Competitive Positioning of the Wood Products Industry in the Leningrad and Vologda Regions of Northwest Russia

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Abstract

Since the beginning of the new millennium, European markets for wood products, especially sawnwood, have suffered from a permanent oversupply and increased competition, further worsened by the present global economic downturn. Consequently, competitive strategies, advantage, and position against rivals have become more critical for the Russian wood products industry. However, only a few studies have investigated the factors related to firm level strategies or dimensions of competition in the Russian wood products industry. This study tries to fill this gap by examining the competitive positioning in the small- and medium-sized sawnwood and plywood (SME) enterprises in the Leningrad and Vologda regions. The resource-based view of the firm was used as a theoretical background in the analysis. Senior level managers of 18 firms in the Leningrad and Vologda regions were interviewed regarding how they themselves benchmark their competitive position against their rivals and what they see as their future opportunities and threats. According to enterprise managers, the most important attributes of their competitive positioning are service reliability, a good image, and skilled personnel. These attributes stress the importance of intangible rather than physical resources, such as raw materials. The challenges mentioned by the respondents were related to external issues, like Russian legislation, a lack of financing, and fluctuating markets. Respondents stated that in the future, their aim will be to shift their production toward more specialized products and focus on increasing their exports to the European Union. The small number of observation units limits the generalization of the results, but the study tentatively indicates that competition in European markets is likely to intensify in the future.

Keywords: competitive positioning, Leningrad and Vologda regions, Northwest Russia, resource-based view, SMEs, wood products industry

Introduction

Investments in new production capacity to increase the volume of Russian forest industry production have slowly increased since the beginning of the 1990s. For example, Russian sawnwood production has not yet reached the volumes once produced in the former Soviet Union. Concurrently, competition in the European sawnwood sector has increased since the beginning of the 2000s due to the large investments in new sawmill capacity, especially in Germany.

The competitive advantage of Russian exporters is based largely on their abundant forest resources, favourable raw material supplies, and energy and labor costs that are low in relation to western competitors. Exports of sawnwood have increased relatively quickly despite slow developments in production capabilities. However, Russian sawmill and plywood industries have in recent years faced problems similar to their western rivals: rising raw material and energy costs, overcapacity in Western European export markets, and volatility in demand. This may, in part, explain the fall in Russian sawnwood and plywood exports during 2007-2008 (Figure 1 — next page). Roundwood export duties may have also had a negative impact on Russia's forest industry production and consumption (Solberg et al. 2010), but this

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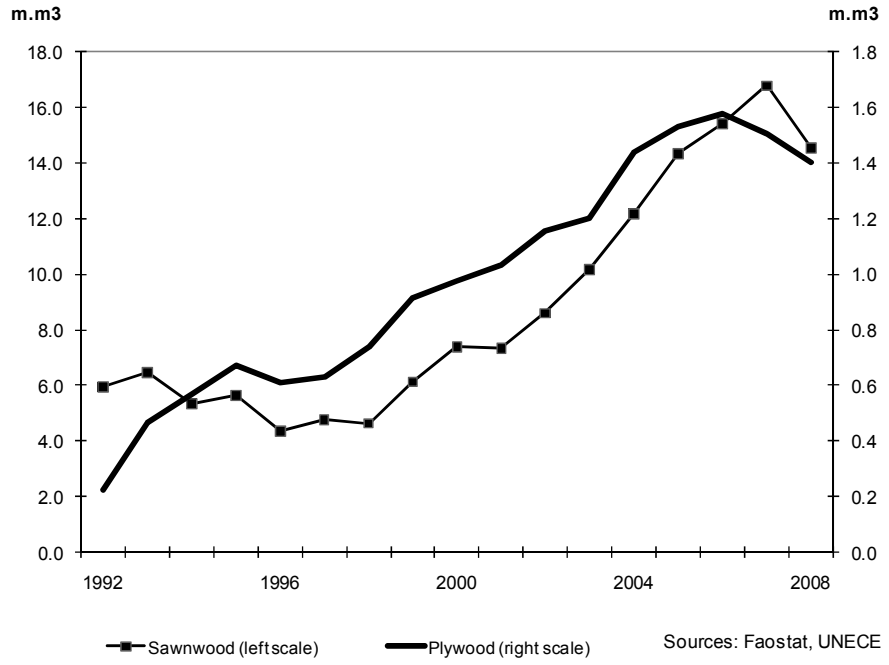

Figure 1. – Exports of plywood and sawn softwood from Russia 1992-2008 and an estimate for 2009.

is difficult to verify because of the possibility of errors in the official industry statistics.

