

Transition economy institutions and international  
investments: Case Kazakhstan

**Jyväskylä University School  
of Business and Economics**

**Master's thesis**

**2018**

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## ABSTRACT

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Title of thesis Transition economy institutions and international investments: Case Kazakhstan	
Discipline International business and entrepreneurship	Type of work Master's thesis
Time (month/year) June 2018	Number of pages 70
<p>Over last two decades, drastic changes in institutional environment of transition economies and its impact on attracting inward foreign direct investments (FDI) received close attention from the academic scholars in the field of international business. However, mechanisms of locating investments by Finnish firms to transition economies of Central Asia remain unexplored and require thorough investigation. In order to overcome the research gap, this qualitative case-study was conducted. The study aims at gaining a deeper understanding of institutional transition in the context of Kazakhstan economy and its influence on Finnish outward FDI. The institutional environment of Kazakhstan was constructed through the cognitive frames of various actors representing host and home countries. The theoretical paradigm of an institutional distance was incorporated in the scope of research to explore entry mode strategies of Finnish firms under distinctive institutional settings of both states. The cognitive frames of host and home country actors were elaborated through in-depth interviews and the method of content analysis. The actors represent facilitators of economic cooperation and Finnish firms doing business in Kazakhstan. The overview of Kazakhstan economy, institutional development and characteristics of trade between both states, presented in the case description, enriched the context of the study and enabled utilization of data triangulation.</p> <p>The evidences derived from the research provide solid grounds for several implications. The institutional transition is characterized by implementation of massive legislative, financial reforms and state programs with the purpose of creating transparent, accountable environment for foreign investors. Despite of the notable changes in regulative and normative domains, the presence of informal institutions such as corruption, political clans Zhuz diminish the quality of the institutional environment in terms of attractive location for investments. Discovered attributes of institutional distance insignificantly influence choice of entry mode to Kazakhstan. Finnish investments refer to transfer of technology and managerial competences to local parent firm as a source for development of non-commodity sectors. Close interaction between home and host countries' institutions at governmental level, valid bilateral investment treaties effectively facilitate the Finnish FDI flow to Kazakhstan.</p>	
Keywords: transition economy, institutional distance, outward FDI, Kazakhstan, framing	
Location: Jyväskylä University Library	

## ACKNOWLEDGMENTS

The initial idea of the master's thesis was born due to my genuine interest towards CIS countries like Kazakhstan in terms of potential investment destination for Finnish firms. I strongly believe that my thesis would benefit development of trade between both countries and provide insights on facilitation of Finnish outward FDI to Kazakhstan. I would like to express my gratitude to management of the East Consulting Oy who revealed their inner interests towards thesis topic and cooperation with me. I received support and useful piece of advice in terms of topic evaluation and identification of potential candidates for the interviews. I would like to address my thankfulness to the Embassy of Kazakhstan in Finland and its diplomatic personnel who were willing to participate in my research and provide insights on institutional development in Kazakhstan. I appreciated the invitation from the Embassy to attend the lecture given by the Chairman of Majilis, Mr. Nigmatullin at the University of Helsinki.

I am very grateful to Professor Kalle Pajunen, who patiently guided me through the whole journey of the thesis execution. Kalle Pajunen as an academic scholar himself was very helpful in terms of conducting literature review, shaping theoretical framework and data analysis.

I would like to thank all representatives of the Finnish companies, FINPRO and educational institution who agreed to take part in my research and data collection through in-depth interviews. The interviewees' experience in doing business in Kazakhstan, shared opinions and observations allowed to collect rich data for deep analysis and answer research questions.

The whole project of the Thesis cannot be completed without dedicated support of my husband, Marko, my daughters, Anna and Linda and my parents who strongly believed in success of my thesis and my capability to carry it on till the end of the long process.

June 2018.

Elena Summanen

## **ACRONYMS AND ABBREVIATIONS**

**BIT-Bilateral Investment Treaty**

**EAEU -Eurasian Economic Union**

**EU-European Union**

**FDI-Foreign Direct Investment**

**FIC- Foreign Investor's Council**

**IGC- Intergovernmental Commission**

**IMF -International Monetary Fund**

**MNE -Multinational Enterprise**

**JV-Joint Venture**

**OECD - Organization for Economic Co-operation and Development**

**SME Small and Medium Sized Enterprise**

**SEZ -Special Economic Zone**

**SOE -State Owned Enterprise**

**GDP-Gross Domestic Product**

**UNCTAD-United Nations Conference on Trade and Development**

**WTO -World Trade Organization**

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# 1 INTRODUCTION

Over two decades, transition economies became an attractive destination for locating direct investments from developed countries due to liberalization, availability of resources, acceleration of the market growth, and generous investors' incentives. In 2016 foreign direct investment (FDI) flows to transition economies reached 68 billion dollars with 3,9% share in the world. (UNCTAD: World Investment Report 2017). Despite of the attractive location factors transition economies represent a challenging environment for the foreign investors due to fundamental changes in its institutions.

The domain of research focused on institutional transition and its impact on attracting FDIs appeared in recent research agenda of international business studies (Bevan, Estrin, Meyer, 2004; Kostevc, Redek, Sušjan, 2007; Pajunen, 2008). The research on transition or emerging economies has been divided into several streams including institutional distance and its impact on choice of entry strategies (Meyer, 2001; Brouthers, 2002; Xu, Shenkar, 2002; Peng, 2003; Eden, Miller, 2004), knowledge transfer and learning in parent organization (Mihailova, 2015), firm's capabilities to cope with uncertainty (Kostova, Zaheer, 1999; Roth, Kostova, 2003) and hassle environment of the transition economy (Henisz, 2000)

The strategical paths of Finnish outward FDI to transition economies are insufficiently studied and represents potential area for further examination. This study is focused on the institutional environment of Kazakhstan under transition and the key factors influencing Finnish investments flow to this country. In this study the institutional environment of Kazakhstan is constructed through cognitive perception by various actors involved in facilitation of trade and investments between host and home countries. The concept of the institutional distance and its impact on ownership strategies of Finnish firms entering Kazakhstan was integrated into the research scope.



The composition of the Thesis follows the clear structure including formulation of research objectives and questions, comprehensive theoretical and methodological framework, brief overview of Kazakhstan economy and development of institutional environment, depiction of research findings and conclusion part.

## 2 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS

This study is aiming at answering several research questions. The first research question refers to the cognitive frames of multiple actors in their perception of host-country institutional environment. The second research question tackles the concept of institutional distance between host and home countries and its influence on ownership strategies pursued by Finnish firms doing business in Kazakhstan. The third question aims at increasing our understanding of the mechanisms of outward investments' flow to Kazakhstan in context of institutional framework of both states.

Research questions can be formulated as follows:

*How do the main actors of host and home countries perceive the institutional environment of Kazakhstan under condition of transition?*

*How does the institutional distance between Kazakhstan and Finland impact on ownership strategies of Finnish firms?*

*How do the main actors perceive facilitation of Finnish outward FDIs to Kazakhstan in context of institutional environment?*

### **3 THEORETICAL FRAMEWORK**

The methodological framework is based on multidisciplinary approach to enhance knowledge of studying subject, follow the recent research agenda and guide the direction of this research. The relevant theoretical concepts have been derived from the field of foreign trade, international business and internationalization of MNEs, strategic management, organizational and institutional theories. The concepts have been critically examined and analyzed in relation with studying subject and research guideline. It is important to notice that due to the nature of qualitative approach and content analysis method used in this study the presented framework mainly serves as an outline for research design and identification of relevant themes and categories.

#### **3.1 The core principals of institutional theory**

The fast pace of globalization in recent decades, rising of transition economies in world trade arena, and changes in patterns of foreign direct investments create challenges and opportunities for multinationals companies. The strategic choice of markets for internationalization is determined by institutional landscape in a target market. The concept of institutions is complicated and multidimensional that provides opportunities to apply this concept in various disciplines and fields of research. North (1991) defines institutions as a set of informal and formal constraints that structure economic, political and social interactions. According to the definition formulated by Scott (2008, 48):

“Institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life.”

Throughout the history, the institutions have been evolving to provide stability and reduce uncertainty. Due to economic constraints institutions reduce transaction costs and make the trade exchange feasible for all actors involved. The fundamental role of institutions in terms of relations with organizations can be defined as follows: creation rules of game, providing means to achieve common objectives as a result of existence and purpose of organizations, shaping the interaction between agents within the institutional framework (North, 1991). The creation rules of game are associated with the regulative pillar of institutions, which incorporates functions of controlling and inspecting other’s conformity to established rules and if necessary imposing sanctions to obey the rules (Scott, 2008). The normative pillar is based on norms and values that are shared by either all members of collectivity or selected types of actors. The important role of the normative pillar refers to setting the goals and objectives and designing the appropriate means to achieve them (Scott, 2008).

The recent stream of research has drawn attention to the concept of comparative capitalisms in context of institutions. Jackson, Deeg (2008, p.541) underline that “institutions exist in distinct national configurations that generate a particular systemic logic of economic action and competitive advantages related to complementarities among those institutions”. This concept focuses on supply-side of institutions providing resources such as labor, capital to the firms, determining their usage and coordinating interactions between the firms and institutions.

### 3.2 Institutional distance

The concept of institutions has been studied through various approaches in the field of international business. One of the main approaches investigates the crucial role of distance in context of institutions. The concept of distance serves as a measurement of fundamental differences between the host and home countries' institutional structure. The numerous of recent studies actively applied this concept to explore the nature of differences and its impact on MNEs strategic choice of a market selection and operation mode in distant markets (Kostova&Zaheer, 1999; Roth&Kostova, 2003; Shenkar, 2001; Ghemawat, 2001; Xu&Shenkar, 2002; Eden&Miller, 2003; Arslan&Larimo, 2010).

The three pillars of institutions - normative, cognitive and cultural- have been introduced and examined as components of institutional distance in research papers of Kostova&Zaheer, 1999; Xu&Shenkar, 2002. The research agenda of Kostova&Zaheer, 1999 study covered institutional distance and its influence on building legitimacy of MNEs in host countries and transferring organizational routines and managerial practices. According to the scholars MNEs face more challenges to establish and maintain legitimacy in host country with greater institutional distance. Xu&Shenkar (2002) argued that strategic choice of target market in terms of institutional distance should be matched with firm specific attributes to establish legitimacy of sub-unit of MINE in host country and ensure successful transfer of competitive advantage. When the strategic choice of target market has been made, entry strategies should be also aligned with institutional distance to sustain competitive advantage either from small distance or reduce negative effect from a large distance.

The outcome of research conducted by Arslan, Larimo (2010) and based on sample of Finnish firms investing in countries of Central and Eastern Europe, does not support findings of Xu&Shenkar (2002). The research revealed that high

normative institutional distance leads to selection of wholly owned subsidiary as an entry mode. Such disagreement with previous studies might be explained by pragmatic Nordic management style and unique characteristics of host country (Arslan, Larimo, 2010). In context of thesis the outcome of Arslan, Larimo (2010) study enhances our understanding of Finnish-based companies' preferences in response to normative distance.

Each component of distance exerts influence on entry strategies of MNEs and transfer of organizational routines to different extend. Normative distance is the most complicated and influential for foreign entrants in terms of constraints on transfer of routines (Kostova&Zaheer, 1999; Xu&Shenkar, 2002). Normative distance is associated with normative institutional pillar or normative institutions and is deeply rooted in values, beliefs and norms of society that are hidden from "outsiders" (Kostova&Zaheer, 1999). It creates additional pressures for foreigners to conform with host-country's common practices and localize their routines. In this sense local firms possess competitive advantage over foreign firms due to familiarity with domestic system of values and norms of behavior. Regulatory distance is easier to observe and interpret by foreign companies as legislative procedures are explicitly codified. Cognitive distance refers to cognitive institutional pillar and emphasizes mental schemas and frames used by the people in given country to select and interpret information (Kostova, 1997 in Eden&Miller, 2004). Cognitive institutions are characterized by cognitive anchors, social knowledge and intrinsic values which are inherited by the people in host-country.

The concept of psychic distance explains differences between the host and home markets in terms of language, culture, political systems and its influence on internationalisation process of the firms (Johanson, Vahlne, 1990). The foreign companies must adapt their strategies in distant host markets where the differences in institutional environment impose significant concern on organizational practices, routines and operations.

