

Company Cultures and Managements Séminar

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THE OBSESSION WITH SHORT-TERM STRATEGY : IS IT AN OBSTACLE TO MULTINATIONAL OPERATIONS ?

by

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Overview

The success of foreign companies in Russia depends a great deal on their capacity to acquire a comprehensive knowledge of formal and informal institutions, the market, all those involved in the enterprise, and their ability to give the impression that their business will continue in the country for a long period of time. Unfortunately, many Western companies give in to the temptation of 'making a killing' and of profiting from the windfall effect which the instability in Russian society still largely produces despite serious attempts over the past few years to curb this. The causes of this short-term strategy lie in a Western obsession with career mobility, and the difficulty encountered in trying to make cultural integration appear attractive in financial and accounting terms. Professional flexibility, which is praised so much in the West, appears to be a handicap in Russia. Experiences of Western companies abroad are in contrast to large companies in developing countries which are more relaxed and react accordingly. Are these countries showing the way forward ?

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TALK : Jacques Sapir

I have been studying the way in which business is conducted by foreign and especially French companies in post-Soviet Russia for many years. I followed the trials and tribulations in Russia of a perfumer, a car manufacturer, an oil company, and even a lift manufacturer. Having watched their successes and failures, I developed a theory about the importance of long-term action even though corporate management often leads companies – consciously or not – to take short-term strategies. Companies which succeed are those which, in one way or another, have been able to overcome this difficulty. Let me quote two examples in order to demonstrate my theory : one is a car manufacturer who handled his new situation well from the start, and the other is an oil company which was able to succeed despite starting off on a bad footing.

Initial worries about establishing a long-lasting business presence

In 1995, a well-known French car manufacturer decided to set up a factory in Russia at a time when there were relatively few international companies there. It was a risky decision to take in view of the country's turbulent political situation, the lack of virtually any financial stability, and very vague laws governing the ownership of industrial tools (which were still highly dependent on those of the Soviet era). Most Western manufacturers preferred to continue producing cars in their own countries, and limited their export and marketing operations in Russia.

Of course, there were many initial difficulties. The plot of land and the infrastructures which the French manufacturer had been advised to buy in order to set up his production unit turned out to be riddled with problems. For example, the electrical power station which supplied the factory with energy had been built a number of years earlier in a marshy area which was particularly unsuitable for any form of efficient operation. Furthermore, it became very clear that almost all the managerial staff would have to be trained. Finally, the overvaluation of the rouble meant that imports were very cheap and raised doubts about continuing to manufacture in Russia.

Nevertheless, the company kept going and survived the serious crisis which affected Russia in 1998 which led to the departure of many foreign companies. Over the years, the company learned to manage the legal problems, train staff on the ground, and adapt its expatriate workforce to the new culture. During this same period, the exchange rate of the rouble became less favourable for imports. The new factory started showing positive results. After 2001, the company had good production figures and was treated by the authorities as if it were a local partner, a situation which is favourable to future profitable developments. The company will increase its presence in the medium-term, even though it is undeniable the case that work will remain difficult for a long time to come.

The abusive use of a position of force

At the end of the 1990s, a well-known Franco-Italian oil company considered setting up a site in Russia, and reducing its risks because of the PSA (Production Sharing Agreement). This is a legal system which the Russians had decided to accept when they were badly in need of foreign investors. The PSA enabled foreign companies to avoid paying local taxes, and exempted them from some other normal obligations.

In terms of immediate and future profits, this might have seemed to be a good idea. As it turned out, it was the opposite : a few years later, when the Yeltsin regime was in a state of decay and the state regained some power, it decided that it did not want to continue to allow

companies to benefit from this system, and saw it as an abuse of power. The state harassed the companies using every means possible. From 2005 onwards, expatriates from some Western companies who had been prosecuted by the Russian courts for offences, most of which were imaginary, were even thrown into prison. From this moment on, the message was very clear : one had to give up one's rights which had been badly granted out of necessity and renegotiate new contracts.