In domestic Russian markets, the transition process to a market economy has brought about large challenges. Most forest industry enterprises were privatized and domestic markets were opened to free competition. As a result, the imports of value-added wood products, such as panels, joinery, and furniture, have grown (Mutanen et al. 2005). An increased inflation rate has meant rising production costs and, consequently, investment activity within the forest sector has been slow. Capacity investments date for the most part, back to the 1970s. Institutional legal changes have been rapid, but changes in the official and unofficial institutions remain slow. The legal rights and liabilities regarding the utilization of forest resources have also been unclear and the new forest code of 2007 only partially clarifies this issue.

Although informal activities and inadequate law enforcement hamper the competitiveness of the Russian wood products industry, the industry has significant potential to strengthen its competitive position in the future (Salnikov and Galimov 2006). Several positive factors, such as a large domestic market with high growth potential and favorable government policies, support the long-term development of the Russian wood products industry. For example, several ongoing programs to support domestic building and wood construction are serving to increase demand for wood products. However, the government's decision to gradually increase the roundwood export tariffs to support investments in the forest sector has led to many problems in the Leningrad and Vologda regions (International Finance Corporation 2000; Toppinen et al. 2007a). To illustrate, a lack of financial resources and long-term forest leases, poor infrastructure, low profitability of sawmills, a lack of marketing skills, and regionally-based operating difficulties have all been documented in these regions.

The above-mentioned problems, coupled with an increasingly competitive global environment, emphasize the importance of analyzing the future competitive position of Russian wood product companies. To address this question, information on the current competitive advantages and future intentions of these companies is important and useful. Although Russian forest resources are vast and the domestic market potential is large, research on forest industry business is limited. With the exception of Toppinen et al. (2007b), previous research published in the English language has focused on market level issues (e.g., Backman 1995, Dudarev et al. 2002, Food and Agriculture Organization of the United Nations 2005, Holopainen et al. 2006, Mutanen et al. 2005). Company-level empirical data and analysis is essential in obtaining information on various aspects of the competitive position of the whole industry and the future intentions for product development and market orientation.

The aim of this study is to analyze small- and medium-sized companies in the Russian wood products industry, focusing on the primary processing level (i.e., firms in sawmilling and plywood production). The present study is an explorative pilot study, where the competitive positions of the firms are examined using descriptive statistics. The study uses a resource-based view, where the availability of resources, tangible, intangible or human, are assumed to be crucial in creating competitive advantage (Barney 1991, Grant 2005, Lähtinen 2009). The evaluation of the current and future competitive position of the Russian wood industry in both Russia and international export markets produces useful information for Russian producers to help in developing their businesses. For foreign competitors, such as Finland, the study provides information needed to assess the possible future changes in the competitiveness of European export markets. Potential foreign investors may benefit from the results when assessing new investment possibilities in Russia. The area of focus for this study is the regions of Leningrad (including the city of St. Petersburg) and Vologda, which are important producers and

exporters of sawnwood and plywood in Northwest Russia.

In this study, our primary interest is in recognizing the main dimensions of company resources and competences/capabilities that the Russian wood industry companies apply to position their offerings in comparison to their rivals. Secondly, we are interested in how companies currently perceive their own performance against their rivals, and how they would like to improve their competitive position based on their strategic resources and competences. Thirdly, we are interested in recognizing the potential plans among wood industry companies in the Leningrad and Vologda regions of Northwest Russia to develop their competitive position through evolving market strategies.

Theoretical Frame of Reference and Hypotheses

To be competitive, a company needs to have a superior position in some respect in comparison with its competitors (Porter 1985). A company is successful in positioning itself in a market when it can effectively benefit from its strategic resources and capabilities to gain a competitive advantage. A sustainable competitive advantage may be seen as a function of the uniqueness of the source of this advantage; the more unique the source, the more difficult it is to imitate, which provides sustainability of the competitive advantage (e.g., Hoffman 2000). Therefore, recognizing both the most promising company-specific capabilities providing the potential for competitive advantage, and the markets and customer segments where this potential can be effectively utilized, may be regarded as key strategic choices for a company.

Accordingly, our theoretical background emphasizes the strategic choices of core competencies/capabilities. Specifically, our approach to the problem of company-level strategic planning follows the resource-based view (RBV), originally outlined by Barney (1991). The availability of resources – tangible, intangible or human – and their unique combinations are regarded as crucial elements in creating competitive advantage (Grant 2005). One needs to consider that only some of a company's resources and competences/capabilities normally have the potential to provide a competitive advantage. To act as a source for sustainable competitive advantage, potential resources must possess four attributes: rareness, value, an inability to be imitated, and an inability to be substituted (Barney 1991). Recently, researchers have also begun to explore the forest industry from the perspective of the resource-based approach. The few existing studies include Bonsi et al. (2008), Bull and Ferguson (2006), Korhonen and Niemelä (2005), and Lähtinen (2009).