The mechanisms of technology transfer and diffusion of knowledge in parent organizations appeared to be important research topic in numerous studies. Mihailova (2015) underlined that Russian firms experienced positive effect of learning through JV with a foreign firm and upgraded managerial and technological capabilities, improved productivity and quality.

Ghemawat, 2001 distinguished four dimensions of distance including cultural, administrative, geographic and economic. In align with other scholars, researcher argued that each of the component of distance affects business operations in different ways. Ghemawat, 2001 gave examples of geographic distance and its impact on transportation and communication costs; additionally, cultural distance and its influence on consumers' product preferences. The researcher proposed a managerial tool" The Cultural, administrative, geographic, and economic (CAGE) distance framework that allows managers identifying and estimating the impact of distance on different industries.

	<b>Cultural distance</b>	<b>Administrative distance</b>	<b>Geographic distance</b>	<b>Economic distance</b>
<b>Attributes creating distance</b>	different languages	absence of colonial ties	physical remoteness	differences in consumer incomes
	different ethnicities; lack of connective ethnic or social networks	absence of shared monetary or political association	lack of a common border lack of sea or river access	differences in costs and quality of: <ul style="list-style-type: none"> <li>• natural resources</li> <li>• financial resources</li> </ul>
	different religions	political hostility	size of country	<ul style="list-style-type: none"> <li>• human resources</li> <li>• infrastructure</li> </ul>
	different social norms	government policies institutional weakness	weak transportation or communication links differences in climates	<ul style="list-style-type: none"> <li>• intermediate inputs</li> <li>• information or knowledge</li> </ul>

Figure 1 The Cultural, administrative, geographic, and economic (CAGE) distance framework. Ghemawat, 2001.

### **Institutional development in context of transition economies**

According to the definition provided by World Bank, transition economies are countries moving from centrally planned to market-oriented economies. Those countries are formed from former republics of the Soviet Union, the countries of Central and Eastern Europe, Central Asia, China, Mongolia, Vietnam. Such economies pass through several stages of transition process including *liberalization, macroeconomic stabilization, restructuring and privatization, legal and institutional reforms* (Transition economies: IMF perspective on progress and prospects, 2000). The liberalization and macroeconomic stabilization stages are characterized by allowance of setting prices in free market, reducing trade barriers, gradual movement of high-rate of inflation to more sustainable balance of payments, implementation of fiscal and monetary policies. Restructuring and privatizations as well as legal and institutional reforms enforce private ownership, limitation of role of state in economic sector and promotion of competitive policies and rule of law (Transition economies: IMF perspective on progress and prospects, 2000).

The evolution of institutions in context of transition economy represents a challenging and highly potential area for research. The institutional environment in transition economies has been gradually transforming in direction of market economy. The process of transformation demands to create attractive economic conditions for business, a system of private property and financial capitals, appropriate legal and regulative policies. Academic scholars emphasize importance of institutional development in transition economies and its impact on inward FDIs (Bevan, Estrin, Meyer, 2004; Li & Liu, 2004; Alguacil, Cuadros, Orts, 2011). Collaboration between investors and local policy makers in terms of effective exploitation of resources and capabilities, private sector development, banking sector reform, liberalization of foreign trade is among most relevant factors to stimulate flows of FDIs to economy in transition (Bevan, et al. 2004).



Alongside with development of formal institutions, it is essential to understand the role of informal institutions in transition economies. When governance infrastructure including “security of property rights and transparency of government and legal processes” is not well-enforced, informal institutions became significant in terms of creating mechanisms for trade exchange, accessing financial capital, corporate ownership (Peng, 2003; Estrin&Prevezer, 2011) Such types of informal institutions as corruption, clientelism, or clan politics are associated with constraints and “problem-creating role in undermining markets, states, and democratic regimes” (Estrin&Prevezer, 2011).

Establishing operations by foreign multinational enterprises in transition economies are associated with high transaction costs due to lack of information, long negotiation process with local partners and authorities, bureaucracies, corruption, weak legal framework (Meyer, 2001). Bevan, Estrin (2004) conducted a research to expand understanding of FDI's determinants from Western countries to transition economies. The results of empirical research revealed certain determinants of FDI's including unit labor costs, host and source market size and proximity. The foreign investors are seeking opportunities to benefit from lower production costs and availability of relatively inexpensive work force in economies of transition.

The attractiveness of certain markets for FDI's inflow is widely explained by favorable institutional factors. Pajunen (2008) pointed out complexity of institutional factors influences on FDI inflows depending on level of development of the country. According to the findings of Pajunen's research (2008), corruption and the lack of property rights are among foremost factors that might prevent FDI's to less-developed countries.

Under condition of fundamental changes in institutional environment of transition economies firms must be able to response strategically to such

changes and deal with institutional upheaval. Roth, Kostova (2003) argued that initial and current condition of institutional environment directly influence firms' behavior in coping with institutional upheaval. More specifically unfavorable institutional condition forces firms to use informal substitutes compared to firms in favorable institutional condition.

Depending on stage of the institutional transition foreign entrants govern their strategic choices in adaptation to uncertainty and resist various institutional pressures. According to Peng (2003) at early phase of transitions foreign entrants rely on local networks and prefer to choose less hierarchical entry modes such as joint venture due to imperfection of institutions. The pressure to align strategies with local norms prevails at this stage. During the late stage of transition, the regulatory environment improved, and market competition increased among all types of organizations that reflects on strategic choices of foreign entrants. They would deploy competitive strategy based on firm's capabilities and resources, internal practices, value and norms (Peng, 2003).

The positive impact from inward FDIs on economy of transition has been highlighted in recent studies (Kostevc, Redek, Sušjan, 2007; Alguacil, Cuadros, Orts, 2011; Lee, Fariza, Sharipova, 2015). The positive consequences from FDIs include growth of economy and volume of trade, transfer and diffusion of technology, development of human capital and employment, improvement of infrastructure. However, in order to achieve efficient spillovers from inward FDIs and stimulate economic performance institutional and macroeconomic framework should be stable, consistent and predictable for the foreign investors (Alguacil et al, 2011).

In case of Kazakhstan and mineral resources-oriented transition economies the results of studies revealed contradictive relationship between quality of institutional environment and inward flow of FDIs. Despite of the fact that the

quality in several areas of institutional environment has been decreased in Kazakhstan, the inflow of FDIs remains stable (Kostevc et al. 2007).

The flow of outward FDIs from developed countries to transition economies is facilitated by signing and ratifying Bilateral Investment Treaties (BIT) between partner countries. According to UNCTAD report (1998) the purpose of BIT is aimed at reducing risk of investing in a country, ensuring property rights as well as intellectual property rights, guaranteeing equitable non-discriminatory national treatment and most-favored nation treatment for the investor, and regulating arbitrate disputes. Egger, Plaffemayer (2004) emphasize positive and compelling effect of ratified BIT that is expressed in about 30% of real outward FDIs stock amount.

### **3.3 Framing**

The complex context of institutional environment for new entrants requires understanding of cognitive frames of actors involved at different levels. The institutional theories distinguish different types of actors including both individual and collective. According to Scott (2008) some of the type of actors such as nation-states, associations and professions participate in the construction of new institutional forms but also interact within the institutional frames and influence on existing forms and processes.

Framing and concepts of frames have been widely applied at institutional context. Cornelissen, Werner (2014) summarized definition of institutions from recent studies (Gofmann, 1974, Borum, 2004, Weber and Glynn, 2006) that “content” of institutions as taken-for-granted cognitive frames: “latent meaning structures that organize social and cultural experience across a general area of activity.” That statement is supported by Scott (2008, p.59), who emphasized the central

role of a cultural-cognitive conception of institutions played by the socially mediated construction of a common framework of meaning”.

“In terms of institutional construction, *states* (in collaboration with legal professionals) possess extraordinary constitutive power to define the nature, capacity, and rights enjoyed by political and economic actors, including collective actors” Scott (2008 p.121)

Individuals within an organization can be characterized as “knowledgeable actors” who construct their organizational realities and try to explain their intentions, experiences, thoughts, and actions (Gioia, Corley, Hamilton, 2012). That notion is particularly important in context of our research and it closely correlates with concept of framing. Construction of reality by various agents determines research design and methodological methods.

## 4 DATA AND RESEARCH METHOD

The whole process of research has been designed and implemented accordingly with purpose to answer the research questions and achieve the objectives of the study (See Figure 2). The research design follows the clear structure of sequential steps beginning from the formulation of approach and researcher's stance, proceeding to the strategies of data collection and data analysis and concluding with interpretation and presentation of the outcome.

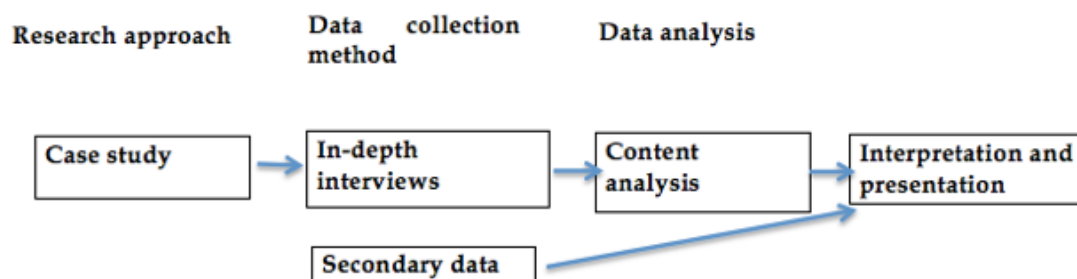


Figure 2. Structure of the research design

### 4.1 Theoretical paradigm and research approach

The primary step in research design starts from choosing a researcher's stance or inquiry paradigms." A paradigm or worldview is a basic set of beliefs that guide action" (Guba, 1990, p.17 in Creswell, 2007). Paradigm reflects to a researcher's general set of beliefs that shape perception of reality, research process and settings, methodology, generation of new knowledge as an outcome of research. There are various paradigms that are compatible with a qualitative inquiry such as post positivism, social constructivism, advocacy/participatory, pragmatism.

As a researcher, I would take a stance of social constructivism as the most suitable paradigm explaining my research position. Social constructivism emphasizes construction of meaning through exploring participants' views, experiences in the frames of historical, social and cultural norms where participants live. The constructivist researcher recognizes impact of own background on interpretation and acknowledges the flow of interpretation from own personal, cultural experiences (Creswell, 2007).

The research inquiry of the thesis can be characterized as a qualitative. The qualitative approach is widely applied in social sciences due to rich context of empirical data collected through various methods, researcher's involvement in interaction with studying object, freedom in data interpretation and possibility to construct concepts and frameworks from empirical data. Graebner, Martin, Roundy (2012) argued that qualitative data can be successfully incorporated in strategic studies due to three fundamental characteristics like *open-endedness, concreteness and vividness and richness and nuances*. Concreteness and vividness stimulate cognitive processes that encourage development of ideas.

The legitimacy of qualitative inquiry in this study can be justified by several factors including social constructive paradigm, nature of research questions, and understanding of different actors' cognitive frames. There are certain characteristics associated with a qualitative study. Creswell (2007) outlined main characteristics embedded in qualitative research: the key role of researcher in terms of collecting data, usage of multiple sources of data, theoretical lens, interpretive nature of inquiry, holistic account as a complex vision of the studying phenomena.

The inductive approach is used in the thesis with a purpose to build up substantial framework for studying phenomena from collected data, determine and explain interconnections between the complex factors. However, the previous studies and theoretical concepts cannot be ignored or underestimated as they

provide basis for formulating research questions, direction of the research, open-ended questions for interviewing, implications.

## 4.2 Case study approach

Main qualitative approaches comprise narrative research, phenomenology, grounded theory, ethnography and case studies. For this study case study approach was selected and implemented to explore phenomenon of institutions and its impact on flow of foreign direct investments in context of particular country. Yin (2014, p.16) defined a case study as:

*....an empirical inquiry that investigates a contemporary phenomenon (the case) in depth and within its real-world context, especially when the boundaries between phenomenon and context may not be clearly evident*

The strengths of case study inquiry include opportunity to explore viewpoints and perception of multiple actors of the same phenomenon, to understand dynamics of on-going changes and consequences, to determine the key factors influencing on implementation of policies (Simons, 2009). The framing of institutional environment by various actors meet the specified criteria of case study inquiry. The case study approach allows using multiples sources of evidence to build up grounds for research settings and data triangulation. Yin (2014) adds to the methodological characteristics of a case study that it benefits from prior theoretical concepts in terms of guiding data collection and analysis.