The last part of the story concerning this company was happier. Once the company realised that it had to give up its PSA, it also understood that it had to change its view of Russia. Its attitude changed from being based on the 'good bargains' and instant profits which could be made and were available in Russia, to a view based on the construction of a genuine, long-term partnership. As a result, from this time, the company has been able to establish a much healthier and more promising relationship with the authorities. Recently, it even won an important invitation to tender for exploration in the Barents Sea.

The value of reasoning on a long-term basis

It is clear from these two examples that the foreign investor's knowledge of the local environment and the way in which the investor is regarded by the local authorities as a potential long-term partner, are key to business success in Russia. More exactly, there are three areas in which it is necessary to have a precise knowledge which can only be acquired with time because the reality cannot be understood straightaway. These are the institutions, the market and the people involved in the business environment.

Formal and informal institutions

In Russia, there are a certain number of formal institutions which are relatively easy to get to know, but there are also informal institutions which, often, run parallel, and which are much more difficult to grasp. I shall outline an example of each, one in the legal sector and the other in the field of budgetary governance.

As in almost all countries, there is written law which defines property rights, work rights, transaction rights, and so on. This law can be found in books. However, what is written does not clearly indicate what one should do, or how a potential dispute may be resolved, because the books do not describe local interpretations of the law. In a country like Russia, where formal institutions are less powerful than in Western countries, interpretation becomes very important. One should also know that throughout the Orthodox world, one never abolishes a law which has been passed : it is still legitimate to unearth a very ancient law to put forward one's opinion. Therefore, it is not so much the laws themselves which are important but how one stands in relation to them, and how one puts them into practice. To do this well requires a great deal of experience, and being accustomed to working with the other legal people involved.

Russian budgetary and administrative organisation normally exists on three levels : national, regional and municipal, each one covering a certain number of well-defined duties. For example, the national budget finances international roads, and the regional budget finances the other roads. When the regional budget is inadequate, the region requests an additional sum from the hierarchy above, or levies a local tax. This is formal institutional practice. However, there is also an informal practice which dates back to the Soviet era which itself was based on a more ancient tradition which is still widely used. It consists of a meeting between the regional governor and important local entrepreneurs, in a place as informal as perhaps the local baths. During the meeting, the governor explains that all those present must take part in a group effort to provide the necessary finance. When the meeting is over and everybody leaves the baths, the amount of money which each entrepreneur is asked to provide has generally been fixed !

Actors and their power

The discrepancy between truth and practical reality also exists for those involved. The person who is in an institutional position to handle a particular dossier is not necessarily the person who has the real power. Furthermore, direct relations between those involved often take precedence over official technical criteria. Today, the state and those in charge are much more directly involved in the activities of private companies than we are led to believe. Recently, the Prime Minister, Vladimir Putin, travelled to St Petersburg to meet representatives from private companies whose workers were on strike because they had not been paid for a long time. A few hours after he delivered a powerful speech directed at the management, the salaries were paid and things had started to get back to normal.

In the legal sector, the importance of relations between those involved can be illustrated by the following joke. Faced with a legal conflict, the foreigner, confident of his rights, says 'I know a judge who knows the law very well. He will sort out the matter.' His Russian assistant replies 'That's good, but I know a judge who knows the prosecutor, and that's even better !'

An unusual market

In a way which is more traditional and one takes into account better strategies aimed at penetrating foreign markets, one has to be aware that the Russian market has some special features. A detail may make all the difference between whether a suitable product finds a prospective buyer, or not. For example, in the food industry sector, Russians prefer yogurts which have a slightly more acidic taste than those marketed in France. Likewise, cars in Russia have to have a higher ground clearance than cars in France because outside large towns in Russia, roads can be very badly maintained and bumpy. One also has to know how to market products according to local practices, and maybe even create devices and systems to compensate for what is missing. For example, until 2004, car manufacturers had to develop their own credit system because the Russian banking system was inadequate.

Time in the company and time to gain knowledge

Since such knowledge can only be learned through experience, and experience takes time and money, it is a real investment. Unfortunately, human resources management methods as well as methods for assessing quoted Western companies do not work like this in Russia.