A successful combination of core competences and other choices included in company-level business or marketing strategies is necessary to increase company profits, assets, and/or market share. Following the definition by Juslin and Hansen (2003), marketing strategy in the context of this study includes product strategies, customer strategies (strategic customer segments) and key geographic market area(s), and the core resources and capabilities providing competitive advantage in the chosen markets. We consider marketing strategy and business strategy to overlap since both concepts concentrate on strategic choices of products, markets, and competitive advantage.

Porter's (1985) well-known framework for analyzing competitive position provides a useful tool for assessing industry- or sector-level competitiveness. This is an important starting point for any company assessing its competitive position in current and potential markets. However, there appears to be an emerging consensus that the RBV is a more suitable approach for analyzing the competitive position of a heterogeneous group of small- and medium-sized companies within one industry sector and market area. The RBV particularly emphasizes the role of a company's internal individual resources instead of concentrating on industry-level competitive factors (Fahy and Smithee 1999), which is also the case in this study. In this way, the framework suggested by Porter (1985) and the RBV approach are interlinked, and both should be applied by any company assessing its competitive position. Dynamics exist between company- and industry-level competitiveness. At the industry level, the performance of individual companies, and thus the successful employment of resources, are interlinked; the good (or bad) performance of one company is likely to affect the strategies adopted by its competitors.

Understanding a company's resource base is central to effective positioning of the company in the marketplace, and in highlighting important differences between company-specific and country-specific resources (Fahy and Smithee 1999). Furthermore, competitive positioning (i.e., a company benchmarking itself against its rivals in current or potential new markets) requires that the strengths and weaknesses of the companies operating in the intended markets are known, in addition to basic features of the market areas and related operating environment. Improvement in the competitive position of a company may be sought through changing strategic choices and existing operations in existing markets, or through transferring or enlarging existing operations to new locations (markets). This may require the development of existing resources and capabilities (through internal investments) or the acquisition of new ones by buying them from outside sources (Grant 2005). In addition, a company may invest in locating itself with its existing capabilities in new markets where a new location may allow the company to gain a higher market share through increased sales or lower production costs.

In analyzing the competitive position of wood products companies in the Leningrad and Vologda regions, we employed a framework put forward by Hooley et al. (2001). Competitive positioning forms a dynamic link between company resources and capabilities, strategies and performance. At the core is the combination of choice of target markets (i.e., the segments in which the company competes) and competitive advantage (i.e., how the company competes in the chosen markets) as benchmarked against rivals. The dynamic is created through a feedback loop where a superior performance (i.e., successful combination of strategic choices of products, customer groups, market locations, and utilization of resources and core competences in providing competitive advantage) results, for instance, in enhanced assets and improvements in customer satisfaction and the company's market share.

The competitive position may be measured using a large number of individual and fairly concrete attributes. However,

these attributes may be condensed into a few broad dimensions, and we chose a classification proposed by Grant (2005). We assume in Hypothesis 1:

> H1: The three main dimensions of potential resource-based core competences/capabilities are 1) company and personnel factors, 2) product and production factors, and 3) attributes related to the operating environment.

The third dimension in the hypothesis, operating environment, underlines the fact that issues such as good relationships and the ability to deal with the political infrastructure and actors are also important potential resources. For example, networks are an important part of Russian business culture as companies largely base their business relationships on informal ties. The role of institutions, policies, and various modes of business networks between companies and relationships between companies and local authorities need to be acknowledged as an important source of competitive advantage or disadvantage (Hoskinsson et al. 2000).

Generally, any component of a company's total offering based on its skills and resources may be a source of competitive advantage. However, the high product quality or low costs (the second dimension of the hypothesis) may be a strategic necessity rather than providing true competitive advantage, especially in mature industries (Grant 2005). Thus, competitive advantage may be based even more successfully on such intangible resources as service skills and relationships underlined in dimensions one and three. Fahy and Smithee (2002), for example, found that intangible resources, which are considered the most difficult to imitate, may have a more important effect on company success than tangible resources. This is important to note as services, company reliability and other intangible characteristics increasingly also build up the total offering provided for customers in the wood products industry (e.g., Grant 2005, Lähtinen 2007, Toivonen et al. 2005). Our Hypothesis 2 is, consequently:

> H2: The most important sources for competitive advantage are company- and personnel-related dimensions capturing intangible resources and competences.

In the empirical section we will explore these two hypotheses in detail, although statistical testing was not feasible at this preliminary stage of research. In addition, managers of the surveyed firms were also asked about their perception regarding future market developments and company challenges.

Methods

Interview-based surveys were used to collect data in this study. The theoretical framework for the survey was operationalized using variables related to the key industry success factors (competitive business environment) (Porter 1985), marketing strategies (Juslin and Hansen 2003), and potential resources and capabilities/competences that create competitive advantages (companies' resources, technology and organization, communication, logistics and external networking). For a comprehensive list of the attributes used, see the questionnaire by Toppinen et al. (2007a). The lists of attributes potentially creating competitive advantage were administered to company managers, who were asked to weigh them according to their perceived importance from the viewpoint of their company's operational environment. Specifically, they were asked about the company's key resources and capabilities/competences regarding their competitive position, including their resources, technology and organization, communications, logistics, and external networking.