The chosen approach of case study reflects to "how" type of research question used in the thesis. Yin (2014, p.20) argues that a "how" or "why" question is being asked about a contemporary set of events over which the investigator has little or no control". The changes in the institutional environment of the host

country are being occurred on contemporary basis that cannot be reproduced in experiment settings and cannot be controlled by researcher. It provides grounds for selecting case study approach in this concrete study.

### 4.3 Methods of data collection and analysis

The process starts from simultaneous data collection and analysis. To regard of data richness, it might be gathered from multiple sources- observations, conversations, formal interviews, autobiographies, public records, organizational reports, respondents' diaries and journals, and own reflections written in memos or tape-recorded (Charmaz in Denzin, Lincoln, 2000). The use of a variety of data sources in a study called *data triangulation* (Denzin 1978 in Denzin&Lincoln, p. 215, 2000). It is advisable for the researcher to rely on triangulation or several methods to make study more comprehensive, credible and valid. Janesik in Denzin&Lincoln, 2000 argued that triangulation is meant to be a heuristic tool for the researcher.

The data is categorized by primary and secondary. Saunders, Lewis, Thornhill (2009, 600) define secondary data as data used for a research project that were originally collected for some other purpose. While collecting secondary data, researchers should connect and validate different data sources, be persistent and critical in their data evaluation (Birks, Malhotra, Wills, 2013). The published external data can be derived from an array of sources including regional and national governments, non-profit organizations, trade associations and professional organizations, commercial publishers, professional marketing research firms, indexes, business guides (Birks, et al. 2013). As it was mentioned earlier, secondary data enriches the context of study, facilitates generation of categories and theory in align with empirical data, increases understanding of studying phenomena, allows data triangulation.



### 4.3.1 Interviewing

In-depth qualitative interviewing matches with case study methods notably well. In-depth interviews are associated with an inductive mode of research when research questions focus on *what* and *how*. It means that nature of research questions should constitute choice of in-depth interviewing.

In process of preparation for the interview the researcher should pay attention to the interview protocol that is focused on research questions (Gioia et al. 2012). It is recommended that interview protocol contains certain blocks such as purpose of the interview, clear instructions for the interviewee, probes to follow research questions, transition messages for the interviewer, space for recoding interviewer's comments and reflections (Source: Tools for Qualitative Researchers: Interview [https://web.stanford.edu/group/ncpi/unspecified/student\\_assess\\_toolkit](https://web.stanford.edu/group/ncpi/unspecified/student_assess_toolkit)). The interview protocol for this study has been created according to the representation of participant's organization (see Appendix).

The candidates for interviews were selected on a basis of knowledge in the research subject. The candidates represent various actors involved in foreign trade between Kazakhstan and Finland, policy-makers and facilitators of economic cooperation. The full list of candidates and organizations is provided in Table 1. The interviews were conducted mainly on face-to-face basis in the English and Russian languages according to the interviews protocols. The interviews were taped-recorded with the permission of interviewee.

The researcher must take into consideration ethical concerns while interviewing participants as objects of inquiry and human beings. The traditional ethical concerns link to *informed consent* (receiving consent by the subject after having carefully and truthfully informed him or her about the research), *right to privacy*

(anonymously) and *protection from harm* (physical, emotional, or any kind) (Fontana&Frey in Denzin, Lincoln, p.662, 2000).

**Table 1. List of interviewees**

<b>Organization</b>	<b>Title/position</b>	<b>Field/industry</b>
Embassy of Kazakhstan in Finland	First secretary	Diplomatic mission
Team Finland/ Finpro	Senior Advisor	Export agency
JAMK University of Applied Sciences	Project Manager	Educational export
Molok Oy	Export assistant	Recycling
Company X	Managing director	Defense, training
Kaukointernational Oy	CEO	Consulting, paper&pulp, energy

#### **4.3.2 Qualitative Content analysis**

The method of content analysis is applied to process of analyzing empirical data. The logic of content analysis embraces describing the meaning of qualitative data in systematic manner through coding or allocating units of the material to the relevant categories (Schreier, 2013). The process of content analysis starts with building up a coding frame. Coding frames contain various numbers of main categories with hierarchical levels of subcategories (Shreier, 2012:ch4, 2013). The phase of building up a coding frame provides basis for data reduction when researcher may select relevant amount of material for attaching to the category.

The construction of main categories and generating subcategories are aligned with research questions of the study and theoretical framework. For example, our study includes main categories such as:

- a) Institutional environment of Kazakhstan under transition
- b) Institutional distance between home and host countries
- c) Ownership strategies of Finnish firms pursuing in host-market
- d) Facilitation of Finnish outward investments to Kazakhstan

The subcategories under the main categories enhance process of deriving meaningful insights from our data and answer the research questions. For instance, the following subcategories were identified and added to the first category: “state strategies”, “role of informal institutions”.

The final stage of data analysis process is associated with presentation of findings that “involves presenting the coding frame and illustrating it with quotes” (Shreier, 2013, p.16). In our case the research findings are displayed in narrative mode and supported by direct quotations derived from interviews’ transcription. The relations between categories are critically examined to draw conclusions and reach research objectives.

#### **4.4 Case Kazakhstan**

The following section provides comprehensive overview of the Kazakhstan economy, development of the institutions under transition and analysis of the trade and political relations between Kazakhstan and Finland. The context of the case study enables to depict specific characteristics that differentiates the institutional transition of Kazakhstan from other emerging economies.

## **Overview of Kazakhstan economy**

Kazakhstan is geographically located in Central Asia and it is bordered with China, Russia, Kyrgyzstan, Turkmenistan and Uzbekistan. The exceptionally favorable geographic location of Kazakhstan provides transit potential from China to Europe and access to Caspian Sea. The country is formed of 14 administrative and territorial regions and two cities of republican significance. The capital is based in Astana. There are ten special economic zones (SEZ) in Kazakhstan where substantial tax preferences, exemption from customs duties and other incentives for members are applied. Each zone has own specialization and priority activities. According to statistical data published by Ministry of National Economy of Kazakhstan, Committee on Statistics, the population of Kazakhstan is equal to 17 753 000 people (1.05.2016). The official language is Kazakh, yet the Russian language is widely used in interethnic communication. Kazakhstan became the sovereign state on December 16, 1991 after the dissolution of the Soviet Union.

In terms of political regime Kazakhstan represents presidential republic. The president of Kazakhstan, Nursultan Arbishuly Nazarbayev has extensive power to determine strategic direction of foreign and internal policies. The legislative power is executed by parliament, which consists of two branches, the Majilis and Senate. The parliament is performing main functions of issuing laws, forming budget, ratifying treaties, and resolving administrative-territorial issues of the country. The executive power is implemented by Government that directs the system of executive bodies and controls their activity. The leader of government is Prime-Minister who is appointed by the President with the approval of parliament.

In terms of economic development Kazakhstan refers to an economy of transition. According to the World Bank Classification by Income Level Kazakhstan retains position of the country with upper middle income. Due to rich

deposits of mineral resources the core industries and sectors in Kazakhstan are oil refining, oil and gas infrastructure, mining and metallurgical industries, chemical, agriculture, construction and tourism. The economy of Kazakhstan has been demonstrating strong tendency to growth during the years of transition period. Since year 2005 national GDP has significantly increased and achieved 249 billion US dollars (estimated) in 2015 (see Figure 4). However, the sharp decline in oil prices, sanctions imposed on Russia and depreciation of tenge against Russian rubles, slowdown of world economy in 2015 negatively influenced GDP of Kazakhstan and Inward FDs. (OECD Investment Policy Review, Kazakhstan 2016). The biggest components of GDP refer to extractive industries, trade and manufacturing (see Figure 3).

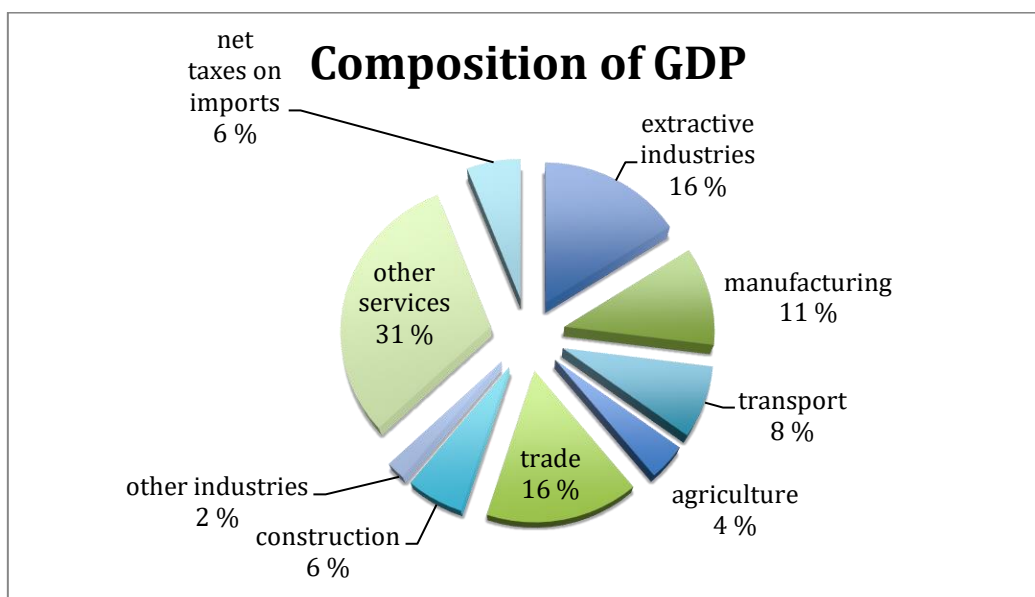
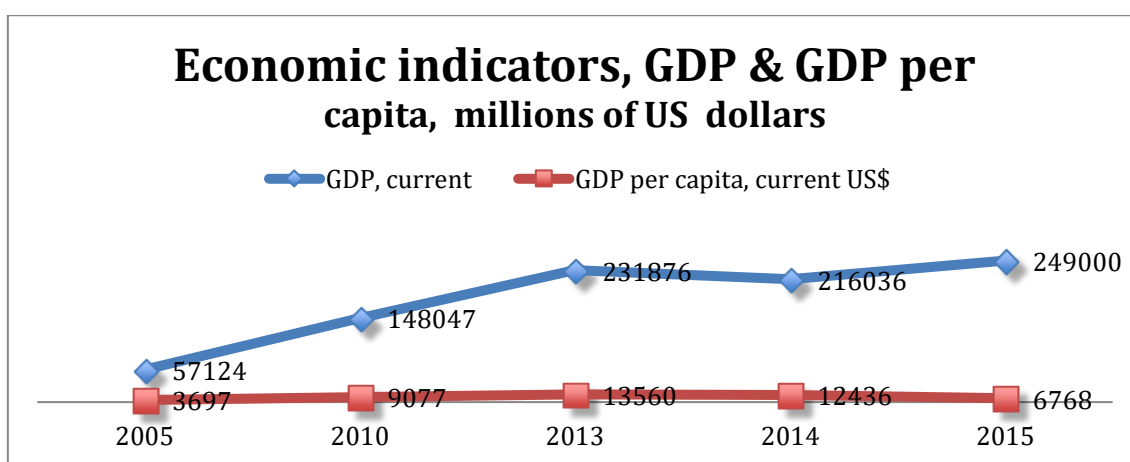


Figure 3. Composition of Kazakhstan's GDP by sector in 2012-2014. Source: Committee on Statistics, <http://www.stat.gov.kz>

The inflation rate in 2015 decreased to the level of 6,45% compare to 6,72% of the previous year. The relative stability of inflation rate of Kazakhstan provides positive sign for investors.

