the food industry in Russia?
5. What companies can be identified as potential business partners in the food industry for an Austrian automation company?