Short time periods to manage executives

Currently, important groups often have rotations for their executives, lasting three to four years. This is too short a period of time for the director of a factory or a local subsidiary to acquire the knowledge which I think is important. It requires ten years or so, or even more, if one really wants to make the investment profitable.

Annual assessment of a company's worth and windfall effects

Most major companies work on criteria of efficiency in terms of evaluated stock appreciation on a short-term basis, perhaps of one year. When one finds oneself in an environment as variable as that in Russia, pressure for efficiency leads one to play with the fluctuations in stock value, and to take advantage of bargains, which can appear and disappear very quickly. It is a race for windfall effects and is a way of life which is completely the opposite of setting up a genuine business in such a complex socio-economic system.

Western 'flexibility' : an inadequate model

In general, the logic behind short time periods is seen positively by Western businesses where the terms 'flexibility' and 'opportunism' are often used. However, in order to incorporate long time periods into strategy, one needs to have a management method which reflects this. I think that one should question these concepts when considering the factors necessary to succeed in a country like Russia.

Since the characteristics which I analysed in Russian business (including the importance of informal institutions, interrelationships, and the special nature of the market) are also usually found in developing countries, it is likely that companies in these countries are more capable of seeing how they ought to adjust in order to be efficient. One should add that in a large number of these companies, their capital is either directly or indirectly financed by various forms of guarantees from their governments, and governments generally tend to take their time. For these reasons, I predict that these companies will be successful in the future.

Finally, contrary to what is commonly thought, it appears to be increasingly difficult to apply our Western company model to Russia. I can see one way in which we can resolve the problem of the long term : the knowledge which I mentioned needs to be seen as an asset (even though it may be perceived to be immaterial). It has a very tangible value, as experience has proved, and it needs to be taken into account in the evaluation of the company's worth. Clearly if this is not realised in the accounts, short-term business choices are more likely.

DISCUSSION

Question : *You mentioned numerous problems – which were more or less obvious – which the car manufacturer discovered in the infrastructure which he had to accept. These sorts of hidden problems can cause irritation for long periods of time. I had a similar experience. How did the manufacturer cope ?*

Jacques Sapir : I do not know the details, but I am sure he knew what action was necessary when he bought the infrastructure. The Russians wanted him to take over the entire site from a local manufacturer and blend in. The French company realised the risk this would represent if they introduced people who were particularly unsuitable into their new factory, especially since the Russian company they were taking over had a reputation for being almost Mafia-like. The French refused the offer, despite the fact that the Russian company had bought a great deal of industrial materials from the French company some years before, and therefore had the advantage of some sort of technical prowess in accountancy. The French managers preferred to create solid foundations for the long term rather than benefit from a sort of windfall. As far as the site was concerned, they immediately sold all the areas which they thought were slightly dubious to the town hall for a token rouble.

Q. : *This way of doing things is in contrast to Ford which, if I remember, got tangled up in corruption practices in Russian society.*

J. S. : The manufacturer I am talking about used his powers of negotiation to remove what he considered to be an excessive risk. Ford tried to compensate financially for the difficulties and risks by obtaining tax breaks over several years – seven, I think. However, even though in the short-term this appeared to be a sound financial transaction, it did not resolve the kinds of problems which I have mentioned. Seven years later, the company was still caught up in these difficulties and had not managed to integrate itself into Russian society which it had said it would do in exchange for tax reductions. As a result, the Russian administration asked the company to pay back the agreed tax advantages, but Ford did not do so and instead used illegal means in order to reduce the sums it owed... And finally, the company found itself even more a prisoner of its initial choice when the Russian government gained more power.

The return of law and order

Q. : *I recently learned about a study of a food company which set up business in the Russian health sector (for the manufacture of foodstuffs for patients in hospitals). The study described a nauseating world, full of corruption, aimlessness, and false accounting. Is this the general situation ?*

J. S. : Yes, as far as the health sector is concerned, but less and less so on a country-wide scale. It is almost official knowledge that the Russian healthcare system is hugely corrupt. President Medvedev has specifically warned this sector on two occasions. In the medium-term, it will have to be completely reformed. Other sectors which are similar to the health sector in terms of being corrupt or having Mafia-like tendencies include the fashion sector and the ready-to-wear clothing industry. However, on the whole, throughout the social system, corruption has been largely reduced over the past ten years. People in power still often try to take advantage in order to supplement their incomes, but no longer take the risk of engaging in large-scale embezzlement operations as was the case in the years following the fall of the Soviet Union.