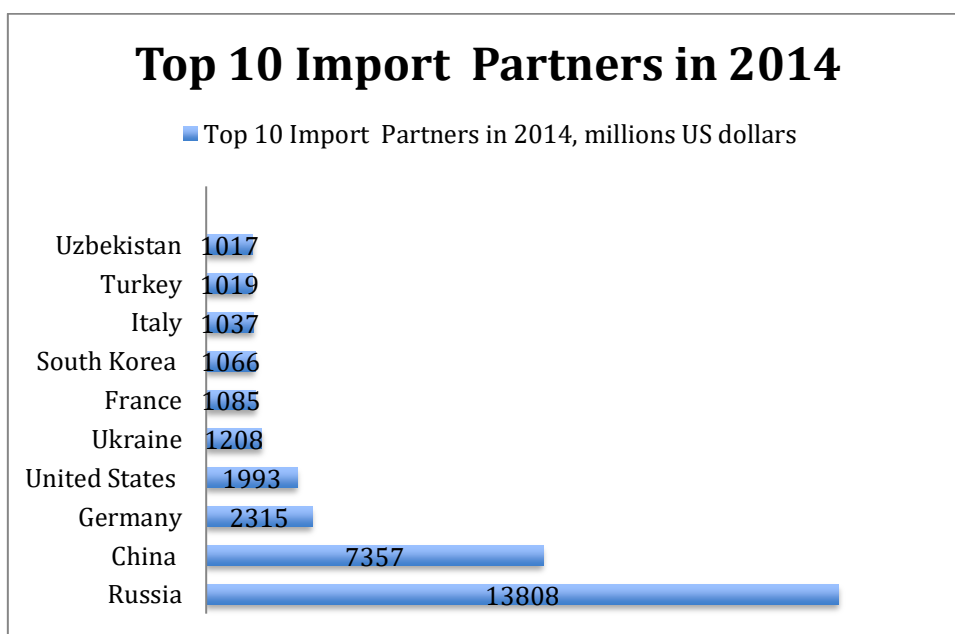
The labor force in 2013 accounted 9.1 million with employed 8,6 million people. The unemployment rate was 5,2% and decreased by 0,6% compare to year 2010-5,8% (IMF Country Report No. 14/243, pp. 9) High efficiency of Kazakhstan's labor market is recognized and proved by ranking number 18 among 140 countries of the world (WEF "Global Competitiveness Report 2015-2016 in Investor's Guide 2016 Kazakhstan)



**Figure 4. Economic indicators of Kazakhstan, GDP&GDP per capita years 2005-2015. Source: Ministry of National Economy of the Republic of Kazakhstan, Committee on Statistics <http://www.stat.gov.kz>**

In terms of the foreign trade volume of merchandise export and merchandise import amounted 79460 and 41 296 million of US dollars in 2014 (UNCTAD Country Profile: Kazakhstan). The indicators of foreign trade in 2014 demonstrated slight decline, export decreased by 6,2% and import fell by 7,5% in comparison with indicators in previous years. The structure of export in 2014 by product group composed of fuels-78%, manufactured goods- 10%, ores and metals-4% (UNCTAD Country Profile: Kazakhstan, International Merchandise Trade). The main export partners in 2014 included Italy, China, Netherlands, Russia and France. The main import partners are shown on Figure 5.

In terms of international relations and economic integration Kazakhstan is pursuing policy of close cooperation with world trade unions and global alliances. Kazakhstan is a member of the Eurasian Economic Union (the EAEU)-an international organization for regional economic integration between the member-states of Belarus, Russia, Armenia and Kyrgyzstan. The EAEU is established to provide the free movement of goods, labor force, services, capital within the union and pursue harmonized and unified policies in the sectors ([www.eaeunion.org](http://www.eaeunion.org)).



**Figure 5. Top 10 Import Partners, 2014** Source: Ministry of National Economy of the Republic of Kazakhstan, Committee on Statistics <http://www.stat.gov.kz>

Kazakhstan joined the World Trade Organization in 2015 under the Finnish chairmanship and support. According to Ms. Lenita Toivakka, Minister for Foreign Trade and Development and head of Finnish delegation to Kazakhstan in 2015:

“The Accession Protocol of Kazakhstan shows the country’s commitment to the multilateral trading system and to the core values of the WTO: openness, transparency, good governance and the rule of law.”

Kazakhstan occupies high positions in international rankings. In ease of doing business rating Kazakhstan is on 41st place among 189 countries (Source World Bank, Doing Business 2016). In Global Competitiveness Index Kazakhstan stands on 42nd place leaving behind Russia. (The Global Competitiveness report 2015-2016).

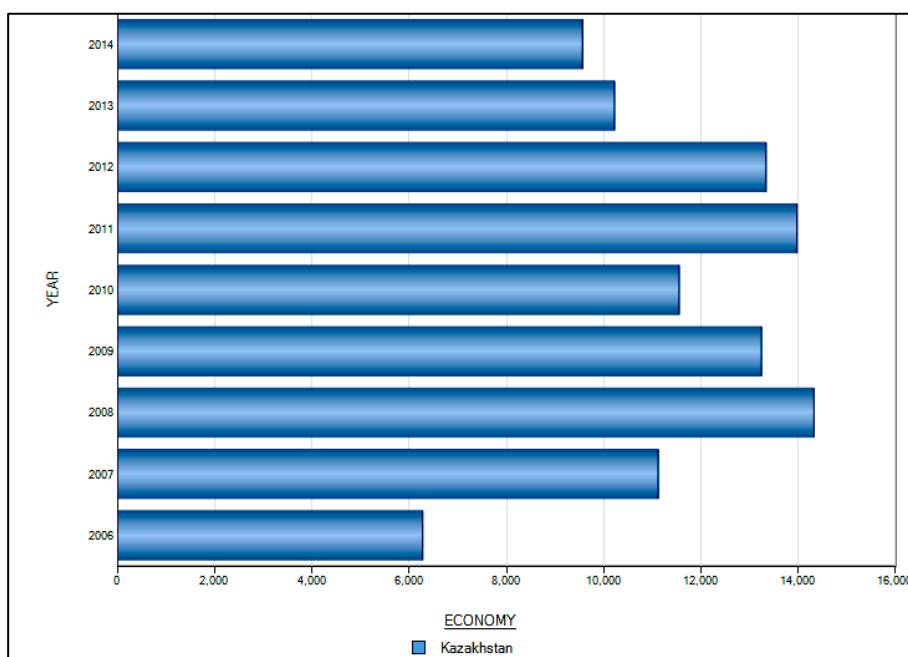


Figure 6. Inward stock of FDI to Kazakhstan, 2006-2014. Source: UNCTAD Statistics <http://unctadstat.unctad.org>

### Institutional development in period of transition

The institutional environment of Kazakhstan had undergone significant changes in transition to market-oriented economy since it became the sovereign state. The fundamental reforms pursued modernization of national economy, political institutions and legal environment. The one of the fundamental reforms" on denationalization and privatization" from June 22, 1991 laid foundations for institution of private ownership. Privatization was carried in several stages including first stage of changing ownership of state enterprises with massive involvement



of citizens, stage of privatization in oil and gas industries and final stage with new approach of power distribution between state and business groups. ("Institutional reforms. Economic Development", National Digital History portal <http://e-history.kz/en/contents/view/1542>). The reform of banking system established two-tier system headed by the National Bank of Kazakhstan.

In overcome domestic challenges of transition period and build up a sustainable modern and well-performing economy the revised strategy for the future economic development was adopted by the state of Kazakhstan. The program or national plan "100 precise steps forward realization of the institutional reforms" was announced by the president of Kazakhstan Nursultan Nazarbaev on May 20, 2015. The precise steps were grouped under five institutional reforms: "formation of a professional state apparatus; the rule of law; industrialization and economic growth; identity and unity; formation of accountable government ("Kazakhstan unveils 100 concrete steps to implement institutional reforms" in The Astana Times, May 2015). The State Program of Industrial Innovative Development for 2015-2019 dated August 1, 2014 is designed to "stimulate diversification and competitiveness of the secondary industry" (.....) One of the major objectives of the Program refers to "...improvement of the institutional environment that provides favorable conditions for development of business and entrepreneurial initiatives" (Ibid).

Formation of functional and attractive base for investors, improvement of investment climate has been priority tasks for Kazakhstan government authorities. The measures on improving investment climate are taken by policy-makers in accordance with OECD recommendations. The major reforms have been implemented in the field of protection of intellectual property rights, corporate governance, employment of foreign labor force, visa formalities, taxation, reduction of bureaucratic barriers. Entrepreneurial code of the Republic of Kazakhstan 375-V dated October 29, 2015 ensures compliance of investor rights: a guarantee of legal protection of investors, a guarantee of income use, a guarantee of investor

rights in case of nationalization and requisition (Investor's Guide 2016 Republic of Kazakhstan, pp.16).

The governance structure of institutions intended for developing inward and outward investments is presented on Figure 7. The Foreign Investor's Council (FIC) has been established with purpose to facilitate constructive dialog between legislature bodies of Kazakhstan and foreign investors. The FIC working groups deal with issues related to foreign investor's operations, investment policies and investor's support of innovative and technological development and diversification of the economy of Kazakhstan (Investor's Guide 2016, p.23). The main functions of Investment Ombudsman include "assistance in protection of investor's rights and legal interests" (Official web-site of the Ministry for Investment and Development of the republic of Kazakhstan, Investment Committee, [www.invest.mid.gov.kz](http://www.invest.mid.gov.kz) ) The Council on Improvement of Investment Climate (CIIC)

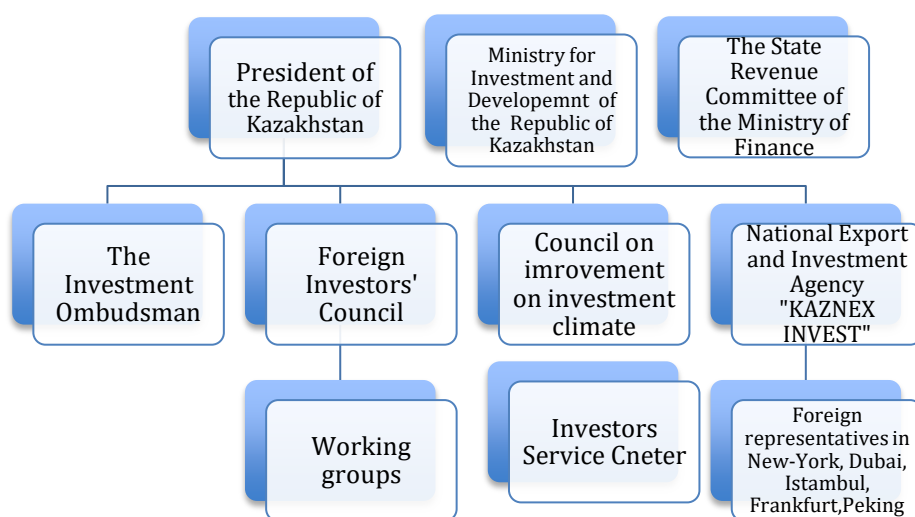


Figure 7. Governance structure of investor's institutions

## **Trade and political relations with Finland**

Kazakhstan becomes an important partner for Finland in foreign trade relations due to constant development in economic cooperation and bilateral agreements. The first official visit of Finnish authorities to Kazakhstan occurred in 1992 when Kazakhstan became an independent state. Since that numerous of visits between two states and big delegations including ministries, representatives of Finnish companies and regional organizations contributed to further acceleration of collaboration in trade and large-scale investment projects. The main discussions and negotiations between two states are held at the regular meetings of the Finnish-Kazakh Intergovernmental Commission (IGC) for Economic Cooperation. The topics on the agenda of the latest meeting were bilateral trade, business issues, energy and cooperation in the field of education (Press release 49/2017 published by Ministry for foreign affairs of Finland).

There are two Bilateral Investment Treaties signed between Finland and Kazakhstan. The first one "Agreement concerning the promotion and reciprocal protection of investments" № 34523 was signed in 1992 and ratified in 1998 by both parties. The second one "Agreement between the Government of the Republic of Finland and the Government of the Republic of Kazakhstan on the Promotion and Mutual Protection of Investments" № 63 was signed in 2007.

The dynamics of foreign trade between Finland and Kazakhstan demonstrates growth until 2014 (see Figure 8). In January-August 2016 volume of commodity turnover amounted 226, 1 million US dollars and decreased by 30% compare to year 2015 when it was estimated by 319, 5 million US dollars (Source: Statistics Finland, 2016). The main reasons for decline in commodity turnover refer to low energy prices, devaluation of tenge and rise in prices of Finnish products. In the structure of export from Kazakhstan to Finland prevail oil products,

coal, oil gas, wheat. The Finnish import to Kazakhstan consists of machinery and industrial equipment, electrical appliances, paper, board and paper products, chemicals and suppliers, medications. Finnish nationals are eligible for visa-free regime established by Kazakhstan for 19 investor countries. It makes border-crossing for Finnish nationals easier and reduces visa formalities.