Our data were mainly collected from small- and medium-sized enterprises (SMEs) in the Leningrad and Vologda regions in the fall of 2006. The annual turnover of the respondent companies did not exceed 40 million euros according to our estimates. Therefore, all respondent companies could be considered SMEs (small- and medium-sized enterprises). Furthermore, the respondent companies were not integrated with the pulp and paper industry, but were genuine wood industry companies.

The main criterion in selecting the companies for interviews was a sufficiently large scale of production (over 5,000 m^3/year) of timber products. In the Leningrad region, 50 wood products companies were selected for the interviews. The preliminary list of companies in the Leningrad region was gathered from a previous study (Bystriakova 1999), the Yellow Pages, and information presented by a Russian consulting company (Statisticheskaja baza dannyh 2003). Some of the companies had incorrect contact information or inadequate production volumes, and consequently, the list was reduced from 50 to 28 companies. Of the 28 companies contacted in the Leningrad region, only a small number were willing to be interviewed. In many cases, managers were unwilling to provide a foreign organization with information related to their business performance. Some potential participants expressed anxiety that the results from the study could be used by Finnish woodworking companies to eliminate Russian competitors or to subsume the resource base of an enterprise. In several cases, the managers initially agreed to participate in the study, but changed their mind without any explanation and simply stopped answering telephone calls. As a result, the total number of companies interviewed in the Leningrad region and St. Petersburg was reduced to 12, of which one insisted on remaining anonymous.

In the Vologda region, six interviews were conducted. Compared to the Leningrad region, the companies in Vologda were generally more eager to participate in the study and only one potential participant refused to answer the questionnaire. That said, due to its low production volumes, the role of the company that refused to participate was rather insignificant.

The low sample size of this study (18 companies) is typical of the difficulties in conducting survey research in transition countries (Mockaitis et al. 2006). Due to the low sample size, only descriptive statistics from multiple choice questions averaged over both regions are reported. Thus, the study needs to be regarded as an explorative pilot study and the results cannot be generalized to the whole wood products industry in Northwest Russia. Methodologically, this approach was suitable for an exploratory study aimed at gaining better under-

standing of an evolving industry on which little previous empirical research has been published in English.

Results

Managerial Perceptions on Companies' Competitive Position

The respondents evaluated 43 attributes relating to their internal resources and capabilities and external factors concerning the competitive position of the company in relation to its rivals. A "clearly better" position was rated as 5 and "clearly weaker" position was rated as 1. The competitive attributes were condensed into three main categories: 1) company and personnel, 2) product and production, and 3) environmentally related attributes (Figure 2). In all three categories, the companies, on average, evaluated their own competitive position to be similar to their competitors'. This suggests a common finding in empirical business level research that managers typically tend to rate their own company at least on average position relative to their competitors.

In Figure 3 to Figure 5 (see next two pages), the distributions of responses in the three main categories regarding companies' competitive positions are presented. In these distributions, the response "better position" includes options 5 (clearly better position) and 4 (somewhat better position). Accordingly, the response "weaker position" includes options 2 (somewhat weaker position) and 1 (clearly weaker position). A "similar" position includes only option 3 from the questionnaire.

Among the company and personnel-related attributes (Figure 3), the overall reliability of the company, a good company image and reputation, and qualified and skilled personnel were the three most important attributes estimated by companies in giving them a competitive advantage over their competitors. Interestingly, these are all mainly related to intangible resources. In profit margins, market share, and networking with other companies producing similar products, the respondents perceived their company to be in the weakest competitive position compared to their competitors.

In product and production-related issues (Figure 4), the interviewed companies perceived they had the best competitive position in comparison to their competitors for well-known product brands, in the quality of physical products, and in innovative products. Research and development activity, high-quality design, and patents on products and processes were issues where the interviewed companies felt themselves to be in the weakest position compared to their competitors.

Ecological and environmental concerns form an important part of the operating environment in the forest industry. The results indicate that the differences between the most important ecologically related attributes seemed to be rather small (Figure 5). However, in two properties, namely the share of renewable energy in the total energy consumption and green arguments in advertising, the interviewed companies estimated themselves to be in a weaker position than their competitors. It should be noted that environmental issues only partially cover the entire operating environment. That said, further information is included in the following section discussing future objectives in a changing market environment.

Development and Future Challenges of Companies

The participating company managers were asked to rate the importance of potential future aims and developments for their companies (Figure 6 — see page 8). The three future aims identified as most important were increasing the physical quality of products, increasing the scale of operations to lower production costs, and increasing the company size through green field investments. The companies clearly wanted to expand their market share in the European Union rather than expand in their domestic markets. By contrast, companies were least interested in moving the company to a more attractive location, attracting Russian investors, or increasing the size of production by mergers or buy-outs.

