

Adaptation of Companies in the Republic of Karelia to the Economic Recession in Russia in 2014–2015



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Abstract. Regional companies in Russia found themselves in unique conditions of negative consequences of sanctions and reducing resource revenues in resource-driven Russian economy. Regional companies are not ready to the new economic reality, which makes it a hallmark of the economic recession in 2014–2015. Our study captures the reaction of regional companies to sharp market changes and selection of new adaptive patterns of behavior aimed at developing and sustaining business. The purpose for the study is to assess the impact of the economic recession in Russia in 2014–2015 on the adaptation of companies in the Republic of Karelia to recession conditions. The impact of events was recorded directly from the estimates and intentions of management in the process of conducting half-formalized in-depth interviews with companies' leaders. Based on the method of quota arrangement, we selected key stakeholder companies in 3 regions in the Republic of Karelia and made a list of special respondents occupying leading positions in the companies. Empirical data were collected by in-depth interview method, where the key topics were the condition of business, strategic development plans, launch of new product lines, current partnership capital. Data were analyzed using methods of condensation of meaning, topic grouping, and constant comparisons. The study created a homogeneous database of 18 quality interviews whose content analysis helped identify key categories used by the respondents and the nature of their influence on economic behavior. We formed a typological image of stakeholders depending on the pattern of behavior in the Republic of Karelia and made a conclusion about the reaction of stakeholders to the recession. The

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research results are applicable in determining the priority areas for supporting stakeholders in a factor-driven region based on the models of their economic behavior amid economic recession. We assess the readiness of international cooperation in the context of the national policy of import substitution. The study includes key stakeholder companies in several regions in the Republic of Karelia during the period of intensive changes. Knowledge about the success of the models of anti-crisis behavior is possible to be improved on the basis of qualitative sociological evaluations by comparing with business models of regional companies in the period of subsequent stabilization.

Key words: regional companies, stakeholders, economic behavior, crisis models, quality interviews.

Introduction. The economy of the Republic of Karelia is heavily dependent on its primary industries. The companies working in these industries are the largest employers in the Republic, and their tax payments collected on its territory constitute a significant share of contributions to the federal and regional budgets. In the economy of the Russian Federation in the period of its existence the primary sector of the economy and the developments in international commodity markets have become essential. “The main risk has always consisted in the dependence on the oil and gas prices” [9, p. 6].

The changes that happened in 2014 in the international markets of mineral resources, the weakening of the national currency and the change in international political conditions negatively affected the business of Russian companies, which are major stakeholders¹ [17, p. 4] in Russia’s regions. Effective demand within the country reduced rapidly, and the import prices in rubles grew. The vast majority of economic assessments of the Russian economy of 2014–2015 indicate an economic downturn with negative dynamics.

¹ *GOST R 51897-2011. Rukovodstvo ISO 73:2009. Menedzhment riska. Terminy i opredeleniya* [GOST R 51897-2011. Guidelines ISO 73:2009. Risk management. Terms and definitions]. Moscow: Standartinform, 2012. 12 p.

An important issue is the social sustainability of settlements, in which these companies are major employers, and often – backbone enterprises [7]. The unstable economic condition of these companies means the growth of unemployment, reduction of investment programs of development and modernization of production. Lingering crisis effects destroy the social stability of settlements and pose a threat to their socio-economic security. A change in the situation in the economy is an incentive to search for new models of economic behavior, development and preservation of sustainability of the business.

The impact of the events of 2014–2015 in the Russian economy on the stakeholders in environmental management of the Republic of Karelia was assessed within the framework of a subproject of the Institute of Economics of Karelian Research Center of the Russian Academy of Sciences entitled “An economic and sociological research on the subject “Evaluation of the structure and development strategies of stakeholders in environmental management of the Republic of Karelia” under an international project KARLANDS within the framework of the contract with the Center for Economic Development, Transport and the Environment for North Karelia (Joensuu, Finland).

Research methods. The goal of the project was to select key stakeholders in the given territories of the Republic, to evaluate their performance and strategic status in the region and to assess their preparedness for diversification on the basis of investment in development and international cooperation.