Currently over 70 companies with participation of Finnish capital is operating in Kazakhstan in different sectors of economics. The Finnish companies are presented in education export, industrial manufacturing, cleantech and energy solutions, logistics, chemical and wood processing industries.

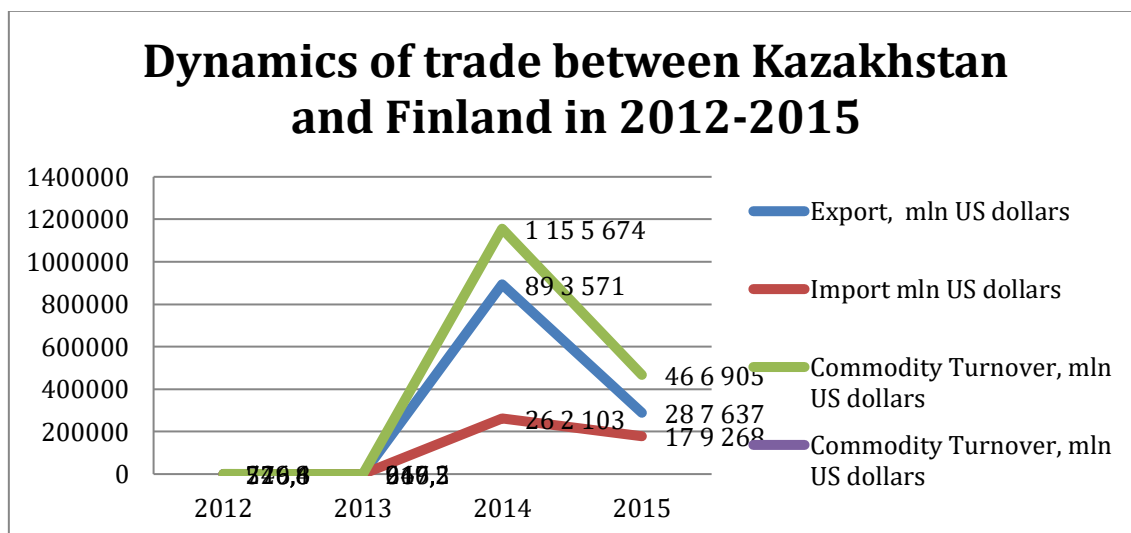


Figure 8. Dynamics of trade between Kazakhstan and Finland in 2012-2015. Source: Statistics Finland.

## 5 RESEARCH FINDINGS

The research findings are presented in line with the main research questions and objectives of the study. The graphical schemes were elaborated by the author to illustrate the actors' cognitive frames of institutional perception.

### 5.1 Framing the institutional environment of Kazakhstan

#### Host-country actor's perception (state)

The construction of institutional environment by the host-country actor, diplomatic officer of Embassy of the Republic of Kazakhstan in Finland, embraces various formal institutions at multiple levels. Such type of host-state actor provides generic picture of institutions at macro-level and context for collective actors including organizations. The functioning institutions are described in relation to foreign investors and location for investments.

The undergoing change in regulative and normative domains of institutional environment was stressed as prerequisites to form attractive and adequate investment destination. The regulative domain is characterized by implementing massive financial, economic and administrative reforms as well as creating legislative and regulatory framework. Institutional reforms seek to reduce transactional costs for investors and enhance accountability.

*" Large-scale reforms are occurring in institutional environment...New amendments to the Law on Investments were issued in 2014...Regarding financial reforms I would like to point out establishment of The International Financial Center in Astana – based on Britain law, independent from domestic justice system..."*

Kazakh authorities succeeded in building up investor-oriented institutions at governmental level to establish direct dialog with strategic investors.

Creation of new institutional forms means strong intention to make governance structures more effective and comply with recommendations of international organizations for economic development. The process of transformation of existing institutional structures into modern well-functioning elements undertaken by state actors is explicitly indicated during the interview.

*" We have the Foreign Investors' Council under the President of the Republic of Kazakhstan where the biggest companies-investors represent interests of all investor's pool and have access to the President ...The institute of Investment Ombudsman was launched in 2014...Besides that entirely new institution a One-Stop-Shop for investors was established...very convenient in terms of providing consultations, handling administrative procedures..."*

Modernization of society within state programs serves an ambitious goal to implement new standards and norms of collective behavior. Social actors and interactions between them and other actors are embedded into canvas of the institutional environment of the host -country. Due to this reason reformation of the society and improving skills of human resources is integrated into scope of the various **state programs**." The 100 concrete steps" program or" Plan of the Nation" announced important measures to diversify economy and ensure sustainable development in major institutions of public administration, rule of law.

*" Nurly Zhol development program includes reformation of road infrastructure, reforms in medicine and education fields, justice system, construction of social housing. A great deal of attention is paid to investors in all reformed fields.*

**The role of informal institutions** reduces to collegial ties of recent graduates from" Bolashak" program who brings professional acquaintances and advanced leadership styles. Diplomatic officer neglects significance of personal connections and favoritism while doing business with Kazakh partners.

*" I can't deny that Kazakhstan is an oriental republic in many terms and post-soviet country... that relations do not decide but those time have gone and, in the past... positive*

*example of personal connections can be educational program Bolashak... personal connections might help at the level of initial idea, suggestion, hints"*

Host country actor's cognitive construction of institutional environment is illustrated by Figure 9.

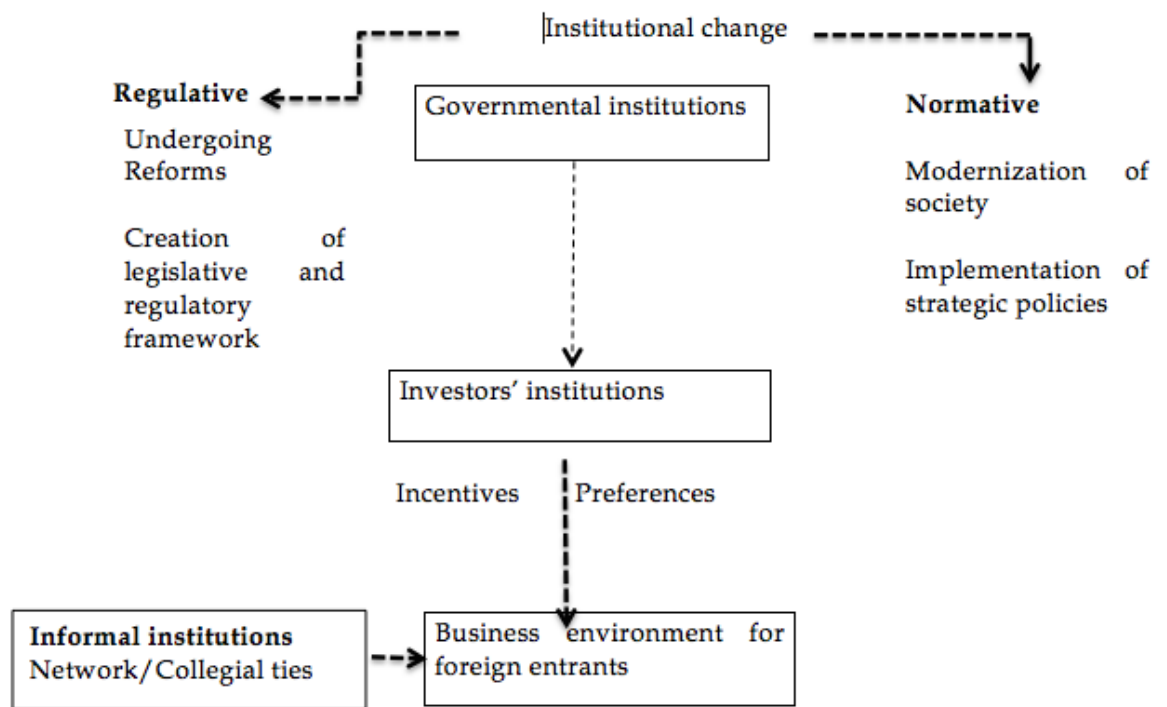


Figure 9. Host-country actor's cognitive construction of institutional environment

### Home-country actor's perception (regional organization)

Home country actor's perception provides insights on institutional environment of the host-country. Perception of institutional environment by multiple stakeholders reveals some common points as well as additional points which were not considered by other actors.

The interviewed actor, representative of FINPRO, is actively involved in business development between both states. The institutional environment of Kazakhstan

is very familiar to him. The senior consultant pointed out well-executed national strategies realized by governmental institutions of Kazakhstan. Such strategies might be used as anchors for Finnish firms which are particularly interested in entering Kazakhstan market. The anchors in this context mean signals of positive dynamic of institutional transition toward stability, accountability and attractiveness for investments. The strategies are highly competent, well-written, and focused on sustainable development due to collaborative and advisory work provided by foreign consultants.

*" From business point of view main observation refers to numerous strategies at national level such as "100 steps", "Nurlyzhol" ...it is important because when we discuss with Finnish firms we in many terms rely on them to tell concrete priorities, plans of development, where resources put on..."*

The extremely interesting notion regarding **informal institutions** was revealed during the interview. The informal institutions in Kazakhstan are presented by three clans "ZHUZ" which are classified as the Senior, the Middle and the Junior. The clans were geographically clustered and differentiated according to the tribes and ethnic groups. The representatives of Kazakh business elite belong to the Senior Zhuz. It might be assumed that Zhuz plays a certain role regarding investments. The senior consultant mentioned:

*" .... It does not make any influence on SME company, but it might affect a large company investing in some strategic industry with possibility to gain significant market share."*

The interviewee pointed out post-soviet type of leaders among informal institutions that impose administrative barriers on communication flow and cooperation with Finnish firms. However, more and more recent graduates from Bolashak program with advanced leadership approach, excellent education, knowledge of languages and mentality successfully enter the working life and develop cooperation with foreign partners. In this sense home-country actor



agreed with the previous interviewee on positive role of Baloshak graduates and their connections to western alumni.

The senior consultant mentioned high level of bureaucracy involved in procedures and communication with ministry officers and authorities. It might be difficult to understand for Finnish firms such formalities in communication flow with host-country's officials. The holistic picture of institutional environment perceived by home-country actor is given on Figure 10.

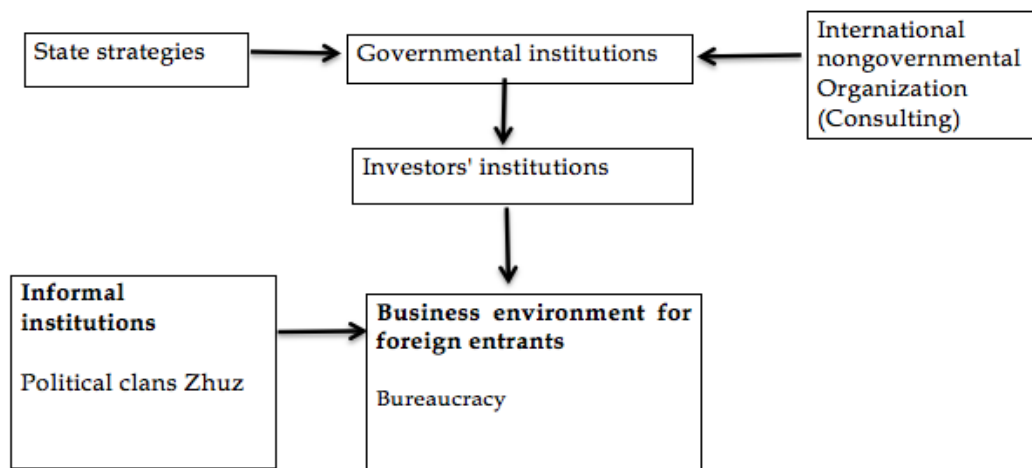


Figure 10. Home-country actor's (export agency) cognitive construction of institutional environment.

### Home-country actor's perception (firms)

Compound analysis of data provided by several interviewees, representatives of Finnish firms, revealed certain common perceptions of host-country institutional environment. The interviewees mainly described the institutional environment in general terms according to their understanding of the concept of institutions and practicalities of doing business. The outcome of perceptions of host-country business environment by Finnish firms is presented on Figure 11.