Q. : *The chaos in the 1990s was also marked by the 'oligarchs' who amassed colossal personal fortunes when companies became privatised. What is their real power currently ?*

J. S. : Their power has greatly diminished. The oligarchs are now controlled almost entirely by the Kremlin. As far as business is concerned, they no longer make any large investments without first having approval from the state.

Cultural adaptation

Q. : *You emphasised the length of time necessary to acquire informal knowledge. But there are, perhaps, ways around this, for example with help from the French Embassy or using networks which exist between entrepreneurs from the same country and which could enable people to share their experiences.*

J. S. : I am not very impressed by the services available from the French Embassy. The embassy certainly offers much less help and advice to its nationals than other embassies such as the Japanese Embassy. I was able to compare the two at information days organised by both embassies : the difference between them in terms of professionalism was huge. One looked like it was a fair organised by students, and the other by professionals. The Japanese are very strong in this area. This is based on their tradition of general trading companies – the *sogo sosha* – which have been the foundations for outsourcing the Japanese economy for many decades. Networks between French companies are not used to organising events where they can talk about business practices and experiences.

Q. : *Another way of saving time is to hire Russians who know France well, or French nationals who have lived in Russia for a long time.*

J. S. : It is possible, but it is not very efficient at the moment because these people are being courted a great deal and can behave like genuine mercenaries, leaving one company at the drop of a hat for another when they get a better offer. On average, they only stay a few months in a job. This length of time is sufficient to solve a specific complication, but not to build a project. The only real solution for a company which wants to have long-term projects is to create its own core of talent, either with expats who will stay a long time, or with local executives who will remain loyal.

When the French car manufacturer expressed his wish to set up a factory in Russia, he called on one of his directors who had worked for the company in Indonesia for several years. He did not know Russia specifically, but he was aware of the sort of practices which existed in non-Western countries and this clearly helped him. This is an intermediary solution.

Q. : *You have not mentioned the need to know the language.*

J. S. : I should have talked about that. To handle technical problems, it is not completely essential, because we can be accompanied by an interpreter, or we speak good English (which is the language which the Russian elite use and is being increasingly spoken by Russians). However, in order to get beyond this and really get to know the informal and related information, mastering Russian is practically a prerequisite. Even if one has one's translator at one's side, one loses a great deal of information because many elements are nuances and are lost in translation. There are also cultural concepts which cannot be translated precisely or have no equivalent.

Q. : *Integrating oneself into the culture is useful but there are limits, notably on the subject of nationalism. It is wrong to think that one can completely ignore nationalism by assimilating oneself into the culture. One must leave them something, in other words, leave the nationals some power even if one has assimilated their culture. Renault took part in two large-scale international operations one of which – the collaboration with Volvo – ended in failure despite many efforts at cultural rapprochement by sending large numbers of expats to Sweden for long periods of time. The other with Nissan was a success : Carlos Ghosn emphasised respect, not only for the culture, but also for the nationality. In this second collaboration, Renault was very careful to make sure that there were fewer expats and that a large part of the decision-making remained in the hands of the Japanese who were in charge.*

J. S. : It is true that nationalism is also a key factor. I saw an example of this in Russia when Western companies sent out teams of Eastern Europeans who had already been working for them for some years, imagining that because they spoke Russian perfectly and were culturally close to the Slav culture, that it would be easier for them. Very often, their Russian counterparts have a nationalistic reaction and refuse to let themselves be dominated by these Eastern Europeans, and so the supposed advantage is effectively lost.