Muzyzersky District of the Republic of Karelia, Kostomuksha Urban District, and the city of Petrozavodsk were chosen as pilot areas for the study.

In the first, cameral, phase of the project, the information on the structure of stakeholders of the pilot areas, their trade turnover, production volume, number of employees, financial status was gathered from open sources. The data of the open sources was also used to analyze their partner contacts and cooperation experience.

Based on the analysis of the market position of the company, the key stakeholders were chosen in the selected territories on the basis of the quotas uniform in their number for the regions of the Republic of Karelia [14]. For the field phase of the study, a list of special respondents – company executives competent in the work of their organization was formed.

During the second, field, phase of the project, in-depth semi-formalized interviews with senior executives and representatives of management of the companies of the first phase were conducted. The interviews contained open-ended questions on the size of companies, their strategic investment units, and partnership capital. The key topics included those concerning the companies' plans for business development, the launch of a new, maybe a non-core, production, and readiness for international cooperation [20].

The study resulted in the formation of a homogeneous base of 18 qualitative interviews with representatives of companies operating in the territory of the Republic, the number of which is sufficient to form a typological picture [1, p. 58].

Analytical methods. The interviews were analyzed with the use of sociological methods of qualitative data analysis. The objective of these methods consists in interpreting private experience and translating it into scientific language. In each case the experience of each company we interviewed was considered with the help of individual assessments and subjective perceptions [10].

From the interviews, by highlighting the “natural units of meaning” expressed by the respondent, we formulated a set of topics present in the text. A. Giorgi calls this definition of the topics a “condensation of the sense of the interview” [5, 19]. M.B. Miles and A.M. Huberman in their work put forward 13 ways of extracting meaning from qualitative texts and its deep interpretation [21]. The allocation of topics helps see “what is aligned with what”; it is a way to achieve greater integration of the data [5]. The topics that were common and recurring in the texts of the interviews we conducted with stakeholders were structured, and the data are summarized in the *Table*.

The basic task of empirical sociological methods is to search for the knowledge about the types of social, cause-and-effect relationships that describe and explain social phenomena [12]. Common types are identified through the data analysis “from the particular to the general” with the help of logical induction method. Inductive analysis begins with cross-

Description of the types of stakeholders in the Republic of Karelia according to the topics highlighted in the interviews

Topic	Stakeholder type		
	Subsidiary companies	Loyal companies	Competitive companies
Size	Divisions and subsidiaries of large Russian and multinational groups	Small and medium companies (limited liability companies, cooperatives)	Small and medium companies (limited liability companies, cooperatives)
Market	Domestic (Russian) and external (global) markets. Dependence on the global trends in prices	Domestic market (other regions, megacities)	Domestic and foreign markets (Republic of Karelia, Russian regions, neighboring countries)
Consumers	Processing enterprises within the group of companies, including those abroad; various large Western and Russian consumers	One major contractor represented by a state monopoly or a company controlled by the state	Many private consumers, public procurement
Strategy	Formed outside the region and depends on the global plans of the group of companies	Strategy for the conservation of the order and 100% capacity utilization	Strategy for profitability and preserving competitiveness on the market
Independence	Executive director and heads of departments with limited powers and resources, restrictions on the sums of transactions	Dependence on major customers (sum of the order, volume of the order, terms of payment)	Full independence and mobility
Cross-border cooperation	As part of the core strategy of the group of companies, shipping products to foreign enterprises of the group, conclusion of international transactions through the central commercial units or with their consent	It is not interesting and it is not considered	Planning and concentration of resources in competitive markets, international cooperation, intensive search for partners (Nordic countries)
Reaction to recession	Greater stability in the presence of foreign currency earnings and favorable global market prices. Balance between reducing the costs caused by depreciation of the national currency and rise in prices of imported equipment. In the adverse scenario: failure or interruption of investment programs, reduction of production and personnel	Reduction of costs, abandonment of plans for equipment update, switching to domestic equipment and supplies	Curtailing unprofitable or unprofitable production, search of new investment opportunities, focusing the resources on new projects or directions
Source: compiled with the use of the data of the field study.			

examination of individual cases, with the further formation of groups according to similar features, where the grouped data are denoted by categories [6].