According to project manager of the JAMK University of Applied Sciences dealing with formal institutions such as Ministries involves time-consuming bureaucratic procedures. The Ministries remain conservatives about organizational and operational methods due to inherited norms from the post-Soviet regime and centrally led country. The quick rotation of personnel at the Ministries and local administration prevents establishing contacts and long-run fruitful cooperation. It was also mentioned by the export manager of Finnish medium-sized manufacturing company.

*" They have this legacy from Soviet Union organizations, structures, education systems ...which affect for quite a lot for institutional environment how it works.*

*"Hierarchy and very limited authorization for decision-making"* were mentioned in describing institutional environment.

The managing director of the large organization providing professional training for pilots shared his experience of building up the large-scale project in cooperation with Kazakh aviation authorities. He faced up with difficulties during negotiation process that resulted in project termination even though the case was agreed and included in Intergovernmental commission's resolution. The main reasons for project failure included corruption, internal contradictions at the Ministry, disruptions at decision-making process and absence of responsibility.

*"it's a big huge hassle this whole thing how it works, very political, very complicated..."*

Regarding informal institutions representatives of Finnish firms emphasized strong informal ties in local network. It might keep a foreign investor outside of local business community. Potential tensions between political clans affect

cautiousness of Finnish firms to make further investments. New wave of young western-oriented leaders become noticeable among informal institutions.

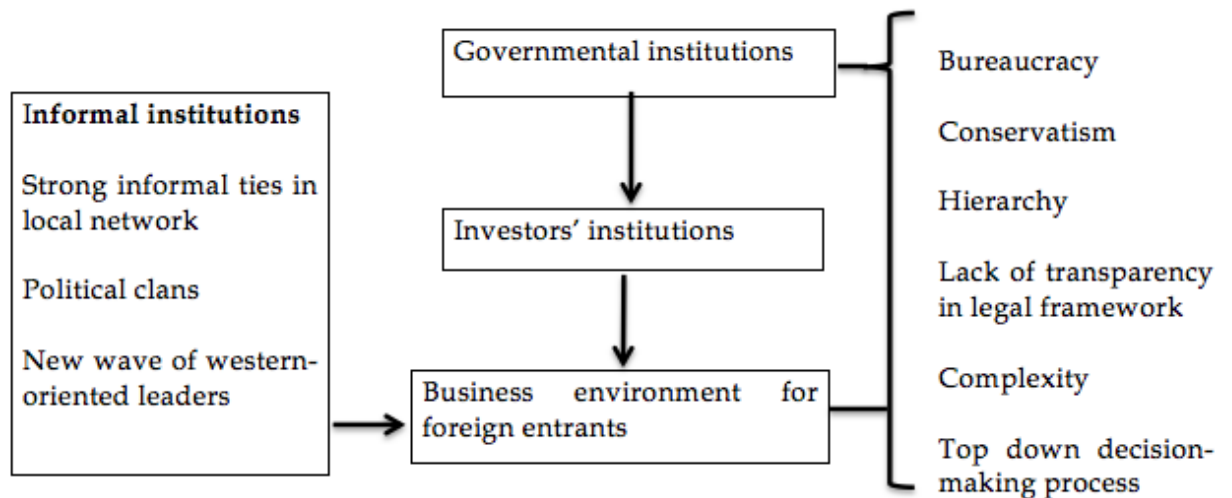


Figure 11. Home-country actors' (firms) cognitive construction of institutional environment

## 5.2 Framing the institutional distance

Based on interviewees' responses institutional distance is mainly associated with differences and similarities in cultural-cognitive elements between host and home countries. However, elements of normative distance were identified through data analysis process.

According to observations of representatives of Finnish firms, centralized power and hierarchy prevail in local organizational structures that influence decision-making process and distribution of authority. The host-country actor admitted that "*...in Finland small power distance, In Kazakhstan -hierarchy, element of oriental mentality, top down, vertical management*". Project manager of Finnish university of applied sciences characterized Kazakhstan as "*...centrally-led country*

*like if you compare roughly for example with Finland on lower level of administration....».* Substantial power distance in leadership styles increases gap between host and home countries. For the purpose to minimize power distance gap Finnish firms are seeking a company with *“an international flavor, doing international business and leading by young CEO”*.

The representatives of Finnish firms faced up with differences in labor discipline between home and host countries such as longer working hours and duration of working week. The diplomatic officer of Kazakhstan explained different arrangement of labour discipline in Kazakhstan due to vital need to rebuild the whole infrastructure.

Diplomatic officer: *“ More Asian/oriental oriented discipline/practices like long working hours, Saturday-working day...Non-standardized working hours are dictated by reality.... We had to build up infrastructure, new capital within short period of time after Soviet Union collapse so we had to use our internal resources as long working hours”*

Finnish firms observed lack of social responsibility in value-added production such as a waste of raw materials, the environmental pollution. In this sense Finnish firms strongly communicated adherence to the Finnish code of conduct in doing business. Such *conformity to home-country normative system* might impose restraints on transferring management practicalities, knowledge.

CEO: *“ ...there is no cleaning, everything putting on the field... ”*

Managing director: *“ ...we made a very clear in the beginning that we only do business on top of the table nothing was under...”*

The home-country actors pointed out a rigid formal communication and high level of bureaucracy while trying to approach the Kazakh officials in Ministries and governmental departments. The slow digitalization and internal procedures in governmental bodies requires substantial amount of paper work, documentation and formal inquiry. The prevalence of the Russian language creates

linguistic and communication barriers for the Finnish firms. The Finnish firms must use services of a professional interpreter that increased transaction costs of doing business in Kazakhstan.

Managing director: *"...most of the time specially on higher level it goes through interpreter and it's a bit complicated, you never know how the message would be translated, is it exactly the way I want to say or if any change in message, kind of lost in translation"*

Project manager: *"There is still quite a lot of documentation that we don't have here in Finland...there is of course this bureauracy for example how to proceed payments from bank"*

Export assistant: *"If we want to contact officials we need to send an official letter in Russian language signed by our CEO with stamp...you can't just make a call or send an email..."*

Senior consultant: *"When we organize meetings with Kazakh governmental officials at Ministries, you need to send copies of your ID and attach your personal CV in Russian language...it might be difficult to understand by Finnish firms when they face up with such requirements..."*

Collectivism and strong informal institutions such as clans differentiate host-country from individualistic home-country with strictly-formalized institutions. The Finnish firms found themselves at less favorable position in comparison to well-connected domestic organizations, so they try to neglect such disadvantage by utilizing local attorney. Finnish firms heavily rely on local intermediary according to the project manager from the Finnish university of applied sciences and CEO of Finnish technology solution corporation.

CEO: *"...I don't think how you can manage without local.... contact..."*

Project manager: *"...then you have a local person who helps you...without local it's impossible..."*

Finnish firms depicted the cultural variables inherited in Asian culture such as fear of losing face, respect to older age and position, demonstration of status. The hospitality and openness to foreigners were positively marked by the

export manager and the CEO as cultural features of the host-market that might reduce the cultural distance.

CEO: *"...Kazakhstan is so near to Asia if it's the combination of some sort of Asian culture, they do not to say no, in Asia it's very difficult for them..."*

Export assistant: *"Kazakh partners were hospitable, inviting us to visit their home...But the most obvious that title and position are very appreciated, the higher the position the more respect, it should be very national feature, they like to demonstrate status..."*

The interesting remark given by the representative of Team Finland referred to the national philosophy principles derived from Kazakh poet and philosopher Abay's postulates. The foreign entrants are usually not familiar with philosophic postulates of Abay that might cause difficulties in understanding of local society values.

The host-country actor, diplomatic officer pointed that despite of *patriarchal culture and Muslim religion*, gender policies maintain females' rights on equal basis at employment and working life.

*" Even though we are Muslim country, we don't have segregation in our culture, we try to build open society".*

The diplomatic officer and Finnish firms identified cultural similarities like directness, straight approach to business issues, determination as Finnish *sisu* that provides common ground for cooperation between home and host country actors.

Diplomatic officer: *" For instance, determination as one of Finn's features also characterizes Kazakh people in achieving goals, becoming a leader...determination in a positive way as a national feature"*

Managing director: *"Kazakhs go directly to the business, they are very straightforward...as Finns ..."*

Physical remoteness of Kazakhstan from Finland was explicitly highlighted by Finnish firms. The weak transportation connections between both countries particularly absence of direct flights make it difficult for Finnish firms to reach the destination. However, the situation with direct air transportation has been improved since June 2017 when Finnair started operating regular flights to Astana. Diplomatic officer of Kazakhstan highlighted importance of achieved agreement in air transportation as it strengthens connections between Kazakhstan and Europe.

*"...as I said Finland for Europeans as a window to Asia and we view Finland as a window to Europe..."*

The managing director of Finnish aviation and defense corporation remarked on little awareness of Kazakhstan among Finns and less desired place for Finnish expatriates.

*"...people here don't know Kazakhstan at all here...no idea what this place is all about and then it creates uncertainties... it's not exactly the place for Finn that you could move to Kazakhstan, not many people think that way..."*

### **Ownership strategies**

Modes of entry or ownership vary across the Finnish firms investing into Kazakhstan and primarily depend on scope of business, executives' vision, available resources, previous experience in post-Soviet republics, industry specialization. According to the senior consultant of FINPRO market-driven factors such as demand for the products primarily determine decision to enter the market.

*"Primary aspect for the company is the market attractiveness, if there is a demand for products, solutions..."*

*"Foreign direct investments are one of the modes to enter foreign market...well, usually it is sequences of steps...firms begin to get familiarized with the market, make some market research, if everything seems to be interesting and perspective, they start*

*trade transactions, partner or customer search, if it goes well, then the matter of locating investments is considered"*

Based on observation of senior consultant of FINPRO Finnish firms attached minor importance to investors' treatment policies such as favorable tax regime, incentives and preferences in Kazakhstan.

*"...if there are incentives, mechanisms to get preferences it will be taken into consideration but it's not the critical, deciding factor..."*

According to the diplomatic officer of Kazakhstan in Finland the most preferable entry modes of Finnish firms are referred to greenfield investments and joint ventures with local producers depending on size of the company and specialization. The host-country state actors expect from Finnish firms locating tangible and intangible assets in Kazakhstan in order to facilitate know-how of domestic producers, train local staff, re-export goods and services.

*"Finns with their pragmatism enter the already set-up production, bring technologies, they pay a lot of attention to improving qualifications of local staff..."*

Large Finnish firms prefer high ownership strategies including acquisitions, wholly-owned subsidiaries, own representatives. Finnish multinational companies involve in implementation of large scale industrial projects. Large companies are willing to pay decent provision to local intermediary in accordance with internal organizational policies in order to get access to strategic projects.

Finnish medium-sized firm pursues strategy of incremental internationalization starting from probing export to licensing and granting patented forms to local manufactures. Low ownership strategy is the most suitable for Finnish SMEs due to low risks of opportunism, protection of IPR.



Export assistant: *"We consider local manufacturing/assembling in Kazakhstan, but our company is not ready to invest... Easiest way to find a local partner in host market who is interested in manufacturing... Our mission would be providing technology, samples, training..."*

### **5.3 Facilitation of Finnish outward FDIs to Kazakhstan**

The data analysis revealed both similarities and distinctions in perceptions of Finnish outward FDIs to Kazakhstan by various actors. The construction of holistic picture of institutions involved in facilitation of FDIs is composed of macro and microlevels. The linkages between the certain institutions from host and home markets are shown and explained to describe a role of each institutions in facilitation of foreign trade between both countries. The results are presented as a graphical scheme (see Figure 12) in respect to illustrative and convenient method of data analysis.

#### **Facilitation of Finnish investments to Kazakhstan by host-country actors**

At macrolevel state institutions of Kazakhstan follow the agenda and recommendations provided by the global institutions of investment policies development such as OECD. Design of the governance structure of institutions involved in facilitation of foreign investments is aimed at creating favorable investment climate, implementing investment policy framework, establishing direct dialog with investors, guaranteeing investors' rights protection, promoting responsible business conduct, coordinating activities abroad on promotion of Kazakhstan as an attractive investment destination.