The sense of long-term

Q. : *Traditionally, Germans concentrate on the long-term. Therefore, their method of managing executives takes into account the individual, the length of time they intend working for the company, and their progress in the company. From your experience in Russia, are there any differences between German and French companies with regard to how long they stay ?*

J. S. : Firstly, one must stress that German banks no longer follow their traditional method of functioning, and have started following the Anglo-American example. This method is characterised by a very strong share-holder pressure in the short-term. Medium-sized industrial companies are also increasingly attracted by the short-term, and in the end succumb to windfall effects. I think that only large companies still have a long-term vision. However, as far as their behaviour in Russia is concerned, I do not get the impression that on average these large companies have a more long-term vision than French companies. On the other hand, they have inherited a favourable image in terms of being very solid and rational, which has undoubtedly helped their attempts to establish themselves in Russia.

One should note that there are many young Russian students who go to finish their studies in Germany. I think that there are about 3,500 to 4,500 of them. This is many more than those who go to study in the United States, contrary to what one often thinks. The link with Germany is very strong.

Q. : *Is France capable of attracting Russian students ? Does it have sufficient structures and networks to do so ?*

J. S. : No. I am currently working with people on a project to create a Maison de la Russie (House of Russia) at the Paris Cité universitaire so that a solid base in Paris can exist to attract and welcome Russian students, but we are having a hard time getting French companies interested and finding the money to finance it. We just cannot motivate the French, whereas if we were to ask Russian companies, we would undoubtedly be able to find half the money necessary. It really is a shame.

Q. : *State financial aid is not the only factor which enables companies to think on a long-term basis. There is also capital in family-owned companies.*

J. S. : I do not know this specific subject very well. All I can say is that a large, family-owned French retailing group is doing well in Russia, and that it conducts its business on a long-term basis. Generally, French family-owned companies are too small and do not have the investment power to set up businesses in faraway locations, contrary, for example, to family-owned German companies.

Q. : *French companies are world leaders in water treatment and distribution. I notice that they tend to function on the basis of long-term contracts. The French method of making contracts with public authorities means that financially they lean very heavily on the state in the broadest sense of the word, even if they are privately owned. Do they succeed in Russia ?*

J. S. : It is the case that in the area of waste and water treatment we do have a know-how which is easy to sell abroad. To be truly competitive in Russia, these companies need to know how to adapt themselves to the specifics of the market in the ways in which I outlined in my talk. In this particular case, that means offering very cheap, technical know-how, even if that means that profits are small. Apart from a few municipalities, such as St Petersburg, which have a lot of money and can buy the necessary machines, most municipalities are very poor. I understand that there are biological treatment techniques which are capable of responding to this challenge. It is in the hands of the technicians.

National communities present for the long-term

Q. : *Which national communities are best established commercially or industrially in Russia ?*

J. S. : The largest and most efficient community is undoubtedly the Indian community. This was already there when it was still the Soviet Union, and because of the political closeness of the two countries, they are still there. There are about 8 million Indians residing in Moscow compared to a few hundred French people. Another community which is also there, but more in the Far East than in Moscow, is the Chinese, although this is not so obvious. The Chinese are strengthening their ties with Russia. This can be seen in numerous joint projects between the nationals of both countries.

Q. : *Who are the French who are permanently resident in Russia ? Why are they there ?*

J. S. : Some of them fell in love with the country when they first went there, and decided to stay. Others are children of second or third generation émigrés. When these people go to the country of their ancestors, they feel that they are going back to their roots.

Q. : *And you ? What made you want to specialise in this country ?*

J. S. : Although I am not an expat, I am one of the third generation émigrés, and this is what attracted me. My father was born in Moscow. This was what motivated me to find a profession which would give me the opportunity to go there regularly and get involved.

Presentation of the speaker :

Jacques Sapir : graduated from the IEPP (*Institut européen des politiques publiques*) in 1976. He wrote a postgraduate thesis on the organisation of work in the USSR between 1920 and 1940 (EHESS, 1980) and his PhD was about investment cycles in the soviet economy (Université Paris X, 1986). He became a professor at the EHESS (École des hautes études en sciences sociales) in 1990. He has been a director of studies there since 1996 and manages the Centre of studies of methods of industrialisation (Centre d'études des modes d'industrialisation : CEMI-EHESS). He has also taught in Russia at the High School of Economics (from 1993 to 2000) and has been a professor at the Moscow School of Economics since 2005.

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