Next, the managers were presented with three open-ended questions regarding perceived challenges and opportunities

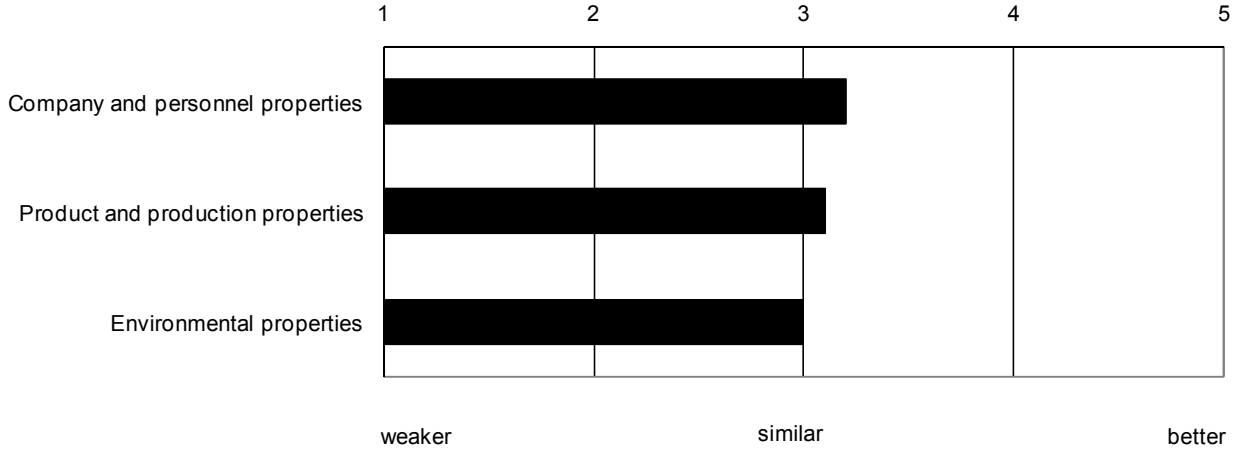

Figure 2. – Average estimated competitive position of the Leningrad and Vologda regions' wood industry in comparison to rival companies.