During the study, the respondents indicate their concerns using local systems of categories. To identify and refine the categories, sociology uses the technique of constant comparisons that helps formulate a theoretical description of the processes through induction repetitions [4]. In our study we did not aim to formulate

a comprehensive theoretical description, but rather to reflect distinctive regional processes. However, the method of “continuous comparative analysis”, which is part of the scientifically substantiated theory, allows us to receive relevant categories and to formulate insights and hypotheses [4, 11]. It is necessary to compare one case within the category with the previous cases in the same and other groups coded in the same category, so as to find out generalizing and theoretical properties of

the category and its relationships with other categories [18]. In our study, we compared cases from different companies and formulated explanations common to the groups, the explanations that could be identified by generalized and explanatory phrases and categories.

Results of the study. In the texts of the interviews of our respondents, grouped into topics, we recorded the negative nature of their statements as a response to the emergence of “sore spots” generated by the recession in the Russian economy since the end of 2014. In the end it turned out that the reasoning of the respondents on the vast majority of topics focused on the challenges caused by internal organization, lack of independence, and dependence on external and internal factors. The nature of the problems is generalized to the fullest extent in the “limitations” category, which was used, in particular, by respondents themselves. According to the nature of the limitations, this category was divided into the following components:

- organizational and functional limitations;
- consumer and market limitations;
- institutional and regulatory limitations;
- infrastructure and transport limitations;
- technological limitations.

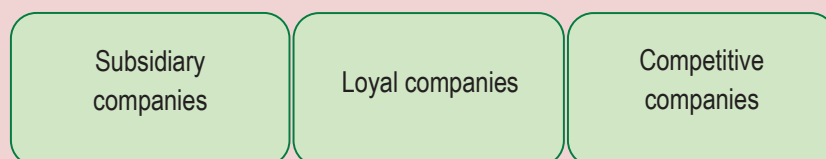
Despite the fact that the degree of influence of the given restrictions on the behavior and

processes in the companies was different, the greatest impact on the strategies of the companies was made by external causes that lie outside the region. This is consistent with the raw materials export-driven nature of the economy of the Republic of Karelia [3].

Taking the “limitations” category as a basis and considering the external nature of limitations in relation to the region and also the degree of their influence on the strategic vision of management, we divide the companies under consideration into three types presented in the Table and in the *Figure*. In the framework of our regional study it is quite difficult to consider the obtained empirical regularities typical of all regions. These types are characteristic of the Republic of Karelia and can be unstable in other regions of Russia. Therefore, in the case of the allocated three types it would be more correct to speak of a typological syndrome as an empirical regularity discovered in the process of data analysis [12, 13]. We provide descriptive generalizations for the types of companies selected.

The mining complex of Karelia ranks second in the volume of industrial production in the region after the forest industry. Karelia produces a variety of mineral products, but in large quantities it produces only iron ore pellets (black metallurgy) and non-metallic materials (crushed stone, stone, sand-gravel mixture, gravel) [16].

Types of natural resource user companies in the Republic of Karelia



The type of *subsidiary companies* includes the largest mining and processing works that provides almost all the iron ore (ore, pellets) in the region. From 2011 to 2015, the production grew by 4–5%, and the company felt virtually no impact of the coming crisis [2]. According to the strategy of the enterprise, the main risk factor was the decline in prices and demand for iron ore. As follows from the data² of the company InfoMine Inc., the iron ore prices for 2014 (rub/t) were slowly decreasing with the restoration movement at the end of the year, related to the devaluation of the ruble. The company did not experience large difficulties caused by falling prices.

The company supplies about 60% of products to the domestic market, the remaining 40% goes on export. It compensates for the fall in domestic demand at the expense of export deliveries to the enterprises of the group abroad. Out of domestic supplies, 65% of the production was shipped to the enterprise Severstal (Cherepovets).

The reduction of costs and personnel in 2014 was carried out in accordance with the plans adopted previously. The company had a business plan for a period of one year, its own development strategy for five years, and the program of technological improvement of the group for 30 years.

The director-general is authorized to make decisions the value of which does not exceed 10 million rubles. Accordingly, the investment strategy on the local and global markets was the responsibility of global management. The expansion of production is possible only after

consultation with senior management and provided that there is a resource base with relevant capabilities on site. The Karelian enterprise does not have the infrastructural capacity to increase production, because the city does not have available electric power facilities.

Diversification of activity and extension of the production cycle on the territory of the Republic was not reflected in the production plans of the group. It was planned to open its new subsidiaries, but Karelia was not considered as a site for the investment in development.

Contracts for production equipment and vehicles are concluded by Russian affiliates of foreign manufacturers of machinery and equipment (Komatsu, Caterpillar, Metso). Importers of machinery in this case are Russian subsidiaries of international companies. Export contracts for the supply of iron ore are in the competence of Central, commercial offices, while Karelian enterprise stands as one of the production units of the group.

The group of subsidiaries also includes enterprises of the Karelian forest complex, which determines specialization of the whole region and which was losing its competitive position during the past decade [15]. According to a representative of a large timber holding company, the crisis had hardly any impact on the volume of harvesting of the company in 2014. Logging is based on the involvement of contractors, which allows having a minimum number of personnel in logging units of the group with a maximum harvesting of trees at the allowable cut. Timber is delivered to processing enterprises of the group, and exported across the Russian-Finnish border.

² Data of InfoMine Inc. Available at: <http://www.infomine.com/ChartsAndData/ChartBuilder.aspx?z=f&gf=140262.USD.t&dr=5y&cd=1>

Regional production units were controlled by the executive director, whose limit of spending per one contract without the consent of the parent company did not exceed 700 thousand rubles at the time of the interview. Investment decisions were made by Moscow executives in accordance with the national plans to accommodate new production, and depending on the forecast market volumes for each product produced by the group.

International contracts for supply of timber were concluded through the Russian representative offices of European companies involved in timber trade, or through direct deliveries to Finnish saw mills and timber companies. Such a contract requires approval of head divisions of the holding during the quarter. Issues of pricing and new contracts are resolved through a centralized sales department. Similarly, the company concludes contracts with Russian representatives of suppliers of European and American forestry equipment (John Deere, Ponsse, Volvo).

The contracts for export deliveries to the EU are limited by international requirements for sustainable forest management and trade. International nonprofit organizations provide forest certification services ensuring the possibility of international cooperation required for international trade in forest products [8].

At the end of 2014, the holding company did not plan any active investments in timber harvesting in the Republic of Karelia. The holding company considered pulp and paper industry of the region as the main object for investment. According to senior executives the company refused to develop new sawmills and wood processing industries due to the lack

of personnel, lack of demand and constraints on the possible competition with the group's companies in other regions.

In the database of the interviews on the results of the research with participation of representatives of limited liability companies and cooperatives working in the sphere of extraction and processing of non-metallic materials, we should highlight the companies that focus on the domestic market and on one major customer, with long-term contracts (large state-owned companies, federal infrastructure projects). This is the second type of companies: *loyal companies*.

Being of the leading regions of the Russian Federation on the reserves of building stone, Karelia has always been providing high-strength gravel to almost the entire European part of Russia, where there are no strong igneous rocks [18]. The important role was played by major transport and construction projects of federal and regional importance that provided a continuous increase in demand. From 2011 to 2015, the production of construction stone in the Republic of Karelia grew by 38.5%, while the production of crushed stone – by 96%, i.e. virtually doubled [2].

As subcontractors on the objects of federal significance, the companies do not adopt long-term development plans and strongly depend on the consumers of their products. Main strategic objectives of such a company consist in streamlining and loading their production by 100%. Investment in equipment depends on its condition and the availability of financial resources.

Major institutional problems are related to the federal land legislation on the use of forest land, despite the consent of leasers of forest

land. There emerge many administrative barriers. In one of the companies with a license the registration of land was not finalized within four years. In order to open a quarry, it was necessary to obtain more than 127 approvals. Great problems arose because of the requirements of fire safety, the execution of which had led to excessive costs for the additional activities and staff.