*" All measures are taken in accordance with OECD recommendations, to create competitive environment, in development of investment climate .... we fulfil all requirements of global institutions and we are open for cooperation with international business community...."*

The facilitation of Finnish FDI to Kazakhstan occurs at multiple levels through engagement of the institutions from both national states in collaborative work. At the national level parliaments and governments of Finland and Kazakhstan interact on the basis of bilateral investment treaties, agreements and resolutions issued by Finnish-Kazakh Intergovernmental Commission. The diplomatic officer praised the excellent relationship between both states by quoting, the Speaker of Majilis, Mr. Nigmatullin:

Speaker of Majilis: *“Relationship between Finland and Kazakhstan are not simply good they are perfect. There is no need to develop relationship, they are already perfect.”*

The diplomatic personnel of the Embassy of Republic of Kazakhstan in Finland who is responsible for economic and investments development, made a valuable contribution to the facilitation of Finnish outward FDI. The diplomatic officer underlined the importance of negotiations with Finnish financial institutions such as the Bank of Finland, the Institute of transition economies, Tekes, Sitra in terms of diversification of financial streams and financing for large-scale investment projects.

*“Development of cooperation with Tekes, Sitra, FinPro, financial elements which can elaborate realization of bilateral relationship... Diversification of financial streams, financing of investment projects so financial sources from Finland are important...”*

The most notable finding in perception of host-country actor revealed that Finland did not belong to the “strategic” countries with the high volume of outward investments to Kazakhstan, instead it was viewed as a **“technological” investor**. Thus, the officer attached a great importance to the Finnish technologies as a source of modernization for the obsolete equipment installed at Kazakh manufactures, plants and workshops. Along with technology transfer from Finland the officer stressed knowledge sharing and training of the local personnel provided by Finnish investors.

*"We don't refer Finland to strategic investor to Kazakhstan but there is another distinctive feature –Finland is a technological investor that is more important than finance investor..."*

*" Finns with their pragmatism enter the already set-up production, bring technologies, they pay a lot of attention to improving qualifications of local staff... They organize trainings on annual-basis for Kazakh specialists, on my opinion, it's extremely valuable experience of cooperation with Finnish investors..."*

The diplomatic officer gave numerous examples of Finnish companies which are succeeded in locating direct investments to Kazakhstan through different operational modes. He emphasized key industries of Kazakhstan economy that provide enormous possibilities for Finnish investors to apply their competences, resource-capabilities and sustain competitive advantage. The strategic sectors of economy for locating Finnish FDI embrace cleantech, green energy and energy savings, water treatment, agriculture, medicine equipment, education export, construction, logistics and transportation infrastructure to develop railway transit of Finnish goods to China via Kazakhstan.

*"Finland is a strategic partner in development of green energy..."*

*"Almost all regions are interested in development of water theme (waste water treatment, industrial water.... In future we are expecting in water industry so huge breakthrough that we even can't imagine ourselves ...So Finnish technologies will be highly demanded..."*

*"Project in cooperation of one Finnish company with authorities of Uralsk creates whole infrastructure on recycling and build up first biogas station..."*

The diplomatic officer admitted that additional efforts on marketing are required to promote Kazakhstan as an investment destination among Finnish companies. With regard to stimulate involvement of SME in trade operations between both states, assist to establish personal contacts, networking and overcome language barrier, he suggested a virtual trade forum or virtual tool for various actors, including business consultants, firms, trade associations.

*" Virtual trade forum for Finnish/Kazakh business...Main task to match SMEs on some business forum, electronic platform where representatives of business, associations, consulting can find each other...."*

### **Facilitation of Finnish investments to Kazakhstan in export agency perception**

At macrolevel perception of institutional environment involved in facilitation of investments is similar to host-country actor's cognitive construction. The governance structure of host-country institutions consists of state bodies and regional agencies that perform regulative and controlling functions, law enforcement, supplying resources and protection policies.

The Finnish internationalization development agency itself is actively contributing by consulting Finnish companies about investment policy regime, country risks, market potential, modes of entry and operations. The agency assists in establishing contacts with potential partners through diplomatic channels and arranging meetings.

*"We discuss country risks with companies...we consult companies along the whole process, advise and use our Ministry resources, diplomatic personnel, organize meetings and reach top executives if needed...our direct responsibilities to help Finnish companies to enter foreign markets..."*

The importance of two official Finnish delegations with the head of Ministers A. Stubb (2012) in and L. Toivakka (2015) in terms of bringing Finnish companies to Kazakhstan was highlighted by the senior consultant. However, it mainly depends on companies and their activeness to continue developing initial contacts received during the visits. The senior consultant strongly encouraged Finnish companies to participate in World Expo 2017 hold in Astana to get connected to Ministry departments, agencies and business community.

*“Two official delegations...in average forty companies participated... were many interesting meetings and undoubtedly it gave some impulse...but it mainly depends on companies if they just visited or they started developing contacts that took place there...”*  
*“participation in World Expo...excellent chance for firms which have serious intentions to enter Kazakhstan”*

### **Facilitation of investments to Kazakhstan perceived in firms perception**

At macrolevel perception of institutions of home and host countries involved in facilitation of outward FDIs to Kazakhstan by Finnish firms corresponds to previous actors' perception. The companies referred to the achieved agreements at Intergovernmental Commission negotiations and Memorandums of Understandings as a guideline for further actions.

Project manager: *“...some kind of formal agreements between institutions... they are very valued in Kazakhstan...if we take some examples those educational Universities they want to have some memorandum of understanding that we can go to the practical issues...”*

Official delegations boost initial collaboration between host and home countries in terms of trade and investments. The Finnish companies appreciate efforts of institutions such as Embassy of Kazakhstan in Finland and Finnish Embassy in Kazakhstan, Team Finland, Finnish Business Hubs for consultations, support in partner search, and possible arrangements.

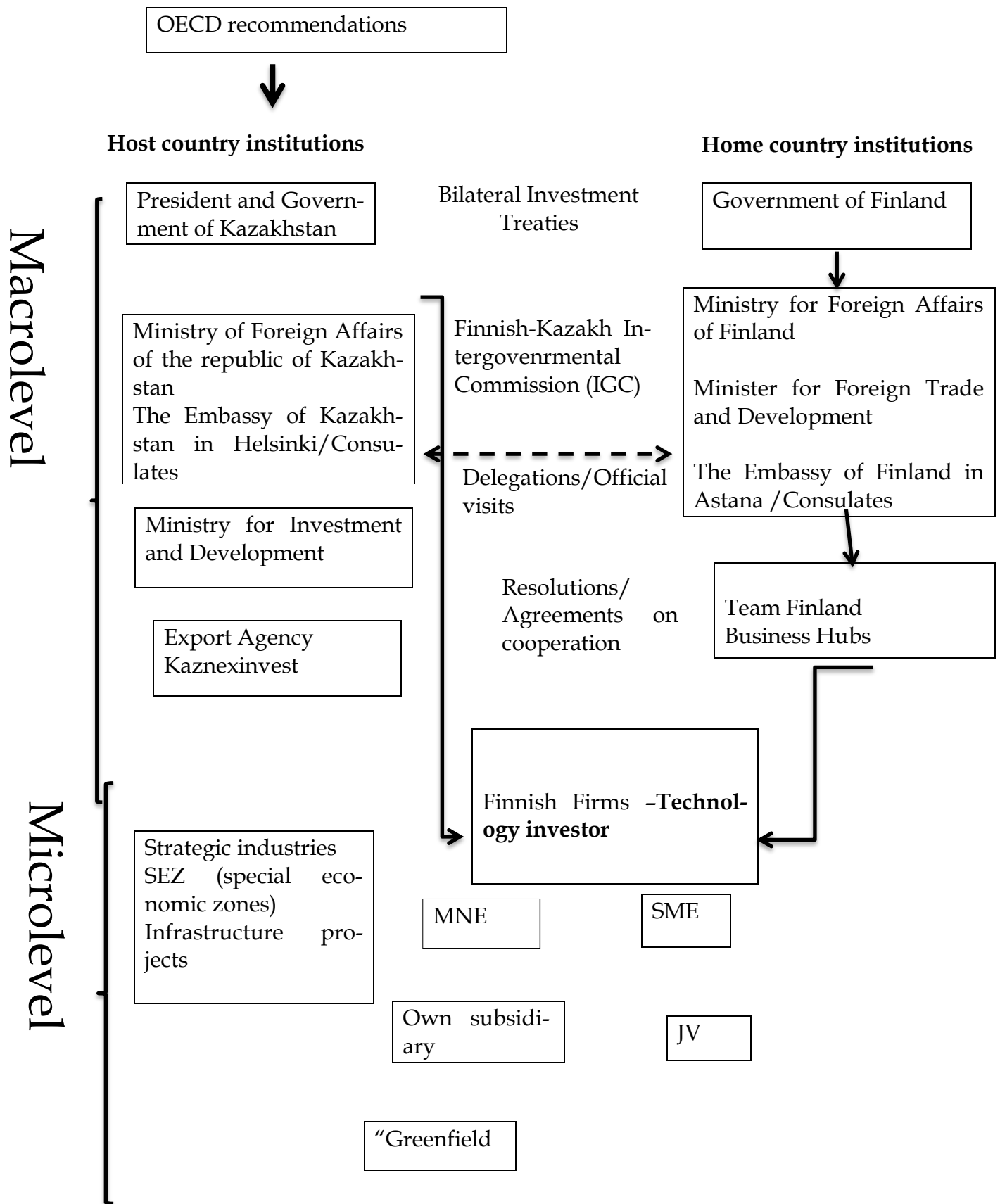


Figure 12. Aggregation of facilitation of Finnish FDI through perception of multiple act

## 6 DISCUSSION

In this section the research findings are examined through the lens of theoretical framework and previous studies. The results of data analysis are discussed in reflection to research questions and objectives. The potential contradictions in perception of institutional environment by different actors might arise that provides the groundwork for discussions.

### 6.1 Institutional environment of Kazakhstan under transition

The perception of institutional environment by home-actor strongly emphasized fundamental change of institutions involved in development of foreign trade and attracting investments at governmental and organizational level. The undergoing transition can be allocated to the three pillars of institutions identified by Scott (2008). The most significant and easily observable changes take place at regulative domain through creating legislative framework and enforcement mechanisms of policies for investors. To this regard host-country authorities effectively utilize their capacity to establish rules, manipulate sanctions, rewards and influence behavior (North, 1991; Scott, 2008) in terms of providing wide array of incentives and preferences for investors. The underlined reforms in institutional environment of Kazakhstan and strong intention to define “rules of the game” for economic actors including foreign investors support the scholars’ view of institutions as incentive structures. (North, 1991; Peng, 2003; Meyer&Peng, 2016).

The inclusion of the rule of law’s principles to the agenda of national state programs, reforms in justice system have been incorporated in action plan executed by legislative authorities of Kazakhstan. Transparent legal system of host-market as a determinant for locating investment to transition economy appeared

in numerous studies (Meyer, 2001; Peng, 2003; Bevan, et al., 2004; Alguacil, et al., 2011). Enforcement of the Entrepreneurial Code with purpose to strengthen investors' rights and protection against expropriation follows the agenda of creation the adequate legal system. Based on evidences from previous studies and research findings, we might conclude that notable development in regulative institutional domain is one of the crucial motives for Finnish firms to locate investments in Kazakhstan.

The strong intention to modernize society of Kazakhstan, increase capability of labor force, create business code of conduct, eliminate corruption through implementing strategic state programs at national level refers to normative pillar. The distinctive feature of normative pillar includes setting up goals for social actors, appropriate means of behavior, routines, organizational forms (Scott, 2008) that might be hidden from foreign entrants. According to the perception of home-country actors, the normative institutional domain of host-country is associated with hierarchical structures within the organization, centralized top-down decision-making, bureaucracy, labor discipline, absence of social responsibility. The normative system of host-country imposes pressures on foreign entrants for legitimacy (Kostova&Zaheer, 1999; Peng, 2003; Meyer&Peng, 2016). However, one of the research findings demonstrates strong adherence of Finnish firms to normative system of the home-country. Such gap in cognition of Finnish firms and changing normative system of host-country might prevent effectively adapting to the institutional environment in transition.

The Kazakh authorities recognized vital necessity for implementing financial reforms with purpose to create well-functioning mechanisms in tax system, financial transactions, capital and security markets for investors. The cooperation with Finnish organizations including The Bank of Finland, Tekes, Sitra allows access to financial sources of funding for realization joint projects in Kazakhstan. The finding supports evidences of positive relations between developed financial market and inflow of FDIs described by Bevan et al., (2004).