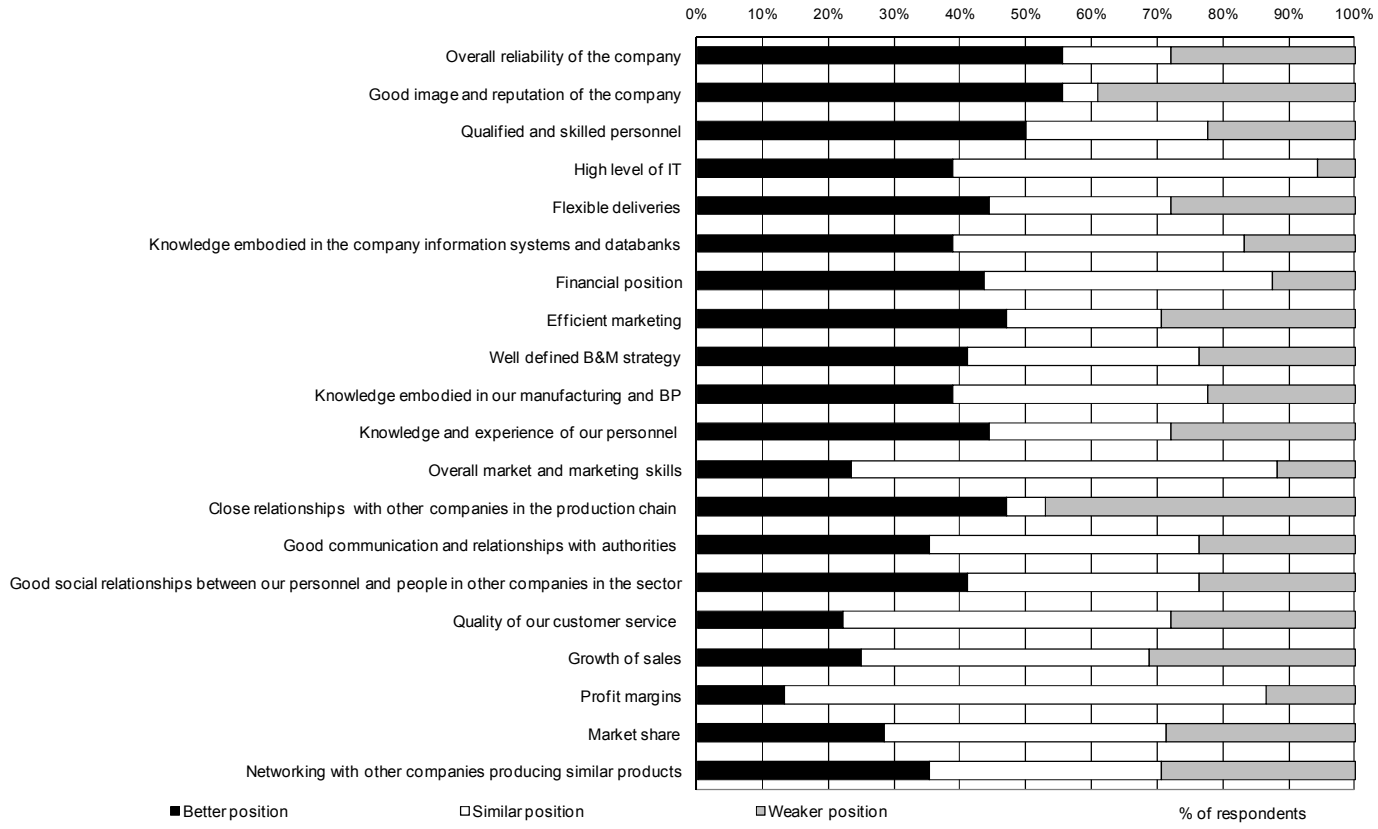

Figure 3. – Perceived competitive positions of wood products companies in the Leningrad and Vologda regions for company and personnel-related attributes.

for their companies in the future. The most frequently identified opportunities and challenges that may arise within the next three to five years are listed in Table 1 (see page 9). On the side of opportunities, participants perceive investments as being important, whether tangible in nature (such as in new equipment or increasing company size) or intangible (such as training of personnel or new product development). The threats perceived by company managers were mainly related to external issues, namely undeveloped legislation and a lack of financing, as well as fluctuating markets and exchange rates. The repeatedly-mentioned lack of capital as a main hindrance to modernization seems to be an acute problem for Russian SMEs, as also discussed on a more general level by Pissarides et al. (2003) among others.

Discussion and Conclusions

Competitive positioning linking company resources and capabilities, strategies, and performance were investigated in this study of SMEs in the wood industry of the Leningrad and Vologda regions. The validity of the results was strengthened by the fact that the managers of the companies had extensive experience in forest business and were knowledgeable about business processes and problems within the Russian wood products industry. The companies in this study accounted for a fairly large share of the total production within the regions targeted. It should be noted that there were a few cases of misunderstanding or incorrect interpretation of the questions, although the interviews were conducted by native Russian speakers. For example, some of the managers considered the question about ecological quality of the company's products as a question related to the amount of polluting materials put out by their companies, and not the broader ecological consequences of their products and production processes.

Our results indicate that the company and personnel dimension is perceived to be the most critical of the three resource/capability based dimensions. This is attributed to its components that include the following: the overall reliability of the company, a good company image and reputation and qualified and skilled personnel. From a managerial point of view, these factors are related to the use of intangible resources in companies rather than physical resources, such as raw materials or the location of the company. Regarding environmental performance, companies did not perceive themselves to be superior to their rivals.

Finally, we explored managerial insights regarding future strategic market areas. In the future, participants aim to shift their production from commodity products toward more specialized products and focus on increasing their exports to the markets in the European Union. If our preliminary results can be more widely generalized, competition for wood products in European markets is likely to intensify in the future. Regarding their future opportunities, companies perceive investments as important, whether tangible in nature, such as in new equipment or in increasing company size, or intangible, such

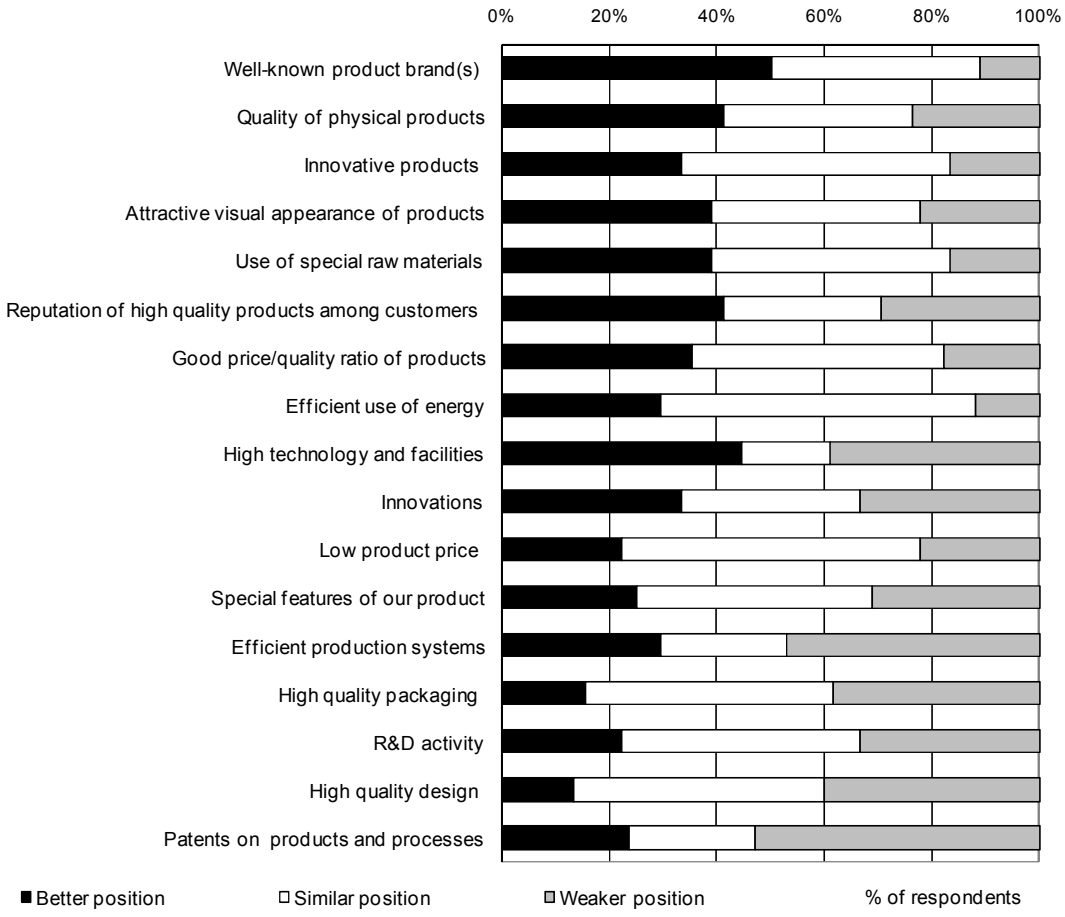

Figure 4. – Perceived competitive positions of wood products companies in the Leningrad and Vologda regions for product and production-related attributes.

as in the training of personnel or in new product development.

A previous study on the marketing strategies and market orientation of Russian companies (Golden et al. 1995) emphasized the dramatic differences between market-oriented companies and those operating under the old planned demand environment. Companies that focused more on their markets seemed to also use strategies that embrace the development of their market positions rather than focusing on operational efficiency. In the United States, Hansen et al. (2006) found that market orientation may have a positive impact on company performance. If similar characteristics are also present within the Russian wood products industry, it would be interesting to focus

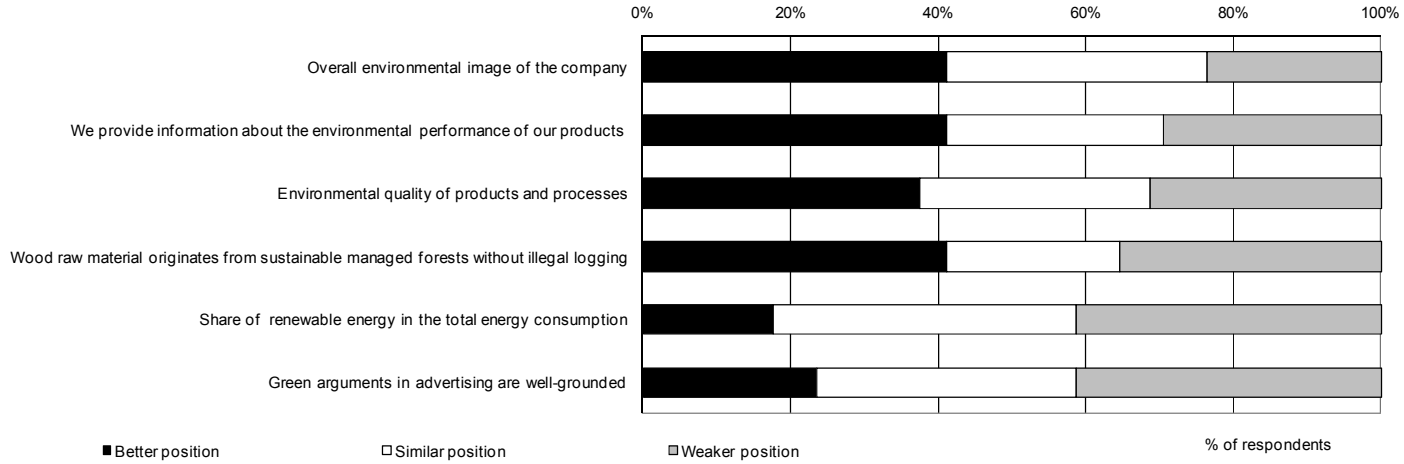

Figure 5. – Perceived competitive positions of wood products companies in the Leningrad and Vologda regions for environmental attributes.

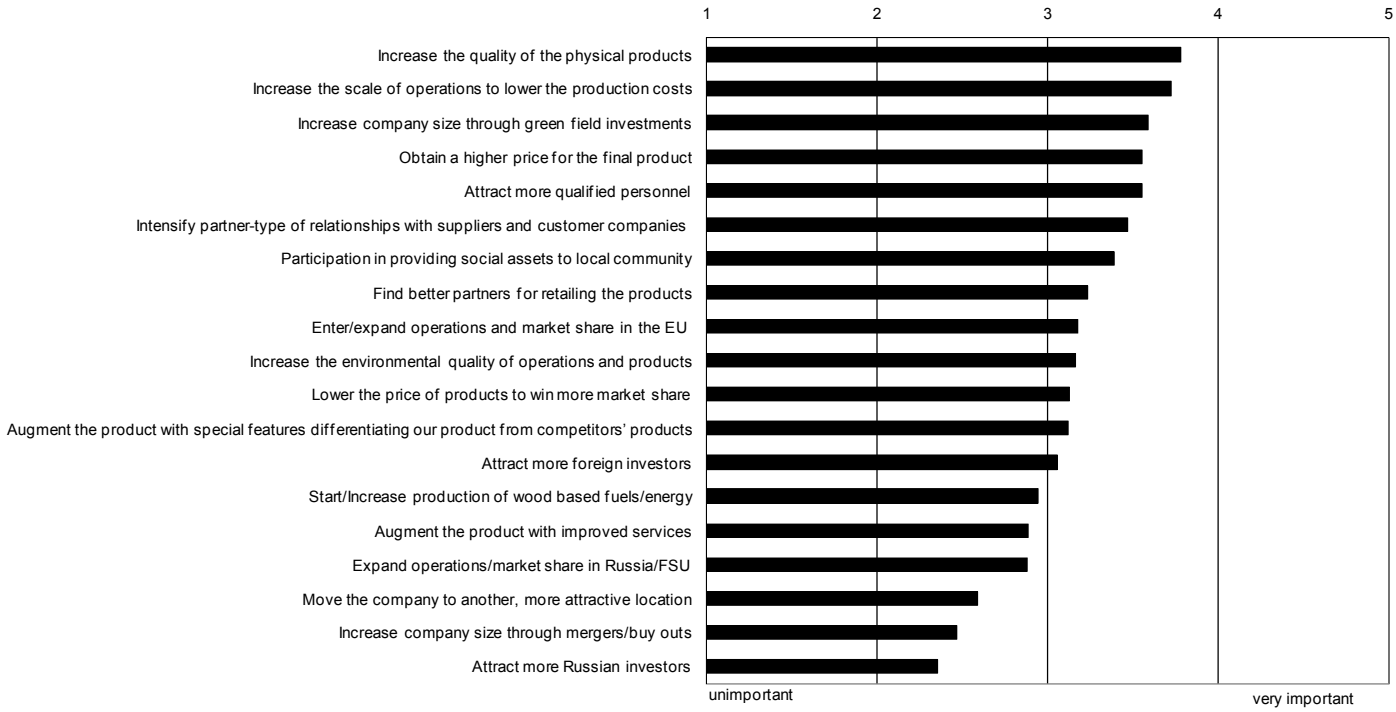

Figure 6. – Importance of wood industry companies' objectives during the next three to five years in the Leningrad and Vologda regions.

on the internationally-orientated companies in future research and examine their strategic choices and realized performance.

A shortcoming in our results was that interview data was collected before the global financial crisis and implementation of rising export tariffs on Russian roundwood. Therefore, results on the future competitive position of the firms could potentially differ due to changing financial circumstances. Regarding the impact of Russian export tariffs, the findings of Solberg et al. (2010) emphasize that the policies to improve the investment climate are even more vital for the development of the Russian forest industry than setting export barriers.

Future studies should aim to obtain a larger set of companies to facilitate better comparison between regions and between different ownership categories (i.e., Russian-owned, foreign-owned, and joint ventures). In addition, to better understand future development paths in business strategies of the wood industry in Russia, a comparative study could be planned for wood products companies in the new European Union countries. For example, strategies of companies operating in the Baltic countries or in the other new European Union member states would be of special interest since these countries, in comparison with Russia, are more developed in the process of economic transition and technological renewal in the wood products industry.

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Opportunities	Challenges
o Increasing the quality and price/quality ratio of production o Investments into new equipment o Improving access to bank loans and falling interest rates in lending o Increasing the scale of production o Introducing new products o Training of personnel o Partnership with both Russian and foreign companies (e.g., IKEA)	o Lack of capital for production and infrastructure development o Vagueness of forest laws o Unpredictability of market development o Uncertainty of legislation o Lack of private property rights o Corruption o Lack of profitability o High exchange rate fluctuations o High taxation o Low liquidity o High share of external factors in cost structure of production o Out-dated tax legislation o Powerful natural monopolies

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