Such companies face another major problem that consists in attracting project financing to expand production, open new pits or deepen the processing.

For the companies operating in the internal market that do not have foreign exchange earnings, the depreciation of the ruble has become more of a problem of rising costs of imported equipment and consumables, rather than a benefit of increasing competitiveness due to decreased costs. In the context of the crisis, these risks were particularly pronounced in the form of refusal to purchase new equipment and sign new lease agreements. The company management recognized the problem but saw no possibility of using Russian machines and equipment instead of their foreign counterparts due to their poor quality or lack of decent analogues. Russian production facilities of Western companies are only partially localized, which results in a lower quality of “imported vehicles with Russian registration” with the increase of the ruble value of its import aspect since the end of 2014.

The dependence of production on the major customer implies the need to consider disputable situations in contracts in more detail. The actual contract situation is far from ideal. It is complicated by the investment of the contractor in expensive and specific assets for

production purposes. It is necessary to provide for the mechanisms for conflict resolution, which is very difficult in practice, in the context of the monopoly of a single large customer.

At the stage of signing the contract when using competitive procedures the victory often belongs to the company that does not have its own full-fledged production base and attracts its competitors for sub-contracts. If this practice continues for 10 years, then it can be considered a rule, to which Karelian companies are forced to adapt. Over time, the dependence of such a supplier is only strengthened.

But the company’s management considered the situation as an opportunity to solve other problems. Such problems were the delay of payments by large consumers, creating cash gaps that lasted a quarter in the budget of the supplier. As a result, there is a lack of financial resources for the execution of current expenditure obligations of the enterprise. The contract with the mediator who won the contract, by contrast, means the timeliness of payments and independence from debt markets.

Thus, the negative practice when dealing with large monopolies is considered by company management as positive, despite a loss of profit in comparison with conditions of the direct contract.

The third type is *competitive companies*, i.e. those that work with different customers, more flexible in business and ready to develop international cooperation in different directions.

Pre-crisis development of one of these companies was based on a two-year work plan, the purpose of which was to preserve the profitability of production and maintain its positions in the market.

In the crisis conditions of falling demand for crushed stone in the domestic market, the risk of shutting down the quarry at the time of the interview actually materialized. The company's management was not ready to save the loss-making business, hoping to renew the demand, as it did not meet the objectives of the company and led to the closure of the production.

Such companies were more affected by the crisis, but they were flexible in the use of the accumulated resources and in the changing profile of the business. Their crisis model of behavior was to search for possibilities to organize production of the most competitive product capable to generate profit in the medium and long term. The management of the company concentrated its accumulated investment resources in this direction.

The owners of the interviewed company were in the process of finding new opportunities for localization of competitive production of feed for the trout on the territory of the Republic of Karelia. The company at the time of the interview had both organizational and financial resources to create local production.

The problem was to find an international partner willing to provide competitive technology, access to production equipment and a brand for entry into the joint capital. Entrepreneurs looked for partners in the Nordic countries in various areas, but encountered problems with making contact or faced complete lack of interest on the part of potential counterparties.

Conclusions. In conclusion, we can state that in the context of recession, the Republic of Karelia was not considered as a platform for development and international cooperation by federal and international business groups due to a lack of personnel and a low demand, and in connection with restrictions on competition among the companies of the group in other regions (intra-group competition). Only single or already launched projects were implemented.

The companies that participated in the implementation of investment projects of state monopolies or projects of federal importance did not consider alternative opportunities for business diversification and faced the risks of sudden and massive cuts in public investment budgets.

The companies of the Republic of Karelia responded to the crisis by refusing to make major investment expenses, and by optimizing their business structure and reducing personnel costs. Some of them, having lost the demand, were forced to shut down or reduce their business dramatically.

As a result, only few of them set the goal of import substitution through the development of production of goods based on international cooperation as a crisis behavior pattern. Most companies were forced to look for every opportunity to save their business.

Our research has allowed us to expand practical understanding of the successfulness of the models of crisis behavior of regional companies of the Republic of Karelia on the basis of qualitative social assessments.

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