The host-country actor highlighted ongoing large-scale infrastructure projects as a part of “Nurly Zhol” state program of infrastructure development. According to Li&Liu (2004), Meyer&Peng (2016) quality of local infrastructure is one of the key conditional factor for attracting investments and host-market growth. The attention to the ongoing projects is in line with above mentioned study containing recommendations for improving local infrastructure.

An interesting notion, derived from host-country actor’s perception, refers to granting bargaining power to foreign investors through interaction with governmental department Foreign Investors’ Council. The major group of strategic investors have authorization to influence important regulatory policies and conditions concerned inward investments. According to Network Bargaining Power Model extended by Nebus & Rufin (2010), each actor of investors’ group possesses certain bargaining influence as well as own objectives and interests that in coalition with other members results in bargaining outcome. We might assume that strategic investors are seeking for the most favorable treatment for own investment projects. However, we did not obtain evidences from this study concerning Finnish investors’ bargaining power among network of foreign investors. To sum up, the perception of institutional environment by host-country actor is tightly connected with convergence of institutions from centrally-planned toward Western contemporary modes in accordance with international organization recommendations and implications from academic papers.

The host-country actor strongly emphasized development of formal institutions and neglected the role of informal institutions. Yet home-country actors identified presence of informal institutions in political structures and business environment at multiple levels. Presence of informal institutions increase uncertainty and transaction costs of doing business in transition economy (Meyer, 2001; Brouthers, 2002; Peng, 2003; Eden&Miller, 2004; Estrin&Prevezer, 2011). In context of Kazakhstan business and political elite belongs to three clans “Zhuz” and

have strong ties to corporate governance boards and management of the state-owned enterprises. According to the research finding, influence of clans “Zhuz” might apply to MNEs entering strategic industries and perceived to be insignificant towards SMEs.

The findings from the interviews’ data revealed that corruption caused termination of the large-scale project preliminary agreed between Finnish MNE and Ministry of Education of Kazakhstan and Civil Aviation Committee. In this case informal institution exerts a power to intervene decision-making process and cause a transaction void. It reflects to studies conducted by Peng (2003); Estrin, Prevezer (2011) emphasizing power of informal institutions to undermine functionality of formal institutions and cause its failure. This finding underlines close interplay between formal and informal institutions in process of implementation strategically important projects, challenge quality of formal institutions in terms of accountability.

Perception of corruption and other forms of unfair treatment like bribery, favoritism was frequently mentioned by foreign firms as constraints on business operations (OECD Investment Policy Reviews: Kazakhstan 2017, p.207). Corruption and political instability might prevent Finnish outward flow of FDI. The negative impact of corruption and political instability on FDI flow to emerging markets was supported by early study (Pajunen, 2008)

## **6.2 Institutional distance and its impact on ownership strategies**

Based on research evidences Kazakhstan is a relatively distant market in perception of Finnish firms. My study revealed that such distinctive features of host-country’s institutional environment as hierarchy in organizational structures, vertical management, top-down decision making, differences in labor discipline, the rigid formal communication increase the normative distance between both

states. The physical remoteness of Kazakhstan from Finland, absence of common borders, weak transportation links make an impact on geographical distance according (CAGE) distance framework proposed by Ghemawat, 2001.

Scholars (Meyer, 2001; Peng, 2003; Eden&Miller, 2004) argued that institutional distance between the host and home countries matters in terms of host country selection and market entry strategies. According to Peng (2003), at the late stage of transition foreign entrants adopt high-ownership strategies such as wholly-owned subsidiaries and acquisitions due to improvements in regulatory environment. Based on achieved progress at institutional and economy development Kazakhstan refers to the late stage of transition characterized by stabilized market-oriented institutions and diminishing role of network-based strategies. The evidences from my research are in line with Meyer (2001), Peng (2003), Eden&Miller (2004) studies that large multinational companies prefer high ownership strategies such as own representative, wholly-owned subsidiary. This finding is also supported by Arslan&Larimo (2010) study that Finnish large enterprises form wholly-owned subsidiaries in transition economies where normative distance is relatively high. According to the research outcome, middle and small sized companies follow patterns of low- ownership strategies including incremental export via local intermediary/agent, joint-ventures or granting license rights for production of spare parts.

Even though Kazakh authorities encourage Finnish SMEs to establish a joint-venture, Finnish firm do not favor a JV mode due to restrictions on foreign equity control and complexity of technology transfer to parent firm. In order to obtain control over operations in a parent organization Finnish firms tend to favor a majority joint venture. This finding is in contradiction with Xu&Shenkar (2002) study where scholars proposed a minority joint venture with low equity control as an entry mode to normatively distant market.

Establishment of joint venture with a local partner is highly appreciated by home-country actors as effective mechanisms to transfer Finnish technology and knowledge sharing. Even though positive effect of learning through JV was recognized by scholar (Mihailova, 2015), patterns of technology transfer and diffusion of tacit knowledge within the local organization remain ambiguous and complex for Finnish firms. Regarding knowledge transfer, my study demonstrates that Finnish firms are willing to share their knowledge and expertise in parent organization via trainings and company visits. However, Finnish firms expressed their concerns regarding potential contractual hazards, including the hazard of technological leakage (Oxley, 1997 in Henisz, (2000) and the hazard of free-riding on brand name and reputation (Klein and Leffler, 1981 in Henisz (2000).

High risks and political hazards involved in doing business in Kazakhstan were captured by Finnish firms. According to Henisz (2000) multinational companies which are exposed to high political hazards in transition economy, would choose a minority- owned joint venture as an entry mode. In case of Kazakhstan Finnish firms do not consider a joint venture mode of entry as a protection format against expropriation of assets by host-country government or indirect forms of political hazards.

### **6.3 Facilitation of Finnish outward investments to Kazakhstan**

At macrolevel perception of foreign trade development by various actors is quite homogeneous in terms of positive effect of bilateral treaties, important role of governmental delegations and achieved agreements, close cooperation between Ministries and export agencies from both states.

According to the research findings, valid bilateral investment treaties between Finland and Kazakhstan serve well initial purposes to facilitate FDI through providing non-discriminatory fair treatment and dispute resolution for

investors (Egger, Plaffermayr, 2004). Finnish firms perceive bilateral treaties as general guidelines and framework for regulations of trade and investments between host and home markets. However, investor-state dispute settlement mechanisms in practical application remain ambiguous for them so they try to avoid initiating any claims against host-country. Such uncertainty in interpretation of investment treaties' provisions is in line with OECD Kazakhstan Investment Report (2016, p.119) noted that "many provisions in Kazakhstan's existing treaties lack specific language"

At microlevel or organizational level perception of Finnish outward FDIs to Kazakhstan slightly differ. The research findings demonstrate that despite array of measures addressing to foster FDI Finnish investors primary evaluate market-potentiality in terms of size and local demand. Market-driven factors impose greater effect on choice of investment location into the host-country. Market-selection for further expansion is constituted by several factors including assessment of market-potential, consumer receptiveness of the product, target industry development (Sakarya, et al., 2007). The research findings relate to the above-mentioned study in terms of criteria for market selection.

Based on the research findings, host-country actors do not attribute Finnish investors to the strategic ones. However, in perception of host-country actor Finland is viewed as a source of technology and know-how in selected industries. In order to diversify economy, reduce dependency on extracting sectors, achieve growth of GDP, Kazakhstan policy-makers should adopt non-commodity investment projects (Lee, et al., 2015). The research outcome revealed that Kazakhstan authorities made a substantial effort in direction of attracting FDI to non-commodity, renewable energy sectors. The transfer of Finnish technologies and value-added activities in cooperation with local firms in Kazakhstan provide spillovers for innovations, modernization of equipment and qualification improvement of local labor force.

## 7 CONCLUSIONS

The purpose of the study was to determine the effect of institutional transition on Finnish outward FDI in context of the Republic of Kazakhstan. The institutional environment under transition was constructed through framing of cognitive perception by various actors representing host and home markets. The institutional transition in Kazakhstan is characterized by massive reforms in regulatory framework in alignment with OECD recommendations. The upheaval of financial institutions, well-executed state programs of modernization economy provide positive motives for locating FDI. Thus, the presence of informal institutions such as corruption, bribery and influential power of political clans identified by home-country actors diminish quality of formal institutions and might negatively affect the FDI flow from Finland.

In perception of home-country actors Kazakhstan is relatively distant market based on attributes of normative, cultural and geographical distances. Substantial institutional distance results in choice of high ownership strategies pursued by large multinational Finnish firms. Medium and small sized firms prefer incremental exporting via distribution network and joint venture with high equity control. However, market-driven factors, prior experience in internationalization and resource capabilities shape the choice of entry modes to Kazakhstan. The host-country investors' incentives play minor role in Finnish investors decision-making of operational mode in Kazakhstan. Despite of mode of entry and form of ownership the constant presence in host-market is required from Finnish investors to develop trust, have control over operations and seize business opportunities.

The facilitation of bilateral trade and Finnish FDI to Kazakhstan takes place at the multiple levels through close interactions of host and home country institutions. Finnish firms might appeal to guidelines of bilateral treaties between

Kazakhstan and Finland, guaranteeing fair treatment of investors, dispute resolutions and investment protection.

The study was executed with limitations that should be taken into consideration. Some participants of interviews might not explicitly respond to interview questions due to several reasons including non-disclosure policies of Finnish export agency and diplomatic service of host-country actor. Secondly, diversity of Finnish companies in size, industry and stage of entry to Kazakhstan impose limitations on generalizability. The data triangulation comprising various sources of secondary data may overcome limitations of interview answers and enhance context of analysis. The active role of researcher in interaction with interview participants and in process of data interpretation may affect the research outcome.

The suggestions for direction of further research refer to the influence of political clans Zhuz as an example of informal institutions on attracting foreign investments into strategic industries of Kazakhstan; impact of institutional distance on transfer of Finnish technologies and managerial competences to the parent organization in Kazakhstan. My research provides several practical implications for Finnish investors locating investments to Kazakhstan. Large-scale infrastructure projects, investors' preferences in special economic zones, shift from mineral-resources dependent to green economy offer vast array of opportunities for Finnish investors to exploit. Some virtual platform as a communication tool would simplify bureaucratic procedures to establish initial contacts between various actors from both states who are interested in doing business in Kazakhstan.

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## APPENDIX

### Interview protocol#1

Interviewee (Name and Title, if permission is given to indicate)

Mr. Serzhan Kadyrbaev, First Secretary of Kazakhstan Embassy in Finland

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Interviewee's background

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#### Introductory Protocol

In order to facilitate note-taking I would like to record our conversation with an audiotape. The recording will be done only with your permission. The interview will last approximately one hour. During this time there will be several questions to ask. If you feel any discomfort or uncomfortable, you might stop at any time.

Thank you for your agreeing to participate!

#### Introduction

The research as a part of Master's Thesis project focuses on exploring institutional environment of Kazakhstan and its impact on Finnish outward FDIs to Kazakhstan. The main research objectives refer to understanding and learning of perception of Kazakhstan institutional environment by various actors and strategical implications in terms of facilitation of outward flow of FDIs. You have been chosen for the interview due to your involvement in development of foreign trade between Kazakhstan and Finland or your experiences in doing business in Kazakhstan, particular interest in locating investments to Kazakhstan market.

1. Kazakhstan is characterized as a transition economy. The institutional environment of Kazakhstan has changed significantly during the transition period due to liberalization of economy, shifting from dependency on mineral

resources as a main driver for GDP growth and national welfare, as well as attracting foreign FDis.

What are the main changes/reforms occurred in institutional environment of Kazakhstan including normative, legal, administrative, financial influencing on attraction of foreign FDis?

Probes:

2. What is the role of formal and informal institutions in doing business in Kazakhstan (search for business partners/local suppliers, registration of legal entity, collaboration with local authorities?)

Probes:

3. How could you characterize development of foreign trade and economic cooperation with Finland and measures on attraction of Finnish business to invest in different sectors of economic, such as clean tech technologies, education, construction, renewable energy, sustainability?

4. What are the principal differences/ similarities in culture, values, norms of behavior between Kazakhstan and Finland and impact of these differences/similarities on attractiveness of Kazakhstan for Finnish business?

5. What kind of mechanisms are developed and implemented for reducing transactional costs of foreign investors while entering Kazakhstan market, launching operations, involvement in infrastructure projects, R&D and innovation centers?

6. What difficulties, obstacles may arise when starting and running business in Kazakhstan by foreign investors/MNEs?

Post interview comments and observations: